Fighting Inequality Through a Progressive Tax System for a Just Future in Tanzania

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ABSTRACT

The problem of inequality is one of the economic problems that developing countries still face including Tanzania. This research therefore focuses on presenting the status and trends of inequality and the progressive tax system to pay for a just future in Tanzania. Research was anchored on the Ability-to-Pay Principle. The study was typically a desk research whereby it dwelled on analyzing and synthesizing large amounts of complex secondary data/information and literature concerning the issue of inequality in Tanzania. The target population for this study consists of secondary data sources, which included Peer-reviewed journal articles on taxation and inequality Government reports and taxation data from the Tanzania Revenue Authority (TRA). A purposive sampling methodology was employed to choose relevant studies and reports. This approach ascertained that only sources directly related to the research goals were included. The sample consisted of 20 sources, selected based on criteria such as: Year of publication. Content analysis was adopted in analyzing data to discover themes, patterns and trends related to progressive tax systems, income inequality reduction, and wealth distribution. Key variables such as tax policies, inequality measures (Gini coefficient), and wealth distribution patterns were extracted and analyzed to determine the effectiveness of progressive taxation in Tanzania. Findings revealed that while progressive taxes can be a remedy, the presence of large informal sectors, as in Tanzania, hinder their reach. Thus, while Tanzania's progressive tax structure holds potential, more reforms are in need to boost implementation alongside widening the tax base. Further, the study concluded that there is little wealth-related taxation in Tanzania. Also, assets such as land ownership or financial assets are hardly/not taxed. The study recommended that given the situation, there is a great need to improve the tax collection with a focus on the existing tax base in Tanzania.

Keywords: Developing Countries, Inequality, Progressive Tax System, Wealth Distribution

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I. INTRODUCTION

Just and resilient societies depend on an adequate public funding base through progressive taxation system to provide important public goods, such as health care and education. It is generally believed that a progressive personal income tax is an effective instrument for enhancing income redistribution and, hence, reducing income inequality. It is a fact that the problem of inequality is one of the economic problems that developing countries still face including Tanzania (World Bank 2023, Thomas, 2020). The sustainable development goals that are to be attained by 2030 does give attention to the problem of inequality with its goal number 10 being "Reduced Inequalities" with organizations such as United Nations Development Program [UNDP] advocating to address challenges of equity.

Kapera (2017) noted that since 1990s, domestic resource mobilization in Tanzania has been relying upon two common taxes, namely income tax (direct tax) and value added tax (an indirect tax). Indirect taxes account for about 60 per cent of tax revenues, which is almost twice the amount of direct taxes. Direct taxes usually target higher incomes and this is relevant in Tanzania since most people are informal workers.

The standard rate of Value Added Tax [VAT] is 18% in Mainland Tanzania and 15% in Tanzania Zanzibar**.** When measuring value added tax (VAT) as a percentage of income, VAT is regressive, meaning that people with lower income pay a higher share of their income in VAT than higher income individuals (Benedek et al., 2019). Measuring VAT relative to expenditures, VAT appears to be roughly proportional, or even slightly progressive. It is worth noting that Few reduced VAT rates or exemptions can produce a small degree of regressivity –Tanzania have no reduced VAT. Morocco and Madagascar had the highest value-added tax (VAT) rate on goods and services in Africa in 2022, each standing at 20 percent. Cameroon followed with the VAT rate set at 19.25 percent. On the other hand, goods and services in Nigeria were taxed at 7.5 percent, the lowest rate on the African continent. The highest standard VAT (Value Added Tax) rate in the world is 27% in Hungary. Some other countries, such as Sweden, have a standard VAT rate of 25%. Andorra has the lowest VAT rate in the world with a standard VAT rate of 4,5% (Duncan & Peter, 2016).

According to Baer and Hodge (2020), apart from taxes applied to everyone (such as income tax and VAT), there are no specific net wealth/worth taxes in Tanzania. Rather property/wealth owners are charged a flat levy on their property such as housing and land observably, there no a personal exemption for low-income earners. As per the Income Tax Act, 2004, gain or profit from property is chargeable to income tax, for example rented houses by National Housing Corporation (NHC) or National Social Security Fund (NSSF) buildings for commercial business are supposed to pay income tax. Gain or profits for use or occupation of any property includes any royalties, rent, and premium or like consideration received for the use or occupation of property example rent from property owned by any person. Private renters pay rent to the NHC and despite NHC rent the houses to the government owned institutions, who pays the rent has remained unclear because most of these public institutions don't pay it. This rent is taxable in both cases. This means the tax base in Tanzania covers buildings only, not like in other countries where the property tax base may include the land and the building or other assets (Gale and Thorpe, 2022).

The Finance Act, of 2023, for example, permitted the Local Government Tax Authority (LGTAs) to increase the property tax – from TZS 12, 000 (4.65 USD) to TZS 18, 000 (6.97 USD) for normal buildings and TZS 60,000 (23.25 USD) to TZS 90,000 (34.88 USD) for each storey building per month. Charging a uniform rate for buildings irrespective of their valuation or revenue productivity is unprogressive (Kapera, 2017). In addition, the single, uniform system of taxation of property and the fact that wealth/property taxes lacks a mark-to-market accounting or valuation of all assets such as capital value of land and/or buildings fuels tax avoidance opportunities. This suggest that property tax is not fully collected and property tax revenue falls short of its potential, irrespective of being recognized as the major source of revenue for the government (Bachas et al., 2021).

Polacko (2021) asserted that public finance theory suggests that property tax is an ideal local tax. Arguably, it is also a 'data-hungry' tax, making it difficult and costly to administer properly-thereby denying the government much revenue that would have otherwise been used to improve social services delivery i.e. health, education, infrastructure etc. Given the available potential in property taxation, the wider use of more effective property tax systems is recommended to generate enough revenues to fund the provision of many public goods and services which are critically needed.

Likewise, Mwenda & Kimuyu (2019) observed that there are no inheritance, estate, or gift taxes in Tanzania. In Tanzania, wealth is taxed only when it is changing hands of ownership. That is, the realization of an investment asset (e.g. shares and securities, land, buildings) is a taxable event for income tax purposes. Where there is a disposal of an investment, then in arriving at the taxable 'net gains' a deduction can be claimed in relation to various costs i.e. those related to acquisition, improvement, and disposal. As such, the absence of taxation on an individual's net worth could suggest that "the current tax regime is thus over-taxing trade and under-taxing wealth, leading to a regressive impact.

1.1 Statement of the Problem

An important factor to take into account when considering pros and cons of introducing progressive taxation of income and wealth is the level of informality in the economy. In some countries, the barrier for effective implementation of a progressive income tax lays in the fact that tax administrations cannot access some information on real / full income of the rich, and thus cannot tax them effectively (Shumba, 2017). Currently, wealthy taxpayers in Tanzania enjoy multiple opportunities for tax avoidance and evasion, including disguising the real type of their income, transferring it to offshores, bank secrecy, etc. In some cases, such data becomes very difficult, or even impossible, to trace, and home tax administrations simply cannot access it to enforce relevant tax legislation effectively due to lack of technical capacity. Where a country is facing significant levels of informality, it might be a bigger problem, and a flat income tax rate might be preferable. Some factors might be specific to the country or the region in question, and understanding of the local context is critical for the impact assessment (Vellutini and Benítez, 2021).

Progressive taxation of income and wealth can be a powerful tool for nurturing more equitable and stable societies, but such policy decisions are very context-depending and must not be recommended automatically without proper consideration (Stiglitz, 2015). It is against this background that this paper therefore focuses on presenting the status and trends on inequality and progressive tax system to pay for a just future in Tanzania across some selected taxable source. The aims to provide a decision maker with an overview of an issue or problem, targeted analysis, and, often, actionable recommendations in the area of under resource mobilization in Tanzania in a bid to articulating out and tackling problem of under resource mobilization in the country, which leads to poor service delivery and undermining government capacity to deal with poverty reduction efforts.

1.2 Research Objectives

i. To assess the effect of a progressive tax system on reducing income inequality in Tanzania
ii. To analyze the effectiveness of current tax policies in enhancing equity in distribution of wealth and social justice in Tanzania.

II LITERATURE REVIEW

2.1 Theoretical Framework
2.1.1 Ability-to-Pay Principle

This describes a core theory in public finance and taxation. This theory was advanced by Edwin Seligman in mid-20th century.. This concept posits that citizens in a country should be taxed based on their capacity to pay. Those earning higher incomes should contribute a larger proportion of their wealth to public revenue (Seligman, 1914). This theory aims to enhance progressive taxation systems, where rates of tax expand as income increase. This intends to minimize income inequality by redistributing wealth (Musgrave, 1959).

This theory is applicable to this present research as it offers a basis for assessing the function of a progressive tax system in addressing inequality in Tanzania. By taxing higher-income persons at a higher rate, the government can generate resources for social projects, public services, and infrastructure that benefit the general population. This will boost a more just and equitable society (Stiglitz, 2015). This theory thus assists in analyzing whether Tanzania's tax policies conform with this concept and combat inequality effectively.

2.2 Empirical Review

A Study on Taxation and Inequality in South Africa by Baer and Hodge (2020) revealed that progressive tax systems were of essence in minimizing income inequality in the nation. Outcomes of research hinted that progressive taxation, particularly income taxes, had a substantial effect on curbing income disparities when properly implemented and integrated with wealth redistribution initiatives.

In 2021, Osei and Quartey performed research focusing on developing economiesin Sub-Saharan Africa, to assess how progressive tax systems influenced income inequality. Their research outcomes posited that, while progressive taxes had the potential to reduce inequality, administrative inefficiencies and tax evasion considerably undermined their effectiveness.

In thier study performed in 2019, Mwenda and Kimuyu evaluated tax reforms in Tanzania and Kenya, focusing on how effective these policies were in promoting wealth redistribution. The study results indicated that despite progressive tax rates, loopholes in addition to tax exemptions for the wealthy diminished the system's effectiveness in attaining social justice objectives.

Mkumbo and Matata (2022) explored the connection between tax policy and wealth distribution in Uganda. The research summarized that while the country had adopted progressive tax policies, the constrained capacity of tax administration and the existence of informal sectors restricted their ability to enhance substantial redistribution of wealth.

These past empirical studies offer evidence for the function of progressive taxation in minimizing inequality and assessing the effectiveness of tax policies in wealth distribution and promoting social justice in Tanzania.

III METHODOLOGY

3.1 Research Design

This study empoyed a desk review research design. According to Esterberg (2002) this methodology entails systematically reviewing and analyzing existing literature. This encompass academic publications, government reports, policy papers, and statistical data all which are linked to progressive taxation and inequality reduction in Tanzania. The desk review method is appropriate as it enables collation and synthesis of different sources to gain a thorough insights into the subject (Krippendorff, 2004a).

3.2 Target Population

The target population for this study consisted of secondary data sources, which included Peer-reviewed journal articles on taxation and inequality Government reports and taxation data from the Tanzania Revenue Authority (TRA). Other sources included publications from international organizations such as the International Monetary Fund (IMF), World Bank, and United Nations. Also included were Policy briefs, working papers, and case studies on taxation in Sub-Saharan Africa.

3.3 Sample Size and Sampling Techniques

A purposive sampling methodology was employed to choose relevant studies and reports. This approach ascertained that only sources directly related to the research goals were included. The sample consisted of 20 sources, selected based on criteria such as: Year of publication (focused on articles published from 2015 onwards) Relevant journals related to progressive taxation, inequality, and wealth redistribution in Tanzania.

3.4 Analysis of Data

Content analysis was adopted in analyzing data to discover themes, patterns and trends related to progressive tax systems, income inequality reduction, and wealth distribution. Key variables such as tax policies, inequality measures (Gini coefficient), and wealth distribution patterns were extracted and analyzed to determine the effectiveness of progressive taxation in Tanzania. Comparative analysis with other Sub-Saharan African countries was also performed where applicable (Krippendorff, 2004a).

IV FINDINGS & DISCUSSION

4.1 Effect of A Progressive Tax System on Income Inequality Reduction in Tanzania

The desk review posited that Tanzania has made efforts to enforce a progressive tax system aimed at minimizing income inequality. The country's taxation models entails progressive income tax rates, where higher-income earners are taxed at higher rates in comparison to low-income earners. However, their effectiveness in curbing income inequality has been constrained by several elements e.g. tax evasion, the informal economy, and a narrow tax base.

4.1.1 Progressive Taxation Structure

Tanzania's tax system shows progressivity, more so with its individual income tax. Nonetheless, the contribution of progressive taxation in decreasing inequality has been hampered because of loopholes that enable wealthier persons and corporations to minimize their tax obligations.

4.1.2 Inequality Trends

In spite of these measures, the Gini coefficient, a common measure of inequality, indicates that income inequality in Tanzania remains relatively high. While there has been some marginal reduction in income disparity, it has not been substantial enough to close the gap between the wealthy and low-income earners.

4.2 Effectiveness of Current Tax Policies in Promoting Equitable Wealth Distribution and Social Justice in Tanzania

The review of existing data and literature indicates that Tanzania's tax policies, while designed with progressive elements, face significant challenges in achieving equitable wealth distribution. The tax burden still disproportionately falls on middle-income earners and small businesses, while wealthier individuals and corporations often benefit from exemptions and tax incentives.

4.2.1 Wealth Distribution

Wealth remains concentrated at the top, with limited redistribution to lower-income groups. Programs funded by tax revenue, such as social welfare and education, have seen improvements but have not significantly narrowed the wealth gap.

4.2.2 Tax Policy Effectiveness

While Tanzania's tax reforms have aimed at wealth redistribution, they are limited by administrative shortcomings, weak enforcement mechanisms, and an over-reliance on indirect taxes (such as VAT), which tend to disproportionately affect lower-income households.

4.3 Discussion

Outcomes conform with research by Baer and Hodge (2020), which asserted that while progressive tax systems have the capacity to decrease inequality in Sub-Saharan Africa, including Tanzania, their impact is often hampered by administrative inefficiencies and tax evasion. In the same vein, Osei and Quartey (2021) contend that while progressive taxes can be a remedy, the presence of large informal sectors, as in Tanzania, hinder their reach. Thus, while Tanzania's progressive tax structure holds potential, more reforms are in need to boost implementation alongside widening the tax base.

Similarly, outcomes of the second objective support the conclusions of Mwenda and Kimuyu (2019), who highlighted that tax policy in Sub-Saharan Africa, including Tanzania, has had limited success in promoting wealth redistribution due to tax loopholes and exemptions that benefit the wealthy. At the same time, Mkumbo and Matata

(2022) alluded that the limited capacity of tax administration and the informal economy in Tanzania hinder the redistributive goals of progressive taxation. The two studies hint that while Tanzania's tax policies have the correct intentions, they demand stronger implementation/enforcement and improved targeting of wealthier people to realize more equitable outcomes.

V CONCLUSIONS & RECOMMENDATIONS

5.1 Conclusions

From the study findings, it is clear that there is little wealth-related taxation in Tanzania. On the one hand, Tanzania is home to very rich people, on the other hand, a large part of the population is affected by extreme poverty. There are ways for higher earners to avoid taxes as assets such as land ownership or financial assets are hardly/not taxed. Thus, the poor and the working population bear the main burden, and in search for justice, this is unfair.

5.2 Recommendations

Public services such as social security and education are essential for making society resilient in the long term, but they require appropriate funding. The Tanzanian government needs sufficient revenue to adequately fund public goods and services; however, it is becoming increasingly clear that the source of that revenue also matters. Given the situation, there is a pressing need to improve tax collection, focusing on the existing tax base in Tanzania.

Taxes on wealth serve as a policy instrument to address wealth inequality and could generate substantial revenue while strengthening the structural weaknesses in the current income tax system. They represent an additional method to raise revenue and address wealth inequality through budget justice. Nevertheless, it is evident that there is little wealth-related taxation in Tanzania.

Moreover, creativity in seeking new sources of revenue, rather than repeatedly focusing on areas that directly burden ordinary Tanzanian citizens, is critical. This means innovating new sources of taxes, such as broad-based wealth and property taxation. Currently, there are no net wealth taxes in Tanzania, which are typically assessed on the net value of a taxpayer's taxable assets. Potential resistance to wealth taxes can be addressed through exemptions, such as allowing for exempt assets (e.g., one house or a part of a house or a plot of land). Families would only pay the tax if their wealth exceeds the exemption threshold.

To address the poor understanding of wealth and property taxation in the country, there is a strong need to broaden the definition of property to include the digital economy and betterment tax (i.e., quantifying the land value increment resulting from infrastructure investment). In terms of tax rates for High-Net-Worth Individuals (HNWIs), the capital gains tax rate should not be lower than the income tax on salaries and wages; the very rich should not pay lower rates than everyday earners.

Focus should be directed toward closing any loopholes that could lead to revenue loss from this sector. The government should aim not only to obtain a larger share of profits but also to exert stronger control over natural resources, ensuring that tax revenue from the mining industry is effectively connected to poverty reduction via the provision of quality public services. This will enable the development of other sectors for the benefit of both present and future generations. Additionally, the government should sharply increase tax collection by reviewing and eliminating tax exemptions and deductions for corporations and wealthy individuals, while also clamping down on tax evasion. Governments have vastly improved their ability to track offshore assets through enhanced data-sharing protocols with other tax authorities.

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