Terms of reference

Managing Tax Exemptions in Tanzania

Dar es Salaam, November 2012

PER working group

1. Context

Tanzania has moved in a positive direction in domestic revenue collection, attributed to wide ranging reforms, including the operationalization of the Tanzania Revenue Authority (TRA) in 1996 and the review of key tax legislations, including the Income Tax Act and Value Added Tax (VAT) Act Cap 148.

Domestic revenue yield has increased from 11.8% in the FY 2004/05 to 17.4% of GDP in the FY 2011/12. Most of the increase in domestic revenue collection has been associated with improved tax revenue collection, which was 15.7% of GDP in FY2011/12. Non-tax revenue collection has lagged behind the targets, as well as the average for Sub- Saharan Africa. The current overall domestic revenue yield in Tanzania is pretty close to the average yield in non-fragile low income Sub-Saharan Africa countries which stands at 17.6% of GDP, but still significantly below some neighbouring countries such as Kenya (24%), Malawi (24%) and Mozambique (22%)[1].

This increase in domestic revenue has played an important role in the financing of the increase in public expenditure from 18% to 30% of GDP from 2004/5 to 2011/12, in priority areas as identified in the national development strategies and plans. It has also underpinned a major process of fiscal decentralization in the same period, whereby the local government share of the expenditure has increased from 13% to 26% of the total government budget from 2004/5 to date.

Notwithstanding Tanzania's substantial progress in improving its tax-revenue collection over the last decade, significant potential for further increases remain. An obvious potential for increased domestic revenue mobilisation is linked to the informal and agrarian economy of Tanzania (around 60% of GDP) and thus very limited tax base. Out of an estimated 22 million economically active people, only 1 million is registered as taxpayers. Broadening the tax base through increased formalisation of the economy is therefore a vital long-term strategy. However, in the short to medium term, this may not yield much in terms of revenue.

A second potential area for further increases is linked to the high level of tax exemptions and reductions. Tanzania is in the high range in the region in terms of the fiscal cost of such practices (estimated to be equivalent to 3.8 % of GDP or 24.5 % of tax revenue collection in 2011/12 for indirect taxes alone).[2] Despite a stated objective and some efforts to reduce the number of exemptions, new exemptions are invariably introduced each year.

Tax exemptions are provided for several different purposes, by different institutions and on different legal grounds. This includes, but is not limited to, tax exemptions given to attract investments to drive economic growth and job creation in general or in certain areas or sectors, exemptions given to

[1] Regional Economic: OutlookSub-Saharan Africa, IMF: 2012
[2] Rapid Budget Analyses for 2011/12

promote social service delivery, enhance food security etc. It also includes exemptions given to honour international obligations/commitments. The granting of exemptions is a remit of the Ministry responsible for finance. In principle, all exemptions are provided for in the tax law governing the administration of the tax in question. Holders of some certificates and contracts, such as the strategic investor status, the TIC Certificate and operators in special economic zones, however, are entitled to a number of exemptions contained in their contracts.

Despite the high estimated costs of the tax exemptions to Tanzania since the early 1990s, there has not been a comprehensive attempt to assess the costs and benefits of these exemptions nor to evaluate their success or contribution to Government's development goals. Some studies have been undertaken including by TRA, mainly focussing on indirect taxes and VAT in particular. Similarly, the African Development Bank recently (2010) completed an analysis of the revenue losses, as did the Tax Justice Network (TJN) in Africa, which estimated both the costs of tax incentives in Tanzania and in the EAC area (summarized in the report "Tax Competition in East Africa" TJN 2012). Tanzanian civil society and religious leaders have also recently issued reports and policy papers on the issue. However, such reports only address the overall estimated costs, not the benefits and not how the exemptions are administered, and thus do not provide a full picture.

2. Purpose

On 15th September 2011 a Public Expenditure Review (PER) technical retreat was held in Dar es Salaam. It was chaired by DPS Likwelile from MOF and PS Lyimo from PMO and gathered a broad range of GoT stakeholders as well as development partners.

Among the issues deliberated on at this PER retreat was the topic of tax exemptions with special attention to the fiscal costs of such. It was concluded from the discussions and confirmed by PS Lyimo in the summing up, that there had never been a comprehensive cost-benefit assessment of the overall tax exemptions provided in Tanzania to take stock of the effectiveness and efficiency of the policy implemented actively over the last decade or more.

As a first step, GOT has initiated policy reforms focussing on indirect taxes and in particular VAT. The IMF is currently providing TA to review current exemptions under the VAT Act and to amend the VAT act. Under the GBS Performance Assessment Framework, it has been agreed that the revision of the VAT Act is to be concluded by November 2013.

It has subsequently been decided by the newly established PER champions group to conduct a study, which would look at the whole range of tax exemptions provided and map out on which legal grounds, they are provided, to which beneficiaries, by which agency, with what purpose, to what cost and with what benefit. It should also include reference to neighbouring countries or other relevant comparators. The purpose would be for GOT to have a solid basis for comprehensive reforms in the area of tax exemptions in the 2013/2014 budget and beyond.

3. Objective and Scope

The main objective of the study is to inform the policy and decisions makers in the Government and other decision-making machineries on the cost and benefits of the tax exemptions provided in Tanzania. The study should also point to best practices, which can be adopted to minimize unnecessary losses of revenue as a result of the application of tax exemptions and propose reforms to drastically reduce the use of tax exemptions and thus increase tax revenue.

To do this, the study will:

i) Briefly review existing literature and studies on national and international experience with tax exemptions. Specifically, the study will review theory and evidence relating to the purpose, the advantages and the disadvantages of exemptions, the costs in terms of revenue losses and the potential gains in terms of for instance contribution to attracting foreign investments, promoting growth in selected sectors or promoting economic redistribution and other social effects.

ii) Review/map the current tax exemptions provided in Tanzania, i.e. what types of exemptions are given, with what purpose and on which legal grounds. The mapping should also include the processes by which the exemptions are granted and the transparency of this process.

iii) Analyse and estimate the distribution and magnitude of tax exemptions by main category of beneficiaries. Besides traditional exemptions for medicines, diplomats, government agencies and parastatals, religious organizations and NGOs, duty free shops and donor funded projects, important beneficiaries of tax exemptions include, inter alia:
    a. Investors meeting a minimum threshold (TIC certificates)
    b. Investors in the EPZs and SEZs
    c. 'Strategic investors'
    d. Mining companies
    e. Agricultural investors
    f. Newly listed companies on the Dar stock exchange

iv) Assess the cost and benefits of tax exemptions provided in Tanzania over a period of time. 1995 could serve as a base year (prior to introduction of VAT), 2000 could be included as middle year and then yearly assessment from 2005 to 2012 should be included. This would give 10 data points in time. The assessment should, to the extent possible, be by type of exemptions, beneficiary sector and commodity.

v) Benchmark the level of Tanzania's performance in exemptions with EAC partners and 2 other selected successful emerging countries to determine whether Tanzania's experience is in line with best practice.

vi) Assess the legal framework underpinning the tax exemptions and the potential loopholes. Furthermore assess the administration of the provision of exemptions – are they solely provided to the intended beneficiaries and for the intended purposes and are they used accordingly. How is this followed up to ensure that the exemptions are not misused and what are the effective consequences of misuse?

vii) Make recommendations that will help to diminish revenue losses and reduce the level of tax exemptions in Tanzania, including engaging relevant stakeholders in developing proposed interventions. Recommendations should be specific to each type of exemption and should spell out possible needed changes to the legal framework and/or administrative practise underpinning the exemptions. Where appropriate the suggested interventions should be sequenced.

4. Deliverables/reporting

The consultants will as a minimum have to provide:

- An inception report consisting of the review of existing literature and studies and the mapping of the different types of exemptions provided in Tanzania. This report will be discussed with a reference group appointed by the PER champions and if timing allows with the GoT Tax Task Force and Think Thank (including PMO, MOF, Planning Commission, BoT, CG-TRA, TIC and CAG plus selected sector ministries (i.e. MEM, MNRT))

- A draft full report containing the requested mappings, cost-benefit analyses and the consultants' recommendations. The report should also contain statistical annexes in a format that allows further analyses. This report will also be discussed with the stakeholders mentioned above and comments will be incorporated as appropriate.

- A final report incorporating the above and including a brief policy paper version of the study findings to be discussed with key stakeholders at PER workshop in Dar es Salaam and subsequently presented to Parliament, Private Sector and Civil Society.

5. Qualifications

The study will be subject to an open international tender. The procurement of consultant will be done by Danida using Danida procurement guidelines. The limit for such tender is 900.000 DKK (around 150.000 USD) for the entire contract (fee and reimbursable), but it is expected that this study can be carried out for less. The composition of the team of consultants; the mix between international and local experience; the exact numbers of days spent in Tanzania and the price will be part of the bidding.

The proposed team should collectively have the following qualifications:

- Senior-level international economic expertise
- Ability to conduct advanced macro-economic statistical analyses
- Local knowledge of GoT operations and processes, knowledge of relevant TRA and MoF data bases and preferably fluency in Kiswahili
- High-level tax policy expertise - preferable from other African countries
- Legal expertise, preferable in tax law
- Political-economy analytical capacity

Furthermore, the team (or as minimum the team leader) should have proven experience in carrying out similar analyses.

6. Timeline

The procurement of consultants will commence immediately after approval of the ToR's. The task should be completed no later than June 2013, but preferable earlier. The team should be ready to present and discuss findings at the foreseen PER workshop in Dar es Salaam in May 2013. In case of international consultants, at least one or two field visits to Tanzania of at least one or two weeks is envisaged.