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Strategic Investment Tax Incentives in Africa: The Case of Tax Holidays in Uganda

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Summary

Tax incentives to attract foreign direct investment are common around the world, especially in Africa. Even though many commentators remain sceptical regarding their effectiveness, tax incentives remain popular policy tools for governments in low-income countries seeking to attract investors.

Like many other countries in Africa, Uganda has attempted to use tax incentives to attract investors for decades. For many years these incentives took the form of statutory discretionary tax holidays issued by the Executive branch of government. These discretionary tax holidays were abolished in 1997 with the amendment of the Investment Code Act and the introduction of the Income Tax Act. However, over the years, non-statutory tax holidays issued by the Executive re-emerged taking the form of private agreements between the government and specific investors. In 2018 Parliament introduced an extensive non-discretionary statutory tax incentives regime which included a ten-year tax holiday for investors meeting criteria set out in statute. Discretionary tax holidays issued by the Executive were now supposed to be a thing of the past. Recent revelations that the country's debt to GDP ratio had exceeded 50 per cent, pressure from the donor community and wider press coverage of tax holidays has led to greater scrutiny and public debate about tax incentives.

This paper examines the statutory and non-statutory tax holidays in Uganda and generates recommendations for the way forward and for how the tax holiday regime can be improved. The research employed a mixture of methods including textual analysis, secondary data analysis, and interviews. The textual analysis covered both primary and secondary literature including court rulings, Parliament Hansards, the reports of Parliamentary committees, tax laws, newspaper reports, and tax expenditure reports. Lastly, we engaged in detailed interviews/discussions with officials from the Ministry of Finance, Planning and Economic Development and the Uganda Revenue Authority.

The research found that tax holiday provisions in Ugandan statutes are ambiguous. They are applied in a discriminatory manner and generally lack transparency. Further, although Parliament has attempted to play an oversight role regarding tax holidays, this has largely been limited to making recommendations which have been ignored by the Executive. It is only in recent years that Parliament has taken positive steps to limit tax holidays by rejecting proposed amendments. The research recommends the elimination of tax holidays as the most suitable solution to the challenges posed. However, other recommendations include the use of non-discretionary holidays, making tax holidays more transparent, using reduced rates in lieu of tax holidays and vigilant monitoring by Parliament and civil society organisations.

Keywords: Africa, Uganda, taxation, exemptions, investment, transparency, good governance.

Ronald Waiswa is a Research and Policy Analysis Supervisor at the Uganda Revenue Authority. He has collaborated with ICTD on a number of research projects in Uganda on issues including taxing wealthy individuals and public sector agencies.

Solomon Rukundo is a lawyer and a Manager – Taxation at Grant Thornton Uganda and a research associate at the Mawazo Tax Policy Research Centre in Kampala. He was

previously a Supervisor in the Rulings and Interpretations Unit of the Business Policy Division of Uganda Revenue Authority where he worked for seven years.

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Acronyms

AGOA	African Growth and Opportunity Act
ATS	Apparels Tri-Star
CIT	Corporate income tax
CSO	Civil society organisation
FDI	Foreign direct investment
GDP	Gross domestic product
IMF	International Monetary Fund
ITA	Income Tax Act
MNE	Multinational enterprise
MoFPED	Ministry of Finance, Planning and Economic Development
MP	Member of Parliament
USh	Ugandan Shillings
UNCTAD	United Nations Conference on Trade and Development
URA	Uganda Revenue Authority
UVCCL	Uganda Vinci Coffee Company Limited
VAT	Value added tax

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Introduction

Tax incentives to attract foreign direct investment (FDI) are common around the world, especially in Africa. In the context of low-income countries, tax incentives are largely meant to compensate for deficiencies in the investment climate. It is assumed that investors in low-income countries tend to face higher levels of cost, uncertainty, and risk than in alternative investment locations. In theory at least, for a rational and profit maximising investor, tax incentives such as tax holidays increase the expected value of an investment (Stausholm 2017). Tax incentives grant certain selected commercial activities a higher after-tax return which can result in import substitution, export promotion, or increased employment. Tax incentives are thus perceived by governments as a temporary sacrifice in revenue which will accelerate balanced growth of the economy, and eventually be repaid through increased tax revenue. In recent years common tax holiday periods have increased from two years to ten years and tax relief in special zones has been expanded to cover trade taxes as well as income taxes (Ampulo 2018). A 2018 World Bank report noted that 49–72 per cent of all low-income countries offer tax incentives and the most common sectors in the economy to benefit are construction, information technology and electronics, machinery and equipment, and manufacturing (Andersen, Kett and Uexkull 2018: 2).

Although tax incentives are used globally, they are particularly popular in Africa as a means of attracting FDI. A 2017 study revealed that virtually every country in Africa had some form of tax incentives geared towards attracting FDI (KPMG 2017). A 2022 International Monetary Fund (IMF) paper described tax systems across Africa as ‘riddled with exemptions and incentives’. (Aslam, Delepierre, Gupta and Rawlings 2022: 2). Like many other countries in Africa, Uganda has used tax incentives to attract investors for decades (UNCTAD 2000). For many years these incentives took the form of statutory discretionary tax holidays issued by the Executive branch of government. These discretionary tax holidays were abolished in the late 1990s. However, over the years, non-statutory tax holidays issued by the Executive emerged taking the form of private agreements between the government and specific investors. In 2018 Parliament introduced an extensive statutory tax incentives regime which included a ten-year tax holiday for certain investors to replace the discretionary tax holidays issued by the Executive. Recent revelations that the country’s debt to GDP ratio had exceeded 50 per cent and wider press coverage of tax holidays has led to greater scrutiny and public debate about tax incentives (Oketch and Nabisubi 2022). While Parliament, civil society organisations (CSOs), development partners and many experts have questioned the effectiveness of these tax incentives, the Minister of Finance and the President himself have spoken out defending them as necessary to attract investors (Fatiah 2019; Ojiambo 2022; SEATINI 2019).

The World Bank describes tax incentives as measurable tax related economic advantages afforded to specific enterprises or categories of enterprises to steer investment into favoured sectors and/or regions, or to influence the character of investments made in a country (World Bank 2009). The United Nations Conference on Trade and Development (UNCTAD) defines tax incentives as any incentives that reduce the tax burden of enterprises to induce them to invest in particular projects or sectors (UNCTAD 2000). For the purposes of this paper, tax incentives are defined as measures that provide for a more favourable tax treatment for certain taxpayers, activities or economic sectors compared to what is granted under the general tax structure.

This paper focuses on tax holidays which aim to encourage investment in identified sectors of the economy by taxpayers (locals and foreigners) meeting certain criteria or obtaining approval from the government. Part 1 of the paper examines the nature of tax incentives. Part 2 focuses on tax incentives in low-income countries. Part 3 begins with a historical look at the tax holidays in Uganda and their evolution from discretionary incentives to a statutory regime. This part also takes a close look at the administration of the current tax holidays regime. Part 4 analyses the limitations of the tax holiday regime in Uganda noting that despite being statutory, the tax holiday regime in Uganda is largely discretionary, discriminatory and lacks transparency. Part 5 has recommendations for improvements to the tax holiday regime which include a more transparent tax holiday regime, limitation of discretion and the use of reduced rates for investors rather than a tax holiday as possible ways of dealing with the challenges.

This research employed a mixture of methods including textual analysis, secondary data analysis, and interviews. The textual analysis covered both primary and secondary literature including court rulings, budget speeches, Parliament Hansards, Parliament committee reports, tax laws, newspaper reports, and tax expenditure reports. Lastly, we engaged in detailed interviews/discussions with officials from Ministry of Finance, Planning and Economic Development (MoFPED) and the Uganda Revenue Authority (URA).

1 The nature of tax incentives

Tax incentives in Africa typically take the form of tax holidays. A tax holiday is a temporary exemption of a firm or investment from certain specified taxes, typically corporate income tax (CIT) (Moore, Prichard and Fjeldstad 2018). A 2013 study of tax incentives in 30 sub-Saharan African countries found that 60 per cent of them are in the form of a tax holiday (James 2013: 11). Tax holidays usually have different thresholds for foreigners and locals and vary in duration from as little as one year to as long as 20 years (Zolt 2014). Tax holidays are often preferred because they have the advantage of simplicity for both the investor and the tax authorities. A very simple and investor-friendly tax holiday regime, for example, can provide that no CIT is payable for a period (Zolt 2014).

Tax holidays may be discretionary or non-discretionary. Discretionary tax holidays typically involve an application seeking approval from a government official such as the Minister of Finance. Discretionary tax holidays may be a government policy that is not laid out in a statute or may be explicitly provided for in a statute. Alternatively, the tax holiday in the statute may be so broadly drafted as to require an approval process even when this is not explicitly provided for. The 2013 study of tax incentives in sub-Saharan Africa found that 47 per cent of them were discretionary (James 2013: 40). Very often the process of applying for and approving discretionary tax holidays is hidden from the public and this lack of transparency makes them prone to abuse, leading to outcomes other than those desired by the government (James 2009). Non-discretionary tax holidays on the other hand have clear criteria set out in statute and can be accessed without any approval when the investor meets the conditions therein. They may be claimed simply by filing a tax return that shows that the requisite conditions have been met (James 2013).

Examples of both discretionary and non-discretionary tax holidays can be found among African countries. An example of discretionary tax holidays is in Tanzania, where the Minister of Finance may, by order published in the Gazette, exempt any income from tax to the extent specified in the order or vary any statutory exemption in the Income Tax Act.[1] Tanzania also has tax holidays based on agreements approved by Cabinet on strategic projects or for a special strategic investment approved by the National Investment Steering Committee.[2] In contrast, Malawi has non-discretionary tax incentives. Firms operating in the agro-processing sector and electricity generation, transmission, and distribution sector which meet requisite capital investment thresholds have a ten-year tax holiday.[3] Non-discretionary tax holidays are

[1] Section 10 of the Income Tax Act (Tanzania).
[2] Section 10(3) of the Income Tax Act (Tanzania).
[3] Eleventh Schedule of the Taxation Act Cap 41:01 (Malawi) and Taxation (Priority Industries) Regulations 2013 (Malawi).

also available in Sierra Leone for any business established after 1 January 2015 which makes the requisite capital investment and the minimum threshold of the number of employees.[4]

2 Tax incentives in low-income countries

A few studies have suggested that tax incentives can be effective in attracting FDI. Tax incentives have reportedly been effective in countries like South Korea, Singapore, Malaysia, Ireland, Costa Rica, and Mauritius (Bolnik 2004; James 2013; World Bank 2009). de Mooij and Ederveen (2003), examining the outcomes of 25 empirical studies on the impact of CIT rates on the allocation of FDI, found that on average a 1 per cent increase in a country's tax rate reduces FDI in that country by 3.3 per cent. Tax incentives appear to be effective in countries with a better overall investment climate such as good infrastructure, reasonable transport costs, and a policy framework favouring investment (Jun 2017). A 2013 study found that the boost in FDI from lowering effective tax rates is eight times stronger in countries with good investment climates (James 2013). A study of FDI in eight Central and Eastern European countries for the period 1995–2004 found that telecommunications and transport infrastructure together with taxes play a role in the location decisions made by multinational enterprises (MNEs) and the tax-rate sensitivity of FDI decreases with the level of infrastructure endowment (Bellak, Leibrecht and Damijan 2007).

However, other studies have suggested that tax policy has little to no impact on overall investment. A 2004 study of 14 Southern African Development Community member countries concluded that non-tax factors such as political stability, the macroeconomic policy environment, infrastructure development, the efficiency of the banking system and the legal and judicial framework are more important than tax incentives in determining the level and quality of investment flows (Bolnick 2004). A 2010 study of 12 CFA Franc Zone countries over the period 1994–2006 found no robust positive relationship between tax holidays and investment (Parys and James 2010). Another study examining the impact of CIT rates on FDI inflows to the gold and silver sectors of 16 African countries found 'no statistically significant impact of mining CIT rates on the host country's gold and silver FDI inflows' (Seydou and Abdramane 2021: 22). Success in using tax incentives to spur rapid development appears to be the exception rather than the rule.

Tax incentives involve direct costs like revenue loss and indirect costs like economic distortions and reduction in tax morale. A 2015 OECD report based on a sample of six African countries estimated that tax incentives reduce government revenues by 1–2 per cent of GDP (OECD 2015). The use of tax incentives to attract FDI may amount to a net transfer from taxpayers in a poor country to investors in a richer one. A lower tax rate in a sub-Saharan African country may be directly offset by a higher rate in the MNE's country of origin resulting in the transfer of revenue from sub-Saharan African countries to the richer home countries (Cleeve 2008; IMF 2015). Costs of incentives are often not measured or considered because tax incentives are generally not perceived by the public as expenditures though they have the same effect (James 2013). The 2018 World Bank report found that tax incentives in low-income countries often undergo less scrutiny than regular government spending and are often not even systematically measured or published (Andersen *et al*. 2018). Tax incentives may even have the reverse effect of discouraging investors because they signal the government's untrustworthiness in tax matters. A tax system that needs to offer temporary incentives to investors likely has some faults when applied fully. Generous tax holidays may be treated as signals of a corrupt or inefficient tax administration (Keen and Mansour 2009). Finally, extensive use of tax incentives is often perceived by ordinary

[4] Section 24 of the Finance Act, 2015 (Sierra Leone).

citizens as a politicisation of the taxation process and can result in tax resistance in the form of protests, avoidance and evasion (Moore *et al.* 2018). Tax incentives can contribute to the general erosion of the tax system through perceptions of unfairness by those who do not benefit from incentives (Wells and Allen 2001).

Tax incentives like tax holidays which are offered for relatively short periods of time such as five years or ten years are likely to attract investors in footloose industries which can easily be relocated (UN and CIAT 2018). These are industries such as light manufacturing goods and general services in which investors can quit one jurisdiction quickly for another. Such firms can enjoy a tax holiday in one country and move to another country willing to give a new holiday when the first one expires. Profit-based incentives such as tax holidays are more attractive to footloose investments that generate firm-specific rents (Zolt 2014).

Tax incentives contribute to what has been described as 'race to the bottom' among African countries which out-compete each other in offering more attractive tax incentives. A study examining the tax structure of 13 African countries between 1996 and 2007 found evidence of a partial race to the bottom (Abbas, Klemm, Bedi and Park 2012). A 2012 study of tax competition in East Africa (Kenya, Uganda, Tanzania, and Rwanda) found evidence of a race to the bottom with the region losing up to US$2.8 billion due to competition in offering lower tax incentives (Tax Justice Network-Africa 2012). In a perverse version of the 'prisoner's dilemma' game, where two non-cooperating prisoners make rational choices which result in a sub-optimal outcome for both, investors play one country against another in seeking generous incentives, causing the successful country to overplay its hand. For example, in 2000, Ramatex, a Malaysia-based textile manufacturer, negotiated with the governments of Botswana, Madagascar, Namibia and South Africa about where to set up its integrated garment complex, expected to create more than 10,000 jobs. Ramatex decided to invest in Namibia which offered, among other incentives, a 20-year tax holiday, while South Africa only offered a six-year tax holiday (Bolnick 2004; Flatters and Elago 2008).

Tax exemptions tend to encourage rent seeking by non-qualifying firms which may be incentivised to engage in corrupt practices to obtain tax incentives to remain competitive with exempt firms (Andersen *et al*. 2018). Investors may have to pay bribes to go through or expedite an approval process when tax holidays are discretionary (Klitgaard 1988). Further, tax holidays create opportunities for abuse and tax avoidance because exempt firms are usually not audited during a tax holiday. Tax avoidance mechanisms like shifting profits from audited and taxed enterprises to those which are exempt may be engaged in (UN and CIAT 2018). Revenue may be lost, and distortions created by businesses that do not qualify for tax exemptions falsifying information and incurring costs to qualify. For example, granting a tax holiday may be conditional upon an investor having a given number of employees, leading to hiring of people with minimal duties and at low wages (UN and CIAT 2018; James 2009). Further, firms may also seek to prolong the exemption period by reinventing themselves under a different name as the tax holiday period ends (Stausholm 2017).

Despite their known limitations, tax incentives persist for various reasons. Greater capital mobility and a decline in non-tax barriers have increased the significance of taxes as a factor in investment decisions (Zolt 2014). Further, some firms use tax holidays as a means of escaping the burden of dealing with corrupt or inefficient tax administrations (Keen and Mansour 2009). Studies of earlier tax exemptions in Uganda found that one of the reasons that firms pursued them was to avoid dealings with the revenue authority (Chen, Matovu and Reinikk 2001). Finally, and most importantly, policymakers act out of frustration and political calculation. Pragmatic alternatives to tax incentives may involve massive expenditure such as infrastructure development, the provision of grants or cash subsidies to investors (UN and CIAT 2018). However, policymakers have control over tax incentives and can enact them relatively easily and quickly. Moreover, while subsidies involving expenditure would undergo closer scrutiny, tax expenditure through incentives attracts less scrutiny (Holland and Vann 1998). Tax holidays are often attractive to governments because:

> …the potential benefits are very easy to understand, whereas the fiscal and economic costs are not. Policy decisions on tax incentives are often based on an analysis that exaggerates the likely benefits and seriously underestimates the probable costs. (Bolnick 2004: 62)

3 Tax holidays in Uganda

3.1 The era of statutory discretionary tax holidays

Tax incentives have historically been controlled by the Executive branch in Uganda. The Income Tax Decree of 1974 empowered the Minister of Finance to declare any class of income to be exempt.[5] Ministerial discretion in granting tax exemptions continued into the early 1990s. On a case-by-case basis, selected firms received six-year exemptions from CIT. As a government policy the thresholds to qualify for tax incentives were US$300,000 for foreign firms and US$50,000 for locals (UNCTAD 2000). Firms applied to the Minister of Finance who relied on a Tax Exemption Committee to guide him or her on whether or not the firm qualified (Parliament Hansard 1995).

This exemptions regime was criticised due to the absence of any link between the tax and potential value added or employment generated by the firms. The tax holiday also tended to favour firms with shorter lead times, as opposed to long-term investment (Bigsten and Kayizzi-Mugerwa 1999). The exemptions regime was also subject to considerable abuse with studies noting arbitrary procedures in granting tax exemptions (Reinikka and Svensson 1999). Due to the negative effect of special regimes on equity, tax administration efficiency, and lost tax revenues, attempts were made to curtail the extent of such exemptions beginning in 1993 (Gauthier and Reinikka 2001). Budget speeches from 1993 to 1996 included initiatives aimed at reducing the extent of tax exemptions (Gauthier and Reinikka 2001). For example, in his 1995 budget speech, the minister stated, 'We have since then carried out extensive studies of exemptions and have found that they constitute an unacceptably large source of revenue loss' (New Vision 1995).

One of the main drivers of this reform was considerable pressure from the IMF and World Bank, which pushed for reducing the tax exemptions as part of the implementation of the structural adjustment programme (Kwagala-Igaga 2016). Tax reform as part of broader structural adjustment included the restructuring of the URA to increase its effectiveness, the introduction of the value added tax (VAT), enactment of a new income tax statute, ending of export levies and ensuring greater dependence on VAT and direct taxes (Kwagala-Igaga 2016).

Discretionary statutory CIT holidays were finally discontinued in 1997, but those already granted could be retained until they expired.[6] Taxpayers who had been granted these discretionary exemptions continued to claim them for up to a decade after they had been abolished. Investor incentives were now to take the form of capital deductions and unlimited carry forward of losses found in statute and available to all taxpayers.[7] The 1997 IMF review of the structural adjustment programmes in Uganda noted that the government had committed that it 'will ensure that tax holidays are not reintroduced' (IMF 1997: 5).

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[5] Section 12 of the Income Tax Decree, 1974.
[6] Section 166(21)–(26) of the Income Tax Act Cap 340 (Uganda) [Hereinafter ITA].
[7] Sections 27–29 of the ITA.

3.2 Non-statutory discretionary tax holidays

3.2.1 The emergence of non-statutory discretionary tax holidays

Initially, the government resisted pressures for a return of investor tax holidays. This was emphasised by the Minister of Finance in his budget speech of 1999 where he stated, ‘While I am well aware of the pressures for income tax reliefs, the budget pressures are even greater and leave me with no room for action’ (Parliament Hansard 1999: 21). However, the government soon gave in to the pressure and resumed tax holidays. The earliest sign that the government’s commitment to resisting tax incentives had waned came during a judicial commission to investigate corruption in the URA in May 2002, when it was revealed that several large Ugandan Asian-owned companies were benefitting from a de facto non-statutory tax exemption. These firms owed more than 30 billion Ugandan Shillings (USh) (US$8 million) in unpaid taxes which had not been collected due to political interference in tax administration (Tangri and Mwenda 2013).

In January 2003, Apparels Tri-Star, a Sri Lankan garments company, entered into an agreement with the Government of Uganda to produce textiles for the US market. The agreement included a generous tax holiday (Budget Committee 2004). The government also entered into an agreement with BIDCO Oil Refineries Ltd on 4 April 2003, granting a 25-year tax holiday (Budget Committee 2017). In 2005 the President reportedly ordered the Ministry of Finance to waive taxes worth USh13.4 billion (US$3.5 million) owed by a prominent businessman and political ally, Hassan Basajjabalaba (Tangri and Mwenda 2013).

The revival of tax holidays can be explained by several factors. First it should be noted that statutory tax exemptions were only abandoned under pressure from development partners and as part of broader tax reform. The belief that tax exemptions were viable tools for attracting FDI remained. President Museveni defended the tax exemptions granted to Apparels Tri-Star as necessary to ensure the success of the investment (Natukunda 2006). Second, it is argued that tax holidays were used as an indirect means of financing presidential campaigns. Tangri and Mwenda (2013) note that the Asian firms benefitting from the de facto tax exemption had allegedly contributed funds to President Museveni’s presidential election campaigns in the 1996 and 2001 elections and were being rewarded with tax waivers by presidential fiat. A URA-sponsored investigation estimated that Basajjabalaba had inflated his tax claims for the purposes of the waiver by USH8.1 billion. Tangri and Mwenda infer that part of the money was used for financing election campaigning (Tangri and Mwenda 2013). Third, tax exemptions re-emerged because of the weak watchdog role played by the media and civil society at that time. There were very few media houses in Uganda in the early 2000s and press freedom was precarious. As a result, hard-hitting critiques of government policies and actions tended to be avoided (Okello 2003). Further, press coverage of issues like tax incentives that required relatively deep analysis remained tepid. A 2003 study of press coverage of Parliament in Uganda noted that ‘reporters hardly venture into in-depth analysis of debates, bills, motions and trends in the house’ (Okello 2003: 48). With regards to CSOs, there was virtually no civil society activity in the taxation space prior to the late 2000s (Kangave and Katusiimeh 2015). Without a vigilant press at its heels or a vibrant civil society to hold it to account, the government could rely on semantics such as the fact that it undertook to pay taxes on behalf of an investor rather than granting an outright exemption (Karugaba 2005). Finally, the particularly strong Executive under President Museveni was able to undermine Parliament, preventing it from fulfilling its oversight role. As one study analysing the role the Ugandan Parliament plays in the budget process noted, ‘Executive sometimes tends to regard Parliament as a merely advisory body whose recommendations can be brushed aside’ (Mushemeza 2015: 35).

However, development partners applied pressure to the government to require it to publicise the list of persons benefitting from this preferential treatment (IMF 2004). In 2004 the government committed to development partners that it would submit to Parliament a comprehensive list of companies that have benefitted from tax expenditures and subsidies on an annual basis (IMF 2005). Beginning in 2006, the Minister of Finance started accounting for payment of taxes on behalf of private companies with tax exemption clauses in their agreements with government in budget speeches. The minister would read out a block figure paid on behalf of private companies without listing the specific beneficiaries.

Table 1 Taxes paid by the Government of Uganda on behalf of investors

	Year	**Amount in UGX (USD) paid on behalf of investors**
1	2004/2005	18.65 billion (5 million)
2	2005/2006	19.2 billion (5.1 million)
3	2006/2007	25.7 billion (7 million)
4	2007/2008	15.1 billion (4 million)
5	2008/2009	16.7 billion (4.5 million)
6	2009/2010	18.5 billion (5 million)
7	2010/2011	11.6 billion (3 million)
8	2011/2012	8 billion (2.1 million)
9	2012/2013	11.6 billion (3 million)
10	2013/2014	13.8 billion (3.7 million)
11	2014/2015	14.19 billion (3.8 million)
Total		**173.04 billion (46.2 million)**

Source: Ugandan Budget Speeches 2005–2015 (CABRI 2023).

It should be noted that the amounts that the government was accounting for are amounts being paid in each year not the total sums owed for that year. The unpaid sums were carried forward as arrears. This became clear in 2019 when Parliament waived tax arrears owed by government as at 30 June 2019 and required the list of taxes waived to be published in the Gazette.[8] The Gazette was published on 13 March 2020 and again on 22 June 2022 and contained 26 private companies with a total of over USh687 billion (US$186 million) in payroll taxes, VAT, excise duties and import duties which the government had undertaken to pay on behalf of these companies.[9]

3.2.2 Shifting away from non-statutory discretionary tax holidays

A shift in the wind took place in the late 2000s when CSOs in Uganda begun to take an interest in tax policy, particularly tax incentives, and published a few studies highlighting the costs and questioning the benefits (Kangave and Katusiimeh 2015; ActionAid 2016; Tax Justice Network-Africa 2012; Oxfam 2015). Similarly, with growing press freedom, media houses begun to take a critical look at tax incentives and their beneficiaries (Karugaba 2014; Walusimbi 2014). Perhaps most crucially, development partners once again took a keen interest in the seemingly unregulated tax incentives and initiated calls for them to be rolled back (IMF 2014; IMF 2017b).

The upshot of this was that in 2017 the Budget Committee of Parliament for the first time declined to approve the government's commitment to pay USh47.7 billion (US$12.5 million) in taxes on behalf of private companies and recommended that the URA recover the money from the companies (Budget Committee 2017). Parliament considered that government

8 Sections 40A(1) and (2) of the Tax Procedures Code Act.
9 General Notice No. 287 of 2020 in The Uganda Gazette, 13 March 2020 and General Notice No. 742 of 2022 in the Uganda Gazette, 22 June 2022.

commitment to pay taxes on behalf of selected taxpayers was illegal and insisted that any tax holidays granted had to be found in statute and available to all investors. In 2018, five-year tax holidays for investors meeting set statutory criteria were introduced in the law and subsequently extended to become ten-year tax holidays.[10] However, the Finance Committee of Parliament rejected a proposed amendment allowing the government to pay taxes on behalf of investors arguing that:

> This will create unfairness to other taxpayers. Taxes like income tax are charged on the income of the person and should not be paid by Government. Government should desist from entering into agreements that exempt some taxpayers from paying tax while allowing others to pay.
> (Parliament Hansard 2018b: 38)

Nonetheless, in 2019 the Tax Procedures Code Act was amended, with the approval of the Finance Committee of Parliament, to allow the Minister of Finance to 'pay any tax due and payable by Government arising from a commitment made by Government to pay tax on behalf of a person'.[11] A few things may have contributed to this change of heart. One is a change in the composition of the committee which in 2019 replaced three non-ruling party members with those from the ruling party (Finance Committee 2019). Another was that the Minister of Finance framed the issue largely as one of counterpart funding whereby government bears the tax burden in the implementation of aid-funded projects. The fact that government could also undertake to pay taxes on behalf of private companies was de-emphasised (Parliament Hansard 2019). Finally, the debate in Parliament focused more on the fact that tax arrears owed by government were to be waived rather than the provision empowering the minister to enter into new agreements (Parliament Hansard 2019).

With the passing of this amendment the era of non-statutory discretionary tax holidays had ended. It was replaced with statutory tax holidays available to all investors meeting set statutory criteria. However, by giving the minister power to pay taxes on behalf of certain persons without laying out any guidelines on how these persons could be selected, statutory discretionary tax holidays had now been reintroduced. The tax holiday regime in Uganda had come full circle.

3.2.3 The legality of non-statutory discretionary tax holidays considered

The legal basis for non-statutory discretionary commitments by the government to pay taxes on behalf of private companies is murky. The government has rejected the characterisation of these commitments as tax holidays. In September 2005 the State Minister for Investment, while appearing before the Finance Committee of Parliament, stated that to attract more investors, the government had introduced tax holidays as an incentive. The Minister of Finance quickly came out and denied this, declaring that there is no law to grant any person exemptions as all discretionary exemption provisions in tax laws were abolished (Karugaba 2005).

This doublespeak was continued by the Minister of Finance who, in a speech to Parliament in April 2007, stated:

> I have not exercised the powers to waive or vary taxes because under the current tax laws there are no provisions granting discretionary powers to any person to waive taxes… However, for my ministry, it is a government policy that each line ministry is appropriated funds under its budget for purposes of paying taxes on goods and services procured by persons operating under their jurisdiction provided the activities

[10] Sections 21(1)(ae) and (af) of the ITA.
[11] Section 40A(1) of the Tax Procedures Code Act.

> involved are deemed to supplement social and economic programmes of Government.
> (Parliament Hansard 2007: 21)

The lack of distinction between a discretionary waiver of tax and a payment of tax by government was quickly pointed out by one MP who argued:

> Tax exemption means you are not paying tax. If a tax has been waived, you do not pay. If Government pays, does a taxpayer pay? No. So, there is no difference between Government paying and saying, 'You have been excused', because even the excuse you are talking about – what Government does, it writes a cheque to URA, URA credits its income and at the same time writes a cheque paying Government thereby making it zero and crediting it with zero balance. There is no tax paid. It is just a book entry.
> (Parliament Hansard 2007: 32)

In a 2017 interview, the Permanent Secretary of the Ministry of Finance asserted that the only tax incentives available to investors are those in the statutes (Ladu 2017).

The first publicly available official government document acknowledging payment of taxes on behalf of some taxpayers as a form of tax exemption was issued in October 2019. In its description of Uganda's tax structure in the *Domestic Revenue Mobilisation Strategy*, the Ministry of Finance included several statutory tax incentives and then added:

> Discretionary exemptions granted to individual companies, which essentially function as private contracts between government and a third party, as well as effective exemptions where government agrees to pay tax on behalf of a company.
> (MoFPED 2019: 66)

Significantly, this was only issued after the 2019 amendment of the Tax Procedures Code Act which introduced a provision explicitly allowing the Minister of Finance to do this. The doublespeak seems to have stemmed from the questionable legality of government paying taxes on behalf of investors premised solely on a contractual obligation. No legal justification was ever given for these commitments by the Minister of Finance in the various budget speeches in which they were mentioned. When the legality of such commitments was questioned in Parliament by different committees, no clear response was ever given.

The legality of these commitments to pay taxes was tested in a constitutional petition by two MPs in 2006. Following the revelations about the government's commitment to pay taxes on behalf of BIDCO, two MPs, Issa Kikungwe and John Ken Lukyamuzi, commenced a constitutional petition seeking a declaration that the agreement was unconstitutional.[12] The petition was dismissed in 2021 on legal technicalities such as the non-inclusion of BIDCO as a party although its rights would be affected, and the absence of adequate documentation relating to the transaction. The court considered that the agreement might violate tax laws but as no evidence had been led on this question, it was not determined by the court.

Nonetheless, it is possible to examine the legality of these agreements based on existing statutes and decided case law. Article 17(1)(g) of the Constitution creates the duty to pay taxes. Article 152(1) gives powers to Parliament to enact laws under which taxes are levied. The Supreme Court has stated that, '…the duty to pay taxes is sanctioned by the Constitution. Unless exempted, the obligation to pay income tax is mandatory.'[13] In the case

12 *Issa Kikungwe and John Ken Lukyamuzi v Attorney General* Constitutional Petition No. 30 of 2006 (Decided on 4 March 2021).

13 *Uganda Revenue Authority v Kajura* [2017] UGSC 63.

of *Heritage Oil & Gas Ltd v URA*,[14] the appellant entered into a petroleum production sharing agreement (PSA) with the Government of Uganda. The agreement contained a clause requiring disputes to be arbitrated in London. A dispute arose regarding tax assessments for capital gains tax. It was contended that the tax dispute was supposed to be arbitrated in London. The judge in the case, Hellen Obura, rejected this, noting that tax was a question of statute not negotiations between government and taxpayers. She stated:

> Taxation is a tool by which the sovereign state extracts finances or funds from its people and property to provide public revenue to support government expenditures and public expenses. It is the most reliable source of funds for most developing economies and therefore subjecting it to the whims and negotiation skills of contractors and government officials would create uncertainty and inequity on the amounts payable and cause economic instability.
> (Judgment in *Heritage Oil & Gas Ltd v URA*)

The court held that it could not have been the intention of government to agree that tax disputes would be referred to arbitration as any attempt to do so would be contrary to the laws of Uganda.

In *Spedag Interfreight Uganda Ltd and others v Attorney General and Great Lakes Port Ltd*[15] the petitioners were engaged in the business of clearing, forwarding, and handling import and export of goods. They were aggrieved by the Government of Uganda executing an agreement giving a ten-year monopoly to Great Lakes Port Ltd to handle importation and exportation of goods to and from ocean vessels in Mombasa, Kenya, the right to facilitate verification of goods and the right to undertake custom, excise and other formalities required by importers or exporters. The creation of this monopoly was found to be unconstitutional, violating the rights of other persons to carry out their occupations. It is arguable that agreements by the government to pay taxes for private companies similarly disadvantage other players who cannot access these incentives and that they are therefore unconstitutional.

Finally, following controversy and public debate over an agreement between the Government of Uganda and the Uganda Vinci Coffee Company Limited (UVCCL) which included a commitment by the government to pay taxes on the company's behalf, the Attorney General issued a statement explaining the legality of the agreement (Kiwanuka 2022). The Attorney General's statement relied entirely on the 2019 amendment to the Tax Procedures Code Act as the basis for the government's commitment (Kiwanuka 2022). This suggests that for the period prior to the 2019 amendment, there was no legal basis for government commitments to pay taxes on behalf of investors.

3.3 Parliament's oversight role

In fulfilling its constitutional role as a check to executive power, Parliament has interrogated and tried to limit and control the use of tax holidays. The extent of Parliamentary intervention has varied over the years and has included rubberstamping tax holidays, detailed interrogation of the circumstances under which certain investors accessed tax holidays, reducing the years of a statutory tax holiday and general calls for evaluation of the effectiveness of tax holidays.

[14] *Heritage Oil & Gas Ltd v Uganda Revenue Authority* High Court Civil Appeal No. 14 of 2011.
[15] *Spedag Interfreight Uganda Ltd and others v Attorney General and Great Lakes Port Ltd* Constitutional Petition No. 85 of 2011.

3.3.1 2001–2004: The period of acquiescence

Parliament first expressed concern about tax holidays in February 2003 when an ad hoc Parliamentary committee examining the sale of a government-owned commercial bank found tax exemption clauses in the agreements with consultants on the sale. The committee found that the consultants had been paid US$2.5 million which had been exempted from tax. The committee considered that this exemption was illegal and recommended that the central bank officials who had signed the contract be held accountable and that the URA follow up to ensure that the tax is collected (Parliament Hansard 2003a). Reverting to doublespeak, the Minister for Planning successfully defended the clauses, arguing that although they stated that the consultants were exempt from taxes, there was in fact no exemption as the government would pay the taxes on behalf of the consultants (Parliament Hansard 2003b).

Subsequently, in September 2004, in its report on the 2004 Finance Bill, the Budget Committee decried the growing use of tax exemptions, questioning their efficacy. The committee stated:

> …government continues to extend generous exemptions and tax holidays to foreign investors as an incentive to for foreign direct investment in Uganda. The committee was informed that contrary to the belief of government, tax exemptions *per se* are not incentives to investors. Genuine investors would want to pay taxes to facilitate government programmes…
> (Budget Committee 2004: 6)

In October 2004, the Finance Committee investigated an agreement between the Government of Uganda and Apparels Tri-Star (ATS) which included a tax holiday (Finance Committee 2004). In January 2003, ATS, a Sri Lankan company in Uganda, started producing textiles for export. The committee investigation revealed that ATS directors' income was not being taxed even though the tax holiday did not extend to their income (Finance Committee 2004). The committee also observed that the incentives available to ATS did not extend to other players in the same sector. Nonetheless, the committee recommended that the government continue to support ATS (Finance Committee 2004). Unfortunately, the company failed to take off and a Parliamentary Select Committee created to investigate its failure ended without a conclusion (*The East African* 2009).

Parliamentary acquiescence to tax holidays can be partially explained by a general belief in the value of preferential treatment of investors to attract FDI. There was enthusiasm at the opportunities for trade presented by the initiatives like the African Growth and Opportunity Act (AGOA) which companies like ATS were trying to take advantage of. The Budget Committee report, while acknowledging the shortcomings of the arrangement between the government and ATS, nonetheless cautioned that 'government should ensure that ATS does not collapse as this would affect the opportunities associated with AGOA' (Budget Committee 2004: 16). Further, the early 2000s were a period of strong influence of the Executive branch over Parliament, especially on matters of investment. A study of the seventh Parliament (2001–2006) noted that the Executive branch held considerable sway, undermining its oversight role to the extent that 'their decisions were influenced by the Executive who strongly wanted investments at whatever cost' (Bainomugisha and Mushemeza 2006: 30). The Parliamentary committees were therefore not inclined to take a strong stance against the actions of the Executive.

3.3.2 2005: Interrogation of the BIDCO Agreement

The next time tax holidays came under Parliamentary scrutiny was in 2005. This involved the review of a contract between the government and BIDCO, a company which had won a tender to run a palm oil project and would be investing US$100 million. In August 2005, the

Finance Committee reviewed the agreement and noted that it contained a 25-year tax holiday, contravening the government policy which had abolished tax holidays (Finance Committee 2005). The committee gave short shrift to the government's doublespeak, observing that:

> The explanation that the Government is not waiving tax but paying from the consolidated fund for the taxes is tantamount to tax exemption and therefore is illegal because the net effect is the same. This is aggravated by the fact that the taxes are to be paid by Government for a period of 25 years.
> (Finance Committee 2005: 6)

The committee also noted that a government commitment to make payments from the consolidated fund implied that Parliament would automatically approve the payments, and that if it refused, this would amount to a breach of contract by the government (Finance Committee 2005).

The committee further observed that firms in the same sector would not receive the same incentives and would therefore be disadvantaged. The government defence that any investor making an investment worth US$100 million would also be granted similar incentives was not convincing as few investors, whether local or foreign, could raise that level of funding, and therefore BIDCO had been made a de facto monopoly (Finance Committee 2005). The Finance Committee argued that the agreement contravened Article 21(1) of the Constitution which prohibits discrimination. The committee stated that government undertaking to pay taxes on behalf of BIDCO amounted to discrimination because it gave BIDCO an upper hand against other existing firms and would push them out of business (Finance Committee 2005).

The Finance Committee recommended that the government revisit the agreement and remove the 25-year tax holiday. The committee also recommended that the government treat other players in the sector equally, especially with regards to taxes to create competition and prevent the rise of an outright monopoly (Finance Committee 2005). The committee also referenced the Tri-Star debacle and the absence of any cost/benefit analysis in granting tax holidays, stating:

> The question that keeps arising is how does government facilitate investors. Unfortunately, just like Tri-Star, there is a tendency to totally cushion investors without quantifying what government is doing and identifying the returns due from the investor to numerically determine their worth.
> (Finance Committee 2005: 19)

In a statement attached to the Finance Committee's report, the Legislative Counsel to the committee questioned the legality of the tax holiday in the government's agreement with BIDCO. The Legislative Counsel emphasised that under Article 152 of the Constitution, only a person with explicit statutory powers to waive taxes could do so, and yet there is no provision for waiver of taxes in any law (Finance Committee 2005). In another report to Parliament in August 2005, the Finance Committee observed that:

> The scrapping of tax holiday to investors was done by the Act of Parliament and therefore should be restored only by another Act of Parliament. Government should not breach the law by reintroducing tax holidays without involving Parliament… when we were interacting with the minister on this policy statement, he informed us that they had actually reintroduced tax holidays and we wondered about that. Therefore, we wanted to put it on record that if they did so it was illegal.
> (Parliament Hansard 2005: 75)

The tone in Parliament had significantly changed. One of the likely contributing factors was the apparent emergence of a major crack in the Executive's edifice. In July 2005, the country had held a referendum on whether or not to adopt multiparty politics and over 90 per cent had voted in favour of the multiparty system (Meldrum 2005). The perception of a relatively weakened Executive might have emboldened Parliament to take a stronger stance on the issue of tax holidays. Further, the entire budget process was coming under greater scrutiny, with Parliament beginning to take greater ownership of the budget process which hitherto had been left largely to the Executive (Loozekoot 2021).

While stronger recommendations were being made, Parliament still did not take any direct action against the tax holidays. Despite the Parliament report calling for review of the agreement, the BIDCO Agreement was not reviewed or terminated. Indeed, tax holidays were not raised again as a serious issue throughout the eighth Parliament (2006–2011). The few times that they did arise, simple explanations by the Executive, such as the fact that a particular exemption had cabinet approval, sufficed (Karugaba 2009). As one study of the budget process observed of this period, party discipline was being enforced because of the new multiparty system and the ruling party, with a 67 per cent majority in Parliament, was able to limit scrutiny of tax holidays (Loozekoot 2021).

3.3.3 2011–2016: Renewed interrogation of tax holidays

A deeper interest in tax holidays was rekindled in the ninth Parliament (2011–2016). This Parliament had a higher number of young members, including ruling party members, who were willing to stand up to the Executive on budget matters. A study of Parliament involvement in budget matters noted that following the 2011 elections, 'Young vibrant MPs from the ruling party… were new, more autonomous and willing to challenge the executive' (Loozekoot 2021: 258).

In 2012, following a petition from Sembule Steel Mills Ltd seeking a tax holiday on the grounds that its main competitor, Steel and Tube, was enjoying one, the Finance Committee sought to rescind all existing tax holidays (Walubiri 2012). The Secretary to the Treasury warned against such a move, arguing that tax holidays were part of the government's contractual obligation with different companies and that their termination or review could result in costly litigation for the government. He further argued that even other regional countries like Rwanda and Kenya have tax holidays (Walubiri 2012).

In 2013 the Finance Committee expressed concern that ministries, other than the Ministry of Finance, were entering into agreements with private companies which provided for tax waivers. The committee considered this to be 'very irregular as this mandate is entrusted to the minister responsible for finance' (Finance Committee 2013: 8). The committee recommended that tax exemptions be streamlined to minimise revenue loss and that the Ministry of Finance review the performance of existing exemptions and present a report to Parliament in December 2013. However, the Parliament Hansard of December 2013 contains no mention of this report ever being presented.

In a 2014 report to Parliament, the Finance Committee stated that the minimal growth in tax-to-GDP ratio from 12.3 in FY 2011/2012 to 12.9 in FY 2012/2013 was '…largely attributed to numerous tax exemptions and waivers granted to NGOs and selected private companies by the Minister of Finance…' (Parliament Hansard 2014: 33).

The Finance Committee observed that:

> …tax exemptions and waivers affect domestic revenue, create unfair competition between companies and shift the tax burden to few citizens… [and] …issuance of tax

> exemptions and waivers worsen the already narrowed tax base and do not provide a level ground for competition in Uganda's liberalized economy.
> (Parliament Hansard 2014: 34)

The Finance Committee therefore recommended:

> …that government scraps tax exemptions to minimize revenue loss. The committee further recommends that the Ministry of Finance, Planning and Economic Development reviews the performance of the existing tax exemptions and waivers and explores the possibility of scrapping all unproductive tax exemptions.
> (Parliament Hansard 2014: 34)

No action, however, appears to have resulted from this report.

In May 2015 the Budget Committee of Parliament, in its report on the *National Budget Framework Paper for FY 2015/16–FY 2019/2020*, committed to drafting guidelines on the criteria to be followed in granting discretionary tax incentives to private sector companies. The guidelines were to be submitted for approval to the full house of Parliament (Budget Committee 2015). The guidelines were never developed.

In September 2015 the Finance Committee examined the government budget proposal allocations for the year 2015/2016 which included payment of taxes on behalf of some private companies, including BIDCO, totalling UShX19.869 billion (US$5.2 million) (PBO 2015). The committee recommended that all these proposed budget allocations be reallocated to other priority interventions. Regarding BIDCO, the committee recommended that Parliament decline to pass BIDCO's tax expenditures in future and that the government review its contractual obligations with the company (PBO 2015). This recommendation, however, was not acted on.

3.3.4 2017 to date: Parliament begins to act

The period since 2017 has seen a rise in media coverage of tax holidays and a concerted effort by CSOs, under the umbrella organisation Tax Justice Alliance, to drum up support to put an end to tax exemptions (SEATINI 2019). Over time, synergies have been built between CSOs and MPs involved in budgeting which has created greater impetus for the scrutiny of tax holidays (Loozekoot 2021).

In 2017 the government proposed to exempt the income of the Bujagali Hydro Power Project up to 30 June 2033 by amending the Income Tax Act (ITA). The Finance Committee which considered the Bill approved this proposal. Nonetheless, the proposal came under assault on the floor of Parliament with one member declaring 'Madam Speaker, the other issue of Bujagali being given a duration of 15 years tax exemption is a killer, in my view' (Parliament Hansard 2017: 36). The MP recommended that the exemption be granted as renewable every two years. In agreeing with him, another MP declared:

> On Bujagali, I do not know what has excited the committee to give a 15-year tax waiver. We are burning our fingers… Honestly speaking, we are saying this in good faith. We are not saying Bujagali should not be given a tax waiver but let us have it renewable.
> (Parliament Hansard 2017: 43)

The Bill was eventually amended to grant only a five-year tax holiday to Bujagali, which could be renewed afterwards.[16]

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[16] Section 21(1) (ac) of the ITA.

In early 2017 the Minister of Energy stunned a Parliament committee when she revealed that she had signed an agreement with a company waiving any capital gains tax, resulting in non-payment of taxes worth US$157 million (Daily Monitor 2017). This sparked greater interest in the tax holidays granted by the government. The Budget Committee examined the basis of government paying taxes on behalf of five private companies (Budget Committee 2017). They found that while there was an elaborate agreement for BIDCO, other companies had letters of commitment and at least one had no supporting documents, but the government claimed to have made a commitment to pay CIT on its behalf (Budget Committee 2017). The committee declined to approve the government's commitment to pay taxes on these companies' behalf amounting to USh47.7 billion (US$12.9 million) and recommended that the URA recover the money from the companies (Budget Committee 2017). CSOs ensured wider exposure and debate around these revelations and called for an end to tax exemptions (Ladu 2017).

Following Parliament's refusal to pass the budget paying taxes on behalf of these companies, in 2018 the government attempted to have all taxes owing from such commitments, purportedly amounting to USh132 billion (US$35.7 million), waived by an amendment to the Tax Procedures Code Act. Parliament rejected the proposal to waive the taxes, with one MP declaring, 'It does not make any sense to hear that government is getting from its coffers to pay taxes for a company that has made a profit; it makes no sense at all' (Parliament Hansard 2018b: 39). Another MP was sceptical about the reasoning behind these exemptions, stating:

> I question the wisdom behind these exemptions. These investors are supposed to be rich people who come to invest in the country. By the way, they get the money cheaply from their foreign banks, they come here to invest and we start exempting them. I think it does not benefit this country, which is trying to develop. We are simply emaciating our country and I do not agree with this. There is no wisdom behind these exemptions.
> (Parliament Hansard 2018b: 43)

Similarly, another MP argued against the discriminatory nature of these exemptions, stating:

> I also object to the selective exemptions because it is unfair. Most times, it is the foreign companies which are exempted yet our local companies, which should be nurtured, are being stifled. We do not see the essence in these selective exemptions.
> (Parliament Hansard 2018b: 43)

Another MP noted that in 2017 the Budget Committee had asked the Minister of Finance to submit before the house the criteria that he used to select certain companies to be exempt from CIT, but he had never done so (Parliament Hansard 2018b). The government committed to having all future tax holidays laid out in statute and the strategic investor tax holidays were then introduced into the tax laws. The State Minister for Investment and Privatization committed that, 'For the avoidance of doubt, any tax incentives or other incentives or benefits that will be granted to investors shall be as prescribed by or under the relevant Acts of Parliament' (Parliament Hansard 2018a: 21). This was subsequently done with the statutory holidays discussed above.

In April 2021, while agreeing to the government proposal extending the number of sectors that can benefit from statutory tax holidays, the Finance Committee recommended that the government study tax exemptions to establish criteria by which companies will be considered to qualify for tax exemptions. Parliament resolved to re-examine the criteria of tax holidays in September 2021 and said that the debate would guide the next budget cycle (Parliament Hansard 2021). The matter did not arise again in 2021.

In January 2022 the Finance Committee demanded that a list of companies benefitting from tax holidays be submitted for review. The Minister of Finance committed to carrying out an analysis of tax exemptions in Uganda and terminating those that were unnecessary (Wadero 2022). Subsequently, in May 2022, on recommendation from the Finance Committee, Parliament rejected a proposal to amend the law to exempt from CIT manufacturers across all sectors investing at least US$50 million. Parliament asserted that no further tax exemptions would be approved until a study had been done to prove that they were beneficial. In rejecting the exemption, one MP passionately pleaded with the Minister of Finance, declaring:

> We are trying to help government. There are studies that are on record that show that the cost of exemption is bleeding our budget. For goodness' sake, overnment should put a stop on exemptions. Do a study – it is actually part of your domestic revenue mobilisation strategy. Let us analyse the cost benefit of these exemptions. It will help us unlock the tax revenue that we need. Otherwise, we are going to have a problem financing our budget.
> (Parliament Hansard 2022: 47)

Parliament also noted that the Finance Committee's request for the list of beneficiaries of tax exemptions had still not been honoured by the Ministry of Finance (Parliament Hansard 2022).

In April 2022 the agreement between UVCCL and the government was published. The Trade Committee investigated the agreement and concluded that it was illegal, and that the Minister of Finance exceeded his mandate when he granted tax waivers (Trade Committee 2022). The Attorney General wrote a response defending the agreement basing on the Tax Procedures Code Act provision allowing the Minister of Finance to pay tax on behalf of any person (Kiwanuka 2022). In May 2022 Parliament demanded that the agreement be terminated and passed a motion urging government to develop a comprehensive taxation policy which would include a policy on tax incentives for investors (Parliament 2022a).

In August 2022 the Ministry of Finance committed to Parliament that it would review the tax incentives to terminate those which are not relevant to the economic environment (Karugaba 2022). In December 2022, Parliament's Public Accounts Committee questioned the selective granting of tax exemptions to businesses and tasked the Ministry of Finance with presenting a list of local and foreign investors who have benefitted from tax exemptions in the last three years (Parliament 2022b).

3.4 The current statutory tax holidays

The first statutory tax holiday in the ITA was introduced in 2008. Section 21(1)(y) of the ITA exempts for ten years a person's income which is derived from the exportation of finished consumer and capital goods.[17] The exemption is accessed by application to the URA Commissioner – Domestic Taxes. This tax incentive is generally in line with the regional practice of incentivising exportation of finished goods (UN and CIAT 2018).

In 2018, following the resolution of Parliament that tax holidays and the criteria for qualifying for them be made statutory, Section 21(1)(ae) of the ITA was introduced exempting the income of a developer of an industrial park or free zone derived from leasing facilities. The provision was introduced in 2018 as a five-year tax exemption where the investment was at least US$100 million.[18] In 2019 it was amended to increase the period of exemption to ten

17 Section 4 of the Income Tax (Amendment) Act, (No 1) 2008.
18 Section 21(1)(ae) of the ITA.

years and to reduce the threshold to US$50 million for foreigners and introduce a new threshold of US$10 million for citizens.[19] There is no statutory application procedure to access this incentive under the law. However, in practice, developers seeking to benefit from this incentive usually write to the URA to confirm that they qualify. The URA responds with a letter purporting to grant this tax holiday. According to respondents, five companies had benefitted from this tax holiday by December 2022.

Section 21(1)(af) of the ITA provides for a ten-year tax holiday for any person carrying on one of the listed businesses whose investment capital is at least US410 million, in the case of a foreigner, or US$300,000, in the case of a citizen, and US$150,000 for a citizen investing upcountry.[20] The provision was introduced in 2018 with a five-year tax holiday, open to any sector and a US$15 million threshold, in the case of a foreigner, or US$5 million in the case of a Ugandan citizen.[21] In 2019 this provision was amended to reduce the threshold for foreigners to US$10 million and for citizens to US$1 million, increase the tax holiday to ten years, and include a list of sectors that the investor should be involved in to benefit from the exemption.[22] The 2019 amendment also extended this incentive to existing businesses which make an additional investment of the threshold amount after July 2019.[23] In 2020 the provision was again amended to remove some ambiguities in the wording that had led to its limited application and clarify how the exempt income for existing businesses would be apportioned against taxable income from the non-exempt investment. The 2020 amendment also added more businesses to the list of strategic investments and reduced the investment threshold for citizens to US$300,000 if the investment is in an urban area and US$150,000 if the investment is upcountry.[24] The statute does not provide for any application procedure. However, in practice, investors apply to the URA to confirm that they qualify for the tax holiday and the URA responds with a letter that purports to grant the exemption. According to respondents, 79 companies had benefited from this incentive by December 2022.

Section 40A of the Tax Procedures Code Act was introduced in 2019 and provides that the Minister of Finance can undertake to pay taxes on behalf of any person. This is a discretionary statutory tax holiday with no time limit, or any conditions attached. Despite repeated requests by various Parliament committees, the Ministry of Finance has not submitted a comprehensive list of investors benefitting from this provision. However, as already observed, in 2019 when the government gazetted the list of arrears owed from commitments to pay, there were 26 private companies benefitting. According to respondents, this incentive is accessed by writing to the Minister of Finance. Typically, an investor making a substantial investment (usually more than US$50 million) in a sector not listed under section 21(1)(af) of the Income Tax Act, or seeking better terms than those provided for under statute, will write to the Minister of Finance or the President. This request is transmitted to the Tax Policy Department at the Ministry of Finance which considers the merits of the application and may then submit it to the minister for approval. When approved, the exemption may take the form of an elaborate agreement between the government and the investor stipulating conditions to be met and the period during which the government shall pay taxes on their behalf (typically ten years). Alternatively, it may simply be a letter from the minister committing to pay taxes on behalf of the investor for a period. Respondents did not have clear data on the number of beneficiaries. However, the December 2019 Auditor General's report stated that the Ministry of Finance had committed to settling taxes for 67 companies (OAG 2019).

[19] Section 21(1)(ae) of the ITA.
[20] Section 21(1)(af) of the ITA.
[21] Section 2 of the Income Tax (Amendment) Act, 2018.
[22] Schedule 2 of the Investment Code Act, 2019.
[23] Section 3 of the Income Tax (Amendment) Act, 2019.
[24] Section 2 of the Income Tax (Amendment) Act, 2020.

The legality of arrangements made under Section 40A of the Tax Procedures Code Act was put to the test in a recent case involving UVCCL. In 2015 UVCCL, which was investing US$80 million, entered into an agreement with the government to develop a coffee processing facility. In February 2022 the government and UVCCL entered into a deed of restatement and amendment of the agreement with clauses including a ten-year tax holiday and a commitment from the government to pay VAT and payroll taxes on behalf of the company. The subsequent publication of this agreement resulted in a public furore and two people sued the government questioning its legality. The court declined to pronounce itself on the grounds that a Parliamentary committee was investigating the matter and that the court should therefore not interfere.[25]

4 Analysis of tax holidays in Uganda

4.1 Tax holidays have remained generally discretionary

In the 1990s the statutory tax holidays were explicitly discretionary. In the 2000s there were discretionary non-statutory tax holidays. Some statutory tax holidays are now supposedly automatic but, due to the overly broad language in which they are couched, the taxpayers are forced to apply to URA making them discretionary. There is also an explicit discretionary tax holiday with the law allowing the Minister of Finance to pay taxes on behalf of any person.

The challenge with discretionary tax holidays is that they create room for corruption and rent seeking. Respondents explained that in the absence of a clear objective criteria for granting exemptions, officials with the power to grant exemptions may take advantage of this and engage in corruption. Further, even when the discretion is exercised in good faith, it is likely influenced more by political than by economic considerations.

Further, the contradiction between the law, which purports to create automatic tax holidays for strategic investments, and the practice, where these tax holidays can only be accessed by application, is very problematic. The result, according to respondents, is that taxpayers who use law firms and audit firms that have strong relationships with the URA can access these tax holidays while other equally deserving taxpayers may not even be aware of this facility. This creates distortions and will likely lead to results contrary to the government's intentions.

4.2 The statutory tax holidays are ambiguous

There is ambiguity in the ITA's strategic investor tax holiday. For example, the provision is unduly lengthy, gratuitously referring to industrial parks and free zones, yet the incentive applies everywhere.[26] It is also not entirely clear what amounts to an 'investment' for the purposes of determining the threshold. Further, the treatment of losses during the exemption period is not clarified. Perhaps most alarming of all is that although it is touted as a ten-year tax holiday, this is not borne out by the statutory language which in fact suggests an indefinite tax holiday with the investor seeking to benefit required to make the investment over a period of ten years.[27]

Previous statutory tax holidays in the 1990s contained ambiguities which resulted in litigation. For example, in *Total Uganda Ltd v URA*[28] the statute was unclear whether the tax holiday

[25] *Byansi Henry and Aboneka Michael v Attorney General & UVCCL* HCMC No. 80 of 2022.
[26] Section 21(1)(af) of the ITA.
[27] Section 21(1)(af) of the ITA.
[28] *Total Uganda Ltd v URA* [2001] UGCommC 5.

applied to the income from the investment (CIT) or to the income earned by the investor (dividend income). The court held that the tax holiday could only apply to the income of the investor and not to CIT. Another example of ambiguity is in *Meera Investments Ltd v URA*[29] where it was unclear whether the tax holiday applied to existing investment at the time it was granted or to subsequent investment made after it was granted. The case was settled out of court in favour of Meera following a presidential directive to the URA not to recover tax arrears and to back off any further probe into the company's affairs (Tangri and Mwenda 2013; *The East African* 2012).

4.3 The statutory tax holidays are frequently amended

The statutory tax holidays have been subject to frequent amendment. A tax holiday for agro-processors was subject to various amendments, each narrowing its application, before it was finally repealed. The strategic investor incentives have been amended every year since they were introduced in 2018. As was observed by UNCTAD, tax incentives ought to be '…expressed as precisely as possible so as to avoid the need for frequent corrections or changes. It is believed that frequent changes could contribute to the perception that the tax system is complex and difficult to comply with' (UNCTAD 2000: 23).

The challenge of frequent amendments was highlighted in the case of *Kinyara Sugar Ltd v URA*[30] where Kinyara sought a tax holiday for income derived from new plant and machinery which expanded production capacity but did not constitute a full independent production line. The URA rejected Kinyara's application on the grounds that it was not eligible under an amendment to the law which restricted the exemption to new investors. The court held that Kinyara could benefit because the law applicable at the time it made the investment did not restrict the tax holiday to new investments.

4.4 There is little to no transparency in granting tax holidays

In 2012 it was reported that several tax exemptions had been awarded by MoFPED to various companies at the behest of well-connected politicians and businesspersons without following the established procedures (*The East African* 2012). The IMF has noted that many tax exemptions in Uganda are not reported (IMF 2017a). The Ministry of Finance has observed that 'A major challenge in the administration of tax exemptions and incentives in Uganda is the opacity in their governance' (MoFPED 2019: 68). The December 2021 Auditor General's report to Parliament observed that:

> …there is no clear policy guideline for the issuance, management, and monitoring of the different tax benefits and incentives issued by the government to different individuals. The absence of a clear mechanism and framework exposes the scheme to mismanagement and abuse.
> (OAG 2021: 17)

Despite multiple demands by various Parliamentary committees and by the full house of Parliament over the last decade, the government has never shared a comprehensive list of investors benefitting from tax holidays.

The effect of the absence of transparency is that the tax holidays are poorly tracked by the government. In 2008 it was reported that the Minister of Finance through a letter had granted a tax waiver to the Kampala Hilton Hotel in preparation for the Commonwealth Heads of Government Meeting to be hosted in Uganda (Ahimbisibwe 2008). However, it was subsequently revealed through the Auditor General's Report in 2014 that these exemptions

[29] *Meera Investments Ltd v URA* [2007] UGCommC 2.
[30] *Kinyara Sugar Ltd v URA* HCCS 73 of 2011.

had continued to be renewed up to 2012, in violation of the Ministry of Finance’s own publicly stated position (Nakatudde 2014). In 2021 the Auditor General found that an investor had been issued with a letter from the Minister of Finance and an agreement signed by the same minister with conflicting tax holiday terms (OAG 2021).

The lack of transparency has made it very difficult to estimate the revenue foregone or carry out a cost/benefit analysis of these incentives. Several studies have been done on tax exemptions in Uganda attempting to estimate the revenue foregone (ActionAid 2016; SEATINI 2019; AfDB 2010). Though these studies contribute to understanding the potential costs of tax holidays to Uganda, they focus on tax expenditure in general, some of which may be non-controversial, without isolating investor tax holidays.

A 2017 IMF fiscal transparency evaluation report on Uganda found that reports on tax exemptions published by MoFPED and the URA cover only a small proportion of total estimated tax expenditures (IMF 2017a). Beginning in 2019, a concerted effort has been made to create and publish a comprehensive tax expenditure report annually. However, the reports consistently lack any data on the ten-year tax holiday for investment in strategic sectors or on tax holidays as result of government commitments to pay taxes (MoFPED 2022).

4.5 The tax holidays are discriminatory

The tax holidays have consistently been applied in a manner that is discriminatory, favouring some players in a sector over others. For example, while BIDCO was given a generous 25-year tax holiday, it was revealed that another company was also planning to invest US$20 million in the same sector without any support from the government (New Vision 2004). In 2012 a company called Sembule Steel Mills petitioned Parliament claiming that it could not survive in a competitive market where its direct competitors had tax holidays which it did not have (Walubiri 2012). In 2014 Sembule was closed, and its assets sold off to pay debts (Daily Monitor 2014). The President has reportedly intervened to award tax exemptions to various favoured businesses over the years (Tangri and Mwenda 2013). This discriminatory application of tax holidays, which appears to be contingent on political rather than economic considerations, undermines the effectiveness of the tax holidays.

5 Recommendations

5.1 Eliminate tax holidays

The ideal approach is to eliminate tax holidays and focus on non-tax incentives for investors. In the 1970s and early 1980s, Indonesia offered foreign investors tax holidays. In a dramatic turnaround in 1984, it eliminated them. There was no noticeable impact on investment (Wells and Allen 2001). The immediate results of the elimination of tax holidays in Uganda in 1997 were quite positive. A 2008 OECD analysis of tax incentives around the world lauded Uganda’s elimination of tax holidays in 1997, observing that:

> The main effects of this tax reform were (comparing averages of three years before and after 1997): an increase of one percentage point in the ratio of investment to GDP, 70 per cent increase in foreign investment inflows, and a one per cent of GDP increase in tax revenue.
> (OECD 2008: 235)

In lieu of tax holidays, the government should focus on the improvement of infrastructure and public services in a country. Studies have shown that one dollar spent directly on infrastructure or services is more productive than one dollar spent on tax concessions (World Bank 2009).

However, as evidenced by the rise of non-statutory tax holidays in the early 2000s, total elimination of tax holidays seems an unlikely prospect. If this were to be attempted again, vigilant scrutiny by Parliament, CSOs and the media would be necessary to ensure that non-statutory discretionary incentives are not reintroduced.

5.2 Statutory non-discretionary incentives

If it is accepted that tax incentives must exist, they ought to be statutory non-discretionary tax incentives. All tax holidays should be granted transparently, through legislation. Discretionary tax holidays such as the minister's power to pay taxes on behalf of any person must be repealed or guidelines set for when they can be applied. Doing so ensures that incentives are granted according to uniform, predetermined criteria available to the public. Some respondents suggested that tax holidays are deliberately crafted as discretionary because the conditions that must be met by investors, such as import substitution, number of employees and use of local raw materials, are complicated to ascertain. Therefore, to limit abuse, some discretion must be given to the Commissioner. Others suggested that it was deliberately done in order to create a loophole for rent seeking by bureaucrats in the approval process.

Current administrative discretion in granting strategic investor incentives can be reduced by redrafting the law to clearly define the criteria under which these incentives can be accessed. The triggering mechanism for accessing the tax holiday should be rendered as automatic as possible. For example, the tax holiday could be accessible by filing a tax return which shows that the statutory criteria have been met. If, however, the conditions to be met cannot be simplified enough to be automatic, then an unambiguous application process should be put in statute or regulations.

5.3 Tax holidays must be transparent

Tax holidays should be established through an appropriate, evidence-based tax expenditure governance framework to improve transparency. Incentives require adequate monitoring and control mechanisms. The tax administration should check that investors receiving tax incentives satisfy the requirements for them. As has been observed by UNCTAD:

> More often than not, follow-up of the firms benefiting from the incentives is neglected. If investors are required to fulfil certain conditions as part of granting incentives, such as import of certain types of machinery, creation of jobs or completion of the project within a certain time frame, it is imperative that following the grant of incentives monitoring of the investment project be undertaken.
> (UNCTAD 2000: 25)

If the provision of the law allowing government to pay taxes on behalf of investors is maintained, then it should be amended to require that beneficiaries be published annually in the Gazette together with the amounts required to be paid by government. This approach will make such information easier to track and might give government bureaucrats pause before they commit to pay taxes on behalf of investors. In 2012 it was reported that a popular view, even within MoFPED circles, was that the list of beneficiaries of tax holidays should be published (*The East African* 2012). As noted above, various Parliamentary committees have called for publication of beneficiaries of the tax incentives.

Significantly, although the government begun publishing a tax expenditure report in 2021, tax incentives are not adequately covered in the report. For example, the two published reports do not make any mention of revenue foregone as a result of government commitment to pay taxes on behalf of investors (MoFPED 2021; MoFPED 2022). Further, the reports state that there is no data available to compute the revenue foregone from statutory exemptions under Sections 21(1)(ae) and (af) of the ITA (MoFPED 2022). Tax incentives ought to be properly tracked so that the amount of revenue foregone can be computed to determine their effectiveness in achieving desired goals.

5.4 Adopt cost-based tax incentives

Tax incentives that lower the cost of investment are often to be preferred over profit-based tax incentives like tax holidays. Profit-based incentives are generally less effective in encouraging investment compared to incentives that reduce the capital cost if profitability is low (IMF 2015). Cost-based tax incentives involve specific allowances linked to investment expenses, such as accelerated depreciation schemes and special tax deductions and credits. They are targeted at lowering the cost of capital (IMF 2015). The magnitude of the benefit to the company is independent of a firm's profit level and instead depends on the size of the investment that is undertaken. Such instruments are also less prone to abuse through profit shifting, and their magnitude is directly linked to the policy outcome on which they are conditioned (Andersen *et al*. 2018). Investment allowances and credits may lead to less loss in tax revenue because, unlike tax holidays, taxes on other firm assets remain and they are directly contingent on new investment. Their implementation can easily be transparent and automatic. Further, with investment allowances and credits, the revenue cost incurred is directly related to the amount of the investment, and their maximum cost is more easily estimated (Zolt 2014). Analysis of the marginal effective tax rate of Ugandan firms under tax holidays and under investment allowances after 1997 indicated that profitable firms that invest heavily in machinery clearly benefitted from this policy change (Chen *et al*. 2001).

5.5 Use of reduced or preferential tax rates

Lowering the statutory tax rate is the least distortionary form of investment incentive. A low standard rate applies uniformly to all profitable business activities without biasing the allocation of capital, the choice of production technology, or the form of financing. The use of tax holidays, as opposed to a reduced tax rate, discriminates against investment in the future when the tax holiday is over. A reduced tax rate applies to income generated by investments made over the life of the investment project. A tax holiday, on the other hand, only applies to income generated over the tax holiday period. Hence a reduced tax rate tends to encourage investment over time to maintain capital equipment and to increase production capacity, compared with a tax holiday which discriminates against sequential investment (UNCTAD 2000).

A low standard rate is automatic and transparent and reduces the incentives for abusive tax planning. Lowering the tax rate can be very effective. For example, the Government of Indonesia found that cutting the tax rate from 45 per cent to 35 per cent was just as attractive to investors as the complex system of incentives previously in place (Bolnick 2004). Preferential tax rates can be made to apply to designated sectors, such as manufacturing or agriculture, or to selected beneficiaries, based on discretionary screening criteria. In Ghana the general CIT rate is 25 per cent. However, businesses in certain sectors are subject to a CIT rate of 1 per cent for varying periods.[31]

[31] First Schedule and Sixth Schedule to the Income Tax Act, 2015 (Ghana).

5.6 Regional collaboration

Collaboration through the East African Community (EAC) in limiting the race to the bottom is necessary. The EAC comprises the Democratic Republic of the Congo, Tanzania, Kenya, Burundi, Rwanda, South Sudan, and Uganda. The avoidance of tax competition is a useful goal at the regional level because it improves outcomes for all the governments involved. There is a need to achieve a degree of harmonisation and coordination regarding tax incentives (IMF 2017b). While some effort has been made at creating a harmonised tax regime, a great deal more effort is still needed to extend the harmonisation to tax incentives.

5.7 Vigilant monitoring by Parliament, civil society and the press

Finally, CSOs and the press will have to play their watchdog role vigilantly. As seen from the doublespeak that persisted until 2019, it is possible for tax holidays to persist and even be presented in Parliament while the government denies their existence. Constant interrogation of government policies will therefore be necessary. CSOs will need to continue to carry out studies analysing the impact of tax incentives and the press will need to publicise tax incentives giving proper context so that the public can understand them and hold the government accountable. Parliament will also need to play a vigilant oversight role which will have to go beyond simply making recommendations to the Executive branch. Committees such as the finance and budget committees will be especially critical. Where a particular aspect of tax holidays needs to be reformed, such as laying out clear criteria, Parliament will have to act by amending the law to lay out the criteria. Recommendations to the Executive will not suffice.

6 Conclusion

Tax incentives inevitably remain an obvious low hanging fruit policy initiative for many low-income countries seeking to grow FDI and spur development. In Uganda, tax incentives have largely taken the form of tax holidays. Prior to 1997 there were discretionary statutory tax holidays. After 1997, tax holidays were eliminated from the statutes, but discretionary non-statutory tax holidays emerged. There followed lukewarm scrutiny of the tax holidays by Parliament until 2017 when CSOs, development partners and the media spurred Parliament to act by mandating that all tax holidays be statutory. In 2018 and 2019 non-discretionary and discretionary statutory tax holidays were introduced. However, in practice, even the supposedly non-discretionary holidays have an element of discretion requiring application to the URA. Discretionary tax holidays take the form of a commitment by the Minister of Finance to pay taxes on behalf of an investor and there is little to no transparency regarding how these firms are chosen. While elimination of tax holidays would be the ideal remedy, this seems unlikely. It is therefore recommended that all tax holidays be non-discretionary statutory tax holidays and, if discretionary holidays must be maintained, that transparency in the form of clear regulations and publishing of beneficiaries be implemented. Finally, it is considered that more detailed and empirical research regarding tax incentives in Africa in general and Uganda in particular is necessary. This can contribute to a proper cost/benefit analysis of these measures.

Appendix: Statutes and case law

Statutes

Malawi
Taxation Act Cap 41:01
Taxation (Priority Industries) Regulations 2013

Tanzania
Income Tax Act

Sierra Leone
Finance Act, 2015
Income Tax Act
Finance Act, 2013
Finance Act, 2011

Ghana
Income Tax Act, 2015

Uganda
Constitution of the Republic of Uganda 1995
Income Tax Decree, 1974
Income Tax Act Cap 340
Tax Procedures Code Act
Income Tax (Amendment) Act, (No 1) 2008
Income Tax (Amendment) Act (No 2) of 2008
Income Tax (Amendment) Act of 2009
Income Tax (Amendment) Act of 2011
Income Tax (Amendment) Act, 2018
Investment Code Act, 2019
Income Tax (Amendment) Act, 2019
Income Tax (Amendment) Act, 2020

Case law

Total Uganda Ltd v URA [2001] UGCOMMC 5
URA v Meera Investments Ltd [2009] UGSC 3
URA v Kajura [2017] UGSC 63
Heritage Oil & GAS Ltd v URA High Court Civil Appeal No. 14 of 2011
Total Uganda Ltd v URA [2001] UGCommC 5
Meera Investments Ltd v URA [2007] UGCommC 2
Kinyara Sugar Ltd v URA HCCS 73 of 2011
Spedag Interfreight Uganda Ltd and others v Attorney General and Great Lakes Port Ltd Constitutional Petition No. 85 of 2011
Byansi Henry and Aboneka Michael v Attorney General & UVCCL HCMC No. 80 of 2022

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