THE IMPACT OF THE LAWS ON TAX INCENTIVES ON THE SOCIO-ECONOMIC DEVELOPMENT IN UGANDA

BY

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DECLARATION

I, ATWINE MARIAM hereby declare this dissertation entitled, "*The Impact of the Laws on Tax Incentives on the Socio-Economic Development in Uganda,*" has never been presented before, to this University or other institution for an academic award; all work is original unless otherwise stated.

Signed ____________ Date 02/08/2013

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APPROVAL

This is to certify that Atwine Mariam is the sole researcher of this dissertation conducted in Uganda under my guidance as a university supervisor in partial fulfillment of the requirements for the award of a Bachelor of Laws of Kampala International University and is ready for submission to the faculty.

Signed ____________________ Date 02.08.2013

M/S BASAJABALABA JALIA

DEDICATION

I dedicate this dissertation to my mum; M/s Kenyangi Joan, Mr. and Mrs. Kiiza Goef for giving Me a place in your home and guiding me all through this journey, Shamiah, Isingoma, Nyakato and Ahumuza who always put a smile on my face and lastly my friends; Ninsiima Doreen and Mr. Kamya Robert who were always there with me through dark and thin.

To all members of Ebenezer group with whom we worked together hardly to attain our goals.

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More than half of this dissertation is a product of knitting together already written materials. I thank the publishers and copy right owners of the books I used.

I adorn my real heartfelt gratitude to my supervisor M/s Basajabalaba Jalia for her guidance based on her academic experience as a lecturer at the school of law.

My family and friends for the encouragement and moral assistance rendered to me.

LIST OF STATUTES

Constitution of the Republic Of Uganda, 1995

Finance Act Cap 173 Laws of Uganda

Income Tax Act Cap 340 Laws of Uganda

Investment Code Act Cap 92 Laws of Uganda

Value Added Tax Act Cap 349 Laws of Uganda

LIST OF CASES

Meera Investment Ltd V URA, UIA and AG HCCS No. 185/2006

Security Group Alarms Ltd V URA Application Tax Appeals Tribunal 10/2004

Total Uganda Ltd V URA, Application Tax Appeals Tribunal 2/2001

LIST OF ABBREVIATIONS

AG	Attorney General
AGOA	African Growth Opportunity Act
Cap	Chapter
EAC	East African Community
GDP	Gross Domestic Product
GNP	Gross Net Product
HCCS	High Court Civil Suit
ICOR	Incremental Capital Output Ratio
ITA	Income Tax Act
LTD	Limited
METR	Marginal Effective Tax Rate
MIL	Meera Investments Limited
NRM	National Resistance Movement
No	Number
OEDC	Organisation of Economically Developed Countries
Sect	Section
TAT	Tax Appeals Tribunal
UIA	Uganda Investment Authority
URA	Uganda Revenue Authority
US	United States of America
VAT	Value Added Tax

ABSTRACT

The dissertation was undertaken to collect data on The Impact of the Laws on Tax Incentives on the Socio-Economic Development in Uganda. It employed both qualitative and quantitative methods in collection of data; theses were questionnaire, interview guide and observation. Using sampling, the research selected 133 respondents out of the 200 targeted population and questionnaire and interview method were used to collect data.

The study targeted various classes of stakeholders ranging from investors, traders, local authority, governmental & Non Governmental Officials and Community Based Organisations. The major findings were to find out how the laws on tax incentives in Uganda have affected the rate of social-economic development. This study was sought to ascertain the effectiveness of the laws on tax incentives. It as based on 4 objectives that are; To find out the origin and nature of laws on tax incentives being administered in Uganda; To evaluate the effectiveness of the laws on tax incentives; To evaluate the impact of laws on tax incentives on socio-economic development in Uganda and To find out recommendations for the improvement of the whole investment climate whether legal or otherwise for social economic development.

The major tool of data collection was questionnaire and the study was both qualitative and quantitative. The current policy of using tax incentives to attract investments to Uganda has many notable flaws. It costs government fortunes in terms of foregone revenue, yet its real contribution to the stimulation of investments is rather minimal. The foregoing discussion showed why this is the case. In summing up the role incentives play in socio-economic growth, we ought to recall three vital points. First, tax incentives do not play a crucial role in the investors' investment location decisions. Tax incentives therefore, do not compensate for the inherent decisions.

However, since all countries ordinarily strive to build effective investment regimes, a country that has built hers would do well supplementing it with a few strategic, well formulated and clearly focused tax incentives. It is in this light that I make the following recommendation for Uganda's tax incentives and investment policies.

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CHAPTER ONE

THE PROBLEM AND ITS SCOPE

1.0 Overview

This research report is about finding the Impact of the Laws on Tax Incentives on the Socio-Economic Development in Uganda. This chapter presents the preliminary sections of the report statement, general objective, research questions, and definition of terms, scope of the study, methodology, literature review, and synopsis of chapters (Chapterization).

Tax incentives are common around the world and are constantly evolving. Few public finance laws are passed without reference to special rules regarding a specific activity or circumstance. Instead of trying to analyze all of their possible manifestations, it is useful to adopt a narrower definition to allow a more thorough study. For the purposes of this paper, tax incentives are defined as all measures that provide for a more favorable tax treatment of certain activities or sectors compared to what is granted to general industry. Under this definition, a general cut in the tax rate or a generous depreciation scheme applicable to all firms would not be considered tax incentives.[1]

Economic development generally refers to the sustained, concerted actions of policymakers and communities that promote the standard of living and economic health of a specific area.[2]

1.1 Background to the study

Taxation refers to a system used by the government, through levying assessments, to obtain money from people, industries and organizations. It is not only relatively permanent but also compulsory and does not guarantee a direct relationship between the amount contributed by a citizen and the extent of government services provided to him/her. A tax can then be defined as an involuntary fee paid by individuals or

[1] Other definitions have been suggested, for example labeling any provision that lowers the after-tax cost of capital below the pre-tax cost as an incentive.

[2] Myles, G. D. (2000). Taxation and Economic Growth, Fiscal Studies (2000), Vol., 21 No.1 Institute of Fiscal Studies, University of Exeter: Pp 41-168

businesses to the government. In any economic system, taxes have three objectives i.e. to transfer resources to socially and economically beneficial use, to stabilize the economy and to redistribute wealth between the rich and the poor[3].

In 1991, Uganda's tax system was typical of those in the other world's poorest countries. Laws governing the collection and administration of taxes were obsolete, with a significantly narrow tax base leading to inadequate tax revenue[4]. In 2006, the tax system and structure have substantially changed. A number of tax policy changes have been suggested and implemented. For instance, there has been upward and downward movement in tax rates, some export taxes have been withdrawn and new taxes introduced to replace the previously emphasised more direct taxes. The Uganda Revenue Authority was established in 1991 as a central body that could manage these changes. It is, however, evident that some changes have been frequent and expected to be adverse, to the extent that the business community has often complained of the resultant business environment. Economically, some of these policy changes have been characterized by dead weight losses.[5]

The relationship between taxation and economic growth has of recent become one of the most important economic issues for discussion. This is particularly due to the poor fiscal performance in a number of developed and developing countries. This relationship is to a large extent empirical and forces one to employ methods of scientific investigation that do not yield aprioristic conclusions and eternal truths, but only statements of validity limited by the character of the model used or by significance of evidence provided[6]. While it could be clear that distortionary taxation might affect the level of GDP, early growth models that assumed the level of long run growth to depend on exogenous technical change could not be used to assess the effect of fiscal policy on

[3] Mwima-Swaya, W.D. (1995). Fiscal reforms and revenue mobilization in Uganda since 1986. A published Master's Dissertation, University of Birmingham, U.S.A.
[4] Kaweesa, K. C. (2004).Taxation and Investment in Uganda: Structure and Trend. A paper presented to the business forum in London, UK, for investment opportunities in Uganda. Uganda Revenue Authority, Kampala, Uganda.
[5] Meier, G. M. (1995). Leading issues in economic development. Oxford University Press, New York, U.S.A.
[6] Dalibor R. (2005). Taxation and Economic Growth: Reconciling Intuition and Theory. A Journal published at the Institute of Economic Studies, Charles University, Prague, Austria.

the rate of capital accumulation, or more generally economic activity. This called for the development of endogenous growth models[7].

Economic development can be referred to as the quantitative and qualitative changes in the economy. Such actions can involve multiple areas including development of human capital, critical infrastructure, regional competitiveness, environmental sustainability, social inclusion, health, safety, literacy, and other initiatives. Economic development differs from economic growth. Whereas economic development is a policy intervention endeavor with aims of economic and social well-being of people, economic growth is a phenomenon of market productivity and rise in GDP. Consequently, as economist Amartya Sen points out: "economic growth is one aspect of the process of economic development."[8]

This study therefore aimed at establishing the impact of taxation on economic growth in Uganda. Particularly, it attempted to examine what effects taxes have had and can have on Uganda's economic growth rates. In consideration of Wagner's Law[9], the opposite direction of the relationship i.e. the question of whether economic growth leads or not to higher tax burden deserved to be discussed as well. There was however no sound economic belief that there can be a direct vis-a-vis simple causation in this direction.

1.1.1 Conceptual framework

Tax incentives are defined by the black's law dictionary, to mean a governmental enticement, through a tax benefit to engage in a particular activity such as mortgage, financing of real estate sales[10].

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[7] Myles, G. D. (2000). Taxation and Economic Growth, Fiscal Studies (2000), Vol. 21 No.1. Institute of Fiscal Studies, University of Exeter. Pp 41-168

[8] Sen, A. (1983). Development: Which Way Now? Economic Journal, Vol. 93 Issue 372. Pp.745-762.

[9] Wagner's Law: Countries on a higher level of economic development tend to increase the scope of activities of their governments and therefore experience higher tax rates.

[10] Brain A. Gurner 2001), Second Pocket Edition

Tax incentives are further defined to refer to fiscal measures that are used to attract foreign investment capital to certain economic activities or particular areas in the country[11].

They are fiscal privileges a state enacts in its taxing legislation to promote investment in its economy. Tax incentives appear in the three principle categories. Those that offset tax liability, such as tax waivers, those that postpone tax liability and finally those that reduce tax liability, such as tax rebates, investment deductions and set up costs. Uganda has experimented all the 3 categories of tax incentives in different economic eras. Tax incentives should be distinguished from tax deductions, deductions for ordinary and normal business expenditures on such items as labor or capital are not tax incentives.

1.2 Statement of the problem

The tax system in Uganda has been one of the victims of numerous economic and political crises that rocked the country in the 1970s and 1980s. Since 1987 the government has undertaken a number of reform measures aimed at improving the performance of tax revenue. In 1991 the government set up the Uganda Revenue Authority to monitor and implement the tax reform measures. These measures include partial removal of some tax exemptions and inclusion of others, narrowing tax rate bands, reduction of some tax rates and increasing others, and introduction of new forms of taxes which are easy to administer[12].

However, whereas Uganda witnessed the rise in investment, the same report puts Uganda among the top major recipients of FDIs in 2006; Uganda skipped seven places from 70th position in 2005 to 77th position in 2006, out of 141 countries.[13]

In most developed countries the level of taxes has risen steadily from about 5-10% of GDP to currently 20-30% of GDP[14]. Thus, only focusing on the merits of different

[11] Makerere Law Journal, Vol. 1, No. 1, 2006. A publication of Makerere Law Society pg 71
[12] Muhumuza, F.K. (1996). Responsiveness of tax revenue to economic growth in Uganda. An unpublished Master's Dissertation, Makerere University, Kampala, Uganda.
[13] Uganda Investment Authority (UIA) in 2010/11

spending programmes or the relative efficiency with which the private and public sectors provide services cannot answer all questions about the appropriate size of government spending[15]. How public spending is financed is also relevant. But current studies on the influence of fiscal policies on growth have mainly concentrated on effects of government consumption spending and ignored the effects of distortionary taxation. There is therefore need to trace the impact of the laws on tax incentives upon the individual decision making that lies behind the processes through which economic growth is generated.

It is against this background that the study attempted to find out how the laws on tax incentives in Uganda have affected the rate of social-economic development

1.3 General objective of the study

The general objective of the study will be to assess, "The Impact of the Laws on Tax Incentives on the Social-Economic Development in Uganda."

1.3.1 Objectives of the Study

1. To find out the origin and nature of laws on tax incentives being administered in Uganda.
2. To evaluate the effectiveness of the laws on tax incentives.
3. To evaluate the impact of laws on tax incentives on socio-economic development in Uganda.
4. To find out recommendations for the improvement of the whole investment climate whether legal or otherwise for social economic development.

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[14] Dalibor R. (2005). Taxation and Economic Growth: Reconciling Intuition and Theory. A Journal published at the Institute of Economic Studies, Charles University, Prague, Austria.

[15] Graeme, L. (2003). The negative impact of taxation on economic growth. An economic paper published by the Institute of Directors, London, UK.

1.4 Research Questions

1. What is the origin and nature of laws on tax incentives being administered in Uganda?
2. How has laws been effectiveness on tax incentives.
3. Do the laws on tax incentives affect the socio-economic development in Uganda?
4. What recommendations can be laid down for the improvement of the whole investment climate?

1.5 Hypothesis

It's clear that existing laws and policy on tax incentives cannot guarantee the improvement of the socioeconomic development of the people. The existence of patchy legislations on the tax incentives without due regard to the socioeconomic development of the people and an inadequate institutional framework cannot guarantee the development and improvement of the socioeconomic wellbeing of the people.

1.6 Significance of the Study

The Study findings will help to improve on the Laws on Tax Incentives in terms of how they can assist in the improvement of the whole investment climate whether legal or otherwise for social economic development and general development of the Social-Economic Development music Industry in Uganda.

The study findings will also help the government where necessary to improve on the Tax Incentives Laws within the country through providing education centers, putting public gatherings and trainings about the impact of the laws on tax incentives on the social-economic development in the country.

It will increase the available literature on the subject matter (laws on tax incentives on the social-economic development). It will therefore provide recommendation to the law enforcers on how best they can enforce these laws.

The study will provide useful information which will be used by future scholars for further research into fresh areas of the problem which have not been exhaustedly dealt with.

The study will help the researcher to gain knowledge and practical skills in the field handling criminal problems; the study is significant because it is a partial fulfillment for the award of a Bachelor's Degree of Laws.

1.7 METHODOLOGY

1.7.0 Introduction

This section provides a full description of the survey methodology and it also shows an outline of the tools, techniques and methods of data analyses which will be consulted to establish a contact and explain the needs to collect and use information from them.

1.7.2 Research Design

The study will adopt a cross-sectional survey design. The study will use both qualitative and quantitative data to determine the Laws on Tax Incentives and Social-Economic Development on the variables of the study at one point in time. The selected survey method allows the collection of data through the use of different instruments such as questionnaire, interviews especially with key informants in case of confidential information.

1.7.3 Research Population

The research population for this study will be 200. This will include the; investors, traders, local authority, governmental & Non Governmental Officials and Community Based Organisations that are advocating for the laws of tax incentives. These categories of population are targeted because they are well versed with issues concerning tax incentive laws and have the capacity to determine issues related to socioeconomic development in the different parts coutry. Basing on the foregoing size of the survey population, the sample size consists of 133 respondents. This sample size will be reached using Solven's Formula sample size table.

1.7.4 Sampling Design

Simple random sampling will be used for selecting respondents. This method will give chance to all potential respondents to participate without bias. The researcher will visit all the targeted organisations and access the names of respondents and write them on pieces of papers. The researcher will then put the names of people from each group in a box and pick the targeted number as respondents. Those whose names are not picked won't be considered as respondents but all those whose names are picked will form part of respondents.

1.7.5 Data Collection Methods

Data collection methods and techniques refer to the methods the researchers use in performing research operations[16]. The researcher will collect secondary and primary data.

Secondary Data will guide the researcher to establish what other researchers could have found out previously. This will enable the current researcher to fill some gaps they could have left behind. In this respect, textbooks, journals, newspapers and other relevant records will be used hand in hand with primary data.

Primary Data will reveal concrete information about the target population being investigated on which basic conclusions will be drawn. Both secondary and primary data will supplement each other to enable researcher analyze information.

1.7.6 Data Collection Instruments and procedures

The study will employ the following instruments for data collection;

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[16] Kothari (2004)

i) Questionnaire method

The questionnaire method is the primary means of data collection. A questionnaire is a set of related questions designed to collect information from a respondent[17]. These will be structured in form of likert scale. The researcher will use a pre-designed set of questions to assess perceptions of the respondents and other responsible stakeholders as far as Tax Incentives and Social-Economic Development is concerned.

ii) Self-administered questionnaire

The self-administered questionnaire (SAQ) will be used as the main tool for data collection because it's quicker in getting data from the respondents[18]. The questionnaire will be structured into the dependent variable, independent variable and background information respectively[19].

iii) Interview method

An interview can be defined as a conversation between an interviewer and a respondent conducted for the purpose of obtaining information[20]. To capture first hand information, the researcher will use an interview guide to get information from minority of the study population. Face to face, interviews will be used. Discussions will be held with key informants of the study on the topic in hand.

1.8 Limitations of the Study

The study will touch a sensitive area as far as Laws on Tax Incentives and Social-Economic Development is concerned. It will therefore be limited by the respondents' poor response under the pretext that they might be accused of lack of secrecy. This tendency however, will be minimized by explaining that the study is purely academic and that no ethics were broken when presenting the findings.

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17 Kendall and Buckland (1960)
18 Bakkabulindi, 2004
19 Oppenheim, 1992
20 Kakinda (2000)

The researcher may also be faced with some financial constraints for proper facilitation in terms of transport, lunch, typing and printing and binding of the book.and accessing some of the relevant information for this researcher. However, the researcher will mobilize money from well wishers to meet the demands of the study.

Lack of enough secondary data: The researcher may lack enough secondary data from the libraries and other sources like newspapers, magazines that hold most of the information as far as the topic is related.

Some respondents may be reluctant to fill in and return the questionnaires. However, the researcher's will make efforts to continue visiting the respondents and keep requesting them to fill in the questionnaires.

Some respondents may not be able to express themselves fully in English language, however, translators will be used where necessary to easy the process.

1.9 LITERATURE REVIEW

1.9.0 Introduction

This chapter contains materials written about this topic of study. Materials include text books both national and international, it also contains information from relevant journals about the subject, and news papers also provide a good area of information.

1.9.1 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".[21]

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.'*[22]

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.

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'*[23]

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[21] Surrey S &McDaniel P (1985): Tax Expenditures (Cambridge, MA. Harvard University Press)1985
[22] http;//www.businessdictionary.corn/definitions .html. Accessed on 27th April 2012
[23] Ibid

1.9.2 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[24]. 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[25] from which a qualifying person would be exempted. Subsequently, the tax incentive/exemption regime was transplanted to the Value Added Tax Act, 1996,[26] and the Income Tax Act, 1997[27] , 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.

1.9.3 Types of Exemptions

1.9.3.1 Exemptions under the Investment Code Act, 1991

The Government enacted the Investment Code Act, 1991[28] with the principal objective of '*...providing more favorable conditions for local and foreign investors...*'[29] 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:

Generation of new earnings or savings of foreign exchange through exports, resource based import substitution or service activities;

The utilization of local raw materials; supplies and services;

The creation of employment opportunities in Uganda;

The introduction of advanced technology in Uganda;

[24] See for example Section 12 of the repealed Income Tax Decree, 1974.
[25] See Investment Code Act, 1991 (CAP 92 of Laws of Uganda).
[26] CAP 349 of Laws of Uganda
[27] CAP 340 of Laws of Uganda
[28] CAP 92 of the Laws of Uganda
[29] The Long title to the Investment Code Act,1991(CAP.92)

The contribution to locally or regionally balanced social-economic development; or

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:

Import duty and VAT exemption on plant and machinery, equipment, vehicles and construction materials for an investment project and other inputs

Stamp duty exemption.

Withholding tax exemption on plant and machinery, scholastic materials, human and animal drugs and raw materials

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.[30]

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.[31]

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

[30] The Investment Code Act,1991(CAP.92)

[31] Information received from former URA staff who were responsible for Corporate Audits

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.[32] The requisite provisions were transferred to the Value Added Tax Act, 1996 (CAP.349) and the Income Tax Act, 1997 (CAP.340)

1.9.4 Income Tax in Uganda.

This was written by Pius K. Bahemuka[33], it gives an account of legal and technical aspects of income tax in Uganda. He mainly covers deductions, allowable expenditures and those that are not allowed. He further writes about persons assessable to income tax, income tax returns, how the assessment is made, how objections and appeals against assessments are instituted among others. This work is not very useful to the research because it does not talk about tax incentives and their role in socio-economic development in Uganda.

1.9.5 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".*[34] 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

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[32] Yasin Mugerwa, "List of tax holiday beneficiaries sent to Parliament", The Monitor,29th September 2010.

[33] Pius K. Bahemuka (2001), Income tax in Uganda, 1st Edition Fountain Publishers Ltd. Kampala pages 4 - 36

[34] The Income Tax Act,1997(CAP.340)

old dispensation or submit to the Income Tax Act.[35] 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.[36]

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[37], and interestingly provides that such DTA *"shall have effect as if the agreement was contained in this Act"*[38]. 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[39].

1.9.6 Investment intent hurt by deceptive incentives.[40]

In his article, he noted that according to the world investment report (WIR), Uganda is reported to have registered an increase in foreign direct investment, from $257 million in 2005 to $307 million in 2006, representing 19% increase, on account of investments from Australia, Egypt, India, Kenya, South Africa, and the United States of America is services and agro-processing. He notes that though the report puts Uganda among the top 10 major recipients of FDIs in Africa, Uganda slipped seven places from 70th position in 2005 to 77th position in 2006. UIA over the same period registered 330 projects of which 54% were associated in FDI in telecommunication, industry, energy, and hospitality. He attributed this to the host of attractive investment incentives the government of Uganda offers to foreign investors in an effort to boost a country's

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[35] The Income Tax Act,1997(CAP.340)
[36] Nicholas Kalungi (2010): Dealing with Tax Holidays, The Prosper Magazine, September, 2010.
[37] The Income Tax Act,1997(CAP.340)
[38] See section 88(1) of the Income Tax Act,1997(CAP.340)
[39] Ligthart J, Vlachaki M &Voget J (2011): The Determinants of Double Tax Treaty Formation, Center and Department of Economics, University of Tilburg, Netherlands.
[40] Sunday Monitor, October 28, 2007, Investment intent hurt by deceptive pg 39

investment potential. He links the investment decision with tax exemptions, tax holidays, and government deliberate stand on bureaucracy and a sound political and macroeconomic environment prevailing in Uganda on one hand and the flow of FDIs on the other hand. He also supports the view that tax incentives have less contribution to the GDP. He explains that the productivity of tax incentives to investment is roughly indicated by the Incremental Capital Output Ration (ICOR). And he notes that as of now, there's a persistent rise in ICOR points to a naked fact of low investment productivity. Low investment productivity implies denial planned job creation, inability to pay off creditors, and somehow indicates taking the entire incentive regime for a ride.

He also notes in his article that transformation of Uganda need to only consider the investment bonanza but most importantly the quality of investment that we attract. He emphasizes in his doubt whether UIA, follows up to find out whether these investors offer what they are licensed for.

He also notes that other factors for FDIs to do well should be put in place, these include power supply, and political climate and infrastructure are good examples of important ingredients in investment consideration.

This is a very good article to the research because it directly explains the nature of tax incentives in Uganda and why they have failed to address the intended objective of attraction of FDI and inflow of capital. The only problem with it is that it does not explain the impact of tax incentives to socio-economic development in Uganda.

1.9.7 Trading Tax Revenue for thirty silver coins; Uganda's costly experiment with tax incentives.[41]

This article was written by Ronald Kalungi, and it is another important literature to the topic of research. He asserts that if a search was for a common link that brings the world economies, poor or rich, to a convergence, that search would end at a focal point called tax incentives, from the world's leading economies, such as US, and her OECD peers to the emerging economies such as India, Ireland and Malaysia and finally to the world's poorest economies such as Uganda and her African sister states. Tax incentives have been adopted as a pivotal tool in the ongoing struggle to attract and indeed compete for both foreign and local investments. For Uganda's case, the justification for the use of tax incentives comes naturally, he notes that the economy is heavily indebted, with perpetual balance of trade and balance of payment deficits, close to a half of the budget is funded by external sources, elite and non elite un employment is rampant and the yields from taxation often f all below the national targets. He notes that most of these ills are linked directly to the low levels of investments in Uganda's economy. He further notes that with this being the general picture, one would observe that any attempt Uganda makes to attract investment her economy is a step in the right direction. His article is about one of such attempts to the use of taxing legislation to woo, investors through the granting of tax incentives.

This article contributes a lot of this research because it traces the origin of tax incentives to Uganda's law and analyses the arguments for and against the use of tax incentives by economies, it then proceeds with a detailed discourse on the cost benefit of tax incentives used today. He lastly gives recommendations which are important in

[41] Ronald Kalungi, Trading Tax Revenue for 30 Silver Coins, Uganda's costly experiment with Tax Incentives. Makerer Law Journal Volume1. No. 1 2006. A Publication of Makerere law society at page 71

improving the use of tax incentives and the general investment climate, however, the author does not clearly show whether these tax incentives are a boost to socio-economic development, hence this research.

1.9.8 Fiscal and economic yardsticks for analyzing the utility of tax incentives.

This is another important literature to the topic of study because Tax experts and economists give the tools used to analyze the cost effectiveness of tax incentives. These include Marginal effective tax rate (METR), Tax expenditures, screening criteria, and tax policies of exporters of capital[42] .

Marginal effective tax rate.

METR measures the extent to which the tax system reduces the rate of return on investment, at the margin. It is determined by the formula: METR=RoRbT-RoRaT/RoRbT, where RoRbT and RoRaT are the real rates of return before and after tax respectively.

METR shows how much the tax obligation distorts investment by creating a gulp between the underlying profitability of a project and the after tax rate of return of the investor. The higher the METR, the bigger the tax wedge and the less profitability an investment will be. Under corporate investments, the tax wedge appears at two levels. Taxes on these levels albeit computation at the latter level gives a better indicator of the effect of the tax system on investment decisions.

Tax incentives reduce the METR by increasing the tax rate of return. From the above analysis, it can be observed that the revenue foregone by the granting of incentives

[42] SADC Technical Report on the effectiveness and economic impact of Tax Incentives in SADC Region, pages, 1 – 4. Published in 2004.

will, absent other factors, be equal to the percentage by which tax incentives reduce the METR.

Some analysts have suggested that un upfront investment tax credit one given by the state before the tax obligation accrues has the most powerful effect on reducing the METR.

Although METR is an excellent tool for assessment the tax wedge, it does not provide adequate information about which tax breaks will spur investments.

Another limitation to METR is that it does not capture slippage in the enforcement of tax laws. In instances where tax administration is arbitrary, ineffective or corrupt or where businesses routinely find ways of misusing the investment incentives to shelter other income from tax, the METR will be artificially low and after tax rate of the return about the effect of the tax system, including incentives, on investment decisions.

1.9.9 Tax Expenditures[43]

This tool is simpler than the METR, tax expenditures refer to the tax revenue government foregoes as a result of enactment of the provisions in a taxing legislation which either waive or reduce the standard tax obligation. Tax expenditures therefore are a form of government assistance to the beneficiary. They are an indirect use of government money.

Tax expenditures are computed by calculating the difference between (a) the actual tax due and (b) the tax incentives were not available for each tax payer who claimed the incentives. If the difference be called a tax benefit for each beneficiary, then the total

[43] SADC Technical Report on the effectiveness and economic impact of Tax Incentives in SADC Region, pages 1 – 4 Published in 2004/.

expenditure for all beneficiaries would be the summation of all individual tax benefits this equation accurately measures the foregone revenue in absence of alteration of tax payer behavior due to tax incentives.

Theory of tax expenditures rests on the predicate that governments should be just accountable for the preferences they give specific causes as they are for ordinary government budgetary income. In furtherance of this accountability, governments are obligated to report tax expenditures a long with the annual budget presentations, a laudable practice in development countries like the U.S. and Germany.

Development countries hardly carry out tax expenditure budgeting. Very little efforts is done to measure the revenue government forgoes annually by the granting of tax incentives and assess the cost benefit of these incentives. This is a little unnerving because most of the tax laws of these countries are modeled along tax legislation of developed countries. It appears that developing countries copy less of the largely good practices of tax administration in developed countries.

Regardless of the above problems, tax expenditures budgeting is a concept developing countries should embrace and which they can afford. Its greatest merit is merit that, with good data storage and analytical methods, the government's tax contribution to the overall attractiveness of an investment environment can be measured with a certain degree of reliability.

Screening criteria[44]

As the name suggests, this yard stick involves the sieving of numerous tax incentives according to different paradigms or standard screening is important because tax

[44] SADC Technical Report on the effectiveness and economic impact of tax incentives in SADC Region, pages 1 – 4. Published in 2004

incentives have different tax incentives have different fiscal and administrative consequences. It's hoped that through this tool tax incentives which are most cost effective which offer great inducements to investments at the lowest cost in terms of foregone revenue and administrative expenses would be considered or granted.

Under screening, investment tax incentives may carry specific eligibility requirements. A good example of such incentives is the accelerated depreciation education or initial allowance under section 28 of ITA.[45] To qualify for this incentive, an investor must prove that she has put an item of eligible property, as defined by the section, into business for the first time during the taxable year.

The last one is the Incremental Output Ratio (ICOR) simply computed as a share of investment in GDP divided by the growth rate of GDP. A lower value of ICOR would therefore, indicate that a Unit of investments makes larger contribution to GDP growth. Unfortunately, the ICOR has been on the rise in Uganda. For example it is averaged 1.8 between 1992 and 1996 and 2.2 in the past decade and reached 2.75 in 2004/2005 Financial Year. This literature is very important for purposes of examining the cost effectiveness of tax incentives granted in an economy.[46]

1.10 Synopsis

Chapter 1

This is the introductory part which contains the background information, statement of the research problem, research questions, objectives of the study, the scope of the

[45] Cap 340 Laws of Uganda 2000

[46] Sunday Monitor, October 28, 2010. Investment intent hurt by deceptive. Pg 39.

study, broad argument layout and justification of the study, the research methodology and the broad chapter breakdown of the entire study.

Chapter 2

This chapter introduces and discusses the legal and institutional framework for the Impact of the Laws on Tax Incentives on the Social-Economic Development in Uganda. Particular reference will be made on the impact of laws on tax incentives on socio-economic development in Uganda.

Chapter 3

This chapter of the study will contain the critical analysis of the legal regime effectiveness of the Tax Incentives on the Social-Economic Development in Uganda and the impact of laws on tax incentives on socio-economic development. Reference will be made recommendations for the improvement of the whole investment climate whether legal or otherwise for social economic development.

Chapter 4

This chapter of the study will present the results and discussion of research findings based on the specific objectives.

Chapter 5

This chapter gives an in-depth analysis and recommendations for laws on the Tax Incentives and henceforth draws conclusions at end of the chapter.

CHAPTER TWO

EVOLUTION OF TAX INCENTIVES ON THE SOCIO-ECONOMIC DEVELOPMENT IN UGANDA

2.0 Introduction

This chapter contains the introduction of tax incentives legislation in Uganda. The nature of current laws on tax incentives and the analysis of the tax incentives legislations.

2.1THE GENESIS OF TAX INCENTIVES IN UGANDA'S LEGISLATION

2.1.1 The Colonial History (1894-1962)

This gives no trace of tax incentives in Uganda's legislation throughout the era when the country was under the British protectorate. The colonial government did not look at tax laws and policies as tools to foster investments. This is not surprising because the colonial government did not consider it their mandate to encourage industrialization especially that it was spear headed by indigenous Ugandans or forms of meaningful investment other than the production of cash crops[47]

The Uganda's economy was designed to be a feeder economy – supplying raw materials to the gigantic industries in Great Britain and her dominions. To ensure continued production of these raw materials, the colonial government did not need to grant incentives to European agriculturalists and farm owners. Free accessibility to land and exploitation of African labor among other policies, were more enough incentives.[48]

[47] Ronald Kalungi, Trading Tax Revenue for Thirty Silver Coins, Uganda's costly Experiment with Tax Incentives. Makerere Law Journal Vol: No; 1 2006, a publication of Makerere law Society. At 71
[48] Ibid

2.1.2 The First Independence Government (1962-1971)

Quite much like the colonial government was not keen at promoting private investments and commerce. As a result, the idea of tax incentives remained novelty even during this period; this was a result of its economic policies as well as the political philosophies of the regime in power at the time.

Political administration was in the hands of the leftists' elite class who believed in socialism and by extension communism. Socialism emphasizes collective ownership of resources and the notion of collectivization determines resource acquisition and distribution[49].

In line with this philosophy, nationalization of business undertakings and investments became a key economic policy of the first independent government since it was the key investor, it could hardly grant tax incentives to its self because it was tax collector, not a tax payer[50].

The era of military dictator (1971-1979): This coincided with the period of socio-economic turbulence characterized by expulsion of the Asian business community which owned most of the relatively few private investments at the time and the collapse of the east African Community (EAC) due to the isolationist policies of the ruling regime at the time[51]

The Income Tax Decree**[52]**: This was the legislation to provide tax incentives in Uganda's legislative history. The Decree created and allowed deductions for investment expenses made in certain sectors. Para 24 (1) of the second schedule thereto gave an

[49] Ibid at 49
[50] Ibid at 49
[51] Ibid at 49
[52] Decree No. 1 of 1974

investment made deduction of an amount equal to 20 percent of the capital expenditure incurred in the construction of an industrial building, purchase of machinery to be used or installed in such building or erection of a building for subsequent use as a hotel. This provision was amended by the Finance Statute No. 13 of 1994 to grant 100 percent investment deduction to investors who incurred capital expenditure outside Kampala, Entebbe, Jinja and Njeru.

The policy goal for that was to encourage an even distribution of industrialization and reduce the localization of industries in the 4 major industrial zones. Para 25[53] gave a shipping investment deduction of 40 percent of the capital expenditures to resident persons carrying on the business of ship owner for the purchase of new power driven ships as well as used ships of this description.

This incentives was an off deduction for each ship, and could be lost if the shipper benefiting from it sold his ship with in a period of five years from the year in which she took the incentive.

The investment deduction incentive did not affect the ordinary provision on recovery of capital through depreciation.

The Decree[54] contained other investor – friendly provisions; prominent among these were double taxation reliefs.

S. 48 of the Income Tax Decree [55] provided that, under special arrangements, a foreign tax paid by a resident tax pay would be allowable as a credit against the tax charged under the decree. The credit would not exceed the amount of tax chargeable on the foreign country the special arrangement referred to here certainly meant reciprocal

53 Ibid
54 Ibid
55 Ibid

taxation. A good example of this arrangement is the double taxation relief's provisions of the law which proceeded and was repealed by the decree. This legislation gave relief from double taxation to income earned from a partner states, Kenya and Tanzania and the rest of the Common Wealth.

This was the status of the law on tax incentives by the time the current regime came to power in 1986. The early experiments with tax incentives did not lead to significant investment growth or development.

A number of factors explain this trend. As seen above, the economic policies of both the colonial and immediate post colonial governments were not attractive to private investments. When this was coupled with numerous civil wars Uganda experienced in the two decades, (1966-1986) it becomes obvious why the country was not the investors destination, the provision of tax incentives notwithstanding.

Attempts to break loose from the inglorious past gained momentum from the early 1990s: For better or worse, the ambitious economic policies and practices of the current regime dictated a fundamental change in the legislation on tax incentives.

2.2 THE LAW ON TAX INCENTIVES ANALYZED

Compliance obligation

As a compliance matter, tax incentives require substantial paper work and record keeping if full benefits of these incentives are to yielded. This is a tall order especially to local investors in Uganda, many of whom are not well groomed in business etiquette. This, with other factors like ignorance of the law and lack of adequate tax specialists affect the effectiveness and administration of tax incentives in Uganda.

Multi-faceted legislation

The law is multi-faceted, with different enactments giving diverse incentives to different investments. The diversity of the legislation has also compelled the existence of different administrative bodies.

While for instance, the incentives under the ITA and VAT Act are administered by URA; those under the code are administered by the UIA. This duplication of administrative responsibility compelled by the lack of a consolidated law on tax incentives was a mistake in waiting. The tax incentive provisions in the code typically put UIA and the URA in unhealthy situation and thus it was not a surprise that the two bodies ended in a battle between Meera Investment Limited V URA, UIA, and AG[56]. Court hard to interpret the legality and scope of the certificate of tax incentive issued by UIA to MIL on October 10, 1994, exempting the real estate entity from corporate tax and withholding tax on dividends distributed from its income for the taxable years between 1996 and 2003. URA disputed the scope of the certificate of incentives since 1999, and the proceeded to assess tax liability and penalties against MIL amounting to shs. 36.5 billion Hence the suit. Its emergence reflects the lack of fore sight on the part of the executive and the legislature. The establishment of URA in 1991 as the body charged with the administration of tax laws would have called for amendment of the code to remove all the provisions on tax incentives and remove such powers to grant incentives from UIA. The UIA would then remain with powers to assess the suitability of the investors for investment incenses to operate in Uganda.

[56] HCC No. 185/2006

2.2.1 Tax Holidays are still alive and well

In the foregoing discussion, I noted that the ITA was amended by doing away with section 25 of the code. This repeal, however, has had little practical significance. The current trends and practices of the executive shoe that tax waivers or holidays are still granted in Uganda. Their legality is a matter of speculation. What is beyond speculation? They are heavily politically motivated for their grant. Between 2002 and 2003, government granted a foreign oil company, BIDCO[57], and a textiles company, apparels Tri-Star, amazing tax package inducements. By agreement between the two parties, BIDCO received from government a twenty five year corporate tax waiver, a twenty – year VAT deferral. Exemption from withholding tax on interest payments in respect of loan obligation incurred for the purpose of funding the company's operations, an exemption from stamp duty for a similar period, payment by government of import duties on select plant and machinery and motor vehicles imported by the company, 26500 hectares of the land on lease basis and other facilitations. Apparels on the other hand received government commitment to meeting its corporate tax obligation, infrastructural assistance in terms a building for production and office space, land, government-acquired loans, accommodation and other facilitations went to the company that expressed interest in investing in Uganda only as a result of the US government's AGOA initiative and whose main investment goal was to sell textiles to the US Market, accessibility to which had been made possible by Uganda's being a beneficiary under this agreement.

Even Basajabalaba, has benefited from these tax incentives, acting on the orders of President Yoweri Museveni, the Ministry of Finance approved a large payment of 13.4

[57] Agreement signed between the Government of Uganda and BIDCO oil Refineries in April 4, 2003.

billion of URA by Bank of Uganda[58]. The payment represented the VAT which but not for the exemption given Basajabalaba by the president, the revenue body would have collected on the supplies for the construction of a teaching hospital for Kampala International University's western campus at Ishaka, Bushenyi.

The Executive actions regarding tax incentives has failed attempts made through the Code and ITA to standardize the conditions for the granting of tax incentives, and has made them another for rewording political loyalties.

2.3 Conclusion

As discussed in this chapter, tax incentives were absent during the colonial period and even in the first independence government until with the coming into force of the Income Tax Decree in 1974

58 Daily Monitor, Wednesday June 13, 2006 Museveni gives Bassajja another 13b in taxes pg 1

CHAPTER THREE

LEGAL FRAMEWORK GOVERNING TAX INCENTIVES

3.0 Introduction

This chapter talks about the laws which are in place to govern tax incentives in Uganda and after which a brief summary is given at the end chapter.

3.1 THE NATURE OF THE CURRENT LAWS ON TAX INCENTIVES

3.1.1 The 1995 Constitution of Uganda[59]

The 1995 constitution obliges the state to stimulate agricultural, industrial, technological and scientific development by adopting appropriate policies and enacting enabling laws.

In line with the constitutional mandate, the parliament passed the investment Code statue in 1991, this was later renamed the investment code act[60] following the comprehensive revision by the Uganda law Reform Commission of all laws of Uganda that were in force by 2000. This law provided a number of tax incentives to investors. Until 1997, the most critical incentive was tax holidays under S.25 of the code, Uganda investment authority could grant tax holidays for a period specified in the certificate of incentives to investors who invested in Uganda's economy investments that met a statutory threshold and did satisfy other requirements.

The statutory lease of the tax holiday's regime did not endure beyond six years and as well shall see later they are still alive.

[59] As amended
[60] Cap 92 Laws of Uganda 2000

In 1997, parliament enacted a new Income Tax Act[61] which repealed S.25 of the Code the application of the repeal to investors that enjoyed holidays before the ITA was enacted caused some pertinent legal problems, some of which have been litigated. In Total Uganda Ltd V URA,[62] _the tax appeals tribunal had to give its verdict on the seemingly retrospective character of the repeal sect. 167 of the ITA repealed Sect. 25 of the code, but under section 168(21) of the former Act, the certificate of incentives, validity acquired under S.25 of the code, were to continue in force until expiry of their life span. Subsection 21, however narrowed the exemption from withholding tax on dividends and interests paid by a corporate person to its shareholders. Unlike before, only resident shareholder would profit from the exception.

The applicant paid dividends to its nonresident share holders, restraining from 50% of the tax thereon, and relying on the certificate of incentives which granted such exemption and sec. 168 (21) or the applicant breached its statutory duty to withhold that certificate of incentives is entitled to a drawback of duties and VAT payable on imported inputs used in producing goods for export, if the duties were paid in compliance with a law requiring such payment of a tax at the payment of dividend. The tribunal ruled that the exemptions under S.168 (21) did not apply to non-resident share holders, a position that was later affirmed by the High Court on the retrospective effect of S.168 (21). The tribunal could not help lamenting that despite its finding which based on the law as it stands, the tribunal observes that the change in the law would be unfair and embarrass the investors. Their investment decision would have been heavily influenced by the availability of incentives. To withdraw them when the investment has already been made can therefore occasion difficulties for the investor.

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[61] Cap 340 laws of Uganda 2000
[62] Application TAT 2/2001

Following the statutory demise of the tax holidays, the range of tax incentives provided by the Code was reduced. In the following paragraphs, I do address the tax privileges that are still provided under the current Act.

3.1.2 THE VALUE ADDED TAX ACT[63]

(a) Sec, 19 and the second schedule to the VAT Act[64] give a list of commercial supply of specific goods which are exempt from VAT. These include among others, educational materials, unprocessed foods, medical, dental, and nursing services and social welfare of services for instance for the elderly. In related way, some supplies are zero rated for purposes of VAT. These include the supplies of drugs and medicine, agricultural implement, educational materials and cereals grown, milled or produced in Uganda.

These supplies carry no VAT obligations essentially because government believes they affect essential commodities and are in the interest of societal welfare to keep the prices of these commodities at affordable rates.

3.1.3 INCOME TAX ACT[65]

1. Start-up costs deductions spread over 4 years.

The principal legislation is income tax, the ITA[66] , also provides a number of incentives.

Section 30 of the Act, allows an investor who incurs expenditure in starting up a business to produce income which is included in the business' gross income a deduction of an amount equal to 25 percent of the amount of expenditure was incurred. Recovery

[63] Cap 349, Laws of Uganda 2000
[64] Ibid
[65] Cap 340, Laws of Uganda 2000
[66] Ibid

of start up costs continues in the three subsequent years; with the same fraction of 25% being recovered every year.

2. Scientific research expenditure of 100%

3. Training expenditure of 100%

4. Mineral exploration expenditure of 100%

5. Initial allowance on hotel, hospitals and industrial building of 20%.

6. Accelerated Depreciation deductions

Accelerated capital recovery happens to be the more dominant of tax incentives available under the ITA[67]. This acceleration is provided in a number of circumstances.

Section 28 of the Act [68] provides that an investor who places an eligible property into business for the first time during the year of income is entitled to a deduction of specific percentage of the cost base of the item determined in accordance with the location of the business. If the business is located in Kampala, Jinja, Namanve, Entebbe, and Njeru, the deduction is 50% of the cost base. If the location is outside these five major industrial zones, the deduction is f75%.

The difference in the amount of deduction depending on location of the business is intended to attract investors to invest outside the major industrial zones and therefore encourage an evenly balanced industrial growth.

The phase "item of eligible property" in section 28(1) is defined under subsection (3) thereof to mean plant and machinery wholly used in the production of income included

[67] Ibid
[68] Ibid

in gross income. The definition, however excludes goods and passenger transport vehicles, house hold appliance and office and house hold furniture, fixtures and fittings. The tax appeals tribunal has had occasion to rule on the application of this exclusion. In Security Group Alarms Ltd. V Uganda Revenue Authority[69], the applicant, a local security services company, imported tailor-made jeeps for use in its business operations. In the year in which the jeeps were placed in service for the first time, the applicant claimed an initial allowance or deduction amounting to 50% of the cost base of the jeeps under section 28(1) of the ITA. The respondent denied the deduction, arguing that jeeps were passenger transport vehicles excluded from items of eligible property by sub-section (3) of the section. The main issue before the tribunal was whether the jeeps were items of eligible property or excluded passenger transport vehicles within the meaning of the sub section(1) and (3) of section 28. Nothing that the Act does not define the phrase passage transport vehicles. The tribunal took recourse to definition of the term of this term under traffic law and the ordinary dictionary meaning. Consequently, it held that the jeeps were not passenger transport vehicles and were items of eligible property for which an initial allowance or deduction was permissible under section 28(1)[70].

The initial allowance above adjusts down words the investors' basis in the capital asset for the purposes of determining subsequent ordinary depreciation deductions. This position is to be contrasted with the provision of the Degree, the law which the ITA repealed, which, in so far as it never required initial depreciation deductions to adjust the investor's basis in the property, appeared to perceive these deductions as a subsidy from government.

[69] Application tax Appeals Tribunal 10/2004
[70] Cap 340 Laws of Uganda 2000

Where the cost base of an asset placed into business for the first time in the year of income is less than one million Uganda Shillings, whole amount is at once deductible during the year

Accelerated depreciation deductions are also permissible in respect of capital investments in industrial buildings. Subsection (4) of the section 28 gives an investor who places a new industrial building into service for the first time during the year of income a deduction equal to 20 percent of the cost base of the building at the time of service. This incentive applies even to mere extensions or existing industrial buildings and relates to buildings erected or extended by or after July 1, 2000. The interpretation of the section defines an industrial building widely as any building which is wholly or partly used or held for use by a person in manufacturing operations, an approved hotel business or an approved hospital.

Investments in horticulture equally benefit from accelerated depreciation deductions. Under sub-section (2), (3) and (4) of section 35[71], a horticulturist is allowed a deduction equal to 20 percent of the expenditure made and the same deduction in each of the four subsequent years.

3.1.4 The Investment Code Act[72]

<u>Exemption from import duty and value added tax.</u>

S. 21 of the investment code Act[73] gives an incentive and investor who imports plant, machinery, equipment vehicles or construction materials for an investment project the privilege of benefiting from concessional rates of import duty and other taxes as may be

[71] Cap 340 Laws of Uganda 2000
[72] Cap 92 Laws of Uganda 2000
[73] Ibid

specified in the Finance Act from time to time. These rates vary every year as the Finance Act wherein they are stipulated almost always undergoes annual amendments.

Other related incentives this Code provides include exemptions from import duty and value added tax on motor vehicles for personal use and house hold items purchased by the licensed investor.

Exporting promotion incentives and facilities

a) Manufacturing under bond.

b) Duty exemption on plant and machinery and other in puts

c) Stamp duty exemption

d) Duty drawback. This is a refund of all or part of any duty paid on materials or inputs imported to produce for export.

e) Withholding tax exemptions on plant and machinery, scholastic materials, human and animal drugs and raw material/

f) Ten year tax holiday duty remission scheme for exporters involved in value added addition

To qualify for the incentive above, an investor must propose an investment that will make a substantial contribution to the economic welfare of Uganda: Determined by taking into account a number of factors. These include,

1. Utilization of local raw materials in the investor production activities.
2. The creation of employment opportunities
3. The introduction of advanced technology

4. And the generation of new earning or savings of foreign exchange through exports, resource based import substitution or service activities.

The investor must therefore inject into the economy at least[74]

a) Five hundred thousand US dollars for citizens of Uganda.

b) One hundred thousand US dollars for non citizens[75]

A foreign investor who invests in non priority activities forfeits the above tax incentives[76]. The policy reason behind this is to reserve investment in these activities to citizens of Uganda.

As a procedural requirement, the investor must, in addition obtain a certificate of incentives form UIA in order to enjoy the tax privilege under the Code. This Certificate is issued under Sec. 23 of the code after the UIA is satisfied that the investor's application satisfies the legal requirements.

3.1.5 International Agreements[77]

These are international agreements entered into between governments for allocation of fiscal jurisdiction. They become part of the tax law of each contracting state, whether by direct incorporation into the domestic law or by direct enactment into that law.

The conclusion of a double taxation treaty is therefore, part of an overall policy of each state to encourage foreign investment or to assist the state's investors to participate in overseas trade and development without undue financial hardships arising from double taxation.

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[74] S. 22 (1) b of the Investment Code Act Cap 92
[75] S. 22 (1) b of the Investment Code Act Cap 92
[76] S. 22 (2) of the Investment Code Act Cap 92.
[77] DJ Bakibinga, Revenue Law in Uganda (2003) Professional books publishers, Kampala at 129

Legal effect of double taxation

Section 89(1) of the ITA[78], 1997 provides that an international agreement entered into between the government of Uganda and that of a foreign country shall have effect as if such agreement was contained in the Act and the agreement prevails over the act in the case of inconsistency.

Where Uganda is a party to a double taxation agreement, credit is given for foreign tax payable in respect of income is allowed as a credit against tax chargeable is less by amount of tax credit.

Adverse effects of a double taxation treaty[79]

A major disadvantage of double taxation agreement occurs where an agreement between developed and undeveloped countries, the agreements are un likely to be more or less equivalent in their revenue effects. Capital flows tend to be one way from the developed countries to developing countries. As a result, the reductions in the tax by the country where the investment occurs may not be reciprocal in effect under the agreements. Consequently developing countries should constantly balance the need for tax revenue and the desire to attract foreign investment.

3.2 Conclusion

As discussed in this chapter, there is an extensive legislation on tax incentives on the socio-economic development in Uganda. From the principle legislation which is the constitution to Acts such as; Value Added Tax, Income Tax among others have been put in place to guide how tax incentives should operate forth socio-economic development of the country.

[78] Cap 340 Laws of Uganda
[79] Pg 141, ibid, 14

CHAPTER FOUR

DATA PRESENTATION, ANALYSIS AND FINDINGS

4.0 Introduction

This chapter mainly discusses the cost-effectiveness of tax incentives in the attraction of investments in an economy for social-economic development.

The practical role of tax incentives is to attract investments in the country. This has been achieved in Uganda because according to UIA Uganda registered an increase in investments form $257 million in 2005 to $ 307-million in 2006. The UIA over the same period registered 330 projects with major destinations in telecommunication, industry, energy and hospitality. This was because of the host of attractive tax incentives the government offers through its legislation.

4.1 Positive impacts

These investments have had the following impact on socio-economic development in Uganda.

a) Tax incentives have attracted mobility of capital in Uganda.

Those in support of tax incentives argue that tax incentives have attracted the flow of capital into Uganda because the tax legislations grant such incentives. The attraction is attributed to a number of factors; which include the following among others; it shows the level of commitment to investment, it markets the country positively as a destination for foreign direct investments (FDIs). Its also gives local investors confidence that government is committed to giving the owners of capital a helping hand if they choose to invest in the economy.

b) Tax incentives have reduced the effective tax rates on the returns on capital.

This makes investment more profitable, hence keeping domestic earnings within the economy through reinvestments and reduced corporate taxation a product of tax incentives necessarily increase the after tax corporate earnings. This has boosted the returns on shareholdings in form of dividends; thus encouraging more equity financing or increase investment in corporate stock.

c) Tax incentives compensate for the deficiencies in the investment climate.

This argument, whose validity relates mainly to FDI's, is normally fronted by policy makers in developing economies. They argue that investment incentives make up for the loopholes in the investment climate such as high cost infrastructure, energy shortages, weak legal and judicial systems, corrupt and inefficient bureaucracies and macro-economic instability.

d) Tax incentives generate revenue

This is, perhaps the most support of all the impacts fronted in favor of tax incentives. The argument begins with a view that in some cases governments do not forsake any revenue by granting tax incentives. If the investment were to be lost to other locations due to the absence of incentives, then the direct revenue loss from the granting of these incentives is nil

Yet the indirect revenue impact from investment tax incentives can be visible, because the new investment that materialize owing to the incentives do create jobs and linkage effects that generate employment and tax revenues. This is in addition to other positive externalities linked to investments, such as fiscal savings by investors with activities linked to investments, like research and training, market surveys, and infrastructural development – efforts that generate more revenue in the short or long term.

e) Tax incentives reduce economic distortions caused by taxation.

Governments impose taxes in order to raise revenue and ensure fiscal and economic stability. For all its merits, however, taxation hardly remains a neutral factor in investment decisions. Quite frequently, it determines when and how capital will be invested in an economy. It is due to this effect that economists and tax specialists have argued that taxation leads to economic distortions.

When a government grants tax incentives, the argument sets in motion fiscal steps by which this distortions can be eliminated or reduced. For preferential investments, capital is invested with little or no regard to tax considerations. The reduction or elimination of the burden through the provision of incentives, a part from lowering operational costs, achieves the much needed investment neutrality an ideal tax system should have.

Tax competition

This impact relates more appropriately to the application of tax incentives in developing world economies. Most of these economies perceive the granting of tax incentives as part of the inevitable tax completion movement. Since many economies grant investments fiscal incentives in one form or the other, an economy which does not grant tax incentives may proactively feel it has put its self at significant competitive disadvantages.

The SADC report[80] gives a collection of poor economies that have overcome economic backwardness by building strong investment bases through the strategic use of fiscal incentives. These include Malaysia, Ireland, Costa Rica, India and Mauritius

4.2 Arguments against the use of Tax Incentives

The opponents maintain that the capacity of tax incentives to attract capital is inconclusive. The investment climate is unsurprisingly complex. It demands the existence of a plethora of enabling factors in order to impress investors on the issue of investment location.

The most important of these are political stability, a lucrative market, enabling infrastructure, an investor-friendly legal and judicial system, an accountable and transparent political administration and skilled, trained and trainable labor. In the absence of all these factors or a rich combination of them, no amount of tax incentives will effectively attract investments. They argue that that's why Uganda continues to witness a naked fact of law investment productivity. That's why the economy is heavily indebted, with perpetual balance of payment and balance of trade deficits; close to half of the budget is externally funded, and yields from taxation always fall below the national targets and the denial of the planned jobs creation. The following are the reasons that explain this trend of affair.

a) The reason that tax incentives compensate for the deficiencies in the investment climate.

This argument is an inadequate reason for the use of tax incentives. The proponents of this reason say that it requires the assumption that investors will not deem the deficiencies in the investment climate so fundamental as to be beyond compensation by

[80] SADC Technical Report, on the Effectiveness and Economic Impact of Tax Incentives in SADC Region

anything. That, any prudent investor will welcome tax incentive as a supplement to the already existing favorable investment regime not as a substitute for such a regime a conclusion to which the compensation argument necessarily leads.

b) Tax incentives and revenue

The opponents, on the other hand argue that tax incentives drain more revenue than they ever can generate. Revenue loss indeed is the most profound reason for the opposition to the use of tax incentives to attract investments. They put the following reasons, (1) redundancy effect. If the tax incentive is redundant, its only effect will be revenue loss.

Revenue is still lost when the tax favored investors undercut the profitability of their non favored competitors who pay taxes. This happens through cut throat price cuts, payment of high prices for raw material and enhanced ability to attract skilled labor and advanced technology. Once then unfavoured investors are driven out of competition, revenue is lost through a reduced tax base, constricted employment earnings and lost externalities.

c) Tax incentives cost government and investors revenue through leakages.

The most common leakages are tax avoidance and evasion. Tax incentives increase the appetite for aggressive tax planning, and thereby facilitate leakage, round tripping schemes and transfer pricing on purchases and sales, loans at above market interest rate among related corporate tax payers. All these activities shift income from a tax laden or burdened corporation to a tax exempt. The overall outcome of this is that a tax burdened corporation will have no taxable income while the corporation with income blissfully enjoys exemption from tax or preferential tax treatment. This is not to mention an even greater loss to the treasury if a tax laden corporation reports massive losses for recovery through carry forwards or backwards in the computation of taxable income.

Other harmful schemes include false export declaration and the huge legislative cost incurred in continually monitoring and updating the tax incentives.

All the above draw backs reduce the argument that tax incentives generate revenue to something a little like a myth.

d) Other opponents of tax incentives urge that it creates more distortions than they remedy.

They reduce on tax revenue and government has to make fiscal adjustments in order to fill the ensuing budget gap. This may necessarily include curtailing government expenditure, increasing the tax burdens of non tax payers through raising tax rates or resorting to other sources of funding.

e) Additionally tax incentives lead to distorted technical decisions[81].

The tax preferences that reduce the cost of capital, for instance, systematically favor capital intensive investments, which reduce the impact of investments on job creation. Tax holidays favor short-term over long term investments.

f) Other negative effects of tax incentives include the sustenance of corporations with low productivity more especially those which benefit from protective tariffs.

Corporations that would have no room in an investment climate without the cushions or spoon feeding provided by the incentive: In developing countries, the above

[81] These are tax preferences that reduce the capital.

distortionary trend is perfected by equity problems. Most of the tax incentives benefit foreign investments, leaving local investors crying foul and feeling alienated by their own tax regimes.

g) One profound challenge is the impact of tax administration.

They do encumber tax administration through the enforcement of the different rules for different tax payers. They lead to greater compliance problems on the part of the benefiting investors and reduced capacity for the effective monitoring on the part of tax administration. This happens because controlling and preventing the abuse of loopholes in the legislation granting tax incentives absorbs highly skilled administrative resources. On a more basic level, no one can dispute the toll designing legislation on the tax incentives has on a country's resources. The law needs to be constantly monitored to assess the extent to which it conforms to changing economic conditions and needs. Then comes the numerous litigation activities the administration of tax incentives necessarily breeds. All these drawbacks affect the overall efficiency of tax administration.

h) Other drawbacks of tax incentives include the unduly costly lobbying they attract as those who benefit from them try to influence the legislative process to maintain their tax-favor status. Discretionary tax incentives also encourage corruption and perpetual lack of transparency in their administration.

The foregoing are the conventional arguments for and against the use of tax incentives. The cost-effectiveness of these incentives is a matter of continuing concern. From the above discussion I can observe that while tax incentives play some positive role, the cases that are not cost effective are greater.

4.3 Conclusion

This discussion has shown that tax incentives have shown an impact on the socio-economic development as they attract mobility of capital, generate revenue, and reduce economic distortions caused by taxation; they are however, open to challenges as they have all been discussed in this chapter.

CHAPTER FIVE

CONCLUSIONS AND RECOMMENDATIONS

5.0 Introduction

This chapter contains the conclusion and recommendations. In this conclusion part of the research, I reflect on the discussion and analyze the ways through which the law on tax incentives and Uganda's investment regime can be improved. The current policy on the use of tax incentives to attract investment to Uganda has many notable flaws. It costs government fortunes in terms of foregone revenue, yet its real contribution to the stimulation of investment is rather minimal.

5.1 Conclusion

In this concluding part of the research, I reflect on the foregoing discussion and analyze the ways through which the law on tax incentives and Uganda's investment regime can be improved. The current policy of using tax incentives to attract investments to Uganda has many notable flaws. It costs government fortunes in terms of foregone revenue, yet its real contribution to the stimulation of investments is rather minimal. The foregoing discussion showed why this is the case. In summing up the role incentives play in socio-economic growth, we ought to recall three vital points. First, tax incentives do not play a crucial role in the investors' investment location decisions. Tax incentives therefore, do not compensate for the inherent decisions. Tax incentives therefore, do not compensate for the inherent defects and distortions in a country's investment climate.

Second, a country with a competitive investment regime will attract investments without necessarily granting tax incentives. And finally, where different investment regimes of different countries are at par in their levels of competitiveness, tax incentives may break the deadlock for an investor who is undecided as to where she should locate her capital or investments.

This is the extent to tax incentives may be relevant. Taking these three points together, the common thread among them is that a country should strive to build a competitive investment climate first and foremost. There is no substitute for political stability, good administration, and efficient and transparent bureaucracy, infrastructural developments, lucrative markets, a good legal and judicial system and a skilled and trained labour force. Any government which does not spend effort and money in building these structures should have no business to do with granting tax incentives.

5.2 Recommendations

However, since all countries ordinarily strive to build effective investment regimes, a country that has built hers would do well supplementing it with a few strategic, well formulated and clearly focused tax incentives. It is in this light that I make the following recommendation for Uganda's tax incentives and investment policies.

5.2.1 Policy Design and Choice of Tax Incentives

This is a very critical aspect. A successful policy on tax incentives requires careful planning and wise policy formulation. The law granting tax incentives should be a product of the well guided study on the foregone revenue estimates and the perceived impact of incentives being granted on investments.

Any incentives granted to investors that would undertake the investment anyway is a waste of public resources.

Some of the issues to investigate in policy formulation include the following:-

1. Choice of incentives

Uganda offers so many incentives, some of which are rather unnecessarily. The incentives granted under the code, such as exemption form import duty, VAT and duty drawbacks are the most expensive because they oblige government to subsidize production and imports. In my view, except VAT exemption or Zero rate for investors in industries manufacturing educational materials, agricultural implements or service industry for the benefit of the elderly and similarly situated groups[82]; Which are administered by URA through the VAT Act, these exemptions should be prescribed, this would have the effect of removing the powers to grant incentives from the UIA, scaling its mandate to licensing of investments. This legislative amendment is necessary if future administrative clashes between the UIA and URA are toe avoided. Let the Meera Investments conflicts be the last of the kind.

It is also recommended that the only incentives Uganda should retain are those provided under ITA.[83] These include start-up costs and accelerated depreciation deductions. These incentives do not cost government much in terms of foregone revenue since they deal basically with the timing of capital recovery, as opposed to subsidizing it.

It alternatively, Uganda should consider moving to a single tax incentive – a low corporate tax rate. The current rate of 30% may be within the average range of which is low in Africa. This coupled with a fair investment climate, would give the country a very competitive position in the race for investment attraction. A uniform low corporate

[82] Value Added Tax Act, Cap 349. Laws of Uganda. Section 19,20 and 24
[83] Cap 340. Laws of Uganda 2000

tax rate is by far the best tax incentive. It is easy to administer, reduces the urge for tax avoidance scheme, treats both local and foreign investors equally and is not manipulated. Although it reduces the tax in the short run, this loss may be compensated in the long rung by the influx of investments seeking to profit from a low tax regime. The experience of Ireland is a good illustration of this point. It is urged that since the 19^{th} century Ireland has managed to attract huge and capital investment in form of high tech corporations because of the lure at a low corporate tax rate and it has done magic wonders in transformation of the country into an economic giant in highly competitive European environment.

2. Amendment on the law of tax incentives

The ITA beckons for the amendment in some respect of particular relevancy to tax incentives. Section 30 needs legislative attention, it is not easy to highlight with any degree of certainty how this provision relates to section 28 initial allowances. The vagueness of this relationship creates the potential for a double benefit to an investor. Section 30 should amended by either defining preciously what start up cost are or giving a general qualification intended to avoid double benefit. A provision of this kind would help to clarify the relationship between section 30 and section 28 of the ITA by delimiting the deductions that fall under either section of strict rules against transfer. Currently, the ITA is rather weak in this regard.

3. Policy objective

The law on tax incentives should have clearly identifiable or identified objectives. These objectives should be related in the choice of incentives itself. Incentives which facilitate faster capital recovery encourage capital intensive means of production. For any economy, the emphasis job creation therefore, these incentives may not lead to this goal. As Kalungi notes that, the US has tried to use employment credits as means of advancing employment, unemployment incentive obviously reduces the cost of labour to the employer. Therefore, it makes labor intensive cheaper than capital intensive techniques of production. Whether the incentive encourages an investor to employ more than capital depends on a number of factors; these include the relative efficiency of either techniques, the nature of the investment and type of technology used in production. In developing economies, however, this incentive may have a practical impact in encouraging job creation because of the relative cheap cost of labour, the absence of a strong labour law regime that would otherwise impose burdens on employers on issues of labour welfare and working conditions and the high employment levels that condemn many of the absence of choice in career decisions.

I would recommend that Uganda examine the possibility of emulating the US in the use of employment incentives.

4. Administration of tax incentives

This is another critical area Uganda should consider reforming. From the very onset tax incentives should be granted by the following clearly defined legal procedures and standards. This sensitive policy area should be freed from political interference and manipulation. Uganda's experience shows that this is a major problem. For instance; although the ITA abolished tax holidays, these incentives virtually resurrected in the package government granted Apparels Tri-star. BIDCO and Basajjabalaba, the experience of these companies is the most remarkable illustration of what experience of these companies is the most remarkable illustration of what political manipulation, lack of accountability and disregard of the requirements of the law can do to the administration of tax incentives. The incentive should be left to the URA, the body charges with the mandate to administer tax laws.

Another administrative reform should be the introduction of tax expenditure budgeting. This practice will enable the URA to keep truck of the estimates of revenue government foregoes every financial year by the granting of investment tax incentives.

Tax expenditure budget is important in ensuring the public resources are used responsibly, with accountability. Tax incentives are a use of public resources, and should be subject to the same standards of accountability as any other resources. Indeed article 152(1) of the constitution of Uganda provides that where a law enacted under clause (1) (tax legislation) of this Article confers powers on any person to wave 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.

It is prudent to read this provision the obligation to practice tax expenditure budgeting by both the URA and the UIA – the two bodies currently in charge of administering tax incentives. In addition to the reform of its policy on the tax incentives, Uganda should address the following issues seriously to supplement tax incentives.

i) Power inadequacy

The outgoing financial year witnessed the most debilitating power shortages in over two decades. Since 1954, Uganda has depended chiefly on one dam, the Own Falls Dam of her hydro electricity. This power plant was built by the colonial government at a time when industrialization and other power generated activities were still at low ebb. The booming industrialization and modernization to date has exceeded the dam capacity to keep Uganda lit. This has been worsened by natural factors, such as sailing falling water's level of Lake Victoria, which has dictated an even worse power generation pattern by the dam.

As a transient measure, government has decided to wave VAT on generators and fuel products by selecting leading industries in order to aid them in coping with a severe energy shortage. This should not be the end rather than the beginning of a concentrated effort to develop a winning energy production policy. One way of doing this would be grant tax credits to investors who inject capital in diverse and renewal sources of energy. This would encourage diversity in power sources.

ii) Political stability and Security

Uganda has remained relatively stable for the past two decade. Apart from the northern part of the country which as lived through horrors of a bloody armed rebellion for a similar period, the rest of the country is secure enough for investments. Government should set up the efforts to end this protracted war for real and for good. Otherwise, this region presents an ideal example of why political stability ranks far higher than tax incentives in investment location decisions. Hardly any investments have come to region in the past years. Despite the greater initial capital allowances granted to investments located in such places by the ITA.

iii) Continuing infrastructural development

Uganda should continue developing infrastructural facilities. The progress registered in the past should be replicated. Good roads play vital role in linking industrial plants to sources of raw materials and of labour to and from work. Telecommunication facilities, affordable public housing and labour training institutions among others also provide positive externalies for investment growth.

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