What is the fiscal costs of tax incentives in Uganda?

Nada Eissa
Priya Manwaring
Nicole Ntungire
Jakob Rauschendorfer

January 2021

When citing this paper, please use the title and the following reference number: F-20217-UGA-1
What is the fiscal cost of tax incentives in Uganda?
Nada Eissa, Priya Manwaring, Nicole Ntungire, and Jakob Rauschendorfer
January 2021

Table of Contents

Executive summary ........................................................................................................... 2
What are tax incentives? ................................................................................................. 4
Tax incentives in Uganda ............................................................................................... 5
  Corporate Income Tax incentives .................................................................................. 6
  Customs tax incentives ................................................................................................. 6
Methodological approach and data ................................................................................ 7
  Calculating fiscal losses from Corporate Income Tax incentives .............................. 7
  Calculating fiscal losses from customs tax incentives ................................................ 9
The fiscal cost of tax incentives in Uganda ..................................................................... 11
  Corporate Income Tax incentives .............................................................................. 11
  Tax incentives in customs .......................................................................................... 14
Concluding remarks: Cumulative losses and the need for (better) monitoring .......... 17
Appendix 1: Extensions and next steps ....................................................................... 18
  Further extensions to the cost analysis ...................................................................... 19
  Quantifying the benefits ........................................................................................... 19
Appendix 2: A taxonomy of Corporate Income Tax incentives offered to firms in Uganda ... 20
Appendix 3: Further data on Corporate Income Tax incentives .................................... 21
Appendix 4: A different calculation approach ............................................................... 21

1 We thank Raymond Ategyeka (URA), Joseph Okello (URA) Vittorio Bassi (IGC), Kyle McNabb (ODI), and Richard Newfarmer (IGC) for their valuable input on the analysis presented here.
Executive summary

Tax incentives - provisions in country’s tax system that reduce a company’s tax payments - are a vital tool to promote and attract investment in Uganda. These incentives are used to encourage specific kinds of economic activity and investment the government deems desirable, often with a promise to create new jobs and raise economic growth rates. Still, they come at a cost to taxpayers, not only in terms of direct costs in terms of tax revenue foregone, but also indirectly through distortions to economic activity. Assessing if tax incentives are justified, therefore, requires calculating their cost.

In this note we provide static estimates of the direct fiscal costs of Uganda’s Corporate Income Tax as well as customs tax incentives using administrative data provided by the Uganda Revenue Authority. Cumulatively, we estimate that revenue foregone due to tax incentives amounted to about 2,411 billion Uganda Shilling (approximately 652 million USD) over the fiscal years 2014/15 to 2017/18, with approximately one third of this figure stemming from Corporate Income Tax incentives and two thirds incurred from tax incentives in place in Uganda’s customs system. Due to various data limitations, this figure is likely to be a lower bound estimate for the fiscal cost of tax incentives in Uganda.

To put this figure in context, our fiscal loss estimate for the 2017/18 fiscal year is 888 billion UGX (or 240 million USD). This corresponds to about 3% of the country’s total budget for the same fiscal year or close to 1 percent of Uganda’s GDP in 2017. In figure 1, we present the total loss estimates from different fiscal years along with the budget allocations for education and health, two budget positions of immediate interest to the Ugandan public. This comparison highlights the opportunity cost of tax incentives. For example, for the 2017/18 fiscal year our estimates suggest that the government lost close to half of what the country spent on its health system by giving out tax incentives to firms and investors.

Figure 1: The fiscal loss of tax incentives in Uganda in comparison with selected budget positions.

Notes: Figures in UGX billion (2019 values). Health and education budgets are taken from official Government of Uganda documentation (see: https://www.budget.go.ug/).

2 After expressing all Uganda Shilling figures in 2019 values.
Given the considerable size of fiscal losses from tax incentives documented in this note, we conclude that there is a need to:

1) Limit direction in the selection of firms receiving tax incentives and instead apply specific rules/criteria for any firm to automatically become eligible
2) Establish mechanisms to link the provision of tax incentives to pre-agreed targets. Since the opportunity cost of tax incentives is high (e.g. investments in the health system), it is necessary to establish clear targets for investment in exchange for incentives, as well as monitoring systems that ensure that “promises made” in return for preferential treatment are “promises kept”;
3) Improve data collection on which firms receive which exemptions. This also includes the need that all registered firms file returns, regardless of whether or not they receive tax incentives.

A crucial next step for policy analysis will be to examine the effectiveness of incentives provided to firms in delivering socially beneficial outcomes including employment, exports and supplier linkages.
What are tax incentives?

Tax incentives are deviations from the national or regional tax code intended to attract investors by reducing the costs of doing business. They are commonly used in both developed and developing countries to promote new industries or increasing exports, promote positive spillovers between related industries, and to protect industries during periods of downturn. Broadly, tax incentives:

1) Target sector or firm-specific changes to induce new economic activity, such as the promotion of a particular sector or encouraging investment;³
2) Target a subset of taxpayers (i.e., firms, sectors or regions) that are either pre-selected or meet specified criteria).

Tax incentives are, in practice, akin to the government directing expenditures to targeted investors. As such, tax incentives are a form of tax expenditure.

**Tax expenditure** refers to deviations from tax rules that are motivated by social or economic policy, which reduce or defer the tax liability of a taxable entity to encourage a particular activity and could be replaced by a system of direct expenditures for this purpose. Tax expenditures can include tax exemptions, deductions, capital allowances, and preferential tax rates. Although not directly observable, all tax expenditures should be reflected in the budget as a form of government spending - given that they are direct losses to tax revenue (in the form of revenue forgone), which would otherwise have financed government spending.

While these incentives may have the potential to encourage productive and socially beneficial investments, they come at significant costs to governments. Beyond the direct cost in terms of lost revenue, tax incentives also have an opportunity cost: the value of government spending not undertaken on alternative investments (e.g., infrastructure projects).

Tax incentives also create distortions both at the firm and at the industry level:

- At the firm-level, incentives targeted towards particular kinds of capital and labour expenditures distort firm choices about factors of production;
- At the industry-level, incentives provided for specific firms create market distortions by providing some firms a competitive advantage over others, and by encouraging rent-seeking activities. Evidence from Egypt and Tunisia suggests that tax incentives offered to politically connected firms have suppressed effective competition and the potential for job creation.⁴

³ As opposed to reducing prices for home consumption, or facilitating humanitarian assistance, for example.
⁴ Schiffbauer et al. (2015), Jobs or Privileges: Unleashing the Employment Potential of the Middle East and North Africa, World Bank MENA Development Reports.
Tax incentives in Uganda

Eligible firms in Uganda can access a number of different tax incentives, ranging from Corporate Income Tax exemptions for aircraft operators to total tax exemptions on imports of machinery used for oil and gas exploration. Table 1 presents a taxonomy of different tax incentives available to eligible enterprises in Uganda.

Table 1: A taxonomy of tax incentives offered to firms in Uganda.

<table>
<thead>
<tr>
<th>Type of tax</th>
<th>Type of incentive</th>
<th>Example</th>
</tr>
</thead>
<tbody>
<tr>
<td>Corporate Income Tax (CIT)</td>
<td>Exemptions</td>
<td>CIT exemptions on income derived from the operation of aircrafts.</td>
</tr>
<tr>
<td></td>
<td>Holidays</td>
<td>10-year CIT holiday for income of firms operating in industrial parks and free zones.</td>
</tr>
<tr>
<td></td>
<td>Income deductions</td>
<td>Taxable income deduction for bad debt from agro-activities.</td>
</tr>
<tr>
<td></td>
<td>Rate deductions</td>
<td>5% CIT rate for non-resident telecom companies.</td>
</tr>
<tr>
<td></td>
<td>Accelerated depreciation</td>
<td>100% depreciation rate for depreciable assets acquired for mining exploration.</td>
</tr>
<tr>
<td>Customs tax exemptions</td>
<td>Reduced or zero import taxes (duties and VAT) for firms engaging in specific sectors or firms located in Special Economic Zones (SEZs)</td>
<td>0% duty on approved quantities of inputs for Ugandan manufacturers of “sanitary towels” (e.g., tissue paper, microfiber towel fabrics, double sided adhesive tapes) through the EAC Duty Remission Scheme.</td>
</tr>
<tr>
<td></td>
<td></td>
<td>0% import duty on imports of earth moving machinery: excavators, bull dozers, angle dozers.</td>
</tr>
<tr>
<td></td>
<td></td>
<td>0% duty and VAT exempt: Importation of machinery for processing agricultural / dairy products</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Zero duties on the importation of goods used by SEZ firms for producing for the export market</td>
</tr>
<tr>
<td>Value Added Tax (VAT)</td>
<td>Exemptions (0% rate applied)</td>
<td>0% VAT rate on the supply of leased aircrafts, aircraft engines, spare engines, spare parts for aircraft and aircraft maintenance equipment.</td>
</tr>
</tbody>
</table>


In line with the definition presented above, the classification of tax incentives for the analysis in this note excludes several tax expenditures in the Ugandan tax code. Specifically, we exclude provisions that:

1) Do not target a subset of taxpayers (e.g., capital gains exemptions that are available to all firms or changes in import tariffs through country wide exemptions from the usual tariff schedule);
2) Do not aim to target or induce specific economic activity (e.g., customs exemptions for humanitarian assistance);
3) Do not differ from national or regional benchmarks (e.g., CIT taxable income deductions for scientific research expenditure).
Corporate Income Tax incentives

The Corporate Income Tax in Uganda is imposed on companies with a revenue of more than UGX 150 million and is set at a flat rate of 30% of chargeable income. To put the tax in context, in 2017/18, roughly 47,000 firms faced a statutory liability of 1.081 trillion UGX or approximately US$300 million.

There are a number of Corporate Income Tax incentives offered to firms in Uganda. These fall under three broad categories:5

1) Income tax holidays, exemptions or direct chargeable income deductions;
2) Deductions from taxable income based on particular types of capital expenditure;
3) Lower tax rates, applicable on certain kinds of activity.

Customs tax incentives

Goods imported into Uganda are subject to two major taxes: Duties (i.e. payments due to tariffs) and the VAT on imports.6 The VAT is always either 0 or 18% of the sum of the value of the import and the duty actually paid on it, and applies equally to imports from all countries of origin. Tariffs apply as a percentage of the value of the imported goods and depend on the product type as well as the country of origin in line with the following three regimes:

- Imports from countries not part of both the East African Community (EAC) as well as the Free Trade Area of the Common Market for Eastern and Southern Africa (COMESA) are subject to the rates of the Common External Tariff (CET) of the EAC customs union of which Uganda is a member;7
- Imports originating from COMESA members are subject to COMESA internal tariff rates which are generally more favorable than those of the CET, although they are sometimes the same;
- Imports originating from any of the EAC members (Kenya, Tanzania, Rwanda, Burundi) are not subject to tariffs and traded freely under the protocol of the EAC customs union.

Since COMESA countries do not account for a large share of Uganda’s import basket (generally less than two percent) in any given year and since intra-EAC trade is free, in practice the CET regulates almost all of Uganda’s taxable imports.

Import taxes actually paid by individuals, firms and organizations can differ significantly from statutory VAT and tariff rates due to a number of exemptions being in place for importers. Many of these are targeted at facilitating access to inputs for productive activities like manufacturing, construction or agriculture, most notably through the Duty Remission Scheme of the EAC, but also other exemption schemes (see examples in table 1). Others grant duty free imports to diplomats, government institutions or NGOs and are not considered tax incentives.

---

5 See Appendix 2 for a full taxonomy of CIT incentives.
6 Beyond duties (i.e. tariffs) and the VAT imports are often subject to smaller fees and charges like the, withholding tax or excise duties.
7 The CET assigns a 0% tariff on imports of capital goods; a 10% tariff on imports of intermediate inputs, a 25% tariff on imports of final/consumption goods and tariffs of 30% or higher on a small list of sensitive items. In recent years, Uganda has increased or decreased tariffs unilaterally by deviating from the CET through unilateral deviations called Stays of Application from the CET (see below discussion of tariff data).
Methodological approach and data

A comprehensive estimate of the fiscal cost of tax incentives would ideally take into account:

- The behavioural effects of tax incentives i.e. how would firms have behaved and therefore what revenue would the government have received if tax incentives were not in place?
- Costs associated with incentives-induced distortions in the allocation of capital or the behaviour of competing firms.

To do this would require estimating – or simulating from existing evidence – the behavioural response of firms to different types of taxes, and then calculate the cost conditional on estimated earnings and firm behaviour (e.g., purchases of local and imported factors of production). Modelling the impact of taxes on the economic activity of firms is beyond the scope of this note given data limitations in Uganda. Instead, we take a simple approach to estimating the cost of tax incentives with no behavioural responses.⁸

To calculate the cost of both CIT and customs incentives, we use a revenue foregone method: we calculate the static revenue loss incurred by the introduction of a tax incentive, assuming that firm behavior would remain unchanged in absence of an incentive. We then compare current revenues with the revenues that would have been collected from the same firms if incentives were not in place. This is an ex post calculation of the difference between the revenue raised by the benchmark and the case in which the tax incentive is introduced into the tax system. Consequently, this approach does not consider either interactions of one tax incentive with others or firm behavior in response to the removal of such incentives.

The bias in the “simple” cost estimate is unclear and depends on the nature and size of the behavioural responses. Assuming firms will not change their investment behaviour, revenue and employment (tax payments) in the presence of tax incentives leads to an overestimate of the costs of incentives. On the other hand, ignoring market distortions (dampened competitiveness/misallocation of capital and rent-seeking) leads to an underestimate of the cost of incentives.

Calculating fiscal losses from Corporate Income Tax incentives

To calculate the cost of Corporate Income Tax incentives provided to firms, we first consider the costs of full tax holidays or exemptions provided to firms. To do this, we rely on data provided by URA on firms whose income is ‘flagged’ for exemption in any given year. Among these firms, we use reported data for taxable income where it is provided as a measure of revenue foregone. For those firms who do not file taxable income for the years they receive exemptions, we use data input into Schedule 1 of the tax return to construct a figure for what taxable income would have been.⁹ We calculate 30% of taxable income as revenue foregone.

It is important to note that for some income deductions and tax holidays/full exemptions, it is not possible from URA data to distinguish between tax incentives and other types of exemptions and deductions e.g. income from collective investment schemes. As such, these figures may be an overestimate – the extent of overestimation depends on how many full exemptions are given a) to all firms b) to firms without the aim of inducing specific investment activity.

---

⁸ We also discuss potential extensions and specify the data needed to generate more precise estimates in Appendix 1.
⁹ In particular, we construct a variable for taxable income using data input into Schedule 1, 7 and 8. To note: this is not possible to construct for shipping and telecommunication income as taxpayers directly declare chargeable income for these activities. Due to data limitations we are not able to do this for short term insurance income, mining income or branch repatriated profits (although the former is unlikely to be subject to tax incentives).
To the above, we add from all other firms:

- 30% of income directly listed as exempted on the tax return\(^\text{10}\);
- 30% of capital allowances listed in the tax return – i.e. initial allowances on plant and machinery, initial allowances on industrial buildings, allowances for horticultural plants and greenhouses, and allowances for capital expenditure in mining exploration\(^\text{11}\).

Finally, we consider losses from rate deductions i.e. lower tax rates applied to certain kinds of activity, by considering what revenues would have been generated if these activities attracted the regular 30% tax rate.

The data used to calculate the costs of CIT incentives come from administrative records on CIT annual returns collected by the Uganda Revenue Authority covering the fiscal years 2014/15 - 2017/18. The dataset includes 173,261 tax returns filed by 83,618 different firms over the four years. Figure 2 provides an overview of the number of CIT returns filed per fiscal year.

**Figure 2**: Number of tax returns by fiscal year in URA CIT data, 2014/15 -2017/18.

![Number of tax returns by fiscal year in URA CIT data, 2014/15 -2017/18.](image)

**Notes**: Authors illustration based on CIT returns provided by the Uganda Revenue Authority.

It is important to note that this data is limited to:

- Non-individual (i.e. company) CIT returns, the dominant source of forgone tax revenues
- Firms that actually file CIT returns. Currently, firms eligible for tax holidays and full exemptions are not required to file tax returns, and there is limited data on how many firms have these exemptions as well as their cost.\(^\text{12}\) The Ministry of Finance estimates that these exemptions amounted to over

---

\(^{10}\) Schedule 1, 3a of the non-individual CIT return.

\(^{11}\) Schedule 2 of the non-individual CIT return. To calculate revenue foregone from initial allowance on plant and machinery, we calculate the difference in tax when the 50% deduction is applied, compared to if a regular depreciation rate of 15% were applied to the assets instead. For the initial allowance on industrial buildings, we calculate the difference in tax when the 20% deduction is applied, compared to if no such deduction was applied and the entire asset was subject to regular 5% industrial building deductible.

\(^{12}\) This highlights the importance of ensuring that also those firms that receive tax incentives continue to file tax returns. The URA is currently a database of firms that apply for and are granted an exception, but do not file returns. Accessing this database would allow us to update the results presented in this paper to take into account the costs of these incentives.
UGX 104 billion in FY2016/17\textsuperscript{13} - this is 140% of the losses we estimate from filed returns. As such, these figures could be a significant underestimate of the costs of tax incentives.

Calculating fiscal losses from customs tax incentives

To estimate the static revenue loss from tax incentives in Uganda’s customs code, we compare duty and VAT revenues actually collected on goods imported into Uganda with revenues that would have been collected if statutory tax rates had applied (i.e., legally binding tariff and VAT rates applicable to importers without access remission schemes).

To identify fiscal losses from tax incentives in customs, we then compute losses for a subset of importing firms that are active in productive sectors.\textsuperscript{14} Specifically, we consider firms operating in any of the following four broad activities that we can observe in the data: Manufacturing, Construction, Agriculture, forestry \& fishing as well as Wholesale and retail trade \& repair services.\textsuperscript{15}

To implement this approach empirically, we employ three sources of data:

1) Customs data collected by the Uganda Revenue Authority, covering the fiscal years 2014/15 to 2017/18. These data show, per each individual import shipment, the value of the transaction, the origin of imports, the tax identification number of the importer (organisations and individuals), as well as the trade taxes (duties and VAT) collected by the URA. We limit the data to imports that originate from outside of the EAC, since trade between the members of the customs union is free, and to those that enter the Ugandan economy in “free circulation”.\textsuperscript{16}

2) Since the customs data does not hold data on statutory tariff and VAT rates, we construct these as follows. First, we build a panel data set of statutory tariffs by product, fiscal year and country of origin to establish the benchmark against which customs duty incentives are evaluated. We obtain data on the regular CET schedules from the East African Community and modify these tariff data with Uganda-specific deviations from the CET through the EAC’s Stays of Application mechanism.\textsuperscript{17} Tariffs applicable to imports from COMESA members are obtained from the World Bank’s WITS database.\textsuperscript{18} Finally, we merge these data with our data on import declarations at the product, fiscal year and country of origin level.\textsuperscript{19} Regarding statutory VAT rates, we compute the median applied VAT rate at the product/fiscal year level from the customs data, which provides us with information on whether or not a product was subject to a statutory 18\% VAT in a fiscal year or not.

3) Monthly Value Added Tax declarations that can be matched with the customs data through common firm identifiers. These declarations show, per each declaring firm, a four digit ISIC code describing their business activity.\textsuperscript{20} For the analysis in this note, we restrict the data to importers for which we have data on sectoral affiliation.


\textsuperscript{14} That is, we exclude losses incurred due to preferential treatment of imports by organisations like the UN, NGOs or the Ugandan government as these are not considered to be active in productive economic sectors.

\textsuperscript{15} We include Wholesale and retail services \& repair services, since assembly and repairs is an important sector in Uganda.

\textsuperscript{16} That is, we drop transactions from the data that are not subject to taxes: transit shipments and exports. Taxes on exports are negligible in the context of Uganda. As of 2019, the only taxes on exports that were in place are a 15\% export tax on “hides and skins” intended to encourage domestic value addition, as well as small taxes on specific raw agricultural commodities targeted at the export market: 0.2 USD per kg on tobacco exports, 0.02-0.05 USD per kg of fish exports, and 1\% and 2\% on exports of coffee and cotton, respectively (WTO 2019: 374).

\textsuperscript{17} The dataset we employ is developed by Rauschendorfer and Twum (2020). Stays of Applications enable individual members to deviate from the CET of the EAC on a product basis and implement lower or higher tariffs. These changes apply to all individuals and organisation in the deviating country.

\textsuperscript{18} Practically, COMESA countries account for a very small portion of Uganda’s import basket (less than 2\% in 2017).

\textsuperscript{19} For the purposes of this note, a “product” always refers to an 8-digit tariff line in the Harmonized Systems nomenclature.

\textsuperscript{20} Relying on VAT declarations limits our sector level analysis to those firms that have at least once in during the study period submitted a VAT declaration, which is equivalent to them reporting an annual turnover of more than 50 million UGX (~14 000 USD). This is an acceptable limitation.
Our final data set consists of about 1,830,000 import transactions of about 4,900 individual products by roughly 56,000 individual importers over the period 2014/16 - 2017/18, complete with statutory information on import taxes and the sectoral affiliation of importers. As shown in Table 2, Uganda’s imports, in terms of value, number of transactions and number of importers has increased steadily over the last number of years.

**Table 2: Uganda’s import volume, number of import transactions and importers per fiscal year.**

<table>
<thead>
<tr>
<th>Fiscal year</th>
<th>Imports (UGX billion)</th>
<th># import transactions</th>
<th># importers</th>
</tr>
</thead>
<tbody>
<tr>
<td>2014/15</td>
<td>20,704</td>
<td>405,700</td>
<td>18,257</td>
</tr>
<tr>
<td>2015/16</td>
<td>19,482</td>
<td>402,546</td>
<td>21,184</td>
</tr>
<tr>
<td>2016/17</td>
<td>18,741</td>
<td>492,488</td>
<td>23,687</td>
</tr>
<tr>
<td>2017/18</td>
<td>19,225</td>
<td>528,750</td>
<td>26,343</td>
</tr>
</tbody>
</table>

**Notes:** Author’s calculations from Uganda Revenue Authority’s customs data. Import values are expressed in 2019 values. Included are only import shipments originating from outside of the EAC and entering the Ugandan economy in free circulation. Importers are firms, organisations and private individuals. For our purposes, since VAT declarations for 2017 and 2018 are incomplete we update this information with data on sectoral affiliation from the register of tax payers for the years 2016/17 and 2017/18. We find that all registered firms account for about 80 percent of Uganda’s import volume. Additionally, transactions by non-registered firms are much smaller on average, suggesting a large share of private imports.
The fiscal cost of tax incentives in Uganda

In this section we present the key findings from our analysis. We first discuss findings from the CIT data before proceeding to estimates for the fiscal cost of tax incentives in Uganda’s customs code.

Corporate Income Tax incentives

In terms of the cost of Corporate Income Tax incentives, we find the revenue forgone between 2014/15-2017/2018:

- from tax holidays/exemptions amounted to 231.4 billion UGX;
- from capital expenditure deductions amounted to 609.4 billion UGX;
- from differential tax rates amounted to 351.4 million UGX.

Table 3 and Figure 3 present these estimates per each fiscal year for which these data are available.

Table 3 and Figure 3: The cost of Corporate Income Tax incentives in Uganda

<table>
<thead>
<tr>
<th>Fiscal year</th>
<th>Tax holidays and exemptions (2019 UGX million)</th>
<th>Total capital expenditure deductions (2019 UGX million)</th>
<th>Differential tax rates (2019 UGX million)</th>
<th>Total loss (2019 UGX million)</th>
<th>Total loss as % of tax take</th>
</tr>
</thead>
<tbody>
<tr>
<td>2014/15</td>
<td>55,419</td>
<td>14,769</td>
<td>25</td>
<td>70,216</td>
<td>7.60%</td>
</tr>
<tr>
<td>2015/16</td>
<td>53,741</td>
<td>17,066</td>
<td>115</td>
<td>70,922</td>
<td>7.90%</td>
</tr>
<tr>
<td>2016/17</td>
<td>56,548</td>
<td>17,656</td>
<td>74</td>
<td>74,285</td>
<td>7.50%</td>
</tr>
<tr>
<td>2017/18</td>
<td>65,659</td>
<td>559,944</td>
<td>137</td>
<td>625,699</td>
<td>56.40%</td>
</tr>
<tr>
<td>Total</td>
<td>231,366</td>
<td>609,436</td>
<td>351</td>
<td>841,122</td>
<td>21.50%</td>
</tr>
</tbody>
</table>

Notes: Figure 3 is expressed in UGX billion (2019 values).

21 All figures in 2019 values using World Bank inflation figures. More details on capital expenditure deductions can be found in Appendix 2

22 One key reason this figure is so low appears to be low number of overall returns filed and current taxes generated by firms operating in shipping and telecom services where rates are significantly lower than 30%. The lower number of firms filing can be seen in Figure 1, but at the same time, these firms appear to be filing much lower taxable income amounts. In 2017/18, for example, for those firms that file shipping income, losses from rate deductions are 14 times higher than current revenues
In total, we estimate that the cost of CIT incentives for the fiscal years 2014/15 to 2017/18 amounts to 841 billion UGX or roughly 227 million USD, equivalent to 22% of assessed CIT liabilities over the same period. We note that the data used for these estimates only include those firms that filed a CIT return in any year during the period. As such, the analysis may significantly underestimate the true costs of tax incentives in Uganda.

Capital expenditures are by far the primary beneficiaries of CIT incentives, and it is important to note that tax incentives provided for capital expenditures expanded significantly in 2017/18 following the reintroduction of initial allowances on plant and machinery and on industrial buildings. These incentives are provided to firms that place property into service 50km from the boundaries of Kampala and to firms that place new industrial buildings into service for the first time respectively, and provide a substantial discount on taxable income for that year based on the expenditure. This resulted in a 33-fold increase in tax incentives for capital expenditures from the previous year.

Looking at the incidence of tax incentives over this four-year period, we can see that of the 83,618 different firms that filed CIT returns, many of these benefited from some type of tax incentive. Capital allowances made up the majority of tax incentives provided to firms (enjoyed by 7-33% of firms each year), while only 1% of firms each year qualified for full tax holidays/exemptions.

### Table 4: Number of firms with different incentives per fiscal year.

<table>
<thead>
<tr>
<th></th>
<th>2014/15</th>
<th>2015/16</th>
<th>2016/17</th>
<th>2017/18</th>
</tr>
</thead>
<tbody>
<tr>
<td>Number of firms with full income holidays/exemptions</td>
<td>443</td>
<td>462</td>
<td>465</td>
<td>471</td>
</tr>
<tr>
<td>Number of firms with partial income exemptions</td>
<td>517</td>
<td>573</td>
<td>648</td>
<td>777</td>
</tr>
<tr>
<td>Number of firms with capital allowances</td>
<td>3,601</td>
<td>3,882</td>
<td>3,166</td>
<td>15,851</td>
</tr>
<tr>
<td>Number of firms with rate deductions</td>
<td>11</td>
<td>29</td>
<td>10</td>
<td>11</td>
</tr>
<tr>
<td><strong>Total number of returns</strong></td>
<td>37,769</td>
<td>43,846</td>
<td>44,236</td>
<td>47,410</td>
</tr>
</tbody>
</table>

Access to incentives is not consistent over this period – as can be seen in Table 5, the majority of firms that receive incentives receive them for some but not all years considered.

### Table 5: Number of firms with access to different incentives over the four years.

<table>
<thead>
<tr>
<th></th>
<th>Never</th>
<th>Sometimes (of which received during and did not lose)</th>
<th>Always</th>
</tr>
</thead>
<tbody>
<tr>
<td>Tax holidays/exemptions</td>
<td>82,975</td>
<td>344 (140)</td>
<td>299</td>
</tr>
<tr>
<td>Partial income exemptions</td>
<td>82,354</td>
<td>1,074 (492)</td>
<td>190</td>
</tr>
<tr>
<td>Capital allowances</td>
<td>64,061</td>
<td>18,910 (13,611)</td>
<td>647</td>
</tr>
<tr>
<td>Rate deductions</td>
<td>83,581</td>
<td>37 (10)</td>
<td>0</td>
</tr>
</tbody>
</table>

---

24 See Appendix 2 for more information on this.
25 Initial allowances on plant and machinery located 50km from the boundaries of Kampala were reintroduced in order to decongest the capital city and attract investment in other regions of the country.
26 This refers to firms that received incentives at some point after 2015/16 within the 4-year period and continued to enjoy these incentives until at least 2017/18.
**Figure 4:** Average profit/loss (pre-tax) in 2019 UGX million over time of firms with different CIT incentives.

Notes: Author’s illustration from CIT returns provided by the Uganda Revenue Authority.

It is interesting to note the disparity in profitability of firms with and without access to incentives. As can be seen in Figure 4, firms that have consistent access to tax incentives over this period are significantly and consistently more profitable than firms that never access incentives. This could either signal wasted use of incentives on already profitable firms, or successful targeting of incentives to encourage profitable investment.

Looking at trends over time, it would seem that firms that were able to newly access tax holidays and capital allowances during this period were able to raise their profitability significantly from below profit levels of firms without incentives. This would suggest that these types of incentives could be helping firms to overcoming constraints to increased production and investment. Conversely, partial income exemptions seem to have been targeted to firms with higher initial profitability levels and have not been associated with increased profitability over time, suggesting that these incentives may be poorly targeted. Further causal analysis is needed to better understand these effects.
Tax incentives in customs

We estimate the fiscal losses from Uganda’s customs tax incentives by employing the methods and data described in the previous sections. Figure 5 presents our main result: For both major taxes due at importation (duties and the VAT on imports) we show the fiscal losses from tax incentives (i.e., losses incurred due to firms in productive sectors importing under preferential terms) as well as losses from exemptions that are not targeted at stimulating productivity and investment (e.g. duty free imports for diplomats).27

Combining the fiscal cost of tax incentives in customs (VAT and duties) over the four years, our results suggest that Uganda lost a total of 1,570 billion UGX over this period (or about 424 million USD). Fiscal losses due to tax incentives in Uganda’s customs seem to have decreased considerably from 2016/17 to 2017/18, from 222 billion UGX to 158 billion UGX in duties foregone and from 127 billion UGX to 104 billion UGX in VAT revenue foregone.

While not tax incentives (and therefore of secondary interest to our exercise), it is important to note that fiscal losses due to tax free imports from exemptions schemes in place for NGOs, the UN and other organisations are sizeable in Uganda. For example, in 2016/17 we find that in total about 517 billion UGX in duties and VAT were not collected due to these exemptions schemes. Examining the data more closely, we find that the large increase in “fiscal loss from other exemptions” observed in 2016/17 can in part be explained by duty free imports of flour by a single organisation active in the humanitarian sector, resulting in a loss of about 47 billion UGX in that fiscal year.

**Figure 5:** Fiscal losses from tax incentives in Uganda’s customs code: Duties and the VAT.

![Figure 5](image)

**Notes:** Author’s illustration based on Ugandan customs data from 2014/15 – 2017/18. All Uganda Shilling values are in billion and expressed in 2019 values using World Bank inflation figures. “Fiscal loss from tax incentives” for both duties and the VAT are calculated as the difference between statutory import tax revenue and actually collected revenues by firms registered as being active in any of the following sectors: Manufacturing, Construction, Agriculture, forestry & fishing and Wholesale and retail trade & repair services.

Figures 6.a - d explore sectoral characteristics of tax incentives in Uganda’s customs focusing on the 2017/18 fiscal year. First, as we show in Figure 6.a, construction and manufacturing together account for almost 80 percent of the fiscal loss from custom related tax incentives in Uganda. Firms active in agriculture, fishing,

27 It is important to note that for the 2017/18 fiscal year, we sometimes miss the sectoral affiliation of an importer due to missing data. This is likely to result in an underestimate for the fiscal cost of tax incentives and other exemptions in Uganda’s customs code.
forestry and fishing cause only around three percent of the total fiscal loss from these incentives, likely because these activities are less reliant on imported factors of production.

**Figure 6.a:** Fiscal losses from tax incentives in customs per sector, share of total in 2017/18 (262 billion UGX).

<table>
<thead>
<tr>
<th>Sector</th>
<th>Fiscal Loss Share</th>
</tr>
</thead>
<tbody>
<tr>
<td>Agriculture, forestry, fishing</td>
<td>3%</td>
</tr>
<tr>
<td>Construction</td>
<td>44%</td>
</tr>
<tr>
<td>Manufacturing</td>
<td>35%</td>
</tr>
<tr>
<td>Wholesale and retail trade, repair services</td>
<td>18%</td>
</tr>
</tbody>
</table>

Figure 6.b suggests that the number of firms that enjoy import related tax incentives in Uganda is relatively small. For example, the number of Ugandan firms active in the sector “Wholesale and retail trade, repair services” in the VAT registry is around 2,800. Figure 5.b shows that only 384 of these firms had access to imported goods under tax incentives in the 2017/18 fiscal year. While these figures are small relative to the overall population of Ugandan firms, expressing the number of beneficiary firms as share of all firms in a sector that actually import yields a far less drastic picture (figure 6.c). For example, around 40 percent of Ugandan manufacturers that use imported materials from abroad had access to customs related tax incentives in the 2017/18 fiscal year.

**Figure 6.b:** Number of firms benefitting from tax incentives in customs, per sector.

<table>
<thead>
<tr>
<th>Sector</th>
<th>Number of Firms</th>
</tr>
</thead>
<tbody>
<tr>
<td>Agriculture, forestry, fishing</td>
<td>68</td>
</tr>
<tr>
<td>Construction</td>
<td>53</td>
</tr>
<tr>
<td>Manufacturing</td>
<td>229</td>
</tr>
<tr>
<td>Wholesale and retail trade, repair services</td>
<td>384</td>
</tr>
</tbody>
</table>

**Figure 6.c:** Number of firms benefitting from tax incentives in customs, as share of firms in a sector that import.

<table>
<thead>
<tr>
<th>Sector</th>
<th>Share of Firms</th>
</tr>
</thead>
<tbody>
<tr>
<td>Agriculture, forestry, fishing</td>
<td>33%</td>
</tr>
<tr>
<td>Construction</td>
<td>22%</td>
</tr>
<tr>
<td>Manufacturing</td>
<td>43%</td>
</tr>
<tr>
<td>Wholesale and retail trade, repair services</td>
<td>14%</td>
</tr>
</tbody>
</table>

28 Note that for a firm to be included as “benefitting from tax incentives in customs”, we impose that the firm saved at least 1 000 000 UGX (~ 270 USD) in import taxes in the fiscal year due to these incentives.
Finally, in Figure 6.d, we show that the beneficiary firms account for most of the imports of the sector they operate in. For example, the 53 construction firms with access to tax incentives in customs (corresponding to 22 percent of all construction firms that import) accounted for 91 percent of the total import volume of the construction sector in 2017/18.

**Figure 6.d:** Share of total imports in a sector done by firms benefitting from tax incentives in customs.
Concluding remarks: Cumulative losses and the need for (better) monitoring

In total, our estimates suggest that forgone tax revenue over the fiscal years 2014/15 to 2017/18 due to Corporate Income Tax and customs tax incentives amounted to about 2,411 billion Uganda Shilling (approximately 652 million USD). Due to various data related issues (e.g., limitation of the analysis to firms that actually file Corporate Income Tax returns or incomplete data on the sectoral affiliation of importers in later fiscal years) this presents a lower bound estimate for the fiscal cost of tax incentives in Uganda.

To put these estimated losses into perspective, the estimated fiscal cost of Uganda's tax incentives in 2017/18 was 888 billion UGX, corresponding to around 3% of total budget for 2017/18 or almost 1 percent of GDP in 2017. Given the considerable size of these tax expenditures, we conclude with the following policy recommendations:

1.) To the greatest extent possible, the application of tax incentives should not be applied based on discretion, but instead automatically apply to firms based on data that shows these firms have met specific rules/criteria. Evidence from the U.S., Europe, China, and cross-country evidence from developing countries has shown that uncertainty regarding profits and policy has a significant negative impact on investment (Meinen and Rohe, 2017; Wang et al., 2014; Baum et al., 2008; Handley and Nuno, 2015; Kange e al., 2014; Feng, 2011). At the same time, clear and transparent criteria for incentives reduces the potential for these benefits being provided to uncompetitive and/or unproductive firms.

2.) Currently, there are no mechanisms in place that link the provision of tax incentives to pre-agreed targets. Since the opportunity cost of tax incentives is high (e.g. infrastructure projects that are not realized), it is necessary to establish clear targets for investment in exchange for incentives, as well as monitoring systems that ensure that “promises made” in return for preferential treatment are “promises kept”;

3.) To achieve this goal there is an urgent need for improved data collection on which firms receive which exemptions. This also includes the need that all registered firms file returns, regardless of whether or not they receive tax incentives.

A crucial next step for policy analysis will be to examine the effectiveness of incentives provided to firms in delivering socially beneficial outcomes including employment, exports and supplier linkages.
References


Appendix 1: Extensions and next steps

Further extensions to the cost analysis

Using masked TINs for the most recent CIT extraction that correspond to other URA datasets, we will be able to:

- Narrow down our analysis to look at only those exemptions offered to firms engaging in productive activity, thereby more accurately capturing losses from incentives.
- Narrow down our analysis to be able to identify incentives based on mining activity more closely
- Use this as well as current data from URA, UFZA and BOU to extend the above analysis to look at the costs of incentives for foreign firms, free zone firms, and other specific firm types (including analysis by sector).

With the relevant sections of the tax return for short term insurance income, mining income, and branch repatriated profits; we can construct a more accurate figure for losses from tax holidays.

Quantifying the benefits

Crucially, to quantify the benefits of tax incentives, we need to be able to link the firms that receive such exemptions to their associated measurable benefits. To do this would require access to additional data, namely:

- Masked TINs for the latest CIT extraction that correspond to other URA datasets
- VAT data for FY 2012/13 – 2018/19
### Appendix 2: A taxonomy of Corporate Income Tax incentives offered to firms in Uganda

<table>
<thead>
<tr>
<th>Type</th>
<th>Examples</th>
</tr>
</thead>
<tbody>
<tr>
<td>Exemptions</td>
<td>• Income derived from the operation of aircrafts&lt;br&gt;• Income of firm which invests over a certain threshold, and subject to availability, uses at least fifty percent of locally-sourced raw materials and employs at least sixty percent citizens and processes agricultural goods</td>
</tr>
<tr>
<td>Holidays</td>
<td>• 10-year holiday for developers of industrial parks and free zones who invest over a certain threshold&lt;br&gt;• 10-year holiday for operators in industrial parks and free zones who invest over a certain threshold&lt;br&gt;• 10-year holiday for exporters of finished consumer and capital goods&lt;br&gt;• 1-year (renewable) holiday for income derived from agro-processing of new products using capital that has not previously been used in Uganda in agro-processing</td>
</tr>
<tr>
<td>Income deductions</td>
<td>• Taxable income deduction for a bad debt from agro-activities&lt;br&gt;• Taxable income deduction for investments in new plants and machinery outside a radius of fifty kilometres from Kampala&lt;br&gt;• Taxable income deduction for investments in new industrial buildings&lt;br&gt;• Taxable income deduction for acquisition or establishment of a horticultural plant/construction of a greenhouse</td>
</tr>
<tr>
<td>Rate deductions (benchmark rate = 30%)</td>
<td>• 2% tax rate on non-resident companies in shipping and aircraft&lt;br&gt;• 5% tax rate for non-resident telecom companies&lt;br&gt;• 25% tax rate on mining companies</td>
</tr>
<tr>
<td>Accelerated depreciation</td>
<td>• 100% depreciation rate for depreciable assets acquired for mining exploration</td>
</tr>
</tbody>
</table>
Appendix 3: Further data on Corporate Income Tax incentives

See below for more information on incentives from capital expenditure:

<table>
<thead>
<tr>
<th>Financial year</th>
<th>Initial allowance on Plant and Machinery</th>
<th>Initial allowance on industrial buildings</th>
<th>Allowance for horticultural plant/construction of a greenhouse</th>
<th>Allowance and/or accelerated depreciation for mining exploration</th>
<th>Total capital expenditure deductions</th>
</tr>
</thead>
<tbody>
<tr>
<td>2014/15</td>
<td>-</td>
<td>-</td>
<td>1,743</td>
<td>13,026</td>
<td>14,769</td>
</tr>
<tr>
<td>2015/16</td>
<td>-</td>
<td>-</td>
<td>3,139</td>
<td>13,928</td>
<td>17,066</td>
</tr>
<tr>
<td>2016/17</td>
<td>-</td>
<td>-</td>
<td>4,163</td>
<td>13,493</td>
<td>17,656</td>
</tr>
<tr>
<td>2017/18</td>
<td>112,822</td>
<td>428,106</td>
<td>3,294</td>
<td>15,723</td>
<td>559,944</td>
</tr>
<tr>
<td>Total loss</td>
<td>112,822</td>
<td>428,106</td>
<td>12,339</td>
<td>56,169</td>
<td>609,436</td>
</tr>
</tbody>
</table>

Notes: All figures in UGX million using inflation-adjusted 2019 values, using CIT returns provided by the Uganda Revenue Authority.

Appendix 4: A different calculation approach

Another approach we attempt in calculating the costs of incentives is to look at the taxable income firms declare in the years before and after receiving incentives. This method takes into account the behavioural effect of incentives on firm investment and income levels by calculating the costs of incentives based on previously declared income.29 We note this calculation is based only on the set of firms which receive or lose such incentives in the five years covered by our dataset. Still, it allows us to simulate the impact for remaining firms assuming a similar behavioural response.

While we can identify the application of tax holidays and full exceptions over time using URA data that marks which firms receive these incentives in particular years, data limitations affect the accuracy of this method. In the majority of cases, firms that receive exemptions/holidays in our study period (2014/15–2017/18) fail to file taxable income amounts even in the years before they receive these holidays/exemptions.

While we may be able to ‘fill’ this data on taxable income using declared income in years before/after, employing this method would leave us unclear as to whether we are capturing losses in revenue resulting from tax incentives or tax evasion in years without incentives. To remedy this concern and allow for analysis that would more accurately track the costs of tax incentives, there is a crucial need to ensure all firms declare taxable income in all years in which they do not receive exemptions or holidays.

29 In undertaking such an approach, it would be important to take into account time variant factors that may increase or decrease taxable income and that are correlated with the application of incentives. A firm’s taxable income in a particular year may or may not be a good representation of their income in the following/preceding years, and this may systematically bias these results upward or downward.
The International Growth Centre (IGC) aims to promote sustainable growth in developing countries by providing demand-led policy advice based on frontier research.

Find out more about our work on our website www.theigc.org

For media or communications enquiries, please contact mail@theigc.org

Subscribe to our newsletter and topic updates www.theigc.org/newsletter-signup

Follow us on Twitter @the_igc

Contact us
International Growth Centre,
London School of Economic and Political Science, Houghton Street, London WC2A 2AE