SEATINI

Strengething Africa in World Trade

TAX EXEMPTIONS
Implications on socio-economic development

A PUBLICATION BY SOUTHERN AND EASTERN AFRICAN
TRADE INFORMATION AND NEGOTIATIONS INSTITUTE
(SEATINI-UGANDA)

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ACRONYMS

ADB	African Development Bank
AGOA	American Growth Opportunities Act commemorate
CAP	Chapter (of the Laws of Uganda)
CET	Common External Tariff
CHOGM	Common Wealth Heads of Government Meeting
DTA	Double Tax Agreement
EAC	East African Community
FDI	Foreign Direct Investment
GDP	Gross Domestic Product
IMF	International Monetary Fund
OECD	Organisation for Economic Co-operation and Development
SAGE	Social Assistance Grants for Empowerment
URA	Uganda Revenue Authority
VAT	Value Added Tax
VATGCR	Value Added Tax Gross Compliance Ratio
WHT	Withholding Tax

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EXECUTIVE SUMMARY

SEATINI UGANDA commissioned a study to analyze the impact of tax exemptions on development in Uganda. The study was done through a concerted literature review that combed the relevant tax legislation and reports generated by the Uganda Revenue Authority, Ministry of Finance and other agencies; including Organisation for Economic Co-operation and Development (OECD) and International Monetary Fund (IMF).

The study has established that tax exemptions appear to have a contradictory impact on the economy. The Government's decision to grant tax exemptions is precipitated by policy considerations like stimulating employment and development as is highlighted in the case of the Investment Code Act, 1991. However, this decision inevitably leads to loss of tax revenue. For example, in the year 2009/10, tax exemptions resulted into a direct loss of 3.99 percentage points for tax to GDP ratio. Without the exemptions, the tax to GDP ratio would have reached a level of 16.15%. This revenue yield would have been sufficient to fund the national budget without recourse to donor funding.

The second finding is that though Government is certainly well-intentioned in granting tax exemptions, there are no reliable research findings that would clearly pin point the positive and sustainable impact of tax incentives and exemptions in propelling socioeconomic development. The IMF has actually come to the conclusion that the tax exemptions Government is generously dishing out are unhealthy for the economy. The IMF is accordingly insisting and has got Government's commitment to review and reduce the current tax exemptions regime in the next couple of years.

Thirdly, tax exemptions are clumsily managed with no clear and consistent legal framework across on how they are managed. The bottom-line is however that the Minister responsible for Finance has practically unfettered discretionary power to grant tax incentives and exemptions with residual oversight role by Parliament. Article 152 of the Constitution does not oblige the Minister to seek and/or account for his/her decision on tax waivers, but rather to notify Parliament over the decision. This environment has ignited rent seeking and patronage leading in some instances to well-connected companies and individuals who may not merit the tax incentives and exemptions enjoying them.

This study accordingly recommends as follows:

That in order to guide proper policy formulation and review tax incentives and regime, the Government institutes a comprehensive assessment of the costs and benefits that have accrued from the introduction of tax exemptions.

(a) That the Government acts on the commitment made in the year 2010 to reduce unnecessary exemptions since they contribute to narrowing of the tax base and loss of tax revenue.

(b) That the discretionary powers given to the Minister (responsible for Finance) to reduce, remit or compound taxes payable and use of this discretion without a reference from the Uganda Revenue Authority (URA) Commissioner-General contained in the Stamp Duty Act and the Excise Tariff Act be removed.

(c) The Government should design a transparent process and procedure for managing and granting tax exemptions. The new system should comply with universal good governance standards and pre-empt rent seeking and political patronage. This should also contain a review of Article 152 of the Constitution to incorporate a requirement by the Minister to explain his decision to Parliament. There should equally be clear oversight role granted to Parliament to proactively supervise the implementation of tax \exemptions in the country.

(d) The reporting structure on tax revenue foregone should be more detailed and comprehensive. A mere report on amounts of tax revenue foregone, after the Minister's decision to grant tax waivers does not add much value to the process since within the Law, Parliament cannot reverse the ministerial decisions once implemented.

(e) That URA should have an express mandate of auditing the exemptions given since it has the monopoly of tax administration in Uganda.

(f) Given the deepening integration within the East African Community, it is necessary to handle the matter of tax exemptions and incentives at a regional level. The intra-regional competition for Foreign Direct Investment (FDI) is only fuelling an unhealthy "Race to the Bottom' in the region.

(g) Civil society organizations (CSOs) should actively participate in tax issues since they are key to governance and human rights. This calls for civil society organizations to gain appropriate competences in fiscal policy, tax administration, budgetary and expenditure management to be able to monitor and follow the developments in this area

(h) This report is arranged in four parts. Part One has the introduction and objectives of the study. Part two details the nature of tax exemptions and how they are granted under the law; Part three looks at the implications of tax exemptions on development; and part four lays out the recommendations on what should be done to ensure proper management of tax incentives and exemptions

Chapter 1 INTRODUCTION

> *"To lay with one hand the power of the government on the property of the citizen and with the other to bestow it upon favored individuals to aid private enterprises and build up private fortunes is none the less a robbery because it is done under the forms of law and is called taxation"* Justice Samuel F Miller.[1]

SEATINI UGANDA commissioned a study on tax exemptions with the objective of analyzing and determining their impact on socioeconomic development in Uganda.

Taxation can broadly be defined as the system through which Governments extract items of value from individuals and business entities for purposes of financing development programs. In the case of developing countries like Uganda, taxation is acknowledged as pivotal in promoting sustainable growth and poverty reduction.[2] This is principally because taxation not only provides a stable and predictable fiscal environment to promote growth, but also finances the developing countries' social and physical infrastructural needs. The other important consideration is that taxation reduces developing countries' reliance on donor aid and grants from the developed world.

In the effort to reduce reliance on donor support, Governments have to enhance domestic revenue mobilization. Matovu (2010)[3] posits that the importance of mobilizing locally is to: strengthen internal budget management as the country is insulated against the volatility and uncertainty associated with donor aid and grants; to give the country a free hand to define its spending in line with national priorities; to provide an alternative source of revenue due to entrenchment of globalization, international trade liberalization and regional economic integration which are progressively trimming down trade taxes; and to increase the participation of the citizenry in the political process and create a sustainable avenue for them to demand for accountability and better governance in managing of public expenditure.

Given the above positives for enhancing domestic revenue mobilization, one is left to wonder why tax exemptions are then given by Government. It is a matter of fiscal policy and Government argues that tax exemptions are necessary to make the country competitive as a destination for foreign investment and to support the vulnerable or marginalized in society. Tax exemptions fall under alternative special measures referred to as **"tax expenditure"** designed for the attainment of policy objectives at the cost of lower tax revenue[4]. This results in reduced tax liability for certain citizens and translates into tax breaks for limited constituencies. It also leads to the contracting of the tax base and the imposition of higher marginal rates for the not favored taxpaying community to recover the forfeited tax revenue. It should therefore be noted that for one person to enjoy the exemption, another person must have his tax liability increased or miss some benefit that would have been got from tax revenue. William Gladstone[5], a British Chancellor of Exchequer stated in his 1863 Budget speech that "...for it must be borne in mind, that in every case exemption means a relief to A at the charge of B". This is what Justice Miller, in the above quotation, reflectively refers to as a "robbery".

1 Cited in Holland O G .Vann R (1998): Income Tax Incentives for investment
2 OECD(2011) OECD's Current Tax Agenda.pp20
3 Matovu JM (2000): Domestic Resource Mobilisation in Sub-Saharan Africa .The case of Uganda .Summer 2010.
4 Department of Finance, Canada (2012): Tax Expenditure and Evaluations.
5 Hansard HC Deb 16 April 1863 vol 170 c.224 (cited in the March 2011 UK Office of Tax Simplification Final Report pp.7)

The findings are summarized in this report which is arranged in four parts. Part one has the introduction, background and objectives of the study; part two details the nature of tax incentives and exemptions and how they are granted under the law; part three looks at the implications of tax incentives and exemptions on development; and part four lays out recommendations on what should be done to ensure proper management of tax incentives and exemptions.

1.1 Objectives of the Study

The study was specifically focused on three objectives which were to;

(a) Examine the nature and processes through which tax exemptions are given in Uganda;

(b) Analyze the implications of tax exemptions to development, and;

(c) Recommend how tax exemptions can be handled more effectively to promote sustainable development in Uganda.

1.2 Methodology

In the course of conducting this study, various tax legislations that provide for tax exemptions were studied and reports generated by the Uganda Revenue Authority, Ministry of Finance and other agencies analyzed for their content. Research papers and periodical survey reports on Uganda by the OECD and IMF were studied. Staff and former employees of Uganda Revenue Authority were consulted for their views on the subject.

It is against this background that this paper proceeds to consider the purpose and presumed benefits from granting tax exemptions, and how they impact on socioeconomic development of Uganda.

Chapter 2

THE NATURE AND PROCESS OF TAX EXEMPTIONS IN UGANDA

2.1 Purpose and Nature of Tax Exemptions

Before considering the nature and process of tax exemptions in Uganda, it would be appropriate to understand the terms *tax incentives* and *tax exemptions*. Tax incentives and exemptions in whatever form they manifest themselves arise from the wider concept of ***tax expenditures.*** Surrey and Mc'Daniel P (1985) gave an elaborate definition of the concept of tax expenditure in the following words:

> *"An income tax is composed of two distinct elements. The first element consists of structural provisions necessary to implement a normal income tax, such as the definition of net income, the specification of accounting rules, the determination of the entities subject to tax, the determination of the rate schedules and exemption levels, and the application of the tax to international transactions. The second element consists of the special preferences found in every income tax. These provisions, often called tax incentives or tax subsidies, are departures from the normal tax structure and are designed to favor a particular industry, activity, or class of persons. They take many forms, such as permanent exclusion from income tax, deductions, deferrals of tax liability, credits against tax, or special rates. Whatever their form, these departures from the normative structure represent government spending for favored activities or groups, effected through the tax system rather than through direct grants, loans or other form of government assistance".*[6]

Most times the words "tax exemptions" and "tax incentives" are used by tax practitioners and scholars to convey the same meaning. They however carry some distinctions as noted in their definitions. For purposes of fostering a better understanding of the nature of tax exemptions, the definitions of both terms are laid out below:

Tax Exemptions have been defined as:

> *"Taxable expenditure, income or investment on which no tax is levied to serve a specific purpose such as to encourage a certain activity for a specified period."*[7]

On the other hand Tax Incentives have been 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]

6 Surrey S &McDaniel P (1985): Tax Expenditures (Cambridge, MA. Harvard University Press)1985
7 http;//www.businessdictionary.corn/definitions .html.Accessed on 27th April 2012
8 http;//www.businessdictionary.corn/definitions.htm.Accessed on 27th April 2012

A common thread in the above definitions is that there is relief given to a particular person, sector or activity which translates into taxes forfeited by government in order for a given policy objective to be actualized. The other common element to note is that the reliefs given must be time bound.

2.2 Evolution of Tax Exemption Regime in Uganda

Prior to 1991, the Minister responsible for Finance was the only authority who had discretionary powers in Uganda to grant tax incentives and exemptions[9]. The Minister was required to publish his/her decision in the Gazette, but had no obligation to explain his/her decision. For the first time in 1991, the Investment Code Act, 1991, introduced a tax incentive and exemption regime that listed a number of different taxes[10] from which a qualifying person would be exempted. Subsequently, the tax incentive/exemption regime was transplanted to the Value Added Tax Act, 1996, (CAP 349 of Laws of Uganda) and the Income Tax Act, 1997 (CAP 340 of Laws of Uganda), in the form of incentives and express exemptions. There are also some tax exemptions detailed in the Stamp Duty Act, the East African Community Customs Management Act, 2005, and the East African Excise Duty Management Act. These are highlighted in the subsequent paragraphs.

2.3 Types of Exemptions

2.3.1 Exemptions under the Investment Code Act, 1991

The Government enacted the Investment Code Act, 1991 (CAP 92 of the Laws of Uganda) with the principal objective of *'….providing more favorable conditions for local and foreign investors…'*[11] The Uganda Investment Authority was established as the agency to administer that Investment Code Act. The desired qualifications to benefit from the provisions of the Act were that the intended business/investment met the following objectives:

(a) Generation of new earnings or savings of foreign exchange through exports, resource based import substitution or service activities;
(b) The utilization of local raw materials, supplies and services;
(c) The creation of employment opportunities in Uganda;
(d) The introduction of advanced technology in Uganda;
(e) The contribution to locally or regionally balanced social-economic development; or
(f) Any other objectives the Authority would consider relevant to the attainment of the objectives of the Investment Code Act.

Qualifying companies would be granted Investment Licences and would among other reliefs benefit from the following incentives:

(a) Import duty and VAT exemption on plant and machinery, equipment, vehicles and construction materials for an investment project and other inputs
(b) Stamp duty exemption.
(c) Withholding tax exemption on plant and machinery, scholastic materials, human and animal drugs and raw materials

9 See for example Section 12 of the repealed Income Tax Decree, 1974.
10 See Investment Code Act, 1991 (CAP 92 of Laws of Uganda).
11 The Long title to the Investment Code Act,1991(CAP.92)

(d) Refund of all or part of any duty paid on raw materials imported for use in the production of goods actually exported.

(e) Investors would benefit from 'First Arrival Privileges" in the form of duty exemption for personal effects and one motor vehicle owned for at least 12 month before arrival in Uganda.[12]

Most holders of the Investment Licences were entitled to a five year tax holiday. They however had the obligation of submitting tax returns to the Uganda Revenue Authority for purposes of ensuring that proper computation of capital deductions and investment allowances were made in accordance with the Income Tax Act, 1997. Information received indicates that the Uganda Revenue Authority could not spare much effort and resources on processing substantial paperwork with no revenue gains. It has also been suggested that a number of the beneficiaries were footloose companies that would close shop at the end of each tax holiday and re-open under different names.[13]

It is worth noting that under this regime, the Minister responsible for Finance had a lot of discretionary powers in granting of investment licenses and hence the enjoyment of tax exemptions. The Uganda Investment Authority would grant the privileges yet the Uganda Revenue Authority had to monitor compliance to the tax provisions. This arrangement created a gap in information flow and partly accounts for the lack of reliable and objective information which one can firmly base onto determine whether the intended objectives of this tax exemption regime were met. The information available in the report tabled to the Parliamentary Committee on Commissions, Statutory Authorities and State Enterprises by the Uganda Investment Authority in 2010, indicates that 300 investors had benefitted from the scheme before changes in the Laws were made.[14] The requisite provisions were transferred to the Value Added Tax Act, 1996 (CAP.349) and the Income Tax Act, 1997 (CAP.340)

2.3.2 Incentives under the Income Tax Act, 1997 (CAP. 349)

The Income Tax Act took effect from 1st July 1997. It was enacted principally to *"amend and consolidate the Law relating to Income Tax and for other connected purposes"*.[15] Matters relating to tax incentives were naturally accommodated in the Act. Investors who had benefited from the tax incentive/exemption regime under the Investment Code Act, were given a specified date on which to elect whether to remain under the old dispensation or submit to the Income Tax Act.[16] The Act repealed the tax incentive and exemption regime that depended on the discretionary powers of the Minister of Finance in order to make the system more transparent, easier to administer and preempt abuse of the tax incentive/exemption regime.[17]

Another basis for granting tax incentives and exemptions is contained in Double Taxation Agreements (DTA). The Income Tax Act, 1997, provides for the operationalisation of DTAs in Section 88[18], and interestingly provides that such DTA *"shall have effect as if the agreement was contained in this Act"*[19]. A DTA can be defined as a treaty between two or more sovereign governments aimed at avoiding the double taxation of cross-border income country and preventing international tax evasion by business organisations and natural persons[20]. Double

12 The Investment Code Act,1991(CAP.92)
13 Information received from former URA staff who were responsible for Corporate Audits
14 Yasin Mugerwa, "List of tax holiday beneficiaries sent to Parliament", The Monitor,29th September 2010.
15 The lncome Tax Act,1997(CAP.340)
16 The Income Tax Act,1997(CAP.340)
17 Nicholas Kalungi (2010): Dealing with Tax Holidays, The Prosper Magazine, September, 2010.
18 The lncome Tax Act,1997(CAP.340)
19 See section 88(1) of the lncome Tax Act,1997(CAP.340)
20 Ligthart J, Vlachaki M &Voget J (2011): The Determinants of Double Tax Treaty Formation, Center and Department of Economics, University of Tilburg, Netherlands.

taxation is generally defined as the imposition of comparable taxes in at least two countries on the same taxpayer with respect to the same subject matter and for identical periods[21], or the taxation of extraterritorial income in both the source and residence country.[22]

The Income Tax Act mentions three purposes of the DTA in Uganda, and these are; to provide relief of international double taxation, to prevent tax evasion; and provide reciprocal administrative assistance in the enforcement of tax liabilities[23]. Currently, Uganda has 13 DTAs with the following countries: Belgium, Denmark. India, Italy, Kenya, Mauritius, Netherlands, Northern Ireland, Norway, South Africa, Tanzania, United Kingdom & Northern Ireland, and Zambia. Uganda is also negotiating taxation treaties with Egypt, China, UAE, Seychelles and the East African Double Tax Agreement for the 5 EAC Countries. Developing countries like Uganda however enter into DTAs with the objective of promoting foreign investment, and this is principally because DTAs impose obligations on the partnering countries which cultivates a stable politico-economic environment and fiscal certainity as the country is unlikely to unilaterally change its fiscal policy[24]. In Uganda, the DTA will provide incentives and exemptions by removing the obligations from companies and individuals from the other country from paying taxes or maintaining nominal tax rates[25].

Exemptions are also given to non-profit organizations deemed to be of public character that meet the legal requirements, and to International Organizations stipulated to be exempt under Bilateral Agreements and International Conventions to which Uganda is a signatory.[26]The Act also provides for a broad range of exemptions and incentives. Some are sector specific like those for the tourism, agriculture, mining, education, agro-processing, manufacturing and other sectors. In the employment category emoluments like pension, salaries for Prisons, Police and Army Officers, lump sum payments to resident retirement funds and others are exempted. Still under the Income Tax Act, a ten year corporation tax holiday is given to companies that produce and export 80% of locally produced consumer and capital goods. In order to encourage starting of businesses and capital investments, the Income Tax Act has incentive provisions relating to treatment of start up costs, accelerated depreciation for business assets, investment (and re-investment) cost and costs of intangible assets. There are also reliefs provided for tax credits for foreign tax and withholding tax, and carrying forward of losses incurred in a particular tax period[27]. Part A of Appendix 1 gives a detailed list of all incentives and exemptions under the Act.

In the spirit of consolidating all laws relating to Income Tax, the management of incentives and exemptions was hence removed from the Uganda Investment Authority and placed under the Commissioner General, Uganda Revenue Authority. The technical skills resident in the tax body combined with the fact that all laws affecting taxation are under the same administration make compliance monitoring relatively easier than in the previous arrangement. The Investment Authority however manages all other aspects concerning Investors.

21 OECD, 2005, Model Tax Convention on Income and Capital: Condensed Version, Organization for Economic Cooperation and Development, Paris and,Ligthart J, Vlachaki M &Voget J (2011): The Determinants of Double Tax Treaty Formation, Center and Department of Economics, University of Tilburg, Netherlands.
22 Ligthart J, Vlachaki M &Voget J (2011): The Determinants of Double Tax Treaty Formation, Center and Department of Economics, University of Tilburg, Netherlands.
23 The Income Tax Act,1997(CAP.340) Section 88(6)
24 Ligthart J, Vlachaki M &Voget J (2011): The Determinants of Double Tax Treaty Formation, Center and Department of Economics, University of Tilburg, Netherlands, and Barthel F, Busse M &Neumayer E (2009): The Impact of Double Taxation Treaties on Foreign Direct Investment: Evidence From Large Dyadic Panel Data; Contemporary Economic Policy (ISSN 1465-7287);doi:10.1111/J.1465-7287.2009.00185.X © 2009 Western Economic Association International
25 See Appendix 5 for Tax Rates under the DTAs.
26 The Income Tax Act, 1997 (CAP.340) Section 2(bb) and the 1st Schedule
27 The Income Tax Act,1997 (CAP.340)Section 21 and Appendix 1 of this report

2.3.3 Exemptions under the Value Added Tax Act, 1996 (CAP 340 of the Laws of Uganda).

The Value Added Tax Act provides for a wide range of zero-rated and exempt goods and services. Some of these are exemptions on raw materials, plant and machinery, drugs, diapers, ambulances, scholarstic materials, vehicles of specific tonnage and others. The Act also has sector specific exemptions like those on provision of feasibility studies and consultancy services to contractors for roads, bridges and dams, exemptions on provision of medical, dental and nursing services and even on provision of educational materials and services. The Agriculture, Health, Education and Manufacturing sectors enjoy a lot of exemptions and zero rating on imports. The Act exempts Diplomats who are classified as privileged persons and provides for fast tracking of VAT refunds for compliant tax payers.

Another interesting practice in the VAT Act is to categorize some goods as zero-rated. The suppliers of these goods do not pay VAT on them, but have a benefit of claiming for the would be VAT equivalent from Government.

The list of exemptions under the Value Added Tax Act, 1996, is attached to this report as *Part B of Appendix 1*. The list also includes zero-rated supplies.

Box 1: **Illustration, Impact of Zero-rated VAT Supplies:**

A taxable person who is registered for VAT but deals in zero rated supplies will receive the tax benefit in the following ways.

- If the person had for example purchased goods that attract VAT and paid UGX. 5.04 million as part of the purchase price. Given a VAT rate of 18%, this will mean that the person paid UGX. 33.04 million, that is, the purchase/cost price of UGX. 28 million, and VAT of UGX. 5.04 million.
- This person will, subject to the provisions of the VAT Act, 1996, submit a claim for the refund of UGX. 5.04 million which the Commissioner-General will pay back to him/her.

It is succinctly clear that the exemptions in both ~~the~~ Income Tax and VAT Acts complement each other to offer complete packages to those that choose to invest in specific sectors. Other Incentives like the VAT deferment scheme have over time been revisited though.[28] Most consumer household items like sugar and kerosene are also exempt from the tax.

2.3.4 Exemptions under the East African Community Customs Management Act, 2005 (EACCMA)

The EACCMA, 2005, applies in the whole region covered by the East African Community and is designed to put into action regional policies that underpin deepening of trade and integration of the five countries that form the Community. Goods imported for re-exportation, transshipment and in transit, stores for use in vessels and aircraft, temporary imports from partner states are exempted from import duty.[29] A comprehensive list is however provided in a schedule to the Act, and this is agreed on by the Council of Ministers for the whole region.[30]

28 The Value Added Tax Act,1996 (CAP.349).Sections 19,20 and the 2nd Schedule.
29 The East African Community Customs Management Act,2004
30 The East African Community Customs Management Act, 5th Schedule.

Goods exempted are those manufactured within the partner states in order to promote intra regional trade. A common external tariff is applied to imports from outside the region.

The list of exemptions under the EACCMA, 2005, is attached to this report as *Part C of Appendix 1*.

2.3.5 Exemptions under the Stamps Act (CAP.342 Laws of Uganda)

Stamp duty is ordinarily applied to all documents that support commercial transactions. For sale of land transactions, it is based on the value of the land sold. In Uganda exemptions are given on a few transactions and these are: documents issued by Post Bank (U) Limited; documents relating to increase of share capital as a condition precedent to obtaining loan funds for a development project; and documents relating to listing of a company on the stock exchange; documents relating to life insurance policies and documents relating to any sale of shares by a company listed on the stock exchange.[31] The important issue about the above exemptions is that they were incorporated into the act to make transactions relating to the newly set up Uganda Stock Exchange cheaper, and to lessen the burden of potential borrowers from Post Bank (U) Limited as the institution chosen by Government to administer development loans to small income households.

The application of the Stamps Act will apply to the transfer of shares of cross-listed companies and to documentation relating to Agricultural loans provided by other financial institutions. The Stamp duty regime is however very disparate in the EAC and in the spirit of progressive economic integration and harmonization of regional trade and tax laws, it is necessary to harmonize all Stamp Duty Laws in the region.

The list of exemptions under the Stamp Duty Act is attached to this report as *Part D of Appendix 1*.

2.3.6 Exemptions under the East African Excise Management Act (CAP.28 Laws of Uganda)

Excise duty is paid on locally manufactured goods like bottled water, soda and cement, and other few specific items like provision of air time. It is also chargeable on provision of specified services and imports like fuel. Exemption of this duty majorly arises in cases where goods are returned to the factory or where goods are exported.[32]

2.4 The Process of granting Exemptions by the Minister (of Finance)

The preceding paragraphs (par. 2.3-2.7 above) have shown some of the exemptions granted under specified tax legislation. The requisite qualifications for the enjoyment of these exemptions are set out in the Law, which makes the process transparent and accessible. Failure or difficulty in getting the exemptions can be attributed to factors like poor record keeping by the taxpayer/investor, poor tax planning and in some cases disharmony in interpreting legislative provisions, which can be subjected to the objections and appeal process provided for under the same Laws. The Minister responsible for Finance however

31 The Stamps Act(CAP.342)
32 The East African Excise Management Act(CAP.28)

still enjoys discretion in granting tax exemptions and waivers under the Laws of Uganda. The Government also has discretion to directly meet some tax payers' tax obligations. The enabling legislation is outlined here under:

Article 152 of the Constitution of Uganda provides that the power to tax is only derived from Laws passed by Parliament. It also provides that the powers to vary or waive a tax can only be effected by a person who is expressly given such authority in a Law enacted by Parliament[33].This implies that various tax laws must carry enabling provisions empowering the Minister (of Finance) to grant exemptions.

Box 2: **Article 152 of the Constitution of Uganda:**

152. Taxation

(1) No tax shall be imposed except under the authority of an Act of Parliament.

(2) Where a law enacted under clause (1) of this article confers powers on any person or authority to waive or vary a tax imposed by that law, that person or authority shall report to Parliament periodically on the exercise of those powers, as shall be determined by law.

(3) Parliament shall make laws to establish tax tribunals for the purposes of settling tax disputes.

In this regard, both the Income Tax Act, 1997, and the Value Added Tax Act, 1996, have appropriate exemption provisions couched in the following [similar] words:

(1) "Where the Commissioner is of the opinion that the whole or any part of tax due under the Act cannot effectively be recovered by reason of:

(a) consideration of hardship, or

(b) impossibility, undue difficulty, or the excessive cost of recovery, the Commissioner may refer the taxpayer's case to the Minister.

(2) The Minister, if satisfied that the tax cannot effectively be recovered may remit in whole or in part the tax due by the tax payer".[34]

The discretion enjoyed by the Minister is premised on the management of a case falling within the ambit defined by Section 162 of the Income Tax Act or Section 67 of the Value Added Tax Act which is referred to the Minister by the URA Commissioner General for his/her decision. The Minister may waive the tax due or not depending on the reasons and evidence of failure to recover furnished by the Commissioner General. In our opinion, proper and equitable use of this discretion depends a lot on the integrity of both the URA Commissioner General and the Minister of Finance. The discretion can easily be abused depending on caliber of the persons in either of the two offices.

The Stamps Act and the Excise Tariff Act empower the Minister to reduce, remit or compound taxes payable and use of this discretion is not premised on a reference from the

33 The Constitution of Uganda,1995.Article 152

34 The Income Tax Act (CAP340) Section 162and the Value Added Act (CAP.349) Section 67.The title "Commissioner" refers to the Commissioner-General of URA.
The Value Added Act (CAP.349) Section 67.The title "Commissioner" refers to the Commissioner-General of URA.

URA Commissioner-General as provided for in the Income Tax and Value Added Tax Laws.[35]

Box 3: **Section 10 of the Stamp Duty Act (CAP 342 of Laws of Uganda)**

10. Power to reduce, remit or compound duties.

The Minister may, by statutory instrument—

(a) in relation to the whole or any part of Uganda, reduce or grant exemption from the payment of the duties with which any instruments or any particular class of instruments, or any of the instruments belonging to such class, or any instruments when executed by or in favour of any particular class of persons, or by or in favour of any members of such class, are chargeable; and

(b) provide for the composition or consolidation of duties in the case of issues by any incorporated company or other body corporate of debentures, bonds or other marketable securities.

The Minister of Finance has in practice granted waivers and exemptions to particular taxpayers for reasons of enhancing growth of a particular sector or to address development imbalances in a particular region, provided a report of the taxes foregone is given to Parliament. This is provided for by Article 152(2) of the Constitution. In the same report, the Minister is also obliged to provide information on how much tax the Government directly paid on behalf of some taxpayers. It is important to note that the Minister is only under obligation to report after the waivers, exemptions or direct payments of tax on behalf of the particular taxpayers has been done. Parliament cannot legally reverse the Minister's decision. Given this format, political hand-outs in form of waivers or exemptions may not be ruled out in some cases. Similarly, a particular taxpayer may end up enjoying the waiver or exemption privileges indefinitely, yet exemptions must be time bound as earlier observed.

The successive Ministers of Finance have always dutifully provided the reports in their budget speeches. Table 1 below is a summary of the reports for the Financial Years 2007/8 to 2010/2011[36].

Table 1: **Report of Tax Expenditure for Financial Years 2007/08-2010/11**

Financial Year	Tax Exemption or Waivers (UGX Billions)	Non-Resource Tax[1] (UGX Billions)	Total Tax Expenditure (UGX Billions)	Total revenue Collected (UGX Billions)	Proportion of total tax revenue (%)
2007/08	4.7	21	25.7	3,161.4	0.8
2008/09	2.3	12.8	15.1	3,662.3	0.4
2009/10	3.1	15.5	18.6	4,205.7	0.4
2010/11	4.3	12.3	16.6	5,024.0	0.3

The table shows a mixed movement in the tax exemptions and waivers granted and non-resource tax, with no disciplined upward or downward trend over the four years. The tax

35 The Stamps Act (CAP.342) Section 10 and The Excise Tariff Act (CAP) Section 7.
36 Information obtained from the Budget Speeches for the respective Financial Years

exemptions average UGX. 3.6 billion per year and the non-resource tax average UGX. 15.4 billion, and they average 0.5% of the total revenue collected. The information available from the Ministry of Finance website indicate that for this financial year 2011/12, Government has for the first quarter of the year awarded exemption to some 32 companies (including charitable institutions and religious bodies) amounting to UGX.*5,656,239,231 (see Appendix 2)*.The collaborative information from other sources seems however to indicate that the Minister of Finance's report to Parliament is not comprehensive and may be leaving out some items[37].

Government has used its discretionary powers to grant tax amnesty in the Financial Years 2007/8 and 2008/9[38]. The first amnesty was given to all tax payers who had penalty arrears. The reasons given for the amnesty were that the action would widen the tax base and promote future compliance. In the following year, all taxpayers who had arrears that had been on URA books for more than seven years were given a blanket amnesty. The reason given was that the collecting agency could no longer collect the arrears. Using the same discretionary provisions, the Minister of Finance in the Financial Year 2005/6 waived all VAT arrears from Companies operating in the then war torn northern region of Uganda.[39] Information from our inquiries is that the Revenue Collecting Agency was not consulted prior to the amnesty announcements, but had to implement the directives in all the above cases.[40] It is also remarkable that Government could not accurately determine the revenue foregone by these fiscal policy decisions.

The use of discretion to grant incentives and exemptions outside the statutory provisions has been roundly criticized as a political tool that is subject to abuse by the Government Officials. A spokesman of a local Traders Association was quoted to have said that

> *"The (tax) incentives are politically given. They do not have a defined formula but are rather given to those affiliated to the government. Unfortunately, they are going to the wrong people"* [41]

A Member of Parliament joined the chorus when he expressed his frustration on the numerous exemptions under the Stamp Duty Act that the Ministers are granting using the discretionary powers:

> *"We should not have given them blanket powers to waive taxes. They are abusing these powers; we need an amendment to the Stamp Duty Act to remove some powers, so that if the Minister is to exercise them, he has to explain why"*[42]

This is made more heartrending on the realization that some tax waivers are not reported to Parliament as required under Article. 152 of the Constitution.[43] Two different studies by

37 ADB (2010): Domestic Resource Mobilization for Poverty Reduction in East Africa: Uganda Case Study, November 2010; and IMF (2011): IMF Country Report No. 11/308, October 2011
38 See Budget Speeches for the Financial Years 2007/8 and 2008/9.
39 Budget Speech for the Financial Years 2005/6.
40 Information from former staff of Uganda Revenue Authority.
41 Issa Sekitto: The Prosper Magazine, September 2010.
42 Hon Abdu Katuntu, MP & Shadow Attorney General as reported on pp. 4 of the East African Newspaper, 30 April-6 May 2012.
43 See pp.4 of the East African Newspaper, 30 April-6 May 2012

the African Development Bank[44] and the IMF[45] on domestic tax mobilization have confirmed that more often than not, tax incentives and exemptions are granted in an ad hoc manner with no specific deadlines or detailed guidelines about managing the tax incentives or exemptions regime, including lack of specific criteria for qualifying for the tax relief. It is, for example, alleged that the Presidency is involved in the extensive award of tax incentives and exemptions to potential investors on an ad hoc basis[46]. The World Bank also expressed reservation over the ad hoc and firm specific interventions that Government adopted in the case of two agro-processing companies, namely BIDCO and Tri-Star Apparels U Limited[47]. Tri-Star Apparels U Ltd is however a notorious example. Though it was started in 2002 as a US$ 20 million joint venture between TriStar, Sri Lanka and an American firm, ISIS Pacific Capital, Inc[48], it depended on the Government support[49] for working capital and capital funds through grants, loan guarantees, subsidies, incentives and premises to be able to produce textiles for export under the AGOA scheme. The Government also participated in sourcing and training young promising girls as knitters who ended up being subjected to slavish working conditions[50]. Government invested US$ 11 million or about UGX. 25 billion in form of subsidies, loan guarantees and incentives[51]. Barely two years later, the industry was closed down with the astronomical loss met by the Ugandan taxpayer!

44 ADB (2010): Domestic Resource Mobilization for Poverty Reduction in East Africa: Uganda Case Study, November 2010.
45 IMF(2010)Uganda: Sixth Review under the Policy Support Instrument and Request for an Extension of Policy Support Instrument-Staff Report
46 Mwenda A &Atuhaire, A (2006) Museveni Gives Bassajja Another Shs. 13b in Taxes The Monitor 14/06/2006, [online] as cited in ADB (2010): Domestic Resource Mobilization for Poverty Reduction in East Africa: Uganda Case Study, November 2010.
47 World Bank (2007): Uganda, Moving Beyond Recovery: Investment and Behaviour Change, For Growth, Country Economic Memorandum, September 2007.
48 Clean Clothes Campaign (2006): Clean Clothes Newsletter, May 2006
49 de Haan E &Stichele M V (2007): Footloose Investors, Investors in the Garment Industry in Africa, SOMO-Centre for Research on Multinational Corporations; and Global Integrity Report, 2007 and 2008.
50 International Confederation of Free Trade Unions (2006): Annual Survey Report, 2006; and Beckman B, Buhlungu S &Sachikonye L (2009): Trade Unions and Party Politics, downloaded from www.hrscpress.ac.za on 3rd June 2012; Independent Magazine, October, 10, 2010.
51 Monitor Newspaper, November 1, 2006.

Chapter 3

IMPLICATIONS OF TAX EXEMPTIONS ON DEVELOPMENT

3.1 Rationale for granting exemptions and incentives

As a fiscal policy tool, tax exemptions have been used since the 1960s in the belief that they lead to the attainment of objectives of public policy that would ordinarily be accomplished through public (revenue) spending or as an avenue of encouraging activities that will lead to setting up of investments that will provide revenue in future. Tax exemptions have also been used to support communities that may need to be protected from the vagaries of open competition or whose standard of living is adversely affected by tax payment.

A comprehensive study by Chalk N (2010)[52] identified the rationale for the grant of incentives and exemptions to *inter alia* include:

(a) improving productivity and efficiency by attracting identified key priority industries to the country that would act as a catalyst for industrial development;
(b) Promoting the transfer of proprietary knowledge and technology;
(c) Creating employment opportunities for the populace;
(d) Giving the local human resources opportunity to be trained and become skilled;
(e) Implementing economic diversification and protecting the economy from undue price movement;
(f) Creating Opportunity for accessing foreign markets
(g) To encourage the location of industries in particulars areas of the country.

The other consideration that leads to the introduction of tax incentives and exemptions is tax competition. Tax competition refers to situations where people manage their tax burdens by shifting factors of production from high-tax jurisdictions to low-tax jurisdictions.[53] The ensuing fiscal rivalry leads to reduction of tax rates and encourages mobility of capital and labour[54]. Countries are then compelled to maintain a competitive tax system in the increasingly globalized economy, with poor African countries principally relying on tax holidays and import duty exemptions while the industrialized countries use investment allowances or accelerated depreciation.[55]

3.2 Tax Exemptions and their Implications to Development in Uganda

There has been increased use of exemptions and incentives in Uganda to spur economic growth particularly in the industrial, Agriculture, tourism and hospitality sectors[56]. Limited research that has been carried out so far has revealed that the degree to which tax incentives and exemptions are used in the economy affects tax mobilization capacity of a given economy,

52 Chalk. N .(2010)Tax Incentives in the Philippines; A Regional Perspective.IMF Working Paper WP01/281
53 Mitchell D (2005): The Economics of Tax Competition: Harmonization vs. Liberalization, A briefing paper by the Adam Smith Institute
54 Ibid.
55 Morissel .J .G .Parma(2000): How Tax Policy And Incentives Affect Foreign Direct Investment, A Review
56 URA (2010): Raising the Tax to GDP Ratio in Uganda

since they tend to reduce revenue in the short run but may spur growth in certain sectors which in turn provide tax revenue in the long run[57].

In order to determine the costs of tax incentives and exemptions, it would be prudent to have the computation to include not only the revenue foregone, but also associated benefits such as raising income, job creation and technology transfer. The estimate of the cost of tax incentives and exemption for the five countries in the East African Community is about US$ 2.8 billion per year[58], a sum which is higher than the annual tax revenue of Uganda which is about US$ 2 billion[59].

Uganda is estimated to have lost revenue from tax incentives for the period 2005-2008 as indicated below:

Table 2: **The Value and Implications of Tax Incentives and Exemptions in Uganda for the years 2005-2008[60] (the figures are in million US$)**

Item	2005	2006	2007	2008
Value of Incentives & Exemptions (US$ mn)	178.8	174.0	217.5	211.4
Revenue foregone (US$ mn)	33.1	36.4	49.4	56.2
Total Trade Taxes (US$ mn)	586	682.1	919.1	1,102.2
Percentage Foregone (%)	5.3	5.1	5.1	4.9

Table 2 shows that Uganda loses an average of 5% of its current revenue to tax incentives and exemptions. The African Development Bank estimated that for the year 2009/10 Uganda lost about UGX 690 billion (US$ 272 million) in tax exemptions[61]. This affirms that the value of incentives and exemptions is still rising. URA shows varying estimates but in the same range as indicated by the ADB: URA estimated that revenue foregone as a result of incentives and exemptions has grown from UGX 481.98 Billion in 2005/06 to UGX 1,231.60 Billion in 2009/10. It estimated that exemptions have resulted into loss of tax effort by 3.1 percentage points.[62]In year 2009/10, tax incentives and exemptions resulted into a direct loss of 3.99 percentage points for Tax to GDP ratio. Without the exemptions the Tax to GDP ratio would have reached a level of 16.15%.[63] Alternatively, this is almost 25% of the revenue realized; and yet external donor funding in the year amounted to about 24%[64].

The objective of introducing tax incentives and exemptions as spelt out by the Investment Code Act, 1991, is close to what was observed in the study referred to above. One Senior Executive made the following statement in support of incentives:

57 Barthel F, Busse M &Neumayer E (2009): The Impact of Double Taxation Treaties on Foreign Direct Investment: Evidence From Large Dyadic Panel Data; Contemporary Economic Policy (ISSN 1465-7287);doi:10.1111/J.1465-7287.2009.00185.X © 2009 Western Economic Association International
58 Report by Tax Justice Network-Africa, ActionAid International, Southern & Eastern African Trade Information and Negotiation Institution and Uganda Debt Network (2010).
59 URA Research & Planning Revenue Reports,2011 (converted by the authors at the rate of US$ 1= UGX 2,500).
60 Report by Tax Justice Network-Africa, ActionAid International, Southern & Eastern African Trade Information and Negotiation Institution and Uganda Debt Network (2010).
61 ADB (2010): Domestic Resource Mobilization for Poverty Reduction in East Africa: Uganda Case Study.
62 URA (2010): Raising the Tax to GDP Ratio in Uganda
63 URA (2010): Raising the Tax to GDP Ratio in Uganda
64 Ministry of Finance, Planning & Economic Development (2011): Background to the Budget for the Fiscal Year 2011/12, extracted from www.finance.co.ug on 5th March 2012.

> *"The thinking that tax holidays reduce domestic revenue is misleading because tax revenue is not the only profit from an investment. There are other benefits such as employment, increased supply and proper use of available resources that come with an investment .In fact, those that say that we lose much because of tax holidays must rethink their stand because we do not only gain revenue from business ventures…"* [65]

The above assertion reflects the philosophy shared by the framers of the Investment Code Act, but the manner in which the Law was executed is perceived differently by other stake holders. One Senior Executive of the Private Sector Foundation is quoted to have said:

> *"Incentives are going to the wrong people. Why would you give an incentive to a Company that is starting out in Uganda when there are companies that are already operating and need help? In fact these incentives should not go to individuals but sectors. This would promote healthy business competition in a particular sector ……… I do not believe that tax exemptions attract investors. It is the general cost of operation that attracts investors .Even if you put a 10 year tax holiday when roads are bad with poor infrastructure and the energy sector lacking, investors will not come…."*[66]

Tax exemptions and incentives must be given in a properly structured environment if the Country is to realize the intended policy objective for their introduction. It is imperative for all stakeholders to agree on the sectors to benefit from the incentives, to set up mechanisms for monitoring and evaluating the intended benefits and to have a transparent method for determining the companies to benefit from the incentives. It must also be observed that incentives *per se* do not attract Foreign Direct Investment (FDI). Other factors such as the efficiency of political institutions, market size, or the education and productivity of the local labor force and other factors of production should be put in place to create a conducive environment for productivity[67]. Governments also need to consider other factors such as natural endowment of physical resources, and cultural and geographic proximity to major source countries. These are neither unalterable nor easily amenable to policy but influence FDI. Alternative policy measures that can be taken as points of difference or competition in the rivalry for FDI, may include easing restrictions imposed on investors on say profit repatriation, reduction of red tape or corporate taxes, which may be handled unilaterally or through concluding bilateral investment treaties or double taxation agreements[68].

The above factors are lacking in the case of Uganda. If the Government was focused on attracting good investment, companies like *Tristar* Apparels (U) Ltd would not have caused the loss they did. Cases of companies getting tax free construction materials way above their actual requirements and the excess being off-loaded on to the market to unfairly compete with other importers would not also arise.[69] Similarly, cases of footloose companies that wind up after every end of tax holiday periods would not have gained currency nor be heard of.

65 Lawrence Byensi: Acting Executive Director, Uganda Investment Authority, quoted in The Prosper Magazine, September 2010.
66 Gideon Badagawa, Executive Director, Private Sector Foundation.Quoted in the Prosper Magazine,September 2010.
67 Barthel F, Busse M &Neumayer E (2009): The Impact of Double Taxation Treaties on Foreign Direct Investment: Evidence From Large Dyadic Panel Data; Contemporary Economic Policy (ISSN 1465-7287); doi:10.1111/J.1465-7287.2009.00185.X © 2009 Western Economic Association International
68 Ibid
69 HCCS NO 433.of 2006 Kampala International University vs Tororo Cement and URA

The fact that there is lack of well researched reports on the economic benefits attributable to Foreign Direct Investments is another big issue to ponder. The Investment Authority issues impressive annual reports[70] based on information given by companies when they are applying for investment licences in accordance with the Investment Code Act, 1991. This information records a potential investor's intentions which could have been tailored purely to win generous benefits under the Investment Law. There is accordingly no monitoring framework that would provide reliable information tied to the Investment licence-holders on issues such as: number of jobs created, kinds of skills developed, number of investors who opted to locate businesses in areas favored by the incentives given, increase in revenue collection attributable to the granting of incentives or the amount of revenue lost in the process.

In its 2010 report, the African Development Bank estimated that Uganda loses at least 2% of its GDP from tax incentives, thus the Country is being deprived of badly needed resources to reduce poverty and improve the general welfare of the population.[71] The same report also shows that Kenya and Tanzania provide greater tax incentives than Uganda but attract less FDI. Studies similar to the one by the African Development Bank suggest that use of incentives to attract FDI ranks low on the list of factors that attract Investors to particular destinations.[72] Another study revealed that mostly large firms with the muscle to arm twist government benefit from the given incentives as opposed to small and medium enterprises which end up bearing a disproportionate tax burden.[73]

As noted, DTAs offer tax relief to an individual or corporate entity resident in another contracting country. DTAs normally provide for the taxation of different kinds of income and take precedence over the tax law of the contracting state. It is noted that DTAs result in a lower effective tax rate in the contracting state. For example, in the absence of DTAs between Uganda and countries like India, Italy, Mauritius, Netherlands Norway, South Africa etc, the WHT on interest, dividends, royalty, and management fees would have been 15% but because of the DTAs, the rate is maintained at 10%![74] In addition, whereas DTAs require the two contracting states to exchange information, they may be prone to abuse through false declarations to lay ground for tax evasion and avoidance schemes.

The impact of having numerous exempt and zero rated goods on revenue generation is well brought out by a report on VAT in Uganda using the VAT Gross Compliance Ratio (VATGCR)[75]. This is an indicator of how well a VAT system is produces revenue for Government. VATCGR is in simple terms a comparison of actual VAT collections as a proportion of the potential VAT collections, and is expressed as a percentage[76]. Uganda has a relatively high VAT rate of 18% but its VATGCR is 26.5% which unfavorably compares with the global and Sub-Saharan Africa average of 65.48% and 38.45 respectively.[77]An IMF report notes that at the time of its introduction in Uganda, the VAT regime reflected good international practice, with a single positive rate, a broad base, and limited exemptions.[78] The Government however diluted the tax's robustness by bringing on board a multiplicity of exemptions especially for intermediate goods that has made VAT appear like the Sales Tax it replaced. Uganda's VAT yield was 3.8% of GDP in the financial year 2009/10, compared to Kenya with 5.8%, Tanzania with 4.6% and Rwanda with 4.1%, yet save for Kenya which uses a 16% VAT rate,

70 See for example, Uganda Investment Authority's Annual Report for the year 2010
71 African Development Bank, Domestic Resource Mobilisation for Poverty Reduction in East Africa; Uganda Case Study, November 2010,pp20.
72 Agodo.D (1978)'The Determinants of US Private Manufacturing Investments in Africa" Journal Of International Business Studies.9.1978. Also cited in Morisset.J. & .Pirma.N.(2000)How Tax Policy and Incentives Affect Foreign Direct Investments.
73 Gauthier B and Renikka; Shifting Tax Burdens through Exemptions and Evasion; An Empirical Investigation of Uganda. Accessed at Citeseerx.ist.psu.edu/viewdoc/.Accessed on 29th April 2012
74 The Income Tax Act (CAP340) and Appendix 5, indicating tax rates under different DTAs
75 ADB (2010) Domestic Resource Mobilisation for Poverty Reduction in East Africa. Uganda's Case Study, November 2010
76 www.fiscalreform.com, =extracted on 29 May 2012.
77 ADB (2010);Domestic Resource Mobilisation for Poverty Reduction in East Africa. Uganda's Case Study, November 2010
78 IMF (2011): IMF Country Report. No.11/308, October 2011.

all other countries have a similar rate of 18%.This shows the impact on exemptions can have on the Country's tax effort.

The tax incentives and exemption provided by the Minister have double-edged impacts on the economy. The measures may for example promote trade or particular sectors in the economy but will also result into revenues loss. For instance, in a bid to ease the transport of persons and goods in the EAC, the Minister extended exemption from import duty of buses and trucks from CET rate of 25% for Tanzania, Uganda and Rwanda for one year. As a result, a total of 742 commercial trucks were imported in the FY 2010/11 as opposed to 368 imported over the entire period of FY 2009/10 indicating an increase of 93.7%. Estimated revenue foregone as a result of extension of this exemption on trucks only stood at UGX. 3.32 billion in the FY 2010/11. On the other hand, 510 buses were imported in the entire FY 2010/11 compared to 369 buses imported in the corresponding period of 2009/10 indicating a 38.2% increase. Revenue foregone as a result of extension of this incentive for buses also amounted to UGX. 2.08 billion for the whole Financial Year. This therefore indicates that the incentive mainly benefitted truck importers as opposed to bus importers. [79]

Another measure is the Minister's proposal to reduce registration fees for Motorcycles by UGX. 81,400 from UGX Shs.222, 800 to Shs,141,400 in order to make transport for the ordinary Ugandan more affordable. During the FY 2010/11, 85,857 motor cycles were registered, indicating a growth rate of 34.51% compared to the FY 2009/10. The highest number of motor-cycles was registered in March 2011 (9,506) as compared to an average of 7,155 motorcycles registered during the whole financial year. This increase was a result of decreased registration fees coupled with the decentralization of the registration process which had improved on the compliance levels among tax payers. Therefore the decrease in registration fees has led to an estimated loss in revenue foregone of UGX. 6.87 billion during the FY 2010/11.[80]

The Minister has also granted a number of taxpayers stamp duty exemptions which over the period from 2005 to 2011 amount to UGX. 5 billion or on average UGX.1 billion per annum,[81] which is about 5% of the revenue yield from stamp duty. The Minister exempts companies that are raising their share capital, debentures and loans, acquiring land and other assets. For example, in the run up to Commonwealth Heads of Government Meeting (CHOGM), in the financial year 2007, the Minister gave the following notable exemptions[82]:

(a) A company called AYA set out to build a hotel for use during CHOGM and received a stamp duty exemption UGX. 504,857,500 on a US$ 41.5 million debenture. In addition AYA received a blanket exemption in 2006 to import construction materials for the construction of a hotel. The hotel was not ready and never used for the CHOGM in spite of receiving generous exemptions.

(b) The Munyonyo Commonwealth Resort received a stamp duty exemption of UGX. 368,702,500 on account of increasing its share capital. It is notable that this company received a grant from the Government which was converted into share capital. Government is currently in the process of divesting itself from this company.

(c) Government also with no easily discernible merit granted Barclays Bank a stamp duty exemption of UGX. 302,827,500 on increasing its share capital. This would partly explain the Finance Minister's omission to include this exemption in his report to Parliament as required by Article 152 of the Constitution[83].

79 URA: Revenue Report 2010/2011
80 URA: Revenue Report 2010/2011
81 See pp.4 of the East African Newspaper 30 April -6 May 2012.
82 See pp.4 of the East African Newspaper 30 April -6 May 2012.
83 See pp.4 of the East African Newspaper 30 April -6 May 2012

(d) When Umeme Ltd was taking over the 20-year concession it leased some assets of Uganda Electricity Distribution Company under exemption of stamp duty.

Companies like AYA are also given public land without payment of money. Sameer Agriculture& Livestock Limited is enjoying a ten-year tax holiday to reap from a public asset, Diary Corporation, which it received on payment of a nominal fee of US$ 1.A report by the IMF issued in 2006,[84] mentions a number of disadvantages associated with tax incentives and they seem to outweigh the benefits if the observations noted above are to be taken into account. Incentives are said to result in loss of current and future tax revenue; create differences in effective tax rates and lead to market distortions; require large administrative resources; could attract footloose firms; and could result in rent seeking and other undesirable activities.

Further still, the foregone revenue reduces what Government would inject in sectors like health, education and public works hence resorting to borrowing at great economic and political cost. Tax incentives and exemptions accordingly reduce the *fiscal space*. Fiscal space is defined as "the capacity of government to provide additional budgetary resources for a desired purpose without any prejudice to the sustainability of its financial position."[85] In Uganda, creation of fiscal space would depend on increasing government revenue, public debt, raising donor funds, and government's capacity to increase efficiency in the utilization of resources. The on-going debate about the 2012/13 budget estimates for various sectors; debates about how to lift a quarter of the population out of absolute poverty; government failing to give teachers a 30% salary increment ;failure to introduce a minimum wage; government ceasing to operate a non-contributory scheme for civil servants; electricity subsidy moving from UGX. 92 billion to UGX. 189 billion; Lack of access to Government health facilities by some citizens; and the worsening state of infrastructure necessary for development are pointers to reduced fiscal space .

Uganda's fiscal architecture is characterized by a large informal sector. It is notable that more than 75% of the population is employed in the agricultural sector, a majority of which take non-wage employment[86], and needless to say this does not lead to generation of much tax revenue. A big percentage of the population is young, and the population is still growing at a supersonic speed of 3.25% with more than 70% of the 30 or so million Ugandans not income earning or with no potential to generate any tax revenue. Tax incentives and exemptions directly deplete an already narrow tax base and inhibit any possibility of expansion of the tax base. Government in the circumstance has no option but to let the limited number of compliant taxpayers progressively bear the burden of taxation. Individual Income tax rates are a good example. In spite of the substantial changes in the economy; Government has been hesitant to vary these rates which have remained stagnant for almost two decades due to the fear of losing tax due from employment income[87]. This may also explain the foot-dragging in respect to the VAT registration threshold[88].

One positive development however is that the Government of Uganda has formally indicated a commitment to reduce tax incentives and exemptions according to the IMF.[89] This commitment is however dampened by the fact that by October 2011, the Government of Uganda had not met the first timeline on this promise which was to be executed in 2010.[90]

84 IMF; Kenya, Uganda and United Republic of Tanzania; Selected Issues,1st December 2006,pp10.
85 Heller, "The Prospects of Creating 'Fiscal Space' for the Health Sector," Health Policy and Planning, 21(2) (2006): 75–79, as cited in Okwero P, Tandon A, Sparkes S, McLaughlin J &Hoogeveen J (2010): Fiscal Space for Health in Uganda, World Bank Working Paper No. 186
86 Private Sector Foundation Uganda (2010): Private Sector Platform for Action, A Synopsis of Key Private Sector Growth Challenges and Proposals for Policy Reforms
87 The Income Tax Act, 1997, the 3rd Schedule, Part 1, Individual tax rates, has never been amended since 1997.
88 The VAT Act, 1996, Section 7(2) that sets the registration threshold at UGX. 50 million has not been amended despite recommendations from various stakeholders, including URA, the Private Sector Foundation Uganda and IMF.
89 IMF; Sixth Review Of Policy Instrument and Request for an Extension of the Policy Support Instrument,1st December,2009.pp 10
90 IMF (2011): IMF Country Report No. 11/308, October 2011.

Chapter 4 CONCLUSION AND RECOMMENDATIONS

4.1 Conclusion

The review has indicated that Government's policy of giving tax incentives and exemptions play a significant though not clearly quantified role in securing momentum for economic growth. In the same vein, it is indicated that this policy is substantially reducing the fiscal space and is therefore a serious challenge to revenue mobilization. Without tax incentives and exemptions, the Government would have attained a tax revenue to GDP ratio of 16%, and this revenue yield is enough to fund the current national budget. This of course is countered by the benefits derived from tax incentives like employment opportunities, transfer of technology and capital investments, and improving the socioeconomic conditions of the citizens through exemptions on household items and low income conveniences like motor cycles.

4.2 Recommendations

It is in light of the study findings and the double-edged nature of tax incentives and exemptions, and the observations of other stakeholders who have deeply researched on the subject, that the following recommendations are made:

(a) We recommend that Government institutes a comprehensive study on the costs and benefits that have accrued from the introduction of the current tax incentives and exemptions regime. The findings will guide proper policy formulation and/or adjustment.

(b) Government should act on its commitment to reduce unnecessary incentives and exemptions since they contribute to narrowing the tax base and lead to loss of tax revenue.

(c) The discretionary contained in the Stamp Duty Act and the Excise Tariff Act which allow the Minister to reduce, remit or compound taxes payable without reference from the URA Commissioner-General should be trimmed away.

(d) The Government should design a transparent process and procedure for managing and granting tax incentives and exemptions. The new system should comply with universal good governance standards and pre-empt rent seeking and political patronage. This should also contain a review of Article 152 of the Constitution to incorporate a requirement by the Minister to explain his decision to Parliament. There should equally be clear oversight role granted to Parliament to proactively supervise the implementation of tax incentives and exemptions in the country.

(e) The reporting structure on tax revenue foregone should be more detailed and comprehensive. A mere report on amounts of tax revenue foregone, after the Minister's decision to grant tax waivers does not add much value to the process since Parliament cannot reverse the Ministerial decisions once implemented.

(f) URA should have an express mandate of auditing the incentives and exemptions given since it has the monopoly of tax administration in Uganda. All tax incentives and exemptions need an input of URA and other stakeholders for appropriate fiscal planning.

(g) Given the deepening integration within the East African Community, it is necessary to handle the matter of tax exemptions and incentives at a regional level. The intra-regional competition for FDI is fuelling an unhealthy "Race to the Bottom' in the region.

(h) Civil Society Organizations should actively participate in tax issues since they are key to governance and human rights. This calls for acquisition of appropriate competences in fiscal policy, tax administration, budgetary and expenditure management to be able to monitor and follow the developments in this area.

APPENDICES

Appendix 1: Statutory Provisions on Tax Expenditure/Exemptions under the Different Taxing Statutes in Uganda.

PART A: The Income Tax Act (CAP.340 of the Laws of Uganda)

(a)	Section 21(1)(a):	Income of a listed Institution under the 1st Schedule
(b)	Section21(1)(b):	Income of organizations or persons entitled under the Diplomatic Privileges Act
(c)	Section 21(1)(c):	Incomes of employees of governments of foreign countries
(d)	Section 21(1)(d):	Allowances paid to employees at Uganda's Foreign Missions abroad
(e)	Section21(1)(e):	Incomes of Local Authorities
(f)	Section 21(1)(f):	Incomes of exempt organizations as qualified in the section.
(g)	Section 21(1)(g):	Educational grants for students studying at recognized educational or research institution.
(h)	Section 21(1)(h):	Alimony or allowances under separation orders or agreements
(i)	Section 19(1)(j):	the value of gifts, bequests, devises or inheritance not being employment, business or property income
(j)	Section 21(1)(l):	Employment income under technical assistance agreements
(k)	Section 19(1)(m):	Foreign source income derived by short-term residents
(l)	Section 19(1)(n);	Pension
(m)	Section 21(1)(o);	Lump sum payments to members of resident retirement funds
(n)	Section 21(1)(p);	Proceeds of life insurance policy
(o)	Section 21(1)(q);	Official employment income of persons employed in the armed forces excluding persons serving in a civil capacity
(p)	Section 21(1)(r);	Income of the Government of Uganda and any other foreign country
(q)	Section 21(1)(s);	The Income of the Bank of Uganda
(r)	Section 21(1)(t);	Income distributed to participants of a collective investment scheme
(s)	Section 21(1)(u);	Interest on agricultural loans
(t)	Section 21(1)(v);	Emoluments payable to employees of the East African Development Bank
(u)	Section 21(1)(w);	Income of an investor compensation fund under the Capital Markets Act

(v)	Section 21(1)(x);	Income from the operation or leasing of aircraft
(w)	Section 21(1)(y);	Income from the export of finished consumer and capital goods as qualified in the Act.
(x)	Section 21(1)(z);	Income derived from agro-processing as qualified in the Act.
(y)	Section 21(1)(a a);	Business income from managing or running an educational institution
(z)	Section 21(1)(ab);	Interest on deposit auction funds issued by the Central Bank
(aa)	Section 74(2);	Dividends paid to a resident company by a resident company as qualified by the Act.
(ab)	Section 80;	Foreign Employment Income taxed in a foreign country
(ac)	Section 83(5);	Interest paid by resident companies on debentures issued outside Uganda
(ad)	Section 88;	Exempt Income under International Agreements between Uganda and other Countries.
(ae)	Section 162;	Taxes remitted by the Minister as qualified in the Act

PART B: The Value Added Tax Act (CAP. 349 of the Laws of Uganda)

Exempt items under the Act;

(1) Section 19(1); Supplies of goods and services specified in the second schedule to the Act, and these include:

- (a) the supply of unprocessed foodstuffs, unprocessed agricultural products and livestock;
- (b) the supply of postage stamps;
- (c) the supply of financial services;
- (d) the supply of insurance services;
- (e) the supply of unimproved land;
- (f) a supply by way of sale, leasing or letting of immovable property, other than
  - (i) a sale, lease or letting of commercial premises;
  - (ii) a sale, lease or letting for parking or storing cars or other vehicles;
  - (iii) a sale, lease or letting of hotel or holiday accommodation;
  - (iv) a sale, lease or letting for periods not exceeding three months; [parking or storing cars or other vehicles] or
  - (v) a sale, lease or letting of service apartments;
- (g) the supply of education services;
- (h) the supply of veterinary, medical, dental, and nursing services;
- (i) the supply of social welfare services;
- (j) the supply of betting, lotteries, and games of chance;
- (k) the supply of goods as part of the transfer of a business as a going concern by one taxable person to another taxable person;
- (l) the supply of burial and cremation services;

(m) the supply of precious metals and other valuables to the Bank of Uganda for the State Treasury;

(n) the supply of passenger transportation services (other than Tour and Travel operators);

(o) the supply of petroleum fuels subject to excise duty, (motor spirit, kerosene and gas oil), spirit type jet fuel, kerosene type jet fuel and residual oils for use in thermal power generation to the national grid;

(p) the supply of dental, medical and veterinary equipment;

(q) the supply of feeds for poultry and livestock;

(r) the supply of machinery used for the processing of agricultural or dairy products;

(s) the supply of photosensitive semiconductor devices, including photovoltaic devices, whether or not assembled in modules or made into panels; light emitting diodes; solar water heaters, solar refrigerators and solar cookers.

(t) the supply of accommodation in tourist lodges and hotels outside Kampala District;

(u) supply of new –

  (i) computers

  (ii) desktop printers; and

  (iii) computer parts and accessories.

(v) the supply of computer software and software licences;

(w) the supply of computer software and software licences;

(x) the supply of lifejackets, life saving gear, headgear and speed governors;

(y) the supply of mosquito nets, insecticides and acaricides;

(z) the supply of specialised vehicles, plant and machinery, feasibility studies, engineering designs, [and] consultancy services and civil works related to hydro-electric power, roads and bridges construction, [and] public water works, agriculture, education and health sectors.

(aa) the supply of contraceptive sheaths and examination gloves;

(ab) the supply of Liquefied Petroleum Gas.

(ac) the supply of any goods and services to contractor and subcontractor of hydro-electric power projects;

(ad) the supply of diapers.

(ae) the supply of salt;

(af) the supply of motor vehicles or trailers of a carrying capacity of 3.5 tonnes or more designed for the transport of goods;

(ag) the supply of packing materials exclusively used by the milling industry for packing milled products;

(ah) the supply of packing materials exclusively used by the diary industry for packing milk;

(ai) the supply of biodegradable packaging materials.

(2)	Section 20;	Imports exempt from duty under the Fifth schedule of the East African Community Customs Management Act.
(3)	Section 67;	Taxes remitted by the Minister as qualified in the Act.

(4) The zero-rated supplies under Section 24(4) , though technically taxable, are included because they realize no revenue:

- (a) a supply of goods or services where the goods or services are exported from Uganda as part of the supply;
- (b) the supply of international transport of goods or passengers and tickets for their transport;
- (c) the supply of drugs and medicines;
- (d) the supply of educational materials and the supply of printing services for educational materials;
- (e) the supply of seeds, fertilisers, pesticides, and hoes;
- (f) the supply of cereals, where the cereals are grown, milled or produced in Uganda;
- (g) the supply of machinery, tools and implements suitable for use only in agriculture;
- (h) the supply of milk, including milk treated in any way to preserve it;
- (i) the supply and installation of Mobilet Toilets, Ekoloo Toilets, and
- (j) components made from polythene with effect from 1st July 2004; and
- (k) the supply of sanitary towels and tampons and inputs for their manufacture.;.
- (l) the supply of leased aircraft, aircraft engines, spare engines, spare parts for aircraft and aircraft maintenance equipment.

PART C: The East African Community Customs Management Act, 2005

Exempt items under the Act.

(a) Goods listed in Parts “A” and “B” in the Fifth schedule to the Act.

(b)	Section 113;	goods remaining on board of any aircraft or vessel in which they were imported as stores or otherwise.
(c)	Section 115(a);	Goods imported for re-exportation, transshipment or in transit.
(d)	Section 115(b)	Goods for use as stores for aircraft or vessels and proved to the satisfaction of the Commissioner.
(e)	Section 116;	Re-imports from Partner states as specified in the Act.
(f)	Section 117;	Temporary imports as specified in the Act.

PART D: The Stamps Duty Act (CAP.342 of the Laws of Uganda)

Exempt items under the Act;

(a)	Section 10;	Minister has powers to reduce, remit or compound due stamp duty.
(b)	Section 11;	Documents issued by Post Bank (U) Limited.

(c) Documents relating to increase of a company's share capital as a condition precedent to obtaining loan funds for a development project.

(d) Documents relating listing of a Company on the Stock exchange.

(e) Documents relating to Life Insurance Policies.

(f) Documents relating to any sale of shares by a Company listed on the stock exchange.

PART E: The East African Excise Management Act

Excise duty will be exempted in the following circumstances;

(a) Where goods are exported;

(b) Where goods are returned to the factory;

There are also circumstances/conditions detailed hereunder when there is remission of excise duty;

- (i) The licensee is entitled to a remission by law
- (ii) Where goods in question were destroyed accidentally by fire or any other unavoidable cause, while in any building, room, place which has been entered with accordance with the law, and is in the factory in which they were produced.
- (iii) Decants or expired, spoilt e.t.c. goods which have been destroyed with the permission of the Commissioner General and under the supervision of a proper officer.
- (iv) Exported Goods with proper documents.

Appendix 2: Indicative List Of Tax Expenditure Commitments: Government Paid Taxes to URA on behalf of Taxpayers for FY 2011/2012 (1st July to 23rd September 2011)[91]

Beneficiary	Nature of Items	Total Tax
ADF-Gulu Diary Co-operation	Motor cycle	2,675,236
African Development Foundation	Compression Engines	8,480,285
All Nations Christian Care	Donations	39,348,808
Arua Diocese	Motor Vehicle	32,044,450
Aya Investments Ltd	Furniture, construction and electrical materials, linen, deformed bars etc.	1,182,146,437
Arch Diocese of Tororo	Telephone	3,505,262
Co-operation and Development	Donations	165,515,036
Diocese of Masaka	Donations	32,579,435
Global Outreach Uganda	Donations	29,183,944
Gulu Diocese	Used Yamaha Motorcycle	564,870
Hoima Catholic Diocese	Motor Vehicle & Donations	76,408,466
Kyambogo University	MSI Equipments	4,158,590
Laburnam Courts Ltd	Building materials	4,137,859
Lydia Home Textiles (U) Ltd	Textile raw materials	662,724,094
Mabale Growers Tea factory (ADF project)	Donations	11,375,476
Mengo Hospital	Motor Vehicle	15,396,066
Mosa Court Apartments Ltd	Building materials	4,323,126
Oil Palm Uganda Ltd	Isuzu Tippers, Spare parts & herbicides	179,435,803
Phoenix Logistics (U) Ltd	Dyes (Raw materials)	2,134,070
Presidential Initiative on Banana	Laboratory equipments	182,139,604
Prisons Support Organisation	Donations	14,561,557
Registered Trustees of Archdiocese	Motor cycle	6,283,213
Southern Range Nyanza	Textile raw materials	2,632,353,959
St. Francis Hospital, Buluba	Double cabin	21,925,363
St. Mary's hospital Lacor	Motor Vehicle & Donations	61,541,068

91 This is an abridged version of the Tax Expenditure Account extracted from the Ministry of Finance, Planning and Economic Development website (www.finance.co.ug).

Beneficiary	Nature of Items	Total Tax
Uganda Episcopal Conference	Motor Vehicle	28,543,120
Uganda Hope builders International	Donations	15,243,601
Uganda National Council for Science	MSI Equipments; Plastic bags &Real time PCR system/ PC	48,757,574
Uganda National Examination Board	Examination materials	171,106,406
Uganda Rural Development and Training	Donations	3,788,494
Victoria Resort Hotel	Glass and Lights	7,745,282
Wandegeya Muslim Community	Building materials	6,112,677
		5,656,239,231

Appendix 3[92]: Representative List of Tax Incentive/ Exemption Recipient Companies

Taxpayer	Period Exempted
Picfare Industries Limited	**10 years**
Roofings Rolling Mills Limited	**10 years**
Sameer Agriculture & Livestock Limited	**10 years**
Quality Chemical Industry Limited	**10 years**
Steel & Tube Industries Limited	**10 years**
Bidco (U) Limited & Oil Palm (U) Limited	**25 Years**
Southern Range Nyanza	**5 Years**

Appendix 4: Schedule of Stamp Duty Exemptions

4.1 Representative List of Recipients with Amounts of Revenue Foregone through the Stamp Duty Exemptions[93]

Recipient of Exemption	Date of Exemption	Particulars/instrument	Amount[2] (UGX)
Barclays Bank of Uganda	October 2008	Raised share capital from $ 1.6 million to $ 24.6 million	302,827,500
Munyonyo Commonwealth Resort Ltd	September 2007	Raised share capital from $ 4000 to $ 29.5 million	368,702,500
AYA	2007	Raised debenture of $41.5 million from Industrial Development Corporation of South Africa for construction of a hotel.	504,857,500
Quality Chemicals Industries Ltd		To register a security for a $ 4 million loan from Barclays Bank.	48,750,000
			1,225,137,500

92 Part of this list was extracted from the Observer Newspaper
93 See pp.4 of the East African Newspaper 30 April -6 May 2012.

4.2 Schedule Showing Some of the Statutory Instruments for Stamp Duty Exemptions Issued by the Minister

Beneficiary of Stamp Duty Exemption	Subject of Stamp Duty Exemption	Stamp Duty Exemption Instrument Number
Bidco(U)Ltd	Increase of share capital and further charge	No.62/2006
Bidco(U)Ltd	Increase of share capital	No.61/2006.
Bidco (U)Ltd, Prime Estates Ltd and Uganda Electricity Transmission Company Limited		No.67/2005
Kiryana Ranch	Lease	No.69/2002
Oscar Industries	Mortgage	No.66/2005
Umeme Limited	Lease of property and assets	No.9/2005
Visa Plastics Limited	Mortgage of Assets	No.83/2005
Uganda Telecom Limited and Kakira Sugar Works Limited	Transfer of shares to CDC Group Plc	No.84/2003
Corporate Holdings Limited	Transfer of National Insurance Corporation Limited Shares to Corporate Holdings Limited	No.71/2005
Picfare Industries Limited	Transfer of Property	No.27/2006
DFCU	Transfer of DFCU shares to CDC Group Plc	No.91/2003
Carriers(U)Ltd		No.23/2006
Civil Aviation Authority, Tororo Cement Industries ,Papco Industries Limited, Uganda Electricity Generation Company Limited, Uganda Grain Milling Company Limited		No.32/2003
Britania Allied Industries Limited	Increase of Share Capital	No.95/2004
Uganda Telecommunication Company Limited		No.6/2005
Uganda Management Institute and Maama Jane Children's Care Centre)	Transfer of Properties	No.79/2000

Appendix 5: Tax Rate Regime under Double Taxation Agreements[94]

Country	Withholding Tax Rate (presented as a percentage [%])				
	Dividends		Interest	Royalties	Technical/ Professional/ Management Fees
	Individuals/ Companies	Qualifying Companies[3]			
Non-Treaty Tax Rates[4]	15	15	15	15	15
Denmark	15	10	10	10	10
India	10	10	10	10	10
Mauritius	10	10	10	10	10
Norway	15	10	10	10	10
South Africa	15	10	10	10	10
United Kingdom	15	15	15	15	15
Italy	15	15	10	10	10
EAC[5]	5	5	10	10	10

(Footnotes)

1 Non-resource tax represents taxes paid by Government on behalf of charities, educational institutions and other deserving institutions.

2 The figures in the the East African Newspaper 30 April -6 May 2012 are denominated in US dollars but have been converted to Uganda Shillings (UGX) at a rate of US$ = UGX. 2500.

3 A company is a 'qualifying company' if it owns at least 25% of the capital of the company paying the dividend. See PWC (2011): DoubletaxtreatieswithEastAfricanCommunity ('EAC')countries – anattractionornot? A paper presented to African Tax and Business Symposium, September 2011.

4 These are withholding tax rates normally payable by a taxpayer, not covered by the DTA arrangement.

5 Not yet operational, awaiting ratification by the 5 members of EAC (see PKF (2011): PKF Worldwide Tax Guide, Uganda 2011.

94 The list is not exhaustive; there are some 5 or so countries not included. It has been adopted from PKF (2011): PKF Worldwide Tax Guide, Uganda 2011; and PWC (2011): Doing business: Know your Taxes East Africa Tax Guide 2011/2012