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Effect of Tax Exemption for Domestic Investors on Government Revenue Collection in Zanzibar

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Abstract: The main aim of this study is examining the effect of tax exemption for domestic investors on the government revenue collection in Zanzibar. Specifically, the researcher concentrated on two types of exemptions, these are; absolute and partial tax exemptions. The researcher has mainly employed quantitative research approach with appropriate method of analysis for this study. A simple random technique was used to select research respondents of 100 sample size and survey questionnaire was used as data collection instrument. To achieve a credible study a multiple regression was used to analyze the collected data from relevant respondents. The study has revealed that one predictor (partial tax exemption) had a significant effect or impact on the outcome variable (government revenue collection). However, one predictor variable that is absolute tax exemption did not show any significant result. The study concluded that tax exemption is a good instrument to stimulate and attract domestic investors when other issues have been incorporated into the procedures, alone, it cannot stand as the only factor. Finally, the study recommended as the tax incentives and exemptions work or not, there is a need for transparency, public scrutiny and dialogue, equity and bargaining are essential to building a culture of tax compliance.

Keywords: Absolute Tax Exempted, Partial Tax Exempted, Government Revenue Collection, Domestic Investors

1. Introduction

With the experience, in Tanzania, the export processing zone authority (EPZA) and special economic zones (SEZs), companies are exempted for the first 10 years from paying corporate income tax and all taxes and levies imposed by local government authorities. They are also granted import duty exemptions on raw materials and capital goods imported for manufacturing goods. Non- Government Organizations given special treatment, and some pay at zero import duty on the importation and other only pay for 25% on importation due to the activities they mention. Non – Government Organization's and other Government offices receive a special VAT relief, where Under the Zanzibar Investment Promotion and Protection Act, 2004.

Despite the high estimated cost of tax exemptions for Tanzania and Zanzibar in general since the early 1990s, there has been no comprehensive attempt to assess the costs and benefits of these exemptions, or to assess their success or contribution to state development goals. The African Development Bank [1] conducted an analysis of revenue foregone, as did the Tax Justice Network (TJN) in Africa, which estimated the cost of tax incentives in both Tanzania and the EAC area (summarized in the report "Tax Competition in East Africa" TJN 2012).

The Revolutionary Government of Zanzibar (RGZ) aims to introduce a broad tax system with as few exceptions as possible. However, exceptions are granted for a variety of reasons in a way of eliminating the tax burden of projects of local investors, to comply with government obligations in legal agreements and to implement certain policies, in a way of supporting domestic investors and NGOs to stimulate economic growth. Tax exemptions are listed in the tax law tables, which define the categories of exemptions and the relevant criteria for eligibility for the exemptions. In addition, tax exemptions are granted through government notices signed by the Minister of Finance and published in the Official Gazette.

Zanzibar has two separate agencies where The Zanzibar

Revenue Board (ZRB) was established under the ZRB Act No. 7 of 1996 as the prime agency of the Government of Zanzibar for collection and administration of all taxes from Inland Revenue sources other than customs, excise and income taxes that are administered by the Tanzania Revenue Authority (TRA). Collecting outstanding financial obligations from the public, those financial obligations can come in a variety of sources—taxes, license fees, fines or use of state facilities.

2. Statement of the Problem

Two basic premises support tax incentive programs in developing countries: first, that additional investment is required to foster faster economic growth; and second, that tax exemptions can effectively stimulate investment. Both theses may seem self-evident, but they are subject to important requirements that are highly relevant for understanding the effectiveness and impact of tax investment incentives [2].

There seem to be two opinions on the effectiveness of tax incentives, with some arguing that tax incentives encourage investment, which creates employment opportunities and leads to overall economic growth. On the other hand, those who discourage tax incentives argue that tax preferences create inequalities, the actual cost of income can be high if the investment was in any way profitable, and abusive tax avoidance schemes erode the income base" [2].

The study attempted to find out the positives and the negatives of tax exemption to domestic investors, thus weigh the two and eventually come up with the best practices in order to foster and improve government revenues, and provide the detailed information on the said exemption granted to the domestic investor on the progress of the country. Therefore, this study attempts to analyze the impact of tax exemption schemes on government revenues using the case of Zanzibar.

3. Literature Review

There are two theories which govern this study, and these are;

Laffer curve Theory: The theory was aimed at Arthur Laffer in 1979, shows the relationship between tax rates and tax revenue collected by the government. The curve suggests that as taxes increase from the zero level, the tax revenue collected by the government also increases. It also shows that increasing the tax rate after a certain point would prevent people from working as hard (or reduce the level of investment), thus reducing taxes on income and investment. If tax rates reached 100% (the far right of the curve), all people would choose not to work or invest because everything they earned would go to the government. *Trickle-Down Theory:* McCracken [3] in Trickle-Down theory it indicates that services and financial incentives should be offered in taxes of large investors and entrepreneurs, as they will improve commercial activities in such companies that will encourage investment that leads to general economic growth.

The theories above has two suggests that there is a significant relationship and impact of taxes and investments, and there is also the gain of government in accordance with Laffer [4], so these theories will support this research work.

4. Empirical Review

Ferede and Dahlby [5] conducted a study on The Impact of Tax Cuts on Economic Growth, the method used a case study from Canadian Province and the data was a secondary source from the Statistics Canada database (CANSIM), and the study found as Taxes can affect growth through their impact on factor accumulation and total factor productivity. As with the first channel, taxes can increase the cost of capital and reduce incentives to invest. To the extent that higher tax rates discourage investment, economic growth will be negatively affected. The negative effect of taxes on entrepreneurship reduces the generation of new ideas and reduces total factor productivity.

Mureșan et al., [6] conducted study on value added tax impact on economic activity: importance, implication and assessment - the Romanian experience. The inductive method was used on the study and the finding of the study was an increase in the distorting tax processes of economic activity and thus reduces the growth rate of economic production, a high value added tax rate at the same time increases consumer and investment opportunities and creates a negative impact on the supply and demand for assets generated by business agents.

Same as Bumpei, [7] on his study of the effect of the VAT rate change on aggregate consumption and economic growth observed as the income effect of Value Added Tax on total consumption is clearly negative as the increase in the VAT rate will reduce people's disposable income. In addition to the income effects, a change in the VAT rate has a substitution effect, which means that even if the government lowers the income tax rate to compensate for the decrease in people's income due to the increase in the VAT rate, the overall consumption will change. The method used was as a case study and historical data was used from International Finance Statistics (IFS) and According to Organization for Economic Co-operation and Development's (OECD's).

On the contrary, Adereti et al. [8] examined the impact of VAT on economic growth in Nigeria using a multiple regression technique. Time series data on gross domestic product (GDP), sales tax revenue, total tax revenue and total federal revenue from 1994 to 2008 were collected for the analysis. The results showed that the ratio of VAT revenue to GDP averaged 1.3%, compared to 4.5% in Indonesia, indicating a positive and significant correlation between VAT revenue and GDP. 2 years.

Owolabi and Okwu [9], examined the contribution of VAT to the development of the Lagos State economy, using simple regression models as abstractions of the respective sectors considered in the study. The study considered a vector of development indicators as dependent variables and regressed each on VAT revenue in Lagos State for the study period. The results showed that VAT receipts contributed positively to the development of the respective sectors. However, the positive contribution was statistically significant only in the development of the agricultural sector. Overall, the analysis showed that VAT revenues have contributed significantly to the development of the agricultural sector development of the economy during the study period.

Oloichi [10] examined the effect of corporate income tax on the investment decision of companies subject to corporate income tax law in Nigeria. The questionnaire was designed to collect data from 180 businesses in the South West region. The results revealed that corporate tax has an influence on the rate of return on investments and the criteria for evaluating investments; Tax incentives motivate investment. The tax was considered very important compared to other factors influencing the investment decision. Fiscal policy should therefore aim to promote economic growth.

Asogwa and Okeke [11] examined the impact of VAT on investments. Data from the Central Bank of Nigeria (CBN) Statistical Bulletin were analyzed using multiple regression analysis. The result shows that VAT has a significant impact on investment growth in Nigeria does not correspond to the previous expectations of the model.

Njuru et al. [12] examined the impact of taxes on private investment in Kenya. A vector auto regression technique was used to achieve the objectives of the study. A time-series research design covering the period 1964-2010 was used. The study found that VAT, income tax and the establishment of the Kenya Tax Agency (K.R.A) It has a negative impact on private investment, while the special tax, the amnesty of tax imports has a positive effect on private investment.

Makere, noel [13] investigated the impact of tax exemption and tax breaks for foreign investors on the revenue generation of the Tanzanian government. The study revealed that tax breaks and exemptions do not contribute to effective revenue collection, but rather undermine and hinder the tax collection process, thus making this country dependent on foreign aid.

Edame and Okoi [14] examine the impact of taxes on investment and economic growth in Nigeria from 1980 to 2010. The analysis used ordinary multiple least squares regression. Data was extracted from the Central Bank of Nigeria Statistical Bulletin and the National Bureau of Statistics. The result of the analysis showed that the estimates of the parameters of corporate income tax and income tax appear with negative signs, which means that there is an inverse relationship. The result implies that a one percent (1%) increase in (CIT) will result in a decrease in investment levels in Nigeria. Consequently, an increase in the PIT leads to a decrease in the level of investment. Therefore, it shows that taxes are negatively related to investment and production levels of goods and services (GDP) and positively related to government spending in Nigeria.

Ezejiofor et al. [15] attempt to assess whether taxes as a fiscal tool affect the performance of selected manufacturing companies in Nigeria. A descriptive method was chosen and data was collected using the six-year financial accounts of the selected companies. The hypothesis formulated for the study was tested with ANOVA using the Statistical Package for Social Sciences (SPSS) version 20.0. Taxation as a tool of fiscal policy has been found to have a significant impact on the performance of Nigerian manufacturing companies.

5. Methodology

Research design: The quantitative research was used to design due to it goes deep into specific experiences with the intent to describe and explore meaning through textual, narrative, or visual data and to develop themes unique to that group of participants through questioner surveys.

Study Area: The study was conducted in Zanzibar. It focused on Zanzibar taxes agencies Tanzania Revenue Authority (TRA) and Zanzibar Revenue Board (ZRB).

Population of the Study: The study population was officials from Tanzania Revenue Authority (TRA) and Zanzibar Revenue Board (ZRB) offices which consist of all if not the largest percent of information required for the purpose of this study.

Sampling techniques and sample size: Simple random sampling was to select 100 sample sizes of the officers of TRA and ZRB were those who are performing the tax administration activities respondents. This technique provided the equal chance to all individuals in the departments that were selected so as to avoid biased statistics.

Data Collection Methods: Survey questionnaire was used as a tool of data collection.

Data analysis Techniques: A regression analysis method was used to examine the degree of relationship between the independent and the dependent variable which have been found in descriptive analysis. The following model used in this study

$$Yi = \beta_0 + \beta_1X_1 + \beta_2X_2 + e$$

Yi: Represents the dependent variable which is Revenue collection (RC);

β_0: Represents a constant factor or the intercept;

$\beta_1$and β_2: Coefficients of independent variables;

X_1: Represents an independent variable, Absolute Tax Exempted (ATE);

X_2: Represents an independent variable, Partial Tax Exempted (PTE);

e: Represents an error term.

Thus,

$$RC = \beta_0 + \beta_1 ATE + \beta_2 PTE + e$$

6. Study Findings

6.1. Profile of the Respondents

Demographic profile questions are an important aspect of any socioeconomic research. In this respect, this study profiled the respondents based on gender, age, marital status and educational attainment.

Table 1. *Profile of the Respondents.*

Variable	Category	Percentage
Age	15-24	6.0
	25-34	22.0
	35-44	54.0
	45 and Above	18
Gender	Male	78.0
	Female	22.0
Marital Status	Single	9.0
	Married	72.0
	Divorced	19.0
Education level	Certificate	1.0
	Diploma	9.0
	Degree	43.0
	Master	47.0

From table 1 above it indicates that 54 percent of the respondents are between the ages of 35-44, which is more than half of the total respondents. This indicates that most of the officers of dealing with tax administration are economically active labor force and they can manage well their responsibilities. Through gender, the findings showed that majority of the respondent (78%) were male and 22 percent were female. In a Zanzibar social conditions most of employed people are normally by males compared to female, from the given sample there are few female who working in tax agencies and performing tax administration, that's why the large number of respondents were males by gender in this study.

An overwhelming number of the respondents (72 percent) were married, 19 percent were divorced and 9 percent were single. This implied that the study respondents were enough matured. Because they have family (they are married) they can work under supervision very effectively in order to protect their family. It can be seen in table 1 that, the respondents were attained their education in different level. The large numbers of the tax officers were from degree and master which represent 43% and 47% respectively. This implied that education represents the basis of a society oriented towards the future; knowledge becomes the main component of the economic and social growth.

6.2. Standard Multiple Regression Results

The results of standard multiple regression as displayed in Table 2 below indicated that the independent variables absolute tax exemption and partial tax exemption accounted for 43.2% of the variability in government revenue collection in Zanzibar (R^2 = 0.432). The adjusted R square value was 0.414. Therefore, these findings substantiate that only 43% of variability in government revenue collection could be explained by absolute tax exemption and partial tax exemption. The remaining 57% of variability depends on other unexplained factors.

Table 2. *Results of Standard Multiple Regression for the Testing of Absolute tax exemption and Partial tax exemption on Government revenue collection. Model Summary[b].*

R	R Square	Adjusted RSquare	R Square Change	F Change	Sig. F Change
.454[a]	.432	.414	.432	2.115	0.000

a. Predictors: (Constant), Absolute tax exemption and Partial tax exemption

b. Dependent Variable: Government revenue collection.

Apart from Table 2 above, the following Table 3 below displays the coefficients' columns for the standard multiple regression conducted.

Table 3. *Coefficients Table for Absolute tax exemption and Partial tax exemption on Government Revenue Collection.*

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	2.246	.564		3.979	.000
	Absolute Tax Exemption	.113	.128	.089	.880	.381
	Partial Tax Exemption	.109	.091	.220	1.197	.040

b. Dependent Variable: Revenue Collection.

With reference to Table 3 above, at the 0.05 level of confidence, the study has revealed that one predictor (partial tax exemption) had a significant impact on the outcome variable (government revenue collection). In other words, the results of predictor variables as seen in Table 3 above are as follow:- partial tax exemption (β = 0.220, t = 1.197, $p < 0.05$).

The estimate multiple linear regression equation becomes:

$$RC = \beta_0 + \beta_1 ATE + \beta_2 PTE + e$$

Constant= 2.246, shows that if absolute tax exempted and partial tax exempted all zero rated, revenue collection prospected 2.246.

β_1= 0.089, reveals a unit change of increased absolute tax exempted outcome in 0. 089 units rise in revenue collection.

β_2= 0.220, reveals a unit changes of increased partial tax exempted outcome in 0.220 units rise in revenue collection.

Basically, the effect of partial tax exemption on government revenue collection in Zanzibar was in a positive direction. This situation indicates that the increase of scores in these predictor variables results in the increase of scores in the outcome variable, Hair et al., [17], Pallant [18]. This condition entails that the business owner and qualified individual household have high level of receiving tax part of tax relief tend to pay more on other tax.

However, one predictor variable that is absolute tax exemption did not show any significant result ($\beta = 0.089$, $t = 0.880$, $p > 0.05$ (0. 381)). This means that the more NGO's receive full tax relief the less government collect from tax.

This finding is reflected with the finding of Asogwa and Okeke [11] who studied the impact of VAT on investments. Data from the Central Bank of Nigeria (CBN) Statistical Bulletin were analyzed using multiple regression analysis. The result shows that VAT has a significant impact on investment growth in Nigeria. The sales tax code does not match the previous expectation of the model.

7. Conclusion of the Study

The study focused on investigating the effect of tax exemption for domestic investors on the government revenue collection in Zanzibar.

Tax exemption is a good instrument to stimulate and attract domestic investors when other issues have been incorporated into the procedures, alone, it cannot stand as the only factor. Current policies on tax exemption do not favor the country on revenue collection. Granting generous tax exemption does not contribute to the effective revenue collection; it undermines and hinders tax collection process, thus making this country dependent much on public loans and aids. Tax exemption contribute to corrupt procedures, as domestic investors seek to evade from tax payment, thus making super profit that do not even benefit the country.

8. Recommendation

The Tax agency must set up mechanisms to monitor and evaluate tax incentives for national investors who have granted tax exemptions. The study is intended to recommend that the tax authority should ensure the imposition of penalties for tax violations, and those penalties should be made clearer and more public. This creates a real threat and the actual conduct of audits, inspections, investigations, sanctions and punishments. for those who tends to claim the false tax exemption. The current Tax Procedures Act should be amended to provide for the establishment of a professional and independent tax tribunal to hear factual and legal issues relating to the contested decision.

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