Tax Competition in East Africa

A race to the bottom?

Tax Justice Network-Africa & ActionAid International

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About TJN-A

Tax Justice Network-Africa (TJN-A) is a Pan-African initiative established in 2007 and a member of the global Tax Justice Network. TJN-A seeks to promote socially just, democratic and progressive taxation systems in Africa. TJN-A advocates pro-poor taxation and the strengthening of tax regimes to promote domestic resource mobilization. TJN-A aims to challenge harmful tax policies and practices that favor the wealthy and aggravate and perpetuate inequality.

About ActionAid

ActionAid International (AAI) is a non-partisan, non-religious development organization that has been working in Kenya since 1972. ActionAid seeks to facilitate processes that eradicate poverty and ensure social justice through anti-poverty projects, local institutional capability building and public policy influencing. The organisation is primarily concerned with the promotion and defence of economic, social, cultural, civil and political human rights and supports projects and programmes that promote the interests of poor and marginalized people.

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Governments in East Africa are providing a wide range of tax incentives to businesses to attract greater levels of foreign direct investment (FDI) into their countries. Such incentives include corporate income tax holidays, notably in export processing zones (EPZs), and reductions from the standard rate for taxes such as import duties and VAT. Yet this study, which focuses on Kenya, Uganda, Tanzania and Rwanda, shows that such tax incentives are leading to very large revenue losses for governments, are promoting harmful tax competition in the region, and are not needed to attract FDI.

In total, Kenya, Uganda, Tanzania and Rwanda are losing up to US$2.8 billion a year from all tax incentives and exemptions. Not all of these mechanisms are bad. Some, such as VAT reductions, can help reduce poverty. But much of the revenue loss is explained by tax incentives provided unnecessarily to attract foreign investment. These revenue losses are depriving countries of critical resources needed for reducing poverty.

Following the re-establishment of the East African Community (EAC) in 1999, Kenya, Tanzania and Uganda created a customs union (a duty-free trade area with a common external tariff) in 2005, and were joined by Rwanda and Burundi in 2009. This has created a larger regional market, and means that firms can be located in any EAC country to service this market. At the same time, however, countries are being tempted to increase investment incentives in order to attract FDI and, they believe, increase jobs and exports.

East African countries are providing an array of tax incentives:

- In Kenya, the more prominent ones concern the EPZs, which give companies a 10-year corporate income tax holiday and exemptions from import duties on machinery, raw materials and inputs, and from stamp duty and value added tax (VAT).
- In Tanzania's EPZs and special economic zones (SEZs), companies are exempted for the first 10 years from paying corporate income tax and all taxes and levies imposed by local government authorities. They are also granted import duty exemptions on raw

materials and capital goods imported for manufacturing goods. Mining companies are given special treatment, and pay zero import duty on fuel, are exempt from capital gains tax, pay a reduced rate of stamp duty, and receive special VAT relief.

- Uganda provides fewer tax incentives than Kenya or Tanzania but still offers a range of tax incentives, such as import duty and stamp duty exemptions, for companies exporting. It also offers corporate income tax holidays for certain categories of businesses, such as companies engaged in agro-processing and those exporting finished consumer and capital goods.

A 2006 report focusing on East Africa by the International Monetary Fund (IMF) notes that, "investment incentives – particularly tax incentives – are not an important factor in attracting foreign investment." More important factors are good-quality infrastructure, low administrative costs of setting up and running businesses, political stability and predictable macroeconomic policy. A 2010 study found that the main reasons for firms investing in Kenya are access to the local and regional market, political and economic stability, and favourable bilateral trade agreements. Fiscal concessions offered by EPZs were mentioned by only 1% of the businesses sampled. Despite its generous tax incentives, Kenya has in recent years attracted very low levels of FDI, largely due to recent political violence and instability. The IMF report notes that the introduction of EPZs in Tanzania in 2002 "has not resulted in a noticeable pickup in foreign investment". Uganda has continued to attract higher levels of FDI than Kenya or Tanzania, which provide much more generous investment incentives. Uganda's attraction of more FDI than its neighbours is unlikely to be due to its use of tax incentives.

International organisations such as the African Development Bank (AfDB) and the International Monetary Fund (IMF) have joined with non-governmental organisations (NGOs) and others in criticising tax incentives and exemptions in East Africa, calling for them to be reviewed and reduced. Governments in East Africa all recognise that the current level of tax incentives presents serious revenue losses and are formally committed to reviewing, rationalising and reducing them. However, progress is slow and there are major questions as to how far governments are really prepared to go.

Unless East African governments deepen and speed up their commitment to reduce tax incentives, the region may experience increasing tax competition and a "race to the bottom". Tax competition makes it harder for countries to maintain higher tax rates, leading to ever-declining rates and revenues. Disparities in tax rates in the EAC have also

encouraged illicit trade, complicated operational systems for companies wishing to carry on business throughout the EAC, and slowed down the integration process.

One significant initiative for promoting tax coordination in the EAC is the Draft Code of Conduct against Harmful Tax Competition, the product of a consultancy commissioned by the EAC secretariat and GIZ, the German government development agency. The draft code is still being discussed and is yet to be adopted by the EAC. Positively, it is meant to "freeze" the current provision of tax incentives so that additional harmful incentives are not introduced. Less positively, the draft code proposes only weak enforcement mechanisms and emphasises tax harmonisation more than regional cooperation. Also, it does not oblige EAC states to undertake tax expenditure analyses to better assess the efficacy of tax incentives in realising development objectives. The weakness of these steps suggests that EAC states may be reluctant to surrender their tax sovereignty, despite the mutual gains that could be realised.

In our view, governments in East Africa should:

- remove tax incentives granted to attract FDI, especially those provided to EPZs and SEZs and, in Tanzania, to the mining sector
- undertake a review, to be made public, of all tax incentives with a view to reducing or removing many of them, especially those that involve the exercise of discretionary powers by ministers. Those incentives that remain must be simple to administer and shown by the government to be economically beneficial provide on an annual basis, during the budget process, a publicly available tax expenditure analysis, showing annual figures on the cost to the government of tax incentives and showing who the beneficiaries of such tax expenditure are
- take greater steps to promote coordination in the EAC to address harmful tax competition.

Abbreviations

AfDB	African Development Bank
EAC	East African Community
EPZ	Export processing zone
FDI	Foreign direct investment
GDP	Gross domestic product
IMF	International Monetary Fund
NGO	Non-governmental organisation
SEZ	Special economic zone
VAT	Value added tax

Introduction

Governments in East Africa are providing a wide range of tax incentives to businesses to attract greater levels of foreign direct investment (FDI) into the country. Such incentives include corporate income tax holidays, notably in export processing zones (EPZs), and reductions from the standard rate for taxes such as import duties and value added tax (VAT). Yet this study, which focuses on Kenya, Uganda, Tanzania and Rwanda, shows that such tax incentives are leading to very large revenue losses for governments, promoting harmful tax competition in the region, and are not needed to attract FDI.

Following the re-establishment of the East African Community (EAC) in 1999, Kenya, Tanzania and Uganda created a customs union (a duty-free trade area with a common external tariff) in 2005, and were joined by Rwanda and Burundi in 2009. This has created a larger regional market, and means that firms can be located in any EAC country to service this market. At the same time, however, countries are being tempted to increase investment incentives in order to attract FDI and, they believe, increase jobs and exports.

> *"Increased competition over FDI and growing pressure to provide tax holidays and other investment incentives to attract investors could result in a 'race-to-the-bottom' that would eventually hurt all three [ie Kenya, Uganda and Tanzania] EAC members. Left unchecked, the contest could result in revenue loss, especially in Tanzania and Uganda, and threaten the objective of improving revenue collection."*[1]
>
> 2006 IMF report

In total, Kenya, Uganda, Tanzania and Rwanda are losing up to US$2.8 billion a year from tax incentives and exemptions, as is detailed later in this report. Not all of these mechanisms are bad. Some, such as VAT reductions, can help reduce poverty. But much of the revenue loss is explained by tax incentives provided unnecessarily to attract foreign investment. These revenue losses are depriving countries of critical resources needed for reducing poverty.

Tax incentives

A tax incentive is defined as "a deduction, exclusion or exemption from a tax liability, offered as an enticement to engage in a specified activity such as investment in capital goods for a certain period".[2] Tax incentives are the fiscal form of investment incentives and include corporate income tax holidays and reductions in tax rates. Non-fiscal or non-tax incentives include direct subsidies like government grants, loans and guarantees for target projects. Tax incentives are granted to attract FDI and/or to promote specific economic policies, such as to encourage investment in certain sectors.

Investment incentives[3]

Corporate income tax incentives

- Tax holidays or reduced tax rates
- Tax credits
- Investment allowances
- Accelerated depreciation
- Reinvestment or expansion allowances

Other tax incentives

- Exemption from or reduction of withholding taxes
- Exemption from import tariffs
- Exemption from export duties
- Exemption from sales, wage income or property taxes
- Reduction of social security contributions

Financial and regulatory incentives

- Subsidised financing
- Grants or loan guarantees
- Provision of infrastructure, training
- Preferential access to government contracts
- Protection from import competition
- Subsidised delivery of goods and services
- Derogation from regulatory rules and standards

1. Tax incentives in East Africa

Countries in East Africa provide a wide range of tax incentives, many of which are intended to attract foreign companies to invest. The most prominent ones are 10-year corporate income tax holidays, generous capital investment deductions, and exemptions from VAT payments, import duties and withholding taxes.

Export processing zones

Both Tanzania and Kenya have established export processing zones offering numerous tax incentives, intended to attract FDI and boost exports and employment. Tanzania's 2002 Export Processing Zones Act requires that at least 80% of the goods produced or processed in an EPZ should be for export. The annual turnover of companies should not be less than US$500,000 for foreign investors and US$100,000 for local investors. In 2006, the government established special economic zones (SEZs), which include economic processing zones (EPZs), Free Ports, free trade zones (FTZs), industrial parks, science and technology parks, agricultural free zones, and tourism development zones. Investors qualify under the SEZ scheme if they demonstrate that their investment is new, achieve a minimum annual export turnover of US$5 million for foreign investors and US$1 million for domestic investors, provide adequate environmental protection and utilise modern production process and new machinery.[4] The tax incentives in Tanzania's EPZs and SEZs include:

- exemption from corporate income tax for the first 10 years
- exemption from withholding tax on rent, dividends and interest for the first 10 years
- import duty exemptions on raw materials and capital goods imported for manufacturing goods in the EPZs
- exemptions from VAT charges on utilities and wharfage

- exemptions from all taxes and levies imposed by local government authorities for the first 10 years.[5]

In Kenya, the EPZs, established in 1990, employ around 30,000 people working in 99 enterprises in 42 zones countrywide. Of these, 40 are privately owned and operated and two are publicly owned. Investments in the zones are valued at KShs 21.7 billion (US$241 million), and the majority of the investors are foreign companies from China, Britain, the US, Netherlands, Qatar, Taiwan and India. A quarter of the firms are joint ventures between Kenyans and foreign companies, and 14% of the enterprises are fully owned by Kenyans.[6] Numerous tax incentives are provided in Kenya's EPZs, the most significant of which are:

- a 10-year corporate income tax holiday, followed by a 25% rate (compared to the standard 30%) for the next 10 years
- a 10-year exemption from all withholding taxes
- exemption from import duties on machinery, raw materials, and inputs
- exemption from stamp duty and VAT on raw materials, machinery and other inputs.[7]

Uganda does not have EPZs and overall offers fewer tax incentives than either Tanzania or Kenya. Yet it does provide tax incentives, such as import duty and stamp duty exemptions for companies exporting.[8] It also offers unlimited corporate income tax holidays for certain categories of businesses, such as agro-processing companies, and provides a 10-year corporate income tax holiday for businesses exporting finished consumer and capital goods (when exports account for at least 80% of production). Moreover, its 2002 Free Zones Bill, which is still awaiting final Cabinet approval, will authorise the creation of free trade areas within Uganda, and offer a range of generous tax incentives.[9]

Incentives for investors in Rwanda

In Rwanda, companies operating under certain conditions (in a FTZ; with their headquarters in Rwanda; investing at least US$2 million; and making international financial transactions of US$5 million which pass through a local bank) are exempt from corporate income tax and a 15% withholding tax on interest. Other companies that invest a minimum of US$250,000 (for foreign investors) or US$100,000 (for domestic companies) are exempt from VAT, customs duty and withholding tax on certain items.[10]

Tax incentives for the extractive industries

Tanzania, Africa's third largest gold producer operates six large-scale mines and provides mining companies with an array of tax incentives. Although a new Mining Act was introduced in 2010 – replacing the Mining Act of 1998 – individual mining agreements signed between companies and the government before 2010 remain in force. Their terms often vary, but many contain, and others are believed (they have not formally been made public) to contain, fiscal "stabilisation" clauses.[11] This means that the range of tax incentives provided in the individual agreements are still likely to apply even under the new Act. The tax exemptions enjoyed by mining companies include:

- zero import duty on fuel (compared to the standard current levy of TShs 200 per litre) and on imports of mining-related equipment during prospecting and up to the end of the first year of production; after this, they pay 5%
- exemption from capital gains tax (unlike other companies in Tanzania)
- special VAT relief, which includes exemption from VAT on imports and local supplies of goods and services to mining companies and their subcontractors
- The ability to offset against taxable income the cost of all capital equipment (such as machinery or property) incurred in a mining operation. Non-mining companies are entitled to a 100% depreciation allowance only for the first five years of operations
- a reduced rate of stamp duty, at 0.3%. This is included in several mining agreements signed between the government and the mining companies, even though the rate of stamp duty is set by law at 4%[12]
- a maximum payment of local government taxes up to US$200,000 a year, which is lower than the 0.3% of turnover required by law.[13]

In Uganda, oil exploration activities led to major discoveries in the Lake Albert basin in western Uganda in 2006. Yet a full picture of the tax incentives offered in the oil sector is not known since the government has refused to make public the production sharing agreements (PSA) it has signed with the oil companies, which include Heritage, Tullow, Dominion and Tower Resources. That said, some parts of some existing PSAs have been leaked, and are seen to include sweeping "stabilisation clauses" which protect companies from increases in taxes for the 20 years duration of the agreements.[14] Some estimates are that the government will earn large revenues from oil – perhaps around US$2 billion a year.[15] Yet analysis by NGOs is that earnings will not be as much as the government

claims, that the principal beneficiaries will be the companies, and that the government could earn much more by improving the fiscal terms of the agreements.[16]

Other tax incentives

East African countries offer various other tax incentives.

Tanzania's "**strategic investor status**" accords various tax incentives to companies investing more than US$20 million. The Tanzania Investment Centre states: "For a big project of over US$20 million offering specific/great impact to the society or economy, investors can request for special incentives from the Government."[17] Thus some companies, notably foreign mining and agribusiness companies, have an individual fiscal agreement with the government, some of which offer special concessions to individual companies but which have never formally been made public.

In Kenya, various tax incentives are accorded under the Income Tax Act, the most significant of which in terms of current revenue losses (see Appendix 3) are the **wear and tear allowance** and the **investment deductions allowance** (IDA). The former is a form of capital allowance (or an allowable deduction) on the depreciation of goods such as tractors, computers and motor vehicles, while the IDA is an allowance on company expenditure on buildings and machinery.

Some governments are also offering a range of tax incentives to **agricultural investors**, some of which, including tax holidays, have been noted above. In Tanzania, agricultural investors are offered: zero-rated import duty on capital goods and all farm inputs; import duty drawback on raw materials for inputs used for exports; deferment of VAT payment on project capital goods; and zero-rated VAT on agricultural exports and for domestically produced agricultural inputs.[18]

VAT exemptions are widespread in Kenya and Uganda. In the latter, over 35 goods and services – including petrol, diesel, gas, computers and software – are VAT exempt. Kenya, meanwhile, is the only East African state to have suspended (in 1985) **capital gains tax**, reportedly after lobbying by some politically-connected individuals who at the height of public land grabbing in the 1980s wanted to transfer these properties without paying tax.[19] In Uganda, and Tanzania, capital gains tax is payable at the rate of 30%.[20]

Table 1: Summary of taxes in the EAC

Tax	Burundi	Kenya	Rwanda	Uganda	Tanzania
Corporate income tax Reductions/ exemptions	35% Zone Franche – tax relief on certain conditions. Export of non-traditional products – 17.5% Certain enterprises exempt for 10 years and then taxed at 15% 10% reduction for enterprises meeting conditions and who employ more than 100 Burundians Leasing and hire purchase enterprises exempt for 3 years and 20% for next 4 years.	30% (non-resident 37.5%) **EPZ** – 10 years 0% 10 years 25% **Newly listed companies listed under the Capital Markets Act** 20% issued shares listed 1st 3 years – 27% 30% issued shares listed 1st 5 years – 25% 40% issued shares listed 1st 5 years – 20% **Non-resident** Shipping operators – 2.5% of gross Transmission of messages – 5% **Capital allowances** Qualifying investment exceeding US$230m outside /Nairobi/Mombasa/ Kisumu – 150% Other qualifying investment –100% Hotels/education building –50%, qualifying residential/commercial building –25%, other qualifying building – 10% (all once only) Farms works – 100% (once only)	30% **FTZ –** 0% indefinitely (exempt from withholding tax and can repatriate profits tax free) **Registered Investors** Profit tax discount of 2% if employs 100-200 Rwandans 5% if employs between 201–400 6% if employs between 401-900 7% if employs over 900 **Export tax discount** Bring to country revenue US$3m–5m 3% US$ 5m + 5% **Investment allowance registered investor** Kigali – 40% Outside Kigali – 50%	30% Exporters of 80+ finished consumer +capital goods out of EAC exempt for 10 years Agro-processing for consumption in Uganda – exempt. Operators of aircrafts – exempt, education institutions – exempt. **Capital allowance** Industrial buildings/hotels (20% initial + 5% annual write down allowance) Plant/machinery (50%/75% initial + annually on reducing balance 2030/35/40%) Commercial buildings (straight line 5%)	30% **EPZ/SEZ –** 10 years tax holiday Newly listed company –25% for 3 years **Capital deductions** Buildings (straight line) (agriculture/ livestock/fisheries 20%; other 5%) Plant/machinery (initial allowance) (agriculture 110%, manufacturing 50%) Plant/machinery (reducing balance Class 1 37.5%, Class 2 25%, Class 3 12.5% Mining exploration/ development –100% Agriculture – improvements/ research and development –100%
Capital gains tax	35%	Suspended 1985	Taxed as business profit (none on private property)	30%	30% (individual 10% for Tanzanian asset)
Presumptive income tax on small businesses		3% (Turnover below US$58,000)	less than US$2,400 - 0%; US$2,400 - 34,000 - 4%	Less than US$2,100 – 0%; US$2,100 – 21,000 - 1%	Less than US$16,000 – graded from about 1.1% to 3.3%

Tax	Burundi	Kenya	Rwanda	Uganda	Tanzania
VAT Registration threshold –turnover a year	18% Zero-rated supplies; Exemptions and tax relief for certain persons US$82,000	16% 12% supply and import of electricity supply and fuel oils; Zero-rated supplies; Exemptions and tax relief for certain persons US$0.06m	18% Investors qualify for exemption on imported capital goods; Zero-rated supplies; Exemptions and tax relief for certain persons US$0.034	18% Zero-rated supplies; Exemptions and tax relief for certain persons US$0.0241m	18% Zero-rated supplies; Exemptions and tax relief for certain persons US$0.0326m
Withholding tax on other kinds of income		Yes	Yes	Yes	Yes
Excise duty		Yes	Yes	Yes	Yes
Stamp duty		Yes	No	Yes	Yes
Environmental levy		No	No	Yes	No

Sources: Mutsotso C, Harmonisation of EAC Tax Policies and Laws, 2010; Petersen H (ed), Tax Systems and Tax Harmonisation in the East African Community, University of Potsdam, 2010; cited in Institute of Policy Analysis and Research-Rwanda, 'East African Taxation Project: Rwanda Case Study', June 2011, Unpublished, Table A2.2

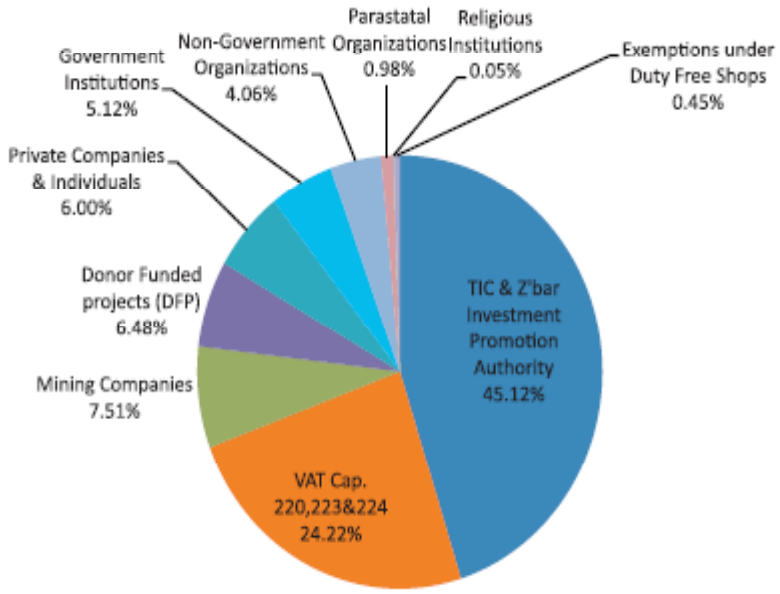
2. Winners and losers from tax incentives

A lack of transparency has long prevented the public scrutinising the extent of tax incentives in East Africa. Yet analysis suggests that the main beneficiaries are foreign investors, and that the principal losers – due to substantial revenue losses – are the general population and the country as a whole.

The winners

In Tanzania, the principal beneficiaries of the incentives and exemptions provided by government are those holding certificates with the Tanzania Investment Centre and the Zanzibar Investment Promotion Authority, which together accounted for around 45% of the incentives and exemptions in 2008/09—2009/10. These are mainly transnational corporations.[21] Mining companies accounted for a further 7.5% of the beneficiaries. Together these companies therefore account for around 52% of the incentives and exemptions provided.

Figure 1: Tax exemptions granted in Tanzania 2008/09—2009/10 by category



Source: Uwazi, 'Tanzania's Tax Exemptions: Are they too high and making us too dependent on Foreign Aid?', *Policy Brief*, TZ.12/2010, p.5

In Rwanda, the main beneficiaries of tax incentives provided to investors are large companies, many of which are foreign owned. Most tax exemptions (84%) are given on import duties, with only a small amount (0.17%) provided for employing Rwandans, even though the latter is generally regarded as preferable since it rewards output (see Appendix 4).[22]

In September 2010, the Uganda Investment Authority (UIA) released a list of 300 investors who had benefited from government tax holidays and incentives. Dr Maggie Kigozi, the UIA executive director, forwarded the list to Parliament's Committee on Commissions, Statutory Authorities and State Enterprises as evidence in investigations into the circumstances under which the Uganda Revenue Authority (URA) had rejected incentives given to some investors. Dr Kigozi noted that the companies were officially given tax holidays even after the tax incentives were formally abolished in 1997.[23]

The losers

Tax exemptions and incentives entail very significant revenue losses in East Africa. Figures often vary, however, depending on different sources used (see Table 2 below), which are sometimes explained by whether the source is referring to *all tax exemptions and*

incentives or certain categories of these, such as trade-related or FDI-related incentives. Based on our analysis of the available figures, we estimate the following losses:

- In **Tanzania**, revenue losses from *all tax exemptions and incentives* may be as high as TShs 1.8 trillion (US$1.44billion) in 2008 – amounting to 6% of GDP[24] – while the *minimum* revenue loss from *tax incentives* granted to companies alone is around TShs 381 billion (US$266 million) a year (for the years 2008/09–2009/10).[25]
- In **Kenya**, the government has recently estimated revenue losses from *all tax exemptions and incentives* at KShs 100 billion (US$1.1 billion) a year. This would amount to around 3.1% of GDP. Of these, *trade-related tax incentives* were at least KShs 12 billion (US$133 million) in 2007/08 and may have been as high as US$566.9 million.[26]
- In **Uganda**, the AfDB estimates that losses from tax incentives and exemptions are "at least 2%" of GDP.[27] This amounts to around UShs 690 billion (US$272 million) in 2009/10.[28]
- In **Rwanda**, we estimate revenue losses from tax incentives as Rwf 94 billion (US$156 million) in 2008 and Rwf 141 billion (US$234 million) in 2009. These were the equivalent of 3.6% of GDP in 2008 and 4.7% of GDP in 2009.[29]

Table 2: Different estimates of revenue losses from tax incentives and exemptions[30]

Source	Tanzania	Kenya	Uganda	Rwanda
Government	2.5% of GDP in 2010/11 and 3.5% in 2007/08[31] US$583 million in the first six months of 2010[32] US$470 million between July 2008–April 2009[33]	US$1.1 billion a year[34] This would amount to around 3.1% of GDP.[35] US$ 669 million a year in VAT exemptions alone[36] US$282 million in 2007/08, and (US$ 1.84 billion in the five years 2003/04– 2007/08 These losses amount to an average of 1.7% of GDP.[37]	US$ 7.3 million in 2011/12[38] and US$6.5 million in 2010/11[39]	US$ 156 million in 2008 and US$234 million in 2009 These amounts to 3.6% of GDP in 2008 and 4.7% of GDP in 2009.[40]
IMF	3.5% of GDP per year[41] (This is the equivalent of US$611 million a year.[42])	US$443 million a year[43]	n.a	
AfDB	Up to 6% of GDP, or US$1.44 billion in 2008[44]	n/a	"At least 2%" of GDP[45] (This would amount to around US$272 million in 2009/10.[46])	

Source	Tanzania	Kenya	Uganda	Rwanda
EAC secretariat	US$ 435.9 million in 2008 and an average of US$ 370 million in the three years 2006–08, from tax exemptions on import duties alone[47]	US$ 566.9 million in 2008 and US$1.49 billion in the four years 2005–08 from tax exemptions on import duties alone[48]	US$56 million in 2008 and US$142 million in the three years 2006–08 from tax exemptions on import duties alone. The figure of US$56.2 million is equivalent to 0.4% of GDP.[49]	
Others	3.5% of GDP in 2007/08 (Tanzanian finance minister)[50] US$417 million in 2009/10 US$2.3 billion in the 5 years 2006–10 Average of 3.9% of GDP between 2005/06–2007/08, 2.8% in 2008/09 and 2.3% in 2009/10 (Uwazi, using Tanzania Revenue Authority sources)[51]	1% of GDP in 2007/08 (Tanzanian Finance Minister)[52]	0.4% of GDP in 2007/08 (Tanzanian finance minister)[53]	

Development foregone

- Tax exemptions cost countries a huge amount in resources that could be devoted to reducing poverty and dependence on foreign aid.
- In Tanzania, if the revenue losses of USD 266mill in 2008/09–2009/10 were spent on education and health, the education budget would increase by a fifth and the health budget by two-fifths.[54]
- In Kenya, the government's entire health budget in 2010-11 was USD 461.[55] Yet the government spent more than twice this amount on providing tax incentives (using the government's estimate, noted above, of losses of KShs 100 billion (US$1.1 billion)).
- Uganda's revenue losses from tax incentives and exemptions – at 2% of GDP, as measured by AfDB – amounted to nearly twice the entire health budget in 2008/09.[56]
- In Rwanda, revenue losses from tax exemptions would be sufficient to more than double spending on health or nearly double that on education.[57]

3. Problems with tax incentives

All the evidence suggests that the disadvantages of tax incentives vastly outweigh the advantages and that such incentives are not needed to attract FDI.[58]

Proponents of tax incentives often argue that lower tax burdens give investors a higher net rate of return and therefore free up additional income for re-investment. The host country thus attracts increased FDI, raises its income and also benefits from the transfer of technology. A further argument, particularly in relation to the less developed countries, is that it is imperative to provide incentives to investors given the otherwise poor investment climate: the volatility in politics, dilapidated infrastructure, the high cost of doing business, the macroeconomic instability, corruption and an inefficient judiciary. Revenue losses are rationalised by arguing that the capital and jobs created will improve the welfare of citizens and expand the economy.

However, the list of the disadvantages of tax incentives is long, as outlined in a recent IMF report. It argues that they:

- result in a loss of current and future tax revenue
- create differences in effective tax rates and thus distortions between activities that are subsidised and those that are not
- could require large administrative resources
- could result in rent-seeking and other undesirable activities
- could, in the case of income tax holidays, be a particularly ineffective way of promoting investment. Companies that are not profitable in the early years of operation, or companies from countries that apply a foreign tax credit to reduce the home country's tax on the foreign source income, would not benefit from income tax holidays. In contrast, such holidays would be of less importance to companies that are profitable from the start of their operation
- could attract mainly footloose firms
- can be outside the budget and non-transparent.[59]

Tax incentives tend to reduce government revenues by 1—2% of GDP, according to the Organisation for Economic Co-operation and Development (OECD).[60] The IMF notes that investment incentives, if they are to be of benefit, should be well targeted and focused narrowly on the activities they seek to promote but that "the corporate income tax holiday usually does not meet the criterion of a well-targeted incentive".[61] Tax holidays strongly favour transitory rather than sustainable investments and create glaring opportunities for aggressive tax avoidance.[62] A joint report by the IMF, OECD, UN and World Bank comes to the same conclusion, noting that, where governance is poor, corporate income tax exemptions "may do little to attract investment". When they do, "this may well be at the expense of domestic investment".[63]

The application of different rules and procedures complicates tax administration and increases costs. Where the administration of tax incentives is abused, as is often the case, there are also social costs caused by corruption and rent-seeking.[64] Tax incentives are also prone to abuse when the incentive is exhausted and the promoters of the business fraudulently wind it down and simultaneously establish another entity to be accorded the same tax incentives. Tax incentives also tend to favour elite private investors who have adequate own capital of their own.[65] In addition, once incentives have been selectively granted, sectors that consider themselves excluded will agitate for inclusion, widening the incentives still further. Once incentives are provided, they are politically difficult to remove. In some cases, incentives are a further waste of resources in that many companies would invest anyway, without the incentive. Generally, investment incentives are recommended when the business is in the nature of a public good, such as with projects for encouraging green technologies, primary health care and disease prevention, upgrading skills of workers, and research and development.[66]

Tax incentives and FDI

> *"Studies... suggest that tax-driven investment does not provide a stable source of investment in the recipient country."*
>
> Joint IMF, OECD, UN and World Bank report for the G20, 2011[67]

Evidence suggests that tax incentives are not needed to attract FDI. A 2006 report by the African department of the IMF, focusing on tax incentives in East Africa, notes that the above-mentioned list of disadvantages of tax incentives is:

"...supported by available empirical evidence which mostly confirms that investment incentives – particularly tax incentives – are not an important factor in attracting foreign investment".[68]

The IMF report argues that countries that have been most successful in attracting foreign investors have not offered large tax or other incentives and that providing such incentives was not sufficient to attract large foreign investment if other conditions were not in place. The report also notes that in "specific circumstances, well-targeted investment incentives could be a factor affecting investment decisions" but that "in the end, investment incentives seldom appear to be the most important factor in investment decisions".[69] This conclusion is supported by a large body of literature showing that more important factors in attracting FDI are good-quality infrastructure, low administrative costs of setting up and running businesses, political stability and predictable macroeconomic policy. A 2010 study by the University of Nairobi found that the main reasons for firms investing in Kenya are access to the local and regional market, political and economic stability, and favourable bilateral trade agreements. Fiscal concessions offered by EPZs were mentioned by only 1% of the businesses sampled.[70] Indeed, this reasoning partly explains why the IMF, and other international organisations such as the AfDB, has been pressing governments in East Africa to radically reduce their tax exemptions (see section 4).

The 2006 IMF report notes that Tanzania's introduction of EPZs in 2002 "has not resulted in a noticeable pickup in foreign investment". Uganda has continued to attract higher levels of FDI than Kenya, which provides much more generous investment incentives.[71] The large tax incentives provided in Zanzibar are intended to attract FDI, yet FDI flows into Zanzibar have rarely exceeded US$19 million in any one year.[72] Table 3 below shows that while Tanzania has received significant FDI flows in recent years there has been only a small increase (just over US$100 million) in FDI in the five years 2006–10. Uganda has received the largest FDI flows in the region, which have been increasing even though it offers fewer tax incentives than other East African countries. In Kenya, which provides a large range of tax incentives, FDI is low level and erratic.[73]

Table 3: FDI flows (US$ million)

	2006	2007	2008	2009	2010
Kenya	51	729	96	141	133
Rwanda	31	82	103	119	42
Tanzania	597	647	679	645	700
Uganda	644	792	729	816	848

Source: UN Conference on Trade and Development, *World Investment Report 2011*, Annex Table 1.1

Problems with export processing zones

Tax regimes provided in EPZs have long been the subject of intense debate and controversy. Despite generous tax incentives, Kenya's EPZs do not employ a huge number of people – around 30,000 – and have not achieved massive investment – around KShs 22 billion (US$244 million).[74] Some exports from the EPZs, notably textiles, are largely driven by the US African Growth and Opportunity Act (AGOA) – which gives African exporters access to US markets – rather than by government incentives: 70% of exports from the EPZs are exported under AGOA.[75] Some EPZ companies have also been criticised for allegedly setting up operations to benefit from the 10-year tax holiday, only to close shop at the expiry of the grace period. The decline in the number of workers in the zones from around 38,000 in 2005 to the current 30,000 could be an indication of these businesses relocating. Other criticisms of the EPZs concern environmental pollution and the low wages and hazardous working conditions endured by some Kenyans.[76]

Kenya's Economic Secretary, Geoffery Mwau, has been quoted as saying that "the EPZ exemptions have not benefited us. We think the key to success of the EPZs is not the exemptions but reducing the cost of doing business."[77] Similarly, a 2010 Parliamentary Budget Office report has suggested that the loss from the EPZs tax incentives is greater than the economic gains from them:

> *"Preliminary EPZ data for 2005 would appear to indicate that the growth in the ratio of taxes foregone to domestic product was 90.8% compared to 13% in 2003 which is unlikely and an indication of either poor data capture or abuse of the system to bring in untaxed imports. Alternatively, the scheme appears to be more costly to revenue performance compared to the overall economic gains accruing from the EPZs."*[78]

Experience with EPZs shows that Mauritius, Malaysia and Ireland have been relatively successful because they offered much more than tax incentives, and heavily promoted integrated trade strategies, infrastructure development, management of the political environment and predictable dispute settlement systems.[79] An official at Kenya's national tax payers' association interviewed in this research held similar views, arguing that tax incentives have encouraged firms to leave, or threaten to leave, once the tax incentive is spent, and that there are few long-term benefits for the country from such "mobile investment". The EPZs have become a micro-economy, with poor linkages and transfer of technology to other parts of the economy, and also encouraged practices such as transfer pricing and declaration of losses.

4. Government policies on tax incentives

International organisations such as the African Development Bank and the IMF have joined with NGOs and others in criticising tax incentives and exemptions in East Africa, calling for them to be reviewed and reduced. Governments in East Africa all recognise that the current level of tax incentives presents serious revenue losses and are formally committed to reviewing, rationalising and reducing them. However, progress is slow and there are major questions as to how far governments are really prepared to go.

Tanzania

Although the Tanzanian government recognises that tax exemptions entail a large revenue loss and is taking some steps to reduce them, it remains unclear what the government will do to reduce tax incentives granted to mining companies and businesses operating in the EPZs and SEZs. The Minister for Industry, Trade and Marketing has said, for example, that "all other countries provide these kinds of incentives [in EPZs]... If we did not decide to provide them, no investor will come."[80] Tanzania's Export Processing Zone Authority (EPZA) has attracted investments worth US$569 million during the past five years, creating 10,500 jobs, according to a senior EPZA official.[81] This means that each job has cost US$54,000.

Even the IMF, long a supporter of low taxes, is now calling on the government to raise taxes on the mining companies. It has called for withholding taxes on interest paid on foreign currency loans; limits on the deductibility of debt financing for income taxes; and a tightening of provisions for investment allowances for exploration and development.[82] In May 2011 the Deputy Minister for Energy and Minerals, Adam Malima, was quoted

as saying that the government would "overhaul the entire tax exemptions package" for mining companies.[83] But this pledge has not yet materialised.

As regards tax exemptions more broadly, finance minister Mustafa Mkulo said in the 2011/12 budget speech that the government has already taken steps to "review procedures for tax exemptions to strengthen control over abuse" and that government policy was to "review and harmonise various tax laws, which have provisions of exemptions, with a view to minimise such exemptions". Government policy, he said, is to reduce exemptions from their current level of 2.5% of GDP to, in his estimate, "at least 1% of GDP".[84]

In the 2009/10 Budget Speech, the finance minister stated that the government proposed to revoke 405 government notices that grant tax exemptions to private companies, non-governmental and religious organisations, international institutions and completed government-sponsored projects in order to prevent the erosion of tax revenue.[85] However, so far only very limited steps have been taken. Not all of the exemptions listed by the minister in the 2009/10 budget speech – notably those benefiting mining companies – were revoked, although some exemptions on excise tax rates, for example, have been removed.

Reports by the AfDB and IMF suggest that the government is dragging its feet on reducing tax exemptions. The AfDB notes the "continued elite resistance to the abolition of the prevailing extensive tax exemptions".[86] Both the AfDB and IMF are imploring Tanzania to radically reduce tax exemptions. The AfDB notes that:

"The level of exemptions [has] not only contributed to undermining efficiency and effectiveness of gains resulting from administrative reforms, but also to the substantial revenue loss, probably accounting for most of Tanzania's tax gap."[87]

In an April 2011 report, the IMF says that "exemptions have unduly multiplied, particularly for the VAT, and could be usefully scaled down." However, "the authorities noted they were aware of the issue but had run into political difficulties when attempting to curtail exemptions. They were therefore putting the onus on tax administration reforms." In its April 2011 memo to the IMF, the government simply told the IMF it would "carefully study" the scope for reducing exemptions and would only "strengthen the management and control of tax exemptions".[88]

Kenya

The Kenyan government recognises that the current level of tax incentives presents a problem and has committed itself to rationalising and reducing them. However, there are major questions as to how far, and how quickly, the government is really prepared to go. In January 2011, it committed itself in its "letter of intent" to the IMF to "rationalising existing tax incentives, expanding the income base and removing tax exemptions as envisaged in the constitution".[89] In June 2011, a further letter of intent committed the government to undertaking a "comprehensive review of tax policy", following the appointment of a Tax Reform Commission in 2011/12, which "will aim at simplifying our tax code in line with best practices, in order to help improve tax compliance, minimise delays and raise revenue". Specifically, the government has said it will make "comprehensive amendments" to the VAT legislation in 2011/12 in order to "minimise revenue losses linked to exemptions".[90]

Past attempts to reform tax incentives and exemptions have failed to promote genuine equity. A 2010 African Development Bank report notes that:

> *"In the past, GOK [Government of Kenya] extended tax exemptions and incentives, especially on import duties to various taxpayers. Since there were no open criteria for these exemptions and incentives, they developed into favours for the well connected. This practice undermined equity and fairness of the tax system and revenue potential. The EAC Customs Management Act of 2004 has restricted the range and quantum of tax exemptions and incentives by member states. However, GOK has gone around this restriction by paying duties on behalf of select institutions such as faith groups and other charities that provide public services. Furthermore, exemptions from domestic taxes remain, but are subject to, an internal criterion which guides processing and approval of such requests. Still, there is no guarantee of equity and fairness in the distribution of these exemptions."*[91]

Uganda

In 2009, the Ugandan government agreed, according to the IMF, to undertake a comprehensive review of existing tax exemptions with a view to eliminating them in the 2010/11 budget. However, this did not happen.[92] In November 2009, the Commissioner General of the Uganda Revenue Authority, Ms Allen Kagina, called for a proper evaluation and management of tax incentives provided to investors to ensure they were not misused.

After the investors had been given incentives, the URA should have the mandate "to go in and audit" the incentives.[93] More recently, the government has formally agreed to review and reduce its tax exemptions. Following an IMF mission to Kampala in October 2011, an IMF report notes that the Ugandan government agreed that "all tax exemptions are to be reviewed, costed in terms of lost revenue and assessed on 'value-for-money'grounds".[94] According to the IMF, the Ugandan government has agreed:

> "*... on the importance of eliminating additional tax exemptions and incentives in FY 2012/13 and beyond, recognising the importance of avoiding a tax competition "race to the bottom" within the EAC Common Market*".[95]

The IMF notes that exemptions on corporate income tax, which provide a 10-year tax holiday for export businesses and for agro-processing firms, are being "streamlined" in 2011/12. This requires the URA to recertify on an annual basis the eligibility of each taxpayer to benefit from the exemptions and to narrow the scope of the eligibility criteria, particularly for agro-processing firms.[96]

The government has committed itself to a long list of measures to remove tax incentives (see Appendix 5). Despite these welcome commitments, the speed with which the Ugandan government is moving to implement them is unclear, as is whether they will actually be implemented at all. In 2009, for example, the government already agreed, according to the IMF, to undertake a comprehensive review of existing tax exemptions with an eye to eliminating them in the 2010/11 budget. This did not happen.[97]

The need to widen the tax base

Reducing tax incentives would expand the tax base in East Africa, which is currently narrow in all countries. According to the Tanzanian Revenue Authority's 2008 annual report, 39 large taxpayers contribute 80% of Tanzania's tax revenues.[98] In Uganda, it is estimated that the 35 highest tax payers account for around 50% of all tax revenue.[99] The taxed category comprises the manufacturing and professional sectors and their salaried employees as well as medium to large farmers. A more simplified tax regime, together with better use and visible benefits of taxes collected, could encourage some formalization of the informal sector and also widen the tax net. A larger tax base would in turn reduce some tax rates and discourage tax evasion.[100] The challenge is to enlarge the net of the taxed public in a manner that is equitable and transparent, especially since the wealthy are often able to use tax avoidance schemes.

One big impediment is that many people evade paying taxes because the benefit is not instantly visible and the government is perceived as corrupt. Most micro and small enterprises evade taxes simply because they can. The high administrative burdens of paying tax also contribute to sub-optimal revenue collection. According to the World Bank, firms in Kenya have to make 41 different tax payments a year (compared to an average of 37 in sub-Saharan Africa and 13 in the OECD), and spend 393 hours a year compiling and paying tax returns (compared to 318 in sub-Saharan Africa and 186 in the OECD).[101]

Improving revenue collection is also vital. In Uganda, actual VAT collections are far less than what would be expected with statutory rates as high as 18%.[102] Moreover, it is estimated that only 5% of the VAT on domestic commodities is actually collected.[103]

5. Tax competition and coordination in East Africa

Unless East African governments deepen and speed up their commitment to reduce tax incentives, the region may experience increasing tax competition and a "race to the bottom". Tax competition can occur when firms are able to locate where tax rates are lowest, thereby encouraging other countries to lower their tax rates in order to retain and attract dynamic firms and able workers.[104] Tax competition makes it harder for countries to maintain higher tax rates, leading to ever-declining rates and revenues. Harmful tax practices in East Africa, noted in the sections above, include the widespread tax holidays, other zero or low effective tax rates, and a lack of publicly-available data on the extent of incentives. Disparities in tax rates in the EAC have also encouraged illicit trade, complicated operational systems for companies wishing to carry on business throughout the EAC and slowed down the integration process.

The EAC was established to deepen political, economic, social and cultural cooperation among states and aims to establish a common market, a monetary union and ultimately a political federation. Some concrete steps to widen and deepen economic cooperation have been taken, most significantly the establishment of a customs union.[105] If effectivelyadministered, the customs union regime will help to reduce harmful tax competition.[106] It is now for the EAC's Council of Ministers to formally approve any waiver of trade tax duties, though in practice national governments continue to set their own rates in many areas.

However, although EAC states have publicly pledged to coordinate and harmonise their tax rates, deadlines and commitments have continually been missed. The EAC's Development Strategy for 2006–10, for example, called for investment incentives to be harmonised by December 2007 and for fiscal policies to be harmonised by June 2008.[107] Clearly, this has not happened. The same commitment to progressively harmonise tax

policies was reiterated in November 2009, when the five EAC states signed the protocol establishing the EAC Common Market which aims to create a full free trade area.

One significant initiative for promoting tax coordination in the EAC is the Draft Code of Conduct against Harmful Tax Competition, the product of a consultancy commissioned by the EAC Secretariat and GIZ, the German government development agency. The draft code is still being discussed and is yet to be adopted by the EAC. The code is intended to set guidelines to eliminate harmful tax practices in order to ensure fair competition in the region. Positively, it is meant to freeze the current provision of tax incentives so that additional harmful incentives are not introduced. It also calls for greater transparency and exchange of information on tax exemptions among the EAC states, the adoption of uniform transfer pricing rules, and common VAT, income tax and excise duty regimes in the EAC countries. However, less positively, the draft code proposes only weak enforcement mechanisms, emphasises tax harmonisation more than regional cooperation, and does not oblige EAC states to undertake tax expenditure analyses in order to better assess the efficacy of tax incentives in realising development objectives.

In addition to the draft code process, the IMF has been the principal external actor calling on the EAC states to deepen their fiscal coordination. The 2006 report by the IMF's African Department noted above argued that:

> *"...a coordinated approach to providing investment incentives should become a priority in the EAC. To facilitate closer regional economic integration and to avoid the damaging uncoordinated contest to attract foreign investors, the EAC members should seek a closer coordination of investment and tax policies and the creation of an EAC-wide legal framework for foreign investment."*[108]

However, there are several reasons why EAC states are insufficiently addressing harmful tax competition:

- It is questionable whether member states are willing to surrender their tax sovereignty.
- The lack of human resource capacity to analyse and negotiate is a problem in the EAC Secretariat and in some national governments.

Lack of information and knowledge is also an issue. Our research suggests that there is widespread lack of knowledge among government officials and businesses, for example, of the various commitments and mechanisms in the EAC intended to promote fiscal coordination. There is also a lack of public knowledge about the staggering level of revenue losses caused by current tax incentives.

Recommendations

In our view, governments in East Africa should:

Remove tax incentives granted to attract foreign direct investment, especially those provided to EPZs and SEZs and, in Tanzania, to the mining sector.

In Uganda's oil sector, make public all the production sharing agreements (PSAs) and subject these to public review, with a view to eliminating the fiscal incentives provided, and to ensure that all future PSAs are shared and debated publicly.

Undertake a review, to be made public, of all tax incentives with a view to reducing or removing many of them, especially those that involve the exercise of discretionary powers by ministers. Those incentives that remain must be simple to administer and shown by the government to be economically beneficial.

Provide on an annual basis, during the budget process, a publicly available tax expenditure analysis, showing annual figures on the cost to the government of tax incentives and showing who the beneficiaries of such tax expenditure are.

Promote coordination in the EAC to address harmful tax competition. This means agreeing on the removal of all FDI-related tax incentives. It does not mean achieving full tax *harmonisation* in the EAC, but increasing tax *coordination*, allowing individual countries fiscal flexibility. In turn, this principally means developing a code of conduct on tax competition in the EAC, which involves agreeing:

- on *minimum* rates on certain taxes, to avoid harmful tax competition
- to provide a mandatory, regular exchange of information to other states concerning proposed tax rate changes
- to adhere to high transparency standards, such as the IMF Code of Good Practices on Fiscal Transparency
- to establish a robust dispute settlement mechanism

- to conduct annual, comparable and publicly available, tax expenditure analyses.

East African governments should also increase the capacity in both the EAC Secretariat, and in their own governments, to analyse tax incentives and negotiate better coordination in the EAC.

Appendix 1

This table shows the EAC secretariat's calculation of tax exemptions related to import duties.

Total Exemptions and Remissions Granted by EAC Partner States. 2005—2008 (US$ millions)

Partner States	Heading	2005	2006	2007	2008	Annual percentage change
Uganda						
	Value of Exemptions	178.8	174.0	217.5	211.4	-2.8
	Revenue Foregone	33.1	36.4	49.4	56.2	13.8
	Total Trade Taxes	586.0	682.1	919.1	1102.0	19.9
	Percent Foregone	5.3	5.1	5.1	4.9	
Tanzania						
	Value of Exemptions	901.6	1225.9	1496.2	1826.1	22.0
	Revenue Foregone	204.2	405.4	268.3	435.9	62.5
	Total Trade Taxes	730.5	822.1	1104.7	1440.9	30.4
	Percent Foregone	21.8	33.0	19.5	23.2	
Kenya						
	Value of Exemptions	800.9	1370.8	1626.7	2306.2	41.8
	Revenue Foregone	201.4	289.5	430.8	566.9	31.6
	Total Trade Taxes	1529.7	1749.0	2273.2	2451.6	7.9
	Percent Foregone	11.6	14.2	15.9	18.8	

Note:

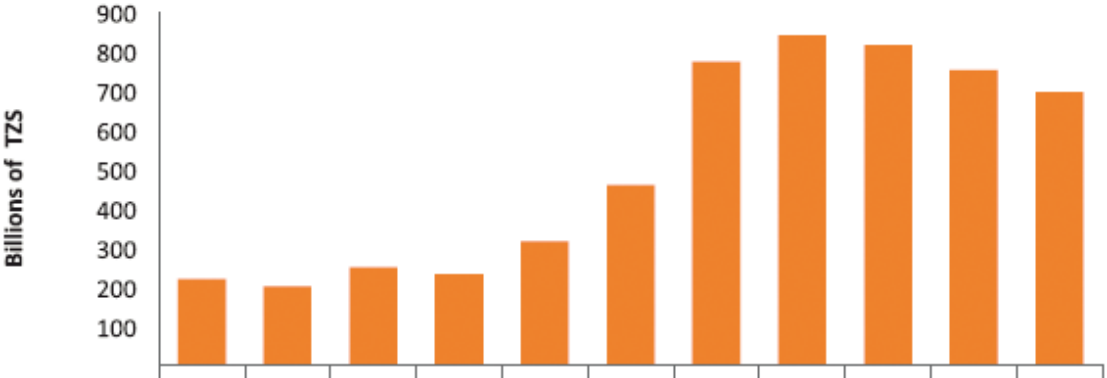
1. Percentage of Tax foregone is calculated from Tax exempted over Gross Tax collection. Gross Tax collection = actual collection + Tax exemptions.
2. Monthly revenue collections and tax exemptions are aggregated into calendar year
3. Annual average exchange rates have been applied to convert into US$

Source: EAC Secretariat, EAC Trade Report 2008, 2010, p.51

Appendix 2

Uwazi's estimates, using Tanzanian Revenue Authority sources, of tax exemptions in Tanzania

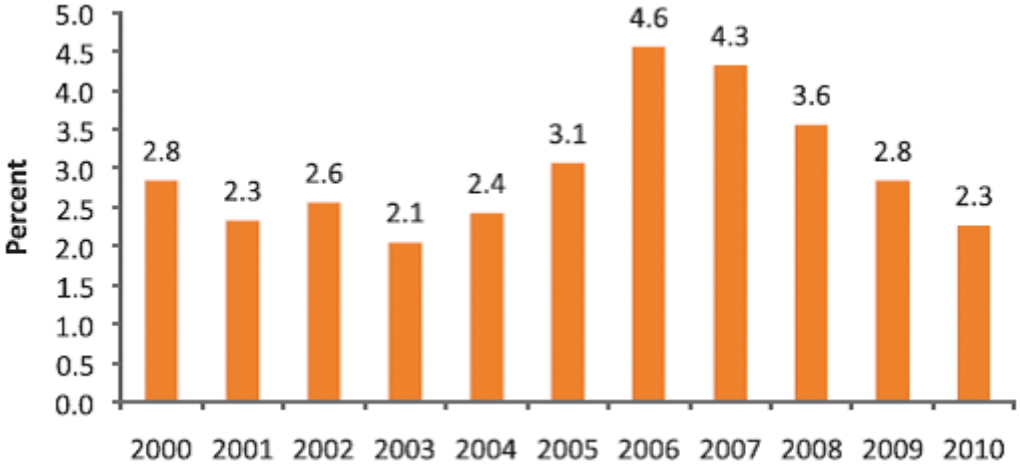
Tax exemptions in Tanzania, 2000–2010



	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010
Exemption	218	201	250	231	316	459	772	840	814	752	695

Source: Uwazi, 'Tanzania's Tax Exemptions: Are they too high and making us too dependent on Foreign Aid?', *Policy Brief*, TZ.12/2010E, p.3

Tax exemptions as proportion of GDP



Source: Uwazi, 'Tanzania's Tax Exemptions: Are they too high and making us too dependent on Foreign Aid?', *Policy Brief*, TZ.12/2010E, p.7

Appendix 3

Kenya Revenue Authority's estimates of revenue losses from tax incentives (excludes revenue losses from key tax incentives such as VAT exemptions and the suspended capital gains tax)

Estimated revenue loss from tax incentives (Kshs million)

	2003/04	2004/05	2005/06	2006/07	2007/08	TOTAL
Investment incentives						
Investment deductions	4,031	14,703	4,323	4,295	11,842	39,134
Industrial building allowance	481	1,021	539	298	494	2,833
Wear and tear	19,007	21,294	21,684	11,109	40	73,134
Farm works allowance	814	1,130	1,256	609	876	4,685
Mining operation deductions	203	715	45	70	215	1,248
Subtotal	24,536	38,863	27,847	16,381	13,467	121,094
Trade-related incentives						
EPZ	103	1,712	5,300	6,694	5,804	19,613
Manufacture under Bond	20	310	937	721	96	2,084
Tax Remission for Exports Office	2,979	2,537	3,974	7,591	6,149	23,590
Subtotal	3,102	4,559	10,211	15,366	12,049	45,287
Total	**27,638**	**43,422**	**38,058**	**31,747**	**25,516**	**166,381**
Revenue loss as % of GDP	**1.43%**	**1.66%**	**2.08%**	**1.85%**	**1.29%**	

Source: Kenya Revenue Authority

Appendix 4

Tax revenue losses in Rwanda, 2008 and 2009

Table 1: Tax foregone due to tax incentives 2008 and 2009 (Rwf)

Tax	2008 Tax foregone	2009 Tax foregone
Investment allowance	..	21,826,890,607
Tax reduction based on number of employees	259,265,691	237,037,365
Corporate income tax at 0% for 5 years (micro finance)	529,065477	61,512,331
Import tax exemptions (VAT, customs duty, withholding tax)	92,211,995,534	118,193,608,019
Domestic tax exemptions resulting from contracts based in bilateral agreement, eg COMESA (Common Market for East and Southern Africa)	1,378,873,200	536,700,600
Total	**94,379,199,902**	**140,855,748,922**
As % total tax revenue	34%	38%
As % total potential tax revenue	25.5%	30%
As % total government revenue	29%	33%
As % total potential government revenue	22.5	24.7
As % of government budget	14%	17%
As % total potential government budget	12.3%	14%
Total as % of GDP	**3.6%**	**4.7%**

Source: Calculation provided by Rwanda Revenue Authority, cited in Institute of Policy Analysis and Research-Rwanda, 'East African Taxation Project: Rwanda Case Study', June 2011, Unpublished, p.28

Appendix 5

According to an IMF report, the Ugandan government has committed to the following list of measures to reduce tax incentives:

Uganda: Measures to Enhance Revenue Performance
Revenue measures to become effective from the start of FY 2011/12:
Eliminate VAT exemption on supply of motor vehicles or trailers of a carrying capacity of 3.5 tons or more designed for the transport of goods; Streamline agricultural processing exemptions and 10-year export holiday under the CIT; Eliminate government incentives for construction materials for hotels; Eliminate investment trader regime under the VAT; URA to issue and begin to enforce proposed transfer pricing guidelines; and Government to begin to gazette and publish on the internet the names of beneficiaries (whether individual or corporation) of all tax expenditures.
Revenue measures to become effective in FY 2012/13:
Introduce a capital gains tax on non-business assets of individuals; Eliminate VAT exemptions on the following intermediate products: ► Supply of petroleum fuels subject to excise duty, except for kerosene (motor spirit, gas oil, spirit type jet fuel, kerosene type jet fuel, as well as residual oils for use in thermal power generation to the national grid); ► Supply of any goods and services to the contractor and subcontractors of hydro-electric power projects; ► Supply of specialized vehicles, plant and machinery, feasibility studies, engineering designs, consultancy services and civil works related to hydro-electric power, roads and bridges construction, public water works, agriculture, education and health sectors; and ► Supply of computers, computer parts and accessories, computer software and software licenses, printers and accessories. URA to begin to pay VAT refunds directly, rather than through budgetary appropriation.
Revenue measures to become effective in FY 2013/14:
Eliminate the following VAT exemptions: ► Supply of machinery used for the processing of agricultural or dairy products; ► Supply of packaging material exclusively used by the milling industry for packing milled products or used by the dairy industry for packing milk; and ► Supply of feeds for poultry and livestock.

Source: IMF, *Uganda: Second Review under the Policy Support Instrument and Request for Waiver of Assessment Criteria, Country Report No.11*, October 2011, p.15

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