TANZANIA REVENUE AUTHORITY

TAX INCENTIVES AND EXEMPTIONS IN TANZANIA: CHALLENGES FOR TAX POLICY AND REVENUE ADMINISTRATION

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Introduction

- Many governments in LDCs are faced with intensive pressure to sweeten their tax regimes to attract both FDIs and DDIs.
- In the investment incentives recipes, championed by centers responsible for investments promotion and protection, tax incentives tops the list.
- The Investment authorities are fast to point to tax incentives as source of investment destination in the respective countries, yet even their own studies fail to substantiate.
- In Tanzania Tax Incentives have given up around 3% of GDP in tax revenues on average with little to show in exchange.
- In most countries, tax incentives and exemptions need major tax policy reforms.
Effectiveness Of Tax Incentives

- Various methodologies have been employed to study the effectiveness of tax incentive:
  - Research on cost-benefits analysis, sector specific approaches etc
  - Investor Motivation surveys
- Tax Expenditures
Effectiveness Of Tax Incentives (cont’d)

- In LDCs experience with tax incentives has produced a mixed results,
- countries such as Mauritius and Malaysia with tangible success from their incentive scheme
- Most countries however have had little to show in exchange for the incentives they have offered
- still, despite suffering sizable revenue loss, have maintained generous tax incentive schemes.
- Mauritius has undergone a significant turnaround in reforming its tax incentives regime- 3.23% of GDP in 2006 to 1.46% in 2010.
- Outcome: revenue growing at 15-20% rates, sound real GDP growth at 5% on average
Effectiveness Of Tax Incentives (cont’d)

- Econometric studies on investment incentives in developing countries are scanty, mainly due lack of good firm level data on investment in these countries.
- To mitigate this problem, several approaches, including investors motivation survey methods, have been used to determine whether incentives are effective in encouraging investments.
- The balance of evidence -fiscal incentives do not effectively counterbalance unattractive investment climate conditions such as poor infrastructure, macroeconomic instability, and weak governance and markets.
Effectiveness Of Tax Incentives (cont’d)

- Investors have confirmed that while incentives were not an important factor in their decisions to invest, they would ask for them anyway because incentives improved their bottom lines.

"Tax exemption is like a desert; it is good to have, but it does not help very much if the meal is not there." - US investor

- An Investor Motivation Survey 2012 (Sebastian, James and Mikra Krasniqi, 2012) in Burundi, Rwanda and Tanzania found out that only 7.9% (39 out of 450 cases) of all respondents in all three countries said that they would not have invested without tax and fiscal incentives they received.
Effectiveness Of Tax Incentives (cont’d)

Most important factors that impacted your investment decision

- Market Potential
- Access to Finance
- Electricity
- Support from IA
- Good Roads
- Raw Inputs
- Water Infrastructure
- Business Support
- Labor Costs
- Acess to Land
- Local Suppliers
- Port Proximity
- Free Zone
- Exchange Rates
- Affordable Labor
- Legal System
- Tax Incentives
- Duty Free Imports
- Competitor
- Protective Tariffs
- Repat. Dividends
- Skilled Labor

Burundi Tanzania Rwanda
Disadvantages of Exemptions

- Although the case against tax incentives is not widely appreciated among policy makers, it is a critically important parameter of sustainable revenue policy design.

- Tax incentives
  - lead to revenue losses,
  - create loopholes for tax avoidance and further erode the tax base,
  - complicate tax administration and make revenue collection less efficient,
  - introduce distortions in resource allocation,
  - impair transparency and accountability, and rarely deliver favourable results
Tax Exemptions in Tanzania

- Tanzania is currently in the high range in the region in terms of the fiscal cost of such practices.
- Measured indirect taxes exemptions are estimated at 2-3% of GDP (3.8% of GDP 2011/12).
- IMF (2011) and ADB (2010) estimates - 5-6% of GDP.
- Of the measured indirect taxes exemptions VAT and Import duty contribute aver 90% of the total exemptions.
Exemptions in Tanzania (cont’d)

- Import Duty: 33%
- VAT on Domestic Consumption: 23%
- VAT on Imports: 41%
- Other: 3%
Tax Exemptions in Tanzania (cont’d)
Exemptions in Tanzania (cont’d)-Scope

- Entire Spectrum
  - investment tax credit,
  - Investment allowance
  - accelerated depreciation
  - Reduced Tax rates
  - Tax Holidays (mainly after 1997)
  - Indirect taxes exonerations
Tax Exemptions in Tanzania (cont’d)

- Almost all tax exemptions are in the tax laws
- Some however entered the tax laws after they were provided for in a different law
- The granting of tax exemptions is primarily a remit of the Ministry responsible for finance
- The level for discretionary exemptions is currently limited
- The Tanzania Investment Centre can grant some exemptions outside the tax laws – under the Strategic Investor window
Tax Exemptions in Tanzania (cont’d)

- Awareness on the cost of Tax Exemptions in Tanzania is now high

- Several studies have been undertaken recently of Tanzania’s revenue losses, including:
  - TRA- mainly focusing on the indirect taxes
  - International Institutions: ADB, IMF, World Bank,
  - Tax Justice Network in Africa,
  - EAC
  - Civil society
  - Religious leaders.

- Theme: Cost
Selected Challenges

- Assessing their effectiveness
- Controlling ‘exemptions creep’ pressure from lobby powers
- Agreeing on the proper incentives recipe-balancing economic vs political interest
- Combating the race to the bottom effects of incentives
- Putting in place effective administrative monitoring machineries
Selected Challenges (cont’d)

- Achieving simplicity in the tax system
- Building data base for informed analysis
- Ensuring predictability of tax revenues
Strategies for the Future

- Increase Transparency
  - Undertake Tax Expenditure Analysis - allows the costs to be scrutinized by the public
  - Place a budget on tax incentives

- Reduce Discretion
  - ensuring that incentives are granted transparently, through legislation.
  - This ensures legislature plays its role
  - criteria is defined
Strategies for the Future

- Selectivity in tax incentive recipe. Avoid period holidays in favour of,
  - investment tax credit,
  - Investment allowance
  - accelerated depreciation

- Tighten administration - reduce leakage in the usage of Tax Incentives by periodically studying their effectiveness - allow the public to see for themselves if incentives work.
Conclusion

- The benefits of tax incentives on investment are widely exaggerated, costs are widely underestimated.
- This bias in favour of incentives arises partly from weaknesses in tax policy analysis, and partly from political pressures that inherently favour special interest groups.
- Revenue mobilization is the central purpose of the tax system, countries should agree in principle that the existing tax incentive programmes are not sustainable and therefore they should be re-designed to ensure prudent tax revenue management.
Conclusion (cont’d)

- Countries should be cautious about offering incentives that create substantial revenue risks,

- All tax incentives should be in the relevant tax legislations, shun from discretionary tax incentive.

- Effective monitoring machinery in the implementation of projects that receive discretionary fiscal benefits contingent on performance criteria are required.

- Learning from successful reforms in implementing and managing tax incentives.

- Limit the granting of incentives to location specific investments.
THANK YOU FOR YOUR ATTENTION