Tax justice and illicit financial flows in extractive sector

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The call for tax justice has in recent years gained credence as alarming evidence now shows that while ordinary tax payers are sinking under the burden of taxation on the other hand, multibillion profiteering corporate and well connected individuals use both illegal (illicit) and deemed appropriate means to dodge taxes and shift their profits and financial proceeds outside the country and the African continent to other destinations and largely low tax jurisdictions. The amounts moved out of less developed countries and the African continent is estimated in billions of United States dollars. The extractive sector is evidently of one of the major conduits of this illicit game of sorts and hence the focus on illicit financial flows as a subject in the extractive sector makes sense.

This policy brief highlights the basic concepts and practice of this increasing murky subject and the relevancy of talking about tax justice and tax dogging in the Extractive Sector with various stakeholders such as professionals and students in higher institutions of learning. Students in higher institutions are a critical nexus in defining the current and future landscape of fiscal policy, taxation, tax justice and curbing illicit capital flight from Tanzania and the African continent as a whole. They are;

- Citizens and have a right to know the intricacies of taxation, dodging tax and development
- Scholars and Researchers
- Future politicians and leaders
- Future policy and decision Makers
- Future Government Negotiators
- Future Corporate professional and executives

[1] This brief is compiled as summary of presentation made for Students of Higher Institutions of Learning at various Universities in Tanzania by Mr. Moses Kulaba , Executive Director, Governance and Economic Policy Center, Tanzania and International Board Member of the Extractive Industries Transparency Initiative (EITI) and Africa Steering Committee of Publish What You Pay, Global Coalition between 2014 and 2018

- Future Civil Society Activists, Community and Development workers

In simple terms, the **future lies in the present**!

Taxation and tax justice

A tax is a compulsory imposition of the state on its citizens. The tenor of Tax Justice is that everyone should pay a fair amount of tax so that the government can be able to finance or provide social, public and development needs for its citizens.

Taxation and a strong tax system may contribute to improved governance through 3 maximum channels. Taxation establishes a fiscal social contract between citizens and the taxing state. Tax payers have a legitimate cause to expect something in return for paying taxes and are more likely to hold their governments to account. Governments have a stronger incentive to promote economic growth when they are dependent on taxes[2].

The major concern from a tax justice point of view is that in recent times, it is evident that those who are able and should pay more are paying less or none while poor and less privileged carry a big burden through payment of various direct and indirect taxes like VAT which are regressive and unfair in nature

In this case, the concern is that available data shows that Corporate persons in the extractive and telecommunications sector dodge paying taxes by enjoying generous tax exemptions and by engaging in tax planning , tax avoidance, outright tax evasion and moving their proceeds out of the country or African continent where its generated to low or zero tax jurisdictions through illicit or deemed legal means.

These illegal movement of tax proceed and capital from one jurisdiction to another is what has been described as Illicit Financial Flight (IFF). According to reports, IFFs typically originates from three sources: Commercial tax evasion (trade mis-invoicing and abusive transfer pricing); criminal activities (including drug trade, human trafficking, and illegal arms dealing, smuggling of contraband; bribery and theft by corrupt government officials.

According to experts (*Ndikumana, Boyce and Ndiaye 2015)*, Africa's high level of poverty has been aggravated by the high level of capital flight. As a consequence of IFFs, tax revenue collection is low, social delivery has remained poor and development agenda are stagnating in most poor countries where it occurs

Tanzania's Tax Collections and tax gap 2016/17

According to Tanzania's Revenue Authority (TRA)

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[2] *CMI Chr Michelsen Institute: Lifting the veil of secrecy; Perspectives on international taxation and capital flight from Africa, Norway, 2017*

- Tax Collection of 12.6% of GDP (Tsh15.1Trillion) was envisaged in 2016/17
- However, proportion of GDP collected has not increased
- Tanzania's tax revenues are also low compared to international standards
- Tax to GDP ratio is 11.9% below the EAC standards which is at 13.1% to 14.7%
- The current tax to GDP ratio of 12% is far below the targeted mark of 20% by
- PAYE and VAT as largest contributors

Illicit capital flight or Illicit Financial Flows (IFF)

Illicit or illegal Capital flight is the transfer of assets abroad in order to reduce loss of principal, loss of return, or loss of control over one's financial wealth due to government-sanctioned activities"

- Also referred to as movement of resources from one jurisdiction to another through illegal means.
- Legal means are supported by the law or through tax avoidance measures which are used to exploit the weaknesses and lacunas within the tax laws
- Illicit flows take place through transfer mis pricing, tax scheming, illicit profit repatriation, tax dodging and money laundering.
- In Tanzania capital flight was reported to be taking place through both legal and illegal means

Statistics of Illicit Financial Flows from Tanzania

- According to existing studies, it is estimated that Tanzania loses USD1.83Bln (Tsh4.09Trillion) every year from tax incentives, illicit capital flight, failure to tax informal sector and other forms of evasion[3]. This figure is an estimate and yet to be confirmed by the Tanzanian government which commissioned its own independent study.
- If estimated loss was collected, it would triple government budget on health and nearly double spending on education.
- Global Financial Integrity (GFI) estimates, USD7.73bln lost from Tanzania illegally in the past five years as a result of trade –mis-invoicing
- At corporate rate of 30% Tanzania could have lost an average of USD464Mln annually

[3]Marc Curtis, Dr Prosper Ngowi and Dr Attiya Waris: One Billion Dollar Question: How can Tanzania stop losing so much tax revenue; A report for the Christian Council of Tanzania, Tanzania Episcopal Conference and the National Muslim Council of Tanzania, 2012

Statistics of Illicit Financial Flows in Extractive Sector

- Export revenue from mining increased from 16% in 2013 to 26% in 2015 due to increase in taxes paid by companies. However, this is still low compared to an average 30% for other Countries such as South Africa.
- TMAA Audit showed Mining (Including Construction) had not paid up to USD688Mln worth of taxes between 2013-2015. An average of USD229Mln annually is not paid
- This figure has since increased as per the estimates made by the Presidential Commission reports (Dr Osoro report).

Some statistics on Gold mining and Resource leakage in Tanzania in 1998-2005

According to available study reports

- Gold worth more than USD 2.54bln was exported between 1998-2005
- Only USD 28mln received in Royalties and taxes
- This was equivalent to only 10% over a 9-year period
- The 3 % royalty charged then brought government only an average USD 17mln a year in recent years
- Cumulatively, USD 26.5mln lost in excessive low rate, government tax concession
- In 2005 at least 400,000 small artisan miners were unemployed since 1998 when they were evicted from the mining areas and therefore denying government billions in tax revenue.

Consequences of extractive resource leakage and development potential

- According to the UNDP and World Bank measure of poverty and development standards, Tanzania is still among the poorest Countries in the world. At least 12mln out of 39mln live in abject poverty. Yet, Tanzania processes around 45mln ounces of Gold. At current prices, Tanzania has a fortune of USD39bln. If well, harnessed Tanzania would be compelled to a middle-income country within less than 10 years.

Vents for extractive resource leakage

- As per the Mining Act of 2010, mining companies offset 100% after their capital expenditure
- 100% ownership of Gold mining Companies
- Mining dominated by two foreign mining companies-Barrick Gold and Anglo Gold Ashanti
- In 2005-AGA paid USD144mln in Royalties

- It sold gold worth USD 1.55bln, paid only 9% royalty
- Barrick Gold paid only 13% of its export. No accurate data on total exports was available
- The Parliamentary Accounts (PAC) reported in 2007, both companies declared losses worth USD1.045bln. Tanzania Extractive Industries Transparency Initiative (TEITI) reconciliation reports also indicate that Barrick has persistently reported loses and never paid corporate tax
- Yet, a leaked ASA tax audit report indicated companies overstated losses by USD502mln between 1999-2003
- Government thus lost revenues worth USD132.3mln between that period alone.

Tanzania's tax incentive regime as at 2017

- Non tax incentives include
- immigration quotas on employment of foreign staff,
- guaranteed transfer of net profits or dividends of the investments,
- payment in respect of foreign loans, remittance of proceeds net of all taxes and other obligations, royalties, fees and other charges on emoluments and other benefits to foreign personnel
- Under mining Act , 2010, Royalty of 3% execpt for diamonds which is 5% & 12.5% for petroleum
- No tax, duty, fee or other fiscal impost on dividends
- No capital gain tax
- No windfall tax
- Losses carried forward for unrestricted period
- Duty rate at 5% and VAT charged after 5 years of commercial production
- Yearly appreciation of unrecovered capital in investment, exploration, prospecting, mineral assaying, drilling or mining company of goods, imported are eligible from duty under customs law
- Services for exclusive use in exploration, prospecting, drilling or mining activities
- Zero rating of all capital goods, spare parts, fuel, oils together with explosives
- Corporate tax of 30% and capital allowance of 50% on Y1 of income
- All capital expended on prospecting and mining is expended

- 100% transferability of profits to foreign accounts

Major strategies for facilitating illicit financial flows in Extractive Sector

Tax Base Erosion and Profit Shifting (BEPS)

- Collective tax planning strategies used by multinational companies that exploit gaps and maximizes in tax rules to artificially reduce its tax base or obligations by shifting profits to low or no tax locations where there is little or no economic activity. In 2012 the OECD Countries initiated collective efforts to tackle concerns over BEPS and perceived international tax systems facilitating tax avoidance (BEPS project and action plan).

Tax avoidance

- Tax 'avoidance' constitutes an 'arrangement of tax payer's affairs that is intended to reduce his ability and that although the arrangement could be strictly legal it is usually in contradiction with the intent of the law it purports to follow'

- Justice Reddy in *Mc Dowell & Co. Ltd Vs CTO 154 ITR 148 (19985) India,* has defined tax avoidance as 'the art of dodging tax without breaking the law. It is the avoidance of tax payment without the avoidance of tax liability.

- Tax avoidance simply involves structuring your affairs legally so that you are paying less tax than you might otherwise pay. It could involve exploiting lacunas with the law to ones advantage.

Tax Evasion

- Tax evasion can be defined as a deliberate measure to escape one's tax obligation through illegal means

- tax evasion is also defined as the illegal non payment or under payment of taxes, usually by making a false declaration or no declaration to tax authorities; it entails criminal or civil legal penalties

- Tax 'evasion' involves 'illegal arrangements through or by means of which liability to tax is hidden or ignored' as a consequence of which "the tax payer pays less than he is legally obliged to pay by hiding income or information from the tax authorities

Tax planning

- Tax planning' is defined as the arrangement of a person and or private affairs in order to minimise tax liability

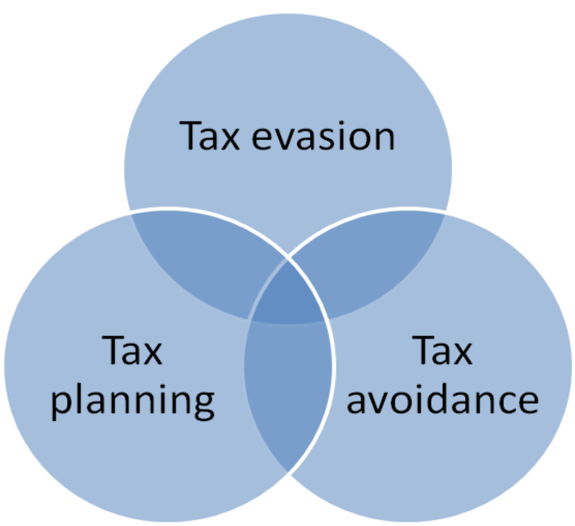
- It enables reduction in the liability through the movement or non movement of person, transaction or funds or other activities that are intended by the legislation

- There is also something called as 'aggressive Tax planning' which is the severest form of tax planning -illegal

Differences and similarities of Tax Evasion and Tax planning

Tax Evasion	**Tax Avoidance**
A deliberate refusal to pay a tax	Exploitation of the weakness in the low to pay less or nothing at all
Clearly illegal	Appears to be legal
Similarities	
Thin line exists between the two and quite often all use to achieve the same goal-minimal or none payment of the tax	
Both are unethical in the face of tax Justice	

Overlap between tax evasion, avoidance and tax planning



How is tax evasion

- Failure by a taxable person to notify of a tax authority of a presence of its operations, if they are taxable operations,
- Failure to report full amounts of taxable income, deduction claims for expenses that have not been incurred or which exceed the amounts incurred but not for the purposes stated,
- Falsely claiming reliefs that are not due, for example VAT refund and exemptions
- Failure to pay over to tax authorities' due taxes,
- Departure from a country leaving taxes unpaid without intention to pay and
- Failure to report items or sources of taxable income for example profits or gains where there is an obligation to do so

Tax Avoidance measures include

- Income splitting measures whereby incomes are shared amongst more than one tax payer for purposes of reducing tax rate or tax obligation.
- where transactions between two related parties are inflated or fixed a Transfer pricing or mispricing measures above the average market price (arms-length) for purposes of avoiding taxes by minimising profits in a high tax location and maximising profits in a low profit location

Relevant readings

- ***Marc Curtis, Tundu Lissu****: A Golden Opportunity? How can Tanzania is failing to benefit from gold mining; A report for the Christian Council of Tanzania, Tanzania Episcopal Conference and the National Muslim Council of Tanzania, 2015*
- ***Marc Curtis, Dr Prosper Ngowi and Dr Attiya Waris****: One Billion Dollar Question: How can Tanzania stop losing so much tax revenue; A report for the Christian Council of Tanzania, Tanzania Episcopal Conference and the National Muslim Council of Tanzania, 2012*
- ***CMI Chr Michelsen Institute****: Lifting the veil of secrecy; Perspectives on international taxation and capital flight from Africa, Norway, 2017*