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What is the impact of corporate tax incentives in Uganda?

While multinational corporations (MNCs) make up only 1.9% of firms operating in Uganda, they are overrepresented among tax holiday beneficiaries. New estimates reveal that Uganda's revenue losses due to these tax expenditures peaked at USD 42 million in 2020.

Many studies examining the effectiveness of corporate income tax (CIT) incentives to support national development goals have identified a link between tax incentives and improved economic outcomes. However, tax incentives can be costly, which can undermine fiscal sustainability and potentially limit opportunities for other public investments. Especially in low-income economies, it is essential to consider whether the advantages of tax incentives outweigh the resulting revenue loss.

Tax incentive beneficiaries are the largest firms

A recent analysis compiles a new dataset that systematically gathers information on the tax incentives offered in Uganda. This dataset is combined with the Ugandan Revenue Authority's (URA) firm panel covering CIT administrative data for the financial years 2013/14 to 2020/21.

Using this comprehensive data, the analysis identifies the characteristics of firms benefiting from various incentives: industry sector, size, multinational versus domestic company status, profitability, and employment. The assessment also provides new evidence on the costs of tax incentives relative the economic benefits reaped by firms operating in Uganda.

The findings indicate a disproportionately higher share of MNCs among tax incentive beneficiaries compared to their share among firms operating in Uganda's economy. The domestic firms which benefit are mostly from the relatively small share of large firms.

FINDINGS

A new dataset allows for the first detailed analysis of corporate tax incentives and the firms that claim them

There's a notable link between tax holidays, investment allowances, and increased employment and investment in Uganda, though causality needs further study

Mostly multinationals and the largest domestic firms benefit from these initiatives

Half of the firms claiming tax holidays would remain highly profitable, even if taxed at the standard corporate income tax (CIT) rate of 30%

The cost of the five studied tax incentives is as high as USD 42 million annually, nearly one-fifth of Uganda's annual CIT receipts

This is significant because Uganda ranks last among sub-Saharan African countries in CIT revenue collected, despite having a relatively high statutory CIT rate of 30%. A previous examination of Uganda's CIT found that MNCs pay lower effective tax rates, by approximately 20 percentage points, on reported profits than large domestic companies do.

Corporate tax incentives are associated with some economic benefits

Next to corporate tax avoidance via profit-shifting to tax havens, numerous and generous tax incentives are considered one of the main causes of low corporate income tax revenues in Uganda. The analysis focuses on tax holidays granted for four qualifying reasons and one specific investment allowance known as accelerated depreciation—which is intended to encourage new investment in plant machinery and other productive technology in certain regions.

Tax holidays are a temporary reduction or elimination of tax liability for qualifying taxpayers, while accelerated depreciation allows firms to depreciate the costs of certain new investments faster and thereby reduce their overall tax liability.

Tax holidays in Uganda offer four types of special 10-year tax exemptions. These exemptions apply to firms exporting over 80% of their production, firms operating within industrial parks, and those in special economic zones. A one-year tax holiday that might be prolonged is granted for firms that start new agroprocessing operations. Accelerated depreciation in Uganda is available to firms making new investments outside of the capital area, encouraging investment beyond Kampala.

The empirical analysis reveals that all observed tax holidays correlate with increased levels of new investments and higher expenditures on personnel by firms, which may indicate a potential connection between the incentives and elevated employment levels, especially outside of the capital area. The data indicates that tax holidays and accelerated depreciation are associated with increased investment and employment. However, this does not prove causality, and further research is needed.

The benefits cost nearly one-fifth of total CIT revenue

The conservative estimates for foregone revenue due to the analysed tax holidays fluctuate annually and range between UGX 65.6 billion and UGX 160.7 billion for the years studied (2013–21). The estimated revenue loss from these incentives varied annually, peaking in 2020 at USD 42 million, which is close to one-fifth of Uganda's total CIT revenue for the latest year data is available (2017). Among the four studied tax holidays, the industrial park tax holiday followed by the one for exporters is the costliest in terms of revenue forgone.

Overall, the results indicate that the top half of the firms benefiting from tax holidays would maintain a net profit margin above 5%—considered the market average across industries—without the tax holiday, and about 25% of firms would maintain a net profit margin above 10%. The availability of tax holidays grants the top 1% of firms a net profit margin of around 88% instead of 62%. Over the period reviewed, the number of firms benefiting also remained stagnant for exporters and agroprocessors, suggesting that the tax holidays may not contribute to the creation of new firms in the targeted industries. This raises the concern that tax incentives in Uganda may benefit firms' bottom lines without translating to benefits for the economy.

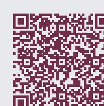
These findings underscore the need for careful consideration of the balance between fiscal incentives and economic outcomes. They also demonstrate that administrative tax data is a valuable source of information for monitoring the costs and benefits of tax policies. Improvements to data can be made if all firms, including tax-exempt ones, filed their taxes electronically.

IMPLICATIONS

Policymakers should reconsider or refine tax incentives to increase Uganda's CIT revenue

Enhancing the collection and analysis of administrative tax data is crucial for evaluating the impact of tax policies

Encouraging all firms to adopt electronic tax filing could improve the monitoring and effectiveness of tax incentives



This Research Brief is based on WIDER Working Paper **Did Uganda's corporate tax incentives benefit the Ugandan economy or only the firms?** by Nicholas Musoke, Tereza Palanská and Caroline Schimanski, prepared as part of the UNU-WIDER project **Building up efficient and fair tax systems – lessons based on administrative tax data**