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Shaping the tax agenda: Public engagement, lobbying and tax reform in Tanzania


Photo: Christine Olson on Flickr

Tax reforms are no longer the exclusive domain of the International Monetary Fund, external experts, and the Ministry of Finance. Increasingly, interest groups across Africa shape the tax agenda. Business associations and other lobbying groups join in alliance with multinational companies to get tax exemptions even though they admit that tax incentives are not of major importance for their decision to invest or not. A high occurrence of tax exemptions reduces the tax base, creates room for bribery and corruption, and increases loopholes for tax avoidance. This brief explores the intensified public engagement in Value Added Tax (VAT) reform in Tanzania and suggests ways to develop a more effective and transparent public-private dialogue essential to ensure taxpayers' trust in the tax system.

CMI CHR. MICHELSEN INSTITUTE

Odd-Helge Fjeldstad
Senior Researcher, CMI
Research Director, ICTD
Extraordinary Professor, ATI

Lise Rakner
Professor, Univ. of Bergen

Prosper Ngowi
Associate Professor
Dar es Salaam Business School, Mzumbe Univ.

The original Value Added Tax Act of 1997

VAT was implemented in Tanzania in July 1998, with technical assistance from the IMF. The VAT was expected to broaden the tax base leading to substantial increase in tax revenues without distorting investment decisions. With few exemptions and zero rates, the Tanzanian VAT Act was perceived by the IMF and international tax advisors as a "best model" for VAT design in developing countries. Subsequent developments, however, deviated from best practice.

Over time, amendments of the Act incorporated an expanding number of exemptions and zero ratings of goods and services and of persons who were entitled to receive exempt supplies. The Minister of Finance had power to make additional exemptions by publishing an Order in the Gazette, a process which made it relatively easy to add exemptions. Some of these exonerations were promoted by the Tanzania Investment Centre (TIC) as necessary in order to attract investments. But generous tax incentives granted to multinational companies, especially in extractive sectors such as mining, led domestic enterprises to lobby for tax exemptions to adjust for the perceived unfairness of the tax regime.

VAT is a consumption tax. It is charged on all taxable supplies made (or in the case of imported goods and services, received) by taxable persons. VAT incurred in making taxable supplies can be offset against the VAT due, which means that the ultimate VAT charge falls on the final consumer of the goods or services, and the taxable amount includes the value added in the supply chain. The core principle of VAT is that supplies of goods or services are taxed unless there is a specific relief. It is common to have low or no VAT on essential goods or services such as food, healthcare, water, power and services relating to homes. Without such social reliefs, VAT would be a regressive tax, falling heavily on those who can least afford it. An advantage of VAT over the sales taxes it has replaced is that sellers have an incentive to collect the tax and pay it to the government in order to realize tax credits. VAT has been widely introduced in both developed and developing countries.

The exemption regime gradually gained its own momentum and expanded. The potential payoff for companies to engage in lobbying for exemptions was high. Numerous exemptions and zero-rated goods and services complicated the underlying VAT structure, caused complexity in the tax system and added to widespread leakages through the many opportunities for abuse and avoidance. They also had an adverse effect on revenue generation. By 2012, Tanzania ranked among the countries with lowest VAT productivity among the Southern African Development Community (SADC) and East African Community (EAC) countries.

Tax incentives are measures that provide for a favorable tax treatment of certain activities or sectors. They occur in many forms, including tax credits, exemptions, exclusions, allowances, and reduced tax rates. They may also be tied to time spans (tax holidays) or certain geographic locations, for instance tax free zones. According to IMF data, the use of tax incentives for investment has increased substantially in Sub- Saharan Africa over the last decade. The growing use of tax incentives granted to investors in developing countries is criticized and seen as a reason for tax base erosion and revenue losses. Incentive schemes may also be vulnerable to capture by lobby groups and therefore likely to lead to governance problems.

Figure 1 – Value of Tax Exemptions in Tanzania from 2000/01-2011/12 (as a percentage of Total Tax Collected)

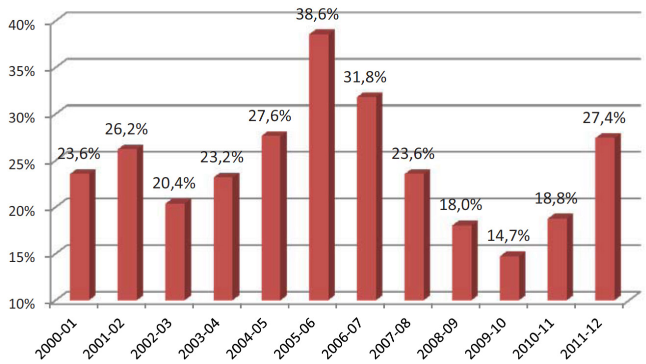

Figure 1 compares tax exemption values to total tax collected. Based on data provided by the Tanzania Revenue Authority (TRA), the ratio goes from 23.6% in 2007-08 to a low of 14.7% in 2009-10, before moving up again to reach a high of about 27% of total tax collected for 2011-12. Source: CSR Sogema (2013).

Figure 2 – Value of Specific Tax Exemptions as a Percentage of Total Value of Tax Exemptions (2011/12)

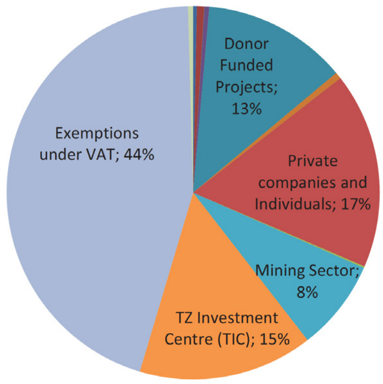

Figure 2 shows that almost 45% of all tax exemptions in Tanzania in 2011-12 were granted under the VAT, followed by exemptions under the Tanzania Investment Centre (23%). Donor-funded projects and the mining sector also benefited substantially from exemptions. Source: CSR Sogema (2013).

Towards a new VAT Act 2014

By 2012, the Tanzanian VAT regime was in dire need of reform. An IMF mission on VAT reform took place and an external VAT consultant was engaged. The Government established a technical reform team composed of staff from the Ministry of Finance, the Tanzania Revenue Authority and the Office of the Attorney General. A new VAT Bill was drafted and submitted to the National Assembly in May 2014. The new "model" bill only included a few exemptions and zero-ratings (mostly food, agricultural implements and other basic necessities). Special reliefs for named bodies were abolished. To reduce the opportunities to introduce new exemptions over time, the draft Bill removed the discretionary power of the Minister of Finance to grant and modify tax exemptions, which was considered to be the main factor behind the "tax exemption regime" that had developed since 1998. The new draft Bill stipulated that exemptions should be approved by the Parliament and that all new tax exemptions should be created or modified via legislation only.

This could have been the end of the VAT story, but the tax environment in Tanzania in 2014 had changed dramatically since 1998. When the new VAT Bill was made public with a statement of its objectives and reasons in May 2014, the considerably strengthened private sector mobilized against the Bill. Aiming to reintroduce exemptions and zero-ratings, the private sector lobbied Parliament and the Ministry of Finance. They argued that the abolition of exemptions would make Tanzania unattractive for investors and make Tanzanian companies uncompetitive in the domestic and regional markets. Although some agreed that the VAT regime needed an overhaul, they argued that the revisions should be made gradually to make it possible for companies to adapt to a new low-exemption regime. Business people and tax advisors interviewed complained about lack of consultation when the Bill was being prepared. The Ministry, however, claimed to have consulted a wide range of stakeholders.

In part, lobbying against the new VAT Bill was coordinated by business associations through the sector's umbrella organization Tanzania Private Sector Foundation (TPSF), who engaged professional tax advisors. Individual businesses also lobbied for their specific interests. In addition, public sector agencies, in particular the Ministry of Agriculture and the ministry responsible for tourism, mobilized against the bill. The main lobbyists for the private sector were experts from the 'Big Four' audit and accounting firms, in particular PricewaterhouseCoopers (PwC), and a former Deputy Commissioner General of the Tanzania Revenue Authority. The lobbyists succeeded to an extent turning the legislators.

In December 2014, the President signed the new VAT Act. It will be operational from July 2015. Although the Act has removed the special relief schedule and the list of exempted items is reduced, some of the exemptions that were removed in the draft bill are reinstated in the new Act (for example, the exemption for tourism services). Further, any tax incentives already granted to investors under the Economic Processing Zones Act and the Special Investment Processes Zones Act shall continue to apply. Since the VAT Act is silent on incentives granted under the Tanzania Investment Act it is not clear whether these incentives will continue to be granted. The discretionary power of the Minister of Finance to grant exemptions has been reduced but not entirely removed in the new Act. The Minister may grant exemptions for Government imports of goods and services that are to be used for relief of natural calamities or disasters.

The *Big Four* are the four largest international professional services networks, offering audit, tax, consulting, advisory, actuarial, corporate finance, and legal services. Ordered by size they are: PricewaterhouseCoopers (PwC), Deloitte, Ernst & Young and KPMG. In 2012 they had a combined turnover of 112 billion USD, 2800 offices and over 700 000 employees worldwide. All four companies have businesses in over 150 countries.

Sources: Based on information published in the official global websites of the firms Deloitte, PriceWaterhouseCoopers, Ernst & Young and KPMG.

A race towards the bottom

Business representatives interviewed as part of this study suggest that tax incentives are not of major importance for their decision to invest or not. They view improvements in the investment and business climate as a better way for Tanzania to boost growth and, thus, increase government revenue. To do so, they argue, the Government should improve efficiency and transparency in the public administration to reduce corruption. Rather than increasing tax exemptions, business people argue in favor of a simple and predictable tax regime. What, then, explains the extensive lobbying for exemptions?

The short answer is that tax incentives reduce business costs, and incentives granted to other companies and/or sectors in a non-transparent way, are perceived to be unfair. When "everyone else" is granted tax exemptions, one's own competiveness depends on exemptions. Second, over time, tax lobbying in Tanzania has become better organized and coordinated through the larger business association, sometimes under the umbrella of the Tanzania Private Sector Foundation.

TPSF represents both domestic and multinational companies. Although lobbying by individual business people still features, larger, organized associations are able to mobilize more powerfully for their demands, partly by engaging professional tax consultants and lobbyists to promote their position to Parliamentarians and senior government officials. The enhanced role of the Big Four international accounting and consultancy firms in tax lobbying in Tanzania, is a reflection of the importance of lobbying and the substantial resources spent on influencing policymakers and legislators.

Professional tax advisors target their lobbying towards influential stakeholders including Parliamentarians and public agencies affected by the proposed legislation. For instance, the agriculture sector has benefited from a vast array of VAT and customs duty exemptions. The lobbyists could easily mobilize the Ministry of Agriculture against any attempt to remove these exemptions. The same applies to the tourism sector. Removal of tax exemptions to elected officials would also easily mobilize Parliamentarians against such a move – although this would make public leaders receive the same tax treatment as their electorate.

In her Budget Speech of 11 June 2015, the Minister of Finance announced a new policy drive to reduce tax exemptions in Tanzania. The purpose is to reduce exemptions offered by discretion and instead cut tax on products with special importance for citizens and the economy directly from the tax law, to ensure equity and tax efficiency, minimizing loopholes and corruption in granting tax exemptions by discretion. The Government should be commended for this policy drive. In spite of the intention to reduce tax exemptions, the Minister announced the grant of strategic tax exemptions to specific sectors and investors. This may open up room for interpretation and thus discretion. It is therefore critical that such exemptions are granted in a transparent manner and that mechanisms for monitoring the tax incentive regime are in place.

In this brief we have shown that interest groups in Tanzania managed partly to reshape the VAT reform. A member of the technical VAT team in the Ministry of Finance said: "The new Act is completely diluted." This statement reflects a disappointment that the new Act did not go as far as

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anticipated in removing exemptions. One may, however, argue that the VAT Act of 2014 is a move in the right direction. It will be harder to make new exemptions, as they have to be publicly debated. The Minister's discretionary options are also more restricted. Yet, given the recent history of tax lobbying in Tanzania, it is likely that pressure will soon emerge to amend the Act to bring back exemptions.

Recommendations:

- Tax reforms need political support. A more gradual approach may ensure reforms being accepted over time by those who are concerned in the first space, i.e. the beneficiaries of exemptions, and, as importantly, the Tanzanian taxpayers.
- Prior to the announcement of a reform, substantial effort should be invested in the design of a comprehensive implementation strategy, working with affected taxpayer groups where possible.
- The tax reform should not proceed until the Government can be reasonably sure of the reform's outcome and success.
- Tax exemptions should be created or modified via legislation only, which would imply the Parliament's approval. Discretionary powers to grant or modify exemptions should be removed.
- Discretionary exemptions should be granted in a transparent manner and reasons for their provision should be made public.
- Policy makers and revenue officials should view consultations with taxpayers as an important mechanism for learning about challenges with the tax system, educating a major constituency, and strengthening the coalition in favor of good tax policy.

Recommended reading

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CMI (Chr. Michelsen Institute)
Phone: +47 47 93 80 00
Fax: +47 55 31 03 13
E-mail: cmi@cmi.no

P.O.Box 6033,
N-5892 Bergen, Norway
Visiting address:
Jekteviksbakken 31, Bergen
Web: www.cmi.no

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