AN ANALYSIS OF TANZANIA'S BUDGET REVENUE PROJECTIONS

HOW MUCH REVENUE ARE WE LOSING?

Tanzania Budget 2009/2010: Policy Brief 3.09

The Issue

This policy brief provides an overview and analysis of Tanzania Government's Revenue based on the projections for 2009/2010 national budget. The brief presents some of the data as provided in the Budget Guidelines and Budget Framework for 2009/10-2011/12 which indicates that government revenue will decline persistently until the end of 2012. The brief highlights some of the challenges the government will face in light of reduced tax revenues in the wake of oncoming global economic financial crisis but also gives a vivid insight with regards to how much revenue Tanzania loses through uncollected tax and mispricing.

Introduction

Over the past years, the government of Tanzania has focused itself on raising revenue from a limited number of sources. Taxation on drinks, fuel, cigarettes & tobacco products, Value Added Tax and Pay as You Earn (PAYE) have been the major focus of taxes. The current general consensus amongst the citizens is that these sectors are already overtaxed and government cannot impose any further taxes in these areas without aggravating the already rising costs of living and sinking the population further into poverty. The emerging question, therefore, is from where else can government raise more money?

In this brief, our analysis based on the available international trade data indicates that the Tanzania Government can raise more revenue by blocking the current massive revenue outflow rather than targeting dependence on foreign aid or over taxation of some limited sectors to raise more revenue for the budget.

Government's 2009/2010 Revenue projections

The Government's projection is that revenue for the year 2009/2010 is expected to fall persistently until the end of 2012.

According to the budget guidelines in period 2009/10, domestic revenue has been projected at 17.0 percent of GDP in 2009/10, from 17.7 percent in 2008/09 and is expected to reach 17.5 percent in 2011/12 . Foreign assistance is projected at 8.9 percent of GDP in 2009/10 from 9.1 percent in 2008/09, and a further decline to 5.3 percent is envisaged in the medium term. Overall resource envelope in 2009/10 is projected to decline to 25.9 percent of GDP, equivalent to a decline of 0.2 percent compared to 2008/09. This trend will persist and reach 22.8 percent in 2011/12, primarily on account of the projected decline in foreign assistance.

The government has committed itself to continued commitment with its policy of zero domestic borrowing for budget financing over the MTEF period. This therefore means that the government has to look to other sources of revenue to cushion its dwindling current sources.

Domestic Revenue and Foreign Revenue

TANZANIA'S domestic revenue collection in the 2008/09 fiscal year will see a **10 percent** shortfall of its 4.73 trillion shilling ($3.53 billion) target and will drop further in 2009/10 due to the world economic slump. The government therefore expects an out turn of **Tsh 6.9 trillion** at the end of the financial year instead of **Tsh 7.2 trillion** budgeted in 2008/09.

During the 2009/2010 financial year the government projects to collect **Tsh 5.2 trillion** as domestic revenue, **Tsh 3.2 trillion** as foreign revenue and domestic borrowing contributing to **Tsh 1.1 trillion** bringing the total projected government expenditure to **Tsh 9.5 trillion.** This compares to a slight increase by **Tsh 2.3 trillion** in Government's overall budget frame since last year but obviously a decline in real terms if the figure is subjected to inflation which is generally expected to be above 7% by end of 2009.

According to the Budget Guidelines and Medium Term Expenditure Framework (MTEF), consistent with the resource envelope, total expenditure in the medium term is projected to decline by 3.1 %, from 25.9 percent of GDP in 2009/10 to 22.8 percent of GDP in 2011/12. The recurrent expenditure which is currently 17.7% of GDP is expected to be 16.8 percent of GDP in 2009/10 and estimated to decline to 15.6 percent in 2011/12.

This is consistent with government's intention of financing the recurrent expenditure from domestic revenues, while steadily building its savings for financing infrastructure projects from domestic sources. Total development expenditure is estimated at 9.1 percent of GDP in 2009/10, a slight decline from 9.3 percent of GDP in 2008/09, and further decline by 1.8 percent is projected in the medium term.

From this data, it is evident that government will for the next three years grapple to manage its budget and as a consequence its macro-economic targets may not be achieved. In order for government to raise these funds, new innovative choices have to be made. According to government plans, the focus

Revenue Source	2008/09 (trillions)	2009/210 (in trillion)
Domestic Revenue	4.7	5.2
Foreign Revenue	2.4	3.2
Domestic Borrowing	N/A	1.1
Total	7.2	9.5

Source: Budget Frame for 2008/09-2009/10

NOTE: All of the data in this brief should be treated with caution, as the Budget Guidelines provide only preliminary indications of what is expected in the coming financial year. This brief is also based on the Guidelines for the Preparation of Medium Term Plan and Budget Framework for 2009/10-2010/12 ; A Christian Aid Report, entitled: False Profits: robbing the poor to keep the rich tax free, March 2009; and figures calculated based on trade statistics available at Eurostat and the US Census Board.

for the year 2009/2010 budget will be to direct efforts in the following areas:

- Improve tax Administration and accountability among the taxpayers and tax collectors;
- Widening of the tax base by registering new taxpayers and improve tax compliance level;
- Instituting improved management and control of tax exemptions;
- Establishing additional Large Taxpayers Units for medium sized taxpayers in order to facilitate collection of more revenue in the medium term;
- Automating the tax system
- Strengthening supervision of excise and customs duties
- Increasing the contribution of Non tax revenue from the current level of about 1 percent of GDP to at least 3 percent of GDP in the medium term.
- Tapping in resources accumulated as revenue from surpluses, dividends and corporate tax from Public investments by making changes in the Finance Act 2008.

Despite these good initiatives, experience in the past years indicates that government's seemingly good plans have never successfully generated resources to meet its anticipated national targets. The revenues generated from governments fiscal and monetary plans are still far below the actual revenue required to finance and achieve the MKUKUTA targets.

According to the budget guidelines the total amount of money required (requirements) to achieve these targets is **Tsh 5.8 trillion**. The actual (ceilings) available resources for which the government has to budget is **Tsh 3.6 trillion**. Hence, the difference between the total requirement and ceilings (MKUKUTA funding Gap) is **Tsh 2.2trillion.** Faced with this shortage, the government has had to make very calculated manoeuvres by thinly spreading the available revenue resources across the three MKUKUTA clusters.

During the budget year 2009-2010 the government has allocated **Tsh 3.6 trillion** equivalent to 38% of the total budget for financing MKUKUTA interventions in 2009/10. Further, within MKUKUTA, **51.2** % has been allocated for Cluster 1, while **29.2** % is for **Cluster 2** and **19.5** percent for **Cluster 3**. In the medium term, it is envisaged that more resources will be directed to MKUKUTA intervention particularly in **cluster 1** through the implementation of projects identified under MPIP.

The consequence of this thin spread of resources to achieve high targets is that the net impact of MKUKUTA has not been adequate enough to bring about changes in the lives of ordinary citizens. This therefore implies that government has to look elsewhere to generate more revenue to finance and achieve its MKUKUTA targets. Faced with an already over taxed population, a shrinking foreign aid source, the logical alternative is for government to look into the massive revenue that has been lost through illicit conduit means.

The Revenue lost to exemptions, illicit means and trade mispricing of Tanzanian products

The revenue lost through a combination of tax exemptions, avoidance, low mining royalties, illicit means and trade mispricing runs into trillions of shillings. Based on available estimated calculations, the government is foregoing over **Tsh 2 trillion** a year in tax revenue lost through exemptions and illicit trade means with foreign countries and multinationals.

Revenue loss arising from Tax exemptions

The Country is losing massive revenue in tax exemptions and tax breaks granted to government departments, donor supported projects, private businesses, NGOs and Mining Companies. According to the Tanzania Revenue Authority, the Government lost **Tsh 587 billion** in tax exemptions made between July 2008 and April 2009. Projects under the Tanzania Investment Center (TIC) accounted for the largest percentage of the total exemption. Other beneficiaries included state owned institutions, the government of Zanzibar, religious and non religious non governmental organizations. In 2008 alone the government lost **Tsh 1.8 trillion** in exemptions.

More revenue was lost to mining companies operating in Tanzania. None of the mining companies have sought exemptions from royalties or corporate income taxes in any of the contracts. However, they have sought significant exemptions from local government taxes, withholding taxes, and fuel levies. The mining agreements stipulate that companies will not pay local government tax in excess of $200 000 a year (Tsh 260 million), even though this is much lower than the 0.3% of the value of company turnover, which the law requires they should pay in local government taxes.

The Bomani Commission has estimated that the government has foregone Tsh 39.8bn in 2006/7 and Tsh59bn in 2007/8 in revenue as a result of fuel levy exemptions granted to the six large mining companies. In addition, the mining contracts have set stamp duties at 0.3%, a tenth of the rate of 4% stipulated in the substantive law.

The mining companies have also engaged in aggressive tax evasion measures aimed at reducing their tax obligation. Tax evasion is an illegal practice, where companies knowingly under declare their profits to lower their tax bill. In 2003, an independent auditor contracted by the government to examine the account of four major Tanzanian gold mining companies alleged that two of them over declared their losses, reducing in turn their tax liabilities to the government. If the auditors report is correct, this has cost the government $132m equivalent to **Tsh 171 billion** in lost revenues between 1998 and 2003. The cumulative revenue loss from exemptions for last year and this year alone is approximately **Tsh 2.3 trillion**. This money would be enough to cover the financing gap of **Tsh 2.2 trillion** required to meet the MKUKUTA cluster requirements for the year 2009/10.

Revenue loss due to mispricing

According to international trade statistics Tanzania lost approximately **Tsh 53.93 billion** in revenue due to illicit means and trade mispricing of Tanzanian products sold to foreign countries between 2005 and 2007. This is a crude figure because it only combines the cumulative revenue estimates lost to European Union, United States and the United Kingdom. The loss excludes revenue lost in trade with trading partners countries like China, India and South Africa. It also excludes revenue lost due to bad contracts in the lucrative sectors like Mining, fishing, forestry and tourism.

Based on the data computed from the United Nations data base Comtrade, Eurostat and the US census board which contains data on the quantity and value of commodity trade between countries (if reported by one of these countries) indicates that there is a significant variation between the quantity and values of the commodity trade between Tanzania and other countries.

The massive loss of revenue is largely due to multinationals evading taxes through a system called **transfer pricing and trade mispricing**. This system includes under pricing, transfer of profits and establishment of subsidiaries of multinationals in **'Tax Havens'** like the Canary Islands, Jersey, Island of Man and Cayman Islands to avoid paying taxes in countries like Tanzania.

It refers to a system in which businesses in particular multinational corporations, shift billions of money in profits between jurisdictions to reduce or even dodge completely, their tax bill. Transfer pricing covers the sale between subsidiaries of the same parent company of everything from nuclear reactors to cornflakes.

Also included are intangibles for which a price is levied such as intellectual property rights, management services and insurance. As long as the subsidiaries of the same multinationals charge each other a fair market price-known in regulatory terms as 'arms' length pricing, such transactions are perfectly legitimate.

However with 60 % of world trade now taking place **within** rather than **between** multinational corporations, the way fees are determined has become increasingly opaque as arms length pricing is forgotten and the figures are manipulated to reduce tax. The great concern is that the major victims of this plunderers act have been poor countries like Tanzania. The impact of such dodging of Tax on Tanzania's economy is great as the Country is badly deprived of the much needed revenue.

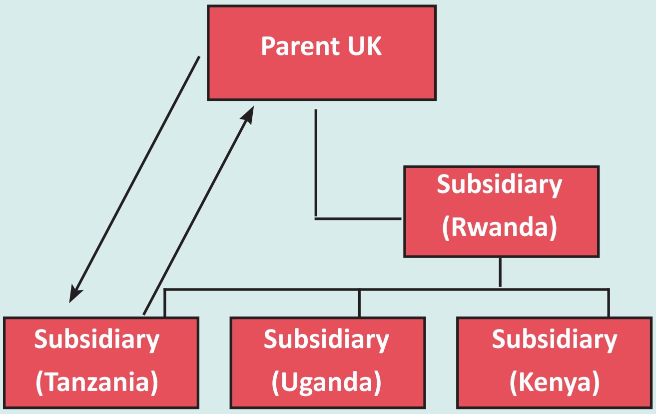
Cumulatively, the total tax loss by emerging and developing countries is more than the annual global development aid budget and much more than 28-42 billion pounds (**Equivalent to Tsh 84 trillion**) the World Bank estimates will be required annually to meet the millennium development goals (MDGs) aimed at halving extreme poverty by 2015.

Through trade mispricing a subsidiary of in one country can charge vastly reduced rates for goods or services to another subsidiary based elsewhere to minimize their tax rate liability. Alternatively, un related companies can make secret deals with each other for exactly the same reason. Goods and commodities are exported at knockdown prices from the country where they are produced to depress profits artificially and dodge tax.

The company buying then sells them on at their true market value and splits the difference between the artificial and the true price with the original seller. In another scam, the goods from the developed world are sold to Tanzania at hugely inflated prices to enable the company that is the 'buyer' to shift large amounts of capital abroad while reducing the company profit margin and minimizing its tax liability. Combined, all these practices are referred to **as 'trade mispricing'**

A classic example of how a Multinational Companies hide their taxes obligations and steal from Tanzania's revenue can be illustrated as follows:

1. Export at Normal Price (Arms length) price



2. Under priced export with tax haven

In this case the Tanzanian subsidiary of a UK parent company sells its goods and services to another subsidiary of the same company established in a tax have country like the Cayman Islands at fairly low prices (due to no or low import duty in the Cayman Islands) and thereafter same goods and services are re-exported to the UK tax free. In this case Tanzania losses Revenue in export duty and the profits accumulated from the transaction are enjoyed by the UK parent company.

3. Income shifting through interest

In this case the subsidiary of the UK parent Company based in the Cayman Islands sells goods and services at highly inflated prices to another subsidiary in a poor country like Tanzania to enable the 'buyer' to large amounts of capital abroad while reducing the Company's profit margin and minimizing its tax liability in Tanzania

Indeed, going the serious impact that trade Mispricing has on poor countries like Tanzania, the practice has been described as the 'ugliest chapter in global economic affairs since slavery'. And yet, as with slavery before abolition, it is widely accepted and gone on for so many years with out any comment or government intervention.

Tanzania's Annual Tax Revenue loss from bilateral trade Mispricing between 2005-2007 (Tsh billions)

Country	2005	2006	2007	Total
European Union	6.89	12.85	19.45	39.19
United States	1.49	1.33	5.99	8.81
United Kingdom	1.31	2.39	2.23	5.93

Source: False Profits: robbing the poor to keep the rich tax free, A Christian aid report, March 2009

The table above indicates that the amount of revenue loss has been increasing significantly with the year 2007 registering the highest level of revenue loss from Tanzania

East African Regional Comparison of Annual Tax Revenue loss from bilateral trade mispricing between 2005 and 2007

The trade data indicates that Tanzania is the second largest loser of Revenues in the East African region (see table below). Kenya loses the largest volume of revenue to the European Union and United States while Uganda follows in third position. One of the explanations for this trend is that Kenya is the biggest economy in the region. But the other explanation is that most of Tanzanian products are smuggled into Kenya and sold as Kenyan products on to the international market. The international trade statistics therefore record this volume of trade as originating from Kenya. The major products smuggled from Tanzania into Kenya include agricultural, mining and tourism

Country	EU(Tshs bn)	US(Tsh bn)	UK(Tshs bn)
Tanzania	39.19	6.37	6.6
Uganda	21.11	1.80	3.26
Kenya	63.54	17.73	22.06
Rwanda	1.22	2.56	00.2
Burundi	1.35	0.09	0.00

Source: False Profits: robbing the poor to keep the rich tax free, A Christian aid report, March 2009

Recommendations

In order for the government to achieve the stated policy objectives, efforts should be directed in the following areas:

- We commend government's plan to improve tax Administration by implementing the TRA's Third Corporate Plan, which focuses on promoting compliance and accountability among the taxpayers and tax collectors.
- Besides, the above recommendations, the government needs to strengthen the link between tax payment and service delivery. According to the research (REPOA report 2006) the majority of the respondents said that they would be enthusiastic to pay more taxes if public services were improved. The bottom line here is tax revenues and service benefits have to be reciprocal or interconnected to build trust of tax payers.
- Locally curbing mispricing by enacting legislation demanding transparency and accountability by Multinational Companies and foreign governments doing business with Tanzania. Company law in Tanzania countries should require all registered mining and other extractive companies to use the EITI template in reporting on their annual financial operations.
- Seeking refund of revenue so far lost through mispricing from Multinational Companies, their agents and Foreign. Governments abroad. Demanding for automatic information on banking operations of individuals and companies operating in their countries. The United States also automatically provides Canada with information about interest paid by banks in the United States to individuals resident in Canada. Mexico has already requested automatic information exchange with the US – an acknowledgement that its Tax Information Exchange Agreement is not sufficient.
- Engaging the international community to stop multinationals from engaging in mispricing of exports from poor countries like Tanzania. A new accounting standard, country-by-country reporting would enable tax authorities, civil society and other regulatory agencies to monitor the activities of MNCs located within their jurisdiction, how their trade is undertaken, and what profits and taxes they declare.
- Seeking the possibility of using Tanzania's influence in the United Nations Security Council to lobby for establishment of an international Tax Police system modelled around the global police body Interpol and the Kimberly certification process, developed to combat transnational crime and global trading in blood diamonds respectively. This process would involve seeking exporting countries or countries of origin to certify that given set of goods have been exported with due consideration of the Country's tax laws.
- Addressing the indiscriminate and uncalled for tax exemptions and subsidies which are fleecing government of much revenue to finance its operations. The best option for exemption should be case by case rather than blanket exemptions to all state institutions, donor supported projects, religious organizations, NGOs and private investments. The exemption and tax waiver policy for large multinational companies and mining companies should be reviewed.

Conclusion:

As our government grapples to maintain financial stability to finance its budget in the face of the current global economic crisis and dwindling foreign sources, it is clear that the government faces a huge vice comprising of tax dogging by big businesses and uncalled for exemptions. Government can raise more revenue internally by blocking the massive loss due to trade mispricing and unnecessary exemption, which have for so many years left companies and individuals to rake in on millions of shillings meant for the Tanzania government. The consequence of this has been a declining revenue collection and declining social service delivery. This has angered the citizens and driven them further towards evading taxes. The citizens need to see improved social service delivery. Social services require revenue and government cannot achieve its targets without collecting more taxes internally. It is no wonder that a recent survey by REPOA indicates that citizens are willing to pay taxes only if they can see an improvement in what their taxes can do. Citizens will be less likely to pay more taxes if they continue seeing those large companies that are eligible to pay taxes do not.

This leaflet was prepared and edited by the Budget Working Group of Policy Forum

policy forum

Policy Forum
270 Kiko Avenue, Off Old Bagamoyo Road, Mikocheni B
P.O. Box 38486, Dar es Salaam, Tel/Fax +255 22 2772611
Email: info@policyforum.or.tz

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