tax justice network- Africa

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Still racing toward the bottom?

Corporate tax incentives in East Africa

June 2016

About ActionAid

ActionAid International is a non-partisan, non-religious development organization. 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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About Tax Justice Network-Africa

Tax Justice Network-Africa is a pan-African initiative established in 2007 and a member of the Global Alliance for Tax Justice. It is a network of 29 members in 16 African countries. Through its Nairobi Secretariat, Tax Justice Network-Africa collaborates closely with these member organizations in tax justice activities at the national, regional and global level. Tax Justice Network-Africa seeks to promote socially just and progressive taxation systems in Africa, advocating for pro-poor tax policies and the strengthening of tax systems to promote domestic resource mobilization.

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Front cover photo: Pupils seen during lessons at Kitama Primary School, in Kitama, Tanzania, part of ActionAid's Budget tracking and Tax Justice Campaign. PHOTO: ANDREW MCCONNELL/PANOS PICTURES/ACTIONAID

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Introduction

In 2012, ActionAid and Tax Justice Network Africa published a report containing estimates of how much revenue East African countries were losing by providing tax incentives.[1] Tax incentives often benefit foreign corporations, as they involve governments reducing or eliminating taxes such as corporate income tax, customs duties or VAT payments, and are ostensibly provided to encourage investment, including foreign investment. The 2012 report estimated that revenue losses from providing such incentives were massive – up to US$2.8 billion a year for just four East African countries: Tanzania, Kenya, Rwanda and Uganda. Especially large estimated annual losses were documented in Tanzania (US$1.2 billion) and Kenya (US$1.1 billion) but significant revenues were also being squandered in Uganda (US$272 million) and Rwanda (US$234 million). These lost revenues could be much better used to fund critical health, education and other public services. The 2012 report received – and continues to receive – widespread attention from the media and governments.

Our 2012 report also documented that many governments in East Africa were pledging to reduce or eliminate tax incentives, which ActionAid and its partners are also advocating them to do. Four years on, this current report asks:

- What progress has been made since 2012 in reducing tax incentives in East Africa, and have governments kept their promises?

Our findings are mixed. Governments have taken some positive steps to reduce tax incentives, especially those related to VAT, which is increasing tax collections and providing vital extra revenues that could be spent on providing critical services. However, they are still failing to eliminate all unnecessary tax incentives, including those such as corporate income tax incentives given to corporations. Although precise figures are impossible to provide due to a lack of transparency when it comes to numbers and vital statistics on incentives, evidence gathered suggests that collectively, figures from the four[2] East African countries focused on in this report could still be losing around US$1.5 billion and possibly up to US$2 billion a year:

- The **Tanzanian** government has remained committed to reducing tax incentives and deserves praise for having taken some concrete steps to do so, especially in introducing a new law in 2015 to reduce VAT exemptions. Yet more needs to be done as the country continues to offer numerous incentives to foreign investors, especially within its Export Processing Zones and Special Economic Zones, and to oil and gas investors. Revenue losses from tax incentives given in 2014/15 were likely to be around US$790 million; although this figure predates a new VAT law that is claimed will result in extra revenues of US$500 million.

- In **Kenya**, government officials often say they are committed to reducing tax incentives, and some limited steps have been taken. However, actual policy has mainly been to maintain and even increase tax incentives, notably though introducing new Special Economic Zones. The amount of revenue lost is unclear since Kenya's tax incentive regime remains completely un-transparent, but it is likely to be near the 100 billion Kenyan shillings (US$1.1 billion) a year level that our 2012 report mentions.

- The **Ugandan** government has also continued its commitment to reduce tax incentives, and has taken significant steps to reduce VAT and some other exemptions, expected to increase tax collections by 0.7% of GDP. However, many incentives for corporations remain, notably for oil companies. It remains unclear how much Uganda is losing to tax incentives since government figures do not appear in full, but the amount is likely to remain large.

- In **Rwanda**, the government has taken steps to reduce some tax incentives, but it has also gone backwards by bringing in a new Investment Code that offers far-reaching tax incentives to foreign investors. Estimates suggest that Rwanda is losing between 87-123 billion Rwandan francs (US$115-176 million) a year.

- For **Burundi**, determining revenue losses due to tax incentives was particularly challenging owing to an almost complete lack of data. Burundi's President Pierre Nkurunziza recently indicated that at least 81 billion Burundian francs (US$52 million[3]) have been lost to companies or officials given tax exemptions to import goods to build infrastructure, and who instead sold on the materials.[4] As a small and poor country, Burundi needs to strengthen its revenue collection to collect all the resources available. Tax incentives to attract foreign direct investment may prove to be especially harmful to Burundi, as there is very little tax base to begin with. These exemptions drastically reduce revenues for the state to be able to provide for quality public goods and services.

In comparison to our 2012 report, the East African Community (EAC) countries have shown that there is regional political will towards ending harmful tax incentives to multinationals. However, what seems to have not been understood is that it takes more than just political will to achieve this. Stronger policies need to be further implemented at both country and regional levels to make sure that they effectively seal loopholes, and that the region is able to get its rightful share of lost tax revenue. As this report finds, although the region has lost less since 2012, the figure of US$2 billion a year is likely to go up again if more is not done – especially at the policy implementation level – on ending harmful tax incentives, harmful tax competition and double taxation avoidance.

The East African Community Treaty came into Force on July 2000 following its signing on 30 November 1999, and subsequent ratification by Kenya, Uganda and Tanzania. Rwanda and Burundi acceded to the EAC Treaty on 18 June 2007, and became member of the Community with effect from 1 July 2007. 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 foreign direct investment and, they believe, increase jobs and exports.[5]

Recommendations

East African countries should:

- Eliminate the worst kinds of tax incentives – discretionary incentives (given to companies in individual agreements), tax holidays, tax incentives in free trade zones, and stability agreements (those between investors and governments that freeze tax terms for a period of time).
- Provide any tax incentives only on the basis of a thorough cost-benefit analysis, including an assessment of the impact on poor people and vulnerable groups. The analysis must be made subject to public debate, scrutiny and parliamentary oversight.
- Ensure that any new incentive offered is grounded in legislation that makes it available to all qualifying investors, foreign or domestic. This would effectively mean an end to discretionary corporate tax incentives.
- Create a public policy framework for granting tax incentives.
- Ensure that tax incentives, if granted, are subject to systematic monitoring and evaluation, and are revocable if the company fails to reach agreed development objectives.
- Publish an annual overview of the costs of tax incentives as part of the annual budget, so the public can see the impact of corporate tax incentives.
- Refrain from entering into stability clauses (which lock in corporate tax incentives long term) when negotiating new corporate tax incentives and investment agreements.
- Ensure that corporate tax incentives are audited, to check that the investment for which an incentive is offered has actually been carried out.
- Incentive regimes must be rationalised by bringing them all under the control of a single entity, with effective and resourced oversight mechanisms to ensure accountability and transparency of public spending.

Tanzania

Our 2012 report

Our 2012 report noted that Tanzanian revenue losses from all tax incentives may have been as high as 1.8 trillion Tanzanian shillings (US$1.23 billion) in 2008 – amounting to 6% of GDP[6] – while the *minimum* revenue loss from tax incentives granted to companies alone was around 381 billion Tanzanian shillings (US$266 million) a year (for the years 2008/09 – 2009/10).[7]

Reducing tax incentives provided to companies would provide vital resources for development and reduce dependence on foreign aid. If the revenue losses of US$266 million had instead been spent on education and health, the education budget would have increased by a fifth and the health budget by two-fifths.[8]

ActionAid worked on a project to help in Transforming Girls Education in Tanzania. Tax raises revenue that pays for public services – Books, teachers, classrooms: high quality, accessible public education.
PHOTO: KATE HOLT/ACTIONAID

What was the government promising to do?

Up to 2012, the government was recognising that tax exemptions entailed a large revenue loss, and was taking some steps to reduce them. However, progress was slow and the real extent of government commitment was questionable. Finance Minister Mustafa Mkulo said in his 2011/12 budget speech 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, was to reduce exemptions from their current level of 2.5% of GDP, in his estimate, to at least 1% of GDP.[9]

It remained unclear what steps the government would take to reduce tax incentives granted to mining companies and businesses operating within Export Processing Zones and Special Economic Zones. 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.

However, reports by the African Development Bank and the IMF suggested that the government was seriously dragging its heels on reducing tax incentives. The Bank noted "continued elite resistance to the abolition of the prevailing extensive tax exemptions".[11] The IMF, long a supporter of low taxes, was by 2010 calling on the government to raise taxes on mining companies.[12]

What has the government done since 2012?

The Tanzanian government has remained committed to reducing tax incentives, calling this a 'new policy drive',[13] and deserves praise for having taken some concrete steps to do so. At the same time, it continues to offer numerous incentives to foreign investors, especially within its Export Processing Zones and Special Economic Zones, and to oil and gas investors.

Most importantly, the government has pushed through a new VAT Act and a Tax Administration Act, intended to increase revenue collections and reduce tax exemptions. The VAT Act which was passed in December 2014 and became law in July 2015 contains two significant changes with regard to VAT.

- First, it significantly reduces the items and persons/companies eligible for VAT exemptions and infers that new investors in the Export Processing Zones and Special Economic Zones will not be given VAT exemptions.
- Second, the new Act severely limits the power of the Finance Minister to grant *discretionary* VAT incentives. It specifies that the Minister may only grant exemptions to imports of goods and services that are to be used solely for the relief of natural calamities. The presumption is that any VAT exemptions must be approved by the Tanzanian parliament.[14] This is clearly an important change.

In addition, the government has also taken some steps to reduce some corporate income tax exemptions (for example, on the gaming and telecoms industry) and to restrict the power of the Minister to grant some income tax exemptions, such as on excise duty on petroleum products.[15]

In the mining sector, the government in 2014 raised royalty rates for gold and copper from 3% to 4%, and scrapped the 15% VAT exemption that mining companies previously enjoyed.[16]

However, these positive changes are mitigated by some qualifications. It appears that VAT exemptions already given to existing investors within free trade zones will continue to apply. Similarly, existing oil and gas investors will continue to enjoy the same VAT relief as they did under the old VAT Act, thus their imports will continue to be VAT exempt. Also, new oil and gas investors will also be largely exempt from paying VAT during exploration and prospecting phases (but not in the development phase).[18]

Further, the new VAT Act applies only to VAT exemptions and not to other taxes, and Tanzania still provides a variety of incentives to foreign investors. For example, companies in the Export Processing Zones are still given income tax holidays for 10 years, and are also exempt from paying withholding tax on interest in respect of foreign loans and on dividends, again for 10 years.[19] In 2015, the government was expecting to register 25 more companies in the Export Processing Zones, which would bring the number to 155; together, they export around US$300 million worth of goods.[20]

In addition, the government has also stressed that, "in spite of the intention to reduce tax exemptions," it will continue to provide these to "attract super strategic investors". These 'super investors' are companies investing at least US$300 million, for which incentives will be available provided that investment is channeled through local financial institutions, and that at least 1,500 jobs for Tanzanians are created. The government has also said that, "it is critical that such exemptions are granted in a transparent manner and that a mechanism for monitoring and evaluation is in place for beneficiaries to be accountable".[21]

A further positive development is that the government has committed itself to making its granted tax incentives public by publishing quarterly tax exemption reports on the Ministry of Finance website and by providing an annual report to parliament on all tax exemptions granted. This is welcome, but again there are limitations. The reports so far placed on the website covers only domestic exemptions and reliefs, larger tax payers' relief, Zanzibar customs and excise exemptions, and mainland customs and excise exemptions. The report only covers VAT exemptions and does not list all incentives granted, notably corporate income tax and other exemptions granted in the Export Processing Zones. Also, the lengthy detail the reports contain is not easily scrutinised by non-expert members of the public.[22]

How much is Tanzania continuing to lose?

Tanzania has the highest level of inward foreign direct investment of any country in the region, currently standing at up to US$17 billion.[23] One drawback of large-scale foreign investment inflows for the country is that up to US$541.4 million (1% of GDP) in 2014 was repatriated outside the host country.

The government has said that from July 2014 to April 2015, tax exemptions amounted to 1.3 trillion Tanzanian shillings, equivalent to 1.4% of GDP – this converts to around US$747 million.[24] It estimated that by the end of the 2014/15 financial year, this amount would reach 1.5% of GDP; pushing revenue losses to around US$790 million. The government has said that this compared to 2% of GDP in the previous year, 2013/14.[25]

A media article citing figures from the Tanzania Revenue Authority reported that tax exemptions amounted to US$964 million in 2013/2014, an increase from US$793 million in 2012/2013. According to the same article, Tanzania Revenue Authority figures for 2013/14 showed that exemptions for multinational companies engaged in exploration for natural gas and oil stood at US$58.8 million, while projects undertaken by state-owned firms enjoyed a waiver of up to US$86.5 million.[26]

These figures predate the introduction of the VAT Act, which the government says can increase revenue collections by US$500 million a year.[27]

Figures recently provided by the government include VAT exemptions granted to large taxpayers. In 2013, these resulted in revenue losses of 442 billion Tanzanian shillings (US$271 million) in 2013 and 306 billion Tanzanian shillings (US$185 million) from January-September 2014. Tanroads, the domestic road authority, has been the largest recipient of VAT exemptions, but of the foreign companies granted VAT exemptions, two companies received more than any others. Together, these two companies were given VAT exemptions worth US$186 million in 2013-14 alone. Given that the new VAT Act will not eliminate the exemptions granted to these companies, continuing large revenue losses can be expected in future.

VAT exemptions granted to large taxpayers January 2010 to September 2014

	2010	2014 (Jan-Sept only)
Total VAT exemptions provided to large taxpayers	TShs 442 billion (US$271m)	TShs 306 billion (US$185m)

Source: 'Exemptions granted to large taxpayers January, 2010 to September, 2014', http://www.mof.go.tz/mofdocs/exemptions/Exemptions%20granted%20to%20large%20taxpayers%20%20January,%202010%20%20to%20September,%202014
Exchange rates: mid-2013: Tshs 1,631/US$; mid-2014: TShs 1,657/US$

Tax incentives not needed in Tanzania

A report conducted in 2013 for Tanzania's Ministry of Finance by Canadian consultancy firm CRC Sogema, which is housed on the Ministry's website, concluded that:

> *"In countries with poor investment climates – that includes Tanzania and other developing countries – the effect [of providing tax incentives] is also non-existent… It is more efficient for developing countries to focus on improving their investment climate rather than granting tax exemptions to corporations."*

The study also recommended that Tanzania entirely remove exemptions on corporate profits.[28]

In 2015, the World Bank continued to implore Tanzania to take greater steps to raise more tax revenues, saying that its revenue collections – at 12% of GDP – are still among the lowest in the world. It noted that, as the new VAT Act was being introduced, Tanzania collected only 3% of GDP in VAT collections, yet the country should be able to collect six times that amount, or 18% of GDP.[29] Humphrey Moshi, of the Economics Department at University of Dar Es Salaam, has called on the government to reduce tax exemptions by 80%.[30] At the same time, widely circulated concerns about illicit financial flows are being addressed in an inquiry led by the Bank of Tanzania, the results of which are due to be released in May 2016.[31]

Kenya

Our 2012 report

Our 2012 report noted that the government had in 2011 said that revenue losses from all tax incentives were 100 billion Kenyan shillings (US$1.1 billion) a year – this would amount to around 3.1% of GDP. Of these, *trade-related tax incentives* were at least 12 billion Kenyan shillings (US$133 million) in 2007/08 and may have been as high as US$567 million.[32]

In 2010/11, the government's entire health budget was 1.5 billion Kenyan shillings.[33] Thus the government spent more than twice this amount in providing tax incentives, using their own estimate.

What was the government promising to do?

Up to 2012, the Kenyan government was recognising that the level of tax incentives on offer presented a problem, and committed itself to reducing them. In January 2011, the government 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".[34] According to the country's Standard newspaper, Economic Secretary Geoffery Mwau even said in August 2011 that tax incentives granted to investors in Export Processing Zones could be abolished in the near future.[35]

In June 2011, the government said it would make "comprehensive amendments" to VAT legislation in 2011/12 in order to "minimise revenue losses linked to exemptions".[36] A draft VAT Bill was published for public debate in July 2011, and sought to address the complexity and inefficiency associated with the current VAT Act. The most far-reaching proposals concerned reductions in exempt and zero-rated taxable items.[37]

What has the government done since 2012?

Kenyan government policy on tax incentives has two faces. Rhetorically, government officials often say they are committed to reducing tax incentives, and some limited steps have been taken. Mainly, however, policy has been to maintain and even increase tax incentives, notably though introducing new Special Economic Zones.

By early 2015 the government had taken several steps to broaden the tax base. It had introduced a new capital gains tax, effective from January 2015, expected to yield annually around 0.2% of GDP in additional revenues, and also brought in a VAT withholding tax that would raise 0.2% of GDP. In addition, it committed itself to abolishing VAT exemption on oil products by August 2016, which would increase VAT revenue by about 0.3% of GDP per year.[38] The government has also said that the Kenya Revenue Authority has intensified the auditing of large taxpayers following the phasing out of the VAT withholding regime, which it said collected the equivalent of an additional 2% of GDP in the first quarter of the 2013/14 financial year.[39]

The government has repeatedly continued to promise to reduce or end tax incentives for corporations:

- In October 2014, senior investment officials reportedly said that Kenya plans to retire most of the tax incentives that foreign firms have been enjoying.[40]
- In December 2014, Treasury Secretary Henry Rotich was quoted as saying that,"the government will rationalize existing distortionary tax incentives, expand the income tax base and remove tax exemptions as envisaged in the Constitution."[41]
- In January 2015, the Head of the Kenya Investment Authority, Moses Ikiara, was quoted as saying that the government plans to remove many tax incentives; "We are seeing scenarios where these firms are making more than the country is gaining. These policies are not helping us anymore and we are in the process of removing them."[42]
- Then in April 2015, it was widely reported that Rotich was considering abolishing tax incentives and exemptions to foreign investors in the Export Processing Zones regime.[43]

Yet actual policy-making has been different. In recent budget speeches, where formal commitments tend to be made, the government has failed to commit to reducing tax incentives. In the last two budget speeches (given in June 2014 and June 2015) the government made no mention of reducing tax incentives. In the previous budget speech, of June 2013 (for the year 2013/14), the Finance Minister mentioned only the need to 'streamline' the 'income tax incentives management process' – an unclear term.[44]

ActionAid works to advance the political influence of people living in poverty to hold governments and corporates accountable. Taxes have the power to improve the quality of public education for all children and support youth to become drivers of change towards a poverty-free planet. Country: Kenya. Location- LRP Kibera slum, Nairobi, Kenya.

PHOTO: PIERS BENATAR/PANOS PICTURES/ACTIONAID

Indeed, the government is actually extending tax incentives, notably through introducing Special Economic Zones. A new Special Economic Zone Act was passed in September 2015 and became operational in December 2015. It gives companies operating in these Zones a raft of incentives: exemptions from all taxes and duties payable under the Excise Duty Act, the Income Tax Act, the EAC Customs Management Act and the VAT Act. Companies within Special Economic Zones are exempt from paying VAT and will pay a corporate tax rate of 10% for the first 10 years and 15% for the next 10 years.

Special Economic Zones are currently being piloted in Mombasa, Lamu and Kisumu. The government says that the impact on government revenues will be evaluated each financial year and if found below expectations, a decision will be made on whether to continue. The Special Economic Zones are meant to eventually replace the existing Export Processing Zones, where companies also receive a large range of tax incentives including:

- a 10-year corporate tax holiday and 25% tax thereafter
- a 10-year withholding tax holiday
- stamp duty exemption
- 100% investment deduction on the initial investment applied over 20 years
- exemption from VAT and customs import duty on inputs
- streamlined regulations and physical infrastructure benefits, including a recent 50% electricity subsidy,[46]

The government plans to freeze new investments within these Export Processing Zones and, at the expiry of their contractual period, will require existing investors to either start paying taxes in line with Kenya's taxation laws or register in a Special Economic Zone.[47] There are currently 58 designated Export Processing Zones hosting around 120 companies.[48]

Although the government claims that Special Economic Zones are based on a more controlled use of tax benefits, such as a reduced corporate tax rate (10%) in the first 10 years (as opposed to zero in the Export Processing Zones),[49] the new Special Economic Zone regime cannot be considered an improvement over that of the Export Processing Zones. For one thing, Kenya's Special Economic Zones have in effect gone offshore, since the Special Economic Zone Act specifies that they are considered as being 'outside the customs territory' of Kenya – a major backward step.[50] As Judy Chebet, a Kenyan advocate, has written, "the tax exemptions that Special Economic Zones entities will enjoy will be by far the most extensive that the government has granted to date".[51] While the Export Processing Zones Act limits tax incentives to manufacturing, commercial and service activities, the Special Economic Zone Act provides a non-exhaustive list of activities including business processing outsourcing, manufacturing and processing, livestock inspection, refrigeration, value addition, and services and activities to facilitate the tourism and recreation sector. As Chebet notes, "apparently, anything (legal) under the sun may now be done in a Special Economic Zone". [52]

Indeed, virtually any area of the country can now be considered Special Economic Zone. The new Act specifies that they could include free trade zones, industrial parks, free ports, information communication and technology parks, science and technology parks, agricultural zones, tourist and recreational zones and business service parks.[53] The government has set aside a total of 3,400 square kilometres of land for the Special Economic Zones [54] – an area nearly five times the size of the city of Nairobi.

Outside of the above process, the government has also been offering new tax incentives. It was reported in September 2015, for example, that the government was to provide tax incentives (by providing Export Processing Zone tax status) to 10 local companies and 11 multinationals, to encourage them to set up cotton manufacturing projects in the country.[55] The government is also waiving corporate income tax for foreign companies generating energy for the national grid, with the aim of cutting generation costs and attracting offshore investment into the sector.[56]

In addition, the Kenyan government has also reversed some decisions to end some tax incentives. In June 2015, for example, it was reported that Treasury Secretary Henry Rotich had scrapped tax incentives for large manufacturers setting up in rural areas, ending the policy introduced in 1991 to give a 150% tax deduction for capital investments of 200 million Kenyan shillings or more spent on industrial buildings and machinery outside Nairobi, Mombasa and Kisumu.[57] Yet just three months later, the government had decided to retain the incentive.[58] Kenya's Institute of Economic Affairs has said the incentive costs the government 4 billion Kenyan shillings (US$39 million) each fiscal year in lost revenues, while pointing out that, "there is no evidence that investors have invested in rural areas".[59]

How much is Kenya continuing to lose?

This question cannot be answered, since Kenya's tax incentives regime remains completely un-transparent. The government provides no figures on its tax expenditure – a major problem in itself. The media continues to widely report the 100 billion Kenyan shillings (US$1.1 billion) revenue loss from tax incentives that our 2012 report mentions. Even with the generous tax incentives that Kenya offered in the past, they generated modest benefits to the economy. Therefore, since few reductions in tax incentives have been made while others have been extended, it is likely that Kenya's revenue losses are at least this amount, and possibly more, and that this is set to continue due to the new Special Economic Zone regime and other policies maintaining tax incentives.

Tax incentives not needed in Kenya

Government policy flies in the face of calls by the Commissioner General of the Kenya Revenue Authority, John Njiraini, to end tax incentives. Njiraini has said that studies show the effect of such concessions and incentives on investor confidence to be minimal:

> "Studies have shown that the main reasons foreign firms invest in Kenya are access to the local and regional market, political stability, security, infrastructure, market size, quality of labour, power costs and regulatory certainty, and favourable bilateral trade agreements. Tax concessions offered by incentives are very minimal."[60]

The government's Letter of Intent to the IMF of February 2016 states that the government:

> "Will complete by end-September 2016 a study on tax expenditures, in order to identify their size, type (e.g., tax exemptions, reduced tax rates), their evolution over time, and the category of taxation to which they apply (structural benchmark). Based on the results of this study, we will devise measures to reduce tax expenditures."

While this is welcome, the clear danger is that government policy will continue as usual – and that promises will not turn into action.

Uganda

Our 2012 report

Our 2012 report cited African Development Bank estimates that Uganda's losses from tax incentives were "at least 2%" of GDP.[62] This would amount to around 690 billion Ugandan shillings (US$272 million) in 2009/10[63] – equivalent to nearly twice Uganda's health budget.[64]

A new and even higher figure was reported in the media in 2013, saying that a Uganda Revenue Authority audit for 2010/2011 reported losses of up to 850 billion Ugandan shillings (US$370 million[65]) in tax waivers and exemptions.[66]

What was the government promising to do?

Up to 2012, the Ugandan government was formally committed to reducing tax incentives. In 2009, for example, the government had already agreed, according to the IMF, to undertake a comprehensive review of tax exemptions with a view to eliminating them in the 2010/11 budget – which did not happen.[67] In November 2009, the Commissioner General of the Uganda Revenue Authority, Allen Kagina, called for an evaluation of tax incentives provided to investors to ensure they were not misused, saying that the Uganda Revenue Authority should have the mandate 'to go in and audit' the incentives.[68] Later, the government formally agreed to review and reduce its tax exemptions. Following an IMF mission to Kampala in October 2011, an IMF report noted 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".[69] According to the IMF, the Ugandan government also agreed:

> "…on the importance of eliminating additional tax exemptions and incentives in financial year 2012/13 and beyond, recognising the importance of avoiding a tax competition 'race to the bottom' within the EAC common market."[70]

The IMF noted that exemptions on corporate income tax, which provide a 10-year tax holiday for export businesses and agro-processing firms, were to be 'streamlined' in 2011/12.[71]

What has the government done since 2012?

The Ugandan government has continued its commitment to reduce tax incentives, with Ministers repeatedly saying that they have a negative impact on revenue collections and are not necessary to attract foreign investment.[72] The government has taken significant steps to reduce VAT and some other exemptions. However, many incentives for corporations remain, notably for oil companies, which continue to result in large revenue losses.

In the 2014/15 budget, the government abolished many tax incentives, notably concerning VAT. The IMF forecast that the removal of these VAT exemptions was expected to yield about 0.4% of GDP, the removal of some income tax exemptions would produce 0.2%, and increases in excises another 0.1%.[73] The media reported that the gains from these removals would be US$74.3 million;[74] however, the gains could be larger, perhaps US$150 million.[75] Gains in the tax-to-GDP ratio are vital in Uganda since this stands at only around 12%, an extremely low percentage. The government had also earlier announced, in 2013, that it was scrapping tax incentives for individuals, saying that, "We shall only be giving tax incentives to specific sectors where we believe it is applicable, for instance, in medical equipment."[76]

However, the IMF noted in 2015, after the elimination of these incentives:

> "Although many statutory tax exemptions were removed, loopholes remain on the policy front. Taxpayer-specific exemptions still exist, and the government is under near constant pressure to provide tax breaks. Continued diligence is required to resist these pressures and create a tax system that is efficient and fair for everyone."[77]

Several tax incentives for corporations remain. For example, a tax holiday of 10 years is available to exporters who export at least 80% of their products, subject to certain conditions. Moreover, companies in several sectors benefit from ongoing discretionary tax incentives. The IMF noted in 2014 that, "*discretionary* tax breaks – now in place for taxpayers operating in the palm oil, steel, chemicals and dairy industries – are subject to contracts that the authorities considered hard to cancel before their expiration." It urged the government to, "renegotiate such contracts and adapt them to the new fiscal and economic reality."[78]

Indeed, some of these deals are resulting in large revenue losses – according to an Auditor General's report one of the companies, palm oil producer BIDCO Uganda Ltd has benefited from a VAT exemption for eight years and a tax holiday for 25 years, resulting in revenue losses to Uganda of more than 540 billion Ugandan shillings (US$160 million). In an effort to increase revenue collection, the government abolished many statutory VAT and income tax exemptions in the financial year 2014/15 and as a result tax revenue increased by 19.2%, while non-tax revenue increased by 50.2%.[80]

Most significantly, the government announced in April 2015 that it would give a big new incentive to oil companies – making them exempt from paying VAT in their exploration and construction phases. This could reportedly result in expected revenue losses of up to a massive **US$2.7 billion.**[81] The deal came as a result of lobbying by oil investors who argued that charging VAT was against international principles and would make Uganda less attractive to new investors, and that, at a time of low oil prices, the economics of oil investment was already challenging.[82]

The government appears to say different things to different audiences on the issue of tax incentives:

- In the budget speech in June 2015, for example, Finance Minister Matia Kasaija said that some existing and potential investors had petitioned the government seeking tax incentives and that they, "will be meeting with investors regularly to discuss options to improve the tax incentive regime for investment and the appropriate changes to be implemented."[83]
- However, a few months later, in November 2015, the government wrote in its Letter of Intent to the IMF – which is strongly pushing Uganda to reduce tax incentives – that, "government will reassess the rationale and value added of the remaining tax exemptions to specific sectors and consider their elimination."[84]

Tax pays to improve the quality of public education for all children and support youth to become drivers of change towards a poverty-free planet.
PHOTO: ACTIONAID

How much is Uganda continuing to lose?

It remains unclear how much Uganda is losing to tax incentives, including to corporations, since government figures do not appear to provide the full picture.

The government has published on the Ministry of Finance website a tax expenditure figure for 2014/15, but the total is just 22.1 billion Ugandan shillings (US$6.6 million), which is scarcely credible. It includes a corporate income tax holiday for only one company (Steel and Tube Industries).[85] Similarly, in budget speeches, the Finance Minister has given a figure for the government's tax expenditures, but these amounted to only around 8 billion Ugandan shillings for 2012/13 and 11.7 billion Ugandan shillings for 2013/14.[86] It is likely these figures cover some but not all tax incentives, and they do not cover projected revenue losses from VAT exemptions granted to oil companies.

Tax incentives not needed in Uganda

Ugandan officials are aware that tax incentives are not needed to attract foreign investment. For example, Uganda Revenue Authority Commissioner General Allen Kagina has said:

> "Recent studies have concluded that tax exemptions are no longer the major incentives for investments. It is security, markets, infrastructural development, energy and skilled labour that are very important for investment attraction, and not tax holidays and exemptions."[87]

Finance Minister Maria Kiwanuka has also said that tax incentives rank just ninth out of 10 needs of investors, with access power being regarded as the most important.[88]

Rwanda

Our 2012 report

Our 2012 report estimated revenue losses from tax incentives as 94 billion Rwandan francs (US$156 million) in 2008, and 141 billion Rwandan francs (US$234 million) in 2009. These were the equivalent of 3.6% of GDP in 2008 and 4.7% of GDP in 2009.[89] These revenue losses would have been enough to more than double spending on health, or nearly double that on education.[90]

What has the government done since 2012?

Since the global financial crisis of 2008-2009, Rwanda has been one of the fastest growing economies in East Africa. Growth was estimated to have reached 7% in 2015.[91] The government has taken steps to reduce some tax incentives, but it has also brought in a new Investment Code that offers far-reaching tax incentives to foreign investors; the latter is likely to continue Rwanda's substantial revenue losses.

In 2014/15, the government brought in measures to eliminate VAT exemptions for investment certificate holders, to reduce other VAT exemptions and to bring all incentives related to customs duties into line with EAC regulations.[92] As a result of ActionAid and Tax Justice Network Africa's work to highlight Rwanda's tax incentives, coupled with the need to become more self-reliant, the government began to closely monitor the tax incentives it was giving to companies.[93]

However, in 2015 Rwanda passed a new Investment Code, which offers increased incentives to investors:

- International companies that base their headquarters or regional offices in Kigali and invest a minimum of US$10 million in Rwanda, in addition to fulfilling a number of other requirements, are exempt from corporate income tax.
- Companies are given a corporate income tax rate of 15%, down from 30%, if they export at least 50% of the goods (excluding coffee, tea, and minerals) and services that they produce in Rwanda, or who invest in the energy, transport, ICT or financial services sectors.
- Tax holidays of up to seven years are offered to investors who invest at least US$50 million in Rwanda.[94]

How much is Rwanda continuing to lose?

The Rwanda Revenue Authority is widely reported as estimating that the country loses 16% of total revenue collection through tax incentives extended to investors.[95] This would amount to around **123 billion Rwandan francs (US$176 million) in 2013/14.**[96]

Slightly lower figures are given in a 2015 analysis by the Institute of Policy Analysis and Research, (IPAR)-Rwanda and ActionAid. This found that in the four years from 2009/10 to 2012/13, Rwanda lost a total of 349 billion Rwandan francs (US$460 million) in revenues from tax incentives – an annual average of **87 billion Rwandan francs (US$115 million)**. Of these, 41.6 billion Rwandan francs (US$55 million) was the result of corporate income tax incentives – an annual average of **10.4 billion Rwandan francs (US$13.7 million)**.[97] According to the IPAR analysis, revenue losses overall have been increasing over this four-year period, although those resulting from corporate income tax incentives have been decreasing.

These are significant revenue losses – the average annual loss of US$115 million is equivalent to 40% of the education budget in 2014/15, for example.[98] It is vital that Rwanda increase its revenue collections, since the country currently raises only 15% of its GDP in tax.[99]

Actionaid works with the most vulnerable community members and takes a holistic approach to reducing poverty, focusing on education, livelihoods and the rights of women and girls.
PHOTO: ACTIONAID

Burundi

Burundi, currently a country in turmoil, is also one of the world's poorest countries. Burundi ranks in 184th place among 188 countries on the 2014 UN Human Development Index,[100] and 81% of the country's population lives below the income poverty line of US$1.25 a day.[101] The economy is dominated by subsistence agriculture, which employs 90% of the population, though cultivable land is extremely scarce.[102] According to the 2015 Index of Economic Freedom, Burundi has a population of nine million people and a GDP of US$5.8 billion, a per capita income of just US$642. The estimated GDP growth rate is expected to be 4.8% in 2015, up from 4.7% the previous year.[103]

Burundi faces a weak investment climate, due mostly to political and macroeco¬nomic instabilities; the government thus appears to regard corporate tax incentives as necessary to attract capital that would otherwise not come. Further, the country is landlocked, has few natural resources, infrastructure is lacking and its population suffers from extreme poverty. Through taxes and the budget, the state can also ensure its economic and social justice. With few other options and limited internal capital, the government of Burundi has sought to increase foreign direct investment through tax incentives to try and foster economic growth. However, it is not clear if these incentives are absolutely necessary and have resulted in job creation, infrastructure development, social reengineering and communities' development.

The processes and parameters for negotiation and the granting of the incentives need to be less opaque and made public. There is also the need for relevant agencies to set up monitoring mechanism to ensure incentives are granted and used appropriately.

In Burundi (2013), over 50% of educated youths and over 60% of uneducated youths were unemployed. The slow economic growth then (4%) was not creating a conducive environment for job creation and employment.
PHOTO: ACTIONAID

Tax incentives offered and revenue losses in Burundi

Currently, Burundi applies investment incentives to both international and domestic companies in the form of income tax deferrals, and exemption from import and export duties.[104] The primary provision for tax incentives in Burundi is in the Investment Code of 2009.

Determining revenue losses due to tax incentives was particularly challenging in the case of Burundi, owing to an almost complete lack of data. As a small and poor country, Burundi needs all the resources that are available to it. Tax incentives to attract foreign direct investment may prove to be especially harmful to Burundi as there is very little tax base to begin with. It is therefore necessary to design indicators and criteria by which foreign companies coming to invest in Burundi should engage on economic and social achievements. Nonetheless, Burundi has undertaken some major positive reforms on their tax system; in part from a then desire to join the EAC common market (Burundi and Rwanda joined the EAC on July 01, 2007). These reforms include the Income Tax Act, Tax Procedure Code and the draft law on VAT. By joining the EAC, while at the same time closing tax loopholes, increasing oversight and reducing potential for corruption, Burundi has experienced a substantial increase in revenues from tax collection. At the end of 2015 however, tax revenue unfortunately, "fell 17% in the last quarter of 2015" according to the Burundi Revenue Office (OBR).[105]

Burundi's President Pierre Nkurunziza recently indicated that at least 81 billion Burundian Francs (US$52 million[106]) have been lost to companies or officials who were given tax exemptions to import goods to build infrastructure, but who instead sold on the materials. As a small and poor country, Burundi needs to strengthen revenue collection to collect all the resources available.

Regional integration

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.[107] Although the code is yet to be adopted by EAC member states; positively, it is meant to "freeze" the current provision of tax incentives so that additional harmful incentives are not introduced. The Code also includes provisions on increased transparency and exchange of information on tax exemptions and adopting uniform transfer pricing rules.[108]

Article 5 (2) of the treaty establishing the East African Community stipulates that: "Partner states undertake to establish among themselves and in accordance with the provisions of the treaty, a customs union, a common market, subsequently a monetary union and ultimately a political federation". It is thus a priority need for all the countries within the EAC to address the issue of harmful tax incentives for greater integration.

Conclusion

This report finds that East African countries still provide foreign investors with excessively generous tax breaks in the form of tax holidays, capital gains tax allowances and royalty exemptions, and countries continue to lose colossal amounts of revenue through unnecessary tax exemptions and incentives. Leaders in the region seem to have felt obligated to respond to pressure from their own citizens and from organisations campaigning against harmful tax incentives, and the issue of reducing and phasing out harmful tax incentives has made headlines for the past few years. Many leaders have made strong statements promising to make more progress on the issue. In many cases, however, we have only read about steps being taken; we have not seen much evidence of significant action. That makes the responses mostly empty rhetoric, not what is necessary or needed. Evidence gathered suggests that collectively, four East African countries (Kenya, Uganda, Tanzania and Rwanda) could still be losing around US$1.5 billion and possibly up to US$2 billion a year.

There is momentum for tax policy reforms to address harmful tax incentives at both the national level and the EAC level. The EAC integration process is stimulating much needed debate and review of tax policies and procedures across the common market.

There is evidence of policy intentions and actions to reform the tax incentives and exemptions regime in East Africa. Nevertheless, there are still issues of national interest, such as tax treaties; and the establishment of Special Economic Zones, that are fueling competition at the EAC level, and derailing any meaningful progress towards regional harmonisation of tax policies.

At the national level, there is a range of new legislations such as VAT laws and tax administration legislation that seek to redress the numerous incentives. Kenya and Tanzania are leading in this reform agenda. Nevertheless, there are drawbacks in a number of areas owing to new investment contracts, and pre-existing contracts such as mining agreements, as well as new waves of incentives to attract investors.

Kenya and Tanzania seem to have learned from the pitfalls of past policies and the enormous revenue losses they have brought, apparently becoming more committed to reforms. Meanwhile Uganda, Rwanda and Burundi continue on a downward trajectory, by continuing to shun real reforms on tax incentives. The smaller EAC economies are more inclined towards granting more incentives rather than curbing harmful incentives, in a bid to ward off competition from the more established economies of the region. It is more a case of survival of the fittest as the latter give excessive incentives through new laws and policies, without laying down any serious procedures to curb unnecessary and harmful incentives.

The level of citizen engagement on matters of tax policy reforms at the regional level is extremely low, as the agenda for reforms is driven by state parties, and private sector and investor interest groups. Policy decisions at the EAC level do not have much input from citizens and civil society, while investors and manufacturers across the region are engaged on these matters.

While efforts are being made to reform the tax incentive regime at the country level, in all five EAC countries the real cost of these incentives remains hidden, as there are as yet neither the mechanisms nor the demand for accountability needed to reveal the huge revenue losses happening on a daily basis.

Recommendations

East African countries should:

- Eliminate the worst kinds of tax incentives – discretionary incentives (given to companies in individual agreements), tax holidays, tax incentives in free trade zones, and stability agreements (those between investors and governments that freeze tax terms for a period of time).
- Provide any tax incentives only on the basis of a thorough cost-benefit analysis, including an assessment of the impact on poor people and vulnerable groups. The analysis must be made subject to public debate, scrutiny and parliamentary oversight.
- Ensure that any new incentive offered is grounded in legislation that makes it available to all qualifying investors, foreign or domestic. This would effectively mean an end to discretionary corporate tax incentives.
- Create a public policy framework for granting tax incentives.
- Ensure that tax incentives, if granted, are subject to systematic monitoring and evaluation, and are revocable if the company fails to reach agreed development objectives.
- Publish an annual overview of the costs of tax incentives as part of the annual budget, so the public can see the impact of corporate tax incentives.
- Refrain from entering into stability clauses (which lock in corporate tax incentives long term) when negotiating new corporate tax incentives and investment agreements.
- Ensure that corporate tax incentives are audited, to check that the investment for which an incentive is offered has actually been carried out.
- Incentive regimes must be rationalised by bringing them all under the control of a single entity, with effective and resourced oversight mechanisms to ensure accountability and transparency of public spending.

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NB. The terms 'incentives' and 'exemptions' are used interchangeably in this report. 'Incentives' is more commonly used to denote tax reductions to encourage investment; however, exemptions, which are often simply reductions in tax to benefit certain domestic groups, can also fall into this category.

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Tax Justice Network-Africa is a pan-African initiative established in 2007 and a member of the Global Alliance for Tax Justice. It is a network of 29 members in 16 African countries. Through its Nairobi Secretariat, Tax Justice Network-Africa collaborates closely with these member organizations in tax justice activities at the national, regional and global level. Tax Justice Network-Africa seeks to promote socially just and progressive taxation systems in Africa, advocating for pro-poor tax policies and the strengthening of tax systems to promote domestic resource mobilization.

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