

# IMPACT OF HARMFUL TAX INCENTIVES AND EXEMPTIONS IN UGANDA

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*Strengthening Africa in World Trade*





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The contents of this document are the sole responsibility of SEATINI-Uganda and can under no circumstances be regarded as reflecting the position of DGF.

## Acronyms

ATO	Africa Tax Outlook
Bns	Billions
CIT	Corporate Income Tax
CSO	Civil Society Organisation
FDI	Foreign Direct Investment
GDP	Gross Domestic Product
IMF	International Monetary Fund
MoFPED	Ministry of Finance Planning and Economic Development
PAYE	Pay As You Earn
PSA	Production Sharing Agreements
SACCOS	Savings and Credit Cooperative Organisations
SEATINI	Southern and Eastern Africa Trade Information and Negotiations Institute
TJAU	Tax Justice Alliance Uganda
UGX	Uganda Shillings
URA	Uganda Revenue Authority
VAT	Value Added Tax

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## Executive Summary

All evidence suggest that the societal costs of tax exemptions are high and that the benefits, in terms of additional investments are low. Accordingly, tax specialists, CSOs and development partners including the International Monetary Fund (IMF) and World Bank have continuously warned African governments about tax exemptions. Despite these warnings, the practice of granting exemptions continues across all African governments. In Uganda, on average, over a trillion Uganda shillings is lost every year in tax exemptions.

Our study was intended to examine the legal and policy framework for tax incentives and exemptions in Uganda, identify tax incentives that were given out in FY 2017/18 and their implications on domestic revenue mobilisation and service delivery and draw mechanisms that should be put in place to better manage tax incentives and exemptions in Uganda.

Tax exemptions in Uganda can be broadly put into two categories: Those that are within the tax laws and those that are granted by the executive arm of government. Over the years, Uganda has witnessed a distinct move away from ministerial discretion in the area of exemptions. Despite the abolition of statutory ministerial discretion in tax matters, government issued tax waivers similar to the abolished ministerial discretion. These exemptions, which are not provided for by statute, primarily take the form of the government paying taxes on behalf of an investor. An investigation by Parliament's Budget Committee discovered that the majority of the agreements between the companies and government on which these payments were based were either not grounded in the law or lacked supporting evidence.

Information on exemptions granted by the executive is largely unavailable making accurate estimation of the revenue lost a difficult task. The agreements in which some of the exemptions are granted are untraceable but also majority of the beneficiaries do not furnish this information to URA in their tax returns.

**UGX 1,420.29 Bns**

Amount estimated to  
have been lost due to tax  
exemptions in 2017/18

Under these conditions, we estimated over UGX 1,420.29 Bns to have been lost due to tax exemptions in 2017/18 with the biggest shares resulting from international trade tax and VAT related exemptions. The most harmful exemptions included (a) Deemed VAT with UGX 202.59 Bns, (b) Government undertakings costing UGX 102.81 Bns in 2017/18, (c) MPs' allowances costing UGX 33Bns and (d) Interest income of SACCOs with UGX 10Bns. Others include restrictions of URA enforcements, Differed VAT, Environment levy, and exempt VAT supplies.

Our study suggests the following measures:

### **a) Government**

- Stop unfair tax exemptions. Exemptions that favor certain categories of taxpayers to others yet they are in the same market field should be avoided. If exemptions are to be given, they should target a particular sector as a whole and not specific taxpayers.
- Statutory exemptions should be preferred over arbitrary executive exemptions.
- Whether exemptions are statutory or from the executive should follow well laid out guidelines. These guidelines should therefore be developed and made public.
- Greater parliamentary supervision of executive practices is necessary. The precise criteria used by executive in granting these tax waivers should be made clear and subject to scrutiny.
- For the case of SACCOs, the exemption should be tagged to turnover. SACCOs with turnovers in excess of the presumptive upper threshold (UGX 150M) should not be exempted.

### **b) Uganda Revenue Authority**

- Close monitoring of exempt taxpayers should be done in order to protect other income sources that are taxable from likely abuses.
- Impose harsh penalties to exempt taxpayers that don't file tax returns. The penalty should be equivalent to the tax exempted.

### **c) Civil Society Organizations**

- Continuous discussions with government on the fact that the costs of tax exemptions are much higher than the benefits.
- Sensitize the public on tax exemptions. This is for two purposes. First, for the public to make use of the available exemptions within the law and second, to increase pressure on government to abolish some of the exemptions.



# INTRODUCTION

## 1.0 Background to the Study

Tax collection in developing countries is still very low. Undeniably, if a country wishes to develop, it needs to collect an amount in taxes closer to 25-30 percent of GDP than the 10-15 percent found in many developing countries, (ATO 2016).

In Uganda's case, the tax to GDP ratio has for long remained stagnant at about 14 percent. This is far below targets set out in the Second National Development Plan and Uganda Revenue Authority's (URA) four year corporate plan of 18%.

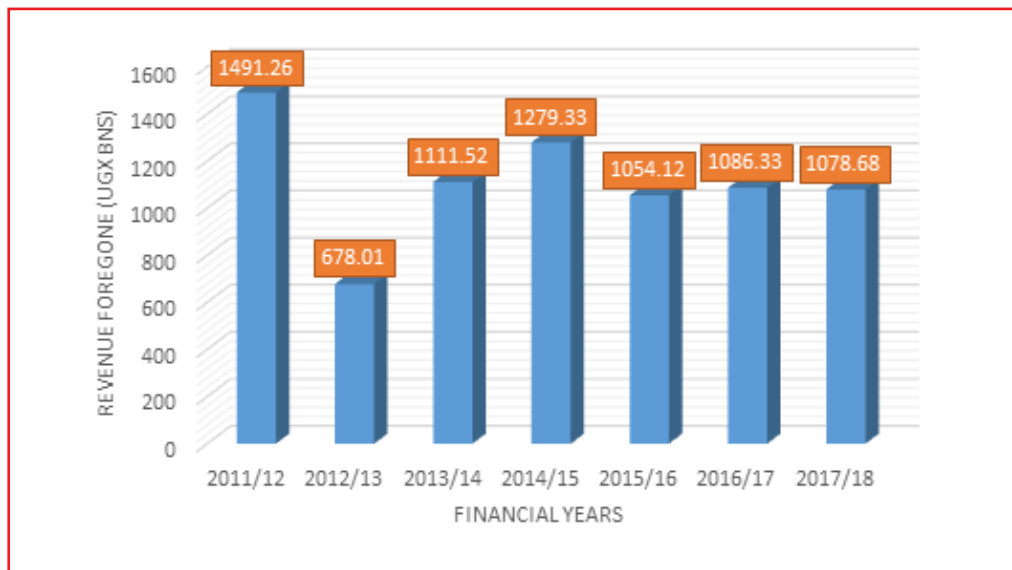
In 2017, the percentage of the budget financed by domestic revenues stood at 62.25 percent, with the remainder covered by loans and grants. According to the 2018/19 Background to the Budget, in 2018/19, this is projected to rise to 69 percent, and to approximately 83.6 percent by 2022/23, indicating that Uganda aims to become more fiscally independent. However, historical performance in increasing the proportion of the budget funded domestically has not been strong. In FY 2011/12 domestic resources funded 66 percent of the budget, which was more than last financial year. The widening financing gap highlights the importance of bringing revenue growth on par with expenditure needs. From 2007 to 2017, the total value of public expenditure increased from 15 percent of GDP to more than 20 percent. Over the same period, the tax-to-GDP ratio grew by an average annual rate of 0.2 percentage points, moving from 10 percent to almost 14 percent. Thus, expenditure growth has consistently outpaced growth in revenue collection.

At the heart of this expenditure- revenue gap is the excessive revenue leakages through tax exemptions and incentives. Tax exemptions have eroded large amounts of tax revenue from many African countries. According to OECD 2013, basing on a sample of six African countries, it's estimated that on average the value of tax exemptions amounts in these countries were about 33% of the taxes actually collected. The OECD (2015) further estimates that in developing countries tax incentives reduce government revenues by 1—2% of GDP.

**UGX 1trn** | Amount lost every year in tax exemptions

In Uganda, on average, over a trillion Uganda shillings is lost every year in tax exemptions as illustrated below.

**Fig 1: Estimated Revenue foregone due to Tax Exemptions (UGX Bns)**



Source: URA 2018

Revenue foregone from Corporate Income Tax (CIT) holidays alone in Uganda is around 19% of total CIT revenue. Exemptions to CIT are estimated to cause foregone revenue of between 1 to 2 percentage points of GDP per year between 2014 and 2016, (IMF 2017). These figures are very high especially due to the fact that Uganda's tax base is still very low.

Tax specialists and development partners including the International Monetary Fund (IMF), World Bank, among others have warned African governments about tax exemptions with a number of researchers indeed agreeing that the costs of tax exemptions are much higher than the benefits. Despite these warnings, the practice of granting exemptions continues across all African governments.

Granting tax incentives and exemptions has and continues to be justified by the need to attract investments and industrialization. Unfortunately, to the best of our knowledge, no one knows the extent to which these incentives have indeed resulted into increased investments in Uganda. As the 2017 Auditor General's report stated (Auditor General, 2017), there are no clear guidelines or routine reviews of the impact or benefits accruing from tax incentives, exemptions and holidays that justifies their continued existence.

## 1.2 What do we know about tax exemptions? Evidence from Research

Preferential tax treatments offered to a selected group of taxpayers usually take the form of special zones, tax holidays, tax credits, investment allowances, accelerated depreciation, financing incentives, preferential tax rates and import tariffs (or customs duties), and deferral of tax liability.

Many countries offer preferential tax treatments as a means of achieving different public policy objectives especially attracting greater levels of foreign direct investment (FDI) that would provide jobs and contribute to future revenues. Indeed, successful economic development in China, Singapore, South Korea and Taiwan have been credited in part to tax incentives specifically economic zones and China has eagerly promoted this model in Africa, (Moore et al 2018). These successful inspirations from East Asian countries have inspired many African countries to adopt tax incentives as a way to promote investment and industrialization.

A study by Zeng (2015) concludes that tax exemptions have generated little additional investments in most African countries. In an analysis of the costs and benefits of manufacturing and exporters tax incentives in Namibia, Amupolo (2018) concludes that tax incentives are bad for governments because they tend to erode the tax base. Despite the fact that they may attract some investors, their costs in terms of revenue loss far exceeds the apparent benefits. Moreover she notes further that they are susceptible to corruption and should therefore be discouraged (Amupolo, 2018).

In an assessment of the impact of corporation tax incentives on Foreign Direct Investment (FDI) in Nigeria, Lawal (2018) argues that tax incentives should not be a priority as they do not generate much stimulus to investment. Simply cutting taxes and granting tax holidays does not attract investment but rather implementing policies to promote fiscal certainty and sustainability, reduction on external imbalances and spending on infrastructure to promote more inclusive growth can stimulate investment. He argues that when investors know that a country has definite set of rules as relates to taxation, they are happy to invest because it helps them invest wisely. If on the other hand, the rules are not fixed, and incentives are granted arbitrarily, such system of discretionary tax waivers interferes with the free market by distorting it and creating unfair competition which favors the beneficiaries of the incentive policy at the expense of others (Lawal, 2018).

*All evidence suggests that the societal costs of tax exemptions are high and that the benefits, in terms of additional investments are low. Put differently, "the disadvantages of tax incentives vastly outweigh the advantages and such incentives are not needed to attract FDI."*

A 2012 study (TJN Africa & ActionAid, 2012) on tax incentives in East Africa found that the countries were in a race to the bottom. The report noted that 'All the evidence suggests that the disadvantages of tax incentives vastly outweigh the advantages and that such incentives are not needed to attract FDI. The study reported that tax incentives,

- (a) create differences in effective tax rates resulting in distortions between subsidised activities and the unsubsidised,
- (b) sometimes require large administrative resources,
- (c) attract footloose companies that pack up when the incentives expire or reduce, and (d) lack transparency and hence increasing the likelihood of corruption (TJN Africa & ActionAid, 2012).

It is indeed unlikely that lowering tax rates can compensate for a bad investment climate. In surveys of investors concluded in seven African countries between 2009 and 2012, an average of 84% of the respondents said that the availability of tax exemptions had not affected their investment decision, (Moore et al 2018).

A study conducted on tax incentives and exemptions by the Tax Justice Alliance of Uganda (2018) states that, when measured against Foreign Direct Investment (FDI), government would be justified to expand the list of beneficiaries of tax exemption. "However, the return of investment (revenues, jobs created and community development) seems to be minimal, Ugandans, especially the youth continue to search for jobs, URA continues to fail to raise the required taxes and the communities in which beneficiaries of tax holidays operate only receive a bare minimum in the corporate social responsibility investment made. Further, that developing countries do not need to grant tax incentives to attract FDI, because the decision to invest by genuine multinational corporations is largely based on other parameters such as market potential, energy and adequate infrastructure.

Tanzi and Zee, (2011) in their IMF paper note that tax exemptions are clearly detrimental to the proper functioning of market forces as sectorial allocation of resources is distorted by differences in tax rates.

Chai and Goyal in another IMF paper assess the costs of tax exemptions given by the small island states in the Eastern Caribbean Currency Union. They do this by comparing revenues forgone to the benefits in terms of increased foreign direct investment. They find that "The costs are very large, while the benefits appear to be marginal at best." They find that the tax revenues forgone amount to between 9.5% and 16% of GDP annually while the sum of foreign direct investment does not appear to depend on these exemptions.

They also note other challenges brought about by these exemptions such as efficiency losses due to the preferential tax treatment to certain investors, the administrative costs associated with overseeing tax exemptions to ensure that they are not abused, and the social costs that arise from rent seeking as a result of the abuse of tax exemption provisions.

**Tax Exemptions come at a considerable fiscal cost as they reduce opportunities for necessary public spending on infrastructure, public services or social support, or requiring higher taxes on other activities.**

OECD, (2015) notes that many developing countries use tax holidays and income tax exemptions that are quite costly to attract investment. The report notes that sector-specific tax incentives for domestic markets and extractive industries generally have little impact. However, tax exemptions for export-oriented sectors and mobile capital are relatively effective. The report notes that good infrastructure, macroeconomic stability, rule of law and the like are much more important in attracting investment. The OECD notes that tax exemptions to investors “generally rank low in investment climate surveys in low-income countries.” They also note that the tax exemptions have even been reported to be redundant—that is, investment would have been undertaken even without them. Further, they come at a considerable fiscal cost as they reduce opportunities for necessary public spending on infrastructure, public services or social support, or requiring higher taxes on other activities.

A study of import tax exemptions in Sri Lanka by Verité, (2018) found that the exemption schemes were prone to abuse. Several weaknesses were cited. The study found that the process was opaque because businesses were required to obtain letters of approval from various government agencies to qualify for the exemptions yet the procedure for this is unwritten. The result is that businesses have to depend on verbal instructions

**Tax incentives and exemptions are often perceived by the population as a politicization of the taxation process and opens space for tax resistance**

from these agencies. The study further found that there was no clear criteria by which exemptions were granted or approved by the relevant government agency. The study further found that the process was prone to abuse by tax evaders who can import products other than those eligible through collusion with officials.

Extensive use of tax incentives and exemptions is often perceived by the population as a politicization of the taxation process and opens space for tax resistance in the form of protests, avoidance and evasion (Pritchard, 2015).

Amidst this glaring evidence about the negative effects of tax exemptions,

the government of Uganda continues to grant more and more preferential tax treatments.

### **1.3 Objectives of the Study**

In this study, our overall objective was to investigate the impact of harmful tax incentives and exemptions in Uganda.

Specifically, the study was intended to:

- i. Examine the policy and legal regime for tax incentives and exemptions in Uganda;
- ii. Analyse the tax incentives and exemptions given out in FY 2017/18 and their implications on domestic resource mobilisation and service delivery;
- iii. Make policy and practice recommendations on the key considerations to addressing harmful tax incentives and exemptions in Uganda

### **1.4 Research Questions**

Our specific research questions were:

- i) What is the legal and policy framework for tax incentives and exemptions in Uganda?
- ii) What tax incentives were given out in FY 2017/18, how much revenue was lost and what were the implications on domestic revenue mobilisation and service delivery?
- iii) What mechanisms should be put in place to better manage tax incentives and exemptions in Uganda?

### **1.5 Methods**

To answer these questions, we employed a mixture of methods including textual analysis, secondary data analysis, and interviews.

The textual analysis covered both primary and secondary literature including Court rulings on tax disputes between Uganda Revenue Authority and taxpayers, Parliament Hansards, domestic tax laws and tax expenditure reports. These were examined to identify instruments that facilitate tax incentives and exemptions and flag up loopholes that create the need for policy reform. Our methodology also consisted of secondary data analysis.

Specifically, it was largely based on data at the Uganda Revenue Authority in its automated systems- e-tax, ehub and ASYCUDA world systems.

Lastly, we engaged in detailed interviews/discussions with officials from the URA including those in business policy division and legal department and other senior officials. Outside the Uganda Revenue Authority, we conducted interviews with representatives from Ministry of Finance Planning and Economic Development- Tax Policy Department.

The rest of the paper is arranged as follows. In Chapter two, we discuss the legal frame work for granting tax exemptions and incentives in Uganda. In chapter three, we discuss the different tax exemptions that were operational in 2017/18, their implications in terms of revenue forgone and service delivery and the challenges or risks posed by tax exemptions. We then conclude in chapter four with suggestions to effectively manage tax exemptions in the future.

## CHAPTER TWO:

# THE LEGAL FRAME WORK FOR GRANTING TAX EXEMPTIONS AND INCENTIVES IN UGANDA

## 2.0 Introduction

The duty to pay taxes is sanctioned by the constitution of the Republic of Uganda. This gives powers to parliament to enact laws under which taxes are levied, Article 152(1). Similarly, tax exemptions also have their roots right from the constitution. As was stated by the Supreme Court, ‘...the duty to pay taxes is sanctioned by the Constitution. Unless exempted, the obligation to pay income tax is mandatory.’<sup>1</sup> Therefore once Parliament has passed a statute creating a particular tax, the obligation to pay is mandatory unless one is clearly exempted.

Uganda’s tax statutes treat tax exemptions with very little favour. Tax exempting provisions are to be strictly construed against the person who benefits from the exemption. As was stated by the Court of Appeal in *Crane Bank v URA*,<sup>2</sup> ‘Laws which permit tax exemptions must be construed strictissimi juris against the entity claiming the same. Thus, he who seeks to be this privileged must justify it by words too plain to be mistaken and so categorical to be misinterpreted.’

Tax exemptions in Uganda can be broadly put into two categories: Those that are within the tax laws and those that are granted by the executive arm of government. We discuss these below:

## 2.1 Tax Exemptions within Tax Laws

All tax laws including Income Tax Act, Value Added Tax (VAT), Excise Duty, Local Service Tax and Customs External Tariff have provisions for tax exemptions. For 2017/18, the following exemptions were operational.

<sup>1</sup> Uganda Revenue Authority v Kajura [2017] UGSC 63

<sup>2</sup> Crane Bank v URA CA No. 96 of 2012 cited with approval by the Supreme Court in Uganda Revenue Authority v Kajura [2017] UGSC 63; A similar approach was adopted by the High Court in Babibaasa Frank v The Commissioner General URA HCCS No 434 of 2011.



**Table 1: List of Exempt Incomes/ Items in 2017/18**

<b>Tax Type</b>	<b>Exemptions</b>
<b>Pay As You Earn (PAYE)</b>	<ol style="list-style-type: none"> <li>1. Employees earning UGX. 235,000 monthly and below.</li> <li>2. Employment Income of the Police and Armed forces.</li> <li>3. Pensions.</li> <li>4. Allowances for members of parliament.</li> </ol>
<b>Corporate Tax</b>	<ol style="list-style-type: none"> <li>1. The Dividend received by a resident company from another resident company where it controls more than 25% of the total share.</li> <li>2. Incomes of Professional bodies.</li> <li>3. Income of Bujagali hydro power project.</li> <li>4. Interest income for SACCOs.</li> </ol>
<b>Presumptive Tax</b>	Taxpayers whose Gross turnover is less than UGX. 10 million.
<b>Rental income tax</b>	20% of the Gross rent as expenditures and losses incurred
<b>Withholding tax</b>	<ol style="list-style-type: none"> <li>1. Companies deemed to be complying with Income tax are exempted. [The Commissioner General profiles and gazettes them on a year-to-year basis].</li> <li>2. Interest paid by (i) a natural person (ii) by a company to associated company or which is exempted from tax in the hands of recipient.</li> <li>3. Interest paid by a resident company were debentures:               <ol style="list-style-type: none"> <li>(i) Were issued by the company outside Uganda for the purpose of raising a loan outside Uganda.</li> <li>(ii) Were widely issued for the purpose of raising funds for use by the company in a business carried on in Uganda. or the interest is paid to a bank or a financial institution of a public character, and</li> <li>(iii) The interest is paid outside Uganda.</li> </ol> </li> <li>4. Dividends paid to a company controlling 25% or more of the voting powers</li> </ol>
<b>Excise Duty</b>	<ol style="list-style-type: none"> <li>1. Duty Free Sales &amp; Exports.</li> <li>2. Locally produced beer whose local input is lower than 75% of the finished product.</li> <li>3. Sugar imported for Industrial use.</li> <li>4. Phone and Landlines Public Pay phones talk time for diplomats.</li> <li>5. Furniture manufactured using local timber.</li> <li>6. Furniture specifically for use in hospitals</li> </ol>

Tax Type	Exemptions
VAT	<ol style="list-style-type: none"> <li>1. The supply of unprocessed foodstuffs, unprocessed agricultural products except wheat grain and livestock.</li> <li>2. The supply of postage stamps.</li> <li>3. The supply of unimproved land.</li> <li>4. The supply of betting, lotteries, and games of chance including Casinos.</li> <li>5. Supply of Petroleum fuels subject to excise duty, (motor spirit, kerosene and gas oil),</li> <li>6. Spirit type jet fuel and Kerosene type jet fuel ,</li> <li>7. The supply of precious metals and other valuables to the Bank of Uganda for State Treasury,</li> <li>8. VAT on contraceptives sheathes and arcaricides,</li> <li>9. The supply of feeds for poultry and livestock,</li> <li>10. Supply of menstrual Cups.</li> <li>11. The supply of deep cycle batteries and composite lanterns.</li> <li>12. The supply of animal feeds and pre-mixes.</li> <li>13. The 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; or (v) a sale, lease or letting of service apartments</li> <li>14. The supply of power generated by Solar.</li> <li>15. The supply of machinery, tools and implements suitable for use only in agriculture and for purposes of this “machinery, tools and implements” means - (i) knapsack sprayers; (ii) ox ploughs ; (iii) drinkers and feeders for chicken; (iv) agricultural tractors (including walking tractors); (v) disk harrows; (vi) cultivators; (vii) ploughs; (viii) weeders; (ix) seeders; (x) planters; (xi) sub soilers; (xii) seed drills; (xiii) threshers; (xiv) bale wrappers; (xv) milking machinery; (xvi) milk coolers; (xvii) maize mills; (xviii) wheat flour mills; (xix) homogenizers; (xx) dairy machinery; (xxi) grain cleaners and sorters; (xxii) feed grinders hatcheries; and (xxiii) implements used for artificial insemination in animals”</li> </ol>

Tax Type	Exemptions
	<p>16. The supply of dental ,medical and veterinary goods and for the purposes of this paragraph “goods” means: Dental, medical and veterinary equipment, ambulances, contraceptives of all forms, maternity kits (mama kits), medical examination gloves, medicated cotton wool, mosquito nets, acaricides, insecticides and mosquito repellent devices, and diapers.</p> <p>17. The supply of educational services.</p> <p>18. The supply of medical, dental, and nursing services.</p> <p>19. The supply of social welfare services.</p> <p>20. The supply of passenger transportation services other than Tour and Travel.</p> <p>21. The supply of crop extension services.</p> <p>22. Supply of irrigation works, sprinklers and ready to use drip lines.</p> <p>23. The supply of financial services.</p>
<p><b>Local Service Tax</b></p>	<p>1. The salaries of the following categories of people are exempted from LST; Members of the Uganda Police Force, Members of the Uganda Prisons Service, Members of the Uganda People’s Defense Forces.</p> <p>2. Unemployed persons, peasants (people living in poverty and unable to earn a minimum income to access basic necessities of life), and</p> <p>3. Members of the Diplomatic Missions Accredited to Uganda.</p> <p>4. Employment Income less than UGX 100,000</p> <p>5. Self-employed professionals with less than UGX 500,000 per year</p> <p>6. Self-employed artisans with less than UGX 200,000 per year</p> <p>7. Business men/ women with less than UGX 5,000,000 per year</p>

Tax Type	Exemptions
<b>Import Duty</b>	<ol style="list-style-type: none"> <li>1. Educational materials, vehicles &amp; equipment designed for dis- abled persons.</li> <li>2. Duty on medicaments.</li> <li>3. Solar equipment and parts.</li> <li>4. Paper for printing text books, examination papers and covers.</li> <li>5. Personal effects.</li> <li>6. Essential inputs for the hotel industry excluding construction materials  "Any of the following goods engraved or printed or marked with the hotel logo imported by a licensed hotel for its use: (a) Washing machines; (b) Kitchen Ware; (c) Cookers; (d) Fridges and freezers, (e) Air Conditioning Systems; (f) Cutlery; (g) Televisions; (h) Carpets;(i) Furniture; (j) Linen and Curtains;(k) Gymnasium equipment</li> <li>7. Industrial spare parts imported as replacement parts used exclusively on industrial machinery classified in Chapters 84 and 85 of the EAC.</li> <li>8. Stranded wire used in manufacture of tyres.</li> <li>9. Treads for cold retreading used in the retreading of tyres.</li> <li>10. Packaging materials for use in the manufacture of goods for export.</li> <li>11. Raw materials for use in manufacture of aluminum cans for the dairy industry.</li> <li>12. Refrigerated trucks.</li> <li>13. Insulated tankers.</li> <li>14. Heat insulated milk tanks for dairy industry.</li> <li>15. Motor vehicles specially designed for refuse/ garbage collection and disposal imported or purchased by local authorities or persons contracted by local authorities to collect refuse/garbage</li> </ol>
<b>Petroleum Duty</b>	Sales to Diplomats, Embassies and Bicycle Manufacturers

Tax Type	Exemptions
<b>Excise Duty on imports</b>	Furniture for use in Hospitals
<b>VAT on imports</b>	<ol style="list-style-type: none"> <li>1. The supply of unprocessed foodstuffs, including agricultural livestock.</li> <li>2. The supply of postage stamps.</li> <li>3. The supply of unimproved land.</li> <li>4. The supply of betting, lotteries, and games of chance including Casinos.</li> <li>5. Supply of Petroleum fuels subject to excise duty, (motor spirit, kerosene and gas oil),</li> <li>6. Spirit type jet fuel and kerosene type jet fuel ,</li> <li>7. The supply of precious metals and other valuables to the Bank of Uganda for State Treasury,</li> <li>8. VAT on contraceptives sheathes and acaricides,</li> <li>9. The supply of feeds for poultry and livestock,</li> <li>10. Supply of menstrual Cups.</li> <li>11. The supply of deep cycle batteries and composite lanterns.</li> <li>12. The supply of animal feeds and pre-mixes.</li> <li>13. Imported goods for use by contractors and subcontractors of hydroelectric power projects</li> </ol>
<b>Withholding tax on imports</b>	<ol style="list-style-type: none"> <li>1) Government Imports</li> <li>2) Importers with a certificate exempting them from 6% withholding tax.</li> <li>3) Supply or importation of petroleum or petroleum products, including furnace oil, other than cosmetics and fabrics or yarn manufactured out of petroleum products;</li> <li>4) Supply or importation of human or animal drugs</li> <li>5) Supply or importation of scholastic materials for use only in educational institutions;</li> <li>6) The supply or importation of raw materials</li> </ol>
<b>Environmental Levy</b>	Vehicles below 5 years from the date of manufacture.

## 2.2 Exemptions granted by the Executive

Historically, in Uganda, tax exemptions were the province of the executive. The Income Tax Decree of 1974 allowed considerable discretion to the minister to declare any class of income to be exempt from tax. Ministerial discretion in customs and excise taxes was prevalent. Section 4 of the Customs Tariff Act of 1970 allowed the minister to remit duty, in whole or in part. Most changes to the tax system in the 1990s were effected through ministerial discretion. The introduction of sales tax on all zero rated and exempt products in 1989/90 and the removal in 1993/94 of all exemptions from tax except those under bilateral agreements with foreign countries and accredited international institutions was all done as an exercise of ministerial discretion.

Over the years, Uganda has witnessed a distinct move away from ministerial discretion in the area of exemptions. In 1995/96, section 22 of the 1991 Investment Code was amended to abolish the granting of discretionary exemptions on import duties (and all other taxes) payable on imported plant and machinery for investors licensed by Uganda Investment Authority. The Income Tax Act introduced in 1997 abolished discretionary ministerial exemptions and tax holidays. The ministerial discretion under the Customs Tariff Act of 1970 was abolished by reforms in 2000/01.

However, despite the abolition of statutory ministerial discretion in tax matters, we still see government issuing tax waivers in recent years similar to the abolished ministerial discretion. These exemptions, which are not provided for by statute, primarily take the form of the government paying taxes on behalf of taxpayers or simply waiving off the tax. We discuss this in detail in the section 3.1.1.

## CHAPTER THREE:

# HARMFUL TAX EXEMPTIONS GRANTED BY GOVERNMENT

## 3.0 Introduction

In instances where the rules for granting tax exemptions are not fixed, and incentives are granted arbitrarily, such system of discretionary tax waivers interferes with the free market by distorting it and creating unfair competition which favors the beneficiaries of the incentive policy at the expense of others. As a result, in addition to the revenue directly lost from these exemptions, there is revenue indirectly lost from the non-beneficiaries because their businesses are now affected because of unfair competition. Furthermore, it opens space for tax resistance in the form of protests, avoidance and evasion from the non-beneficiaries.

## 3.1 Different Tax Exemptions Granted

Below are some of the harmful exemptions that are hitting revenue mobilisation efforts and service delivery really hard.

### 3.1.1 Government under takings

These are exemptions where the government signs agreements with taxpayers to pay taxes on their behalf. Usually, beneficiary companies are those whose businesses are deemed to be of strategic importance. “Interestingly however, in some instances, some tax heads that do not even directly relate to the companies are also exempted such as PAYE. Government agencies are instructed to pay PAYE taxes for contractors/ employees for some of these companies,” (interview response). Two of the beneficiary companies (names intentionally withheld) are exempted from almost all tax heads including corporation tax, VAT, Stamp duty, import duty and withholding taxes.

In the financial year 2016/17 the Government had committed to pay UGX 29 billion on behalf of Quality Chemicals for corporation tax, UGX 25 billion for Uganda Electricity Generation Company Ltd (UEGCL) for stamp duty, UGX 6 billion for Southern Range Nyanza in import taxes, UGX 5 billion for BIDCO (corporation tax), UGX 3 billion in import taxes for Aya Investments (import taxes) and UGX 1.5 billion in corporation tax for Steel and Tube industries,

(Parliament Hansards). In June 2017 it was reported that the Government had paid UGX 77.2 billion to Uganda Revenue Authority (URA) on behalf of seven private companies which the Minister of Finance had granted as tax waivers for varying periods<sup>3</sup>.

In FY 2017/18, government undertakings were UGX 102.81 Bns, (MoFPED 2017).

An investigation by Parliament's Budget Committee discovered that the majority of the agreements between the companies and government on which these payments were based were either not grounded in the law or lacked supporting evidence. Only the agreements with Uganda Electricity Generation Company Limited (UEGCL) was found to be in compliance with the law because it is a government owned entity<sup>4</sup>.

The Parliament Committee found that they specifically violated Article 119(5) of the Constitution which provides that 'no agreement, contract, treaty, convention or document by whatever name called, to which the Government is a party or in respect of which the Government has an interest, shall be concluded without legal advice from the Attorney General, except in such cases and subject to such conditions as Parliament may by law prescribe<sup>5</sup>.'

Evidence presented to the committee in support of the UGX 77.2 billion tax expenditures included various agreements. The agreement between the Government of Uganda and BIDCO Oil Refineries Ltd was signed on April 4, 2003. Article 5 of the agreement awarded a range of incentives to BIDCO, including corporation tax exemption for 25 years from the first year of project activities. The circumstances and procedures followed in granting the exemption were not legally supported. Aya Investments Ltd only had a letter dated July 29, 2015, written by the Minister of Finance to the company extending the period of exemption for payment of taxes and duties on hotel equipment and materials for the Hilton Hotel Project up to December 31, 2015. There were no supporting documents for Steel and Tube Industries Ltd exemption. For CIPLA Quality Chemicals Industries Ltd, a letter dated May 31, 2010 communicated a Government decision to pay income taxes on behalf of the company for a period of 10 years, effective July 1, 2009. For Southern Range Nyanza, a letter by the Minister of Finance to URA confirmed a decision by the Government to pay VAT and import duty on raw materials for textile manufacturers. The Committee ruled that the expenditures be treated as a loss or URA recover the money from the companies as the Government had never in fact paid the money on behalf of the companies. These commitments to pay were therefore in effect exemptions or waivers. URA, however, declined to pursue recovery of the money<sup>6</sup>. This money is therefore highly unlikely to be recovered.

3 Solomon Arinaitwe, 'Govt pays Shs77.2 b in taxes for private firms', Daily Monitor, June 4 2017, <https://www.monitor.co.ug/News/National/Govt-pays-Shs77b-in--taxes-for-private-firms/688334-3955046-9nyhnt/index.html> accessed 7 January 2019

4 Solomon Arinaitwe, 'Govt pays Shs77b in taxes for private firms', Daily Monitor, June 4 2017, <https://www.monitor.co.ug/News/National/Govt-pays-Shs77b-in--taxes-for-private-firms/688334-3955046-9nyhnt/index.html> accessed 7 January 2019.

5 Article 119(5) of the Constitution of the Republic of Uganda

6 Umaru Kashaka, Government on the spot over sh47b tax exemptions, New Vision, 31 October 2018, [https://www.newvision.co.ug/new\\_vision/news/1488727/government-spot-sh47b-tax-exemptions](https://www.newvision.co.ug/new_vision/news/1488727/government-spot-sh47b-tax-exemptions) accessed 7 January 2019.



It has been reported that between the Financial years 2009/10 and 2016/17, the Government paid UGX 198 billion in respect of tax expenditure on behalf of hotels, hospitals, textile companies, manufacturers of steel, milk, palm oil and tertiary institutions. These payments included exemptions on corporation tax, withholding tax, stamp duty, import duty and excise duty on behalf of the companies<sup>7</sup>.

As the Parliament Committee noted, these exemptions are of questionable legality. The Minister is given no power to issue such exemptions or waivers without Parliament approval under any statute. Article 154(1) of the Constitution provides that no monies shall be withdrawn from the Consolidated Fund except to meet expenditure charged on the fund by this Constitution or by an Act of Parliament; or where the issue of those monies has been authorized by an Appropriation Act<sup>8</sup>. As the payment of taxes that the Minister committed to is not authorised by Parliament or any statute, it is of questionable legality.

The mere entering into agreement is unlikely to satisfy the legal requirements. In the case of *Heritage Oil & GAS Ltd v Uganda Revenue Authority*<sup>9</sup> the appellant entered into a Production Sharing Agreement (PSA) for petroleum exploration, development and production with the Government of the Republic of Uganda. The agreement contained an arbitration clause to the effect that dispute under the agreement which could not be settled amicably within sixty days would be referred to arbitration in accordance with the United Nations Commission for International Trade Law (UNCITRAL) Arbitration Rules. The agreement also provided that taxes shall be paid by the licensee in accordance with the laws of Uganda in a timely fashion. The appellant sold its interests under the agreement to Tullow Uganda Limited and was issued tax assessments for Capital Gains Tax. It was contended that the tax dispute was supposed to be arbitrated in London. It was held that the Income Tax Act and other tax statutes specify the taxes payable and the URA is mandated to collect those taxes.

Hellen Obura J stated, 'Taxation is a tool by which the sovereign state extracts finances or funds from its people and property to provide public revenue to support Government expenditures and public expenses. It is the most reliable source of funds for most developing economies and therefore subjecting it to the whims and negotiation skills of contractors and Government Officials would create uncertainty and inequity on the amounts payable and cause economic instability.' The court held that it could not have been the intention of at least Government to agree that tax dispute would be referred to arbitration as any attempt to do so would be contrary to the laws of Uganda.

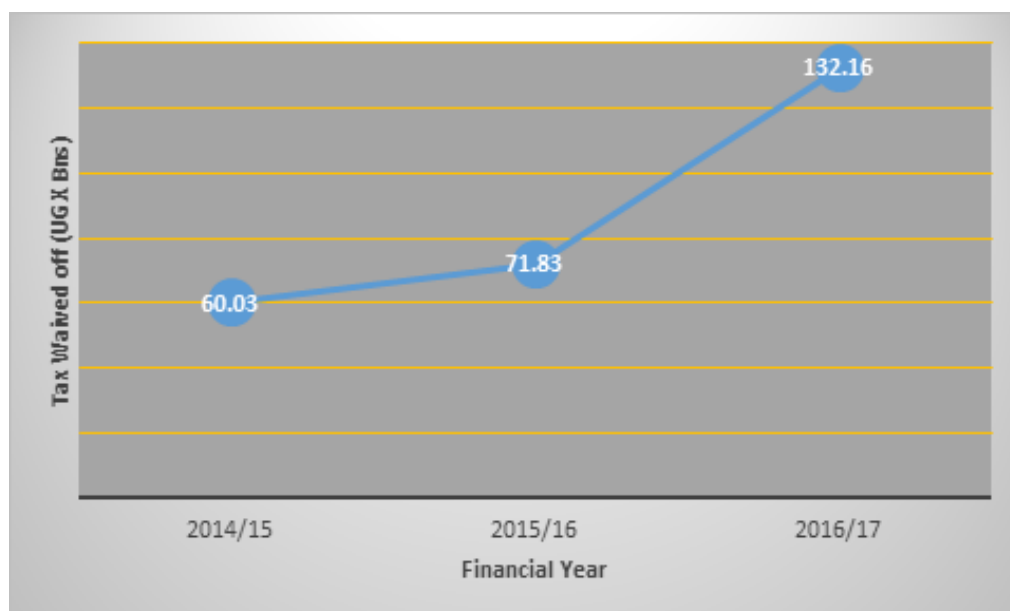
Sometimes, government fails to pay these taxes and they are written off and this has been increasing over time as seen in figure 2 below.

<sup>7</sup> Umaru Kashaka, Government on the spot over sh47b tax exemptions, New Vision, 31 October 2018, [https://www.newvision.co.ug/new\\_vision/news/1488727/government-spot-sh47b-tax-exemptions](https://www.newvision.co.ug/new_vision/news/1488727/government-spot-sh47b-tax-exemptions) accessed 7 January 2019

<sup>8</sup> Article 154(1) of the Constitution of the Republic of Uganda 1995

<sup>9</sup> *Heritage Oil & GAS Ltd v Uganda Revenue Authority* High Court Civil Appeal No 14 of 2011

**Fig 2: Amount of tax Waived off (UGX Bns)**



Source: Authors' computations from URA reports

For FY 2019/10, there is a proposal before parliament to authorize government to write off Shs500bns worth of tax waivers for at least 34 private companies and government agencies<sup>10</sup>

### **3.1.2 Deemed VAT**

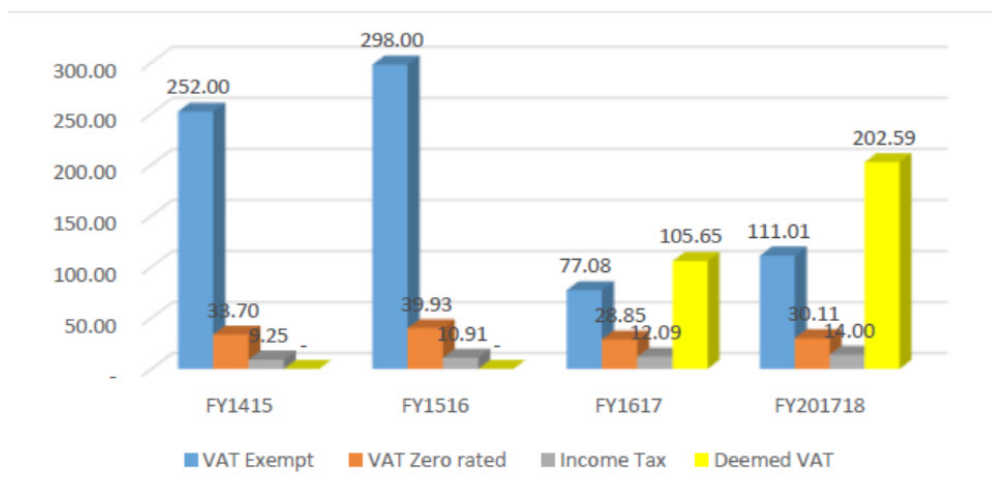
In earlier years, VAT exempt supplies comprised the biggest revenue loss among all tax exemptions. The increasing reductions in the number of VAT exempt supplies brought government into another dilemma. First, suppliers/government contractors invoiced government VAT inclusive. Government was not paying these contractors on time yet URA was assessing the contractors and charging penalties for failing to meet timelines. It was also difficult for the contractors to claim the input VAT. Second, oil companies in particular were making heavy long term investments. The suppliers to these oil companies had to invoice these companies VAT inclusive- a cost that was understandably high yet their expected returns were not in the near future. Third, under counterpart funding, government receive funds from donors to undertake some projects such as the construction of the markets in different parts of the country. These donors are not willing to pay for these taxes to government. Not to distort the VAT implementation, government was meant to pay this part of VAT to URA. This resulted into tax arrears.

These scenarios gave birth to deemed VAT. Here, suppliers invoice government VAT inclusive but this is deemed to have been paid and they can successfully claim their input VAT from URA.

<sup>10</sup> <http://parliamentwatch.ug/ministry-of-finance-appears-before-the-parliamentary-committee-on-finance/#.XNWzxo4zY2w>

As seen in figure below, this now constitutes the biggest share of revenue lost due to tax exemptions.

**Fig 3: Break down of Domestic tax exemptions over the years.**



Source: Authors' computations from URA reports

### 3.1.3 Restriction of URA enforcements

There are some taxpayers both public and private that have not complied with their tax obligations. "Efforts to recover the taxes by URA have been blocked by government. By January 2018, there were about 9 companies under this category, (interview response)". The revenue at stake was estimated to be approximately UGX 200 Bns, (Authors' computations).

### 3.1.4 The Army shop

"“Soldiers are the “favored children” of the country as far as taxation matters are concerned. In addition to their salaries being exempt from income tax, they can get construction materials that are VAT free. The government meets this VAT cost on their behalf,” (interview response).

"The army shop concept was there even during the times of President Idi Amin. That time, almost everything they purchased was subsidised by government," (interview response).

This is highly likely to be abused in instances where non-soldiers connive with soldiers.

### 3.1.5 Exemption of SACCO's from Income Tax

The income of Savings and Credit Cooperative Organizations (SACCOs) is exempted from tax until 2027. The rationale for this was to increase financial inclusion especially for the rural poor. Discussion with tax officials also indicated some "selfish" justification for this exemption. "This exemption originated from

the army SACCO- Wazalendo. URA recovered taxes from Wazalendo through an agency notice. They ran to state house and the directive came to exempt them from the tax”, (interview response). Exempting Wazalendo SACCO alone was resisted by parliament –it also owns a Sacco and in the end, all SACCOs ended up being exempted, (interview response)

Not all SACCOs are small in turn-over and for the rural poor as it is currently perceived. Banks have lost reliable customers because of the influx of SACCOs in many of the organizations in the country. URA SACCO for example buys off staff bank loans and staff are encouraged to make use of Sacco loans compared to bank loans (interview response). The most reliable customers for banks were generally employees as loan payments would be directly deducted at source minimizing the chances of defaulting. Now its common practice in organizations to have a staff SACCO. For example large institutions like URA, Parliament, the army, Ministry of Finance among others have their staff SACCOs. These give staff loans at a much cheaper interest rate compared to banks. Additionally, many SACCOs do not only earn interest income which ideally is exempted from tax. Some, have diversified sources such as operating car washing bays, buying and selling property among others. All these incomes are potentially at risk of escaping the tax net in the disguise of being exempt. Approximately UGX 10Bns were lost in 2017/18 due to this exemption.

### **3.1.6 Exemption of allowances of members of Parliament from Income Tax**

This attracted a country wide protest. The public aversion to this exemption was visible from various quarters: Professional associations opposed the taxes, activists filed a petition in the Constitutional Court seeking nullification, it dominated the airwaves and civil society campaigns, songs were composed against the exemption among others. To date, the resistance to this exemption persists. Despite the public outcry, the law was passed without any hopes that it will be repealed in future. Ugandans are slowly getting to terms with it. On average, approximately UGX 33 Bns are lost annually due to this exemption.

### **3.1.7 Deferred VAT**

The Value Added Tax (Deferment of Tax on Plant and Machinery) Regulations came into force on 1st July 2013. Deferment means the postponement of payment of the value added tax in respect of imported plant and machinery. The approval for VAT deferment is granted at the point of declaration of an entry at customs. After customs approval, the challenge is now monitoring the deferred VAT and ensuring that it is recovered where it is due.

This is a “temporary exemption”. However, many a times the deferred VAT is not recovered or not accounted for, (interview response).

In some cases, it’s deferred until a time when the importer of the machinery decides to sell it off, (interview response). The beneficiaries of this exemption are largely taxpayers that are registered for VAT.

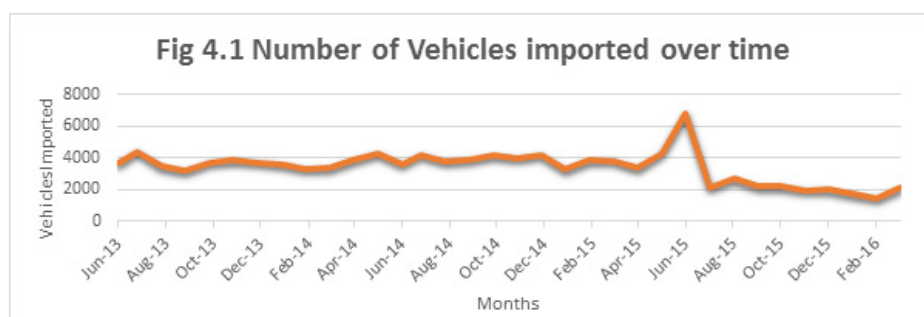
### 3.1.8 Zero percent environmental levy on vehicles below 5 years from the date of manufacture

The arguments in support of this policy are valid. In order to protect the environment, reducing automobile pollutant emissions is a critical step. It's estimated that almost three quarters of the transport emissions come from road transport especially passenger cars and light duty trucks (Kahan Ribeiro et al 2007).

The government of Uganda increased an environmental levy in FY 2015/16 to ensure that few used vehicles come into the country through charging high taxes on imported used vehicles. In FY 2014/15, there was a slight adjustment in the levy from 20% to 25% for all cars older than 8 years. In FY2015/16, the government revised it further-this time in three bands that's for cars less than 5 years it was (0%), 5 to 10 years (35%) and all cars exceeding ten years (50%) of the Cost Insurance and Freight (CIF) value of that particular vehicle, (URA, 2015).

However, this policy is more of a revenue mobilisation policy than a policy intended to protect the environment. The revenues generated from it are not directly linked to environmental protection measures but rather mixed with all other revenues and put in the consolidated fund which is later allocated according to government priorities. Secondly, much as new cars attract 0% levy, majority of Ugandans cannot afford such cars even without this tax component. Therefore it only benefits a very small portion of the population. Indeed, much as we notice a slight fall in the demand for cars after the policy changes (see figure 2), the objective to increase demand for new cars is still not being met. After the introduction of the policy all the cars imported were manufactured before 2010, (URA 2017).

**Figure 2: Graphical display of the number of vehicles imported over time**



Source: Author's computations from URA datasets

### 3.2 Estimated Revenue lost and implications of tax exemptions in 2017/18

Accurate estimation of the revenue lost is a difficult task given the information vacuum on tax exemptions. The agreements in which some of the exemptions are granted are untraceable but also majority of the beneficiaries do not furnish this information to URA in their tax returns. Additionally, as earlier discussed, tax exemptions also lead to loss of revenue indirectly on the part of the non-beneficiaries because of the motivation to evade taxes given the perceived unfairness.

We thus estimate revenue lost to tax exemptions for cases where reliable information is available as seen in table 3 below. Over UGX 1,420.29 Bns are estimated to have been lost due to tax exemptions in FY 2017/18. This figure is likely to be more if all the necessary information was available to ascertain the exact amount foregone.

**Table 3: Estimated Revenue lost in 2017/18**

Exemption category	Estimated revenue loss (UGX Bns)	% share
VAT Exempt	111.01	7.8%
VAT Zero rated	30.11	2.1%
Deemed VAT	202.59	14.3%
International trade tax exemption	513.97	36.2%
SACCOs	10	0.7%
MP's allowances	33	2.3%
Other Income tax	14	1.0%
Government undertakings	102.81	7.2%
Restriction of URA enforcements	195.8	13.8%
Policy Reversals	207	14.6%
<b>Total</b>	<b>1,420.29</b>	<b>100.0%</b>

Source: Authors' computations and URA reports

This revenue lost to tax exemptions exceed the budget allocations of key sectors such as agriculture, health, education, water and environment among others (see table 4 below). Specifically, agriculture has consistently remained one of the most underfunded and slowest growing sectors of the economy. In the financial year 2017/2018, only 3.8% of the budget was allocated to agriculture. This was a drop from 4% dedicated to it in 2016/2017. The proportion of the budget dedicated to agriculture is also below the 10% that Uganda committed to under the Maputo Declaration. As a result of underfunding, the sector that employs 70% of Uganda's population, is only able to contribute 25% of the

GDP. Low investment in this sector worsens inequality and leaves the poorest and most vulnerable behind. Indeed, recent figure from Uganda Bureau of Statistics indicate that the national poverty level has increased from the 19.7% in 2014/15 to 21.4 per cent in 2016/2017.

**Table 4: Sector Budget allocations**

SECTOR/VOTE	FY2016/17		FY2017/18	
	Ushs Bn	Share (%)	Ushs Bn	Share (%)
SECURITY	1,578.4	7.7%	1,472.8	6.7%
WORKS AND TRANSPORT	3,823.8	18.7%	4,587.3	20.8%
AGRICULTURE	823.4	4.0%	828.5	3.8%
EDUCATION	2,447.5	12.0%	2,501.3	11.4%
HEALTH	1,827.3	8.9%	1,824.0	8.3%
WATER AND ENVIRONMENT	689.6	3.4%	632.0	2.9%
JUSTICE/LAW AND ORDER	1,103.6	5.4%	1,159.3	5.3%
ACCOUNTABILITY	962.1	4.7%	896.2	4.1%
ENERGY AND MINERAL DEVELOPMENT	2,377.2	11.6%	2,319.8	10.5%
TOURISM, TRADE AND INDUSTRY	89.6	0.4%	116.6	0.5%
LANDS, HOUSING AND URBAN DEVELOPMENT	147.0	0.7%	139.9	0.6%
SOCIAL DEVELOPMENT	192.8	0.9%	175.8	0.8%
ICT & NATIONAL GUIDANCE	55.3	0.3%	104.3	0.5%
PUBLIC SECTOR MANAGEMENT	1,273.6	6.2%	1,450.4	6.6%
PUBLIC ADMINISTRATION	532.3	2.6%	563.4	2.6%
LEGISLATURE	470.0	2.3%	483.8	2.2%
SCIENCE, TECHNOLOGY AND INNOVATION	14.2	0.1%	71.9	0.3%
INTEREST PAYMENTS DUE	2,022.9	9.9%	2,675.40	12.2%
<b>TOTAL</b>	<b>20,430.61</b>	<b>100%</b>	<b>22,002.7</b>	<b>100%</b>

Source: MoFPED 2017

# CONCLUSION AND RECOMMENDATIONS

## 4.1 Conclusion

The cost of tax exemptions are high. However, they are less likely to be completely abolished. To reduce the pressure from development partners and CSOs, government is more likely to just keep rebranding its name to terms like counterpart funding, government undertakings, deemed VAT and waivers. Yet, in actual sense, these are exemptions. The executive has a high investment agenda. The president for example is very passionate about supporting investment on grounds that they generate employment opportunities for the struggling youth. There are instances where he has warned URA officials “frustrating” investors yet they are doing their mandate. With such an agenda, tax exemptions are less likely to disappear. Additionally, the low public awareness as a result of scanty information on some of the exemptions reduces the pressure on government to stop granting them.

In the strict sense of the word, tax exemptions are for the powerful, tax consultants and those that can lobby. There are less chances for the less connected or ordinary Ugandans to benefit from them. In the first place, many of the ordinary Ugandans are not aware of the existence of exemptions that are even provided for in the law. Only companies that are able to make use of tax experts stand the chance of benefiting from even the exemptions provided for in the law.

## 4.2 Recommendations

We suggest recommendations to the government, URA and Civil society Organizations as follows.

### d) Government

- Stop unfair tax exemptions. As much as possible, the principle of taxation (fairness and equity) need to be emphasized. Exemptions that favor certain categories of taxpayers than others yet they are in the same market field should be avoided. If exemptions are to be given, they should target a particular sector as a whole and not specific taxpayers.



- Statutory exemptions should be preferred over arbitrary executive exemptions. Statutory exemptions are less distortionary as they usually apply to entire sectors not specific entities and are more transparent.
- For any exemption either statutory or from the executive should follow well laid out guidelines. Uganda presently lacks clear guidelines on tax exemptions. As the 2017 Auditor General's report states, "there are no clear guidelines for granting exemptions neither are there routine reviews of the impact or benefits accruing from tax incentives, exemptions and holidays that justifies their continued existence". These guidelines should therefore be developed and made public.
- Greater parliamentary supervision of executive practices is necessary. The precise criteria used by executive in granting these tax waivers should be made clear and subject to scrutiny.
- For the case of SACCOs, the exemption should be tagged to turnover. SACCOs with turnovers in excess of the presumptive upper threshold (UGX 150M) should not be exempted.

#### **e) Uganda Revenue Authority**

- Close monitoring of exempt taxpayers should be done. If an entity is exempted such as SACCOs, there is a high likelihood of URA officers not monitoring the activities of such taxpayers simply because of the brand of being tax exempt. In the end, other income sources that are taxable can easily go untaxed.
- Impose harsh penalties to exempt taxpayers that don't file tax returns. This information is relevant in decision making. If not submitted it makes it very difficult or even impossible to estimate the gains/ losses from exemptions. The penalty should be equivalent to the tax exempted.

#### **f) Civil Society Organizations**

- Continuous discussions with government on the fact that the costs of tax exemptions are much higher than the benefits. Evidence from various researches from different countries have revealed the same results.
- Sensitize the public on tax exemptions. This is for two purposes. First, for the public to make use of the available exemptions within the law and second, to increase pressure on government to abolish some of the exemptions.

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