

DANGERS OF DOUBLE TAXATION AGREEMENTS
IN FINANCING DEVELOPMENT:
CASE STUDIES OF TANZANIA DTAs WITH SOUTH
AFRICA AND INDIA

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DANGERS OF DTAs IN FINANCING DEVELOPMENT

- OUTLINE

1. Context of the study
2. Domestic Resource Mobilization (DRM) and Taxation
3. Need for financing Development in TZ
4. DTAs and DRM
5. Discussion of a case study DTAs (TZ vs SA and India)
6. Policy recommendations

1. CONTEXT OF THE STUDY

- Taxation has been the main source of Domestic Resource Mobilization for financing development in African countries.
- Some countries have pursued tax treaties as fiscal policy instruments to attract investments
- Concerns of Tax treaties
 - ✓ To what extent these treaties were given weight to contribute to DRM, (What is the objective behind signing of such treaties)
 - ✓ How such treaties were negotiated; and
 - ✓ How taxing rights are shared between the participating countries

1.2 Objectives of the study

General:

To shed light on logic behind signing of various tax treaties in Tanzania.

Specific:

- i. To review DTAs signed by Tanzania with SA and India
- ii. To Analyse the dangers that DTAs pose towards financing development in Tanzania; and
- iii. To make policy recommendations

1.3 Methodology

Methodology

- Desk research - qualitative nature.
- Applied a qualitative data analysis (QDA) approach

1.4 Need for financing Development in TZ

- LDC /Poor country
- Population (2017)= 57m
- Population growth rate = 3% annually
- Urbanization rate = 30%,
- These have triggered a rise in demand for infrastructure and social amenities implying a need for financing.
- Sustainable development goals (SDGs)

2. Domestic Resource Mobilization (DRM) and Taxation

- **DRM is key to achieving SDGs**
 - **Tax and non-tax sources:** (royalties, licenses, levies or other income)
 - **Savings:** In 2016 Tanzania saved 5.6% of GDP, South Africa 19.6% and in India 28.9%.
- **Ability to collect taxes and spend them effectively**
- **LDCs face particular challenges in tax policy and administration:**
 1. **Tax Incentives and Exemptions, Evasion and Avoidance**
 - (2017), Loss of \$1.83 billion (TShs 4.09 trillion) a year from *tax incentives, illicit capital flight, the failure to tax the informal sector and other forms of tax evasion*
 2. **Corruption**
 - \$1.3 billion (TShs 2.9 trillion)
 3. **Narrow Tax Base,**
 - Few large tax payers, low compliance, informal sector

3. DTAs-DRM

3.1 DTAs and DRM

What is the contribution of DTAs to DRM?

3.2 Theoretical Benefits of DTAs

- i. To avoid double taxation
- ii. Mitigation of international tax avoidance and evasion
- iii. To Catalyse the movement of capital between the treating countries, internationally accepted tax standards
- iv. To foster access to market and business confidence between the Contracting States.

3. DTAs and DRM

3.3 Costs of DTAs

i. Unequal distribution of revenues

- Income flows from LDCs (source) to DCs (residency)
- Lost taxing rights by LDCs, E.g. In 2011 USD 854.7 million was estimated revenue foregone by LDCs to the Netherlands alone, excluding royalties,

ii. Tax avoidance, tax havens

iii. Lack of technical capacity – Inability to effectively negotiate and implement DTAs

4. DISCUSSION OF CASE STUDIES

- Tanzania has a network of 10 DTAs
- India has over 90 DTAs
- South Africa has 69 DTAs

Models On which the two DTAs are built

- Both models are based on OECD model

4.1 Tanzania – India DTA

- First DTA was signed in 1979 . The revised Agreement was signed in Dar es Salaam in 2011.
- The existing taxes to which the Agreement applies are:
 - **In India**
 - the income tax, including any surcharge thereon; (hereinafter referred to as "Indian tax");
 - **In Tanzania**
 - the income tax and any other tax on income imposed under the Income Tax Act, Cap. 262, Revised Edition 2004 (hereinafter referred to as "Tanzanian Tax")

4.1 Tanzania – India DTA...

The potential dangers in the DTA in respect of losing taxing rights

i. Lack of Clarity in the Definition of tax

- Tax is narrowly defined as Indian or Tanzanian Tax.
- Some gaps still exist i.e. tax on incomes of religious institutions' staff are not incorporated into the agreement.

ii. MAP (Mutual Agreement Procedure)

- No provision for guidelines or format for taxpayers to present a MAP
- According to OECD, MAPs should not be necessarily pursued
- What if MAP doesn't work?

4.1 Tanzania – India DTA...

iii. Competent Authority

- The scope and powers of the Ministers and their representatives have not been defined
- In case the competent authorities of the contracting states do not agree, the appeal procedures are not provided

iv Does not address partnerships with some members who are not residents of the contracting states

4.2 Tanzania – South Africa DTA

- Signed DTA in June 2007
- The existing taxes to which the Agreement applies are:
 - In South Africa:
 - i. the normal tax;
 - ii. the secondary tax on companies; and
 - iii. the withholding tax on royalties; (hereinafter referred to as “South African tax”);
 - In Tanzania:
 - i. the income tax; and
 - ii. the withholding taxes under the Income Tax Act, 2004; (hereinafter referred to as “Tanzanian tax”).

4.2 Tanzania – South Africa DTA ...

The potential dangers in the DTA in respect of losing taxing rights

i. Lack of Definition of tax

ii. Competent Authority

- The DTA has the defined “*competent authority*”, which is the Minister of Finance or authorised rep of the minister in TZ and the commissioner of SARS or his authorised rep in SA
- Why unequal authority?
- The scope and powers of competent authority have not been defined

4.2 Tanzania – South Africa DTA ...

iii. Partnership is narrowly defined

- How about partnership with some non-residents of a contracting states?

5. Brief Discussion of Findings

Dangers identified in double taxation treaties

5.1 General Dangers

- Tax treaty provisions in both case study DTAs override domestic law;
- The OECD Models on which these two DTAs are based, favour capital exporting states against capital importing states
- UN model focuses on taxing income from the source, how is it widely accepted and used?
- Provision of certainty on the taxing rights of Tanzania is denied.

5. Brief Discussion of Findings...

5.2 Main dangers from a Tax Justice perspective

i. **Double non-taxation**

ii. **Source or resident**

iii. **Enablement of harmful tax practices**

- **Treaty shopping** in which a resident of a third state may artificially acquire residence in one or both of the contracting states just to take advantage of the favourable tax treaties; and
- **Round tripping**, where investments, capital, income and profits are routed through low tax jurisdictions or 'tax havens'.

5. Brief Discussion of Findings...

5.3 What should be done differently...

- A typical tax treaty should be designed to deal with three challenges of double taxation:
 - i. The dual residence problem
 - ii. The source problem: contracting states can provide a common source of income rule in the tax conventions.
 - iii. The model tax treaty: Countries should **develop a model tax treaty** (tailor-made model) that reflects their actual needs.

6. POLICY RECOMMENDATIONS

Tanzania Tax Authorities should do the following:

- i. Review the existing DTAs to improve positive impact to DRM
- ii. Build Capacity of the relevant negotiators of double taxation agreements
- iii. Raise awareness to the citizens and other stakeholders on the DTA issues
- iv. Improve the level of public participation needed towards the negotiation process of DTAs
- v. Tanzania should avoid tax incentives/holidays (EPZs and SEZs)

Important Questions

1. What is the actual contribution of DTAs in DRM in Tz?
2. Can DTAs be effective without MAPs?
3. Is UN model fully accepted by DCs?
4. According to Baker, (2014), empirical evidence as to whether DTAs indeed lead to higher investment flows is far from conclusive. Is it true?
5. Do we need DTAs for the development of our countries?