Agricultural Council of Tanzania

POLICY BRIEF NO. 3

PRODUCE CESS TAXATION SYSTEM IN TANZANIA

OPPORTUNITIES AND CHALLENGES

❖ *Background*

There is no doubt that produce cess / tax contributes significantly to the revenue stream of all Local Government Authorities (LGAs) in Tanzania Mainland; for the past five years its contribution has averaged 24% of the aggregate own sources of revenue of all LGAs. Own revenue sources contribute to around 8% of the total revenues of all LGAs; the significance of produce cess to the revenue streams of LGAs in the country varies considerably. Unfortunately, a study carried out by ACT in 2012, revealed that LGAs produce cess collection system is obscured by many weaknesses in its adminitration procedures and controls, as well as limited collection capacities. The study indicates that when all these factors are improved, the 2% Produce Cess rate on agricultural commodities, or the demand that it should tally with that of the industrial sector (0.3%) requested by agriculture sector actors is feasible.

Statement of the Problem

For many years agriculture sector actors have been requesting the Government of Tanzania to reform the inefficient crop taxation system in Tanzania. High tax rates are controversial as they have a negative effect on the agricultural sectors, especially on its small-scale farmers. For this reason the Agricultural Council of Tanzania (ACT) conducted a study on the Crop Produce Taxation System in Tanzania. Moreover, the Cess study was motivated by many other factors; these included: Stakeholders argument that the cess is too high, and therefore creates a disincentive for investments in the agriculture sector. It is also argued that there is no plough back of funds collected to the agriculture sector and that the cess so levied does not contribute to the development of the agricultural sector.

There are also observed weaknesses in produce cess collection and accountability mechanisms that have been discouraging agricultural production and trade. Moreover, the very high tax rates, discourages many taxpayers to comply with cess payment by-laws, and hence negatively affecting revenue collection in most LGAs. Other complaints include: the claim that there are variations in produce cess rates across the country which hinder competitiveness in agricultural production and trade. At the same time other stakeholders have been arguing the Government of Tanzania to borrow a leaf from some neighbouring countries that have abolished the produce cess.

These challenging factors contributed to the need to assess crop taxation system in Tanzania with the aim to identify problematic areas, and suggest the actions to take in order to improve the system, and strategies that can be adopted to advocate for reforms.

This policy brief presents a snap shot of the findings of the 2012 ACT study with respect to the challenges pertaining to produce cess rates, its administration and procedures, and recommends some measures to take to lobby for necessary reforms.

- ***What change does the brief want to achieve? Reforms in rates, administration systems and procedures and reducing crop taxation rate.***

'*One stylist fact on revenue collection indicates that good tax administrative systems have positive impact on the amount of tax revenue generated'.* The past studies and the 2012 ACT study on Producer Cess Taxation in Tanzania provide evidences that tax collection in the LGAs is surrounded by many administrative weaknesses. When reforms in the tax administrative and control systems are in place, more revenue can be collected and this would automatically increase Local Government revenue. Thus, a 1% to 2% produce cess as suggested by many stakeholders in the agricultural sector is very likely feasible and realistic.

Present Policy Options

- ***Justifiable reason for LGAs to demand for high Produce Cess from the agricultural sector.***

Local Government Authorities (LGAs) provide public goods, such as health services, education, road networks, safety and security. These services provided require funding. Moreover, agriculture being the main economic activity in most LGAs; produce cess is among the major sources of revenue for financing mentioned public services and goods. Other reasons for charging produce cess include; inadequate

DRAFT

grants provided by the Central Government to offset budgetary deficits, and taxes collected from traders within LGA's jurisdiction. Despite these high cess rates, producers do not see any direct benefits from what they are taxed in terms of contribution to agricultural development. Instead the ACT study finds that the funds collected are predominantly used to cater for District Councils' administrative expenses such as travel, sitting and per diem allowances for Councilors and conference charges during meetings. More transparency in local government financial management would certainly allow for more insight and thus either address potentially erroneous perceptions or lead to improvements in LGA income and spending logic.

Significance of Cess to District Revenue sources

- Produce cess could present a substantial contribution to revenue sources in most LGAs, however, in some Councils the collection is below the target. According to the Ministry of Finance's statistics, produce cess represented only 2.4% of the LGAs own aggregate revenue in the country (MoFE, 2013/14). However, a recent study by ACT, 2012 reveals that over the past five years, on average produce cess contribution to the LGA coffers is about 24% of the aggregate own sources of revenue. Own revenue source contributes to around 8% of the total revenues of all LGAs. In terms of overall LGA revenue streams, the study also revealed that recurrent transfers from the Central Government contribute between 92% and 98% of total LGA revenues.

- ***From these facts, it is quite obvious that, unless there is improved mode of cess administration which accounts for compliance and social accountability as well as efficient collection, produce cess will not yield significant impacts to LGAs revenues. Failure of LGAs to justify its existence to cess payers perpetuates the arguments to abolish it.***

- ***Legal requirements for Cess collection***

The rate and administrative procedures of the produce cess is guided by the Local Government Finances Act No. 9 of 1982.The Act empowers LGAS to collect cess and stipulates that produce cess as one of the sources of revenue to district and urban councils in Tanzania. Section 7 (1) (g) of the Act states that: *"All moneys derived from any cess payable at source on any agricultural or other produce produced in the area of district council, imposed under this Act or any other written law except for the major export crops whose produce cess shall range between zero and five percent of the farm-gate price shall be payable at source".* However, this Act requires that all district councils formulate by-laws to support it and guide its application in terms of local procedures for collection, the rate, and its administrative control mechanism, something which is not yet implemented in many LGAs where this study was conducted. This has caused many district councils not to comply with the law in terms of chargeable rates, collection point and who should pay cess, promoting chances for corruption, cess tax evasion and revenue losses.

Moreover, the basis for crop price setting is not clear in the sense that in many district councils crop values at which cess rates are set, stand below market prices and there were no convincing explanation as to how the rate was estimated. Again produce cess seemed to vary between the same crop in the same district, and level of production. Un-harmonized cess rates across similar commodities, has promoted unnecessary competition among districts for the agricultural produce and causing market distortions.

Notwithstanding the differences, the rate are controversially charged on selling / purchase price or revenue and not on profit as it is applied in the industry sector, and some charges are affected at the stage of exchange. The cess reduction argument goes hand in hand with the harmonization argument which is key for increasing tax compliance.

Table 1: **Differences in produce cess charges between District Councils (in Tsh.)**

Crop(Per 100kg bag)	Kilosa	Kilombero	Mvomero	Moshi
Sugar (per ton)	200	120	1,275	100
Paddy (per 100kg bag)	2,500	1,000	1,000	4,500
Maize (per 100kg bag)	1,500	1,000	1,000	2,250

Source: ACT study – 2012

- **Overall Cess Administration and Contol Mechanisms**

The LGAs identified outsourcing private agents as one of the viable options for financial reform to improve revenue collection. However, this option proved to have many weaknesses including: lack of a proper feasibility study on the potential amount of revenue which can be collected, and reliance on past performance data when setting revenue collection targets. Another weak spot is non-existent, or poorly formulated contracts, private collectors failure to meet the set targets, non-submission of financial returns, poor financial records, and non-issuance of official receipts.

Other weaknesses include: weak or inadequate Monitoring and Evaluation systems, poor inspection of the work done by private cess collectors, and limited capacity of the Internal Auditors in most LGAs. Lack of effective monitoring mechanism provides an undesired opportunity for private cess collectors to take advantage of the situation to collect more, and remit less than what was targeted.

It could also be noted that sometimes private cess collectors have been negotiating for lower cess tax rates with tax payers, mostly traders, thus exacerbating unfair competition among crop sellers (farmers) and revenue losses to most LGAs. This is supported by evidence from the National Audit Office that revenues in most District Councils continued to decline despite the use of private collectors (NAO, 2012 & 2013). Lack of adequate control mechanisms in the course of cess collection, reflect poor district

DRAFT

councils' administrative structures embedded with inadequate skills in financial resource management as well as few cess collectors relative to number of marketing centers.

❖ ***Concluding Remarks***

Based on the above evidences and arguments, ACT and other actors in the agricultural sector are convinced that the amount of Produce Cess currently being collected by the district councils is very low. It can be increased significantly if the collection systems are improved. It will also pay dividends if the produce cess is reduced to say 2% of farm gate price, or better scale it down to tally with the 0.3% rate the industrial sector pays. Moreover, the argument to lower crop cess is also supported by tax practices and theories that indicate that tax compliance is negatively related to the marginal tax rate, i.e. ***the lower the marginal tax rate the higher the compliance rate and the more the revenue collected***.

This means that if LGAs want to collect more revenue from any taxation source, they should fix lower tax rates to attract for more compliance.

The argument for cess reduction is supported by the fact that produce cess rates that are practiced by some district councils, ranged from 0.34% to 5%. For instance, in the 2009/2010 season, the actual produce cess rate in sugarcane in Mvomero District was 2%, 1.6% in year 2010/11, it was 1.6%, in year 2011/12 it was 3% whereas according to existing by-laws, Mvomero LGA has the mandate to raise sugarcane cess up to 5%. In Monduli District Council, the Councilors are aware of the fact that by-laws allow them to elevate the crop cess to 5%, pegged on the farm gate price. However, in practice all crops are charged at TZS. 1,000 per sack, irrespective of the value of the crop. This is equivalent to a cess ranging between 1 and 2 percent. Again, Mufindi District Council is charging TZS. 8.50 per kilogram of leaf tea, this is equivalent to 0.34% of the farm gate price. These examples support the merits for lowering produce cess as they are applied in many LGAs.

However, as indicated above, positive reforms will be required to support this process. These will include: improving the tax administration and management systems, fixing high tax evasion penalty, and improving audit and control measures. This would be a tremendous improvement on the current situation of weak administration in the taxation systems, resulting to more than 60% of potential revenue not being collected. Reducing produce cess levels should be done gradually, from the current level which is between 3 and 5%, down to 2%; and eventually harmonizing it so as to match with the 0.3% cess on the industrial produce. These measures would definitely increase the level of revenue which all LGAs need very badly.

❖ ***Recommendations***

In light of the above arguments, Agricultural Stakeholders recommend the following:

**** Reduce and harmonize produce cess rates, improve financial controls and administration systems.***

Evidences provided above indicated that there is a high opportunity of increasing revenue generation when the LGAs improve their financial controls and administrative systems that in turn increase compliance to the LGAs tax by-laws and collect more revenue. It is also evident that cess rates can be reduced to 1% or to a harmonized industrial rate of 0.3% without negative effects in revenue collected by LGAs. This can be practical as some LGAs are already applying the low rates. This argument is also supported by taxation theories and practice as lower marginal tax rates attracts tax compliance.

**** Capacity building required for Local Government Authorities***

LGAs require expertise in the areas of tax forecasting, affordability assessments, control mechanism, monitoring and evaluation system, contract negotiations, and in preparation and procurement procedures. Capacity building programs in these areas need to be designed properly in order to increase revenue collection from produce cess, as well as from other local sources.

**** Encourage and reward innovative LGAs***.
Apart from crop cess, the Government should encourage and provide incentives to LGAs to collect more revenue from other sources apart from crop cess. Reward innovative LGAs, and establish best administration and management competitions among LGAs, and reward best performers who improve their administration and tax management systems, and who collect extra revenue from other sources apart of produce cess. This approach will encourage innovations in revenue collection, and reduce dependency on Crop Cess as the major source of LGAs revenue.

**** Revenue plough back:*** Allocate some revenues collected from cess to agricultural development projects in the districts and inform beneficiaries to justify the cess revenue collection and the services enjoyed as a result of cess revenues collected.

**** Need for conducting feasibility study to project the potential revenues considering the economic and production trends in the particular season.*** Computation of production costs prior to cess deductions is inevitable to enable farmers to realize profit for future investment plans.