

Budget Brief-Uganda 08

Economic Commentary

2007/08 Economic performance

The economy is estimated to have grown by 9.8% compared to 7.9% recorded in the previous year.

This growth is attributed to increased regional demand for goods and services and Commonwealth Head of Government Meeting (CHOGM) related activities.

Agriculture sector

The agricultural sector performed poorly in 2007/08 with output increasing by only 0.7% during the year. The poor performance is attributed mainly to fishing which declined by 12.4% compared to a decline of 3% in 2006/07. There was a slight growth in forestry of 2.6% this year compared to 1.9% in 2006/07.

Growth in the livestock subsector remained stable at 3%. Agricultural productivity remains unacceptably low, yet the sector employs about 85% of Ugandans.

Manufacturing sector

The industrial sector is estimated to have grown by 6.4% in 2007/08 compared to 9.9% in 2006/07. The decline is attributed to the slow growth of the mining and construction subsectors. Mining registered an estimated growth of only 0.8% compared to 19.4% in 2006/07.

Construction also registered a growth rate of only 6% compared to 14.3% in 2006/07. The construction industry slowed after peak investment activities related to CHOGM, though it is expected to pick up as the Bujagali dam construction gains momentum.

The supply of electricity has picked up, registering a growth of 6%. The recovery is attributed to increased investment in emergency thermal power.

Services sector

The services sector contributed a massive 49% to gross domestic product (GDP) growth up from 47.1% and 45.8% in 2006/07 and 2005/06 respectively. The services sector has been the fastest growing sector over the past five years with a consistent annual growth rate above 6% since 2003/04. The service sector is expected to drive GDP growth in the medium term.

Financial sector

Financial services, incorporating commercial banking, central bank, insurance, foreign exchange bureaus and related services, registered growth of 29% compared to 9.9% in 2006/07.

The banking sector witnessed stability and grew considerably both in terms of numbers and size following the

unfreezing of the licensing of new banks.

The volume of non performing assets as a percentage of total advances remained low at 3.94% as at March 2008, which is far below the prudential limit of 10%. Other developments in 2007/08 include:

- Licensing of five new banks; and
- Proposed establishment of a credit reference bureau.



Increased budget allocations to improve agricultural productivity

The Capital Markets Authority made a significant contribution to the deepening of the financial sector.

Market capitalisation grew by 36%, while the overall share index is estimated to have grown by 21% during 2007/08. The market will become more vibrant with the expected IPO of National Insurance Corporation, Kinyara Sugar Works Limited and Crane Bank Ltd in 2008/09.

The pension sector still remains unregulated. In February 2008, parliament approved a general framework for pension regulation and supervision. A bill is currently being drafted to facilitate the establishment of a fully functioning regulatory authority by December 2008.

Inflation, interest and exchange rates

The annual headline inflation rose from 5.6% in 2006/07 to 11.2% as at the end of May 2008, which is above the Government target of 5%. The underlying inflation rose from 5.9% to 11.8% at the end of May 2008. The inflationary pressures are attributable to:

- Increase in transport costs and the cost of manufacturing inputs due to rising international petroleum prices;
- The high regional demand for Uganda's farm produce;
- The increase in general prices in Kenya which is a major source of imports; and
- The rise in international prices of metals and other commodities such as steel and cement.

Interest rates faced upward pressure during the year due to increased sale of government securities.

The shilling appreciated against the US dollar with the average exchange rate appreciating by 4.5% from September 2007. This is attributed to large foreign exchange inflows and the global weakening of the dollar.

Economic challenges

- Maintaining macroeconomic stability amid increased foreign inflows;
- Increasing investment in infrastructure without resorting to huge budget deficits;
- Increasing household incomes;
- Providing security in the conflict and post conflict areas.

Budget Commentary

The theme for this year's budget is **"Strategic priorities to accelerate prosperity for all"**. In line with the above theme the main objectives of the 2008/09 Budget are:

- Development and maintenance of transport infrastructure;
- Energy infrastructure;
- Industrial development;
- Human development / service delivery;
- Security and governance.

The long term vision of the budget is to transform Uganda into a prosperous country.

Budget thrusts

- Investment in new roads and implementation of a vigorous national, district and community road maintenance program;
- Increase agricultural production through mechanization, and provision of tested seed varieties and improved animal breeds nationwide;
- To commence the construction of the Karuma Hydro Power dam and critical power transmission lines, and conduct feasibility studies for Isimba Hydro-power Project;
- Enhance the pace of industrialization by providing financial, organizational and technical know-how and support to agro processors;
- Implement minimum service delivery standards in the health centers for reproductive health, child health services including immunisation, and control of communicable diseases including HIV/AIDS and Malaria; and
- Extend comprehensive peace and security to all areas of Uganda.

Key highlights

- Increment of resources for National Agricultural Advisory Services (NAADS) by 62%, to increase access to agricultural inputs and machinery;
- Tripling resources for microfinance from Shs. 10 billion to Shs. 32 billion;
- Increase of the road infrastructure budget from Shs. 625 billion to Shs. 1.1 trillion;
- Provision for an additional Shs. 20 billion to Uganda Development Bank for capital injection in small and medium enterprises;
- Provision for an additional Shs. 50 billion as credit guarantees for banks that lend to the agricultural sector;
- Tax exemptions to encourage enterprises to invest in rural agricultural processing, construction of hotels, hospitals and educational institutions;
- Increase in the energy fund to Shs. 316 billion to address power shortages; and
- Substantial increase in expenditure on education and health to increase access to quality education, life saving drugs and other health services.



The financial sector grew by 29% in 2007/08

Tax Highlights

Value Added Tax

Heavy Fuel Oil

Previously Heavy Fuel Oils (HFOs) used in thermal power plants and for industrial purposes were standard rated. To reduce the pass through effect to the electricity tariff and to lower the cost of doing business, HFOs are now exempt from VAT.

Plant and machinery

To encourage investment in industries, VAT on plant and machinery (including essential spare parts) used in industries is now deferred at importation.

Salt

Table salt has been exempted from VAT to make it affordable to more people.

Exemption of VAT on trucks

In order to reduce the cost of transportation and its effect on the prices of food and other products, trucks with a loading capacity of 3.5 tonnes and above, will now be exempt from VAT.

Excise Duty

Payment of duty by government on diesel for manufacturers

For the last two years the Government has paid excise duty on diesel for generators on behalf of manufacturers to cushion them against power shortages. With the improvement in the energy situation, the government has now terminated the facility.

Beer

To encourage local value addition, excise duty on beer made from local raw materials has been reduced from 30% to 20%.

Cigarettes

In order to raise revenue, excise duty on cigarettes has been increased. The details are contained in the Excise Tariff (Amendment) Bill.



Tax relief to spur investment in schools, hotels and hospitals

Income Tax

Investment incentives

To encourage investments in the education sector, the income derived from managing, operating and running schools and tertiary institutions is now exempt from income tax. This will enable the institutions to provide better services and improve curricula.

Taxation of airlines

Last year, international airlines were exempted from Income Tax. For purpose of equity, the Income Tax Act will be amended to exempt the income of resident airlines from income tax and withholding tax on payment of lease rentals.

Support to hotels, hospitals and educational institutions

Government has for the last two financial years been providing tax relief in form of payment of duty and taxes on construction materials for investments in hotels, hospitals, and to a limited extent, educational institutions.

To encourage investments in education and the health sector, the relief has been extended by one more year.

Agro processing

In order to attract investments in the agricultural sector and to encourage value addition of agricultural products especially in rural areas, the income arising out of new agro processing investments commencing 1st July 2008 has been exempted from income tax. This incentive will however be limited to investments located 30 kilometers outside the district of Kampala and for processing of Uganda grown produce.

Bank of Uganda Deposit Auction Fund

One of the instruments used by bank of Uganda to maintain low inflation is the Deposit Auction Fund. To support Bank of Uganda in the conduct of its liquidity management, the interest income derived out of Deposit Auctions issued for purposes of liquidity management will be exempt from withholding tax.

Deduction of Local Service Tax:

Last year, parliament enacted the Local Service Tax Act which imposes a local service tax on persons earning an income. The local service tax is not allowed as a deduction when computing income tax. To prevent the incidence of tax on tax, the Income Tax Act is to be amended to allow deduction of local service tax.

Other Tax Proposals

Environmental levy

Last year an environmental levy of 10% was introduced on used vehicles aged over eight years and other used goods. To further discourage importation of used vehicles, the levy on used cars has been increased to 20%.

First motor vehicle registration fees

During the last financial year, the government abolished road license fees, however, with the ever increasing budget pressures and the need to maintain roads, the minister has proposed to increase rates on first registration of passenger motor vehicles.

Tax treatment of petroleum exploration and production

For the last ten years, the government has supported the oil industry by paying



Oil production to start in 2009

tax on behalf of companies licensed to undertake petroleum exploration, development and production activities.

The industry has strengthened and the companies will now bear the cost of their imports.

Tax arrears to be written-off

During the last fiscal year, a tax amnesty was extended to taxpayers resulting in increased compliance. In addition, the policy brought on board a number of new taxpayers. To further encourage compliance, the minister has proposed to write off tax arrears accrued up to June 30, 2002.

Ratification of the Uganda-Belgium Double Taxation Agreement

In February 2008, the government signed a Double Taxation Agreement (DTA) with Belgium. This will soon be placed before Parliament for ratification. In the coming year, the government of Uganda will conclude DTA's with the United Arab Emirates, Peoples Republic of China, Egypt, Sudan, and Seychelles.

East African Community

At the Pre-Budget Consultations of the EAC Partner States on 02 June 2008 in Nairobi, the Ministers of Finance reviewed the import duty structure on a number of items as follows:

- The import duty rate for Palm Stearin fractions has been revised from 0% to 10%, but allowed Uganda to retain the rate of 0% for one more year;
- Garbage trucks are now exempt from import duty on condition that:
 - they are specially designed for collection of garbage; and
 - imported or purchased by local authorities or persons contracted by the local authorities to collect garbage;
- Milk tankers, gym equipment for hotels, deep cycle batteries for use with solar equipment, computer printers and telecommunication equipment have also been exempted from import duty; and
- The import duty on cement was reduced from 40% to 25%.

The Ministers also agreed to maintain the ban on plastic bags and articles for the conveyance of goods of less than 30 microns and the excise duty of 120% on plastic bags of 30 microns and above.

Contact us

KPMG Uganda
1st Floor Ruwenzori Courts,
Plot 2 & 4A Nakasero Road
P. O. Box 3509 Kampala, Uganda
Tel: +256-41 4340315/6
Fax: +256-41 4340318
Email: info@kpmg.co.ug

The budget proposals included in this BudgetBrief may be amended significantly before enactment of the Finance Act. Please note that our interpretation of tax legislation may differ from that of the various Revenue Authorities. Similarly, the content of this BudgetBrief is intended to provide a general guide and should not be regarded as a basis for ascertaining tax liability or as a substitute for professional advice. If you would like specific advice on the contents of this publication, please get in touch with your regular contact at KPMG.

KPMG International, a Swiss cooperative, is a network of independent member firms. KPMG International provides no audit or other client services. Such services are provided solely by member firms in their respective geographic areas. KPMG International and its member firms are legally distinct and separate entities. They are not and nothing contained herein shall be construed to place these entities in the relationship of parents, subsidiaries, agents, partners, or joint venturers. No member firm has any authority (actual, apparent, implied or otherwise) to obligate or bind KPMG International or any member firm in any manner whatsoever.

© 2008 KPMG, the Uganda member firm of the KPMG network of independent member firms affiliated with KPMG International, a Swiss cooperative. All rights reserved. The KPMG logo and name are trademarks of KPMG International. Printed in Kenya.