TRANSFER PRICING IN TANZANIA: My Experience in tackling tax avoidance/evasion through Parliament - Zitto Kabwe, MP

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Transfer Pricing

It happens when a company with subsidiaries from different parts of the world (tax jurisdiction) trade with each other. Normally prices set are not market prices hence rules are made to manage. Tax authorities use 'arms length principle' to manage transfer pricing. However it is a large source of loss of tax revenues especially from developing countries which have weaker tax authorities in terms of capacity to enforce the rules. My brief talk is about real examples that happened/is happening in Tanzania.

For example, A multinational company stores its brands in the Netherlands, where it collects royalties, pays management fees to a sister company in Switzerland and puts its logistics centre in Mauritius. Netherlands, Swiss and Mauritius are low tax jurisdictions (tax havens, secrecy jurisdictions). In this way rights of nationals from the country where actual economic activity takes place are infringed by denying them the rightful tax revenues.

Real Tanzanian cases

1. In January 2008 as a Member of Presidential Mining Review Commission, I visited Resolute Goldmine in Nzega, western Tanzania. At the time Gold Prices were around US$1200/ounce but the company was selling at US$530/ounce. They told us that they hedged at that price. Later we found out that they were selling to a sister company offshore. This denied Tanzania millions of dollars as royalty (at the time royalty was 3% charged at netback value) as well as tax revenues. The mine was closed in 2012 after exporting US$3.5 billions value of gold and paid corporate tax only once since 1997 when it started operations.

Action taken - The commission proposed a new formulae to charge royalty. That, royalty be charged at spot price, London metal markets, and on gross value. This is due to the fact that a country like Tanzania has no control on the deductible costs like transportation, insurance,
refinery and even mechanics of hedging. The new law, Mining Act 2010, legislated with great and notable participation of the CSOs, includes the new rule.

2. During same period we examined the financial accounts of Geita Gold Mine from the then Mwanza Region and now Geita Region. It was discovered that the company was using thin capitalisation to plan its taxes. That means, the investments is artificially undercapitalised by having heavy debts from subsidiaries and because interests payments are tax deductible, Tanzania lost US$830 millions from 2001-2007 (Bomani Mining Review Report, 2008 and Masha Mining Review Report, 2006). Examples of ratios of debts to equities of 3 main gold mines in Tanzania during the year ending December 2007 are

(i) Geita Gold mine – 12,597,000 %

(ii) Bulyanhulu Gold mine – 791 %

(iii) Resolute Gold mine – 5088%

Debt-equity ratio of Geita Gold Mine was at 12.5m:1! The company which started to produce gold in 1999 at the largest gold mine in sub Saharan Africa minus Ghana and South African mines, paid its first corporation tax in 2012. The amount of tax revenue lost from ‘thin cap’ technique alone, between 2001 and 2007 was enough to cover the whole 2011 budgets of Ministries of Water and Energy combined or whole budget of Ministry of Education of 2011.

Action taken - It took three years for Parliament to accept my proposals to legislate against abuse of ‘thin cap’ arrangements. In 2011 thin cap rule of 70:30 was introduced by finance act 2011 and In 2012 i moved an amendment to strengthen it further to curb abuses on tax deductibles (Finance act 2012 s.28)

“Interest payable to a non resident bank by a strategic investor except for interest payable on any loan taken by a strategic investor from an associated or related company” NOT DEDUCTABLE

3. Companies use formation structures to avoid paying capital gains tax. A good case in Tanzania is that of Airtel telecommunication company. Originally Celfel company was sold to Zain and later Zain sold to Airtel and capital gains tax was never paid because technically a Tanzanian company was not sold. Celfel International owns Celfel Africa BV registered in Netherlands. Celfel Africa BV owns Celfel Tanzania BV registered in Netherlands and Celfel Tanzania BV owns Celfel Tanzania limited registered in Dar es Salaam. So Tanzanian subsidiary was never sold as
a result a capital gains tax of US$ 312 millions were never collected. Similar case we have in Uranium mining company called Mantra from Australia which was sold to a Russian company. In 1999 Barrick Gold bought Kahama Mining company using the same technicalities and Tanzania received nothing from the sale.

Action - Parliament enacted a new law to curb this abuse and now so long as asset is in Tanzania, regardless of the structure, approval will not be given unless capital gains tax is paid. Again it took an effort of a single MP to push for this and it took two years for government to comprehend the enormous loss of revenues.

"Tanzania Revenue Authority(TRA) informed the POAC that Tanzania lost USD 308m as Tax revenue from sale of Zain Africa assets in Tanzania to Bharti Airtel.

How we lost the Revenue:

*TRA argues that we lost revenue because assets in Tanzania were not sold since its owner did not change. These are tax planning measures ‘complex registration mechanisms’ were used.

*There is a ghost company called Celtel BV which owns Celtel Tanzania and itself owned by Celtel Africa. Celtel Africa was sold to Zain and then to Bharti Airtel but Celtel BV continued to own Zain Tanzania and even now Airtel Tanzania. So they avoided tax and will continue doing so unless we change our laws to curb tax avoidance measures.

*We (POAC) have directed Hazina to bring an investigation report on the matter within a month with proposals to change/improve our laws.

*We have also instructed Hazina to start a process of divestment of 50% of its shares to the public through the Dar-es-Salaam Stock Exchange (DSE) so as to improve corporate governance( transparency) & curb transactions costing the Nation. This will help us to see the true valuation of shares as a response to any transactions." from zittokabwe.com

4. TSh320bn loss looming over uranium project,


Recent estimates indicate that Tanzania risks losing about Sh320 billion in mining taxes
because of weak legal checks, particularly when it comes to uranium.

Local mining experts said yesterday that the country must go back to the drawing board and put in place a watertight policy and regulations before it allows uranium mining.

Earnings from the mineral are believed to have the potential to turn around the lives of thousands of poor Tanzanians. The chief concern right now, though, is that some subsidiaries of multinational firms licensed to explore uranium in Tanzania are capitalising on a weak legal and institutional framework to transfer ownership to affiliated companies. In the process, there are missed opportunities to collect revenue.

According to a renowned environmental lawyer, Dr Rugemeleza Nshala, the government could lose up to Sh320 billion in unpaid capital gain tax by the ARMZ holding company, which holds a prospecting licence for the Mkunju River uranium project.

Speaking at a breakfast meeting organised by the Policy Forum, he cited the example of Mantra Resources—which reportedly changed hands in a span of three years from two connected companies, ARMZ of Russia and Uranium One.

"In short, the transfer of Mantra Resources Limited to ARMZ enables its former shareholders to pocket $1.04 billion without paying capital gains to the Tanzanian government," said Mr Nshala.

ARMZ of Russia owns 79.49 per cent of Mantra Resources. According to the expert, under section 36 (1) of the Income Tax Act, Mantra Resources Limited of Australia was supposed to have paid capital gains tax to Tanzania.

The Tanzania Revenue Authority issued a series of demand notices to ARMZ seeking $200 million in capital gains tax and stamp duty, Dr Nshala said.

ARMZ has disputed the tax demand and currently has a case pending at the Tax Revenue Appeal Board (TRAB).

According to Dr Nshala, after complete sale of the Mantra Resources uranium to its affiliated companies—ARMZ and Uranium One—the company will earn about $250 million annually but will pay just $5 million in taxes, royalties, fees and workers’ Pay as You Earn.
“This is a very miniscule amount that cannot warrant exploitation of such environmentally harmful minerals,” said Dr Nshala.

But the minister for Energy and Minerals, Prof Sospeter Muhongo, said his ministry was aware of the concerns but steps have been taken to ensure the country does not lose out on uranium extraction. He added: “I know that so many experts claiming to be competent in the area of uranium and gas will be emerging everyday at this time. I think some of them are just there to create confusion in this sensitive area.”

Declining to comment further, he said: “I find it difficult to comment on second hand information. You can bring your source with you and address your concerns.”

In the meantime, Dr Nshala insists that Tanzania stands to gain nothing from the eventual purchase of Mantra Resource Limited by Uranium One from ARMZ in June next year since the two companies are affiliated.

This arises from a loophole in the Mining Act 2010, which legally keeps the commissioner for minerals and the minister out of any transaction involving transfer of ownership or price between affiliated companies.

“In June 2013, Uranium One will not need to seek and obtain consent from the Commissioner for Minerals or the minister because it is a company that is directly controlled by ARMZ,” said Dr Nshala.

“The principle is that the country with minerals has to receive a large share from mining activities, otherwise it should not allow the activities to take place,” pointed out Dr Nshala.

The director of nuclear technology at the Tanzania Atomic Energy Commission, Dr Mwijarubi Nyaruba, said the country has a strong legal framework to manage uranium mining, citing the Mining Act of 2010 and Atomic Energy Act of 2003, but acknowledged that more needed to be done. “The country has yet to set mechanisms to enforce them effectively and clear some of the overriding issues between the two Acts,” said Dr Nyaruba.

Tanzania will have to work on issues such as how to control dusts, monitor people and ensure self-storage of the processed uranium. It will also have to work on proper waste
management and record keeping for future use.

*Dr Nyaruba is concerned that some stakeholders have been left out and that no clear roles have been assigned to stakeholders.*

*Tanzania needs clear standards and procedures to be taken in the implementation of the uranium mining and also establish accredited laboratories, he added.*

The government will impose capital gains tax (CGT) on the sale of shares of a local entity by its parent company, activating the Income Tax Act, 2004, cited several times as having provisions for such action.

The measure, according to the Minister for Finance and Economic Affairs, Dr William Mgimwa, is intended to cap a tax loophole when assets change hands. For example, if you buy a house for one 1m/- and sell it for 2m/-, then you have made a capital gain of one 1m/-.

In other countries, this gain is usually taxed at 30 per cent rate, so you would have to give the taxman 300,000/-. But as for the sale of shares relating to a local company by the parent company, it is the first time the government is moving to impose tax on such transactions.

Analysts praise the move as important to bolster shrinking sources of government revenue. This, analysts say, is because of the government's desire to widen the tax base to get revenues to sustain projected expenditure. The government proposes to spend 15.1trn/- in 2012/13.

An estimated 8.7trn/- would come from tax and non-tax revenues, equivalent to 18 per cent of Gross Domestic Product (GDP) and 3.6trn/-, equivalent to 0.7 per cent of the GDP, would be sourced from local governments.

Some 3.1trn/- would come from Development Partners in the form of grants and concessionary loans, 842.5bn/- from General Budget Support (GBS) and 2.3trn/- from grants and loans meant for development projects, both the Basket Fund and Millennium Challenge Account funds integrated.

In an interview with the 'Daily News', Mr Boniface Matambula, a tax expert with Zantel says there are plausible reasons to have Capital Gains Tax on sale of shares relating to local company by the parent company. A capital gains tax is charged on profit realised after the sale of a non-inventory assets bought at a lower price.
The most common capital gains are realised from sale of stocks, bonds, minerals and property. In an interview with the 'Daily News', Mr Matambula said such a tax structure could substantially increase revenue yields.

However, in a PriceWater House Coopers commentary, "Growing tomorrow's economy", released over the weekend, it noted that the Minister's speech also included reference to the introduction of changes so as to redeem a tax charge where gains arise on share transactions overseas, which result in the change in effective control of local companies.

"This area has been one that has generated significant political debate recently - particularly, as regards the mining and energy sectors. However, it is a change that has to be carefully managed and considered so as to ensure that it does not unintentionally make Tanzania an unattractive investor destination,"

it noted PWC notes that in many cases, the identity of the entity selling or being sold is driven not by tax considerations but by other factors -for example, where the ultimate parent was originally listed so as to raise funding, or where a group holding company is located if the sale is of a number of companies rather than just one.

"The risk in terms of investment attractiveness arises in relation to the possibility of double taxation - as well as uncertainty, for example, how valuations will be arrived at where the underlying value of a transaction can be attributed to assets in a number of countries not just Tanzania.

To understand the ramifications of this significant change, reference will need to be made to the detailed legislative wording, which is not yet available. Welcoming the CGT clause from the Budget tabled by Dr Mgimwa on Thursday, the chairperson of the Parliamentary Standing Committee on Parastatal Organisations Accounts (POAC), Mr Zitto Kabwe made reference to the reported government loss of almost half a trillion shillings in tax revenue from the sale of Zain Africa assets in Tanzania to Bharti Airtel.

"Such a clause in the Capital Gains Tax will help the country not lose such huge revenues again,"said Zitto. The Kigoma North MP said the amount lost in the deal was equivalent to 30 per cent of the government's capital which it deserved to gain after the sale of four million shares at USD 252 each. The government owns 40 per cent shares of "airtel" while 'Bharti Airtel' company of India holds 60 per cent. "This amount has been lost due to bad financial structure," said Kabwe at the time." DailyNews June 12th, 2013.
Other abusive and excessive tax planning measures

4. Cashew exports where India reported imports of 120,000 tons from Tanzania in 2011 and Tanzania reported export of 80,000 tons. This exports under invoicing aims to evade export taxes

5. Lack of ring fencing led to Tulawaka mine to finance Buzwagi project to the tune of US$400 millions that was to be paid as tax. The Mining Act 2010 introduced ring fencing (mine by mine ring fencing)

Transfer pricing and other tax planning measures are real as shown by examples. As a Parliamentarian i saw it important that i give this testimonial so that our international partners comprehend the extent of the problem. Tax avoidance/evasion is a developmental problem and must be tackled through global solidarity.