

Tax Competition in East Africa

A race to the bottom?

Tax Incentives and Revenue Losses in Tanzania



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About TJN-A

Tax Justice Network-Africa (TJN-A) is a Pan-African initiative established in 2007 and a member of the global Tax Justice Network. TJN-A seeks to promote socially just, democratic and progressive taxation systems in Africa. TJN-A advocates pro-poor taxation and the strengthening of tax regimes to promote domestic resource mobilization. TJN-A aims to challenge harmful tax policies and practices that favor the wealthy and aggravate and perpetuate inequality.

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ActionAid International (AAI) is a non-partisan, non-religious development organization that has been working in Kenya since 1972. ActionAid seeks to facilitate processes that eradicate poverty and ensure social justice through anti-poverty projects, local institutional capability building and public policy influencing. The organisation is primarily concerned with the promotion and defence of economic, social, cultural, civil and political human rights and supports projects and programmes that promote the interests of poor and marginalized people.

About Policy Forum

Policy Forum is a network of over 100 Tanzanian civil society organisations drawn together by their specific interest in influencing policy processes to enhance poverty reduction, equity and democratization with a specific focus on public money accountability.

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Summary

The government of Tanzania is providing a wide range of tax incentives to businesses to attract greater levels of Foreign Direct Investments (FDIs) into the country. This study shows that such tax incentives are leading to very large revenue losses and may not necessarily be needed to attract and retain FDIs.

Different estimates are available for the revenue losses caused by the government's granting of tax incentives and exemptions. We show that, taking these different estimates into account, revenue losses from *all tax exemptions and incentives* may be as high as TShs 1.8 trillion (US\$ 1.23 billion) in 2008 and that the *minimum* revenue loss from *tax incentives* granted to companies alone is around TShs 381 billion (\$174 million) a year (for the years 2008/09 – 2009/10). For the year 2011/12, exemptions amounted to TShs.1,016,320,300,000 which is about 18 per cent of total tax collections. This is an increase of 3 per cent compared to the ratio of exemptions to total revenue collections in the 2009/10 financial year.

Due to the exemptions, the country is being deprived of the badly-needed financial resources needed for financing public expenditure of goods and services both in the development and recurrent budget. These are resources that, if collected, could contribute substantially in to reduce the number of 36 per cent of Tanzanians living beyond the poverty line. For example, if the public revenue lost through tax incentives were spent on education and health, the education budget would increase by more than a fifth and the health budget by more than two-fifths. This is vital when average per capita incomes are just US\$ 530 and when more than a third of the country's 44 million people live under the poverty line.

Tanzania's provision of tax incentives is arguably part of the tax competition among the members of the East African Community (EAC). Following the EAC's establishment in 1999, Kenya, Tanzania and Uganda created a customs union (a duty-free trade area with a common external tariff) in 2005, and were joined by Rwanda and Burundi in 2009. This has created a larger regional investments destination for FDIs in general and market-seeking FDIs in particular¹. Under the EAC common market, firms in general and Multinational Enterprises (MNEs) undertaking FDIs in particular can be located in any of the EAC countries. At the same time, however, countries are being tempted to increase tax incentives in order to attract and retain more FDIs in order to benefit from these investments in for of employment; revenues from taxes, fees, royalties and dividends among others; inter-sectoral linkages; technology transfers and other potential gains from FDIs in host economies . Our analysis suggests that the provision of tax incentives across the East Africa region in general and in Tanzania in particular represents harmful tax competition and may be leading to a 'race to the bottom'.

Tanzania provides a wide range of tax incentives. In the Export Processing Zones (EPZs) and Special Economic Zones (SEZs) , companies are exempted for the first 10 years from paying corporate income tax and all taxes and levies imposed by Local

¹ FDIs can be market-seeking, resources-seeking or efficiency-seeking

Government Authorities (LGAs), and are also granted import duty exemptions on raw materials and capital goods imported for manufacturing goods. If they export at least 80 per cent of their products, such products are not taxed. Mining companies are given special treatment, and pay zero import duty on fuel, are exempted from capital gains tax, pay a reduced rate of stamp duty and receive special VAT relief. Other groups of investors that benefit from incentives include companies holding certificate of incentives from the Tanzania Investment Centre (TIC); investors with 'strategic investors' status and investors in agricultural sector.

Analysis suggests that the main beneficiaries of tax incentives and exemptions in Tanzania are a small group of foreign investors, while the losers – due to substantial revenue losses - are the general population and the country as a whole. Yet a 2006 report by the African Department of the International Monetary Fund (IMF), focusing on East Africa, notes that 'investment incentives – particularly tax incentives – are not an important factor in attracting foreign investment'. More important factors are good quality infrastructure, low administrative costs of setting up and running businesses, political stability and predictable macro-economic policy. In Tanzania, the introduction of EPZs in 2002 'has not resulted in a noticeable pickup in foreign investment', the IMF report notes. Uganda has continued to attract higher levels of FDIs than Tanzania, which provides much more generous investment incentives.

The government recognises that tax exemptions and incentives entail a large revenue loss and is taking some steps to reduce them. However, the progress is slow and the real extent of government commitment is questionable. Most importantly, for this analysis, it remains unclear what further steps the government will take to reduce tax incentives granted to mining companies, businesses operating in the Export Processing Zones and Special Economic Zones; investors with TIC certificate of incentives as well as those with 'strategic investors' status.

In our view, the government should:

- Remove some tax incentives granted to attract and retain FDIs, especially those provided to the mining sector, EPZs and SEZs.
- Undertake a review, to be made public, of all tax incentives with a view to reducing or removing many of them, especially those that involve the exercise of discretionary powers by Ministers.
- Provide on an annual basis, during the budget process, a publicly available tax expenditure analysis, showing annual figures on the cost to the government of tax incentives and showing who are the beneficiaries of such tax expenditure.
- Be responsible and accountable to the public in all matters related to granting of incentives and exemptions.
- Take greater steps to promote coordination in the EAC to address harmful tax competition and support current initiatives in favour of Country-by-Country reporting by multinational companies.
- Take deliberate fiscal and policy moves to curb transfer pricing and illicit shifting of profits generated from the enormous tax and non-tax incentives granted by government.

Abbreviations and Acronyms

AfDB	–	African Development Bank
CAG	–	Controller and Auditor General
DFP	–	DonorFunded Projects
DSE	–	Dar es Salaam Stock Exchange
EAC	–	East African Community
EPZs	–	Export Processing Zones
EPZA	–	Export Processing Zones Authority
EU	–	European Union
FDI	–	Foreign Direct Investments
GDP	–	Gross Domestic Product
IMF	–	International Monetary Fund
LGAs	–	Local Government Authorities
MNEs	–	Multinational Enterprises
NGO	–	Non Governmental Organization
PAYE	–	Pay As You Earn
TMAA	–	Tanzania Minerals Audit Agency
TRA	–	Tanzania Revenue Authority
Tshs	–	Tanzanian Shillings
UN	–	United Nations
USD	–	United States of America Dollar
SEZs	–	Special Economic Zones
VAT	–	Value Added Tax

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Introduction

The government of Tanzania is providing a wide range of incentives in general and tax incentives in particular. The aims are to attract and retain greater levels of Foreign Direct Investments (FDIs) into the country. The presence of tax holidays has enabled a number of firms, notably mining companies, manufacturing and processing firms, hotels and tourist lodges, to effectively escape taxation altogether.² This study shows that such tax incentives are leading to very large revenue losses and are not necessarily needed to attract and retain more FDIs.

Different estimates are available for the revenue losses caused by the government's granting of tax incentives and exemptions. We show that, taking these different estimates into account, revenue losses from *all tax exemptions and incentives* may be as high as TShs 1.8 trillion (US\$ 1.23 billion) in 2008 and that the *minimum* revenue loss from *tax incentives* granted to companies alone is around TShs 381 billion (\$174 million) a year (for the years 2008/09 – 2009/10). For the year 2011/12 exemptions amounted to Shs.1,016,320,300,000. This is about 18 per cent of total tax collections. This is an increase of 3 per cent compared to the ratio of exemptions to total revenue collections in the 2009/10 financial year which was 15 per cent³.

Due to the exemptions, the country is being deprived of the badly-needed financial resources needed for financing public expenditure of goods and services both in the development and recurrent budget. These are resources that, if collected, could contribute substantially in to reduce the number of 36 per cent of Tanzanians living beyond the poverty line. For example, if the public revenue lost through tax incentives were spent on education and health, the education budget would increase by more than a fifth and the health budget by more than two-fifths. This is vital when average per capita incomes are just US\$ 530 and when more than a third of the country's 44 million people lives under the poverty line.

In 2009/10, Tanzania collected TShs 4.45 trillion in taxes. Of these, around 30 per cent came each from Value Added Tax (VAT), income tax and import/excise duties.⁴ The taxes collected amounted to 14.6% of Gross Domestic Product (GDP) in 2009/10,⁵ yet the IMF estimates that Tanzania has a potential tax revenue of 20.9% of GDP.⁶ This means that its 'tax gap' – the difference between actual and potential revenue collections – was a massive 6.3% of GDP in 2009/10, amounting to around TShs 1.9 trillion.⁷

² Odd-Helge Fjeldstad and Kari Heggstad, 'Tax system in Tanzania: Capacity and Constraints', *The Citizen*, 26 June 2011

³ See Controller and Auditor General (CAG) 2011 report

⁴ MOF, Financial Statement and Revenue Estimates, 2011/12 Budget, Vote 21, www.mof.go.tz.

⁵ IMF, *Staff Report for the 2011 Article IV Consultation and Second Review under the Policy Support Instrument*, 21 April 2011, p.25; World Bank, *United Republic of Tanzania, Public Expenditure Review 2010*, September 2011, pp.9, 85

⁶ IMF, *Seventh Review under the Policy Support Instrument*, 18 May 2010, p.20

⁷ IMF, *Staff Report for the 2011 Article IV Consultation and Second Review under the Policy Support Instrument*, 21 April 2011, p.25; Tax gap in TShs is based on GDP figures of TShs 30,321 billion in 2009/10

There has been an increase in the proportion of exemptions as a per cent of total tax collection in Tanzania. This is partly captured in the table below.

Table 1: Tax collection and exemption for 2009/10 and 2011/12

Explanation	2011/2012	2009/2010
Actual Collection	5,550,205,244,378	4,637,686,999,618
Exemptions	1,016,320,300,000	680,667,900,000
Proportion of exemptions to actual collection	18%	15%
Deficit in collection	298,888,455,622	391,235,100,382
Surplus if exemptions had not been granted	717,431,844,378	289,432,799,618

Source: Controller and Auditor General's report 2011

Tanzania's provision of tax incentives is arguably part of the tax competition among the members of the East African Community (EAC). Following the EAC's establishment in 1999, Kenya, Tanzania and Uganda created a customs union (a duty-free trade area with a common external tariff) in 2005, and were joined by Rwanda and Burundi in 2009. This has created a larger regional investments destination for FDIs in general and market-seeking FDIs in particular⁸. Under the EAC common market, firms in general and Multinational Enterprises (MNEs) undertaking FDIs in particular can be located in any of the EAC countries. At the same time, however, countries are being tempted to increase tax incentives in order to attract and retain more FDIs in order to benefit from these investments in for of employment; revenues from taxes, fees, royalties and dividends among others; inter-sectoral linkages; technology transfers and other potential gains from FDIs in host economies. Our analysis suggests that the provision of tax incentives across the East Africa region in general and in Tanzania in particular represents harmful tax competition and may be leading to a 'race to the bottom'.

Unfortunately, countries are continuously being tempted to increase investment incentives in general and tax incentives in particular in order to attract and retain more FDIs As a 2006 IMF report notes:

*'Increased competition over FDI and growing pressure to provide tax holidays and other investment incentives to attract (and retain) investors could result in a "race-to-the bottom" that would eventually hurt all three [ie, Kenya, Uganda and Tanzania] EAC members. Left unchecked, the contest could result in revenue loss, especially in Tanzania and Uganda, and threaten the objective of improving revenue collection.'*⁹

Our analysis suggests that this is indeed happening and that the wide range of tax incentives provided by Tanzania and its fellow member states in the EAC are leading to a 'race to the bottom'.

⁸ FDIs can be market-seeking, resources-seeking or efficiency-seeking

⁹ IMF, *Kenya, Uganda and United Republic of Tanzania: Selected Issues*, 1 December 2006, p.5

Box 1: Understanding Tax Incentives

A tax incentive is defined as ‘a deduction, exclusion or exemption from a tax liability, offered as an enticement to engage in a specified activity such as investment in capital goods for a certain period’.¹⁰ Tax incentives are the fiscal form of investment incentives and include corporate income tax holidays and reductions in tax rates. Non-fiscal or non-tax incentives include direct subsidies like government grants, loans and guarantees for target projects. Tax incentives are granted to attract FDI and/or to promote specific economic policies, such as to encourage investment in certain sectors.

Investment Incentives¹¹

Corporate income tax incentives

- Tax holidays or reduced tax rates
- Tax credits
- Investment allowances
- Accelerated depreciation
- Reinvestment or expansion allowances

Other tax incentives

- Exemption from or reduction of withholding taxes
- Exemption from import tariffs
- Exemption from export duties
- Exemption from sales, wage income or property taxes
- Reduction of social security contributions

Financial and regulatory incentives

- Subsidised financing
- Grants or loan guarantees
- Provision of infrastructure, training
- Preferential access to government contracts
- Protection from import competition
- Subsidised delivery of goods and services
- Derogation from regulatory rules and standards

¹⁰ See <http://www.businessdictionary.com/definition/tax-incentive.html> accessed on 11th April, 2011.

¹¹ IMF, *Kenya, Uganda and United Republic of Tanzania: Selected Issues*, 1 December 2006, p.10

1. Tax Incentives in Tanzania

Tanzania applies a wide range of tax incentives. Some of these are outlined in what follows.

Tax incentives for all TIC certificate of incentives holders¹²

Investors who meet the minimum investment threshold of \$100,000 for local companies and \$300,000 for foreign companies are eligible for a Certificate of Incentives issued by TIC. Such certificate holders receive:

- Import duty exemption on project capital goods in lead sectors, including agriculture, mining and infrastructure
- 5 per cent import duty exemption on project capital items in priority sectors, including aviation, commercial buildings, commercial development and microfinance banks, manufacturing, natural resources including fishing, radio and television broadcasting and tourism.
- 100% capital allowance on industrial plant, buildings and machinery and on agricultural expenditure.
- 0% Value Added Tax (VAT) on inputs for mining, agriculture, tourism and goods manufactured for export.
- Under the import duty drawback scheme, businesses are entitled to a refund of duty charged on imported inputs for goods destined for export or to be sold to international institutions like the United Nations (UN).
- Businesses can carry over losses for five years against future profits.

Tax incentives for investors in Export Processing Zones and Special Economic Zones¹³

Tanzania's Export Processing Zones (EPZs) Act was passed in 2002 and sought to attract FDIs and promote exports, increase employment opportunities and promote technology transfer.¹⁴ The Act requires that at least 80 per cent of the goods produced or processed in an EPZs should be for export. The annual turnover of companies should not be less than US\$ 500,000¹⁵ for foreign investors and US\$ 100,000 for local investors. In 2006, the government established Special Economic Zones (SEZs), which include EPZs, Free Ports, Free Trade Zones, Industrial Parks, Science and Technology Parks, Agricultural Free Zones, and Tourism Development Zones. Investors qualify under the SEZ scheme if they demonstrate that their investment is new, achieve a minimum annual export turnover of US\$ 5 million for foreign investors and US\$ 1 million for domestic investors, provide adequate environmental protection and utilize

¹² See 'Corporate Tanzania: Business, Trade and Investment Guide 2010/2011', www.corporate-tanzania.com, p.57; Tanzania Investment Centre, 'FAQ Related to Investing in Tanzania' <http://www.tic.co.tz/>

¹³ Tanzania Export Processing Zones Authority and the Export Processing Zones Act No. 11 of 2002; 'Corporate Tanzania: Business, Trade and Investment Guide 2010/2011', www.corporate-tanzania.com, pp.57, 99

¹⁴ Information sourced from personal interview with a Senior Investment Facilitation Officer at the Tanzania Investment Authority. See also the official website of Tanzania Export Processing Zones Authority: <http://www.epza.co.tz/About-EPZ-Program.html>

¹⁵ The USD to Tshs exchange rate on June 3rd 2012 was about 1 USD to 1600 Tshs

modern production process and new machinery.¹⁶ The tax incentives in EPZs and SEZs include:

- Exemption from corporate income tax for the first 10 years.
- Exemption from withholding tax on rent, dividends and interest for the first 10 years.
- Import duty exemptions on raw materials and capital goods imported for manufacturing goods in the EPZs.
- Exemptions from VAT charges on utilities and wharfage.
- Exemptions from all taxes and levies imposed by Local Government Authorities (LGAs) for the first 10 years
- Unlimited repatriation of profits

Among the issues of concern in the context of tax exemption ‘for the first 10 years’ is that foot-loose investments, may easily close their operations after the expiry of the tax incentives and relocate in other EPZs and SEZs within the country as a new investment or even flag out to other countries. This implies that even after the ten years of tax exemptions, it is not guaranteed that investors in EPZs and SEZs will pay taxes.

Tax incentives for ‘strategic investors’

Tanzania’s ‘Strategic Investor Status’ accords various tax incentives to companies investing more than \$20 million. According to TIC, ‘For a big project of over US\$20 million offering specific/great impact to the society or economy¹⁷, investors can request for special incentives from the Government’.¹⁸ Thus some companies, notably foreign mining and agribusiness companies, have an individual fiscal agreement with the government, some of which offer special concessions to individual companies but which have never formally been made public. This lack of transparency in such agreements is a among the key burning issues in the context of good governance and prudent public financial management in general and taxation for funding public expenditure in particular.

Tax incentives for mining companies

Mining companies are given various tax incentives and exemptions. They include individual Mining Development Agreements which the government has signed with them. Although a new Mining Act was introduced in 2010 – replacing the Mining Act of 1998 – the mining agreements signed before 2010 remain in force. Their terms often vary, but many contain, and others are believed (they have not formally been made public¹⁹) to contain, fiscal ‘stabilisation’ clauses.²⁰ This means that the range of tax

¹⁶ Information sourced from personal interview with a Senior Investment Facilitation Officer at the Tanzania Investment Authority. See also the official website of Tanzania Export Processing Zones Authority: <http://www.epza.co.tz/About-EPZ-Program.html>

¹⁷ We are of the opinion that these ‘great impact to the society or economy’ should be more specific in order to avoid what now seems to be a loop hole for subjective rather than objective interpretation.

¹⁸ ‘Investment incentives’, <http://www.tic.co.tz/>

¹⁹ There are among the areas that call for transparency in public financial management

²⁰ In June 2011, for example, it was reported that the government was considering levying a ‘super profits tax’ on windfall earnings from mining. But AngloGold Ashanti, which operates the country’s

incentives provided in the individual agreements are still likely to apply even under the new Act. The tax exemptions enjoyed by mining companies include:

- Zero import duty on fuel (compared to the standard current levy of TShs 200 per litre) and on imports of mining-related equipment during prospecting and up to the end of the first year of production; after this, they pay 5 per cent.
- Exemption from capital gains tax (unlike other companies in Tanzania).
- Special VAT relief, which includes exemption from VAT on imports and local supplies of goods and services to mining companies and their subcontractors.
- The ability to offset against taxable income the cost of all capital equipment (such as machinery or property) incurred in a mining operation. Non-mining companies are entitled to a 100% depreciation allowance only for the first five years of operations.
- A reduced rate of stamp duty, at 0.3 per cent. This is included in several mining agreements signed between the government and the mining companies, even though the rate of stamp duty is set by law at 4 per cent.²¹
- A maximum payment of local government taxes up to \$200,000 a year, which is lower than the 0.3 per cent of turnover required by law.²²

Tax incentives for agricultural investors²³

Agricultural investors are offered:

- Zero-rated import duty on capital goods and all farm inputs
- Import duty drawback on raw materials for inputs used for exports
- Deferment of VAT payment on project capital goods
- Zero-rated VAT on agricultural exports and for domestically produced agricultural inputs

Further tax exemptions are provided under the 'Kilimo Kwanza' (Agriculture First) initiative²⁴, which aims to promote commercialisation and new technology in farming²⁵:

largest gold mine, stated that the introduction of such a tax would not affect its tax payments since its mining agreement with the government has a fiscal stabilisation clause, forbidding the government from raising taxes on the company.

'Documents confirm Tanzania is looking at mining "super profit tax"', Reuters, 8 June 2011; 'Anglo Gold says any Tanzanian "super profits" tax will not apply', Reuters, 8 June 2011

²¹ See Mark Curtis and Tundu Lissu, *A Golden Opportunity: How Tanzania is Failing to Benefit from Gold Mining*, October 2008, for discussion of fiscal incentives provided to mining companies and for the full sources in the section that follows

²² See Mark Curtis and Tundu Lissu, *A Golden Opportunity: How Tanzania is Failing to Benefit from Gold Mining*, October 2008, for discussion of fiscal incentives provided to mining companies and for the full sources in the section that follows

²³ See 'Corporate Tanzania: Business, Trade and Investment Guide 2010/2011', www.corporate-tanzania.com, p.72

²⁴ Initiated by the private sector in 2009.

²⁵ In the 2011/12 budget, the Minister of Finance stated that Kilimo Kwanza is expected to create employment, particularly for the rural youth, and that the World Bank plans to finance this initiative with US\$ 60 million, the equivalent of Tshs 92.8 billion; <http://www.mof.go.tz>. These exemptions are likely to benefit mainly large-scale, commercial farmers and bypass the majority of Tanzanians who are small-scale, subsistence farmers. The VAT exemptions on fuel, for example, apply only to organised farmer groups not individual smallholders while the import duty exemptions on tractors

- VAT is exempted on a number of items such as fuel used for the transportation of agricultural products like sugar cane, sisal and tea from the farm to the processing factory, animal feed and agricultural machines such as combine harvesters.
- Import duty is exempted on tractors.

Other tax exemptions

Newly-listed companies on the Dar Es Salaam Stock Exchange (DSE) with at least 30 per cent of their shares issued to the public pay only 25 per cent **corporate income tax** (compared to the standard 30 per cent) for the first three years.²⁶

Shares of companies listed on the DSE are exempted from paying **capital gains tax** (whose normal rate is 30 per cent).²⁷

There are a number of items exempted from **VAT**, in addition to those mentioned above. These include but are not limited to insurance, education, financial services and tourist services. Goods provided under technical aid or donor-funded projects and voluntary organisations are relieved from VAT.²⁸

Tax incentives for investors in Zanzibar²⁹

Zanzibar has established Free Economic Zones and Free Ports and also offers investors various incentives, the most important of which include:

- Exemption from corporate income tax (in an EPZ: 100 per cent for the first 10 years then 75 per cent for the next 10; in a Freeport: 100 per cent for the first 20 years)
- Exemption from import duty on machinery, equipment, construction/raw materials
- Exemption from taxes on goods for export
- Exemption from taxes on dividends for the first 10 years (in an EPZ only)
- Exemption from all local taxes for goods produced in the zone

are largely irrelevant to smallholders unable to afford such equipment which anyway is not relevant to working small plots of land. Policy Forum, 'Do Kilimo Kwanza Exemptions Benefit Poor Farmers?', *Policy Brief 3:10*, 2010

²⁶ TRA, *Taxes and Duties at a Glance 2010/2011*, p.1

²⁷ TRA, *Taxes and Duties at a Glance 2010/2011*, p.2; PKF, *Tanzanian Tax Guide 2010*, p.1

²⁸ TRA, *Taxes and Duties at a Glance 2010/2011*, p.6

²⁹ 'Corporate Tanzania: Business, Trade and Investment Guide 2010/2011', p.116, www.corporate-tanzania.com

2. *Winners and Losers from Tax Incentives*

A lack of transparency on the extent of tax incentives has long prevented the public adequately scrutinizing them. Yet analysis suggests that the main winners (beneficiaries) of tax incentives and exemptions in Tanzania are a small group of foreign investors. Losers – due to substantial revenue losses - are the general population and the country as a whole. The tax incentives enjoyed by beneficiaries imply more profits and dividends for shareholders. The money lost through incentives imply money that can no longer be available to finance public expenditure in forms of, inter alia, public education, health, infrastructure, water and security.

There are very different estimates available for the revenues losses caused by Tanzania's tax incentives and exemptions:

- A report for the African Development Bank (AfDB) notes that exemptions and incentives account for up to 6% of Gross Domestic Product (GDP), or TShs 1.8 trillion (US\$ 1.23 billion) in 2008.³⁰
- The East African Community (EAC) secretariat – covering *exemptions on import duties alone* - estimates that revenue losses from tax exemptions amounted to US\$ 435.9 million (TShs 955 billion) in 2008 and an average of US\$ 370 million (TShs 811 billion) in the three years 2006-08.³¹
- Analysis by a Non Governmental Organization (NGO), Uwazi, based on figures from TRA, shows that losses from incentives and exemptions amounted to TShs 752 billion in 2008/09 and TShs 695 billion in 2009/10.³²

According to the Uwazi analysis, the principal beneficiaries of these incentives and exemptions are those holding certificates with the Tanzania Investment Centre and the Zanzibar Investment Promotion Authority, which together accounted for around 45 per cent of the incentives and exemptions in 2008/09 – 2009/10; these are mainly transnational corporations.³³ Mining companies accounted for a further 7.5% of the beneficiaries. Thus together these companies account for around 52% of the incentives and exemptions provided. This amounts to an average of around TShs 381 billion in the years 2008/09 – 2009/10.

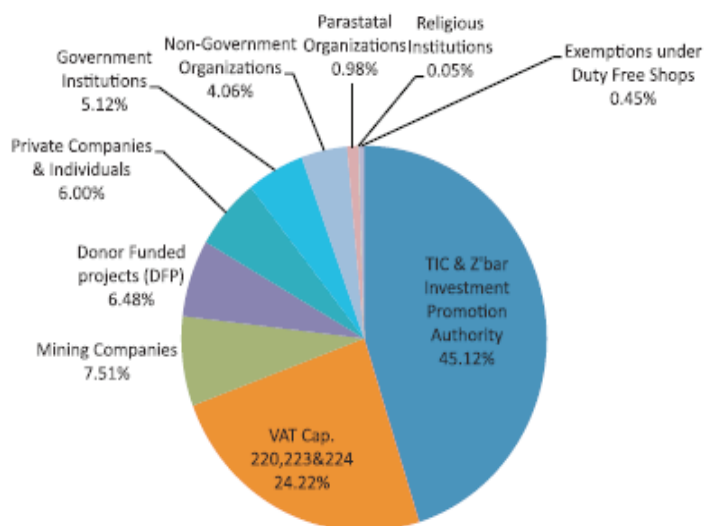
³⁰ African Development Bank, *Domestic Resource Mobilisation for Poverty Reduction in East Africa: Tanzania Case Study*, November 2010, p.20

³¹ *The EAC Trade Report, 2009*, <http://www.eac.int/statistics/index.php?option>

³² Uwazi, 'Tanzania's Tax Exemptions: Are they too high and making us too dependent on Foreign Aid?', *Policy Brief*, TZ.12/2010E, p.3

³³ Uwazi, 'Tanzania's Tax Exemptions: Are they too high and making us too dependent on foreign aid?', *Policy Brief*, TZ.12/2010E, pp.1, 5

Exemptions granted in 2008/09 – 2009/10 by category



Source: Uwazi, 'Tanzania's Tax Exemptions: Are they too high and making us too dependent on Foreign Aid?', *Policy Brief*, TZ.12/2010, p.5

Tax exemption issues in the CAG 2011 Report³⁴

The Controller and Auditor General (CAG) report for 2011 has identified some issues related to tax in general and tax exemption in particular. Key issues include the following:

- i. The tax revenue accounts for Tanzania Mainland closed with an actual collection of Shs.5,550,205,244,378 against an Approved Estimates of Shs.5,849,093,700,000 resulting in an under collection of Shs.298,888,455,622.
- ii. The TRA revenue statements reported tax exemptions of Shs.1,016,320,300,000 equivalent to 18% of total collections. It was noted that if the amount had not been exempted, total collection would have increased to Shs.6,566,525,544,378 thus resulting in an over collection of Shs.717,431,844,378.

According to the CAG report, TRA revenue statements reported tax exemptions of Shs.1,016,320,300,000. The exemptions were granted to various institutions as summarized below.

³⁴ Annual General Report of the Controller and Auditor General on the Audit of the Financial Statements of the Central Government for the Year Ended 30th June, 2011

Table 2 : Summary of tax exemptions issued to institutions in the 2010/11 Financial Year

Institution	Customs & Excise Dept (Shs)	Domestic Revenue Dept (Shs)	Total (Shs) 2010/2011	Total (Shs) 2009/2010
Government institutions	35,867,200,000	-	35,867,200	52,743,800,000
Parastatal Organizations	8,131,200,000	-	8,131,200,000	8,758,700,000
Religious Institutions	1,569,300,000	-	1,569,300,000	281,200,000
NGOs	25,462,600,000	-	25,462,600,000	22,147,100,000
Donor Funded Projects (DFP)	115,758,100,000	--	115,758,100,000	72,458,100,000
Private Companies & Individuals	182,706,100,000	-	182,706,100,000	36,174,600,000
Mining Sector	109,885,900,000	-	109,885,900,000	48,738,600,000
Tanzania Investment Centre exemptions	239,667,300,000	-	239,667,300,000	268,002,300,000
VAT Exemptions under Duty Free Shops		17,427,400,000	17,427,400,000	2,691,600,000
Total	719,047,700,000	297,272,600,000	1,016,320,300,000	680,667,900,000

Source: CAG Report 2011, page 50 – 51.

The figures from CAG's report show an increase of exemptions by Shs 335,652,400,000 or 49% from Shs 680,667,900,000 reported during the financial year 2009/2010 to Shs 1,016,320,300,000 reported in 2010/2011. The exemptions of Shs. 1,016,320,300,000 is 18% of the actual collections. According to CAG, if this money was collected as taxes, the reported revenue under collection of Shs.298,888,455,622 for Tanzania Mainland would have been off set. It would leave a surplus collection of Shs.717,431,844,378.

Tax exemption issues in the 2011/12 budget

As is the case for many other years, the government granted a number of incentives in the 2011/12 financial year. Some of these are outlined in what follows.

- i) VAT exemption on spare parts for agricultural implements including threshers, rice dryers and mills; planters), and power tillers.
- ii) VAT exemption on NASCOR Pellet Feed
- iii) VAT exemption on Nylon Fishing Twine)
- iv) VAT exemption on sprayers, harrows and grain conveyors
- v) Tax refund for retail purchases done by foreigners for purchases worth Tsh 400,000
- vi) Tax exemption on allowances paid to government employees and those working in institutions that receive government subsidies
- vii) To reduce charges on heavy fuel used to operate plant and equipment from Tsh 80 to Tshs 40 per litre as a measure to reduce production costs
- viii) To charge levy of 50 per cent instead of 120 per cent on Polymers of ethylene and related products with HS. Code 3923.2900
- ix) Tax exemption on petrol levied on fuel used for exploration and prospecting of minerals

Generally, exemptions in Tanzania Mainland have shown an increasing trend as partly shown in the table below.

Table 3: Exemptions in 2011/12 and 2009/10

Explanation	2011/2012	2009/2010
Actual Collection	5,550,205,244,378	4,637,686,999,618
Exemptions	1,016,320,300,000	680,667,900,000
Proportion of exemptions to actual collection	18%	15%
Deficit in collection	298,888,455,622	391,235,100,382
Surplus if exemptions had not been granted	717,431,844,378	289,432,799,618

The level of tax exemptions in Tanzania, according to the 2011 CAG report, is higher compared with other countries such as Kenya and Uganda. The CAG is of the correct opinion that Tanzania, poor as it is, can not afford to lose its much needed revenue by allowing massive tax exemptions. In most cases, according to the CAG report, exemptions are granted to able people and multinational companies who have all the resources. It is not prudent therefore to depend so much on donor support³⁵ at the same time as the country exempts taxes that should be collected to finance public expenditure of goods and services in both the development and recurrent budgets. Although the exemptions are governed by the Tax law, there is a need to make sure that they are for wider public interest.

³⁵ The 2011/12 budget was about 28.% donor-dependent

According to Citizen newspaper on Wednesday 4th April 2012, the planned budget for 2012/13 is Tshs 13.5 trillion³⁶. Therefore, the 2011 total exemptions to the tunes of Tshs 1.02 trillion is about 7.6 per cent of the planned 2012/13 total budget. It was forecasted in the planned 2012/13 budget that a total 7,466 billion Tshs would come from taxes and non-tax sources. This is less than the Tshs 1.02 trillion that was exempted in 2011. The 2012/13 budget plan figures show also that about 3,397 billion Tshs are expected to come from the development partners in forms of grants and loans. These 1.02 trillion Tshs that were exempted in 2011 are also much more than the funds expected from donors for the 2012/13 budget. According to the newspaper cited above, the government plan was to borrow some 2,292 billion Tshs in the 2012/13 budget. This too is less than the 1.02 trillion exempted in 2011. The plan in the 2012/13 budget is to spend Tshs 9.3 trillion for recurrent expenditure. The amount of tax exemption to the tunes of Tshs. 1.02 trillion is about 11 per cent of the recurrent budget. The plan for 2012/13 budget is to use Tshs 4.1 trillion for development expenditure. The amount exempted in 2011 is a whole 24.9 per cent of the planned development expenditure budget for 2012/13.³⁷

Taking account of the various estimates, our conclusion is that revenue losses from *all tax exemptions and incentives* may be as high as TShs 1.8 trillion (US\$ 1.23 billion) in 2008 (according to the AfDB estimate), and that the *minimum* revenue loss from *tax incentives* granted to companies alone is around TShs 381 billion (\$174 million) a year (for the years 2008/09 – 2009/10). For 2011/12, the figures for specific exemptions are as shown in table number one above.

Revenue Loss Estimates for Tax Exemptions and Incentives

Below are the revenue loss estimates from tax exemptions and incentives as given by various sources. There are various possible reasons for differences in figures. These reasons include but are not limited to differences in original sources, differences in computation techniques and estimation eras. It was beyond the scope of this study to identify the actual causes of these reported differences in data.

Box 2: Various Estimates of Revenue Loses From Tax Exemptions and Incentives

Government

Government budget speeches estimate that tax *exemptions* amounted to 2.5% of GDP in 2010/11 and 3.5 per cent in 2007/08 (the latter accounting for 30 per cent of total tax revenues).³⁸ For 2010/11, our calculation is that this would amount to around TShs 866 billion

³⁶ By the time this report was accomplished, the 2012/13 budget speech by the Minister for Finance and Economic Affairs was not yet out. Therefore the figures that were released in April 2012 might be slightly different from those in the mid June 2012 official budget speech.

³⁷ Tax exemption issues in the CAG report has been covered in the media. One place where this is covered is online at <http://mobile.theeastafrican.co.ke/Business/Tanzania+loses+460m+US+dollars+surplus+to+tax+exemptions+/-/433844/1390978/-/format/xhtml/-/3732n/-/index.html>

³⁸ Finance Minister, Budget Speech 2011/12, p.25; Budget Speech 2009/2010, para. 78, <http://www.mof.go.tz>

(US\$ 395 million).³⁹ . In the first six months of 2010, the government estimated that tax *exemptions* amounted to around one third of gross tax collections, or TShs 833 billion (US\$ 480 million).⁴⁰ The Tanzania Revenue Authority estimated that revenue loss arising from tax *exemptions* was TShs 587 billion (US\$ 403 million) between July 2008-April 2009.⁴¹

IMF

The IMF estimates that tax *exemptions* cost the government 3.5% of GDP per year.⁴² Our calculation is that this is the equivalent of TShs 1.06 trillion (US\$ 611 million) a year.⁴³

African Development Bank

A report for the AfDB notes that *exemptions and incentives* account for up to 6% of GDP, or TShs 1.8 trillion (US\$ 1.23 billion) in 2008.⁴⁴

East Africa Community Secretariat

The EAC – covering *exemptions on import duties alone* - estimates that in 2008, Tanzania's revenue losses from tax exemptions amounted to US\$ 435.9 million, and an average of US\$ 370 million in the three years 2006-08.⁴⁵

Import Duty Exemptions Granted by Tanzania 2005-2008 (US\$ millions)

	2005	2006	2007	2008
Value of Exemptions	901.6	1225.9	1496.2	1826.1
Revenue Foregone	204.2	405.4	268.3	435.9
Total Trade Taxes	730.5	822.1	1104.7	1440.9
Percentage Foregone	21.8	33.0	19.5	23.2

Source: EAC Secretariat, *EAC Trade Report 2008*, 2010, p.51

Uwazi

³⁹ Based on nominal GDP projection of TShs 34,656 billion. IMF, *Staff Report for the 2011 Article IV Consultation and Second Review under the Policy Support Instrument*, 21 April 2011, p.24

⁴⁰ IMF, *Staff Report for the 2011 Article IV Consultation and Second Review under the Policy Support Instrument*, 21 April 2011, p.36

⁴¹ African Development Bank, *Domestic Resource Mobilisation for Poverty Reduction in East Africa: Tanzania Case Study*, November 2010, p.20

⁴² IMF, *Staff Report for the 2011 Article IV Consultation and Second Review under the Policy Support Instrument*, 21 April 2011, p.14

⁴³ Based on figures in IMF, *Staff Report for the 2011 Article IV Consultation and Second Review under the Policy Support Instrument*, 21 April 2011, p.24. Nominal GDP of TShs of 30,321 billion.

⁴⁴ African Development Bank, *Domestic Resource Mobilisation for Poverty Reduction in East Africa: Tanzania Case Study*, November 2010, p.20

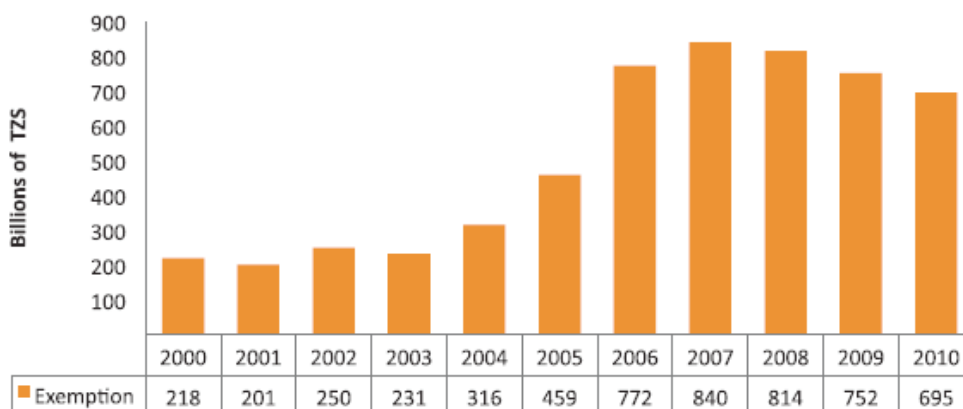
⁴⁵ *The EAC Trade Report, 2009*, <http://www.eac.int/statistics/index.php?option>

⁴⁶ Uwazi, 'Tanzania's Tax Exemptions: Are they too high and making us too dependent on foreign aid?', *Policy Brief*, TZ.12/2010E, pp.2-3

⁴⁷ Uwazi, 'Tanzania's Tax Exemptions: Are they too high and making us too dependent on foreign aid?', *Policy Brief*, TZ.12/2010E, p.3

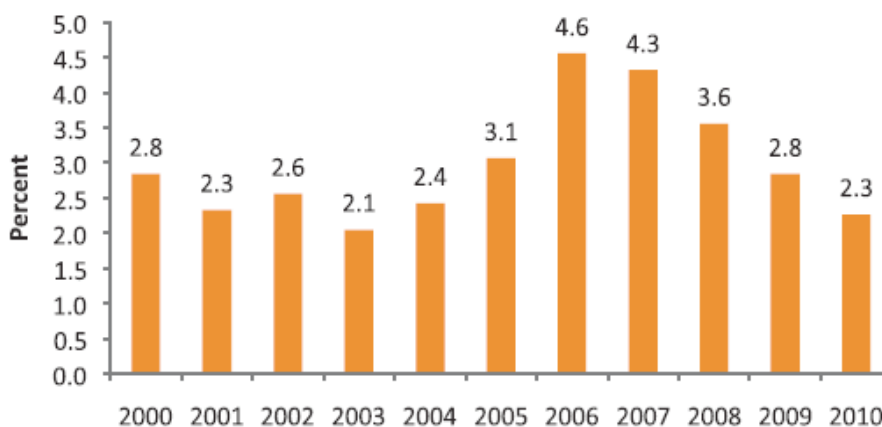
The NGO, Uwazi, estimates, using TRA sources, that tax exemptions averaged 3.9% of GDP between 2005/06 – 2007/08 and were 2.8% in 2008/09 and 2.3% in 2009/10. In the latter year, exemptions amounted to TShs 695 billion (US\$ 417 million).⁴⁶ The amount of exemptions has increased substantially during 2006-10: in those five years, revenue losses from exemptions amount to a massive TShs 3.87 trillion (US\$ 2.3 billion).⁴⁷

Tax Exemptions in Tanzania, 2000-2010



Source: Uwazi, 'Tanzania's Tax Exemptions: Are they too high and making us too dependent on Foreign Aid?', *Policy Brief*, TZ.12/2010E, p.3

Tax exemptions as proportion of GDP



Source: Uwazi, 'Tanzania's Tax Exemptions: Are they too high and making us too dependent on Foreign Aid?', *Policy Brief*, TZ.12/2010E, p.7

Revenue Losses in the Mining Sector

Given that Tanzania is one of Africa's largest gold producers, the expectation has been that mining would contribute significantly to economic development. Yet this expectation has not been fulfilled. The IMF notes that gold exports have risen from around US\$ 500 million to US\$ 1.5 billion in the last five years due to rising gold prices, but that government revenues have remained at around US\$ 100 million a year. This is largely because of corporate income tax holidays provided to the mining companies. In fact, 'none of the existing gold projects have paid material income tax to date', the IMF notes.⁴⁸ Furthermore, mining revenues will not grow much in the near future: according to the IMF, 'the growing mining sector has so far had little net fiscal impact and this is unlikely to change in the coming years, partly because of large embedded tax holidays'.⁴⁹ As noted, although the new mining act was passed in 2010, existing gold mines remain governed by their respective agreements.

Revenue losses from tax incentives granted to mining companies are significant, although the overall figures have never been calculated:

- The Bomani Commission estimated that the government lost TShs 39.8 billion in 2006/7 and TShs 59 billion in 2007/8 simply as a result of **fuel levy exemptions** granted to the six large mining companies.⁵⁰ As of late 2011, mining companies were making claims to the government for refunds totaling US\$ 274 million related to their fuel levy exemptions for the period since 2002.⁵¹
- Mining companies have exclusive ownership of their operations and the minerals recovered and the power to dispose of them as they wish, including to transfer those rights to other companies without incurring **capital gains tax**. This means that the practice of buying and selling mining operations can be very lucrative.⁵²
- Mining companies' ability to **offset against their taxable income** the full costs of their expenditure on items such as plant and machinery has led to perpetual declaration of tax losses, and thus non-payment of corporate income tax. In response to this the government introduced in 2008 an Alternative Minimum Tax of 0.3% of turnover, payable when companies declare three consecutive years of tax losses, although it is likely that revenues from this tax are far lower than the losses caused by the capital allowance.

⁴⁸ IMF, *Staff Report for the 2011 Article IV Consultation and Second Review under the Policy Support Instrument*, 21 April 2011, p.17

⁴⁹ IMF, *Staff Report for the 2011 Article IV Consultation and Second Review under the Policy Support Instrument*, 21 April 2011, p.14

⁵⁰ Policy Forum, 'How Much Revenue Are We Losing?', *Policy Brief*, March 2009

⁵¹ David Malingha Doya, 'Tanzania May Abolish Tax Refund for Miners to Boost Revenue', 25 October 2011, www.bloomberg.com

⁵² In 2003, for example, the Australian company, East African Gold Mines, made US\$252 million by selling one Tanzanian gold mine to the Canadian company Placer Dome (which was later bought by Barrick), from an original investment of US\$90 million. Neither the government of Tanzania nor ordinary citizens receive anything from these multi-million dollar deals. Tundu Lissu, "'Conducive environment' for whose development?: Globalisation, national economy and the politics of plunder in Tanzania's mining industry', unpublished paper, November 2006, pp.16-17

Box 3: Selected Examples of Tax Incentives for Mining Companies

- Mining companies' ability to **offset against their taxable income** the full costs of their expenditure on items such as plant and machinery has led to perpetual declaration of tax losses, and thus non-payment of corporate income tax. In response to this the government introduced in 2008 an Alternative Minimum Tax of 0.3 per cent of turnover, payable when companies declare three consecutive years of tax losses, although it is likely that revenues from this tax are far lower than the losses caused by the capital allowance.
- The Bomani Commission established by the government estimated that the country lost TShs 39.8 billion in 2006/7 and TShs 59 billion in 2007/8 simply as a result of **fuel levy exemptions** granted to the six large mining companies.ⁱ As of late 2011, mining companies were making claims to the government for refunds totaling US\$274 million related to their fuel levy exemptions for the period since 2002.ⁱⁱ

Financial claims in the mining sector

In 2010, the Tanzania Minerals Audit Agency (TMAA) audited 12 mining companiesⁱⁱⁱ and raised a number of audit 'queries' concerning those companies' financial claims. It reports that companies had over-declared their capital allowances and operating expenditures. The table below outlines the unresolved queries.

Table 4: Key audit queries communicated by the TMAA to mining companies, 2010

Wrongly claimed hedge financial liability and losses	\$183.6 million
Over-claimed capital allowance	\$179.3 million
Unsupported capital and operating expenditure	\$141.2 million
Disallowable items	\$53.8 million and TShs 1.7 billion
Wrongly claimed and premature capital deduction	\$44.5 million
Understated mineral sales	\$12.4 million and TShs 3.0 billion
Payments for technical services of which withholding tax was not withheld	\$50.9 million and TShs 1.5 billion
Management fees for which withholding tax was not withheld	\$23.1 million
Overstated payroll costs	\$9.9 million
Underpayment of Skills Development Levy	\$1.7 million
Unpaid royalties	\$0.2 million and TShs 466 million
Unpaid Pay As You Earn (PAYE)	TShs 911 million
Unpaid annual rent for granted mineral rights	0.5 million
TOTAL	\$705.8 million

Source: TMAA, *Annual Report 2010*, p.36

Unresolved Audit Queries to Mining Companies

When TMAA is unable to resolve issues with mining companies, the queries are communicated to TRA. Below are the key unresolved audit queries to mining companies communicated by TMAA to the TRA in 2010.

Table 5: Key Unresolved Audit Queries Communicated by TMAA to the TRA

Wrongly claimed capital and operating expenditure for tax purposes	\$119.2 million
Wrongly claimed hedge financial liability and losses	\$75.3 million
Disallowable items claimed as allowable expenses	\$53.3 million
Over-claimed wear and tear deductions	\$3.3 million
TOTAL	\$251.1 million

Source: TMAA, *Annual Report 2010*, p.37

The \$705 million implies considerable further tax liability. The 2003 gold mining audit alleged that true tax liability amounted to about one quarter of the figure of alleged over-declared losses. Therefore, the \$705 million implies a tax liability of about \$176 million. The year 2010 was the first year in which TMAA conducted audits on companies. It is possible that similar alleged over-claims were made by some companies in previous years. It is also possible that over-claims are made in other sectors beyond mining.

Costs of incentives

Tax incentives imply that the money that could be collected as taxes is not collected. This implies less funds in the government coffers. This is the money that could be used to finance some public goods and services in the development and recurrent expenditure budgets. These goods and services include but are not limited to communication infrastructure such as roads and bridges; and social services such as health, education and water. The costs are elaborated in the box below.

Box 4: Some Costs of Tax Incentives

Development foregone

Reducing tax incentives provided to companies would provide vital resources for development and reduce dependence on foreign aid. If the revenue losses of TShs 381 billion in 2008/09 – 2009/10 were spent on education and health, the education budget would increase by a fifth and the health budget by two-fifths.⁵³

More analysis on what the Tshs 1.02 trillion that were exempted in 2011 implies for the planned total budget in 2012/13, the planned development and recurrent expenditure as well as on planned donor funding and borrowing for the budget has been done earlier in this report. All those have many and far-reaching implications in terms of development foregone. In economic terms, the exemptions are opportunity costs in that the exempted funds cannot at the same time be available to fund development because one cannot eat his or her cake and have it.

⁵³ Based on figures in Uwazi, 'Tanzania's Tax Exemptions: Are they too high and making us too dependent on foreign aid?', *Policy Brief*, TZ.12/2010E, p.2

3. *Problems with Tax Incentives*

All the evidence suggests that the disadvantages of tax incentives vastly outweigh the advantages and that such incentives are not needed to attract FDI.⁵⁴

Proponents of tax incentives often argue that lower tax burdens give investors a higher net rate of return and therefore free up additional income for re-investment. The host country thus attracts increased FDI, raises its income and also benefits from the transfer of technology. A further argument, particularly in relation to the less developed countries, is that it is imperative to provide incentives to investors given the otherwise poor investment climate: the volatility in politics, dilapidated infrastructure, the high cost of doing business, the macroeconomic instability, corruption and an inefficient judiciary. Revenue losses are rationalized by arguing that the capital and jobs created will improve the welfare of citizens and expand the economy.

However, there is a long list of disadvantages with tax incentives, as outlined in a recent IMF report, which argues among other things that they:

- Result in a loss of current and future tax revenue
- Create differences in effective tax rates and thus distortions between activities that are subsidized and those that are not
- Could require large administrative resources
- Could result in rent-seeking and other undesirable activities
- Could, in the case of income tax holidays, be a particularly ineffective way of promoting investment Companies that are not profitable in the early years of operation, or companies from countries which apply a foreign tax credit to reduce the home country's tax on the foreign source income, would not benefit from income tax holidays. In contrast, such holidays would be of less importance to companies that are profitable from the start of their operations
- Could attract mainly footloose firms
- Can be outside the budget and non-transparent⁵⁵

Tax incentives tend to reduce government revenues by 1-2 per cent of GDP, according to the OECD.⁵⁶ The IMF notes that investment incentives, if they are to be of benefit, should be well-targeted and focused narrowly on the activities they seek to promote but that 'the corporate income tax holiday usually does not meet the criterion of a well-targeted incentive'.⁵⁷ Tax holidays strongly favour transitory rather than sustainable investments and create glaring opportunities for aggressive tax avoidance.⁵⁸ A joint report by the IMF, OECD, UN and World Bank comes to the same conclusion, noting that, where governance is poor, corporate income tax exemptions 'may do little to

⁵⁴ There is abundant literature on the rationale for tax incentives. See for example, M. Blomstrom, 'The Economics of International Tax Incentives', <http://www.oecd.org/dataoecd/55/1/2487874.pdf> and IMF, *Kenya, Uganda and United Republic of Tanzania: Selected Issues*, 1 December 2006

⁵⁵ IMF, *Kenya, Uganda and United Republic of Tanzania: Selected Issues*, 1 December 2006, p.10

⁵⁶ IMF, *Kenya, Uganda and United Republic of Tanzania: Selected Issues*, 1 December 2006, p.12

⁵⁷ IMF, *Kenya, Uganda and United Republic of Tanzania: Selected Issues*, 1 December 2006., p.16

⁵⁸ World Bank, Foreign Investment Advisory Service, *Sector Study of the Effective Tax Burden in Tanzania*, May 2006, http://siteresources.worldbank.org/EXT/EXPCOMNET/Resources/2463593-1213973103977/09_Tanzania.pdf

attract investment' and when they do, 'this may well be at the expense of domestic investment'.⁵⁹

The application of different rules and procedures complicates tax administration and increases costs while there are social costs caused by corruption and rent-seeking where the administration of tax incentives is abused, as is often the case.⁶⁰ Tax incentives are also prone to abuse when the incentive is exhausted and the promoters of the business fraudulently wind it down and simultaneously establish another entity to be accorded the same tax incentives. Tax incentives also tend to favour elite private investors who actually have adequate own capital.⁶¹ In addition, once incentives have been selectively granted, sectors that consider themselves excluded will agitate for inclusion thus widening the incentives still further. Once incentives are provided, they are politically difficult to remove. In some cases, incentives are a further waste of resources in that many companies would anyway invest without the incentive. Generally, investment incentives are recommended when the business is in the nature of a public good, such as with projects for encouraging green technologies, primary health care and disease prevention, upgrading skills of workers and research and development.⁶²

Tax incentives and FDI

*'Studies...suggest that tax-driven investment does not provide a stable source of investment in the recipient country' (Joint IMF, OECD, UN and World Bank report for the G-20)*⁶³

Evidence suggests that tax incentives are not needed to attract FDI. A 2006 report by the African Department of the IMF, focusing on tax incentives in East Africa, notes that the above-mentioned list of disadvantages of tax incentives is:

*'supported by available empirical evidence which mostly confirms that investment incentives – particularly tax incentives – are not an important factor in attracting foreign investment'.*⁶⁴

The IMF report argues that countries that have been most successful in attracting foreign investors have not offered large tax or other incentives. Providing such incentives was not sufficient to attract large foreign investment if other conditions were

⁵⁹ IMF, OECD, UN and World Bank, *Supporting the Development of More Effective Tax Systems*, Report to the G-20 Development Working Group, 2011, p.19

⁶⁰ H. Zee et al, 'Tax Incentives for Business Investment: A Primer for Policy Makers in Developing Countries', *World Development*, Vol. 30, No. 9, 2002, pp. 1497-1516.

⁶¹ Goldin and Reinert, 'Globalization for Development, Trade, Finance, Aid, Migration and Policy, 2007; citing also a 1998 World Bank study, the authors argue that poor people face higher tariffs than the non-poor by more than twice. Poor people also face significant tariff peaks in products of export interest to them.

⁶² Global Tax Simplification Team of the IFC Investment Climate Advisory (April, 2011), presentation at the EAC's Validation Workshop of the Study of Double Taxation Avoidance Model and the Code of Conduct Against Harmful Tax Competition held in Arusha, April 2011

⁶³ IMF, OECD, UN and World Bank, *Supporting the Development of More Effective Tax Systems*, Report to the G-20 Development Working Group, 2011, p.19

⁶⁴ IMF, *Kenya, Uganda and United Republic of Tanzania: Selected Issues*, 1 December 2006, p.11

not in place. The report also notes that in ‘specific circumstances, well-targeted investment incentives could be a factor affecting investment decisions’ but that ‘in the end, investment incentives seldom appear to be the most important factor in investment decisions’.⁶⁵ This conclusion is supported by a large body of literature showing that more important factors in attracting FDI are good quality infrastructure, low administrative costs of setting up and running businesses, political stability and predictable macro-economic policy.⁶⁶ Indeed, this reasoning partly explains why the IMF, and other international organisations such as the African development Bank, has been pressing Tanzania, and other governments in East Africa, to radically reduce their tax exemptions (see section 4).

In Tanzania, the introduction of EPZs in 2002 ‘has not resulted in a noticeable pickup in foreign investment’, the 2006 IMF report notes. Uganda has continued to attract higher levels of FDI than Tanzania, which provides much more generous investment incentives.⁶⁷ The large tax incentives provided in Zanzibar are intended to attract FDI yet FDI flows into Zanzibar have rarely exceeded US\$ 19 million in any one year.⁶⁸ The table below shows that while Tanzania has received significant FDI flows in recent years, there has been only a small increase in FDI in the five years 2006-10 – of just over US\$ 100 million. Uganda has received the largest FDI flows in the region, which have been increasing. In Kenya, which provides a large range of tax incentives, FDI is low level and erratic.⁶⁹

Table 6: FDI Flows in Tanzania, Kenya and Uganda (US\$ million)

	2006	2007	2008	2009	2010
Kenya	51	729	96	141	133
Tanzania	597	647	679	645	700
Uganda	644	792	729	816	848

Source: UNCTAD, *World Investment Report 2011*, Annex Table 1.1

FDI Volume in Tanzania

The latest available Tanzania investment Report (BoT, NBS and TIC, 2009: vii) informs that the stock of FDI increased persistently from USD 4,438.7 million in 2005 to USD 6,239.9 million in 2008. This is an increase of 40.6% during the period under consideration. According to IMF (2011), the value of FDI in Tanzania (net, current US\$) was \$433,441,900⁷⁰. The Citizen⁷¹, citing UNCTAD (2011) informs that although there is

⁶⁵ IMF, *Kenya, Uganda and United Republic of Tanzania: Selected Issues*, 1 December 2006, p.11

⁶⁶ At a Trade Justice Network-Africa/Action Aid roundtable in Nairobi in July 2011, John Njiraini, the Commissioner of Domestic Taxes in Kenya, confirmed this truism. He cited the example of a large tax payer, a blue chip company in Kenya which increased the level of investment considerably within months of KRA’s withdrawal of some previously enjoyed incentive. Apparently, certain categories of taxpayers, mostly, large, were allowed to offset VAT refunds against other tax liabilities, a facility which was withdrawn due to challenges in management.

⁶⁷ IMF, *Kenya, Uganda and United Republic of Tanzania: Selected Issues*, 1 December 2006, p.13

⁶⁸ ‘Zanzibar Investment Policy’, <http://www.zanzibarinvest.org>, p.2.

⁶⁹ Uganda Investment Authority: ‘Why invest in Uganda?’, <http://www.ugandainvest.go.ug>

⁷⁰ IMF Balance of Payment Statistics Year Boos 2011, online at <http://www.indexmundi.com/facts/tanzania/foreign-direct-investment>

a decline of FDIs in Africa since the 2008 global economic crisis, Tanzania has recorded 8.5% increase of FDIs in 2010. The inflow increased from \$645 million in 2009 to \$700 million in 2010.

The various volumes of the Tanzania Investment Report indicate that FDIs have been flowing to virtually all sectors of the economy and in many geographical locations since mid 1980s.

For example, the stock of FDIs by sector (in million UDS) for the period 2005 – 2008 were 4,438.7 for 2005 while for 2006 it was 4,827.1. for 2007 and 2008⁷² the stock was 5,950 and 6,239.9 respectively⁷³. In terms of geographical distribution of FDI stock for the same period, a total of 16 regions in Tanzania Mainland had some FDI stocks. Dar Es Salaam had the majority (58%) followed by Shinyanga (12.3%), Mwanza (9.7%) and Arusha (5.7%). The smallest stock was in Coast region with only 0.1% of the total FDI stocks in the country⁷⁴

The ‘Race to the Bottom’

Fiscal incentives imposed in one country can lead to tax competition among countries and a ‘race to the bottom’, a process that is being witnessed in East Africa. Tax competition can occur when firms are able to locate where tax rates are lowest, thereby encouraging other countries to lower their tax rates in order to retain and attract dynamic firms and able workers.⁷⁵ Tax competition can make it difficult for countries to maintain desired tax rates, leading to ever-declining tax rates and revenues. In both Kenya and Uganda, for example, governments are also granting massive tax incentives, partly in a competition to attract and retain FDIs, with the result being significant revenues losses for the government, as in Tanzania. Tax rate disparities in the EAC member states have also encouraged illicit trade, complicated operational systems for companies wishing to carry on business throughout the EAC and slowed down the integration process.

Economic and Finance Ministers in the European Union (EU) have defined harmful tax competition as including factors such as: an effective level of taxation which is significantly lower than the general level of taxation in the country concerned; the presence of tax benefit categories reserved for non-residents; and tax incentives for activities which are isolated from the domestic economy and therefore have no impact on the national tax base.⁷⁶

The EAC has taken some concrete steps to widen and deepen economic cooperation among its members. Article 83 of the Treaty establishing the EAC provides for monetary

⁷¹ Online at <http://thecitizen.co.tz/news/51-other-news/13184-fdi-inflows-into-tanzania-increase-85pc-to-hit-700m.html> (retrieved on 16th March 2012)

⁷² Provisional

⁷³ See BoT, NBS and TIC (2009:21) for details

⁷⁴ See BoT, NBS and TIC (2009:25) for details

⁷⁵ A .Hansson and K.Olofsdotter, ‘Integration and Tax Competition: An Empirical Study for OECD Countries’, econpapers.repec.org/RePEc:hha:lunewp:2005_004

⁷⁶ Petersen et al, ‘Tax Systems and Tax Harmonization in the East African Community (EAC)’, p. 22, http://www.eacgermany.org/index.php/documents-and-studies/cat_view/39-tax-harmonisation-in-the-eac/43-study-on-tax-systems-in-the-eac

and fiscal harmonization including the removal of tax distortions. Tariff barriers between Kenya, Uganda and Tanzania, the original EAC member countries, were removed in 1999. Rwanda and Burundi joined the community in 2007.⁷⁷ Yet Tanzania, along with the other EAC members, is taking only limited steps to promote such fiscal coordination. A senior officer of a public investment centre in Tanzania informed the authors that there should be continuous evaluation of the framework agreed on the harmonization of the tax regimes between the EAC partner states in order to address the challenge of harmful tax competition.

Tanzania’s narrow tax base

Reducing tax incentives would expand the tax base in Tanzania, which is currently narrow. According to TRA’s 2008 annual report, 39 large taxpayers contributed about 80% of Tanzania’s tax revenues.⁷⁸ A larger tax base would in turn reduce some tax rates and discourage tax evasion.⁷⁹ The informal sector accounts for between 40 and 60 per cent of GDP^{iv} and around 70 per cent of Tanzania’s workforce^v but it is largely untaxed. The number of individuals who pay tax in Tanzania is low: According to the TRA, only 1.6 million out of a potential 15 million people pay taxes.^{vi}

Another indicator of narrow tax base in Tanzania is the collections as a proportion of GDP. This can be seen from the IMF report partly presented in the table below.

Table 7: Tax revenue as percentage of GDP (actual collections)^{vii}

2005/06	2006/07	2007/08	2008/09	2009/10
11.4	13.0	14.7	15.3	14.6

From the table above, it can be seen that tax collections have been at around 15 per cent of GDP. The comparable figure is 19 per cent of GDP in Kenya and 11.8 per cent in Uganda.^{viii} In OECD countries, the proportion is around 30 per cent.^{ix} According to the IMF, Tanzania has a potential tax revenue of 20.9 per cent of GDP.^x With actual collections of about 15 per cent, it means that the tax gap (difference between actual and potential revenue collections)^{xi} is about 6 per cent of GDP.

⁷⁷ ‘About EAC’, <http://www.eac.int/about-eac.html>
⁷⁸ African Development Bank, *Domestic Resource Mobilisation for Poverty Reduction in East Africa: Tanzania Case Study*, November 2010, p.21
⁷⁹ Similar to its EAC partners, the government is undertaking measures to widen the tax base by including the informal sector. A Senior Ministry of Finance official has stated that spreading the tax burden could make the tax system more equitable and that must be taken to ensure that the formalization of the informal sector would neither be punitive nor too costly. A. Elinaza, ‘TRA Eye Now Turns to Informal Sector to Fill Tax Collection Gap’, www.allafrica.com, 6 December 2010

4. Government Policy on Tax Incentives

The government recognises that tax exemptions entail a large revenue loss and is taking some steps to reduce them. However, progress is slow and the real extent of government commitment is questionable. Most importantly, for this analysis, it remains unclear what further steps the government will take to reduce tax incentives granted to mining companies and businesses operating in the EPZs and SEZs. The Minister for Industry, Trade and Marketing has said, for example, that ‘all other countries provide these kinds of incentives [in EPZs]...if we did not decide to provide them, no investor will come.’⁸⁰ Tanzania’s EPZA has attracted investments worth \$569 million during the past five years, creating 10,500 jobs, according to a senior EPZA official.⁸¹ This means that each job has a cost of US\$ 54,000 (TShs 92 million) to create – a large amount. It is also important to note that the quality of jobs created matters in order to justify the incentives. The more the proportion of high skilled, well paid and permanent jobs for Tanzanians out of the total number, the better for the country. However, the number of jobs alone without the above specifications is not adequate to justify incentives.

Even the IMF, a long supporter of low taxes, is now calling on the government to raise taxes on the mining companies. It has called for withholding taxes on interest paid on foreign currency loans; limits on the deductibility of debt financing for income taxes; and a tightening of provisions for investment allowances for exploration and development.⁸² In May 2011 the then Deputy Minister for Energy and Minerals, Adam Malima, was quoted as saying that the government would ‘overhaul the entire tax exemptions package’ for mining companies.⁸³ But this pledge has not yet materialised.

As regards tax exemptions more broadly, the then Finance Minister Mustafa Mkulo said in the 2011/12 budget speech that the government has already taken steps to ‘review procedures for tax exemptions to strengthen control over abuse’ and that government policy was to ‘review and harmonise various tax laws, which have provisions of exemptions, with a view to minimize such exemptions’. Government policy, he said, is to reduce exemptions from their current level of 2.5% of GDP, in his estimate, to ‘at least 1% of GDP’.⁸⁴ This is in recognition of the fact that:

*‘The increasing levels of tax exemption contribute to low revenue collection and thus weaken Government ability to finance social economic infrastructure and ultimately reduces the pace of improving well being of our people. Tax exemptions have also created loopholes for tax evasion and revenue leakage’.*⁸⁵

In the 2009/2010 Budget Speech, the then Finance Minister stated that the government proposed to revoke 405 government notices which grant tax exemptions to private companies, non-governmental and religious organisations, international institutions and completed government-sponsored projects in order to prevent the erosion of tax revenue. The Minister stated that most government notices issued during the period 1964-2005 were ambiguous and non-specific on the type of taxes exempted, the term

⁸⁰ See, ‘EPZ, SEZ Programmes come under one Regulator’, <http://www.epza.co.tz>

⁸¹ Victor Karega, ‘10,500 jobs created from investing \$569m in EPZs’, *The Citizen*, 14 April 2011

⁸² IMF, *Seventh Review under the Policy Support Instrument*, 18 May 2010, p.20

⁸³ Ally Hamisi, ‘Tanzania asked to raise mining tax’, *East Africa Business Week*, 16 May 2011

⁸⁴ Finance Minister, Budget Speech 2011/12, pp.11, 25, www.mof.go.tz

⁸⁵ Finance Minister, Budget Speech 2009/2010, paras. 78, 71, www.mof.go.tz

of the exemption and the amounts. He proposed measures such as revoking government Notice No. 99 of 2005 with respect to the partial fuel levy exemption as well as the excise duty exemption granted to mining companies.⁸⁶ Unfortunately, only very limited steps have so far have been taken. Not all of these exemptions listed by the Minister in the 2009/2010 Budget Speech – notably those benefitting mining companies - were revoked, although some exemptions on excise tax rates, for example, have been removed.

Reports by the African Development Bank and IMF suggest that the government is seriously dragging its heels on reducing tax exemptions. The AfDB notes the ‘continued elite resistance to the abolition of the prevailing extensive tax exemptions’.⁸⁷ Both the AfDB and the IMF are imploring Tanzania to radically reduce tax exemptions. The AfDB notes that:

*‘The level of exemptions [has] not only contributed to undermining efficiency and effectiveness of gains resulting from administrative reforms, but also to the substantial revenue loss, probably accounting for most of Tanzania’s tax gap’.*⁸⁸

In an April 2011 report, the IMF says that ‘exemptions have unduly multiplied, particularly for the VAT, and could be usefully scaled down’. However, ‘the authorities noted they were aware of the issue but had run into political difficulties when attempting to curtail exemptions. They were therefore putting the onus on tax administration reforms.’ In its April 2011 memo to the IMF, the government simply informed the IMF that it would ‘carefully study’ the scope for reducing exemptions and would only ‘strengthen the management and control of tax exemptions’.⁸⁹

⁸⁶ Finance Minister, Budget Speech 2009/2010, para. 78, www.mof.go.tz

⁸⁷ African Development Bank, *Domestic Resource Mobilisation for Poverty Reduction in East Africa: Tanzania Case Study*, November 2010, p.vi

⁸⁸ African Development Bank, *Domestic Resource Mobilisation for Poverty Reduction in East Africa: Tanzania Case Study*, November 2010, p.21

⁸⁹ IMF, *Staff Report for the 2011 Article IV Consultation and Second Review under the Policy Support Instrument*, 21 April 2011, pp. 17, 41

5. Recommendations

In our view, the government should:

- Remove tax incentives granted to attract and retain FDIs, especially those provided to the mining sector, EPZs and SEZs.
- Conduct an independent study to evaluate the economic impact and volume of foreign revenue that has been generated by the EPZs and SEZs viz the incentives given by government
- Undertake a review, to be made public, of all tax incentives with a view to reducing or removing many of them, especially those that involve the exercise of discretionary powers by Ministers. Those incentives that remain must be simple to administer and shown by the government to be economically beneficial.
- Provide on an annual basis, during the budget process, a publicly available tax expenditure analysis, showing annual figures on the cost to the government of tax incentives and showing the beneficiaries of such tax exemptions
- Establish clear mechanisms for government responsibility and accountability to citizen for tax incentive matters at all level of the government
- Promote coordination in the EAC to address harmful tax competition. This means agreeing on the removal of all FDI-related tax incentives. It does not mean achieving full tax *harmonisation* in the EAC but increasing tax *coordination*, allowing individual countries fiscal flexibility. In turn, this principally means improving the existing draft Code of Conduct on tax competition in the EAC, and agreeing:
 - on *minimum* rates on certain taxes, to avoid harmful tax competition
 - to provide a mandatory, regular exchange of information to other states concerning proposed tax rate changes
 - to adhere to high transparency standards, such as the IMF Code of Good Practices on Fiscal Transparency
 - to establish a robust dispute settlement mechanism
 - to conduct annual, comparable and publicly available, tax expenditure analyses

Further relevant recommendations are as stated in the 2011 CAG report. Some of them are similar to the ones above. These include:

- i) The tax law on exemptions should be reviewed to address and boost revenue sources.
- ii) 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.
- iii) Tax incentives being administered by TIC should be abolished or harmonised with TRA and other government agencies.

- iv) There is need for a study to be made on how much the country collects from investors and how much it loses in these tax holidays and exemptions.
- v) The Government should review its tax exemption policy with a view of narrowing down the scale of exemptions. There is a need to ensure that exempted amounts are restricted to a minimum tolerable level that is essential for the public interest.
- vi) The government should curb tax loopholes including tax exemptions and illicit transfer pricing amongst multinational companies

Institutions Interviewed

Confederation of Tanzania Industries
The Tanzania Institute of Bankers
Ministry of Finance
Tanzania Investment Centre
Bank of Africa
Institute of Finance Management
European Union
Tax Revenue Appeals Board
Tanzania Revenue Authority
University of Dar es Salaam School of Business
Zanzibar Revenue Authority
Zanzibar Investment Promotion Authority

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ⁱ Policy Forum, ‘How Much Revenue Are We Losing?’, *Policy Brief*, March 2009

ⁱⁱ David Malingha Doya, ‘Tanzania May Abolish Tax Refund for Miners to Boost Revenue’, 25 October 2011, www.bloomberg.com

ⁱⁱⁱ Geita Gold Mine Ltd, Tanzanite One Mining Ltd, Bulyanhulu Gold Mine Ltd, Pangea Minerals Ltd, North Mara Gold Mine Ltd, Resolute Tanzania Ltd, Williamson Diamond Ltd, Tanzania

Oxygen Ltd, El Hillal Minerals Ltd, Mbeya Cement Company Ltd, Tazaro Kongoro Quarry and one unspecified holder of a Dealers Licence

^{iv} The size of the informal economy is by definition hard to estimate. The government and the Economic and Social Research Foundation estimate 40 per cent (TRA, *Review of Informal Sector for Taxation Purposes*, Draft, January 2011, p.xii; 'Informal Sector Taxation in Tanzania', *TAKNET Policy Brief, No.12*, 2010, p.1); A recent World Bank analysis suggests around 60 per cent (Friedrich Schneider et al, *Shadow Economies all over the World: New Estimates for 162 Countries for 1999 to 2007*, World Bank, June 2010); the Tax Justice Network has recently used a figure of 56.3 per cent (*The Cost of Tax Abuse: A Briefing Paper on the Cost of Tax Evasion Worldwide*, November 2011)

^v 'TRA has no tax evasion statistics', *Daily News*, 11 August 2010

^{vi} 'Tax compliance is a legal obligation', *Daily News*, 12 December 2011, citing a recent TRA report

^{vii} IMF, *Staff Report for the 2011 Article IV Consultation and Second Review under the Policy Support Instrument*, 21 April 2011, p.25; World Bank, *United Republic of Tanzania, Public Expenditure Review 2010*, September 2011, pp.9, 85. Government figures on no and non-tax revenues show collections of 16.4 per cent of GDP in 2009/10 and a projection of 16.1 per cent of GDP in 2010/11. MOF, *Budget Digest 2010/11*, June 2010, unpaginated, section III; Tanzania, memorandum to the IMF, 15 April 2011, in IMF, *Staff Report for the 2011 Article IV Consultation and Second Review under the Policy Support Instrument*, 21 April 2011, p.37

^{viii} IMF, *First Review under the Three-Year Arrangement under the Extended Credit Facility*, 15 June 2011, p.20

^{ix} Nehemiah Osoro, *Domestic Resource Mobilisation in Sub-Saharan Africa: The Case of Tanzania*, 2010

^x IMF, *Seventh Review under the Policy Support Instrument*, 18 May 2010, p.20

^{xi} This IMF analysis does not define what it means as the 'tax gap'. We understand it refers to uncollected revenues from the informal sector and also from tax exemptions. The 'tax gap' is usually referred as 'the difference between what is legally due under the law, and what the government will be able to collect' (IMF Task Force on Harmonization of Public Sector Accounting—Working Group 2, July, 2004, <http://www.imf.org/external/np/sta/tfhpsa/2004/trjd.pdf>)

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