

**TAX INCENTIVES FOR ATTRACTING FOREIGN DIRECT INVESTMENT IN  
SUB-SAHARAN AFRICA: A COMPARATIVE STUDY OF GHANA AND  
KENYA**

by

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## **DEDICATION**

This work is dedicated to my sons, and brothers, Eyrarn Usikome Ofori and Elikem Uttemeh Ofori: the Lord our God shall go ahead of us, and prepare us a sojourning place.

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## ABSTRACT

Developing countries have increasingly resorted to the use of tax incentives to attract FDI, despite existing evidence of the shortcomings of tax incentives. In sub-Saharan Africa, tax incentives are a prominent feature of many investment codes. Sub-Saharan African countries find tax incentives as a means of attracting FDI because there are no viable alternatives per se, and they believe that tax incentives can be structured to ensure that FDI advances socio-economic and technological development. But the reliance on tax incentives at the expense of maximizing domestic tax revenue poses a challenge to sustainable development. This study examines Ghana and Kenya to see which of them will better achieve this balance, and makes recommendations on how this balance can be enhanced. The study finds that tax incentives are not well designed and administered. The recommendations suggest that legislative and administrative reforms be undertaken to make tax incentives more effective.

## LIST OF ABBREVIATIONS USED

1D1FP	-	One District, One Factory Programme
AGC	-	Ashanti Goldfields Corporation
AGOA	-	African Growth and Opportunity Act
AU	-	African Union
BIT	-	Bilateral Investment Treaty
BPO	-	Business Process Out-sourcing
CIT	-	Corporate Income Tax
COMESA	-	Market for Eastern and Southern Africa
CRS	-	Common Reporting Standard
DTA	-	Double Taxation Agreement
EAC	-	East African Commission
EACCMA	-	East African Community Customs Management Act
ECA	-	Economic Commission for Africa
ECOWAS	-	Economic Community of West African States
EPA	-	Export Promotion Act
EPZ	-	Export Processing Zone



EPZA	-	Export Processing Zones Act
EPZE	-	Export Processing Zone Enterprise
ERP	-	Economic Recovery Programme / Economic Reform Programme
EU	-	European Union
FDI	-	Foreign Direct Investment
FZ	-	Free Zone
FZA	-	Free Zone Act
FZE	-	Free Zone Enterprise
G20	-	Group of Twenty
GDP	-	Gross Domestic Product
GFZB	-	Ghana Free Zone Board
GIPC	-	Ghana Investment Promotion Centre
GoG	-	Government of Ghana
GoK	-	Government of Kenya
GRA	-	Ghana Revenue Authority
GSE	-	Ghana Stock Exchange
GSGDA	-	Ghana Shared Growth and Development Agenda

ICT	-	Information Communication Technology
ID	-	Investment Deduction
IMF	-	International Monetary Fund
IPA	-	Investment Promotion Act
ITA	-	Income Tax Act
KCMA	-	Kenya Capital Market Authority
KEPA	-	Kenya Export Promotion Authority
KEPZA	-	Kenya Export Processing Zones Authority
KES	-	Kenyan Shilling
KIA	-	Kenya Investment Authority
KRA	-	Kenya Revenue Authority
KSEZA	-	Kenya Special Economic Zones Authority
MoFEP	-	Ministry of Finance and Economic Planning
MOTI	-	Ministry of Trade and Industry
MSME	-	Medium, Small and Micro Enterprise
NEIP	-	National Entrepreneurship and Innovation Plan
NHC	-	National Housing Corporation

NSHDF	-	National Social Housing Development Fund
OECD	-	Organisation for Economic Cooperation and Development
OECDMTC	-	Organisation for Economic Cooperation and Development Model Tax Convention
PE	-	Permanent Establishment
PITA	-	Petroleum Income Tax Act
PNDCL	-	Provisional National Defense Council Law
PPP	-	Public Private Partnership
REIT	-	Real Estate Investment Trust
SADC	-	Southern African Development Community
SAP	-	Structural Adjustment Programme
SEZ	-	Special Economic Zones
SEZA	-	Special Economic Zones Act
SEZE	-	Special Economic Zone Enterprise
SME	-	Small and Medium Enterprise
TNC	-	Transnational Corporations
TSA	-	Tax Sparing Agreement
UN	-	United Nations

UNCTAD	-	United Nations Conference on Trade and Development
USD	-	United States Dollars
VAT	-	Value Added Tax
VATA	-	Value Added Tax Act
VCFC	-	Venture Capital Financing Company
WBG	-	World Bank Group
WHT	-	Withholding Tax
YEP	-	Young Entrepreneurs Programme

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## CHAPTER 1 INTRODUCTION

Developing countries have increasingly resorted to the use of tax incentives to attract FDI, despite existing evidence of the shortcomings of tax incentives. In sub-Saharan Africa countries, tax incentives are a prominent feature of many tax codes.<sup>1</sup> Although rates vary widely by jurisdiction, in most cases, tax rates remain attractively low, and there are various tax incentive schemes, including tax holidays, preferential tax rates, manufacturing zones, and concessionary tax arrangements, that are designed to promote investment. In many cases, tax incentive packages are further reinforced by BITs or DTAs that reduce the source country's ability to impose tax on income earned by non-residents. The paradox, however, is that although in most cases tax incentives have not brought about the needed investment, and result in revenue loss and other unintended consequences, they continue to be offered.<sup>2</sup>

Considering the developmental needs of sub-Saharan African countries, the importance of raising adequate tax revenue cannot be overlooked. But as emphasis is laid on the potential of tax incentives as part of general pro-market liberalization measures to attract FDI, policy efforts to use tax incentives to stimulate FDI inflows in Sub-Saharan African countries have increased. However, the attention of sub-Saharan African policy-makers and citizens is not often drawn to the potential downside of tax incentives. Although at first tax incentives appear to be costless because they do not seem to affect the current

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<sup>1</sup>See Howell H. Zee, Janet G. Stotsky & Eduardo Ley, "Tax Incentives for Business Investment: A Primer for Policy Makers in Developing Countries" (2002) 30:9 WD 1497-1516 at 1497.

<sup>2</sup>See EY, "Tax Insights for business leaders № 13" (1 November 2015), online: *EY* <[www.ey.com](http://www.ey.com)> [perma.cc/Publication/vwLUAssets/EY-tax-insights-for-business-leaders-issue-14/\$file/ey-tax-insights-for-business-leaders-issue-14.pdf] at 9.

budget, they may entail significant costs. For sub-Saharan African countries in particular, there are three main reasons the use of tax incentives to attract FDI may not be the right approach for them.

First, the widespread use of tax incentives to attract FDI in sub-Saharan African countries can jeopardize public revenues. Tax incentives risk crowding out the significance of taxes and crippling efforts in raising domestic revenue for development. As barriers to the global movement of capital decline,<sup>3</sup> and the potential of FDI as a significant external source of financing for emerging economies is becoming increasingly acknowledged,<sup>4</sup> attracting global capital, even at the risk of losing domestic revenue, risks becoming a major practice in sub-Saharan Africa. However, juxtaposed with the risk of potential revenue loss, attracting FDI remains just a tip of the iceberg of the ills of tax incentives.

Second, tax incentives have inherent costs, which if not well provided for, may outweigh their benefits and erode the tax base. Tax incentives come with increased administrative and compliance costs and require that excessive tax planning and anti-avoiding strategies be put in place. Furthermore, tax incentives can result in economic distortions, engender corruption, and benefit TNCs and home countries more than host countries.<sup>5</sup>

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<sup>3</sup> Eric Zolt, “Tax Incentives: Protecting the tax base” (Paper for Workshop on Tax Incentives and Base Protection, New York, 23-24 April 2015) [unpublished] at 1 [Zolt].

<sup>4</sup> According to UNCTAD (2018), in 2017, 65 countries and economies adopted at least 126 investment policy measures: 84 per cent of the measures were favourable to investors. See UNCTAD, “World Investment Report 2018” (2018), online (pdf): UNCTAD <unctad.org> [perma.cc/en/PublicationsLibrary/wir2018\_en.pdf] at viii.

<sup>5</sup> See Jasna Bogovac, “The Paradox of Tax Incentives in Developing Countries” (Paper for Conference on System of Financial Law, Mikulov, Czech Republic, September 2014) at 1 [Bogovac].



Third, both theoretical and empirical evidence suggest that Sub-Saharan African countries' governments are paying too much by using tax incentives to attract investment. Although tax incentives have been widely used to promote investments in sub-Saharan Africa countries, they have not been effective, and their impact has been detrimental. Only a small number of them have had marked success, many more have failed and have been abused by both investors and government officials: only the interests of a few elite individuals and TNCs have been served – the states and the citizens have been left worse off.

Ghana and Kenya provide useful illustrations of some of the risks of using tax incentives to attract FDI. In Ghana, tax incentives have been determined to have an adverse impact on domestic tax revenue, and an overall damaging effect on the welfare of the country. Analysis of the use of tax incentive between 2008 and 2013 revealed that tax incentives accounted for a loss (tax expenditure) of about 14.18 per cent to 41.20 per cent of total tax revenue, about 1.80 per cent to 5.31 per cent of total GDP.<sup>6</sup> Similarly, in Kenya, tax incentives have been found to deprive the country of revenue needed to improve the general welfare of the population.<sup>7</sup> It is estimated that over USD 1.1 billion is lost annually through the use of tax incentives. In the fiscal year 2009-10, an estimated amount of USD 3.05 billion, about 3.1 per cent of Kenya's GDP, was projected to have been lost mostly through tax incentives. Moreover, in most of these countries, the use of a wide range of tax

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<sup>6</sup> See Tax Justice Network-Africa, "The West African Giveaway: Use and Abuse of Corporate Tax Incentives in ECOWAS" (2015) Report for ActionAid International (August 2015) at 1-20 [*Tax Justice Network-Africa*]; Wilson Prichard & Isaac Bentum, "Taxation and Development in Ghana: Finance, Equity and Accountability" in Ghana Report, eds, Matti Kohonen, Steve Manteaw & Alvin Mosioma (Tax Justice Network, 2009) at 24-26 [*Wilson & Bentum*].

<sup>7</sup> See Oxfam, "Taxing for a More Equal Kenya – A five point action plan to fight inequality" (5 December 2017), online: *Oxfam* <[cng-cdn.oxfam.org/ken](http://cng-cdn.oxfam.org/ken)> [perma.cc/kenya.oxfam.org/s3fs-public/file\_attachments] at 18, 25 [*Oxfam*].

incentives has resulted in the neglect of other desirable goals associated with taxation, such as simplifying the tax system, strengthening tax administration, and achieving equity in the tax burden.<sup>8</sup>

Therefore, any attempt to consider tax incentives as an economic policy option must be balanced with a due consideration of the potential harmful effects of tax incentives. Tax incentive programmes must be well designed to maximize efficiency and effectiveness. In other words, even where tax incentives clearly play an important role in attracting new investment, the cost at which that may come – which is often significant – must be considered.<sup>9</sup> More so, this is required given that most tax incentive schemes are likely to result in small incremental new investment.<sup>10</sup> Furthermore, the inherent costs of tax incentives in terms of the economic distortions that are associated with them, and the opportunity for rent-seeking and corruption that come along with them, must also be taken into consideration.

However, it appears these factors are overlooked in the design and administration of tax incentives in most sub-Saharan African countries. Tax incentive programmes often suffer from weak design, lack of transparency, administrative inefficiencies, and are not properly targeted. Even where tax incentives ought to be targeted at particular kinds of

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<sup>8</sup> *Ibid.*

<sup>9</sup> According to UN (2018), tax incentives have traditionally been used by governments as tools to promote a particular economic goal. They are preferential tax treatments that are offered to a selected group of taxpayers and take the form of exemptions, tax holidays, credits, investment allowances, preferential tax rates and import tariffs (or customs duties), and deferral of tax liability. As a matter of fact, developed countries normally use tax incentives to promote research and development activities, export activities, and support the competitiveness of their enterprises in the global market; while developing countries use them to attract foreign investment and foster national industries. See UN, *Design and Assessment of Tax Incentives in Developing Countries: Selected Issues and A Country Experience* (New York: United Nations, 2018) [UN, 2018] at ii-iii.

<sup>10</sup> See George E. Lent, “Tax Incentives for Investment in Developing Countries” (1967) 14:2 IMF Staff Papers 249-323 at 249 [Lent].

FDI (like efficiency-seeking FDI), they are often offered to all investors, including those motivated by access to natural resources or market, who are less likely to respond to tax incentives.<sup>11</sup>

As such, the reliance on tax incentives to attract FDI in Sub-Saharan African countries poses a challenge to sustainable development. This situation, if not realized and addressed in time, will derail the efforts of sub-Saharan African countries and hinder their ability to leverage on the potential of FDI as a major source of external financing for development. Therefore, it is worth asking whether tax incentives constitute beneficial tax policies for sub-Saharan African countries, or only favour corrupt government officials, and investors and their home countries.<sup>12</sup> Should sub-Saharan African countries abandon the use of tax incentives to attract FDI, and rather focus on maximizing tax revenue?

Most of these countries wish that tax incentives achieved better results, or that other countries did not offer tax incentives, and that all investors pay their taxes. However, because most other countries, including developed countries, offer tax incentives, sub-Saharan African countries often feel obliged to do so, even to the point where they offer more than others to retain their “competitive” position, without careful thought about their impact on domestic revenue.<sup>13</sup>

The question then is: how can sub-Saharan African countries improve the effectiveness of tax incentives offered in order to increase FDI inflows and at the same

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<sup>11</sup> See Maria R. Andersen, Benjamin R. Kett & Erik von Uexkull, “Corporate Tax Incentives and FDI in Developing Countries” in World Bank Group, ed *Global Investment Competitiveness Report 2017/2018: Foreign Investor Perspectives and Policy Implications* (Washington, DC: World Bank Group, 2018) at 73 [Andersen, Kett & von Uexkull].

<sup>12</sup> See Andres E. Bazo, “Tax Incentives Offered by Developing Countries: Attracting Foreign Investment or Creating Disaster?” (2008) 52:4 *TNI* 1-23 at 1.

<sup>13</sup> Andersen, Kett & von Uexkull, *supra* note 11 at 73.

time maximize tax revenue? In other words, how can sub-Saharan African countries design their tax incentives to achieve the objective of attracting FDI, but minimize the risk of revenue loss?

The ideal for sub-Saharan African countries is that the economic benefits of the additional FDI attracted through tax incentives out-weigh the revenue loss from enterprises that would have invested without concessionary tax treatment.<sup>14</sup> This requires a well-thought-out approach to the design and administration of tax incentives within these jurisdictions. The starting point is critical study of the tax incentive regimes within the sub-region, and benchmarking them with best practice.

## **A. THE RESEARCH QUESTION**

As policymakers in sub-Saharan African countries seek to use tax incentives to attract FDI, the ideal objective should be to achieve the greatest possible benefits at the lowest cost. This will require that tax incentives be designed to maximize FDI flows, minimise potential revenue loss, and reduce the opportunity for rent-seeking and corruption. Tax incentives should be targeted at only those investors who would have invested in another jurisdiction, but for the tax incentives offered. Granting tax concessions to those investors whose decision to invest is not determined by potential tax benefits will just amount to a transfer of wealth which otherwise would have accrued as tax revenue to the government to the investor or the investor's home government.<sup>15</sup>

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<sup>14</sup> See *Lent, supra* note 10 at 249.

<sup>15</sup> *Zolt, supra* note 3 at 1. See also Kim Brooks, "Tax Sparing: A Needed Incentive for Foreign Investment in Low-Income Countries or an Unnecessary Revenue Sacrifice?" (2009) 34 *QLJ* 505-564 at 505 [*Kim Brooks*].

The challenge is that sub-Saharan African countries are caught in a tax-incentive trap: despite the existence of empirical evidence pointing to the inefficient and ineffective use of tax incentives in sub-Saharan African countries, these countries continue to grant tax incentives, and design new ones. In view of this dilemma, what measure can sub-Saharan African countries adopt to maximize their gains – i.e., attract the desired level of FDI through the use of tax incentive schemes, as well as reduce the risk of revenue loss?<sup>16</sup>

This study proposes to answer this question – that is, what policy measures must sub-Saharan African countries adopt to make tax incentive schemes effective in attracting FDI and at the same time maximize tax revenue? In order to develop a contextual framework within which the research question can be answered, other related policy questions are also explored in the study, such as: are tax incentives effective in attracting FDI? Why do sub-Saharan African countries or developing countries in general continue to offer tax incentives to attract investment? And, are sub-Saharan African countries offering overly generous tax incentives and foregoing revenue much needed for development?

In a simple analysis of the situation, it may be argued that if tax incentives are designed to promote and facilitate investment, then the regime offering more tax incentives should attract higher FDI inflows. Yet the other side of the argument is that such a regime may not be maximizing revenue from taxes, at least in the short run. That country may be giving away too much of its revenue in tax concessions – and where all countries give such incentives, the result will be poverty and underdevelopment in sub-Saharan Africa.

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<sup>16</sup> See Philippa Biggs, “Tax Incentives to Attract FDI (Geneva, 8-9 March 2007, UNCTAD Meeting of Experts on FDI, Technology and Competitiveness) at 9-11.

## **B. THE OBJECTIVE OF THE STUDY**

The study reviews the tax incentive regimes in sub-Saharan African countries with the purpose of recommending a practical approach, derived from a careful analysis of the specific cases of two sub-Saharan African countries, to designing and administering efficient and effective tax incentives in of sub-Saharan African countries. As way to explore standard principles for designing efficient and effective tax incentive regimes in sub-Saharan African countries, the study analyses and evaluates the relative effectiveness of the different tax incentive regimes in promoting and attracting FDI in sub-Saharan African countries. It also examines theoretical and empirical evidence of the impact of tax incentives on FDI and domestic tax revenue in sub-Saharan African countries, and other jurisdictions (both developing and developed countries). The aim is to identify inherent weaknesses in the design and implementation of tax incentives in sub-Saharan African countries, and recommend ways that can be improved upon, based on global practice.

The objective is for both academic and policy purposes – the study will provide tax policy researchers and tax administrators in sub-Saharan African countries with a pragmatic and easy-to-implement approach to the design, assessment and administration of tax incentive programmes. In order to promote the sustainable use of tax incentives in sub-Saharan African countries, there is the need for policy reform, coordination and harmonization within the sub-region. Legislative reforms aimed at improving tax incentive administration, and promoting greater tax efficiency and effectiveness in attracting FDI in sub-Saharan African countries also will have to be undertaken.<sup>17</sup>

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<sup>17</sup> Meinzer et al, “Comparing tax incentives across jurisdictions: a pilot study” (3 January 2019), online (pdf): tax justice network <[www.taxjustice.net](http://www.taxjustice.net)> [[perma.cc/wp-content/uploads/2018/12/Comparing-tax-](https://perma.cc/wp-content/uploads/2018/12/Comparing-tax-)

The study also brings to the fore the need to increase accountability and transparency of tax incentives, and provide guidelines for the design and operation of tax incentives in sub-Saharan African countries. Among other recommendations, it proposes that tax incentive budgets be prepared to ensure general tax expenditure analysis, to enable tax policy experts and tax administrations make more informed decisions in designing tax incentive schemes.

### **C. THE STUDY METHODOLOGY**

The study is a comparative analysis of the tax incentive regimes in sub-Saharan African countries.<sup>18</sup> It comprises theoretical and empirical assessment of the relative effectiveness of tax incentive programmes across sub-Saharan African countries. The study uses Ghana and Kenya as case studies. As such, it looks at the similarities and differences in the tax incentives regimes of the two countries, and attempts to determine which of the two regimes facilitates more FDI and why. The overall objective is to recommend ways to improve the effectiveness of tax incentives in sub-Saharan African countries. Even though the study is designed to provide a basis for drawing an inferential conclusion on the effectiveness of tax incentives in attracting FDI in sub-Saharan African countries, data and the literature on the subject from other jurisdictions, including other developing and developed countries, are employed in the analyses.

Ghana and Kenya have been chosen for the study because both countries offer tax incentives including tax holidays, tax amnesties, ID allowances, customs duty exemptions,

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incentives-across-jurisdictions\_Tax-Justice-Network\_2019.pdf] at 4 [*Meinzer et al*]; *Bogovac, supra* note 5 at 1.

<sup>18</sup> *Ibid* at 1.

and concessionary CIT rates. Ghana's tax incentive regime comprises several pieces of legislation including, the ITA, 2015 (Act 896), the GIPC Act, 2013 (Act 865), the FZA, 1995 (Act 405), the Minerals and Mining Act, 2006 (Act 703), Minerals and the Mining Act, 2010 (Act 794).<sup>19</sup> Similarly, Kenya's tax incentives are provided for under various pieces of legislation, including the IPA; the ITA; the EPZA; and the SEZA.<sup>20</sup>

However, despite the commonalities, there are also differences that make Ghana and Kenya good independent cases for the purpose of comparative analysis. The major disparities are that the two countries are geographically distant from each other, and belong to separate regional economic blocs.<sup>21</sup> Kenya, on the east, is a member of the EAC and the common COMESA; and Ghana, on the west, belongs to the ECOWAS.

The study comprises five Chapters. Chapter 1 provides an introduction and theoretical background to the study. It offers an outline of the general framework of the study, and sets the bounds within which the study is conducted, including the significance, the methodology, and the limitations. Chapter 2 reviews the literature on countries' use of tax incentives to attract FDI. It explores the subject by identifying contemporary scholarly

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<sup>19</sup> See the *Income Tax Act, 2015 (Act 896)* (Ghana) [*ITA Ghana*]; *Ghana Investment Promotion Centre Act 2013 (Act 865)* (Ghana) [*GIPC Act 2013*]; *Free Zone Act, 1995 (Act 504)* (Ghana) [*FZA*]; *Minerals and Mining Act, 2006 (Act 703)* (Ghana); *Minerals and the Mining Act, 2010 (Act 794)* (Ghana).

<sup>20</sup> See *Income Tax Act, 1973 (CAP. 470)* (Kenya) [*ITA Kenya*]; *Investment Promotion Act, 2004 (Act No. 6 of 2004)* (Kenya) [*IPA*]; *Export Processing Zones Act, 1990 (CAP. 517)* (Kenya) [*EPZA*]; *Special Economic Zones Act, 2015 (Act No. 16 of 2015)* (Kenya) [*SEZA*].

<sup>21</sup> Even though the criteria for the selection of cases for a comparative analysis depends on the purpose of the study, generally, cases should be representative of the population, and the results obtained from the study generalisable, and applicable to the whole population. Purposive modes of selection is required to choose cases that most reflect the population characteristics. Selecting good cases require in-depth familiarity of each case, and the criteria considers factors such as, whether the cases are typical, diverse, extreme, deviant, influential, most similar or most different, of the population characteristics. See Jason Seawright & John Gerring, "Case Selection Techniques in Case Study Research: A Menu of Qualitative and Quantitative Options" (2008) 61:2 PRQ 294-308 at 294. See also Chinonso Okafor, "How to choose an appropriate case study for your research project" (27 August 2017), online (blog): *Classgist* <[www.classgist.com](http://www.classgist.com)> [perma.cc/blogs/64/how-to-choose-an-appropriate-case-study-for-y.aspx].



and policy debates, and ways that the literature suggests developing countries can maximize the benefits of using tax incentives to promote and attract FDI.

Chapter 3 discusses the tax incentives regime for the promotion, attraction and facilitation of FDI in Ghana. It begins with a brief overview of the regulatory framework for FDI and tax incentives in the country. It then reviews empirical evidence of the impact of various legislative reforms on FDI over the period 1985-2017. Next, the main tax incentives for promoting FDI in Ghana are considered. The chapter concludes with an analysis of the impact of tax incentives in the natural resource sector, and the operations of FZs in Ghana.

Chapter 4 discusses the tax incentive regime in Kenya. It begins with a brief overview of the regulatory regime of investment in the country. It then looks at the impact of tax policy reforms on FDI for the period 1963-2020. This is followed by a discussion of the framework of tax incentives, and the major tax incentive schemes employed. It concludes by assessing the potential effectiveness of the tax incentives offered in Kenya.

Chapter 5 offers an analysis of tax incentives in Ghana and Kenya under five main incentive categories: tax exemption and tax amnesty schemes, general reduced CIT rates, targeted reduction in the effective CIT rate, DTAs, and import duty exemption and reduced excise duty schemes. The analysis indicates that both countries have similar tax incentive regimes, and the impact of tax incentives on domestic revenue has been undesirable. The chapter makes recommendations that tax incentives schemes should be designed to achieve clarity in objective and purpose, be simple and transparent, be targeted at efficiency-seeking FDI, and be consolidated under one enactment and one authority – the Minister of Finance and Economic Planning, to be enforced and monitored by the tax authorities.

Chapter 6 provides the summary and conclusion of the study. Similar conclusions were reached for both Ghana and Kenya that in view of the fact that tax incentives have resulted in large revenue losses, it is important that both countries review their tax incentive strategies, minimise the use of tax incentives, and focus on creating an enabling investment environment through measures such as good governance, rule of law, prudent macroeconomic management, security enhancing policies, infrastructural development, openness to trade, and human resource development.

## **E. LIMITATIONS**

Generally, the objective in assessing the performance of tax incentive schemes is to determine the incremental investment due to tax incentives, and the costs and benefits associated with attracting that investment. This requires making assumptions regarding the amount of investment that would have been made without the tax incentive programme, and the amount of revenue foregone due to the grant of the tax incentive.<sup>22</sup> Practically, it will be difficult to develop a framework that will determine which investment is undertaken solely due to tax incentives, or estimate what the levels of investment would be with or without the existence of tax incentives.<sup>23</sup>

The following general limitations are recognised. First, care should be taken in generalizing the outcomes, and in applying them to other countries. Although, where available, the study draws on data and other information from other jurisdictions, as a comparative analysis, the study focused much on the tax incentive regimes in Ghana and

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<sup>22</sup> *Zolt, supra* note 3 at 1; *Meinzer et al, supra* note 17 at 1.

<sup>23</sup> *Ibid.*

Kenya. Even within these two jurisdictions, due to the limited availability of data, much of the review of the impact of tax incentives on FDI is based on existing research findings, and analysis of secondary data.

Second, circumspection is required in any attempt to make relative judgments about the effectiveness of tax incentives in attracting FDI, or any other variable, in the two countries used as case studies. Although much consideration was given in selecting the countries as sample for the study, differences in tax incentive regimes and outcomes may reflect differences in other investment factors such as, markets size, resource endowment, business opportunities, political and social factors, and the general investment climate. Furthermore, the study is not for the purpose of making relative evaluation of the general administrative efficiency and effectiveness, governance, resource allocation, any other measure (political or social), or the general state of affairs in the two countries.<sup>24</sup>

Third, as acknowledged in much of the study, there are many other policy variables that may determine the FDI-attractiveness of a country, apart from tax incentives. Occasionally in the study, the effect of these variables are held constant in order to highlight the impact of tax incentives as the primary variable. However, in the end, an overall analysis is presented, taking into consideration the interplay of all possible variables in determining the effectiveness of tax incentives in attracting FDI.<sup>25</sup>

Fourth, in determining the effectiveness of tax incentives in both Ghana and Kenya, the study relied on investment survey reports and other secondary data. This is because,

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<sup>24</sup> See *Lent, supra* note 10 at 291.

<sup>25</sup> See Collins Osei, *UK Foreign direct investment in Ghana: Determinants and Implications* (PhD Thesis, Edinburgh Napier University, 2014) [unpublished] at 264 [Osei].

despite the popularity and widespread use of tax incentives in sub-Saharan African countries, assessment in terms of tax expenditure reports are rarely conducted. Additionally, there is an absence of reliable data on actual investments made, their direct and indirect benefits, and their cost in terms of direct spending or revenue loss. This is due to the fact that, generally, there have not been systematic reviews of the effectiveness of the various incentives programmes offered in the two countries.<sup>26</sup>

Finally, there is the general difficulty of relying on the results of different studies, with different data sources, methodologies and limitations, carried out at different points in time, and in different jurisdictions, to come to a general conclusion.<sup>27</sup>

## **F. CONCLUSION**

In conclusion, notwithstanding the limitations acknowledged or any other circumstance, it is hoped that the outcome of the study will form a strong basis for reform, and where applicable, coordination and harmonization in the design and administration of tax incentives sub-Saharan African countries. It is also hoped that the study will add to the body of knowledge available on the subject, and serve as a foundation for further research in tax incentives and FDI attraction in sub-Saharan Africa. Even in the short run, based on some of the recommendations offered, sub-Saharan African countries can begin unilateral reforms to make tax incentives better targeted and more efficient. By identifying and re-focusing tax incentive policies on investments which are most likely to respond favourably,

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<sup>26</sup> See OECD, “Tax Incentives for Investment – A Global Perspective: experiences in MENA and non-MENA countries – Draft 1” (Version June 2007), online: OECD <[www.oecd.org](http://www.oecd.org)> [perma.cc/mena/competitiveness/38758855.pdf] at 1 [*OECD-MENA*].

<sup>27</sup> See *UN, 2018, supra* note 9 at 10.

sub-Saharan African countries can reduce the unnecessary loss of tax revenue resulting from the grant of tax incentives. Further, sub-Saharan African governments should focus on improving investment fundamentals, promote administrative transparency and the rule of law, and maximize efficient tax collection rather than offer tax incentives. This way, tax incentives can have the desired impact in inducing investment in sub-Saharan African countries, and result less in revenue leakage.

## CHAPTER 2 LITERATURE REVIEW

This chapter reviews the literature on countries' use of tax incentives to attract FDI. It explores the subject by identifying contemporary scholarly and policy debates and ways that literature suggests developing countries can maximize the benefits from using tax incentives.<sup>28</sup>

Although the existing literature is not conclusive on the role of tax incentives in attracting FDI and creating employment, there is clear consensus that careful study of the effect of tax incentives on FDI and employment is worthwhile. Both theoretical and empirical evidence on the subject present a mixed result; some studies have found tax incentives to have a significant positive effect on FDI, yet others have found that tax incentives do not have a major effect on FDI.<sup>29</sup> However, the use of tax incentives as a strategy to attract FDI continues to receive favourable attention in various countries.<sup>30</sup>

Why do countries continue to grant tax incentives, even though evidence on the subject is inconclusive? Why do tax incentives seem to work in some countries and not in others? What are some of the measures to ensure that tax incentives are well designed to achieve the desired results? This chapter attempts to answer these questions. It is organized

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<sup>28</sup> This excerpt is adapted from my term research paper in International Taxation II, Winter, 2019 entitled Tax Incentives and Foreign Direct Investment – A Review of Literature.

<sup>29</sup> For example, Van Parys (2012) found that CIT rate and the tax holidays affected FDI, but did not affect gross private capital formation. He, however, observed that the impact of tax incentives on investment in Africa is insignificant, and that tax holidays did not have an effect on FDI inflows or fixed capital formation in the CFA zone and the Eastern Caribbean Currency Union (See Stefan Van Parys, “The effectiveness of tax incentives in attracting investment: evidence from developing countries” (2012) RP 129-141 at 30 [*Van Parys*]).

<sup>30</sup> Also, Peters and Kiabel (2015) examined the influence of tax incentives on FDI in Nigeria. The result showed that increase in tax incentives does not bring about a corresponding increase in FDI (See George T. Peters & Bariyima D. Kiabel, “Tax Incentives and Foreign Direct Investment in Nigeria” (2015) 6:5 IOSR-JEF 10-20 at page 1). Also, UNCTAD (2000) noted that nearly all countries offer tax incentives even though their efficacy in attracting FDI is doubted (See UNCTAD, “Tax Incentives and Foreign Direct Investment – A Global Survey” (2000) ASIT Advisory Studies, UNCTAD Working Paper No. 16 at 3 [*UNCTAD 2000*]).

in four parts. It begins by an attempt to distinguish tax incentives from the general or normative tax system, drawing on the pioneering work of Stanley S. Surrey.<sup>31</sup>

Tax incentives come in various designs. The second section of this chapter looks at six different tax incentives schemes commonly offered across countries to provide further insight on the practical design and application of tax incentives.

The third sections examines evidence on the use of tax incentives and the effectiveness of tax incentives in both developing and developed countries. It suggests that, largely, the objective of using tax incentives is to promote economic goals, such as employment and market efficiency. It also finds that much of the evidence is to the effect that, even though tax incentives are not desirable in most situations, tax incentives are more likely effective in developed countries than in developing countries. It also suggests that, among others, developing countries may resort to the use of tax incentives as a result of international competition, or pressure from TNCs.

The final section looks at some the measures to ensure that tax incentives achieve the desired result. Among others, it identifies factors including setting clear and measurable objectives, and having tax incentives well spelt out and consolidated in legislation, as some of the desirable characteristics of an effective tax incentive scheme. The section also explores the policy debate whether tax incentives should be limited to only foreign investment, or tax incentives should be of benefit to domestic and local investors as well.

The chapter concludes by noting that although tax incentives may help boost domestic FDI inflows, they will not alone make up for serious deficiencies in the investment climate. Therefore, developing countries must focus on building a favourable

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<sup>31</sup> See Stanley S Surrey, *Pathways to Tax Reform: The Concept of Tax Expenditures* (Cambridge: Harvard University Press, 1974).

investment climate, and ensure transparency and accountability in the use of tax incentive policies. It further recommends that the award and monitoring of tax incentives be guided by the rule of law.

#### **A. DEFINITION OF TAX INCENTIVES**

There is a major challenge of defining tax incentives, and a general conceptual problem of identifying and drawing a fine line between tax incentives (or tax expenditures) and the general or normative tax system. The attempt to delimit or draw a distinction between the two systems, and establish the relationship between them, can be credited to Stanley Surrey's work in 1974.<sup>32</sup> He began the scholarly work of conceiving tax incentives as special treatments, or separate schemes from the general tax system, and a deliberate departure from accepted concepts of income tax. He identified that through special schemes, such as exemptions, deductions, tax credits, preferential tax rates, and tax deferrals, the tax system may operate to achieve the effect that a direct budget expenditure may be designed to accomplish.<sup>33</sup>

He further identified that tax incentives constitute a system of tax expenditures under which governmental financial assistance programs are carried out through special tax provisions, as against the provisions of the ITA (or any other tax legislation) which may form the basis for taxing individual and corporate incomes. In other words, a tax incentive scheme can be conceived as a special provision or an alternative system to direct

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<sup>32</sup> *Ibid* at 3-7.

<sup>33</sup> *Ibid*.



government expenditures, such as, grants, and loans, and a subsidy scheme that relies on the framework of the income tax system as a method of disbursement.<sup>34</sup>

He also observed that the concept of tax incentives can be considered as consisting of two legs: the imputed tax payment (that would have been made in the absence of the tax incentive), and the accompanying expenditure of that payment as a direct grant to the beneficiary. He further asserted that although tax incentive schemes have a similar purpose as direct government expenditures, they may have little or no basic relation to the design and operation of such direct expenditures. Any given program involving fiscal assistance may be designed to use the tax system to provide that assistance (which may be referred to as a tax incentive), or a direct government assistance (which may be referred to as a direct expenditure). That is, the incentive process assumes payment of the proper tax by the taxpayer, and an appropriation by the government of an expenditure made to that taxpayer in the amount of the incentive benefit.<sup>35</sup>

Since Surrey's work, many other definitions of tax incentives have been adopted. For example, the IMF et al (2015) define tax incentives as special tax provisions which are a favourable deviation from the general tax laws, granted to selected investment projects or firms.<sup>36</sup> From this simple definition, it can be deduced that tax incentives constitute a deliberate policy that exempts an entity from a tax liability or grants an entity a concession to a tax liability.<sup>37</sup> The intention for granting tax incentives is to favour

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<sup>34</sup> *Ibid.*

<sup>35</sup> *Ibid.*

<sup>36</sup> See IMF et al, "Options for Low Income Countries' Effective and Efficient Use of Tax Incentives for Investment" (2015) A Report to the G-20 Development Working Group No. 100756 at 8 [*IMF et al*].

<sup>37</sup> See Shirley Ayangbah & Liu Sun, "Comparative study of foreign investment laws: The case of China and Ghana" (2017) 3:1355631 CSS 1-22 at 5 [*Ayangbah & Sun*].

investors, through exceptional or concessionary provisions in the tax laws, compared to the general standard tax system. Tax incentives are part of general fiscal tools, such as, sector prioritization, infrastructural development, and in extreme cases, assignment of monopoly rights, to attract investments.

Furthermore, tax incentives are exceptions to the general tax regime, and include favourable tax treatments as a means of inducing investors to invest in specific projects or sectors. Tax incentives are measurable advantages, specifically designed either to increase the rate of return, or reduce the costs or risks of a specific FDI undertaking, or domestic enterprises, for the purpose of securing investment.<sup>38</sup> To qualify as a tax incentive, a measure must provide for an explicit favourable tax treatment of particular sectors, or type of firms, or activities, or investment, as against the standard applicable in the industry as a whole.<sup>39</sup>

Also, tax incentives can be defined as policies that provide for a more favourable tax treatment of some enterprises or sectors as against what is available to the general industry.<sup>40</sup> In this sense, tax incentives can be considered special provisions that allow for exclusions, credits, preferential tax rates, or deferral of tax liability.<sup>41</sup> Examples of tax incentives include reduced tax rates on profits, tax holidays, accelerated depreciation and loss carry forwards for tax purposes, reduced tariffs on imported equipment and raw materials (or increased tariffs to protect import substituting investment), special zones,

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<sup>38</sup> See *UNCTAD 2000*, *supra* note 30 at 11-12.

<sup>39</sup> See Laura Abramovsky et al, "Are corporate tax incentives for investment fit for purpose? Revisiting economic principles and evidence from low- and middle-income countries" (26 March 2018), online: *Institute for Fiscal Studies* <[www.ifs.org.uk](http://www.ifs.org.uk)> [perma.cc/publications/12875] at 5-13 [*Abramovsky et al*].

<sup>40</sup> See Alexander Klemm, "Causes, benefits, and risks of business tax incentives" (2010) 17:3 *ITPF* 315-336 at 315.

<sup>41</sup> *Zolt*, *supra* note 3 at 18.

investment tax credits, investment allowances, exemptions from various taxes, and financing incentives.<sup>42</sup>

Further, it must be noted that, generally, tax incentives can be classified into two broad categories based on their mode of operation – cost-based tax incentives and profit-based tax incentives. Cost-based tax incentives operate to reduce the cost of investment, and profit-based tax incentives operate to reduce the tax rate on taxable income, or eliminate tax altogether. For example, import duty exemptions may be targeted at reducing the cost of plant, machinery and equipment, while tax holidays may waive CIT for a given period.<sup>43</sup>

Profit-based tax incentives may be better suited to attract short-term investments, and cost-based tax incentives may be suitable for long-term investments.<sup>44</sup> In their design, cost-based incentives (like accelerated depreciation) are targeted at capital intensive long-term investments in order to decrease the cost of capital – their benefits are designed to be realised over the life time of the assets. On the other hand, profit-based incentives (like tax holidays) are targeted at short-term, low capital investments, with quick returns. They are usually granted over the early years of an investment, and their benefits are designed to be realised only in the short-term.

Thus, cost-based incentives are of benefit, or accrue to investors only if capital investments are made, and may be appropriate for targeting long-term investments in industries, like mining, and oil and gas, in which returns are realised over a longer period

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<sup>42</sup> See *UNCTAD 2000*, *supra* note 30 at 11-12.

<sup>43</sup> See Abramovsky et al, *supra*, note 12 at 5-13.

<sup>44</sup> See Jacques Morisset & Neda Pirnia, “How Tax Policy and Incentives Affect Foreign Direct Investment” (2001) World Bank Working Paper, No 2509 at 14 [*Morisset & Pirnia*].

of time. This makes them unsuitable for short-term investments. However, profit-based incentives have their benefits accruing as soon as the firm begins to make profits. This makes them suitable for short-term projects with low upfront investment costs, and quick returns.<sup>45</sup>

It is advisable that tax incentives should not be limited to only foreign investors, but should be equally available to domestic investors. The justification is that domestic investors are likely to be operating in fundamental sectors of the economy in which the positive impact of favourable tax treatments may be more profound, as against FDI which is mostly in the secondary or tertiary sectors. Secondly, if tax incentives are not equally offered to domestic investors, it may create a preference for foreign investors, and an incentive for round-tripping – that is, local investors would transfer their capital abroad to be returned as FDI. That notwithstanding, tax incentives may be designed to focus on the attraction of FDI to diversify the export base.<sup>46</sup> However, the point is that tax incentives should not be preferential in terms of their application – that is, exclusively focused on attracting FDI.

However, in defining tax incentives, it is advisable that they are distinguished from broader non-discriminatory fiscal incentives, such as general infrastructure development, and the general legal regime for FDI and business, including investment guarantees.<sup>47</sup> The latter are generally available to all enterprises, and are not intended to induce investment in specific sectors or give an additional benefit to any particular investment. This is

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<sup>45</sup> See Abramovsky et al, *supra*, note 12 at 5-13.

<sup>46</sup> See Haozhen Zhang, “Property Rights, Tax Incentives and Bogus Foreign Direct Investment” (2012) 4:4 TCR 19-45 at page 24 [*Zhang*].

<sup>47</sup> See *UNCTAD 2000*, *supra* note 30 at 11-12.

required so that tax incentives can be designed in a more coherent, simple, and transparent manner to allow their objectives and impact to be easily assessable, so that they are not subject to corruption and abuse.<sup>48</sup>

Also, it is appreciated that tax incentives can be looked at from two mirror sides – from the perspective of tax authorities, and from that of investors. While tax administrations, in tax expenditure analysis, may regard some tax concessions as tax incentives, investors may see that in a different light. For instance, governments may regard capital allowances and allowable depreciation schedules as tax incentives, but investors may simply consider them as part of the normal treatment of business expenses, and a basic characteristic of a conducive tax system. Investors may be inclined to regard tax policies, such as tax holidays that waive the CIT, as a classic tax incentive.<sup>49</sup>

Finally, the debate notwithstanding, what may be critical to determining if a fiscal policy qualifies as a tax incentive may be the desired objective, and whether it constitutes a treatment available to specific sectors, or it is just a general allowable treatment. For example, accelerated depreciation allowed in a specific industry to encourage investment in that sector, which is not available in other sectors, may qualify as a tax incentive.

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<sup>48</sup> See Maya Forstater, “The Good, the Bad, and the Ugly: How Do Tax Incentives Impact Investment?” (16 October 2017), online (blog): *Center for Global Development* <[www.cgdev.org](http://www.cgdev.org)> [[perma.cc/blog/good-bad-and-ugly-how-do-tax-incentives-impact-investment](https://perma.cc/blog/good-bad-and-ugly-how-do-tax-incentives-impact-investment)] [*Forstater*].

<sup>49</sup> *Ibid.*

## **B. THE BASIC DESIGNS OF TAX INCENTIVES**

The design of tax incentives will differ depending on the type of investment and the quality of governance in the country concerned.<sup>50</sup> Six different tax incentives are discussed in this section: tax holidays, accelerated depreciation, special size or scale tax incentives, special sectors, and special regions or zones.<sup>51</sup>

### **B.1. Tax holidays**

Tax holidays are a profit-based incentive that consists of complete or limited exemptions from tax obligations. With a tax holiday, new firms are allowed a period of time during which the burden of income taxation is waived.<sup>52</sup> A tax holiday may take the form of a complete exemption from profits tax (and other taxes), a reduced rate of tax or a combination of the two. For example, a firm may be granted two years' exemption from taxation, plus a further three years at half the standard rate.<sup>53</sup> Although tax holidays are to encourage investment by reducing or eliminating the tax liability of firms over the holiday period, they generally deny firms deductible expenses, such as, depreciation costs, and interest tax deductions, to partly compensate for the loss in revenue resulting from the exemption.

Tax holidays are used in many emerging countries because they are considered simple to implement and easy to comply with.<sup>54</sup> By offering temporary tax relief to

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<sup>50</sup> See *UN, 2018*, *supra* note 9 at 8.

<sup>51</sup> See *Ayangbah & Sun*, *supra* note 37.

<sup>52</sup> See *Holland & Vann*, *supra* note 55 at 2-4.

<sup>53</sup> See *UN, 2018*, *supra* note 9 at 3-5.

<sup>54</sup> According to UNCTAD (2005), in 1995, as many as 59 out of 67 countries offered various types of incentives (See UNCTAD DTCI, "World Investment Report 1995: Transnational Corporations and Competitiveness" (Geneva: UNCTAD, 1995) at 298. See also *UNCTAD 2000*, *supra* note 30 at 20.

profitable firms, tax holidays benefit industries that start making profits in the early times of the holiday period, providing benefits as soon as a company begins earning income, compared to lower CIT rates whose advantages accrue over a longer period. Tax holidays target total profits in the short-term, and tend to benefit short-term projects. However, tax holidays may be to the advantage of readily mobile business activities which are least likely to generate the desired multiplier effects compared to long-term investments.

## **B.2. Accelerated depreciation or capital allowance**

Accelerated depreciation or capital allowance enables taxpayers to deduct the cost of their expenses more quickly than they actually decline in value (permitting as a consequence greater deductions earlier). These incentives can be designed as deductions or credits. Tax deductions (allowances) reduce the taxable income of the firm (and therefore turn on the tax rate faced by the firm); tax credits reduce the outstanding taxes to be paid (and therefore are worth the same to taxpayers regardless of their tax rate). Accelerated capital allowance are cost-targeted incentives which provide tax benefits over and above the depreciation allowed for the asset.<sup>55</sup> Investment allowances may apply to all forms of capital investment, or may be limited to only plant and machinery, and be may granted in addition to, or in place of the normal depreciation allowance.

The advantages with investment tax allowances is that they target the incentive at the desired activity, are tied to current capital spending, and may result in lower revenue foregone, than tax holidays. They also promote new investments, unlike a reduction in CIT

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<sup>55</sup> See David Holland & Richard J. Vann, "Income Tax Incentives for Investment" in Victor Thuronyi, ed, *Tax Law Design and Drafting*, Volume 2 (New York: IMF, 1998) at 6 [*Holland & Vann*].

rates, which benefits even owners of old capital. Tax payments in nominal terms are unaffected, but their net present value is reduced and the liquidity of firms is improved.

A disadvantage with the use of investment allowances and credits is that it favours capital intensive investment, and may not result employment creation, compared to tax holidays. It may also create a preference for assets with a short lifetime to enable further allowance, or credit to be claimed on replacement.

### **B.3. Special size or scale tax incentives**

Special size or scale tax incentives grant investments with assets valued above a threshold amount, or that create a minimum number of new jobs, a negotiated package of tax incentives. They may be cost- or profit-based, and are suitable for countries or regions that need major transformational investments, financial or technical ease ups in their economies.<sup>56</sup> In Ghana, for example, an investor making worth over USD 50 million of investment in one of the key sectors, including, energy, infrastructure, and railways, can negotiate tax concessions on import duties and other development costs.<sup>57</sup> One other advantage of this approach is that, because it limits incentives to large investments, which may be few, governments may be able to monitor their use at minimal cost.

A major disadvantage to the use of special size or scale incentives is that, because of the element of discretion that may be involved in negotiating the incentives, they can be manipulated, abused and distorted by bureaucrats to their own advantage. Furthermore,

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<sup>56</sup> See *Morisset & Pirnia*, supra note 44 at 14. Financial or technical ease up is an expansionary fiscal policy to inject capital into the economy as means to stimulate growth. See Wikipedia, “Quantitative easing” (8 July 2019), online: *Wikipedia* <en.wikipedia.org> [perma.cc/wiki/Quantitative\_easing].

<sup>57</sup> *GIPC Act 2013*, supra note 19, s. 26.



there is a high propensity to create uneven competition, and stifle the growth of smaller firms which may not have access to such incentives, even when they are highly productive.<sup>58</sup>

#### **B.4. Special regions or zones, or special sectors**

Special regions or zones, or special sectors, including designated cities or administrative areas, may be granted favourable tax status in order to attract investment into such locations or industries. Special sector incentives are applicable to sectors of the economy considered most desirable and most likely to be influenced by tax. These tax incentives may be offered to start-ups or infant industries.

The zones provide a discrete environment within which enterprises can import machinery, components and raw materials free of customs duties and other taxes. Production may be for export, and products sold on the domestic market treated as imports, subject to appropriate import taxes. Import and export requirements within the zones may be less stringent, and the zones may also be called customs-free zones, duty-free zones, free trade zones, or SEZs.<sup>59</sup> The major advantage of special zones is that they may be used to address inequality in the geographical distribution of industries or development. On the other hand, the main disadvantage of special zones is the propensity to displace investments in other sectors of the economy.<sup>60</sup>

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<sup>58</sup> *Ibid.*

<sup>59</sup> See *Holland & Vann, supra* note 55 at 19.

<sup>60</sup> Among the activities commonly preferred are tourism, offshore financial centres, film production and manufacturing. The idea is that these activities bring more socially valuable spillover effects (See *IMF et al, supra* note 36 at 21).

## **B.5. Import duty or tariff exemptions**

Import duty or tariff exemptions can be used to reduce or eliminate tariffs on imported capital equipment and spare parts for qualifying investment projects. Exemptions from import duties and other taxes, such as tariffs, excises and VAT on imported inputs, may be granted on imported goods, including plant and machinery, raw materials, and special equipment, in manufacturing or natural resource extraction. The effect is to reduce the cost of investment. On the other hand, increased tariffs can be charged on imported competing products in order to protect the domestic market from competition.<sup>61</sup>

The advantage of import duty or tariff exemptions schemes is that import duty relief may be necessary to attract investment in capital intensive projects, such as, mining investment, because it helps reduce cost of inputs, and other financial risks, considering the substantial amount of capital investment that may be required in such projects. Nevertheless, import duty exemptions come with some tax risks. Investors may increase the cost of imported equipment and materials to reduce taxable income. Charging import duties may reduce the incentive to inflate the cost of imported equipment and machinery, granting a waiver.<sup>62</sup>

## **B.6. Reduced CIT rates**

A reduced CIT rate may be set, as an exception to the general tax regime, in order to attract FDI into specific sectors or regions. It may be targeted at foreign investment

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<sup>61</sup> See *UNCTAD 2000*, *supra* note 30 at 22.

<sup>62</sup> See IGF-OECD, “The Hidden Cost of Tax Incentives in Mining” [unpublished, IGF-OECD Programme to address BEPS in Mining, Consultation Draft] at 11, 28 [*IGF-OECD*].

which meet specified criteria, or it may be granted to particular industries as a whole.<sup>63</sup> For example, Kenya offers reduced CIT rate in the hospitality industry.

### **C. EVIDENCE OF THE EFFECTIVENESS OF TAX INCENTIVES IN DEVELOPED AND DEVELOPING COUNTRIES**

Even though tax incentives are a popular policy tool for attracting FDI, evidence on the effectiveness of tax incentives is not certain. Some studies have suggested that tax incentives work across all jurisdictions; others suggest that tax incentives do not work at all, no matter the jurisdiction; yet others claim that tax incentives work, but they are more effective in developed countries than in developing countries. However, the final analysis suggests that tax incentives work for certain kinds of investments, in certain situations, and in certain sectors, across all jurisdictions.<sup>64</sup>

In the mist of this debate, however, it has been observed that most countries, irrespective of their stage of development, use tax incentives in order to attract FDI, making tax incentives widespread and commonplace around the world.<sup>65</sup> High income countries favour the use of investment tax credits, and allowances for research and development (R&D), to promote export activities and achieve competitive advantage in the global marketplace. Low-income countries more often provide tax holidays and reduced tax rates,

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<sup>63</sup> According to UNCTAD (2000), countries, including Hong Kong, Indonesia, Ireland, the Lao People's Democratic Republic, Cambodia and Estonia, use this type of tax incentive. Also, Malaysia resorted to this strategy in the mid-1980s when investment inflows were below expectations. See *UNCTAD 2000, supra* note 30 at 19.

<sup>64</sup> James (2014) asserts that there is much greater use of tax incentives for research and development in OECD, East Asia and Pacific countries; the use of tax and duty exemptions in SEZs is quite popular across all the regions. *James, supra* note 75 at 1-15.

<sup>65</sup> See WBG, *Global Investment Competitiveness Report 2017-2018: Foreign Investor Perspectives and Policy Implications*, (Washington, DC: WBG, 2018) at 116-118.

in order to attract foreign investment and foster national industries.<sup>66</sup> Middle-income countries, on the other hand, offer preferential tax zones to fast-track industrialization.<sup>67</sup>

This section first considers evidence from developed countries, drawing on five different studies, in 2017, 2008, 2000, 1994 and 1973. There are many available studies, but for the purposes of this thesis, offering an illustrative sampling seems sufficient to support the point that the evidence of effectiveness is mixed and turns on the unique circumstances of the country and incentive.

The broad suggestion is that the types of tax incentives offered by developed countries can be effective.<sup>68</sup> For example, Dechezleprêtre et al (2017) conducted a study on the causal impact of R&D tax incentives on innovation among UK firms. The evidence indicated the existence of statistically and economically significant effects of tax policy change on both R&D and firm level innovation, with large elasticities. The study also found that R&D generated by tax policy had a positive spillover effects on the innovations on related firms.<sup>69</sup>

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<sup>66</sup> See UN, 2018, *supra* note 9 at iii, 3.

<sup>67</sup> According to the UN (2018), the use of tax incentives across countries is widespread – while developed countries employ cost-based tax incentives, such as, accelerated depreciation and investment allowance, developing countries employ profit-based tax incentives, such as tax holidays and reduced CIT rates. *Ibid* at 3. See also IMF et al, *supra* note 36 at 1, 8. According to this report, in 1980, less than 40 percent of the low-income sub-Saharan African countries offered tax holidays – there were no free zones. But by 2005, more than 80 percent of these countries offered tax holidays, and 50 percent had created free zones. Although the average length of tax holidays has declined, the number of countries in sub-Saharan Africa granting tax holidays and establishing free zones has been on the increase. The objective, as indicated earlier, may be to achieve international competitiveness, address market failures, boost regional development, and improve income distribution. See Simon Munongo, Olusegun Ayo Akanbi & Zurika Robinson, “Do tax incentives matter for investment? A literature review” (2017) 13:2 BEH 152-168 [*Munongo, Akanbi & Robinson*].

<sup>68</sup> Also, it has been argued that, even though the vast majority of FDI outflows is from developed countries, the receivers of the majority of FDI inflows are still developed countries, with the US, the UK, France, Belgium, and Luxembourg are among the top recipients. See Timothy J. Goodspeed, “Taxation and FDI in Developed and Developing Countries” (1 January 2004), online: IssueLab <[www.issuelab.org](http://www.issuelab.org)> [[perma.cc/resources/5313/5313.pdf](http://perma.cc/resources/5313/5313.pdf)] at 1, 3.

<sup>69</sup> See Antoine Dechezleprêtre et al, “Do Tax Incentives for Research Increase Firm Innovation? An RD Design for R&D” (2016) CEP Discussion Papers dp1413 at 1.

Furthermore, in a cross-sectional time series study of the impact of fiscal incentives in attracting FDI in 16 Sub-Saharan African countries for the period 2000-1990, Cleeve (2008) found that tax incentives are an important determinant in the location of FDI in advanced developed countries, especially in the location of US firms in other developed countries. He also found that, of the fiscal incentives, tax holidays seem to have the most significant impact on the location of FDI in these countries.<sup>70</sup> Moreover, Hall and Reenen (2000), conducted a survey of the econometric evidence of the effectiveness of tax incentives on research and development (R&D) in OECD countries between 1983 and 1997. The study concluded that a dollar in tax credit for R&D stimulates a dollar of additional investment in R & D.<sup>71</sup>

In addition, Swenson (1994) examined the impact of U.S. tax reform on FDI in the United States, using the tax history for the 1980s. He found that increased taxes (in investor home countries) spurred inward foreign investment in the U.S. He concluded that foreign investor response is positively affected by lower taxes on assets in the U.S. relative to the tax provisions faced by the foreign investor in his home country.<sup>72</sup>

Finally, according to Hadari (1990), an empirical study conducted by World Institute in Israel in 1973 found that tax incentives including grants, export incentives, and the right to withdraw profits, significantly influenced investors to invest.<sup>73</sup> Thus, although it has been suggested that the use of tax incentives has not been successful in attracting

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<sup>70</sup> See Emmanuel Cleeve, "How Effective Are Fiscal Incentives to Attract FDI to Sub-Saharan Africa? (2008)" 42:1 JDA 135-153 at 135.

<sup>71</sup> See Bronwyn Hall & John Van Reenen, "How effective are fiscal incentives for R and D? A review of the evidence" (2000) 29 RP 449-469 at 1.

<sup>72</sup> See Deborah L. Swenson, "The impact of U.S. tax reform on foreign direct investment in the United States" (1994) 54:2 JPE 243-266 at 1.

<sup>73</sup> See Yitzhak Hadari, "The Role of Tax Incentives in Attracting Foreign Investments in Selected Developing Countries and the Desirable Policy" (1990) 24:1 TIL 121-152 at 122-123 [*Hadari*].

FDI in both developed and developing countries, it can be argued that tax incentives are effective in developed countries.<sup>74</sup>

Although the evidence on the effectiveness of tax incentives in attracting FDI in developing (medium- or low-income) countries varies, the general conclusion from the review of the literature is that tax incentives are not effective in developing countries.<sup>75</sup> First, James (2013) in surveys of investors in developing countries, including Jordan, Mozambique, Nicaragua, and Serbia analyzed the effect of tax incentives on private investment in developing countries for the period 1997-2007.<sup>76</sup> He found that although exporters considered such incentives very important, most non-exporters do not rank investment incentives among their top reasons for investing.

The study also suggests that tax incentives do not have as much effect on FDI in developing countries as in developed countries, and that fiscal incentives do not effectively counterbalance unattractive investment climate conditions, including poor infrastructure, macroeconomic instability, and weak governance, in many developing countries. In his conclusion, he suggested that the investment climate is more important than tax breaks or other nontax incentives.<sup>77</sup>

Secondly, Van Parys (2012) looked at evidence from developing countries on effectiveness of tax incentives in attracting investment using data in over 40 Latin American, Caribbean and African countries for the period 1985-2004. He found that the CIT rate and tax holidays positively affect FDI in developing countries, but not robustly.

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<sup>74</sup> See *Holland & Vann, supra* note 55 at 2.

<sup>75</sup> See Sebastian James, "Effectiveness of Tax and Non-Tax Incentives and Investments: Evidence and Policy Implications" (28 February 2014), online: SSRN <papers.ssrn.com> [perma.cc/sol3/papers.cfm?abstract\_id=2401905] at 1-15 [*James*].

<sup>76</sup> *Ibid.*

<sup>77</sup> *Ibid* at 8, 15-17.

He also observed that the impact of CIT rate and tax holiday was more significant in Latin America and the Caribbean than in Africa. However, there was no evidence that investment allowances affected FDI. The suggestion is that firms reward higher transparency and security more than a lower tax burden, and that basic investment climate conditions (which may be lacking) are key to investors, before tax incentives.<sup>78</sup>

Thirdly, Zee et al (2002) reviewed the empirical literature on the effectiveness of tax incentives in developing countries, including East Asian economies and transition economies, such as Brazil, for the period 1984-2001. They found that the overall economic characteristics of a country are more critical for the success or failure of FDI attraction measures than any tax incentive package. They also found that even if tax incentives stimulate investment, they are not generally cost-effective. The example was cited of Brazil where the extensive use of incentives resulted in significant revenue losses (compared to the investment generated) and distortions in the general tax system.<sup>79</sup>

Fourthly, Biggs (2007) reported on a review of the fiscal regimes in twenty-one countries, for the period 1994-2006, including CIT exemptions, tax holidays, investment allowances, accelerated depreciation, and tax credits, to attract technology-intensive FDI. She concluded that CIT exemptions and tax holidays are not efficient in attracting investment. She also found that developing countries use the wrong tax incentives, like tax holidays and accelerated depreciation, which do not work in their economies. The recommendation was that policy makers in developing countries should focus their tax

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<sup>78</sup> The explanation is given that the low impact of tax incentives on investment in Africa may be due to poor investment climate which makes the granting of tax incentives not sufficient to compensate for. See *Van Parys, supra* note 29 at 135-138.

<sup>79</sup> See Howell Zee, Janet G. Stotsky & Eduardo Ley, "Tax Incentives for Business Investment: A Primer for Policy Makers in Developing Countries" (2002) 30:9 *WD* 1497-1516 at 1508.

incentives on small domestic corporate players (who may be more responsive to tax incentives) than large TNCs which may be looking for other non-tax incentives in addition to tax incentives.<sup>80</sup>

Country-specific empirical studies also show contradicting results. The effectiveness of tax incentives in attracting FDI remains unsettled, and their importance differs with the jurisdiction of the study and the methodology.<sup>81</sup> Klemm and Van Parys (2012) examined the impact of CIT tax holidays on investment in two monetary unions – the Eastern Caribbean Currency Union and the African CFA Franc zone – for the period 1994-2006. The study found lower CIT rates and longer tax holidays are effective in attracting FDI in Latin America and the Caribbean, but not in Africa.<sup>82</sup>

Finally, while Kransdorff (2010), in a review of South Africa's tax regime and its potential to attract FDI, concluded that taxation can be important in attracting efficiency-seeking FDI in South Africa, Bolnick (2004), relying on data from the SADC Tax Database in 2003, suggested that tax incentives are not enough to convince foreign investors to choose their locations in the SADC region.<sup>83</sup> However, Kransdorff reckons that, even though tax incentives are effective in attracting FDI, the low FDI flows in South Africa are due to a poor investment climate.<sup>84</sup> He suggested that in the short-term, offering more

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<sup>80</sup> See Phillipa Biggs, "Tax Incentives to Attract FDI" (2007) Meeting of Experts on "FDI, Technology and Competitiveness" A conference convened in honour of Sanjaya Lall, UNCTAD, 2007 at 1.

<sup>81</sup> However, even though tax incentives receive a lot of criticism, they continue to be used in most economies. See *Munongo, Akanbi & Robinson, supra* note 67 at 152.

<sup>82</sup> See Alexander Klemm & Stefan Van Parys, "Empirical evidence on the effects of tax incentives" (2012) 19 ITPF 393 at 1.

<sup>83</sup> See Michael Kransdorff, "Tax Incentives and Foreign Direct Investment in South Africa" (2010) 3:1 TJSD 68-69 at 68. See also Bruce Bolnick, "Effectiveness and Economic Impact of Tax Incentives in the Southern Africa Development Community (SADC) Region" (2004) Report by Nathan-MSI Group to the SADC Tax Subcommittee at XI. The study cites Mauritius, Costa Rica, Ireland and Malaysia as economies that have successfully used non-tax incentives to attract FDI. These countries implemented successful economic reforms, ensured political stability, educated their work-force, built good infrastructure and instituted investment promotion agencies to increase their appeal to investors.

<sup>84</sup> *Ibid* at 68.



competitive tax incentives could improve FDI flows, while South Africa works to better the investment climate. Bolnick, on the other hand, concludes that non-tax elements of the investment climate are far more important than tax incentives in determining the level and quality of FDI. However, it would be difficult to rely on Kransdorff's assertion for policy reform purposes, because it lacks further empirical backing.

From the discussion so far, it can be seen that the evidence in developing and transition countries on the effectiveness of tax incentives is not consistent with that of developed countries. It appears that at a general level, tax incentives of the type offered by developed countries have some effectiveness, but tax incentives of the type offered by developing and transition economies are more likely to result in revenue sacrifice than increased foreign direct investment.

The question then is, why do tax incentives work in developed countries, and not in developing countries? It has been observed that tax incentives are ineffective in promoting FDI in developing countries mainly because of the poor investment climates. In many cases, developing countries lack high quality investment climate, basic infrastructure, reasonable transport costs, and a policy framework favouring investment. As a result, investors are unlikely to respond to even the most generous tax incentives. For example, tax holidays cannot compensate for shortcomings in infrastructure, and may be benefiting mainly firms that would have invested anyway.

Similarly, tax incentives may be ineffective in developing countries due to economic or political challenges. For instance, most developing countries have inadequate protection of property rights, rigid employment laws or a poorly functioning legal system.

In such situations, it is more important to correct these deficiencies than to provide investors with additional tax benefits.<sup>85</sup>

Such a situation may be the case in Africa, particularly, sub-Saharan Africa. The low effectiveness of tax incentives may be as a result of the fact that the investment climate may be poor and granting tax incentives is insufficient to compensate for the poor climate. The impact of the lack of transparency, security and accountability, coupled with the complexity of the tax system is likely to cause investors to look elsewhere.<sup>86</sup> Perhaps African developing countries can take a clue from the observation that tax incentives cannot overcome fundamental problems that inhibit investment.<sup>87</sup>

Furthermore, tax incentives may not work in developing countries because they are poorly designed, without proper economic and social assessment (such as, forecasts, projections and externalities). For example, incentive programmes often include a specific sunset provision as part of the original legislation; have long duration; do not require beneficiaries to report to investment agencies; and may not specify which government agency is responsible for monitoring, enforcement and evaluation.<sup>88</sup> In short, tax incentives may not work in developing countries because of the poor investment climate and inadequate design.

However, most emerging economies are still adopting new tax vehicles across all sectors.<sup>89</sup> Why do developing countries continue to grant tax incentives, in spite of the ineffectiveness that may be associated with their use? Five main arguments have been

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<sup>85</sup> *Andersen, Kett & von Uexkull, supra* note 11 at 89.

<sup>86</sup> According to Van Parys (2012), these factors are critical in Sub-Saharan Africa, leading to a generally poor investment climate. See *Van Parys, supra* note 29 at 129.

<sup>87</sup> See *Holland & Vann, supra* note 55 at 2.

<sup>88</sup> See *UN, 2018, supra* note 9 at 42.

<sup>89</sup> PricewaterhouseCoopers, “PWC Report: Government's Many Roles in Fostering Innovation” (PWC Report, 2010) [unpublished] at 3.

advanced as the justification for this seeming anomaly in policy action – pressure to counterbalance the poor investment climate, response to competitive pressures, lobbying from TNCs, and reliance on successful examples.

Firstly, as indicated earlier, developing countries use tax incentives as a means to counter the negative effects of a bad tax system. Tax incentives are also seen as compensating measures for the effects of poor macroeconomics, inadequate infrastructure, and lack of effective institutions. It may be easier for developing countries to grant tax incentives than to provide, for instance, a secure and stable political environment; develop a skilled workforce; or undertake reforms to correct deficiencies in the legal system, improve the tax administration or upgrade the communications system. Also, discretionary tax incentives generate more political influence, and can promote more corruption, compared to other policy options.<sup>90</sup>

The justification may be that eliminating taxes, or reducing tax rates will help mitigate losses associated with inefficiencies.<sup>91</sup> However, as mentioned earlier, granting tax incentives may not be enough to compensate for poor investment climate and other factors, like, political instability and intolerance.<sup>92</sup> There is the need to protect the revenue base, and improve the investment climate. This can then be followed by the use of tax incentives to become more FDI competitive.<sup>93</sup>

Secondly, in addition to addressing market failures, tax competition is a major force behind the grant of tax incentives in developing countries. Tax incentives are introduced

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<sup>90</sup> See OECD, “Checklist for Foreign Direct Investment Incentive Policies” (30 April 2003), online (*pdf*): *OECD* <[www.oecd.org](http://www.oecd.org)> [perma.cc/2506900] at 26 [*OECD (2003)*].

<sup>91</sup> See *Munongo, Akanbi & Robinson, supra* note 67 at 153-156.

<sup>92</sup> See James Ike Ugwu, “Tax Incentives and Foreign Direct Investment (FDI): Implication for Export Promotion in Nigeria, Ghana and South Africa, Post IFRS Adoption” (2018) 6:09 *IJMSS* 31-52 at 33 [*Ugwu*].

<sup>93</sup> *Andersen, Kett & von Uexkull, supra* note 11 at 89.

by many transitional and developing countries because they are granted by neighbouring countries. The aim may be to compete for investment that otherwise would have gone to different regions or countries.<sup>94</sup> Also, legislators may feel the need to do something to attract investment, but may find it difficult to address the main factors that discourage investment. In that case, tax incentives are policy options over which they have control, and which they can enact relatively easily and quickly.<sup>95</sup> Closely related to the above is the fact that many developing countries assume that investment is automatically attracted by lowering the tax burden, but the costs related to tax incentives are often ignored; these costs often outweigh the reduced tax burden.<sup>96</sup>

Thirdly, developing countries may feel under pressure from TNCs, which threaten to locate investment elsewhere if they are not granted tax concessions.<sup>97</sup> The effect of lobbying by TNCs can be strong, especially where tax incentives can be granted on a discretionary basis.<sup>98</sup> This lobbying may be driven by the profit motive of TNCs in seeking to exploit natural resources or looking to take advantage of other favourable market conditions. It may also be facilitated by the rent-seeking opportunities of officials. However, the effect on developing countries may be that they outcompete each other and race to the bottom while TNCs gain.

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<sup>94</sup> According to UN (2018), countries may seek to compete for different types of investments, such as headquarters and service businesses, mobile light assembly plants or automobile manufacturing facilities. The competition for foreign investment will differ depending on the reason for the investment. For example, tax competition will exist among countries of a common customs union for the manufacturing or distribution facility that will service the entire region. See *UN, 2018, supra* note 9 at 8.

<sup>95</sup> See David Holland & Richard J. Vann, "Income Tax Incentives for Investment" in Victor Thuronyi, ed *Tax Law Design and Drafting Volume 2* (New York: IMF, 1998) at 2, 4 [*Holland & Vann*].

<sup>96</sup> See *UNCTAD 2000, supra* note 30 at 12.

<sup>97</sup> See *Holland & Vann, supra* note 95 at 2, 4.

<sup>98</sup> See *UNCTAD 2000, supra* note 30 at 12.

Fourthly, developing countries may prefer the use of tax incentives to alternatives that may involve the expenditure of funds. Tax incentives do not require upfront use of government funds, compared to other incentives, such as, grants or subsidized loans, which are frequently employed in developed countries.<sup>99</sup> For example, subsidies may undergo closer scrutiny, and so may not be easy to grant.<sup>100</sup> The rationale may be to suffer a temporary reduction in tax revenue associated with the grant of tax incentives, and focus on expected benefit to offset the loss.<sup>101</sup>

Finally, developing countries may be opting for tax incentives because the use of fiscal incentives is familiar. The use of tax incentives to attract FDI has become a global phenomenon from which developing countries do not wish to be left out. For instance, tax incentives have been used in the history of developed countries, and they continue to be used, to attract FDI. Also, developing countries may be spurred on, in the use of tax incentives, by the success stories of recent successful users, including Ireland, Singapore and China.<sup>102</sup> Developing countries may grant tax incentives in the hope of attracting FDI commensurate with their own level of development.

#### **D. MEASURES THAT COUNTRIES CAN ADOPT TO ENSURE EFFECTIVE USE OF TAX INCENTIVES**

Although, in many instances – particularly among developing countries – the effectiveness of tax incentives in attracting FDI has been questioned, it is believed that, if

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<sup>99</sup> See Alexander Klemm & Stefan Van Parys, “Empirical Evidence on the Effects of Tax Incentives” (2009) IMF Working Paper No. WP/09/136 at 134.

<sup>100</sup> *Holland & Vann*, *supra* note 95 at 2, 4

<sup>101</sup> See *Ugwu*, *supra* note 92 at 33.

<sup>102</sup> See *Morisset & Pirnia*, *supra* note 44 at 23.

rightly designed and implemented, tax incentives can be a useful tool for attracting investments that would otherwise not have been made.<sup>103</sup> Six measures that must be given due policy consideration in the design and use of tax incentives in order for them to achieve the desired results objectives have been identified: clear objectives, consolidated legislation, diligent record keeping, compliance conditions, limited duration, and improved investment climate.<sup>104</sup>

Firstly, in order to design a desirable, appropriate and effective tax incentive scheme, the objective must be clearly set forth, and the incentive programme crafted to best fit the objective. In-depth analysis of the costs and benefits of tax incentives must be carried out. This analysis should start by developing a realistic view of what can, and cannot, be achieved.<sup>105</sup> A framework for policy design and implementation is required, which will identify the market imperfections which the incentives are intended to address.<sup>106</sup> Objectives must be compared with potential revenue loss, or other unintended results associated with the use of the tax incentives. Also, the linkages between FDI attraction and other policy objectives, and their effect, must be well established. If possible, other more effective, cost-neutral measures must be considered. It should also be clear which governmental body will be responsible for the formulation of policies, and which

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<sup>103</sup> See *UN, 2018, supra* note 9 at 27, 32.

<sup>104</sup> See *IMF et al, supra* note 36 at 23-24.

<sup>105</sup> *OECD (2003), supra* note 90 at 26.

<sup>106</sup> See *UNCTAD 2000, supra* note 30 at 18.

other authority may be involved in implementation process, for proper accountability.<sup>107</sup> Incentives should not be granted based on the bidding of investors.<sup>108</sup>

Secondly, an effective tax incentive scheme requires that they be clearly prescribed and consolidated in legislation. An ideal tax system should keep tax laws as simple as possible and aim for a global tax, with few exemptions or concessions. The pursuit of too many social and economic goals must be avoided, and eligibility criteria for granting tax incentives should be clearly defined and readily verifiable. The ultimate and sole authority to enact tax incentives at the national level should be with the legislature – the Minister of Finance and Economic Planning should be responsible for approving the grant of tax incentives.<sup>109</sup> Revenue administrations should only be in charge of the implementation and enforcement of tax incentive schemes. Tax administrations should keep a balance between tax stability for existing firms and equal treatment for new entrants into the market.<sup>110</sup> Tax incentives should be awarded with as little discretion and as much transparency as possible, based on performance.

Thirdly, an effective tax incentive scheme requires proper record keeping, and periodic tax reporting to ensure transparency and accountability. Tax incentive regimes should require regular filing to allow for proper assessment of the success or otherwise.

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<sup>107</sup> It is advisable that the tax administration (which is responsible for raising revenue) should also be responsible for administering tax incentives. In that way, the risk, where one government body grants tax incentives without being responsible for balancing the ripple effects, can be avoided. For instance the investment promotion agency which doesn't have to raise the associated tax revenue is administering tax incentives, it may always grant tax incentives because there is no downside for that agency.

<sup>108</sup> In some regions in Africa, countries are coordinating efforts to assess the revenue costs of tax incentives. See *UNCTAD 2000*, *supra* note 30 at 29

<sup>109</sup> See *James*, *supra* note 75 at 1-15.

<sup>110</sup> According to IMF et al (2015), as many as 10 organizations or agencies have the authority to grant tax incentives and exemptions in Ghana – including the Parliament, Ministry of Finance & Economic Planning, Revenue Agencies, Minerals Commission, Environmental Protection Agency, Food and Drugs Board, Ghana Free Zones Board, Ghana Investment Promotion Centre, and Ghana National Petroleum Company. See *IMF et al*, *supra* note 36 at 27.

The choice of strategies and policy tools, the design and management of individual programmes, and transparency of procedures for monitoring and evaluation, should be under regular review. The potential costs of unsuccessful or poorly designed incentives should inform the decision for subsequent schemes. Where desired results are not achieved, authorities must be willing to terminate or modify the programme.<sup>111</sup>

Fourthly, initial compliance with qualifying conditions must be clearly spelt out so that it can be determined whether an investment meets the required standards. For example, some incentive provisions may require initial approval or inter-agency decision making. Tax authorities can request for some form of written certification to verify whether stipulated local content, job creation thresholds or minimum capital requirements have been met. Plant, machinery and equipment can be assessed to establish whether they qualify, as advanced technology, for accelerated depreciation.<sup>112</sup> The agency responsible for monitoring and enforcing, and the parties responsible for conducting the review must be clearly identified.<sup>113</sup>

Fifthly, effective tax incentive schemes must have a limited duration, or must contain a definite sunset provision, to allow for a regular evaluation of their continued relevance. Also, including a sunset provision will also reduce the risk that tax incentives are kept working due to administrative or political inertia. In determining the duration, factors such as the political cycle and the time horizon for the development of a given locality may be considered.

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<sup>111</sup> See *UN, 2018, supra* note 9 at 27-32.

<sup>112</sup> *Ibid.*

<sup>113</sup> *Ibid.*



Finally, effective tax incentive schemes must be complemented with an improved investment climate. There is the need for developing countries to work at improving domestic investment climates, and use tax incentives only to address market failures.<sup>114</sup>

One other issue in the design and operation of tax incentives that may be worth exploring is whether tax incentives should be generally applicable to both domestic and foreign investors. While it is my view that tax incentives, in the general context, should be designed to be of benefit to both domestic and foreign investors, in some particular contexts, that may not be the objective. For example, where FDI tax incentive schemes need to be distinguished from the general domestic tax system, tax incentives may be construed to mean inducements that are not available to comparable domestic investors.<sup>115</sup> But even where it is agreed that tax incentives are an inducement that constitutes a deviation from the standard practice in an industry, it leaves much to be desired that tax incentives should be construed to be applicable only to foreign investment. Granted that where tax incentives grant special privileges to attract investments that are particularly desirable, and, perhaps, would not be made without such tax treatments, it is my suggestion that domestic investors must equally be treated.<sup>116</sup>

The equal treatment of domestic and foreign firms is required for four main reasons. First, because both domestic and foreign investors are equally exposed to the general investment climate, they are equally likely to feel the distortionary and other adverse impacts of tax incentive policies.<sup>117</sup> General best practice discourages the use of special tax

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<sup>114</sup> *Ibid* at 31.

<sup>115</sup> *Ibid* at 21: the UN contextually defined tax incentives to mean measures to influence the size, location or industry of an FDI project by affecting its cost or altering its risks by means of inducements that are not available to comparable domestic investors.

<sup>116</sup> See *UN, 2018, supra* note 9 at 21.

<sup>117</sup> *Zolt, supra* note 3 at 18.

incentives because they distort investment decisions, are often ineffective, and are prone to abuse and corruption. But, where for some reason it becomes necessary to introduce tax incentives, they should be available to all investment that would meet the requirements. For example, a reduced CIT rate across a broad base is a simpler approach that can be applied to all domestic and foreign investors. This approach can be adopted to avoid distortions associated with other forms tax incentives (such as, tax holidays), and relieve the tax administration of tax-planning pressures.<sup>118</sup>

Additionally, because of their desirable outcome on business, tax incentives can play a useful role in encouraging both domestic and foreign investment. The ultimate end of tax incentives is a reduction in the effective tax rate, to guarantee higher after-tax return on investment – that should be encouraging to both domestic and foreign investment. Also, if disincentives, or unfavourable changes in domestic tax rules – such as, upward adjustment in the CIT rate – are expected to be applicable to both domestic and foreign investments, then, similarly, tax incentives should apply to both foreign and domestic investors.<sup>119</sup>

Moreover, local investors are likely to venture into riskier sectors, long-term investment, and primary sectors (with higher linkage effects), compared foreign investors.<sup>120</sup> Although studies show that foreign investors earn higher returns, and bring greater efficiency to the market, due to superiority in terms of analytical skills and access to information,<sup>121</sup> domestic investors may be more reliable, especially in times of adverse

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<sup>118</sup> See *OECD-MENA*, *supra* note 26 at 1.

<sup>119</sup> See David G. Hartman, “Domestic Tax Policy and Foreign Investment: Some Evidence” (1981) NBER Working Paper No. 784 at 1.

<sup>120</sup> See *Morisset & Pirnia*, *supra* note at 14.

<sup>121</sup> Dick Svedin & Jesper Stage, “Impacts of foreign direct investment on efficiency in Swedish manufacturing” (2016) 5:614 JSP at 1.

economic conditions.<sup>122</sup> For instance, the majority of foreign investment may be footloose investment – primarily short-term investments with smaller multiplier effects.<sup>123</sup> Such investments may quickly disappear, or be terminated, to relocate in another country, as soon as tax benefits are exhausted.<sup>124</sup> Moreover, limiting tax incentives to the foreign firms may increase the risk of round-tripping – a situation where domestic investors channel funds to special purpose entities abroad, and subsequently return them to local firms as FDI.<sup>125</sup>

Fourth, tax incentives need not be preferential because both domestic and foreign investments are motivated by profits, and the two can strongly complement each other. Also, domestic investment may be a significant part the enabling environment for FDI to thrive, and FDI may just be enhancing or maximizing some of the positive effects already generated by local investment. For example, FDI might not create as many employment opportunities as the domestic private sector, but FDI may generate higher paying jobs commensurate with higher skills to shift the production frontier of the host economy.<sup>126</sup> Moreover, if well incentivized, domestic investment can equally generate some of the advantages traditionally attributed to FDI. For instance, domestic investments usually create more employment in a host country than FDI does.<sup>127</sup>

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<sup>122</sup> See François Moreau, “Domestic Investment and FDI in Developing Countries: The Missing Link” (2012) 37:3 JED 1-23 at 1. See also Cecile Fruman Xavier Forneris, “The false debate: choosing between promoting FDI and domestic investment” (6 June 2016) online (blog): *World Bank* <[blogs.worldbank.org](http://blogs.worldbank.org)>; The Economic Times, “Domestic investment, not FDI is central to India's economic recovery” (22 July 2013), online: *Economic Times* <[economictimes.indiatimes.com](http://economictimes.indiatimes.com)>.

<sup>123</sup> See *Morisset & Pirnia*, *supra* note at 14.

<sup>124</sup> According to Li, Jinyan (2008), about one quarter of all FDI enterprises registered in China since 1979 were believed to have paid no income tax mainly because the investment was terminated after the tax holidays. See Li, Jinyan, "The Rise and Fall of Chinese Tax Incentives and Implications for International Tax Debates" (2008) CRLPE Research Paper No. 5/200 at 24.

<sup>125</sup> See *Zhan*, *supra* note 46 at 19.

<sup>126</sup> See Cecile Fruman Xavier Forneris, “The false debate: choosing between promoting FDI and domestic investment” (6 June 2016), online (blog): *World Bank* <[blogs.worldbank.org](http://blogs.worldbank.org)> at 1.

<sup>127</sup> *Ibid.*

In conclusion, this chapter has reviewed literature on the use of tax incentives to attract FDI. It established that, generally, tax incentives constitute a favourable departure from the general tax regime that is intended to induce investments in particular sectors of the economy. Also, tax incentives may be used as tools to promote particular economic goals, such as employment, correction of market inefficiencies, or reversal of a downturn. Tax incentives come in several forms, including tax holidays, reduced CIT rates, and import duty exemptions. It has also been found that tax incentives are used by both developed and developing countries, however, they have been found more likely to work in developed countries than in developing countries. Developing countries may continue to use tax incentives because of existing competition, pressure from TNCs, the ease in the use of tax incentives, or the examples of successful users.

Lastly, the use of tax incentives may be justified, given that, without government intervention, the level of FDI can be suboptimal.<sup>128</sup> However, an effective tax incentive scheme requires clear objectives; simple, concise and consolidated legislation; filing of tax returns; and monitoring and evaluation. Also, government decision-making process, policies and administration must be transparent, and subject to scrutiny and evaluation. Above all, it is recommended that the award and monitoring of tax incentives should be guided by the rule of law, with clarity on eligibility criteria, and centralized administration. Developing countries must focus on building a favourable investment climate, and ensure transparency and accountability in the use of tax incentive policies.

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<sup>128</sup> UN, *UN, 2018, supra* note 9 at 27, 32.

## **CHAPTER 3                    TAX INCENTIVES FOR ATTRACTING FDI IN GHANA**

This chapter discusses the tax incentives regime for the promotion, attraction and facilitation of FDI in Ghana. It is divided into four main sections. It begins with a brief overview of the regulatory framework for FDI and tax incentives, with a short discussion of the GIPC Act, 2013 (Act 865),<sup>129</sup> and tax policy adjustments under the ERP. The second section reviews the history of efforts to attract FDI in Ghana from the period 1985-2017, looking at the impact of various legislative reforms on FDI over the period. In the third section, the main tax incentives for promoting FDI in Ghana are considered, including their desired objectives, the authorizing legislation, and the administering body. It concludes with an assessment of the effectiveness of tax incentives in Ghana, with a review of the impact of tax incentives in the natural resource sector, and the operations of FZs.

### **A. OVERVIEW OF THE LEGAL REGIME OF INVESTMENT AND TAX INCENTIVES IN GHANA**

It is necessary that an overview of the general investment climate and the regulatory framework for FDI in Ghana precede the analysis of Ghana's tax incentives, since tax incentives do not operate in a vacuum. Tax incentives operate within an investment climate of a country, much of which is created by the state's policy, vision and objectives. Thus the investment climate, to a large extent, determines whether the tax incentives offered would be effective, or not.

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<sup>129</sup> See *GIPC Act 2013*, *supra* note 19.

The main FDI regulatory framework in Ghana is the GIPC Act.<sup>130</sup> The Act codifies into law the government's economic policy framework, which is aimed at attracting investment into the private sector through a transparent FDI regulatory regime. It guarantees against expropriation, and spells out incentives and procedures relating to taxation, and the transfer of capital, profits and dividends.

Under the Act, the GIPC is the main administrative body to regulate all aspects of FDI, except in minerals and mining, oil and gas, and FZs. The GIPC is also the government agency that is to, among others, encourage and promote investments, and provide for the creation of an attractive incentive framework, and a transparent, predictable and facilitating environment for investments in Ghana.

The GIPC Act requires that all companies in which there is foreign participation register with the GIPC. Registration occurs after each enterprise has been incorporated at and licensed by the Registrar General's Department. Also, business entities may be required to register with other sector-specific regulatory bodies, based on the industry of operation.

Ghana was among the first African countries to pursue economic liberalization, overhauling its tax system in sweeping policy reforms in 1983.<sup>131</sup> A number of fiscal incentives were introduced to encourage investment. Since then, successive legislative reforms have offered further fiscal incentives, including the GIPC Act and the ITA of 2015.<sup>132</sup> These pieces of legislation are replete with concessionary tax provisions, such as

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<sup>130</sup> *Ibid.*

<sup>131</sup> See UNCTAD, "Investment Policy Review Ghana" (2003) UNCTAD Paper No UNCTAD/ITE/IPC/Misc.14 at 3 [*UNCTAD 2003*]. See also Camara Kwasi Obeng, "Effect of Corporate Tax on Sector Specific Foreign Direct Investment in Ghana" (2014) MPRA Paper No. 58454 at 2 [*Obeng*].

<sup>132</sup> See *ITA Ghana*, *supra* note 19.

tax holidays, capital/investment allowances, locational incentives and customs duty exemptions, tax credits, preferential/concessionary rates, and inducements and benefits, intended to entice investors.<sup>133</sup>

Currently, many of the tax incentives are set out in the ITA, and are of general application.<sup>134</sup> However, a number of them, which have a narrower focus and sector specific application, are specified in statutes, such as, the GIPC Act, the FZA and the Petroleum Act.<sup>135</sup>

Investors are guaranteed all the general tax incentives provided for under the law, but special tax incentives may be available in particular sectors of the economy.<sup>136</sup> For example, a CIT rate of 25 per cent applies to all sectors, except non-traditional exports and oil and gas explorations;<sup>137</sup> businesses in manufacturing and other key priority sectors can carry forward losses, while other sectors cannot; and accelerated depreciation is allowed mainly in the industrial sector, excluding banking, finance, commerce, insurance, mining and petroleum. The tax provisions also allow the government to grant additional customs duty exemptions and tax incentives beyond the minimum stated in the law to investments

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<sup>133</sup> See IMF, “Ghana Fifth and Sixth Reviews under the Extended Credit Facility, Request for Waivers for Nonobservance of Performance Criteria, and Request for Modification of Performance Criteria” (2018) IMF Country Report No. 18/113 at 5 [*IMF 2018*].

<sup>134</sup> See *ITA Ghana*, *supra* note 19 at 1<sup>st</sup>, 3<sup>rd</sup> and 6<sup>th</sup> Schedule.

<sup>135</sup> See *GIPC Act 2013*, *supra* note 19; *FZA*, *supra* note 19; *Petroleum (Exploration & Production) Act, 2016 (Act 919)* (Ghana).

<sup>136</sup> See *ITA Ghana*, *supra* note 19; *Internal Revenue Act 2000 (Act 592)* (Ghana); *VATA, 2013 (Act 870)* (Ghana); *Harmonized System: ECOWAS Common External Tariff and Other Schedules 2017*(ECOWAS). For example, while investors operating under the FZA are exempted from corporate tax for 10 years, investors operating under the GIPC Act are not automatically entitled to tax holidays. There are also other temporary tax holidays and location-based tax rebates for some sectors.

<sup>137</sup> Income from the export of non-traditional goods is taxed at 8 per cent (reduced rate); and enterprises in the petroleum sector can negotiate their CIT rate under the *PITA, 1987*. See the *Petroleum Income Tax Law, 1987 (P.N.D.C.L. 188)* (Ghana).

of strategic national interest.<sup>138</sup> There is, however, much skepticism about the level of monitoring, and it is unclear whether data on the entire range of negotiated incentives granted is kept and used for tax reporting purposes.<sup>139</sup>

## **B. HISTORY OF EFFORTS TO ATTRACT FDI IN GHANA, 1985-2017**

This section considers the evidence of tax incentives on investment in Ghana from 1985 to 2017. It offers an outline of the effects of series of legislative reforms on FDI in Ghana, starting from the introduction of the ERP in 1983, continuing to the period of global decline of FDI in 2001. It also looks at the rise in FDI in 2017, and ends by projecting from thence into the medium term.

The effects of FDI in Ghana have been undulating. Although the history of FDI dates back several centuries, with early foreign establishments,<sup>140</sup> in more recent times (1970s), FDI had mainly been in import-substitution manufacturing, underpinned by policies to complement income from traditional exports – cocoa, timber and gold.<sup>141</sup> This situation necessitated the adoption of new initiatives to open the country to attract investment in the manufacturing sector.<sup>142</sup>

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<sup>138</sup> Under the GIPC Act, an investor can negotiate specific incentive packages in addition to the general incentives available (See *GIPC Act 2013*, *supra* note 19, s 26).

<sup>139</sup> *Wilson & Bentum*, *supra* note 6 at 24-26.

<sup>140</sup> See *UNCTAD 2003*, *supra* note 131 at 1.

<sup>141</sup> According to Asafu-Adjaye (2005), starting from a general mistrust of FDI in the 1960s and early 1970s, developing country governments have now come to embrace it. They now consider FDI as a source of capital and a major tool in the fight against poverty (See John Asafu-Adjaye, “What has been the Impact of Foreign Direct Investment in Ghana?” (2005) 1:9 IEAPA 1 at 1). Developing country share of FDI increased from 5 per cent in 1980 to 36 per cent in 2004 (See UNCTAD, *Economic Development in Africa – Rethinking the Role of Foreign Direct Investment* (New York & Geneva: UN, 2005) at 1).

<sup>142</sup> See *Osei*, *supra* note 25 at 25.



In 1983, Ghana introduced the ERP, which saw the country undertake a transition from a state-controlled economy to a market economy.<sup>143</sup> As a developing country with significant FDI flows to the mining (gold) sector, Ghana adopted three main fiscal changes affecting the sector, in a new mining law in 1986.<sup>144</sup> Minimum royalties were reduced from 6 per cent to 3 per cent; CIT from 55 per cent to 35 per cent; and tax exemptions were granted for imported plant and equipment.<sup>145</sup> The country also embarked on a privatization programme as part of the reforms.<sup>146</sup>

The new mining law enacted in 1986 sent a positive signal among investors, resulting in a sudden rise in investments.<sup>147</sup> Soon FDI revamped, and for the period 1991-1995, Ghana was considered a prime investment destination, ranking among the top 10 countries in Africa. FDI soared from a yearly average of USD 19 million during the period 1980-1993 to USD 128 million in 1994-2002, and gross capital formation rose from 10 to 22 per cent of GDP.<sup>148</sup> This spectacular performance was credited to the adoption of new policies under the ERP. The divestiture programme, which involved the privatization of unprofitable state enterprises, started in 1988, also contributed to this relative success.<sup>149</sup>

FDI inflows peaked in 1994 with the partial sale of AGC to the South African giant, Lonmin.<sup>150</sup> The acquisition, which also saw FDI flowing to the services sector, brought the

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<sup>143</sup> See IMF, “Ghana – Enhanced Structural Adjustment Facility Economic and Financial Policy Framework Paper 1998-2000” (29 July 2017), online: IMF <[www.imf.org](http://www.imf.org)> [/external/terms.htm].

<sup>144</sup> See *Minerals and Mining Law, 1986 P.N.D.C.L. 153* (Ghana).

<sup>145</sup> See *Minerals and Mining Law, 1986 P.N.D.C.L. 153* (Ghana), s 27.

<sup>146</sup> See IMF, “Ghana – Enhanced Structural Adjustment Facility Economic and Financial Policy Framework Paper 1998-2000” (29 July 2017), online: IMF <[www.imf.org](http://www.imf.org)> [/external/terms.htm].

<sup>147</sup> See *Minerals and Mining Law, 1986 P.N.D.C.L. 153* (Ghana), s 1.

<sup>148</sup> See OECD, *Investment for African Development: Making it Happen*, Roundtable organised under the joint Auspices of NEPAD and the OECD Investment Committee (Entebbe, Uganda: 2005) at 21.

<sup>149</sup> *Ibid.*

<sup>150</sup> This is regarded one of Africa’s largest privatization to date (See *UNCTAD 2003, supra* note 131 at 4).

country to the limelight for international investment. The privatization of AGC by the government was also to signal its preparedness to encourage foreign participation in the private sector of the economy.

In order to further boost FDI inflows, an Investment Centre was established, under the Investment Code, in 1994,<sup>151</sup> in line with the country's development strategy framework. Hailed as the best in Africa at the time, the Code<sup>152</sup> eliminated entry barriers, eased requirements for enterprise establishment and provided incentives and guarantees to investors. The Gateway strategy was launched alongside, with the objective of developing the country into a regional investment centre, by removing the constraints to exports, and attracting export-oriented firms and investment.

The period 1996-2000, however, saw FDI inflows decline, with the economy subsequently suffering a shock in the period 1998-1999, due to the fall in prices of its major exports, and the rise in the price of its major import, oil.<sup>153</sup>

In an effort to resuscitate investor interest, a new phase of the divestiture process was launched in 1998.<sup>154</sup> The policy, under which foreign investors were reassured of government's commitment to business, helped stabilize the economy, and FDI inflows recovered in 2000. But the worldwide decline of FDI in 2001 caused inflows to Ghana to

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<sup>151</sup> See *Ghana Investment Promotion Centre Act, 1994 (Act 478)* (Ghana).

<sup>152</sup> *Ibid.*

<sup>153</sup> See *UNCTAD 2003*, *supra* note 131 at 4.

<sup>154</sup> See IMF, "Ghana Enhanced Structural Adjustment Facility Policy Framework Paper, 1999-2001" (13 April 1999), online: *IMF* <[www.imf.org](http://www.imf.org)> [external/np/pfp/1999/Ghana]. See also Kojo Appiah-Kubi, "State-owned enterprises and privatisation in Ghana" (2001) 39:2 *JMAS* 197-229 at 197; Stephen Adei, "Governance, State-Ownership and Divestiture: The Ghanaian Experience", online: <[unpan1.un.org](http://unpan1.un.org)> [AAPAM/UNPAN025579.pdf].

decelerate, as in many other developing countries. FDI inflows in 2002 fell to a record low of USD 60 million.<sup>155</sup>

Nonetheless, the government, was determined to shore up the gains made thus far. Critical domestic strategies, such as enhancing the regulatory framework governing privatization, improving good governance, reviving the Gateway Strategy, and committing to regional integration, were adopted to reposition the country among the top investment destinations in Africa. Through policy revision, adoption of new strategies and the provision of guarantees and protection to investment, the country staged a comeback in 2008, with FDI hitting a high at USD 2,710 million.<sup>156</sup> The country continued this progress in attracting capital and technology for development, and in 2016, FDI reached its peak at USD 3,490 million, falling off slightly to USD 3,250, in 2017.<sup>157</sup>

Projecting forward, from 2018, there is still room for Ghana to sustain its FDI trend to further rake in the benefits that rising inflows could bring.<sup>158</sup> This underscores the need for the government to further enhance the attractiveness of the country and instil confidence among investors, through the adoption of institutional and legal frameworks, holding of stakeholder forums, and promotional campaigns.

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<sup>155</sup> See The Global Economy, “Ghana: Foreign Direct Investment, billion dollars” (26 April 2019), online: The Global Economy: <[www.theglobaleconomy.com](http://www.theglobaleconomy.com)> [Ghana/fdi\_dollars].

<sup>156</sup> *Ibid.*

<sup>157</sup> *Ibid.* See also, *Osei* at 25. The Trade Gateway and Investment Project for Ghana aims at the development of a multi-purpose industrial park, and the improvement of the quality and standards of services delivered to investors and exporters.

<sup>158</sup> See *UNCTAD 2003*, *supra* note 131 at 21.

## C. TAX INCENTIVE FRAMEWORK IN GHANA

In this section, we discuss the main legal framework on tax incentives available in Ghana, including, the ITA, 2015 (Act 896), the GIPC Act, 2013 (Act 865), the FZA, 1995 (Act 405), the Minerals and Mining Act, 2006 (Act 703), Minerals and the Mining Act, 2010 (Act 794).<sup>159</sup> Although these are the main pieces of legislation regulating investment activities in the private sector, others that may be required in discussing specific tax incentives will be cited under the appropriate incentive category.

It is worth noting that the operation of tax incentives in Ghana is automatic, as set out in the tax provisions, except in a few specific cases where administrative intervention is required. These major tax incentives are discussed under five broad headings, in the order as follows: tax exemptions and tax amnesty, general reduction in the CIT rates, targeted reduction in the effective CIT rate, DTA, and import duty exemptions.

### C.1. Tax Exemptions and Tax Amnesty

Ghana offers tax exemptions as schemes that grant certain categories of investment the right to pay no taxes for a limited or an unlimited period of time. Under this category, two main schemes operated are discussed: the FZs scheme, aimed at enhancing the industrial capacity of the country, and the tax amnesty provision, the first to be offered in the last seven years.<sup>160</sup>

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<sup>159</sup> See the *ITA Ghana*, *supra* note 19; *GIPC Act 2013*, *supra* note 19; *Free Zone Act*, *supra* note 19; *Minerals and Mining Act, 2006 (Act 703)* (Ghana); *Minerals and the Mining Act, 2010 (Act 794)* (Ghana).

<sup>160</sup> See Ghana Web, “Ghana rising: Tax amnesty 2018” (24 August 2018), online: *Ghana Web* <[www.ghanaweb.com](http://www.ghanaweb.com)> [2018-679074].

Firstly, the GoG enacted the FZA for the purpose of promoting economic development in Ghana, and positioning the country as the gateway, from whence investors can expand their operations to neighbouring emerging markets in West Africa and beyond. The FZs are to be utilized as production centres for manufacturing and value addition, and also as hubs for growing and developing the industrial sector in the country.<sup>161</sup> Goods and services produced under this programme are mainly for export, although domestic sales may be allowed under limited circumstances.

Also, FZEs are exempted from paying CIT for the first ten years of operation. In addition, after the ten year tax holiday, an FZE is entitled to a reduced CIT rate for up to ten years. FZEs are charged a concessionary rate of 15 per cent CIT on export of goods and services outside the national customs territory, and 25 per cent on all domestic sales.<sup>162</sup> Also, under the Act, the imports of FZEs are exempt from the payment of all indirect taxes and duties, and shareholders are exempted from the payment of withholding taxes on dividends arising out of FZ investments. Moreover, under the scheme, any area of land or building may be declared a FZ, and any port a free port. Only corporate bodies may be licensed by the Authority to develop and/or manage or operate under a FZ. FZEs are also guaranteed free transfer of dividends, profits, loan payments, fees and charges, and remittance of proceeds in the event of sale or liquidation.<sup>163</sup> The scheme is administered by the GFZB in collaboration with the GRA.<sup>164</sup>

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<sup>161</sup> *Ibid.*

<sup>162</sup> See *Free Zones Act 1995 (Act 504)* (Ghana) s. 28; *ITA Ghana, supra* note 19 at 1<sup>st</sup> Schedule.

<sup>163</sup> See *Free Zone Act, supra* note 19, ss. 7 (1), 28; *Companies Code 1963 (Act 179)* (Ghana); *Private Partnership Act 1962 (Act 152)* (Ghana).

<sup>164</sup> *Wilson & Bentum, supra* note 6; *Free Zone Act, supra* note 19.

Secondly, the Tax Amnesty Act, 2017 offers a special incentive to existing tax defaulters to regularize their obligations under the law.<sup>165</sup> Under this initiative, persons who had failed to register or file their tax returns with the GRA, or pay their taxes as required, are granted amnesty to do so. The strategy is to encourage a voluntary compliance culture, broaden the tax base, as well as update the database.<sup>166</sup> It is also part of government's programme to streamline regulation in the private sector in order to accelerate growth.

In this regard, amnesty is offered on outstanding taxes, penalties and interest from previous years through to 2017. Taxpayers who would register and file their taxes for the years 2014, 2015, 2016 and 2017, on or before September 30, 2018 would be exempted from paying penalties and interest, and from prosecution. This exemption applies to persons who have not been registered with the GRA, or have not submitted returns, or are in arrears. It does not, however, apply to persons who have been assessed, or are under an audit or investigation in respect of unpaid tax liabilities, or have been notified of an

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<sup>165</sup> Tax amnesties are included in the analysis because although in the strict sense, amnesty programmes may not qualify as incentive for attracting FDI, as favourable treatments to induce tax compliance, they may have an impact on FDI, especially where beneficiaries include foreign investors. For example, the FDI implication of the amnesty programme in Kenya may be profound, given that it is aimed at encouraging the repatriation of assets held abroad and incomes derived outside of Kenya (see *Tax Amnesty Act, 2017 (Act 955)* (Ghana), s. 1; Taxkenya, "Tax Amnesty in Respect of Foreign Assets and Income" (30 May 2018), online: Taxkenya <[www.taxkenya.com](http://www.taxkenya.com)> [[perma.cc/kenya-tax-amnesty-in-respect-of-foreign-assets-and-income](http://perma.cc/kenya-tax-amnesty-in-respect-of-foreign-assets-and-income)]). Furthermore, some analysts regard tax amnesty schemes as tax incentives (See Taiwo Azeez Olaniyi, Reuben Olanji Ajayi & Godwin Emmanuel Oyedokun, "Tax Policy Incentives and Foreign Direct Investment in Nigeria" (2018), 3:3 *FUOJM XXX-XXX*). An assessment of the amnesty programme – the Voluntary Compliance Window (VCW) – of the Malawi Revenue Authority in 2013-2014 by Masiya (2019) described the programme as a huge success. He, however, advised against a second amnesty programme, and encouraged post-amnesty enforcement efforts, given that tax amnesty programmes may have a negative effect on taxpayers' attitudes and behavior (initial compliance gets worse if taxpayers expect additional future amnesties). See Michael Masiya, "Lessons from Voluntary Compliance Window (VCW): Malawi's tax amnesty programme" (2019) CESifo Working Papers 7584.

<sup>166</sup> See *Tax Amnesty Act, 2017 (Act 955)* (Ghana), s. 1.

enforcement action in relation tax compliance.<sup>167</sup> It does not also apply to payments and returns due from 1st January 2018.<sup>168</sup> After the amnesty period, GRA will intensify campaigns to prosecute continuing defaulters.<sup>169</sup>

## **C.2. General CIT rates reduced**

Although the general CIT rate in Ghana is 25 per cent, attractive tax structures that provide for lower CIT rates in particular sectors, types of firms and activities are granted to ensure higher after-tax profit. These incentive schemes, which range from geographical or locational incentives to livestock production, are operated mainly under the ITA. Concessionary CIT rates are assigned to specific sectors to encourage investment in those sectors.

To begin with, the manufacturing sector is one of the main beneficiaries of this scheme. The aim is to promote industrialization and ensure the even spread of development across the country. Under the ITA, companies in manufacturing are entitled to concessionary tax rates, based on their geographical location in the country. Manufacturing companies located in the regional capitals (the equivalent of provincial capitals) are entitled to a 25 per cent rebate on the general CIT. This is equivalent to 75 per cent of the standard CIT, or an effective CIT of 18.7 per cent. However, manufacturing companies located in Accra (the national capital), and the major industrial city of Tema pay the standard CIT of 25 per cent. Further, manufacturing business located elsewhere in Ghana, but not in a

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<sup>167</sup> See Ali Nakyea & Associates, “Highlights of Recent Amendments to the Tax Laws in Ghana” (26 April 2019), online: <[www.alinakyea.com](http://www.alinakyea.com)> [/publication1.pdf].

<sup>168</sup> *Ibid* at 5.

<sup>169</sup> See *Tax Amnesty Bill, 2017* (Ghana) at 1-3.

regional capital, or Accra and Tema, are entitled to a 50 per cent reduction on the standard CIT, which equals an effective CIT rate of 12.5 per cent. As mentioned earlier, manufacturing businesses located in a FZ enclave are entitled to a concessionary rate of 15 per cent CIT on export of goods and services, and 25 per cent on domestic sales, after the 10 years tax holiday period. These incentives are administered by the GRA.<sup>170</sup>

Moreover, in order to curb post-harvest losses in the local fishing industry, and diversify the export base of the economy, agro-processing and cocoa by-product businesses operating wholly in Ghana are offered a reduced CIT rate of 1 per cent for the first 5 years of operation. After the tax holidays, agro-processing enterprises which use local agricultural raw materials as their main input have their CIT rates fixed in accordance with their location, as follows: Accra-Tema, 20 per cent; other regional capitals (except the three northern regions), 15 per cent; outside regional capitals, 10 per cent; and the three northern regions (including capitals and all other locations), 5 per cent. Also, income from non-traditional exports is taxed at a concessionary rate of 8 per cent for the first 5 years.<sup>171</sup> The administering authority is the GRA.<sup>172</sup>

Furthermore, in order to promote a responsible and well regulated utilization of forestry and wildlife in Ghana, and to ensure that such resources are conserved and managed in a sustainable manner, tree crop, cash crop, and livestock farming have been granted concessionary CIT rates. The GRA, under the ITA, grants tree crop farming, and

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<sup>170</sup> See *ITA Ghana*, *supra* note 19 at 1<sup>st</sup> Schedule.

<sup>171</sup> *Ibid.* Non-traditional exports are classified to include, horticultural products, processed and raw agricultural products grown in Ghana (other than cocoa beans), wood products (other than lumber and logs, handicrafts, and locally manufactured goods.

<sup>172</sup> See *ITA Ghana*, *supra* note 19 at 1<sup>st</sup> Schedule. Agro-processing businesses are classified as manufacturing enterprises that convert fish and livestock into edible canned products, and a cocoa by-product business is a venture that uses substandard cocoa beans, husks or any other cocoa waste, as the main raw material in production on a commercial basis.



enterprises in cash crop, or livestock production (excluding cattle) a reduced CIT rate of 1 per cent for the first 5 years of operation.<sup>173</sup>

Additionally, as part of measures to make Ghana a financial hub in West Africa, tax policies have been adopted to boost activity on the GSE, increase investor confidence, and promote favourable investment in the financial sector as a whole. Under the ITA, companies listed on the GSE are offered a reduced CIT rate of 22 per cent; and rural banking businesses and VCFCs are each entitled to a reduced CIT rate of 1 per cent for the first 10 years of their operations.<sup>174</sup> The Income Tax (Amendment) Act, 2017<sup>175</sup> allows non-resident investors to invest on the GSE with no limits or prior exchange control approval. Moreover, losses from disposal of shares or any investment made during the incentive period may be carried forward, for a period exceeding the 10 years exemption, for up to 5 years.<sup>176</sup> Capital and all associated earnings can be fully remitted in foreign exchange, and net gains from securities traded on the GSE are exempt from tax through to the fiscal year 2021.<sup>177</sup> Also, financial institutions granting loans to leasing companies, and farming enterprises are entitled to 20 per cent CIT rate. There is, however, 8 per cent WHT (final tax on dividend income) for all investors, both resident and non-resident, and the administrative authority is the GRA.<sup>178</sup>

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<sup>173</sup> *Ibid.* Tree cropping is defined to include, the cultivation of, for example, coffee, oil palm, shea-butter and coconut, on a commercial scale. Cash crops are classified to include, cassava, maize, pineapple, rice and yam.

<sup>174</sup> *Ibid.* See also *Banks and Specialised Deposit-Taking Institutions Act, 2016 (Act 930)* (Ghana), definitions. A rural banking business is an enterprise designated as a local community bank specialised in deposit-taking within a defined locality.

<sup>175</sup> See *Income Tax (Amendment) Act, 2017 (Act 941)* (Ghana).

<sup>176</sup> *Ibid.*, s.7.

<sup>177</sup> *Ibid.*

<sup>178</sup> See *Stock Exchange Act, 1971 (Act 384)* (Ghana); Michael Mensah, Dadson Awunyo-Vitor & El Wilson Sey, “Challenges and Prospects of the Ghana Stock Exchange” (2012) 2:10 DCS 2225-0565.

Also, the GoG recognizes real estate as an emerging sector that can contribute significantly to the development of the economy to meet the increasing housing needs of Ghanaians. In order to promote the growth and development of this sector, and to encourage public and private sector participation in housing investment and delivery in Ghana, tax incentives are granted to registered housing schemes.<sup>179</sup> The GRA, under the ITA, exempts the incomes of REITs, including approved unit trust schemes, and mutual funds, and the interest or dividend paid to a member or a holder of an approved unit trust or mutual fund from tax.<sup>180</sup> Also, low-cost residential housing enterprises are entitled to a reduced CIT rate of 1 per cent for the first 5 years, and waste processing businesses, 1 per cent up to the first 7 years of operation. There is a requirement, however, that the housing project be approved by Minister for Works and Housing.

Further, in order to develop sustainable tourism and creative arts, and to ensure an enabling environment for public-private-partnership in resource mobilization and investment in the tourism sector for accelerated national development, companies in the hotel or hospitality industry are offered a reduced CIT rate of 22 per cent. The administering body of the scheme is the GRA.<sup>181</sup>

Likewise, the GoG acknowledges the need for mining investment under a win-win value proposition.<sup>182</sup> In order to make Ghana the leading destination of mining sector

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<sup>179</sup> See *Securities Industry Act, 2016 (Act 929)* (Ghana). See also Oxford Business Group, “Real estate: Although real estate in Ghana has slowed down, REITs hold potential” (13 May 2019), online: Oxford Business Group <oxfordbusinessgroup.com> at 1.

<sup>180</sup> See *Income Tax (Amendment) (No.2) Act, 2017 (Act 956)* (Ghana).

<sup>181</sup> See *Income Tax Amendment Act 2017 (Act 956)* (Ghana); *ITA Ghana*, *supra* note 19 at 1<sup>st</sup> Schedule, 6<sup>th</sup> Schedule.

<sup>182</sup> See Global Business Reports, “West Africa’s mining industry – A rising mining market emerges in a challenging global context” (2014) E&MJ 114-127 at 116. See also CNBCAfrica, “Ghana’s Nana Akufo-Addo calls for win-win mining deals at Mining Indaba” (6 February 2019) online (video): *YouTube* <www.youtube.com> [perma.cc/watch?v=8waNA9tLbI0]; CNBCAfrica, “Time for Africa to reject half-

investment in Africa, and to promote the effective utilization of the mineral resources of Ghana in a safe environment for sustainable development, the sector is granted some tax concessions. Although the general CIT rate applicable in this sector is 35 per cent, under the Minerals Commission Act, 1993 and the ITA, companies operating in the minerals sector can negotiate the CIT rate to be paid. Additionally, the GRA allows companies that have stability or investment agreement with the GoG to be eligible to the reduced rate as set out under the agreement.<sup>183</sup> However, the operations of such firms are strictly subject to written agreement ratified by parliament, and an approved investment agreement may contain a clause that allows GoG to freeze or reduce the tax rate.

### **C.3. Targeted reduction in the effective CIT rate**

This section discusses incentive schemes aimed at reducing the effective CIT rate, including accelerated depreciation, interest expense deductions, special treatment of capital gains and losses, loss carry forward in some given sectors, special initiatives, and rules for strategic major investment projects. These are different from the schemes considered under the general CIT-reducing category above, because they are not a direct reduction in the CIT rate, but operate by reducing the cost of production and thereby lessening the tax burden of affected businesses.

First of all, under the ITA, accelerated capital allowance deductions, prescribed at statutory rates, are granted to replace enterprise-specific depreciation deductions, which are disallowed. Deductions may be computed on a reducing-balance basis, for the

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baked mining deals - Ghana president” (6 February 2019) online (video): *YouTube* <[www.youtube.com/perma.cc/watch?v=uJvL3tRAmHc](http://www.youtube.com/perma.cc/watch?v=uJvL3tRAmHc)>.

<sup>183</sup> See *Minerals Commission Act, 1993 (Act 450)* (Ghana).

following assets classes, at the following rates: class one asset pool, including computers, data handling equipment and accessories, 40 per cent; class two asset pool, including plant and machinery, and automobiles, 30 per cent; and class three asset pool, including locomotives and accessories, water transportation equipment, aircraft, public utility plant and equipment, and office equipment and fixtures, 20 per cent. Deductions may be computed using the straight-line method, as follows: class four assets, such as, buildings and permanent structures, 10 per cent; class five assets, such as, intangibles, useful life; mining and petroleum expenditure, 20 per cent; and machinery and equipment to affix excise tax stamps, 50 per cent.<sup>184</sup>

Furthermore, under the ITA, interest expense is deductible, but deduction of financial costs is limited. Interest incurred on financing used in generating the income of an enterprise can be deducted. However, other financial costs, apart from interest, are limited to the sum of financial gains derived from the investment, and fifty per cent of the income, excluding financial gains or financial costs incurred.<sup>185</sup> Making interest deductible is to encourage investment in capital intensive sectors such as the extractive industry and manufacturing.

In addition, under the ITA, gains on disposal of assets, as reported in financial statements, are not taxable, and losses on disposal of assets, as reported in financial statements, are not allowable. Gains are deducted from profits, and losses added to profits. This is in line with provisions in the ITA that do not recognize enterprise-specific depreciation policies; largely because the classification system adopted by the ITA for capital allowance deductions is such that it is very difficult to determine whether a loss or

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<sup>184</sup> See *Income Tax Act, 2018 (Act 979)* (Ghana), 3<sup>rd</sup> Schedule.

<sup>185</sup> See *ITA Ghana, supra* note 19, ss. 10, 16.

gain is realised on the sale of an asset. The cost of fixed assets disposed of may, however, be deducted.<sup>186</sup>

Moreover, although Ghana does not allow tax losses to be carry over, as an incentive, seven key priority sectors are allowed to carry forward their losses for five years. These include, farming, petroleum, mining, and agro-processing, ICT, manufacturing, and tourism. For a manufacturing business to qualify under this scheme, it should be exporting more than 50 per cent of its output. There are transition provisions that enable companies with development and stability agreements, and firms operating in the petroleum sector, which were allowed to carry forward losses indefinitely, under the PITA, 1987,<sup>187</sup> to continue to do so, even though the ITA now limits the period to 5 years. The administering agency is the GRA.

Also, for the purpose of promoting identified strategic or major investments in key sectors of the economy, provision has been made under the GIPC Act to grant strategic investors the right to negotiate tax incentives. A strategic investment is an investment in a priority area determined by the government. Currently, an investor making over USD 50 million worth of investment can negotiate tax concessions on import duties and other development costs. Key priority areas that have been identified under this scheme include energy, infrastructure, roads, railways, ports, property development, agriculture/agri-business, manufacturing, oil and gas services, tourism services, ICT, education and financial. However, the designated sectors, and the qualifying threshold value of investment, of USD 50 million, are subject to change, to be determined from time to time

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<sup>186</sup> See Ghana Investment Promotion Centre, “Laws & Regulations – Doing Business and Applicable Laws in Ghana” (25 April 2019), online: GIPC <[www.gipcghana.com](http://www.gipcghana.com)> [/invest-in-ghana/doing-business-in-ghana/laws-regulation.html].

<sup>187</sup> See the *Petroleum Income Tax Law, 1987 (P.N.D.C.L. 188)* (Ghana).

by the development policy of the GoG. The administering authority is the GIPC in collaboration with the Minister of Finance and Economic Planning.<sup>188</sup>

Finally, two special initiatives – the 1D1FP, and the YEP – have been launched to incentivize the private sector. The 1D1F is the GoG’s flagship incentive programme for the manufacturing sector. As part of the GSGDA II, the 1D1F is aimed at improving private sector productivity, and the competitiveness of MSMEs. It is also targeted at attracting private capital, expanding market access, and ensuring rapid industrialization through agriculture and the use of other natural resources. In addition to the tax exemptions that may be negotiated, under the programme, the GoG provides direct financial support, and other interventions, such as assistance in securing land, access to utilities, as may be appropriate. This scheme is administered by the MOTI.<sup>189</sup>

On the other hand, the YEP is to provide support for start-ups, and SMMEs founded by young entrepreneurs, under the age of 35 years. It grants reduced CIT rates, and allows loss carry forward. Its primary focus is to offer assistance, in terms of business development services, start-up incubation and funding, for new business initiatives to grow and be successful.

Under the programme, entrepreneurs, under the age of 35 years, in manufacturing, information and communications technology, agro processing, energy, waste processing, tourism and creative arts, horticulture and medicinal plants, can negotiate tax incentives for their businesses. After the negotiated incentive period has elapsed, they are granted reduced CIT rates for five years, based on the location, as follows: Accra and Tema, 15 per

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<sup>188</sup> See *Ghana Investment Promotion Centre Act, 2013 (Act 865)* (Ghana), s 26(4).

<sup>189</sup> See GIPC, “Ghana incentives inventory” (26 April 2019), online: GIPC Ghana <[www.gipcghana.com](http://www.gipcghana.com)>.

cent; other regional capitals (outside the three northern regions), 12.5 per cent; outside other regional capitals, 10 per cent; and the three northern regions, 5 per cent. The programme, which is administered by the NEIP, also allows eligible businesses to carry forward losses for 5 years.<sup>190</sup>

#### **C.4. DTAs**

This section discusses DTAs – international tax treaties to ensure relief from the multiple taxation of incomes of entities in any of the tax jurisdictions under the treaty. The tax policy in Ghana is geared toward providing relief from double taxation to encourage international trade. Through DTAs, taxing rights are designed to provide reduced tax rates for non-resident individuals as an incentive for investors from global tax sourced jurisdictions. The objective is to free investment capital and prevent base erosion. For example, income from shipping and air transport operations in international traffic is taxable only in the place of effective management of the enterprise.

Provision for DTA is made under the GIPC Act, and covers taxes related to income and capital gains. Ghana has signed DTAs with France, Germany, the United Kingdom, South Africa, Italy, Belgium, the Netherlands, Switzerland and Denmark, and is yet to ratify the DTAs signed with the Czech Republic, Singapore and Mauritius. The agreements are regulated by GIPC, and allow for foreign income tax paid with respect to the income

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<sup>190</sup> The NEIP.

derived from outside Ghana to be deducted.<sup>191</sup> The rates applicable under DTAs in force in Ghana are provided in Table 1.<sup>192</sup>

Also, under the ITA, a resident person is entitled to a credit for foreign income tax paid, which is not above the average rate of Ghanaian income tax of that person. A person's assessable income, for which a foreign tax credit may apply, would be increased by the amount of the credit, and where taxable foreign income includes a dividend, tax is deemed to have been paid on the dividend. Foreign tax credits are administered by the GRA.<sup>193</sup>

However, the tax treatment of dividends and interest in Ghana varies slightly from that allowed under the OECDMTC.<sup>194</sup> The OECDMTC rules out the extra-territorial taxation of dividends and interest realised through a PE. The taxing rights of States in which PEs are situated is restricted under Articles 10 and 11, in combination with Article 7. These provisions ensure that dividends and interest are not subjected to double taxation since the interest and dividends are already taxable (in accordance with the provision under Article 7) as part of the profits attributable to the PE.<sup>195</sup> However, the OECDMTC allows dividends and interest (other than that attributable to a PE) paid by a resident entity to a non-resident entity to be taxed by the resident state. The OECDMTC also provides that the

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<sup>191</sup> See *Ghana Investment Promotion Centre Act, 2013 (Act 865)* (Ghana), s.3.

<sup>192</sup> See PwC Ghana, "A quick guide to taxation in Ghana" (18 May 2018), online: PwC <[www.pwc.com/pdf/2018-tax-facts-and-figures-gh.pdf](http://www.pwc.com/pdf/2018-tax-facts-and-figures-gh.pdf)> at 11-18; PwC, "Double Tax Treaties and the Income Tax Act 2015 (Act 896) Relevance to Bilateral Trade and Foreign Investment" (4 May 2016), online: <[www.pwc.com](http://www.pwc.com)>; *ITA Ghana*, *supra* note 19, ss. 105, 60.

<sup>193</sup> See GIPC, "Ghana incentives inventory" (26 April 2019), online: GIPC Ghana <[www.gipcghana.com](http://www.gipcghana.com)>.

<sup>194</sup> See Articles 7, 10 & 11 of OECD Model Tax Convention.

<sup>195</sup> See Commentaries on the Articles of the Model Tax Convention at 194-215 [*OECD Commentaries*].



rate at which dividends may be taxed by a resident contracting state shall not exceed 15 per cent, and that for interest should not exceed 10 per cent.<sup>196</sup>

On the other hand, the Ghanaian tax system treats dividends and interest paid by a resident entity, including PEs, as payments sourced from Ghana, and are, therefore, subject to tax. Also, where the debt obligation giving rise to the interest is secured by real property situated in Ghana, the interest is deemed as sourced from Ghana, and is liable to tax in Ghana. However, the rate at which dividends on income sourced in Ghana are taxed is consistent with the OCDMTC provisions, which provides for dividends to be taxed between 5 and 15 per cent.<sup>197</sup> With regard to interest, the upper limit at which Ghana taxes interest exceeds that provided under the OECDMT. Ghana taxes interest paid to non-resident persons between 7 and 12.5 per cent.<sup>198</sup> Thus, the upper limit of 12.5 per cent exceeds the OECD Model's provision of 10 per cent by 2.5 percentage points.<sup>199</sup>

Therefore, unlike as provided for under the OECDMT, dividends and interest of PEs are treated as income of a resident entity, and are subject to tax in Ghana. Also, the income and liability of a PE are treated as if the PE is a different entity from its owner, but business arrangements between the two entities are given due consideration. Moreover, the net profit of a branch is deemed as repatriated profits, and is subject to a final WHT of 8 per cent. WHT rates for payments to non-resident persons are provided in Table 2.<sup>200</sup>

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<sup>196</sup> See Ghana Investment Promotion Centre, "Laws & Regulations – Doing Business and Applicable Laws in Ghana" (25 April 2019), online: *GIPC* <[www.gipcghana.com](http://www.gipcghana.com)> [/invest-in-ghana/doing-business-in-ghana/laws-regulation.html].

<sup>197</sup> See the DTA rates in Table 1.

<sup>198</sup> *Ibid.* Lowest for Mauritius and Singapore, and highest for UK and France.

<sup>199</sup> *Ibid.*

<sup>200</sup> *Ibid.*

### **C.5. Import duty exemptions / reduced excise duty**

This section considers waiver of taxes, such as, tariffs, excises and VAT, on imported plant and machinery, collected at the borders and/or the ports, to reduce the cost of inputs and thereby encourage manufacturing and production. Generally, industrial and agricultural plant, machinery or equipment, or parts imported for investment purposes are duty exempt under the Customs Act, 2015, but investors can apply for exemptions for specific machinery which are not exempt. Under this category, four major schemes have been identified, and are discussed, in the order as follows: first, general plant, machinery, equipment and parts; second, mining equipment and machinery; third, local raw material for the production of malt drinks, stout beer and cider beer; and, fourth, forestry developers.

First of all, under the GIPC Act, an enterprise may apply for its plant, machinery, equipment or parts not exempted to be exempted from import duties and related charges. If the GIPC determines that the machinery or parts will promote the establishment and operation of the enterprise, and facilitate changes in technology, it shall recommend the application to the Minister of Finance and Economic Planning for approval. These exemptions are solely based on the provisions of the GIPC Act and are administered by the GIPC.<sup>201</sup>

Secondly, mining equipment and machinery are also eligible for import duty exemptions. Under the Minerals and Mining Act 2006, mining companies registered with the Minerals Commission may be exempted from import duties on mining equipment and machinery. The classification of equipment eligible for the exemption is contained in the

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<sup>201</sup> See *Ghana Investment Promotion Centre Act, 2013 (Act 865)* (Ghana), s. 26(4); *Customs Act, 2015 (Act 891)* (Ghana), 3<sup>rd</sup> Schedule; *Internal Revenue Act, 2000 (Act 592)* (Ghana). The *VAT Act 1998 (Act 546)* (Ghana).

mining list, which may be reviewed and updated periodically by the GRA together with the Ghana Chamber of Mines. Mineral rights are granted by the Minister of Lands and Natural Resources to companies registered with the Ghana Chamber of Mines.<sup>202</sup>

Thirdly, producers of malt drinks, stout beer and cider beer who use local raw material for production are offered concessionary rates, under the Excise Duty Act of 2015.<sup>203</sup> The Act provides favourably reviewed rates of duty payable on excisable goods used as raw materials for the production of beverages. In the production of malt drinks, where less than 50 per cent of the raw materials is sourced locally, an excise duty of 17.5 per cent of the ex-factory price is charged; where the proportion is between 50 and 70 per cent, a rate of 10 per cent is applicable; and where it is above 70 per cent, a rate of 7.5 per cent is applicable. In the production of stout beer, where less than 50 per cent of raw material is sourced locally, a rate of 47.5 per cent applies; where the proportion is between 50 and 70 per cent, a rate of 32.5 per cent applies; and where it is above 70 per cent, a rate of 10 per cent applies. In the production of production of cider beer, the rate of excise duty payable for locally sourced raw material is fixed at 17.5 per cent. The administering institution is the GRA.<sup>204</sup>

Finally, forestry developers receive a favourable tax treatment for imported machinery, under the Timber Resources Management (Amendment) Act, 2002. Forest plantations and wildlife developers can apply for import duties, VAT or excise taxes on their plant, machinery and equipment to be exempted. They are also entitled to special

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<sup>202</sup> See *Minerals and Mining Act, 2006 (Act 703)* (Ghana), s.5.

<sup>203</sup> See *Excise Duty (Amendment) Act, 2015 (Act 891)* (Ghana).

<sup>204</sup> See *Excise Duty (Amendment) (No.2) Act, 2015* (Ghana).

income tax concessions, which can be negotiated with the Forestry Commission. The awarding institution is the Ministry of Lands, Forestry and Mines.<sup>205</sup>

#### **D. EVALUATION OF THE IMPACT OF TAX INCENTIVES IN GHANA**

This section discusses the impact of tax incentives on tax revenue in Ghana, and argues that the impact has not been desirable. It looks at two main sectors, the mining industry and the FZs for the period 2008-15, drawing on two major studies – one conducted by Actionaid International in 2015, and the other Prichard and Bentum (2009).<sup>206</sup>

To begin with, there are strong indications to the effect that the tax incentive regime in Ghana has been damaging to the overall welfare of the country. Although some econometric models<sup>207</sup> indicate that tax havens in Ghana have had some positive effect on GDP, much of the evidence points to the contrary. Even where tax incentives have been successful in stimulating growth in GDP, their adverse impact on domestic tax revenue has been heavier. Analysis of the tax incentive regime between 2008 and 2013 indicates that tax incentives accounted for a loss (tax expenditure) of about 14.18 per cent to 41.20 per cent of total tax revenue, about 1.80 per cent to 5.31 per cent of the GDP of Ghana.<sup>208</sup>

Also, it has been found that tax incentives significantly reduce domestic revenue collection, and are not needed to attract FDI. It is estimated that annual tax revenue loss in

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<sup>205</sup> See *Timber Resources Management (Amendment) Act, 2002 (Act 617)* (Ghana), s. 44.

<sup>206</sup> See *Tax Justice Network-Africa*, *supra* note 6 at 1-20; *Wilson & Bentum*, *supra* note 6 at 24-26.

<sup>207</sup> See for example Trimisiu Tunji Siyanbola et al, “Tax incentives and industrial/economic growth of sub-Saharan African States” (2017) 7:2 JARBMS 78-90 at 84-88. They found that increase in tax incentives granted in 2010 boosted the economy of Ghana and caused manufacturing companies to relocate from neighbouring countries (including Nigeria) to Ghana. But this is an isolated situation, which also has been attributed to a combination of factors including, erratic power failures in Nigeria. See also Hammed A. Adefeso, “Government Tax Policy and Performance of Listed Manufacturing Firms in Nigeria: Evidence from Dynamic Panel Data Model” (2018) 21:1 ZIREB 1-15 at 1.

<sup>208</sup> See *Tax Justice Network-Africa*, *supra* note 6 at 1-20; *Wilson & Bentum*, *supra* note 6 at 24-26.

Nigeria, Ghana and Senegal is about USD 5.8 billion.<sup>209</sup> In Ghana alone, revenue loss associated with tax exemptions, including corporate tax holidays and special regimes, is estimated to be USD 2.27 billion a year, an average of 6 percentage of total GDP. In 2008, corporate tax incentives ranged from 1.8 per cent to 5.31 per cent of GDP.<sup>210</sup>

Moreover, in the period 2011-13, annual revenue loss associated with tax incentives in Ghana was between USD 299 million and USD 1.23 billion, with an average of USD 693 million.<sup>211</sup> This average is approximately three times the allocation to the health sector, and could be spent on improving public service delivery in sectors including, health, education and infrastructure, to create a more attractive investment climate.<sup>212</sup>

Likewise, in the natural resource sector, despite the fact that mineral policy reforms in Ghana have contributed to a significant increase in investment in the sector, and an upsurge in gold production, and external earnings, taxing the sector has been a great challenge.<sup>213</sup> Various tax incentives are granted in this sector, but the wealth generated has not been of benefit to the national economy and the communities around the mines. Like many developing countries, the economy is still characterised by high budget deficits, rising debt-to-GDP ratios, and trade deficits; and the livelihood of people in mining communities has not seen much improvement. Annual revenue loss associated with tax incentives granted in this sector is estimated at USD 1.2 billion. Between 2008 and 2015,

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<sup>209</sup> *Ibid.*

<sup>210</sup> *Ibid.*

<sup>211</sup> *Ibid.*

<sup>212</sup> *Ibid.* About 46 per cent of firms in Ghana, Nigeria and Cote D'Ivoire receive tax holidays, with 10 per cent being completely exempted from CIT, and another 10 per cent paying reduced CIT. Also, about 15 per cent of firms are granted discretionary incentives by tax officials. Some firms are also subsidized to export their output.

<sup>213</sup> See Abdallah Ali-Nakyea & John Amoh, "Have the generous tax incentives in the natural resource sector been commensurate with FDI flows? A critical analysis from an emerging economy" (2018) 10:3/4 IJCA 257-273 at 1-22.

estimated annual average revenue loss (tax expenditures) due to tax incentives to the mining sector was 2.01 per cent of total GDP.<sup>214</sup>

Furthermore, in addition to the perennial huge annual tax revenue losses, the impact in respect of the damage caused to the environment, and the displacement of people in towns and villages have also been a cause for concern. Some of the negatives associated with this sector include environmental degradation, resulting in loss of farmlands, destruction of crops and vegetation, pollution of water bodies, and noise, vibration and air pollution associated with blasting. The outcome in most instances have been outbreaks of disease, and economic deprivation.<sup>215</sup>

Additionally, in the industrial sector, there is a general perception, and instances of malpractices in respect of the operation of FZEs. There have been reports of abuse of the tax incentives granted FZEs, estimated between 9 and 12 per cent of total tax revenue from the sector. A significant number of FZ firms had been in active operation, and making profits in Ghana prior to the creation of the FZs regime. Although conversion to FZ status may have been occasioned by additional investment, it is probable that all these firms have ceased paying taxes. Also, some FZEs use dubious schemes, such as, change in ownership, in some instances, between related business interests, to extend or access new tax incentives. Others also engage in activities that make them less eligible for being FZEs, such as, the importation of finished products, or consumer goods; and others use goods for purposes other than those for which exemptions were granted, including the import of raw materials onto the local market.<sup>216</sup>

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<sup>214</sup> *Ibid.*

<sup>215</sup> *Ibid.*

<sup>216</sup> *Ibid.* About 50 per cent of Free Zone imports have been of consumer goods, largely to be repackaged for export to the West African sub-region.

Worst of all, there are no serious monitoring and evaluation processes for the various tax incentives offered in FZs. Overall monitoring capacity is limited, and only a few systematic studies of revenue impact are available. In both sectors, the way forward is to determine whether the revenue loss is commensurate with the benefits of new investment envisaged to be made. There is also the need for transparency, controls in revenue streams to prevent corruption, and measures to set and enforce environmental standards, alongside the need to protect the rights of indigenous people, and to fund capacity-building for monitoring.

In conclusion, it is suggested that the real FDI attraction advantage for Ghana may not be in just granting tax incentives to transnational corporations. It may have to minimize the use of tax incentives, and focus on and creating an enabling investment environment through measures, such as, good governance, the rule of law, prudent macroeconomic management, and investment in infrastructure and training. Perhaps, these, coupled with tax incentive schemes may be enough to attract investment to the desired levels.<sup>217</sup>

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<sup>217</sup> *Wilson & Bentum, supra* note 6.

## CHAPTER 4 TAX INCENTIVES FOR ATTRACTING FDI IN KENYA

This chapter discusses the tax incentive regime for the promotion, attraction and facilitation of FDI in Kenya. It is in four parts. It begins with a brief overview of the legal framework or the regulatory regime of investment in the country, focusing mainly on the IPA, 2004, and the roles and responsibilities of the KIA established under the Act, as the lead institution in the promotion and facilitation of investment in Kenya.<sup>218</sup>

The second part discusses the history of efforts to attract FDI in Kenya for the period 1963-2017. It looks at the high volatilities of FDI flows in Kenya attributable to series of policy reforms, starting from the high periods of early independence in 1963, through the lows of the 1980s – the beginning of the SAPs, to the recovery period of 2004, with the enactment of the IPA, and the subsequent establishment of the KIA.<sup>219</sup> It concludes by projecting that a growing trend in FDI is expected for the short-term period 2017-20, given improvement in the investment climate.

In the third part, the framework of tax incentives is discussed, including tax exemptions and tax amnesty, reduction in the CIT rates, targeted reduction in the effective CIT rate, DTA, and import duty exemptions / reduced excise duty. These constitute the major incentive schemes employed under various pieces of legislation, such as the IPA, the EPA and the ITA, in order to entice investors and induce investment in key priority sectors of the economy.<sup>220</sup>

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<sup>218</sup> See *IPA*, *supra* note 20; *Kenya Vision 2030 (July - August, 2007)* (Kenya) [*Kenya Vision 2030*].

<sup>219</sup> *Ibid.*

<sup>220</sup> See *IPA*, *supra* note 20; *EPZA*, *supra* note 20; *ITA Kenya*, *supra* note 20.



The chapter concludes by assessing the potential effectiveness of the tax incentives offered in Kenya. Drawing on three different studies by the Institute of Economic Affairs, Kenya, (2012); Tax Justice Network-Africa and ActionAid International (2012); and Mutua and Muya (2013), it argues that, as in many other developing African countries, tax incentives have not had the desired impact on the Kenyan economy – they result more in revenue leakage than in inducing investment.<sup>221</sup> It further suggests that the Kenyan government focus on improving the investment fundamentals, and maximizing efficient tax collection rather than offering tax incentives.

## **A. OVERVIEW OF THE LEGAL REGIME OF INVESTMENT AND TAX INCENTIVES IN KENYA**

The major legislation for regulating and promoting FDI in Kenya is the IPA, 2004.<sup>222</sup> Under the IPA, the KIA was established as the lead institution in the promotion and facilitation of investment in Kenya. The KIA is also responsible for advocating for a conducive investment climate, providing accurate information, and offering quality services, such as, obtaining all the necessary licenses for investors, and implementing new investment projects. Moreover, the KIA assists in the grant of incentives to investors and advises the government on measures to increase the ease of doing business and attracting

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<sup>221</sup> See IEA Kenya, “Tax Incentives and exemption regime in Kenya: Is it working?” (2012) 30 TBF 1 at 1; John Mutua and John Mutua & Raphael Muya, “Tax incentives and exemption regime in Kenya: Is it working?” (11 May 2013), online: *The East African* <[www.theeastafrican.co.ke](http://www.theeastafrican.co.ke)>; Tax Justice Network-Africa and ActionAid International, “Tax competition in East Africa: A race to the bottom? Tax incentives and revenue losses in Kenya” (30 May 2012), online (pdf): *Tax Justice Network* <[www.taxjustice.net](http://www.taxjustice.net)> [[perma.cc/cms/upload/pdf/kenya\\_report\\_full.pdf](http://perma.cc/cms/upload/pdf/kenya_report_full.pdf)] at IV, 7.

<sup>222</sup> See *IPA*, *supra* note 20; *Kenya Vision 2030*, *supra* note 218.

FDI.<sup>223</sup> Furthermore, the KIA provides information on investment opportunities and sources of capital, and is responsible for organizing both local and international investment promotion activities.<sup>224</sup>

In addition, as the main government body responsible for facilitating investment, the KIA aims to reduce bureaucratic delays in the licensing of investors, and in the grant of tax incentives and exemptions from the relevant authorities. It is also to ensure minimal government interference, as an active market participant, in the private sector through effective regulation.<sup>225</sup>

Also under the IPA, after a business is incorporated at the Registrar of Companies, it must register with the KIA and obtain an investment certificate. The IPA also requires that enterprises in which there is foreign participation satisfy the minimum foreign capital investment condition, and that the KIA undertake an assessment of the potential impact of the investment to the Kenyan economy in terms of criteria such as, employment generation, upgrade of skills, and transfer of technology. An environmental impact assessment, and registration with other regulatory bodies may also be required, based on the activities of the business.<sup>226</sup>

In relation to the tax incentives that Kenya grants, although it has been suggested that part of Kenya's tax reforms are geared towards the introduction of new taxes and a

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<sup>223</sup> See Kenya Investment Authority (KenInvest), "Who We Are" (16 June 2019), online: <[www.invest.go.ke](http://www.invest.go.ke)> [perma.cc/who-we-are/] [*KenInvest*].

<sup>224</sup> *Ibid.*

<sup>225</sup> See *Kenya Vision 2030*, *supra* note 218 at 1.

<sup>226</sup> This requires a minimum foreign capital investment of USD 100,000. See *IPA*, *supra* note 20, s. 6; UNCTAD, "An investment guide to Kenya" (16 June 2019), online: theiGuide <[www.theiguide.org](http://www.theiguide.org)> [perma.cc/public-docs/guides/Kenya] at 1.

reduction in the use of tax incentives,<sup>227</sup> the country still offers various kinds of tax incentives in many sectors of the economy. The tax system is comprised of myriad pieces of legislation, including the IPA; the ITA; the EPZA; and the SEZA that grant tax concessions to investors.<sup>228</sup> The major tax incentive schemes employed under these pieces of legislation include tax holidays, ID allowances, customs duty exemptions, and concessionary CIT rates for some sectors.

Most of the incentives are contained in the ITA and are of general application across sectors, but others of specific application are contained in specific acts, such as, the IPA, the EPZA, and the SEZA.<sup>229</sup> The operation of the tax incentives is automatic, as provided for under the Acts, except in a few specific cases where administrative intervention is required. For example, although the current CIT rates applicable are 30 per cent for resident corporations and 37.5 per cent for permanent establishments (PEs), reduced CIT rates apply in specific sectors, including the capital markets and the local automobile industry. Furthermore, to encourage investment in physical capital, including industrial buildings, and machinery and equipment, IDs are allowed under the ITA in the tourism, hospitality, and agricultural sectors; and accelerated deductions are allowed for plant, property and equipment in EPZs, and mining.<sup>230</sup>

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<sup>227</sup> See IEA Kenya, “Tax Incentives and exemption regime in Kenya: Is it working?” (2012) 30 TBF 1-5 at 1.

<sup>228</sup> See *ITA Kenya*, *supra* note 20; *IPA*, *supra* note 20; *EPZA*, *supra* note 20; *SEZA*, *supra* note 20.

<sup>229</sup> *Ibid.*

<sup>230</sup> See Wikipedia, “Tourism in Kenya” (16 June 2019), online: *Wikipedia* <en.wikipedia.org> [perma.cc/wiki/Tourism\_in\_Kenya].

## **B. HISTORY OF EFFORTS TO ATTRACT FDI IN KENYA, 1980-2017**

As in most developing African countries, Kenya's FDI flows have been subject to high volatilities. After independence in 1963, because the country was less optimistic about the benefits of free trade and investment, several policy strategies were adopted, culminating in the alternation of the roles of the public and private sectors as drivers of the economy. Eventually, there was a general shift from public to private investment-led economy.<sup>231</sup>

Beginning in the 1970s, due to various factors in favour of attracting FDI, the country received relatively large capital inflows. Although the period suffered from macroeconomic instability, investors considered the market-oriented FDI strategy, and a large regional market, the EAC, as an advantage. This led to the positive net inflows.<sup>232</sup> However, by the close of the 1970s, because Kenya took a restrictive approach by imposing trade controls as part of an industrialization process supported by import-substitution strategies, FDI flows did not show a general positive trend.<sup>233</sup>

The 1980s saw a rather sharp decline in FDI inflows, due to the implementation of the SAPs, and a reduction in the market size after the collapse of the EAC. The policy reversal and the shift away from import substitution to an export-oriented industrialization strategy, coupled with significant changes in the political system and ineffective

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<sup>231</sup> See Francis M. Mweya & Rose W. Ngugi, "Foreign Direct Investment in Kenya" in S. Ibi Ajayi, ed, *Foreign Direct Investment in Sub-Saharan Africa: Origins, Targets, Impact and Potential* (Nairobi: African Economic Research Consortium, 2006).

<sup>232</sup> See WBG, "Foreign direct investment, net inflows ( per cent of GDP)" (16 June 2019), online: *The World Bank Group* <[data.worldbank.org](http://data.worldbank.org)> [[perma.cc/indicator/bx.klt.dinv.wd.gd.zs](https://perma.cc/indicator/bx.klt.dinv.wd.gd.zs)] [*WBG 2019*].

<sup>233</sup> Samuel Muiruri Njoroge, *Determinants of Foreign Direct Investment Growth in Kenya* (PhD Thesis, Jomo Kenyatta University of Agriculture and Technology, 2016) [unpublished] at 2.

management of the economy, unsettled investor confidence, resulting in an abysmal FDI performance.<sup>234</sup>

In addition, rising costs, ethnic infighting, persistent corruption, high political risks, and souring relationship between the government and donors further weakened the macroeconomic environment.<sup>235</sup> The volatility in FDI flows continued, and by the close of the decade, FDI was its lowest at 0.005 per cent of GDP. This prompted further policy intervention.<sup>236</sup>

In the 1990s, comprehensive reform programmes aimed at macroeconomic stability showed initial signs of positive response, with FDI increasing sharply in 1993. However, by the close of the following year, FDI took a further dip. This was attributed to the fact that government's commitment to the reforms weakened along the way. With uncertainty in return on investments, there were huge FDI outflows, and a downward economic trend.<sup>237</sup>

The sharp but short-lived rise in 1993 was due to a policy intervention to make the private sector a new engine of growth. Various initiatives were introduced by the GoK, including the establishment of the EPZs in 1990, the introduction of low tariffs for plant and machinery, and the liberalization of trade. These changes brought some positive

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<sup>234</sup> The political reversal was largely caused by the introduction of a one-party system. FDI as a percentage of GDP dropped from 1.35 in 1979 to 0.21 in 1981. See *WBG 2019*, *supra* note 232.

<sup>235</sup> See Many Anza Rhodah, *Determinants of Foreign Direct Investment in Kenya (1970 - 2009)* (M.A. Thesis, Kenyatta University, 2012) [unpublished] at 5.

<sup>236</sup> *Ibid.* See also UNCTAD, *Investment Policy Review – Kenya* (New York and Geneva: UN, 2005) at 1.

<sup>237</sup> The World Bank Group, *supra*, note 17. FDI rose from .078 per cent of GDP in 1992 to 2.53 per cent in 1993, but fell to 0.01 per cent in 1994. See also See Francis M. Mwega and Rose W. Ngug, "Foreign Direct Investment in Kenya" in S. Ibi Ajayi, ed, *Foreign Direct Investment in Sub-Saharan Africa: Origins, Targets, Impact and Potential* (Nairobi: African Economic Research Consortium, 2006) at 121.

response in terms of GDP growth, causing FDI to fluctuate between 1990 and 2010, with unusual rises in 1993 (2.53 per cent of GDP) and 2007 (2.28 per cent of GDP).<sup>238</sup>

The period 2010-2016 witnessed another record rise and fall in FDI. FDI rose to its peak at 3.457 per cent of GDP in 2011 (from 0.45 per cent in 2010), but took a nose dive to 0.56 per cent of GDP in 2016.<sup>239</sup> The sharp drop in FDI in 2016 may be due to escalated security crisis in 2015. But for the crises, it would have been expected that the establishment of the KIA in 2004, and the subsequent adoption of measures to streamline investment and ensure investor assurance and guarantee against risk could have had a large positive impact on FDI.<sup>240</sup>

Since 2016, FDI inflows have been rising steadily from USD 681.325 (in 2016) to a high of USD 1.625 billion in 2018.<sup>241</sup> The rise is at the back of policy reforms, including the adoption of strategy on PPPs, initiated to restore investor confidence in the economy.<sup>242</sup> FDI inflows have mainly been in diverse industries including manufacturing, chemicals, hospitality, and oil and gas. The positive trend is expected to continue in response to further regulatory reforms such as ongoing integration within the EAC and the strategy to position the country as a hub within the EAC.<sup>243</sup>

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<sup>238</sup> See *WBG 2019*, *supra* note 232. The sharp rise in 2007, and fall in 2008 may be attributable to the political and humanitarian crisis triggered by a disputed presidential election in 2007. See ICRtoP, “The Crisis in Kenya” (15 June 2019), online: ICRtoP <[www.responsibilitytoprotect.org/perma.cc/index.php/crises/crisis-in-kenya=pdf](http://www.responsibilitytoprotect.org/perma.cc/index.php/crises/crisis-in-kenya=pdf)>.

<sup>239</sup> The World Bank Group, *supra*, note 17. The sharp drop in FDI in 2016 may be due to escalated security crisis in 2015. See Human Rights Watch, “World Report 2016” (15 June 2019), online: *Human Rights Watch* <[www.hrw.org/perma.cc/world-report/2016/country-chapters/Kenya](http://www.hrw.org/perma.cc/world-report/2016/country-chapters/Kenya)>.

<sup>240</sup> *Ibid.*

<sup>241</sup> See CEIC Data, “Kenya Foreign Direct Investment” (15 June 2019), online: *CEIC Data* <[www.ceicdata.com/perma.cc/en/indicator/kenya/foreign-direct-investment](http://www.ceicdata.com/perma.cc/en/indicator/kenya/foreign-direct-investment)> [*CEIC Data*].

<sup>242</sup> See Colin Poulton & Karuti Kanyinga, “The Politics of Revitalising Agriculture in Kenya” (2014) 32:S2 DPR 151-172 at 1.

<sup>243</sup> See UNCTAD *World Investment Report 2019* (Geneva: UN, 2019) at 37.

For the period 2018-20, the growing trend is projected to further continue. Although the Kenyan economy may remain susceptible to global economic uncertainties, sustained economic growth and business-friendly reforms can keep investor confidence high, and FDI on the increase.<sup>244</sup> Nonetheless, challenges, including insecurity, infrastructure inadequacy, low skills, and corruption, may continue to threaten the growing trend in FDI, and hamper Kenya's efforts to increase foreign investment, and promote sustained growth and development.<sup>245</sup>

Therefore, to keep the growing trend, Kenya will have to work to enhance the investment climate through further reforms, good governance, and improved security, infrastructure, and human skills. These measures will increase the country's FDI attractiveness, and ease the flow of resources from the global capital market into its economy.<sup>246</sup>

### **C. TAX INCENTIVE FRAMEWORK IN KENYA**

As mentioned earlier, the statutory regimes that govern fiscal incentives in Kenya include the ITA, the IPA, the EPZA, and the SPZA. Although these are the main pieces of legislation regulating investment activities in the private sector, others, such as, the VATA, 2013; Finance Act, 2018; and the Nairobi International Financial Centre, 2017, provide for specific tax incentives, and will be cited in the discussion under the appropriate incentive

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<sup>244</sup> The Economist, "Kenya – FDI inflows hit a new peak in 2015" (28 June 2016), online: *The Economist* <country.eiu.com>.

<sup>245</sup> *Ibid.*

<sup>246</sup> See Samuel Muiruri Njoroge, *Determinants of Foreign Direct Investment Growth in Kenya* (PhD Thesis, Jomo Kenyatta University of Agriculture and Technology, 2016) [unpublished] at 81-85.

category.<sup>247</sup> The incentives are administered by the KRA, in collaboration with other regulators, such as, the KCMA, and the EPZA.

Furthermore, the GoK provides a wide range of tax incentives to attract FDI, including tax exemptions, reduction in CIT rates, investment allowances, accelerated depreciation, special zones, and indirect tax incentives, capital deductions, industrial deductions, and farm work deductions.<sup>248</sup> These deductions are mainly made at the point of computation of the gains or profits of an entity, except in a few cases where administrative intervention may be required.<sup>249</sup> In this section, I discuss five major tax incentives, under five broad headings, in the order as follows: tax exemptions and tax amnesty, general reduction in the CIT rates, targeted reduction in the effective CIT rate, DTA, and import duty exemptions.

### **C.1. Tax Exemptions and Tax Amnesty**

The GoK envisions transforming Kenya into an industrialized, middle-income country by the year 2030, through a strategic, comprehensive and integrated programme. The policy is to guide Kenya on its journey to industrialization by ensuring diversified and

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<sup>247</sup> See *ITA Kenya*, *supra* note 20; *IPA*, *supra* note 20; *EPZA*, *supra* note 20; *SEZA*, *supra* note 20; *VATA*, 2013 (Act No. 35 of 2013) (Kenya) [*VATA 2013 (Kenya)*]; *Finance Act, 2018 (Act No. 10 of 2018)* (Kenya); *Nairobi International Financial Centre, 2017 (No. 25 of 2017)* (Kenya); *The Customs and Excise Act, 1978 (No. 13 of 1978)* (Kenya).

<sup>248</sup> See IEA Kenya, “Tax Incentives and exemption regime in Kenya: Is it working?” (2012) 30 TBF 1-5; John Mutua and Raphael Muya, “Tax incentives and exemption regime in Kenya: Is it working?” (11 May 2013), online: *The East African* <[www.theeastafrican.co.ke](http://www.theeastafrican.co.ke)>; *KenInvest*, *supra* note 223. For examples, investments exceeding KES 200 million incurred outside Nairobi or the municipalities of Mombasa or Kisumu are allowed an ID of 150 per cent. All other qualifying investments are allowed a 100 per cent ID in the year the asset is put into use.

<sup>249</sup> See *KenInvest*, “Investment Incentives” (16 June 2019), online: *KenInvest* <[invest.go.ke](http://invest.go.ke)> [[perma.cc/starting-a-business-in-kenya/investment-incentives](http://perma.cc/starting-a-business-in-kenya/investment-incentives)].



competitive manufacturing, tourism, agricultural, trade, financial, and BPO industries.<sup>250</sup>

Tax incentive schemes have been adopted in order to foster an enabling environment to accelerate industrial development through SMEs.<sup>251</sup>

In order to encourage the promotion and facilitation of export oriented investment, the EPZA was enacted in 2015 to provide for the establishment of the KEPZA, and the creation and management of EPZs.<sup>252</sup> Under the EPZA, EPZEs are exempted from CIT for ten years, starting from the first year of operation. After the initial ten years, EPZEs are taxed at 25 per cent for the next ten years, and thereafter, 30 per cent for the remaining life of the business. Also, EPZEs are entitled to 10 years WHT holiday on dividends and other remittances to non-resident entities; VAT exemptions on local purchases of goods and services; and customs duty exemptions on imported inputs, including raw materials, machinery, and equipment. EPZEs are also granted perpetual exemption from payment of stamp duty on legal instruments, and 100 per cent ID on investment in buildings and machinery for a period of 20 years.

Approval must be granted by the KEPZA for a company to operate as an EPZE, and at least 80 per cent of production must be for export. Domestic sales, within 20 per

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<sup>250</sup> Kenya's investment objectives are underlined by the Vision 2030 strategy document. This is a new long-term national planning strategy to increase annual GDP growth rate to 10 per cent, and maintain that performance for the period 2008-2030. In tourism, the target is to quadruple the sector's contribution to GDP to over KSh 80 billion (USD 775.469 million) and raise international visitors from 1.8 million in 2006 to 3 million in 2012. The objective, in agriculture, is to increase value addition in livestock and fisheries in order to raise incomes. The Vision is also to help enhance efficiency in the trade sector, and provide basic manufactured goods in eastern and central Africa, as well as promote a vibrant and globally competitive financial sector, and facilitate the provision of business services through the use of the internet to companies and organizations in the developed world (business process off shoring - BPO). See *Kenya Vision 2030 (July - August, 2007)* (Republic of Kenya) at 1.

<sup>251</sup> See Kenya, Ministry of Industrialization and Enterprise Development, *Kenya's Industrial Transformation Programme, 2015* (Nairobi: Ministry of Industrialization And Enterprise Development, 31 July 2015) at 2.

<sup>252</sup> See *EPZA, supra* note 20, s. 3.

cent of output, must be approved and taxed at the standard CIT rate.<sup>253</sup> The scheme is administered by the KEPZA in collaboration with the KRA.

Secondly, for the purpose of promoting and facilitating the development, provision and management of affordable and decent housing for all Kenyans; and in order to deepen the use of efficient capital markets, and promote wider participation of the general public in the securities and derivatives market in Kenya, concessionary tax schemes have been designed for registered REITs, unit trusts, and collective investment ventures. Under the Markets Act, 2000, registered unit trusts and collective investment schemes are income tax exempt, provided they distribute 80 per cent of their net income.<sup>254</sup> Also, exemption from stamp duty is granted on the initial transfer of property into a listed REIT scheme, and on trading in a listed REIT security. However, dividends or distributions paid to investors are charged 5 per cent withholding tax, and the administering body is the KRA.<sup>255</sup>

Furthermore, as part of efforts by the Kenyan government to promote investment, and increase the revenue base by encouraging the repatriation of financial assets taken out of the country, a tax amnesty on foreign income has been instituted. The amnesty programme is to provide an avenue for taxpayers who have not been declaring taxable

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<sup>253</sup> *Ibid*, s 29, 2<sup>nd</sup> Schedule; *Customs and Excise (CAP. 472) (No. 13 of 1978) (Kenya)*, ss 3, 9; *VATA 2013 (Kenya)*, *supra* note 247, Part A. According to UNCTAD (2012), by 2011, there were 40 EPZs in operation or under development close to Nairobi or Mombasa. The largest EPZE single investment has been by De La Rue in security and printing – USD 48 million. Investment opportunities are mostly in the garment sector, under the AGOA; and plots in EPZs can be leased or rented. See UNCTAD, *An investment guide to Kenya – Opportunities and Conditions* (New York and Geneva: UN, 2012) at 34.

<sup>254</sup> See the *Capital Markets Act [Act No. 3 of 2000, s. 3.] (Kenya)*, s.11.

<sup>255</sup> See Lex Group Africa, “Real Estate Investment Trusts (REITS) Frequently Asked Questions” (17 June 2019), online: *Lex Group Africa* <[www.lexgroupafrica.com](http://www.lexgroupafrica.com)>.

foreign income to do so, and bring back assets held, and incomes earned or derived outside of Kenya.<sup>256</sup>

In addition, even though the overall objective, as mentioned earlier, is to encourage voluntary repatriation of foreign held assets to Kenya and invest in the development of the Nation, the tax amnesty programme is part of the preparatory works to join the CRS regime, for the purpose of automatic sharing of annual financial account information.

Under the Finance Act, 2018, taxpayers who received untaxed Kenya-sourced income or assets, earned in Kenya, which are now located outside Kenya, can have amnesty covering taxes, penalties, and interest, and declared funds may be exempted from criminal, and or related investigations.<sup>257</sup> The amnesty covers the period up to 31st December 2017, and is available to all resident entities, including individuals, corporations, trusts, and international organisations. Entities wishing to take advantage of the programme would have to disclose the foreign income earned up to and including the year ended 31st December 2017, on or before 30th June 2019.<sup>258</sup>

Additionally, funds voluntarily declared under the programme shall be repatriated not later than 30th June 2019. However, provision is made for late transfers up to 30th June 2024. Where the Funds have not been transferred to Kenya by this date, a 5-year extension period may be granted, with a penalty of 10 per cent levied on the transfer. However, the amnesty will cease to apply where such voluntarily declared funds are not repatriated

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<sup>256</sup> See Deloitte, “Kenya Budget Insight 2016 – The Story behind the Numbers” (1 July 2016), online (pdf): *Deloitte* <[www2.deloitte.com](http://www2.deloitte.com)> [[perma.cc/content/dam/Deloitte/ke/Documents/tax/Financial%20Insight.pdf](http://perma.cc/content/dam/Deloitte/ke/Documents/tax/Financial%20Insight.pdf)] at 1.

<sup>257</sup> See *The Finance Act, 2016 (No. 38 of 2016)* (Kenya), s. 37B.

<sup>258</sup> See RSM, “Kenyan Tax Amnesty FAQs” (18 February 2019), online: *RSM* <[www.rsm.global](http://www.rsm.global)> [[perma.cc/kenyan-tax-amnesty-faqs-updated-february-2019](http://perma.cc/kenyan-tax-amnesty-faqs-updated-february-2019)].

within the 5 years period, and repatriations can be made in instalments, on or before the filing of the return.<sup>259</sup>

Foreign assets, such as bank deposits, investment portfolios, insurance policies, shares and other properties, situated outside Kenya, and funded by income derived from or accruing from sources within Kenya, including those held under trust, or foreign income earned outside Kenya which would have been taxable under Kenyan laws, may be repatriated.<sup>260</sup> In situations where the funds cannot be repatriated for reasons beyond the taxpayer's control, the discretion of the Commissioner of the KRA is required.<sup>261</sup> The programme is administered by the KRA, and taxpayers who wish to be considered for the amnesty would have to apply on the KRA's online platform.<sup>262</sup>

## **C.2. General CIT rates reduced**

As indicated earlier, the CIT rates applicable in Kenya is 30 per cent for resident corporations, and 37.5 per cent for PEs. That notwithstanding, in order to promote and facilitate domestic and foreign investment in key strategic sectors of the economy, GoK provides reduced CIT rates for enterprises in certain sectors of the economy, including the financial sector, the housing industry, and the manufacturing sector.

Firstly, for the purpose of stimulating long-term investments to deepen the operation of efficient capital markets, by enabling the establishment of a nationwide system of commodity and derivatives markets, and in order to encourage the development

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<sup>259</sup> *Ibid.*

<sup>260</sup> See Taxkenya, "Tax Amnesty in Respect of Foreign Assets and Income" (30 May 2018), online: *Taxkenya* <[www.taxkenya.com](http://www.taxkenya.com)> [perma.cc/kenya-tax-amnesty-in-respect-of-foreign-assets-and-income].

<sup>261</sup> See RSM, "Kenyan Tax Amnesty FAQs" (18 February 2019), online: *RSM* <[www.rsm.global](http://www.rsm.global)> [perma.cc/kenyan-tax-amnesty-faqs-updated-february-2019].

<sup>262</sup> See *The Finance Act, 2016 (No. 38 of 2016)* (Kenya), s. 37B.

of new financial products and institutions, an incentive programme has been developed for operators in the capital market. Under the ITA and the Capital Markets Act, 2013, newly listed companies on the Nairobi Stock Exchange (NSE) are entitled to reduced CIT rates.<sup>263</sup>

The reduced rates vary between 20 per cent and 27 per cent, and apply for a period of 3 to 5 years, depending on the percentage of capital listed.<sup>264</sup> Where 20 per cent of shares are listed, a reduced CIT rate of 27 per cent is applicable for the first three years after listing; where 30 per cent of shares are listed, a 25 per cent CIT rate is applicable for the first five years after listing; and where 40 per cent of shares are listed, a CIT rate of 20 per cent is applicable for the first five years after listing. Also, gains realised from securities listed on the NSE are exempt from tax. The incentive scheme is administered by the KRA.

Secondly, in order to promote and facilitate investment in integrated infrastructural facilities, and other economic and business activities in designated areas, a special scheme broader in concept than that under the EPZA, has been instituted under the SEZA in 2015.<sup>265</sup> The Act also established the KSEZA to regulate activities within the designated areas, and to design, approve, establish, develop, and promote SEZEs. The KSEZA is also in charge of determining the investment criteria and investment thresholds for the businesses in the zone, and ensuring that investors have access to quality infrastructure,

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<sup>263</sup> See *ITA Kenya*, *supra* note 20, 3<sup>rd</sup> Schedule; Capital Markets Act, 2013 (Act No. 38 of 2016) *Kenya*, s. 11.

<sup>264</sup> See *Capital Markets Act, 2013 (Act No. 38 of 2016)* (Kenya), s. 11.

<sup>265</sup> EY, “Global Tax Alert: Kenya enacts Special Economic Zones Act, 2015” (4 December 2015), online: *EY* <[www.ey.com](http://www.ey.com)> [*EY Global Tax Alert*]. However, the establishment of SEZs is a recognition that EPZs have not had the expected impact on the Kenyan economy. See Carol Newman & John Page, “Industrial clusters: The case for Special Economic Zones in Africa” (2017) WIDER Working Paper 2017/15 at 24. See also KPMG, “Analysis of the Special Economic Zones Act, 2015” (16 June 2019), online (pdf): KPMG <[assets.kpmg.com/content/dam/kpmg/ke/pdf/tax/analysis-of-the-special-economic-zone-act.pdf](https://assets.kpmg.com/content/dam/kpmg/ke/pdf/tax/analysis-of-the-special-economic-zone-act.pdf)> [*KPMG*] at 2-3.

and are well incentivized to enhance productivity.<sup>266</sup> It is also to make policy recommendations to the government in relation to the ease of investing, investor protection, simplified tax regimes, and labour regulations.<sup>267</sup>

Under the Act, SEZEs, developers, and operators are entitled to a reduced CIT rate of 10 per cent for the first ten years of operation, and a CIT rate of 15 per cent for the next ten years. SEZEs are also granted exemption from withholding taxes and VAT on goods and services supplied to them, and 100 to 150 per cent ID for buildings and other capital expenditures. In addition, instruments relating to the business activities of licensed SEZEs are exempt from stamp duty, and SEZEs can repatriate their profits.

The Secretary in charge of Industrialization may declare any area as special economic zone, and businesses may apply to be granted SEZEs status, or set up operations within existing zones.<sup>268</sup> SEZEs may also include free trade zones, industrial parks, free ports, ICT parks, science and technology parks, recreational zones, business service parks, and livestock zones. Licensing of SEZs is done by KSEZA, and the tax incentive is administered by the KRA.<sup>269</sup>

Thirdly, GoK wants to ensure the provision and management of affordable and decent housing for all Kenyans through the facilitation of financial resource mobilization and management in the housing industry. In order to achieve this objective, an incentive scheme has been designed for the housing industry. Under the Finance Act, 2018, real estate developers who will construct at least 100 housing units per year are entitled to a

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<sup>266</sup> See *SEZA*, *supra* note 20, s 3.

<sup>267</sup> *Ibid*, s 4; *The Finance Act, 2016 (No. 38 of 2016)* (Kenya), s 49; *KPMG*, *supra*, note 47.

<sup>268</sup> See *SEZA*, *supra* note 20, s.4; *ITA Kenya*, *supra* note 20, 2<sup>nd</sup> Schedule.

<sup>269</sup> See Stratton Consulting, “Tax incentives for the hospitality industry” (17 June 2019), online (*pdf*): Stratton Consulting <[www.stratton.consulting](http://www.stratton.consulting)> [[perma.cc/Tax Incentives for the Hospitality Industry\\_1521990329.pdf](http://perma.cc/Tax_Incentives_for_the_Hospitality_Industry_1521990329.pdf)] at 1-4.

reduced CIT rate of 15 per cent, and the sale of land and residential premises are VAT exempt.<sup>270</sup> In addition, the GoK is to establish a NSHDF, and strengthen the NHC to fast track the achievement of this vision.<sup>271</sup>

Fourthly, in order to facilitate, promote and boost the local auto industry, and enhance the capacity of SMEs in the local assembling of motor vehicles and manufacturing of parts, an incentive scheme has been designed for the sector. Under the National Automotive Policy, 2019, local motor vehicle assembly companies have been granted a concessionary CIT rate of 15 per cent for the first five years of operation. This may be extended for a further period of five years for companies whose local content will be equivalent to 50 per cent of the value chain.<sup>272</sup> The programme is under the SEZs scheme, and qualifying firms are entitled to 10 per cent import duty, or 10 per cent excise duty for 3 years, for 1000 units of production, if all consumable parts are procured or manufactured locally.<sup>273</sup>

Furthermore, local content developers are exempted from import and excise duties, and entitled to 50 per cent discount on corporate tax for 10 years. Additionally, the local forging and casting industry under the scheme will be granted 100 per cent discount on income tax for 10 years, and excise and import duty exemptions on materials for 3 to 10 years, depending on the percentage of value addition.<sup>274</sup> However, a higher tariff rate of

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<sup>270</sup> See *VATA 2013 (Kenya)*, *supra* note 247, s. 5, 1<sup>st</sup>, 2<sup>nd</sup> Schedule.

<sup>271</sup> See Kenya, *The National Treasury, The Fiscal Budget For The Financial Year 2018/2019* (Nairobi: The National Treasury, 28 February, 2018) at 9.

<sup>272</sup> See Kenya, State Department for Industrialization, *Draft National Automotive Policy* (Nairobi: State Department for Industrialization, January 2019) at 26-33; *EY Global Tax Alert*, *supra* note 265 at 45.

<sup>273</sup> *Ibid.*

<sup>274</sup> *Ibid.*

25 per cent will be applicable where parts are imported. The programme is run by the Department for Industrialization, and the incentive scheme by the KRA.<sup>275</sup>

Fifthly, in order to position Kenya as an international commercial and financial hub, and become a premier aviation hub in the East African region, the aviation industry has been given concessionary tax rates to enhance its competitiveness. Under the ITA and the Finance Act 2018, the ownership and operation of ships and aircraft is charged a reduced CIT rate of 2.5 percent.<sup>276</sup> Also, in order to transform Kenya into an ICT hub in East Africa, and leverage on ICT to support the growth of the economy through innovation and job creation, the transmission of messages is offered a concessionary CIT rate of 5 per cent. This scheme is also under the ITA, and is administered by the KRA.<sup>277</sup>

Finally, under a special operating framework to attract investment into key priority areas, and create job opportunities to enhance prosperity, the KoG has identified four key sectors that will provide the necessary spillover effects for economic growth and development, including affordable housing, manufacturing, infrastructure, and food production. Under the Finance Act, 2018, strategic entities operating under the special operating framework arrangement can negotiate for special CIT rates, and other incentive packages.<sup>278</sup> However, although the ITA gives the Minister the right to demand by notice the filing of returns by any person for tax assessment purposes, the Finance Act 2018 does

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<sup>275</sup> However, according to Duncan (2016), for the National Automotive Policy Scheme to be successful, the Kenyan government must make power supplies cheaper, and address other factors to improve upon investment climate. See Duncan Miriri, “Kenya car industry urges more incentives to attract investment” (29 September 2016), online: *Reuters* <[www.reuters.com](http://www.reuters.com)> [perma.cc/idUSL8N1C52ZZ].

<sup>276</sup> See Kenya, The National Treasury, *The Fiscal Budget for the Financial Year 2018/2019* (Nairobi: The National Treasury, 28 February, 2018) at 37; PwC, “Kenya Corporate – Taxes on corporate income (25 January 2019), online: *PwC* <[taxsummaries.pwc.com](http://taxsummaries.pwc.com)> [perma.cc/ID/Kenya-Corporate-Taxes-on-corporate-income].

<sup>277</sup> See *EY Global Tax Alert*, *supra* note 265 at 44.

<sup>278</sup> See *The Finance Act, 2018, (Act No. 10 of 2018)* (Kenya), s. 11.



not make any provision for reporting, monitoring or assessment of tax incentives granted to firms under the special operating framework scheme. No regulation that makes provision to that effect has also been sighted.<sup>279</sup>

### **C.3. Targeted reduction in the effective CIT rate**

In this section, we consider incentive schemes aimed at reducing the effective CIT rate, including accelerated depreciation, investment deduction, and capital deduction, granted to strategic major investment projects. As discussed in the previous chapter, incentives schemes targeted at reducing the effective CIT rate differ in operation from general CIT-reducing incentives considered above. While the latter involve a direct reduction in the CIT rate, the former operate by reducing the cost of production, and thereby lessening the tax burden.

Generally, the GoK recognises the existence of huge infrastructure gaps in key sectors, including roads, rail and the ports, as constraints to economic growth. In order to lower the cost of closing the gap, and enhance access to manufacturing zones, tax incentive schemes have been designed to induce private investment into the development and efficient management of modern infrastructure in ports, railways, and other key sectors.<sup>280</sup>

First of all, to encourage investment in physical capital such as industrial buildings, machinery and equipment, IDs are allowed.<sup>281</sup> Under the ITA, 100 per cent deductions are

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<sup>279</sup> See also *ITA Kenya*, *supra* note 20, s. 52.

<sup>280</sup> Kenya, The National Treasury, *The Fiscal Budget For The Financial Year 2018/2019* (Nairobi: The National Treasury, 28 February, 2018) at 1.

<sup>281</sup> *ITA Kenya*, *supra* note 20, Part V, 2<sup>nd</sup> Schedule.

claimable on building and machinery, civil works and structures forming part of an industrial building, and filming equipment of a local film producer.<sup>282</sup>

Secondly, the GoK under the National Tourism Strategy, aims to reinforce the Kenyan tourism industry as a high quality service sector, and position the country as the number one tourism destination in East Africa.<sup>283</sup> Tourism in Kenya is the second-largest foreign exchange earner, following agriculture.<sup>284</sup> However, inadequate financing and investment in the sector are reported to be hampering its growth and contribution to national development. The GoK therefore, is promoting investment in tourism infrastructure, and adopting policy measures to ensure the efficient management, marketing, and regulation of the sector.<sup>285</sup>

Therefore, under the ITA and the Tourism Act, the tourism industry is granted a concessionary tax treatment.<sup>286</sup> Firstly, under the ITA, 100 per cent ID is allowed for hotel buildings, and customs duty exemptions are granted on a number of items purchased by hotels, such as, equipment, furniture and fixtures.<sup>287</sup> Also, all locally financed materials and equipment used in the construction of tourist hotels, tourism facilities, recreational parks, and convention and conference facilities are excluded from tax, and local services supplied to a hotel or restaurant is VAT exempt.<sup>288</sup>

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<sup>282</sup> EY, “2019 Kenya Tax Guide” (21 September 2018), online (pdf): *EY* <[www.ey.com](http://www.ey.com)> [perma.cc/Publication/vwLUAssets/ey-tax-guide/\$File/ey-tax-guide.pdf] at 50.

<sup>283</sup> See Kenya, Department Of Tourism, *National Tourism Strategy 2013-2018* (Nairobi: Ministry of East Africa, Commerce and Tourism, 16 June 2018) at 5.

<sup>284</sup> See Wikipedia, “Tourism in Kenya” (16 June 2019), online: *Wikipedia* <[en.wikipedia.org](http://en.wikipedia.org)> [perma.cc/wiki/Tourism\_in\_Kenya].

<sup>285</sup> *Ibid.*

<sup>286</sup> See *Tourism Act, 2011 (Act No: 28 of 2011)* (Kenya), s. 3.

<sup>287</sup> See *The Finance Act, 2016 (No. 38 of 2016)* (Kenya), s. 62; *ITA Kenya*, *supra* note 20, Part V, 2<sup>nd</sup> Schedule.

<sup>288</sup> See *Ibid*; Stratton Consulting, “Tax incentives for the hospitality industry” (17 June 2019), online (pdf): Stratton Consulting <[www.stratton.consulting](http://www.stratton.consulting)> [perma.cc/Tax Incentives for the Hospitality Industry\_1521990329.pdf] at 1-4.

Furthermore, to encourage the dispersion of investment outside the central business districts of Nairobi, Mombasa and Kisumu, construction of a building or purchase and installation of machinery for manufacturing purposes exceeding KES 200 million (about USD 1.95 million) incurred outside the municipalities of Nairobi, Mombasa or Kisumu are allowed an ID of 150 per cent.

Additionally, shipping enterprises can be entitled to 100 per cent IDs for the purchase of a new power driven ship of more than 125 tons. However, the deduction is disallowed where a ship is sold within a period of five years after the deduction has been granted.

Moreover, industrial or capital deductions are allowed for the construction of an industrial building to be used in a business. For an industrial building, 2.5 per cent capital deduction is applicable within the first 40 years of operation; for hotels, 10 per cent capital deduction is allowed within the first 10 years of operation; for hostels and educational buildings, 50 per cent capital deduction is granted for the first 2 years of operation for buildings used in training film producers, actors or crew, 100 per cent capital deduction; and for approved rental residential and commercial buildings, 25 per cent capital deduction.<sup>289</sup> Also, production of export goods under bonded warehouses is entitled to 100 per cent investment deduction. The administering authority is the KRA.

Furthermore, although Kenya does not allow deduction for accounting depreciation or impairment, in order to encourage investment in capital-intensive key sectors, such as

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<sup>289</sup> Buildings for educational purposes include laboratory, workshops, accommodation halls, classrooms, dining halls/cafeteria, and other halls for use by the students, administration building, sporting facilities and staff quarters. See *ITA Kenya, supra* note 20, Part 1, 2<sup>nd</sup> Schedule.

manufacturing, telecommunication, petroleum, and agriculture, accelerated depreciation and depletion of assets is permitted at varying rates.

Class one assets, including heavy earth moving equipment, such as, caterpillars, tippers, tractors, loaders, rollers and graders, combine harvesters, mobile cranes and forklifts, are allowed to be depreciated at 37.5 per cent. Class two assets, including office machinery and equipment, such as, computers printers, scanners and processors, photocopiers, stamping and fax machines, and cash registers, are also allowed to be depreciated at 30 per cent. Class three assets, including other self-propelling machines, such as, motor bikes, saloon cars and hatchbacks, pick-ups and delivery vans, aircrafts, and minibuses, can be depreciated at 25 per cent.

Class four assets, including other non-self-propelling machines, such as, ships, bicycles, wheelbarrows, lifts and conveyor belts, furniture and fittings, tractor trailer, train coaches, milking machinery, ploughs and lawn mowers, and petroleum pipelines, can be depreciated at 12.5 per cent. Class five assets, including computer software and telecommunication equipment, can be depreciated at 20 per cent for five years; and irrevocable right to use fibre optic cable, at 5 per cent.<sup>290</sup>

Moreover, in order to encourage investment in the mining industry, and to compensate for the high risk associated with the industry, accelerated deductions are allowed for all mining and specified minerals equipment, at 40 per cent in the first year, and 10 per cent for the remaining 6 years. Finally, in order to enhance capital

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<sup>290</sup> Deductions for plant and machinery are on a reducing-balance basis; deductions for telecommunication equipment and computer software are on a straight-line basis; deductions for capital expenditure under a concessionaire arrangement are allowed on equal proportions basis over the period of the concession. See *ITA Kenya, supra* note 20, Part 1, 2<sup>nd</sup> Schedule.

accumulation, and encourage modernization in the agricultural sector, farm works deductions are allowed on construction of farm works at the rate of 20 per cent for 5 years; and one-third of the expenditure on farm houses are deductible, and expenditure on immovable property for the operation of a farm can be deducted at 100 per cent.<sup>291</sup>

#### **C.4. DTAs**

As has been seen in the previous chapter, DTAs are international tax treaties to ensure relief from the multiple taxation of incomes of entities in any of the jurisdictions under the treaty. DTAs can be useful to ensure that income earned by TNCs is not subjected to taxation by both the source state and resident state. DTAs also enhance cooperation among tax administrations, especially in fighting international tax evasion.

The GoK uses DTAs as tax incentives to effectively reduce the tax burden of international investors and permanent establishment, and thereby encourage international investments.<sup>292</sup> By using DTAs, Kenya's ensures that the incidence of double taxation on incomes earned in Kenya by residents of other countries with which Kenya has such agreements is minimized or eliminated. The power to enter into DTAs is provided for under the ITA.<sup>293</sup>

As of March 2018, Kenya has signed and ratified 14 DTAs with other countries including, Canada, Denmark, France, Germany, India, Norway, Sweden, United Kingdom,

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<sup>291</sup> *ITA Kenya, supra* note 20, Part IV, 2<sup>nd</sup> Schedule.

<sup>292</sup> Taxkenya.com, "Double Taxation Agreements in Kenya" (23 July 2019), online: *Taxkenya.com* <[www.taxkenya.com](http://www.taxkenya.com)> [[perma.cc/double-taxation-agreements-kenya/](https://perma.cc/double-taxation-agreements-kenya/)].

<sup>293</sup> See *ITA Kenya, supra* note 20, s. 41.

Zambia, South Africa, Qatar, UAE, South Korea and the Netherlands.<sup>294</sup> DTA rates are applicable on dividends, interest, royalties, and management and professional fees. Furthermore, where there is a DTA in force, lower rates may apply to non-residents. Table 3 shows the rates applicable under the various agreements in force. Kenya provides no tax credit for foreign tax paid on business income except as provided for under a DTA. Under such an agreement, some investments may be allowed to make deductions against their tax liabilities, or foreign tax expense.

Furthermore, under the ITA, Kenya imposes no WHT if the beneficiary is a resident company controlling at least 12.5 per cent of the capital in the paying company. However, WHT is levied at rates 3 per cent and 30 per cent on a range of payments to both resident and non-resident entities, and non-resident WHT is a final tax.<sup>295</sup> Loan interest paid to residents and non-residents is subject to a 15 per cent WHT, and royalties paid by a resident person to a non-resident person are subject to a 20 per cent WHT. Payments of management and professional fees paid to a non-resident person are subject to 20 per cent WHT.<sup>296</sup> As indicated earlier, the rate of WHT may be reduced where a double tax treaty with Kenya applies.<sup>297</sup> WHT rates applicable on payments to non-residents in the oil and gas sector are as follows: dividends 10 per cent, interest 15 per cent, natural resource income 20 per cent,

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<sup>294</sup> See *Oxfam*, *supra* note 7 at 33. See also Deloitte, “Kenya Tax Treaty Workshop” (29 March 2018), online: Deloitte <[www2.deloitte.com](http://www2.deloitte.com)> [perma.cc/ke/en/pages/tax/articles/kenya-tax-treaty.html].

<sup>295</sup> The non-resident WHT is considered the ultimate tax obligation to Ghana on that income – the recipient of the payment is not obliged to report this income on his tax return. See Canada Revenue Agency, “Non-Residents and Income Tax – 2018” (8 July 2019), online: Government of Canada <[www.canada.ca](http://www.canada.ca)> [perma.cc/en/revenue-agency/services/forms-publications/publications/t4058/non-residents-income-tax-2016.html].

<sup>296</sup> *ITA Kenya*, *supra* note 20, ss. 3, 7.34, 39.

<sup>297</sup> For example, the WHT rate for management and professional fees under the Kenya-United Kingdom double tax treaty is 12.5 percent. See ALN, “Investment Guide – Kenya” (31 December 2015), online (*pdf*): ALN <[www.africalegalnetwork.com](http://www.africalegalnetwork.com)> [perma.cc/wp-content/uploads/2015/12/Kenya-Investment-Guide-2015.pdf] at 11.

and management or professional fees 12.5 per cent. Table 4 provides the general WHT rates applicable to various incomes.

Capital gains (and losses) on gains arising from transfer of property situated in Kenya are charged at the rate of 5 per cent. Property includes shares of companies, land and buildings and other assets. Various exemptions are provided on capital gains, including where certain thresholds have been met. For example, gains on the transfer of agricultural property of less than 100 acres are tax exempt.<sup>298</sup>

However, like Ghana, Kenya treats dividends and interest slightly different from the rule prescribed under the OECDMTC. As seen in the previous chapter, the OECDMTC does not allow the extra-territorial taxation of dividends and interest realised through permanent establishments (PEs). This is in order to avoid double taxation. Under the OECDMTC, the taxing rights of resident states of PEs is restricted under Articles 10 and 11, in addition to Article 7. These provide that the rate at which dividends may be taxed by a resident contracting state shall not exceed 15 per cent, and that for interest should not be greater than 10 per cent.

However, under the ITA, Kenya regards interest and dividends of paid by PEs to non-residents as income accrued in or derived from Kenya, and are, therefore, subject to tax.<sup>299</sup> Also, as in Ghana, where the debt obligation giving rise to the interest is secured by real property situated in Kenya, the interest is deemed as sourced from Kenya, and is

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<sup>298</sup> See *ITA Kenya*, *supra* note 20, s. 15, Part IV, 2<sup>nd</sup> Schedule; *The Finance Act, 2016 (Act No. 38 of 2016)* (Kenya).

<sup>299</sup> See *ITA Kenya*, *supra* note 20, s. 10.

taxable in Kenya. But the rate at which dividends are taxed in Kenya is consistent with the OECDMTC provisions.<sup>300</sup>

Moreover, with regard to interest, the minimum rate at which interest is charged in Kenya is the upper limit provided for under the OECDMT. The OECDMT requires that charges on interest should not exceed 10 per cent, but Kenya taxes interest paid to non-resident persons between 10 and 20 per cent. Thus, the OECDMT's ceiling is Kenya's floor, and Kenya's upper limit of 20 per cent exceeds the OECD Model's ceiling of 10 per cent, by 10 percentage points.

Therefore, unlike as provided for under the OECDMT, dividends and interest of PEs are treated as income of a resident entity, and subject to tax in Kenya. Furthermore, the income and liability of a PE are treated as if the PE is a different entity from its owner, but business arrangements between the two entities are duly regarded.

### **C.5. Import duty exemptions / reduced excise duty**

The GoK, under Vision 2030, desires to revive the industrial sector in order to support value addition, and increase the sector's contribution to 15 per cent of GDP over the medium term (by 2022). In line with this, interventions to increase the production of domestically manufactured goods have been adopted to steer the needed industrial growth, and make the country globally competitive. Special programmes have been designed targeting critical sectors including, iron and steel production, manufacture of fertilizers,

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<sup>300</sup> The OECDMTC provides for dividends to be taxed between 5 and 15 percent, and Kenya taxes dividends between zero (Zambia) and 10 percent. See *ITA Kenya, supra* note 20, s. 7; *The Finance Act, 2018 (Act No. 10 of 2018)* (Kenya), s. 3. See Articles 7, 10 & 11 of OECD Model Tax Convention; *OECD Commentaries, supra* note 195 at 194-215.



agro-processing, machine tools and machinery, motor vehicle assembly, and manufacture of spare parts, for investment under a PPP framework.<sup>301</sup>

In this light, although import duties in Kenya are administered under the EACCMA, 2004 based on the nature and description of the goods in the Custom External Tariff Code, concessionary duty rates have been granted to iron and steel, textile and footwear, paper, timber, and vegetable oil production entities.<sup>302</sup> Three input categories have been identified under the scheme for tax concessions. First, raw materials, capital goods, agricultural inputs, certain medicines, and medical equipment are import duty exempt; second, semi-finished goods, to be used as input in production, are charged 10 per cent import duty; and third, finished products are charged import duty at the rate of 25 per cent.<sup>303</sup>

Further, in order to promote the penetration of ICT, and support the assembly of computer and computer accessories locally, imported computer parts or parts purchased locally for the assembly of computers are exempted from import duty and VAT.<sup>304</sup> In addition, under the VATA most machinery for manufacturing, and services relating to goods in transit, are fully exempt from VAT.<sup>305</sup> However, all other imported finished goods attract VAT at the rate of 16 per cent. The VATA also provides for tax exemptions for

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<sup>301</sup> KPMG, “Budget Brief Kenya 2018 June 2018” (30 June 2018), online (*pdf*): KPMG <home.kpmg> [perma.cc/content/dam/kpmg/ke/pdf/tax/kenya-budget-brief-2018.pdf] at 12.

<sup>302</sup> See *East African Community Customs Management Act, 2004* (East African Community); East African Community, EAC Customs Union, Common External Tariff 2017 Version (Nairobi: EAC Publication, 2017); ALN, “Investment Guide – Kenya” (31 December 2015), online (*pdf*): ALN <www.africalegalnetwork.com> [perma.cc/wp-content/uploads/2015/12/Kenya-Investment-Guide-2015.pdf] at 13.

<sup>303</sup> ALN, “Investment Guide – Kenya” (31 December 2015), online (*pdf*): ALN <www.africalegalnetwork.com> [perma.cc/wp-content/uploads/2015/12/Kenya-Investment-Guide-2015.pdf] at 13.

<sup>304</sup> See Kenya, National Treasury, *The Fiscal Budget For The Financial Year 2018/2019* (Nairobi: The National Treasury, 28 February, 2018) at 17.

<sup>305</sup> *VATA 2013 (Kenya)*, *supra* note 247, 1<sup>st</sup> Schedule.

goods and services exported from Kenya, goods and services supplied to EPZEs, export of coffee and tea, and the supply or importation of goods used in agriculture, health and education.<sup>306</sup> Furthermore, under the VATA, the Minister of Finance and Economic Planning may remit taxes payable on any goods or services if he is satisfied that it is in the public interest to do so.<sup>307</sup> The administrative body in charge of the scheme is the KRA.

#### **D. EVALUATION OF THE IMPACT OF TAX INCENTIVES IN KENYA**

Although it has been suggested that tax incentives have a significant positive impact on the attraction and retention of FDI, and, therefore, investment levels and the GDP growth rate in Kenya<sup>308</sup>, there are concerns, as in many other developing African countries, about the detrimental effect of tax incentives on tax revenue.

Tax incentives have been found to deprive Kenya of revenue needed to reduce poverty, and improve the general welfare of the population. The government has not been able to strike the appropriate balance between increasing tax revenue collection and encouraging investment through the use of tax incentives. Moreover, by resorting to the use of a wide range of tax incentives, other desirable goals associated with taxation, such as simplifying the tax system, strengthening tax administration, and achieving equity in the tax burden, have also been overlooked.<sup>309</sup>

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<sup>306</sup> ALN, “Investment Guide – Kenya” (31 December 2015), online (pdf): *ALN* <[www.africalegalnetwork.com](http://www.africalegalnetwork.com)> [perma.cc/wp-content/uploads/2015/12/Kenya-Investment-Guide-2015.pdf] at 12; *VATA 2013 (Kenya)*, *supra* note 247, 1<sup>st</sup> Schedule Part A.

<sup>307</sup> *Ibid.*, s. 23. Also, the 8<sup>th</sup> Schedule of this Act provides for zero rating of various goods and services.

<sup>308</sup> See Gladys Wanjiku Thuita, “An Investigation of the Effect of Tax Incentives on the FDIs: A Case of EPZs in Athi River Kenya” 3:1 (2017) *JAFAS* 17-36 at 1. See also Hilda M. Alegana, *The Effect of Tax Incentives on Economic Growth in Kenya* (MSc Thesis, University of Nairobi, 2014) [unpublished] at 1.

<sup>309</sup> See *Oxfam*, *supra* note 7 at 18, 25.

Empirical evidence shows that FDI has not played an important role in the Kenyan economy despite several reforms that have been undertaken, and the many incentives provided to foreign investors under such reforms. It has also been suggested that tax incentives in Kenya are introduced through lobbying, and in an ad hoc manner, without proper medium to long-term impact assessment.<sup>310</sup> The assertion, therefore, is that the disadvantages of tax incentives in Kenya far outnumber the advantages, and that countries that have been most successful in attracting FDI have not offered as generous tax concessions as Kenya may seek to do.<sup>311</sup> Moreover, it has been observed that no cost-benefit analysis has ever been conducted to ascertain the net benefit of tax incentive programmes in Kenya.<sup>312</sup>

It has been estimated that Kenya is losing over USD 1.1 billion a year through the use of tax incentives. In the fiscal year 2009-10, an estimated amount of USD 3.05 billion, about 3.1 per cent of Kenya's GDP, projected to be the difference between actual and potential revenue collection, was mostly attributed to tax incentives, including CIT, VAT and import duty exemptions. In addition, revenue loss as a result of trade-related tax incentives in 2007-8 fiscal year was USD 133 million, and import duty exemptions for the same period was USD 566.9 million. Overall, investment related incentives accounted for 72.4 per cent of total revenue loss for the period, and export related incentives accounted for 27.6 per cent of total revenue loss for the same period. The loss averagely translates

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<sup>310</sup> See IEA Kenya, "Tax Incentives and exemption regime in Kenya: Is it working?" (2012) 30 TBF 1-5 at 6.

<sup>311</sup> See Tax Justice Network-Africa and ActionAid International, "Tax competition in East Africa: A race to the bottom? Tax incentives and revenue losses in Kenya" (30 May 2012), online (pdf): *Tax Justice Network* <[www.taxjustice.net](http://www.taxjustice.net)> [perma.cc/cms/upload/pdf/kenya\_report\_full.pdf] at IV, 11.

<sup>312</sup> See IEA Kenya, "Tax Incentives and exemption regime in Kenya: Is it working?" (2012) 30 TBF 1-5 at 6.

into USD 423.5 million, or about 1.7 per cent of total GDP for the period (the figure could be higher if all tax incentives were captured).<sup>313</sup>

Additionally, the government has consistently missed its revenue targets. Over the last decades revenues collected have not been sufficient to fund the budget, resulting in budget deficits.<sup>314</sup> Also, for the six years period, 2003-04 to 2008-09, the total amount of revenue lost in Kenya was estimated at USD 2.56 billion. This translates to an average of USD 427 million in a year.<sup>315</sup> Moreover, a study on the tax incentive trend for the period 2003-2012 shows that revenue losses due to IDs were about USD 143.06 million.<sup>316</sup>

Furthermore, it has also been found that although tax incentives may be valuable in attracting EPZ firms, the survival of these firms depends on factors other than tax incentives, and that EPZ firms leave when their tax holiday period is expired, to avoid paying taxes.<sup>317</sup> Also, the lack of transparency has long prevented the public from adequately scrutinising tax incentives.<sup>318</sup>

In summary, since it has been established that not only are tax incentives not needed to attract FDI, but also that tax incentives have resulted in large revenue losses to the Kenyan government, and that the use of tax incentives has in recent years attracted very

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<sup>313</sup> John Mutua and Raphael Muya, "Tax incentives and exemption regime in Kenya: Is it working?" (11 May 2013), online: *The East African* <[www.theeastafrican.co.ke](http://www.theeastafrican.co.ke)>.

<sup>314</sup> Hilda M. Alegana, *The Effect Of Tax Incentives On Economic Growth In Kenya*, A Research Project Submitted In Partial Fulfillment Of The Requirements For The Award Of The Degree In Masters Of Science In Finance, University Of Nairobi November, 2014.

<sup>315</sup> John Mutua and Raphael Muya, *Tax incentives and exemption regime in Kenya: Is it working*, May 11 2013

<sup>316</sup> Martin S. O. Gumo, *The Effect of Tax Incentives on Foreign Direct Investments in Kenya* (MSc Thesis, University Of Nairobi, 2013) [unpublished] at 41.

<sup>317</sup> Accordign to Kuria (2016), in 2003 there were 66 EPZ firms (which benefited from tax incentives available), but after ten years, only 22 still existed. See John Njoroge Kuria, *Effects of Tax Incentives on the Performance of Export Processing Zone (EPZ) Firms in Kenya* (DBA Thesis, United States International University Africa, 2016) [unpublished] at VI.

<sup>318</sup> See Tax Justice Network-Africa and ActionAid International, "Tax competition in East Africa: A race to the bottom? Tax incentives and revenue losses in Kenya" (30 May 2012), online (pdf): *Tax Justice Network* <[www.taxjustice.net](http://www.taxjustice.net)> [[perma.cc/cms/upload/pdf/kenya\\_report\\_full.pdf](http://perma.cc/cms/upload/pdf/kenya_report_full.pdf)] at 7.

low levels of FDI. It is important, therefore, that the government focus on improving the investment fundamentals. It is suggested that factors, including security, good governance, infrastructure, respect for the rule of law, and openness to trade<sup>319</sup>, must be given critical attention, as opposed to the use of tax incentives which is likely to result in further distortions in the tax system, large administrative costs, and rent-seeking, compounded inefficiencies, and corruption.<sup>320</sup> An alternative approach may be for the Kenyan government to maximize efficient tax collection, and use part of the revenue to offer financial incentives through direct expenditure.<sup>321</sup>

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<sup>319</sup> Many Anza Rhodah, *Determinants of Foreign Direct Investment in Kenya (1970 - 2009)* (M.A. Thesis, Kenyatta University, 2012) [unpublished] at 16, 22, 121.

<sup>320</sup> See John Mutua & Raphael Muya, "Tax incentives and exemption regime in Kenya: Is it working?" (11 May 2013), online: *The East African* <[www.theeastafrican.co.ke](http://www.theeastafrican.co.ke)> at 1.

<sup>321</sup> IEA Kenya, "Tax Incentives and exemption regime in Kenya: Is it working?" (2012) 30 TBF 1-5 at 2.

## **CHAPTER 5                      ANALYSIS OF TAX INCENTIVES IN GHANA AND KENYA**

This chapter analyzes the tax incentive regimes for promoting and attracting FDI in Ghana and Kenya. It has two main parts. Part A analyses the two tax incentive regimes under five categories (the tax incentives in the two regimes were each discussed under these five categories in chapters 3 and 4, respectively) – namely: tax exemption and tax amnesty schemes, general reduced CIT rates, targeted reduction in the effective CIT rate, DTAs, and import duty exemption and reduced excise duty schemes. The analyses reveal that there is a considerable degree of similarity in tax incentive provisions, investment laws, and general tax administration structures in both countries, save slight variations in the codification, classification and duration of incentive provisions. This observation is generally true of most the sub-Saharan African countries.

Part B makes ten recommendations to enable effective and efficient use of tax incentives in sub-Saharan African countries in general: only the MoFEP should be responsible for administering tax incentives; each tax incentive programme should have a specific sunset provision as part of the original legislation; profit-based tax incentive schemes should be avoided – instead, cost-based tax incentives should be used; tax incentives must be restricted and targeted; tax incentive policies should benefit both domestic and foreign investors; frequent amnesty schemes should be stopped – instead, monitoring and enforcement must be improved; DTAs must be reviewed, and circumspection is required in signing new DTAs; tax incentives must be based on clear, objective eligibility criteria, with as little discretion as possible; all tax incentives should be consolidated in one legislation; and tax incentives must be disclosed to Parliament.

## **A. COMPARATIVE ANALYSIS**

### **A.1. Tax Exemption and Tax Amnesty schemes**

By means of comparison, both Ghana and Kenya offer tax exemptions and tax amnesty schemes. In both countries, tax exemptions are granted on a long-term basis with the objective of promoting industrialization and facilitating exports within their respective sub-regions – West Africa, in Ghana’s case; and East Africa, in Kenya’s case. Also, each country has legislation providing for its tax exemption scheme and institutions established under the legislation to administer the scheme. Similarly, in both countries, the tax exemption scheme is administered by the tax authorities – GRA and KRA. However, the licensing of enterprises to entitle them to the benefits under the tax incentive schemes is undertaken by the regulatory bodies established under the respective Acts – that is, GFZB, and KEPA.<sup>322</sup>

A common characteristic of the two exemption schemes is that they each provide additional tax concessions on inputs. For instance, in Ghana, FZEs are exempt from payment of duties on imported raw materials and inputs, and their shareholders are exempted from the payment of withholding taxes on dividends arising out of FZ investments. Similarly, in Kenya, shareholders of enterprises under EPZs are entitled to 10 years WHT holiday on dividends and other remittances, and raw materials and other inputs are exempted from local taxes. However, Kenya’s exemption scheme also provides for 100

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<sup>322</sup> Whereas Ghana’s tax exemption scheme is provided for under the Free Zone Act, which established the GFZB as a body responsible for regulating the scheme; Kenya’s scheme is provided for under the Economic Zones Act, which also established the KEPZA to regulate activities under the scheme.

per cent ID on buildings and machinery – a feature that is not available under Ghana’s exemption scheme.

Nonetheless, there is a major distinction between the schemes in the two countries. Although the qualifying entities are more or less the same, whereas the incentive scheme in Ghana ends after 20 years, the incentive scheme in Kenya is indefinite. Ghana’s scheme is in two distinct stages – qualifying entities are entitled to tax exemption for the first ten years of operation, and thereafter, an additional ten years of reduced CIT rates (15 per cent on exports, and 25 per cent on domestic sales); Kenya’s scheme is in three stages – EPZEs are exempted from CIT for the first ten years of operation, taxed at 25 per cent for the next ten years, and at 30 per cent for the remaining life of the business (domestic sales are taxed at the standard rate of 30 per cent).

The observation is that, under the tax exemption scheme, Kenya grants bigger tax concessions than Ghana. It implies that if investors were motivated only by profit, they may prefer Kenya to Ghana, and Kenya may attract more FDI because it grants more concessions. However, Kenya’s relatively generous incentive scheme may just constitute more of a give-away, and higher revenue loss. This is because, generally, investors are not attracted by considerations only of tax incentives, but also by the existence of other fundamental factors making up the investment climate, such as, good infrastructure, sound macroeconomic policies, security of investment, and the rule of law. Also, a bigger ripple effect in terms of revenue loss through exemption schemes is expected in Kenya than in Ghana. A bigger impact is expected in Kenya because, as noted in Chapters Three and Four, in the case of both Ghana and Kenya, incentive schemes have been subjected to



abuse. And, because Kenya offers more tax concessions relative to Ghana, the opportunity for abuse in Kenya is expected to be higher than in Ghana.

Moreover, as noted earlier, both Ghana and Kenya have granted tax amnesty schemes with the objective of enhancing revenue mobilization and expanding the tax base. In both cases, the amnesty schemes are on a short-term basis. Although it not clear how frequently tax amnesty schemes are offered in Kenya, the recent amnesty scheme in Ghana is the first to be offered in the last seven years.<sup>323</sup> However, the main difference between the two schemes is that, while the scheme in Ghana is aimed at encouraging a voluntary compliance culture, the scheme in Kenya is aimed at encouraging the repatriation of assets held or derived outside of Kenya, and preparing the country to join the CRS regime.<sup>324</sup>

Additionally, it can be observed that although the schemes in both countries are designed to foster tax compliance, in principle, Kenya's amnesty scheme appears novel and more ambitious – it may likely have more positive impact on FDI attraction than Ghana's. This is because, as mentioned earlier, Kenya aims its scheme at encouraging the repatriation of foreign assets held abroad or incomes abroad derived in Kenya. However, it is not estimated how much of income or assets are held abroad by residents in Kenya. Furthermore, the scheme in Kenya offers too long a period of time for the amnesty – it makes provision for a 5-year extension period, although with a penalty of 10 per cent to be levied on the transfer. This can further weaken the effectiveness of the whole scheme.

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<sup>323</sup> See Ghana Web, “Ghana rising: Tax amnesty 2018” (24 August 2018), online: *Ghana Web* <[www.ghanaweb.com](http://www.ghanaweb.com)> [perma.cc/2018-679074].

<sup>324</sup> See Deloitte, “Kenya Budget Insight 2016 – The Story Behind the Numbers” (1 July 2016), online (pdf): Deloitte <[www2.deloitte.com](http://www2.deloitte.com)> [perma.cc/content/dam/Deloitte/ke/Documents/tax/Financial%20Insight.pdf] at 1.

Further, another major concern in both Ghana and Kenya is that amnesty programmes may have a dire impact on revenue mobilization by weakening taxpayer attitudes and moral, and thereby engendering corruption and non-compliance. This is because, if amnesty schemes are resorted to too frequently as an alternative to enforcing the tax laws by prosecuting offenders, taxpayers may become accustomed to them and take them as routine. This will heighten the risk of taxpayers becoming lukewarm (by adopting a wait-and-see attitude) in fulfilling their tax obligations. Moreover, defaulters may even resort to bribing tax officials, or governments to declare amnesty programmes.<sup>325</sup>

## **A.2. General reduced CIT rates**

In addition, the analysis indicates that, under reduced CIT rates in both Ghana and Kenya, there are tax incentive programmes that provide reduced CIT rates in key priority sectors. While the general CIT rate in Ghana is 25 per cent; the general CIT rate in Kenya is 30 per cent for resident corporations, and 37.5 per cent for permanent establishments (PEs). In both cases, concessionary CIT rates are provided in the manufacturing, financial, and the housing sectors. However, in addition to the three common sectors each country provides reduced CIT rates in other sectors. For example, Ghana provides reduced CIT rates in five additional sectors, including non-traditional exports, agriculture, tourism and creative arts, and mining. On the other hand, Kenya provides reduced CIT rates in four additional sectors, including transport, ICT, SEZs, and the local automobile industry.<sup>326</sup>

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<sup>325</sup> See *Tax Amnesty Bill, 2017* (Ghana) at 1-3.

<sup>326</sup> SEZs include special regions or zones, or special sectors, including designated cities or administrative areas that are granted favourable tax status in order to attract investment into such locations or industries.

Moreover, it is worth noting that Ghana's tax incentive programme is more elaborately designed in favour of rural development, particularly in the manufacturing sector (with various categorizations for industrial cities, regional capitals, and the less developed areas of the country). On the other hand, Kenya's incentive programme does not have general locational incentives. The only location-based tax incentive Kenya offers is ID of 150 per cent for investments outside Nairobi, Mombasa and Kisumu, as against a deduction of 100 per cent for investments located in any of the three major cities. It may be concluded that the GoK does not have a policy to steer investment to specific geographic locations.<sup>327</sup> Comparatively, even though it can be argued that Ghana's design may allow for an even spread of investment opportunities across all sectors and all geographical regions, Kenya's simple and uniform design may be more advantageous in allowing for effective monitoring and supervision.

Furthermore, in terms of tax incentives for the capital markets, although the risk of revenue loss in both Ghana and Kenya is high – because tax incentive schemes permit entities to negotiate tax concessions – Kenya's design may allow for less revenue to be ceded. This is because, compared to Ghana, Kenya does not provide a blanket reduced CIT rates in the financial. Rather, Kenya's incentive programme in this category is structured according to percentage listing on the markets.<sup>328</sup>

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<sup>327</sup> See Export.gov, "Kenya – Openness to, and Restrictions Upon, Foreign Investment" (6 July 2019), online: Export.gov <[www.export.gov](http://www.export.gov)> [[perma.cc/article?id=Kenya-openness-to-foreign-investment](https://perma.cc/article?id=Kenya-openness-to-foreign-investment)].

<sup>328</sup> In Ghana, strategic investors under GIPC Act; investors under One District, One Factory Programme (1D1F); and investors under the YEP can negotiate tax incentives. Kenya: special operating framework can negotiate their incentives. See *GIPC Act 2013*, *supra* note 19, s 26.

### **A.3. Targeted reduction in the effective CIT rate**

Further, the analysis shows that under targeted reduction in the effective CIT rate, if tax concessions were the only determinant of FDI attraction, Kenya would be expected to attract more FDI than Ghana. This is because, in spite of the fact that both Ghana and Kenya offer various schemes, including accelerated depreciation, interest expense, capital gains and losses, loss carry forward, and special initiatives, aimed at reducing the effective CIT rate in sectors such as, manufacturing, agriculture, and mining, the deductions are not based on geographical locations; arguably, Kenya makes bigger tax incentives than Ghana.

For instance, in terms of accelerated depreciation, although both countries disallow enterprise-specific depreciation deductions, accelerated deductions are granted at prescribed statutory rates in key sectors such as manufacturing, telecommunication, petroleum, and agriculture. However, in both countries, the assets are grouped together, and classified in the same pool. For example, assets including computers and accessories, are classified in Ghana as class one assets, and allowed a deduction rated of 40 per cent. On the other hand, similar assets are classified in Kenya as class two assets, and allowed a deduction rate of 30 per cent. Similarly, while assets including plant and machinery and automobiles, are classified in Ghana as class two asset and allowed a deduction of 30 per cent; similar assets in Kenya are classified as class one assets and are allowed to be depreciated at 37.5 per cent.

In additionally, in both Ghana and Kenya interest expense is deductible in priority sectors, including farming, petroleum, mining, and agro-processing, ICT, manufacturing, and tourism. However, Kenya, additionally, allows 100 per cent deductions on building and machinery, including civil works and structures – which is not available in Ghana.

Also, unlike Ghana, Kenya provides custom duty exemptions on inputs for building and running of hotels, including equipment, and furniture and fixtures. Such concessions are not available in Ghana.

Moreover, Kenya offers more concessions in IDs and capital allowances. For instance, 150 per cent IDs are allowed for investments of about KES 200 million (about USD 1.95 million) made in the manufacturing sector outside the municipalities of Nairobi, Mombasa or Kisumu; and 100 per cent deduction is allowed in shipping and production of export goods under bonded warehouses. In addition, the mining industry in Kenya is allowed accelerated deductions at 40 per cent in the first year, and 10 per cent for the remaining 6 years; and the agricultural sector is allowed 100 per cent deductions on all immovable farm property. On the other hand, Ghana's does not have ID schemes. Furthermore its deduction allowance scheme is not geographically based.

#### **A.4. DTAs / TSAs**

The analysis reveals that both Ghana and Kenya have signed DTAs to provide reduced tax rates for non-resident individuals as an incentive to ensure relief from multiple taxation of incomes. In Ghana, DTAs are provided for under the GIPC Act; in Kenya, DTAs are provided for under the ITA.<sup>329</sup> Ghana has signed DTAs with 12 other countries; Kenya, on the other hand, has signed DTAs with 14 other countries.<sup>330</sup> However, each of the two countries has DTAs with 6 countries in common: France, Germany, United

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<sup>329</sup> See *ITA Kenya*, *supra* note 20, s 41.

<sup>330</sup> Ghana has signed DTAs with France, Germany, the United Kingdom, South Africa, Italy, Belgium, the Netherlands, Switzerland, Denmark, Czech Republic, Singapore and Mauritius. Kenya has signed DTAs with Canada, Denmark, France, Germany, India, Norway, Sweden, United Kingdom, Zambia, South Africa, Qatar, UAE, South Korea and the Netherlands.

Kingdom, South Africa, Netherlands, and Denmark. In addition, while Ghana has DTAs with Italy, Belgium, Switzerland, Czech Republic, Singapore, Mauritius, Kenya does not have DTAs with these countries. Likewise, while Kenya has DTAs with Canada, India, Norway, Sweden, Zambia, Qatar, UAE and South Korea, Ghana does not have DTAs with these countries.

Each country has given tax concessions as part of its DTA negotiations. DTAs provisions are applicable on dividends, interest, royalties, and management and professional fees, at reduced withholding rates (discussed further below). However, while Ghana generally provides tax credit for foreign tax paid Kenya does not – except as provided for under a DTA. Each country has also used its DTAs to secure tax sparing provisions. As of 2016, Ghana and Kenya have each signed a TSA with at least two OECD countries – Ghana has signed 2, and Kenya has signed 6.<sup>331</sup>

Comparing the two countries to the OECD MTC, both Ghana and Kenya treat dividends and interest slightly differently from the rule prescribed under the OECD Model. As noted in the previous chapter, the OECD Model rules out the extra-territorial taxation of dividends and interest of permanent establishments (PEs). The taxing rights of source States is restricted under Articles 10 and 11, in combination with Article 7, in order to avoid double taxation of interest and dividends – interest and dividends are taxable under Article 7, as part of the profits attributable to the PE.<sup>332</sup> The Model provides that WHT on

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<sup>331</sup> See Dhammika Dharmapala and Céline Azémar, “Tax Sparing, FDI, and Foreign Aid: Evidence from Territorial Tax Reforms” (2016) Coase-Sandor Institute For Law And Economics Working Paper No. 758 at 1.

<sup>332</sup> See *OECD Commentaries*, *supra* note 195 at 194-215.

dividends should not exceed 15 per cent, and that on interest should not be greater than 10 per cent.

However, both Ghana and Kenya treat interest and dividends of PEs as income accrued in or derived from their respective countries, and are, therefore, subject to tax.<sup>333</sup> Also, in both Ghana and Kenya, where the debt obligation giving rise to the interest is secured by real property situated within the jurisdiction, it is deemed as sourced from the jurisdiction, and, therefore, taxable.

Also, in both Ghana and Kenya, the rate at which dividends are taxed is consistent with the OECD Model provisions – the Model provides for dividends to be taxed between 5 and 15 per cent.<sup>334</sup> However, each country varies in treatment of interest, compared to the OECD Model. The Model requires that charges on interest should not exceed 10 per cent. But Ghana taxes interest paid to non-resident persons between 7 and 12.5 per cent,<sup>335</sup> and Kenya charges interest at between 10 and 20 per cent. Thus, Ghana's upper limit of 12.5 per cent exceeds the OECD Model's provision of 10 per cent, by 2.5 percentage points,<sup>336</sup> and Kenya's upper limit of 20 per cent exceeds the OECD Model's ceiling of 10 per cent, by 10 percentage points (i.e., the OECD Model's ceiling is Kenya's floor).

Therefore, in both Ghana and Kenya, unlike as provided for under the OECD Model, dividends and interest of PEs are treated as income of a resident entity, and are subject to tax. Furthermore, in both countries, the income and liability of a PE are

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<sup>333</sup> See *ITA Kenya*, *supra* note 20, s. 10; *ITA Ghana*, *supra* note 19, s. 6.

<sup>334</sup> The OCDMTC provides for dividends to be taxed between 5 and 15 percent, and Kenya taxes dividends between zero (Zambia) and 10 percent; See Articles 7, 10 & 11 of OECD Model Tax Convention.

<sup>334</sup> See *OECD Commentaries*, *supra* note 195 at 194-215.

<sup>335</sup> *Ibid.*

<sup>336</sup> *Ibid.*

differentiated from those its owner, but business arrangements between the two entities are recognised. Moreover, the net profit of a branch is deemed as repatriated profits, and subject to a final WHT as provided in Tables 2 and 4, for Ghana and Kenya, respectively.<sup>337</sup>

However, although DTAs and TSAs can be useful in attracting investment, and enhancing cooperation among tax administrations, especially in fighting international tax evasion,<sup>338</sup> caution must be exercised by both countries in signing such agreements. This is because the effectiveness of DTAs and TSAs may be skewed against both Ghana and Kenya, as developing or capital importing countries. DTAs and TSAs have been proved to be useful in some cases, and at the same time, detrimental in many cases, particularly, in developing countries.<sup>339</sup>

#### **A.5. Import duty exemption and reduced excise duty schemes**

The analysis shows that both Ghana and Kenya have interventions to increase the production of domestically manufactured goods as a means to steer the needed industrial growth. As such, there are no significant differences in tax incentives granted as import duty exemptions in the two countries. In both countries, there are incentive programmes targeting critical sectors including manufacturing, agro-processing, infrastructural development under a PPP framework.<sup>340</sup> General import duty exemptions for industrial and

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<sup>337</sup> *Ibid.*

<sup>338</sup> See *Oxfam*, *supra* note 7 at 33.

<sup>339</sup> See *Kim Brooks*, *supra* note 15 at 505; Dhammika Dharmapala and Céline Azémar, “Tax Sparing, FDI, and Foreign Aid: Evidence from Territorial Tax Reforms” (2016) Coase-Sandor Institute for Law and Economics Working Paper No. 758 at 1.

<sup>340</sup> See KPMG, “Budget Brief Kenya 2018 June 2018” (30 June 2018), online (pdf): KPMG <home.kpmg> [perma.cc/content/dam/kpmg/ke/pdf/tax/kenya-budget-brief-2018.pdf].



agricultural plant, machinery or equipment, or parts imported for investment purposes are granted to investors in both countries. Three input categories have been identified under import duty exemption schemes: first, raw materials, capital goods, agricultural inputs, certain medicines, and medical equipment; second, semi-finished goods, to be used as input in production; and third, finished products.<sup>341</sup>

In addition, in both countries, most machinery for manufacturing, and services relating to goods in transit, are fully exempt from VAT.<sup>342</sup> Also, VAT exemptions are provided for goods and services exported, and goods and services supplied for special zones operations, or use in agriculture, health and education.<sup>343</sup> However, all other imported finished goods attract VAT at the rate of 16 per cent in Kenya, and 17.5 per cent in Ghana.

Moreover, both Ghana and Kenya have special tax incentive schemes by which investors can negotiate for import duty exemptions for plant, machinery and equipment, and other concessionary tax treatments. For example, in Ghana, under the GIPC Act, an enterprise may apply for its plant, machinery, equipment or parts not exempted to be exempted from import duties and related charges.<sup>344</sup> Also, under the Minerals and Mining Act 2006, mining companies registered with the Minerals Commission can apply for import duty exemptions for mining equipment and machinery; under the Timber Resources

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<sup>341</sup> See ALN, “Investment Guide – Kenya” (31 December 2015), online (pdf): ALN <[www.africalegalnetwork.com/perma.cc/wp-content/uploads/2015/12/Kenya-Investment-Guide-2015.pdf](http://www.africalegalnetwork.com/perma.cc/wp-content/uploads/2015/12/Kenya-Investment-Guide-2015.pdf)>.

<sup>342</sup> See *VATA 2013 (Kenya)*, *supra* note 247, 1<sup>st</sup> Schedule.

<sup>343</sup> *Ibid*, Part A. See also KPMG, “Ghana - Indirect Tax Guide” (7 July 2019), online: KPMG <[home.kpmg/perma.cc/xx/en/home/insights/2019/03/ghana-indirect-tax-guide.html](http://home.kpmg/perma.cc/xx/en/home/insights/2019/03/ghana-indirect-tax-guide.html)>.

<sup>344</sup> See *Ghana Investment Promotion Centre Act, 2013 (Act 865)* (Ghana), s. 26(4); *Customs Act, 2015 (Act 891)* (Ghana), 3<sup>rd</sup> Schedule; *Internal Revenue Act, 2000 (Act 592)* (Ghana). *The VATA 1998 (Act 546)* (Ghana).

Management (Amendment) Act, 2002, forest plantations and wildlife developers can apply for import duties exemptions for plant, machinery and equipment. Similarly in Kenya, under the Finance Act, 2018, strategic entities operating under the special operating framework arrangement can negotiate for concessionary duty rates, special CIT rates, and other incentive packages.

However, in both countries, there is much skepticism about the level of monitoring, and it is unclear whether data on the entire range of negotiated incentives granted is kept and used for tax reporting purposes.<sup>345</sup> Additionally, the enabling Acts in both countries do not make any provision for reporting, monitoring or assessment of tax incentives granted to firms under the special schemes. And, in both cases, no regulation that makes provision to that effect has also been sighted.<sup>346</sup>

#### **A.6. Summary of the analysis**

Based on the analysis, it can be concluded that in both Ghana and Kenya there are apparent similarities in the tax incentive regimes – although there are differences in codification and classification of incentive provisions. This observation also applies generally across sub-Saharan African countries. There is a considerable degree of similarities in tax incentive provisions, tax administrative structures, and investment laws. In all the five categories of tax incentive identified for the study – namely: tax exemption

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<sup>345</sup> *Wilson & Bentum, supra* note 6 at 24-26.

<sup>346</sup> *Ibid.* See also *ITA Kenya, supra* note 20, s. 52; *The Finance Act, 2018, (Act No. 10 of 2018)* (Kenya), s. 11

and tax amnesty schemes; general reduced CIT rates; targeted reduction in the effective CIT rate; DTAs; and import duty exemption and reduced excise duty schemes – both countries have almost the same provisions, except slight variations in the duration and administration of each specific tax incentive.

For instance, each of the two countries offers tax exemption and tax amnesty schemes, with appropriate legislation providing for each scheme, and establishing institutions to administer them. Also, in both countries, tax exemptions are granted with the objective of promoting industrialization and facilitating exports. However, Kenya grants more concessions under this scheme than Ghana – which implies that Kenya may be in the position to attract more FDI, but stands a higher risk of revenue loss.

Further, although we should be concerned about the frequency – and the likely attendant risk of abuse – of amnesty schemes in both countries, it is worth noting that the objective of Kenya’s amnesty scheme appears novel and more ambitious, and may likely have more positive impact on FDI attraction than Ghana’s.<sup>347</sup>

Also, the analysis indicates that although the general CIT rate in Ghana is 25 per cent, and the general CIT rate in Kenya is 30 per cent for resident corporations, and 37.5 per cent for permanent establishments (PEs), in both countries, concessionary CIT rates are provide for entities in key priority sectors such as manufacturing and agriculture. However, Ghana’s tax incentive programme under this category appears more elaborately designed in favour of rural development than Kenya’s. That notwithstanding, Kenya’s tax

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<sup>347</sup> The scheme in Kenya is aimed at encouraging the repatriation of assets held or derived outside of Kenya. See Deloitte, Kenya Budget Insight 2016, The Story Behind the Numbers, [www2.deloitte.com/content/dam/Deloitte/ke/Documents/tax/Financial%20Insight.pdf](http://www2.deloitte.com/content/dam/Deloitte/ke/Documents/tax/Financial%20Insight.pdf) at 1.

incentives for the capital markets, may allow for less revenue loss than Ghana's – although the risk of revenue loss in both countries is still high.

Moreover, under targeted reduction in the effective CIT rate, Kenya is expected to attract more FDI than Ghana. This is because, even though both Ghana and Kenya grant deductions in priority sectors, Kenya offers more concessions in IDs and capital allowances.

In addition, both Ghana and Kenya have signed DTAs with other countries – Ghana has signed 12 DTAs, and Kenya has signed 14 DTAs. Also, as of 2016, Ghana had signed 2 TSAs with at least two OECD countries, and Kenya six.<sup>348</sup> In both countries, DTA provisions are applicable on dividends, interest, royalties, and management and professional fees. However, each of the two countries treats dividends and interest slightly different from the rule prescribed under the OECD Model.

Finally, both Ghana and Kenya provide import duty and VAT exemptions for most plant, machinery, and equipment in sectors such as, manufacturing, and the extractive industries. Also, both countries have special tax incentive schemes by which investors can negotiate for import duty exemptions for plant, machinery and equipment, and other concessionary tax treatments. However, in both countries, there is much skepticism about the level of monitoring, and it is unclear whether data on the entire range of negotiated incentives is kept or used for tax reporting purposes.<sup>349</sup> Also, the enabling Acts in both

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<sup>348</sup> See Céline Azéma & Dhammika Dharmapala, "Tax Sparing, FDI, and Foreign Aid: Evidence from Territorial Tax Reforms," Coase-Sandor Working Paper Series in Law and Economics, No. 758 (2016) at 1.

<sup>349</sup> *Wilson & Bentum*, *supra* note 6 at 24-26. See also *ITA Kenya*, *supra* note 20, s. 52; *The Finance Act, 2018*, (Act No. 10 of 2018) (Kenya), s. 11.

countries do not make any provision for reporting, monitoring or assessment of tax incentives under these special schemes.

## **B. RECOMMENDATIONS**

The study makes ten recommendations to enable effective and efficient use of tax incentives in sub-Saharan African countries. The recommendations are based on the results of the analysis, which emphasize the need for improving the efficiency and effectiveness of investment tax incentives in sub-Saharan African countries, to enhance transparency, accountability, and effective administration of tax incentives, to reduce associated costs and opportunity for abuse.

### **B.1. Ministry responsible for administering tax incentives.**

First, in order to protect the tax base, reduce the risk of revenue loss through tax incentives and secure national interest, it is recommendable that the Ministry of Finance, through the tax administration (which is responsible for raising revenue), should be responsible for administering tax incentives. Although it is advisable for all agencies concerned with implementing the tax incentives to be involved in the formulation of the incentive policy, as noted in chapter two, respective tasks should be well set out, and the incentive programme should be crafted to best fit their objectives.<sup>350</sup> This will help reduce the risk where one government body grants tax incentives without being responsible for

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<sup>350</sup> See A J Easson, *Tax incentives for foreign direct investment* (The Hague: Kluwer Law International, 2004) at 161. See also *Zolt*, *supra* note 3 at 1 [Easson].

balancing the revenue consequences. For instance, where the Investment Promotion Agency (which is not responsible for raising tax revenue) is administering tax incentives, it may be predisposed in granting tax incentives because it does not bear the associated risk of revenue loss.

The recommendation is to address the observation that although in both Ghana and Kenya, the operation of tax incentives is automatic, and the tax administration is largely responsible for granting tax incentives, in many other cases, other regulatory authorities are involved or are responsible for administering tax incentives.<sup>351</sup> In such cases, the tax administration does not have absolute responsibility or discretion in designing and administering tax incentive programmes. Different government agencies are involved in designing investment regimes, approving projects, and monitoring investments, including the Investment Promotion Agency, Ministry of Finance and Economic Planning, Export Processing / Free Zones Authority.<sup>352</sup> However, the major objective of these agencies is attracting investments – they are often less concerned about the risk of tax revenue loss or protecting the tax base. This often results in conflict of interests and priorities of the different governmental institutions.

## **B.2. Sunset clauses / termination of incentives**

Secondly, to allow for a specific time to assess the success and failure, the merits and demerits of tax incentives, and to reduce the potential costs of poorly designed

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<sup>351</sup> For example the grant of tax incentives for strategic investment under GIPC (see *GIPC Act 2013*, *supra* note 19, s 26); and the grant of tax incentives for entities under special operating framework in Kenya (see *The Finance Act, 2018, (Act No. 10 of 2018)* (Kenya), s. 11).

<sup>352</sup> See *Easson*, *supra* note 350 at 161.

incentive programmes, it is advisable that each incentive scheme contain a specific sunset provision as part of the original legislation. Designing incentive schemes that have provision for expiry will provide opportunity to assess whether the incentive has had the desired impact and should be continued or not. This will then be a basis for policy reform, or renegotiation of existing incentive provisions, and will help keep a balance between tax stability for existing investors and equal treatment for new ones. In the absence of sunset clauses and opportunities for review, tax incentive may become open-ended. For instance, tax holidays may more or less turn into permanent tax exemptions.<sup>353</sup>

This recommendation is based on the observation that in both Ghana and Kenya most of the investment laws contain sunset clauses for specific tax incentive provisions (e.g. tax holidays for a period of 3 -10 years, and concessionary CIT rates for 1-10 years); however, sunset clauses are not provided for other tax incentive schemes such as import and excise duty exemptions for plant and machinery; also, the incentive schemes as a whole do not have sunset or termination provisions to ensure their cessation and assessment of their impact on the economy. Furthermore, there are other investment laws that allow the operation of stability clauses as guarantee against undesirable changes and securing governments' commitment. This can create room for abuse and provide a discriminatory advantage for old firms over new ones, resulting in market inefficiencies.<sup>354</sup> For instance, firms can keep importing plant and machinery and inputs and diverting them to be sold on the market.

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<sup>353</sup> See *UN, 2018, supra* note 9 at 32; *OECD-MENA, supra* note 26 at 8; *IMF et al, supra* note 36 at 19, 29.

<sup>354</sup> *Ibid.*

### **B.3. Type of tax incentives to be granted**

Profit-based tax incentive schemes, particularly, tax holidays and reductions in the corporate tax rates, should be avoided. Instead, more cost-based tax incentives, such as investment credits and accelerated depreciation, should be used. The cost-based tax incentive should be designed within the scope of a realistic set of policy goals.<sup>355</sup> This is because research suggests that profit based tax incentives are less efficient and effective, and pose more administrative challenges when they are temporary (e.g. tax holidays), geographically confined (e.g. economic zones), and when they provide full tax exemption (as against concessionary CIT rates).<sup>356</sup>

Like many low-income countries, both Ghana and Kenya rely heavily on both profit-based tax incentive including, tax holidays, preferential tax rates, and tax credits; and cost-based tax incentives such as, accelerated depreciation and import duty exemptions, investment allowances, to attract investment. As noted in the review of literature, while cost-based tax incentives have been proven to be effective and less expensive for developing countries, profit-based incentives are ineffective and costly.<sup>357</sup> The disadvantage of profit-based tax incentives is that they are more attractive for firms with already high profits and short time horizons. Also, profit-based incentives can be easily abused through tax planning and profit shifting. On the other hand, cost-based tax

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<sup>355</sup> *Andersen, Kett & von Uexkull, supra* note 11 at 87.

<sup>356</sup> *Meinzer et al, supra* note 17 at 1.

<sup>357</sup> See Laura Abramovsky et al, “Are corporate tax incentives for investment fit for purpose? Revisiting economic principles and evidence from low- and middle-income countries” (26 March 2018), online: Institute for Fiscal Studies <[www.ifs.org.uk](http://www.ifs.org.uk)> [[perma.cc/publications/12875](http://perma.cc/publications/12875)] at 5-13 [Abramovsky et al].



incentives directly lower the cost of investment, and can be targeted more closely at policy objectives.<sup>358</sup>

#### **B.4. Type of industry / sectoral target / type of taxpayer**

To reduce the cost of tax incentives and help identify the types of investment that governments seek to attract,<sup>359</sup> tax incentives should not be offered broadly across all sectors – they must be restricted and targeted at investments with the most desirable objective, and most likely to be influenced by tax policy. Priority should be in targeting efficiency-seeking (low production cost) FDI such as research and development and investments that result in significant transfers of technology and infrastructural development. However, this must be complemented by efforts to address the fundamentals of the investment climate. The extractive industry, market-seeking investors, and relatively highly mobile and profitable activities such as, banking and financial services, should not be incentivized, or should have limited tax incentives schemes. Tax incentives for such investments are often redundant – they require further evaluation or total removal.<sup>360</sup>

Restriction and targeting of tax incentives is recommended based on the fact that tax incentives can be more effective in attracting efficiency-seeking FDI than market- and natural resource-seeking FDI. In spite of this, it was observed in the analysis that in both Ghana and Kenya tax incentives are not targeted specifically at these sectors – they are offered in almost every sector of the economy, from banking to manufacturing,

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<sup>358</sup> *Andersen, Kett & von Uexkull, supra* note 11 at 87.

<sup>359</sup> *Zolt, supra* note 3 at 1.

<sup>360</sup> *Andersen, Kett & von Uexkull, supra* note 11 at 73-88.

infrastructure, agriculture, hospitality, natural resource extraction. Although both countries claim that these sectors are key priority sectors, it can be noted that they are basically all sectors that may form the bigger part of the tax base. Also, tax incentives are not deliberately targeted, but rather are largely available to all investors – both foreign and domestic, existing and new.

However, because incentives do not compensate for shortcomings and are likely to succeed only if they are part of a broader strategy to address investment climate constraints, targeting efficiency-seeking FDI also requires that each country focus on creating a favourable overall investment climate.<sup>361</sup> Investors are less likely to respond to even the most generous incentives in the absence of a good investment climate, basic infrastructure, reasonable transport costs, and a sound policy framework toward investment. Macroeconomic stability and rule of law should be enhanced in order to correct market inefficiencies.<sup>362</sup> Other sectors with high spillover effects, such as manufacturing, and export-oriented investment, can then be targeted and incentivized.<sup>363</sup>

#### **B.5. Availability to both domestic and foreign investors**

In sectors where tax incentives should be granted, they should be designed to benefit both domestic and foreign investors. Equal treatment of investors is required because incentivizing, encouraging and promoting both foreign and domestic investors is

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<sup>361</sup> *Ibid.* Resource- or market-seeking investors are less likely to respond to tax incentives.

<sup>362</sup> See *IMF et al, supra* note 36 at 19, 29 at 3.

<sup>363</sup> Tax incentives targeted specifically at export-oriented investment tend to be more effective than most other forms of tax incentive, due to the higher degree of mobility of such investment. See *Zolt, supra* note 3 at 14-15.

a prudent strategy that can maximize the potential of investment and offer flexibility in directing investments for the benefit of national development.<sup>364</sup> It was noted in the analysis that in both Ghana and Kenya tax incentives are available to both foreign and local investors – this is a commendable practice that should be continued.

Restricting tax incentives to foreign or new investors can be ineffective or unproductive. It may create a disadvantage for local enterprises. Further, domestic investors, in order to meet foreign ownership requirements to qualify for incentives or take advantage of favourable tax treaty provisions, may seek to disguise their investments by channeling local investments through special foreign entities. Also, existing investors, in order to continue to benefit from the incentives, may register subsidiary entities to continue the same activity; or an existing business may be sold at the end of an incentive period to a new investor who may then be eligible for a new period of tax incentives.<sup>365</sup>

## **B.6. Tax amnesties**

Tax amnesties should not be granted. Rather than resort to frequent amnesty schemes, the tax administration in both Ghana and Kenya should improve upon monitoring and enforcement – compliance provisions in the tax laws must be enforced intelligently, but firmly.<sup>366</sup> It appears that in both countries the tax laws have the necessary provisions

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<sup>364</sup> See *UNCTAD 2000*, *supra* note 30 at 16; Hadari, *supra* note 73 at 139.

<sup>365</sup> Similar practices have occurred in a number of countries with economies in transition, especially in connection with the privatization of State-owned firms in which the existing management has acquired ownership of the firm through the vehicle of an offshore company. See *UN, 2018*, *supra* note 9 at 29.

<sup>366</sup> See Stanley S. Surrey, *Tax Administration in Underdeveloped Countries*, 12 U. Miami L. Rev. 158 (1958) at 175.

for effective enforcement, but the problem is the capacity and the will to do so. In any case, the legal obstacles to the tax administrations' access to taxpayer information must be addressed to encourage compliance, and the need to generate higher revenues through amnesty schemes should be evaluated against doing the same through enforcement.<sup>367</sup> While the most recent amnesty programme in Ghana was to encourage a voluntary compliance culture, and broaden and update the tax base, the amnesty programme in Kenya was to encourage voluntary repatriation of foreign-held assets, and facilitate the sharing of tax information under the CRS regime.<sup>368</sup>

While it may be expected that an amnesty programme may foster compliance and increase tax revenue collection, it is likely to be successful only when it is unanticipated.<sup>369</sup> Increasing the frequency of tax amnesties might not generate additional revenue, and may even weaken compliance because existing tax defaulters will continue to evade tax in anticipation of future amnesties, and compliant taxpayers will regard them as an unfair reward to tax evaders.<sup>370</sup>

Additionally, although amnesty programmes can help transition individual, small and medium taxpayers from operating in the shadows (or the informal) sector to the formal

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<sup>367</sup> According to Le Borgne & Baer (2008), Ireland's tax amnesty programs, especially the voluntary disclosure schemes, have had a positive impact on reducing noncompliance and on driving long-term revenue upward. Key to this success, however, was not the tax amnesty programs per se, but the much improved enforcement capacity that was developed prior to the launch of the programs. In many developing and transition countries, despite reforms undertaken to date, the legal framework for tax administration is deficient. See Eric Le Borgne & Katherine Baer, *Tax Amnesties: Theory, Trends, and Some Alternatives* (Washington, D.C.: IMF, 2008) at 6, 31, 49.

<sup>368</sup> See Tax Amnesty Act, 2017 (Act 955) (Ghana), s 1; The Finance Act, 2016 (No. 38 of 2016) (Kenya), s. 37B; RSM, "Kenyan Tax Amnesty FAQs" (18 February 2019), online: *RSM* <[www.rsm.global/perma.cc/kenyan-tax-amnesty-faqs-updated-february-2019](http://www.rsm.global/perma.cc/kenyan-tax-amnesty-faqs-updated-february-2019)>.

<sup>369</sup> See Pinaki Bose & Michael Jetter, "Liberalization and tax amnesty in a developing economy" (2012) 29:3 *EM* 761-765 at 761 [*Bose & Jetter*].

<sup>370</sup> See S. V. Junpath, M. S. E. Kharwa & L. J. Stainbank, "Taxpayers' attitudes towards tax amnesties and compliance in South Africa: an exploratory study" (2016) 30:2 *SAJAR* 97-119 at 97.

sector,<sup>371</sup> as typical in many developing countries, tax amnesties may be necessitated by fundamental weaknesses in the legal framework, and the management, and operations of the tax administration.<sup>372</sup> Under such circumstances, amnesties will rarely address the challenges in maximizing tax revenue. Prosecuting delinquents may then generate more revenue for the regulator than an amnesty programme.<sup>373</sup> Therefore, amnesty programmes should be stopped.

### **B.7. DTAs, including sparing agreements**

In order to curb the risk of DTAs restricting the right to tax FDI inflows,<sup>374</sup> and to ensure that revenues are realised to their full potential, review of some of the existing DTAs is needed, and general caution or circumspection is required in signing new DTAs or including DTAs in tax treaties.<sup>375</sup> It is further recommended that DTAs in the two countries must be designed to contain provisions that will limit reductions in WHT rates, and allow increased taxation of FDI inflows and other types of cross-border income.<sup>376</sup> Also, selective application of DTAs must be encouraged – that is, DTA provisions must apply only to

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<sup>371</sup> See Lisa Kayaga, *Tax Policy Challenges Facing Developing Countries: A Case Study of Uganda* (LLM Thesis, Queen's University, 2007) [unpublished] at 79.

<sup>372</sup> See Eric Le Borgne & Katherine Baer, *Tax Amnesties: Theory, Trends, and Some Alternatives* (Washington, D.C.: IMF, 2008) at 6, 31, 49.

<sup>373</sup> See *Bose & Jetter*, *supra* note 369.

<sup>374</sup> See Martin Hearson, "When Do Developing Countries Negotiate Away Their Corporate Tax Base?" 30 *JID* 233-255 at 1.

<sup>375</sup> See Evert-jan Quak & Hannah Timmis, "Double Taxation Agreements and Developing Countries" (2018) *IDS Helpdesk Report* at 1.

<sup>376</sup> *Ibid.*

companies that meet specific tests, such as having genuine presence and being tax compliant.<sup>377</sup>

Thirdly, it is recommended that both Ghana and Kenya consider developing or adopting model DTAs (with increased reserved right to tax incomes derived in their jurisdictions), and signing agreements on mutual assistance in tax matters.<sup>378</sup> It is also necessary that both countries take steps to strengthen the technical expertise of tax officials in treaty negotiation.<sup>379</sup>

The adoption of model DTAs is recommended based on the observation that both Ghana and Kenya have signed a number of bilateral investment treaties (BITs) and DTAs with other countries, based largely on the OECD MTC and the UN Model Double Taxation Convention (UN Model).<sup>380</sup> However, although DTAs can play a key role in international cooperation on tax issues, and encourage FDI by reducing tax barriers, facilitating the transfer of skills and technology, and reducing cross-border tax avoidance and evasion through exchange of tax information and mutual assistance, the risk of signing unbalanced DTAs appears significant in both Ghana and Kenya. In addition, it appears the two

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<sup>377</sup> *Ibid.*

<sup>378</sup> See AU/ECA Conference of Ministers of Finance, Planning and Economic Development, “Illicit Financial Flow” (2012) Report of the High Level Panel on Illicit Financial Flows from Africa, February 2012 at 59, 73, 81.

<sup>379</sup> See *United Nations Manual for the Negotiation of Bilateral Tax Treaties between Developed and Developing Countries* (UN: New York, 2016) at iv [*UN BIT Manual*].

<sup>380</sup> The key difference between the two Models is that the UN Model preserves a greater share of taxing rights for the source country, which is more advantageous for developing countries than the OECD Model. See Evert-jan Quak and Hannah Timmis, “Double Taxation Agreements and Developing Countries” (2018) IDS Helpdesk Report.

countries do not to have the requisite skills and experience to effectively negotiate and administer DTAs to encourage FDI and at same time protect their tax base.<sup>381</sup>

In most cases, apart from containing a number of loopholes, DTAs appear to be designed to benefit foreign investors more than the governments. For instance, DTAs are designed with unnecessary tax liability waivers and provisions that are harmful to domestic resource mobilization. This, coupled with the fact that both countries are net capital-importers, can limit their potential in preserving a greater share of taxing rights as source countries.<sup>382</sup>

#### **B.8. Determination of eligibility**

Clear, objective eligibility criteria for granting tax incentives, with as little discretion as possible, should be established. Also, tax incentives should be awarded to qualified investors based on the criteria set out in the law, rather than through a separate approval process.<sup>383</sup> Limiting granting of tax incentives within the confines of clearly spelt out provisions in the relevant legislation will enhance predictability for investors and reduce opportunities for rent-seeking and corruption. As noted earlier, one body – the MoFEP – should be responsible for the grant of tax incentives. The agency responsible for promoting and attracting investment should not also be responsible for granting or

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<sup>381</sup> See *UN BIT Manual*, *supra* note 379 at iv.

<sup>382</sup> *Ibid.* See also *Andersen, Kett & von Uexkull*, *supra* note 11 at 73.

<sup>383</sup> *Ibid.*

approving incentives. This will help avoid excessive cost associated with the grant of incentives, and enable the counter-balancing effects to be captured.<sup>384</sup>

Additionally, if tax incentives are to influence investor decisions, the use of discretion in granting tax incentives should be minimized. Where the use of discretion cannot be avoided, to promote transparency and consistency, the relevant legislation should set the general context within which the discretion may be exercised, the level that decision is taken, and the limits within which the discretionary authority may be exercised. For instance, a two-stage process involving minimum investment value and the exercise of discretion can be developed.<sup>385</sup>

Minimizing the use of discretion in granting tax incentives is recommended based on the observation that although in both Ghana and Kenya, tax incentives apply automatically,<sup>386</sup> in a few cases, investors have to apply for incentives to be granted. In Ghana, for example, strategic investments, and investment under special initiatives – the 1D1F, and the YEP – allow investors the right to apply for concessionary tax treatments. Similarly, in Kenya, under the Finance Act, 2018, entities under the special operating framework arrangement can negotiate for concessionary tax rates.

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<sup>384</sup> See *Easson*, *supra* note 350 at 161.

<sup>385</sup> *Ibid* at 164.

<sup>386</sup> Apart from business permits (such as registration, building, utility connection, regulatory permits) that may be required, granting incentives is part of the general approval or registration process – no special application or formal conferral of tax privileges is required. Exemption of import duties are claimed at the ports in accordance with the necessary legislation, and deductions are allowed at the point of filing of returns.



### **B.9. Protecting the tax base and preventing tax incentive abuse.**

To avoid conflict between foreign investment law and the general tax laws, and to prevent incentive overlap and opportunities for abuse by investors, it recommended that all tax measures should be consolidated in one legislation. Also, it is important that tax incentives are matched to their targeted objectives through ongoing monitoring and evaluation, to ascertain compliance with the conditions under which tax incentives are granted. This can help detect non-compliance and abuse – intentional or unintentional – and enhance predictability in the grant of tax incentives.<sup>387</sup> Also, the qualifying conditions for tax incentives must be clearly set out and in detail in the legislation to enable potential investors determine whether or not they qualify for the incentives, or what they have to do to qualify. The qualification rules should also be justiciable, so that an investor who is denied the benefit of an incentive can appeal against that decision.<sup>388</sup>

These measures are recommended in view of the abuses that have been reported in both Ghana and Kenya, and the fact that in both countries, granting tax incentives forms part of the liberalization of foreign investment, and tax incentive provisions are set out in several pieces of legislation, including the ITA and other FDI promoting laws.

### **B.10. Disclosure of cost to Parliament**

Finally, in order to determine the potential costs and benefits of tax incentives, and ensure proper accountability, transparency-enhancing reforms of tax incentives must be

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<sup>387</sup> See *Easson, supra* note 350 at 166.

<sup>388</sup> *Ibid* at 161.

undertaken.<sup>389</sup> Tax expenditure analysis should be undertaken, and reporting should be done by both taxpayers and tax authorities to parliament. This is because it has been noted that in both Ghana and Kenya, tax expenditure reporting is not a requirement, and is seldom carried out. But because the income tax law is an instrument to implement major social and economic policies, and because revenue losses are associated with tax incentive schemes, the development of tax expenditure budgets are required for tax incentive policies to be given a critical public scrutiny. Tax expenditure reporting must, therefore, become an integral part of the annual budget presentation.<sup>390</sup>

Reporting tax expenditures and disclosing information relating to them will provide a comprehensive overview of the means that government uses to implement economic, social and other policies, and how these policy objectives align with government spending. This information will enable legislators and other users of public financial information have access the purpose, effectiveness, the estimated fiscal cost, the method of estimation and projections, and legal references of tax incentives.<sup>391</sup>

The end is to enable policy makers to craft more efficient, equitable and administratively simple tax systems for raising maximum tax revenue. Reporting tax expenditures will also increase the value of democratic governance by promoting transparency through accountability in the allocation of public resources and distribution of tax burdens. This may require that the capacity of the relevant tax administration be

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<sup>389</sup> See *Andersen, Kett & von Uexkull*, *supra* note 11 at 73.

<sup>390</sup> Neil Brooks, "The Tax Expenditure Concept" (1979) 1 CT 31-35 at 31.

<sup>391</sup>See Canada, Auditor General, Victoria, B.C., *Understanding Tax Expenditures 2018* <[www.bcauditor.com](http://www.bcauditor.com)> [perma.cc/site at 3-7]. at 3-7; Canada, Department of Finance, Report on Federal Tax Expenditures - Concepts, Estimates and Evaluations 2019, <[www.fin.gc.ca](http://www.fin.gc.ca)> [perma.cc/taxexp-depfisc/2019/taxexp1901-eng.asp].

enhanced for there may not be much value in designing a complex system and the relevant authorities lack the requisite capacity to implement it.<sup>392</sup>

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<sup>392</sup> See Lisa Philipps, “The Globalization of Tax Expenditure Reporting: Transplanting Transparency in India and the Global South” (2012) Comparative Research in Law & Political Economy Research Paper No. 43/2012 at 1.

## CHAPTER 6 CONCLUSION

The study analysed the tax incentive regime for promoting and attracting FDI in sub-Saharan African countries, using Ghana and Kenya as a case study. The purpose was to provide tax policy makers, academics, and administrators in sub-Saharan African countries with a pragmatic and easy-to-implement approach to the design, administration and assessment tax incentive programmes in order to achieve the objective of attracting FDI, and at the same time maximize domestic revenue mobilization. This will enhance efficiency and effectiveness in the use of tax incentives in these countries.<sup>393</sup>

The use of tax incentives in sub-Saharan African countries threatens domestic revenue mobilization and poses a challenge to sustainable development. Although tax incentives have the potential to attract FDI, and have been successful in other jurisdictions, in sub-Saharan Africa, empirical evidence of the impact of tax incentives indicates that Saharan African countries are offering overly generous tax incentives and foregoing much needed revenue for development. Not only have tax incentives been inefficient and ineffective, but also tax incentives have been abused. In many cases, tax incentives have provided opportunity for rent-seeking and corruption.

The study aimed to find a solution to the inefficient and ineffective use of tax incentives in sub-Saharan Africa countries to attract FDI. It looked at the research question of how Saharan African countries can improve upon the effectiveness of tax incentives in order to increase FDI inflows and at the same time maximize tax revenue collection. In other words, how can Saharan African countries best design their tax incentives to achieve

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<sup>393</sup> *Meinzer et al, supra* note 17 at 4; Jasna Bogovac, “The Paradox of Tax Incentives in Developing Countries” (9 January 2017), online: *Researchgate* <[www.researchgate.net](http://www.researchgate.net)> at 1.

the objective of attracting FDI, but minimize the risk of revenue loss through the use of tax incentives?

In order to answer this question, the study conducted theoretical and empirical assessment of the tax incentive regimes in Saharan African countries, using Ghana and Kenya as case studies. To allow for the determination of the relative effectiveness of tax incentive programmes in the two countries, the study compared the tax incentive regimes of the two countries, benchmarking them with theoretical standard design and best practice in other jurisdictions.

The study found that tax incentives in Saharan African countries are not well designed and administered, and recommended legislative and administrative reforms aimed at improving tax incentive design. The study further recommended that the objective of attracting FDI must be well balanced with the need to maximize tax revenue. Also, tax incentives should be targeted at efficiency-seeking FDI and not market- or natural resource-seeking FDI. Finally, tax incentive programmes must be designed and administered in a manner that will promote accountability and transparency of tax incentives budgets, and ensure general tax expenditure analysis and assessment.

The study also found that tax incentives are ineffective in promoting FDI in developing countries (particularly, African countries) because of poor investment climate, and poor design of tax incentives. Furthermore, the study found that developing countries continue to grant tax incentives due to five main factors: pressure to counterbalance the poor investment climate; response to competitive pressures such as, lobbying from TNCs; reliance on successful examples; non-involvement of the expenditure of funds in the use

of tax incentives; familiarity with the use of fiscal incentives; and the general global use of tax incentives to attract FDI.

The thesis was presented in six chapters. Chapter 1 provided an introduction and theoretical background. It offered an outline of the general framework of the study, and set the bounds within which the study would be conducted, including the significance of the study, the methodology and the limitations. Chapter 2 reviewed the literature on the subject-matter. It identified contemporary scholarly and policy debates, and reviewed the ways that the literature suggests developing countries can maximize the benefits from using tax incentives. It also underscored the challenge of defining tax incentives, and delineating tax incentives from the general tax system.

Three different definitions of tax incentives were considered: tax incentives as special tax provisions which are a favourable deviation from the general tax laws, granted to selected investment projects or firms; tax incentives as policies that provide for a more favourable tax treatment of some enterprises or sectors as against what is available to the general industry; and tax incentives as a system of tax expenditures under which governmental financial assistance programs are carried out through special tax provisions, as against the provisions of the ITA (or any other tax legislation). Also, the need to distinguish tax incentives from broader non-discriminatory fiscal incentives, such as, general infrastructure development, the general legal regime for FDI and business, including investment guarantees was noted.<sup>394</sup>

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<sup>394</sup> See *UNCTAD 2000*, *supra* note 30 at 11-12.

In addition, six basic designs of tax incentives were discussed including tax holidays, accelerated depreciation, special size or scale tax incentives, special sectors, and special regions or zones.<sup>395</sup> It was noted that in order to reduce the opportunity for corruption and abuse of tax incentives, they should be coherent, simple, and transparent so that their objectives and effect can be easily evaluated.<sup>396</sup>

Furthermore, evidence of the effectiveness of tax incentives in developed and developing countries was considered. Tax incentives work for certain kinds of investments, in certain situations, and in certain sectors, across all jurisdictions.<sup>397</sup> However, tax incentives of the type offered by developed countries appear to be more effective than the types of tax incentives offered by developing and transition economies, which were more likely to result in revenue sacrifice than increased FDI.

Moreover, some of the measures that developing countries can adopt to ensure efficient and effective use of tax incentives were discussed, including setting clear objectives, having consolidated legislation, ensuring diligent record keeping, setting compliance conditions, limiting the duration of FDI, and improving the investment climate.<sup>398</sup> It was also noted that, tax incentives should be designed to be of benefit to both domestic and foreign investors. This is because both domestic and foreign investors are equally likely to feel the distortionary and other adverse impacts of tax incentive policies; tax incentives can play a useful role in encouraging both domestic and foreign investment;

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<sup>395</sup> See *Ayangbah & Sun*, *supra* note 37 at 5.

<sup>396</sup> See *Forstater*, *supra* note 48.

<sup>397</sup> James (2014) asserts that there is much greater use of tax incentives for research and development in OECD, East Asia and Pacific countries; the use of tax and duty exemptions in SEZs is quite popular across all the regions; and super-deductions (where deductions are allowed for more than actual expenses) is most prevalent in South Asia. See *James*, *supra* note 75 at 1-15.

<sup>398</sup> See *IMF et al*, *supra* note 36 at 23-24.

local investors are likely to venture into risky, long-term investment (with higher linkage effects), compared foreign investors;<sup>399</sup> and both domestic and foreign investments can complement each other.

In chapter 3, the tax incentive regime for the promotion, attraction and facilitation of FDI in Ghana was discussed. It was noted that the main FDI regulatory framework in Ghana is the GIPC Act, 2013 (Act 865) (GIPC Act),<sup>400</sup> under which the GIPC is established as the main administrative body to regulate all aspects of FDI, except in minerals and mining, oil and gas, and FZs. It was also noted that Ghana pursued economic liberalization in 1983,<sup>401</sup> and introduced a number of investment incentives. Ghana offers tax incentives, including concessionary tax provisions, tax holidays, capital/investment allowances, locational incentives and customs duty exemptions, tax credits, preferential rates, and other inducements and benefits, intended to entice investors,<sup>402</sup> but the effects of FDI in Ghana have been undulating, and, therefore, there is still room for Ghana to improve its FDI trend.<sup>403</sup>

Furthermore, the main legal framework on tax incentives available in Ghana was discussed, including, the ITA, 2015 (Act 896), the GIPC Act, 2013 (Act 865), the FZA, 1995 (Act 405), the Minerals and Mining Act, 2006 (Act 703), Minerals and the Mining Act, 2010 (Act 794).<sup>404</sup> The major tax incentives were discussed under five broad headings:

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<sup>399</sup> See *Morisset & Pirnia*, *supra* note at 14.

<sup>400</sup> *Ibid.*

<sup>401</sup> See *UNCTAD 2003*, *supra* note 131 at 3. See also *Obeng*, *supra* note 131 at 2.

<sup>402</sup> See IMF, “Ghana Fifth and Sixth Reviews under the Extended Credit Facility, Request for Waivers for Nonobservance of Performance Criteria, and Request for Modification of Performance Criteria” (2018) IMF Country Report No. 18/113 at 5 [*IMF 2018*].

<sup>403</sup> See *UNCTAD 2003*, *supra* note 131 at 21.

<sup>404</sup> See *ITA Ghana*, *supra* note 19; *GIPC Act 2013*, *supra* note 19; *Free Zone Act*, *supra* note 19; *Minerals and Mining Act, 2006 (Act 703)* (Ghana); *Minerals and the Mining Act, 2010 (Act 794)* (Ghana).



tax exemptions and tax amnesty, general reduction in the CIT rates, targeted reduction in the effective CIT rate, DTA, and import duty exemptions.

The chapter concluded with an evaluation of the effectiveness of FDI in Ghana in the mining industry and the FZs for the period 2008-15, drawing on two major studies – one conducted by Actionaid International in 2015, and the other Prichard and Bentum (2009).<sup>405</sup> The impact of tax incentives on the two sectors has not been desirable.

Chapter 4 discussed the tax incentive regime for the promotion, attraction and facilitation of FDI in Kenya. It provided an overview of the legal framework or the regulatory regime of investment in the country, and noted that the major legislation for regulating and promoting FDI in Kenya is the IPA, 2004,<sup>406</sup> under which the KIA was established as the lead institution in the promotion and facilitation of investment in Kenya.<sup>407</sup>

The chapter also discussed the history of efforts to attract FDI in Kenya for the period 1963-2017. It noted that as in most developing African countries, Kenya's FDI flows have been subject to high volatilities, starting with less optimism about the benefits of free trade and investment at independence in 1963. The chapter also indicated that beginning in the 1970s through to the period 2010-2016 there has been alternation of periods of rise and fall. Policy reforms, including the adoption of strategy on PPPs, restored investor confidence, causing FDI inflows to rise from USD 681.325 (in 2016) to a high of

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<sup>405</sup> See *Tax Justice Network-Africa*, *supra* note 6 at 1-20; *Wilson & Bentum*, *supra* note 6 at 24-26.

<sup>406</sup> See *IPA*, *supra* note 20; *Kenya Vision 2030*, *supra* note 218.

<sup>407</sup> *Ibid.*

USD 1.625 billion in 2018.<sup>408</sup> The analysis projected that Kenya could keep the growing trend for the period 2018-20, but would have to enhance the investment climate through further reforms, good governance, and improved security and infrastructure.

Furthermore, the framework of the tax incentives in Kenya was discussed. We observed that Kenya offers a wide range of tax incentives to attract FDI, through enactments such as, the ITA, the IPA, the EPZA, the SPZA, the VATA, 2013, Finance Act, 2018, and the Nairobi International Financial Centre, 2017.<sup>409</sup> These incentives, including tax exemptions, reduction in CIT rates, investment allowances, accelerated depreciation, special zones, and indirect tax incentives, capital deductions, industrial deductions, and farm work deductions were also discussed under five broad headings: tax exemptions and tax amnesty, general reduction in the CIT rates, targeted reduction in the effective CIT rate, DTA, and import duty exemptions.

The chapter concluded by assessing the potential effectiveness of the tax incentives offered in Kenya, drawing on studies by the Institute of Economic Affairs, Kenya, (2012); Tax Justice Network-Africa and ActionAid International (2012); and Mutua and Muya (2013). It argued that, as in many other developing African countries, tax incentives have not had the desired impact on the Kenyan economy – they have rather resulted in revenue leakage than in inducing investment.<sup>410</sup> It was suggested that Kenya focus on improving

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<sup>408</sup> See *CEIC Data*, *supra* note 241; See Colin Poulton and Karuti Kanyinga, “The Politics of Revitalising Agriculture in Kenya” (2014) 32:S2 DPR 151-172 at 1.

<sup>409</sup> See *ITA Kenya*, *supra* note 20; *IPA*, *supra* note 20; *EPZA*, *supra* note 20; *SEZA*, *supra* note 20; *VATA 2013 (Kenya)*, *supra* note 247; *Finance Act, 2018 (Act No. 10 of 2018)* (Kenya); *Nairobi International Financial Centre, 2017 (No. 25 of 2017)* (Kenya); *The Customs and Excise Act, 1978 (No. 13 of 1978)* (Kenya).

<sup>410</sup> See IEA Kenya, “Tax Incentives and exemption regime in Kenya: Is it working?” (2012) 30 TBF 1 at 1; John Mutua and John Mutua & Raphael Muya, “Tax incentives and exemption regime in Kenya: Is it working?” (11 May 2013), online: *The East African* <[www.theeastafrican.co.ke](http://www.theeastafrican.co.ke)>; Tax Justice Network-Africa and ActionAid International, “Tax competition in East Africa: A race to the bottom? Tax incentives

the investment fundamentals, and maximizing efficient tax collection rather than offering tax incentives.

Chapter 5 analysed the tax incentive schemes in Ghana and Kenya. It concluded that there are apparent similarities in the tax incentive regimes in both Ghana and Kenya, although there are differences in codification and classification of incentive provisions. It also revealed a considerable degree of similarities in tax administrative structures, investment laws, and tax incentive provisions. In all the five categories of tax incentive identified for the study – namely: tax exemption and tax amnesty schemes; general reduced CIT rates; targeted reduction in the effective CIT rate; DTAs; and import duty exemption and reduced excise duty schemes – both countries have almost the same provisions, except slight variations in the duration and administration of the incentive.

Based on the analysis, we observed that in both Ghana and Kenya (and for that matter sub-Saharan African countries) there is the need for improving the efficiency and effectiveness of investment tax incentives – through carefully designed, and well-administered schemes – to ensure transparency, accountability, reduce associated costs, and check abuse. Ten recommendations were made to enable effective and efficient use of tax incentives in the two countries, and sub-Saharan Africa in general. These recommendations are summarized as follows.

First, tax incentives schemes should be designed to achieve clarity in objective and purpose, and there should be consensus among stakeholders regarding their general fitness for purpose. In most cases, investment would have been undertaken even without the grant

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and revenue losses in Kenya” (30 May 2012), online (*pdf*): *Tax Justice Network* <[www.taxjustice.net](http://www.taxjustice.net)> [perma.cc/cms/upload/pdf/kenya\_report\_full.pdf] at IV, 7.

of tax incentives.<sup>411</sup> Second, tax incentives should be targeted at sectors geared toward export and mobile capital – these appear to be relatively effective – and not at sectors producing for domestic markets or extractive industries – these generally have little impact. Third, enabling conditions such as, good infrastructure, macroeconomic stability, rule of law, should be enhanced. These are important for tax incentives to be effective and efficient.

Fourth, there is the need to improve transparency in order to facilitate accountability, and reduce the potential for rent seeking and corruption. This requires that tax incentives be subject to parliamentary approval, be consolidated under the tax law, and reviewed annually as part of a tax-expenditure budget. This will reduce their fiscal costs. Fifth, the approval process of tax incentives should be consolidated ultimately under the authority of the Minister of Finance and Economic Planning, to be enforced and monitored by the tax authorities. As much as possible, the granting of tax incentives should not be based on discretion, but on the application of rules and procedures.<sup>412</sup>

Finally, tax incentives schemes should be simple and uniform, rather than discriminatory. In all cases, the minimal use of tax incentives is advised – cost-based incentives such as, accelerated depreciation, are more likely to be effective than tax profit-based incentives such as, tax holidays.

Chapter 6 provides the summary and conclusion of the study. Similar conclusions apply to both Ghana and Kenya – that since it has been established that not only are tax incentives not needed to attract FDI, but also that tax incentives have resulted in large

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<sup>411</sup> See *Andersen, Kett & von Uexkull*, *supra* note 11 at 87.

<sup>412</sup> See *IMF et al*, *supra* note 36 at 1.

revenue losses, and that the use of tax incentives has in recent years attracted very low levels of FDI, it is important that both countries review their tax incentive regimes. For Ghana, it is suggested that the real FDI attraction advantage may not be in just granting tax incentives to transnational corporations. Ghana may have to minimize the use of tax incentives, and focus on creating an enabling investment environment through measures such as, good governance, the rule of law, prudent macroeconomic management, and investment in infrastructure and training. Perhaps, these, coupled with tax incentive schemes may be enough to attract investment to the desired levels.<sup>413</sup>

Likewise, Kenya must focus on improving the investment fundamentals. It is suggested that factors, including security, good governance, infrastructure, respect for the rule of law, and openness to trade,<sup>414</sup> must be given critical attention, as opposed to the use of tax incentives, which is likely to result in further distortions in the tax system, large administrative costs, rent-seeking and corruption.<sup>415</sup> An alternative approach is for the Kenyan government to maximize efficient tax collection, and use part of the revenue to offer financial incentives through direct expenditures.<sup>416</sup>

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<sup>413</sup> *Wilson & Bentum, supra* note 6.

<sup>414</sup> Many Anza Rhodah, *Determinants of Foreign Direct Investment in Kenya (1970 - 2009)* (M.A. Thesis, Kenyatta University, 2012) [unpublished] at 16, 22, 121.

<sup>415</sup> See John Mutua & Raphael Muya, "Tax incentives and exemption regime in Kenya: Is it working?" (11 May 2013), online: *The East African* <[www.theeastafrican.co.ke](http://www.theeastafrican.co.ke)> at 1.

<sup>416</sup> IEA Kenya, "Tax Incentives and exemption regime in Kenya: Is it working?" (2012) 30 TBF 1-5 at 2.

## Final Reflections

The potential for growth in both Ghana and Kenya is great, and the prospects are high. FDI remains a crucial source of external financing, and can play a key role in the overall development process, by augmenting domestic revenue mobilization. The impact of FDI can be great if well-harnessed in the financing and delivery of infrastructural services.<sup>417</sup> The state of infrastructure has been one of the key inhibiting factors to growth and development, and in turn, FDI flows. FDI can be leveraged into bridging the existing infrastructural gap in critical sectors, such as transport (road, rail and inland water) and energy, particularly through PPP arrangements. Attention must also be on attracting efficiency-seeking investment that will facilitate technology spillovers, and enhance local capacity in the manufacturing and extractive industries (minerals and oil).

Tax incentives can be more effective in attracting FDI when combined with other non-tax factors that create an enabling climate for private investment, such as a strong policy environment, and efficient and effective administration.<sup>418</sup> Policy measures to maximize the advantages of FDI must clearly envision FDI into the overall development strategy. Tax incentive schemes must be within a well-designed policy framework, and supported by principles of independence and objectivity, responsibility and transparency, and technical excellence.<sup>419</sup>

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<sup>417</sup> See Tony Addison and George Mavrotas, “Foreign Direct Investment, Innovative Sources of Development Finance and Domestic Resource Mobilization” (2004) Revised Draft Paper for UNU-WIDER Global Economic Agenda – Helsinki Process on Globalisation and Democracy Track II at 1.

<sup>418</sup> See Simon Munongo, Olusegun Ayo Akanbi and Zurika Robinson, “Do tax incentives matter for investment? A literature review” (2017) 13:2 BEH 152-168 at 152; Paul Kamau, “Government Policy and Foreign Investment in Kenya” (13 November 2014), online (pdf): Include Platform <includeplatform.net> [perma.cc/wp-content/uploads/2014/12/KamauGovernmentPolicyAndForeignInvestmentInKenya.pdf].

<sup>419</sup> See Daniel Darlington Kwaku Aheto, *The Role of Foreign Direct Investment in Ghana’s Infrastructure Development* (MA Thesis, University of Ghana, 2014) [unpublished] at xii.

Given the substantial need for additional revenue in both countries, domestic revenue mobilization should receive a new momentum to play a pivotal role in complementing FDI. An effective and efficient tax incentive regime should result in attracting more FDI, which in turn should boost tax revenue performance. Strong political will is required to build a fairer, and a less corrupt tax system that effectively limits incentives and opportunities for rent-seeking to spearhead development.<sup>420</sup>

Both Ghana and Kenya must improve the taxation of natural resources, and scale back preferential treatments in the sector. A sustainably credible and a potentially conducive tax regime is required in the natural resource sector. An efficient natural resource incentive regime must complement other initiatives to ensure effective management of the sector for a win-win outcome for both investors and governments. Granting exemptions or preferences in the natural resource sector that are not available under the standard fiscal regime should be avoided, and tax expenditure and policy analysis must be regularly undertaken.

There should also be strong capacity building through international cooperation and regional integration in tax policy and administration for the sustainable management of natural resources. Designing an effective incentive regime for the natural resource sector poses a particular challenge because investments involve high initial costs, investors are normally TNCs capable of sophisticated tax planning, and the resources by their nature are

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<sup>420</sup> A common element of success stories is sustained political commitment at the highest levels. See IMF Fiscal Affairs Department, *Revenue Mobilization in Developing Countries* (8 March 2011), online (pdf): *IMF* <[www.imf.org](http://www.imf.org)> [perma.cc/external/np/pp/eng/2011/030811.pdf] at 4-5, 76; James O. Alabede, “How Does Tax Revenue Respond to Financial Inflow from FDI and Aid?: Panel Evidence from West African Sub-Region” (1 September 2016), online (pdf): *ResearchGate* <[www.researchgate.net](http://www.researchgate.net)> [perma.cc/publication/264823946\_Tax\_revenue\_effect\_of\_foreign\_direct\_investment\_in\_West\_Africa] at 1.

depletable.<sup>421</sup> To effectively tax this sector, governments must encourage investor credibility, and ensure equitable sharing of risks and returns between them and investors. State interest must include a combination of royalties and progressive profit-based taxes that are effectively monitored and evaluated. Royalties can pass additional risks to investors (who may be in a better position to take corrective measures than governments), and profit-sensitive taxes can ensure that governments get a fairer share of the rents.<sup>422</sup>

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<sup>421</sup> See IMF Fiscal Affairs Department, Revenue Mobilization in Developing Countries (8 March 2011), online (pdf): *IMF* <[www.imf.org](http://www.imf.org)> [[perma.cc/external/np/pp/eng/2011/030811.pdf](http://perma.cc/external/np/pp/eng/2011/030811.pdf)] at 4-5, 76.

<sup>422</sup> *Ibid.*



Table 1 Tax rates applicable under DTAs in Ghana

Country	Dividends (where the recipient holds at least 10% of shares) %	Dividend (in any other case) %	Royalties %	Technical or management service fee %	Interest %
France	7.50	15.00	12.50	10.00	12.50
United Kingdom	7.50	15.00	12.50	10.00	12.50
Germany	5.00	15.00	8.00	8.00	10.00
South Africa	5.00	15.00	10.00	10.00	10.0 (5.0 for non-resident banks)
Belgium	5.00	15.00	10.00	10.00	10.00
Italy	5.00	15.00	10.00	10.00	10.00
The Netherlands	5.00	10.00	8.00	8.00	8.00
Switzerland	5.00	15.00	8.00	8.00	10.00
Czech Republic	6.00	6.00	8.00	8.00	10.00
Denmark	5.00	15.00	8.00	8.00	8.00
Singapore	7.00	7.00	7.00	10.00	7.00
Mauritius	7.00	7.00	8.00	10.00	7.00
The DTA with Czech Republic is yet to be ratified.					
Source: ww.pwc.com.					

Table 2 WHT rates applicable in Ghana

Payment	Rate
Dividends	8.00
Royalties, natural resources payments and rents	15.00
Management and technical service fees	20.00
Goods, works or any services	20.00
Repatriated branch after-tax profits	8.00
Interest income (excluding individuals)	8.00
General insurance premiums	5.00
Income from telecommunication and transportation business	15.00
Payments to petroleum subcontractors	15.00
Source: ww.pwc.com.	

Table 3 Tax rates applicable under DTAs in Kenya

<b>Payee Residence</b>	<b>Dividends</b>	<b>Interest</b>	<b>Royalties</b>	<b>Management and professional fees</b>
	<b>%</b>	<b>%</b>	<b>%</b>	<b>%</b>
Canada	10.00	15.00	15.00	15.00
Denmark	10.00	20.00	20.00	20.00
France	10.00	12.00	10.00	20.00
Germany	10.00	15.00	15.00	15.00
India	10.00	10.00	10.00	10.00
Norway	10.00	15.00	20.00	20.00
Sweden	10.00	15.00	20.00	20.00
United Kingdom	10.00	15.00	15.00	12.50
Zambia	-	15.00	15.00	15.00
South Africa	10.00	10.00	10.00	20.00
Qatar	10.00	10.00	10.00	20.00
UAE	5.00	10.00	10.00	20.00
South Korea	10.00	12.00	10.00	20.00
Where the treaty rate is higher than the non-treaty rate, the lower rate applies.				
Source: EY Kenya Tax Guide 2019.				

Table 4 WHT rates applicable in Kenya

Payment / Withholding Tax	Resident	Non-resident
	%	%
Dividends - Housing Bonds	5.00	10.00
Dividends - Government bearer bonds	10.00	15.00
Dividends - Other sources	15.00	15.00
Deemed interest	15.00	15.00
	-	15.00
Commission on insurance brokerage	5.00	20.00
Commission on other activities	10.00	20.00
Royalties	5.00	20.00
Management, professional, and training fees	3.00	20.00
Contractual fees	10.00	30.00
Real estate rent	10.00	30.00
Telecommunication service fees	-	5.00
Lease of equipment	-	15.00
Services of a petroleum or mining service-subcontractor with no PE	-	5.63
Transfer of a petroleum or mining interest	10.00	20.00
Natural resource income	5.00	20.00
Pension and retirement annuities	0-30	5.00
Sporting or entertainment income	-	20.00
Winnings	20.00	20.00
Demurrage charges	-	20.00
Insurance premiums	-	5.00
Source: EY Kenya Tax Guide 2019.		

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