

The Fiscal Management Framework on Tax Expenditures in Uganda

Silver Namunane, PhD
DRM Specialist
Ministry of Finance, Uganda
October, 2022

Tax Expenditure Framework-Tax expenditures defined

- Tax Expenditures broadly refer to any reductions in tax liability compared to some benchmark tax system.
- Tax Expenditures can be in form of:
 - tax exemptions,
 - reduced tax rates,
 - tax credits,
 - tax deferrals,
 - Executive decisions that alter a taxpayer's tax liability.
- Tax expenditures may encourage new investments and support the development of sectors or economic activities that are critical to the social economic transformation of the economy.
- However, these tax expenditures need to be anchored in a clear fiscal management framework to minimize abuse and ensure that the intended objectives are achieved.

Basis for the designing the Tax Expenditure Framework

- The existing Tax Expenditure System indicates some strengths;
 - Most tax expenditures are in the tax laws;
 - There is limited discretion in granting tax expenditures; and
 - Annual publication of cost of revenue foregone, thus improving transparency
- However, Government of Uganda has in recent years come under scrutiny:
 - Incurring tax expenditures without clear criteria for selecting beneficiaries
 - No clear reporting and monitoring framework to assess effectiveness of these Tax Expenditures.
- Tax Expenditures are costly in terms of revenue foregone:
 - As of FY2019/20 TEs are estimated to be UGX 2,334.5bn – about 1.68 percent of GDP.
 - Constitutes a significant increase over the last five financial years from about 0.87 percent of GDP in FY 2015/16.

Statement of the problem that the framework intends to address

- A comprehensive review of the current tax expenditure framework identified the areas below as those that required to be addressed through appropriate reforms:
 - i. The absence of documented minimum standards, and or fiscal rules against which tax expenditures are assessed;
 - ii. During the budget cycle, tax expenditure proposals can be made at **any stage** and **by any entity**, which limits predictability and the time required for in-depth analysis;
 - iii. Analysis of Tax Expenditures is not detailed enough to include impact on equity, cost of revenue foregone, administerability, and socio and economic benefits expected;
 - iv. There are no sunset clauses for new tax expenditures – Risks tax expenditures becoming a permanent feature of the tax system;
 - v. There is no periodic evaluation of the tax expenditures to determine continued relevancy;
 - vi. Legislature is not mandated to debate the tax expenditure report submitted by the Minister of Finance.

Overarching goal of Tax Expenditure reporting

- Improve transparency in fiscal management.
 - Tax expenditures are as important as all other Government expenditure programs.
- If TEs are not well managed can have distortionary effects
 - creating unfair competition.
 - Less job creation than would have otherwise occurred without the intervention.
- Improved targeting in Government interventions (TEs)
 - Encourages industrialization and job creation.

Tax Expenditure Governance Framework

- There is a **Tax Expenditure “Governance Framework”**: 3 primary objectives:
 1. Clarify criteria for approval of new (continuance of existing) tax expenditures
 2. Instate minimum requirements for proposing new tax expenditures and management/monitoring/administration of existing ones
 3. Clarify roles & responsibilities of the entities involved in the governance of tax expenditures
- Would incorporate stakeholders from **MoFPED, URA, Cabinet, Parliament**

Tax Expenditure Governance Framework

- (Proposed) Pre-approval criteria for new Tax Expenditures:
 - a) Confirmation that the new tax expenditure is **consistent with a fair and efficient tax system,**
 - b) Confirmation that the tax expenditure is consistent with the **economic management priorities of Government and the general policy of the Government on tax expenditures.**
 - c) A comprehensive analysis of the ***economic, policy, efficiency, administrability* and *equity* of new tax expenditures to confirm feasibility.**

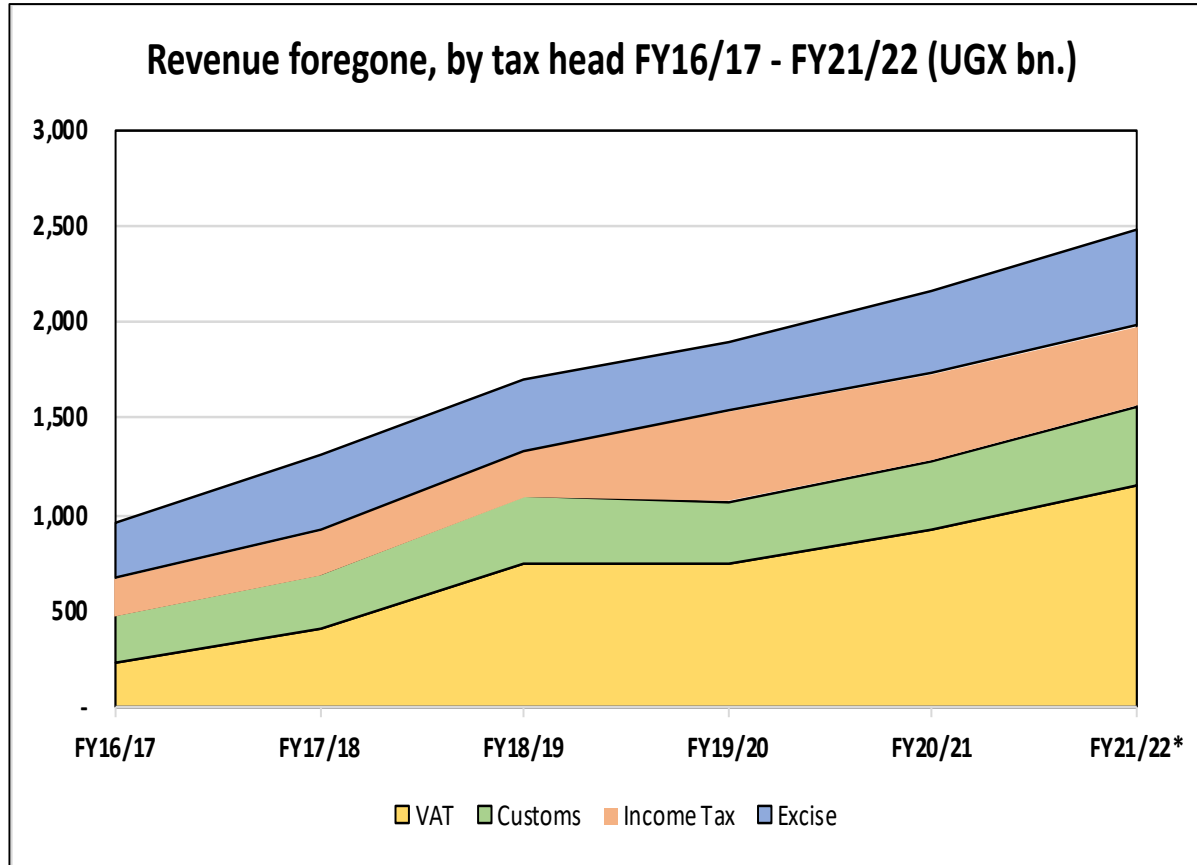
Thank you

Annex

How much Revenue is forgone in TEs?

- Earlier estimates had indicated that the value of tax expenditure in Uganda stood at UGX 5,413.92 Bn which represented 3.88 percent of GDP.
- However, these figures were based on a benchmark that was unrealistic and did not take into account Uganda specific attributes such as;
 - the need to promote value addition,
 - the need to modernize agriculture,
 - Uganda being a landlocked country and may have to provide preferential rates for cargo vehicles, and
 - the need to provide preferential rates for equipment that are not locally available yet are critical in the generation of hydro-electric power
 - a cleaner source of energy
- Factoring in these country specific attributes when determining the benchmark resulted in a much lower estimate for tax expenditures.

How much Revenue is forgone in TEs?



- The current tax expenditure report shows TEs for FY2020/21 estimated at UGX 2,164.86bn.
 - About 1.5 percent of GDP.
 - increase over the last five FYs from about 0.87 percent of GDP in FY 2016/17.
- In FY 2020/21, revenue foregone
 - VAT constituted the largest form of tax expenditure (0.62% of GDP),
 - Excise Tax (0.3% of GDP)
 - Income Tax (0.3% of GDP), and
 - Customs (0.24% of GDP).
- Estimates of TEs under Income Tax have grown substantially, from 0.17% of GDP in FY2016/17 to 0.3% in FY2020/21.
 - Tax Exemptions account for about 85 percent (0.26 % GDP) of the revenue foregone from Income Tax.

Minimum Requirements for TE Application

Any Application for Tax Expenditures shall contain at least the following:

- a) The problem or challenge to be addressed by tax expenditure being applied for.
- b) Consideration of available fiscal options to address the challenge and confirmation that this challenge can only be addressed by a tax expenditure and not any other fiscal policy tool.
- c) Confirmation that the envisaged investment or activity aligns to national priority strategic goals as stated in the National Development Plan.
 - a) Confirmation that the envisaged investment or activity aligns to the program or sector strategy within which the tax expenditure is expected to apply.
- d) Statement of the envisaged cost of the tax expenditures.
- e) Statement of the envisaged benefits from granting the tax expenditures.
- f) Summary statement on the projected economic and social cost-benefit assessment of the tax expenditures
- g) Proposal of the monitoring and evaluation mechanism of the tax expenditure

Key Players and Roles –

Applicants

Strategic and Planning Phase

- Submit Requests which meet minimum Requirements to MoFPED

Analysis Stage

- Available for Consultation by MoFPED

Implementation Stage

- If granted, utilize tax expenditures and account by submitting regular returns and /or reports for monitoring

Monitoring and Evaluation Stage

- Ensure TE performance data required to undertake TE effectiveness evaluations is available.

Key Players and Roles –

MoFPED

Analysis Stage

- design and monitor a fair, broad-based, and efficient tax system- setting tax expenditure fiscal rules
- On receipt of Application, screen new tax expenditures (a) for consistency with a fair and efficient tax system; (b) to ensure consistency with GoU economic management priorities and c) carry out comprehensive *economic, policy, efficiency* and *equity* analysis

Approval Legislative Stage

- Secure MoFPED Top Management, Cabinet and Presidential Approvals
- Work with First Parliamentary Counsel to draft and gazette Bills which include Tax Expenditures
- secure Parliamentary approvals

Implementation Stage

- Implement Pay on Behalf Discretionary Tax Expenditures by securing budget approvals, executing MoUs and Monitoring

Monitoring and Evaluation Stage

- Keep and avail data on discretionary tax expenditures (pay on behalf)
- Prepare and Submit Annual Tax Expenditure statement to Parliament.
- Include sector specific tax expenditures in their strategic program reviews.
- Lead and carry out 4-year interval or rolling basis TEs evaluation and inform retain, drop or modify decisions

Key Players and Roles –

Cabinet

Strategic and Planning Phase

- Ensure Sector Specific Strategic Plans are comprehensive and where applicable articulate areas where TEs will meet sector objectives
- Ensure sector TE requests meet minimum requirements

Analysis Stage

- Be available and support MoFPED in analysis of sector specific TE proposals

Approval Legislative Stage

- Grant MoFPED approvals for proposed and analyzed TEs
- Support Parliamentary debate on approved TEs

Implementation Stage

- None

Monitoring and Evaluation Stage

- Review 4-year interval or rolling basis TEs evaluation report and guide retain, drop or modify decisions

Key Players and Roles –

Parliament

Strategic and Planning Phase

- Ensure sector TE requests proposed at Parliamentary level meet minimum requirements

Analysis Stage

- Refer Parliamentary sponsored TEs to MoFPED for comprehensive analysis

Approval Legislative Stage

- Receive and Debate Executive Proposals for Tax Expenditures
- Conduct Stakeholder Consultations for TEs,
- Refer new TE proposals to MoFPED for Detailed Analysis and issuance of Certificate of Financial Implications/compliance
- Approve analyzed, debated and appropriate Tax Expenditures

Implementation Stage

- None

Monitoring and Evaluation Stage

- Receive and debate annual Tax Expenditure Statement

Key Players and Roles –

URA

Strategic and Planning Phase

- None

Analysis Stage

- Provide Data and information required by MoFPED in analyzing TEs
- Be available and support MoFPED in analysis of new TE proposals

Approval Legislative Stage

- None

Implementation Stage

- Amend processes and systems to implement new TEs and ensure adequacy in collecting data needed
- Educate Taxpayers on New TEs,
- Administer URA level discretionary Tax Expenditures
- Audit and ensure taxpayer compliance to minimum requirements before utilization of TEs
- Receive feedback, returns and data related to tax expenditures

Monitoring and Evaluation Stage

- Avail data to MoFPED to enable preparation of annual Tax Expenditure Statement
- Support and participate in four year or rolling basis Tax Expenditure Reviews