

Transforming the local government revenue system in Tanzania: A roadmap for reform

1. Background: The dissatisfaction with the previous local government revenue system

1.1 Background

Until 2003, Tanzania followed a relatively “permissive” approach to local government taxation, meaning that local governments were given substantial latitude in coming up with their own local revenue structure. This open approach to local revenues was a major contributing factor to a highly fragmented local tax system. It was broadly felt that the fragmented local tax structure imposed an excessively high burden on local taxpayers (through high cumulative rates and high administrative costs) and caused an environment not conducive to economic growth. In addition to the collection and taxpayer compliance problems caused by the lack of a uniform local revenue system, the absence of a uniform local revenue system also has hindered the systematic collection of data on local government revenues.

Recognizing the shortcomings of the local revenue system, PMO-RALG sought to promote the voluntary “rationalization and harmonization” of local revenue systems, by encouraging local government authorities to broaden their tax bases and keep tax rates low. In this vain, PMO-RALG produced a set of *Guidelines for Rationalization and Harmonization of Local Government Sources of Revenue, Tanzania Mainland (2002)*, along with related training materials.

In June 2003, the system of local taxation in Tanzania was significantly reformed by proclamation of the Minister of Finance during the Budget Speech. In contrast to the voluntary nature of the previous reform efforts, the reforms announced in June 2003 imposed a forced, top-down rationalization of local revenue sources eliminated the Development Levy, abolished eight fees, eliminated two types of licenses fees, and abolished the local brew cess and the livestock cess. The remaining “permitted” local government revenue sources were captured in a Schedule incorporated into the Local Government Finances Act (Table 1). Subsequently, in 2004, local business license fees were virtually eliminated as part of a broader reform of business licensing in Tanzania. A more detailed description of the local revenue reforms that took place in 2003-2004 are contained in Chapter 3 of the *Local Government Fiscal Review 2004*.

Table 1
List of permitted local government taxes and revenue sources

<p><i>Taxes on property</i></p> <ul style="list-style-type: none"> ▪ Property rates <p><i>Turnover Taxes</i></p> <ul style="list-style-type: none"> ▪ Service levy <p><i>Taxes on Goods and Services</i></p> <ul style="list-style-type: none"> ▪ Crop cess ▪ Forest produce cess <p><i>Taxes on Specific Services</i></p> <ul style="list-style-type: none"> ▪ Guest house levy <p><i>Motor Vehicles, Other Equipment and Ferry Licenses</i></p> <ul style="list-style-type: none"> ▪ Vehicle license fees ▪ Fishing vessel license fees 	<p><i>Business and Professional Licenses</i></p> <ul style="list-style-type: none"> ▪ Commercial fishing license fee ▪ Intoxicating liquor license fee ▪ Private health facility license fee ▪ Taxi license fee ▪ Plying (transportation) permit fees ▪ Other business licenses fees <p><i>Other Taxes on the Use of Goods, Permission to Use Goods</i></p> <ul style="list-style-type: none"> ▪ Forest produce license fees ▪ Building materials extraction license fee ▪ Hunting licenses fees ▪ Muzzle loading guns license fees ▪ Scaffolding/Hoarding permit fees
<p><i>Administrative Fees and Charges</i></p> <ul style="list-style-type: none"> • Market stalls/slabs dues • Magulio fees • Auction mart fees • Meat inspection charges • Land survey service fee • Building permit fee • Permit fees for billboards, posters or hoarding • Tender fee • Abattoir slaughter service fee • Artificial insemination service fee • Livestock dipping service fee • Livestock market fee • Fish landing facilities fee • Fish auction fee • Health facility user charges • Clean water service fee • Refuse collection service fee • Cesspit emptying service fee • Clearing of blocked drains service fee 	<p><i>Administrative Fees and Charges (Cont'd)</i></p> <ul style="list-style-type: none"> • Revenue from sale of building plans • Building valuation service fee • Central bus stand fees • Sale of seedlings • Insurance commission service fee • Revenue from renting of houses • Revenue from renting assets • Parking fees <p><i>Entrepreneurial and Property Income</i></p> <ul style="list-style-type: none"> • Dividends • Other Domestic Property Income • Interest • Land rent <p><i>Fines, Penalties and Forfeitures</i></p> <ul style="list-style-type: none"> • Stray animals penalty • Share of fines imposed by Magistrates Court • Other fines and penalties

Source: Local Government Finances Act (Schedule), as adopted in 2003. Revenues are categorized as on the Ministry of Finance website (www.mof.go.tz).

In many ways, the reforms of 2003 and 2004 failed to address the fundamental shortcomings of the local government revenue system, and in many ways the local government revenue system in Tanzania continues to be one of the weakest components of Tanzania's local government finance system. In particular, weaknesses of the current system include (1) local governments are mostly assigned low-yielding taxes which are among the least popular and politically acceptable revenue sources; (2) the fragmentation of the local tax system causes horizontal inequities and inefficiency; (3) the "benefit principle" is largely missing as a conceptual foundation for local government revenues; and (4) local revenues are hard to administer and hard to enforce, while compliance costs for local taxes are unnecessarily high. A more detailed assessment of the local government revenue system is presented in Section 4 of the *Final Report: Development of a Strategic Framework for the Financing of Local Governments in Tanzania* (LGRP/GSU, June 2005).

1.2 Importance of a sound local revenue system as part of a sound framework for local government finance

The abolition of local government revenue sources in 2003 and 2004 had a significant negative impact on local government revenue collections; the abolition of the Development Levy had a particularly negative impact on rural districts, whereas the near-abolition of business licenses significantly reduce the revenue-raising ability of urban councils.

Although local government revenues are generally an easy target for central government politicians, the elimination of local government revenues in Tanzania was also the result of a prevailing skepticism in policy circles in Tanzania with respect to the policy relevance of own local revenues as part of a viable system of local government finance. The prevailing mood in Tanzania in this regard, both among central government officials as well as among some development partners, was fed by a number of biases and misconceptions held about local taxation. During a process of consultation and discussion that led to the development of a strategic framework for the financing of local governments in Tanzania, a common understand was reached that a sound local revenue system forms an essential element in a sound framework for local government finance. In fact, consensus was reached on four principles which form the conceptual foundation of the strategic framework for local government finance in Tanzania. Two of the four principles directly related to the role of local government revenues, and stated:

- *The role of taxation in the public sector is more than maximizing revenue yield. If structured appropriately, local taxation empowers communities, enhances accountability, helps improve vertical imbalance problems, and overall, it improves the efficiency of the public sector.*
- *Each government level requires control over at least one good revenue source. The deficiencies in local tax administration should not be addressed by eliminating local taxes without consideration of their revenue impact; rather, deficient local taxes should be transformed into sound revenue instruments. There is a need for a limited*

“closed list” of local taxes that captures the diverse circumstances of local government authorities in Tanzania. Revenue autonomy should be separated from the issue of tax administration; local taxes can be administered by the central tax administration as needed.

1.3 Overarching policy vision: the framework for local government finance

The fourth phase government is currently in the process of reviewing and adopting a policy framework for local government finances in Tanzania. The policy document indicates the Government’s desire to transform the current local government revenue structure in a manner that balances an appropriate level of local revenue autonomy on one hand with the desire for a clearly structured, transparent and efficient local revenue system on the other hand.

In achieving this policy objective, it is envisioned that the transformation of the local government revenue system will take place in a gradual process, which will incrementally improve and strengthen the local government revenue system over time. As a guiding principle in the transformation of the system of local government finance system, the current deficiencies in the local structure and local tax administration should not be addressed by eliminating local taxes without considering their impact on local revenue autonomy; rather, deficient local taxes should be transformed into sound revenue instruments.

From an implementation perspective, five steps are needed to ensure that the transformation of the local government revenue system conforms to this policy framework:

1. Assuring broad-based acceptance of the “closed-list” approach
2. Revising the legislative framework guiding local government revenues
3. Strengthening and standardizing the regulatory framework for local revenue administration
4. Strengthening local government capacity and local revenue administration practices
5. Gradually simplifying the local revenue structure by consolidating and harmonizing local revenue sources.

2. Formalizing the closed-list structure of local government revenues

As a first step in transforming the local revenue system, broad-based recognition should be given to the fact that local revenue autonomy is to be pursued within the context of a “closed list” of local taxes in order to achieve both objectives (a standardized, more efficient framework for local taxation, as well as local revenue autonomy and flexibility). Although the current permitted list of local government revenues was incorporated into the Local Government Finances Act three years ago, little was done in practical terms to assure proper adoption of the closed list.

The clear and formal recognition of the “closed list” as a basis for local taxation –in the regulatory framework, in practices and procedures, and so on- would ensure the overall legitimacy of the local government revenue system. While embracing a restrictive approach to local taxation denies local authorities the option of introducing their own local revenue instruments, the approach would continue to provide local governments with the discretion to change local tax rates (within centrally established limits). Furthermore, the list of permitted taxes should be defined in such a way that it provides flexibility to LGAs by allowing them to select from various different options how to administer local taxes. As such, the reform of the local government tax system would allow for asymmetries in revenue assignments. For instance, the right to collect certain revenues (e.g., local property rates) might be subject to certain centrally-defined conditions.

Table 2

Proposed re-organization of the list of permitted local government revenue sources

I. Local Rates

- A. Local rates on immovable property and land
 - i. Local property rates*
 - ii. Land rent*
- B. Local rates on income, business, or activity
 - i. Service Levy*
 - ii. Produce Cess*
 - iii. Guest House Levy*
 - iv. Other rates on income, business, or activity (incl. Forest Produce Cess and the Fish Landing or Auction Levy)*

II. Local Licenses and Permits

- A. Licenses on business activities
- B. Permits on construction activities
- C. Licenses on extraction of forest products and natural resources
- D. Licenses and permits on vehicles and transportation

III. Local Fees and Charges

- A. Market fees and charges
- B. Sanitation fees and charges
- C. Specific service fees and charges

IV. Other Local Revenue Sources

- A. Fines and penalties
 - B. Income from (sale or rent of) property, goods, or services
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A helpful starting point in the formalization of the “permitted local revenue list” would be to re-categorize the permitted revenue sources. While the list of local government revenues itself would not be modified in the process, the permitted revenues would be grouped in a manner that is more consistent with overall local government finance framework (Table 2).

Clarifying the local tax structure would make the system easier to understand for taxpayers and local government officials alike, thereby contributing to greater legitimacy of the system of local government revenues. Greater clarity and greater legitimacy should also help to improve the administration of local government revenues, improve taxpayer

compliance, and also in facilitate the monitoring of the performance of local tax systems. Having a formal local government revenue structure is also a precondition for moving forward with the necessary legislative, regulatory and administrative reforms, which are discussed in Sections 3, 4 and 5, below.

Under the proposed reorganization, four groups of local revenue sources would be recognized. Local rates have the following three characteristics: (1) They are broad-based local revenue sources; (2) there is no *quid pro quo* involved in their collections; and (3) their primary function is to raise revenues for LGAs. The category of local licenses and permits consists of revenue instruments that have the following features: (1) Licenses and permits are issued for specific activities; and (2) while their primary purpose is typically regulatory, the revenues raised from these sources may exceed cost recovery. In contrast, local fees and charges are defined by the fact that (1) there is a specific *quid pro quo*, and (2) fees and charges are collected exclusively for cost recovery of the provided service. Other local revenue sources would include fines and penalties, as well as income from (the sale or rent of) property, goods, or services.

The re-organized list of permitted local revenues groups local revenue instruments together in a way that is consistent with the vision that, over time, the primary sources of local government revenue in Tanzania over time would be drawn from two sources: first, a unified local tax on business activity, and second, a local tax on property ownership (imposed on land and buildings). Accordingly, the Land Rent was moved together with property rates under the heading “Local taxes on immovable property (buildings and land)”.¹ Likewise, the various local taxes on local business activity were similarly brought together under a single heading, as an initial step towards a more unified tax or rate on local business activity. The future emergence of a unified local business rate and a unified local rate on property (buildings and land) is discussed below in Section 6.

3. Updating the legislative framework

The Local Government Finances Act (LGFA) imposes on LGAs the duty to raise sufficient rates to cover local expenditures (Section 14), and broadly authorizes local government authorities to make and levy annual rates based upon any one or more of the following systems (Section 15):

- (a) a uniform rate per capita;
- (b) a graduated rate per capita;
- (c) a rate based on the value of immovable property situated within the area of the authority or in any part of that area;
- (d) a rate assessed on the earnings, livelihood or possessions of persons in the area liable to payment of rate;
- (e) a rate based on the fact of the ownership of immovable property situated in a specified area or at a specified place within the area of the authority.

¹ As noted in Table 1, the Schedule of the Local Government Finances Act, currently classifies Land Rent as “entrepreneurial income.”

Since 1982, the Local Government Finances Act (LGFA) has been periodically amended to reflect intermittent changes in the local government finance system. In particular, the introduction of the restrictive local revenue approach in 2003 was done “through the back door”: while the language in the Act continues to suggest a permissive approach to local government revenues,² the notion of a permissive approach is contradicted in the new section which was included in the Act in 2003 (Section 13(2)) along with the Schedule it refers to.³ As a result of the periodic (partial) revisions, the Act no longer provides a well-structured legal and regulatory framework for guiding local government finances. Instead, the Act includes numerous unclear, duplicative, and in some cases contradictory sections. Adoption of the Policy Paper on Local Government Finance would set the stage to update the LGFA in a manner that is consistent with the “closed list approach”.

For each of the permitted local revenue sources, the legislative framework should clearly and consistently define (1) the legal tax payer (who is responsible for paying the tax), as well as (2) the exact nature of the tax base (e.g., what is being taxed) and by extension, in what local jurisdiction does the tax obligation arise. Doing so could prevent confusion that currently arises over local tax liability when different LGAs put forth competing claims over an activity.⁴ The legislative framework should further indicate (3) any restrictions on the tax rate to be established by local authorities; (4) the general framework for revenue administration; collection; enforcement and appeals.

Rather than allowing each local authority to establish their own local by-laws regarding local government revenues, the LGFA should indicate that local authorities should establish by-laws in a standardized manner to set forth the tax rates for local revenue sources consistent with the local Rating Rules (as discussed further below). Further specific details (e.g., how the tax base should be measured or approximated) should be relegated to the regulatory framework, as discussed in the next section.

In some cases, certain limitations on local tax bases which are incorporated into the legislative framework may wish to be reconsidered. For instance, the LGFA Schedule of permitted local revenues limits the imposition of local rates on “buildings not in actual occupation”. It would be appropriate to consider the impact of this clause on the progressivity or incidence of local revenue collections, as this clause may excessively

² Section 13, subsection (1) of the LGFA reads: “Subject to this Act and to rules made by the Minister under this section, a local government authority may make by-laws imposing such rates to be paid by the inhabitants or such categories of inhabitants, for, on or in connection with such services, things, matters or acts as the authority may describe or specify in the by-laws in question.”

³ The language inserted as Section 13(2) reads: “Notwithstanding the powers to impose rates, charges, levies, fees or dues . . . , the local government authorities shall not impose rates to be paid [as] specified in the Third column of the Schedule.” Further clarification is provided by the Ministry of Finance, which states that “Local governments are not allowed to levy any taxes, levies or fees which are not on this list.”

⁴ For instance, should the Service Levy be paid in the jurisdiction where the enterprise pays its VAT, or should Service Levy be paid in the jurisdiction where the economic value is added? The determination of the tax base has important implications for the ability of LGAs to collect revenues from financial institutions, phone and utility companies, as well as extractive businesses that have their offices in one district but that operate in another district (or multiple districts).

restrict taxation of property that is held for speculative purposes or property that is occupied on a seasonal basis.

Also, as discussed further in Section 6.2, the envisioned re-orientation of the legislative framework will also require review and revision of the Urban Ratings Act (1983) as it pertains to the transformation of the local property rates system.

4. Standardizing the regulatory framework for local government revenues

In order to promote a legitimate local government revenue system, provide a stable local business environment, and minimize the compliance burden faced by taxpayers from local government taxes, the administration of local revenues should be guided by detailed set of nationally standardized local revenue administration guidelines.

4.1 Formulating standardized Rating Rules

In fact, the LGFA provides for such standardized Rating Rules to be established by PMO-RALG with consultation of the Ministry of Finance (Section 13:2-3). However, such Rating Rules have not been developed and/or put in place. Instead, PMO-RALG and the Ministry of Finance have periodically issued circulars or guidelines to direct local government revenue practices. Such irregular instructions outside the context of a well-structured regulatory framework fail to provide for a transparent and consistent local revenue administration process.⁵

Building on the revised legal framework provided by the LGFA, PMO-RALG (under DLG, LGA Finance Section) should proceed to formulate and impose standardized Rating Rules. This regulatory framework should provide a clear definition of the taxpayer and the tax base; the permitted options for the valuation of the tax base; the administrative procedures in collecting the revenue (including the tax forms to be used); as well as any enforcement and appeals procedures. The Rating Rules should also provide standardized language for local by-laws with which local authorities are able to determine the local tax rates (within minimum and maximum limits established by law). Standardization of local tax administration processes will also enable central government officials to more systematically monitor the collection of local government revenues and to assist in building local government tax administration capacity.

PMO-RALG should develop the Rating Rules in a participatory process which incorporates feedback from local government revenue officials as well as input from the private sector and civil society. It would be expedient for the development of the Rating Rules to be guided by the current by-laws and local revenue administration practices from a variety of different types of local authorities. Indeed, implementation of the new

⁵ For instance, in 1997, PO-RALG directed LGAs –among others- to share 20 percent of local revenues with the village and mtaa level. However, it appears that no written record of this directive could be located by consultants in 2003. (See: PO-RALG/UNCDF/DFID. 2003. Local and Lower Local Government Revenue Sharing and Management of Finances at the Village, Ward and Mtaa Levels.)

regulatory framework could be piloted in a number of districts before being rolled out across Mainland Tanzania.

Although a standardized set of Rating Rules should be provided to all LGAs across Mainland Tanzania, the regulatory framework requires adequate flexibility to meet the different economic, fiscal, demographic, and geographic conditions across local government jurisdictions. For instance, while more complex property valuation approaches may be appropriate for municipal authorities, simpler valuation techniques may be appropriate for less economically developed, rural districts. Indeed, local revenue assignments could possibly be asymmetric, as the LGFA or the Ratings Rules could restrict permission to collect certain local revenue sources (such as value-based property rates) exclusively to local authorities that have met certain minimum conditions.

4.2 Appropriately structure the different local revenue administration processes and functions

As the local Rating Rules regulate the overall local revenue administration process, this regulatory framework should appropriately structure the different local revenue administration functions to maximize the efficiency of local revenue administration and to minimize the opportunity for revenue corruption. Some of the elements that will have to be considered in the development of the regulatory framework for local revenue administration include the following:

1. ***Separate the determination of the tax liability and the collection of local government revenues.*** If the same local official has the power to determine the size of the local tax liability and to collect the revenue source, this opens up a major opportunity for corrupt practices. Sound (local) revenue systems separate the functions of valuing the tax base and assessing the tax liability on one hand, and collection the liability on the other hand. At no point should a tax collector be authorized to change the tax liability without approval from a supervisory body.
2. ***Assure transparency in the payment process.*** Whenever possible, assure transparency in the payment process. When possible, local tax liabilities should be directly paid to the cashier of the Local Government Authority, or to the LGA through a trusted intermediary (such as a bank or financial institution). Whenever possible, situations should be avoided in which only the taxpayer and the collection agent are present during payment. Mechanisms should be put in place which would allow taxpayers to verify that their tax payments were indeed deposited into the council's account.
3. ***Whenever possible, create "tax handles" in collecting local revenues.*** Good (local) tax administration is facilitated when the collector has a "tax handle" that provides the collector with an effective instrument whereby collection of the revenue source can be enforced. One way in which a tax handle can be assured is by inserting the tax collection processes into transactions at the stage where money is changing hands. Often this is enhanced where the party to the transaction which is not paying the tax is required to withhold the revenue and

pay it the government before the transaction can proceed. Thus taxation of goods being bought and sold at a market, or taxation of incomes done at the point of remuneration, is easier to enforce. Likewise, connecting the collection of revenues to the provision of a service or document (such as a permit, license, or certificate of payment) can greatly improve the ability of the collecting agent to collect the tax liability.⁶ Accordingly, it would be appropriate to eliminate any restrictions on the collection of local revenues at market-sites; as long as a local revenue source is a legitimate local revenue instrument, it should be collectable wherever the tax handle is available (without unnecessarily disrupting commerce).

4. ***Combine the collection of different revenue sources when possible.*** Combining the collection of related revenue sources can reduce the taxpayer's compliance burden and also strengthen the local government's tax handle if taxpayers have an incentive to pay one of the revenue sources. For instance, collaboration (such as information sharing, or even joint collection) between local revenue officials and TRA on the collection of the Service Levy (together with the VAT) could significantly improve local revenue performance. Likewise, linking the collection of the Land Rent and local property rates could improve collection of local property rates if local rate payers receive a benefit from paying Land Rent.
5. ***Put in place realistic penalties and enforcement procedures.*** A second type of tax handle is provided is when realistic sanctions exist for non-payment of (local) taxes. Indeed, unless there is a penalty for failure to pay taxes, rational taxpayers will simply not pay taxes. Failure to put in place a realistic enforcement mechanism will result in an unfair tax system and reduce revenue compliance. As such, good enforcement is critical to an effective and fair tax system.

4.3 Local revenue administration: different institutional options

Different institutional approaches for administering local revenues may be appropriate given different circumstances. As such, the Rating Rules should set forth the options for administering local government revenues: (1) council officials may be organized to assess and collect local government revenues themselves; (2) the responsibility to collect certain local revenues could be assigned to the Tanzania Revenue Authority (TRA); or (3) local revenue administration could –in part or in full- be outsourced to private collection firms.

The regulatory framework should provide guidance when each of these options is appropriate. PMO-RALG should inform the options that are made available to local authorities by studying the administrative costs of different collection modalities.

⁶ Tax handles are commonly used both by central as well as local authorities. For instance, withholding of income taxes is an example of reliance on a tax handle. Likewise, withholding crop cesses from crop buyers (rather than the seller), tied to crop-buying permits to purchase crops in a district, is another example of a tax handle.

- ***Local revenue administration by council officials.*** The advantage of local revenue administration by council officials is that –if done properly- this would enhance the legitimacy of local revenue payments, as the taxpayer feels he or she is directly contributing to the local treasury. This would reinforce the link between local revenue payments and the benefits received from local expenditures.
- ***Tanzania Revenue Authority.*** The TRA may have an advantage in collecting the Service Levy, as the Service Levy is levied on a similar basis as the central government’s VAT. As such, it might be possible for TRA to act as a collection agent for LGAs and possibly receive a collection fee of one or several percent. Likewise, since all vehicles in Tanzania are centrally registered, TRA would also be well-positioned to collect local vehicle registration fees (if indeed assigned to the local government level). In contrast, TRA would not necessarily be in a superior position to administer local property rates, as it has no particular expertise in property valuation or enforcement of property tax payments. Of course, this should not preclude the TRA from acting as a collection agent for a local authority upon mutual agreement between the TRA and an LGA.
- ***Outsourcing of tax administration processes to private firms.*** Outsourcing of local tax administration processes is an attractive option when private firms are more efficient at performing certain local revenue administration functions. Local governments could rely to varying degrees on outsourcing of local revenue administration processes. First, it is common in developing and developed countries alike to outsource the valuation of taxable properties to private sector firms. Second, reliance on private tax collection agents is still quite common in many developing countries.⁷ Third, private firms are relied on in some countries in the enforcement of local taxes, as local authorities may sell the unpaid tax liabilities to private collection agents (at a discount), who can then pursue collection of the outstanding debt with the taxpayer directly. If the enforcement of local revenue collection is outsourced to a private firm beyond the control of the local council, this may reduce the political interference with local revenue collections.

5. Strengthening and enhancing local revenue administration practices

Rolling out of the new regulatory framework for local government revenues should be accompanied by an intensive series of seminars and capacity building workshops for local government officials.

⁷ Although financial institutions are sometimes used as intermediaries or collection agents in developed countries, it is no longer a common practice to outsource the actual collection of tax payments in industrialized countries. However, it is not unusual in more developed economies for public authorities to tender the management of a public facility (for instance, operation of a toll road) to a private firm, so that the private firm is put in charge of operating the facility as well as collecting user fees.

5.1 Guiding the transformation towards the new administrative structure

The process of transforming the local revenue system should involve every LGA going through a process of identifying gaps between their current local revenue structure and the new permitted list of local revenues, as well as any gaps between their local revenue administration practices and the regulatory guidance contained in the standardized regulatory framework for local revenues. Local governments should then be provided sufficient time (and possibly limited external support) to transform their local revenue administration processes to come into compliance with the new local government revenue system.

5.2 Ensuring greater transparency in local revenue administration

The legitimacy and success of the local revenue system will depend to a large extent on the confidence that local taxpayers have in the fact that their local revenues will be put to good use. This will require local governments' active involvement in pursuing greater transparency in the local revenue administration process. The transparency of local revenue systems can be enhanced in a variety of different ways:

- ***Improving the visibility of local tax compliance:*** Local tax administration practices can enhance the visibility of local tax compliance. Local businesses which paid their local business rates could be issued a “certificate of payment” that should be visibly displayed on the business premises. Likewise, ratable properties could be required to display a decal to signify that property rates have been paid (or alternatively, be visibly marked for their failure to pay).
- ***Improving internal control and audit:*** Improving internal administrative controls and audits of local revenue collections is required in order to assure that local revenues are deposited in the appropriate local accounts and subsequently used for the intended public purpose. This is true for both for local revenues deposited into the general account of the local council, as well as user fees and other revenues retained by service delivery units (such as Health Centers) and Village Councils.
- ***Greater downward accountability:*** In many cases, local taxpayers are currently unable to verify whether their tax payments are indeed deposited into the local authority's revenue account. Revenue corruption could be reduced and downward accountability enhanced by requiring local authorities to post local revenue collection details for the main local revenue sources on local notice boards. For instance, local governments could be required wrong to post revenue collection details on notice boards by receipt number, so that each local taxpayer could verify that their tax payments was included in total revenue collections. However, in order to impose this requirement, most local governments would likely require assistance from PMO-RALG with computerizing their local revenue administration.
- ***Greater upward accountability:*** There are limits to the degree with which local taxpayers are able to monitor the revenue collection activities of their own local authorities. Therefore, in addition to stronger downward accountability mechanisms, the central government (through the LGA Finance Section, DLG, PMO-RALG) should also play a more active role in monitoring local government revenue administration to ensure that local taxpayers are treated fairly by their local authorities.

5.3 Strengthening the link between local revenues and local expenditures

One of the most noted reasons for low levels of local revenue compliance in Tanzania is the absence of a clear link between local revenue collections and the perceived benefits from local expenditures. As a result, in addition to the transformation of the local revenue system, PMO-RALG should also pursue steps outside the realm of local revenue administration in order to encourage greater local revenue performance. Such steps could include:

- Increasing in the participatory nature of the local budget process, thereby increasing the likelihood that local taxpayers will receive value-for-money for their local tax payments.
- Enhancing the transparency in local spending. For instance, local budget documents could be required to provide a summary how locally-raised revenues are spent. Likewise, road signs should be posted at the site of capital project to indicate that locally-raised monies are used to fund (part of) the capital project.
- Awareness should be increased among local officials and the civil society that General-Purpose Grants (GPG) are provided to local authorities to cover the cost of local administration expenditures. The provision of the GPG means that LGAs should in a position to dedicate most or all locally-raised revenues towards the delivery of public services that are deemed local priorities, thereby providing the highest-possible value-for-money for local taxpayers.

5.4 The importance of local revenue enforcement

A fundamental feature of any tax is that it is non-voluntary. In fact, according to the “free rider” principle, rational taxpayers should be expected to pay no taxes whatsoever unless tax collections are properly enforced. This means that taxpayers will only “voluntarily” pay their outstanding tax liability when there is a realistic (and proportional) threat in place for failure to pay one’s taxes.

Since enforcement of local revenue collections is often politically unpopular at the local level, PMO-RALG may need to set clear standards in order to assure uniform enforcement of local revenue collections. Contracting out certain enforcement tasks (as distinct from revenue collection tasks) or selling off tax debt to private collection firms is a common practice in other countries and could reduce the local political influence over the collections process. As the ultimate sanction, LGAs that fail to meet such minimum enforcement standards could be prohibited from collecting (selected) local revenues. Such enforcement standards would not only ensure (horizontal and vertical) equity in the collection of local revenues, but would also likely result in increased revenue yield and reduced revenue corruption.

6. Gradually consolidate and simplify the local government revenue structure

The reform should focus on the simplification of the current structure by combining several fragmented local taxes and levies into a small number of broad-based local tax

instruments with a more significant revenue potential; the prime sources of local revenue would be the Unified Local Business Tax and a Local Property Tax. Compliance costs and horizontal inequities would be further reduced by the introduction of a nationally standardized framework for local revenue administration, which would assure that taxpayers across the country would face the same administrative processes and procedures, including the same local tax forms. Additional local revenues would also be collected from a number of Local Levies (local taxes with a specific tax base) as well as from User Fees. The framework for local government revenues would further be tightened by clear defining the role of Contributions in the local government finance system, and providing additional context for the sharing of local revenues with the village-level.

6.1 Moving Towards a Unified Local Business (ULB) Tax

The Local Government Finance Study (LGRP/GSU, June 2005) recommends consolidating the various local taxes on business activity into a Unified Local Business Tax. Once introduced, the Unified Local Business Tax would absorb (eliminate) the Service Levy, the Crop Cess, the Forest Produce Cess, the Guest House Levy, and the Fish Landing or Auction Levy; each of these revenue instruments would become a component part of the ULB Tax. In addition, businesses not subject to any of these existing revenue instruments would be subject to an alternative presumptive tax payment, which would be similar to the (previous) village-level taxes on business activity for minor settlements.⁸ These smaller businesses (or businesses that cannot produce turnover information the local government) would be assessed fixed charges according to a centrally legislated schedule that will allow variations by type, size, and location of the business.

The introduction of a ULB Tax would mean that in accordance with the benefits principle, anyone engaging in business activity in a local government jurisdiction would be required to contribute to the public revenues of the local authority.⁹ One (minor) adjustment that would be required to maintain the correspondence principle would be to change the name of the Crop Cess into “Crop Cess Withholding”, which would signify that although the Crop Cess is legally paid by the crop buyer, that it is in fact withheld by the buyer on behalf of the crop grower who benefits from the locally-funded infrastructure and who also bears the economic burden of the tax. Indeed, over time, local authorities could be given greater flexibility in determining how best to collect the Crop Cess.

⁸ It appears that village council jurisdictions are too small to efficiently collect formalized own source revenues. However, district councils could be required to share locally-collected revenues with their constituent villages, either on a derivation basis, or on the basis of a simple formula (e.g., on a per capita basis).

⁹ In fact, consistent with the previous tax on local business activity for minor settlements, business activities in the rural areas a districts (outside of villages and settlement areas) would be excluded from the alternative presumptive tax on the basis that they are likely to benefit less from the infrastructure and public services provided by the local authority. This also makes good sense from a tax administration perspective, as it is much more costly to collect local revenues outside villages and settlements.

For enforcement purposes, the local authorities could issue an annual “*local business operating permit*” or a “*certificate of payment*” as proof of payment of the ULB tax which businesses would be required to display on a permanent basis within their premises.

Given that the introduction of the ULB tax would be a major reform of the local tax system, a first step would be to pull together the various existing business taxes under a single “umbrella” tax instrument and to broaden the tax base to include all businesses and productive enterprises at the local level, including any business currently not taxed locally. Broadening the local tax base by reaching smaller businesses would improve horizontal equity in accordance with the benefit principle and would allow the rate structure to be set low by spreading the costs of local government services to all businesses that benefit from it, rather than by burdening only a narrow base of local businesses.

A subsequent step in the introduction of the ULB would be to harmonize the effective tax rates (and the schedular charges) applied to gross turnover across the different business activities and categories. Currently, the main tax rates range from 0.3 percent of turnover for the Service Levy to 5 percent for the Crop Cess. However, given that the relationship between gross turnover and net income may vary across industries and sectors, it is not necessarily the case that the tax rate imposed on turnover for each type of productive activity under a presumptive local business tax is necessarily the same. Furthermore, the ULB tax rate schedule should be harmonized with the differential rates imposed by central government taxes on different types of business activities. Further study will be needed to determine the appropriate relative tax rates between different types of business activity in order to assure horizontal equity.

6.2 Strengthening the role of the local property tax

The property tax has been identified by many previous studies as one of the local taxes in Tanzania that has not lived up to its revenue potential. Numerous improvements should be made to the structure and administration of the property tax over time, across all facets of the tax, including improvements to the process of maintaining the cadastre, valuation, assessment, administration, collection, and enforcement of the property tax.

The first step in the strengthening of the local property tax should be to harmonize the legislative and regulatory frameworks for the local property tax consistent with the role that the local property tax is expected play in the local government finance system. For instance, the legislative and regulatory framework should clarify that local property rates can be collected by urban as well as district authorities. Likewise, the legislative framework should further be reviewed and revise to permit certain practices which are commonly accepted but where the legal basis is unclear, such as the practice of imposing different property rates for residential and commercial properties within a local authority. Additional considerations in strengthen the local property tax in Tanzania include:

- ***Moving towards a single tax on building and land.*** Currently, there are two separate and overlapping taxes on land and real property in Tanzania, notably the Land Rent

(which is shared 80/20 between central and local authorities) and the local property tax on buildings, which is fully retained at the local level. The local government financing study (LGRP/GSU, June 2005) recommended that ultimately, the Land Rent and the property tax should be fully integrated and assigned to the local level. As a first step, the study recommended assigning the Land Rent exclusively to the local government level or at least (perhaps more politically viable) shift revenue sharing from the current sharing arrangement (in favor of the Ministry of Lands) to 20/80 in favor of district. The gradual harmonization of the Land Rent and the local property rates should increase the tax handle that local authorities have over property tax collections since payment of the Land Rent has specific quid pro quo (namely the continued registration of the land title, and possible use of this title as collateral for loans). Even without any modification to the current revenue assignments, integrating the administration and collection of the Land Rent and local property rates could simplify revenue administration procedures and compliance.

- ***Development of local property cadastre.*** The legislative and regulatory framework needs to provide a framework for establishing and maintaining local property cadastre of all ratable (and non-ratable) properties. The tax base for local property should be clarified and widened to include non-resident property owners as well as properties not occupied year-round (which are currently excluded from taxation).
- ***Property valuation.*** The legal and regulatory guidance on property valuation should provide local authorities with the flexibility to choose the most appropriate valuation technique. Mass-appraisal techniques and presumptive types of valuation (such as banding) should be permitted as long as it is done in an equitable fashion. Annual increases in property valuations -to capture general increases in the value of property within a local authority- should be possible without a full-blown re-assessment of all individual properties.
- ***Administration and collection processes.*** Sending out tax collectors to collect property rates door-to-door increases collection cost, increases the opportunity for corruption, and reduces transparency in the collection process. It would generally be preferable if local rate payers would be required to pay their rates at one or more central cashier's locations in the district. However, such "voluntary" payment compliance can only be relied on if adequate enforcement mechanisms are in place. Furthermore, in order to protect local rate payers against capricious local tax administration, there is a need for central government (PMO-RALG) to assure that local property registration, valuation and administration are done in an equitable way.
- ***Enforcement and political will.*** Local authorities currently lack realistic "tax handles" in enforcing local property rate collections, as it is seldom politically feasible to sell house or land as enforcement measure for failure to pay property taxes in Tanzania. More viable alternative enforcement mechanisms should be explored and piloted. Furthermore, although no tax is ever well-liked, popular acceptance and the political will to collect local property rates can be strengthened by improving the

link (and making the link more visible) between tax payments and improvements in locally-funded public services and infrastructure.

- ***Betterment levies.*** A final recommendation made by the local government financing study (LGRP/GSU, June 2005) was that the environment should be strengthened for the imposition of so-called Betterment Levies. Subject to rules and conditions to be set in the reformed legislative framework, local authorities would be encouraged to levy a special, location-specific property rates to cover the costs of specific capital infrastructure projects with identified localized benefits for a limited number of properties in the ratable area, such as street lighting, sidewalks, and so on.

6.3 Other considerations

In addition to the formalization of the “closed list” as discussed in Section 2 above, a few issues may warrant further consideration and clarification. For instance, the legislative and regulatory framework should clarify the exact revenue base of the Intoxicating Liquor License Fee; is it a revenue source either on the production or on the sale/consumption of intoxicating liquor, or are both options permissible? Likewise, is the licensing of private health facilities an appropriate function of local authorities, and correspondingly, is the continued collection of a Private Health Facility License Fee appropriate? Further, as noted by the Local Government Finance Study (LGRP/GSU, June 2005), it would be appropriate to reclassify the Billboard Fee as a annual regulatory-type permit or license, instead of an administrative fee that is collected based on the cost recovery principle.

7. Concluding remarks

The driving force in the transformation of the local government revenue system in Tanzania should be LGA Finance Section, which is located in the Directorate for Local Government within PMO-RALG. In order to properly champion these reforms, this newly created section should develop authoritative expertise in local government revenue policy and administration. The transformation of the local revenue system should be done in close collaboration with LGRP’s Finance Outcome, as well as with other involved stakeholders in the area of taxation in Tanzania, including MOF (particularly CPAD), TRA, as well as private sector and civil society representatives. The transformation should also closely involve representatives from the local government level, include the DSM municipalities, as well as other urban and district councils.

The transformation should be able to make quick headway in some areas, such as the formulation of the overall local government revenue framework, transformation of the legislative framework, the formulation of standard Rating Rules, as well as the development of learning materials on the local government revenue system (e.g., a Manual on Local Government Revenue Mobilization). Substantial headway in these areas should be possible within the time span of 1-2 years.

Rolling out the transformation of local revenue administration practices at the local level should be expected to require effort and capacity building over several years. Longer-term initiatives will also include the more gradual harmonization of the various local taxes on business activities into a ULB Tax and the incremental strengthening of local property rates, to –over time- form the two main pillars of the local government revenue system in Tanzania Mainland.