policy forum

TAX JUSTICE NETWORK AFRICA

Trade Mis-Invoicing: A Threat to Domestic Revenue in Tanzania

1. About this policy brief

This policy brief intends to bring about an understanding of the concept of trade mis-invoicing and lay out its causes, impacts to domestic revenue and ways to curb it.

2. Meaning of Trade Mis-Invoicing

Trade Mis-invoicing refers to the intentional misstating of the value, quantity, or composition of goods on customs declaration forms and invoices, usually for the purpose of evading taxes or laundering money. There are four basic categories of trade mis-invoicing: import under-invoicing, import over-invoicing, export under-invoicing, and export over-invoicing. Most trade mis-invoicing is done with the knowledge and approval of the seller and the buyer in the transaction. The two parties, if they are not part of the same company, will agree to the mis-invoicing and how they will settle the transaction outside legal confines, often through a deposit into another bank account.

3. The magnitude of trade mis-invoicing in global economy

Trade mis-invoicing is one of the most pressing challenges facing policymakers. The global figure for illicit financial outflows from developing countries is approximately $542 billion per year on average (over a 10-year time series), and trade mis-invoicing makes up close to 80 percent of this or $424 billion. Capital flight, facilitated by a global network of secrecy jurisdictions and complex, opaque corporate and account structures, robs governments and societies of needed revenue for domestic investment in the private sector, infrastructure development, and the provision of vital social services. This translates into lost opportunities, lost jobs, and lost potential.

4. Position in Tanzania

Estimations by Global Financial Integrity (GFI) indicate that trade mis invoicing was responsible for two-thirds of all IFFs, which amounted to $600-900 billion for developing countries alone. In Tanzania illicit flows due to trade mis invoicing were $18.73 billion from 2002–2011 which is approximately $1.87 billion (TZS 3 trillion) annually. This annual loss is nearly three times the amount the Government must service the national debt for the FY 2023/24 which is TZS 10 trillion (6 trillion being principal payment and 4 trillion being interest). This means that if Tanzania manages to tackle mis invoicing, there won't be a need to borrow the amount of funds that we currently do.

Similarly, based on revised edition of 2017 (I billion-dollar question) the study revealed that the pre-eminent body analysing illicit financial flows, the US-based GFI has found that $7.73 billion in domestic capital drained out of the Tanzanian economy illegally in the five years 2007-11 as a result of trade mis invoicing – an average of $1.55 billion a year.

5. Why tackle trade mis-invoicing?

Trade mis-invoicing is one of the many forms of illicit financial flows and the global shadow financial system. The mis-invoicing occurs through commercial invoices and customs declarations, but the transfers and motivations involved are linked to money laundering and cross-border tax evasion or avoidance.

A country with weak laws or law enforcement of money laundering statutes is likely to encourage trade mis-invoicing by making it easier to transfer and use the money gained from the illegal transaction. Trade mis-invoicing also happens when the custom authorities fail to collect the data they need to analyse the magnitude of illicit flows due to the tax revenue and investment capital lost as a result. Insufficient data and limited processes for questioning mis-valued invoices are plaguing efforts of the government to curtail trade mis invoicing and reduce the reach of the shadow financial system.

6. Trade Mis-invoicing has a negative impact in domestic revenue mobilization due to the following reasons:

- Trade mis-invoicing is a significant source of illicit outflows and inflows of capital resulting in billions of dollars of lost investment and hundreds of millions of dollars in unrealized domestic resource mobilization.
- Trade mis-invoicing robs governments of customs duties and corporate tax revenues and deprives the economy of domestic capital for investment.
- It leads to the reductions of economic growth and opportunity, in potential resources for infrastructure investment, and in potential resources for expanding social services severely undermine efforts to develop a country's economy.

8. Recommendations

1. The Government should develop a specific law/policy that will govern trade mis invoicing in Tanzania as it did on transfer pricing. Greater transparency is key to designing new or improving policies to address these illicit transfers of capital out of the country.
2. The Government should put emphasis on exchanging tax information with other countries on corporations that have a presence in both countries, this can help officials detect possible trade mis-invoicing.
3. The Government through the Tanzania Revenue Authority should strive to improve internal efficiency information & technology for tax administration.
4. The government should emphasize on beneficial ownership registry. Having access to beneficial ownership information will help the government officials to track and prosecute the parties engaged in trade mis-invoicing.

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