

**ASSESSMENT OF THE EFFECTIVENESS OF THE LAWS
GOVERNING TAX EXEMPTIONS ON DONOR FUNDED
PROJECTS IN TANZANIA MAINLAND**

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GOVERNING TAX EXEMPTIONS ON DONOR FUNDED
PROJECTS IN TANZANIA MAINLAND**

By

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**Research Dissertation Submitted in Partial Fulfillment for Masters Degree of Laws
(LLM – Commercial Law) of the Mzumbe University.**

2014

CERTIFICATION

The undersigned certifies that they have read and hereby recommends for acceptance by the Mzumbe University a dissertation entitled: **Effectiveness of the Laws Governing Tax Exemption on Donor Funded Projects in Tanzania**, as partial fulfillment of the requirements for the Degree of Masters of law (LLM) of the Mzumbe University.

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DECLARATION AND COPYRIGHT

I, Restituta Peter Maseu, declare that this dissertation is my own original work and that it has never been presented and will not be presented to any other university for similar or any other degree award

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I must thank my parents Mr. and Mrs. Peter Maseu for granting me financial support to go for further studies at the Mzumbe University and allowed me to continue writing this dissertation just after coming back home for the first time.

Despite its loneliness and ultimate sole responsibility this research was heavily inspired and therefore I would like to gratefully register to my husband, Nicas Japhet and our children Johnson and Johnsolina who though outside the family where the study was conducted for all the time, but they provide me with remarkable support and loyalty.

DEDICATION

This dissertation is dedicated to the most precious woman in my life my beloved Mother, Mary Maseu, my father, Peter Maseu and to my beloved kids, Johnson and Johnsolina.

ABBREVIATIONS AND ACRONYMS

DFP	-	Donor Fund Project
EAHC	-	East African High Commission
EAITM	-	East Africa Income Tax Management
IMF	-	International Monetary Fund
NGOs	-	Non-Governmental Organization
Pg	-	Page
TIC	-	Tanzania Investment Centre
TRA	-	Tanzania Revenue Authority
USA	-	United States of America
WB	-	World Bank
NPO	-	Non Profitable Organisation
REPOA	-	Research on Poverty Alleviation

ABSTRACT

This study aims at making assessment on the effectiveness of the laws governing tax exemption on donor funded projects in Tanzania, particularly the enactment of the provision of tax exemption, whether they are effective in relation with donor funded projects. In assessing this issue, the basic question relates to the extent and significance of the provisions of the laws in bringing about the needful of its intention to enhance income collection for the growth of the government revenue in Tanzania.

A necessary concomitant of the study is to endeavor or render a jurisprudential justification for the effectiveness of these Laws towards the recognition of the possible loopholes of which one may use in vacating from paying tax on the ground of being a donor funded project. Also, the need for the decisions based on income generation and socio-economic consideration within the country.

The qualitative approach and literature review for collection of primary and secondary data were adopted. It has been observed that tax exemption in donor funded projects is the results of decreased of government revenue, tax avoidance, existence of bias between donor funded projects and indigenous projects within the country and corruption

Also the researcher suggested and recommended on the way in which such loopholes are to be controlled and the measures to be taken to avoid such problems by find what conditions and limitations the law provides for the donor funded project to receive tax exemption and to what extent, its judicial process and sophistication influence its perception, development and utilization of the tax exemption on donor funded projects in enhancing income generation within the country.

Hence the study recommends enactment of an efficient and responsive legal framework to address the above legal issues with the view to enhance donor funded projects in the all system of government revenue. Not only that it is recommended that further research has been conducted on the tax exemption especially on donor funded projects.

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CHAPTER ONE

GENERAL INTRODUCTION

1.0 Introduction

The government of any state in the world has a duty to make sure that their citizens are living in standard life. This noble purpose can be achieved through ensuring that there is availability of social services such as health, education, infrastructures, the list may continue for some time. However, all these depend on the economic status of a given state. Hence, there is a need of the government to struggle for the growth of its economy. Among the major sources of the economic growth, it is tax collected from various projects and sources, which can be internal or external investments.

Therefore, the government has to levy tax for the economic growth based on the law. However, there are some projects which have legal exemption from paying tax. These may include charities and the donor funded projects on the ground that these projects are useful directly to the society. This study was conducted to assess the effectiveness of the laws governing tax exemption on donor funded projects in Tanzania i.e. the Income Tax Act¹ as to whether the provisions of the Law provides for the needful of the intention for other enactment.

1.1 Historical Background

Tanzania has had a taxation system according to modern principles since the turn of the century. It was introduced by the European colonial powers which took charge of the administration of the territory. The first colonial administrators to introduce taxation were the Germans. They introduced simple forms of direct taxes such as the 'hut' and 'poll' taxes. These were introduced primarily to force the African population to participate in the money economy and only incidentally to raise revenue. The budgetary expenses of the colonial administration were mostly financed by grants from the imperial government². However, the German period in Tanzania did not have a lasting impact on the failed to establish effective control of the territory. Between 1884 and 1891 the only German presence in Tanganyika was through the German East

¹ Cap 299 R.E 2006

²Luoga F.D.A Makinyika (1996) A Sourcebook of Income Tax Law in Tanzania. Dup Ltd, Dar es Salaam University Press.

Africa Company. It was not until 1898 that a colonial government was established. But even then no effective control was achieved. The colonial government's power was severely limited by lack of staff and money. Further, the technique employed to rule the territory was very militaristic and involved the use of strong and ruthless resistance by the people. The end of the first World War in 1919 saw the end of the Germans in Tanganyika. The country was declared a trust territory of the League of Nations and she was handed over to the British (as trustees on behalf of the League of Nations). It was the latter who established institutions that shaped Tanzania's legal and tax structures.

Income taxation was first introduced by the British in 1940. The first income tax legislation was based on a model Colonial Income Tax Ordinance which was essentially a simplified version of the United Kingdom's tax legislation as it existed in about 1920.

Under the British, income taxation was primarily intended for the European portion of the population. The Africans were taxed through import and excise duties mainly because of their low income and literacy levels.

In 1948 the British created the east African High Commission³ as a statutory corporation to administer and provide in Kenya, Uganda and Tanganyika (The High Commission Territories) certain inter-territorial services. The order in council set up a Legislative Assembly with powers to legislate in a certain specified matters. Such legislation would, when enacted override the conflicting Territorial legislation. The specified matters were listed in the Third Schedule to the Order in Council and included in Head 5 income tax – Administration and General Provisions (but not including the rates of tax and allowances).

The High Commission decided to synchronise all the tax legislation on the territories by enacting a single managing Act to deal with the whole of east Africa (excluding Zanzibar) leaving each territory to enact separated legislation dealing with rates and

³Tiley J. REVENUE LAW, 3rdE.d (London Butterworths, (1981)pg.2

allowances. The East African income Tax (management) Act, 1952⁴ was passed to repeal the territorial Ordinances with retrospective effect to January 1, 1951. Between 1952 and 1958, this Act was amended five times.⁵ However, it remained in force until 1958 when the East African income Tax (Management) Act of 1958 was enacted. Thus it was not until 1958 that a stable system was established.

According to the scheme of the 1948 Act the tax was levied on residents of East Africa upon their income from sources within East Africa. Income from sources outside East Africa was taxed to the extent that such income was remitted to and received in East Africa. The income enumerated in section 3(2) on the income Tax Act of 1973. Luoga⁶ discusses in extensor the scheme of the 1958 Act in his “Ability to pay: The basis for Fair Income Taxation in a Developing country.”⁷

The 1958⁸ Act remained in force until 1971 when the East African income Tax (Management) Act of 1971⁹ was enacted. The latter was short – lived because of the immediate breakdown of the East African community thereafter. The income Tax Act of 1973¹⁰ was repealed and replaced the 1971 Act. However, in many respects it is a carry-over of the previous legislation, unfortunately, with some endemic distortions rather than improvements. It is a brief legislation which attempts to achieve a gargantuan task of providing for every aspect of income taxation and apparently, bursting its rums in the process.

Tax exemption refers to a reduction or elimination of tax liability on the individual or organisation. The origin of tax exemption can be traced its way back to England whereby the system of tax exemption predates the formation of the republic, and its existence can be traced when early settlers started forming charitable and other

⁴Act No.8 of 1952

⁵See the East African (High Commission) Order in Council, 1947

⁶Luoga F.D.A Makinyika (2007) A source book of Income Tax law in Tanzania. Dar es Salaam University Press.

⁷By East Africa Income Tax (Management) (Amendment) Acts No.2 of 1954; (NO.2) Act NO.14 of 1954; NO.11 of 1955; NO.8 of 1956; and NO.4 of 1958

⁸East Africa Income Tax Act No.4 Of 1958

⁹LLM. Thesis, 1988 at the University of Queens, Ontario, Canada

¹⁰Act No.33 of 1973

voluntary associations such as hospitals, fire departments and orphanages to confront wide variety of issues. The provision of tax exemption was provided in the English statutes, in 1799 when the system of tax exemption was introduced at the first time. And it was this time where there was high level of exemption; hence, only minority of the population paid income tax. However as people's income rose more people were caught in the tax net.¹¹ In turn the system changed in England where the government grants exemption of taxes for the entities governed by charities law.

It was during the British colonisation in America where the tax system was introduced and it was in 1894 where the tax exemption system was incorporated in the statutory provisions at the time when the Wilson Gorman Tariff Act was passed. This was the earliest statutory reference which provided for tax exemption on corporation, and organisation which were organised and conducted their activities solely for charitable, religious and educational purposes. Among the principle for granting the exemption was that organisation must be operating for charitable purposes. However, with the development, the modern tax exemption principles have been incorporated under the Revenue Codes passed in United States of America in 1954 which had widened the scope of exemptions and introduced the current structure.¹²

East Africa like America the tax system is colonial oriented it was during the colonial period where the system of tax was introduced. The first tax legislation was enacted in Kenya in 1937, (The Income Tax Ordinance 1937) the ordinance can best be described as simplified synthesis of English tax legislation which existed around 1920. With the formation of the East African High Commission, The East Africa Income Tax Management (EAITM) Act was passed in 1952 to consolidate both existing tax legislation in the region which was repealed and replaced by EAITM Act of 1958 which was used until 1973 when the EAITM was split up and each member of the community established its own system. As afore said that these laws had much

¹¹Atkinson A. B. INCOME AND TOP INCOMES OVER THE TWENTIETH CENTURY, Nuffield College, Oxford, (2004) pg 125

¹²Fuller, Lon. L; The Morality Of Law, New Haven, London Yale University Press, (1964) pg 166

resemblance with the English laws the provisions relating to tax exemption were embodied therein.

In Tanzania, as aforementioned, that tax exemption concept was not a new idea as it has been existed since colonial era especially in 1940 when The Income Tax Legislation was first introduced in Tanganyika and since then it has been used with some amendments suiting the existing tax law legislation. Until in 1973 when Tanzania passed the Income, Tax Act which contained quite extensive provisions of exemption including the exemptions of any income in respective charitable organizations, exemption of particular sources of interest income payable to nonresident person or non citizens only on government security and loans. With the amendment of the law governing income tax, tax exemption has also been provided in the current legislation, The Income Tax Act¹³. One of the beneficiaries of these tax exemptions are the donor funded projects.

It can be observed currently that there is growing number of these donor funded projects of various scales, with diverse coverage, all of these projects call for tax exemption not only for the goods imported to facilitates, but also for income received by foreigner who are working within the country in facilitation of those projects.

1.2 Statement of the Problem

In Tanzania, there are various development projects which are going on in different parts of the country on various sectors such as in education, health, water and electricity to mention just a few. Some of these projects are funded by the government, some by the citizens themselves and others are funded by the donors from other countries. These donors from foreign countries may be government, international organisation, such as World Bank and International Monetary Fund, non-governmental organisation or an individual. The assistances given by these donors may be designed to facilitate development, reforms, or may respond to natural disaster or humanitarian crisis.

¹³Section 10 and its provision on third schedule of the Income Tax Act, R.E 2006

The Tanzania Revenue Authority, Report on Income Tax Collection shows that Donor funded projects are one of the major beneficiaries of the tax exemption in Tanzania ranking the second after those benefiting with the exemption with Tanzania Investment Centre. There is no doubt that in fiscal year 2008/2009-2009/2010 donor funded projects occupied 6.48 percent of total exemptions in Tanzania.¹⁴ It is a growing concern that there are so many tax exemptions granted by the authorities to the extent of making the government goals unrealisable. The government goal is to establish the tax system which is broad based with few exemptions as possible¹⁵. However it is observed that a sheer amount of revenue is lost through exemptions.

Currently, the government through the Tax Revenue Authority has made their best in ensuring that their goals in tax collection are met by observing transparency, and efficiency in following up collection as well as curbing up whatever possible loophole for tax avoidance. The effects of these are the decrease of tax exemption in 2009/2010. It is unfortunate that such decrease IS not seen on the donor funded projects; hence, tax exemption on these projects is one of the factors which hinder the revenue collection.

Hence this research report intended to assess the provisions of Income Tax Act¹⁶, The VAT Act¹⁷ Excise Management and Tariff Act¹⁸ and The Tax Revenue Appeals Act¹⁹ relating to tax exemption on donor funded projects with the view of determining how effective they prevent tax evasion and promote economic growth in Tanzania.

1.3 Literature Review

Once it is noted that taxes have existed virtually as long as there have been organised governments. The Bible records instances when people were expected to pay taxes. During Jesus Christ's life ministry tax collection took place. One recalls the story of zacchaeus, a chief tax collector who took Jesus to his home. People considered

¹⁴ TRA report on Income Tax Collection of 2010 at pg 23

¹⁵ <http://www.policyforum-tz.org/files/TANZANIAGOVERNANCEREVIEW200809.pdf> Assessed on 22 July 2013

¹⁶ Section 10 of Cap 299 R.E 2006

¹⁷ Cap 148 R.E 2006

¹⁸ Cap 147 R.E 2002

¹⁹ Cap 408 R.E 2002

Zacchaeus a sinner (probably because he was a tax collector) but the Lord accepted him. And queried whether people should pay tax or not Jesus replied “Give to Caesar what is Caesar’s and to God what is **God’s**”²⁰.

Further, Paul said that²¹ “Everyone must submit himself to governing authorities, for there is no authority except that which God has established therefore it is necessary to submit to the authorities not only because of possible punishment but also because of conscience. This is also why you pay taxes, for the authorities are God’s servants, who give their full time to governing. Give everyone what you owe him. If you owe taxes, pay taxes, if revenue, then revenue...”

Most transfers of money from one individual to another are voluntary. Taxation is compulsory for those who are eligible to pay tax. In Africa, wherever there was organised government, subjects were required to pay taxes, which were king²². That was before monetary transactions became the norm. With colonisation, there came the introduction of legislations that required people to pay taxes.

Government needs money for running the same. It follows therefore that payment of tax is a civil responsibility. It is a citizen’s contribution towards the development of the nation. But generally, people detest taxes. All efforts are made by some to avoid taxes.

In the words of **Lord Denning**,²³ “... some wicked people keep two sets of books: one for themselves to use; the other to be shown to the revenue. There are those who make out two invoices. One is for the customer and the other one is to be shown to the taxman. These are the ones who enter into fictitious transactions and write them into their books as genuine. Those shown to the taxman are the ones which show losses while to the contrary they have in fact made gains. In the tax evasion pool, there are some who are fish, those who do not stop at tax avoidance. They resort to frauds to a

²⁰ See Luke 20:20-26

²¹ Romans 13:1 – 6 of the Holy bible

²² http://en.wikipedia.org/wiki/Taxation_in_Tanzania Assessed on July 2013

²³ See Regina v I.R.C Exp, Rossminster (1980) A.C. at pp.971-972

large scale. It is obvious that if the legislations were to confine or could be confined to people of that sort, it would be supported by all honest citizens. Those who defraud the revenue in this way are parasites that suck out the life – blood of our society. The trouble is that the legislation is drawn so widely that in some hands it might be an instrument of oppression.²⁴”

Pursuant to the foregoing, legislation is required to determine tax payable and by whom it is payable. As “tax” has been defined as a charge by the Government on the income of an individual, corporation or trust, as well as the value of an estate gift.²⁵ A “tax” has also been defined as any contribution imposed by Government upon individuals for the use and services of the state whether under the name toll, custom, excise, tribute, tillage, import duty, subsidy, but in which its essential characteristics is not a debt.²⁶ But the value Added Tax Statute 1996 of Uganda introduces the aspect of tax as a debt due to the Government. Section 41 (1) of the statute provides that tax due and payable under the statute is a debt due to the Government and is payable to the commissioner General by the person specified in section 6. The persons liable to pay tax under section 6 suppliers of taxable supply, importers of goods and recipients of imported services.

But who can impose tax and who can impose tax exemption?. This was the issue in the Kenyan case of *Nyali Ltd v Attorney - General*²⁷ where Nyali with the island of Mombasa, both in Kenya.

The bridge was built under an agreement of October 9, 1929 with the Government of Kenya, which entitled the company to charge tolls for

All passengers’ vehicles (persons limited to six)....

Foot passengers or persons in excess of six in number “travelling in any vehicle” but provided for exemptions in respect of “military on duty or their equipment, luggage or transport”

²⁴ibid

²⁵Black’s Law Dictionary, p.1457

²⁶<http://www.worldbank.org/en/country/tanzania> Assessed on July 2013

²⁷(1956) 1 Q.B.1

In former times there were many cases where a man set up a ferry or made a bridge to cross a river or an arm of the sea. It was usually done to connect two high ways so as to save a long journey round. In such a case, it well settled that the owner of the ferry or bridge cannot of his own head impose a toll upon the people who use it. The reason is because it is a thing of public benefit and use and it ought, therefore, to be under public regulation. He must get lawful authority to levy a toll; and the only authority recognized for this purpose is a crown grant of a franchise of tolls, or an Act of parliament. The toll charged must not exceed the amount specified in the crown grant or in the statute.

It is clear from the foregoing quotation that authority to levy tax and to exempt tax should be derived from an Act of Parliament. The all important matter of imposing tax and exemption tax should be contained in primary legislation and not left to subsidiary, delegated or secondary regulations. If the latter is done, it may lead to abuse, excessive taxation or imposing taxes which are *ultra vires* the parent Act. In the case of **Woolwich Equitable Building Society v IRC**²⁸, the House of Lords considered the Finance Act of 1985 (England) which included sections enabling the inland Revenue to make regulations for the payment by building societies of tax on 'such sums as may be determined in accordance with regulations; The Act went on to provide that any such regulation might contain' such incidental and consequential provisions as appeared to the Board to be appropriate; why it was thought appropriate to leave the important matter of imposing tax on building societies to secondary rather than primary legislation in this way remains a mystery. But, whatever the explanation the experiment was a total disaster and resulted in the Revenue producing some regulations in respect of a particular period of assessment which were so hopelessly flawed that the House of Lords founds itself compelled to declare them void as being *ultra vires*.

On the other hand 'the Government aims for a tax system which is broad based with as few exemptions as possible. However, exemptions are granted for a variety of reasons, such as to adhere to international norms for those with diplomatic status, to

²⁸(1991) 4 All ER 92

remove tax burden from donor funded projects, to respect Government commitments in legal agreements, and to implement certain policies such as support for NGOs or for certain economic sectors. Tax exemptions are listed in the schedules to the tax laws, which set out categories of exemptions and the relevant criteria for qualifying for exemptions. In addition, tax exemptions are granted through Government Notices signed by the Minister for Finance published in the Government Gazette'²⁹

In reviewing literatures both empirical and theoretical literature, it is argued by **George**,³⁰ that there is some evidence that donor funded project can contribute to increasing employment, enhanced management, and the transfer of technology which has important spillover effects on local firms and society at large through supply and outsourcing. The author has consonant views but he does not talk of any effectiveness of the law on exemption over donor funded project.

F jeldstad, & L Rakner³¹ perceives the rise in tax exemptions in recent years as an indication of limited political to fight fiscal corruption and tax evasion in Tanzania.³² Widespread exemptions and prohibitive rates had made the tax structure difficult to administer. The author does not address how effective the law is, instead he gives the effect of tax exemption.

Clements & Diamond³³ insist that tax exemption to Charitable and Donor funded projects can be available when yearly or other annual payment is applied to targeted beneficiaries only. The author went little further that Tanzania Tax laws take care of tax exemptions to the aforementioned groups and therefore they were silence on the effectiveness of the laws governing tax exemption on donor funded projects which the researcher is interested.

²⁹.(http://www.mof.go.tz/index.php?option=com_content&view=article&id=45&Itemid=111 Assessed on July 2013.

³⁰ *A paper prepared for a Policy Dialogue for Accelerating Growth and Poverty Reduction in Tanzania, held at the Conference Hall, ESRF, on May 25,2006*

³¹F jeldstad, O.-H. / L. Rakner (2003): Taxation and tax reforms in developing countries: Illustrations from sub-Saharan Africa, CMI Report 6, Bergen: Christian Michelsen Institute (CMI).

³² Ibid.

³³Clements & Diamond (1971),Revised Edition 'Butherworths' Digest of Tax cases at pg 471 -497

Luoga, & Makinyika³⁴ Authors did not perceive in their book, tax exemption for donor funded projects as an issue, instead they have addressed brief history of taxation in Tanzania, theoretical concepts of taxation, tax evasion, tax avoidance and many others. Therefore it's a missed opportunity for Tanzania authors not to address this issue which is also a part to be investigated by the researcher.

TRA Report³⁵ set forth the main groups of beneficiaries as holders of Tanzania Investment Centre Certificates (45%), private companies (20%), Donor-funded projects (9%) and Mining (8%). The TRA points to the large empirical literature that shows that tax exemptions and incentives – tax expenditures, as they are often called - rarely achieve their supposed goals, the report shows the impact of tax exemption in various spheres but it says nothing on effectiveness of the law governing exemptions to donor funded projects which is what the researcher is interested in.

OECD report³⁶ in respect with Donors, frequently secured tax exemptions from developing countries on aid inputs. The exemptions typically include income taxes on aid workers' salaries, goods and services and value-added taxes on local purchases, and customs duties and excise taxes on imports. Tax officials in recipient countries consider that such special exemptions weaken their tax systems, cause considerable cost and complication and provide opportunities for corruption. This report also shows the impact of tax exemption in various projects in society but it does not show the effectiveness of the law governing tax exemption on donor funded project which is what the researcher is interested in.

Institute of Policy Analysis and Research-Rwanda³⁷ maintains that, Rwanda tax laws are more effective than Tanzania to the extent that tax exemptions for NGOs and religious groups are allowed only when their activities are of direct benefit to society. The report finds support with the topic under investigation by the researcher although it does not state how effective Tanzania tax laws are.

³⁴Luoga,F.D.A,Makinyika(2007) 1stEdn, 'A source book of income tax Law in Tanzania. Dar –es Salaam University Press at pg 35-39

³⁵Tanzania Revenue Authority (2011) "Risk Assessment of Tax Exemptions 2006/07 – 2009/10" at pg 46

³⁶OECD Global Forum on Development; 'Domestic resource mobilization for development: the Tax Challenge'

³⁷<http://www.uwazi.org/uploads/files/Tanzania%20Tax%20exemptions.pdf> Assessed on July 2013

UNITAR³⁸ the report insist that in case tax provisions are ambiguous the court is obliged to decide in favour of the tax payer or a recipient of tax exemption, this has all along frustrated the purpose for the legislation. In addition, the author has succeeded to show how ambiguous legislation can be dealt with for making tax laws efficient, but the report is silence on the effectiveness of the laws governing tax exemption which is the areas of the study.

1.4 Objective of the Study

1.4.1 General Objective

The general object of this study is to assess the effectiveness of the laws governing tax exemption on donor funded project in Tanzania in relation to government development.

1.4.2 Specific objective

The specific objectives of this study include to:

- To critically examine to what extent tax exemption has contributed to the advancement of economic growth in Tanzania
- To examine the possible loopholes within the provisions of the law which one may use in tax avoidance on the ground of the donor funded projects
- To recommend what should be done by the law making authorities and officials responsible for implementing the law in order to secure a good law and make effective use of the same as an important yardstick for an improved of tax exemption in Tanzania.

1.5 Research Hypothesis

This research arose from the presumption that:

- The tax exemption on donor funded projects result in low revenue.
- The result of tax linkage gap between donors funded projects and local projects are caused by tax exemption on the said donor funded project.

³⁸Ibid

- The tax exemption on donor funded projects result in the loopholes for tax avoidance.

1.6 Significance of the study

This study is important in the society and to the researcher in particular as;

- It provided for the awareness of the lacuna within the laws governing Tax exemption on donor funded project.
- It is useful to the government of the United Republic of Tanzania in making review of tax exemption laws and amendment of the laws through parliament.
- The study assisted the researcher to identify variable areas for further studies.
- It provided in depth information that were utilize as reference material for the future researches in the similar field or related disciplines.
- It provided better recommendations to the government on tax matters related to tax exemption.

1.7 Research Methodology

This area is about the research methodology where the researcher shows how, when and what will be done during the whole research processes. It includes research design, population sample, sampling, sample frame, sample size, sampling techniques, scope of the study, study area, methods of data collection and method of data analysis³⁹. This is essentially a library and field research. It concerns critical assessment on the law governing tax exemption on donor funded project.

1.7.1 Research Design

This is the legal research project, which is a scientific research, thus the nature of this research is doctrinal and non doctrinal. Therefore an investigation involved library and case study design taking TRA and donor funded projects as areas of the study. This design was chosen on the reason that it would be flexible, simple in the process of data collection and it would provide more insight towards obtaining depth and broader information.

³⁹C.R. Kothari,(2004) RESEARCH METHODOLOGY: Methods and techniques, 2Ed, New Delhi; New Age International (P) Limited, Publishers. Pg 56

1.7.2 Population Sample

The target population involved both men and women managers from TRA. Data were collected from TRA with specific number of respondents from each unit. Questionnaire was used to collect data from the following categories of respondents: 10 officers from TRA department of Human Resources; 5 Accountants from TRA; 7 operation Managers who were responsible for the operation system concerning tax such as tax collection machines; 6 ICT managers responsible for preparing the tax machines receipts, and 5 Lawyers who dealt with laws in tax system.

Also the researcher used interview to collect the data from 2 donor funded projects in Tanzania, that is, 1 Manager from Tanzania Energy Development and Access Expansion Project (TEDAP) and 1. Officer from Independent Power Tanzania Ltd. (IPTL) Power Planting Conversion. The researcher interview 2 managers from TRA This made a sum of 37 respondents

1.7.3 Sampling

Sampling refers as a definite plan for obtaining a sample from a given population. Therefore it is a technique or the procedure the researcher would adopt in selecting items for a sample.⁴⁰ Sampling may as well lay down the number of items to be included in the sample. In this research project, the researcher used deliberate sampling because the researcher targeted specific group of people from TRA and specific people from projects which were funded by donors.

Also Convenient sampling method was employed, to study the unit which was available and willing to share information concerning the problem at the time of data collection. The focus was on informants who possess sufficient and reliable data on the matter.

⁴⁰C.R. Kothari,(2004) RESEARCH METHODOLOGY: Methods and techniques, 2Ed, New Delhi; New Age International (P) Limited, Publishers.pg 59

1.7.4 Sampling Techniques

The selection of sample, TRA and donor projects was done during preliminary stage of the study; hence, the sampling technique to be used in this research project were both random and purposive sampling. Random sampling was applied to obtain representative sample that was relatively equal with those who were not selected. Also Purposive sampling was used specially for a researcher to get information that could not be obtained from any other respondents. Respondents were drawn from relevant authorities such as TRA and the two Donor Funded project in Tanzania mainland.

This method would be employed to select respondents in relevant areas of the study and this method every member of the population would have an equal opportunity of being included in the research so as to avoid bias and it would help the researcher to obtain the persons who were knowledgeable and responsible to this research topic.

1.7.5 Sample Size

This refers to a number of items to be selected from the universe to constitute a sample. The study used TRA as a unit of analysis but within TRA the researcher selected management directors and officers of donor funded projects who were customers of TRA. This made a sum of 37 respondents. From this sample size the researcher obtained sufficient information on tax exemption on donor funded project in Tanzania.

1.7.6 Scope of the study

In this study the researcher embarked on making assessment on the Laws governing the tax exemption on donor funded projects in Tanzania mainland, specifically the Income Tax Act, VAT Act and Tanzania Revenue Authority Act. Concentration was on its application in different matters concerning tax exemption on donor funded projects in Tanzania.

1.7.7 Area of the study

This research project was conducted in Dar es Salaam. This was because the headquarters for TRA is located in the city. It was further assumed that the researcher would gather sufficient information concerning the effectiveness of the laws on tax

exemption on donor funded projects. The researcher expected to visit these field areas which are donor funded projects where taxes were collected for the government revenue.

1.7.8 Data Collection methods

Both primary and secondary data were used. Primary data was useful as it testified the reality and revealed to what extent the problem of the study exist. Secondary data was covered through intensive visit of articles, journals and books concerning the problem of the study, which gave the researcher a gap to scrutinize what, has been done by other researchers and what loophole the researcher should address.

In this study data were collected mainly through questionnaires, interviews and documentary review. In questionnaires the researcher issued the questionnaires to the target persons in TRA while through interview method, both structured and unstructured interviews were conducted to various experts in law. In the meantime, the donor funded projects with a view to extract information relating to the law governing tax exemption on donor funded project in Tanzania. In documentary review, data were collected from different published materials such as text books, international and regional instruments and other Acts of parliaments, law journal periodicals, articles, news papers and other publication relevant to the subject.

1.7.9 Data Collection Instruments

The major data collection instrument which was employed included: questionnaires and interview The instruments were designed to extract information from cases and variables so as to be formulated and tested well⁴¹. As this study required qualitative data, the questionnaires were designed to complete both close ended questions for sample analysis of data and open ended questions with the aim of acquiring opinions and critical presentation of the ideas of the respondents. This study used face to face interview to collect required information from the interviewees. These instruments were pretested to ensure their validity and reliability.

⁴¹ Adam, J and Kamuzora F; (2008) Research Methods for Business and Social Studies, Morogoro Mzumbe book Project.

1:7:9:1 Interview

The interview method of collecting data involves presentation of oral verbal stimuli and reply in terms of oral verbal responses⁴². This method can be used through personal interview and if possible through telephone interview. In this study the researcher used personal interview because it required the researcher to ask questions generally through face to face contact with the respondents so as to obtain information sufficient for this study.

1:7:9:2 Questionnaires

This method of data collection is quite popular where by the researcher is required to send the questions which the researcher has prepared to the respondents concerned with the request to answer the questions and return the questionnaire with the answers⁴³. The researcher used this method because other respondents were not easy to interview them and hence instead of interviewing the researcher sent them questions to respond for the purpose of obtaining required data.

This method helped the researcher to obtain information from different respondents. The respondents were given questionnaire to fill in. Due to its shortcoming such as, the method involved only people who were literate and isolated those who were illiterate, some respondents were not able to answer the questions therefore interview method of data collection was applied to fill such gap.

1.7.10 Methods of data processing and analysis

The data obtained were analyzed and interpreted through both qualitative and quantitative approaches. Qualitative approach involved a descriptive analysis of the obtained information, while quantitative approach involved simple descriptive statistics, namely, tables, calculation of frequencies and percentages as well as presentation of some information through bar-graphs

⁴²C.R. Kothari,(2004) RESEARCH METHODOLOGY: Methods and techniques, 2Ed, New Delhi; New Age International (P) Limited, Publishers.pg 97

⁴³ Ibid pg 100

After the data collected, edited and coded the researcher then analysed the data to determine the adequacy of information and the credibility, usefulness, consistency and validation or non-validation of the research questions. A researcher closely evaluated the usefulness of the information in answering the research questions.

1.7.10.1 Data Quality Control

There was a well-organized data gathering and analysis procedures. The study was conducted to confirm that the information and data attained was authentic and reliable. Responses that were irrelevant to the study were not included in analysis in order to control the quality of data.

1.7.11 Limitation of the study

During the process of data collection, the researcher experienced different problems. Nevertheless, the researcher employed different techniques in order to collect the data intended. These factors limited the researcher from getting sufficient information relating to the problem at hand. Hereunder were factors which hindered the researcher during the process of data collection:

1.7.11.1 Time and Financial Factors

Research writing requires sufficient time and funds for its accomplishment. These involve costs and time for preparing and consuming? to the targeted respondents. However, some respondents were absent during data collection, so this also affected the time schedule of the researcher in finalizing the work on time. Furthermore, lack of sufficient funds was a factor which limited the researcher. Despite reading online books (e-books), it was difficult for the researcher to afford the cost of latest literature which was also useful in this study. So this factor positively limited the researcher.

1.7.11.2 Availability of the Respondents

Due to the nature of this topic, the researcher found some difficulties to collect sufficient data from the respondents who exactly possessed sufficient information on tax law. During interview, it was difficult to reach some of the interviewee for some reasons; consequently, instead of interviewing the participants the researcher chose to distribute the interview guides for the interviewee to fill in the same. This was the case

with TRA officer respondents. Also most of respondents were not familiar with the tax law especially in exemption of tax in donor funded projects. Moreover, some respondents who were too busy, they were not reached by the researcher so some data were not collected from them, particularly, donor funded project respondents.

CHAPTER TWO

CONCEPTUAL FRAMEWORK OF THE TAX EXEMPTION ON DONOR FUNDED PROJECTS

2.0 Introduction

Generally it is important to have the knowledge of the keen concepts of which the study is based. Therefore, in this chapter the principles and theories of taxation are examined and the definitions of the main tax-related concepts used in this study are clearly described. These are concept of tax, tax exemption, and donor funded project and further revisits some of the tax exemptions principles for which a broad consensus has been observed in the literature. A summary of recent assessments of the value of tax exemptions on donor funded projects in Tanzania is proposed, and trends are identified. The chapter concludes with a list of lessons learned in managing tax exemption on donor funded projects for the purposes of attracting economic growth efficiently within the country.

2.1 Principles and theories of taxation

In general, the main purpose of a country's taxation system is to raise revenue in order to fund public goods, services and activities that will help a government achieve its policy objectives. Government leaders can choose between two approaches or use a mix of the two to deliver on their commitments;⁴⁴

The more conventional "fiscal direct expenditures" approach, where resources are allocated and money is spent on particular activities, individuals, business or governments, or

The "tax expenditure" approach, where tax reductions are granted to selected group of taxpayers to generate incentives and/or promote desired behavior.

However tax registrations impose obligations on citizens to pay tax and failure to do so is counteracted by sanctions. Therefore it is important that the citizens should be able to ascertain the law by reading what the draftsman and parliament has laid

⁴⁴ Tax Expenditure in the EOC countries EOC (2010) Report at pg 13

down as law. Where tax provisions are ambiguous the court is obliged to decide in favor of the tax payer thereby frustrating the purpose for the legislation.

2.2 The concepts of the tax related terms

2.2.1 Meaning of the term tax.

Generally there is no legally formulated definition of the term tax or taxation. The Oxford dictionary defines a tax to mean a compulsory contribution to the support of government levy on a person's property, income, commodities, transactions and at affixed rate mostly proportionate to the amount on which the contribution is levied.⁴⁵

This definition as correctly observed and tells very little apart from the fact that taxes are compulsory. As it appears to have three major weaknesses in content. First, it appears that the definition limits the purpose of taxation to the support of the government. This is not wholly true since taxes are known to be levied with the non revenue object such as the use of customs duties to protect domestic industry and the use of tax to discourage certain habits, for example, the heavy taxation on tobacco and cigarettes which is intended also to discourage smoking. Second, the definition gives an irrelevant description of the tax base that the tax is levied on a person's, property, income etc.

Third, it gives undue emphasis on proportionate taxation. The tax can be exacted at progressive rates which are now considered the most appropriate in achieving vertical equity in taxation. Tiley⁴⁶ contends that not only that tax is compulsory, but they are also imposed by the legislature, levied by public body and that taxes are intended for public purposes.

In line with his reasoning on the concept of the term tax defines taxes to mean; Compulsory levies on private units for general governmental purpose.⁴⁷

⁴⁵Prof: Ghormade, V.(2013) Student Manual on International Tax Law Treaties Regulating Tax & Particularly to Avoid Double Taxation Problem, Vol II, Mzumbe University Morogoro, at Pg 33 .

⁴⁶Tiley. J, Revenue Law , 3rd Edition at pg 2

⁴⁷The *Encyclopaedia Britannica* Volume II, 15th edition at pg 584

2.2.2 Tax Exemption

Tax exemptions: refers to the incomes that are excluded from the tax base. For example, capital gains that are not subject to income tax would be considered as a tax exemption. Here, the exemption applies to a specific income (capital gains), but tax exemptions can also be granted to individuals, non-governmental organization and donor funded projects. In the common language the expression “tax exemptions” is often used as a substitute for “tax expenditures”, which is in fact a broader concept since it includes tax exemption and other types of tax expenditures.⁴⁸

Simply put a tax exemption is a loss of revenue for a government, and for a taxpayer it is a reduction in tax liability. One of the definitions used by the Organisation for Economic Cooperation and Development (OECD) is the one from Kraan⁴⁹ who describes tax exemption as:

“a transfer of public that is achieved by reducing tax obligations with respect to a benchmark tax, rather than by a direct expenditure” .

Most experts agree on such a definition, which refers to two important notions, i.e, the tax reduction for taxpayers (or a reduction of revenue for a government) and the deviation from a benchmark tax structure. Therefore, to identify and estimate tax exemption, it is necessary to establish a “benchmark” tax structure that applies the relevant tax rates to a broadly defined tax base – e.g. personal income, business or consumption. Tax exemptions are then defined as deviations from this benchmark. Significant differences of opinion exist about what should be considered as benchmark to tax system and hence about what should be considered in tax exemption.

Therefore Tax exception is to be free from, or not subject to, taxation by regulators or government entities. A tax exemption is a reduction or elimination of the taxes normally imposed on individuals and organisations by state and federal governments. Taking for example in order to be tax-exempt, an organization must meet certain criteria that are specifically defined by the United States Internal Revenue Code

⁴⁸www.UniversalDemandLaw.com 1975 Accessed on 22nd August, 2013.

⁴⁹<http://www.policyforum-tz.org/files/TANZANIAGOVERNANCEREVIEW200809.pdf> Accessed on may, 2013

(IRC). Many organisations which receive tax exemption under the IRC are charities, churches, and any other organisations which operate for tax-exempt purposes.

A tax exemption is usually provided to an organisation which is part of a sector of the economy which the government wants to promote economically. This is certainly the case, for example, with charitable organisations. The government wishes to reduce the tax burden on these types of organisations, based on the premise that doing so will encourage the economic activity of the tax-exempted organization. Tax exemptions can also serve the purpose of reducing the taxes borne by a particular segment of society in the interest of fairness.

Non-profit organisations are generally tax-exempted on a federal level in the Tanzania. These may include schools, churches, charities, labor unions, and even amateur sports leagues. For these organisations, their tax exemption depends on a number of factors, namely sources of income, their purpose, and their activities. The tax laws at the state level also provide tax exemption for many of these same organisations although the laws vary from place to place. Generally, they would be exempted from property taxes and state income taxes, as well as sales tax.

2.2.3 Donor Funded Project

Donor agencies have been heavily involved in promoting governance policies in Tanzania, in funding programmes and projects designed to improve public accountability, and in providing budget support for Tanzania's MKUKUTA. Critics⁵⁰ maintain that budget support which is financed over a third of the national budget in the review period undermines internal accountability processes. A critical view is that donors' support for non-state actors contradicts their commitment to respecting and using national accountability procedures. Compared to earlier periods, donors were not very critical of the GOT's governance performance during 2006-07, particularly regarding corruption control. For many years, critics have argued that poor

⁵⁰United Republic of Tanzania 2009b. Budget Speech of the Minister of Water and Irrigation, Dodoma, 1 July and United Republic of Tanzania 2009c. Poverty and Human Development Report 2009, Research and Analysis Working Group, MKUKUTA Monitoring System, Ministry of Finance and Economic Affairs.

governance undermines aid effectiveness. Aid helps finance budgets that could and should be financed locally if natural resources were properly valued, taxed and unwarranted tax exemptions are eliminated in order to increase the government revenue.

2.3 Tax exemption on donor funded project

Every year the Parliament of Tanzania carefully scrutinizes the Government's budget. Tax exemptions on the other hand do not receive the same attention in the Parliament, thus making them hidden expenditures. Tax exemptions involve very large sums of money. In 2009/10 alone, 2.3 percent of GDP or TZS 695 billion was granted in tax exemptions. The sheer size of the amount involved raises questions about whether the purpose of these incentives serve and whether the amounts spent on them are justified. In 2013, FOT approved funding for 11 projects for a total of \$25,576. These Regular funded projects were located in 8 different regions of Tanzania. In addition to the Regular funded projects, four FOT Member Sponsored projects were approved totaling \$29,852. Thus FOT and its members provided funds for 15 projects in 2013, with a grand total of \$55,428.

Tax exemption in donor founded projects aims to contribute to a debate on whether the current practice is desirable. The analysis is based on information contained in Revenue Reports obtained from the Tanzania Revenue Authority (TRA). It shows that Tanzania size of tax exemptions increased substantially in the second part of this decade (2006-2010). If tax exemptions were harmonised with what is practiced in Kenya (1 percent of GDP) the existing shortfall in tax revenue would have been avoided⁵¹. TRA grants twice as much in tax exemptions in Zanzibar as it does in Mainland Tanzania.

Tax exemptions benefit mainly multinational investors with certificates of incentives from the Tanzania Investment Centre (TIC) and Zanzibar Investment Promotion Authority (ZIPA). This shows that Tanzania tax exemption in donor funded project are granted more in order to promote projects which are donated by the donor countries.

⁵¹http://www.mof.go.tz/index.php?option=com_content&view=article&id=45:tax-exemptions&Itemid=111 Accessed on August 2013

2.3.1 Increase of the tax exemption on donor funded project

The Tanzania Revenue Authority report⁵² shows that between 2010/11 and 2012/13 the amount granted in tax exemptions declined from TZS 752 billion to TZS 695 billion. This shows the change in the amount of exemptions granted across different categories of recipients for the last two years. It shows that the largest reductions were related to imports and involved exemptions to companies with certificates of incentives from the TIC and ZIPA. This is followed by reductions in exemptions for NGOs, and private companies and individuals. At the same time, more import related tax exemptions were granted to donor funded projects.

In recent years, tax exemptions for donor-financed projects have come to the fore within the international community. Interest has increased because of the need to improve domestic resource mobilisation (DRM). This has become all the more necessary following a series of recent development crises which has led to a predictable decrease in the volume of aid as it decreased by 3 per cent in 2011. According to OECD statistics Public development aid (PDA) contributes up to 30 per cent of budget resources in many developing countries. The needs for this aids increasing as these countries fail to mobilise sufficient domestic resources. Apart from providing budget support, project aid is a significant component of PDA.⁵³

Donor-funded projects often enjoy tax exemptions in recipient countries. These exemptions take various forms and they are mainly for taxes like VAT⁵⁴, customs duties, excise duties, registration fees and what have you. The policy of most donors is that the funds they allocate as PDA should not be used to pay taxes in beneficiary countries. As a result, tax revenue is forgone in these countries. In some countries, the tax revenue forgone is estimated to represent about 20 per cent of donor funding and imports.⁵⁵

⁵² The (2010) Tanzania Revenue Authority report at pg 31

⁵³ First global international tax dialogue (ITD) Conference Rome March 2005 report at pg 129

⁵⁴ TRA, Fourth Corporate Plan 2013/14 - 2017/18, January 2014.

⁵⁵ International Tax Dialogue ITD Tax Treatment of Donor Financed Project. October 2006 Report at pg 17

2.3.2 Why Government grant tax exemptions on donor funded projects?

The main reason mentioned by governments of developing countries to grant tax exemption is the need to attract investment, and often foreign direct investment (FDI). The idea is for country and its population benefit from social and economic returns that are expected to be higher than the cost incurred to attract these investments. Proponents often argue that lower tax burdens give investors a higher net rate of return and therefore free up additional income for re-investment. The host country thus attracts increase FDI, raises its income and also benefits from the transfer of technology. A further argument is that it is imperative to provide incentives to investors so as to give the otherwise poor investment climate⁵⁶, the volatility in politics, dilapidated infrastructure, the high cost of doing business, the macroeconomic instability, corruption and an inefficient judiciary. Tax revenue losses are rationalised by arguing that the capital and jobs created improve the welfare of citizens and expand the economy.

In its most recent report, the OCAG considers that tax exemptions are necessary tool (sic) for investment promotion and economic growth. They are granted for various reasons such as social, economic, political reasons or international agreements (bilateral or multilateral). Often, tax exemptions are granted to stimulate economic development, for example, the tax exemption provided to mining companies and tax incentives provided to investors registered with the TIC.

The OECD⁵⁷ considers that if tax expenditure is enacted, it is because there are perceived legitimate reasons for their use. Tax expenditures have a role to play as they are employed widely and there are few if any, suggestions that all tax expenditure should be repealed. Assuming in the first instance that, there are valid reasons for government involvement, there are conditions under which tax expenditures are most likely to be successful or even the best policy tools to achieve their objectives.

⁵⁶http://www.tzdp.org.tz/fileadmin/documents/external/Aid_Effectiveness/PER_2012_-_2013/150_Inception_Report_PER_Study_Tanzania-2.pdf Accessed on August 2013

⁵⁷<http://www.policyforum-tz.org/files/TANZANIAGOVERNANCEREVIEW200809.pdf> Assessed on August 2013

Therefore there are reasons why tax exemptions can be granted in Tanzania as follows:

- When activities of certain organisations do not earn them a profit but have a direct benefit to society which the Government may not be able to otherwise procure (e.g., charities, NGOs, Donor-Funded Projects).
- When consumption of certain goods are deemed to have direct benefits to society (e.g, VAT exemptions on drugs, fire fighting vehicles).
- When the government wants to stimulate economic growth by increasing direct investments in the country. These exemptions should normally lead to increased investment, employment, output growth, and thus lead to more tax revenues in the long run. Groups of companies granted exemptions such as favorable corporation taxes on profits and reduced import duties fall under this category. Most notable among these are companies established under the Export processing Zones Authority (EPZA) Act, mining companies and other companies which hold certificates of incentives from TIC or Zanzibar Investment promotion Authority (ZIPA).

2.4 Why tax exemption in Tanzania

The Income Tax Act⁵⁸ provides tax exemptions for a variety of reasons. In Tanzania, exemptions may be given for the following reasons:⁵⁹

Where the foreign or official nature of the item in question does not warrant a tax, for example, consumption on internationally bound aircraft or goods consumed by the armed forces and diplomatic missions, they are normally tax exempted.

Where activities of certain organizations do not earn them any profit, but have a direct benefit to society which the Government may not be able to otherwise procure. This basis is used to grant exemptions to charities including religious organisations.

Where consumption of certain goods are deemed to have direct benefit to society, for example, certain human and veterinary medicines are exempt from VAT, as are

⁵⁸ Cap 299 R.E 2006

⁵⁹ Maliyamkono T, Mason H, Ndunguru A, Osoro N, Ryder A (2009) Why Pay Tax? At pg 141-142

firefighting vehicles. Exempting such goods from taxes, this increases their consumption, which in return brings greater benefits due to their positive effects on society.

Another reason for exemptions is granted to stimulate economic growth. These exemptions should normally lead to increased investment, employment, output growth and thus lead to more tax revenues in the long run. Groups of companies granted a wide range of exemptions are such as favourable corporation taxes on profits and reduced import duties fall under this category. Most notable among these are companies established under the Export Processing Zones Authority (EPZA) Act, mining companies and other companies which hold certificates of incentives from TIC and ZIPA

2.5 Position of tax exemption at international level

This part discusses tax exemptions applicable to international support projects. The benefits from discussions at the first global ITD⁶⁰ conference held in Rome, draws on work currently underway by participants in the ITD. It is intended to provide background information to the Committee of Experts on International Cooperation in Tax Matters and to stimulate further discussion. International assistance may be provided by governments, government-controlled agencies, international organisations, non-governmental organisations, and individuals. Assistance may be designed to facilitate development or reform which may respond to natural disasters or other humanitarian crises or it may advance other purposes. This is due to private charitable assistance raises its own set of issues and its focused on assistance provided by or on behalf of governments and international organisations (although some of the arguments are applicable to charitable assistance as well)⁶¹. Assistance may take the form of grants, as may be provided in kind or financed by concessional loans. The form in which the aid is provided typically does not affect

⁶⁰ The International Tax Dialogue (ITD),(2005) is an initiative by the IDB, IMF, OECD, World Bank, and UN to encourage and facilitate discussion of tax matters among national tax officials and international organizations. See www.itdweb.org Assessed on March 2014.

⁶¹ Ndunguru A., Manager, TRA, “Tax Incentives and Exemptions in Tanzania: Challenges for Tax Policy and Revenue Administration”, Presentation at ICTD Annual Meeting 12-13 December 2012, Institute for Security Studies, Cape Town.

the tax treatment. Exemptions for various transactions under international assistance projects apply in many countries often at the insistence of donors.

Tax exemptions relating to international aid are varied. Imports of goods may be exempt from custom duties, VAT, excises, and other indirect taxes. Goods or services procured locally may be exempt from VAT or sales tax. Income tax exemption may be extended to persons working under contracts. There may be exemptions from other taxes as well.

The legal instruments for providing exemption vary as well. In some cases, domestic tax laws set the conditions for exemption. In other cases, the terms for exemption are provided by treaties or other agreements entered into by recipient governments.

Exemptions are not always provided. The World Bank for example, has not sought exemptions; rather, the policy of the Bank has been that it would not use its loans to finance taxes.⁶² Recipient countries therefore have a choice as they can provide exemption for goods and services procured under Bank-financed projects or they can provide budgetary funds to pay for the portion of the project costs representing tax. On 13 April 2004, the World Bank changed its policy to allow financing of reasonable, non-discriminatory tax costs.⁶³ Going forward therefore recipient countries will not have to face the choice of providing exemptions for Bank-financed projects where their taxation system has been determined to be a reasonable one for the purposes of this policy⁶⁴.

Where exemptions are provided, the question arises as to which specific transactions qualify for exemption. As discussed below, exemption might be

⁶² General Conditions Applicable to Loan and Guarantee Agreements, sec. 5.08: “no proceeds of the Loan shall be withdrawn on account of payments for any taxes levied by, or in the territory of, the Borrower... on goods or services, or on the importation, manufacture, procurement or supply thereof.” (as in effect before April 13, 2004)

⁶³ See BP [Bank Procedure] 6.00 (April 2004); OP 6 (“The Bank may finance the reasonable costs of taxes and duties associated with project expenditures.”)

⁶⁴ <http://www.theeastafrikan.co.ke/news/Tanzania-starts-review-of-all-tax-exemptions/-/2558/2198046/-/11lh8t8z/-/index.html> Assessed on March 2014

granted by the general domestic tax rules or by general rules of double tax treaties or by specific exemptions in domestic law directed to international assistance or by bilateral agreement.

2.6 Position of tax exception in East Africa

Customs duty, import duty and VAT are among the most contentious and difficult tax issues faced by Non Profitable Organisation's in practice. Even if the law of a particular country provides for exemption for public benefit organisations from both, custom duties and VAT on imports related to the organisations, public benefits purposes, customs officials often disregard the law and public benefit organisations must often spend a disproportionate amount of time dealing with customs officers to actually receive the benefit of their exemptions.⁶⁵ At the same time, it is understandable that tax officials are cautious for allowing customs and import VAT exemptions for organisations benefiting the public. Sometimes it attracts charlatans and crooks into the Non Profitable Organization's sector with the prime motive of using a fake NPO⁶⁶. The purpose is to obtain exemptions on the import of certain goods.

2.7 Conclusion

- The practice of tax exemption seems to take new face from time to time this was due to the technological development in the world as well as in Tanzania. The researcher has observed that tax exemption is so wider compared to the laws which provide for tax exemption and seems to have many problems and challenges which affect the implementation of such practice in Tanzania.
- Apart from problems, there are also a number of crimes associated with tax exemption which can be happen at any time. It is the responsibility of TRA to insure the implementation of tax exemption in tax system are more effective in which it consider the problems, risks and challenges which exist when they are dealing with tax exemption in Tanzania, either by enacting laws, policy as well as

⁶⁵<http://www.ipppmedia.com/frontend/?l=53459> Assessed on March 2014

⁶⁶Ibid

electronic tax laws so as to counter those problems which arise during tax exemption.

As mentioned above, the policy of donors is that the funds they allocate via PDA should not be used to pay taxes in recipient countries. From this perspective, granting tax exemptions to donor-funded projects is less of a political choice for recipient countries and more a conditionality of aid. Of course, these exemptions can be considered as contributing to the public good. However despite their economic and social benefits, they cause significant tax revenue to be forgone in beneficiary countries.

CHAPTER THREE
LAWS GOVERNING TAX EXEMPTION ON DONOR FUNDED PROJECTS
IN TANZANIA

3.0 Introduction

Donors Funded Projects are benefiting from various countries including Tanzania. Projects involving development, humanitarian, and other assistance provided by governments or public international organisations often enjoy tax exemptions. Exemptions may apply to imports and procurement of goods, services and may extend to both direct and indirect taxes (including custom duties). Discussions among donors and recipients have identified problems with current practice. These, together with reduced tax rates and improvements in governance in many potential recipient countries, have led to a review of policy in some instances. This note summarises the issues and proposes steps that could be considered both by donors and by countries that are recipients of assistance. It argues that there is considerable merit in the emerging movement toward a presumption of subjecting foreign project assistance to tax under the general tax regimes applicable in recipient countries. This is a particular case in developing guidelines toward a coordinated approach of this kind that countries would be free to adopt⁶⁷.

Generally, Tanzania's Government strives for a tax system which is broad based with as few exemptions as possible. However, exemptions are granted for a variety of reasons such as adhering to international norms for those with diplomatic status, removing tax burden from donor funded projects, respecting Government commitments in legal agreements and implementing certain policies such as support for NGOs or for certain economic sectors. Tax exemptions are listed in the schedules to the tax laws. These set out categories of exemptions and the relevant criteria for qualifying the exemptions. In addition, tax exemptions are granted through Government Notices signed by the Minister for Finance published in the Government

⁶⁷<http://www.theeastafrican.co.ke/news/Tanzania-starts-review-of-all-tax-exemptions/-/2558/2198046/-/11lh8t8z/-/index.html> Accessed on March 2014

Gazette. In this study the researcher deals with an analysis of the law in regard to tax exemption on donor funded projects in Tanzania. In view of the above, there are several arguments that can be made for reviewing tax exemptions for donor-funded projects in Tanzania under the law.

3.1 Position of tax exemption in Tanzania

Tanzania is among the countries with generous tax exemption regime covering a wide range of taxes, ranging from donor funded projects, tax holidays, asset expensing and VAT exonerations. Almost all tax exemptions are in the tax laws. However some exemptions entered to the tax laws after they were provided in the different laws. 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 Centre⁶⁸ provides for benefits which the investors can enjoy after being granted the certificate for investment. There are various statutes governing tax management in Tanzania. These are: Excise Management and Tariff Act,⁶⁹ Income Tax Act,⁷⁰ Tanzania Revenue Authority Act,⁷¹ Value Added Tax Act,⁷² The Income Tax Act,⁷³ The Tax Revenue Appeals Act⁷⁴.

3.1.1 The Tanzania Revenue Authority Act

According to this act in order for exemption to be granted, the act⁷⁵ gives power to the Board (TRA) and the minister to grant this immunity or waive where seen the exemption is needed as follows:

Section 14(1)⁷⁶ provide that, the board shall recommend to the minister criteria or factors by reference to which any exemption, mitigation, deferment or remission may be granted.

⁶⁸ Section 19 of The Tanzania Investment Act Cap 38 R.E 2002.

⁶⁹ CAP 147 Revised Edition of 2002

⁷⁰ CAP 299 Revised Edition 2006

⁷¹ CAP 299 Revised Edition 2006

⁷² Cap 148 Revised Edition 2006

⁷³ Cap 332 of the Revised Edition 2002

⁷⁴ CAP 408 of the R.E 2002

⁷⁵ Section 14 The Tanzania Revenue Authority Act R.E 2006

⁷⁶ *ibid*

Also the act provide that where the minister has declared some items to be exempted from tax liability must be published in the gazette and provide factors for such exemption as follows;

Section 14(2) The minister shall by order published in the Gazette, specify the criteria or factors recommended under subsection (1) and may from time to time amend such order

(3) the minister may by order published in the gazette exempt, mitigate, defer or remit any tax, duty or other levy on the grounds of public or interests subjects to the published criteria made in subsection (2).

(4)The board in the public interests refers back any exemption, mitigation, deferment or remission made with sufficient information relating to the matter.

Moreover the board has given power to receive the total amount of tax exemption from the commissioner general and during the exercise of their functions the powers of the board is limited as regarding to the procedure provided by the minister as follows

Section 14(5⁷⁷)The Commissioner-General shall, subject to this Act, regularly submit to the Board the total amount of tax remitted or foregone in respect of each of the criteria specified under subsection (2).

(6)Notwithstanding the provisions of any other written law, where a revenue law has conferred power of the revenue commissioner to refrain from assessing any person to tax or from recovering tax from him-

(a) the board shall, by order published in the Gazette, specify criteria by reference to which the power shall be exercised by the Revenue Commissioner;

(b) the board may, from time to time, by Notice published in the Gazette, determine the amount of tax beyond which a Revenue commissioner may not exercise his discretionary power of remission conferred on him by any law.

⁷⁷ The Tanzania Revenue Authority Act R.E 2006

(7) In the exercise of its functions under this Act, the board shall, subject to this restrictions, qualification and instructions regarding procedure as the minister may give in writing to the Board, have power-

(a) to consider applications for and grant remission or abandonment of tax amounts beyond the financial limits of the discretionary power of the relevant Revenue Commissioner

(b) to require a Revenue Commissioner to submit returns to the Board, at such intervals not exceeding three months, as the Board may direct, of the identity of the taxpayers, the reasons for the remission and the amount of tax remitted or abandoned by him.

Under these circumstances, it is obvious to say that the law gives more power to minister and the Board (TRA) to grant tax exemption where seen needed, but this created gap on where there are other sectors which enjoy more relief as donor funded project compared to other sectors as NGOs and individual projects. Though the Act provides for the tax exemption but with respect of the discussion in Parliament there are some amendments concerning tax exemption in general whereby they reduced tax exemption on these donor funded project⁷⁸.

3.1.2 The Income Tax Act

Moreover this act also provide for tax exemption in Tanzania whereby the minister has given more power to exempt any income from tax and the list under the second Schedule to enjoy and cease to enjoy this relief by publish in the gazette as follows⁷⁹

Section 10(1)⁸⁰ The Minister may, by order in the Gazette, provide-

(a) that any income or class of incomes accrued in or derived from the United Republic shall be exempted from tax to the extent specified in such order; or

(b) that any exemption under the Second Schedule shall cease to have effect either generally or to such extent as may be specified in such Order.

⁷⁸ Parliament budget Report 2014- 2015 at Dodoma

⁷⁹Section 10 of Income Tax Act R.E 2006

⁸⁰ *ibid*

(2)The minister may, order in the Gazette, amend, vary or replace the second Schedule

(3)Notwithstanding any law to the contrary, no exemption shall be provided from tax imposed by this Act and no Agreement shall be concluded that affects or purports to affect the application of this Act, except as provided for by this Act or by way of amendment to this Act.

Further more tax exemption provided under the second schedule⁸¹ whereby it provides the list of items to be excluded from tax liability. It means that the listed which can be found in this schedule are exempted from payment of tax and the minister has given power to make any amendment by remove any items from this list and the item which has been removed shall cease to enjoy tax exemption. Moreover the minister has power to add any items which he thinks it fit to be exempted from tax liability and the item which has been added to the list of the second schedule⁸²by the minister shall enjoy tax exemption.

Therefore the act provide more powers to the minister to exempt any items from tax liability by publish in the gazette and those under the second schedule to still enjoy the relief or cease to enjoy the relief.

3.1.3 The Tanzania Investment Act

As per the Tanzania Investment Act⁸³ provide for the tax relief whereby for the one who want to invest in Tanzania must possess the certificate of the incentive from the Tanzania investment centre for the purpose of been exempted for payment of tax. It means that Tanzania as other countries recognized tax exemption on the investment sectors as one of the incentives granted for the people who wishes to invest in the country. These incentives granted for the purpose of encourage more investment in the country.

⁸¹ The income tax Act, R.E 2006

⁸² *ibid*

⁸³ Section 19 of The Tanzania Investment Act (Cap 38) R.E 2002

Therefore for the projects which want to enjoy tax exemption in Tanzania must possess certificate of incentives from the Tanzania investment centre in order to be exempted from tax liability in Tanzania

3.1.4 Value Added Tax (VAT) act

As according to VAT⁸⁴ provides for the tax exemption of goods or services rendered to the persons or organisations if any as follows:

S.10.(1) A supply of goods or services is an exempt supply if it is of a description specified in the Second Schedule to this Act.

S 10(2) The VAT is not chargeable on an exempt supply, and deduction or credit of input tax is not allowable on purchases made in respect of the exempt supply

Also the Act⁸⁵ provides for special relief which a persons or organisation may be granted as prescribe in the third schedule of the Act, and its amendment of the schedule.

S.11. The persons and organisations listed in the Third Schedule to this

Act shall be entitled to relief from VAT within the limits and conditions prescribed in that Schedule subject to procedures which may be determined by the Minister.

S.12. The Minister may after consultation with the Authority by order published in the Gazette, amend, vary, add to or replace the Schedule to this Act.

Also under the Third schedule⁸⁶ provide for the organizations or persons which may be enjoyed tax exemption. It means that the listed organization and persons in this schedule are exempted from tax liability and the minister with consultation with the board shall amend either by removed any of the organization or persons from tax exemption list or add any organization or persons from tax exemption list.

⁸⁴ Section 10 VAT Act (cap 148 R.E 2002)

⁸⁵ Section 11 VAT Act (cap 148 R.E 2002)

⁸⁶ *ibid*

Therefore the act also provide for the goods or services which enjoys tax exemption on vat under the second schedule and the minister has given more power to exempt any goods or services from tax liability

In VAT⁸⁷, it has emerged rapidly to become one of the main modes of revenue raising worldwide, it is such an efficient means of extracting tax revenue in countries with good written or electronic records of economic transactions, VAT has facilitated trade liberalisation by replacing import and export taxes, and also it has contributed strongly to the steady increase in governments shares of rising national incomes. In the country like Tanzania, where governments have traditionally been especially dependent on revenue from trade taxes, the promotion of VAT has been even more closely tied to trade liberalisation, but still donor funded projects are exempted from VAT liability

In poorer and more agrarian environments where effective tax handles are relatively scarce governments find it easier to raise revenue by concentrating their tax collectors on customs posts at their borders. So many developing countries have fitted into the global division of labour as exporters of primary products. International trade has been the obvious place for their governments to gather revenue. In trade taxes, there was a very minor source of government revenue in high income countries, but it was significant in both middle and low-income countries. An important component of the global tax law reforms which led to the exemption of tax in donor funded project, backed by economists' denunciations of this tax bias against International trade⁸⁸. The reduction of trade taxes and an increasing emphasis on broad based consumption taxes such as the VAT on the low-income countries decreased about 45-60 per cent of the trade revenues because of the exemption granted to donor funded projects⁸⁹. The researcher observed that from Tanzania, Uganda and other countries in East and Southern Africa are economically poor because of the tax exemption granted to these donor projects. This is because once it granted it lower the revenue of the government.

⁸⁷ VAT Act (cap 148 R.E 2002)

⁸⁸ <http://www.policyforum-tz.org/sites/default/files/DonorMoneyinthebudget.pdf> Assessed on May 2014

⁸⁹ <http://www.mof.go.tz/mofdocs/AMP/Amp%20Monthly%20Report%20Jan%202012%20.pdf>

Assessed on May 2014

3.2 Critical analyses of the procedures on tax exception on donor funded projects

The law (legal authority) which applies in tax exemption in Tanzania are five schedule of EACCMA Item 5 and 6 exempt Import Duty, Government Notice number 197 & 200 of 2001, Exempt import Duty and Excise Duty, Item 10 of the Third Schedule to the VAT Act, 1997 as amended by 2013 Finance Act and Value Added Tax (VAT).

3.2.1 Procedures for tax exemption for Donors funded projects

In countries around world, the tax rules and preferences that apply to Non Profitable Organization's and their donors are generally applied by the tax authorities. There may be different authorities to handle different taxes, such as the income tax, VAT, custom duties, and real property taxes. In many countries, each tax authority develops its own rules and procedures and it may define basic terms, such as "public benefit organization," differently. In many developed countries with sophisticated tax systems and large NPO sectors, there may be separate forms, rules, and procedures for NPOs, tailored to the unique characteristics of various kinds of NPOs.⁸⁷ For example; there may be special rules for public benefit organizations, which are treated more favorably than other NPOs. Some countries have developed separate accounting rules and standards for NPOs, and some tax authorities have separate units to deal with NPOs.

In many countries, however, NPOs must file and report using the forms and procedures designed for business entities, and tax officials with little understanding of, or sympathy with, NPOs often apply the tax rules to them. Like other laws, tax laws are no better than they way they are administered, and in most countries much work needs to be done to make the rules, procedures, and forms that apply to NPOs suitable to their special characteristics and to ensure that the rules and procedures are applied effectively and fairly⁹⁰.

⁹⁰http://www.mof.go.tz/mofdocs/budget/Citizens%20Budget/CITIZEN_ENGLISH_2011_12_FINAL.pdf Assessed on May 2014

3.2.2 Procedure of processing exemption for imported Goods

- i. Importer is required to apply for exemption approval letter to the Commissioner for Customs and Excise attaching along with their application letter, an original Confirmation letter from District Commissioner,
- ii. Copies of importation documents,
- iii. a copy of Certificate of Registration issued by the Ministry of Home Affairs,
- iv. And a copy of TIN certificate. It takes one working days to get a letter of exemption approved by the Commissioner for Customs and Excise.
- v. The applicant after receiving a letter of exemption from the Commissioner for Customs will be required to declare his/her imported goods to Customs through a Licensed Customs agent.
- vi. Customs will process such declaration and issue assessment notice, assessment notice will be dispatched to the Treasury for a treasury checkup
- vii. Upon receiving Treasury cheque, Customs will issue a release order to the importer to allow him take delivery of the goods from the port
- viii. If goods have been properly declared, currently it is an average of five days from lodgment to release of goods.

3.2.3 Procedure of processing exemption for domestic supplies

- i. The applicant will approach the Domestic Revenue Tax Region where such organisation operates and submits documents as listed in the check list (item 7 of this presentation) for approving exemption together with an Invoice, a Treasury Voucher will be prepared and sent to the Treasury for a Treasury Cheque⁹¹
- ii. Upon receiving Treasury Cheque, the applicant will be requested to complete form VAT 223/224
- iii. Upon approval of VAT form 223/224 the applicant will proceed to his supplier to take his VAT free goods.
- iv. VAT Form 223/224 is approved within 24 hours.

⁹¹ VAT Act, R.E 2002

3.3 General observation of the Law on Tax exemption on Donor funded projects

It is true that in recent years, tax exemptions for donor-financed projects have come to the fore within the international community. Interest has increased because of the need to improve domestic resource mobilisation (DRM). This has become all the more necessary following a series of recent development crises, which led to a predictable decrease in the volume of aid (it decreased by 3 per cent in 2011, according to OECD statistics)⁹² as for the table below

Donor funded projects often enjoy tax exemptions in recipient countries. These exemptions take various forms and they are mainly for taxes like VAT, custom duties, excise duties, registration fees, the list may continue for some time. The policy of most donors is that the funds they allocate as PDA should not be used to pay taxes in beneficiary countries. As a result, tax revenue is forgone in these countries. In some countries, the tax revenue forgone is estimated to represent about 20 per cent of donor funding and/or imports.

From the tax law perspective, the following problems arise from tax exemptions in general, and those granted to Donor funded projects in particular: that the procedures are very complicated system, this may cause important risks of tax fraud (deviation of destination), especially with respect to VAT; restrictions on the right to refunds affecting the neutrality of the VAT and in view of the above, there are several arguments that can be made for reviewing tax exemptions for Donor funded projects.

3.4 Conclusion

Therefore it has been observed that the tax legal framework is not relevant to address all issues related to tax exemption on donor funded projects. Besides all, the minister is given more power to exempt a certain group or items to enjoy this tax exemption. Also the Board (TRA) is given power to grant the relief where necessary. There should be taken into account that the law be amended so as to meet the requirement

⁹²See more at: <http://www.ictd.ac/en/tax-exemptions-aid-funded-projects-reasons-change#sthash.da7Cs4UV.dpuf> Assessed on May 2014

for tax exemption and reduce more power to the minister and the board (TRA) whereby there should be more than one board which deal with the tax laws.

However this chapter has shown the critical of the laws governing tax exemption on donor funded projects in Tanzania the researcher has observed that there are legal challenges in tax system including the administer of the tax in Tanzania, hence; it estimates the tax revenue of the government.

Thought the act provide for tax exemption but according to the discussion in parliament whereby they reduce tax exemption on donor funded projects in Tanzania. Therefore these projects will not enjoy the full tax exemption like it was before.

CHAPTER FOUR

RESEARCH FINDINGS AND DATA ANALYSIS

4.0 Introduction

This chapter provides a comprehensive data interpretation and analysis of the findings in response to the information available in the discussion of the findings. Information retrieved from the research findings categorically was the basis of explanation and exploration of meaning. An attempt has also been made in this section to relate the validity of the information and responses for each research question to the practical situation as it seems now in general. This study is about the effectiveness of the law governing tax exemption on donor funded project in Tanzania. The findings in this study reflect the research questions that this study attempts to answer.

In this chapter, the researcher presents the data collected from TRA as the institution dealt with tax system and two donor funded projects in Dar es salaam. The categories of respondents in the study included: 5 lawyers from TRA who were in legal section on matters relating to laws governing tax system, 10 officers from Human resources department who dealt with collection of tax as government revenue, 7 operation Managers who dealt with operation tax system in Tanzania and 5 accountants who dealt with taxes collected as the government revenue and 6 officers from ICT who made a total of 33 respondents.

Also, data were collected from interview involved the target group from TRA as the 1 legal officer, 1 TRA manager who is an Operation Manager who deals with matters concerning taxation and 2 officers from two donor funded projects which made a total of 4 respondents.

4.1 Responses from lawyers on tax exemption on donor funded projects

Five questionnaires were distributed to lawyers working in TRA as the institution dealt with tax system in Tanzania, all of the questionnaires returned representing the rate of (100%). With regard to the question on whether there were laws governing tax exemption in Tanzania, the response was 100% affirmative.

As to the question whether the laws were effective to then situation in relation to tax exemption on donor funded projects the response was negative. In answering this question the respondents describe that the laws governing tax exemption were wider because they provided more powers to the minister and the Board of the TRA to exempt or cease to exempt certain groups or items in tax payment. In respect with the donor funded projects, they enjoyed more tax exemption compared to other projects in Tanzania hence it created the wide gap.

Multilateral and bilateral aid agencies provided large-scale financial and technical assistance support for governance programmes and projects in Tanzania. These projects which were funded by donor countries were exempted from payment of tax and hence this situation was stipulated as tax incentives⁹³

With regard to the question on whether there are problems facing tax exemption in Tanzania, the answer was affirmative by 3 respondents which representing (80%) and 2 respondent were negative which representing (20%) on the ground that in theory, donor funded projects frees up government resources that can then be used to finance other projects⁹⁴. But, in practice, it supplements government investments and it does not help achieve balanced budgets. From the tax (administration and policy) perspective, the following problems arise from tax exemptions in general, and those granted to donor-funded projects in particular: more complex tax systems; additional management costs both for tax payers and tax administrations; important risks of tax fraud (deviation of destination), especially with respect to VAT and the restrictions on the right to refunds affecting the neutrality of VAT. According to REPOA, there is no indication that foreign assistance has declined in the two years of 2011/12 and 2012/13.

⁹³ Tanzania investment Act (Cap 38) R.E 2002.

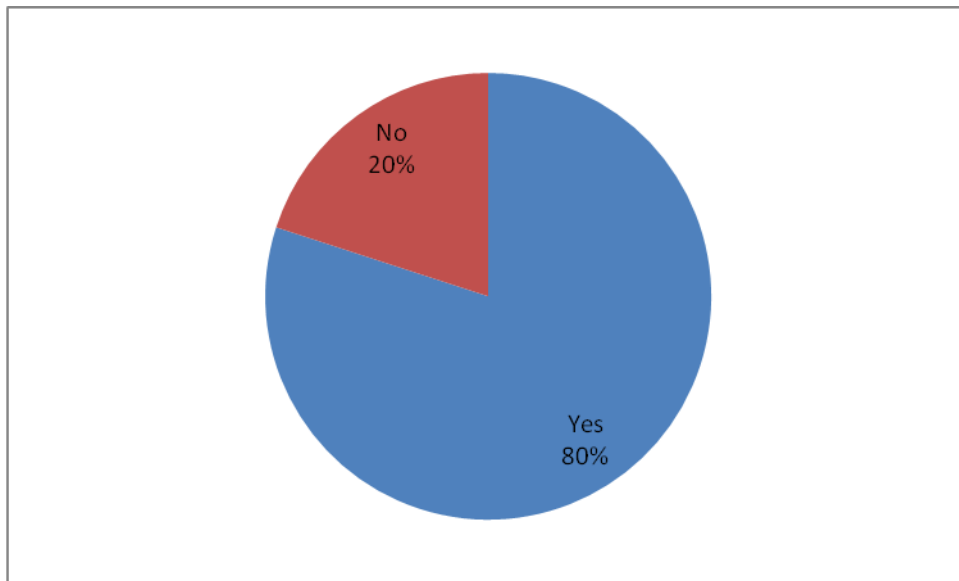
⁹⁴ As a lawyer how do you find the problem facing tax exemption in relation to promoting the economic growth of the Tanzania

Therefore there is a need for the laws to be amended, so as to cater for the linkage gap between the donor funded projects with other domestic projects which are not funded by donors in order to get more government revenue for government expenditures.

Table 4.1 whether there are problems facing tax exemption in Tanzania in relation to the economic growth in Tanzania

Response	No of respondents	percentage
YES	3	80
NO	2	20
TOTAL	5	100

Figure 4.1: Problems of Tax Exemption



Source: Field findings

4.2 Response from ICT Managers

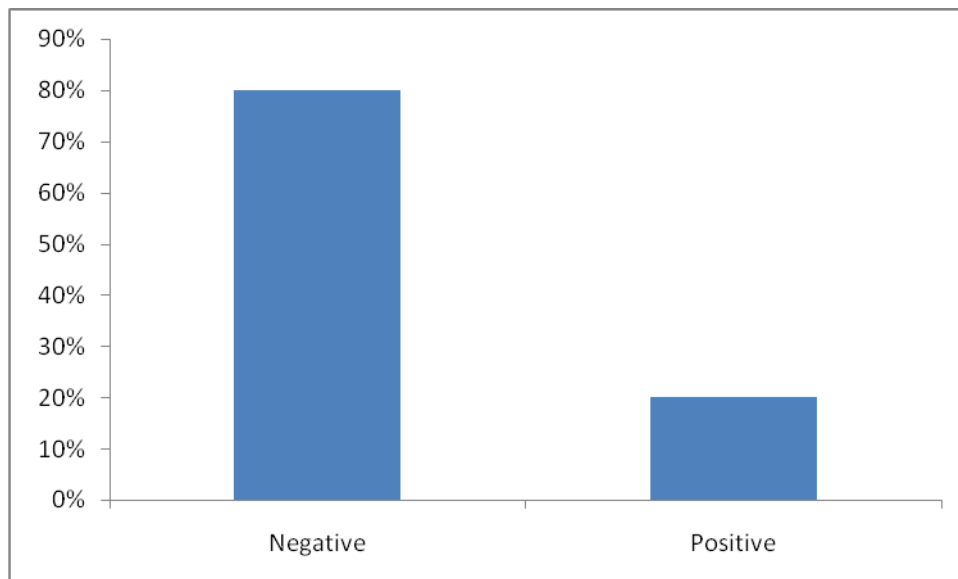
With respect to responses from ICT Managers who worked at the TRA, 6 questionnaires were issued to them representing the response rate of 100%.the question required the respondents to say whether the law need reviewable concerning tax exemption on donor funded projects as incentives granted to projects. The response was affirmative from 7 (70%) respondents; 3 responses (30%) were negative. On the question whether the laws were relevant to ICT the response was negative by 6 responses which represent the rate of (80%) and 2 responses were positive which represents (20%). And in their explanations they commented that, this had happened

due to lack of Tax policy and laws, so it was hard to handle cases concerning tax exemption and the minister was given power to exempt any items or a person from paying tax. Also this became a problem due to there were some projects which were useful to the society but they did not get these incentives; hence, it created bias to these projects.

Table 4.2 whether the law is effective concerning tax exemption. If this law is to be reviewed, what are sensitive areas which need serious re-examination which in turn may help improve economic growth in Tanzania?

Response	No of respondents	Percentage
NEGATIVE	6	80
POSITIVE	2	20
TOTAL	8	100

Figure 4.2: Relevance of the Tax Laws in relation to tax exemption



Source: Field findings, 2014

4.3 Responses from Human Resources officers on tax exemption

These were respondents who dealt with tax system who also identified customized taxable items in Tanzania. It means all taxable items in Tanzania were subjected to this department for tax liability.. With regard to the question whether there were weakness facing donors on tax exemption when dealing with resources on tax system

in Tanzania. The answer was positive on the ground the tax systems provided an avenue for good tax system administration which prompted people to pay. But more taxes were taxed from individual projects compared to donor funded projects. Hence the resources which were allocated to donor funded projects were generally exempted from tax liability.

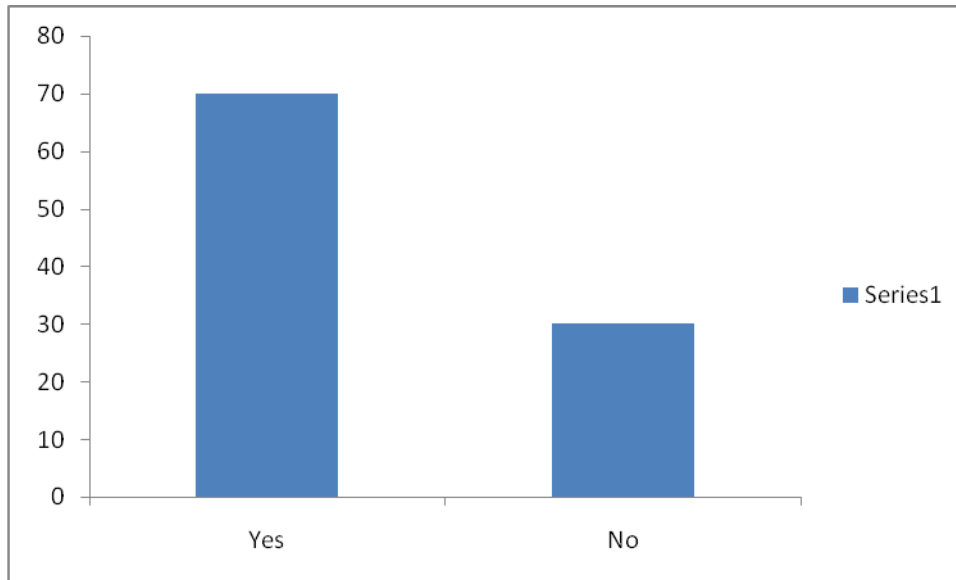
As noted above, much of the early efforts focused on the development of progressive personal income tax system⁹⁵ Progressive income taxation became the major tax base as initially anticipated. Personal income tax accounts for less than 10% of all tax revenue in most low-income countries compared to an average of more than 25% in OECD-countries. It comes almost entirely from wage withholding (pay-as-you-earn) tax on public sector and large enterprises employees. Commonly, less than 5% of the population pays personal income tax compared to nearly 50% in developed countries.

Table4.3 whether there are weakness facing donors on tax exemption

Response	No of respondents	Percentage
YES	3	70
NO	2	30
TOTAL	5	100

⁹⁵ Income tax Act (cap 332, R.E 2006)

Figure 4.3: Weaknesses facing tax exemption on donor funded projects



Source: Field Findings

In International Tax Compact categorizes, donor support to taxation and development into four broad working areas;

- i. Tax policy and reform e.g. different types of taxes, tax systems reform, simplification of tax structures
- ii. Tax administration and organisational reform e.g. integration and establishment of revenue authorities, institutional efficiency, large taxpayer units.
- iii. Tax law e.g. legislation, procedural law.
- iv. Tax procedure e.g. auditing, enforcement, automation.

4.4 Responses from Accountants

On the part of TRA, 5 questionnaires were distributed to the accountant. A total number of 5 questionnaires were returned representing a response rate of (100%). With regard to question concerning whether there were laws which governed tax exemption on donor funded projects, the answer was affirmative by (100%).

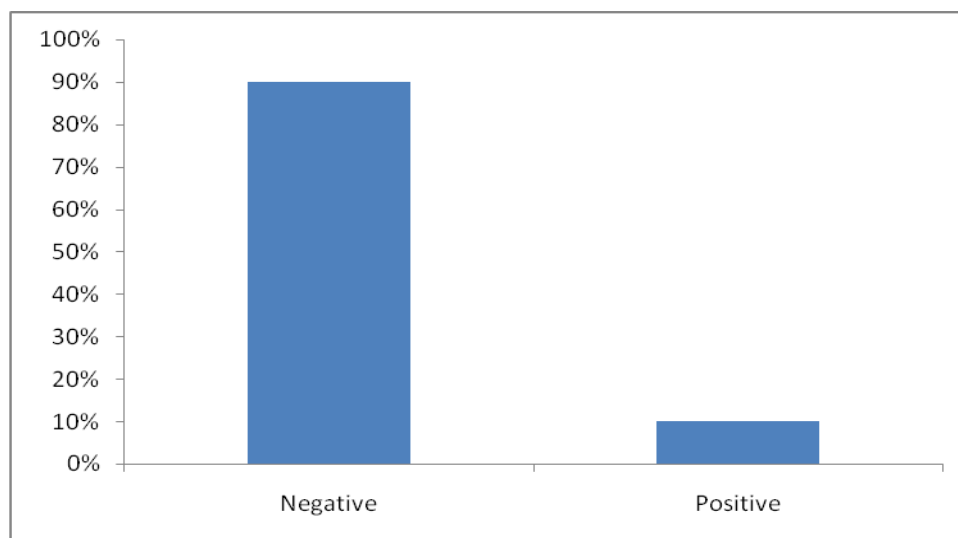
In the question on whether the laws were effective with regard to matters relating to tax exemption on donor funded projects, the answer was negative by 3 responses which represent (90%) and 2 responses were affirmative which represents (10%) which explained to the researcher that, the laws were too general because they

provided the powers to the minister to exempt any items or a person from the liability of paying tax. Also the law did not specify to what extent did this donor funded projects enjoy this relief; hence, the donor funded projects were full exempted from tax liability; otherwise they were specified by the minister for finance or the board (TRA).

Table 4.4 whether there are laws governing tax exemption on donor funded project are efficient

Response	No of respondents	percentage
Negative	3	90
Positive	1	10
Total	4	100

Figure 4.4: Laws Governing Tax Exemption on donor funded project



Source: Field findings 2014

Also they complained that donors were far too ready to praise signs of improved governance and far too reluctant to punish poor governance by the GOT. In the absence of convictions of major personalities and the massive restoration of stolen wealth, donors could only note arrests and on-going cases while frequently lamenting the lack of closure. It was clear that the GOT was not seriously pursuing the good governance prescriptions of the aid agencies, but merely paying lip service to them in order to assure uninterrupted aid flows until the next crisis of donor confidence.

4.5 Responses from Operation Managers

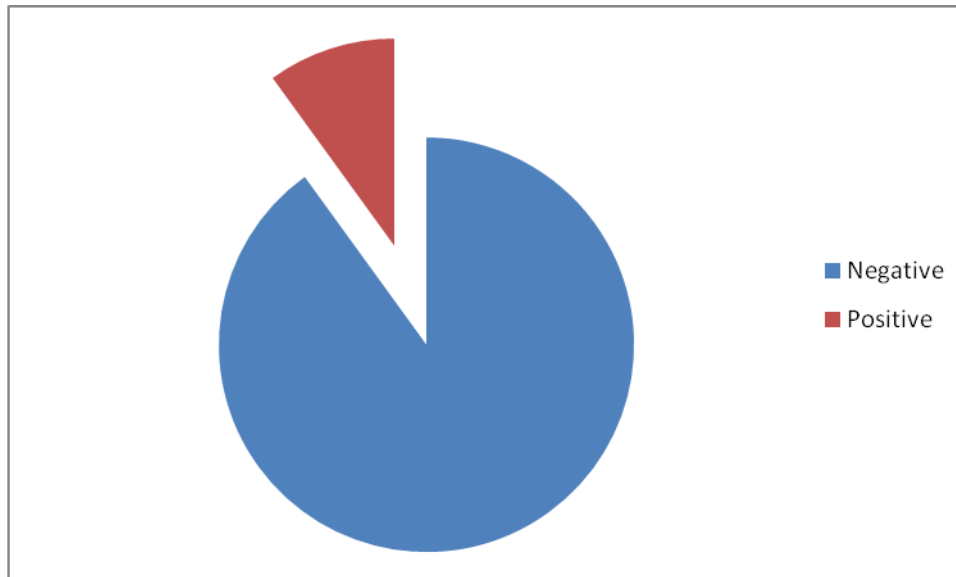
With respect to responses from operation managers, 7 questionnaires were distributed equals to (100%). In the first question on whether there was a policy or laws which governed tax system in Tanzania. Seven response equals to (100%) were positive. With regard to the question whether there were problems faced their office in providing services, the answer was positive which represent (100%) in total.

On the question whether the laws were effective to encounter the problem associated with tax system, especially when solving tax exemption problems, the response was negative. This is because 5 responses representing (90%) and 2 responses were affirmative represents (10%) whereby they explain that most of cases concerning tax exemption were acquitted because the one who paid tax was the one to prove the allegation on whether he avoided from paying tax and he would be liable from tax liability. And whether there was tax cases concerning tax matters. It was revealed that the law provided for the room to determine the case in favour of the tax payer. Hence the laws were not effective because it did not provide for the procedure to follow when dealing with tax exemption cases.

Table 4.5 laws with regard to the tax exemption cases

Response	No of respondents	percentage
Negative	5	90
Positive	2	10
Total	7	100

Figure 4.5: Cases concerned Tax Exemption



Source: Field findings 2014

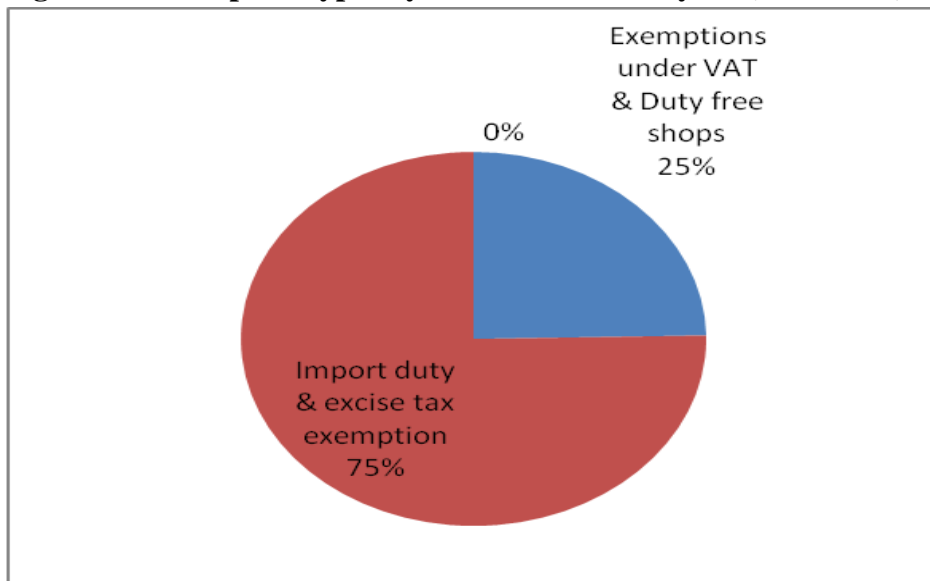
4.6 Data collected by Interviews

The interview method of gathering data was also used to collect information from the 1 legal officer, 1 TRA manager, as an Operation Manager in tax machineries sections who responded on behalf of their office and on behalf of the service, they provided in their offices and 2 officers from two different donor funded projects.

The senior legal officer was the one who responded on behalf of his office. Responding to the question regarding whether the laws were effective on matters relating to tax exemption on donor funded projects; he replied that the laws were not effective to tax exemption.

He stated that there were different laws in tax exemption that were to be amended so as to reflect the tax system in Tanzania. He was of the view that the prosecution was difficulties when there was a case concerning tax system because whenever there was a tax case then it had to be concluded in favour of the taxpayer.

Figure 4.6 Exemption types by share in the last 1 year (2012-2013)



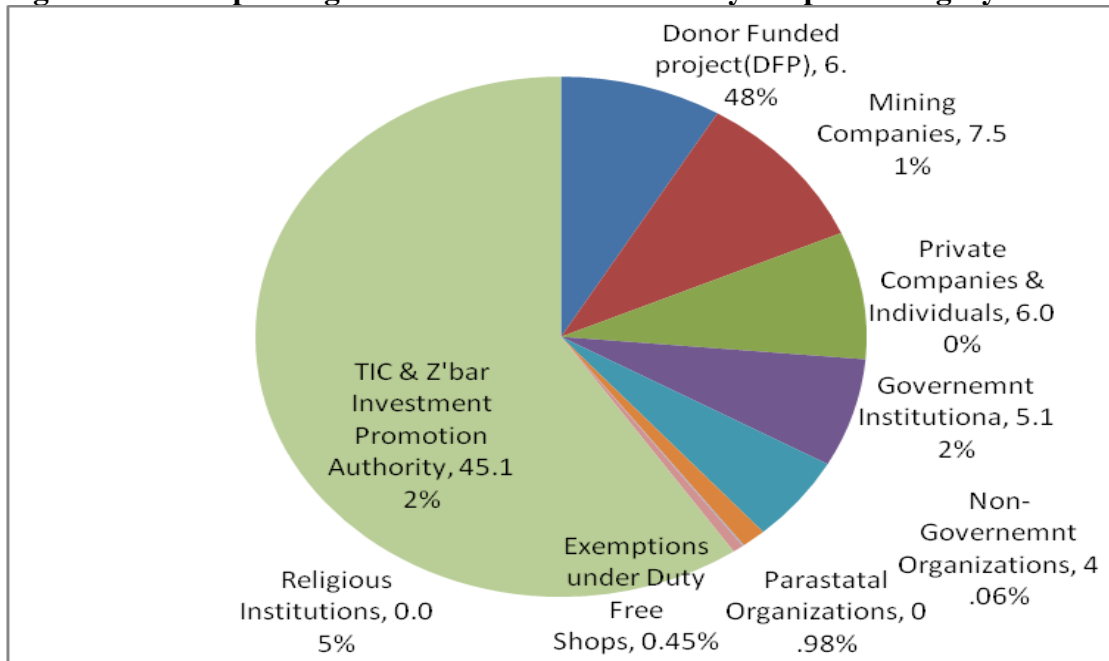
Source of data: Tanzania Revenue Authority revenue reports

According to TRA manager who is an operation manager, in responding whether the laws were effective in relation to tax exemption, they said that, laws provided for more tax relief in donor funded projects arising VAT likely to be less regressive than the trade and excise taxes it has replaced and in some developing countries it may be as progressive as the income tax would also contribute to widening the revenue base and simplifying the tax system. It might further improve both budgetary transparency and resource allocation by fully accounting for public investment costs. Thus, a step forward would be to abolish exemptions granted to donor projects and programs.

Also on donor support laws largely focused on the national tax systems. Due to the overall fiscal constraints, the reform of the laws of the sub-national tax system has not been a priority over the mobilization of central government revenues. Local government tax systems in many low-income countries, especially in Tanzania.

A widely found characteristic of local government revenue systems in Africa is the huge number of revenue instruments in use. They are often distortive, costly to administer, exacerbate inequity, have an inhibiting effect on the start-up of new enterprises and the achievement of economic growth. Moreover, there is little or no co-ordination with respect to taxation between various levels of government.

Figure 4:7 Exemptions granted in 2010 /11-2012/13 by recipient category



Source Tanzania Revenue Authority Report

Also the researcher obtained data through interview on two different projects which were funded by donors as follows:

In the **Tanzania Energy Development and Access Expansion Project (TEDAP) at Dar es salaam** which deals with energy one of the plant officer stated that, this project aim to improving the availability and reliability of the system components of the network and substations as well as reduction of technical and non technical losses in the distribution networks. The project is funded by donor (World bank) whereby it is useful to the people of Tanzania after the poor performance of TANESCO for the poor services. The project aim to insure quality services of electricity to the people in Tanzania. The projects enjoy tax exemption because it is useful to the people of Tanzania at large.

Moreover another project known as **Independent Power Tanzania Limited project (IPTL), Dar es salaam** which deals with gas one of the officer stated that, the project is for power plant conversion whereby it aim to provide power known as gas for the purpose of domestic use for the people of Tanzania. The project enjoys tax exemption

because it is useful to the society. The law recognized tax exemption on different items but it also provides exemption on donor funded projects because the projects are profitable to the society. Also it is one way of attraction of investors when they come to invest in Tanzania.

Hence through this two projects which were funded by donors enjoyed tax exemption because they are useful, profitable to the society and it is for the attraction of investors to enhance the flow of investors in Tanzania, but the government forgone that if these projects were taxed the government revenue would be improved on increase, thus resulting in provision of quality services to citizens.

4.7 General Observation

This study therefore has observed that the present laws are inadequate to cover tax exemption in the tax system. Time has come to formulate and introduce the new system of laws which reflect tax administration, design which will help to increase government revenue through getting rid of tax relief which is enjoyed by the donor funded projects.

Also, from this study it is observed that, there are legal challenges in tax exemption in Tanzania. For instance, the law itself which provides for more power to the minister to exempt the items or person from the payment of tax. The government is advised to concentrate on establishing simple, predictable and neutral tax systems that will not discourage private enterprise and minimize interference with market signals⁹⁶.

Specific tax policy changes associated with these reforms have included;

- Simplification of tax structures and procedures
- The elimination of export taxes
- Reduced tariffs and less reliance on trade taxes
- A dual income tax system with a simplified progressive tax on labour and a simple, often flat, and fairly low corporate tax
- Expanded reliance on goods and services taxes, in particular the VAT.

⁹⁶ The Tanzania Revenue Authority Act (cap 399 of R.E 2002)

Hence this will help the government to introduce good tax administration and encourage tax payer to voluntary contribute tax in the society. But if still tax exemption is granted more to these donor funded projects it will create bias to the society and hence the failure of good tax system in Tanzania.

Moreover tax as a major challenge for building effective, transparent and accountable tax systems are the current tax policies in relation to exemptions and tax incentives. Generally tax exemption is one of the incentives which are offered in Tanzania especially in donor funded projects. Generous investment incentives to specific companies, institutions and sectors which are funded by donor countries lead to large revenue losses and distorted competition. According to the OECD, tax incentives tend to reduce government revenues by 1-2 per cent of GDP. However, this figure is probably at the lower end. A recent study on Tanzania suggests that exemptions and tax incentives could account for up to 6 per cent of GDP⁹⁷.

In making reference to the IMF, OECD, UN and the World Bank (2011) reaches the same conclusion where governance is poor, corporate income tax exemptions may do little to attract investment and when they do this it may well be at the expense of domestic investment. In that regard, the IMF, OECD and other multilateral agencies have engaged in the policy dialogue on tax exemptions in developing countries, few bilateral agencies are involved and this is because they are benefitting from the current exemption regime.

Generally, transactions associated with foreign development assistance are exempted in the payment of tax and hence this is due to their support to the government. Poor countries are often forced to administer a myriad of exemptions that typically vary from donor countries in order for them to fund their projects. This places unnecessary burdens on already weak tax administration. Even worse, it fuels a tax-exemption culture and promotes corruption. The removal of tax exemptions granted to aid agencies and their employees would help boost the credibility of both the government and of donors in relation to building taxpaying cultures.

⁹⁷ Tanzania Revenue Authority Report of 2012

4.8 Conclusion

This chapter has shown various categories of respondents, based on items which were asked to them and their responses. However, the legal officers are in hard time since they apply tax laws which are not effective and efficient to cater for the problems of tax exemption in tax system. The laws are too general and provide more powers to the minister and the board (TRA) to exempt any items or person from payment of the tax. Also the procedures to be followed when dealing with tax cases are too complicated because the areas (tax system) are too technical and broader.

The general observation is that there are challenges in the legal framework in Tanzania especially in tax exemptions. The researcher has made analysis to different respondents and observed that many criticisms are from the legal framework concerning the tax system, the laws which govern tax system in Tanzania and the policy. Also the law provides the room for the tax exemption but also this room can be used as the loopholes for the tax evasion to some projects.

Hence there is a need to amend the laws concerning tax exemption in order to avoid these loopholes, reduce more powers to the minister and the board (TRA) and remove the bias between the projects so as to have good taxation system to increase the government revenue.

CHAPTER FIVE

CONCLUSION AND RECOMMENDATION

5.0 Introduction

Tanzania is among other countries which gain revenue from taxation by collecting the taxes from various sources of incomes, and she faces many problems in administering tax. Tax laws in Tanzania are not effective to cater for the all system of taxation in Tanzania.

So, this research examined critically the effectiveness of the laws governing tax exemption in donor funded projects in Tanzania. The researcher in this study examined the current situation on the laws governing taxation and its relevancy to collection of tax.

However, in this chapter the researcher concluded that what has been discussed in the study as well as to recommend better ways so as to counter the problem of laws governing tax exemption on donor funded projects.

5.1 Conclusion

There is a considerable merit in the emerging movement towards tax projects assistance activities to the donor. Thus a strong case for developing guidelines towards a coordinated approach that the system of tax should be reflect by the law governing tax exemption in donor funded projects.

Each donor country is of course free to establish the conditions under which she is willing to provide International assistance. There is no doubt that there will be tax exemption. Tax exemption is a growing practice today. Where there is sufficient confidence in governance structures in recipient countries not least in relation to public expenditure management countries and International organizations providing aid should be encouraged not to insist on exemption from tax for transactions relating to aid projects. This is except for areas where the rules in the

recipient country to tax aid-related transactions fail to comply with internationally accepted guidelines or they are considered to result in excessive taxation.

In recipient countries should be encouraged to strengthen their public expenditure management systems and review their tax/tariff structures so as to provide donors with the assurance that they will need that any taxes paid on aid will be in reasonable amount and efficiently used.

While donors will naturally differ in their concerns and priorities, there may be potentially considerable benefits in moving towards a presumption of taxation on the basis of internationally agreed concepts, criteria, and practices. Without this, recipients may find themselves with a new set of burdensome complexities to deal with.

Guidelines should be developed more fully so as to facilitate the dialogue among aid donors and recipient countries. These guidelines should be developed with the participation of donor and recipient countries. One option is for the ITD to establish a working group that would allow these stakeholders to participate in the development of such guidelines.

Countries and International organisations providing international assistance should be encouraged to share with each other and with recipient countries, analyses of the reasonableness of tax rules for the taxation system of aid-project-related transactions by recipient countries.

In cases where tax exemption for aid-related transactions is contemplated that, countries are encouraged to use mechanisms that minimise administrative burdens and reduce fraud. Examples are direct payment by government (though ensuring payment can be problematic), use of refund schemes in the case of VAT (though establishing proper control of VAT refunds as a continuing challenge in many developing countries) the use of vouchers (though such schemes also have their difficulties, as noted earlier). While some form of control is clearly advisable, all of the options have serious difficulties.

In cases where tax exemption for aid-related transactions is contemplated, the parties are encouraged to use legal instruments that support the rule of law in recipient countries by:

- Making sure that exemption is provided by law or, if provided under agreements, that the agreements are authorized by law;
- Identifying with specificity the transactions benefiting from exemption, the applicable taxes, and the conditions for benefiting from exemption.

To provide the transparency and information needed for policy making and public discussion, aid recipients should be encouraged to prepare and publish tax expenditure analyses indicating the tax forgone as a consequence of exemptions granted on foreign assistance.

Additionally, donors negotiating agreements for exemption could take a flexible approach agreeing to taxation of those kinds of transactions where fraud and administrative expenses are likely to be particularly high. There is no reason, in other words, why exemption needs to be extended on a blanket basis. It can be tailored to minimize problems of administration of taxation.

This note has focused on the treatment of project aid provided by governmental agencies. Many of the same economic and practical concerns also arise in relation to the provision by NGOs and private foundations. Indeed, difficulties may be created by extending different tax treatment to support from such sources. All these points support the presumption in favour of levying tax. The private organizations are treated differently, that is to say, they do not enjoy the tax exemption legislation.

5.2 Recommendation

We have seen a change in donor policy for some years now. For example, on 13 April 2004, the World Bank allowed financing of reasonable, non-discriminatory tax costs.⁹⁸ The main arguments for this are the rationalisation of tax systems in recipient countries, and the search for greater coherence in aid policy management.

With respect to rationalisation, problems derive from providing tax exemptions to donor-funded projects. Removing them could help to make tax systems simple, reduce management costs, minimise the risk of tax fraud and strengthen the neutrality of VAT within the country hence the increasing government revenue.

In terms of public financial management, it is agreed that especially by donors like the IMF and World Bank, that budget support is preferable to project aid when the recipient country is recognised as a good manager. Along the same line of reasoning, taxation of projects aid are defensible because, in any case all or part of the aid will go into state coffers.

Furthermore, with respect to aid policy, there should be agreement on development priorities between donors and recipient countries. The tax share of the aid can then be assumed to finance national priorities in terms of economic and social development (for example, National Poverty Alleviation Programmes towards the achievement of Millenium Development Goals), as well as to ensure good public financial management.

Moreover, non-taxation of aid-funded projects is a major handicap to improving DRM. This is why public authorities of developing countries and tax experts in general want to tax this type of aid which donors are funded.

At a time when there is a call to strengthen aid towards DRM (tax administration and policy), reviewing tax exemptions for aid-financed projects should be the first solution and may be the best one with respect to taxation. As we have seen during the Budget year of 2013/2014 in the parliament at Dodoma whereby they reduce tax exemption on these donor funded projects.

⁹⁸ Victor T, (2005) Tax Aspects of Donor Financed Projects; UN Economic and Social Council E/C.18/2005/9 of 22nd November 2005 at pg 63

With scarce budgetary resources, all government allocation decisions should be as efficient as possible. This study recommended that the current use of tax exemptions though originally well intended is harmful to economic development of the country and her population. Therefore there is a need to review laws governing tax exemption on donor funded projects.

This study does not recommend eliminating completely tax exemption on donor funded projects in Tanzania; rather it favors a reform in which each tax exemption is reviewed thoroughly. Also, decision to keep, abolish or modify a tax exemption provisions based on clear objectives against which an evaluation of its efficiency would be possible on the donor funded projects. That will reach the extent that each tax exemption on donor funded projects would be granted on legal ground and discretionary decisions should not be permitted.

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APPENDICES

APPENDIX I

QUESTIONNAIRE FOR TRA

Dear Sir/ Madam.

This questionnaire is based on the research topic titled, **“The effectiveness of the laws governing tax exemption on donor funded projects in Tanzania.”** I humbly request you or your honourable office to respond to the following questions.

Gender: Male Female
Age: 18-24 25-34 35-54 55+

Your job title? _____

1. What do you understand about Taxation _____

2 Are you aware of tax exemption

YES NO I DON'T KNOW

3 Please mention any example of tax exemption you know, _____

4 Is there any problems on tax exemption which you know?

YES NO I DON'T KNOW

5 Please mention any problem you know in relation to tax exemption.

6 Does your Institution TRA exercise any measures on the problems of tax exemption?

YES NO I DON'T KNOW

7 Is there any laws regulating tax exemption in Tanzania (Please tick any).

YES NO I DON'T KNOW

8. Mention any laws which y regulate tax exemption in Tanzania.

9. Do you think the laws are effective to cover the tax exemption system in Tanzania?

YES NO I DON'T KNOW

10 Justify your answer in question nine

11 Is there any measures which are taken in your institution on tax exemption in Tanzania?

YES NO I DON'T KNOW

12 Please mention any measures which are taken by the institution when dealing with tax exemption in Tanzania.

13 To what extent does the law provide for tax exemption in Tanzania

14 Are you aware of donor funded projects in Tanzania? (tick if any)

YES NO I DON'T KNOW

15. Mention any donor funded projects which you know in Tanzania.

16. Are these donor funded projects enjoys any relief of taxation in Tanzania?

YES NO I DON'T KNOW

17. What are those tax exemption granted to this donor funded projects in Tanzania?

18. What are the reasons for why these donor funded projects been exempted from tax liabilities?

19. Do you think there is a need for the continuation of tax exemption on these donor funded projects? Justify you answer

YES NO

20. Is there any procedures to comply with when these donor funded projects exempted from tax liabilities? Justify your answer

YES NO

THANK YOU FOR YOUR COOPERATION

APPENDIX II

INTERVIEW GUIDE

These questions based on the research topic titled, “**The effectiveness of the laws governing tax exemption on donor funded projects in Tanzania.**” I humbly request you on behalf of your honourable office to respond accordingly.

Your job title? _____

- 1 What tax exemption means?
- 2 Does the tax exemption been recognized in Tanzania?
- 3 Is there any problems facing in your office when dealing with tax exemption?
- 4 What are those problems and why those problems arises.
- 5 Is there any laws governing tax exemption in Tanzania?
- 6 What are those laws governing tax exemption in Tanzania and to what extent?
- 7 Does the laws effective on tax exemption in Tanzania and why?
- 8 Are you aware of donor funded projects in Tanzania?
- 9 What are those projects?
- 10 Why those projects been exempted from tax liabilities and to what extent?
- 11 Do you think tax exemption is important to donor funded projects in Tanzania and why.

THANK YOU IN DEED FOR YOUR COOPERATION.