THE EFFECT OF TAX INCENTIVES AND TAX HOLIDAYS ON FOREIGN DIRECT INVESTMENT (F.D.I) IN THE OIL AND GAS SECTOR OF UGANDA

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MAY, 2023

DECLARATION

I, Akoko Patrick Synclaire, declare that this thesis is my own original work and that it has not been presented and will not be presented to any other University for similar or any other degree award

Sign……………………………………….

Date……………………………………….

APPROVAL

I, the undersigned, certify that I have read and here by recommend for acceptance by Institute of petroleum studies Kampala a dissertation titled *"The Effect of Tax Incentives and Tax Holidays on*

Foreign Direct Investment (F.D.I) In the Oil and Gas Sector of Uganda" in fulfillment of the requirements for the award of the Master's Degree in Law Oil and Gas of Institute of petroleum studies Kampala

MR. MUGABI IVAN

Sign:

Date: 10/May/2023

DEDICATION

This research work is dedicated to my family whose company I missed during the undertaking of this programme.

ACKNOWLEDGEMENT.

I thank the Almighty God, the source of knowledge and wisdom for having seen me through my studies, having been able to fund my education and enabling me to undertake my research successfully.

I extend my deep appreciation to my supervisor Mugabi Ivan for his full support, guidance and advice provided during the study that made it possible for me to successfully complete this report.

May Almighty Lord bless you abundantly!

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LIST OF ACRONYMS

EAC East African Community

FDI Foreign Direct Investment

GDP Gross Domestic Product

IMF International Monetary Fund

MNC Multi-National Corporations

MNE Multinational Enterprise

OECD Organization for Economic Cooperation and Development

PSFU Private Sector Foundation Uganda

TNC Transnational Corporations

UIA Uganda Investment Authority

UNCTAD United Nations Conference on Trade and Development

USD United States Dollar

Abstract

Foreign Direct Investment (FDI) plays a crucial role in the development and growth of economies, particularly in the oil and gas sector. To attract FDI, countries often offer tax incentives and tax holidays as part of their investment promotion strategies. This study aims to examine the effect of tax incentives and tax holidays on FDI in the oil and gas sector of Uganda.

The research adopts a quantitative approach and utilizes panel data analysis, covering the period from 2010 to 2022. The study employs regression models to assess the relationship between tax incentives, tax holidays, and FDI inflows into Uganda's oil and gas sector. Control variables such as GDP growth, political stability, infrastructure development, and resource availability are included to capture their potential influence on FDI.

Preliminary findings suggest that tax incentives and tax holidays have a positive impact on FDI in the oil and gas sector of Uganda. The analysis reveals a significant correlation between tax incentives, tax holidays, and increased FDI inflows. The findings indicate that these fiscal policies enhance the attractiveness of Uganda's oil and gas sector to foreign investors, leading to higher levels of FDI.

Furthermore, the study explores the mechanisms through which tax incentives and tax holidays stimulate FDI. It examines the role of reduced tax burdens, accelerated depreciation allowances, and exemptions on corporate taxes in incentivizing foreign investors. The research also investigates the impact of stability and predictability in the tax regime on FDI inflows.

The study's implications suggest that the Ugandan government should consider maintaining and improving its tax incentive and tax holiday framework to attract more FDI into the oil and gas sector. Policy recommendations include streamlining the tax system, ensuring transparency and stability in tax regulations, and aligning tax incentives with sector-specific goals and development plans.

This research contributes to the literature on FDI and tax policies in the context of developing economies, specifically focusing on Uganda's oil and gas sector. The findings provide valuable insights for policymakers, investors, and scholars interested in understanding the dynamics of FDI attraction and the role of tax incentives in stimulating investments in the oil and gas industry.

CHAPTER ONE
INTRODUCTION

1.1: Introduction

FDI is crucial for the energy sector, particularly in capital-intensive projects, due to the significant financial requirements involved. Energy projects, such as oil and gas exploration, development of power plants, and renewable energy installations, typically demand substantial upfront investments, infrastructure development, and technological advancements. However, host governments often lack the necessary financial resources to undertake these projects on their own. Hence, FDI becomes a vital source of capital to meet the funding gap and facilitate the development of the energy sector.

Firstly, energy projects require extensive capital investments in infrastructure development, including pipelines, refineries, power transmission lines, and distribution networks. These infrastructure components are often expensive and require specialized knowledge and technology, making them financially burdensome for host governments. FDI brings in the necessary financial resources and expertise to construct and maintain these infrastructure networks, thereby enabling the efficient and effective functioning of the energy sector.

Secondly, the exploration and production of energy resources, such as oil and gas reserves, demand substantial investments in drilling operations, extraction technologies, and processing facilities. These projects involve high risks and uncertainties, making them less attractive to domestic investors who may have limited experience or risk appetite. FDI from international companies with expertise in energy exploration and production provides the necessary financial backing and technical know-how to mitigate risks and optimize resource extraction, leading to increased efficiency and productivity in the energy sector.

Thirdly, renewable energy projects, such as solar, wind, and hydroelectric power, often require significant capital investments in equipment, installation, and grid integration. These projects contribute to sustainable development and environmental conservation but necessitate substantial funding that may surpass the financial capabilities of host governments. FDI plays a critical role in financing renewable energy projects, enabling the adoption of cleaner and more sustainable energy sources, reducing dependence on fossil fuels, and addressing environmental concerns.

Additionally, FDI brings several benefits beyond capital infusion. Foreign investors often introduce advanced technologies, managerial expertise, and best practices in the energy sector, enhancing operational efficiency, productivity, and safety standards. They also facilitate knowledge transfer and skill development through training programs, creating employment opportunities and fostering human capital development in the host country. Moreover, FDI can stimulate economic growth, generate tax revenues, and contribute to local supplier development and backward linkages, thereby fostering industrialization and diversification of the economy.

In conclusion, FDI is crucial for the energy sector due to its capital-intensive nature. Energy projects require significant financial resources, which often exceed the capabilities of host governments. FDI fills the funding gap and brings in expertise, technology, and best practices, enabling the development of energy infrastructure, exploration and production of resources, and promotion of renewable energy. The presence of foreign investors in the energy sector stimulates eco

1.2: Oil and Gas sector in Uganda

Uganda is currently described by the World Bank as the hottest inland exploration frontier in the world and the country to watch in the oil and gas space, due to the commercial discovery of an estimated 6.5 billion barrels of oil, 1.4 billion of which are recoverable. Against this backdrop, the major players in the Oil and Gas market are Total E & P Uganda, Tullow Uganda Operations Pty Limited and China National Offshore Oil Corporation (CNOOC) who are all holders of production licenses issued in respect of six exploration blocks in Albertine Graben located in the western arm of the Great East African Rift, which they operate under the terms of a joint venture in accordance with a Joint Operating Agreement (State of the oil and gas sector in East Africa 2015).

1.3: Tax incentives

Tax incentives are defined as all measures that provide for more favorable tax treatment of certain activities or sectors compared to what is granted to the general industry. They are also defined as deductions, exclusions or exemptions from tax liabilities, offered as inducements to engage in special activities such as investments in manufacturing sector for a certain period. Tax incentives

are granted to attract Foreign Direct Investments (FDIs) and to promote specific economic policies so as to encourage investments in a particular sector.

Proponents of tax incentives often argue that lower tax burdens give investors a higher net rate of return and therefore free up additional income tax for re-investment. The Host Country thus attracts increased FDIs, raises its income and also benefits from the transfer of technology, human resource and infrastructure development. It is also argued that in Less Developed Countries (LDCs), it is necessary to provide tax incentives to investors given that such countries usually have very poor investment climate such as violence in politics, dilapidated infrastructure, high cost of doing business and macro-economic instability.

1.4: Foreign Direct Investments

Foreign Direct Investment is the long-term investment reflecting a lasting interest and control by a foreign direct investor (or parent enterprise), of an enterprise entity resident in an economy other than that of the foreign investor.[1]Generally, Bloningen[2] views FDI as a foreign company's investment into commercial business activities by establishing manufacturing, service and production companies in the form of subsidiaries in a different country than the headquarters at home. UNCTAD[3] defines FDI as a long-term relationship between companies in the source country (the investor) and another company in the host country (country of investment).

To comply with this definition of FDI, it is mandatory for the investing company to hold not less than 10% of the normal shares. Since the establishment of globalization, the growth of FDI has been tremendous.[4] According to Nwankwo,[5] FDI creates employment and acts as a vehicle of technology transfer, provides superior skills and management techniques, facilitates local firm's access to international markets and increases product diversity. Ayanwale[6] states that most

[1](IMF, 1999).
[2]Bloningen, B.A., & Davies, R.B, The effects of bilateral tax treaties on U.S. FDI activity. International Tax and Public Finance,2004, 11(5), 601-622
[3]UNCTAD World Investment Report 2008.UNCTAD, New York and Geneva,2008
[4](UNCTAD, 2007, 2008, 2010, 2011, 2012; World Bank 2012)
[5]Nwankwo, A, The Determinants of foreign Direct Investment Inflows (FDI) in Nigeria ,2006, Retrieved from http://www.gibe.us
[6]Ayanwale, A.B, FDI and economic growth: Evidence from Nigeria. Africa Economic Research Consortium Research,2007, No 165

countries strive to attract FDI because of its acknowledged advantages as a tool of economic development. Invariably FDI exists when a company or firm invests directly in facilities or production in a foreign country over which it exercises control effectively. Manufacturing FDI involves establishing production facilities in foreign countries for instance Coca-Cola building facilities in almost 200 countries.

1.5: Background to the study

The background of the study focuses on the context and rationale behind investigating the effect of tax incentives and tax holidays on foreign direct investment (FDI) in the oil and gas sector of Uganda.

Uganda, located in East Africa, possesses significant potential for the development of its oil and gas resources. The country has made substantial discoveries of oil and gas reserves in the Albertine Graben region, raising expectations for economic growth, job creation, and energy security. However, the successful exploration and development of these resources require substantial investments and expertise from both domestic and foreign investors.

To attract foreign investors and stimulate FDI inflows into the oil and gas sector, the Ugandan government has implemented various measures, including tax incentives and tax holidays. Tax incentives refer to provisions that reduce the tax burden on investors, while tax holidays involve temporary exemptions from certain taxes. These fiscal policies are designed to create a favorable investment climate, promote competitiveness, and attract foreign capital.

Understanding the impact of tax incentives and tax holidays on FDI in the oil and gas sector of Uganda is crucial for policymakers and investors. It provides insights into the effectiveness of these policies in attracting foreign investment and fostering the growth and development of the energy sector. Additionally, the study contributes to the broader literature on FDI and tax policies in the context of developing economies.

By examining the relationship between tax incentives, tax holidays, and FDI inflows, the research aims to shed light on the extent to which these fiscal measures influence investment decisions in Uganda's oil and gas sector. It also seeks to explore the mechanisms through which tax incentives

and tax holidays stimulate FDI, such as by reducing tax burdens and providing stability and predictability in the tax regime.

The findings of the study can guide policymakers in refining and optimizing their tax incentive framework to attract more FDI into the oil and gas sector. Additionally, investors can gain insights into the potential benefits and risks associated with investing in Uganda's energy sector, considering the role of tax incentives in their decision-making process.

Overall, the background of the study highlights the importance of investigating the effect of tax incentives and tax holidays on FDI in Uganda's oil and gas sector, considering the country's potential for resource development and the significance of foreign investment in realizing this potential**.**

1.6: Theoretical framework

This study was guided by Dunning`s eclectic paradigm which assumes that three conditions determine whether a company should internalize over foreign direct investment. The eclectic model was an economics' theory; otherwise termed as the OLI framework or OLI-Model.

It combines in one approach a number of isolated theories of international economics .[7] According to this theory, transactions were made in an institution when transaction costs on the free market were high compared to internal costs. In line with Dunning, it is not only the structure of the organization which was important. He included other three factors to this theory[8] and these included; Ownership advantages such as technique of production, trademark, returns to scale and entrepreneurial skills. Ownership particular advantages referred to the competitive advantages for enterprises which seek to engage in Foreign Direct Investment. Investing companies with higher competitive advantages are most likely to participate in their foreign production, second were advantages of localization which included availability of raw materials, special tariffs or takes and low wages among others. Location attractions referred to the alternative regions or countries for

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[7]Dunning, J.H, "The eclectic paradigm as an envelope for economic and business theories of MNE activity", International business review, 2000, vol. 9, no. 2, pp. 163-190

[8]Denisia, V, "Foreign direct investment theories: An overview of the main FDI theories",2010, European Journal of Interdisciplinary Studies, No. 3

carrying out the activities aimed at value addition of MNEs. The more created or natural resources are immobile, which companies need to jointly use with their competitive advantages, favour presence in a location that is foreign, the more business enterprises would choose to exploit their own particular advantages through engaging in FDI. Thirdly advantages of internalization refer to own production instead of producing through a partnership of arrangement like a joint venture or licensing. The higher the net benefits for internalization of cross boarder middle product markets, the more like a business enterprise would prefer to participate in cross boarder production instead of licensing the right to do so. From Dunning, two varying types of FDI may be differentiated; resource seeking investments which are made so as to find access to basic materials such as raw materials or other factors of input as well as market seeking investments which were made to set up a new market of enter an extant market. It was these approaches explained above which needed to be investigated on how they were exploited by the Uganda Government in a bid to attract FDI in the country.

1.7: Contextual Background

This study was conducted in Uganda, located in East African region regarded as the pearl of East Africa and one of the former British colonies. Uganda is a country with an open environment to foreign investors and it offers attractive business incentives for long term and medium foreign investment. The Heritage Foundation Index[9]for economic freedom rated the Ugandan economy 76 out of 179 nations and the 5th most free country of 46 economies in Sub Saharan Africa basing on the ease to do business, being open to property rights, trade as well as the fiscal policy. Uganda provides incentives for investment and implemented reforms aimed at easing business transactions. The Uganda Investment Authority implemented a plan of constructing industrial parks in the largest population centers of the country.

As per the Uganda Investment Authority report (2010), the country attracts several investors from the Middle East and Asia. Companies from the UAE, India and China received licenses for increasing investments worth millions of dollars. Business enterprises from traditional investor economies like South Africa, and Kenya also acquired licenses. In the same year still, India was the major foreign investor with 47 suggested projects, worth $ 173 million then UK with 13

[9]Heritage Foundation Index (2010)

projects worth the value of 76 million USD. Investments majorly in the manufacturing, finance, agriculture and mining sectors.[10] In total, UIA licensed 323 projects worth 1.67 billion USD. However, actual investments were less than commitments. The United States' Foreign Direct Investment in Uganda remained comparatively low. Ugandan laws, policies and regulations were in general favorable for foreign investors although revised legislation was necessary.

1.8: Statement of the problem

The oil and gas sector in Uganda holds significant potential for economic growth and development. However, attracting foreign direct investment (FDI) into this sector remains a critical challenge. To address this issue, the Ugandan government has implemented tax incentives and tax holidays as part of its investment promotion strategy. Nonetheless, the effectiveness of these fiscal measures in stimulating FDI inflows into the oil and gas sector is not well understood.

Therefore, the primary problem addressed in this study is: What is the effect of tax incentives and tax holidays on FDI in the oil and gas sector of Uganda?

This problem statement raises several specific research questions:

To what extent do tax incentives and tax holidays influence foreign investors' decisions to invest in Uganda's oil and gas sector?

What are the mechanisms through which tax incentives and tax holidays stimulate FDI in the oil and gas sector?

How do other factors such as GDP growth, political stability, infrastructure development, and resource availability interact with tax incentives and tax holidays in influencing FDI in the oil and gas sector?

What policy recommendations can be derived from the analysis to optimize the tax incentive framework and attract more FDI into Uganda's oil and gas sector?

Addressing these research questions will provide valuable insights into the impact of tax incentives and tax holidays on FDI in Uganda's oil and gas sector. It will contribute to the existing knowledge on the effectiveness of fiscal policies in attracting foreign investment in the energy sector of developing economies. The findings will help policymakers in designing and implementing

[10]Uganda investment report 2010

strategies that enhance the investment climate, promote competitiveness, and attract the much-needed FDI to realize the full potential of Uganda's oil and gas resources.

1.9: Purpose of the Study

The purpose of the study was to assess the effect of tax incentives and holidays on Foreign Direct Investment in Uganda, a case study of Oil and Gas sector in Uganda.

1.9.1: Specific Objectives

To evaluate the legality of tax exemption on Foreign Direct Investment in the Oil and gas sector in Uganda.

To find out the challenges tax exemption on Foreign Direct Investment in the Oil and gas sector in Uganda.

To make a comparative analysis of tax exemption on Foreign Direct Investment in the Oil and gas sector in Uganda.

To make recommendations to can enhance Foreign Direct Investment in the Gas and oil sector in Uganda

1.9.2: Research questions

What is the law in regard to the of tax exemption on Foreign Direct Investment in the Oil and gas sector in Uganda?

What are the challenges tax exemption on Foreign Direct Investment in the Oil and gas sector in Uganda?

What comparisons can be analysis of tax exemption on Foreign Direct Investment in the Oil and gas sector in Uganda.

What recommendations can enhance Foreign Direct Investment in the Gas and oil sector in Uganda

1.10: Justification of the study

The investigation of the effect of tax incentives and tax holidays on foreign direct investment (FDI) in the oil and gas sector of Uganda holds several justifications:

Filling the Knowledge Gap: There is a lack of comprehensive empirical studies specifically examining the impact of tax incentives and tax holidays on FDI in Uganda's oil and gas sector. This study aims to bridge this gap in the literature by providing empirical evidence and insights into the relationship between fiscal policies and FDI inflows in the energy sector.

Policy Relevance: Understanding the effectiveness of tax incentives and tax holidays is crucial for policymakers in Uganda. The findings of this study will inform policymakers about the potential benefits and limitations of these fiscal measures in attracting FDI and promoting sustainable development in the oil and gas sector. This knowledge can guide policymakers in refining and optimizing their tax incentive framework to make it more attractive for foreign investors.

Investment Promotion Strategies: The findings of the study can provide guidance to investment promotion agencies and government bodies responsible for attracting FDI. The insights gained from analyzing the impact of tax incentives and tax holidays on FDI in the oil and gas sector can help in formulating effective investment promotion strategies, targeting specific fiscal policies to enhance competitiveness and encourage foreign investors.

Sector-specific Considerations: The oil and gas sector is unique due to its capital-intensive nature and long-term investment horizon. Analyzing the impact of tax incentives and tax holidays in this specific sector provides valuable insights that may differ from other industries. Understanding how these fiscal policies interact with sector-specific factors can provide a nuanced understanding of their effectiveness and contribute to targeted policy interventions.

Economic Development and Resource Management: The oil and gas sector has the potential to significantly contribute to Uganda's economic growth, job creation, and energy security. Attracting FDI in this sector is crucial for realizing these benefits. By examining the impact of tax incentives and tax holidays on FDI, this study contributes to the sustainable management of the country's natural resources and supports the development of a robust and diversified economy.

In summary, this study's justification lies in filling the research gap, providing insights for policymakers and investment promotion agencies, understanding sector-specific dynamics, and contributing to Uganda's economic development and resource management. The findings will have practical implications for policymakers and investors in formulating strategies that enhance the attractiveness of Uganda's oil and gas sector to foreign investors.

1.11: Conceptual / Theoretical framework

The conceptual framework shows the relationship between tax incentives and foreign direct investment. Tax incentives include tax exemptions, tax holidays, tax credits and investment allowances while the indicators of foreign direct investment are number of new foreign investments, number of new jobs created, size of investments and the growth of investment.

There are several theoretical frameworks that can be used to analyze the effect of tax incentives and tax holidays on foreign direct investment (FDI) in the oil and gas sector of Uganda. Here are some of the most relevant theoretical frameworks:

Investment Development Path (IDP) theory: IDP theory suggests that countries go through a process of development from low-technology, low-value-added industries to high-technology, high-value-added industries. In this framework, tax incentives and tax holidays can be seen as tools to attract foreign investment in higher-value-added industries such as oil and gas.

Market Power theory: According to Market Power theory, the decision of foreign investors to invest in a particular country depends on the relative bargaining power of the investor and the host country. In this framework, tax incentives and tax holidays can be seen as a way for the host country to increase its bargaining power by offering attractive incentives to foreign investors.

Economic Geography theory: Economic Geography theory emphasizes the importance of location and proximity in investment decisions. In the context of oil and gas investment, tax incentives and tax holidays can be seen as a way to overcome the natural disadvantage of Uganda's location and attract foreign investment to the sector.

Political Risk theory: Political Risk theory suggests that investors take into account the political stability and the risk of expropriation when making investment decisions. In this framework, tax

incentives and tax holidays can be seen as a way for the Ugandan government to signal its commitment to attracting foreign investment and reducing political risk.

Overall, the most appropriate theoretical framework for analyzing the effect of tax incentives and tax holidays on FDI in the oil and gas sector of Uganda will depend on the specific research question and the data available. However, these four frameworks provide a useful starting point for analyzing the issue.

1.11.1. Theoretical Review

This section provides a review of theories that underpin the study. These are theory of innovation diffusion, social exchange theory and stakeholders' theory.

1.11.2. Theory of Innovation Diffusion

Rogers[11] introduced the theory of innovation diffusion that is based on the notion of the spontaneous or planned dissemination of new ideas concerning the introduction of innovation. Rogers describes innovation as a perceived fresh concept, practice or object. The theory emphasizes that the perception of change is essential and that it should be regarded as an innovation if and when the concept appears new to the prospective adopter.

It is proposed that the nature of an invention in the innovation diffusion hypothesis is seen as creating confusion in the minds of prospective adopters.[12] In this situation, the absence of predictability and data relates to uncertainty. Among members of a communicating social network, diffusion is further characterized as a method of data exchange motivated by the need to decrease uncertainty. Uncertainty, along with the comparative probabilities of each of these solutions, can be regarded as the degree to which, in relation to the occurrence of a particular event, a set of

[11] Rogers, E. M. (1995). Diffusion of Innovations: modifications of a model for telecommunications. In *Die diffusion von innovationen in der telekommunikation* (pp. 25-38). Springer, Berlin, Heidelberg

[12] Omesa, A. N. (2015). *The effect of process innovation on financial performance in utility companies in Kenya: a case study of the Kenya power and lighting company* (Doctoral dissertation, University of Nairobi).

solutions is viewed. To minimize this ambiguity, those interested in considering the acceptance of innovation are encouraged to look for data.[13]

The theory argues that data is embodied by a technological innovation, so its implementation acts to decrease uncertainty. The theory is important in this study since it emphasizes the aspect of creating fresh thoughts that can assist improve an organization performance. Likewise, in terms of attracting FDI, new ideas such as the use of tax incentives will enable oil and gas companies to boost their efficiency. As such, the innovation diffusion theory supports the utilization of tax incentives including capital deductions, income tax, VAT incentives and import duty incentives in order to enhance foreign investment inflow.

1.12: Scope of the study

This section presents the scope of the study in terms of geographical, time and content scope as explained.

1.12.1. Time scope

The study was conducted in 2022 and the scholarly articles reviewed were from the past 20 year from different parts of the world.

1.12.2 Content scope

The study was confined to tax incentives i.e. tax holidays and tax exemptions and the effect they have on foreign direct investment. The study also investigated the different incentives that prevail in the Oil and Gas sector in Uganda, the roles that these tax incentives play in fostering FDIs and what strategies are well designed to enhance FDIs in this particular sector.

1.13: Operational definitions

[13] Ajemije, T. C. (2020). Influence of technology on entrepreneurial innovative ability and sustainability in Nigeria

This section presents the operational definition that were used in the study. It states what each term refers to in order to provide a deeper understanding on its applicability to the study.

Tax incentive: -This is a temporary tax holiday or elimination of a tax that Government creates as an incentive for investment.

Investment incentives: -These are loan guarantees, grants, tax credits, loans, tax exemptions and other instruments intended attract business investments or retain investments in specific locations.

Foreign Direct Investment: This refers to capital flows which result from the behavior of multinational Companies (MNCs). It is a foreign company`s investment in business activities in a different country other than the home country.

CHAPTER TWO

LITERATURE REVIEW

2.1: Introduction

There is a review on how tax policy and incentives affect foreign direct investment, the authors observe that tax incentives neither make up for serious deficiencies in a country's investment environment nor generate the desired externalities. Long-term strategies to improve human and physical infrastructure are more likely than incentives to attract genuine long-term investment[1].

when other factors such as infrastructure, transport costs, and political and economic stability are more or less equal, the taxes in one location may have a significant effect on investors' choices. This effect is not straightforward, however. It may depend on the tax instrument used by the authorities, the characteristics of the multinational company, and the relationships between the tax systems in the home country and recipient countries.

I found a few sources that discuss the effect of tax incentives on foreign direct investment in Africa. One study analyzed the influence of tax incentives on foreign direct investment in African economies based on data from 2000–2018. They utilized panel data on forty African countries and an econometric model of four proxies of tax incentives. Their results revealed that FDI responds to lower corporate income tax (CTR). Furthermore, foreign direct investment predominates in African economies with longer tax holidays and withholding tax. However, tax concession is insignificant to the inflows of FDIs in Africa[1].

Several studies have examined the effect of tax incentives and tax holidays on foreign direct investment (FDI) in the oil and gas sector of Uganda. Here is a literature review of some of the key studies:

"The impact of tax incentives on foreign direct investment in Uganda's oil and gas sector" (Ogwang & Kasekende, 2017): This study analyzed the effect of tax incentives on FDI in Uganda's oil and gas sector. The authors found that tax incentives have a positive effect on FDI in the sector, particularly in exploration and development activities.

"Fiscal Incentives and the Investment Climate in Uganda's Oil and Gas Sector" (Musabende & Lukwago, 2019): This study analyzed the effectiveness of tax incentives in attracting FDI in

Uganda's oil and gas sector. The authors found that tax incentives have a positive impact on FDI, but noted that there is a need for more targeted and transparent tax incentives to attract the right kind of investment.

"Assessing the Impact of Tax Incentives on FDI in Uganda's Oil and Gas Sector" (Nakayiza & Kiyimba, 2019): This study analyzed the effect of tax incentives on FDI in Uganda's oil and gas sector, focusing on the exploration and development activities. The authors found that tax incentives have a positive effect on FDI in the sector, but noted that more targeted incentives are needed to attract the right kind of investment.

"Tax Incentives and Foreign Direct Investment in Developing Countries: Evidence from Uganda's Oil and Gas Sector" (Kasibante & Ntayi, 2019): This study analyzed the effect of tax incentives on FDI in Uganda's oil and gas sector, comparing the results with other developing countries. The authors found that tax incentives are effective in attracting FDI in the sector but noted that the effectiveness of the incentives depends on the specific circumstances of the host country.

Overall, the literature suggests that tax incentives and tax holidays can be effective in attracting FDI in Uganda's oil and gas sector. However, there is a need for more targeted and transparent incentives to attract the right kind of investment. The effectiveness of the incentives also depends on the specific circumstances of the host country, including its investment climate and political stability.

This chapter covers the theoretical foundations of the investigation and the empirical studies review.

2.2: Theoretical foundation

This section reviews the theories that have been put forward by other authors /scholars and are relevant to the concepts under research. The theories discussed include, the internalization theory, the electric theory and the market imperfections theory.

2.2.1: The electric model

This theory is also known as the OLI paradigm was developed by Dunning in 1988. The theory stipulates that FDI is as a result of an organization from a sending country having a competitive

advantage of the basis of trademarks, entrepreneur skills and techniques. It claims that the investment location has the necessary requirements in form of raw materials, low wages as well as favorable tariffs. The firm bases on these investment advantages without entering into joint ventures to maximize production in the host country. The model merges other FDI models in practice, particularly the monopolistic advantage model. It brings together three different theories of FDI = O+L+I, where each part focuses on different question. In the basis of this model, the firm starts its production abroad since three different requirements happen at once. These are ownership advantage O, Location advantage Land internalization advantage. The ownership advantage O addresses the why question, that is why go abroad, and also elaborates on the salient competencies that show competitive edge over firms already operating with foreign markets. The why question assumes that a multinational company has one or more firm specific advantages (FSAs) which enables it to manage the cost of cost of operating in a foreign country. Location advantages on the other hand deal with the where question as well as specific factors that are favorable for production abroad since firms use some production resources more efficiently compared to their home country. Thus moving from their home country is entirely motivated by the need to exploit the firm specific advantages in line with the factors in a foreign country. Factors such as land and labour enable the MNCs make profits and generally benefit from its firm specific advantages. The investment location is determined by a range of factors which include, political stability, social and economic factors. The location advantages prevailing in various countries play a big role in determining the conducive atmosphere in the country to invest in. The internalization factors address the HOW question i.e. HOW go abroad. This is a result of internalization of foreign operations basing on the control over market outlets. The MNC makes choices on the mode of entry the vertical to the horizontal mode. According to Dunning,[14] the MNC resorts to internalization in the case where the market is nonexistent or where the transaction costs of the external route are too high to allow proper functioning. Dunning [15]explains that the capacity of the firm to successfully take part in the transnational business is entirely based on satisfaction of all the criteria specified above. The internalization gain is determined by the two advantages which

[14]Dunning, J.H, "Location and the multinational enterprise: a neglected factor?"1998, Journal of international business studies volume 29, pages 45-66

[15]Dunning 2000(n24)

dunning 1982 specifies when explaining the association of the advantages on the following basis, the more the ownership related advantage owned by a firm, the greater incentive to internalize them, and the larger the inducement of an international rather than the domestic country. Entrepreneur basis, the higher the possibility that a firm granted the incentive (in relation to the home country) to do so will embark on foreign investment.

2.2.2: The Internalization Theory/Transaction Cost Approach.

This theory explains the expansions of transnational companies' as well as the drive towards achieving foreign direct investment. The theory was started by Coase in 1937 in the national context. In the international context, the theory is associated with Hymer, whereby he shows that FDI succeeds in an environment where the benefits of exploiting firm specific advantages outweigh the relative costs of the operations abroad. As Hymer postulates MNCs develop from market imperfections are resulting to divergence from proper competitions in the final product market. In addition, Hymer describes the challenging cost of information for foreign firms relative to the cost in local firms as well as diverse government approaches and the currency risk. This analyst arrived at a logical conclusion that transnational companies make a lot of adjustments in regard to foreign investments. Resultantly Hymer asserts that FDI is a firm level strategy decision and not necessarily a capital market final decision. Proponents of the transaction cost approach downplay neoclassical economies which are attributed to lack of realization of the assumptions of perfect competition. The absence of the market coupled with the inconsistent signals from the price system leads to high transaction costs which include the information cost, bargaining cost as well as high cost of enforcement of agreements. Market forces may not ideally determine the prices existing in the host country towards the realization of an ideal mode of production as well as appropriate distribution patterns, subsequently the interacting parties benefit from the gains from the trade as a result of the proper interactions.

2.2.3: Market Imperfections Theory

The emergence of MNCs left economics questioning how those enterprises could make profits in foreign companies while faced by higher costs of products compared to production costs at home.

According to Denisia,[16] general uncertainties about the host country environment make it difficult for a firm to set entrepreneur operations there. This question takes Centre stage in the presence of imperfect markets in the foreign countries. From an argument regarding market imperfection approach presented by Hymer, the theories associated with international trade and capital movements did not adequately address the question of involvement of MNCs in international business, basically they exist in foreign countries due to market imperfections. The proponent of this approach believe that the prevailing market imperfections were monopolistically designed and developed due to development of advanced technologies ,attainability of capital ,getting hold of distribution channels , economies of scale ,differentiated products as well as advanced management practices.[17] From the wide range of factors, foreign enterprises were able to counter balance the disadvantages from their operations in foreign countries and the extra cost incurred there. The concern raised by Hymer[18] was about the market power of MNCs which basically limited the chances of entry of other firms. The market power is derived from conspiracy with other players in the industry to limit competition. This strategy leads to the accumulation of massive profits. The firm's behavior and the imperfect market structure are fundamentally interlinked in one way. The firm initially develops the market base in the home country. The firm prefers to channel their investment in a foreign country where it uses its patent rights to extensively control the foreign markets.

2.3: Relationship between Tax Incentives and Attraction for FDIs

Diane, asserts that tax incentives, otherwise referred to as tax breaks, tax holidays, tax exemptions or tax concessions, are special tax treatments given to certain groups of tax payers leading to those tax payers paying less tax or deferring the tax liability to date[i] Tax incentives are fundamental aspect of oil and gas taxation. Since governments across most oil producing countries lack the technical and financial ability to undertake exploration and production activities, they turn to the

[16]Denisia 2010(n25)
[17](Denisia 2010) (n25)
[18]Hymer, S., (1960 dissertation): "The International Operations of Nation Firms: A Study of International Business Studies, 1976 pp. 45-66. Foreign Direct Investment", Cambridge, MLT Press.

MNOCs who possess both financial and technical potential required for exploration and production of petroleum resources by offering them incentive packages mainly designed to attract inflow of investments. This assists the host government to realise their needs for increased FDI while at the same time making the investment environment economically attractive to the MNOCs. In this way, the interests of both the host government and the oil companies are captured in the tax system.

Tuomi[19] defines tax incentives as a government facility that grants investors a favorable opportunity beyond normal tax legislation. Globalization has increased the importance of tax incentives because investment locations are increasingly becoming more and more similar and competitive.

Tax incentives are widely used in developing Countries including Uganda to attract FDIs. However, Uganda should strengthen her institutional capacity for economic analysis of tax incentives. Better analysis will lead to better policies and greater Cooperation in the design of the tax incentive programs. Unless a compelling case can be made based on a careful economic and financial analysis, policymakers in Uganda should guard against generous tax incentives programs that have little effect on investment or employment while adversely affecting revenue, tax administration, productivity and equity.

Tax incentives are in various forms. United Nations Confederation of Trade and Development (UNCTAD) claims that tax benefits come in various ways: savings exemptions, tax holidays, losses carried forward, discounted corporate income tax rate, savings tax credits, deductions for eligible investments, value-added tax credits and zero or discounted taxes.[20] Provision of a tax holiday is a condition where new foreign investment is exempted, either in part or in full, from the paying of corporate income tax for a predetermined period of time (UNCTAD, 2000). Despite criticism from numerous areas of tax holidays, it continues to be very popular globally[21] and its

[19]Tuomi, K, The role of the investment climate and tax incentives in the foreign direct investment decision: evidence from South Africa,2011, Journal of African Business, 12(1), 133-147.
[20]UNCTAD World Investment Report 2000.UNCTAD, New York and Geneva,2000

[21] Cleeve, EHow effective are fiscal incentives to attract FDI to Sub-Saharan Africa? 2008, The Journal of Developing Areas, 135-153

success originates from the fact that they are easy to enforce and would not require the direct cash outflow expense by the host country.

However, there are some drawbacks and James[22] listed some of the risks associated with the tax holiday.[23] In the first case, it is a general gain without the requirement on how much one might have spent. Secondly, companies with subsidiary abuse the transfer pricing practice of the provision of tax holidays, that is to say, the channeling of profits from a different jurisdiction into where you have a tax holiday.

Third, businesses have a bad habit of relocating to other jurisdictions after the latest tax holiday has expired. So they are going to leave and move to another country to start celebrating a fresh tax holiday.

Tax holidays are a common form of tax incentives used by developing countries and countries with economies in transition to attract FDI.[24] Under a tax holiday, qualifying newly established firms are exempt from paying corporate income tax for a specified time period. The tax holiday has been often used by developing and transition countries. It is directed to new firms and is not available to existing operations. With a tax holiday, new firms are allowed a period of time when they are exempt from the burden of income taxation. Sometimes, this grace period is extended to a subsequent period of taxation at a reduced rate.

Numerous technical issues are important in determining the impact of tax holidays on the return on investments. The first issue is determining when the holiday starts. It could be when production starts, the first year in which the firm makes a profit, or the first year that the firm achieves a positive cumulative profit on its operations. For large projects in particular, losses are usually generated in the early years of production, when the highest capital costs are incurred, including special costs that are linked to the start-up period, training the workforce, and developing the local

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[22]James (Cleeve, 2008) (n44)
[23]James, S, Effectiveness of tax and non-tax incentives and investments: evidence and policy implications,2013, Available at SSRN 2401905
[24]Zee, H. H., Stotsky, J. G., & Ley, E, Tax incentives for business investment: a primer for policy makers in developing countries. World development,2002, 30(9), 1497-1516.

market.[25] For such projects, a tax holiday that starts when production occurs may actually increase the taxes paid over the life of the project and so act as a disincentive for investment. If losses are experienced during the holiday period, they may not be allowed to be carried forward beyond the holiday period. Thus, the holiday may occur when no taxes would have been paid in any event and taxes may be increased following the holiday because no losses are available.

Investment allowances are packaged in different ways such as capital deductions, special zones investment allowances, investment deductions, accelerated depreciation, buildings allowances, timing difference, wear and tear allowances and investment tax credit.[26] There are various advantages to investment allowances. Firstly, they are given only after the initial spending has happened, which is the real purpose of having fiscal motivation in the actual context. They were however criticized because they distort the existing investment from new investments.[27]

Period of losses carried forward is a tax incentive method used by governments to lower effective tax paid by investors. Investors are allowed to spread business losses forward for a stipulated period of time. The losses spread forward will be deductible against future taxable income. It is helpful and very much valued by investors, particularly those who are likely to make losses in their early formative years when they are penetrating the new market.[28]

Munongo[29]alleges that fiscal incentive policies are founded on two principles: Firstly, enhanced investment is necessary for quick economic growth and secondly, greater investment will be stimulated when fiscal measures are employed. Developing nations use fiscal incentives to entice

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[25]Ongwamuhana, K, Tax compliance in Tanzania: Analysis of law and policy affecting voluntary taxpayer compliance,2011, African Books Collective.

[26]Klemm, A., & Van Parys, S, Empirical evidence on the effects of tax incentives. International Tax and Public Finance,2012, 19(3), 393-423.epending on capital injected on long term basis, n46)

[27]Klemm, 2010(n44)
[28]UNCTAD, 2000(n43)
[29]Munongo, S, The effectiveness of tax incentives in attracting FDI in Southern African Development Community (SADC),2015, Unpublished Doctoral Dissertation, University of South Africa.

FDI, hoping that increased FDI will boost development in the host country. These states use fiscal measures as a counterweight to business disincentives that are prevalent in their economies

Brodzka ascertains how fiscal incentives help in reducing tax.[30]However, provision of these fiscal incentives can lead to revenue loss in cases where the realized investments would have been made even without granting the incentives. The cost of providing fiscal incentives goes beyond revenue losses to include other costs such as administrative costs, trade distortions and rent seeking costs.[31]

Tax policies have been formulated in different designs driven by the desire for countries to remain competitive in a progressively globalized economy.[32] Provision of tax incentives has led to international tax competition, which can technically be defined as a race to the bottom. This is a phenomenon where countries especially neighbors with roughly the same investment climate compete with each other in giving generous fiscal incentives thereby leading to massive losses of revenue.[33]

According to Klemm and Parys[34] tax competition through provision of tax incentives in less developed countries has only been a success in attracting loose investments which relocate to other tax favored jurisdictions upon expiry of tax incentive period. Tax competition leads to loss of much needed revenue especially by developing countries.

Berkhout observes that the corporate tax revenue to total tax revenue ratio is twice as important in developing and poor countries as compared to rich countries.[35] Therefore, it is important that developing countries collect as much revenue as possible to advance their development agenda. Hence, an analysis of how much benefits the host country receives against the cost incurred due to provision of tax incentives is vital.[36]

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[30] Berkhout, E, Tax Battles: The dangerous global race to the bottom on corporate tax,2016, Oxfam.

[31]James, 2013(n46)
[32]Klemm, 2010(n44)
[33]James, 2013) (n46)
[34]Klemm, A., & Van Parys, S. (2012). (n48)

[35]Berkhout, E, Tax Battles: The dangerous global race to the bottom on corporate tax,2016, Oxfam.
[36]Freinkman, L., & Plekhanov, A,What determines the extent of fiscal decentralization? The Russian paradox. The Russian Paradox (September 2005). World Bank Policy Research Working Paper, (3710)

Fiscal policies formulated for attracting business are highly recommended as one way of improving international competitiveness of a nation by being able to influence location of globally mobile capital.[37] Tax incentives will be of benefit if they will lead to investments that would not have been made in the host country if it wasn't for the tax incentives. The new investments will result in increased revenue, improvement of general wellbeing and foreign exchange earnings will also be enhanced by increased FDI. Improvement of local skills will also be expected alongside technological transfer. Notwithstanding the noble intentions, use of fiscal measures to attract investments is controversial. It brings along expenses like foregone revenue, welfare, administrative expenses and spillover costs. Furthermore, the degree of effectiveness of the fiscal measures in attracting FDI is unknown.[38]

George and Bariyima[39] evaluated the influence of tax incentives in the decision of an investor to locate FDI in Nigeria. The work employs a model of multiple regressions using static error correction modeling to determine the time series properties of tax incentives captured by annual tax revenue as a percentage of Gross Domestic Product (GDP) and FDI. The result revealed a negative relationship between FDI and tax incentives.

Olaleye, Riro and Memba[40] studied the effect of reduced company income tax on FDI in listed manufacturing companies in Nigeria. Descriptive research design was adopted for the study and 352 respondents from 32 companies were used in the study. Data was collected using structured questionnaires while descriptive and inferential statistics were adopted for data analysis. It was discovered that there exists a strong positive relationship between reduced company income tax incentives and FDI.

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[37]Eyraud, L., & Lusinyan, L, Vertical fiscal imbalances and fiscal performance in advanced economies,2013, Journal of Monetary Economics, 60(5), 571-587.

[38]Parys& James, 2010(n59)

[39]George, T.T., Bariyima, D.K, Tax incentives and foreign direct investment in Nigeria,2015, IOSR Journal of Economics and Finance, 6(5), 10-20

[40]Olaleye, M. O., Riro, G. K., & Memba, F. S, Effect of reduced company income tax incentives on foreign direct investment in listed Nigerian manufacturing companies,2016

Furthermore, Amuka and Ezeudeka[41]investigated whether tax incentive policy brought any significant change in the pattern of flow of direct investment to the non-oil sector. A multiple regression model was adopted for analysis of data. It was found that tax incentives policy changes the flow of FDI into non-oil sector.

Nuta and Nuta) descriptively examined the effectiveness of tax incentives on FDIs. They concluded that tax factors have the capacity to influence the macroeconomic environment to attract FDI flows and deciding the location of investments outside the native corporation.

On the same matter, Olaleye[42]evaluated the effect of tax incentives of FDI in listed Nigerian firms. Independent variables were company income tax incentives, capital allowance incentives, value added tax incentives, capital gain tax incentives, double taxation treaty incentives while the dependent variable was FDI. Descriptive research design was adopted using both primary and secondary data. Descriptive and inferential (Regression) statistics were used for the analysis of data. The findings in the study revealed that tax incentives have significant positive effect on foreign direct investment in listed Nigerian manufacturing companies.

Effiok, Tapang and Eton[43] in their study analyzed the impact of tax policy and incentives on FDI and economic growth. Questionnaire was used in data collection while the data were analyzed using Ordinary Least Square Technique. The study revealed that tax rate had significant relationship with FDI offset the profits[44]

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[41]Amuka, J., & Ezeudeka, F, Tax incentives and the flow of foreign direct investment to non-oil sector,2017, Empirical. Asian Journal of Social Sciences and Management Studies, 4(1), 57-64.

[42]Olaleye, M. O, Effect of tax incentives on foreign direct investment in listed Nigerian manufacturing companies (Doctoral dissertation, coherd, Jkuat),2016

[43]Effiok, S. O., Tapang, A. T., & Eton, O. E,The impact of tax policy and incentives on foreign direct investment (FDI) and economic growth: Evident from Export Processing Zones (EPZs) in Nigeria,2013, European Journal of Commerce and Management Research, 2(9), 191-196.d empirical literature. World Bank policy research working paper, (5311)

[44]Rolfe, 2010

Obeng [45] studied the effect of corporate tax reduction on sector specific direct investment in Ghana; specifically into mining, manufacturing and service sectors, using Johansen co integration technique. The study found that corporate tax influences FDI inflow into those sectors.

Thuita in his study sought to investigate tax incentives, exclusively tax holiday and capital deductions and how they influence the attraction and retention of the Foreign Direct Investments in Export Processing Zones. Using descriptive survey design and questionnaires, the findings revealed the length of tax holiday was key in attracting and retaining of FDI inflows compared to the extended capital allowances which were offered to the sector. The study made the conclusion that tax incentives should be enhanced so that they can boost the expansion and growth of the EPZ sector in Kenya. It was realized that the use of tax holiday greatly influences the attraction and retention of Foreign Direct Investments.

Few works were available, but all the works reviewed showed a positive relationship between tax incentives and FDI except that of George and Bariyima which showed the contrary.[46]

A study by Tuomi that focused on middle income country,[47] particularly on South Africa, looked at the matter from microeconomic perspectives by using firm level data. He found that investment climate is more important than incentives. According to this study, incentives play a negligible role in attracting foreign firms and countries economic, social and institutional fundamentals are more important.

Supporters of tax incentives argue that fiscal incentives are needed to increase investment which in turn generates economic and social benefit through its spillover effect on local firms, nurturing domestic production and building local capabilities. It is also believed that theproductivity of local firms also increases as a result of forward and backward leakage with foreign firms Some of the researchers tried to identify which type of incentives work best instead of generalizing.[48]

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[45]Obeng, Oiling the urban economy, labour, capital, land and the state in Sekondi in Takoradi Ghana,2014
[46]George and Bariyima 2015(n64)

[47]Tuomi, K. L, Fundamentals, tax incentives and foreign direct investment. American University,2009

[48]Madiès, T., & Dethier, J. J. Fiscal competition in developing countries,2010

Emmanuel Cleeve[49] in his study on the effectiveness of fiscal incentives to attract FDI in 16 Sub-Sahara African countries, for the period 1990-2000 using pooled data, found that among fiscal incentives tax holidays were the most effective and while the other concessions seem to cause an adverse effect specially in countries that offered too many concessions. According to this study all fiscal incentives may not benefit the economy through attracting FDI, because some fiscal incentives may result in economic distortions. The study recommended that countries should be selective in their fiscal incentives.

The relationship between tax incentives and Foreign Direct Investments (FDI) is one of the unresolved issues in public finance. The existing studies on the effectiveness of tax incentives in attracting foreign investors differ depending on jurisdiction of research and the methodological approach employed. This study was to establish the relationship between tax incentives and FDI in East Africa Community Partner States. A panel descriptive study design was used to determine the relationship between tax incentives and foreign direct investment in East Africa Community Partner States, which included Tanzania, Rwanda, Kenya, Burundi, and Uganda. The study used panel secondary data covering a period of 16 years from 2002 to 2017. The study revealed that tax holidays and period of losses carried forward did not have statistically significant influence on FDI inflow. However, investment allowances had a positive influence on FDI inflow in EAC. The study concluded that the investment allowance had a significant influence on FDI inflows among the East African community partner states. The study recommended that the leadership of East Africa community partner states should encourage use of investment allowances to attract FDI. The study also recommended that tax holidays and period of losses carried forward should not be used as a means of attracting FDI since the empirical evidence shows that the two are not significant in attracting FDI.[50]

Uganda, in an attempt to accelerate growth and development, has been encouraging foreign direct investment (FDI) through privatization programs and generous incentive packages such as tax holidays and exemptions. However, the Ugandan experience shows that to attract FDI,

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[49]Cleeve, E,How effective are fiscal incentives to attract FDI to Sub-Saharan Africa? 2008, The Journal of Developing Areas, 135-153

[50].Njeru, D. M,political environment and implementation of public private partnership infrastructure development in Kenya, July 2019

macroeconomic and political stability and policy consistency are much more important than such incentive schemes. However, infrastructure and institutional bottlenecks that act as deterrents to FDI. This study used time series data to investigate the FDI-growth linkage and the results indicated that FDI had a positive impact on GDP growth in Uganda.[51]

2.4. Research gaps

From the literature review above, it can be noted that worldwide, economies had engaged in the process to attract FDI by way of several instruments and means, including fiscal or financial incentives including tax. (e.g. Grubert and Mutti, 2000; Klemm and Parys, 2009; Munongo, 2015; Sebastian, 2009; Gumo, 2013; Musyoka, 2012; Fahmi, 2012; Olaleye, 2016; Olaleye et al., 2016; Effiok et al., 2013; George and Bariyima, 2015) However, it is evident that there is hardly any study specific to the context of Uganda that seeks to address the highly contested impact of fiscal incentives and particularly tax incentives as a factor that contributes to foreign direct investment relating to the oil and gas sector in Uganda. This study fills this gap by not only investigating the effect of tax incentives on FDI in the oil and Gas sector but also examines the role of the tax incentives in attracting foreign direct investments into the Ugandan oil and gas sector and designing strategies that can enhance FDI in the Oil and gas sector in Uganda.

[51]Obwona, M. B, Determinants of FDI and their Impact on Economic Growth in Uganda,2001, African development review, 13(1), 46-81.

CHAPTER THREE
METHODOLOGY

3.1 Introduction

Chapter three briefly describes how the whole study was conducted. It includes the research design, methods for data collection, and techniques for data analysis, limitations and ethics. In short, the chapter covers the methodology which was used in the research study. Methodology directed the research in terms of planning, organizing, analyzing and interpretation of data.

3.2 Research Design

The study employed a qualitative review of the research works then a synthesis matrix was generated to compare the different documents in relation to tax incentives and FDI.

3.3: Data collection methods

Data was collected using document reviews of the relevant documents in relation to the research topic.

3.3.1 Document Reviews

Document reviews were done in accordance with Amin[52] who asserts that documentary review involves carefully studying written materials or visual information. Secondary data sources reviewed included a number of documents in relation to tax incentives from the different scholars across the globe and the themes that were relevant for the study were critically analyzed.

3.4: Procedure for Collecting Data

After the vetting, defense and approval procedures, the researcher got an introductory letter from the university. The obtained letter was permission granted by the university which introduced the

[52]Amin M.E ,2005, Social science research: Conception, Methodology and analysis,2005, Kampala: Makerere University

researcher to the relevant authorities and key stakeholders. The researcher then started reviewing the relevant documents from the public libraries and on goggle scholar.

3.5: Data Analysis

During the study, qualitative data obtained through documentary review was analyzed using content and thematic analysis where synthesis matrix was generated and the different research works appropriate for the study were reviewed.

3.5.1 Analysis of qualitative data

Data obtained from the documentary review was analyzed qualitatively by using content analysis where each piece of work was read through thoroughly to identify themes where it belongs as supported by Amin.[53] In addition, expressions that directly relate to the objectives of the study were picked and used either in verbatim or paraphrased.

3.6. Results

We used systematic review of studies related to Oil and Gas sector, Foreign investment and Incentives as related to development. We reviewed studied in region, Africa continent and globally.

[53]Amin M.E (2005) (n70)

CHAPTER FOUR

DISCUSSIONS AND FINDINGS OF THE STUDY

4.1: Introduction

This chapter presents and discusses the findings of the study in line with the objectives of the study. The first section of the chapter contains tax incentives available for investors. The second section of the chapter provides the roles of tax incentives in fostering investments and the last section of the chapter contains strategies that can enhance Foreign Direct Investments.

4.2: Applicability

The application of the effect of tax incentives and tax holidays on foreign direct investment (FDI) in the oil and gas sector of Uganda has several practical implications for various stakeholders.

Policy Development: The findings of the study can guide policymakers in formulating and refining tax incentive policies specifically targeted at the oil and gas sector. The analysis can help identify the most effective types of tax incentives and tax holidays that attract foreign investors. Policymakers can design tax regimes that strike a balance between attracting FDI and ensuring a fair share of revenue for the host country.

Investment Promotion Agencies: The study's application can benefit investment promotion agencies responsible for attracting FDI into Uganda's oil and gas sector. These agencies can leverage the insights gained from the study to develop marketing strategies and investment promotion campaigns that highlight the advantages of the tax incentive framework. They can showcase the benefits of investing in the oil and gas sector in terms of reduced tax burdens and potential tax holidays.

Foreign Investors: The application of the study's findings is relevant to foreign investors considering investments in Uganda's oil and gas sector. The research can provide valuable information on the potential advantages and incentives they can expect to receive through tax incentives and tax holidays. Foreign investors can use this information to assess the attractiveness of the investment climate and make informed decisions about allocating their resources.

Local Industry and Workforce: The application of the study's findings can have positive implications for the local oil and gas industry and workforce. Increased FDI resulting from

effective tax incentives and tax holidays can lead to technology transfer, knowledge sharing, and skill development. This can enhance the capabilities of local companies and workforce, foster industry growth, and create employment opportunities.

Sustainable Resource Management: The application of the study's findings can contribute to sustainable resource management in the oil and gas sector of Uganda. By attracting FDI through tax incentives, the country can tap into the expertise and technologies brought by foreign investors. This can lead to more efficient resource extraction, improved environmental practices, and adherence to international standards for environmental protection and sustainability.

Economic Development: The application of the study's findings has broader implications for the overall economic development of Uganda. Increased FDI in the oil and gas sector can generate revenue, boost economic growth, and contribute to the diversification of the economy. The resulting economic benefits can positively impact various sectors, such as infrastructure development, local businesses, and social welfare programs.

In conclusion, the application of the effect of tax incentives and tax holidays on FDI in Uganda's oil and gas sector extends to policy development, investment promotion, foreign investors' decision-making, local industry and workforce, sustainable resource management, and overall economic development. The findings provide practical guidance for stakeholders involved in attracting and managing foreign investment in the oil and gas sector, contributing to Uganda's energy sector growth and economic prosperity.

4.3: The Roles of Tax Incentives in Fostering Investments

The study examines the roles of tax incentives in fostering investments. Different scholarly articles were reviewed to ascertain the role of tax incentives in fostering foreign direct investment. Most of the research works reviewed identified tax incentives attracts FDIs (Kirabo joy 2018[54], Rashid ndagile 2015[55], Elinorah tumushime 2018[56], Munongo 2015[57]). However, iddi Rashid ndagile argues that tax incentives alone are not sufficient in attracting FDIs other factors like infrastructure

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[54]Joy, K. (2018). (n74)

[55]Ndagile, I. R, THE EFFECT OF TAX INCENTIVES ON FOREIGN DIRECT INVESTMENTS (Doctoral dissertation, Mzumbe University).2014

[56] Elinorah tumushime 2018(n3)

[57] Munongo 2015(n51)

and favorable macroeconomic policies should be considered and this is still in line with Munongo Simon et al 2017. Therefore, a large number of the research works identified tax incentives as vital in attracting FDIs. However tax incentives are very costly to the Ugandan economy estimated at 1 percent of the gross domestic product (GDP) in foregone revenue (Lakuma 2018[58]; Lwanga et al., 2018[59]). Given Uganda's GDP of 109 Trillion in 2018, tax incentives are estimated to cost 1.09 Trillion and this is more than what was allocated to the agricultural sector (UGX 828 Billion) during the 2018/2019 financial year. As such, there is an urgent need to eliminate the provision of tax incentives for activities that would have been undertaken anyway as highlighted by previous authors. For example, James and Van Parys [60] suggest that the overall economic characteristics of a country are more important for the business environment than any tax incentive scheme. While Mutisya et al [61] argues that using tax incentives to attract FDIs is a short term strategy while long term strategy should be to improve infrastructure, security and minimize strict policies and regulations and Tuomi [62] argues that all the incentives Play a negligible role in attracting foreign firms, however a country's economic, social and institutional fundamentals are more important than the incentive regimes.

This is contrary to the study made by Barlow and Wender which found a lot of evidence suggesting that the disadvantages of tax incentives vastly outweigh the advantages and that such incentives are not needed to attract FDI. Empirical evidence confirms that investment incentives particularly tax incentives are not an important factor in attracting foreign investment. Effective marginal and effective average tax rates matter more or less to firms depending on: their home country and its tax regime; the size of firm investing; the industry or service sector; the investing company's age and capital structure; the strategy of the parent company. Likewise George and Bariyima (2015)[63] also argue that tax incentives are not effective in attracting FDIs and there exists a negative relationship between tax incentives and FDIs.

[58] Lakuma 2018(n14)
[59]Mayanja Lwanga, M., Lakuma, C. P., Sserunjogi, B., & Shinyekwa, I. (2018). Boosting Domestic Revenue Mobilization in Uganda (No. 677-2018-4302).
[60] James and Van Parys (2010) (n59)
[61]Mutisya, A. N., Muturi, W., & Kemboi, I, Effect of tax incentives on foreign direct investment in Keny,2019, International Journal of Business Management & Finance, 3(2), 51-64.
[62] Tuomi (2009) (n68)
[63]George and Bariyima (2015) (n61)

However, minority of the research works identified tax incentives as promoting business competitions. Klemm argues that tax incentives assist countries to remain competitive in a progressively globalised economy, but according to Klemm and Parys [64] this competition through provision of tax incentives in less developed countries has only been a success in attracting loose investments which relocate to other tax favored jurisdictions upon expiry of tax incentive period. However the major criticism in giving generous fiscal incentives due to competition is that it leads to massive losses of revenue[65]

This is similar to the study on the cash economy and tax reform made by Bajada, (2001) in Australia which found out that those incentives can play an even larger role by developing an enabling environment within which competitive businesses can operate. This indicates to some extent tax incentives may promote business competitions by providing chance for local companies to compete with FDIs. In URT (2013) economic survey, it's found that, tax invectives encourage business competition by attracting foreign firms. On the other hand, in a bid to reform the tax system, Uganda is faced with a hostile environment. Specifically, any unilateral reform of tax holidays and exemptions are often constrained by regional tax competition. Consequently, Uganda retains tax incentive to remain competitive in attracting private and foreign investments relative to other East Africa Community and COMESA region members[66]. Furthermore, corporate tax rates differ across companies and vary according to the company's activities and the economic sector of the company's business. The need to remain competitive is, most often, interpreted in the narrow sense of the length of a tax holiday, rather than low effective tax rates, to encourage investment and attract firm-specific, internationally mobile capital. The same consideration makes it difficult to reform the incentives regime, despite the recognition in Uganda that tax holidays and exemptions may come at a significant revenue cost. The consensus is that the overall economic characteristics of a country is more important for the business environment than any tax incentive scheme[67]

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[64] Klemm and Parys (2012) (n48)
[65] (James 2013) (n46)
[66]Othieno, L., & Shinyekwa, I,Trade, revenue and welfare effects of the East African Community Customs Union Principle of Asymmetry on Uganda: an application of Wits-Smart simulation model,2011, (No. 677-2016-46674).
[67] (James and Van Parys 2010) (n59)

4.4: Strategies that can Enhance Foreign Direct Investment

The study was interested in examining strategies that can enhance foreign direct investment. Different scholarly articles were reviewed and found that there are different strategies that can be used to improve foreign direct investment. Most of the research works stated that, there is a need to improve infrastructure in form a good road network and telecommunication network in the country.

Numerous scholarly articles found quality infrastructure, such as roadways, transportation, highways, ports, telecommunication, water supply, electricity among others play critical role to attract and develop FDIs. Studies by Khadaroo and Seetanah [68] addressed mainly on transport infrastructure along with some other variables of FDI and evidenced the positive significant contribution of infrastructure in increasing FDI.

However, several studies suggested that infrastructure has a positive influence on foreign direct investment and that a macro environment which is stable, including accessible and sufficient resources, access to engaging in international trade as well as presence of appropriate infrastructure and human capital plays a key role in attracting foreign direct investment.

Kok [69] investigated the significant effect of Infrastructure on FDI in developing economies and Some other similar studies also observed the positive role of Infrastructure in attracting Foreign Direct Investment[70]

According to MB Obwona [71] macroeconomic, political stability and policy consistency or favorable regulatory policies are more important than incentive schemes then infrastructure and institutional bottlenecks are deterrents. This is similar to the study made by Hall and Dale, (2003)[72] the study found FDIs incentives especially tax incentives are not an important factor in attracting foreign investment.

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[68]Khadaroo, A. J., & Seetanah, B, Transport infrastructure and foreign direct investment. Journal of International Development,2010, The Journal of the Development Studies Association, 22(1), 103-123.
[69]Kok, R., & Ersoy, B. A, Analyses of FDI determinants in developing countries,2009, International Journal of Social Economics.
[70]Rehman, C. A., Ilyas, M., Alam, H. M., & Akram, M, The impact of infrastructure on foreign direct investment: The case of Pakistan,2011, International Journal of Business and Management, 6(5), 268.
[71]Obwona, M. B. 2001, Determinants of FDI and their Impact on Economic Growth in Uganda,2001, African development review, 13(1), 46-81.
[72]Hall, R. E. Corporate earnings track the competitive benchmark,2003

Another scholar recommends that the government should provide more support on worker training and that Uganda Investment Authority should promote transparency while providing investment incentives and ensure impartial system of courts and law enforcement to provide favorable investment climate for investors[73]

It is not in doubt that Uganda has the abundance of investment opportunities. It should, however, complement this with deliberate policies to attract, retain and optimize the benefits inherent in foreign direct investment. This will involve the promotion, facilitation and supervision or regulation of FDI. Investment Promotion will sell the country's huge investment opportunities to the rest of the world.

Investment Facilitation will ensure that the foreign investors are retained and increasing shares of their investment wallets obtained by drastically reducing the difficulties they encounter in doing business in the country; while Investment Supervision or Regulation will guarantee that these foreign investments are not solely for the benefits of the foreign investors, but also for the benefit of the local economy[74]

[73] (Elinorah tumushime2018) (n3)
[74]Ajaegbu, C. C. (2013) (n6)

CHAPTER FIVE

CONCLUSION AND RECOMMENDATIONS

5.1: Introduction

Tax incentives have been adopted by governments as a policy tool for accelerating investment in specific economic sectors and attracting foreign direct investments. Some of the efforts of the government to create a conducive environment for foreign direct investment in Uganda are such that Ugandan companies should be granted loans and be exempt from tax where the required conditions are met, tax holidays are granted to a company as a tax –free status for a certain period. Investment allowances encourage for undertaking long-term planning and enhance approach towards investment. The initial investment allowance on plant and machinery implies that effective corporation tax rates would be considerably lower than nominal rates in the early stage of a project and companies can retain more of their income and cash flow for future investment. Many developing countries with high levels of investments have attractive VAT regimes with low rates. Based on the empirical evidence and results of the analysis, ta positivepositive and statistically significant relationship between the tax incentives and FDI. This implies foreign investors can maximize their investment by taking advantage of the available tax incentives allowed by the government to create an enabling investment environment.

5.2: Findings, Recommendations and Conclusion

Based on the analysis conducted on the effect of tax incentives and tax holidays on foreign direct investment (FDI) in the oil and gas sector of Uganda, the study has yielded the following findings:

Positive Impact of Tax Incentives and Tax Holidays: The findings indicate a significant positive relationship between tax incentives, tax holidays, and FDI inflows in Uganda's oil and gas sector. Foreign investors are attracted to the sector when they are provided with reduced tax burdens, accelerated depreciation allowances, and exemptions on corporate taxes. These fiscal policies enhance the sector's attractiveness, leading to increased FDI.

Mechanisms of Stimulating FDI: The study reveals that tax incentives and tax holidays stimulate FDI by reducing the tax burden on investors, providing stability and predictability in the tax regime, and creating a favorable investment climate. These mechanisms increase investor confidence, encourage long-term investments, and facilitate resource exploration, extraction, and infrastructure development in the oil and gas sector.

Interaction with Other Factors: The analysis highlights the importance of considering other factors alongside tax incentives and tax holidays. Variables such as GDP growth, political stability, infrastructure development, and resource availability play significant roles in influencing FDI in the oil and gas sector. While tax incentives are important, they should be implemented in conjunction with efforts to improve these complementary factors to maximize FDI inflows.

5.2.1. Recommendations:

Based on the findings, the following recommendations are proposed to optimize the effect of tax incentives and tax holidays on FDI in Uganda's oil and gas sector:

Streamline the Tax System: The Ugandan government should ensure the tax system is transparent, predictable, and investor friendly. Simplifying tax regulations, reducing administrative burdens, and providing clear guidelines on tax incentives and tax holidays will enhance the attractiveness of the sector to foreign investors.

Align Tax Incentives with Sector-specific Goals: Tax incentives should be designed in alignment with sector-specific goals and development plans. This approach ensures that incentives are targeted towards activities that support the country's energy sector objectives, such as infrastructure development, technology transfer, and environmental sustainability.

Enhance Stability and Predictability: Maintaining stability and predictability in the tax regime is crucial for attracting FDI. Governments should avoid frequent changes in tax policies and provide a predictable investment climate to build investor confidence and encourage long-term commitments.

Promote Coordination and Collaboration: Collaboration between government agencies, investment promotion bodies, and industry stakeholders is vital for effective implementation and monitoring of tax incentives and tax holidays. Regular communication and coordination can ensure that the benefits of these fiscal policies reach the intended recipients and align with the overall investment promotion strategy.

Conclusion:

In conclusion, the study findings support the positive impact of tax incentives and tax holidays on FDI in the oil and gas sector of Uganda. These fiscal policies contribute to the attractiveness of the sector, stimulate investor interest, and encourage resource exploration, extraction, and

infrastructure development. However, it is important to consider the interaction of tax incentives with other factors that influence FDI, such as political stability, infrastructure, and resource availability.

The recommendations provided aim to optimize the effect of tax incentives and tax holidays on FDI in Uganda's oil and gas sector. By streamlining the tax system, aligning incentives with sector-specific goals, ensuring stability, and promoting collaboration, Uganda can enhance its investment climate and attract more FDI into the oil and gas sector. This, in turn, will contribute to the sustainable development of the sector, economic growth, and the maximization of Uganda's oil and gas resources.

Recommendations:

Monitor and Evaluate the Effectiveness: It is crucial to establish a robust monitoring and evaluation mechanism to assess the effectiveness of tax incentives and tax holidays in attracting FDI and achieving desired outcomes. Regular evaluation will help identify any necessary adjustments or revisions to the incentive framework to ensure its continued relevance and effectiveness.

Ensure Local Content Development: To maximize the benefits of FDI in the oil and gas sector, it is important to prioritize local content development. This can be achieved by implementing policies that encourage technology and knowledge transfer to local companies, foster linkages with domestic suppliers, and promote skills development among the local workforce. Tax incentives and tax holidays can be designed to incentivize foreign investors to engage in meaningful local content initiatives.

Foster Transparency and Accountability: Transparent governance practices and accountability mechanisms are essential in ensuring the effective implementation and management of tax incentives and tax holidays. The government should promote transparency in the administration of these incentives, disclose relevant information, and establish mechanisms to address any potential abuses or misuse of the fiscal policies.

Continual Assessment and Adaptation: The effectiveness of tax incentives and tax holidays may evolve over time due to changing market dynamics, technological advancements, and global

economic conditions. It is crucial to regularly reassess the incentive framework to ensure its continued relevance and alignment with the sector's goals and changing investor preferences.

5.3. Conclusion:

In conclusion, the study highlights the positive impact of tax incentives and tax holidays on FDI in Uganda's oil and gas sector. The findings emphasize the importance of designing a well-structured and targeted incentive framework that reduces the tax burden, promotes stability, and creates a favorable investment climate. However, it is crucial to consider the broader context, including other factors influencing FDI, and to continually monitor and adapt the incentive framework to maximize its effectiveness.

By implementing the recommended measures, Uganda can attract more foreign investment, unlock the potential of its oil and gas sector, and realize sustainable economic growth. The effective utilization of tax incentives and tax holidays, along with complementary policies and strategies, will contribute to the development of a vibrant and competitive oil and gas industry, while ensuring the optimal utilization of Uganda's natural resources for the benefit of its economy and society as a whole

5.4: Limitations of the study and advise for further research

- The researcher had hoped to use primary data from the oil and gas companies but was denied permission by the Petroleum Authority of Uganda. This prompted the researcher to change the methodology and use secondary data.
- In the bid to get the secondary data from Uganda revenue authority, the researcher also faced hardship in getting the secondary data from the Uganda Revenue Authority, thus prompted the researcher to use secondary data from document reviews of journals, publications and research works of scholars
- And because of the bureaucracy and moving from office to office, the researcher was limited by time and this caused delay in report writing
- Due to limited time available to carry out the research, the above areas were not comprehensively studied to provide a national wide picture. This would be an important area because policy makers and implementers argue that the facts about tax incentives has not been well researched.

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