

5. CHAPTER FIVE

5.0 TAX REFORMS IN TANZANIA

5.1 BACKGROUND OF TAX REFORMS IN TANZANIA

The methods of changing the way the taxes are managed and collected by the tax authorities on behalf of government within a territory is referred to tax reforms.¹ Broadening of tax base is the chief objective of tax reforms in developing countries.² In Tanzania, the chief objectives are the promotion of productive efficiency and enhancing trade liberalization.³ Also, reduction or elimination of the current high dependency on foreign aid for budgetary support in Tanzania.⁴ Other were to ensure revenue, equity and protection in Tanzania, 1960s.⁵

In Tanzania, tax reform took place since the late 1960s.⁶ In addition to the era, the major tax reforms took place during 1970s.⁷ Moreover, most of tax reforms were done on indirect taxation before 1985 where the rates of both sales tax and import duty were effectively elevated every year.⁸ In 1985 there were abolition of all export taxes for the objectives of giving incentive to producers, hence reducing the tax burden to them.⁹

Meanwhile, the significant falls of tax rate arose after 1987.¹⁰ In 1989, the marginal rates of income tax were reduced from 25 percent-95 percent in 1986-87 to 10 percent-50 percent, purposely for the enhancement of the take home pay of workers that later on, had proved failure and reducing the tax burden on a wage earner.¹¹

¹ *Supra note 845.*

² Odd-Helge Fjeldstad, *Taxation and Tax Reforms in Tanzania: A Survey*, 6, 12, 22 (Working Paper No. WP 1995: 4, Chr. Michelsen Institute Development Studies and Human Rights Bergen Norway ISSN 0804-3639, 1995). The paper also cited by Bird, 1992; Tanzi, 1991; and Tanzi and Shome, 1993.

³ *Id.*, at 27.

⁴ *Id.*

⁵ *Supra note 845.*

⁶ *Id.*, at 9-11.

⁷ *Id.*

⁸ *Id.*

⁹ *Id.*

¹⁰ *Id.*

¹¹ *Id.*

Furthermore, so as to attract foreign investors, the Investment Promotion Center had established by the Tanzanian Parliament via the Investment Promotion Act of 1990, however, the target was not yet attained as expected.¹² The history shows that, since 1969, the numbers of tax reforms have executed for the sole target of improving taxation system in the country, reported by Osoro, 1992a:413:

- a) Commencement of Sales Tax Act, 1969.
- b) The new income tax legislation in 1973,
- c) Establishment of a new Sales Tax Act of 1976,¹³
- c) Modification of the existing tax legislation to revise the tax bases and rates,
- d) Ending of some excise duty in 1979 and export duty in 1985-1986, and
- e) Re-introduction of previously abolished excise duty in 1989.¹⁴

In October, 1989, the Tanzanian government appointed a Tax Commission to look after the tax system and hence preventing the poor functioning of the same.¹⁵ The sole task of the Commission was to study and revising both the central and local government tax system, tax administration and making recommendations to the government on the existing tax system¹⁶, specifically to:

- 1) Enlarging the tax base,
- 2) Boosting the revenue collections, and
- 3) Encouraging production efficiency in the country.

The report of the Commission was presented to the government in December, 1991.¹⁷ Considerably, the records show that, tax reforms have been taking place almost during each fiscal year in Tanzania.¹⁸ Example, consider the drop in direct taxes revenues in

¹² *Id.*

¹³ *Id.*

¹⁴ *Supra note* 860, at 12.

¹⁵ *Id.*

¹⁶ *Id.*

¹⁷ *Id.*

¹⁸ *Id.*, at 6.

fiscal year 1991-1992 from 10 percent-50 percent to 7.5 percent-35 percent for both income and wealth headed by reduction in revenues from company taxes.¹⁹

Simultaneously, in fiscal year 1992-1993, a significant decline in indirect taxes revenues was recorded on both domestic goods and services; and international transactions from which the reduction of tax rates contributed the same.²⁰ This situation implying that, rising of direct taxes revenues like income and wealth in each fiscal year will help rising in government as well as company revenue within the country. Also, based from these records, it is implying that, the variable of tax rate is the potential determinants that influencing the domestic tax revenue performance in Tanzania.

The above records and background supports the research findings of specific objective number one that, from 1992 to 2018, the tax rate appears to have a strong long-run positive influence or relationship with tax revenue performance in Tanzanian economy (Table 10.0). This is because, the coefficient of tax rate suggests that, as tax rate increase by 1 percent, the tax revenue in Tanzania increases by 4.62 percent (Table 10.0). These results are in agreement with past empirical studies obtained by M. Aamir *et al* (2011), E.K. Browning (March, 1989), Sangkyun Park (March, 1997), and W.F. Stine (July, 1988).

This mean that, there are statistically significant results indicating that, an increase in tax rate would increase in the ratio of total tax revenue over G.D.P. So, based from the records shown regarding tax reforms, tax rate is the potential determinant that historically had determined and influenced the level of tax revenue performance in Tanzania.

Despite the presence of strong significant long-run positive influence or impact of the tax rate on the tax revenue performance in Tanzania. It is recommended that, the 18 percent V.A.T tax rate should not be increased, thus it should remain unchanged. This is because, V.A.T is one type of an indirect consumption tax, such that it is charged upon purchasing of commodities by final consumers. In this regard, it will cost every one of the citizens if it will be increased, say from 18 percent to 20 percent, since it's regressive in nature.²¹

¹⁹ *Id.*

²⁰ *Id.*, at 6.

²¹ *Supra* note 148.

Therefore, it is very good recommendation to remain as it is. Since, if it will be increased, it will add more inflation within the country, hence the rising of prices of goods and services will be reported in the land. In this regard, it is suggested that, instead of further increasing the tax rate, the tax authorities should first strengthen the whole tax system in the country, e.g., capturing the whole taxpayers who are required to pay taxes (seizing shadow economic activities), e.g. by looking the number of registered companies against those who comply with the country's taxes laws, rules and regulations. Doing so, will assist in increasing the country's tax revenue collections.

Meanwhile, another suggestions are that, the tax payer education department must focus on giving knowledge to the citizens regarding the importance of paying taxes to the nation, since there are variety of taxes with different deadlines. Also, conducting periodical auditing schedule so as to make sure the proper declaration have been met. Likewise, giving high punishments to tax offenders so as to give lessons to other tax payers in the country. Similarly, making reminders upon reaching of deadline, if possible, etc.

In the time being, so as to decrease the tax burdens to private sectors, businesses and others tax stakeholders; and to generate more revenue to the Tanzania government. The government must impose more tax rates to the direct taxes, such as Pay As You Earn, taxes on profits (corporate tax), basic skills and development levy, withholding taxes, and others income taxes compared to indirect taxes rates, e.g. V.A.T, specific consumption taxes, international trade taxes, others domestic taxes and charges (Table 11.0, Annexure VB).²²

This is because, the direct taxes are commonly progressive in nature, rather than indirect taxes that having unjust effects on income distribution,²³ this will ensure the greater domestic government revenue compared with expenditure. Also, the rising of our domestic production capacity must be prioritized so as to enhance more exports rather than importation of goods and services in the country.

²² *Supra* note 1.

²³ *Supra* note 316, at 24.

Also, the records of tax reforms show that, The Tax Commission appointed by the Tanzanian government in October, 1989, had had the real goal of avoiding deficit by achieving a surplus in the recurrent budget and ensuring the country's fiscal self-reliance during the decade.²⁴ In this regard, the Commission came up with proposed tax structure reforms at direct taxes, indirect taxes, personal income taxes and company income taxes.²⁵

For the past decades, the "low-rate, broad-base" strategy had followed by Tanzanian tax system because of equity and efficiency in allocating the country's resources compared to "high-rate, narrow-base" strategy that was dominated by Tanzanian tax system in the past years.²⁶ The commission proposal also had shared the features of other country's tax reforms like that of the United State since 1986.²⁷

Avoiding deficit by achieving a surplus in the recurrent budget, development budget and ensuring the country's fiscal self-reliance is the chief problem facing Tanzania.²⁸ This is because, it is reported that, in the fiscal year 2017-2018, the government ran under a budget deficit of Tanzanian Shilling 2,300.7 billion, equivalent to 1.9 percent of GDP, relative with a budget deficit of Tanzanian Shilling 1,594.1 billion, equivalent to 1.5 percent of GDP of previous year.²⁹

The deficit was largely sponsored by both foreign and domestic borrowing of Tanzanian Shilling 1,702.1 and Tanzanian Shilling 598.6 billion, respectively.³⁰ During 2016-2017, the government made a net inland repayment of Tanzanian Shilling 110.9 billion.³¹

In addition, this statement is connected with the problem statement of this research. That is, the finance gap of Tanzania depends on foreign donors and other development partners while the country's expenditures exceed domestic government revenue for the

²⁴ *Supra note* 860, at 12.

²⁵ *Id.*, at 12-15.

²⁶ *Id.*, at 13.

²⁷ *Id.*

²⁸ *Supra note* 269, at 19.

²⁹ *Id.*

³⁰ *Id.*

³¹ *Id.*

government to finance public services. Once more, it is founded that, based on question number 12 under Table 15.0 Annexure VF, respondents 79.3 percent (31.7% strongly agreed plus 47.6% agreed) had agreed that, the budget deficit or gap of Tanzania depend on foreign donors and other development partners for the government to finance public services (for instance health, education, infrastructures, and others (Table 15.0, Annexure VF). However, 11.0% of the respondents said don't know (Table 15.0, Annexure VF).

In this regard, in order to solve deficit problem in the country, having considering question number 5 under the table, it is recommended that, the Tanzanian government is very advisable to invest in physical capital, human resources and institutional infrastructures, for the growth in both private sector and sustainable economic development (Table 15.0, Annexure VF). Also, it's vastly advisable to strengthen or use our maximum available capacity so as to fund or finance our own public expenditures. This is because, the findings indicate that, Tanzania finances 60 percent of the budget, while the remaining 40 percent comes from the external finance, examples, aid, loans and grants.³²

Also, in order to solve the problem, it is suggested to plan and concentrate on achievable projects at a time, at times projects should be planned for the implementation at a particular year, even with full knowledge of level of resources in the same year.³³ Apart from the suggestions, the fighting against corruption must be prerequisite matter, since it makes things complicated.³⁴

Besides, so as to generate more revenue, the informal sector and underground economic activities by private sectors, businesses and other tax stakeholders must be curbed by government in Tanzania, strengthening the service sector in G.D.P, secondary sector like manufacturing, reviewing and reducing tax exemptions in the country, etc. (Table 12.0 Annexure VC; and Table 22.0 Annexure VM).

³² *Supra* note 252.

³³ *Supra* note 253.

³⁴ *Supra* note 254.

Further, the fighting against tax evasion and avoidance must be prioritized for Tanzania Revenue Authority and Zanzibar Revenue Board. Likewise, lowering the V.A.T base from 40 million Tanzanian Shilling of turnover to 20 million Tanzanian Shilling of turnover, so as to widening the tax base, thus increasing the performance of tax revenue in the country (Table 12.0, Annexure VC).

Doing so, will enhance domestic tax revenue collections and performance in Tanzania. Moreover, however, the Constitution of Tanzania has promoted the local government decentralization in the land,³⁵ it is suggested that, the recently domestic tax revenue collected from the local authorities should be bestowed to them instead of shifting to the central government, doing this reform would remove much dependence from the central government and persisting in deficits in the country.

Table 30.0 Annexure VP illustrates the stakeholder's findings on policies or mix of policies do Tanzania can undertake in case of budget deficit. From these policies, it is recommended on S/N 4 and 5 that referring to the undervaluation of the real effective exchange rate by expansionary monetary policy, and increasing government expenditures while lowering taxes which means (expansionary fiscal policy), respectively (Table 30.0, Annexure VP).

Specifically, regarding S/N 4, it is recommended that, the government have to reduce the Required Reserves Ratio from commercial banks, lowering the Discount Rate from the loans pursued by the banks, and finally buying more government bonds from the general public so as to release more funds to them for the enhancement of domestic Tanzanian economic activities (Table 30.0, Annexure VP).

Meanwhile, for the domestic tax revenue to be improved in the country. The imposition of tax receipts from import should be appreciated rather than export taxes.³⁶ Therefore, the country should not overvaluation of the real effective exchange rate by contractionary financial policies.³⁷ By doing so, the expectation would be the reduction of the tax revenue

³⁵ *Supra* note 364.

³⁶ *Supra* note 25, at 10.

³⁷ *Id.*

performance because of the adversely affect towards the overall economic activities.³⁸ For more information about the policies, refer to Annexure II and III (pg. 21-22 & 20), respectively.

Likewise, in order to solve deficit problem and rising domestic tax revenue in the country, it is also suggested on the facilitation conditions for formalization of informal businesses and enterprises as among the way of fighting against the problem in the nation (Table 33.0 Annexure VS).³⁹ For more information about the suggestions, refer to Annexure II and III (pg. 23-24 & 22), respectively.

Apart from the appointment of the Tax Commission by the Tanzanian government in October, 1989. In the year 2000 Tanzania also had introduced the Large Taxpayers Department which is one among the important reforms to be established in tax administration system of the territory.⁴⁰ During the nine months of preparations, a directorate of large taxpayers which then became Large Taxpayers Department was officially established on October 1, 2001.⁴¹ The idea behind the establishment of the same was the reform strategy so as to renovate and improve the Tanzanian tax administration system.⁴²

Finally, regardless of all these tax changes, reforms, exemptions, etc., the Tanzanian tax revenue performance had remained poorly especially in 1994 where indirect tax rates were raised by government.⁴³ The poor performance was mainly contributed by corruption and weak tax administration.⁴⁴ Also, despite the great efforts of simplifying the country's tax system. The country's tax reform has failed to achieve the reform of tax administration and efficiency in the system.⁴⁵

In the meantime, for the decades, the country had experienced a huge shortage of revenue, hence a large fiscal deficit, despite the great help by the International

³⁸ *Id.*

³⁹ *Supra* note 856.

⁴⁰ *Supra* note 845.

⁴¹ *Id.*

⁴² *Id.*

⁴³ *Id.*, at 11-13.

⁴⁴ *Id.*

⁴⁵ *Id.*

Development Association to increase tax revenue, improving tax administration and the legal framework via the Tax Administration Project.⁴⁶ Ultimately, the tax reforms had achieved little in raising revenue productivity in Tanzanian tax system.⁴⁷

5.2 FACTORS MOTIVATED TO TAX REFORMS IN TANZANIA

Among the factors motivated to tax reforms in Tanzania are revenue securing, improving collections and management of tax debts, considering motivation in term of models for testing new processes, procedures, structures and systems to other countries. Also, improving auditing programs, and providing consistent and quality services to taxpayers, e.g. establishment of Large Taxpayers Units.⁴⁸ Moreover, the apparent failure of the tax system to generate adequate revenue required to meet the growing expenditure needs, motivated for tax reforms in the country. Others factors are, complicated tax structure that has prevailed since the 1970s and the granting of generous statutory and discretionary tax exemptions in the nation.⁴⁹

All these factors together with all mentioned under the motivation of the research, i.e. greater fiscal deficit has been a common problem that demoralizing development prospects of the United Republic of Tanzania.⁵⁰ The greater relying on indirect taxation by Tanzania's public finance authorities, the uncertainty of the national debt resulted from foreign aids, loans and grants for her running recurrent and development expenditures, have been contributed to the fiscal imbalances in Tanzania.⁵¹

In these regards, some necessary reforms and adjustments must be made. Example, both the government of United Republic of Tanzania and Revolutionary Government of Zanzibar must play supportive roles by investing in physical capital, human capital and institutional framework; and infrastructures for the purpose of improving the environment of private sector development and sustainable economic growth.⁵² Hence, both, the

⁴⁶ *Id.*

⁴⁷ *Id.*

⁴⁸ *Id.*, at 5.

⁴⁹ *Id.*, at 11.

⁵⁰ *Supra* note 25, at 10.

⁵¹ *Id.*

⁵² *Id.*

crowding out of the private sector and inflationary financing have to be avoided in the country.⁵³ Doing that, will generate more tax revenue collection to finance investments in physical capital, human capital, institutional framework and infrastructures.⁵⁴

Also, for the improvement of tax reforms in Tanzania, the country can utilize the analysed determinants under this research, so as to enhance domestic tax revenue performance both in the short-run and in the long-run. Therefore, the domestic tax revenue collections and performance in Tanzania will be enhanced.

5.3 THE NEED FOR REFORMS IN TANZANIA: WHY TAX REFORMS?

Numbers of institutional constrains, extensive tax evasion and avoidance, reflection of poor compliance and poor administrative capacity together have called a need for tax reforms in Tanzania.⁵⁵ Secondly, the ongoing economic and political reforms insisted by the Economic Recovery Programme, that providing measures of increasing government revenue, reducing the growth of public expenditures and broadening political outlines in the land.⁵⁶

Thirdly, the significant changes of internal and external economic, and political conditions especially from 1995 to date that impacts public revenue and expenditure structures in Tanzania.⁵⁷ In 1969 sales tax was introduced so as to solve the decline in import duty revenue stimulated by growth in import substitution industries, and to reduce the rural taxation.⁵⁸ Economic crisis of 1980s was the reason of the tax reform of the era.⁵⁹

In 1976, the Sales Tax Act 1976 was reformulated to offer a *ring* system of sales taxation where also a road toll was introduced in the same period.⁶⁰ The Tanzania's tax revenue performance for the years 1997 to 1998 was only 12.4 percent of G.D.P which is the worst

⁵³ *Id.*

⁵⁴ *Id.*

⁵⁵ *Supra* note 860, at 1.

⁵⁶ *Id.*

⁵⁷ *Id.*

⁵⁸ *Supra* note 845, at 9.

⁵⁹ *Id.*, at 10.

⁶⁰ *Id.*, at 12.

figure to be reported in S.S.A region.⁶¹ Also, a huge difference between government revenue and expenditures; and the failure of Tanzania Revenue Authority to attain the peak tax revenue generation to fill deficit budgetary gap of the government led to the reforms in the land.⁶²

Therefore, for the Tanzanian government to make appropriate reforms and attaining the quality tax system. It should set the simple rules that based on common sense to all stakeholders including private sectors, businesses and general public so as to keep their duty on paying taxes.⁶³ Also, the Tanzanian taxes laws and rules must be affordable, simple, fair and transparent by taxpayers.⁶⁴ Doing so, will stimulate domestic tax revenue collections and performance in the country.

5.4 SHORTCOMINGS IN IMPLEMENTATION OF TAX REFORMS IN TANZANIA

Tax exemptions is one of the major shortcomings against the implementation of tax reforms in Tanzania.⁶⁵ In 1989 there were the exemptions granted to both central and local governments where grants and commodity aid exempted from fiscal year 1987-1988 to 1991-1992, political parties and commercial enterprises on imports constituted more than 96 percent of the potential taxes on these imports, they were abolished from June 1992.⁶⁶

Because of the exemptions, the government estimated to increase its revenue by 9,850 million Tanzanian Shilling.⁶⁷ However, there were still many loopholes in the system because the implementation of the abolishment of these exemptions was inadequate. Secondly, high tax rates, during fiscal year 1992-1993, the major tax rates reductions reforms were announced in Tanzania.⁶⁸ The major reasons behind the reforms was that, in the past, the high tax rates had adversely affected industries' productivity, that led onto

⁶¹ *Id.*

⁶² *Id.*

⁶³ *Supra note 29, at V and IX.*

⁶⁴ *Id, at XII-XIII.*

⁶⁵ *Supra note 845, at 19-20 and 23.*

⁶⁶ *Id.*

⁶⁷ *Id.*

⁶⁸ *Id, at 19.*

increasing operational costs, ultimately had badly affects the competitiveness of locally produced commodities vis a vis import.⁶⁹

In addition, only one element of the "low-rate, broad-base" strategy was followed, since the reductions in tax rates were implemented without *de facto* and *de jure* broadening the tax base.⁷⁰ Thus, the significant losses were reported in the country.⁷¹

Thirdly, tax evasion and avoidance, evasion of tax is a prevalent problem in Tanzanian tax system.⁷² In fact, undervaluation of imported goods applying to the most own-funds imports is the key problem in the area.⁷³ That was contributed where the importers had access to foreign exchange without going through Bank of Tanzania records.⁷⁴

In addition to that, the government and parastatal's imports exempted from taxation, lower to zero rates on goods imported to Zanzibar "Freeport" led importers to avoid import duties, Bank of Tanzania had funded imports while importers uses local currency in exchange for foreign currencies, while both corruption and administrative constraints (bureaucracy) at entry points increases undervaluation problem of imported goods in Tanzania.⁷⁵

Frequent tax policy changes have risen the issue of credibility on Tanzanian government policy stability.⁷⁶ It also adds uncertainty in the environment of business community especially against foreign investors.⁷⁷ Similarly, unstable tax policy environment may discourage the business community to take a longer-term perspective in their finance and investment decisions.⁷⁸ In this regard, tax changes must be reformulated as a long-term strategy and made after adequately consideration of the transitional arrangements in the tax system.⁷⁹

⁶⁹ *Id.*

⁷⁰ *Id.*

⁷¹ *Id.*

⁷² *Id.*, at 20-21.

⁷³ *Id.*

⁷⁴ *Id.*

⁷⁵ *Id.*

⁷⁶ *Id.*, at 22-23.

⁷⁷ *Id.*

⁷⁸ *Id.*

⁷⁹ *Id.*

Since, a high revenue productivity is the key criteria for the nations appropriate tax system, in Tanzania the effect on revenue has also been the primary question for the territory's tax reforms.⁸⁰ Despite unstable tax policy environment to the business community, frequent tax policy changes, tax evasion and avoidance, high tax rates, tax exemptions to be the major shortcomings against the implementation of tax reforms in Tanzania. The reforms made under the mining tax regime constituted another major shortcoming against the success of the revenue sector in the nation (International Centre for Tax and Development, 2012).⁸¹

The key reforms undertaken in the mining tax regime since the advances of large-scale mining operations can be summarized in three key phases (International Centre for Tax and Development, 2012).⁸² The first phase started in 1998, when the Mining Act, 1998 and the V.A.T Act, 1998 came into force.⁸³ The landmark reform during the second phase started in 2004, where the new Income Tax Act, 2004 was introduced.⁸⁴ Finally, the third phase started in 2010 which is defined by the enactment of the new Mining Act, 2010.⁸⁵

It is observed that, the binding agreements between the government of Tanzania and the mining companies were signed before the tax reforms regardless of the long-term extraction of the Tanzania's bulks of minerals (International Centre for Tax and Development, 2012).⁸⁶ This means that, the legal reviews, tax law reviews, mining policy, mining Act and others have had limited impact in the sector.⁸⁷ This situation led the government to be the good will of the mining companies despite its principal roles of ensuring good governance and public accountability.⁸⁸

⁸⁰ *Id.*, at 25.

⁸¹ *Supra* note 136.

⁸² *Id.*

⁸³ *Id.*

⁸⁴ *Id.*

⁸⁵ *Id.*

⁸⁶ *Supra* note 136, at 32.

⁸⁷ *Id.*

⁸⁸ *Id.*