

PricewaterhouseCoopers Tanzania*
Post Budget Client Seminar
13 June 2008

*connectedthinking

PRICEWATERHOUSECOOPERS 

Staying the Course*

Today's Agenda

INTRODUCTION

Edmund Mndolwa, Partner – Assurance Services

ECONOMIC REVIEW

Onesmo Shuma, Director – Advisory Services

REVENUE PERFORMANCE, TAX CHANGES

David Tarimo, Partner – Tax Services

PANEL DISCUSSION

COCKTAILS

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Budget 2008 Economic Review 13 June 2008

Onesmo Shuma, Director

Agenda/Contents

1. How did we perform?
2. Prospects for growth!
3. Looking ahead, what targets have we set for ourselves?
4. Key issues/challenges
5. What else?

The objective of the 2007/2008 budget?

- To make headway in achievement of MKUKUTA objectives for increased economic growth and poverty reduction (particularly income poverty)
- To achieve this, the following indicators were proposed:
 - Achievement of GDP growth of 7.7%
 - Contain inflation at 4.5% by June 2008
 - Accelerated financial sector reforms
 - Strengthen basic national infrastructure
 - Enhanced agricultural production

How did we perform?

Approach # 1: Analysis of key policy targets set in 2007

	2006	2007
Real GDP (%)	6.7	7.1
Inflation rate (%)	7.3	7
Exchange rate (Tshs)	1,253	1,244
Per capita income (Tshs million)	478,434	548,388
Money supply (%)	13.7	28.8
Credit extended to private sector (Tshs million)	30%	42.2%

Note:

1: Between Dec 2007 and April 2008, inflation increased to 9.7%

2: By Dec 2007, the value of a Shs. was 1,132.1 to a dollar compared to 1,261.6 at end of Dec 2006

How did we perform?

- **Inflation:** The economy continues to experience inflationary pressure- like many other countries in the world-rise in oil and food prices!.
 - Unless the world oil prices declines significantly (very unlikely!!), the impact is going to be felt for a foreseeable future.
- **Exchange rate:** In general, the value of Tshs has marginally stabilised against US\$. This was largely due to:
 - depreciation of US\$ against major currencies,
 - adoption of tight monetary policies and
 - other measures adopted by BoT.

How did we perform?

- **Balance of payments:** Overall, we performed poorly! Current account deficit increased by 49.1%. This is due to increase in value of imports compared to exports.

However, there was a slight improvement in service receipts-tourism, trade and transit passengers. This is not enough!

- **Foreign reserves:** Despite deficits in the balance of payments, foreign reserves increased by 21.9% between 2006 and 2007. The reserve position in 2007 was enough to cover 4.6 months of goods and services

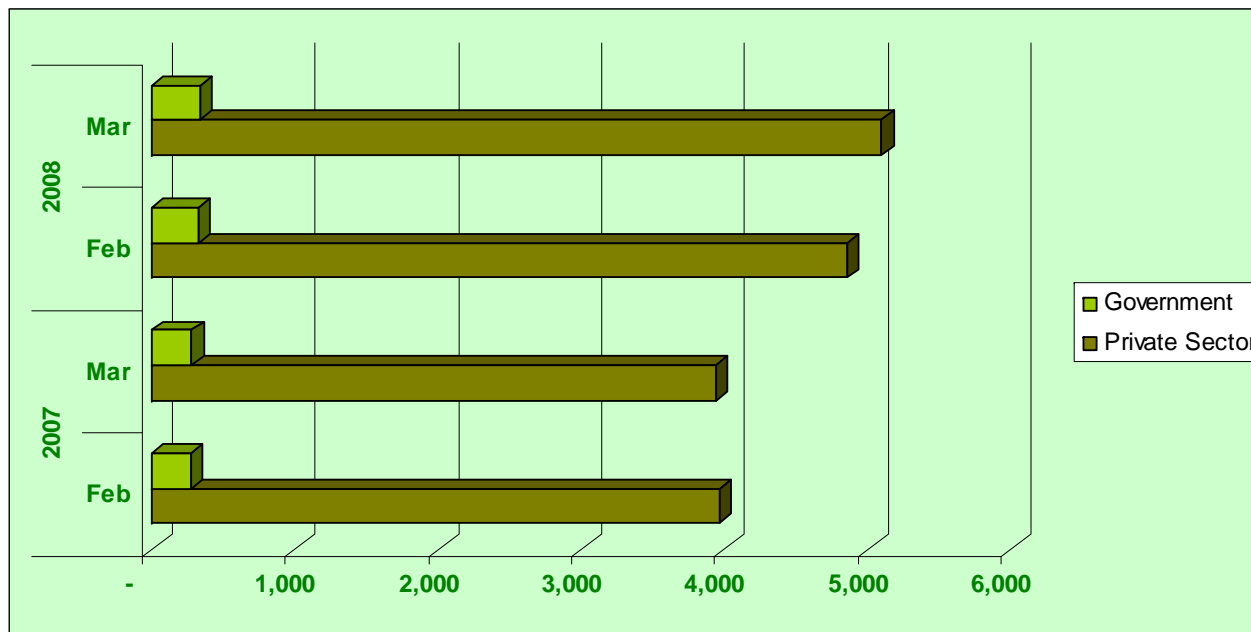
How did we perform?

- **Agriculture** - Contribution to GDP has declined due to the fact that other economic activities have grown at a relatively higher rate
- There has been a revision in the methodology for National Accounts.
- Revisions have changed the structure of the economy- revisions of weights of the various activities in the GDP.
- **Income per capita:** The per capita income increased to Tshs 548,388 in 2007 from 478,434 in 2006. equivalent to an increase of 14.6% at current prices.
- **Capital formation:** Capital formation to GDP increased from 27.6% in 2006 to 29.6% in 2007. This is due to increase in building and construction activities, imports of capital equipment and other construction work- e.g. roads and bridges

How did we perform?

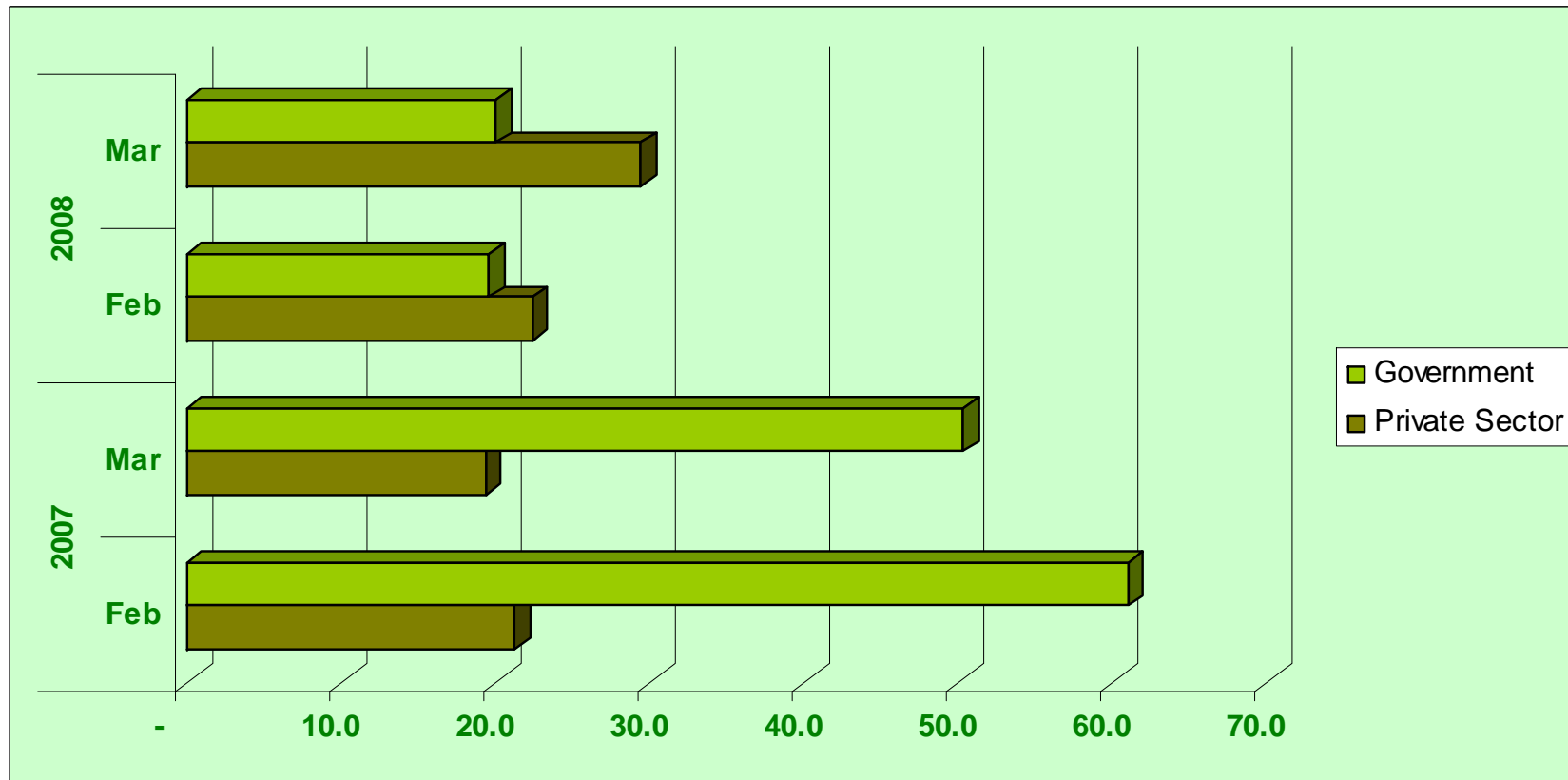
- **Domestic lending:** The increase in domestic credit resulted from a strong performance in commercial banks credit to private sector.
- Overall deposit rates =7.8% (June 2007) to 8.2% (Dec. 2007). The 12- month deposit rates= 9.25%-10.2%: Lending rates: dropped slightly=16% to 15.2%

Total deposits in the commercial banks in billion shillings



How did we perform?

Total deposits in the commercial banks – Annual growth rates in %



How did we perform?

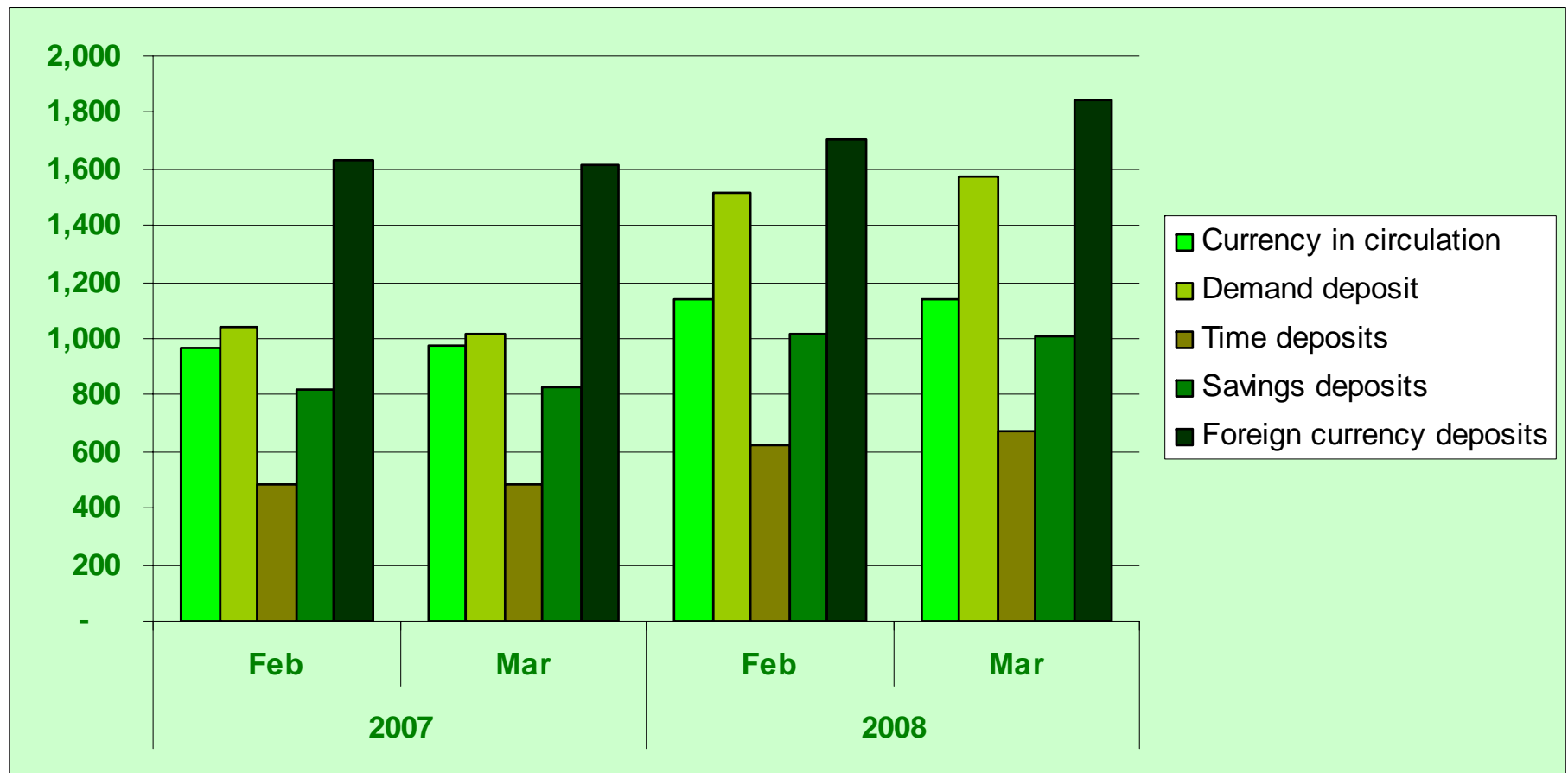
- **Money Supply:** Progress has been made in keeping on track the growth of broad money supply. M2 grew at an annual rate of 28.8% by Dec 2007 compared to 13.7% in Dec. 2006.
- The annual growth rate of extended broad money M3 was 21.4% compared to 22.0% over the same period.
- The increase in the growth of M2 was due to growth in demand deposits following a large increase in commercial banks credit to private sector

How did we perform?

- There has been a significant fall in the base rate of Treasury Bills. Recent development in these markets have influenced the pattern of interest rates on deposits and loans.
- There has been a declining demand in the Treasury Bill due, partly to declining return on investment which has reduced incentive for some commercial banks to trade in government securities,
- The overall weighed average treasury bills rate declined steadily from 17.1% in June 2007 to 7.4%, in March 2008, far below the overall lending rates. This is in line with BOT's continued efforts to control the level of liquidity in the economy.

How did we perform?

Broad money supply (M2)



How did we perform?

Approach # 2: Review of the performance of the prime areas of the economy.

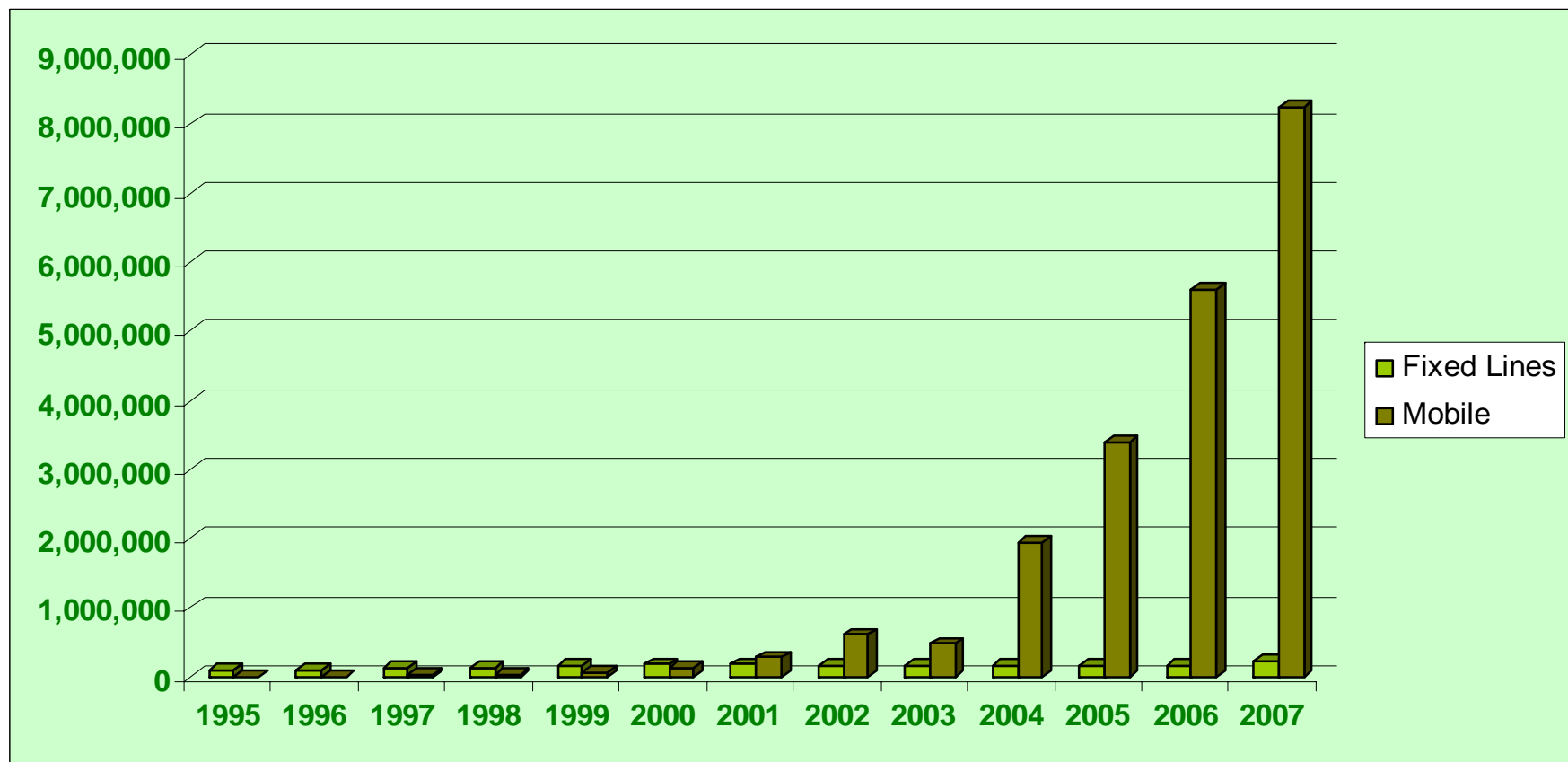
- The GDP grew by 7.1% compared to 6.7% in 1996. This is good, BUT only in comparative terms!, In absolute terms, we are starting from a very Low Base!
- The increase in the growth rate is attributed to an increase in the economic activities in the following sectors:

Communication	20.1%
Mining	10.7%
Financial intermediation	10.2%
Trade	9.8%
Construction	9.7%
Health	8.8%
Agriculture	4.0%

Communication

- The Tanzanian communication sector is still in a nascent stage of development.
- Mobile phones have overtaken fixed lines subscribers but the teledensity is still low

Fixed line telephones compared to mobile phone in Tanzania



How did we perform?

Approach 3: # What are we practically seeing on the ground - (A quick litmus test)

- Escalating food prices - Although generally Tanzania is self-sufficient in food production. What has happened?
 - Transport costs have led to an increase in the cost of locally produced food
 - Transport has multiplier effect - 'cause food products have to be taken to the market to reach the final consumer
 - Transport costs constitutes 9.7% of Tanzanian inflation basket

Prospects for growth?

- Overall, there are good prospects for economic growth
- BUT??Inflation growth trend is already showing signs of bleak prospects for continued growth unless drastic measures are taken
- Food is the dominant factor in the Tanzanian inflation basket. Inflation is almost reaching a historic double digit for the first time after a decade of maintaining a single digit
- This trend has a tremendous negative impact on the consumption patterns- why? 'cause of a unique (perhaps anomalous !) relationship between food consumption and incomes

Prospects for growth?

- Will erode the purchasing powers of most of the citizens-”cause they will have to spend the bulk of their incomes on food. This is bad to the economy and business at large
- This will harm businesses because the bulk of the consumers are low income
- Businesses needs a critical mass of consumers for them to break even. This will unfortunately not be the case

Given these challenges, what will be the key drivers to economic growth?

- **Contain inflationary pressure:** continue with implementation of strategic monetary policy e.g. of reducing broad money growth
- **Increase in productivity:**
 - Improvement in public infrastructure is a key component for fostering productivity. Increased productivity will lead to result of poverty reduction. This should be the government priority going forward
 - Reduction of energy costs- Over the past couple of years, high energy costs (mainly due to un-reliable power supply) have increased the cost of doing business in Tanzania. Efforts to achieve economic and financial viability for TANESCO is critical to address this problem
 - Establishment of common market-Through EAC market integration by way of free trade amongst member countries. The trade agreement with EU which in effect will replace the Cotonou Agreement by extending free access to EU markets for products from EAC

Looking ahead, what targets have we set for ourselves? (2008/2009 Budget)

- Sustaining macroeconomic indicators, including economic growth, inflation, domestic revenue and the exchange rate
- Increase in momentum in the implementation of NSGRP and resource allocation in the areas that have rapid multiplier effects in the economy
- Improvement in rural infrastructure, improved access to rural finance through SACCO's and various Credit Trust Funds-These measures will have an overall effect of increasing the growth rate of agricultural activities

Looking ahead, what targets have we set for ourselves? (2008/2009 Budget)

- Improved domestic revenue collection-through tax administration reforms and formalisation of businesses
- Foreign assistance, including grants and concessional loans will stay on course
- Increased progress in private sector development
- Institute a supportive monetary policy reflected in an appropriate fiscal framework, low inflation, narrowing interest rate spread, and increased credit to the private sector

Looking ahead, what targets have we set for ourselves ?

Macroeconomic Projections

Indicator	2008	2009	2010	2011
GDP Growth	7.8%	8.1%	8.0%	9.2%
Cons. Price inflation		7.0%		
Domestic Revenue	18.5%	18.6%	19.0%	
Growth of M2	23.9%	22.9%		
Official foreign reserves in months	Not less than 5			

Challenges ahead?

Despite achievements in economic growth and revenue collection, some challenges remains:

- Have we adequately exploited potential opportunities in the agriculture sector?
- Do we have enough human capital-critical mass of private entrepreneurs/owner managed businesses, MSE's?
- The current ongoing negative trend in global economy may slow flow of FDI. Hence slow economic growth-inability to reduce poverty and meet MDG's
- Resources required for financing MKUKUTA by far exceeds national capacity. This calls for more involvement for private sector-internally and externally (PPP's models??)

Challenges ahead?

Despite achievements in economic growth and revenue collection, some challenges remains:

- Budget execution in infrastructure is constrained by shortage of contractors with required capacity, skills, equipment and experience
- The need to increase Government capacity for self reliance and move away from donor dependence
- the execution of the budget faces risks if prices of fuel, foodstuffs, raw materials and inputs continue to rise

Economic Review

What else?

Budget 2008

Revenue Performance, Tax Changes

13 June 2008

David Tarimo, Partner

Revenue Performance, Tax Changes

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Revenue Target - 2008/2009

Revenue Performance - 2007/2008

Budget Tax Changes

Emerging Issues

Does it all add up?

Revenue Performance, Tax Changes

The Revenue Picture

Revenue Target - 2008/2009

Revenue Performance - 2007/2008

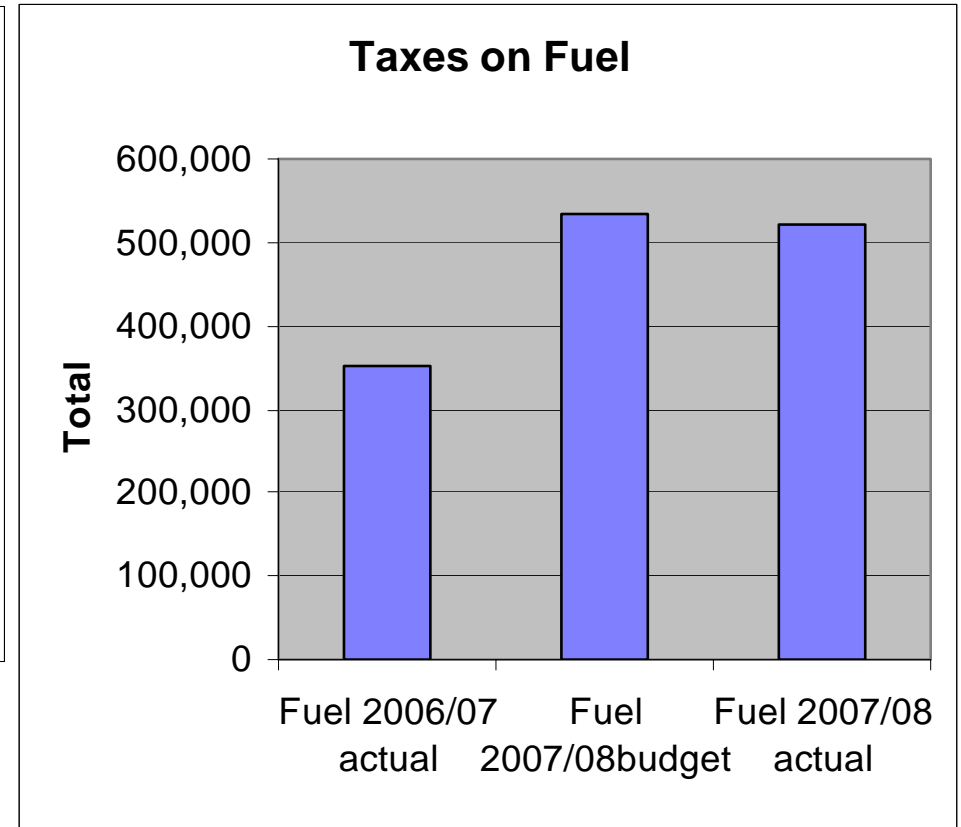
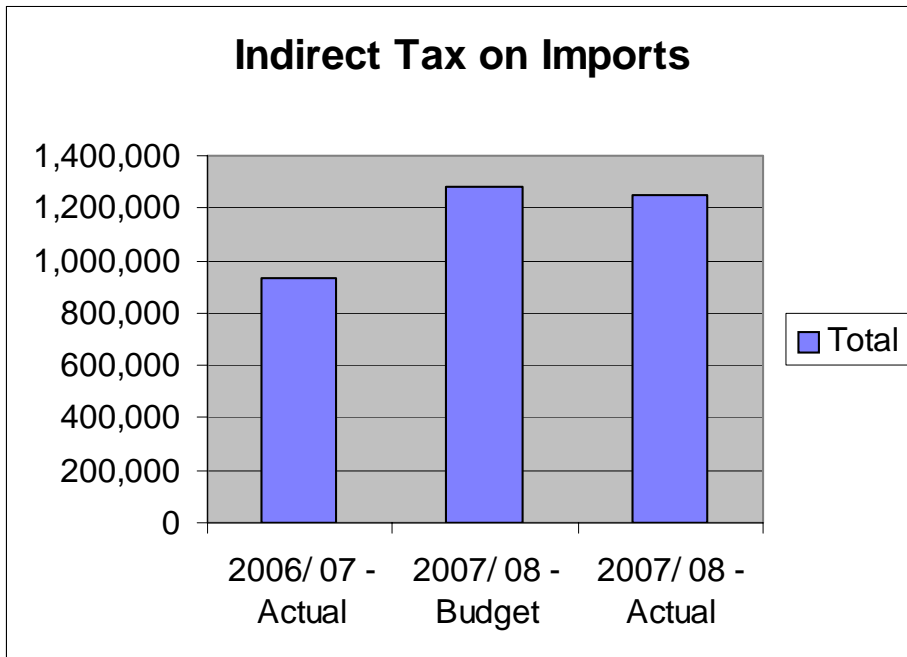
Revenue Target – 2008 / 2009 – is it realistic?

Significant planned increase in domestic revenue:

- Shs 4,729 billion
- Increase of more than 30% of likely 2007/08 out-turn
- 18.5% of GDP (compared to expected 16.5% 2007/08 outturn)
- Counting on more than the additional revenue measures?

Revenue Performance, Tax Changes

But taxes on fuel, as well as imports generally, are below budget



So how did collections on other big revenue items compare?



Indirect tax collections reflect growth of communications sector, but for other excisable products revenue though well up still below budget

10 months to April

	Total 2006/ 07 prior year	Total 2007/ 08 budget	Total 2007/ 08 actual	Total 2007/ 08 Prior Yr %	Total 2007/ 08 Budget %
Excise and VAT					
Beer and spirits	108,889	140,224	132,418	22%	-6%
Phones / mobile phones		101,312	126,365	*	25%
Cigarettes	51,800	66,659	64,249	24%	-4%
Soft drinks	21,944	28,584	27,690	26%	-3%

Excise (excluding VAT)

Beer, Spirits, Konyagi	69,377	92,226	84,848	22%	-8%
Cigarettes	35,309	46,625	45,398	29%	-3%
Mobile phones - excise	26,169	32,774	35,839	37%	9%
Soft Drinks	13,085	17,203	15,275	17%	-11%

Corporate tax and payroll tax collections were very robust ... perhaps giving grounds for optimism for further significant revenue increase this coming year .. and corroborating the growth story of the economy

10 months to April

	Total 2006/ 07 prior year	Total 2007/ 08 budget	Total 2007/ 08 actual	Total 2007/ 08 Prior Yr %	Total 2007/ 08 Budget %
Corporate Taxes	190,737	236,627	287,147	51%	21%
PAYE	320,211	391,372	414,188	29%	6%
Skills & Dev. Levy	50,146	60,662	63,009	26%	4%

Revenue Performance, Tax Changes

Tax Changes

Income Tax

Fuel and Motor Vehicles

Excise

VAT

Customs Duty

Income Tax

- Alternative Minimum Tax
 - 0.3% tax on turnover for perpetual loss makers
 - Criteria: Making tax loss for three consecutive years
- 2% withholding tax on payments by Government to suppliers without TIN
- No income tax on disposal of units in Collective Investment Schemes
- Increase in personal tax bands - monthly thresholds increased:
 - For paying tax to Tshs 100k (from Tshs 80k)
 - For paying top rate of tax to Tshs 720k (from Tshs 540k)

Alternative Minimum Tax – raises a number of concerns

- Policy Concerns:
 - Inconsistency: why pay AMT if losses triggered by generous capital deductions (eg agriculture, mining, manufacturing, tourism) legislated for by the Government; should reference point not be accounting losses? Alternatively, be honest and reduce the capital deduction rates that you object to?
 - Additional complexity to the law, and administrative duplication* as there are other taxes paid based on turnover
- Technical issues:
 - When do the three years start to run? When is the tax paid?
 - Presumably, no credit carried forward – so tax rate increases?

* Budget speech acknowledges that *“procedures to operate businesses in the country are still cumbersome.... It is therefore important to strengthen the business environment”* !!

Personal tax thresholds revised upwards

Taxable Income (monthly)	PAYE old	PAYE new	Saving	Saving
Tshs	Tshs	Tshs	Tshs	%
100,000	3,000	0	3,000	
200,000	19,000	15,000	4,000	21%
500,000	86,000	67,000	19,000	22%
700,000	144,000	115,000	29,000	20%
1,000,000	234,000	204,000	30,000	13%
2,000,000	534,000	504,000	30,000	6%

- **But concerns remain on payroll taxes:**
 - Skills and Development Levy still high at 6%
 - Social Security Contributions highest in the region and uncapped
 - Outcome = Current structure:
 - By loading costs does not encourage employment
 - Discourages informal businesses from operating formally
 - Not competitive compared with the region

Fuel and motor vehicles

- No change on specific rates on fuel
- Reduction of excise duty on HFO - now Tshs 97/litre (previously Tshs 117)
- Partial reversal of 2007 increases in annual road licence fees
- Registration fees increased by approximately 30%
- 5% excise duty on small vehicles (>1,000cc up to 2,000 cc)

Mobile phone taxation above Kenya but in line with Uganda

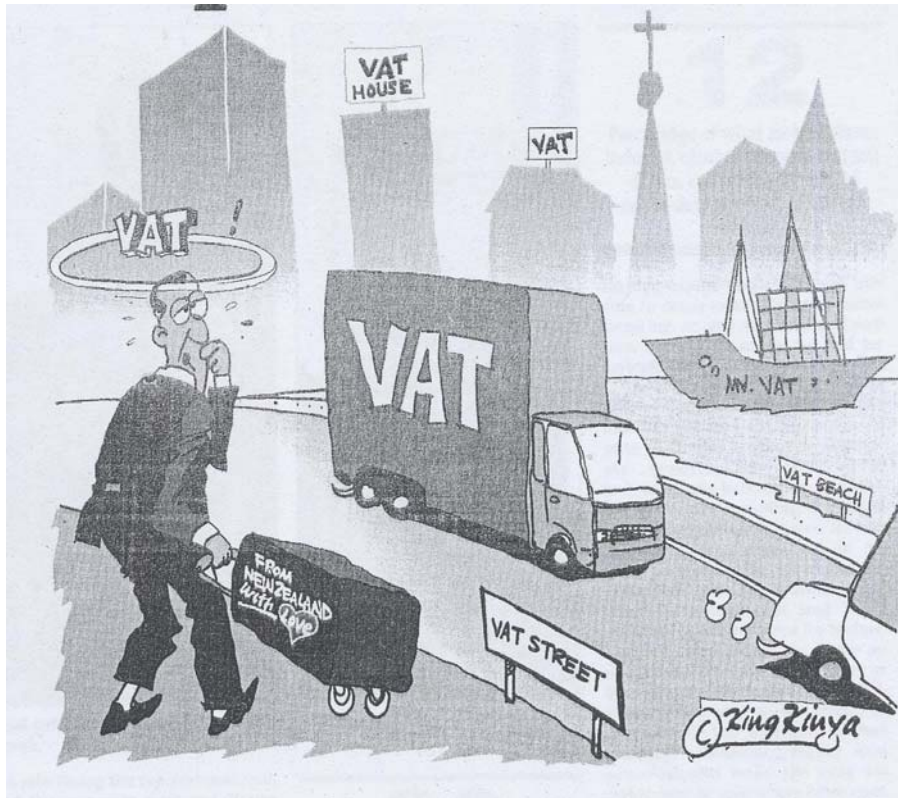
		Tanzania Now	Tanzania Before	Kenya	Uganda
Airtime cost before tax	b	100.0	100.0	100.0	100.0
Excise duty		10.0	7.0	10.0	12.0
		<hr/>	<hr/>	<hr/>	<hr/>
		110.0	107.0	110.0	112.0
VAT		22.0	21.4	17.6	20.2
		<hr/>	<hr/>	<hr/>	<hr/>
		132.0	128.4	127.6	132.2
Less: cost excluding tax		-100.0	-100.0	-100.0	-100.0
Taxes on airtime	a	32.0	28.4	27.6	32.2
		<hr/>	<hr/>	<hr/>	<hr/>
Increase in tax level		12.7%			
% of tax inclusive price	a / b	24.2%	22.1%	21.6%	24.3%
Excise duty rate		10%	7%	10%	12%
VAT rate		20%	20%	16%	18%

Note: mobile telecommunications companies also pay 1% of revenue to regulator (TCRA)

Does 12% increase on excise on alcohol, tobacco and carbonated drinks contradict previous commitments?

- Finance Act 2005:
 - *“the specific excise duty rates imposed shall be annually adjusted in accordance with the projected inflation rate”*
- Budget Speech 2008:
 - *“Mr Speaker, it is proposed to make the following amendments adjust the specific excise duty rates on non petroleum products by 12 percent. The primary objective of this adjustment is to keep pace with inflation and thus preserve the real value of Government revenue..”*
 - *“Mr Speaker, the macroeconomic projections and policy targets for the period ... are as follows.....Control Consumer Price Inflation (CPI) at below 7.0 per cent by end June, 2009”*

Most significant VAT change relates to export of services



- Export of services:
 - Issue: Finance Act 2003 amendment
 - Change to be made w.e.f. Jan 2009 once regulations in place
 - Will bring Tanzania back into line with international best practice and improve competitiveness
- New exemptions:
 - Burning gel (Moto Poa) for domestic use
 - Compressed Natural Gas (CNG) and CNG cylinders
 - Bitumen

Certain EAC Customs Duty changes proposed:

Goods	Old Rate	New Rate
	%	%
Sodium Sulphate	25	10
Garbage collection vehicles imported by local authorities or its approved agents	25	0
Barley imported by brewery companies of up to 20,000 metric tons to December 2009	25	0
Crude palm oil	10	0
Data processing machines	10	0
Hand hoes	10	0
Inputs imported by TANELEC for manufacturing transformers and switch gears	10	0

Other changes to increase revenue base:

- Commitment to strengthening of excise and customs duty collections
- New conditions for VAT reliefs for Non Governmental Organisations
- Recovery of excess revenues of regulatory authorities
- Review of all tax exemptions with a view to elimination, specific reference made to exemptions / reliefs including TIC and mining

Mining – wait and see

- No changes announced, but Budget speech made clear that the tax regime for mining is being reviewed and noted the intention to “set up new investment rules and regulations in mining activities”.
- Bomani Commission recommendations being reviewed by Minister for Energy & Minerals
- With a stated need to encourage exports, it is critical that this sector flourishes. Indeed BoT April 2008 commentary on exports performance noted that “*gold continued to dominate by accounting for about 37.9 per cent of merchandise exports*” → important that any proposals implemented should not discourage investment into the sector.

Finance Bill ... wait and see

Budget speech:

- *“it is further proposed that amendments be made to various tax statutes with a view to simplifying revenue collection. These amendments are shown in the Finance Bill”.*

Emerging technical issues not related to Budget

Emerging issues

Income Tax

- Transfer pricing – management fees
- Interpretation of net of tax contracts
- Source rules for withholding tax

VAT

- VAT on imported services
- Reconciliation of revenue per VAT returns and Financial Statements
- Transactions at below market value
- Partial exemption

Back to the BudgetDoes it all add up?

...Meeting revenue target appears to be dependent on extra revenue generated by excise increases and from growth?

	Shs'm
Budgeted Revenue - 2007/08*	3,502,583
Theoretical gap - before taking account of new measures	1,226,012
Budgeted Revenue - 2008/09	<u>4,728,595</u>
Additional measures:	
VAT	(1,211)
Income Tax	4,353
Motor vehicle	(2,380)
Customs	(762)
Stated effect of measures (excluding excise changes)	0
Excise - not specified	?
Other - not specified (reduction of exemptions)	?
Increase generated by economic growth	?
	<u>1,226,012</u>

* Expected to be marginally exceeded

One thing is for sure ... this budget will generate significant discussion ... in itself a source of additional revenue!



Panel Discussion - Any Questions?