policy forum

TAX JUSTICE NETWORK AFRICA

Tanzania and The Burden of Tax Incentives

1. Introduction

The document evaluates the current policy framework and practices, highlighting gaps and paving way for proposed recommendations on the effective use of tax incentives and addresses the challenges associated with their application and goes on to outline issues concerning incentives for investors.

2. What are Tax Incentives?

Tax incentives are government policies designed to encourage specific behaviours or economic activities. They can take the form of tax exemptions, deductions, or credits. Categories may include the following.

Tanzania offers various tax incentives, such as tax holidays, reduced tax rates, and exemptions, primarily through the Tanzania Investment Centre (TIC) and the Export Processing Zones Authority (EPZA). These incentives are directed toward sectors like agriculture, manufacturing, tourism, and infrastructure development.

Tax exemption in Tanzania is regulated by several key laws, including the Tanzania Investment Act,2022, the Tanzania Revenue Authority Act, 2019, the Tax Administrative Act, 2022, the Value Added Tax Act, 2014, the Income Tax Act, 2019, and the EAC Customs Management Act, 2019.

Authority for granting exemptions is bestowed on Ministers and the commissioner General for Tanzania Revenue Authority (TRA) depending on the applicable Law. For instance: the Finance Act, 2021 introduced amendments to various tax laws, including the Value Added Tax Act, CAP 148 RE 2019 which granted the Commissioner General of TRA the authority to issue Value Added Tax (VAT) exemptions, power that previously rested with the Minister.

3. Investment incentives

Corporate income tax incentives	Financial and regulatory incentives	Other tax incentives
■ Tax holidays or reduced tax rates ■ Tax credits ■ Investment allowances ■ Accelerated depreciation. ■ Reinvestment or expansion allowances	■ 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	■ Exemption from or reduction of withholding taxes ■ Exemption from import tariffs ■ Exemption from export duties ■ Exemption from sales, wage income or property taxes

4. Common Tax Incentives

Some common tax incentives include investment deductions, export processing zones, special economic zones, and tax credits. Tax exemptions, particularly, contribute significantly to overall tax expenditure.

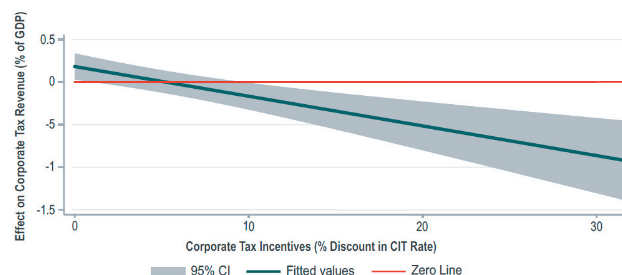
5. Reasons for Tax Incentives

Tax incentives in the form of exemptions in Tanzania are granted for various reasons, including cases where the foreign or official nature of an item doesn't warrant taxation, where certain organisations engage in non-profit activities benefiting society, and where the consumption of specific goods is deemed to have a direct benefit to society. Furthermore, incentives are provided to stimulate economic growth, leading to increased investment, employment, output growth, and ultimately higher tax revenues. Notable beneficiaries of these exemptions include companies under the Export Processing Zones Authority Act, mining companies, and entities with certificates of incentives from the relevant authorities.

6. The Burden of Tax Incentives

Tax incentives play a significant role in African governments economic strategies, although their effectiveness has yielded mixed results. Several studies highlight their potential to positively impact economic growth, Foreign Direct Investment (FDI), and job creation. However, according to a World Bank paper from 2020, titled "Finance, Competitiveness & Innovation" in the Investment Climate, underscores a negative correlation between the generosity of corporate tax incentives and corporate tax revenue as a percentage of GDP globally as shown in the figure.

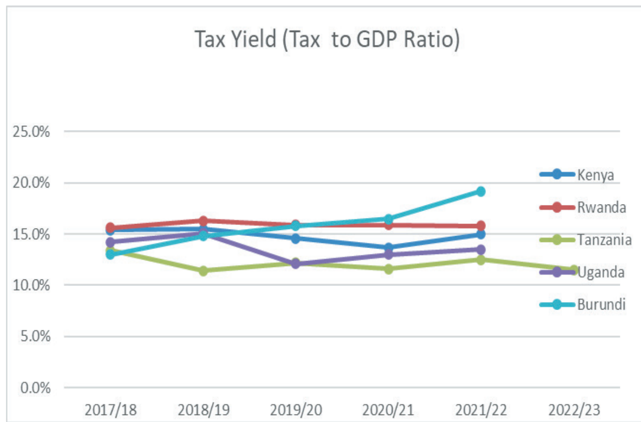
More Generous Tax Incentives are Associated with Lower Corporate Tax Revenue



(Andersen, Kett, and von Uexkull 2018) and World Development Indicators (WDI), covering 109 countries: 72 developing countries and 37 high-income countries, for 2009–15

As an example, from the graph above, the study shows the global trend in corporate tax incentives has a negative impact. The more tax incentives offered through Corporate Income Tax (CIT) the lower the level of revenue collected. The fallacy that tax incentives are the main factor for attracting Foreign Direct Investments (FDI) to increase economic activities such as jobs may be skewed due to the increase of automation technology.

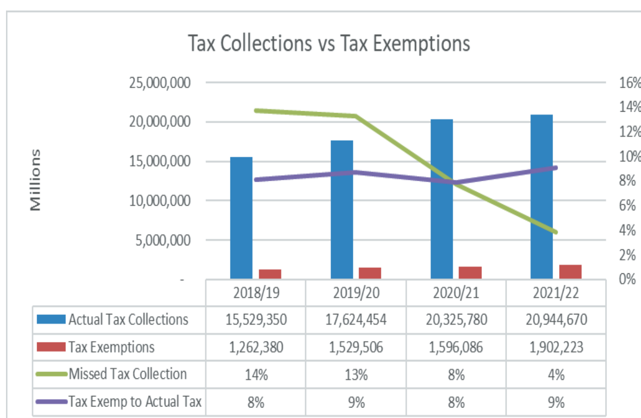
Domestic Resources are primary means of attaining budget credibility, but Tanzania has been struggling attaining tax collection targets. In the graph below it shows the Tanzania tax performance trend that is below regional peers. Best collection period was in 2017/2018 at 13.4% despite the fact that the Tanzania Revenue Authority missed its target by 14%. The World bank recommends the level of tax performance at 15% in which Tanzania economy attains growth without burdening while in 2022/2023 Tanzania could only attain 11.5% of GDP.



Data Source from CAG Report 2021/2022 and Citizens Budget 2023/2024

The government of Tanzania offers tax incentives under various acts and government notices to attract foreign and local investments, including exemptions and relief for Import Duty, VAT, Excise Duty, income tax, and Fuel levy. Tax exemptions are not subjected to the same level of scrutiny as the national budget in the Tanzanian Parliament, which can lead to hidden expenditures.

These exemptions practices are burdening the country in a huge way, analysis shows the amount of exemptions offered over the period can cover the tax deficit and improve resource allocations, see the graph below.



	2018/19	2019/20	2020/21	2021/22
Actual Tax Collections	15,529,350	17,624,454	20,325,780	20,944,670
Tax Exemptions	1,262,380	1,529,506	1,596,086	1,902,223
Missed Tax Collection	14%	13%	8%	4%
Tax Exemp to Actual Tax	8%	9%	8%	9%

Data Source from Consolidated Financial Statements 2018/2019 to 2021/2022

Previously the level of exemption recommended by the Controller and Auditor General (CAG) was not more that 5% but the graph above shows otherwise.

The extent of tax incentives offered are within the deficit for 2020/2021 and 2021/2022 while could reduce them in other years. This shows negative impact of offered tax exemptions on reaching tax revenue target.

7. Critical Gaps and Concerns in the Current Tax Incentive Framework

- There is no specified time on construction stage exemptions which may lead to abuse of the exemptions for the intended purpose.
- There is no transparency in determining the quantity of exempted raw materials for trial operations.
- There is no cost-benefit analysis on the 5-year tax holiday.
- The practice of annual changes in exemptions and tax reliefs creates uncertainty for businesses and can lead to unnecessary incentives.
- The current regulatory framework does not align with principles of transparency and accountability concerning tax or non-tax incentives. There is no law or practice mandating a transparent process for issuing tax incentives, nor is there an annual reporting mechanism for tax incentives as part of tax expenditure.
- The current Controller and Auditor General (CAG) Report does not assess the losses resulting from tax incentives or evaluate the decision-making process leading to these incentives.

8. Recommendations

The following are recommendations to the Parliament, and Ministry of Trade and Commerce on a reform of tax incentive policies to ensure their efficiency, fairness, and overall effectiveness.

i. The Parliament through constitutions and legal affairs committee should conduct periodic reviews of laws guiding tax incentives. The reviews should consider eliminating tax exemptions benefiting individuals and companies who should pay taxes.

ii. The Government through the ministry of Finance should strive to reach tax revenue targets as highlighted by FYDP 2020/21-2025/26 and avoid tax incentives that may stimulate illicit financial flow and jeopardise the maximisation of Domestic Resources Mobilization (DRM).

iii. The Government should not grant tax incentives on critical and strategic minerals including Tanzanite in order to take economic advantage within world geopolitics.

iv. The Ministry of Trade and Commerce in collaboration with the Ministry of Foreign Affairs should promote strategic investments by encouraging incentives for strategic and transformative investments based on assured future growth and value chain expansion rather than low commodity value investments.

v. The Government should regularly implement a monitoring and evaluation framework for tax incentives to assess their effectiveness in achieving their intended objectives.

Conclusion

Tax incentives may be a useful tool for stimulating productive investment, research and development, and training. However, they must be carefully designed, balanced and well administered so as to avoid side effects that diminish productivity by distorting resource allocation, sustaining inefficient or unsustainable activities, and losing revenue needed for other components of the productivity package.

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