Double Taxation Agreements

Gain or Loss to Tanzania?

A study by Tanzania Tax Justice Coalition

May 2016

Written by Moses Kulaba, Executive Director of Governance and Economic Policy Centre.

Tanzania Tax Justice Coalition (TTJC) is a loose coalition of NGOs interested in tax justice. The group was started in 2013 under Policy Forum. The group comprises of Policy Forum, Action Aid Tanzania, Kepa, Youth Partnership Countrywide (YPC), Tanzania Coalition on Debt and Development (TCDD), Tanzania Trade and Economic Justice Forum (TTEJF),Tanzania Youth Vision Association (TYVA), Governance and Economic Policy Centre, Tanzania Education Network (TenMet), The Interfaith Standing Committee on Economic Justice and Integrity of Creation and Norwegian Church Aid (NCA).

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Methodology

In conducting this study, we reviewed available literature and analysed key clauses of various Double Taxation Agreements (DTAs) signed by Tanzania. The report was validated at a meeting attended by stakeholders including high ranking officials from Tanzania Revenue Authority (TRA). It is aimed at stimulating critical discussion and reflection about Tanzania's DTA regime and informing new policies.

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Executive Summary

This study shows that most of Tanzania's current Double Taxation Agreements (DTAs) are old and contain taxation regimes that surrender Tanzania's taxing powers in favour of economically developed treaty partners.

The DTAs have capped withholding tax rates that can be levied on interests, dividends and royalties. Although most of the current DTAs have rates that are higher than the 10 % rate set in Tanzanian income tax law, risks gloom in the future. The South African DTA, which is the latest treaty signed in 2005, sets withholding tax rates at 10 % and caps future justifications of the income tax law. The agreements now negotiated with the Netherlands, the UK, the United Arab Emirates, Mauritius, Kuwait, Iran and China could potentially follow suit or pose even lower tax rates.

Furthermore, the DTAs limit Tanzania's taxation of profits derived from air and shipping operations. Collectively the provisions in the DTAs have created a lacuna for possible minimization or total avoidance of taxation on income derived in Tanzania.

This study does not show that DTAs are totally irrelevant for attracting Foreign Direct Investment (FDI) but evidence does not support the common assertion that DTAs attract FDI to Least Developed Countries (LDCs). Most of Tanzania's largest investments originate from countries with which Tanzania does not have DTAs.

The study concludes that the existing treaties can be costly to Tanzania in taxes foregone. Tanzania needs to reconsider its DTA network, especially now that it is negotiating treaties with many new countries.

Recommendations

- Review the tax rates and taxation rights of current DTAs and cancel all harmful DTAs.
- Impose a moratorium on signing new DTAs and develop a new policy directive for DTA negotiations.
- Ensure parliamentary approval and oversight of all DTAs.
- Invest in capacity building and greater understanding of DTAs within the public administration.
- Adopt a model DTA which favours the taxing rights of source countries
- Join or form coalitions on common concerns regarding DTA negotiations. These could strengthen Tanzania's bargaining position.
- Invest more in other measures to attract FDI. These measures could include non-tax preferences like government participation in investments.
- Leverage on the current momentum as a popular FDI destination in East Africa to renegotiate new DTAs.

What are Double Taxation Agreements?

Double Taxation Agreements (DTAs) are written treaties between two contracting states ensuring that nationals or residents of the states are not being taxed twice. The primary purpose of double taxation agreements is to facilitate the international flow of capital, technology and services by eliminating double taxation of income and other taxes in international transactions through a bilateral (occasionally multi-lateral) resolution of the conflicts between overlapping tax jurisdictions.[1]

Therefore, in absence of DTAs, it is said, it would be costly to do business because companies or individuals deriving income in one country would be taxed in that country and when they bring that income back home they would be taxed on the same income.

1 Hellawell, R. (1966). United States Income Taxation and Less Developed Countries: A Critical Appraisal. Columbia Law Review, 66(8), 1393–1427.

Photo: courtesy of shutterstock

DTAs identify all items of income and what standards should apply to their taxation as well as where each income would become taxable. This includes stipulating whether the tax will be levied based on residence of the tax payer (residence principle) or whether it will be levied at the source of income (source principle), or a combination of both, and when this should be done. A DTA can also include provisions for exchange of information for tax purposes between the two countries.

DTAs have for many years been a common instrument in international taxation. Governments sign DTAs with an understanding that such arrangements will be economically beneficial to both countries. Least Developed Countries (LDCs), like Tanzania, often judge that a combined effect of DTAs will be increased FDI and an expanded tax base through new investment. DTAs are also considered to promote international tax compliance and information sharing. Furthermore, governments seek to strengthen diplomatic relationships with their treaty partners.[2]

Why can DTAs be problematic?

In recent times DTAs have become a subject of controversial debate. DTAs were once thought to be key drivers in facilitating International trade, determining investor decisions and attracting Foreign Direct Investments (FDI). Recent research shows, however, that there is little evidence to support this view.[3] In fact, some studies now suggest that their perceived and practical impacts on attracting FDI are exaggerated.[4] When the contracting states are at different economic levels the income flows substantially in one direction – from the developing country as a source to the developed country as a residency country.[5]

2 Adelard Alfred (2016). Input at validation workshop of this report. 6.4.2016.
3 Baker P.L. (2014). Analysis of Double Taxation treaties and their effects on Foreign Direct, 341-377.
4 Christian, A. (2005). Tax Treaties for Investment and Aid to Sub-Saharan Africa, A Case study; Brooklyn Law Review, 71(2) 639-700.
5 Irish, C.R (1974) International Double Taxation Agreements and Income Taxation at Source; The International and Comparative Law Quarterly, Vol. 23, No.2, (Apr.,1974), pp. 292-316; Cambridge University Press on behalf of the British Institute of International and Comparative Law.

What is often then overlooked is the significant cost that arises from DTAs because of lost taxing rights by LDCs. LDCs are normally the source countries, where the actual investment takes place. They surrender their taxing rights to wealthier developed countries that are most often the resident countries of multinational companies. Indeed, various studies have even suggested that the underlying purpose for developed countries to sign DTAs is to shift tax revenues from LDCs to their home countries.[6] For example, the loss to developing countries as a result of Belgian tax treaties amounted in approximately USD 38.8 million, with the Democratic Republic of Congo alone losing an estimated USD 8.7 million in 2012.[7] The estimated revenue foregone by LDCs to the Netherlands only in 2011, excluding royalties, was a striking USD 854.7 million.[8] In other words the current system of tax agreements creates the anomaly of aid in reverse from poor to rich countries.

Due to the estimated costs in revenue foregone, a number of studies have warned countries like Tanzania to proceed with caution, re-examine their economic benefits and consider renegotiation or cancellation of the existing harmful DTAs.[9]

In addition to lost taxing rights, it has become evident that DTAs are being used as conduits for tax avoidance by multinational companies across tax jurisdictions. DTAs allow aggressive tax planning schemes like 'treaty shopping' and 'round tripping', where investments, capital, income and profits are routed through low tax jurisdictions or 'tax havens'. Round tripping means that capital sourced from a country is re-routed back into the country as an investment from abroad so as to enjoy tax treaty protection. Treaty shopping means that a company registers a subsidiary in a country with a vast treaty network and invests through it to enjoy treaty benefits. Countries with an ample

6 Ibid. and Dagan (2000) and Baker (2014).

7 Van de Poel, Jan (2016). In search of a new balance: The impact of Belgian tax treaties on developing countries, February, 2016. Sums converted from EUR to USD with the Bank of Tanzania exchange rate of 18.4.2016.

8 McGauran, Katrin (2013). "Should the Netherlands Sign Tax Treaties with Developing Countries?" SOMO.

9 See for example ibid and IMF (2014) and OECD (2014), Tax Justice Network Africa (2015) and SEATINI & ActionAid (2014).

tax treaty network, like the Netherlands or Mauritius, have low or zero tax rates. The adverse impact of these treaty networks is that they have created a situation of low taxation or 'double non-taxation' of multinational companies and made it practically impossible for governments of least developed countries to impose and collect highly needed tax revenue from foreign businesses and individuals operating in their countries. Most LDC governments survive on high indirect taxes, such as VAT, to cushion or offset this loss.

Tanzania's Tax Treaties and the State of Play

Tanzania has signed DTAs with nine countries. These are Sweden, Canada, Denmark, Finland, Norway, India, Italy, Zambia and South Africa. Most of the treaties are old and signed in the 1960s, 1970s and 1980s. These have remained in force despite the changing economic conditions in Tanzania and globally, including the rapid developments in e-commerce. Their substantive economic value is difficult to measure.

International treaties signed between Tanzania and other countries enjoy a special status in Tanzania's legal jurisprudence. International treaties are treated as 'superior' to Tanzanian laws and therefore have significant influence on how Tanzania's laws are drafted and exercised.

Table 1. Tanzania's Double Taxation Agreements

S/n	Country	Year and Place of Signing	Entry into Force	Effective Date
1	Zambia	02/03/1968, Dar es Salaam	Unknown	01/01/ 1964
2	Italy	07/03/1973, Rome	6th/05/1983	01/01/1970
3	Sweden	02/05/1976, Stockholm	31st /02/1976	01/01/ 1977
4	Denmark	06/05/1976, Copenhagen	31st /12/1976	01/01/1977
5	Norway	28/04/1976, Oslo	4th /08/1978	01/01/1979
6	Finland	12/05/1976, Helsinki	27th /12/1978	01/01/1979
7	India	5/09/1979, Dar es Salaam	16/10/1981	01/01/1982
8	Canada	15/12/1995, Dar es Salaam	29th/ 08/ 1997	1 /01/1998
9	South Africa	22/09/2005, Pretoria	15th /06/2007	15/06/2007

Currently, Tanzania is negotiating nine new DTAs with the Netherlands, Mauritius, United Kingdom, United Arab Emirates, Kuwait, Iran and China. A treaty with Oman has been concluded in 2011 but not yet signed and one with Vietnam was concluded in 2014 but negotiations were re-opened before signing due to changes in Vietnam's income tax legislation.[10]

So far there are no publicly known DTAs lined up for re-negotiation or cancellation. Publicly available information shows that the last tax treaty to be terminated by Tanzania was with Switzerland. It seems that the reason for termination was that the treaty was applicable to Tanzania as an extension of a tax treaty signed between Switzerland, the United Kingdom and Ireland in 1954.

In recent years a number of African countries have successfully either renegotiated or cancelled DTAs after citing multiple economic reasons. It appears that Tanzania has not caught up with its counterparts in the African region. Interestingly, some of Tanzania's DTA partners have also been renegotiating their treaties status with other countries (see annex 1). From this evidence, it is clear that Tanzania's DTA partners understand the importance of renegotiating of DTAs and would be willing to renegotiate if Tanzania demanded.

10 Adelard Alfred (2016). Input at validation workshop of this report. 6.4.2016.

Table 2. Examples of African Countries that have Renegotiated or Cancelled DTAs

Terminating Country	Partner Country	Status	Year Terminated or renegotiated	Reason given
Rwanda	Mauritius	Terminated	2012	Renegotiation strategy
Kenya	United Kingdom	Terminated		Colonial extension, renegotiation
Malawi	United Kingdom	Terminated		Colonial extension, renegotiation
Zambia	Netherlands	Renegotiated	2013	
Nigeria	United Kingdom	Terminated		
Malawi	Netherlands	Terminated	2013	Renegotiation strategy
Uganda		Suspended new negotiations	2015	Renegotiation strategy

Assessment of Tanzania's Double Taxation Agreements

The DTAs define what constitutes a Permanent Establishment (PE), what business profits are and how they will be taxed. Only business profits from a PE can be taxed in Tanzania. They also prescribe what constitutes interests, dividends, royalties and management fees and how these will be treated for tax purposes and the rates to be applied. The current DTAs place emphasis on taxation based on residence rather than source. This means that Tanzania as a source country has less taxing rights than its treaty partners.

The DTAs with the nine countries are based on a mix of provisions from the UN and the OECD model treaties for DTAs (see Annex 2). Comparative research with other East African countries shows that Tanzania has been quite successful in negotiating its treaties and not surrendering too much of its taxing rights to its treaty counterparts.[11] The period for PE status qualification is capped at 6 months, with one exception in the treaty with South Africa, which is along the lines of the UN model treaty.

11 Daurer, Veronika and Richard Krever (2012). Choosing between the UN and the OECD Tax Policy Models: An African Case Study. EUI Working Papers. Robert Schuman Centre for Advanced Studies. European University Institute. According to the Tanzania Revenue Authority, Tanzania currently regards its DTA treaty template as a combination of the OECD and UN models with slight domestic modifications. Source: Adelard Alfred (2016). Input at validation workshop of this report. 6.4.2016.

Permanent Establishment (PE) requires that enterprises are resident PEs or operate in a fixed place or their profits can be attributed to resident PEs. In other words, Tanzania cannot impose a tax if the company is not a PE. A permanent establishment is defined as a fixed place of business in which the business enterprise is wholly or partly carried on. It includes a place of management, a branch, an office, a factory, a workshop, a mine, a quarry or an oil field or other place of extraction of natural resources. A resident, on the other hand, is any person who under the laws of the state is liable to taxation by reason of his domicile, residence, place of management or any other criterion of a similar nature. Residence can also be determined by location of a permanent home, closer personal relations, and center of vital interest, habitual abode and nationality.

Multinational companies (MNCs) often escape being residents or having permanent establishment by operating through intermediaries in a manner which renders them to be non-residents and operating without a fixed base. A recent court case in the Tanzania Tax Revenue Appeals Tribunal against African Barrick Gold (Acacia Mining) has been an example of a case where a MNC claims that it is not a resident of Tanzania despite having a number of mines.

Having a PE-status defines whether a company pays business profits in Tanzania or not. The definition of business profits in the DTA has been narrowed to mean income derived by an enterprise from carrying on business. It does not include income in the form of rent, royalties in respect of cinematographic films or video tapes for television, fees for technical services, management charges, remuneration fees for providing services of a technical nature or other personnel, interests, dividends, capital gains remuneration for labour (including professional) services or income from the operation of ships and aircrafts, as tax rates for these activities are defined separately.

The DTAs have capped withholding tax rates on interests, dividends, royalties and management fees to a maximum of between 20 and 25% (see table 3). Interestingly most of the current DTAs offer favourable rates compared to the ones recommended by the OECD treaty model or the National Income Tax Act, which sets rates at 10 to 15 %. Nonetheless the set rates mean the DTAs hinder the government to easily revise its tax rates above the rates provided in the DTAs.

Royalty payments often raise eyebrows as copyrights, patents, trademarks are intangible commodities whose true market price is quite difficult to determine. Multinational companies use this opportunity to reduce their profit tax liability by inflating royalty costs paid to their overseas subsidiaries or headquarters for use of these intangible commodities. Recent case studies of large companies like Google show that most patent holders are non-resident entities located in tax havens. However, cases where a Tanzanian resident would be the receiver of royalty payments are likely to be rare. Under the Canadian DTA with Tanzania, however, royalty payments paid as a consideration or right to exploit a mine, oil well and quarry or any other place of extraction of natural resources have been exempt. This can provide Canadian mining companies that are running mines a possibility to avoid paying tax on royalties gained from the investment.

Taxation rates on interests vary between 10 and 15 %. In cases where interest is paid on debt claims from abroad there is no problem with interests on loans going untaxed in Tanzania. However, the downside with interest payments abroad are that they allow for tax planning arrangements where high interests can be used to minimize profits and corporate taxes paid in Tanzania.

Management and expert fees are capped at 20 %. However, typically companies operating in developing countries buy expert services from subsidiaries abroad. Rather than being a taxable income, this is usually a cost and a claimed allowable expense, which decreases business profits.

Table 3. Qualification of Permanent Establishment (PE) Status and Withholding Tax Rates

	India	Italy	Finland	Norway	Canada	Sweden	Denmark	South Africa	Zambia	Tanzania Income Tax Act
PE Status	6 mos	6 mos	6 mos	6 mos	6 mos	6 mos	6 mos	6 mos building sites, 12 mos for services	6 mos	
Interests	12.5%	12.5%	15%	15%	15%	15%	12.5%	10%	Exempt	10%
Dividends	15%	10%	20%	20%	25%	25%	15%	20%	Exempt	10%
Royalties	20%	20%	20%	20%	20% with exemption	20%	20%	10%	Exempt	15%
Mgt/ Expert/ director fees	20%	No limit	20%	20%	20%	20%	20%	No limit	Exempt	15%

The DTAs also contain provisions on how associated enterprises that are residents in the contracting states should be taxed. They rely on the OECD standard of associated businesses conducting business at 'arm's length', i.e. based on market prices. This provision is aimed at tackling transfer mispricing arrangements between the contracting states. Some DTAs, like the one with Canada, set a time limit for when tax authorities can claim for further adjustments in revenue payments. The time limit in the DTA with Canada is set at five years.

In general the South African DTA offers the highest risk by setting the withholding tax rates on interest and royalties at 10 % which is in line with or less than the current Tanzanian income tax legislation. This implies that Tanzania cannot increase the rates, if it so wanted, above this, without renegotiating with South Africa.
The DTA with South Africa is the newest treaty having been signed in 2005. Because it is the newest agreement, it is likely to be an agenda setter for others that are under negotiation. South Africa is also the biggest economy and a base for many multinational companies operating in Africa. Currently a lot of investment comes into Tanzania from South Africa.[12]

12 Bank of Tanzania (2013): Tanzania Investment Report 2013.

Zambia is quite unique and of particular interest because it is economically quite symmetrical with Tanzania. The DTA exempts levying of withholding taxes on various sources of income thus hindering revenue collection in Tanzania and Zambia. Considering the low volumes of foreign investments movement between Tanzania and Zambia, the generous exemptions given under this treaty may be of less concern but it is largely not clear what the DTA is sought to achieve.

Table 4. Provisions of Tanzania's Newest and Oldest DTAs

	South Africa (2005)	Zambia (1968)
Taxation of Income	Income from immovable property may be taxed. Ships, boats and aircrafts excluded from immovable property	Income derived by government entities exempt,W and by residents on overland transport taxed by apportionment
Taxation of Business profits	Only resident PEs or attributable income to PEs is taxed in Tanzania	Business profits and profits on non-residents is exempt from taxation
Taxation of Shipping and Air Travel	Profits deemed not to exceed 5%. Tax chargeable not to exceed 50%	Exempt unless if it operates wholly or mainly between places in the treaty states
Taxation of Interests	Taxed in Tanzania at a maximum of 10%	The maximum chargeable tax on interest under Tanzania's DTA with Zambia is exempt
Taxation of Royalties	Taxable at a maximum of 10% of gross amount	Royalties are exempt under Tanzania's DTA with Zambia.
Taxation of Dividends	Tax chargeable at 10% if beneficial owner is a company holding 15% capital. 20% in all other cases	Dividends under the Tanzania-Zambia DTA are exempt.
Taxation of Technical, Managerial or Directors' fees	Taxable for residents	Remuneration other than pensions paid by the Government of Zambia or Tanzania for any individual for services rendered to that government are exempt
Pensions and Annuities	Taxable for residents	Exempt from taxation

In addition to provisions concerning taxation, the agreements provide instructions for settlement of disputes through a mutual agreement process. In case a resident entity considers that actions by Tanzania are in contravention of the provisions as provided in the DTA, it can seek assistance from the competent authority of the state in which he is resident. The competent authority in Tanzania is the Ministry of Finance, which can contact the competent authority of its treaty partner to seek exchange of information and in search of a mutual agreement. It is common practice, however, that MNCs seek diplomatic intervention from their foreign missions whenever issues of this nature arise. This is the case of a Norwegian Cement Company which invoked the DTA provisions to seek diplomatic cover. This case is still ongoing.

The agreements are also a means for promoting information sharing, as contracting states agree to share information for tax purposes. It is not evident whether these provisions are exercised. All information is treated as secret and not disclosed to any other authorities other than tax related bodies. This implies that access to this information by oversight bodies like parliament may be impeded.

The DTA does not impose on the contracting state the obligation to carry out administrative measures or practice which is different from its own laws or the laws of the other country. Supply of information which is not obtainable under the local laws is not obligatory and disclosure of any trade, business, industrial, commercial, professional secrets or trade process is forbidden.

Do DTAs Attract Foreign Direct Investment?

There is a lack of statistical evidence to confirm that increased FDI is a result of DTAs signed between two countries.[13] A comparison of the numbers and rates of DTAs in East African Community (EAC) and the Southern African Development Community (SADEC) countries with their respective FDI flows does not reveal a clear pattern that would support this argument. Tanzania and Mozambique, for example, have

13 Baker P.L (2014). Analysis of Double Taxation treaties and their effects on Foreign Direct Investment. International Journal of Economics of Business, 2014, Vol 21, issue 3, 341-377

rather high withholding taxes but nearly as much FDI inflow as Zambia, which has many more treaties with lower rates. Burundi and Rwanda have low withholding tax rates but do not seem to attract much less FDI than Zimbabwe which has rather high withholding taxes.[14]

It is also known that tax advantages granted in the DTAs have minimal influence on investment decisions made by MNCs.[15] Taxes are only one of a great variety of the considerations affecting foreign investments in developing countries. Other factors that are said to be availed by DTAs like fiscal certainty, stability and the signalling of a favourable host investment climate, are incidental. Also issues like host workforce, skill levels, rule of law, infrastructure far outweigh the incidental reputational benefits attributable to DTAs.[16]

Furthermore, the elimination of double taxation through DTAs is not completely true since host countries unilaterally eliminate double taxation through various measures including providing reduced non-treaty withholding tax rates, tax credits and exemptions on taxes paid abroad.

FDI to Tanzania

Most of the FDI inflow into Tanzania has originated from ten major countries.[17] Inflows from the developed countries largely come from the United Kingdom, Canada, Switzerland, the United States and Luxembourg. Investments from emerging and developing economies mainly originate from South Africa, Brazil, Kenya and Botswana.

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14 Daurer, Veronika and Richard Krever (2012). Choosing between the UN and the OECD Tax Policy Models: An African Case Study. EUI Working Papers. Robert Schuman Centre for Advanced Studies. European University Institute.

15 Irish, C.R (1974). "International Double Taxation Agreements and Income Taxation at Source". The International and Comparative Law Quarterly, Vol. 23, No.2, (Apr., 1974), pp. 292-316; Cambridge University Press on behalf of the British Institute of International and Comparative Law.

16 Christian, A. (2005). Tax Treaties for Investment and Aid to Sub-Saharan Africa. A Case study. Brooklyn Law Review, 71(2) 639-700.

17 Bank of Tanzania (2013). Tanzania Investment Report 2013.

Table 5. Tanzania's Top 10 FDI Source Countries (2012)

	Country	Amount (million USD)	DTA with Tanzania
1	United Kingdom	786.9	DTA under negotiation
2	Canada	308.8	x
3	Switzerland	219.4	
4	USA	198.9	
5	South Africa	148.3	x
6	Kenya	108.7	
7	Australia	76.3	
8	Luxembourg	72.1	
9	Botswana	28.7	
10	Brazil	20.9	

Source: Tanzania Investment Report 2013.

Over 80 % of FDI flows in 2012 originated from only four countries; namely the United Kingdom, Canada, Switzerland and the USA. The United Kingdom remained a leading source of FDI. Most of the investments went into mining, quarrying, manufacturing, finance, insurance, wholesale and retail trade, as well as information and communication activities.

There is no supporting evidence to show that the existence of DTAs was a major determining factor influencing MNC decisions to invest in Tanzania as most countries of investment origin do not have DTAs with Tanzania.

However, measuring the FDI stock inflows, gives a different picture. South Africa was the leading source in terms of stock of FDI in 2012 with USD 3,221 million. The top five stock of FDI source countries included South Africa, United Kingdom, Barbados, Canada and Kenya which account for 58.2 % of the total stock of FDI.

Table 6. Tanzania's Top 10 FDI Stock Source Countries (2012)

	Country	Amount (million USD)	DTA with Tanzania
1	South Africa	3,221	x
2	United Kingdom	2,328.1	DTA under negotiation
3	Barbados	1,874.4	
4	Canada	1,333.3	x
5	Kenya	621.8	
6	Mauritius	617.6	DTA under negotiation
7	Switzerland	564	
8	Netherlands	314	DTA under negotiation
9	USA	268.2	
10	Norway	210.2	x

Source: Tanzania Investment Report 2013. The list excludes international financial centres.

From the figures it is reasonable to raise questions as to why small economies and well known low tax jurisdictions (tax havens) like Barbados, Mauritius, Switzerland and the Netherlands continue to be among the leading FDI stock source countries. Equally in 2012, FDI stocks were received from notorious tax havens like Jersey Channel Island, Cayman Islands, Isle of Man, Liechtenstein, Bahamas and the Virgin Islands. There is a strong reason to suggest that investment and capital are being re-routed through these low tax destinations. This probability, however, needs to be confirmed by an independent study. A further study would also be needed to establish why treaties with FDI stock inflow countries are more common than with FDI source countries.

Nonetheless, signing a DTA with known "treaty shopping" countries like the Netherlands and Mauritius increases the risk of double non-taxation on investments from these countries, given their current status as low or non-tax jurisdictions. They might also increase the amount of investment stock flowing in to Tanzania from Mauritius and the Netherlands.

Tanzania's investment report survey findings show that on a net basis companies with external debt made repayments to related parties, while receiving disbursements from unrelated parties. The activities that received large disbursements during 2012 were mining and quarrying, manufacturing and information technology sectors which accounted for 65.3% of the total private sector external debt in 2012. The major sources of the debt were the USA, South Africa and Barbados.

While cautious not to appear accusatory with sparse evidence, the disbursements from renowned tax havens like Barbados are of particular concern and warrant further investigation. It is possible that the disbursements were beneficiaries of aggressive tax planning arrangements. Bank of Tanzania's findings that the companies were making payments to related parties and receiving disbursements from unrelated parties indicate that the companies have internal loans and might engage in thin capitalization, i.e. tax avoidance. The companies could have been receiving disbursements from 'letter box' subsidiaries located in low tax jurisdictions and making debt and interest payments back to them. During 2012 alone, retained loss worth USD 51.3 million was recovered by enterprises from Mauritius, while at the same time repayments of loans worth USD 90 million were made.[18] UNCTAD has estimated that USD 90 billion per year in taxes are lost by developing countries due to thin capitalisation, or internal debt payments between related parties.[19]

Conclusion

The right to tax is an obligation bestowed on sovereign states. Every country tries to exercise this mandate to its fullest with an ambition to raise as much tax revenues as possible. These revenues are vital for financing public goods and services. Countries sign up to international tax treaty commitments with anticipation that through these international arrangements vital economic objectives will be advanced. This ambition must have been one of the incentives for Tanzania signing up on to the multiple DTAs with other countries. The findings from this study show that Tanzania's DTAs are mainly several decades old and their provisions are not severely harmful. However, in principle provisions in these DTAs restrict Tanzania's powers to tax, and some DTAs like the one with Zambia is generous

18 Ibid.
19 UNCTAD (2015) World Investment Report 2015.

with exemptions. Furthermore, the increased tax revenue benefits from these DTAs are difficult to trace. It is evident that the anticipated investment promotion benefits may have been over-amplified since the top investors in Tanzania are not exclusively tax treaty partners.

The latest DTA with South Africa from 2005 includes provisions that restrict Tanzania's taxing power more than before. This treaty could be an agenda setter for the DTAs that are now under negotiation with the Netherlands, the UK, the United Arab Emirates, Mauritius, Kuwait, Iran and China. With the following recommendations, we want to encourage the Tanzanian Government to take measures to review the development benefits of any future treaties.

Recommendations to Tanzanian Policy Makers

- ***Review the tax rates and taxation rights of current DTAs and cancel all harmful DTAs***

  The current DTAs should be replaced with agreements which permit greater taxation of foreign income and capital by the source country so that tax revenues derived from these incomes are fairly apportioned between Tanzania and its developed tax treaty counterparts. The tax rates should be in line with Tanzania's revenue collection ambitions without imposing a heavy tax burden and dampening private investment.

- ***Impose a moratorium on signing new DTAs and develop a new policy directive for negotiations of DTAs***

  Tanzania should develop a policy to guide ongoing and future DTA negotiations. The policy should outline the underlying principles that should not be compromised. Currently there is no evidence of coherent policy guidelines of this kind. We are worried that the negotiating teams, ministers and diplomats abroad use their 'best judgement' and are often driven by pressures to sign off new agreements as a sign of advancing Tanzania's diplomatic stature abroad without carefully weighing the costs in taxes foregone through such agreements.

- ***Ensure parliamentary approval and oversight of all DTAs***
  It appears that common practice is that DTAs are negotiated, presented to Cabinet for approval, signed by the responsible Ministers or diplomatic missions abroad and ratified by Government without meaningful participation of Parliament. As DTAs are instruments of long-term international commitment, the anticipated benefits and costs of each DTA should be clearly presented, debated and endorsed by Parliament. The Government should also provide regular reports or updates in regards to the benefits accrued from the various DTAs signed and enforced.

- ***Invest in capacity-building and greater understanding of DTAs***
  Promotion of greater understanding of consequences of DTAs in Tanzania is vital. Emphasis should be on building the understanding and capacity of the tax administration, negotiating teams, policy-makers and citizens on the advantages and disadvantages of DTAs. These include the Ministry of Finance, the Ministry of Foreign Affairs, Attorney General's Office, Tanzania Revenue Authority and Parliament. Wider awareness should be made on the existing opportunities of securing DTAs with a balanced emphasis on source taxation.

- ***Adopt a model DTA which favours the taxing rights of source countries***
  The UN Model Convention has been often seen as a much more favourable template for least developed countries as it has significant provisions with a bias towards taxation at source and taxation of e-commerce. It has its own weaknesses and is largely criticized by the OECD countries and the United States. There have been initiatives to develop African Tax Administration Forum (ATAF), Common Market for Eastern and Southern Africa (COMESA), Southern Africa Development Community (SADC) and East African Community (EAC) model DTAs over the past years. Tanzania should support pan-African initiatives of this nature and explore the benefit of some of the provisions contained in these model treaties.

- ***Join or form coalitions on common concerns regarding DTA negotiations***

  Tanzania can strengthen its bargaining position on DTAs by joining or forming coalitions with other developing countries for the single purpose of negotiating or re-negotiating DTAs. The global tide has been moving towards having fair and balanced DTAs.

- ***Invest more in other measures to attract FDI***

  The government should invest more in other measures to attract FDI and winning investor confidence instead of relying on DTAs as a tool for FDI attraction. Factors such as functioning infrastructure and skilled labour are normally more important determinants for investment decisions than the existence of a DTA. Measures could also include non-tax preferences like government participation in investments.

- ***Leverage on the current momentum as leading FDI destination to negotiate new DTAs***

  The reviewed literature suggests that the strength of a developing country's bargaining power is closely related to the degree to which the country provides attractive opportunities for foreign investors. Consequently, the developing countries to which foreign investors are favourably disposed such as Kenya, India, Argentina or Brazil are in a stronger bargaining position than countries which have not attracted the favourable attention of foreign investors. Tanzania can leverage on its current international interest as an investment destination and future economic power to either renegotiate or completely cancel some of the existing DTAs.

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Glossary

Assets: A resource with economic value that an individual corporation or country owns or controls with the expectation that it will provide future benefits.

Attributed Income: Income said to have been derived from activities that are connected to the taxable entity or Permanent Establishment.

Business Profits: A financial benefit realized when the amount of revenue gained from a business activity exceeds the expenses, costs, taxes incurred in sustaining the activity.

Capital Gains Tax: A tax levied on the gains or profit realized on the sale of a non-inventory asset that was purchased at a cost amount that was lower.

Connecting Factors: Factors that link the tax entity to the tax liability or obligation. These include nationality, residence or domicile, place of business, control or effective management and income.

Contracting Parties: The states that sign onto the Double Taxation Agreements.

Country of Origin of an Investment: Usually used to mean the residence of the shareholders and where the main decisions on operations of a company are made. It is significant in the determining the residence of a taxable entity.

Direct Investment: Used to mean an International investment by a resident entity of one economy (direct investor) in an enterprise resident in another economy (direct investment enterprise) made with

Dividends: Part of profits paid to shareholders. Dividends are recorded at the moments shares are declared and received.

Domestic Permanent Establishment: All PEs of a non-resident individual, partnership, trust or corporation situated in the United Republic

Double Taxation: Same income is taxed twice by the same or different tax jurisdictions

Double Non Taxation: Used to refer to a situation where income or a taxable entity escapes being taxed across different taxing authorities

Equity: A stock or any other security representing an owner's interest.

Flag of convenience: A business practice of registering a merchant ship in a sovereign state different from that of the ship's owners, and flying that state's civil ensign on the ship. Ships are registered under flags of convenience to reduce operating costs or avoid the regulations of the owner's country.

Foreign Direct Investment flow: Movement of private investments between two countries in a specified period.

Foreign Direct Investment outflow: An increase in country's investment (assets) abroad during a specified period of time. This also implies investments abroad by a domestic enterprise.

Foreign Permanent Establishment: Means all PEs of an individual , partnership, trust or corporation that are situated in any one country that is not in the other country in which the individual partnership, trust or corporation is resident but excludes a domestic establishment.

Foreign Source: An amount that is not treated as having a source in the United Republic of Tanzania by sections 67, 68 or 69 of the Income Tax Act 2004 (RE 2014).

Intangible Assets: An asset which is not physical in nature. In tax language used to comprise corporate intellectual property rights (such as patents, trademarks, copy rights, business methodologies, secret formulas) goodwill and brand recognition.

Interest: A fee paid for the use of another person's money. To the borrower it is the cost of renting money and to the lender it is the income from lending money.

International Financial Centre: A territory, city or geographical location with a heavy concentration of financial institutions offering highly developed commercial services, communication, infrastructure and where a great number of domestic and international trading takes place. Examples include Singapore, Frankfurt, London and New York.

Lasting Interest: Used to imply the existence of a long-term relationship between the direct investor and the direct investment enterprise and a significant degree of influence by both the initial transaction between the two entities and all subsequent capital transactions between them and among affiliated enterprises both incorporated and unincorporated.

Offshore Financial Centre: A small low tax jurisdiction specializing in providing corporate and commercial services to non-resident offshore companies and for investment of offshore funds. Examples include; Anguilla, Antigua, Isles of Man, Canary Islands, Bahrain, Lebanon, Hong Kong and Bahamas.

Permanent Establishment (PE): Fixed place of business which generally gives rise to income or value added tax liability in a particular jurisdiction.

Private Sector External Debt (PSED): Loans contracted by domestic sectors covering long and short term loans from related and unrelated companies and supplies, credit from related or unrelated companies.

Related companies: Subsidiaries (where a non-resident owns more than 50 percent of the shares), associates (where a non-resident owns 50 percent or less) or branches (where unincorporated enterprises is wholly owned by non-residents).

Rent: Payments made for the use of or right to use or forbearance from using an asset situated in the United Republic of Tanzania.

Repatriated Income: Income that is brought back home on a foreign investment or transferring foreign earnings home, in case of an individual.

Resident/Resident tax entity: Any individual enterprise or other organisations ordinarily residing in a country and whose centre of interest is in the country. For statistical purposes a person who lives in a country for more than a year is considered a resident of that country, regardless of the individual's citizenship or nationality.

Resident Company/Enterprise: A company or enterprise incorporated in that country, irrespective of the domicile of the owners of the company. It also includes a foreign branch of a company operating in the country for more than one year.

Residency principle: Residents of a country or tax jurisdiction are subjected to tax on their worldwide income and non-residents are taxed on a source basis.

Round Tripping: When a local company establishes residence in another country and uses the existing treaty or tax incentives on foreign investment to come back and register as a foreign company so as to enjoy the tax benefits under the treaty cover.

Royalty: A payment to an owner for the use of property, especially patents, copy righted materials, franchise or natural resources.

Source Principle: Income taxed from where it is derived whenever it arises in the respective tax jurisdiction irrespective of the residence of the tax payer.

Stock: Assets and liabilities position at a point in time, for instance end of year position.

Stock of FDI: The value of the share of capital and reserves (including retained profits) attributed to the parent enterprise plus the net indebtedness of affiliates to the parent company.

Tax Avoidance: Using the weaknesses within the law to modify or reduce an individual's or a corporation's tax liability.

Tax Evasion: Illegal practice where a person, organization or corporation avoids paying taxes.

Tax Haven: A country that offers foreign individuals and business little or no tax liability, high financial secrecy, in a politically and economically stable environment. Examples in Canary Islands, Panama and Bahamas.

Tax Inversion: A practice where a company changes residence or becomes a subsidiary of a new parent company in another country for purposes of failing under beneficial tax laws. Usually used by companies to relocate residence to low tax domiciles.

Tax Jurisdiction: Used in reference to tax authority with legal powers to levy a tax.

Tax Liability: Total amount of tax that an entity is legally obliged to pay to a tax authority as a result of the occurrence of a taxable event.

Thin Capitalization: The practice of profit shifting from high to low tax jurisdictions through intra-firm debt arrangements.

Treaty shopping: When a company or an individual who is a resident in one country is able to benefit from a DTA between the source country and yet another country.

Unrelated Companies: Companies that are not related in terms of shares.

Withholding Tax: A resident has an obligation to withhold income tax from payments, employment, dividends, interests, natural resource payments, rent, royalty and payments as per section 82 of Tanzania's income tax Act.

ANNEX 1. Recent Treaty Renegotiations and Cancellations by Tanzania's treaty partners

Terminating Country	*Partner Country*	*Status*	*Year Terminated or renegotiated*	*Reason given*
South Africa	Mauritius	Renegotiated	2012	Renegotiation on right to tax capital gains tax from sale of south African assets by Mauritian owned property, impose WHT, Royalties and higher tax on dividends
India	Mauritius	Renegotiated	2015	Concerns by India over 'round tripping' and tax evasion via Mauritius
Norway	Switzerland	Renegotiated	2015	Access information on tax matters and Arbitration clauses
Denmark	France	Terminated	2009	No details publicly available
Netherlands	Zambia	Renegotiation	2013	Insert of Anti-Fraud Provisions
Canada	United Kingdom	Renegotiated	2015	Concerns on arbitration
Finland	Denmark	Renegotiated	2008	Taxing of dividends

ANNEX 2. Summary overview of DTAs signed by Tanzania

Country	Taxing Powers	Scope	Taxes Covered	General definition	Fiscal Domicile	Income Taxation	Business Profits	Air transport	Shipping
Italy	Residency	Resident persons	All Income taxes	All Tanzanian and Italian territory	Resident	Immovable property may be taxable at source. Ships and aircrafts not immovable	Business profits or attributable income of a PE is taxed at source	Profits taxed in state where effective manag't of the enterprise is situated	Profits taxed in state where effective manag't of enterprise is situated
India	Residency	Resident persons	All Income taxes	All Tanzanian and Indian territory	Resident	Immovable property may be taxable at source. Ships and aircrafts not immovable	Business profits or attributable income of a PE is taxed at source	Profits taxed in state where effective manag't of the enterprise is situated.	Profits taxed in state where effective manag't of enterprise is situated
Finland	Residency	Resident persons	All Income taxes	All Tanzanian and Finnish territory, excluding County of Åland	Resident	Immovable property may be taxable at source. Ships and aircrafts not immovable	Business profits or attributable income of a PE is taxed at source	Profits taxed in state where effective management of the enterprise is situated	Profits taxed in state where effective manag't of enterprise is situated
Norway	Residency	Resident persons	All Income taxes	All Tanzanian and Norwegian territory	Resident	Immovable property may be taxable at source. Ships and aircrafts not immovable	Business profits or attributable income of a PE is taxed at source	Profits taxed in state where effective management of the enterprise is situated	Profits taxed in state where effective manag't of enterprise is situated

Country	Taxing Powers	Scope	Taxes Covered	General definition	Fiscal Domicile	Income Taxation	Business Profits	Air transport	Shipping
Canada	Residency	Resident persons	All Income taxes	All Tanzanian and Italian territory	Resident	Immovable property may be taxable at source. Ships and aircrafts not immovable	Business profits or attributable income of a PE is taxed at source	Profits taxed in state where effective manag't of the enterprise is situated	Profits taxed in state where effective manag't of enterprise is situated
Denmark	Residency	Resident persons	All Income taxes	All Tanzanian and Danish territory, excluding the Faroe Island	Resident	Immovable property may be taxable at source. Ships and aircrafts not immovable	Business profits or attributable income of a PE is taxed at source	Profits taxed in state where effective manag't of the enterprise is situated	Profits taxed in state where effective manag't of enterprise is situated
South Africa	Residency	Resident persons	All Income taxes	All Tanzanian and South African territory	Resident	Immovable property may be taxable at source. Ships and aircrafts not immovable	Business profits or attributable income of a PE is taxed at source	Profits taxed in state where effective manag't of the enterprise is situated	Profits taxed in state where effective manag't of enterprise is situated
Zambia	Residency	Resident persons	All Income taxes	All Tanzanian and Zambian territory	Resident	Immovable property may be taxable at source. Ships and aircrafts not immovable	Business profits or attributable income of a PE is taxed at source	Profits taxed in state where effective manag't of the enterprise is situated.	Profits taxed in state where effective manag't of enterprise is situated

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