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Sealing the Gaps

An analysis of revenue forgone within the Tanzania tax system and how it could be used to fund public education

NOVEMBER 2021


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Acknowledgements

This study was commissioned by ActionAid Tanzania within the context of the Norad-funded multi-country 'Breaking Barriers' project, which aims to ensure that all children can enjoy their right to free, quality, inclusive public education.
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Copyediting and proofreading services were provided by Hannah Beardon. Layout and design were done by www.NickPurser.com

Cover photograph: CREDIT: Natasha Mulder/ActionAid

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FOREWORD

Tax justice is a central concern for anyone working for social justice and for ActionAid Tanzania, it means ensuring fair and progressive tax systems that not only generate sufficient public revenue, but also ensure such revenue is fairly redistributed in order to redress widespread economic and gender inequalities.

Tax justice is also instrumental in increasing domestic revenue, which in turn is fundamental for reducing dependency on external sources such as debt and aid, and in making continual progress towards the achievement of the Sustainable Development Goals.

As part of its long-standing work on Tax Justice, ActionAid Tanzania commissioned the present study to understand how the Government of Tanzania can fairly and progressively increase its domestic revenue and better finance free, quality, inclusive public education.

By reviewing a range of recent, credible sources, the report shows that on average, the Government of Tanzania is losing an estimated TZS17.4 trillion each year as a result of internal inefficiencies, tax evasion, harmful tax incentives, double taxation agreements and illicit financial flows.

If just 20% of this total amount forgone (i.e. TZS 3.4 trillion) had been allocated to the education sector in 2019/20, it could have nearly doubled the education budget, raising it from TZS 4.5 to 7.9 trillion.

We hope that the findings in this report spark a lively and constructive debate about the best ways to seal the many gaps leading to loss of potential revenue and support the Government of Tanzania to achieve its long-term development goals.

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Acronyms

ACE	Anti-Corruption Evidence initiative
ADR	Alternative dispute resolution
CAG	Controller and Auditor General of Tanzania
CIT	Corporate income tax
DTA	Double taxation agreement
EAC	East Africa Community
EFD	Electronic fiscal device
FDI	Foreign direct investment
GDP	Gross domestic product
GFI	Global Financial Integrity
ICT	Information communication technology
IFF	Illicit financial flows
ILO	International Labour Organization
IMF	International Monetary Fund
LGA	Local government authority
OECD	Organization for Economic Cooperation and Development
SDG	Sustainable Development Goal
SEZ	Special economic zone
TANCIS	Tanzania Customs Integrated System
TMAA	Tanzania Minerals Audit Agency
TRA	Tanzania Revenue Authority
TRAB	Tanzania Revenue Appeal Board
TTJC	Tanzania Tax Justice Coalition
TZS	Tanzanian Shilling
UNICEF	United Nations International Children's Fund
VAT	Value-added tax

PHOTO: MAKMENDE MEDIA/ACTIONAID

EXECUTIVE SUMMARY

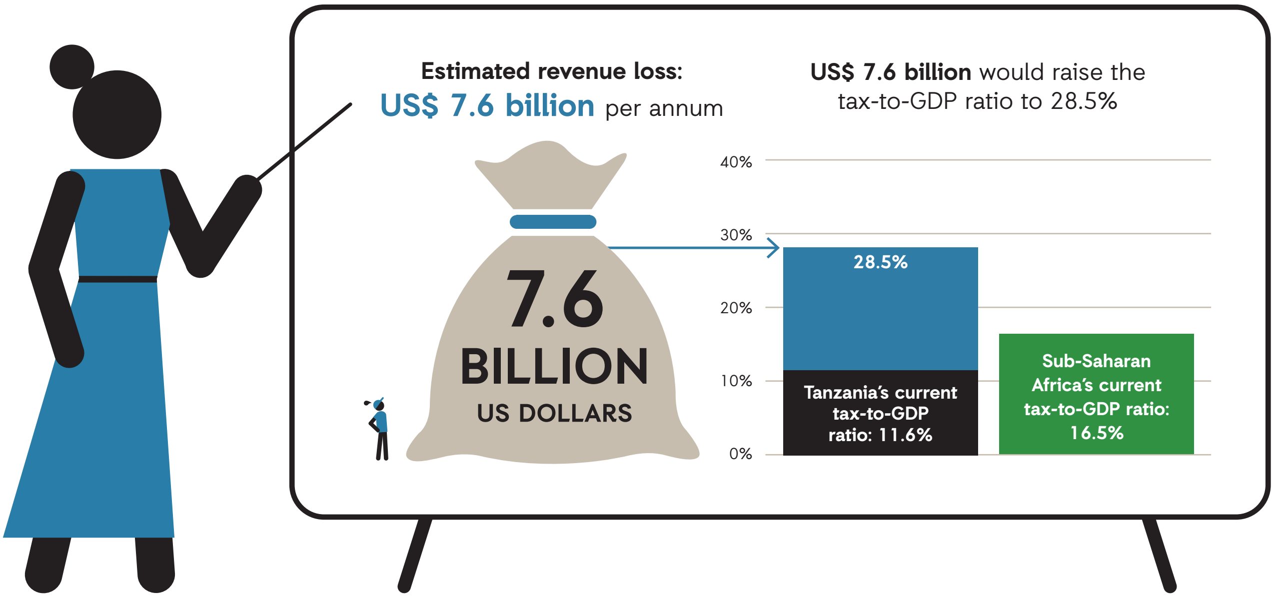
Taxation provides governments with the funds needed to invest in development, relieve poverty and deliver public services. It offers an antidote to aid dependence in developing countries and provides the fiscal reliability and sustainability needed to promote growth.[1]

Sustainable Development Goal (SDG) 4 aims to ensure inclusive and equitable quality education and promote lifelong learning opportunities for all by 2030. With under 10 years to go, it is clear that the timely achievement of SDG4 will require the Government of Tanzania to ensure that adequate funding is allocated to the education sector, meeting or exceeding the globally agreed benchmarks of 4-6% of gross domestic product (GDP) and 15-20% of the national budget allocated to education. However, while education remains a key government priority, there has been a markedly downward trend in allocations compared to these targets.

Raising the funds needed to adequately finance education will require the Government to not only increase the *share* of the budget it allocates to the sector (which stood at 13.6% of budget or 3.7% of GDP in 2020), but also to take rapid measures to increase the overall size of its budget by steadily raising its tax-to-GDP ratio.

Recent research from the International Monetary Fund (IMF) and World Bank indicates that tax-to-GDP ratios lower than 15% are insufficient to finance even the most basic State functions.[2] Yet Tanzania's tax-to-GDP ratio stood at a mere 11.6% in 2018,[3] well below the sub-Saharan average of 16.5%.[4] Thus, increasing tax-to-GDP ratios by 5% in the medium-term (around five years) would be an ambitious, yet realistic way forward.

The most effective way to achieve this, and ensure long-term, predictable and sustainable funding for education, is through domestic resource mobilisation using tax policy. Successive reports by the Controller and Auditor General (CAG) of Tanzania have highlighted that the country consistently trails behind other East African States in terms of tax efficiency, underscoring the need for increased government efforts to mobilise revenue by widening the tax base, plugging revenue leakages and improving voluntary compliance, tax efficiency and effectiveness.



With this in mind, this research study aims to identify some of the key issues, barriers and bottlenecks leading to loss of revenue across the tax system in Tanzania, to help drive forward national policy responses aimed at curtailing such losses.

Whilst it does not presume to offer a definitive and comprehensive overview of *all* of the amounts foregone, by outlining and compiling a range of relatively recent examples for which reliable estimates exist, it can provide a snapshot of the huge volumes of potential tax revenue being lost. It also recommends steps that the Government of Tanzania can take to seal these gaps and generate additional funds to invest in public education, and other priority development sectors.

Overall, the study finds that, between 2013 and 2020, the cumulative effect of internal inefficiencies, tax evasion, harmful tax incentives, double taxation agreements and illicit financial flows has resulted in estimated losses of around TZS 17.4 trillion (around US$ 7.6 billion) per annum. This amount, which is almost equal to the country's entire annual tax collection for 2020/21,[5] would be enough to raise the tax-to-GDP ratio to 28.5%, close to that of Switzerland and just 5.3 percentage points below the average Organisation for Economic Cooperation and Development (OECD) rate of 33.8%.[6] It would be enough to cover the country's annual budget deficit of TZS 3.4 trillion five times over.

If just 20% of this total amount forgone (i.e. TZS 3.4 trillion) had been allocated to the education sector in 2019/20, it could have nearly doubled the education budget, raising it from TZS 4.5 to 7.9 trillion ($1.9 to $3.4 billion).[7] These additional funds would have been enough to:

- Cover the annual salaries of the estimated 186,898 pre-primary and primary teachers needed to reach the ambitious pupil-teacher ratios of 40:1 at primary level and 25:1 at pre-primary level;[8 i]
- Cover the construction costs of all 226,065 classrooms estimated to be needed across the country;[9 ii]
- Cover the education costs of the 3.5 million children and young people aged between 7 and 17 estimated to be out of school;[iii] and
- Still have around TZS 1 trillion ($461 million) left over to cover other critical needs within the education sector.

i. Based on figures in the Education Sector Development Plan 2016/17–2020/21 and an average annual salary of TZS 8,796,000.
ii. Based on a rough calculation of $10,000 per classroom.
iii. Based on UNESCO statistics from 2014 of $92 per pupil x the estimated 3.5 million out-of-school children set out in the referenced UNESCO and Government of Tanzania report.

Just 20% of the estimated revenue lost in 2019/20 (US$ 1.9 billion/TZS 3.4 trillion) could pay for:

186,898 pre-primary and primary teachers

The cost of educating all **3.5 million children** estimated to be out of school

Constructing all **226,065 classrooms** estimated to be needed

Other critical needs within the education sector.

Even with all these costs accounted for, there would still be a remaining balance of TZS 13.9 trillion ($6 billion) to invest in wider national development priorities such as health, water, infrastructure, energy and agriculture.

As a result, the study suggests that the Government of Tanzania needs to take urgent steps to increase its domestic revenue collection in a progressive manner, so that the wealthiest contribute a proportionally larger share, whilst simultaneously tackling the weaknesses and corruption that cause huge amounts of potential revenue to be lost. It especially needs to invest in measures aimed at tackling internal inefficiencies.

Without such measures, the achievement of the country's development goals set out in Tanzania's Development Vision 2025,[10] not to mention the education targets outlined in SDG4, are likely to remain out of reach.

It is hoped that the findings of this study will facilitate further research, open-minded debate and discussion, and help to generate ideas and proposals to inform and shape national initiatives to mobilise additional domestic resources through fair taxation and adequately finance public services, especially education.

PHOTO: NATASHA MULDER/ACTIONAID

1. PURPOSE AND METHODOLOGY

This study was carried out within the context of the Norad-funded multi-country Breaking Barriers project, which aims to ensure that all children are able to enjoy their right to free, quality, inclusive public education. In Tanzania and the other three implementing countries, the project emphasises the critical importance of increasing the overall *size* of the national budget through progressive domestic resource mobilisation, in order to increase the amounts of sustainable funding available to finance public education.

Purpose

The purpose of this study was to better understand some of the areas and ways in which the Government of Tanzania is currently losing precious revenue, and how such losses can be stemmed in order to increase the overall size of the national budget, and thus the amount of funds available for education for the attainment of SDG targets.

Methodology

The study has been researched primarily through a desk review of a range of secondary data sources including reports, books, journals and government statistics. The study screened a range of documents to assess their relevance to the research questions, selecting for inclusion a range of published research reports and studies covering issues related to tax revenue losses or loopholes, ways to increase revenue and financing public education in Tanzania. Unpublished reports or studies on these issues and those published prior to 2010 were not included.

A range of documents authored and/or commissioned by ActionAid, United Nations agencies, OECD, World Bank and respected research institutes and organisations were considered reliable. In addition, a significant number of sources from the Government of Tanzania were referenced, including the Tanzania Revenue Authority (TRA), education sector plans and a range of CAG reports, which provided remarkably interesting and useful data.

Limitations

The findings from this report draw solely on existing data, meaning that no new calculations or assessments of revenue loss were undertaken. In addition, not all data on potential revenue losses were from the same timeframe, making it difficult to make assertions about the total amounts being lost on an annual basis. Despite these limitations we hope that this report will help to draw renewed attention to the overwhelming amounts of revenue currently being lost through a range of different gaps in the Tanzania tax system, and focus on ways to increase the overall size of the national budget, to allow for greater investment in essential public services, especially education, and support the achievement of SDG4.

Report structure

The report structure includes a brief introduction to the issues and rationale for the study, followed by a section enumerating some of the main 'gaps' within the tax system and estimates of some of the amounts of revenue being lost as a result. This is followed by analysis of how such amounts could be used to invest in public education, and a range of recommendations for the government of Tanzania.

Table 1: Summary of revenue lost between 2013 and 2021

Sector/Area	Estimated revenue loss[iv]		Year	Comments
	TZS	US$		
Informal Economy[v]	6.5 trillion	2.8 billion	2021	
Inefficiencies at local government level[11]	109.5 billion per year	50.2 million per year	2015/16-2018/19	
Failure of Public Authorities to issue EFD receipts[12]	1.5 billion	0.6 million	2020	This amount represents the estimated amount of VAT forgone at the rate of 18%
Inadequate tax compliance by public authorities[13]	33.6 billion	14.6 million	2020	
Non-payment of tax arrears[14]	303.1 billion	133.8 million	2018/19	
Amounts held up in unresolved tax appeals[15]	7.9 trillion	3.4 billion	2021	Estimation based on resolution of the Acacia Barrick Gold case, which constituted around 98% of the amounts withheld.
Amounts withheld in unresolved tax objections[16]	38.7 billion	1.6 million	2019/20	
Harmful Tax incentives including corporate VAT exemptions and SEZ[17]	1.1 trillion	531.5 million per year	2017	
Illicit Financial Flows (IFF). Cumulative value of under-reporting across all traded commodities[18]	1.4 trillion	750 million	Between 2013 and 2017	Figure arrived at by applying the country's nominal CIT (30%) on the total estimated $10 billion (TZS 20.9 trillion) lost to IFFs between 2013 and 2017, and then dividing by four to get an estimated annual amount.
Total	**17.4 trillion**	**7.6 billion**		
Overall deficit	3.4 trillion[19]	147.6 billion	2019/2020	
Education budget	4.51 trillion[20]	1.9 billion	2019/20	

Why are we talking about tax?

Taxation provides governments with the funds needed to invest in development, relieve poverty and deliver public services. It offers an antidote to aid dependence in developing countries and provides fiscal reliance and sustainability that is needed to promote growth. Tax system design is also closely linked to domestic and international investment decisions, including in terms of transparency and fairness. Strengthening domestic resource mobilisation is not just a question of raising revenue: it is also about designing a tax system that promotes inclusiveness, encourages good governance, matches society's views on appropriate income and wealth inequalities; and promotes social justice.

Taxation is integral to strengthening the effective functioning of the State and to the social contract between governments and citizens. By encouraging dialogue between States and their citizens, the taxation process is central to more effective and accountable States.[21]

iv. All historical exchange rates calculated using average rates for the year/s in question as found at https://data.worldbank.org/indicator/PA.NUS.FCRF?locations=TZ

v. Author calculations based on estimates by the Economic and Social Research Foundation which projected that revenue loss from failure to tax the informal sector amounts to around 35-55% of total current tax revenue.

PHOTO: NATASHA MULDER/ACTIONAID

2. EDUCATION FINANCING IN TANZANIA: WHY DOES IT MATTER?

There is under 10 years to go to meet the 2030 target to achieve SDG4, to ensure inclusive and equitable quality education and promote lifelong learning opportunities for all. To achieve this, the Government of Tanzania urgently needs to ensure that adequate funding is allocated to the education sector.

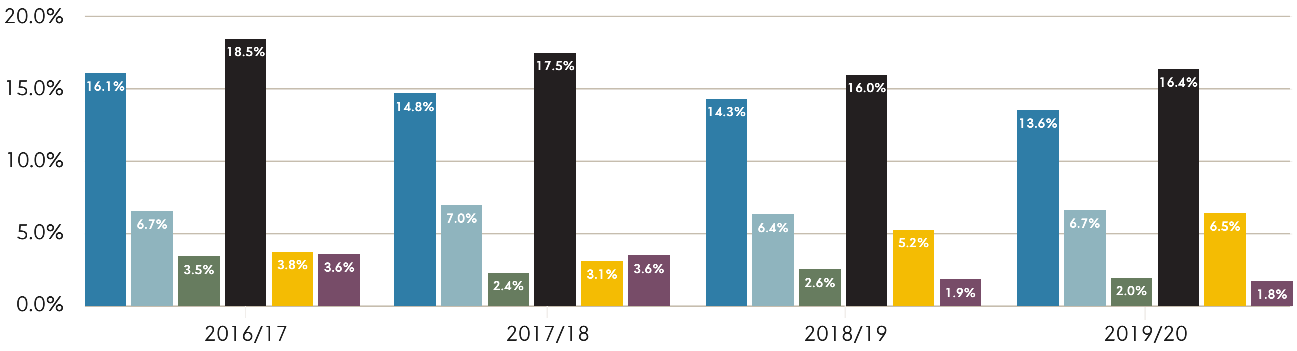
The first target under SDG4 is to ensure that all girls and boys complete free, equitable and quality primary and secondary education. However in 2018, despite government commitments, an estimated 3.5 million children aged 7 to 17 were out of school across Tanzania.[22] Furthermore, despite the country's relative success in providing inclusive education compared to other countries in sub-Saharan Africa, an estimated 45% of children with disabilities remain out of school.[23]

High levels of sustainable investment are needed to provide adequate numbers of well-trained and motivated teachers to deal with increased pupil demand,[24] whilst meeting commitments to quality, equity and inclusion.[25] Yet Tanzania still needs an estimated 56,173 pre-primary and 130,725 primary school teachers to reach pupil-teacher ratios of 25:1 and 40:1 respectively.[26]

Unfortunately, relatively low salaries and poor working conditions, as well as the perceived status of the profession, affect teacher morale and motivation leading many to seek alternative employment, or supplement their income through additional activities.[27] Unless addressed, these factors will continue to constitute a major barrier to government efforts to fill the considerable teacher shortages.[28]

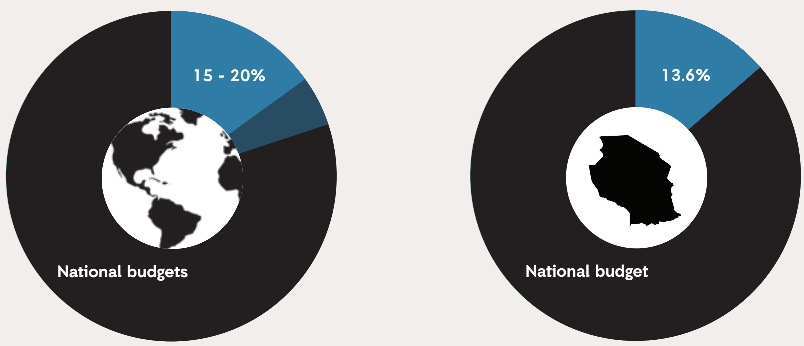
Globally-agreed financing benchmarks suggest that 4-6% of GDP, or 15-20% of national budgets, should be allocated to education,[29] and evidence suggests that countries with the furthest to go to meet SDG4 targets will need to meet or exceed the higher of these targets.[30] However, as can be seen from the data below, although education remains a key government priority, there is a markedly downward trend in terms of allocations.[31] Given the enormous scale of the challenges affecting the sector, this does not bode well for timely achievement of SDG4 targets in Tanzania.

Figure 1: Education approved budget versus other key sector shares over total national budget (%) between FY 2016/17 and 2019/20



Source: Ministry of Finance and Planning estimates and budget books FY 2019/20

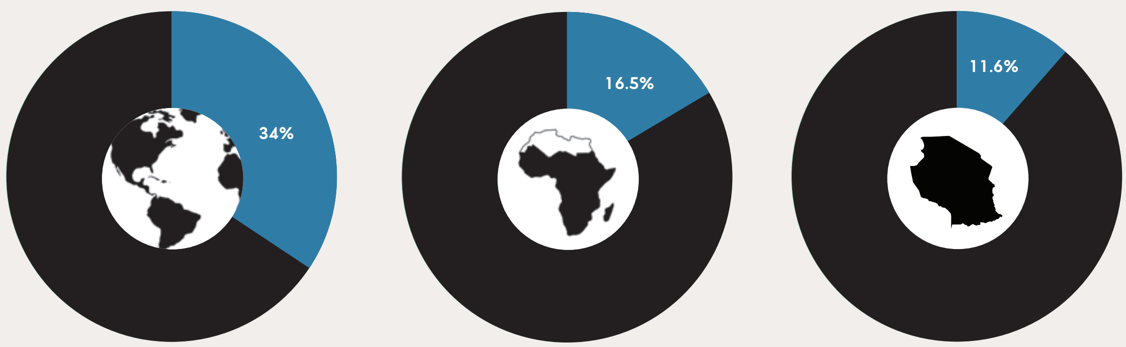
Education as a percentage of national budgets:



Globally agreed benchmark

Tanzania

Tax-to-GDP ratio:



Average tax-to-GDP ratio in OECD member countries

Average tax-to-GDP ratio across sub-Saharan Africa

Tax-to-GDP ratio in Tanzania

Raising the funds to adequately finance education will require the Government to increase the *share* of the budget it allocates to the sector which, at TZS 4.5 trillion, equalled 13.6% of budget or 3.7% of GDP in 2020.[32] But it will also need to take rapid measures to increase the overall size of the budget, by steadily raising its tax-to-GDP ratio.

In 2010, the United Nations estimated that a minimum 20% tax-to-GDP ratio was needed to deliver on the Millennium Development Goals.[33] More recently, research from the IMF and World Bank indicates that tax-to-GDP ratios lower than 15% are insufficient to finance even the most basic State functions.[34] In 2018, the average tax-to-GDP ratio in OECD member countries was 34.3%, whilst in sub-Saharan Africa the average was just 16.5%. Standing at a mere 11.6%, Tanzania's tax-to-GDP ratio is not only well below the sub-Saharan average,[35] but also well below the minimum threshold of 15%.

In other words, whilst the appropriate level of taxation depends on each country's specific characteristics, increased tax capacity is likely to play a significant role in a country's ability to deliver basic public services and attain the SDGs. In 2019, the IMF estimated that most low-income countries would need to spend an additional 15% of GDP or more to reach the SDG targets, suggesting that increasing tax-to-GDP ratios by 5% in the medium-term (around five years) would be an ambitious, yet realistic, way forward.[36]

Arguably, the most effective way to achieve this, and ensure long-term, sustainable funding for education, is through domestic resource mobilisation.[37] However, data in Table 2 below indicates that Tanzania has a persistent revenue gap, with domestic revenue collection consistently falling short of the total expenditure envelope across all years.[VI]

Table 2: Domestic revenue and total expenditure in Tanzania 2015-2020

	2015/16 Actual	2016/17 Actual	2017/18 Actual	2018/19 Actual	2019/20 Budgeted	2019/20 Actual March	2019/20 Likely Outturn June
A. DOMESTIC REVENUE (incl. Revenues from LGAs)	**14,048,034**	**16,639,831**	**17,944,887**	**18,529,558**	**23,045,337.46**	**16,074,950.43**	**21,146,768.22**
DOMESTIC REVENUE	13,622,182	16,128,113	17,403,388	17,868,195	22,279,854.08	15,536,350.43	20,281,284.85
1. Tax revenue	12,410,951	14,055,173	15,191,421	15,511,330	19,100,932.25	13,465,878.88	17,614,959.53
Import duty and excise duty	3,090,110	3,116,298	3,313,671	3,585,509	4,363,696.35	2,995,245.81	3,902,828.81
Sales tax (local and imports)	3,553,637	3,979,473	4,478,851	4,781,633	6,159,344.30	3,988,781.52	5,282,099.36
Value Added Tax (VAT)	1,717,902	1,803,667	2,054,675	2,259,827	2,756,738.70	1,849,956.47	2,471,164,43
Imports	1,835,735	2,175,806	2,424,175	2,521,806	3,402,605.60	2,138,825.04	2,810,934.93
Domestic	4,608,245	4,832,759	5,157,886	5,148,192	6,322,811.70	4,726,058.51	6,130,702.16
Income Tax	1,921,459	2,216,357	2,299,242	2,130,594	2,392,980.10	1,918,424.00	2,449,860.15
Other Taxes	-762,499	-89,714	-58,229	-134,598	-137,900.20	-162,631	-150,531
Refunds accounts	1,211,231	2,072,941	2,211,967	2,356,865	3,178,921.83	2,070,471.55	2,766,325.32
2. Non-tax revenue	425,852	511,718	541,499	661,363	765,483.38	538,600.00	765,483.38
3. Revenues from LGAs							
B. TOTAL EXPENDITURE	**17,759,598**	**18,898,690**	**20,468,072**	**22,300,627**	**27,669,093.81**	**17,574,240.24**	**24,573,891.95**
1. Recurrent expenditure	13,420,045	11,625,866	12,852,304	13,806,789	15,420,491.53	9,474,683.63	14,649,466.96
2. Development expenditure	4,339,553	7,272,824	7,615,768	8,493,838	12,248,602.28	8,099,556.61	9,924,425.00
Local funds	2,904,530	5,141,451	5,397,034	6,535,879	9,737,738.81	5,874,853.33	7,790,191.05
Foreign funds	1,435,023	2,131,374	2,218,735	1,957,959	2,510,863.47	2,224,703.28	2,134,233.95
C. DEFICIT/SURPLUS (A-B)	**-3,711,564**	**-2,258,859**	**-2,523,185**	**-3771,069**	**-4,623,756.36**	**-1,499,289.80**	**-3,427,123.73**

Source: Ministry of Finance and Planning, Economic Survey Book 2019

vi. Overall, tax revenue accounts for more than 90% of all government revenue, while non-tax revenue, including proceeds from fees and licenses, privatization, and LGAs' own revenues account for just 9% (2017/18) of which 3.5% constitute local government contribution (%) to overall direct revenue management.

This demonstrates that not only are levels of domestic revenue generation too low to finance the country's ambitious development programme, but more also needs to be done to address the deficit, which was estimated to stand at TZS 3.4 trillion (around $1.4 billion) in 2019/2020.[vii]

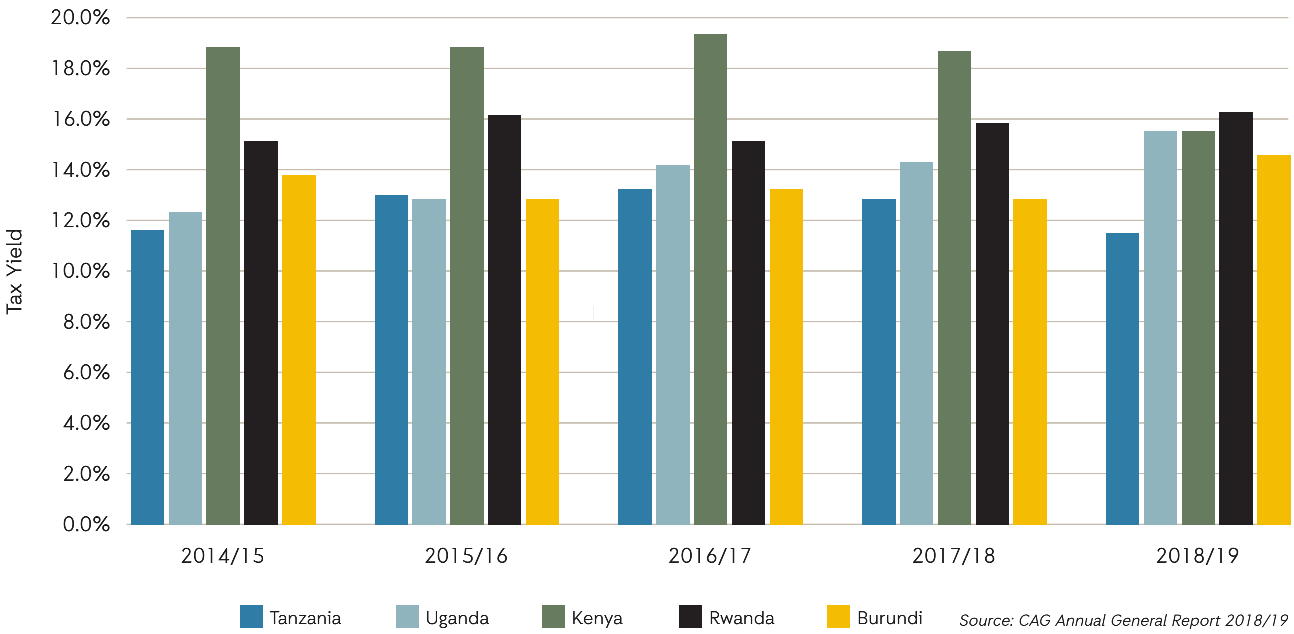
Table 3: Trend of estimates, actual collection and percentage of contribution from each identified source

Details	FY 2018/19 (TZS billion)	FY 2018/19 (TZS billion)	FY 2018/19 (TZS billion)	FY 2018/19 (TZS billion)	FY 2018/19 (TZS billion)
Estimates	32,475.95	31,711.99	29,539.00	22,495.00	19,506.00
Actual collection	25,817.45	27,695.96	25,307.00	21,109.00	18,417.00
% of contributions					
Tax	60%	55%	57%	59%	54%
Non-tax collection	9%	5%	8%	8%	5%
Domestic borrowings	15%	21%	23%	25%	22%
Grants and external borrowings	16%	19%	12%	8%	19%

Source: CAG Annual Report for FY 2018-19

In 2015, the World Bank implored Tanzania to take greater steps to raise tax revenues, noting that its revenue collections were among the lowest in the world.[38] Since then, successive CAG reports have highlighted the fact that Tanzania consistently trails behind other East African States in terms of tax efficiency.[39] This underscores the need for increased government efforts to mobilise revenue by widening the tax base, plugging revenue leakages, and improving voluntary compliance, tax efficiency and effectiveness.

Figure 2: Analysis of tax yield for Tanzania and other EAC countries



Source: CAG Annual General Report 2018/19

vii. Calculated using average TZS/US$ exchange rate for 2020 at: https://data.worldbank.org/indicator/PA.NUS.FCRF?locations=TZ

With this in mind, this study aims to identify some of the key issues (or gaps) leading to the loss of revenue across the tax system in Tanzania. It does not presume to offer a definitive and comprehensive overview of all the amounts foregone, but by outlining and compiling a range of relatively recent examples for which reliable estimates exist, it provides a snapshot of the huge volumes of potential tax revenue forgone and recommends steps for the Government of Tanzania to take to seal the gaps and generate additional funds to invest in quality public education.

In summary, our findings suggest that Tanzania needs to take urgent steps to increase domestic revenue in a progressive manner, so that the wealthiest contribute the biggest share, whilst simultaneously tackling the internal inefficiencies, weaknesses and corruption that cause potential revenue to be lost. Without such measures, the achievement of SDG4 is likely to remain out of reach.

Key takeaways

- At 13.6% of the budget and 3.6% of GDP, Tanzania's allocation to education falls short of the international financing benchmarks of 4-6% of GDP and 15-20% of the national budget.
- Tanzania has consistently been falling behind other East African States in terms of domestic revenue generation.
- In 2018, Tanzania's tax-to-GDP ratio stood at 11.6%, far below the average ratio for sub-Saharan Africa of 16.5%, and below the 15% estimated to be required to perform even the most basic State functions.
- Tanzania's domestic revenue has continued to fall short of requirements, generating an average deficit of TZS 3.1 trillion ($1.3 billion) between 2015 and 2020.

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3. WIDENING THE TAX BASE

Implications of a vast informal economy

Informality' is extensive in developing countries, accounting for around 40% of GDP on average, up to 60% in many countries. Arguably it is not in itself a problem: micro traders may be informal, for instance, but are also likely to have income and sales well below any reasonable tax threshold. The most egregious evasion is usually by qualified professionals.[40]

In 2018 the International Labour Organisation (ILO) estimated that informal employment accounted for up to 85.8% of all employment (or 71.9% excluding agriculture) in sub-Saharan Africa.[41] In the case of Tanzania, this figure is estimated to be even higher, with 76% of the non-agricultural workforce subsisting outside of the formal economic framework.[42] It is worth noting that, in most countries for which data is available, there are more women in informal employment in non-agricultural activities than men.[43] In Tanzania for example, an estimated 51% of those working in the informal sector are women.[44]

There are many benefits of the informal sector, including low barriers to entry and high levels of competition, entrepreneurship and job creation, all of which arguably contribute to poverty reduction. However, it presents a significant challenge to governments' ability to accurately measure their economies, and limits the collection of tax revenue.[45]

Most informal businesses and workers are not visible to government, and thus do not pay income tax or value-added tax (VAT). However, they do regularly pay other forms of taxes and levies, including VAT on purchases, as well as numerous types of fees, charges and licensing costs (e.g. market taxes). These often overlap, resulting in the payer being taxed multiple times, and often at a flat rate.[46] Because so many informal workers are women, such taxation risks being both income and gender regressive.[47]

Finding ways to better tax the informal sector has been a focus of increasing attention by revenue authorities. In 2012, Fjeldstad and Heggstad highlighted the introduction of a Block Management System by the TRA, which simplified the registration of traders, and brought more non-filers and non-payers into the tax net through closer monitoring and collaboration with local government authorities (LGAs).[48]

However, large taxpayers remain one of the main sources of revenue for the Government of Tanzania, generating just under 40% of all revenue in 2018/19.[49] In April 2019 the late President Magufuli stated with dismay that he could not understand why the TRA was collecting tax from only about 2.7 million of the country's estimated population of 55 million people.[50] This, he considered, meant that the TRA was *"squeezing the few available taxpayers"* and highlighted the urgent need to widen the tax base and bring in new sources of revenue. This statement underscores the fact that Tanzania's revenue collection potential remains hugely untapped.

Although the majority of those working in the informal economy do so as a consequence of a lack of opportunities in the formal economy and other means of livelihood,[51] many better-off urban professionals and owners of larger businesses also operate in the informal sector, intentionally avoiding paying their fair share.[52]

In 2017, a report published by Norwegian Church Aid looked at data regarding revenue losses in Tanzania's informal sector from the *"relatively non-poor who should be taxed".* This found that some sectors make a disproportionately low contribution to taxes, including agriculture, construction and trade. The report points out that only some of these are genuinely *"hard to tax"*, noting that around 7,000 construction businesses reported five or more employees and should have been visible to the tax authorities. The report adds that many professional consultancies are also believed to avoid paying taxes by withholding tax collection (at 5% of the contract amount). This is already extremely low by international standards and compared to public procurement contracts awarded to consultants through tenders.[53]

Higher-earning workers and businesses should not operate in the informal sector but should be formalised, registering for personal and corporate income tax (CIT). In other words, taxing thriving businesses rather than people on very low incomes, by incentivising and enforcing formalisation, should be a priority for any government concerned with progressive taxation, labour standards and workers' rights.

Ideally this should be done in ways that do not perpetuate economic and gender inequalities (for example through tax thresholds and progressive rates), and ensure that informal workers are adequately represented in policy dialogue and planning.[54] Such processes should not just focus on the obligations of informal workers and businesses to register and pay taxes and fees, but ensure that their fundamental rights are respected along with access to decent working conditions and social protection in line with ILO Recommendation 204.[55]

Using efficient mechanisms to fairly and progressively widen the tax base by encouraging formalisation could generate huge revenues for Tanzania. The Economic and Social Research Foundation has estimated that revenue loss from failure to tax the informal sector amounts to around 35-55% of total current tax revenue.[56] Using this projection, and applying it to the amount collected by the TRA (TZS 14.5 trillion in 2020/21[viii]), this would amount to TZS 6.5 trillion or $2.8 billion.[57]

In addition, broadening the tax base can help to build a culture of tax compliance and a reduced sense of unfairness, whilst generating greater government accountability to citizens, particularly the poor.[58] Some of these issues are explored further in the following section.

» Key takeaways

- The TRA is currently estimated to be collecting tax from a mere 5% of the population.
- Estimates indicate that revenue loss from failure to tax the informal sector amounts to around 45% of total tax revenue. For 2021 this would amount to TZS 6.5 trillion or $2.8 billion.
- Taxing businesses making a good income, rather than people on very low incomes, by incentivising and enforcing formalisation, should be a priority for any government concerned with progressive taxation, labour standards and workers' rights.
- A wider tax base can generate a culture of tax compliance as well as greater government accountability to its people.

Awareness, tax morale and compliance

Low taxpayer morale, corruption and poor governance are often deeply entrenched. Corruption indicators are strongly associated with low revenue, as are other governance indicators such as weak rule of law and political instability. Indeed, corruption functions like a tax itself, and is likely to be a particularly regressive and inefficient form of taxation. A perception of low corruption at different levels of the executive branch (President's office, government officials or tax authorities) has a significant and positive impact on tax morale.[59]

viii. As of April 2021, the total domestic revenue amount collected was 24.53 trillion shillings of which revenue collected by TRA amounted to TZS 14.54 trillion (Source: 2021/22 National Budget Speech).

Public awareness influences key enabling factors for widening the tax base and taxing the informal economy more effectively. It also affects the relationship between tax morale and compliance. Naturally, to be compliant, people need to be aware of the concept of tax as well as their own obligations, the advantages of compliance and the penalties for failure to do so.

In Tanzania, the Taxpayer Education Programme is used to sensitize taxpayers to voluntarily meet their tax obligations. The TRA has used a range of methods for this, including radio programmes in Swahili and 'tax clubs' in secondary schools and higher learning institutes across the countries. These clubs are given reading materials, TRA officers provide information on tax issues, and once a year the clubs participate in a competition representing their school. According to information on the TRA website,[60] the idea behind the clubs is to *'bend a fish while it is not yet dry'*, or in other words, to increase awareness of taxation issues and promote compliance amongst future potential taxpayers.

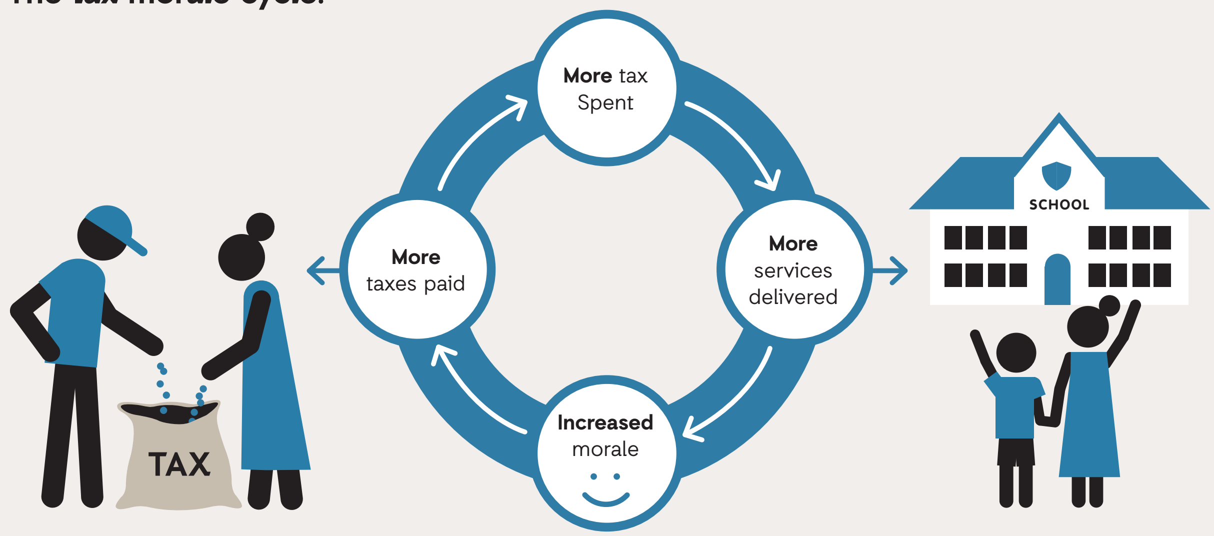
To some extent these programmes have been successful. A 2016 baseline study carried out by ActionAid in 30 communities in Kilwa and Singida districts indicated general community-level understanding that tax was used for financing public services, in this case, the Government's education budgets.[61]

In 2019 the OECD published a report comparing attitudes towards tax avoidance and evasion, to measure and compare tax morale in different regions, including Africa.[62] The research suggested that, between 2005 and 2015, the proportion of Africans who strongly believed that tax authorities had the right to make people pay taxes increased from 22% to 30%. According to the research, gains in the perceived legitimacy of the tax authority have the largest impact in boosting tax morale and linking taxes to public spending could improve willingness to increase tax payments.

Nevertheless, awareness does not necessarily equate to compliance. In his 2011 book, Tax Compliance in Tanzania, Ongwamuhana notes other reasons behind Tanzania's relatively low taxpayer compliance, including the narrow tax base, the prevalence of dissatisfaction with taxation, and the perception that the tax administration is high-handed and tainted with corruption.[63] This, coupled with the fact that the TRA has tended to rely primarily on detection and punishment, has led to a response to non-compliance characterised by criminal prosecutions and fiscal penalties.[64]

According to Fjeldstat and Heggstat, taxpayers perceive the current tax system to be unfair, favouring large multinational companies with exemptions and tax incentives. Where the majority of (potential) taxpayers perceive the system to be unfair, it is difficult to build a taxpaying culture characterised by broad-based (quasi) voluntary compliance.[65]

The tax morale cycle:



In 2019 former president Magufuli deplored the rising number of court cases in which taxpayers complained about unfair tax rates imposed on them, and directed the TRA to resolve the problem and create a friendly environment where taxpayers would more freely comply with tax payments.[66] In the same year, the Government of Tanzania undertook a review of the tax regime, while being cautious not to burden citizens financially or make it administratively harder for the TRA to collect taxes.[67]

In tackling perceived unfairness, some key elements for the TRA include: transparency in the application of tax laws; consistency and impartiality in decision-making or action; allowing for sufficient taxpayer input in reaching tax decisions; respecting the right to challenge decisions or actions; and respect for adjudication bodies. These are basics in a tax system, ensuring that there is fairness in the administration of tax, and potentially promoting voluntary tax compliance.[68]

The 2019 OECD study highlights the correlation between tax morale and tax-to-GDP ratios, noting that for the 21 countries included in *Revenue Statistics in Africa 2018*, the average tax-to-GDP passed the 15% mark in 2004.[69] The report notes that the achievement of this minimum threshold may reflect the development of a virtuous circle between tax and service delivery. In other words, continuing efforts to improve tax morale, supported by visible efforts to improve service delivery, are likely to be a key step in Tanzania's efforts to increase its tax-to-GDP ratio.

>> Key takeaways

- Ensuring balanced, fair and transparent taxpayer systems that ensure visible benefits from tax payment, especially by linking taxes to public spending, is key to enhancing taxpayer morale and compliance.
- Taxpayers perceive the current tax system to be unfair, favouring large multinational companies by granting exemptions and tax incentives.
- Evidence suggests a clear correlation between tax morale and tax-to-GDP ratios, and that continuing efforts to improve tax morale will be key for Tanzania to increase its tax-to-GDP ratio.

4. IMPROVING INTERNAL EFFICIENCIES

A well-functioning tax administration is key to mobilising domestic resources, and tax system design should recognise the capacity of tax administrations. Many administrations continue to be staffed by poorly trained and low paid officials, have structures which do not encourage an integrated approach to different taxes, and are marked by imbalanced service and enforcement functions.[70]

The application of technology to tax administration, including enforcement, can make more information available to revenue authorities and provide several advantages. For example, enabling them to widen the tax base, identify and mitigate compliance risks, more effectively identify and prosecute evaders, strengthen deterrence and stimulate voluntary compliance.[71]

Since 2006, the World Bank, the United Kingdom Department for International Development and the Danish International Development Agency have contributed significant resources to support Tanzania's tax modernisation project. This project aimed to promote an effective and efficient tax administration and included a technology upgrade, allowing the country to automate systems for registering, documenting and collecting taxes. A new e-filing system improved the efficiency, speed and effectiveness of tax administration and revenue collection. Internal reforms to the tax administration included training staff on the anti-corruption policy and creating a stronger infrastructure for monitoring and evaluation.[72]

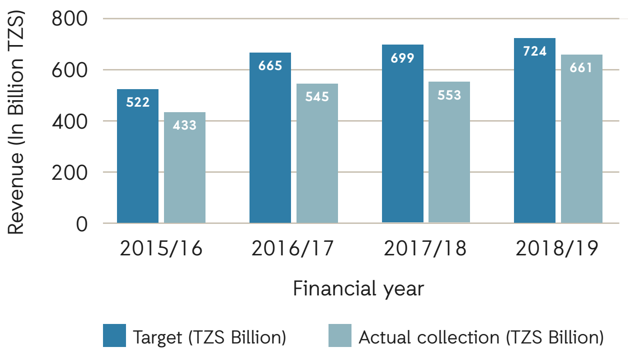
The Government of Tanzania has conducted a series of additional reforms such as the Local Government Reform Programme and Public Finances Reform Programme, which aimed specifically to improve revenue collections at LGA level.[73] However, despite these efforts, a range of challenges to effective revenue collection persist.

Local government level Inefficiencies

In Tanzania, effective LGA revenue collection is essential to ensure the sustainability of public service provision and reduce dependence on central government.[74] The 2020 CAG report into LGA revenue collection notes that, from 2015/16 to 2018/19, almost 70% of LGAs failed to achieve their targets for revenue collection.[75] The report attributes this to factors such as inadequate supervision, failure to collect revenue to the full potential of available sources, unrealistic targets, staff shortages, and inadequate human resource capacity and tools for revenue collection.

Figure 3 shows that this has resulted in cumulative losses of TZS 438 billion between 2015/16 and 2018/19, or an average loss of TZS 109.5 billion per annum (equivalent to $50.2 million).[ix] This not only increases financial dependency on central government, but also severely limits LGA capacity to serve increasing demand for critical public services in their jurisdictions.[76]

Figure 3: Target versus actual amount of revenue collected in LGAs



Source: Report on collection of revenue 2017

» Key takeaways

- LGAs are routinely underperforming in terms of revenue collection, generating a mere 41% of their targeted amounts. This has resulted in average losses of TZS 109.5 billion ($50.2 million) per year between 2015/16 and 2018/19.
- LGA-level revenue losses increase financial dependency on central government, and severely limit LGA capacity to deliver critical public services.

ix. Calculated using the average exchange rate for the period: https://data.worldbank.org/indicator/PA.NUS.FCRF?locations=TZ

5. TAX EVASION OR NON-PAYMENT OF TAXES

PHOTO: MAKMENDE MEDIA/ACTIONAID

At the start of his tenure, former President Magufuli led a crackdown on tax evasion and a shake-up of the revenue service. This allegedly resulted in TZS 1.3 trillion ($564 million) recovery of unpaid taxes in just two months.[77] He concentrated his attention on the activities of some of the biggest and oldest mining companies in the country, and allegations of illegal operations and avoidance of tax on their Tanzanian profits.

The 2021 CAG report outlines a series of further ways in which the Government of Tanzania loses money beyond the mining sector, including the failure of public authorities to pay taxes or issue Electronic Fiscal Device (EFD) receipts, and non or late submission of taxes to the TRA.[78]

Inefficient management of tax arrears and appeals

Issues causing loss of significant potential revenue are not the only concern for Tanzania. The 2019 and 2020 CAG reports also underscore the monumental impact of a range of inefficiencies in the management of tax arrears and appeals.

Tax arrears

An audit of sample tax regions revealed that the TRA is owed outstanding tax arrears amounting to TZS 303.1 billion (equivalent to $133.8 million[x]). This was largely attributed to inadequate follow up of issues identified in the previous year's CAG report regarding enforcement and debt management, leading to delays in collection and piling up of long outstanding amounts.[79]

Tax appeals mechanisms

Disputes are an inevitable feature of any tax system, enabling fair decisions to be reached on tax matters. In Tanzania, the Tax Revenue Appeals Act accords taxpayers the right to contest assessments issued by the TRA.[xi]

However, as noted in Mngumi (2019),[80] the more complex the resolution mechanism, the longer it takes to resolve a dispute, and it is not uncommon for tax disputes in Tanzania to last over five years. Regardless of whether the final ruling favours the Government or the taxpayer, such protracted tax disputes benefit no-one, as real values diminish over time.

Indeed, successive CAG reports note an increasing build-up of tax disputes at various levels of the tax appeals machinery, with most of these stalled at the Tax Appeals Board, as indicated in table 4.

x. Calculated using the average exchange rate for 2018 https://data.worldbank.org/indicator/PA.NUS.FCRF?locations=TZ
xi. This is done firstly by way of a formal objection to Commissioner General. If unsatisfied by the decision on the objection, taxpayers may appeal at TRAB. If dissatisfied by the decision of TRAB, the taxpayer can further appeal to the Tax Revenue Appeals Tribunal and the Court of Appeal subsequently. The decision of the Court of Appeal is final.

Table 4: Cases existing in tax appeals authorities until 30 June 2020[81]

Tax Appeal Authorities	Number of cases	Taxes withheld on objections	
		TZS trillion	US$ million
Court of Appeal	20	0.1	150
Tax Appeals Council	94	2.7	23
Tax Appeals Board	983	357.2	8
TOTAL	**1,097**	**360.1**	**181**

Source: CAG report April 2021[82]

The CAG report suggests that this constitutes a significant obstacle to revenue collection, a major understatement given the sheer size of the amounts involved, as summarised in table 5 below.

Table 5: Amounts held in unresolved tax objections and appeals

Year	Number of cases	Amounts Withheld (TZS trillion)	Total Annual Budget (TZS trillion)	% Actual Budget
2015/16	451	7.2	22.5	32.2
2016/17	709	4.4	29.5	15.0
2017/18	817	382.6	31.7	1,206.5
2018/19	950	366.03	32.4	1,129.7
2019/20	1,097	360.1	33.1	1,087.9

Source: National data (CAG reports and budget books)

According to the 2018 CAG report, a significant increase in tax appeals was due to greater public awareness of the Tax Revenue Appeal Board (TRAB), as well as amendments to the TRAB rules in 2018 which simplified appeal procedures. However, four cases against the Acacia Mining Company, claimed by the Government of Tanzania to be worth TZS 374.7 trillion ($162 billion), accounted for 98% of cases held up in the TRAB (see section below on Illicit Financial Flows).[83]

A quick calculation reveals that the staggering amounts recorded as withheld from 2017/18 onwards are, on average, equivalent to 11 times the size of the annual national budget. Full recovery of these amounts would have been sufficient to increase Tanzania's tax-to-GDP ratio from the current 11.3% to an impossible-sounding 299%.[xii]

The Acacia case was finally settled for $300 million,[84] suggesting that the amounts currently withheld are likely to be more in the region of TZS 7.9 trillion ($3.4 billion).[xiii] However, this amount alone is equivalent to 22.7% of the annual budget for 2020/21,[xiv] and its recovery could nearly double Tanzania's tax-to-GDP ratio to 20.5%, bringing it three percentage points above the sub-Saharan average.

Successive CAG reports conclude that capacity issues, including inadequate staffing and lack of skilled and experienced personnel in tax audit and technical units, have limited the efficiency of the Tanzania Tax Appeals system, contributing to delays in settlements.[85] The 2018/19 CAG report, in particular, notes that one of the main reasons for the pending tax disputes was the limited financial resources of these entities.[86]

On balance, and given the size of the amounts at stake, it would seem pertinent to make urgent and targeted investments to strengthen the capacity of the relevant entities to carry out their functions. To add to this, the 2021 CAG report notes the existence of 44 objections in the Central Taxpayers' Department, the Tax Investigation Department and the Internal Revenue Department, with a tax worth TZS 38.7 billion ($1.6 million), which have not been resolved within the six months allowable under the TRA quality management procedures and taxpayer service charter.[87] This issue has been raised in successive CAG reports, which repeatedly underscore the negative impact of such delays on revenue collection targets.[88]

In order to address such challenges, Mngumi notes that the introduction of an alternative dispute resolution system (ADR), currently in use by neighbouring countries such as Kenya and South Africa, could expedite disputes outside of the normal appeal process. In South Africa, for example, the ADR process is less formal and less costly than the courts, and allows for disputes to be resolved without litigation and within a reduced time frame.[89]

xii. Author's calculation based on 2018 data at https://data.worldbank.org/indicator/GC.TAX.TOTL.CN?locations=TZ and https://data.worldbank.org/country/TZ. If the amount of TZS 382.6 trillion withheld were added to the total annual revenue of TZS 15 trillion, against a GDP of TZS 132.5 trillion, the resulting tax-to-GDP ratio would increase from 11.3% to 299.9%.

xiii. At the time of writing no further information on the current amount withheld was available. For the purposes of this report, the team simply subtracted the amount corresponding to the cases against Acacia Barrick Gold in 2017/18 from the total amount withheld in the same year. This is a simplistic calculation, but the resulting total is not too dissimilar from the amount withheld in 2015/16, even before the case against the mining company was made.

xiv. The annual budget for 2020/21 was TZS 34.8 trillion. https://www.tanzaniainvest.com/budget#:~:text=Tanzania's%20approved%20budget%20for%202021,in%20the%202020%2D2021%20budget.

Key takeaways

- Inefficient management of tax arrears revealed an outstanding amount of TZS 303.1 billion ($133.8 million) in 2018/19.
- Successive CAG reports from 2017/18 show that amounts stuck at various levels of the tax appeals machinery were, on average, equivalent to 11 times the annual national budget.
- Even with the resolution of the Acacia Barrick Gold case (which accounted for over 90% of these amounts), withheld sums are likely to be equivalent to around 22% of the total annual budget for 2020/21.
- A range of internal inefficiencies, including human and financial resources and failure to comply with time limits for settlement of tax objections, were thought to have contributed to the pending tax disputes currently holding up vast amounts of potential revenue.[90]
- Swift action to address these backlogs could have a transformative effect on the overall size of the national budget, greatly increasing the country's tax-to-GDP ratio, and making additional resources available for investment in public services.

Non-payment of tax by public authorities

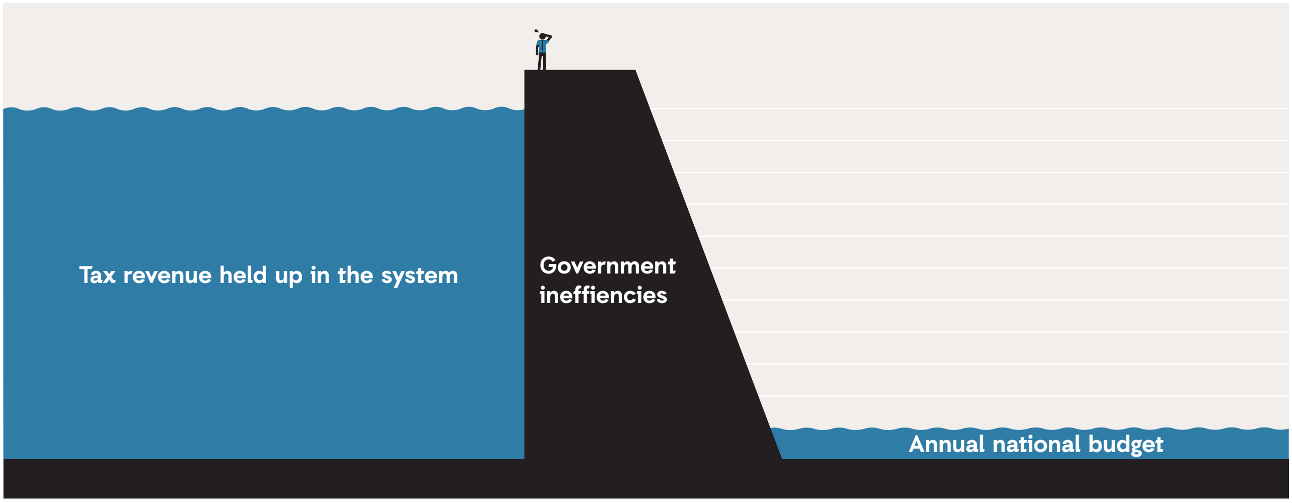
According to the CAG, instances of inadequate tax compliance by public authorities, and inadequate enforcement mechanisms by the TRA, have resulted in a failure to deduct and submit withholding tax amounting to TZS 1.9 billion ($867,826).[91] Further losses were incurred due to failures to file VAT payable amounting to TZS 19.7 billion ($8.5 million) and corporate tax assessed at TZS 12.0 billion ($5.2 million). The total losses incurred amount to TZS 33.6 billion ($14.6 million).[92]

Electronic Fiscal Device receipts

Despite requirements outlined in the Income Tax regulation and Tax Administration Act,[xv] during the period under review, five public authorities had earned revenues from services amounting to TZS 6.5 billion ($282.7 million) without issuing corresponding fiscal receipts.[93] A further eight made payments to service providers amounting to TZS 1.9 billion (equivalent to $826,086) without demanding electronic fiscal receipts or invoices. In other words, non-compliance by public authorities in issuing and demanding receipts was observed to result in losses totalling an estimated TZS 8.4 billion ($3.6 million). The estimated amount lost in VAT equates to TZS 1.5 billion ($645,851) at the current rate of 18%.

Key takeaways

- Non-compliance by public authorities in issuing and demanding receipts resulted in losses totalling TZS 8.4 billion ($3.6 million) in 2019/20. The estimated amount lost in VAT equates to TZS 1.5 billion at the current rate of 18%.
- Non-payment of taxes by public authorities resulted in reported losses of TZS 33.6 billion ($14.6 million) in 2019/20.



xv. Regulation 28 of the Income Tax (Electronic Fiscal Devices) Regulations, 2012 requires every purchaser to demand a fiscal receipt or invoice in his possession. Section 36 (1) of the Tax Administration Act (CAP 438, RE, 2019) requires a person who supplies goods, renders services or receives payment in respect of goods supplied or services rendered to issue a fiscal receipt or fiscal invoice by using EFD.

PHOTO: MAKMENDE MEDIA/ACTIONAID

6. TAX INCENTIVES

The OECD notes that designing an attractive tax regime for both domestic and foreign investment, through tax incentives and securing the revenues for public spending, is a difficult balance that can result in a *'race to the bottom'*, as developing countries compete for investment.[94]

Despite this, evidence suggests that tax incentives are not the priority factor for investment in developing countries, and many investments would have been made without them. A 2010 United Nations Industrial Development Organisation survey of over 7,000 companies in 19 sub-Saharan African Countries revealed that other factors rank much higher in influencing investment decisions. These included economic and political stability, the cost of raw materials, local markets, transparency of the legal framework, the availability of skilled labour and labour costs.[95]

In addition, the fiscal cost of incentives can be high, reducing opportunities for much-needed public spending on public services.[96] A 2018 ActionAid study found that Tanzania was losing an estimated $531.5 million (TZS 1.1 trillion) per year, due to corporate tax revenue foregone through VAT exemptions and Special Economic Zones (SEZ) alone.[97]

Accurate calculations of amounts lost due to tax incentives granted by the Government are inherently tricky. This is because of a lack of publicly available data on the potential tax revenues forfeited through discretionary incentives (offered to individual companies rather than open to whole sectors of the economy), coupled with reluctance by government agencies to provide information (citing provisions in Tanzanian law which make it illegal for the Government to disclose the tax affairs of individual companies).[98] Nevertheless, it is likely that the figures provided so far constitute an under, rather than over, estimation.

›› Key takeaways

- Tax incentives do not generally rank high in decisions of whether to invest in specific countries, and much investment would have been undertaken without them.
- Despite a lack of comprehensive data, it is estimated that Tanzania is losing at least TZS 1.1 trillion ($531.5 million) per year in tax revenue foregone through corporate VAT exemptions and SEZs.[99]

7. DOUBLE TAXATION AGREEMENTS

Tax treaties, or double taxation agreements (DTAs), are commonly established to set the allocation of taxing rights between States in order to avoid double taxation of the same income or transaction, and reduce evasion of taxation of income and capital. DTAs include, for example, provisions specifying maximum rates of withholding tax on interest, dividends, royalties and other payments from source countries.

Additional motives for establishing DTAs include the encouragement of foreign direct investment (FDI), a factor which can lead to a downward trend in withholding tax rates in treaties and domestic law. This practice has opened doors to abusive practices like treaty shopping and round tripping,[xvi] which ultimately lead to loss of revenue, especially for capital-importing countries (mainly developing countries).[100]

Tanzania has signed DTAs with nine countries: Canada, Denmark, Finland, India, Italy, Norway, Sweden, South Africa and Zambia,[101] and is currently negotiating DTAs with the Netherlands, United Kingdom, United Arab Emirates, Mauritius, Kuwait, Iran and China. The country does not have a public or democratically scrutinised negotiation policy.[102]

A 2016 study by the Tanzania Tax Justice Coalition (TTJC) found that most of Tanzania's DTAs surrender the country's taxing powers in favour of economically-developed treaty partners.[103] The study notes that these DTAs limit Tanzania's taxation of profits from air and shipping operations, and cap rates of withholding tax that can be levied on interests, dividends and royalties. For example, the DTA with South Africa, signed in 2005, sets withholding tax rates at 10% and caps future justifications of the income tax law. The agreements currently under negotiation could follow suit or pose even lower tax rates.

The same TTJC study argues that there is little evidence to support the common assertion that DTAs are critical to attract FDI. In Tanzania, FDI has mostly been drawn to mining, oil and gas, and primary agricultural products (coffee, cashew nuts and tobacco).[104] According to a report published by the Bank of Tanzania and the Tanzania Investment Centre, the top 10 sources of FDI to Tanzania between 2013 and 2017 were: South Africa, Canada, Nigeria, Netherlands, United Kingdom, Mauritius, Kenya, United States of America, Vietnam and France.[105] Based on these findings, the study concluded that there is little evidence that the existence of DTAs in itself constituted a major determining factor in decisions to invest in Tanzania, as the majority of countries of origin did not have DTAs with Tanzania.

Under current DTAs, the term *'permanent establishment'* is exclusively tied to physical rather than economic presence.[xvii] Such provisions exclude specific types of income earned in the source country (Tanzania) by residents of the other signatories, and imply that DTAs limit countries' ability to tax cross-border activities. This provides opportunities for multinational corporations to avoid their tax obligations.

Overall, it is reported that the provisions in Tanzania's DTAs have created the potential for minimization or avoidance of taxation on income derived in the country. As such, although no estimates are available, it is likely that Tanzania may be losing revenue from the agreements.[106]

›› Key takeaways

- There is little evidence to support the common assertion that DTAs are critical to attract FDI. Indeed, in 2019, most of the countries from which investment flows originated did not have a DTA with Tanzania.
- Provisions in current DTAs have created the potential for minimization or avoidance of taxation on income derived in Tanzania and, as such, it is likely that Tanzania may be losing revenue as a result.

xvi. Round tripping refers to money from one country going out through unofficial channels and being invested back into the same country from outside to avail of tax benefits under the DTA. Treaty shopping typically involves the attempt by a person to indirectly access the benefits of a tax treaty between two jurisdictions without being a resident of one of those jurisdictions.

xvii. "An enterprise of a Contracting State shall not be deemed to have a permanent establishment in the other Contracting State merely because it carries on business in that other State through a broker, general commission agent or any other agent of an independent status, where such persons are acting in the ordinary course of their business. However, when the activities of such an agent are devoted wholly or almost wholly on behalf of that enterprise, he would not be considered an agent of an independent status within the meaning of this paragraph."

PHOTO: NATASHA MULDER/ACTIONAID

8. ILLICIT FINANCIAL FLOWS

Between 1980 and 2018, sub-Saharan Africa received nearly $2 trillion in FDI and official development assistance, and lost over $1 trillion in illicit financial flows (IFFs).[107] As such, IFFs represent a huge challenge for domestic resource mobilisation and efforts to adequately finance the SDGs. So much so that IFFs are directly mentioned under SDG target 16.4, which calls to: *"By 2030, significantly reduce illicit financial flows and arms flow, strengthen the recovery and return of stolen assets and combat all forms of organised crime."*[108]

Global Financial Integrity (GFI) defines IFFs as *"the illegal movement of money or capital from one country to another."* This definition includes hiding the proceeds of crime, channelling funds towards criminal destinations, and evading tariffs and taxes through misreporting of transactions. Other, broader definitions also take into account actions that are not strictly illegal, but which are undesirable because they result in reduced tax revenues, including tax avoidance actions such as strategic transfer pricing.[109]

Unlike developed countries, where income tax is a major source of revenue, developing countries tend to rely heavily on trade-related taxation. The East Africa Community (EAC) Customs Union and Trade Protocol was established in 2005 to promote intra-regional trade and strengthen the productive capacities of member countries through trade agreements and tariff schedules. However, according to recent research by the Anti-Corruption Evidence initiative (ACE), it has in fact contributed dramatically to rent-seeking[xviii] over the last 15 years, through trade misinvoicing and smuggling, resulting in significant revenue losses.[110] Indeed, recent estimations by GFI indicate that trade misinvoicing was responsible for two-thirds of all IFFs, which amounted to $600-900 billion for developing countries alone.[111]

Although tariff evasion is a worldwide phenomenon, it is particularly severe in countries where government has difficulties enforcing tariff rates, customs procedures and rules. In such contexts, it is common for importing firms to engage in trade misinvoicing.[112] This can take different forms, primarily relating to the *under-reporting* of commodity flows to avoid the payment of tariffs set for imported goods, and *over-reporting* as a way of moving capital out of the country.[113] Between 2013 and 2017, the cumulative value of under-reporting across all traded commodities in Tanzania is estimated to amount to over $10 billion.[114] Calculating the potential revenue lost, using the CIT rate of 30%, gives an estimate of TZS 6.27 trillion ($2.7 billion), or roughly TZS 1.4 trillion ($750 million) per year.

xviii. According to the Corporate Finance Institute, rent-seeking describes practices whereby an individual or entity seeks to increase their own wealth without creating any benefits to society, through the manipulation of distribution of economic resources. For more information see: https://corporatefinanceinstitute.com/resources/knowledge/economics/rent-seeking/

Evidence shows that the majority of IFFs take place in the natural resources sector, especially the extractive and mining industries,[115] but other commodities are also associated with smuggling, including sugar, cooking oil, cement and timber.[116] For the purposes of this document we will focus on a couple of recent examples from a selection of these sectors.

Gold and other minerals

Tanzania is said to have lost millions of dollars through IFFs in its mining operations, the country's most important foreign exchange earner. Gold accounts for 90% of the value of Tanzania's mineral exports.[117] During his tenure, President Magufuli introduced major reforms in the sector in an effort to increase revenue collection by the TRA. This included forming various committees tasked with concentrating attention on allegations of illegal operations and tax avoidance by some of the biggest and oldest mining companies in the country.

As part of this process, in 2017 the TRA charged one company, Acacia Gold Mining, with an assessed bill of $190 billion (TZS 424 trillion) for allegedly operating in the country illegally and failing to fully disclose its export earnings over 17 years between 2000 and 2017. The bill was made up of $40 billion in unpaid, backdated revised taxes and $150 billion in penalties and interest.[xix] [118]

Illicit trade in other valuable minerals is also rife. For example, the Tanzania Minerals Audit Agency (TMAA) airport desks seized minerals worth $10.8 million (TZS 1.1 billion) in 89 separate incidents of smuggling and royalty evasion between July 2012 and December 2015.[119] The aforementioned Norwegian Church Aid report highlights the illicit trade in Tanzanite as a specific example of misinvoicing, noting that around $300 million worth of gemstones are smuggled out of the country each year, reportedly ending up in either Kenya or India.[120]

Rice

An ACE study on rice production and trade in Tanzania highlights the prevalence and impact of under-reporting in trade in this commodity. According to the report, in 2017 alone the value of the difference between exports (from foreign countries) and imports (declared by Tanzania) was around $100 million. Assuming that this is an accurate approximation of the value of smuggled rice, and that this rice would have attracted 75% import duties, rice smuggling in 2017 alone would account for a revenue loss of around $75 million.[121]

Sugar

Further evidence from the ACE Initiative demonstrates how, over the period 2001 to 2017, significant volumes of sugar (over 100,000 metric tons per year) were purposely mislabelled. Sugar that was supposed to enter Tanzania for industrial use was sold on the final wholesale market for domestic use. The mislabelling is not accidental, and reflects attempts to apply the lowest potential import duty to the commodity. The data presented indicates that misreporting peaked at over $60 million in 2012 and 2015.[122]

Overall, studies such as these conclude that, depending on the year and the specific import duty, tax revenue losses from misinvoicing can be in the order of millions of dollars. Of course, given the nature of misinvoicing, such calculations cannot capture the exact amounts involved, especially when deliberate mislabelling takes place.

According to the ACE study series, some of the reasons why trade misinvoicing is so widespread in countries like Tanzania include:[123]

- Capability: customs officers are not well trained or equipped with the necessary tools to perform their complex tasks.
- Pay/motivation: customs officers are not always well paid and can be under significant pressure to allow rent capture to happen.
- Complex patron-client networks: revenue and port authorities are contested by political parties and ruling coalitions, with interests in capturing the multi-billion rents that these authorities manage for the Government.

The combination of these factors, in particular the final point, means that simple capacity development and training alone is unlikely to be sufficient to bring about the necessary reforms to tackle corruption and revenue loss.

The 2020 CAG report identified a series of examples (see box below) of unsatisfactory control of commodities being imported and exported and lack of compliance with customs regulations and procedures, which resulted in significant losses of government revenue.

xix. In 2019 the long-running tax dispute between Acacia Mining and the Government of Tanzania was finally settled with a deal that included a payment of $300 million to settle outstanding tax and other disputes, the lifting of a concentrate export ban, and the sharing of future economic benefits from mines on a 50-50 basis https://www.reuters.com/article/us-barrick-gold-tanzania-idUSKBN1WZ0DL

Examples extracted from CAG report 2020

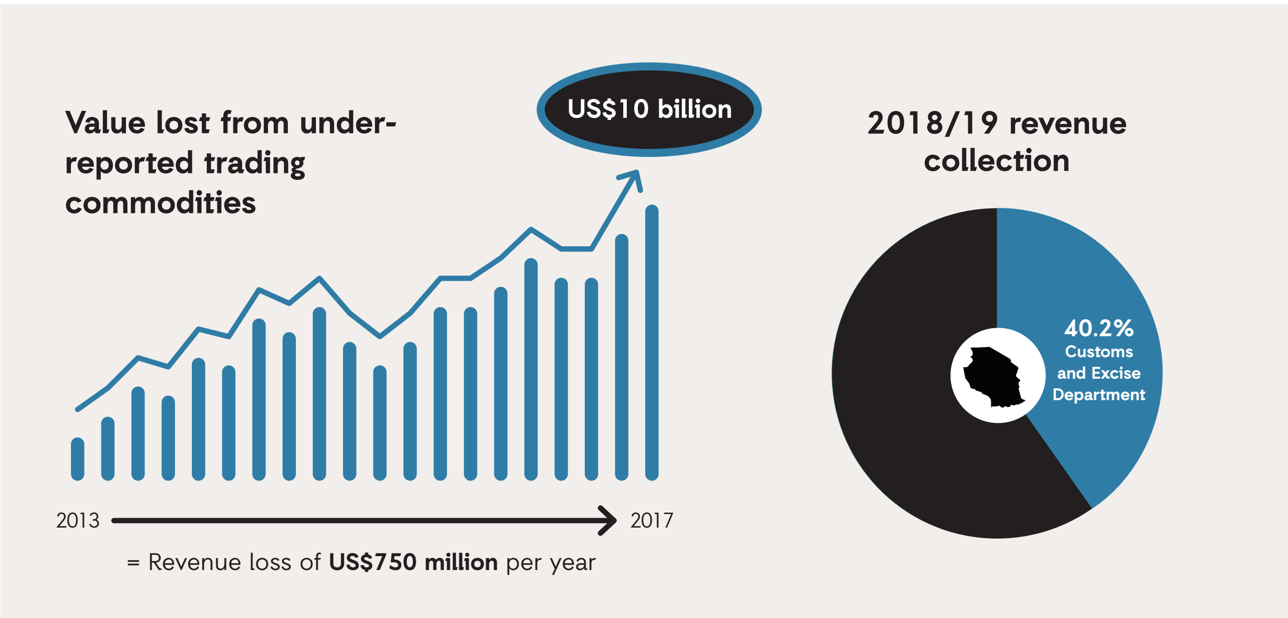
- TZS 13,884 million in customs duties on imported goods for export through Tanzanian ports that were not certified in the Tanzania Customs Integrated System (TANCIS), with no evidence to prove that these goods came from the intended destinations.
- TANCIS information on imported goods through Tanzanian borders with deposits of TZS 113,747 million, which had been entered in the register of receipts at those borders, were not verified in the TANCIS system as the goods in question went to the intended countries.

This lack of compliance with customs regulations and procedures could result in goods intended for export being used domestically without paying taxes, resulting in the loss of government revenue.

The report also highlights:
- Customs taxes on oil worth an estimated TZS 125 million not paid by oil companies due to failure of TRA officials to collect.
- Eleven bills of lading containing nearly 12 million litres of fuel imported into the TANCIS customs system but not estimated for tax purposes, meaning that taxes and port fees worth TZS 3.5 billion were not collected by the TRA.

CAG attributes these losses to customs agents not comparing bills of landing with documents showing the list of cargo imported by ship in the TANCIS system.

It is worth noting that, according to the 2019 CAG report, the Customs & Excise Department accounted for 40.2% of actual revenue collection, making it the single largest source of revenue, followed by the Large Taxpayers Department at 39.8%, and Domestic Revenue Department at 20%.[124] This strongly indicates that resolving issues related to capability, capacity, pay and motivation, as well as 'rent-seeking' and corruption, is critical to maximising revenue.



Key takeaways

- Between 2013 and 2017, the cumulative value of under-reporting across all traded commodities in Tanzania was estimated to be over $10 billion. Calculating the potential revenue lost against this amount, using the CIT rate of 30%, gives an estimated revenue loss of TZS 6.27 trillion ($2.7 billion), or TZS1.4 trillion ($750 million) per annum.
- In 2017, a single mining company, Acacia Gold Mining PLC, was charged by the TRA with an assessed bill of $190 billion (TZS 424 trillion) for allegedly operating in the country illegally and failing to fully disclose its export earnings over 17 years between 2000 and 2017.
- Between July 2012 and December 2015, the TMAA seized minerals worth $10.8 million (TZS 1.1 billion) in 89 separate incidents of smuggling and royalty evasion.
- Revenue loss due to smuggling in rice in 2017 alone is estimated to amount to around $75 million.
- In 2018/19 the Customs and Excise Department accounted for 40.2% of actual revenue collection, making it the single largest source of revenue and highlighting the importance of addressing revenue loss due to capacity gaps, pay and motivation, rent-seeking, corruption and failure to adhere to procedures.

PHOTO: AMRI LUTERA/ACTIONAID

PHOTO: MACLINA KASUNGA

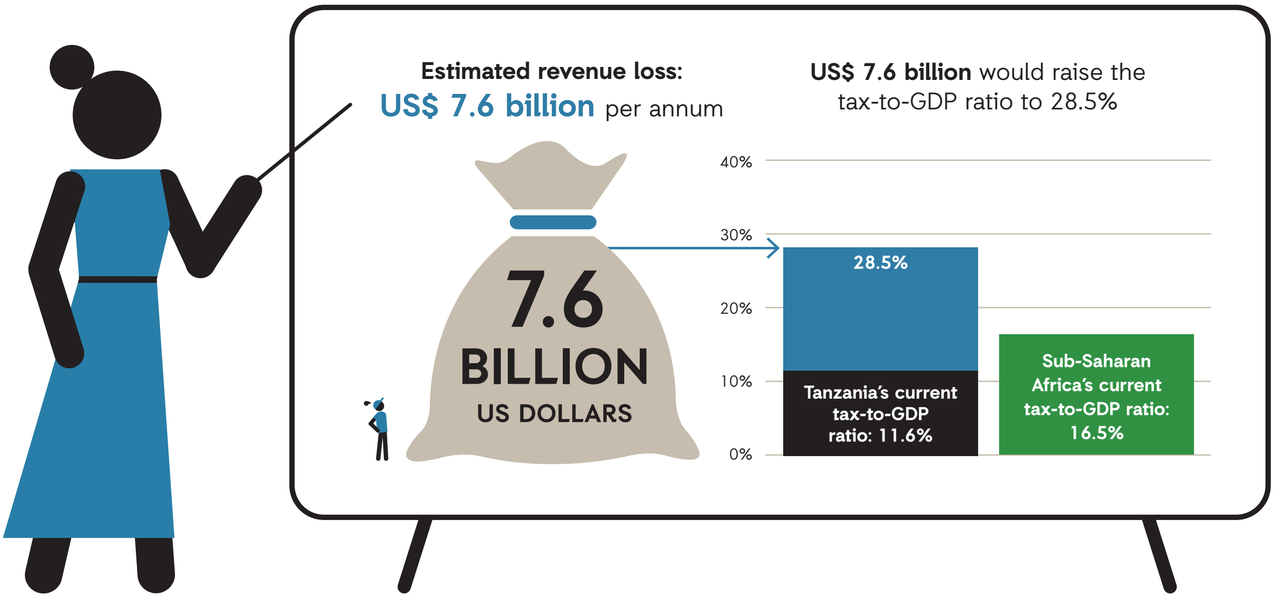
9. CONCLUSIONS: WHY SEALING THE GAPS IS CRITICAL TO IMPROVE EDUCATION FINANCING

Overall, this report shows that Tanzania is currently experiencing huge losses in potential domestic revenue each year due to a range of gaps and weaknesses across the system. These include: the failure to adequately widen the tax base to bring in those thriving businesses currently operating within the country's vast informal sector; weaknesses and inefficiencies within the tax administration system; harmful tax incentives; DTAs and IFFs. Among the greatest amounts, however, are those held up in the tax appeals system, which is likely to be equivalent to around 22% of the national budget for 2020/21.

Once addressed, these funds could be used to reduce external dependency, cover the internal deficit and contribute to the achievement of the country's ambitious social and economic development plans, including the achievement of the country's commitments on SDG4.

Whilst not comprehensive, the findings of this report demonstrate that, between 2013 and 2020, forgone revenue added up to an estimated TZS17.4 trillion (around $7.6 billion) per annum. This is almost equal to the country's annual tax collection for 2020/21,[125] and would be enough to raise the country's tax-to-GDP ratio to 28.5%, close to that of Switzerland and just 5.3% points below the average OECD rate.[126] This would be enough to cover the country's annual budget deficit of TZS3.4 trillion five times.

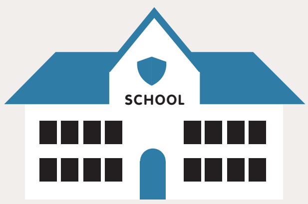
If just 20% of this total amount forgone (TZS3.4 trillion) had been allocated to the education sector in 2019/20, it could have nearly doubled the education budget, from TZS4.5 trillion[127] ($1.9 billion) to TZS7.9 trillion ($3.4 billion). These additional funds would have been enough to cover:



Just 20% of the estimated revenue lost in 2019/20 (US$ 1.9 billion/TZS 3.4 trillion) could pay for:

186,898 pre-primary and primary teachers

The cost of educating all **3.5 million children** estimated to be out of school



Constructing all **226,065 classrooms** estimated to be needed

Other critical needs within the education sector.

- the annual salaries of the estimated 186,898 pre-primary and primary teachers needed to reach the ambitious pupil - teacher ratios of 40:1 at primary level and 25:1 at pre-primary level;[xx] [128]
- the construction costs of all 226,065 classrooms estimated to be needed across the country;[xxi] [129]
- the education costs of the 3.5 million children and young people aged between 7 and 17 estimated to be out of school;[xxii]
- And still have around TZS 1 trillion ($ 461 million) left over to cover other critical needs within the sector.

Even with all these costs accounted for, there would still be a remaining balance of TZS 13.9 trillion ($6 billion) to invest in other national development priorities such as health, water, infrastructure, energy and agriculture.

For this to happen, and for Tanzania to benefit from the additional domestic revenue it could mobilise, it is critical that the Government take urgent measures to seal the various gaps identified in this report, and we provide some recommendations for ways forward.

xx. This is based on figures in the ESDP 2016/17 – 2020/21 and an average annual salary figure of TZS 8 796 000
xxi. This is based on a rough calculation of US$10 000 per classroom.
xxii. This is based on UNESCO per-pupil spend statistics from 2014 of $92 per pupil x the estimated 3.5 million out of school children as per the UNESCO and Government of Tanzania out of school children report.

Recommendations

The Government of Tanzania should:

Expand the tax base in fair and progressive ways by ensuring that:

- Taxation of the informal sector distinguishes clearly between those who are earning too little to meet VAT or income tax thresholds and those 'hiding' in the informal economy to evade taxes. The latter should be brought into the formal economy and pay income taxes and VAT.
- Informal sector taxes are fair and progressive, for example by ensuring that women and the poorest are not disproportionately affected, with thresholds below which informal workers and businesses are not taxed.
- Formalization processes guarantee that fundamental workers' rights and conditions and social protection are respected, in line with ILO Recommendation 204.

Enhance tax-payer morale and compliance by ensuring that tax payment is clearly linked to public spending, making visible and transparent investments in critical public services in order to enhance taxpayer morale and compliance and increase Tanzania's chances of raising its tax-to-GDP ratio.

Improve revenue generation at local government level, by implementing measures to improve LGA performance against revenue collection targets, reduce LGA dependency on central government and increase their capacity to deliver critical public services. Measures should include:

- improving supervision;
- ensuring revenue is collected to the full potential of available sources;
- setting more realistic targets;
- tackling staff shortages and capacity gaps; and
- ensuring that effective tools for revenue collection are in place and properly used.

Address non-compliance and non-payment, adequately addressing issues such as the failure to demand and issue EFD receipts, failure to deduct and submit withholding tax, and failure to file VAT payable.

Improve management of tax arrears, making urgent investments in improving the efficiency of systems for managing tax, in order to avoid the pile-up of long outstanding amounts, for example by ensuring effective and timely implementation of recommendations regarding enforcement and debt management mechanisms highlighted in CAG annual reports.

Introduce more effective and efficient tax appeals mechanisms, by increasing the numbers of skilled and experienced personnel in the various tax audit and technical units and improving compliance with time-limits established for settlement of tax objections to limit revenue loss.

Stop offering harmful tax incentives, and offer incentives selectively only to facilitate development:

- Review all current tax incentives, including discretionary tax incentives and those applicable to SEZs, to assess whether they are fit for purpose, including a cost-benefit analysis.
- Subject all tax incentives, both statutory and discretionary, to public scrutiny, including by Parliament, media, civil society and citizens. This should include publishing an annual overview of the costs of tax incentives as part of the annual budget, so that the public can see the impact of corporate tax incentives.

Review tax treaty networks, as well as current withholding tax rates e.g. for dividend and interest payments abroad, to ensure that they do not result in tax losses and renegotiate those that do. Cancel or renegotiate disadvantageous tax treaties.

Take serious action to curb illicit financial flows, by continuing to take action to address the various underlying complex issues, especially in the sectors most frequently associated with illicit trade. Actions should include:

- addressing gaps in capacity, capability and motivation amongst customs officials;
- tackling Base Erosion and Profit Shifting and trade misinvoicing;
- identifying ports, airports and borders associated with smuggling, enforcing compliance with customs regulations and procedures; and
- rooting out corruption and rent-seeking.

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ActionAid is a global movement of people working together to achieve greater human rights for all and defeat poverty. We believe people in poverty have the power within them to create change for themselves, their families and communities. ActionAid is a catalyst for that change.

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November 2021