Tanzania and the problem of Tax Exemptions

Policy Brief 3:2013

Given Tanzania's challenged ability to collect domestic revenue and high dependence on external sources for funding the national budget, the government recognises the need to revise its revenue policies. In recent years, the government has continued to declare its intention to implement policy decisions aimed at increasing both tax and non-tax revenue as well as curtailing tax exemptions. The annual budget process offers a valuable opportunity to assess whether such objectives are being met.

This post-budget brief looks at whether the government's budget is in line with the declared revenue policies, particularly from the perspective of tax exemptions reduction.

"Tax exemption is like a dessert; it is good to have, but it does not help very much if the meal is not there"- American investor[1]

Introduction

In the 2012/13 financial year, the government implemented new revenue policies aimed at increasing domestic revenue and reducing dependence on external funding which included undertaking measures such as enhancing tax laws, boosting the use of electronic systems in tax collection and expanding the tax base by formalising the informal sector. Also, on their plans in the previous financial year, was the intention to reduce tax exemptions.

Tax exemptions

Tax exemptions in Tanzania have reached exorbitant heights and the government recognises that they result in large loss of revenues that are severely needed for service delivery. According to the speech by the Minister for Finance William Mgimwa during the 2013/14 Budget Speech, in FY 2011/12, tax exemptions amounted to 4.3% the Gross Domestic Product (GDP) and the target in the medium term is to reduce them to 1%.[2] To achieve this, however, will require drastic measures because as the trend shows, exemptions increasing over the years (see table below) from Tshs. 680m/- in the FY 2009/10 to Tshs. 1.8tri in FY 2011/12, which stood at about 21.6% of the Tshs. 8.3tri that was collected in the same financial year.

[1] An American investor as quoted in a survey by Yair Aharoni (1966) "The foreign investment decision process", Division of Research, Graduate School of Business Administration, Harvard University

[2] Speech by the Minister for Finance William Mgimwa during the 2013/14 Budget Speech whilst introducing to the National Assembly, the estimates of Government revenue and expenditure for the Fiscal Year 2013/2014

Tax Exemptions Trend [3]

FY	2009-10	2010-11	2011-12
Exemptions	680,667,900,000	1,016,320,300,000	1,806,203,559,827
Proportion of exemptions to actual collection	15%	18%	27%

The measures the minister stated would be required by government for the FY 2013/14 included removing VAT exemptions on tourist services; reviewing the Tanzania Investment Act Section 38 so as to reduce tax exemptions for deemed capital goods (and retain only a few which will stimulate strategic investments); and continue enhancing the capacity of Government officials including Tanzania Revenue Authority (TRA) officials in order to enhance their knowledge and skills with a view to curb tax evasion and avoidance particularly on deceptions often used by big companies especially in communication, minerals and gas sectors including transfer pricing.

Furthermore, for FY 2013/14, the Government intends to focus on tax exemptions which are not productive, excessive and are prone to abuse. In that respect, the Government is currently undertaking a comprehensive review of the Value Added Tax Act and is also in the process of finalizing the study on Tax Exemptions with a view to assess costs and benefits.

But would these measures be enough to reduce the exemptions when the government intends to continue providing tax exemptions to investors in the Economic Processing Zones (EPZs) and Special Economic Zones (SEZs)? The Minister for Finance says these are needed to "promote production of exports and investments in desirable economic activities."[4] It would have been more appropriate, however, to first conduct an independent study to evaluate the economic impact and volume of revenue that has been generated by the EPZs and SEZs as a result of the incentives given by government.

After all, researches such as those conducted by the African Department of the IMF continue to show that tax incentives are not the leading factor for foreign investors when deciding to invest in a country. Good infrastructure, low administrative costs in running businesses, a stable political situation and predictable macroeconomic policy are more significant considerations for

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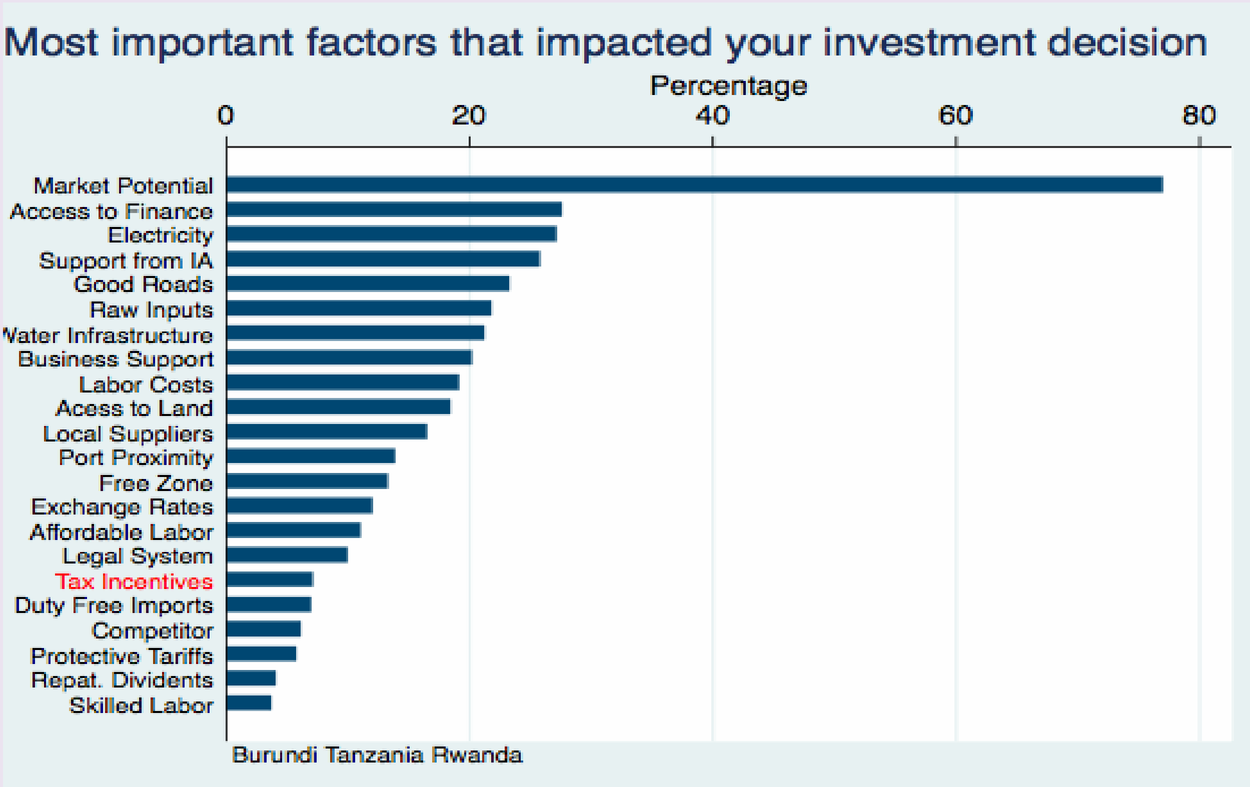
[3] Annual General Reports of the Controller and Auditor General on the Audits of the Financial Statements of the Central Government for the years ending 30th of June, 2010, 2011 & 2012.

[4] Speech by the Minister for Finance William Mgimwa during the 2013/14 Budget Speech whilst introducing to the National Assembly, the estimates of Government revenue and expenditure for the Fiscal Year 2013/2014

investors. In Tanzania, moreover, the IMF report notes that the introduction of EPZs in 2002 'has not resulted in a noticeable pickup in foreign investment'[5].

An investor motivation survey for 2012 found that in Burundi, Rwanda and Tanzania, only 7.9% (39 out of 450 cases) of all respondents in all three countries said that they would not have invested without tax and fiscal incentives they received (also see graph below on most important factors that investors base the decisions on).[6] All this creates a compelling case for working towards the elimination of tax incentives that are granted solely to attract and retain Foreign Direct Investments.



The envisioned study on tax exemptions aimed at assessing their costs and benefits is welcome. In a bid to expand the scope, the study should, moreover, examine closely the tax exemptions that involve the exercise of discretionary powers by Ministers and suggest ways the economical beneficial ones can be made simple to administer. Following this, the report should be made public as an initial step towards improving mechanisms for government accountability on matters related to tax exemptions. In the long term, there should be regular, transparent and calibrated tax expenditure analyses (and budgeting for these tax exemptions as 'expenditures') that are shared with and scrutinised by the public.

5 IMF, *Kenya, Uganda and United Republic of Tanzania: Selected Issues*, 1 December 2006,

6 Sebastian, J. and Krasniqi, M. (2012) Investor Motivation Survey.

Further relevant recommendations are as stated in the 2011 CAG report[7] which include:

1. The Government should either limit exemptions to 5% of the total collected revenues or do away with granting tax exemptions which benefit able people and companies which should pay tax.
2. Tax incentives being administered by TIC should be abolished or harmonised with TRA and other government agencies.
3. The government should curb tax loopholes including tax exemptions and illicit transfer pricing amongst multinational companies

At the regional level, other measures should include the promotion and coordination in the East African Community to address harmful tax competition. This means agreeing on the removal of all Foreign Direct Investment related tax incentives and improving the existing draft Code of Conduct on tax competition in the community. Together with this, minimum rates on certain taxes can be agreed and annual, comparable tax East Africa expenditure analyses can be conducted and made publicly available for all citizens in the region to see whether tax exemptions are beneficial.

Conclusion

Tanzania has not reduced its tax exemptions according to the policy statements despite the risk that the benefits of tax incentives on investment could be considerably exaggerated and costs mostly underrated. If the country is to progressively increase the collection of domestic revenue and reduce its high dependence on external sources for funding the national budget, it is paramount that the government steadfastly moves towards reducing these expenditures that are limiting financing aimed at crucial public services.

[7] Annual General Reports of the Controller and Auditor General on the Audits of the Financial Statements of the Central Government for the years ending 30th of June, 2011.

This policy brief was prepared by:

Policy Forum Budget Working Group.

policy forum

Plot 14, Sembeti Road
Off Old Bagamoyo Road,
Mikocheni B, P.O. Box 38486
Tel: +255 22 2780200
Email: info@policyforum.or.tz
www.policyforum.or.tz