LAWS OF TAXATION IN TANZANIA

By

Eliud Kitime and Doreen Mwamlangala

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ABBREVIATION

C+/CP	Cost Plus
CAP	Chapter
CUP	Comparable Uncontrolled Price
E.U.	European Union
Ibid	Ibidem
ICT	Information Communication Technology
ITA	Income Tax Act
GATT	General Agreement on Tariffs and Trade
OECD	Organisation for Economic Cooperation and Development
Pg.	Page
R.E.	Revised Edition
RPM	Resale Price Method
TRA	Tanzania Revenue Authority
TRAB	Tax Revenue Appeals Board
TRAT	Tax Revenue Appeals Tribunal
US	United States
V	Versus
VAT	Value Added Tax
VTC	Voluntary Tax Compliance
WTO	World Trade Organization
ZRB	Zanzibar Revenue Board

CHAPTER ONE

INTRODUCTION TO TAXATION IN TANZANIA

1.0 Introduction

In this chapter, we are going to discuss the meaning, concepts and purpose of tax laws in any jurisdiction including Tanzania. The aim is to familiarize students with the main concepts and meaning of tax laws prior to discussion.

1.1 Objectives

At the end of this chapter students should have: -

- Attained knowledge and understanding of the basic concepts of tax and taxation.
- Accustomed with understanding on the objectives or goals of taxation.
- Advanced ability to describe a brief historical background of taxation in Tanzania.
- Established ability to describe the classification taxation or taxes.

1.2 Tax

There is no single universal meaning of the term "tax". Hence, different authors have defined tax differently at different times.

Adam Smith[1] defines "tax as a compulsory payment levied by the government on individuals or companies to meet the expenditure which is required for public welfare."

The term "tax" is also defined by Oxford Dictionary[2] to mean a compulsory contribution to state revenue, levied by the government on workers' income and business profits, or added to the cost of some goods, services and transactions.

Prof Luoga defines tax as a compulsory contribution to the support of government levied on persons, property, income, commodities, transactions etc., now at a fixed rate mostly proportionate to the amount on which the contribution is levied[3].

On the other hand, Black's Law Dictionary defines the term tax to mean a monetary charge imposed by the government on persons, entities, transactions, or property to yield public revenue.

Most broadly, the term embraces all governmental impositions on the person, property, privileges, occupations, and enjoyment of the people, and includes duties, imports and exercises. Although a tax is often thought

[1] Smith, A. Cannan, E. The Wealth of the Nations New York, N. Y. Bantam Classic, 5th Ed.2003
[2] http://oxforddictionaries.com/definition/english/tax
[3] Makinyika, F. D. A. L. A Sourcebook of Income Tax Law in Tanzania, 1st Ed, Dar es Salaam University Press, Dar Es Salaam 2000

of as being a pecuniary in nature, it is not necessarily payable in money in money[4].

Taxes are further defined as the enforced proportional contributions from persons and property, levied by the state by virtue of its needs.

The above definitions have been approved and applied by courts and administrative tribunals not wholly, as some have been criticized by various scholars including Tiley[5] who has termed some of them narrow. He points out that there are three weaknesses in the above definitions.

First, he points out that the above definitions confine the rationale of taxation to the support of the government. This is not the only rationale because in spite of taxation supporting the government it is also levied for non-revenue purposes such as protecting domestic industries and discouraging some behaviors.

An example of this is imposing heavy taxes on imported goods so that they cannot compete with domestic goods and hence protecting local industries, also imposing high taxes on cigarettes to deter smoking.

Secondly, he points out that the given tax definitions provide inappropriate tax base, that tax is levied on persons, property and income and the like.

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4 Black's Law Dictionary 8th Edition, West Publishing Co., USA, 2004.
5 Tiley, J. Revenue Law, 3rd ed, London, Butterworths, 1981, p 2.

Thirdly, he contends that the definitions give unjustifiable emphasis on proportionate taxation. This is because tax can also be exacted at progressive rates, which are now considered more appropriate method in achieving vertical equity in taxation.

Tiley argues that taxes are not only compulsory but are also imposed by the legislature, levied by public organization, and are intended for public purposes[6].

In line with Tiles way of thinking Dalton Hugh[7] defines tax to mean a compulsory contribution imposed by a public authority, irrespective of the amount of service rendered to the taxpayer in return, and not imposed as penalty or any legal offence.

The above definition by Hugh is less restrictive and comparatively much wider in scope and it accommodates Tiley's observation but still it is insufficient and perhaps its applicability is outdated.

This is because the changing socio-economic environment has made it mandatory for the taxing authorities to establish new taxing strategies. In recent times, taxing authorities made new development geared to eliminate the element of compulsion in taxation.

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[6] Ibid. p. 2.

[7] Dalton, H. Principles of Public Finance, (1985), Mumbai, Allied Publishers PVT Ltd.

An example of this is the method of collecting taxes through national lotteries[8] and in all goods and services rendered[9]. There is a big difference between a person who contributes to the support of the government compulsorily by paying income tax and the one, who does so by buying a lottery tax or buying goods in which VAT is inclusive.

However, both are taxes, the manner in which the levy is exacted, that is whether the element of compulsion is there or not is immaterial. For this reason, the term taxation still begs for a definition.

1.3 A Brief History of Taxation in Tanzania

Taxation was introduced in Tanzania for the first time during colonial times by the then colonial powers when they took charge of the administration of the territory.

The first colonial powers to introduce taxation were the Germans. The forms of taxes that they introduced were simple direct taxes such as hut tax, poll tax and head tax.

Those taxes were introduced with the primary objective of forcing the African population to participate in the money economy; raising revenue was only incidental result. However, the German rule in the then

[8] See the National Lotteries Act, Cap 41, 2002
[9] See the Value Added Tax Act, Cap 148, 2002.

Tanganyika did not have a lasting impact in the country's legal institutions, taxation inclusive.

In 1919, it was the end of German administration in the former Tanganyika and the territory was handed over to the British as a trustee on behalf of the League of Nations.

It was the British who established institutions that shaped Tanzania's legal and tax system. The British first introduced income taxation in 1940.

The first income tax legislation introduced was a simplified version of the Income Tax Ordinance of the United Kingdom, which existed from 1920. However, in the British period the income taxation was primarily intended for the European portion of the population. Africans were taxed through import and excise duties mainly due to their low income and literacy levels.

In 1948 the British government created the East Africa High Commission[10], which was a statutory corporation to administer and provide in Kenya, Uganda and Tanganyika certain inter territorial services.

The High Commission decided to harmonize all the tax legislation in the territories by enacting a single managing Act to deal in respect of the whole of East Africa (Zanzibar exclusive).

[10] East African (High Commission) Order in Council, 1947

However, each country was left to enact separate legislation that will provide for rates and allowances. The High Commission enacted the East African Income Tax (Management) Act, 1952[11] which repealed respective retrospective effect from January 1, 1951. This Act was amended 5 times between 1952 and 1958[12].

Nevertheless, it remained in force until 1958 when the East African Income Tax (Management) Act, 1958 was enacted. This means that it was not until 1958 that a stable tax system was established.

Furthermore, according to the scheme established by the 1958 Act, tax was levied on residents of East Africa upon their income from sources within East Africa. Income from sources outside East Africa was taxed to the extent that such income was remitted to and received in East Africa.

The 1958 Act remained in force until 1971 when the East African Income Tax (Management) Act, 1971[13] was enacted. In the same year the Income Tax (Allowances and Rates) (Amendment) Act No.25 was enacted.

In 1973 the Income Tax Act, 1973 was enacted and this repealed and replaced the Income Tax (Allowances and Rates) (Amendment) Act of 1971

[11] Act No 8 of 1952
[12] This is by virtue of the East African Income Tax (Management) (Amendments) Acts as follows; Act No. 2 of 1954, Act, No. 14 of 1954, Act No 11 of 1955, Act No. 8 of 1956, and Act No. 4 of 1958.
[13] Cap 24 of the Community Laws

as well as ceasing application to the United Republic of Tanzania of the East African Income Tax (Management) Act of 1971[14].

This Act was amended 44 times between 1973 and 2004. The above chain of events and trend is a clear testimony that Tanzania has had a modern taxation system with modern principles of tax since time immemorial.

1.4 Theoretical Concepts behind Taxation

More often than not people have curiously raised a question as to what is the need and rationale of taxing any society. There are many answers but the most classical answer to this question is that taxation is the handmaid for raising revenue to meet government expenditure.

This is because that the government is duty bound to provide social services, maintain law and order, ensure defence and a horde of other undertakings which the free market cannot provide or which the state feels are better provided by itself, such as education and health services.

In order to meet all these, it is the responsibility of the citizen to pay taxes to sustain the government and make sure that the government exists and functions smoothly.

[14] See section 139 of the Income Tax Act, 1973 Act No.33

However, from the classical point of view, citizens cannot demand from the government benefits equivalent to the taxes that they have paid. Moreover, in contemporary times the theories and functions of taxation have been extensively discussed.

It is argued that it is not viable to consider taxes as only a means of obtaining revenue since it may also be used for other specific goals such as discouraging the use of alcohol, deterring smoking, protecting local products at the expense of imported products or as inducement to production for the market as opposed to subsistence[15].

1.5 General Classification of Taxes

There are variety types of taxes but all of them can be easily classified into two groups namely direct and indirect taxes. This classification is mainly based on the incidence of the particular taxes.

1.5.1 Direct taxes

A direct tax is a kind of charge or tax, which is imposed directly on the taxpayer whether individual or non-individual and paid directly to the government by those persons i.e. juristic or natural on whom it is imposed.

A direct tax is one whose incidence cannot be shifted by the taxpayer to someone else. The subject of the imposition of the tax is the one

[15] Ibid at p 590

responsible for the payment of the entire tax. Thus, the tax is levied on and paid by the same person.

Direct taxes are generally regarded as more equitable than indirect taxes because they can be related to the taxpayer's ability to pay through the progressive rate structure.

A change of income automatically pushes the taxpayer to the next higher or lower bracket without altering tax rates (the more the income someone earns the higher the contribution or tax to be paid to the state).

As the economy gradually expands, the tax base is also likely to increase overtime. In addition, as more people acquire more business and employment income revenue collections increase correspondingly. Examples of direct taxes include personal income tax and corporation tax.

1.5.2 Indirect Taxes

These are taxes on consumptions and outlay (expenditure). The tax is levied on goods and services and hence the tax yield depends on the level of the populations' consumption on the taxed commodity, outlay or other services. An indirect tax is one that can be shifted by the taxpayer to someone else.

An indirect tax may increase the price of a goods or service as the case may be so that consumers are actually paying the tax by paying more for

the products. Some of the important indirect taxes imposed are like value added tax (VAT) and customs duty.

However, there are some criticisms on this type of taxation on the ground that it does not take into account the individual's ability to pay the tax and hence it is regarded as regressive.

1.6 Objectives of Taxation

Every tax jurisdiction has a set of objectives that are to be met through taxation. These goals may be different from one tax jurisdiction to another. However, there are several objectives, which at least every tax jurisdiction seems to seek. These are as follows:

1.6.1 Need for revenue

Taxes are introduced to raise revenue that will make it possible for the government to carry out its core mandate of maintaining peace and order in addition to provision of social services.

This is owing to the fact that Governments have obligations such as to maintain peace and order, defending the country, providing social services such as health, education, transport infrastructures, water and many others. The above named services need a huge capital to be provided and the government can raise that money mainly from taxes.

1.6.2 Mobilisation of funds for capital formation

To bring about economic development, a country must acquire adequate capital for the purpose of investment. Through taxation, the government can mobilise, accumulate capital from public, and then invest it where the government regards to be of high economic priority according to its plans.

1.6.3 Stabilization of the Economy

Taxation is for economic stabilization. This is through resources to ventures or geographical areas that are underdeveloped, like by offering exemptions and low tax rates to agriculture and mining business can attract more investors to invest in those enterprise.

Furthermore, taxation can be a tool for stabilization of economy by being an inducement to market oriented production as opposed to subsistence production.

It is a tool of boosting domestic industries by levying high taxes on imports thereby creating more market for domestic goods and services. It is a tool for stabilizing economy when it is introduced and it forces people increase production over and above subsistence level in order to get surplus for paying taxes.

1.6.4 Redistribution of wealth

Taxation may also be used as a means of redistribution of wealth, for example by levying high taxes from the wealth to provide services to those who are poor. This is mainly achieved by using progressive rate structure, which seeks to lessen the inequalities of wealthy in the society.

1.7 Summary

In this chapter we have been able to learn the meaning of the term tax, traced the history behind the development of the tax legal regime in Tanganyika then after Tanzania. We have further seen that tax is compulsory levy or charge by the state on its citizens and non-citizens alike that is usually payable in monetary form.

The Colonialist in Tanganyika introduced taxation and the main aim was to incorporate the natives to money economy. Nevertheless, the British shaped Tanzanian tax regime as it is seen today. Therefore, Tanzania has had a taxation system according to the modern principles since the turn of the century.

The government may spend the revenue collected from taxation on the provision of any social and economic services it deems desirable and beneficial to the society.

However, particular individuals may not directly benefit from such expenditure nor is the government bound to account for the expenditure to an individual or to a group of people except through some general accountability and control through other processes.

In this chapter we further saw the essence of taxation in not only to collect revenues needed by the government but also for social and economic programmes the government may undertake for the benefit of the general public and for other non-revenue goals. Taxes levied by the state may mainly be classified into two categories, which are direct, and indirect taxes.

We also saw that there are some main criteria or cannons of evaluating a tax system. These are canon of equity, convenience, certainty and economy

1.8 Review Questions

1. What is taxation?
2. Explain the reasons and justification for the imposition of taxation.
3. State the major classes of tax and briefly discuss each of them.
4. Critically discuss theoretical concept of tax distribution.

1.9 References

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CHAPTER TWO

THEORIES AND PRINCIPLES OF TAXATION

2.0 Introduction

Taxation is differentiated from other forms of payment, such as market exchanges, in that taxation does not require consent and is not directly tied to any services rendered. Tax systems have varied considerably across jurisdictions and time.[16]

In most modern systems, taxation occurs on both physical assets, such as property, and specific events, such as a sales transaction. The formulation of tax policies is one of the most critical and contentious issues in modern politics.[17]

Therefore, this chapter aims at enlightening students on theories behind as well as the principles or principles of taxation. These aspects are important because they give out the understanding on why taxation and under what principles should taxation be based.

2.1 Objectives

At the end of this chapter students should have: -

[16] See, Paul Collier (2010), The Political Economy of Natural Resources, social research Vol 77: No 4: Winter 2010.

[17] See, Keen; Mansour (2010). "Revenue Mobilisation in Sub-Saharan Africa: Challenges from Globalisation I – Trade Reform". Development Policy Review. 28 (5): 553–571.

- Learnt basic knowledge on the term taxation and its difference from other concepts.
- Acquainted with understanding on basic theories, which provided the philosophical foundation of taxation and its systems.
- Accustomed with the ability to describe the principles, which makes the good taxation system.
- Familiarised with the assessment skills of the tax system and discuss whether it is good or not according to the principles of taxation.

2.2 Taxation

Taxation refers to compulsory or coercive money collection by a levying authority, usually a government.[18] The government compels taxation through an implicit or explicit threat of force. Taxation is legally different from extortion or a protection racket because the imposing institution is a government, not private actors.

[18] Read more: Taxation Definition | Investopedia http://www.investopedia.com/terms/t/taxation.asp#ixzz4caopBRgL

Moreover, taxation can be defined to mean a means by which governments finance their expenditure by imposing charges on citizens and corporate entities.[19]

Governments use taxation to encourage or discourage certain economic decisions. For example, reduction in taxable personal (or household) income by the amount paid as interest on home mortgage loans results in greater construction activity, and generates more jobs.[20]

Governments use different kinds of taxes and vary the tax rates. They do this in order to distribute the tax burden among individuals or classes of the population involved in taxable activities, such as the business sector, or to redistribute resources between individuals or classes in the population.[21]

Historically, taxes on the poor supported the nobility; modern social-security systems aim to support the poor, the disabled, or the retired by taxes on those who are still working.[22]

In addition, taxes are applied to fund foreign aid and military ventures, to influence the macroeconomic performance of the economy a government's

[19] Read more: http://www.businessdictionary.com/definition/taxation.html
[20] See, Simkovic, Michael (2015). "The Knowledge Tax". University of Chicago Law Review. SSRN *2551567*
[21] See, Riël C. D. (2005). Land Value Taxation: An Applied Analysis. Ashgate Publishing, Ltd. p. 4
[22] See, Schneider, Buehn, and Montenegro (2010), Shadow Economies all over the World: New Estimates for 162 Countries from 1999 to 2007.

strategy for doing this is called its fiscal policy or to modify patterns of consumption or employment within an economy, by making some classes of transaction more or less attractive.[23]

2.3 Theories of Taxation

Several theories of taxation exist in public economics. Governments at all levels national, regional and local need to raise revenue from a variety of sources to finance public-sector expenditures.[24]

There are a number of theories of tax distribution which have been used to select the rates as well as bases upon which tax ought to be levied.[25] In this part shall discuss four principle theories, which are benefit theory, ability to pay theory and sacrifice theory.

2.3.1 Benefit Theory

This is a theory or principle, which holds that individuals should be taxed in proportion to the benefit they receive from the government.[26] In addition, those who receive the direct benefit of the government programs and projects out of the taxes they pay should pay that tax.

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[23] See, IMF Working Paper 108/12 (2012), Mobilizing Revenue in Sub-Saharan Africa: Empirical Norms and Key Determinants

[24] See, Samuelson, Paul A. "Diagrammatic Exposition of a Theory of Public Expenditure" (PDF). University of California, Santa Barbara

[25] See, ibid

[26] See, Adam Smith, The Wealth of Nations: A Translation into Modern English, ISR/Google Books, 2015. Book 5 (Government Finances: Public Expenditure, Taxation and Borrowing), pages 423, 429.

This theory advocates that each individual's tax obligation should be based on the direct and measurable benefits that he/she receives from the government through enjoyment of the public services.

This theory is supported by **Thomas Hobbes,** when he observes that "when the impositions are laid upon those things which men consume, every man payeth equally for what he useth, nor is the commonwealth defrauded by the luxurious waste of private men"[27].

The application of this theory is the rationale of differential taxation on those individuals who particularly benefited by the public services when no redistributive purpose is desired and it is not possible to charge directly for the service rendered. An example is special taxes on motor vehicles, fuel, electricity and water rates.

However, this theory is difficult to apply because it is difficult to measure the proportionality of the benefits enjoyed to income. It is also difficult to find an appropriate measurement of benefits received from government services or economy in general.

[27] Hobbes, Thomas, Leviathan, Philosophy, Oxford University Press, London, 1996

Lastly but not least there is no way that the legislature can ascertain the benefits received by each individual so as to enact laws that suit the rates of taxes to be contributed by each.

2.3.2 Sacrifice Theory

This theory advocates that payment of tax is a sacrifice that a person makes towards the support of the government. The proponent of this theory contends that it is a sacrifice for someone to give up some enjoyments of his income to be able to pay taxes.[28]

Moreover, they also hold that payment of taxes should be done only from the part of income that is spent on luxuries. That means that the sacrifice should only be in respect of an individual's income over and above subsistence.

This theory is often associated with proportional rates of income tax[29]. However, application of this theory is difficult unless it is expressed in terms of income and consumption.

[28] See, Friedman, David D. (December 1999). 'Price Theory: an intermediate text". South-Western Publishing Co

[29] Ibid at p 12

2.3.3 Ability to Pay Theory

This theory was developed so as to cure the inadequacies of the benefit theory and sacrifice theory. This principle holds that taxes should relate with the peoples' income or their ability to pay.

This means that people with greater income or wealth and who can afford to pay higher taxes should be taxed at a higher rate than those with low income. In principle, this theory is applied to individual income tax.

This theory was also defined by Goode to mean "the capacity of paying without undue hardship on the part of the person paying"[30]. However, this theory does not suggest any base upon which taxes are to be levied.

It raises difficulty of trying to translate ability to pay into an actual pattern of tax distribution. That means it is not clear on what should be the measure of a taxpayer's ability and what should be the pattern of distributing the burden[31].

The economists are not unanimous as to what should be the exact measure of a person's ability or faculty to pay. The main viewpoints advanced in this connection are as follows:

[30] See, Goode, R. The Individual Income Tax, Revised Edition. Washington DC, The Brookings Institute, 1976, p 17.

[31] See, Simmons, H. Personal Income Tax, Chicago, the University of Chicago Press, 1955, p 17

(a) Ownership of Property

Some economists are of the opinion that ownership of the property is a very good basis of measuring one's ability to pay. This idea is out rightly rejected on the ground that if a person earns a large income but does not spend on buying any property, he will then escape taxation.

On the other hand, another person earning income buys property, he will be subjected to taxation. Is this not absurd and unjustifiable that a person, earning large income is exempted from taxes and another person with small income is taxed?

(b) Tax on the Basis of Expenditure

It is also asserted by some economists that the ability or faculty to pay tax should be judged by the expenditure, which a person incurs. The greater the expenditure, the higher should be the tax and vice versa. The viewpoint is unsound and unfair in every respect.

A person having a large family to support has to spend more than a person having a small family. If we make expenditure. as the test of one's ability to pay, the former person who is already burdened with many dependents will have to' pay more taxes than the latter who has a small family. So this is unjustifiable.

(c) Income as the Basics

Most of the economists are of the opinion that income should be the basis of measuring a man's ability to pay. It appears very just and fair that if the income of a person is greater than that of another, the former should be asked to pay more towards the support of the government than the latter.

That is why in the modern tax system of the countries of the world, income has been accepted as the best test for measuring the ability to pay of a person.

2.3.4 The Cost of Service Theory

Some economists were of the opinion that if the state charges actual cost of the service rendered from the people, it will satisfy the idea of equity or justice in taxation.

The cost of service principle can no doubt be applied to some extent in those cases where the services are rendered out of prices and are a bit easy to determine, e.g., postal, railway services, supply of electricity, etc., etc.

However, most of the expenditure incurred by the state cannot be fixed for each individual because it cannot be exactly determined. For instance, how can we measure the cost of service of the police, armed forces, judiciary,

etc., to different individuals? Dalton has also rejected this theory on the ground that there is no quid pro qua in a tax.[32]

2.4 Principles of Taxation

Principles of taxation are basic principles or rules set to build a good tax system. These are also criteria used for evaluating a good tax system as promulgated by Adam Smith in the Wealth of Nations[33]. They are basic concepts by which a government is meant to be guided in designing and implementing an equitable taxation regime.[34]

According to him, there are four principles or characteristics of a good tax system, namely principle of equity, convenience, certainty and economy.[35] However, there are other principles, which are discussed hereby.

According to John Stuart Mill, the four principles of taxation are that the system be efficient, understandable and equitable and those who benefit from publicly provided services should sponsor and pay for those services through taxes. A good tax system follows the four principles of taxation.[36]

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32 See, http://economicsconcepts.com/theories_of_taxation.htm. Accessed on 28th March 2017 at 08:20 hours

33 See, Ibid

34 See, Read more: http://www.businessdictionary.com/definition/taxation-principles.html

35 See, Smith, Adam (1776), Wealth of Nations, Penn State Electronic Classics edition, republished 2005, p.704

36 See, https://www.reference.com/business-finance/principles-taxation-5f2c67e04c3bb7fd#. Accessed on 28th March 2017 at 08:15 hours

2.4.1 Principle of equity

This principle aims at providing economic and social justice to the people. It advocates that every person should pay tax to the support of the government depending on his ability to pay. It also means that those in equal circumstances should pay equal amount of tax or similar individuals should be treated similarly.[37]

This principle also means that those in unequal circumstances should pay different amounts of tax or persons with different financial capabilities should be treated differently.

2.4.2 Principle of convenience

This principle requires that the mode and timing of tax payment should be as far as possible convenient to the taxpayers. This means that tax is to be levied at the time or manner, which will be convenient to the taxpayer.

For example, income tax to be deducted from the source encourages people to pay tax as it is convenient to them, such as using Pay As You Earn (PAYE) for collecting tax from employees.

[37] See, Smith, Adam (1776), Wealth of Nations, Penn State Electronic Classics edition, republished 2005, p.704

2.4.3 Principle of certainty

This principle simply means that the scope of tax should be clear. The tax which every taxpayer is obliged to pay should be certain and not arbitrary.[38]

The amount to be paid, the manner of payment, and the time of payment ought to be clear and plain to the contributor and to every other person.

2.4.4 Principle of economy

This principle states that there should be economy in tax administration. This implies that the cost of tax collection should be lower than the amount of tax collected. It may not serve any purpose, if the taxes imposed are widespread but are difficulty to administer.

In modern times, activities and functions of the government have increased significantly compared to Adam Smith's time. Nowadays the government is expected to maintain economic stability, full employment, reduce income inequality, and promote growth and development.

So the principles or principles of a good tax system have been modified to meet the requirements of growing state activities. In the circumstances of the modern times, principles of taxation have been added to include.

[38] See, Smith, Adam (1776), Wealth of Nations, Penn State Electronic Classics edition, republished 2005, p.704

2.4.5 Principle of revenue adequacy

It is also known as principle of productivity, which requires that the tax strategy adopted should be capable of raising adequate revenue for the treasury and the government so that at the end of the day they need not resort to deficit financing.

2.4.6 Principle of flexibility

According to this principle, it should be possible with undue delay for the authorities to revise the tax structure both with respect to its coverage and with respect to rates to suit the changing requirements of the economy.

With changing times and conditions, the tax system needs to be changed without much difficult. The tax system must be flexible and not rigid.

2.4.7 Principle of simplicity

This is also known as a principle of ease of administration. It means that the tax system should not be complicated. It should be administered at reasonable cost by both the government as well as the taxpayer.[39]

It should be simple to compute, understand in terms of its concepts, assessed on an easy base, levied at moderate rates and payable in a convenient manner.

[39] See, Smith, Adam (1776), Wealth of Nations, Penn State Electronic Classics edition, republished 2005, p.704

It should not be the one, which can be easily avoided and evaded through legal loopholes and subterfuges and hence result into problems of interpretation and disputes.

2.4.8 Principle of Diversity

This is also known as a principle of social justice of equity. This principle states that taxes should be collected from different source rather than concentrating on a single source of tax. This clearly indicates that taxes imposed should be just and impartial in their application.[40]

It is not advisable for the government to depend upon a single source of tax, because it may result in inequity to certain section of the society and uncertainty for the government to raise funds. The tax regime should be designed to reduce economic inequalities by treating equals equally and unequal unequally.

2.5 Summary

In this foregoing chapter, we have learnt that tax systems have varied considerably across jurisdictions and time. In most modern systems, taxation occurs on both physical assets, such as property, and specific events, such as a sales

[40] See, Smith, Adam (1776), Wealth of Nations, Penn State Electronic Classics edition, republished 2005, p.704

transaction. The formulation of tax policies is one of the most critical and contentious issues in modern politics.

In addition, we have understood that taxation is a compulsory contribution to the state revenue, levied by the government on personal income and business profits or added to the cost of some goods, services and transactions, at fixed rate mostly proportionate to the amount on which the contribution is levied.

Moreover, there are a number of theories of tax distribution which have been used to select the rates as well as bases upon which tax ought to be levied. In this chapter, we have discussed four principle theories which are benefit theory, ability to pay theory, sacrifice theory and the cost of service theory.

Furthermore, principles of taxation are basic principles or rules set to build a good tax system. These are also criteria used for evaluating a good tax system as promulgated. There are four major principles or characteristics of a good tax system, namely principle of equity, convenience, certainty and economy.

2.6 Review Questions

1. What do you understand by the term taxation?
2. Discuss theories of taxation
3. What are the basic principles of taxation?
4. Assess Tanzania tax system in relation to the basic principles of taxation.

2.7 References

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CHAPTER THREE

SOURCES AND INTERPRETATION OF TAX LAWS

3.0 Introduction

In this chapter, we shall focus on the sources of tax law and proceed further to explore rules of construction and interpretation of tax statutes. The aim being to familiarize students with the main sources of tax law and how to interpret them before we can dwell much into the other aspects of the subject of tax law.

3.1 Objectives

At the end of this chapter students should have: -

- Learnt basic knowledge on the terms sources, interpretation, and construction and tax laws.
- Acquainted with understanding on basic sources of the principles of tax laws in Tanzania.
- Accustomed with the ability to describe the basic principles of interpretation and construction of tax statutes.
- Familiarised with the skills of describing the rationales behind interpretation and construction of tax statutes.

3.2 Sources of Tax Law

Tax law like any other branch of law has several main sources and these are the constitution, statutes, cases laws, writings of eminent scholars and departmental practice.

i) Statute Laws

Tax laws like any other laws in other branches of law are derived from Acts of Parliament. These are Income Tax Act Cap 332 of 2008, Value Added Tax, Act No. 5 of 2014 and the Tax Revenue Appeals Act, Cap 408 of 2006. All the above becomes the main source of tax laws applicable in day-to-day lives.

ii) Constitution

Constitution is the basic law of the land. It is the basis for each law which is enacted by the Parliament and any law which is not grounded upon the Constitution is null and void hence tax laws are made by virtue of the Constitution which establishes authorities and powers to impose levy upon citizens as well as the mandate to utilize revenue. The constitution in Tanzania is very categorical that no tax will be imposed upon a subject in the absence of a statute, which clearly establishes and impose that tax.

iii) Case Law

These are prior decisions of judicial authorities on landmark cases on taxation, which are referred in tax disputes. However, it is important to

note that in construing tax statutes judges do not create new law, but precedents are very essential on deciding particular points at issue and also for establishing binding principles that may be derived from the interpretation of statutes by the courts.

iv) Writings of Eminent Scholars

More often than not writings of eminent scholars have formed basis of authorities and a good source of law and so is the tax law. These have gone to the extent of persuading even judges when interpreting tax statutes during dispute resolutions.

v) Departmental practice

The application of tax laws on daily business frequently gives rise to difficulties especially in absence of precedents or case law to be referred to on that particular point.

However, statements of departmental practice or departmental interpretation applied in that statutory provision as a matter of practice becomes of great importance as it can solve the problem. However, application of the departmental practice is subject to challenges in courts of law.

3.3 The real meaning of Tax Law Construction

Frequently many terms and expression that are used in taxing statutes either have no technical meaning in law or they simply have no precise meaning in ordinary use. An example is the word "profit and gains" of a "business" in the Income Tax Act Cap 332, 2008.

These words lack a statutory definition and it is difficult to establish its meaning in its ordinary usage. As a result of this lack of precise meaning of some words and phrases it has become necessary to define them by using departmental practice or case laws (precedents), so as to enable those applying taxing laws to make a proper decision on various tax matters.

Statutory construction is defined as the art of seeking the intention of the legislature in enacting a statute and applying it to a given state of facts[41]. A judicial function is required when a statute is invoked and different interpretations are in contention.

Courts have been playing the important role of interpreting the law as provided in the statutes to give meaning to the words and phrases which in themselves do not have precise meaning.

[41] Freedman, J. Interpreting Tax Statutes: Tax Avoidance and the Intention of Parliament, London Sweet & Maxwell, 2007.

However, what the court does in construing tax statutes is the same as what it does in other statutes, to ascertain the intention of the legislature as it appears from the language it has used.

This was clearly discussed in the case of ***Inland Revenue Commissioner v Hinchy***[42], where it was held that even the most well drafted statute may be capable of more than one interpretation in any particular situation. Therefore, the courts must ascertain the meaning of a statute in order to apply it.

3.4 Principles in Construing Tax Statutes

There are two basic principles in construing taxing statutes

i) No tax can be imposed on a subject without words in the Act showing clearly the intention to impose tax. This implies that the authority to impose tax should be derived from the Act of Parliament[43]. This means that even where it may be within the spirit of the Acts to impose tax on some item, no tax would be imposed if the statute is silent or has no clear provision. This was clearly shown in **Cape Brandy Syndicate v IR**[44], where it was stated that a subject is only

[42] (1960) 1 ALL ER 505
[43] UNITAR: T ax Legislation and the Lawyer's Training Needs: An African Perspective, Geneva, Document 12, 2000. P 8.
[44] (1921) 1KB 64.

to be taxed on clear words, not on intendment or on the equity of an Act. In Tanzanian this principle is enshrined in the Constitution[45] under article 138, which prohibits imposition of tax of any kind save, by an Act of Parliament. This was clearly shown in ***Alibhai v the Commissioner of Income Tax[46]*** where it was held that the subject is not to be taxed unless the words of the taxing statutes unambiguously impose the tax upon him.

ii) In construing taxing statutes, the court may ignore the legal position and regard the substance of the matter or the equivalent financial results. This was clearly shown in the case of ***IRC v Duke of Westminster[47]*** where the Duke's gardener was paid weekly, but to reduce tax, his solicitors drew up a deed in which it was said that the earnings were not really wages, but were an annual payment payable by weekly instalments. It was held that to find out what the true relationship was and what the true nature of these payments were, you had to look at the deed. It was also stated that "in revenue cases there is a doctrine that the Court may ignore

[45] The Constitution of the United Republic of Tanzania, 1977.
[46] (1961) A. E. 610
[47] (1936) AC 1.

> the legal position and regard what is called 'the substance of the matter'. Here the substance of the matter is that the annuitant was serving the Duke for something equal to his former salary or wages, and that therefore while he is so serving, the annuity must be treated as salary or wages. This supposed doctrine seems to rest for its support upon a misunderstanding of language used in some earlier cases.

3.5 Rules for Construing Taxing Statutes

There are various rules applicable during the construction of tax statutes. They are hereby described: -

3.5.1 The strict construction rule

The general rule is that tax statutes must be strictly construed. This rule in principle means two things:

This is the approach of looking merely at what is clearly said. This rule requires the court to regard the words of the taxing statute and not to suppose any general principle underlying them and remaining unexpressed.

This was clearly shown in ***Cape Brandy Syndicate v IRC***[48] where it was stated, "in taxation one has to look at merely on what was clearly said. There is no room for any intendment.

There is no equity about tax; there is no presumption as to tax. Nothing is to be read in, nothing is to be implied. One can only look fairly at the language used".

Furthermore, according to this rule no tax can be imposed on a subject unless the words in the Act of Parliament clearly impose the tax on him.

Secondly, it advocates for the use of contra-preferentum rule. That is, regard is to be made to all the words used in the taxing statute without making any addition to them. But if there is ambiguity the taxing statute should be construed in favour of the taxpayer.

This was clearly shown in ***AON Uganda Ltd v URA***[49] where it was held that where there is ambiguity in taxing laws the ambiguity should be resolved in favour of tax payer.

This was also celebrated in the case of ***Tanzania Tea Packers Ltd v Commissioner of Income Tax and another***[50] where the court adopted

48 supra
49 (2009) UGCOMMC 39.
50 (1999) LLR 8 (HCT)

similar position and held that where there is ambiguity in taxing statutes it should be resolved in favour of tax payer.

However, strict construction rule has come under attack in recent times by those who favour a more liberal construction, aimed at giving effect to the intention of the legislature, particularly when interpreting anti avoidance provisions[51], due to the fact that it is not possible for the legislature to anticipate and forestall ingenious taxpayer schemes of tax avoidance.

However, before the above recent trend, the attitude of the East African Court of Appeal can be clearly seen in cases of omission within taxing statutes ("Casus Omissus").

However, though courts in East Africa were concerned with the spirit of the legislation, were reluctant to fill gaps which the legislature left open even with anti-avoidance provisions.

This can be clearly seen in ***CIT v U[52]***, where the Commissioner asked the court to construe the word "public" in conformity with the spirit of the provision, that is to curb tax avoidance, but the court rejected the proposed liberal construction in favour of strict construction.

[51] Ramsay v IRC (1982) AC 300 (HL)
[52] 2 EATC 1

The position of the East African courts can also be seen in ***TM Bell v CIT***[53] where it was held that the words in taxing statutes must be construed strictly.

It was also stated that if a person sought to be taxed comes within the letter of the laws he must be taxed; however great the hardship may appear to the judicial mind.

3.5.2 Considering the statute as a whole

In construing taxing statutes sometimes, it is important to consider the Act as a whole. This is because sometimes the meaning of a word or phrase is unclear and hazy in one part but is clear in another or the two are clear when considered together. On that ground sometimes it helps to consider the Act as a whole to get a clear meaning of some words, parts or phrases[54].

However, it is essential for a student to note that under a rule where the two provisions on the surface appear to be irreconcilable, each is to be interpreted on its own but in a manner, which will not contradict the other.

[53] 3 EATC 102

[54] For a detailed account of this read the application of this rule in *B v CIT, 1 EATC 6*, where the court was involved in the construction of the word "individual"

This was clearly stated in the case of ***CIT v J***[55], where it was pointed out that the words of Section 24 (1)(a) of the then Income Tax Ordinance must be read in context of section 34(3)(a) of the same Act.

3.5.3 Words of the Statute must be read in their context

In construing taxing statutes, words and phrases used in the Act must be read in their context. The rule here is that the words and phrases are to be construed in the sense in which they are ordinarily used. However, where they have a technical meaning in taxing law they have to be construed in accordance with that meaning.

3.5.4 Departure from the Literal Construction of Statutory Language

As we have seen in the previous discussion above in construing taxing statutes one should look merely on what it is clearly said. However, courts may sometime depart from the literal construction rule where such construction leads to an absurd result, which could not have been contemplated by the Parliament. Nevertheless, where the words are not ambiguous the courts will be bound by the literal construction rule.

[55] 1 EATC 80

This was clearly stated in the case of ***IRC v Hinch***[56] where it was pointed out that words must be interpreted according to their literal, ordinary and natural meaning.

3.6 Summary

In this chapter, we have seen that the sources of tax laws are the statutes such as the Constitution, 1977, Statutes made by the Parliament. Other sources are decisions on tax disputes delivered by the highest court in the country (precedents), writing of the eminent scholars, as well as Departmental practice and other rules and regulations.

Moreover, in this chapter we have seen that the essence of construing taxing statutes is for the courts to ascertain the intention of the legislature in enacting the statute and apply it in a given state of facts.

On the other hand, we saw that there are two main principles of construing taxing statutes. First is that no tax can be imposed on a subject without words in the Act showing clearly the intention to impose tax. Secondly, in construing taxing

[56] Supra

statutes courts may ignore the legal position and regard the substance of the matter or the equivalent financial results.

Furthermore, we have learned that there are different rules of construing taxing statutes. Firstly, taxing statutes should be construed strictly. This means that the courts should use plain meaning approach but if that approach leads to some ambiguity then that ambiguity should be resolved in favor of the taxpayer.

Also in construing taxing statutes sometimes, it is important to consider the statute as a whole so as get the proper meaning. It is also important that the words of a tax statute should be read in their context when construing taxing statutes.

Lastly, in this chapter we have learnt that in construing taxing statutes sometimes it is important for the court to depart from the literal meaning if it leads to absurdity, which may not have been contemplated by the parliament.

3.7 Review Questions

1. Mention and explain the sources of tax laws in Tanzania
2. Discuss the basic principles of construing tax statutes
3. Mention and explain the rules of construing taxing statutes.

3.8 References

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CHAPTER FOUR

TAX AVOIDANCE AND TAX EVASION

4.0 Introduction

In this chapter, we are going to learn the concepts of tax evasion and tax avoidance. We are going to see how these two concepts are as old as the tax law itself and any problems if at all relating to the two concepts.

Therefore, we shall learn on how the legislature and courts have tried to minimize and curb problems occasioned because of the two acts namely tax avoidance and tax evasion.

4.1 Objectives

At the end of this chapter students should have: -

- Learnt basic knowledge on the terms tax avoidance and tax evasion with their differences.
- Acquainted with understanding on the causes of tax evasion and tax avoidance.
- Accustomed with the ability to describe principles of tax avoidance

- Familiarised with the skills of describing the mechanisms employed to reduce tax avoidance and evasion in Tanzania.

4.2 Tax Evasion

Tax evasion can be defined as a taxpayer's deliberate contravention of the tax laws to minimize or eliminate liability altogether. It is done through application of fraudulent practice with the intention of minimizing or eliminating tax liability. It involves practices such as:

i) Not filling an income return at all

ii) Filling a false return of income by omitting or understating income or overstating expenses in the year of income.

iii) Giving false information that will affect your tax liability.

iv) Preparing and maintaining of a false book of accounts which disguise the real income of the tax payer.

v) Arranging for the receipt of income in a jurisdiction or form whereby that income will not come to the attention of the tax authorities e.g. Receiving payment for a service rendered in cash which the tax payer believes it cannot be traced.

vi) Application of fraud like non-issue of sales receipt, manipulation of stock sheets and valuations or destruction of the accounting records.

In other words, tax evasion is said to be failure of the tax payer to do what is required by the law. However, not all of the above named acts if done by the taxpayer constitute tax evasion. It all depends on the amount involved and the prevailing circumstances. This is because the omission of an item of income, false claim of expenditure or the wrong total amount of income may not be designed but a genuine error of omission or arithmetic.

This was discussed with approval in the case of ***Regina v Hummel***[57], where the accused was charged with wilful evasion of the payment of taxes and making false and deceptive statements in tax returns.

However, he was acquitted on the ground that there was no mens rea. The frequency of such errors, the amounts involved the seniority and experience of the staff or person involved should all be considered to establish the presence of fraud[58].

This is because the law imposes heavy penalties if fraud and gross neglect is established by the Commissioner. Heavy penalties as well as court fine on conviction are provided for in section 102 and 109 of the law[59] so as to deter the tax evasion.

[57] 3 EATC 84
[58] See the case of Regina v G.F.R. 3EATC 84, and Regina v Branch, (1976) CTC 193
[59] See Sections 102 and 109 of the Income Tax Act, 2004.

4.3 Tax Avoidance

This is the practice and attempt by the taxpayer to arrange his business transactions in a way that he minimizes or eliminates his tax obligation but without contravention of the taxation laws. It can also be defined as a misuse or abuse of the tax legislation provisions so as to achieve an improper tax benefit.

In tax avoidance the tax payer takes advantage of the loop holes, weaknesses and loose or vague clauses in tax legislation which lead to differences in interpretation to minimize or eliminate his tax liability.

Under this practice the tax payer enters into transactions which are lawful in nature but have little or no impact in his financial position and hence tax obligations.

This was also explained ***in IRC v Duke of Westminster*** [60]where it was stated that "every man is entitled if he can to put in order his affairs so that the tax attaching under the appropriate Acts is less than it otherwise would be".

Moreover, for a transaction to be treated as tax avoidance three requirements or ingredients must be met. Firstly, the taxpayer must have

[60] (1936) AC 1.

received the alleged amount as part of his income that would make him liable to tax, but due to the practice of tax avoidance he is not liable.

Secondly, the transactions that the taxpayer enters into must be intended to minimize or eliminate his tax liability. This implies that it must be shown the taxpayer could not have done those transactions if tax avoidance was not the intention.

This was clearly pointed out in ***AR v CIT***[61] where it was stated that the act of the owner of the company to transfer all personal assets and income to the company in return for a fixed annuity constituted tax avoidance. It was held that the main intention of the named transaction was avoidance of tax liability.

Moreover, in ***BD Co v CIT***[62] it was stated that the onus of proving that the main purpose of the transaction was not tax avoidance lies upon the tax payer.

Thirdly, the act that is alleged to be tax avoidance must be a systematic one or acts that occurs regularly and not an act that is exceptional or that occurs once. This implies that the acts must be a habit of the tax payer.

61 2EATC 202
62 3EATC 202

This was also discussed in the case of ***Bisland v CIR***[63]***,*** where the court ruled that due to the fact that this was a single operation not a systematic one, and there had never been any other attempts of similar nature leading to the same result, therefore it could not be treated as tax avoidance.

4.3.1 Principle methods of avoiding Tax

i) Income splitting

It is the art of structuring one's affairs to take advantage of lower rate taxes. This involves the splitting or dividing of the income between more than one taxpayer so as to reduce the marginal rate of tax chargeable thereon. It involves the use of partnerships, corporation, trusts and others.

For example, a taxpayer may form a partnership restricted to family members and hence fragment his income to the members of the partnership, who at the end of the day return the income to him as the head of the family and the owner of the company, consequently avoid progressive individual rates of taxation and hence achieving income splitting.

This was clearly discussed with approval in the case of ***Peate V FTC***[64] where a taxpayer who was a medical practitioner formed a family company

[63] 20 TC 446
[6464] (1966) 40 ALJR 155

which purchased his practice and equipment. He agreed to save it for a salary. It was held that the profits made were derived whole from the medical practitioner's own activities.

ii) Sheltering of income

This is the art of avoiding tax legally by using schemes such as tax heavens where by the tax payer may move the management of his company to a jurisdiction where offshore companies are subject to low tax rate or no tax at all, and hence avoid paying tax.

The tax payer may also apply schemes such as issuing generous capital allowances, offering liberal deduction to mining and agricultural businesses and hence minimize his tax obligation.

Sometimes the taxpayer himself may migrate to another tax jurisdiction where the tax incidence is low or may transfer his property to a foreign trustee and hence minimize or eliminate his tax obligations.

This has recently happened in the US and UK where most multinational companies including Google which has been accused of tax avoidance. The UK is a key market for Google but the enormous profit derived is out of reach of the UK's tax system. Google generated US $18 billion revenue from the UK between 2006 and 2011. Information on the UK profits derived

from this revenue is not available but the company paid the equivalent of just US $16 million of UK corporation taxes in the same period. Google defends its tax position by claiming that its sales of advertising space to UK clients take place in Ireland—an argument which the UK find deeply unconvincing on the basis of evidence that, despite sales being billed from Ireland, most sales revenue is generated by staff in the UK.

It is quite clear to the UK government that sales to UK clients are the primary purpose, responsibility and result of its UK operation, and that the processing of sales through Google Ireland has no purpose other than to avoid UK corporation tax.

This is deliberately done for most corporations which find it far too easy for companies to exploit the rules and set up structures in low-tax jurisdictions, rather than pay tax where they actually conduct their business and sell their goods and services.

iii) Dividend stripping

This is another method of tax avoidance where by the interest paid on shares is stripped from the tax authorities as a tax refund. An example of this can be seen when a solvent company is bought by a shareholding

company. Then large dividend is declared and shares are sold at a loss to the former shareholders which are then used it as a basis for tax refund.

This was clearly revealed in the case of ***BD Co Ltd v CIT***[65] where the appellant company entered into an agreement with one L.M by which L. M sold his shares to the appellant company in a higher amount. The dividend was declared and the appellant company resold the shares to L. M for an amount less than the purchase price.

As a result, L.M realised some capital gain on which he paid no tax, and the appellant company received the dividend, but had a loss for income tax purposes in excess of the amount of dividend declared and hence became entitled to refund of tax paid by it on the profits out of which the dividend was declared. It was held that the main purpose of the above transaction was tax avoidance.

iv) Conversion of capital expenditure into current expenses

This is a method of tax avoidance where by the taxpayer arrange his business affairs in a way that ordinary expenditures are being regarded as qualifying for deductions.

[65] Supra

An example of this is the arrangement by the company to have his director of his own and run a car while making motor vehicle expenses expenditure exclusively incurred for the production of income and hence deducted for taxation purposes.

v) Capitalisation of income

This is another tax avoidance method whereby the tax payer arranges his business in a way that he converts a taxable income into capital which may remain untaxed or taxed at a lower rate. An example of this can be seen where the tax payer let property on lease at a large premium and in a reduced rent.

vi) Income or Asset shifting

It is another tax avoidance technique where by the tax payer shifts his income or income producing asset to another person or entity which is chargeable to a less tax and the tax payer has beneficial interest that person or entity. That entity or legal person may be trust, charitable organisation or any other entity with preferential tax treatment.

This was clearly shown in ***AG v CIT***[66], where a tax payer used a trust he created to accumulate income. The court held that only the trust was assessable to tax and not the trustee.

It is important to stress at this juncture that the above techniques are not the only one used in tax avoidance as there are several more others which we could not exhaust them but they discovered and applied every day by the tax payers.

4.4 Causes of Tax Avoidance and Tax Evasion

An endeavour to limit or eliminate taxation through tax evasion or avoidance there are several or a combination of factors as explained below:

i) High marginal tax rates and frequent changes in the tax rates. It suffices to say that when tax rates are very high, the tax payers may consider the distribution of their incomes unfair and hence try to make unilateral adjustment for equity by non-compliance through tax evasion or try to find some loop holes to lessen the burden and hence tax avoidance.

ii) Deficiencies in the legal structure of the tax laws. This may be the main cause of tax avoidance because poor draftsman ship causes a lot of loop holes and vague provisions which support tax avoidance.

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66 2 EATC 43

iii) Multiplicity of taxes. This implies that availability of too many taxes raises difficulties in compliance on the part of the tax payer and hence tax avoidance or tax evasion.

iv) Low prospect of detection and punishment of tax evaders. This leads to induced evasion. This s because the more tax evaders a person knows who are not caught and punished the more likely he will also like to join them.

4.5 Mechanisms to limit Tax Avoidance and Tax Evasion

A number of techniques have been used by courts to put limits on the ingenuity of taxpayer in minimizing or eliminating their tax liability. One of them is a common law approach that tax statutes should be construed strictly.

This as we have seen earlier connotes that in taxation one is to look simply at what is clearly said[67]. However, in recent times some people prefer liberal construction aimed at giving effect to the intention of the legislature especially when interpreting anti avoidance provisions of the taxing statutes[68].

[67] IRC v Duke of Westminster (1936) AC 1
[68] Furniss v Dawson (1984) 1 All ER 530 (HL) and Ramsay v IRC (1982) AC 300 (HL)

Other methods include keeping marginal tax rates low, bearable and not subject to frequent changes. Tax avoidance and tax evasion can also be minimized by avoiding multiplicity of taxes by retaining few major taxes only to make it easier to administer and comply.

Thirdly by enacting simple tax laws and avoids ambiguity provisions. Lastly but not least by punishing those who avoid and evade taxation severely so that it can have a deterrence effect[69].

There are also statutory mechanisms that have been provided for in the Income Tax Act with a view of curbing tax avoidance and tax evasion. The first one is section 33, which empowers the Commissioner of Income Tax to make adjustment, which may lead to charging of higher amount tax counteracting tax avoidance if the transaction done was for tax avoidance.

Secondly, under section 34 the Act empowers the Commissioner to make adjustments that may lead to charging of higher tax by a taxpayer who tries to reduce tax through income splitting.

Thirdly, section 35 allows the Commission to make adjustment, which may cause a tax payer to pay higher amount of tax if in his opinion he believes that some arrangement was done with the intention of avoiding or reducing

[69] Supra

tax liability. Section 91 of the Act imposes liability to the tax payers to file return of income and declare their chargeability to tax.

Furthermore, section 94 (5) empowers the Commissioner to make estimated tax assessment for tax payers who attempts to evade or avoid tax by non-filling of income returns. Section 94 (6) empower the Commissioner to raise assessment for those who evade tax wilfully by fraud or wilful neglect.

Lastly but not least sections 100 to 109 prescribe heavy penalties to be paid and even imprisonment for those who evade or avoid taxation as well as those who are abetting or aiding others to evade or avoid taxation.

4.6 Summary

In this chapter, we have seen that tax avoidance and tax evasion are inherent features of all tax systems. Tax avoidance is the art of minimization or elimination of tax liability without contravention of the law, while tax evasion is the elimination or minimization of tax liability through deliberate contravention of the law.

Tax avoidance is not punishable by the law, but upon conviction the tax authorities may only amend, the law to stop

the practice and the taxpayer will be asked to pay the tax he is supposed to pay plus some interest as it is considered a debt.

Tax evasion is punishable by the law, and upon conviction, the taxpayer may be punished by paying fines as shown in the Income Tax Act sections 102 and 109.

Some sections dealing with tax evasion and tax avoidance in the Income Tax Act, 2008 are section 33, 34 and 56.

4.7 Review Questions

1. Define and distinguish between tax avoidance and tax evasion.
2. Mention and explain main causes of tax avoidance and tax evasion and suggest appropriate ways and means to minimize them.
3. Discuss main techniques used in tax avoidance.

4.8 References

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CHAPTER FIVE

BASIS OF INCOME TAX IN TANZANIA

5.0 Introduction

In this chapter, we are going to learn about the basis of income tax applicable in Tanzania. There are two important questions to ask in relation to the basis of taxation. Firstly, which person or group of persons is to be taxed? Second, which basis should be considered for imposing taxation? This chapter will seek to answer the above questions at the end of the day.

5.1 Objectives

At the end of this chapter students should have: -

- Learnt basic knowledge on bases of income taxation in Tanzania.
- Acquainted with understanding on how the residence of an individual and that of a company are different for income tax purposes in Tanzania.
- Accustomed with the ability to describe alternative bases of income taxation in Tanzania.
- Familiarised with the skills of describing the importance of determining residence for income tax purposes.

5.2 Bases of Taxation

Generally, there are different bases of taxation. However, the most common bases used by nations for imposing income tax are nationality or citizenship, domicile, country of source and country of destination and residence.

It is important to highlight that most taxing systems use a combination of these bases not necessarily use one base only. These are going to be discussed in details in this chapter:

i) Nationality or Citizenship

This is a tax base used in some nations or states when imposing taxations to their citizens. Under this base income tax is imposed on the people as an obligation for them as nationals to support the state through paying income tax regardless of whether they are living within the state or not. This indicates that citizens are supposed to pay tax to their home country from wherever they are in the globe.

Taxation based on citizenship or nationality is easy test to apply, however it attaches overstated and obsolete importance to the jurisdiction in which an individual was born or obtained nationality. This tax base may also facilitate tax evasion by expectant mothers awaiting the birth of their child in a tax have.

ii) Domicile

This is also a base of income taxation in some states. Domicile of choice involves two things, first is the presence within the jurisdiction and second is the intention on the part of the individual to maintain his permanent home in the jurisdiction.

This demonstrates that income tax under this base is charged to those who live within the jurisdiction or those with permanent home within the jurisdiction.

iii) Country of Source and Country of Destination

Under this base the states impose income tax on all income that originates in that state as its source. It can be an income earned from working in that country, investing or carrying on business in such a country.

Some states also impose income tax to all the incomes that are earned by its residents all over the world through working, investing or doing business. An example of this is Tanzania which imposes income tax on her residents in respect of income earned worldwide[70].

iv) Residence

This is a tax base where a state imposes income tax upon its people on the ground that being residents it is their obligation to support the state

[70] Section 6 the Income Tax Act, 2008.

through paying taxes. Under this base income tax is imposed on the residents of a state on income earned by them worldwide. An example of states using this base is Tanzania, which imposes income tax to its residents for incomes earned worldwide[71].

5.3 Residence for Income Tax purposes in Tanzania

Residence is the main basis of income tax in Tanzania. The term residence is defined in section 6 and 66 of the Income Tax Act 2008. It has been defined at three levels; these are individuals, body of persons and corporations.

It is also important to highlight that residence is determined in relation to the year of income. These levels of residence are briefly highlighted below;

i) Residence of an individual

As explained above residence for income tax purposes is determined in relation to the year of income. According to section 66 of the Income Tax Act there are two categories of individuals, first is those having permanent home in Tanzania and secondly those who do not have permanent home in Tanzania.

[71] See Sections 6 and 67 of the Income Tax Act 2008.

Section 66(1), (a) provides that if a person has a permanent home in the United Republic of Tanzania and he was present in the country in any part of the year of income, he will be a resident for income tax purposes. This indicates that if the person has a permanent home and at any times in that year of income that he is about to be taxed as if he was present in Tanzania; he is a resident for income tax purposes.

For example, if a person has a permanent home in Kilimanjaro, but currently living in Japan, and during the year of income he visits his permanent home or Tanzania in he deemed to be a resident for income tax purposes.

The length of his stay in the country is immaterial. The fact that he was present in the country in that year of income where he has a permanent home is enough to make him a resident.

This was clearly stated in the case of ***Levene v Inland Revenue Commissioner***[72], where the appellant had been a resident in the UK. Then for five years he spent only five months in UK each year. He spent the rest of the months in hotels abroad. It was held that he was a UK resident for income tax purposes in UK during those years.

[72] AC 217, (1928) UKHL

Furthermore, section 66 (1)(b) of the Income Tax Act provides that if a person is present in the United Republic of Tanzania during the year of income for a period or periods amounting in aggregate of 183 days or more, he will be a resident for income tax purposes.

This indicates that the person without a permanent home in the country he does not become a resident just because he is present in Tanzania in any part of the year of income. To be a resident he must be present in the country for a period or periods amounting in aggregate of 183 days.

For example, if a person visits Tanzania on holiday for three months and leave, and then visit again on business for four months in the same year, then he will be in Tanzania for an aggregate number of 210 day and hence deemed a resident for income tax purposes as clearly provided for under section 66 (1)(b).

Moreover, the same section provides that a person may be a resident for income tax purpose if he is present in the United Republic of Tanzania during the year of income and in each of the two presiding years of income for periods averaging more than 122 days in each such year of income[73].

[73] Section 66 (1) (c) of the Income Tax Act, 2008.

For example, if in 2010 "A" was in Tanzania for 150 days, in 2011 he was in Tanzania for 140 days and in 2012, he was in Tanzania for 150 days. So a total number of days he was in Tanzania is 440 days.

The average is 147 days and hence a resident under section 66 (1) (c). It must be highlighted that to be a resident under this section the average must be more than 122 days and not only 122 days.

The law also provides that an employee or an official of the government of the United Republic of Tanzania posted abroad during the year of income[74] is also resident for income tax purpose. This includes ambassadors and consular, military personnel and all others posted abroad by the government.

ii) Residence of a Body of Persons

Body of persons includes partnerships and trusts. According to section 66 (2) a partnership is a resident partnership for the year of income if at any time during the year of income a partner is a resident of the United Republic of Tanzania.

[74] Section 66 (1) (d)

This means that for a partnership to be a resident, it is not necessarily that it is registered in Tanzania. The fact that one of the partners is a resident of Tanzania in that year of income is enough to make it a resident.

A trust becomes a resident trust for a year of income if it was established in Tanzania, or if at any time during the year of income, a trustee of the trust is a resident person, or if at any time during the year of income a resident person directs or may direct senior managerial decisions of the trust[75].

Presence of one of the above named criteria may make the trust qualify to be a resident for income tax purposes. It is not necessary to prove all the criteria.

iii) Residence of Corporations

Residence is a material factor in companies in determining the tax liability and for applying many provisions of tax legislation. A company resident in the United Republic is liable to corporation tax on its worldwide profits, not just its Tanzanian source profits[76].

[75] Section 66 (3)(a)(b)(c)
[76] Section 67 of the Income Tax Act, 2008

Whether or not these profits are brought into Tanzania is irrelevant for this purpose. Residence of a company for income tax purposes in Tanzania is provided for under section 66 (4)(a)(b) of the income Tax Act, 2008.

It provides that a company will be a resident corporation for a year of income if it is incorporated or formed under the laws of the United Republic of Tanzania, or if at any time during the year of income, the management and control of the affairs of the corporation are exercised in the United Republic of Tanzania. This means that if one of the two criteria is met then the company is a resident in that year of income.

This position was clearly discussed with approval in the case of ***DeBeers Consolidated Mines v Howe***[77] where it was stated that a company resides for income tax purposes where its real business is carried on and the real business is carried on where central management and control actually abides.

However, there are special circumstances where the company is not engaged in active trading and its administrative control is divided between two different jurisdictions.

[77] (1906) AC 455

This was the case in ***Swedish Central Railway Co. Ltd. v. Thompson***[78]***,*** where the company was not engaged in active trading and its administrative control was divided between the United Kingdom and Sweden. The Courts decided that the company, while it might be resident abroad, was still resident in the United Kingdom for tax purposes.

Moreover, since residence may now also be determined by reference to the place of incorporation a company can also for that reason be resident in more than one jurisdiction.

5.4 Importance of Determining Residence for Income Tax Purposes

Determining residence of an individual or accompany is of vital importance for income tax purposes. This is because an individuals' liability to income tax is based on his/her status as a resident or non-resident, as well as that of a company and other non-personal entities.

This is clearly provided for under the Income Tax Act, 2008 in particular section 6 which states, that if a person is a resident during the year of income, he is subject to income tax on his worldwide income from all sources[79].

[78] 1925, 9 TC 342
[79] Section 6 (1)(a)

In addition, if an individual is a non-resident in the year of income, he is only subject to Tanzanian income tax on income earned from sources inside Tanzania[80]. It is also important to determine a residence of a person for income tax purposes as it affects grants of personal reliefs in taxation. This is because some of the reliefs are granted for citizen only.

5.5 Summary

In the chapter, we have seen that the common tax base used for imposing income tax are citizenship or nationality, domicile residence and country of source and country of destination. We also saw that residence is the main basis of income tax in Tanzania.

On the other hand, we saw that under the Income Tax Act, 2008 residence has been defined at three levels, namely residence of individuals, residence of non-individual persons other than corporations (i.e trust and partnership) and residence of corporations.

We also saw that it is very important to determine the residence of an individual for income tax purposes because an individual's

[80] Section 6 (1)(b)

liability to income tax is based on his/her status as a resident or nonresident during the year of income.

5.6 Review Questions

1. Critically explain the conditions for residence of the following:
   a) An individual
   b) Partnership
   c) Trust
   d) A corporation
2. What is the significance of classifying persons as residence and non-residence in the United Republic of Tanzania for income tax purposes?
3. How fair is the income tax regime in as far as taxation of none resident Tanzania is concerned?

5.7 References

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CHAPTER SIX

TAXATION OF INCOME FROM OFFICE AND EMPLOYMENT

6.0 Introduction

This chapter is going to introduce the readers to the taxation concepts like who is an employee, and who is a self-employed person for income tax purposes.

There are two important questions to ask in relation to the basis of taxation. Firstly, which person or group of persons is to be taxed? Second, which basis should be considered for imposing taxation? This chapter will seek to answer the above questions at the end of the day.

6.1 Objectives

At the end of this chapter students should have: -

- Learnt basic knowledge on who is an employee and the self-employed person for income tax purpose.
- Acquainted with understanding on what is included in employment income for income tax purposes.
- Accustomed with the ability to describe the test used in characterisation of income and determination of contract of service.

- Familiarised with the skills of describing how the deduction of tax from emoluments is done.

6.2 Income from Office and Employment

The term employment is statutorily defined in section 3 of Income Tax, 2008. It means a position of an individual in the employment of another person. In addition, it denotes a position of an individual as manager of an entity other than as partner of a partnership, or a position of an individual entitling the individual to a periodic remuneration in respect of services performed, or a public office held by an individual, and includes a past, present and prospective employment.

However, employment is a wider term and it is usually associated with an office or position, which entitles someone to some remuneration. It also includes any formal contract to provide services for some consideration.

An employee is defined to mean an individual who is the subject of an employment conducted by an employer. Furthermore, the employer is defined as a person who conducts, has conducted or has the prospect of conducting the employment of an individual. The employment contract may be a "contract of service" (employed) or a "contract for service" (self-employed).

The question whether a person is employed or self-employed and whether the source of income is employment or business is very essential in determining tax liability.

The main reason is that in employer/employee relationship, the employer must withhold tax at the source from the employment income in trust for the crown. While the self-employed persons are not taxed at source, but are required to file returns of income and pay their taxes to a different procedure.

6.3 Test Used in the Characterization of Income

At common law, there is no test, which is conclusive to classifying a relationship as that of employer / employee or that of an independent contractor (self-employed). The courts have evolved several tests that are going to be explained below:

i) The control test

Courts traditionally in determining the master-servant relationship focused on the control test. The 'control test' was the traditional test used to determine whether an employment relationship existed.

A person who agreed to detailed control by another in relation to ***what*** work was to be performed, ***when*** *it* was to be performed, ***where*** it was to be performed and, most importantly, ***how*** **i**t was to be performed would

be characterized as an employee working under a contract of service. What was important under the control test was the degree and actual exercise of control.

Of course, the *what, when* and *where* aspects mentioned above would also be present in an independent contract. It is the *how* aspect, which distinguishes an employment, contract from an independent contract. That is, the *how* aspect is present in an employment contract, but not in an independent contract.

This is clearly explained in Halsbury's laws that under control test "a servant (employee) acts under the direct supervision and control of his master. That he is bound to obey all the reasonable orders given him in the course of his work.

An independent contractor, on the other hand, is entirely independent of any control or interference, and merely undertakes to produce a specified result, employing his own means to produce the result.

In distinguishing the two the test is whether or not the employer retains the power not only in directing what is to be done but also of controlling the manner of doing the work"[81].

[81] Halsbury's Law of England, 4th Ed. Vol. 23 (London: Butterworths, 1978) pp.272-5; paragraphs 390 to 392.

There are four aspects of the control, the courts have considered in assessing the nature and degree of control. These are:

- The power of selection of the servant
- The payment of wages
- Control over the method of work, and
- The master's right of suspension or dismissal.

The following cases are very descriptive of the control test.

First case is the case of ***Isaac v MNR***[82] In this case the appellant was a nurse working in Canadian Forces Hospitals. She was a civilian hired on a day-to-day basis subject to availability of military nurses.

She was not paid, unless she worked and could be dismissed within 24 hours' notice. She was paid only per diem rate with no benefits or holidays and had not signed any contract.

The appellant considered herself to be a self-employed nurse and deducted certain expenses from her income. The commissioner of income tax disallowed most of the deductions contending that she was an employee. The court established that she was self-employed under common law test.

82 70 DTC 1285

This is because the degree of control, which the hospital had over the manner in which she performed her normal duties as a nurse was not adequate to create a master and servant relationship.

However, the usefulness of the control test eroded over time because of the nature of the work, like professional jobs as well as in highly skilled tradesmen.

For example, in many modern instances, the employee's skill exceeds the expertise of the employer. Thus, the employee may be given a significant degree of autonomy as to the manner in which their skills are exercised.

The limited use of the control test discloses itself in situations where it is difficult to be applicable due to nature of the work. The courts especially found the control test inapplicable in determining master-servant relationship in professional jobs as we as in highly skilled tradesmen.

This was clearly stated in ***Rosen v The Queen***[83] where it was stated that control test was of little value in cases involving a professional man or man of particular skill and experience.

In practice, the courts now use a multi-factor approach. This involves weighing up the factors, which point to the existence of a relationship of

[83] (1976)

employer/employee and balancing them against the factors which point to the existence of a relationship of engager/independent contractor.

In other words, the courts examine the totality of the situation between the parties in order to reach a conclusion. This gave rise to other approaches rather than control test such as the integration test.

ii) Integration Test

This test was developed after the difficulties of using control test to professional and highly skilled workers. It was intended to consider the broad range of potential employer-employee relationships in a modern world. It is also known as the "organization test", or the "economic dependency test".

This test examines whether the tasks performed by an individual form an integral part of the business as opposed to merely being accessory to the business.

The test will also determine whether the individual is in business in his or her own right and provides services to other businesses as an independent contractor. An employee is not perceived as operating his or her own business, but rather as being an integral and necessary part of the payer's business.

The court in ***Rosen v The Queen***[84] relied on the integration test. In this case the plaintiff had resigned as a full time professor at the University of Ottawa. However, he gave chapters on part time basis in three institutions.

When he purported to deduct expenses he incurred in the course of producing the income from lecturing, on the ground that he was not an employee of either of the three institutions where he gave chapters, but rather an independent contractor engaged in the business of lecturing a dispute with taxation authorities.

It was held that the work he was doing for the three institutions was done as an integral part of the curricula of the schools. Therefore, he was an employee engaged for the purpose of delivering chapters on a part time basis but not an independent contractor.

iii) Economic Reality Test

This is another test used to assess and determine the work relationship, if it is that of employer- employee relationship or that of an independent contractor. Under this test the court examines several economic factors and draws a conclusion as to the nature of relationship. The factors assessed include:

84 (1976) CTC 462

- Control (as in control test)
- Ownership of tools
- Who has the chance of profit from the work done?
- Who bears the risk of loss?

These four elements are an attempt to examine all aspects of relationship with an emphasis on determining if the employee is carrying on his activities for himself or on his own behalf and not merely for a supervisor.

This was clearly portrayed in ***Hauser v MNR***[85] where it was established that in cases where the taxpayer takes no financial risks, supplies no funds and has no liability at all, under economic reality test he is an employee.

iv) The specific Result Test

This is another test used by the courts in distinguishing an employee from an independent contractor or self-employed person. The employer – employee relationship generally requires the employee to put his personal service at the disposal of his employer for the agreed period of time, without reference to a specified result but usually envisaging the accomplishment of the agreed work on an ongoing basis.

[85] 78 DTC 1532

However on the other side of the coin, where a party agrees that certain specified work will be done for the other, it may be inferred that employer-employee relationship does not exist but that of independent contractor[86].

6.1 What is included in the employment income

Employment Income generally includes most types of receipts that enrich the taxpayer, including interest, dividends, rents, royalties, annuities, pensions, and all manner of other items[87]. Many systems exclude from income part or all of superannuation or other national retirement plan payments.

Most tax systems exclude from income health care benefits provided by employers or under national insurance systems. What is included in the employment income are going to be discussed in detail as follows:

i) Gain and Profits of Employment

Section 7 of the Income Tax Act, 2008 enumerates what constitutes gains or profits of employment. These includes wages, salary, payment in lieu of leave, fees, commissions, bonuses gratuity or any subsistence, travelling

[86] Lafleur & Pohs v MNR 84 DTC 1478
[87] Section 7 of the Income Tax Act, 2008.

entertainment or other allowances received in respect of employment or service rendered.

This implies that gains or profit from employment need not arise from the employer. Any voluntary payment to the holder of an office or employment is a profit of employment if it accrues to the holder by virtue of his office or employment notwithstanding that there may not be any legal obligation to make the payment.

An example of this was shown in ***Colvert v Wainwright***[88] a case which involved tips to a taxi driver. It was held that though the money was received from a third party after the services were complete it was still party of the continuing employment as a taxi driver and hence taxable.

However, the above presumption is rebuttable on the ground that not all payments from the employer are by virtual of employment. This was clearly stated in ***Hochstrasser v Mayes***[89] where it was stated that the test is whether such payment are rewards for services past, present or future.

Therefore, if the payments are personal, they are not taxable as emoluments from employment. This was clearly shown in ***Ball v***

[88] 27 TC 475
[89] (1960) AC 376

Johnson[90] where it was stated that a bonus payment for passing professional examination is a personal success reward, not arising from services or employment and hence not taxable.

Furthermore, it is important to note that payments paid after a contract of employment has been terminated are not taxed as emoluments of employment.

This was the issue in **Durga Daas Dawa v CIT**[91], where the taxpayer who was a sole distributer of a certain company was given a personal gift of shs 100,000/= after termination of the contract, for long cordial and success business relationship.

It was held that the amount was not taxable as it was made after termination of the contract, but if the same amount could have been given during the subsistence of the contract it would have been taxable as a reward for services past, present or future.

The above presumption was shown in ***Cowan v Seymour***[92] where it was stated that payments made to a voluntary office holder after completion of the work, for a work well done was taxable as benefits of employment.

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90 47 TC 155
91 (1963) EA 695
92 7 TC 372

ii) Gifts, Gratuities, Prizes and Awards

Gifts, gratuities, prizes and other awards are taxable in Tanzania under section 7 (2) (a) as amounts received in lieu of employment particularly when they are not testimonial payments.

This was clearly shown in ***Laidler v Perry***[93] where the employer had given gift vouchers to its employees every Christmas, and the vouchers were held liable to tax.

On appeal it was held the gift of 10 pounds was taxable because the intention was to thank them for services past and obtain beneficial results for the company in future.

This was also a decision in ***Wright v Boyce***[94] where a Christmas gift to employees for personal qualities were held to be taxable as profits of employment, on the ground that the gifts were expected as a result of general custom and accrued to the holder by reason of his office.

iii) Benefits

In today's working world employees enjoy many quantum benefits on top of salaries and wages from their employers. Some of these include

93 (1966) AC 16
94 38 TC 1

pensions, life and health insurance, paid holidays, annual vacations free or subsidized transport, commodity discounts, recreation facilities and many others.

Traditionally under common law benefits were not taxed on the reason that they are not income. This is because under common law income includes money and something capable of being converted into money only, and only these can be liable to income tax. The leading authority for this proposition is the decision given by the House of Lords in the case of ***Tennant v Smith***[95].

However, eventually many tax jurisdictions have brought within the ambits of income tax most of the fringe benefits. Now the general rule is that benefits are taxable as emoluments of employment.

Benefits in Tanzania are taxable under section 7 (2)(f) of the Income Tax Act 2008. This was clearly shown in ***Heaton v Bell***[96] where it was stated that a car loan by the employer for the personal use of an employee through reduction of the payable wage was held taxable as a benefit and hence emolument from employment.

[95] (1892) AC 150
[96] (1970) AC 728

iv) Compensation Payment for Redundancy or Loss of Office

The general rule under common law is that compensation for redundancy or loss of office is not taxable as an emolument of employment, because it is in nature of capital payment for loss of opportunity to earn income or for the abandonment of a right to income under a contract of service.

In exception to the general rule, redundancy payment or compensation for loss of office may be taxable as emolument of employment if it represents profits which would have been earned by the employee saves for the cancellation. However, where the compensation is in the form of an ex-gratia payment (i.e. golden or silver shake hand) it is not taxable because it is payment for the cessation of employment.

In Tanzania compensation paid on redundancy or on any other termination from employment is taxable as profit and gains of employment. These are taxable under Section 7 (2) (e) of the Income Tax Act, 2008.

v) Deduction of Tax from emoluments

In Tanzania the law requires that tax from employment income to be deducted at the source through the operation of the Pay As You Earn (PAYE) scheme. The guiding principles for withholding the tax at the source are provided for under section 81 and 82 of the Income Tax Act, 2008.

This provides in part that "a resident employer who makes a payment that is to be included in calculating the chargeable income of an employee from the employment shall withhold income tax from the payment at the rate provided for in paragraph 4(a) of the First Schedule".

From the wording of the law it is the obligation of every employer to deduct income tax at the source from all the employees regardless of their numbers, breach of which will attract penalties.

Furthermore, according to section 82; where a resident person pays a dividend, interest, natural resource payment, rent, royalty or, where the person is an approved retirement fund, a retirement payment to another person. The payment has a source in the United Republic and is not subject to withholding under section 81, the person shall withhold income tax from the payment at the rate provided for in paragraph 4(b) of the First Schedule.

The above sections imply that tax should be withheld from all the incomes that a person gets and has a source from the United Republic of Tanzania. The employer or any other withholding agent need not be told to do so. It is an obligation imposed by the law.

In the wording of section 84 of the Income Tax Act, 2008 the employer or the withholding agent is duty bound, within seven days after the end of each calendar month shall pay to the Commissioner any income tax that has been withheld during the month.

Furthermore, the employer or the withholding agent shall file with the Commissioner within 30 days after the end of each six-month calendar period, a statement in the manner and form prescribed showing payments made by an agent, the name and address of the withholdee and income tax withheld from each payment.

6.4 Summary

In this chapter we have seen that the question whether a person is employed or self-employed and whether the source of income is employment or business is very essential in determining tax liability.

The main reason is that in employer/employee relationship, the employer must withhold tax at the source from the employment income in trust for the crown. While the self-employed persons are not taxed at source, but are required to file returns of income and pay their taxes to a different procedure.

On the other hand, we saw that there are some tests used in the characterization of income under common law, which include control test, specific result test, integration test and economic reality test. We also saw that tax from employment income is done at the source through PAYE scheme.

6.5 Review Questions

1. Critically explain the tests used in characterization of income under common law.
2. Mention and explain clearly, what is included in employment income for income tax purpose.
3. Explain the procedures stipulated by the law for deduction of tax from emoluments.

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CHAPTER SEVEN

TAXATION OF INCOME FROM BUSINESS

7.0 Introduction

In this chapter, we shall focus on the income from property and business and proceed further to explore what is included in the income from property and business for income tax purposes.

The aim is being able to familiarize students with specific kinds of property income that is taxed and income from business that is liable to taxation under Income Tax Law.

7.1 Objectives

At the end of this chapter students should have: -

- Learnt basic knowledge on what is included in the income from business.
- Acquainted with understanding on what comprise income from business.
- Accustomed with the ability to explain distinctions between capital receipts and revenue receipts.

- Familiarised with the skills of describing the principles used in determining whether expenditure has been incurred wholly and exclusively for producing income.

7.2 Income from Business

According to section 8 of the Income Tax Act, 2008[97] income from business include gains and profits from a business. The Act imposes income tax from profits and gains of a business in a year of income.

Moreover, tax is imposed on residents' person income in the year of income irrespective of the source of the income, but a non-resident person is liable to income tax income only for that part of his income that has a source in Tanzania[98].

However, the Act[99] does not define what conducting a business means but it includes the following in calculating income from a business, these are service fees, incomings for trading stock, gains from the realization of business assets or liabilities of the business. In addition, assets of the business, amounts derived as consideration for accepting a restriction on the capacity to conduct the business and gifts.

[97] CAP 332 RE 2008
[98] Section 6 of the Income Tax Act, 2008
[99] Ibid

Other ex gratia payments received by the person in respect of the business; amounts derived that are effectively connected with the business and that would otherwise be included in calculating the person's income from an investment; and other amounts required to be included under the provisions of the Act[100].

Nevertheless, some incomes will be excluded in calculating the persons' income from conducting a business. These includes exempt amounts and final withholding payments; and amounts that are included in calculating the person's income from any employment.

7.2.1 Gains or Profits from a Business

It is a vital rule in taxation that in taxing income from business demarcating line should be drawn between gains or profits of a business income and those of capital nature.

This was clearly stated in **Henriksen v Grafton Hotel Ltd[101],** where it was held that it frequently happens in income tax cases that the same result in a business sense can be secured by two different legal transactions, one of which may attract tax and the other not. The above

[100] ITA, CAPM332 RE 2008
[101] (1942) 1 A. E. R. 678 at 682

advocates that it is important to differentiate profits or gains of a business and those earnings that are capital in nature.

A typical example is profits arising from the disposition of a property. This may constitute income if that disposition arises in the course of business. However, it may not constitute income if the disposition arises not in the course of business.

Moreover, many incomes may be treated as income gained or capital earnings depending on the circumstances. Incomes such as payments of damages, premiums of loans, premiums for granting leases, government subsidy payments and proceeds of expropriation of property may be treated as gains of an income or of capital nature depending on the circumstances.

However, in many cases difficulties have arisen in determining whether a certain gain in that particular case constitutes gains of income or is of a capital nature.

To solve this problem different test has been developed by the court in order to distinguish between ordinary income and capital gains. These tests are known as badges of trade.

7.3 Badges of Trade

This is a collection of principles established by case law to determine whether a person is trading. If so, he or she is taxed under different rules from non-traders.

The case law now lists nine badges of trade, which are profit-seeking motive, the number of transactions, the nature of the asset, existence of similar trading transactions or interests, changes to the asset, the way the sale was carried out, the source of finance, interval of time between purchase and sale, method of acquisition. These are going to be discussed below:

i) Profit seeking motive

It is clear that having an intention to make a profit can indicate a trading activity; however, by itself it is not enough. This was clearly shown in ***Salt v Chamberlain***[102], where a research consultant made a loss on the Stock Exchange after trying to forecast the market. The loss was made after several years and over 200 transactions. This was not seen as trade and capital in nature.

[102] Ch D 1979, 53 TC 143

It was concluded that share trading by a private individual can never have the badges of trade pinned to them. These transactions are subject to capital gains tax.

Moreover in another case of ***Rutledge v CIR***[103], the taxpayer was on a business trip to Germany. He purchased one million toilet rolls. On returning to the UK the sole consignment of toilet rolls was sold to one individual for a profit. The profit made on this large quantity single purchase and resale item was 'an adventure in the nature of trade'. The case was decided on the fact that the purchase was not made for own use or investment purposes.

ii) The number of transactions

A single transaction can amount to a trading activity; moreover, it is more indicative if there are repeated and systematic transactions. This was clearly displayed in the case ***Pickford v Quirke*** [104]– CA 1927, 13 TC 251. A syndicate purchased a cotton-spinning mill with the intension of using it in a trade; however, on purchase of the mill, it was in a worse state than first anticipated.

[103] CS 1929, 14 TC, 490
[104] CA 1927, 13TC 251

The syndicate then decided to strip the mill of its assets and sell it piecemeal, making a profit. This was repeated a number of times with a number of mills. Due to the repeated nature of the transactions it was held that the profits were trading profits and taxable as such.

iii) The nature of the asset

This principle looks at the asset, but problems arise when assets are bought either as an investment that has the ability to generate income, personal assets or some assets used by a trade such as plant and machinery.

An important case in this area was ***Marson v Morton***[105]***,*** where land was purchased with the intension to hold it as an investment. No income was generated by the land, however, it did have planning permission. The land was sold later following an unsolicited offer.

It was held that the transaction was far removed from the taxpayer's normal activity (potato merchant) and was similar to an investment, and hence it was not a trading profit. The transaction was not an adventure in the nature of a trade.

However, in ***Wisdom v Chamberlain*** the court looked at the principle 'pride of possession' assets that generate no income. A taxpayer purchased

105 [1986] 1 WLR 1343

two large quantities of silver bullion to counter the effects of the devaluation of the pound. The purchase was made following advice and was partly financed by loan.

It was held that as the purchase was done on a short term basis in order to realize profit. There was an adventure in the nature of trade and was therefore assessed as trading profit.

iv) Existence of similar trading transactions or interests

This is best demonstrated in the case ***CIR v Fraser***[106], where the taxpayer was a woodcutter who bought a consignment of whisky in bond. He subsequently sold the whisky through an agent at a profit. Within the decision the judge stated

> *"the purchaser of a large quantity of a commodity like whisky, greatly in excess of what could be used by himself, his family and friends, a commodity which yields no pride of possession, which cannot be turned to account except by a process of realisation, I can scarcely consider to be other than an adventurer in a transaction in the nature of a trade… Most important of all, the actual dealings of the respondent with the whisky were exactly of the kind that take place in ordinary trade."*

106 [1942] 24 TC 498

v) Changes to the asset

It is important to take note of any changes or modifications made to an asset that may make it more marketable. In the case ***Cape Brandy Syndicate v CIR***[107], where members of a wine syndicate joined in a separate syndicate to purchase brandy from South Africa.

Some was shipped to the East with the remainder being sent to London to be blended with French brandy, re-casked and sold at a profit. The taxpayer tried to argue that the transaction was of a capital nature from the sale of an investment. It was held that a trade or business was carried on and was assessable as a trading profit.

vi) The way the sale was carried out

It is a common law guidance that, it is always a pointer of trading for profit if a transaction follows the principle of an 'undisputed trade'. This was shown in the case of **CIR v Livingston and others**[108]**,** which involved three unconnected individuals who together, they bought a cargo vessel. The vessel was converted into a steam-drifter and sold for a profit.

[107][1921] 2 KB 403
[108] 11TC538

The purchase was the first vessel the three individuals bought. An assessment was raised on the profit which was upheld as a trading profit. Within the decision the judge stated:

> *"I think the test, which must be used to determine whether a venture such as we are now considering is, or is not, in the nature of "trade", is whether the operations involved in it are of the same kind, and carried on in the same way, as those which are characteristic of ordinary trading in the line of business in which the venture was made."*

vii) The source of finance

Determining the source of finance is important when deciding whether a trade is carried on or not. Finance taken out to purchase an asset, in the first instance may indicate that to repay the debt the asset would have to be sold.

This was demonstrated in the case of **Wisdom v Chamberlain**[109] where a taxpayer purchased two large quantities of silver bullion to counter the effects of the devaluation of the pound. The purchase was made following advice and was partly financed by loan, the purchase was done on a short

[109] [1969] 1WLR 275

term basis in order to realize profit. It was held that the finance taken out to purchase an asset in the first instance indicate that to repay the debt the assets have to be sold and hence a trade is carried on.

viii) Interval of time between purchase and sale

The length of time an asset is held is an important indicator of trade. The longer the period of ownership the greater the chance of it been seen as an investment rather than a trade.

The court looks at the intention, if you can demonstrate an intention it could indicate the tax treatment. This was shown in a where the taxpayer purchased a residential flat in the course of construction.

Shortly afterwards the taxpayer sold the flat at a profit. The taxpayer submitted that the flat had been purchased with a view to being a long term investment for rental purposes.

It was held that the length of the period of ownership was short and without convincing evidence of the reasons for an early sale is indicative of trading. The evidence given to the Board was not sufficient to discharge the onus of proof and accordingly the appeal was dismissed[110].

[110] Inland Revenue Board Review Decisions- Case No D 31/ 95

ix) Method of acquisition

Finally, it is important to look at how an asset is acquired. If it is inherited or gifted it is a good indication that a trade is not being carried, although this is not always the case.

An asset acquire at a market could indicate that it has either been purchased for a trade or an investment, so each case should be treated in its own merits.

This was depicted in **Taylor v Good**[111] where a taxpayer purchased a house with the intention of using it as a family home. The taxpayer's partner did not approve the house and refused to move in, which forced the taxpayer to sell the house immediately.

The purchaser genuinely had the intention of not buying the property for a profit motive. As the sale was a short period of time after purchase it was still not deemed to be a trade.

However, within the decision the judge stated that even if the house was purchased with no thought of trading, I do not see why an intention to trade could not be formed later.

[111] CA 1974

What is bought or otherwise acquired (for example, under a will) with no thought of trading cannot thereby acquire immunity so that, however filled with the desire and intention of trading the owner may later become, it can never be said that any transaction by him with the property constitutes trading.

For the taxpayer a non-trading inception may be a valuable asset: but it is no palladium. The proposition that an initial intention not to trade may be displaced by a subsequent intention, in the course of the ownership of the property in question, is, I think, sufficiently established.

7.4 Distinction between Capital expenditure and Revenue expenditure

From the income tax point of view, it is necessary to know the difference between capital and revenue receipts. This is because only revenue receipts are taxed according to income tax ordinance, while capital receipts are not taxed.

However, when it becomes very difficult for the assessee to differentiate the capital and revenue receipts, these are brought into the courts.

7.4.1 Capital Receipts

This refers to amount received in form of capital from the owners and a loan from outsiders. Besides cash received from selling shares, debentures

and permanent assets is also capital receipts. These are of non-recurring type or receipts. It is treated as obligation of the business. Items such as amount received from the owner as capital, amount received through the sale of shares and debentures, received from loans, from sale of old assets and other receipts of non-recurring nature are regarded as capital receipts in nature.

This was clearly depicted in ***Vallambrosa Rubber Co v Farmer***[112] where it was suggested that capital expenditure is that which is made once and for all.

The above test was expanded and qualified and gave rise to a more elaborate and often quoted rule given in ***British Insulated and Helsby Cables v Atherton***[113].

It was stated that an expenditure that is made not only once and for all but with a view to bring into existence an asset or an advantage for the enduring benefit of trade it is to be treated as capital in nature.

7.4.2 Revenue Receipts

This is an amount, which is received from the regular transaction of business. It is the amount received from the sale of goods and services. It

[112] 5 TC 529
[113] 10 TC 155

is the main source of income. Items such as those received from the sale of goods and services, received in a way of discount, commissions, rent, interest, dividends and amount received from the sale of waste paper and packing cases are regarded as revenue receipts.

This is also supported by the case of **Vallambrosa Rubber Co. v Farmer**[114] where it was stated that revenue expenditure will recur year by year.

7.5 Summary

In this chapter, we have seen that income from business includes gains and profits from a business. The ITA imposes income tax from profits and gains of a business in a year of income.

Moreover, tax is imposed on residents' person income in the year of income irrespective of the source of the income, but a non-resident person is liable to income tax income only for that part of his income that has a source in Tanzania.

Furthermore, many incomes may be treated as income gained or capital earnings depending on the circumstances. Incomes such as payments of damages, premiums of loans, premiums for

[114] Supra

granting leases, government subsidy payments and proceeds of expropriation of property may be treated as gains of an income or of capital nature depending on the circumstances.

The case laws list various badges of trade which are profit seeking motive, the number of transactions, the nature of the asset, existence of similar trading transactions or interests, changes to the asset, the way the sale was carried out, the source of finance, interval of time between purchase and sale, method of acquisition.

These badges are there to determine whether the person is conducting business or not for calculating income tax.

From the income tax point of view, it is necessary to know the difference between capital and revenue receipts. This is because only revenue receipts are taxed according to income tax ordinance, while capital receipts are not taxed. Capital receipts are amounts received in form of capital from the owners and a loan from outsiders.

Besides cash received from selling shares, debentures and permanent assets is also capital receipts. These are of non-

recurring type or receipts. It is treated as obligation of the business.

On the other hand, revenue receipt is an amount, which is received from the regular transaction of business. It is the amount received from the sale of goods and services. It is the main source of income. Items such as those received from the sale of goods and services, received in a way of discount, commissions, rent, interest, dividends and amount received from the sale of waste paper and packing cases are regarded as revenue receipts.

7.6 Review Questions

1. How do you define the term income from business?
2. Describe with relevant authorities the amount included when calculating the income from business for the income taxation purpose.
3. Explain with authorities the badges of trade for the purpose of income taxation in Tanzania
4. Illustrate with legal authorities the amounts excluded when calculating the income from business for the income taxation purpose.

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CHAPTER EIGHT

TAXATION OF INCOME FROM PROPERTY AND INVESTMENT

8.0 Introduction

Most of us are familiar with paying Income Tax on our earnings from employment, but do you know how your investments affect your tax-free allowance, can affect whether you pay basic rate tax and change your tax brackets?

Most types of investment income are also subject to Income Tax, such as the interest received on savings, and any money received from share dividends. Investments made for capital growth also have tax implications any gain, or profit, may also be subject to Capital Gains Tax.

Therefore, in this chapter we are going to acquaint ourselves with knowledge and understanding on the income taxation from investment and properties. We shall understand the concept of income from property and investment, rationale, purposes and amounts, which are subjected to the income tax particularly in Tanzania.

8.1 Objectives

At the end of this chapter students should have: -

- Learnt basic knowledge on what is included in the income from property.
- Acquainted with understanding on what comprise income from investment.
- Accustomed with the ability to explain distinctions between income from investment and property.
- Familiarised with the skills of describing the principles used in determining whether expenditure has been incurred wholly and exclusively for producing income from investment or property.

8.2 Income from Property and Investment

The Income Tax Act 2008 imposes taxation to any gains or profits of an individual that results from investment or property in a year of income. The word property is not defined in the Act, but it may include movable and immovable property such as buildings, furniture and land.

Moreover, it may include both tangible properties such as buildings and intangible properties like copyrights and patent rights. Under this category legal and beneficial owner alike are chargeable to income tax. In situations where the property is held in trust, the assessment is made on the trust.

Furthermore, existence of a dispute over the title of the ownership of a property does not curtail assessment, even if he suits has been filed to court.

This implies that the recipient is taxable although there is a rival claim to the source of the income, and may someday have to give up the income and account for what is taxed upon[115].

Section 9 of the Income Tax Act, 2008 describes gains and profits from property to include dividend, distribution of a trust, and gains of an insured from life insurance, interest of an unapproved retirement fund, royalty, rent, interest, and natural resource payment.

It also includes amounts received from the realization of investment asset and amounts received as consideration for accepting restriction on the capacity to conduct the investment. These types of property income are going to be discussed below.

8.2.1 Types of property Income

i) Royalties

At common law royalties are defined as usage based payment, paid to the owner of the property. The property may be patents, copyrighted works or

[115] See Franklin v I.R. 15 TC 464

franchises. These are payments made by those who wish to make use of the property for the purpose of generating income or any other desirable activities[116].

It was also defined in ***CIR v Longman's Co[117],*** where it was held that annual payments to an author and holder of a copyright are royalties. Moreover, it should be remembered that to constitute royalty, payments need not be periodical.

This was stated in ***Constantines Co v King[118]***, where it was held that a lump sum award for patent use of an invention is a royalty and hence taxable.

The term royalty is also statutorily defined to mean any payment made by the lessee under a lease of an intangible asset and includes payments for the use of, or the right to use, a copyright, patent, design,model, plan, secret formula or process or trademark, the supply of know-how including information concerning industrial, commercial or scientific equipment or experience, the use of, or right to use, a cinematography film, videotape,sound recording or any other like medium, the use of, or right

[116] McCanley v FTC, [1944] 69 CLR 235
[117] 17 TC 272
[118] (1927) 43 TLR 727

to use, industrial, commercial or scientific equipment, or a total or partial forbearance with respect to a the rights mentioned above[119].

Royalties are taxable under section 9 (2)(a), but it is important to distingish between annual payments for the right of use which may be capital and annual payments for actual use which consitute royality income. This is because the former in not taxable.

This was clearly depicted in ***IRC v British Salmon Aero Engines[120]***, where the owner of aero engines patent granted an exclusive right to manufacture the same to amanufacturer.

Consideration payable in part by lumpsum money paid in three instalments, the other party in annual royalties. It was held that the lumpsum was a capital sum and royalties income.

ii) Annuities

Annuity is defined as an annual sum payable for a term of years, for life or in perpetuity and amounts to an income in the hands of the receiver.

[119] Section 9 of the Income Tax Act, 2008
[120] (1938) 2 KB 482

This was clearly shown in ***Williamson v Ough***[121] where a testator by will left an annuity to his wife for life and authorized trustees during the life of his wife to make advance payments out of the income or capital of the trust fund.

It was held that even where the payments were made from capital under this power in the hands of the recipient the amount is chargeable to tax as annuity.

However, it is important to note that not every annual payment is an annuity. Some annual payment may be deferred payments of a principle or income the right to which has been purchased by expend of capital.

These types of annual payments for a disposed capital are not annuities. Similarly, annual installments of the purchase price for the transfer of land payable over a period of time do not qualify to be taxed as annuities.

This was clearly depicted in Secretary of ***State for India v Scobble***[122] where the appellant purchased railway company shares with option to pay full value or a gross sum in the form of an annuity for a term of years.

[121] (1936) AC 384
[122] (1903) Ac 299

It was held that since the purchase was of shares and capital of the railway company the annual payments were capital payments and hence not taxable. So each case should be looked at on its own merits and circumstances.

iii) Interest

The definition of interest has been the subject of much judicial interpretation over the years. In **Westminster Bank Ltd v. Riches** [123] Lord Wright observed that:

> *"...the essence of interest is that it is a payment which becomes due because the creditor has not had his money at the due date. It may be regarded either as representing the profit he might have made if he had had the use of the money, or, conversely the loss he suffered because he had not had that use. The general idea is that he is entitled to compensation for the deprivation."*

In simple words interest is defined as an income earned on deposits at banks and credit unions, on money market funds, on bonds, on loans such as seller financial mortgages.

[123] 28TC159

Interest is taxed as ordinary income subject to the ordinary income tax rates. Interest is chargeable to tax under section 9(2)(a) of the Income Tax Act, 2008, where the Act accommodates interest from unapproved retirement fund as well as interest in general as part of income from investment and hence subject to taxation. Interest becomes taxable when actually paid.

i) Dividends

Dividends are a type of investment income generated from stocks and mutual funds containing stocks. Dividends represent a share of corporate profits paid out to investors. So it is an income from property. Dividends[124] are taxed when paid out.

It is chargeable to tax through section 9 (2)(a) of the Income Tax, 2008. The act imposes income tax to any type of dividend that accrues to the tax payer.

ii) Rent, Retirement payment, Natural resource payment and other incomes on lease.

[124] A dividend is a part of the company's profits that is given to shareholders – the dividend is calculated per share, so the more shares you own, the more money you get

Rent, retirement payment, natural resource payment and other incomes derived as consideration for accepting a restriction on the capacity to conduct the investment are regarded by the Act as part of the income from investment and hence subject to income tax.

These are covered by the Income Tax Act, 2008 under section 9 (2)(a)(c). In **Green v Favorite Cinemas**[125] it was stated that rent payable on a lease for occupation of premises is income in the hands of the recipient and hence subject to taxation.

Furthermore, in **AL v CIT**[126] there was a lease. Consideration was paid in the form of a premium and monthly rent was paid. It was held that the consideration in form of premium was taxable as it was received in respect to the use of an asset and not from realization of it.

8.3 Exemption of Income from Taxation in Tanzania

The Income Tax Act, 2008 provides for exemption of some income accrued or derived from sources in Tanzania to be exempted from taxation. This is provided for in section 10, which provides that

> *"The Minister may, by order in the Gazette, provide that any income or class of incomes accrued in or derived from the United Republic*

[125] 15 TC 390
[126] 2 EATC 148

shall be exempt from tax to the extent specified in such order; or that any exemption under the Second Schedule shall cease to have effect either generally or to such extent as may be specified in such order".

From the above provision, the exemption is in the discretion of the Minister. This implies that the Minister can grant or allow an exemption that is not provided for in the Act. Also under his discretion, he may also vary, amend or replace the second schedule.

However, the Act also under section 10(3) provides a restriction to the discretion of the Minister that in exercising the power granted by the Act that no exemption should be allowed that purports to affect the application of the Income Tax Act.

8.4 Summary

In this chapter, we have seen that most types of investment and property income are also subject to Income Tax, such as the interest received on savings, and any money received from share dividends.

Investments made for capital growth also have tax implications any gain, or profit, may also be subject to Capital Gains Tax. The

Income Tax Act 2008 imposes taxation to any gains or profits of an individual that results from investment or property in a year of income.

The word property is not defined in the Act, but it may include movable and immovable property such as buildings, furniture and land.

Section 9 of the Income Tax Act, 2008 describes gains and profits from property to include dividend, distribution of a trust, and gains of an insured from life insurance, interest of an unapproved retirement fund, royalty, rent, interest, and natural resource payment.

It also includes amounts received from the realization of investment asset and amounts received as consideration for accepting restriction on the capacity to conduct the investment.

8.5 Review Questions

1. How do you define the term income from property and investment?

2. Describe with relevant authorities the amount included when calculating the income from property or investment for the income taxation purpose.
3. Illustrate with legal authorities the amounts excluded when calculating the income from property or investment for the income taxation purpose.

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CHAPTER NINE

TAX EXEMPTIONS IN TANZANIA

9.0 Introduction

The Government aims for a tax system, which is broad, based with as few exemptions as possible. However, exemptions are granted for a variety of reasons, such as to adhere to international norms for those with diplomatic status, to remove tax burden from donor funded projects, to respect Government commitments in legal agreements, and to implement certain policies such as support for NGOs or for certain economic sectors.

Therefore, in this chapter we are going to learn about tax exemptions. We shall understand the nature, rationale behind tax exemptions in Tanzania. We shall also know the beneficiaries of tax exemptions according to the tax laws of Tanzania. Moreover, we shall be acquainting ourselves with the skills for analysing the laws related to the tax exemptions in Tanzania.

9.1 Objectives

At the end of this chapter students should have: -

- Learnt basic knowledge on the concept tax exemption and reasons behind tax exemptions.

- Acquainted with understanding on beneficiaries of tax exemption according to Tanzania tax laws.
- Accustomed with the ability to describe criteria applicable to determine whether the tax exemptions are justifiable or not.
- Familiarised with the skills of describing the various exemptions under Income tax Act, CAP 332 RE 2008.

9.2 Tax Exemptions

Tax exemptions are incomes that are excluded from the tax base[127]. For example, capital gains that are not subject to income tax would be considered as a tax exemption. Here, the exemption applies to a specific income such as capital gains, but tax exemptions can also be granted to individuals.

In the common language, the expression "tax exemptions" is often used as a substitute for "tax expenditures", which is in fact a broader concept since it includes tax exemptions and other types of tax expenditures[128].

Tax exemptions are privileges permissible by law. It means that before exemptions can be granted or claimed a law is needed to identify which

[127] Based on Organisation for Economic Co-operation and Development (OECD), "Tax Expenditures in OECD Countries", OECD, 2010, page 12 and Government of Quebec, "Tax Expenditures - 2010 Edition", 2011, pp. 9-11

[128] Tax Justice Network-Africa & ActionAid International, "Tax Incentives and Revenue Losses in Tanzania", June 2012, p. 20

categories of individuals, organizations or products are exempts from taxes. Once in place, these privileges are hard to revoke as the beneficiaries are likely to lobby for their continuity[129].

9.3 Criteria for fair and good tax exemptions

There are five criteria to help determine whether it is advisable for a given exemption to remain in the legislation, be amended or be removed. These criteria justify the existence of the tax exemptions if at all the tax exemptions comply with them.

9.3.1 Consistency

The intended and real effect of an exemption has to be consistent with the government's public policy commitments and objectives. In other words, the exemption is nothing but a tool that contributes to achieving a government's policy or priority.

An exemption found in a law that contradicts another law or exemption, or that constitutes duplication (double exemption), should be amended or removed from the legislation.

[129] Maliyamkono T, Mason H., Ndunguru, A., Osoro N. E., & Ryder, A., (2009). Why Pay Tax? Dar es Salaam, Tema Publishers and Siyaya Publishing (Pty) Ltd

9.3.2 Simplicity

An exemption has to be "manageable", i.e., TRA can access to and develop indicators/data to assess its costs (revenue foregone), identify its beneficiaries, monitor its compliance and sue abusers. For the eligible taxpayer, the exemption has to be reasonably easy to understand, comply to and benefit from.

9.3.3 Transparency

Given that revenue forgone with an exemption is tantamount to a fiscal spending (i.e., it is about usage of taxpayer's money), the exemption has to be included in a law that is approved by the Tanzanian Parliament or by the EAC Council of Ministers.

The exemption's policy objective is clearly defined and its cost assessed. Ultimately, information about the exemption is reported periodically in a government publication.

9.3.4 Fairness

The exemption has to serve public policy objectives and commitments for which the government has been elected. It should not be perceived a "privilege" granted on an arbitrary or discretionary basis. In addition, the exemption should not give an advantage to a few that compete against others in a same sector of activities.

9.3.5 Efficiency

The exemption does not create undesirable or unnecessary distortion in the economy, nor does it induce inefficiencies that alter the country's productivity or economic performance. The cost of an exemption has to be reasonable compared to the expected and real benefits to the country as a whole.

In addition, the exemption is not defined, nor is it administered, in such a way that it encourages underground economy, tax evasion or other forms of abuse from taxpayers or members of the public service.

9.4 Overview of tax exemptions in Tanzania

Tax exemptions do not receive the same attention in the Parliament, effectively making them hidden expenditures. Tax exemptions involve very large sums of money. [130]

In 2009/10 alone, 2.3 per cent of GDP or TZS 695 billion was granted in tax exemptions. The sheer size of the amount involved raises questions about the purpose, these incentives serve and whether the amounts spent on them are justified.[131]

9.5 Reasons for tax exemptions in Tanzania

[130] Policy Forum (2009), How Much Revenue Are We Losing? Issue brief no. 3.09. Accessed in 30th August 2016 from http://www.policyforum-tz.org/files/Howmuchrevenuearewelosing.pdf
[131] Tanzania Revenue Authority (TRA), revenue reports 1997/98-2009/10

Tax exemptions are granted for a variety of reasons. In Tanzania, exemptions may be given for the following reasons: -

The main reason mentioned by governments of developing countries to grant tax exemptions is the need to attract investment, and often foreign direct investment (FDI).[132]

The idea is to have the country and its population benefit from social and economic returns that are expected to be higher than the cost incurred to attract these investments.[133]

Tax exemptions are granted where the foreign or official nature of the item in question doesn't warrant a tax for example, consumption on internationally bound aircraft or goods consumed by the armed forces and diplomatic missions[134].

Also, where activities of certain organizations do not earn them a profit but have a direct benefit to society which the Government may not be able to otherwise procure.[135] This basis is used to grant exemptions to charities including religious organizations.

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[132] Uwazi, "Tanzania's Tax Exemptions: Are they too high and making us too dependent on foreign aid?", Policy brief TZ.12/2010E, October 2010, page 2.
[133] World Bank Group, "Investor Motivation Survey Results: Tanzania", Tax Incentives Study in the East African Community Member (EAC) States, Presentation by Global Tax Team, CIC, IFC, Washington.
[134] Australia, Department of Treasury "International Comparison of Australia's Taxes", Chapter 14: Tax Expenditures, 2006, page 24
[135] See Mieszkowski 1969; Break 1974; McLure 1975; Kotlikoff and Summers 1987; Atkinson 1994; Fullerton and Metcalf 2002, Dixon and Jorgenson (2013) among others

Moreover, tax exemptions are granted where consumption of certain goods are deemed to have direct benefit to society[136]. For example, certain human and veterinary medicines are exempt from VAT, as are fire fighting vehicles. Exempting such goods from taxes increases their consumption, which in return brings greater benefits due to their positive effects on society.

Another reason exemption is granted is to stimulate economic growth. These exemptions should normally lead to increased investment, employment, output growth and thus lead to more tax revenues in the long run.

Groups of companies granted wide-ranging exemptions such as favourable corporation taxes on profits and reduced import duties fall under this category.[137]

Most notable among these are companies established under the Export Processing Zones Authority (EPZA) Act, mining companies and other companies which hold certificates of incentives from TIC and ZIPA.

9.6 Beneficiaries of tax exemptions

[136] Delorme, François, "A Pragmatic Roadmap of Empirical Methods to Quantify Tax Incentives", August 2013

[137] IMF, "A Partial Race to the Bottom: Corporate Tax Developments in Emerging and Developing Economies", IMF Working Paper No. WP/12/28, January 2012

TRA revenue reports show that a wide range of items and organizations are tax exempt. Three groups gain most of the exemptions. These are companies with certificates of incentives provided under the Tanzanian Investment Act and Zanzibar Investment Promotion Act[138], recipients of Value Added Tax exemptions[139] and mining companies under the Mining Act[140].

At the bottom of the list of beneficiaries are purchases made at duty free shops and import related exemptions granted to religious institutions.[141] Most of the exemptions granted through the investment promotion agencies, as well as those granted to mining companies accrue to multinational companies.

9.7 Challenges of tax exemptions benefits assessment

Tax exemptions are granted upon assessment and evaluation of the benefits that can occur after the grant of such tax exemptions. These benefits are the ones, which justify the tax exemptions. If the assessment

138 AllAfrica.com, 25 March 2010. "Tanzania: Investors in Dar Transport to Enjoy Tax Exemptions." Accessed 4th October 2016 from http://allafrica.com/stories/201003250228.htm
139 AllAfrica.com, 27 November 2009. "Tanzania: Tax Waivers Set to Eat Up Sh3 Trillion." Accessed on 3rd October 2016 2016 from http://allafrica.com/stories/200911270656.html
140 The Citizen, 4 July 2010. "Investor Dispels Fears about Mining Law." Accessed in 4th october 2016 from http://thecitizen.co.tz/sunday-citizen/41-sunday-citizen-business/2797-investor-dispelsfears-about-mining-law.html
141 World Bank Group – Private sector and Infrastructure Network: "Using Tax Incentives to Attract Foreign Direct Investment", in Public Policy for the Private Sector, Note number 253, February 2003

is encountered with challenges, then the justification of exemption becomes vain.

First and foremost, it is very difficult to determine which economic agents have really changed their behaviour as a result of a particular tax incentive for instance, which investors would have invested in the first place even if a given tax incentive had not been in place.[142]

Moreover, the exact scope of benefits from tax exemptions is almost impossible to determine since direct and indirect benefits are very numerous.[143]

Direct and indirect benefits are also very difficult to quantify, as rigorous assessment of benefits would require a significant amount of data and the use of sophisticated analytical tools which capture the complexity of direct and indirect effects as well as the different possible economic interactions.[144]

Therefore, the results from such assessments are also highly dependent on a number of key assumptions and parameters for which the empirical

[142] IMF, OECD, UN and World Bank, "Supporting the Development of More Effective Tax Systems", Report to the G-20 Development Working Group, 2011, page 24.
[143] IMF, "Kenya, Uganda and United Republic of Tanzania: Selected Issues", 1 December 2008, pages 10-11
[144] Mwachinga, Edward, Mikra Krasniqi, and Sebastian James, "Tax Incentives in the EAC Member States", Presentation to the EABC Conference, Dar Es Salaam, Investment Climate Advisory Services, November 11-12, 2011.

literature is hardly ever converging, such that results may be highly arbitrary.[145]

9.8 Exemptions under Income Tax Act[146]

Under income taxation, there various amounts, which are exempted from, tax imposition in Tanzania. These are exemptions are granted by the law itself. They are enshrined in the Second Schedule to the ITA. They are explained hereunder: -

9.8.1 Exemptions to elected officials

Salaries, duty and entertainment allowance payable to the president of the United republic of Tanzania and President of Revolutionary Government of Zanzibar are exempted from the income taxation in Tanzania.[147]

However to suffice their exemption, such payments payable to the president must come from public funds in respect of or by virtue of the office as President.[148]

In addition, gratuity granted to a Member of Parliament at the end of each term is exempted from income taxation.[149]

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[145] Organisation for Economic Co-operation and Development (OECD), "Tax Expenditures in OECD Countries", OECD, 2010, page 14
[146] Cap 332 RE 2002
[147] Item 1 (a) of 2nd Schedule to ITA, CAP 332 RE 2008
[148] Ibid
[149] Item 1 (s), ibid

Current exemptions can be perceived as a "favour" that ordinary people cannot benefit from. Pay adjustments could fully or partially offset the effect on officials' disposable income, but it is important to note that any adjustment could affect the public perception of such a decision. No or limited adjustment would be seen as a strong symbolic move towards a modern tax exemptions reform.

9.8.2 Exemptions on income derived from various sources

Amounts derived from the East Africa Development Bank, the Price Stabilization and Agricultural Inputs Trust, the Investor Compensation Fund under the Capital Markets Regulatory Authority and The Bank of Tanzania are exempted from income taxation in Tanzania.[150]

The ITA should be applicable to a tax based that is as large as possible, and refrain from granting exemptions on specific sources of income with no clear policy objective that serve the nation. In general, such a type of exemptions leads to resource allocation inefficiencies and amper the fairness of the tax system.

[150] Item 1 (f), ibid

9.8.3 Exemptions on war caused injuries pensions or gratuity

Pensions or gratuities granted in respect of wounds or disabilities caused in war and suffered by the recipients of such pensions or gratuities.[151]

9.8.4 Exemptions on diplomatic and government officers

Amounts derived by any person entitled to privileges under the Diplomatic and Consular Immunities and Privileges Act to the extent provided in Act or in regulations made under that Act[152] and amounts derived by way of foreign living allowance by any officer of the Government that are paid from public funds and in respect of performance of the office overseas[153].

9.8.5 Exemptions on non-residents

Amounts earned by non-residents on deposits in Banks registered by the Bank of Tanzania and rental charges on aircraft lease paid to a non-resident by a person engaged in air transport business are exempted from income taxation in Tanzania.[154]

9.8.6 Exemptions on agricultural related societies

Amounts derived by a crop fund established by farmers under a registered farmers' cooperative society, union or association for financing crop

[151] Item 1 (h), ibid
[152] Item 1 (c) and (e), ibid
[153] Item 1 (m), ibid
[154] Item 1 (n) and (q), ibid

procurement from its members and amounts derived by a crop fund established by farmers under a registered farmers' cooperative society, union or association for financing crop procurement from its members.[155]

9.8.7 Exemptions on assets realisation

Amounts derived in respect of an asset that is not a business asset, depreciable asset, investment asset or trading stock[156] and amounts derived from gains on realization of asset by a unit holder on redemption of a unit by a unit trust[157]

9.8.8 Other exemptions

A scholarship or education grant payable in respect of tuition or fees for full-time instruction at an educational institution[158]; amounts derived by way of alimony, maintenance or child support under a judicial order or written agreement.[159]

9.9 Summary

In this chapter, we have seen that tax exemption refers to a monetary exemption, which reduces taxable income. Tax-exempt status can provide complete relief from taxes, reduced

[155] Item 1 (r), ibid
[156] Item 1 (l), ibid
[157] Item 1 (u), ibid
[158] Item 1 (i), ibid
[159] Item 1 (j), ibid

rates, or tax on only a portion of items. Examples include exemption of charitable organizations from property taxes and income taxes, veterans, and certain cross-border or multi-jurisdictional scenarios.

Tax exemption generally refers to a statutory exception to a general rule rather than the mere absence of taxation in particular circumstances, otherwise known as exclusion. Tax exemption also refers to removal from taxation of a particular item rather than a deduction.

However, exemptions are granted for a variety of reasons, such as to adhere to international norms for those with diplomatic status, to remove tax burden from donor funded projects, to respect Government commitments in legal agreements, and to implement certain policies such as support for NGOs or for certain economic sectors.

The intended and real effect of an exemption has to be consistent with the government's public policy commitments and objectives. It is very difficult to determine which economic agents have really changed their behaviour as a result of a particular tax exemption for instance, which investors would

have invested in the first place even if a given tax incentive had not been in place.

These are exemptions are granted by the law itself. They are enshrined in the Second Schedule to the ITA, CAP 332 RE 2008. Some of them are exemptions to elected officials such as presidents and member of parliaments, exemptions to farming cooperative societies, investment companies, to mention but a few.

9.10 Review Questions

1. What is tax exemption? Critically explain the relevance of tax exemption in Tanzania
2. Describe the exemptions of taxes according to the income tax Act, Cap 332 RE 2008.
3. Discuss the assessment criteria of tax exemptions benefits, which justify the tax exemptions.

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CHAPTER TEN

TAX DEDUCTIONS IN TANZANIA

10.0 Introduction

Tax deduction is a reduction of income that can be taxed, and is commonly a result of expenses, particularly those incurred to produce additional income. The difference between deductions, exemptions and credit is that deductions and exemptions both reduce taxable income, while credits reduce tax.

Therefore, in this chapter we are going to learn the concept of tax deductions, reasons for the tax deductions. In addition, this chapter is vital because it will acquaint students with the understanding on the general principles regarding to the tax deductions in the Tanzania's context. Moreover, the chapter shall equip the students with knowledge of what amounts are subject to deductions according to the income tax laws in Tanzania.

10.1 Objectives

At the end of this chapter students should have: -

- Acquired knowledge and understanding of the basic concepts of tax deductions, expenditure and losses of income

- Acquainted with knowledge and understanding on purposes and reasons for the tax deductions**.**
- Developed ability to explain the general principles governing the tax deductions in Tanzania.
- Acquired competency to illustrate the amounts, which can be deducted according to the income tax laws of Tanzania.

10.2 Tax Deductions

Tax deductions are amounts that reduce taxable income.[160] A tax deduction is a reduction in tax obligation from a taxpayer's gross income. Tax deductions can be the result of a variety of events that the taxpayer experiences over the course of the year.[161] Tax deductions are removed from taxable income. They are known as the adjusted gross income. Thus, they lower the taxpayer's overall tax liability.

An example of deductions can be expenditures made to earn an investment income and which can be subtracted from this income. Other common deductions are investment losses that can be applied against gains to reduce the total amount of taxable income.

10.3 Purpose of tax deductions

[160] Hoffman, W., *et al.*: Individual Income Taxes, Annual editions, 2011
[161] Piper, M., Taxes Made Simple: Income Taxes Explained in 100 Pages or Less. Simple Subjects, LLC, (Sep 12, 2014).

The purpose of tax deductions is to decrease taxable income, thus decreasing the amount of tax a person owes to the government.[162] There are hundreds of ways to use deductions to reduce taxable income, but many people don't know about them or know how to take advantage of them.

Tax deductions can be used to allocate resources to ventures or geographic areas that are considered underdeveloped.[163] For example, by offering liberal expense deductions in respect of agricultural and mining businesses, investors may be attracted to invest in such enterprises

10.4 General principle of tax deductions

According to section 11 (1) of the ITA[164] for the purposes of calculating a person's income no deduction shall be allowed for consumption expenditure incurred by the person or excluded expenditure incurred by the person otherwise, except as provided for by the law governing income tax.

[162] http://money.howstuffworks.com/personal-finance/personal-income-taxes/tax-deductions.htm. Accessed on 4th October 2016

[163] Makinyika, L.F.D. A. A Sourcebook of Income Tax Law in Tanzania, Dar Es Salaam, DUP (1996) LTD, 2000, at page 18

[164] CAP 332 RE 2008

The law defines consumption expenditure as any expenditure incurred by any person in the maintenance of himself, his family or establishment, or for any other personal or domestic purpose.[165]

However, tax deductions are on expenditure basis as provided under section 11 (2) of ITA[166] for calculating a person's income for a year of income from any business or investment, there shall be deducted all expenditure incurred during the year of income, by the person wholly and exclusively in the production of income from the business or investment.

Nevertheless, the expenditure subjected to deductions under income tax must not be of capital nature.[167] Expenditure of a capital nature means expenditure that secures a benefit lasting longer than twelve months or incurred in respect of natural resource prospecting, exploration and development.[168]

10.5 Income tax deductions in Tanzania

There are various amounts, which are subjected to tax deductions in Tanzania for various purposes. The law regulates these. They are described hereunder as follows: -

[165] Section 11(4), ibid
[166] CAP 332 RE 2008
[167] section 11 (3), Ibid
[168] section 11 (4), Ibid

10.5.1 Interests deduction

An interest incurred during production or investment shall be treated as deductible amount if where the debt obligation was incurred in borrowing money, the money is employed during the year of income or was used to acquire an asset that is employed during the year of income wholly and exclusively in the production of income from the business or investment.[169]

In addition, the same interest subject to deduction under income tax when in any other case, the debt obligation was incurred wholly and exclusively in the production of income from the business or investment.[170]

Notwithstanding, the total amount of interest that an exempt-controlled resident entity[171] may deduct for a year of income shall not exceed the sum of all interest derived by the entity during the year of income. That is to be included in calculating the entity's total income for the year of income plus 70 per cent of the entity's total income for the year of income calculated without including any interest derived or deducting any interest incurred by the entity.[172]

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169 Section 12 (1) (a), ibid
170 Section 12 (1) (b), ibid
171 An entity is an exempt-controlled resident entity for a year of income if it is resident and at any time during the year of income 25 per cent or more of the underlying ownership of the entity is held by entities exempt under the Second Schedule, approved retirement funds, charitable organisations, non-resident persons or associates of such entities or persons.
172 Section 12 (2), op-cit

10.5.2 Tax Deductions on Trading Stock

Business allowance of the trading stock shall be deducted for the purposes of calculating a person's income for a year of income from any business.[173]

However such business allowance shall be calculated as the opening value of trading stock of the business for the year of income[174] plus expenditure incurred by the person during the year of income that is included in the cost of trading stock of the business less the closing value of trading stock of the business for the year of income[175].

10.5.3 Tax deductions of repair and maintenance expenditure

The income tax Act allows the deductions of the expenditure incurred by the person for the repair and maintenance during the year of income. It is provided under section 14 (1) of the ITA[176] for calculating a person's income for a year of income from any business, there shall be deducted all expenditure to the extent incurred during the year of income, by the person and in respect of the repair or maintenance of depreciable assets owned

[173] Section 13, supra
[174] The opening value of trading stock of a business for a year of income shall be the closing value of trading stock of the business at the end of the previous year of income
[175] The closing value of trading stock of a business for a year of income shall be the lower of the cost of the trading stock of the business at the end of the year of income; or the market value of the trading stock of the business at the end of the year of income.
[176] CAP 332 RE 2008

and employed by the person wholly and exclusively in the production of income from the business.

Nevertheless, no deductions shall be allowed for expenditure in improving an asset, but that expenditure may be included in the cost of the asset if the requirements are met[177].

10.5.4 Agriculture improvement, research development and environmental expenditure

The law grants tax deductions on the expenditure incurred for the agricultural improvement, research development and environment. Section 15 of ITA provides that for the purposes of calculating a person's income for a year of income from any business, there shall be deducted agricultural improvement[178], research and development[179] and environmental expenditure[180] to the extent incurred by the person during the year of income in conducting the business.

[177] Requirements are provided under section 36 of ITA, CAP 332 RE 2008

[178] Agricultural improvement expenditure means expenditure incurred by the owner or occupier of farm land in conducting an agriculture, farming or fish farming business where the expenditure is incurred in clearing the land and excavating irrigation channels or planting perennial crops or trees bearing crops

[179] Research and development expenditure means expenditure incurred by a person in the process of developing the person's business and improving business products or process and includes expenditure incurred by a company for the purposes of an initial public offer and first listing on the Dar es Salaam Stock Exchange but excludes any expenditure incurred that is otherwise included in the cost of any asset used in the use in any such process, including an asset referred to in paragraph 1(3) of the Third Schedule

[180] Environmental expenditure means expenditure incurred by the owner or occupier of farm land for the prevention of soil erosion; or in connection with remedying any damage caused by natural resource extraction operations to the surface of or environment on land

10.5.5 Gifts to public, charitable and religious institutions

For calculating a person's income for a year of income from any business, there shall be deducted amounts contributed during the year of income to a charitable institution[181] or social development project, any donation made[182] and amount paid to local government authority, which are statutory obligations to support community development projects.[183]

However, the deduction available to amounts of gifts made to charitable institution or social development project for a year of income shall not exceed two per cent of the person's income from the business calculated without a deduction.[184]

10.5.6 Depreciation allowance in depreciable assets

For the purposes of calculating a person's income for a year of income from any business, there shall be deducted in respect of depreciation[185] of depreciable assets owned and employed by the person during the year of income wholly and exclusively in the production of the person's income from the business.[186]

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181 Referred to in subsection (8) of section 64 of ITA, CAP 332 RE 2008
182 Under section 12 of the Education Fund Act
183 Section 16 (1), op-cit
184 Section 16 (2), op-cit
185 The allowances granted under the Third Schedule of ITA, CAP 332 RE 2008
186 Section 17, ibid

10.5.7 Losses of business assets realisation

For the purposes of calculating a person's income for a year of income from any business, there shall be deducted any loss of the person[187], from the realisation during the year of income of a business asset of the business that is or was employed wholly and exclusively in the production of income from the business.[188]

In addition, a debt obligation incurred in borrowing money, where the money is or was employed or an asset purchased with the money is or was employed wholly and exclusively in the production of income from the business shall be deducted from income.[189]

Moreover, a liability of the business other than a debt obligation incurred in borrowing money, where the liability was incurred wholly and exclusively in the production of income from the business shall be deducted from the income subjected to taxation.[190]

10.5.8 Losses of business or investment

For the purposes of calculating the income of a person[191] for a year of income from a business or investment, there shall be deducted any

[187] As calculated under Division III of this Part III, ibid
[188] Section 18 (a), ibid
[189] Section 18 (b), ibid
[190] Section 18 (c), op-cit
[191] Other than a partnership or a foreign permanent establishment

unrelieved loss of the year of income[192] of the person from any other business or investment and any unrelieved loss[193] of a previous year of income of the person from any business or investment.[194]

Nevertheless, unrelieved losses from business or investment can be deducted by the person under certain circumstances. The circumstances are enshrined under section 19 (2) of the ITA[195] which provides that a person may deduct an unrelieved loss:-

(a) In the case of a foreign source loss from an investment, only in calculating the person's foreign source income from an investment.

(b) In the case of other losses from an investment, only in calculating the person's income from an investment.

(c)In the case of other foreign source losses, only in calculating the person's foreign source income

(d) In the case of loss incurred on agricultural business, only in calculating the person's income derived from agricultural business[196].

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192 Loss of a year of income of a person from any business or investment shall be calculated as the excess of amounts deducted in calculating the person's income from the business or investment over amounts included in calculating such income

193 Unrelieved loss means the amount of a loss that has not been deducted in calculating a person's income under subsection (1) or section 26(3) of ITA, CAP 332 RE 2008

194 Section 19 (1), ibid

195 CAP332 RE 2008

196 Agricultural business means the practice of rearing of crops or animals including forestry, beekeeping, aqua-culture and faming with a view to deriving a profit but excludes extraction of natural resources or processing of agricultural produce other than preparing such produce for the purpose of sale in its original form

Where a person calculates income for a year of income from more than one business or investment of the person, and deducts an unrelieved loss in more than one such calculation, the person may choose the calculation or calculations in which the loss or part of the loss is deducted.[197]

10.6 Summary

In this chapter we have seen that tax deduction is a reduction of income that can be taxed, and is commonly a result of expenses, particularly those incurred to produce additional income. The difference between deductions, exemptions and credit is that deductions and exemptions both reduce taxable income, while credits reduce tax.

The purpose of tax deductions is to decrease taxable income, thus decreasing the amount of tax a person owes to the government. Tax deductions can be used to allocate resources to ventures or geographic areas that are considered underdeveloped.

Generally, no deduction shall be allowed for consumption expenditure incurred by the person or excluded expenditure

[197] Section 19 (3), op-cit

incurred by the person otherwise, except as provided for by the law governing income tax.

There are various amounts, which are deducted according to income tax law in Tanzania.

These are depreciation allowance, gifts to public, charitable and religious institutions, expenditure on agricultural improvement, research development, losses for business or investment and business assets realisation to mention but a few.

However, each deduction is subjected to the conditions and calculations provided within the tax laws of Tanzania. Hence, they must be understood and complied with for tax deductions.

10.7 Review Questions

1. What is tax deduction? How is it different from tax exemptions?
2. Describe the reasons for the imposition of tax deductions
3. Discuss with relevant authorities the general principles, which govern the tax deductions in Tanzania.

4. Illustrate the amounts, which are subject to tax deductions according to income tax law in Tanzania.

10.8 References

Education Fund Act, Act No. 9 of 2001

Income Tax Act, Cap 332 RE 2008

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CHAPTER ELEVEN

TAXATION OF ENTITIES IN TANZANIA

11.0 Introduction

Legal entity taxation is levied on legal entities engaged in any either business or profit-making activity. There various entities, which are either business oriented or non-business, oriented.

However, for the purpose of this chapter we are going to learn partnership, trusts, corporations and insurance entities for understanding the income taxation.

11.1 Objectives

At the end of this chapter students should have: -

- Acquired knowledge and understanding of the basic concepts of entity, trust, corporation, partnership, insurance business, arrangements etc.
- Acquainted with knowledge and understanding on principles of taxation of trust.
- Developed ability to explain the general principles governing the taxation of corporation.
- Acquired competency to illustrate taxation of insurance business in Tanzania.

- Developed ability to explain the general principles governing the taxation of partnerships.

11.2 Entity

These are bodies of persons undertaking business in the country with a view of profit making or not profit making. They are institutions. They may be recognised as legal person or not depending on the country laws and tax laws of the country.

Certain joint undertakings give rise to entities for tax purposes that are not entities under state business law. Certain state business entities are not entities for tax purposes.

11.3 Taxation of partnership

A partnership is an arrangement in which two or more individuals share the profits and liabilities of a business venture. Various arrangements are possible: all partners might share liabilities and profits equally, or some partners may have limited liability.

Not every partner is necessarily involved in the management and day-to-day operations of the venture. In some jurisdictions, partnerships enjoy favorable tax treatment relative to corporations.[198]

In a broad sense, a partnership is any cooperative endeavor undertaken by multiple parties. These parties can be governments, non-profits, businesses, individuals, or a combination, and the goals of the partnership can vary widely.

There may or may not be a written agreement governing the partnership, but it is generally a good idea to lay out specific terms at the outset, so that disagreements can be settled according to predetermined rules. In some cases, such an agreement is legally required.

Section 3 of ITA[199] defines partnership as any association of individuals or bodies corporate carrying on business jointly, irrespective of whether the association is recorded in writing.

11.3.1 Principles of taxation

A partnership shall not be liable to pay income tax with respect to its total income and shall not be entitled to any tax credit with respect to that

198 Partnership Definition | Investopedia
http://www.investopedia.com/terms/p/partnership.asp#ixzz4M74wTQLd
199 CAP 332 RE 2008

income.[200] This is because Partnership income or a partnership loss of a partnership shall be allocated to the partners.[201]

However, amounts derived and expenditure incurred by partners in common shall be treated as derived or incurred by partnership and not the partners.[202]All activities of a partnership shall be treated as conducted in the course of the partnership business.[203]

Assets owned and liabilities owed by partners in common shall be treated as owned or owned by the partnership and not the partners. They shall be treated as in the case of assets, acquired when they begin to be so owned, in the case of liabilities, incurred when they begin to be so owed and realised when they cease to be so owned or owed.[204]

11.3.2 Income or loss of partnership

Partnership income from a business of a resident or non-resident partnership for a year of income shall be the chargeable income of the partnership for the year of income from the business calculated as if the partnership were a resident partnership[205].

200 Section 48 (1) of ITA CAP 332 RE 2008
201 Section 48 (2), ibid
202 Section 48 (3), ibid
203 Section 48 (5), ibid
204 Section 48 (4), ibid
205 Section 49 (1), op-cit

A partnership loss from a business of a resident or non-resident partnership for a year of income shall be the loss of the partnership for the year of income from the business calculated[206].[207]

11.3.3 Taxation of partners

For calculating a partner's income[208] from a partnership for a year of income of the partner there shall be included the partner's share of any partnership income[209] and deducted the partner's share of any partnership loss[210] for a year of income of the partnership ending on the last day of or during the year of income of the partner.[211]

Partnership income or a partnership loss allocated to partners shall retain its character as to type and source. It shall be treated as an amount derived or expenditure incurred, respectively, by a partner at the end of the partnership's year of income[212]. It shall be allocated to the partners proportionately to each partner's share, unless the Commissioner, by notice in writing, permits otherwise.[213]

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[206] Under section 19(4), ibid
[207] Section 49 (2), ibid
[208] The costs and incomings of partnership membership interests shall be included in the costs of the partners in the partnership for the purpose of income taxation in Tanzania.
[209] Under section 49(1), ibid
[210] Under section 49(2), ibid
[211] Section 50 (1), ibid
[212] Any income tax under this ITAct or foreign income tax paid or treated as paid by the partnership with respect to the partnership income shall be allocated to the partners, proportionately to each partner's share, and treated as having been paid by them
[213] Section 50 (2), ibid

11.4 Taxation of trust

A trust is a relationship whereby one party for the benefit of another holds property. A settlor, who transfers property to a trustee, creates a trust.[214]

The trustee holds that property for the trust's beneficiaries. An owner of property that places property into trust turns over part of his or her bundle of rights to the trustee, separating the property's legal ownership and control from its equitable ownership and benefits.[215]

The trustee is given legal title to the trust property, but is obligated to act for the good of the beneficiaries. The trustee may be compensated and have expenses reimbursed, but otherwise must turn over all profits from the trust properties.

Trustees who violate this fiduciary duty are self-dealing. Courts can reverse self-dealing actions, order profits returned, and impose other sanctions. The trustee may be individual, a company, or a public body. There may be a single trustee or multiple co-trustees. The trust is governed by the terms under which it was created.

[214] Hayton, DJ (2005). Hayton and Marshall's Commentary and Cases on the Law of Trusts and Equitable Remedies (12th ed.). Sweet & Maxwell

[215] Hayton, DJ and Matthews, P., (2006). Underhill and Hayton's Law Relating to Trusts and Trustees (17th ed.). Butterworths.

11.4.1 Trust under income tax law

Section 3 of ITA[216] provides that trust mean an arrangement under which a trustee holds assets but excludes a partnership and a corporation. Also, trustee means an individual or body corporate holding assets in a fiduciary capacity for the benefit of identifiable persons or for some object permitted by law.

Whether or not the assets are held alone or jointly with other persons or the individual or body corporate is appointed or constituted trustee by personal acts, by will, by order or declaration of a court or by other operation of the law.

11.4.2 Principles of taxation of trust

A trust or unit trust shall be liable to tax separately from its beneficiaries and separate calculations of total income shall be made for separate trusts regardless of whether they have the same trustees.[217]

Amounts derived and expenditure incurred by a trust or a trustee in the capacity of trustee[218] whether or not derived or incurred on behalf of another person and whether or not any other person is entitled to such an

[216] CAP 332 RE 2008
[217] Section 52 (1), op-cit
[218] Other than as a bare agent

amount or income constituted by such an amount. It shall be treated as derived or incurred by the trust and not any other person.[219]

Assets owned and liabilities owed by a trust or a trustee in the capacity of trustee[220] shall be treated as owned or owed by the trust and not any other person.[221]

Distributions of a resident trust or unit trust shall be exempt in the hands of the trust's beneficiaries; and of a non-resident trust or unit trust shall be included in calculating the income of the trust's beneficiaries.[222]

Where a receiver is a trustee,[223] the trust shall be treated as conducting or continuing the activities of the person whose assets come into the possession of the receiver. The amounts derived and expenditure incurred by the trust shall be included in calculating the income of the trust in the same manner, as they would have been included in calculating the income of the person if they were derived or incurred by the person prior to the event resulting in the appointment of the receiver.[224]

11.5 Corporation

[219] Section 52 (3), op-cit
[220] Other than as a bare agent
[221] Section 52 (4), ibid
[222] Section 52 (2), ibid
[223] referred to in section 116(5), ibid
[224] Section 52 (5), ibid

A corporation is a legal entity that is separate and distinct from its owners.[225] Corporations enjoy most of the rights and responsibilities that an individual possesses[226] that is, a corporation has the right to enter into contracts, loan and borrow money, sue and be sued, hire employees, own assets and pay taxes.[227] It is often referred to as a legal person.[228]

11.5.1 Corporation under income tax law

However under section 3 of ITA[229], corporation means any company or body corporate established, incorporated or registered under any law in force in the United Republic or elsewhere, an unincorporated association or other body of persons, a government, a political subdivision of a government, a parastatals organisation, a public international organisation and a unit trust but excludes a partnership.

[225] Blumberg, P. I., The Multinational Challenge to Corporation Law: The Search for a New Corporate Personality, (1993)
[226] Cadman, J. W., The Corporation in New Jersey: Business and Politics, , (1949)
[227] Dignam, A., and Lowry, J., Company Law, Oxford University Press, (2006)
[228][228] Hunt, B., The Development of the Business Corporation in England (1936)
[229] CAP 332 RE 2008

11.5.2 Taxation of corporation

A corporation shall be liable to tax separately from its shareholders[230]. Arrangements[231] between a corporation and its managers or shareholders shall be recognised.[232]

Amounts derived and expenditure incurred jointly or in common by the managers or shareholders for the purposes of a corporation that lacks legal capacity, shall be treated as derived or incurred by the corporation and not any other person.[233]

Assets owned and liabilities owed jointly or in common by the managers or shareholders for the purposes of a corporation that lacks legal capacity shall be treated as owned or owed by the corporation and not any other person.[234]

11.5.3 Taxation of shareholders

Dividends[235] distributed by a resident corporation shall be taxed in the hands of the corporation's shareholders in the form of a final withholding

230 Section 53 (1), supra
231 Arrangement includes an action, agreement, course of conduct, dealing, promise, transaction, understanding or undertaking, whether express or implied, whether or not enforceable by legal proceedings and whether unilateral or involving more than one person
232 Section 53 (4), ibid
233 Section 53 (2), ibid
234 Section 53 (3), ibid
235 Dividend of an entity means a distribution by the entity to the extent that it is not a repayment of capital

tax and distributed by a non-resident corporation shall be included in calculating the income of the shareholder.[236]

A dividend distributed by a resident corporation to another resident corporation shall be exempt from income tax where the corporation receiving the dividend holds 25 per cent or more of the shares in either the corporation distributing the dividend and controls, directly or indirectly, 25 per cent or more of the voting power in the corporation.[237] However, this shall not apply to a dividend distributed to a corporation by virtue of its ownership of redeemable shares.[238]

11.6 Insurance business

Section 3 of ITA[239] defines insurance business the business of an insurer in effecting, issuing and carrying out insurance.

A person's activities in insurance business conducting a general insurance business[240] shall be treated as a business separate from any other activity of the person and the person's income or loss from the business for any year of income shall be calculated separately.[241]

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236 Section 54 (1), supra
237 Section 54 (2), ibid
238 Section 54 (3), ibid
239 CAP 332 RE 2002
240 general insurance business means any insurance that is not life insurance
241 Section 58 (1), ibid

For calculating the income of a person for a year of income from a general insurance business, there shall be included, together with any other amounts to be included under other provisions of this Act premiums derived during the year of income by the person as insurer, including as re-insurer, in conducting the business. The proceeds derived during the year of income by the person under any contract of re-insurance in respect of proceeds[242].[243]

For calculating the income of a person for a year of income from a general insurance business, there shall be deducted, together with any other amounts deductible, proceeds incurred during the year of income by the person as insurer, including as re-insurer, in conducting the business. The premiums incurred during the year of income by the person under any contract of re-insurance in respect of proceeds[244].[245]

11.7 Summary

In this chapter, we have seen that entities are bodies of persons undertaking business in the country with a view of profit making or not profit making. They are institutions. They

[242] for the purposes of calculating the income of a person, the treatment of proceeds derived by the person from insurance shall be determined in accordance with section 31, supra
[243] Section 58 (2) (a), ibid
[244] for the purposes of calculating the income of a person, the treatment of proceeds derived by the person from insurance shall be determined in accordance with section 31
[245] Section 58 (2) (b), supra

may be recognised as legal person or not depending on the country laws and tax laws of the country. Certain joint undertakings give rise to entities for tax purposes that are not entities under state business law. Certain state business entities are not entities for tax purposes.

Partnership is any association of individuals or bodies corporate carrying on business jointly, irrespective of whether the association is recorded in writing. A partnership shall not be liable to pay income tax with respect to its total income and shall not be entitled to any tax credit with respect to that income. This is because Partnership income or a partnership loss of a partnership shall be allocated to the partners.

A trust is a relationship whereby one party for the benefit of another holds property. Trust means an arrangement under which a trustee holds assets but excludes a partnership and a corporation. A trust or unit trust shall be liable to tax separately from its beneficiaries and separate calculations of total income shall be made for separate trusts regardless of whether they have the same trustees.

Corporation means any company or body corporate established, incorporated or registered under any law in force in the United Republic or elsewhere, an unincorporated association or other body of persons, a government, and a political subdivision of a government, a parastatals organisation, a public international organisation and a unit trust but excludes a partnership.

A corporation shall be liable to tax separately from its shareholders. Arrangements between a corporation and its managers or shareholders shall be recognised.

Insurance business denotes the business of an insurer in effecting, issuing and carrying out insurance. A person's activities in insurance business conducting a general insurance business shall be treated as a business separate from any other activity of the person and the person's income or loss from the business for any year of income shall be calculated separately.

11.8 Review Questions

1. What is an entity? Explain the entities, which are subjected to income taxation in Tanzania.

2. Define the term trust and describe the principles of taxation of trust.
3. What is corporation? How corporation is taxed in Tanzania?
4. How do you define the term insurance business? What are the principles of taxation of insurance business?
5. Define partnership. What are the principles of taxation of partnership in Tanzania?

11.9 References

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CHAPTER TWELVE

VALUE ADDED TAX IN TANZANIA

12.0 Introduction

In this chapter, we shall be discussing the meaning, concepts and bases of value added tax. In addition, we are going to acquaint with tax unit and tax base for value added tax and their rates.

The aim is to familiarize students with knowledge of value added tax, bases for its imposition, its subjects, chargeable tax, and registration and deregistration.

12.1 Objectives

At the end of this chapter students should have: -

- Learnt basic knowledge on VAT and sales tax as well as their differences.
- Acquainted with understanding on imposition of VAT and determination of place of taxation according to Tanzania tax laws.
- Accustomed with the ability to describe registration and deregistration processes for value added tax liability in Tanzania.

12.2 Value Added Tax

Value added tax can be defined to mean an indirect tax that is paid by a person who consumes or imports goods and or services in particular state or jurisdiction.[246]

It is a consumption tax charged on taxable goods, service and immovable property of any economic activity whenever value is added at each stage of production and final stage of sales. It is charged on both local goods and services and imports.

Value-Added Tax (VAT) is a tax on consumer spending. VAT-registered traders collect it on their supplies of goods and services affected within the State, for consideration, to their customers.[247]

Generally, each such trader in the chain of supply from manufacturer through to retailer charges VAT on his or her sales and is entitled to deduct from this amount the VAT paid on his or her purchase

According to section 5 of Value Added Tax Act[248], VAT is chargeable on the taxable supplies of goods and services. The rates are **18%** for standard rated supplies, and **0%** for exports of goods and services.

12.3 Imposition of value added tax

[246] Uganda Revenue Authority, Taxation Handbook: A guide to Taxation in Uganda, Fountain Publishers, Kampala, 2011, at p 69

[247] Smart, M., & Bird, R. M. (2009). The impact on investment of replacing a retail sales tax with a value-added tax: Evidence from Canadian experience. National Tax Journal, 591-609.

[248] Act No. 5 of 2014

In principle, VAT applies to all provisions of goods and services. VAT is assessed and collected on the value of goods or services that have been provided every time there is a transaction, which is either sale or purchase. The seller charges VAT to the buyer, and the seller pays this VAT to the tax authority in the respective country or state.

If, however, the purchaser is not an end user, but the goods or services purchased are costs to its business, the tax it has paid for such purchases can be deducted from the tax it charges to its customers.

The government only receives the difference; in other words, it is paid tax on the gross margin of each transaction, by each participant in the sales chain.

In Tanzania according to section 3 of Value Added Tax Act[249], the VAT shall be charged on **any supply of goods, services and immovable property of any economic value** whereby it is taxable supply made by taxable person in the course of economic activity carried by such person.

However, the importation of taxable supply from outside Tanzania shall be charged VAT and normal procedures shall be applicable. All supply consumed outside Tanzania shall be zero rated upon proof.

[249] Value Added Tax Act, Act No. 5 of 2014, supra

According to section 4 of Value Added Tax Act subjects of VAT[250] are persons who undertake the importation of taxable goods[251], supply of taxable goods and services[252] and purchaser of supply of imported taxable services.

12.3.1 VAT Registration

Registration is the process of getting eligible persons put or recorded on the VAT register. Upon registration, the person will be entitled to various rights stipulated in the law governing value added tax at hand on the effective date of registration.

Registration for VAT is mandatory to every person upon attaining the registration threshold[253] of 100 million in the period of twelve months and above or 50 million in period of six months ending at the end of the previous months.[254]

This condition applies to all types of registration except for professional service providers.[255] However, professional service providers shall be required to register if they carry economic activity involving the supply of

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250 ibid
251 See section 8, ibid
252 See section 12, ibid
253 This refers to the minimum level of taxable turnover above which a person is required to register for VAT
254 See section 28, ibid and regulation 14 of Value Added Tax (General) Regulations, GN 225 of 2015
255 Professional service providers may be natural persons, artificial persons, government entity, institution that carries on economic activity in Tanzania mainland as per section 29 (2) of Value Added Tax Act, Act No. 5 of 2014

professional service in Tanzania mainland whether they are provided by their employees, members or themselves and if they are ordinarily by person who is licensed to provide such service.[256]

Application for VAT registration can be done online or by filling form ITX245.02.E[257] Application for Registration for VAT within 30 days to commissioner general from the date of requirement to do so as per section 30 of Value Added Tax Act[258] and regulation 11 of Value Added Tax (General) Regulations[259]. This can be done by the person himself or herself or his or her representative.[260]

Upon registration, a taxpayer shall be issued with a Certificate of Registration stating the name and principal place of business of the taxable person, the date on which the registration takes effect and his Taxpayer Identification Number and his VAT registration number.

A person shall show his Taxpayer Identification Number and his VAT registration number in any return, notice of appeal or other documents used for official VAT purposes and display his certificate of registration in a noticeable position at his principal place of business.[261]

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256 See section 29(1), supra
257 Application form which is found in Schedule to Value Added Tax (General) Regulations, GN 225 of 2015
258 Act No. 5 of 2014.
259 GN no. 225 of 2015, which was made by Minister in respect of section 31 of Act no. 5 of 2014
260 See section 30 (3) of the Value Added Tax Act No. 5 of 2014
261 See section 35, ibid

When there is failure to process the application by a person who has applied for registration within the time required, applicant shall not be subjected to VAT until the person is duly registered.[262]

12.3.2 VAT deregistration

Deregistration is the process of removing or cancelling a registered person from VAT register. It implies discharge of the duties and rights attached to a registered person. It is done upon application under the grounds recognized by the law.

Application shall be made by specified form ITX246.02E as prescribed in the Schedule to the Value Added Tax (General) Regulations.[263] Such application shall be made within 14 days after the date the person ceases permanently to make taxable supplies.[264]

Circumstances, which may lead to application for cancellation of VAT registration, are hereunder explained:

i. If registered person who permanently ceases to make taxable supplies shall apply for the cancellation of its registration.[265]

[262] See section 34, ibid
[263] GN 225 of 2015
[264] See section 39(2), ibid
[265] See section 39 (1), ibid

ii. Also, a registered person who fails to maintain threshold may apply for cancellation of his registration.[266]

Upon satisfaction to the Commissioner General, within time prescribed under section 40 of Value Added Tax Act[267], the Commissioner General by notice in writing shall cancel the registration if it is appropriate to do so.[268]

Powers to cancel VAT registration are vested to Commissioner General. Such powers are discretionary basing on the wording of section 41 of Value Added Tax Act.[269]

However, Commissioner General may do so by notice in writing. The grounds upon which the commissioner General may exercise his powers are: -

i. Registration of the applicant based on false or misleading information
ii. Cessation of carrying on economic activity
iii. Cessation to produce taxable supplies.
iv. Taxable person turnover falls below registration threshold.

12.4 Place of taxation for VAT

[266] See section 39(3), ibid
[267] Act no 5 of 2014
[268] Regulation 15(2) of Value Added Tax (General) Regulations, GN 225 of 2015
[269] Act no 5 of 2014

The place of taxation is the place where the business receiving the goods and services is established.[270] The place of taxation is determined by where the supply of goods and service are made. This not only depends on the nature of the goods and services supplied, but also on how the supply is made.

The location of the business customer to whom the services are supplied can be where they have established their business, where that person's fixed establishment is located or, in the absence of such place of business or a fixed establishment, the place where he or she has a permanent address or usual place of residence.[271]

In Tanzania, place of taxation for VAT is determined as hereunder accounted for: -

i. If goods are delivered or made available in Tanzania mainland are deemed to be supplied in Tanzania mainland.[272] If they are imported but prior to home consumption, then they shall be delivered or made available outside Tanzania mainland.[273]

[270] Ahmed, Ehtisham and Nicholas Stern, the theory and Practice of Tax Reform in Developing Countries Cambridge University Press, 1991

[271] Bird, Richard M. and P.-P, Gendron, 2000, "CVAT, VIVAT and Dual VAT; Vertical 'Sharing' and Interstate Trade," International Tax and Public Finance, 7: 753–61.

[272] See section 44 (1) of the Value Added Tax Act No. 5 of 2014

[273] See section 44 (2), ibid

ii. If goods are assembled or installed in Tanzania mainland or under contract with supplier in Tanzania mainland, they shall be supply made in Tanzania mainland.[274] If they are dispatched or transported from Tanzania mainland to outside Tanzania, they shall be treated to be supply made in Tanzania mainland.[275]

iii. If supply of immovable property situated in Tanzania mainland or service directly related to Tanzania mainland, they shall be treated as supply made in Tanzania mainland.[276] If service is supply of immovable property outside Tanzania but supplier is resident of Tanzania or non-resident but carries on economic activity or fixed place in Tanzania, it shall be treated as supply made in Tanzania.[277]

iv. If supply of essential service[278] to place of Tanzania mainland or from Tanzania mainland to outside, it shall be treated supply made in Tanzania.

v. If service performed, enjoyed by person or delivered to person in Tanzania mainland, it shall be treated as supply made in Tanzania mainland.[279]

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274 See section 45 (1), ibid
275 See section 45 (2), ibid
276 See section 46 (1), ibid
277 See section 46 (2) and 47, ibid
278 Supply of water, gas, oil, electricity or thermal energy as per section 48, ibid
279 See section 51 , op-cit

vi. If telecommunication service is initiated in Tanzania mainland by any person other than service provider, it shall be treated supply made in Tanzania mainland.[280]

vii. If supply of services by a non-resident who is a registered person to a customer who is a registered person shall be treated as a supply made in Mainland Tanzania[281]

12.5 Summary

In this chapter, we have learned that VAT is indirect tax based on consumption of goods, services and imports. It is an alternative to sales tax as paid by end user of such taxable supplies when value is added upon the same.

VAT is charged to supply of goods, services and imports as per section 3 of VAT Act. The person who are subjected to pay VAT are importer in case of taxable import, supplier in case of supply made or delivered or made available in Tanzania and purchaser of imported taxable supply according to section 4 of VAT Act.

[280] See section 50, ibid
[281] See section 49, loc-cit

Moreover, taxable person who has attained threshold of 100 million in 12 months is required to register for VAT as per section 28 of VAT Act and regulation 14 of VAT (General) Regulation.

Furthermore, a registered person may apply for cancellation of VAT registration when his turnover falls below threshold, ceases to make economic activity in Tanzania according to section 39 of VAT Act.

Place of taxation for VAT is determined by where the supply is made available or delivered as well as residence of supplier or purchaser as per section 44-65 of VAT Act.

Therefore, VAT is like a sales tax in that ultimately only the end consumer is taxed. It differs from the sales tax in that with the sales tax, the tax is collected and remitted to the government only once, at the point of purchase by the end consumer.

With the VAT, on the other hand, collections, remittances to the government, and credits for taxes that are already paid occur each time a business in the supply chain purchases products.

12.6 Review Questions

1. Explain the meaning of VAT
2. Distinguish between VAT and sales tax.
3. Who are the subjects of VAT in Tanzania?
4. Under which circumstances, person registered for VAT be cancelled from the registration of VAT?
5. Opine on the discretionary powers of Commissioner General upon cancellation of VAT registration

12.7 References

Ahmed, Ehtisham and Nicholas Stern. 1991. The Theory and Practice of Tax Reform in Developing Countries (Cambridge University Press).

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CHAPTER THIRTEEN

DUTIES AND TARIFFS

13.0 Introduction

Duties and tariffs are both forms of taxes that are imposed on the import and export of goods to and from foreign countries. Since both are taxes, they are not voluntarily offered and are usually forced onto businesses and individuals. Duties and tariffs are quite similar to one another in their purposes and features, and the two terms are often used interchangeably.

Henceforth, this chapter aims at imparting knowledge on the concepts of duties and tariffs as applicable in tax laws or revenue laws. In addition, it covers the other concepts of single customs territory and its essence as well as laws governing duties and tariffs taxation in Tanzania.

13.1 Objectives

At the end of this chapter students should have: -

- Learnt basic knowledge on the term duties, tariffs and single customs territory.
- Acquainted with understanding on classification of duties and tariffs.

- Accustomed with the ability to describe the principles which makes the single customs territory.

13.2 Duties and Tariffs

They are like a consumer tax on goods imported from other nations. The two words are sometimes used interchangeably. When a government and the economy are mentioned, the word "tariff" is more appropriately used, and when the rates are discussed and an amount mentioned, then the words used are "duty" or "custom duty." The term "duty" also refers to the custom duty imposed on the goods of a single person bringing in something from another country as a personal usage item.[282]

13.2.1 Duties

Duties are taxes that are levied by the government on goods that are imported into and exported from a country. Duties are imposed on certain types of goods and services, and the duty that applies to the good or service will vary with the nature of the goods being imported or exported.

For example, the duty that applies to cigarettes, alcohol and vehicles maybe higher than the duty imposed on clothing, shoes, and towels.

[282] Read more: Difference Between Duty and Tariff | Difference Between http://www.differencebetween.net/business/finance-business-2/difference-between-duty-and-tariff/#ixzz4c1qxSel1

Import duties are paid to obtain permission from the country's customs authority to import goods or services from other countries.

There are different words used in reference to a duty. A custom duty is considered an indirect tax imposed by the government of a nation on goods imported during international trade. It is another popular word for "tariff" and refers to list of commodities along with their rates.[283]

A duty is an indirect tax which is again imposed by the government of a country to protect the domestic industries and also generates revenue.

An import duty is the duty which is levied by a government on goods which are imported. An export duty refers to duties levied by the government on export goods. A duty is also seen as a consumption tax because it is imposed by the government on consumers.[284]

13.2.2 Types of Duties

There are two types of duties. These are custom duties and excise duties. Both of these taxes are levied by the government and are indirect taxes but there is a distinct difference between the two.

(a) Excise Duty

283 See more at http://www.datamyne.com/whats-difference-tariff-duty/
284 Read more: Difference Between Duty and Tariff | Difference Between http://www.differencebetween.net/business/finance-business-2/difference-between-duty-and-tariff/#ixzz4c1rfRtRw

The government and the goods and products that are manufactured in the country levy **excise duty**. Excise duty is collected on the goods produced by a manufacturer that are to be sold in that particular country.

Excise duty constitutes the largest proportion of taxes in the price of a good. Unlike sales tax, excise duty is charged ad valorem, that is it is generally calculated on the number of goods or in volume of liquid like gasoline.

Every country has its own ways of imposing excise duty and is calculated as per the guidelines issued by that particular country.

(b) Customs Duty

Customs duty is applied for goods imported from foreign countries. This duty is one of the most important duties because it hampers illegal import and export of goods.

Custom duty also known as the authorities collect **consumption duty** on the goods imported by an importer and are meant to be sold in the country. The custom duty is levied on the goods whose value is determined by its assessable value.

The government of the country in which the goods are being imported decides the rate of custom duty. The custom duty generally caries a very high rate on products like tobacco and liquor.

13.2.3 Tariff

Tariffs are also taxes that are levied on goods and services that are imported to a country. Tariffs are used to amend trade policies by reducing the volume of imports through making imports expensive. Tariffs are imposed to collect government income, protect domestic small and medium firms and to reduce trade deficits.

A tariff is defined as a form of duty or tax levied on goods for protective purposes and revenue purposes when they are transported from one customs area to another.[285]

It is also defined as a comprehensive list or schedule of merchandise or goods along with their prices which need to be paid for each item according to the regulations and rules of the government.

Tariffs are considered the amount which needs to be paid by a nation for trading products, exports or imports. The price of the goods being traded

285 Ibid

always increases in case of tariffs being imposed on the products. Custom duties are the collected income from tariff taxes.[286]

However, tariffs have some disadvantages. When tariffs are imposed on imported products, the local producers do not face much competition and will, therefore, become inefficient.

Tariffs act as a safety bubble for these firms and, as long as tariffs are imposed, local industries will not strive to improve quality or reduce cost as much as exported products. Furthermore, tariffs are generally imposed only on imported goods and quite rarely on imported products.

13.2.4 Functions of Tariffs

Tariffs have three primary functions: to serve as a source of revenue, to protect domestic industries, and to remedy trade distortions (punitive function).[287]

The revenue function comes from the fact that the income from tariffs provides governments with a source of funding. In the past, the revenue function was indeed one of the major reasons for applying tariffs, but

[286] Read more: Difference Between Duty and Tariff | Difference Between http://www.differencebetween.net/business/finance-business-2/difference-between-duty-and-tariff/#ixzz4c1snDxRi

[287] See, http://www.canadacustomer.fedex.com/ca_english/customsguide/understanddutytax.html

economic development and the creation of systematic domestic tax codes have reduced its importance in the developed countries.[288]

For example, Japan generates about one trillion yen in tariff revenue, but this is less than two percent of total tax revenues. In some developing countries, however, revenue may still be an important tariff function.

Tariffs is also a policy tool to protect domestic industries by changing the conditions under which goods compete in such a way that competitive imports are placed at a disadvantage.

In point of fact, a cursory examination of the tariff rates employed by different countries does seem to indicate that they reflect, to a considerable extent, the competitiveness of domestic industries.

In some cases, "tariff quotas" are used to strike a balance between market access and the protection of domestic industry. Tariff quotas work by assigning low or no duties to imports up to a certain volume (primary duties) and then higher rates (secondary duties) to any imports that exceed that level.

[288] Ibid

13.2.5 Types of Tariffs

There are two basic types of tariffs imposed by governments on imported goods. First is the *ad valorem* tax which is a percentage of the value of the item. The second is a *specific tariff* which is a tax levied based on a set fee per number of items or by weight.

(a) Ad valorem Tariffs

Ad valorem tariff means any tariff imposed on the basis of the monetary value of the taxed item. Literally the term means according to value. It is tariff which is a percentage of the value of the item.[289]

They are charges levied on an item on the basis of its value and not on the basis of its quantity, size, weight, or other factor.[290]

Ad valorem tariffs rates, which have come into increased use, have the important advantage of adjusting the tax burden according to the amount the consumer spends on the taxed items.[291]

They thus avoid the serious discrimination of specific rates against the low-priced varieties of the commodities. The primary difficulty with the ad

289 Read more at https://www.britannica.com/topic/ad-valorem-tax
290 Read more: http://www.businessdictionary.com/definition/ad-valorem-tariff.html
291 Ibid

valorem taxation, especially in the case of tariffs, is in establishing a satisfactory value figure.[292]

(b) Specific Tariffs

They are Import tax expressed in an amount of money per unit imported. A specific tariff is levied as a fixed fee based on the type of item. Specific tariffs are trade barriers designed to reduce imports into countries.[293]

13.3 Relation of Duties and Tariffs

Duties and tariffs are both taxes that a country's government will impose on the import and export of goods and services. These terms are quite similar to one another and are most often used interchangeably.

Both tariffs and duties are imposed for the same purposes, which are to protect domestic industries, and companies, earn government income, and reduce trade deficits. A duty can also refer to customs duty that is imposed on goods that are brought into a country by tourists and other individuals. While duties and tariffs can be beneficial to a country, there are also a few disadvantages.

The main issues with these taxes are that they protect local producers too much, and by not exposing domestic producers to international

[292] Ibid
[293] Read more: http://www.businessdictionary.com/definition/specific-tariff.html

competition, they will remain within the same quality standards and inefficiencies, and the industry as a whole will remain underdeveloped in comparison to more efficient foreign industries.

The only difference between the terms 'duty' and 'tariff' is that tariff may often be used where the government and economy mentioned. This basically means that tariff is used to refer to the rate of tax that must be applied as tax. For example: the tariff is 15% of the total cost whereas, the term 'duty' is used to refer to the actual amount or the figure that must be paid as tax. For example: a duty of $1000.[294]

13.4 Jurisprudence of Duties and Tariffs

The government could be trying to protect the economies domestic producers and small and medium enterprises from external competition. When duties are imposed, exported products become more expensive, and local products become more attractive to consumers.[295]

Another reason for import duties is to discourage imports. Imports can result in a balance of payments deficit, which is not healthy for a country's economy. By imposing duties, the volume of imports can be reduced. However, the disadvantage in taking this measure is that countries may

294 Read more at http://www.differencebetween.info/difference-between-duty-and-tariff
295 See, Ibid

retaliate and in turn impose duties on their imports which will reduce a country's export income.[296]

A tariff helps protect the domestic industries in the market of a country by restricting the amount of goods traded and generates revenue for the government.

Tariffs are useful for a nation as they help in earning revenue for the government and also help in raising the country's GDP. With the help of protective tariffs, the underdeveloped and non-competitive domestic industries of a country receive encouragement and incentives to compete. It also helps in controlling trade between two nations.[297]

Tariffs are seldom imposed on export goods and mostly imposed on imported goods. They are consumer taxes thus always costing extra money to the consumer. Tariffs are restrictions used to control foreign products entering the domestic market of a country.

13.5 Duties and Tariffs in East Africa Community

Section 2(1) of the East African Community Customs Management Act (EACCMA) 2004[298] defines dutiable goods means any goods chargeable

296 Read more at http://www.differencebetween.com/difference-between-duty-and-vs-tariff/.
297 Ibid
298 RE 2009

with duty. Also it defines duty to include any cess, levy, imposition, tax, or surtax, imposed by any Act.

Part X the East African Community Customs Management Act (EACCMA) 2004[299] provides for liabilities to pay duties. The liability to pay duty shall be according to the protocol established regarding rates of duties for the partner states and non-partner states.[300]

Goods originating from the Partner States shall be accorded Community tariff treatment in accordance with the Rules of Origin , provided for under the Protocol.[301]

13.5.1 Import duties

Import means goods and services brought to Tanzania from a foreign country. Import procedures have to be followed in order to clear goods from Customs control as per the East African Community Customs Management Act (EACCMA) 2004[302].

Imports to Tanzania are subjected to different stages whereby the importer is advised to make declaration through his appointed Clearing and

299 RE 2009
300 Section 110, ibid
301 Section 111, ibid
302 RE 2009

Forwarding Agent by lodging documents at least 7 days before arrival of the vessel.

Section 2(1) of the East African Community Customs Management Act (EACCMA) 2004[303] defines import duties. It says that import duties mean any customs duties and other charges of equivalent effect levied on imported goods. It also defines import as to bring or cause to be brought into the Partner States from a foreign country

13.5.2 Export duties

Section 2 (1) of the East African Community Customs Management Act (EACCMA) 2004[304] defines export means to take or cause to be taken out of the Partner States. Also it defines "export duties" means Customs duties and other charges having an effect equivalent to customs duties payable on the exportation of goods

Exports are free of duty and taxes except for three items; Rawhides and skins, which are chargeable to export duty at the rate of 80% of, FOB value or USD 0.25 per kg whichever is higher. In addition, raw cashew nuts which are chargeable to export duty at the rate of 15% of FOB value or USD 160

303 RE 2009
304 RE 2009

per metric ton whichever is higher and Wet blue leather are levied at the rate of 10% on FOB.

Section 71 the East African Community Customs Management Act (EACCMA) 2004[305] provides for the prohibition and restriction on exportation. It provides that he goods specified in Part A of the Third Schedule are prohibited goods and the exportation of the goods is prohibited

Also, the goods specified in Part B of the Third Schedule are restricted goods and the exportation of the goods, save in accordance with any conditions regulating their exportation, is prohibited.

13.5.3 Single Customs Territory in Tanzania

(a) Introduction

Tanzania Revenue Authority is currently using Single Customs Territory on goods passing through Tanzania to the EAC countries and intra trade of the region. This is initiative, which was launched in October, 2013 and piloted first in the Northern Corridor involving Kenya, Uganda and Rwanda. Following successful implementation in the Northern Corridor, the same is

[305] RE 2009

now been implemented in the Central Corridor, which involves Tanzania, Burundi, Rwanda and Uganda.

(b) Single Customs Territory

The Single Customs Territory (SCT) can be described as the stage for full attainment of the Customs union which is achieved by the removal of duties and other restrictive regulations and/or minimization of internal border customs controls on goods moving among Partner States with an ultimate realization of free circulation of goods.[306]

Under Single Customs Territory, all five Partner States: Tanzania, Kenya, Uganda, Burundi and Rwanda are regarded as one Customs Territory which means there only one Customs declaration is made in the Country at which goods are consigned. Such one declaration has replaced the old system where imports to Rwanda, Burundi or Uganda requires multiple customs declarations; first in Tanzania as Transit Goods and then in Rwanda, Burundi or Uganda as Imports that ultimately involves two or more Customs Agents to clear the consignment. The overall benefit for using this system is time and cost saving.

(c) Modus Operandi

306 See http://www.tra.go.tz/publications/Single%20Customs%20Territory%20brochure.pdf

- **Goods originating from EAC (Intra regional trade**

These are locally produced goods (within EAC) for transfer from one Partner State to another. These goods are now declared and entered only once in the destination Partner State[307].

The principles to be applied under free circulation for locally produced goods:

- There is only one Customs declaration that will be made in Tanzania and applied across EAC**.**
- Upon receipt of Invoice from the Supplier; Importers through their Customs Agents is required to lodge their Customs declaration to Customs in Tanzania.
- Declaration will be processed in Tanzania and tax payment will be made accordingly.
- Upon payment of taxes information will be sent in the form of a Release Order to Transferring Partner State to facilitate release and movement of goods

- **Goods originating from outside EAC (International Trade)**

[307] See http://www.wcoomd.org/~/media/wco/public/global/pdf/events/2015/regional-integration-conference/72-session-7eac-single-customs-territory2.pdf?la=fr

These are goods which are imported into EAC regional from International Markets. Such goods were formally treated as transit goods. These type of goods follow the following procedures[308];

- Clearance of Goods to Rwanda, Burundi and Uganda are now no longer subjected under Transit Regime but direct import**.**
- There is only one declaration which is lodged and processed in the destination Country for goods for Warehousing and for home consumption. System interface has been created to facilitate exchange of Manifest information, receipt of tax payments confirmation and Release Order. Such exchange of data between countries is necessary for initiation of Customs clearance process and release of goods to destination Partner State
- Goods which are cleared under Warehousing Regime (from Bonded Warehouse to another Bonded Warehouse) are now processed as explained upon receipt of Release Order from destination Country, goods are allowed to move under Electronic Cargo Tracking System or using Regional Bond Guarantee (RCTG)

Goods for export from EAC

[308] See http://www.wcoomd.org/~/media/wco/public/global/pdf/events/2015/regional-integration-conference/72-session-7eac-single-customs-territory2.pdf?la=fr

These are Goods which are manufactured in the EAC region. Such goods were previously treated as transit when crossing one Partner State for export to foreign. The principles applied to these goods are[309]:

- The consignments are subjected to only one Customs declaration that which is made and processed in the Country of Export
- The declaration upon release is transmitted to the Customs authorities where the consignment is passing through;
- After release of the declaration, the consignment may be armed with the electronic cargo seal and removed to commence the journey to destination.
- The declaration is covered by the regional bond and or armed with the electronic cargo trucking system;
- The inland border officer confirms exit once the consignment arrives and the next country takes over the process of monitoring through its territory. The system has not yet been implemented in full to all countries. The status of implementation by each country is;

- **Tanzania and Rwanda**

- All goods destined and from Rwanda are subjected to the system.

- **Tanzania and Burundi**

[309] See http://www.wcoomd.org/~/media/wco/public/global/pdf/events/2015/regional-integration-conference/72-session-7eac-single-customs-territory2.pdf?la=fr

- The system is applied only to some selected imports and selected importers. The goods subjected to the system are empty glass bottles, cement, cosmetics, fertilizes, cooking oil and steel products

- **Tanzania and Kenya**

- All imports from Kenya to Tanzania are subjected to the system including imports from outside EAC passing through Kenya. Goods from Tanzania to Kenya have not yet been included in the system

- **Tanzania and Uganda**

- The system is used for maritime petroleum products (fuel), self-driven motor vehicles, wheat flour and vegetable cooking oil to Uganda. In the case of intra trade all goods to and from Uganda are subjected to the system.

- **Tanzania and Congo**

- The system is applied to goods heading to Congo only. The goods subjected to this system are wheat four, maize flour, petroleum products and self-driven vehicles.

13.6 Summary

In this foregoing chapter, we have learnt that duties and tariffs are both forms of taxes that are imposed on the import and export of goods to and from foreign countries. Both tariffs and

duties are imposed for the same purposes, which are to protect domestic industries, and companies, earn government income, and reduce trade deficits. Duties and tariffs are quite similar to one another, and these terms are most often used interchangeably.

A tariff is a tax on imports or exports. Money collected under a tariff is called a duty or customs duty. Tariffs are used by governments to generate revenue or to protect domestic industries from competition.

Duties are classified in two categories such as excise and customs duties. Superficially, both excise and custom duty are taxes levied by the government but the major difference between the two is that excise is the tax levied by the government on the goods manufactured in the country while customs duty is a tax levied upon goods imported in to the country from foreign countries.

There are two basic types of tariffs imposed by governments on imported goods. First is the *ad valorem* tax which is a percentage of the value of the item. The second is a *specific*

tariff which is a tax levied based on a set fee per number of items or by weight.

The East African Community Customs Management Act (EACCMA) 2004 governs the duties and tariffs in Tanzania. Tanzania Revenue Authority is currently using Single Customs Territory on goods passing through Tanzania to the EAC countries and intra trade of the region. This is initiative which was launched in October, 2013 and piloted first in the Northern Corridor involving Kenya, Uganda and Rwanda.

The Single Customs Territory (SCT) can be described as the stage for full attainment of the Customs union, which is achieved by the removal of duties and other restrictive regulations and/or minimization of internal border customs controls on goods moving among Partner States with an ultimate realization of free circulation of goods.

13.7 Review Questions

1. Differentiate between duties and tariffs with vivid examples.
2. Discuss the jurisprudence behind imposition of duties and tariffs.

3. Describe the single Customs Territory and its essence in Tanzania.

13.8 References

East African Community Customs Management Act (EACCMA) 2004, RE 2009

http://www.tra.go.tz/publications/Single%20Customs%20Territory%20brochure.pdf.

http://www.wcoomd.org/~/media/wco/public/global/pdf/events/2015/regional-integration-conference/72-session-7eac-single-customs-territory2.pdf?la=fr.

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UK National Archive, Looking for records of death duties 1796-1903

CHAPTER FOURTEEN

STAMP DUTY TAXATION

14.0 Introduction

Stamp duty is a tax that is levied on documents. Historically, this included the majority of legal documents such as cheques, receipts, military commissions, marriage licences and land transactions.

A physical stamp had to be attached to or impressed upon the document to denote that stamp duty had been paid before the document was legally effective. More versions of the tax are no longer require an actual stamp.

This chapter is going to bring about the concept of stamp duty, jurisprudence of stamp duty taxation, chargeability, rates and adjudication of the stamp duty issues in Tanzania.

14.1 Objectives

At the end of this chapter students should have: -

- Acquired knowledge and understanding of the basic concepts of stamp duty, instruments, etc.
- Acquainted with understanding on the historical development of stamp duty taxation.

- Developed ability to describe nature and importance of stamp duty tax.
- Developed ability to describe the adjudication on stamp duty issues in Tanzania.
- Acquainted with ability to discuss persons who are to ay stamp duty in Tanzania.

14.2 Stamp Duty

A stamp duty is the tax placed on legal documents usually in the transfer of assets or property.[310] This is a tax on legal documents such as those used, for example legal documents for the sale or purchase of shares or the conveyance of a property to a new owner.[311] These legal documents ought to be specified by taxation statute. Not every instrument is liable to stamp duty.

Stamp duty may be fixed or ad valorem meaning that the tax paid as a stamp duty may be a fixed amount or an amount which varies based on the value of the products, services or property on which it is levied. It is basically a kind of tax paid on any transaction based on exchange of documents or execution of instruments.[312]

310 Read more on Stamp Duty http://www.investopedia.com/terms/s/stampduty.asp#ixzz4bYjYyQBt
311 Read more at http://www.businessdictionary.com/definition/stamp-duty.html
312 See more on https://blog.ipleaders.in/stamp-duty-types-of-stamp-duty/

Where enforced, this tax is placed on the transfer of homes, buildings, copyrights, land, patents and securities. The transfer of documents in locations where this law exists is only legally enforceable once they are stamped, which shows the amount of tax paid. It is also referred to as stamp tax.

14.3 Nature of stamp duty tax

Stamp duty is collected based on property value at the time of registration. Stamp duty's amount varies from state to state and property type old or new.

Stamp duty is a legal tax payable in full and acts as an evidence for any sale or purchase of a property. The government levies stamp duty on specified instruments and fixes the rates for these instruments.

The buyer with regardless to agreement and in case of property exchange, both seller, usually pays it and the buyer has to share the stamp duty equally.

It is payable before execution of the document or on the day of execution of document or on the next working day of executing such a document. Execution of the document means putting signature on the instrument by the person's party to the document.

14.4 Genesis of stamp duty tax

The duty is thought to have originated in Spain, being introduced (or re-invented) in the Netherlands in the 1620s, France in 1651, Denmark in 1657, Prussia in 1682, and England in 1694.[313]

However, it is indicated that stamp duty was initiated when the Stamp Act of the British Parliament was passed in 1765. The tax was imposed on American colonists who were required to pay tax on all printed paper, for example licenses, newspapers, a ship's papers or legal documents. At the time, funds collected from stamp duties were used to pay for positioning troops in certain locations of America.[314]

The Stamp Duty Act, 1972 came into operation on July 1, 1972. It repealed the Stamps Ordinance. Its objectives were designed to consolidate and amend the law relating to stamp duty, by introducing minor amendments, most of which were of procedural nature. Provisions relating to composition agreements were clarified. Special provisions relating to offences were incorporated.

Stamp duty on legal instruments is a tax on the stamping of such legal instruments to make them recognized in a court of law. The former stamp

313 See Dagnall, H., (1994), Creating a Good Impression: three hundred years of The Stamp Office and stamp duties. London: HMSO, p. 10

314 See Jones, Rupert (24 March 2010). "Budget 2010: stamp duty boost for first-time buyers", The Guardian

duty on receipt on business income, which was a turnover tax payable by businesses, which are not registered for VAT, was abolished in July 2004.

14.5 Jurisprudence of Stamp duty tax

A stamp duty paid instrument / document is considered a proper and legal instrument / document with evidentiary value, and is admitted as evidence in courts. Document not properly stamped, is not admitted as evidence by the court.

Possession is the physical transfer of the property, but it is not sufficient. There is need to have legal evidence of ownership. For this a person shall have to get the property registered in his or her name in the local municipal records, with the seller documenting that the property is being transferred to him or her.[315] At the time of registration, person will also have to pay a stamp duty which is a government tax levied on property transactions.

14.6 Legal framework on stamp duty tax in Tanzania

The Stamp Duty Act, 1972 came into operation on July 1, 1972. It repealed the Stamps Ordinance. Its objectives were designed to consolidate and amend the law relating to stamp duty, by introducing minor amendments, most of which were of procedural nature. Provisions relating to composition

315 See more at http://www.indiainfoline.com/article/research-articles/what-is-stamp-duty-and-why-to-pay-it-37749558_1.html

agreements were clarified. Special provisions relating to offences were incorporated.[316]

Stamp duty on legal instruments is a tax on the stamping of such legal instruments to make them recognized in a court of law. The former stamp duty on receipt on business income which was a turnover tax payable by businesses, which are not registered for VAT, was abolished in July 2004.[317]

14.7 Instruments charged stamp duty tax in Tanzania

The instrument specified in the schedule, which is executed in Tanganyika (Tanzania mainland) or if executed outside Tanganyika relating to any property or any matter or thing performed in Tanganyika, must be charged with duty of amount that is specified or calculated in the manner specified in the schedule in relation to such instrument unless it is exempted.[318]

The Stamp Duty Act specifies the persons to pay stamp duty where in most cases it is payable by the person drawing, making, or executing the instrument.[319]

When a person is, in doubt as to whether or not an instrument is required to be stamped or as to the amount of the Stamp Duty payable in respect

316 See more at http://www.tra.go.tz/index.php/stamp-duty
317 Ibid
318 See section 5 of the Stamp Duty Act, CAP 189 RE 2006
319 See more at https://tanzaniataxlaws.co.tz/stamp-duty-tanzania/

of any instrument, he can refer the matter to the Stamp Duty Officer for adjudication.[320]

14.8 Who pays stamp duty

The law of stamp duty taxation considers the agreement between the parties of the instrument charged with stamp duty as matter of essence in the determination of who has to pay the stamp duty. Therefore, it depends on the agreement of the parties of the instrument under the charge of the stamp duty.

Nevertheless, the law goes further when there is no agreement on who has to pay the stamp duty. Section 41 of the Stamp Duty Act provides that in the absence of an agreement to the contrary, the expense for stamp duty shall be borne by the person drawing, making or executing the instruments. And in the case of administration bonds, bills of exchange, bonds, bottomry bonds, customs bonds, debentures, further charges, indemnity bonds, promissory notes, releases, respondentia bonds, security bonds and settlements.[321]

In addition, the law provides that the expense for stamp duty shall be borne by the person effecting the insurance in the case of a policy of insurance

[320] See more at http://www.tra.go.tz/index.php/stamp-duty
[321] See section 41 of the Stamp Duty Act, CAP 189 RE 2006

other than fire insurance and in the case of a policy of fire insurance, by the person issuing the policy.[322]

Moreover, in the case of a conveyance (including a reconveyance of mortgaged property), by the guarantee; in the case of a lease or agreement to lease, by the lessee or intended lessee and in the case of a counterpart of a lease, by the lessor. Then, in the case of a mortgage-deed, shall be by the mortgagor and in the case of an instrument of exchange, by the parties in equal shares. In the case of a certificate of sale, by the purchaser of the property to which such certificate relates.[323]

In the case of an instrument of partition, by the parties in proportion to their respective shares in the whole property partitioned, or when the partition is made in execution of an order passed by a civil court or arbitrator, in such proportion as such court or arbitrator directs.[324]

Also, in the case of a transfer of shares in an incorporated company or other body corporate, by the purchaser or transferee as well as in the case of a transfer of debentures, being marketable securities, whether the debenture is liable to duty or not, by the purchaser or transferee.

322 Ibid
323 Ibid
324 See section 41 of the Stamp Duty Act, CAP 189 RE 2006

Furthermore, in the case of a transfer of any interest secured by bond, mortgage deed or policy of insurance, by the purchaser or transferee and in the case of a receipt or acknowledgement of a debt, the person giving or issuing same.[325]

Generally the law provides that in any other case, such party to the instrument as a Stamp Duty Officer may direct.[326]

14.9 Time of stamp

All chargeable instruments executed by any person in Tanzania Mainland shall be stamped within thirty days of execution.[327]

Where any such instrument is brought to a proper officer for adjudication, is supposed to be stamped within thirty days. This period is between the presentations of the instrument to the proper officer until the notification to the person who presented it of the decision of the proper officer. It shall been excluded in computing the said period of thirty days. Every receipt, acknowledgement of a debt, promissory note and bill of exchange shall be stamped on the date of execution or the date of the instrument.[328]

325 Ibid
326 Ibid
327 See section 25 of the Stamp Duty Act, CAP 189 RE 2006
328 See Proviso of section 25 of the Stamp Duty Act, CAP 189 RE 2006

Every chargeable instrument executed out of Tanzania Mainland shall be stamped within thirty days of its first arrival in Tanzania Mainland.

However, where any such instrument is brought to a proper officer for adjudication within such thirty days[329], the period from the presentation of the instrument to the proper officer until the notification to the person who presented it of the decision of the proper officer shall be excluded in computing the said period of thirty days.[330]

Also, promissory notes and bills of exchange payable on demand or at not more than thirty days from sight or date shall be stamped within seven days of first arrival in Tanzania Mainland.[331]

14.10 Rates of stamp duty tax

Stamp duty is charged on specified instruments at varying rates. Some few common instruments and their duty rates are provided forthwith under Schedule of the Stamp Duty Act[332] as follows:-

Description of Instruments	Proper Stamp Duty
AFFIDAVIT, Including an affirmation or declaration in the case of persons	TSHS. 500/=

329 See under section 42 of the Stamp Duty Act, CAP 189 RE 2006
330 See Proviso of section 26 (a) of the Stamp Duty Act, CAP 189 RE 2006
331 See Proviso of section 26 (b) of the Stamp Duty Act, CAP 189 RE 2006
332 Ibid

by law allowed affirming or declaring instead of taking oath.	
AGREEMENT OR MEMORANDUM OF AGREEMENT	TSHS. 500/=
AGREEMENT RELATING TO DEPOSIT OF TITLE DEEDS, HYPOTHECATION, PAWN OR PLEDGE,	TSHS. 500/=
APPRAISEMENT OR VALUATION, made otherwise than under an order of the Court in the course of a suit:	TSHS.500/=
Instrument of EXCHANGE OF PROPERTY	0.5 percent for the first TSHS. 100,000/=, then 1 percent of value in excess of TSHS. 100,000/=
LEASE, including an under-lease or sublease and any agreement to let or sublet:	1 percent of the annual reserved rent for lease of all durations
MEMORANDUM OF ASSOCIATION OF A COMPANY	TSHS. 5,000/=

Instrument of PARTNERSHIP: (i) Where the capital does not exceed TSHS. 10,000/=.	TSHS. 1,000/=
(ii) Where the capital exceeds TSHS. 100,000/= but does not exceed TSHS. 1,000,000/=.	TSHS. 2,000/=
(iii) In any other case.	TSHS. 5,000/=
(iv) Dissolution of partnership.	TSHS. 1,000/=
POWER OF ATTORNEY,	TSHS. 500/=
TRANSFER (whether with or without consideration) (a) of shares in an incorporated company or other body corporate;	1 per cent of the value of the shares approved by the Board
(b) of debentures whether the debenture is liable to duty or not;	1 percent of the value of the shares approved by the Board

(c) of any interest secured by a bond, mortgage-deed or policy of insurance	1 percent of the value of the shares approved by the Board.

14.11 Adjudication of Stamp Duty

Where any person is in doubt as to whether or not any instrument is required to be stamped or as to the amount of the stamp duty payable in respect of any instrument, he may, upon payment of such fee as may be prescribed, apply for adjudication by a Stamp Duty Officer.[333]

Where an application is made to a Stamp Duty Officer, such officer may require to be furnished with an abstract of the instrument, and with such affidavit or other evidence, as he may deem necessary to prove that all the facts. Circumstances affecting the chargeability of the instrument with duty, or the amount of duty with which it is chargeable, are fully and truly set forth therein and may refuse to proceed upon any such application until such abstract and evidence have been furnished accordingly.[334]

333 See section 43 (1) of the Stamp Duty Act, CAP 345 RE 2006
334 See section 43 (2) Ibid

Any person aggrieved by an adjudication by a Stamp Duty Officer under this section may submit to the Stamp Duty Officer a memorandum of appeal setting forth the grounds of his objections within thirty days after the date of such adjudication.

Upon receipt of such memorandum and such fee for lodging and appeal as may be prescribed, the Stamp Duty Officer shall forward the memorandum to the Commissioners for their decision.[335]

The Commissioners may call for from the Stamp Duty Officer or the person lodging the memorandum such particulars as they may require for the purposes of determining the matters rose in the memorandum of appeal.[336]

The decision of the Commissioners on an appeal shall, subject to reference to the Tax Revenue Appeals Board, be final and bind the Stamp Duty Officer and the parties to the instrument.[337]

14.12 Summary

In the foregoing chapter, we have learnt stamp duty is a tax that is levied on documents. Historically, this included the majority of legal documents such as cheques, receipts, military commissions, marriage licences and land transactions.

335 See section 43 (3) ibid
336 See section 43 (4) ibid
337 See section 43 (5) ibid

A physical stamp had to be attached to or impressed upon the document to denote that stamp duty had been paid before the document was legally effective. Modern versions of the tax no longer require an actual stamp.

In Tanzania the Stamp Duty Act, 1972 came into operation on July 1, 1972. It repealed the Stamps Ordinance. Its objectives were designed to consolidate and amend the law relating to stamp duty, by introducing minor amendments, most of which were of procedural nature. Provisions relating to composition agreements were clarified. Special provisions relating to offences were incorporate

Also, the instrument specified in the schedule, which is executed in Tanganyika (Tanzania mainland) or if executed outside Tanganyika relating to any property or any matter or thing performed in Tanganyika, must be charged with duty of amount that is specified or calculated in the manner specified in the schedule in relation to such instrument unless it is exempted.

The Stamp Duty Act specifies the persons to pay stamp duty where in most cases it is payable by the person drawing, making, or executing the instrument. When a person is in doubt as to whether or not an instrument is required to be stamped or as to the amount of the Stamp Duty payable in respect of any instrument, he can refer the matter to the Stamp Duty Officer for adjudication.

14.13 Activities

1. Define the following terms: -
   (i) Stamp duty
   (ii) Instruments
2. Account for the historical development of the stamp duty taxation.
3. Describe the nature and significance of stamp duty.
4. Illustrate who pays stamp duty under which circumstances in Tanzania.
5. Discussion the adjudication of disputes related to stamp duty in Tanzania.

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CHAPTER FIFTEEN

LOCAL GOVERNMENT TAXATION IN TAZANIA

15.0 Introduction

Local government revenues generally contribute to a very modest share of total national public revenues in poor countries. Local government revenues are heavily reliant on broad based direct taxes mainly property taxes and taxes on businesses, various levies, licenses, fees and user charges.

Thus, local government taxes affect many directly, including the poor. Local taxation may, thus, be particularly important to fostering positive linkages between taxation, responsiveness and accountability because local taxes are more visible and broad based, owing to the simple fact of proximity.

Therefore, this chapter enshrines the concept of local government taxation, its characteristics, nature and jurisprudence. In addition, the it contains the scope, overview and challenges of local government taxation in Tanzania.

15.1 Objectives

At the end of this chapter students should have: -

- Learnt the concept of local government taxation and its jurisprudence.
- Been conversant with understanding on nature, characteristics of local government taxation.
- Advanced understanding on the overview and scope of the local government taxation in Tanzania.
- Familiarised with the strengths and weaknesses of the local government taxation system in Tanzania.

15.2 Local government taxation

Local government taxation is the determination of tax liability by a local authority such as a county or municipality. A local tax is usually collected in the form of property taxes, and is used to fund a wide range of civic services from garbage collection to sewer maintenance. The amount of local taxes may vary widely from one jurisdiction to the other.[338]

They are taxes that are due in addition to state and federal taxes. These can be in the form of property, sales, water, sewer, school, and occasionally, income taxes. Funds generated from this cover some

[338] Read more: Local Tax Definition | Investopedia
http://www.investopedia.com/terms/l/localtax.asp#ixzz4cE7DSr4x

community services. For example, they can be used for public school-related expenses.[339]

15.3 Jurisprudence of Local Government Taxation

The growth of Africa's towns and cities has outpaced local governments' capacity for service delivery in terms of management, infrastructure, and financing.

As a result, many African towns and cities are now faced with a governance crisis. The restructuring of governmental functions and finances has entered the core of the development debate.

Policy makers are increasingly aware of the potential and need to mobilise domestic revenues through broad based local government taxation.

At the same time as many towns and cities are booming economically, physically and demographically, municipal authorities face major challenges to cope with the fast-growing population.

A growing number of urban residents live in areas characterised by deficient basic services such as housing, clean water, sanitation, refuse collection, roads, and transport. Many municipalities are financially weak and rely on financial transfers and assistance from the central government.

[339] Read more: http://www.businessdictionary.com/definition/local-taxes.html

Further, revenue collection administrations are often inefficient and there are indications that substantially amounts of revenues collected are inappropriately managed.

Therefore, the benefits arising from local taxes are generally apparent at the community level. Municipalities have to face a constant balancing act with regards to levying local taxes, since rising taxes may lead to "taxpayer revolt," while low taxation levels may lead to a cutback of essential services.[340]

15.4 Scope of local government taxation in Tanzania

Local Governments have the mandate to raise certain revenues from taxes, levies and fees. The Local Governments set their own revenue policy within the limits set by Central Government. They retain all their revenue and use it as part of their own budgets. These revenues do not form part of Central Government revenue.

The taxes, levies, fees and revenue sources, which Local Governments are mandated to raise under the Local Government Finances Act, are as follows. Local Governments are not allowed to levy any taxes, levies or fees which are not on this list[341]: -

340 Read more: Local Tax Definition | Investopedia http://www.investopedia.com/terms/l/localtax.asp#ixzz4cE7nMgfn

341 See http://www.mof.go.tz/mofdocs/revenue/revlocal.htm

(a) Taxes on Property

- Property rates

(b) Taxes on Goods and Services

- Crop cess (maximum 5% of farm gate price)
- Forest produce cess

(c) Taxes on Specific Services

- Guest house levy

(d) Business and Professional Licences

- Commercial fishing license fees
- Intoxicating liquor license fee
- Private health facility license fee
- Taxi license fee
- Plying permit fees
- Other business licenses fees

(e) Motor Vehicles, Other Equipment and Ferry Licences

- Vehicle license fees
- Fishing vessel license fees

(f) Other Taxes on the Use of Goods, Permission to Use Goods

- Forest produce license fees
- Building materials extraction license fee
- Hunting licenses fees

- Muzzle loading guns' license fees
- Scaffolding / Hoarding permit fees

(g) Turnover Taxes

- Service levy

(h) Entrepreneurial and Property Income

- Dividends
- Other Domestic Property Income
- Interest
- Land rent

(i) Administrative Fees and Charges

- 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
- Revenue from sale of building plans
- Building valuation service fee
- Central bus stands fees
- Sale of seedlings
- Insurance commission service fee
- Revenue from renting of houses
- Revenue from renting of assets
- Parking fees

(j) Fines, Penalties and Forfeitures

- Stray animals' penalty
- Share of fines imposed by Magistrates Court
- Other fines and penalties

15.5 Characteristics of local government taxation

Many local taxes perform poorly with respect to the basic principles of taxation. However, these issues do not appear to be recognised by most local governments, whose main concern simply seems to be to increase local tax revenues at almost any cost.[342]

This concern has been encouraged by calls from the central government to local authorities to try harder to collect enough revenues to cover the council's wage bill.[343]

The effective rates for the same tax item (for instance crops) may differ significantly among councils. Therefore, producers living in councils with high taxes transport and sell their products in low tax councils where they can obtain higher after tax prices.

In border areas, smuggling has become extensive due to relatively high cess rates on some crops, for instance on tea and coffee. Thus, peasants dodge and manoeuvre to avoid the deprivation inflicted upon them by public policy.

342 See, Odd-Heige Fjeldstad and Joseph Semboja, Local government taxation and tax administration in Tanzania, Chr. Michelsen Institute, 1998.
343 Ibid

Some council have imposed high local taxes on export crops, in conflict with the national governments development policy to stimulate export production.[344]

The stakeholders involved in local tax design reinforce the variations observed between councils. In particular, the emphasis by local politicians on equity considerations has led to a fine-tuning of the tax structure in councils where politicians have the power to influence tax design.[345]

Thus, the present local revenue structure are partly a result of the different interests of the stakeholders involved in tax design, and partly a consequence of the councils' and the ministry's inability to understand the financial, economic and social implications of the local tax system.[346]

15.6 Local Government Taxation in Tanzania

Local taxes represent less than 5 per cent of total tax revenues in Tanzania. However, the large number of these taxes, together with their unsatisfactory nature, means that their economic, political and social impacts are considerably more significant than their figure implies.[347]

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344 See, Odd-Heige Fjeldstad and Joseph Semboja, Local government taxation and tax administration in Tanzania, Chr. Michelsen Institute, 1998.
345 See, ibid .
346 Ibid
347 See, Odd-Heige Fjeldstad and Joseph Semboja, Local government taxation and tax administration in Tanzania, Chr. Michelsen Institute, 1998.

Local authorities levy a large number of taxes, licences, fees and charges. For instance, in one council studied more than 60 different revenue bases were applied, not including the various sub-groups of individual taxes and the various tax rates in use. Moreover, large variations exist among councils with respect to the number of revenue source.

In spite of the large number of revenue sources, four main sources are crosscutting almost all district councils; these are development levy, crop and livestock cess (agricultural cess), business licences and market fee.[348]

Improvements have been achieved in different ways, for example by expanding the tax base, revaluing properties, improving tax administration, pursuing a successful collection-led strategy to improve the collection ratio among existing properties.

Introduction of modern technology for mass valuation of properties has proved effective in some countries. In 2014, Arusha City Council in Tanzania changed from a manually administered own-source revenue system to a modern Local Government Revenue Collection Information System (LGRCIS) integrated with a geographic information system (or a GIS platform).

348 Ibid

The new system allows the local government to use satellite data to identify taxpayers' properties and includes an electronic invoicing system that notifies and tracks payments.

15.7 Local Government Taxation Challenges

The by-law system gives local authorities quite a wide discretion to introduce new local taxes and to set tax rates, subject to ministerial approval.

Due to lack of capacity and poor co-ordination between the central and local government only limited restrictions are in practice imposed by the central level on local governments' tax design.[349]

Therefore, the local revenue systems have developed without much interference from above. This has led to large variations in the revenue structures of local authorities, and to duplication of local and central government taxes.

All the relevant decision making levels lack the required tax expertise for designing an appropriate tax system. At the local level the serious shortage of qualified staff at the treasury and planning departments has been noted across almost all councils.[350]

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[349] See, Odd-Heige Fjeldstad and Joseph Semboja, Local government taxation and tax administration in Tanzania, Chr. Michelsen Institute, 1998.

[350] Ibid

Even the available staffs lack expertise on tax issues. At the ministerial level, experience shows that the main concerns with respect to local tax design are raised by the Legal Department; the ministry has no tax experts.

Fiscal corruption is extensive in the councils studied, facilitated by the complicated and non-transparent tax system. Corruption takes many forms and varies by types of taxes, methods of tax collection and location.

It cuts across all levels of the local government, from the village to the district council headquarters. Magnitude in terms of the amounts of money involved seems to rise by the level of the council.

Taxpayers' resistance to pay adds to the enforcement costs, Collectors often have to use harsh methods and violence. Roadblocks and the local militia are frequently used as instruments of tax enforcement. For instance, manned barriers are used to control buyers of certain crops like cashew nuts in some regions. The buyer has to produce the cess receipt before he is allowed to take any cashew nuts from the district.[351]

15.8 Summary

[351] See, Odd-Heige Fjeldstad and Joseph Semboja, Local government taxation and tax administration in Tanzania, Chr. Michelsen Institute, 1998.

In the above chapter, we have well read that local government revenues generally contribute to a very modest share of total national public revenues in poor countries. Local government revenues are heavily reliant on broad based direct taxes mainly property taxes and taxes on businesses, various levies, licenses, fees and user charges.

In addition, we have understood that local government taxation is the determination of tax liability by a local authority such as a county, region, town, city, village, ward, district or municipality. The benefits arising from local taxes are generally apparent at the community level. Local authorities have to face a constant balancing act concerning levying local taxes, since rising taxes may lead to taxpayer revolt, while low taxation levels may lead to a cutback of essential services.

Moreover, we have well-known that the present local revenue structure is partly a result of the different interests of the stakeholders involved in tax design, and partly a consequence of the councils and the ministry's inability to understand the

financial, economic and social implications of the local tax system.

Furthermore, it has become in our mind that local authorities in Tanzania levy a large number of taxes, licences, fees and charges. Moreover, large variations exist among councils with respect to the number of revenue source.

Generally, it is important to note that the by-law system gives local authorities quite a wide discretion to introduce new local taxes and to set tax rates, subject to ministerial approval.

15.9 Review Questions

1. Define the concept local government taxation
2. Describe the characteristics of local government taxation
3. Discuss the essence of the local government taxation
4. Illustrate the scope of the local government taxation in Tanzania
5. Talk over authoritatively on the local government taxation in Tanzania and its challenges.

15.10 References

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CHAPTER SIXTEEN

ACCOUNTING FOR TAX AND LODGING OF RETURNS

16.0 Introduction

In this chapter, we are going to learn the concepts of tax accounting, tax returns and tax payment systems. However, we are going to acquaint mostly on the principles governing accounting of tax, preparation and submission of tax returns.

Finally, we shall be discussing the tax payment systems and their procedures. Hence, be ready to grasp ideas and brainstorm beyond what is within this chapter.

16.1 Objectives

At the end of this chapter students shall be able to: -

- Understand and explain meaning of accounting for tax and its purposes.
- Acquaint yourself with concept of tax returns, types and their legal requirements.
- Familiarise yourself with the tax payment systems and brainstorm on their advantages and disadvantages.

- Grasp process of submission of tax returns and how to go about to their completion.

16.2 Accounting for tax

Tax accounting is a specialized field of accounting where accountants focus on the preparation of tax returns as well as tax planning for future taxable years. Accounting for tax is governed by the specific rules that companies and individuals must follow when preparing their tax returns.

The purpose of accounting is to track funds associated with an individual or business. Accounting for tax focuses solely on those transactions that affect an entities tax burden, and how those items relate to proper tax calculation and tax document preparation. Accountings for tax principles under tax laws of Tanzania are hereby briefly stated: -

❖ Establishment of tax accounts

The law empowers the commissioner General to establish and operate in electronic system the tax account for each taxpayer or taxable person.[352] This is done for easily tracking payment of the taxpayers in every period of income or due payment.

❖ Submission of true and correct tax documents

[352] Section 58 of VAT Act, Act No. 5 of 2014

A registered taxpayer is required to submit with the returns for purpose of determination of tax liability payable true and correct tax documents such as tax invoices or receipts.[353] Submission of untrue or incorrect tax documents is penal offence under tax law which attracts penalties to the taxpayer or taxable person.

If the value of the supply in tax invoices exceeds the minimum amount prescribed in the regulations, the name, address, Taxpayer Identification Number and value added tax registration number of the customer, then they shall be valid however cannot be used to support input credit claims by taxpayer or taxable person.[354]

- **Maintenance of tax documents**

A taxable person shall keep record of all accounts, documents, returns, and other records that are required to be issued or given under tax law.[355] This maintenance shall be done within at least five years or later date of the final decision is made out of audit.[356]

- **Investigation or auditing tax affairs**

[353] Section 86 (1), ibid
[354] Section 86 (2), ibid
[355] Section 89 (1), ibid
[356] Section 89 (2), of VAT Act, Act No. 5 of 2014

The tax law vests the power to the Commissioner General to undertake audit or investigate tax affairs of taxpayer or taxable person.[357] Such auditing or investigation shall focus on history of non-compliance, amount of tax payable, business activity taxpayer or taxable person undertakes and other relevant matters observed.[358] Auditing or investigation in one period shall not bar the auditing or investigation of the same person in another period is there are reasonable grounds for doing so.[359] Moreover, investigation or auditing can be done for the purpose of the different laws of taxation.[360]

- **Access to information**

Commissioner and every officer who is authorized in writing by the Commissioner shall have at all times during the day between 9am and 6pm and without any prior notice and at all other times as permitted by a search warrant granted by a district or resident magistrate's court, full and free access to any premises, place, document or other asset. Also they may make extract copy, seize document found reasonably believed to be of relevance for accounting tax.[361]

357 Section 45 (1), ibid
358 Section 45 (2), ibid
359 Section 45 (3), ibid
360 Section 45 (4), ibid
361 Section 138 of Income Tax Act, CAP 332 RE 2008

16.3 Tax returns

Tax return is a form on which a taxpayer makes an annual statement of income and personal circumstances, used by the tax authorities to assess liability for tax.[362] Tax returns allow taxpayers to calculate their tax liability and remit payments or request refunds, as the case may be.

16.3.1 Introduction

Tax return can be defined to mean a declaration of personal income made annually to the tax authorities and used as a basis for assessing an individual's liability for taxation. However such declaration must be accurate, complete and signed by a person who made it.[363]

Generally according to section 37(1) of Tax Administration Act[364] a person who prepares the tax return shall sign it. However returns of entity shall be declared and signed by the manager of the entity.[365]

16.3.2 Who has to prepare tax returns?

Generally, a taxpayer or taxable person is the one to prepare and file tax return for determination of amount of tax liability made under a tax law.

[362] Collins English Dictionary, 12th Edition HarperCollins Publishers, 2014
[363] Section 37 (1) of Tax Administration Act, Act No. 10 of 2015
[364] Act No. 10 of 2015
[365] Section 37 (2) of Tax Administration Act, Act No. 10 of 2015

However, taxpayer or taxable person can be assisted in preparation of tax return.

The person who assists taxpayer or taxable person to prepare and file tax return must sign the return or attachment and certify that he has done examination of relevant documents and truth or fairness of return according to circumstances.

If he has not been satisfied by documentation and information available shall state reasons.[366] Under certain circumstance Commissioner General can prepare tax return when he makes adjustment in assessment or jeopardy assessment.

16.3.3 Types of Returns

In Tax, laws of Tanzania there are three types of returns of income, namely, normal returns, provisional returns and occasional returns. However, the Act empowers the Commissioner to require any person to furnish him with returns aimed at gathering information or preventing evasion these are referred to as occasional returns.

(a) Normal Returns

[366] Section 38 of Tax Administration Act, Act No. 10 of 2015

These are returns furnished after a notice has been issued to the taxpayer or taxable person. They are made under section 37 (3) and (4)[367] and 92.[368]

Normal returns have to be completed by taxpayers and filed with the Commissioner within time prescribed in the notice served to the taxpayer or taxable person.

In the case of a person carrying on a business who has made a provisional return of income, such normal return (referred to as final return in such cases) may be filed within a period not exceeding three months from the date to which he makes up the accounts of such business.

Further, the Commissioner is empowered, under sub-section 91 (3)[369] to issue notice for filing return of income in the case of executors or administrators of a deceased person, or of a liquidator of a resident company or partners of a firm being wound up, or of a bankrupt. In addition to any person whom he has reason to believe is about to leave Tanzania at any time whether before or after the end of the year of income to which such return relates.

(b) Provisional Returns

[367] Tax Administration Act, Act No. 10 of 2015
[368] Income Tax Act, CAP 332 RE 2008
[369] Income Tax Act, CAP 332 RE 2008

These are returns submitted by individuals, firms or companies deriving their income from business. The Commissioner may require any person other than an employee or a person who has been required to furnish a normal return under sub-section 37 (3) and (4) of Tax Administration Act and has furnished the same, to furnish a provisional return.

A provisional return is a kind of self-assessment by the taxpayer. In a provisional return the taxpayer shall estimate his income chargeable to tax, the tax chargeable on such income and shall make a declaration that such return contains full and true estimates of his income and tax to the best of his knowledge and belief.

An individual taxpayer can amend a provisional return by filing an amended provisional return if during the year of income, he discovers that the provisional return furnished is likely to be substantially incorrect because of changed circumstances or where he is dissatisfied with an estimated provisional assessment raised by the Commissioner.

(c) Occasional Returns

In order to provide the tax authorities with information to enable them to trace potential taxpayers and prevent evasion of tax, the Act empowers the Commissioner to require any person to furnish him with returns containing details of payments made to other person and as useful

information according to section 42 and 44 of Tax Administration Act.[370] For instance:

(i) Return by an employer giving details of persons employed and salaries paid to them.

(ii) Return by businesses giving details of fees, commissions, royalties etc. paid for services rendered by other persons.

(iii) Return by occupiers giving names and addresses of lodgers and tenants and the rents payable by them.

(iv) Return on dividends paid by a resident corporation.

(v) Return as to interest paid or credited by banks.

(vi) Return as to income exempt from tax.

(vii) Return as to income received on account of other persons.

Such returns shall be filed with a reasonable time specified by the Commissioner in the notice, provided that such specified time shall not be less than thirty days form the date of service of such notice.

16.3.4 Requirements in respect of Returns

(a) Declaration:

[370] Act No. 10 of 2015

According to section 37 (1) of Tax Administration Act[371] and section 91(2) (c) of Income Tax Act[372] all returns must contain a declaration signed by the person filing the same that the return is a full and true statement.

(b) Accounts:

A copy of the balance sheet and the trading profit and loss account must accompany save for occasional returns, all returns.

(c) Verification of Accounts:

The copies of the balance sheet or trading profit and loss account must[373]:

(i) Be signed by the taxpayer or authorized auditor or authorised accountant.

(ii) Be accompanied by a certificate signed by such person.

(iii) Where the accounts were prepared by an authorised auditor or authorised accountant, the certificate shall specify the nature of books of account and documents from which such accounts were so prepared and shall state to what extent he or she considers the accounts to present a true and fair view of the gains or profits from the business.

371 Act No. 10 of 2015
372 CAP 332 RE 2008
373 Section 91(2) of Income Tax Act

(d) Certain Returns to be prepared by Authorized Auditor or Accountant:

Section 91(2) (b) of Income Tax Act imposes a requirement that a return of income or a provisional return of income of a corporation must be prepared or certified by a certified public accountant in public practice.

(e) Records:

Every taxpayer must keep proper books of account and records and preserve the same for a period of not less than 5 years after the year of income to which such books and records related, and he shall at any time produce them for examination or retention by the Commissioner, and shall not destroy damage or deface them.

16.4 Submission of tax returns

There are main two means of submission of tax returns such as manual submission and online submission.

16.4.1 Manual submission of tax return

The taxpayer or taxable person visits TRA office in his area and submit hardcopy of accurate and true tax return as supposed to be submitted for the determination of tax liability and payment of amount of tax payable.

16.4.2 Online submission of tax returns

Online submission this is a system of submitting return to TRA through TRA Web.

(a) Procedures of online submission

On line submission of tax returns require the following steps:

i. Register for Electronic Filing:

In order to file returns electronically to TRA, the registered taxpayer will be required to click on the e-filing hyper link. This will take the taxpayer to the e-filing System linkage.

The taxpayer (Individual and Entity) will have to register into the System on initial access and will be given an Electronic Filer Identification Number (e-fin).

The taxpayer will further be issued with an initial password to facilitate creation of his/her own password, login and filing of returns.

ii. Signature of an individual filing the return electronically

Since the requirement to sign the return is mandatory and taking into consideration that the return shall be filed electronically. The e-filer's

signature shall automatically be retrieved from the Automatic Finger Identification System (AFIS) where the filer's signature was captured when the e-filer was requesting from TRA on one of the following services:

1. Application for driver's license
2. Registration of a motor vehicle or
3. Normal application of TIN for any other business.

iii. Signature for the Company or Entity Filing the Return Electronically:

On e- filing registration for a Company or any other Corporate Entity, the System will prompt for a Taxpayer Identification Number (TIN) of one of the Directors' and will hence check if the Director has undergone biometric scanning before proceeding to retrieve the taxpayer's general information. If the e- filer's signature has not been captured in the TRA AFIS System, then the e- filer is required to arrange for signature capturing at the TRA office where the filer or the entity files its VAT returns.

(b) Advantages of submitting tax return online

The web-based return system offers the following benefits: -

- Taxpayers will interact with TRA while at their houses or offices.
- Elimination or reduction of queues at TRA offices during due dates

- E-filing will result in fewer errors and creates simple and quicker processing of documents.
- Taxpayers can save their records in their e-mail boxes or print hard copies for future reference.

16.5 Tax Payment System

Payment time of tax varies nature of tax payable. There are different taxes payable under different tax laws. Each law its own time for payment of tax chargeable under it, hence there is no same and specific time for payment of all taxes.

In addition, time of payment of tax can be based on the assessment made and prescription of the notice however, in adjusted assessment the taxpayer must pay tax within thirty days since notice of adjusted assessment.[374]

Taxpayer can apply for extension of time of payment of tax in case of delay. Such application must be in writing. It must be sent Commissioner General for extension of time to pay tax under a tax law. Nevertheless, the applicant must have sufficient cause. Such extension of time is upon the discretion of the Commissioner General.[375]

[374] Section 54 (1) of Tax Administration Act, Act No. 10 of 2015
[375] Section 55 of Tax Administration Act, Act No. 10 of 2015

Basing on the current system, taxpayers are required to pay taxes through banks and submit evidence of payments to TRA. The following are modes of payments

16.5.1 TISS mode

Bank payment system of tax is one the recent mode of tax payment in Tanzania. It is regulated under TISS, which stands for Tanzania Interbank Settlement System.[376]

This is a simplest way used by the taxpayers to order the commercial bank to transfer payments to BOT, and the contents, which are found in the TISS form, are: Name of Account holder (s), Account number, Name of commercial Bank, Amount in TSHS, Amount in words and value date.

TRA has taken a number of initiatives to modernize its operations through automation and improve the quality of services provided to the Taxpayers. In order to have secure and efficient payment systems, the two institutions; BOT and TRA agreed to develop the interface that will improve the process of revenue collections and achieve straight through process (STP) between TISS-CBS at BOT and EPICOR, ITAX and TANCIS at TRA.

[376] Section 56 (1) (b) of Tax Administration Act, Act No. 10 of 2015

Revenue Gateway is an intelligent software interface designed and developed to improve the process of revenue collections by achieving STP between BOT and TRA, and Commercial Banks.

i. Taxpayer will select mode of payment (TISS); upon submission, the RG shall generate pay slip and assign a unique control number. The Control number, which is eight (8) digits, will be used for reconciliation between TRA and Commercial Banks
ii. The taxpayer shall then submit a printed pay-in slip to the Commercial Bank and order the Bank to transfer tax to Commissioner's account at BOT
iii. Commercial bank shall receive a pay slip and command the transfer by initiating the transaction into SWIFT terminal by indicating the Control number of the slip
iv. The Gateway shall receive transaction details in form of SWIFT messages from TISS and Gateway will validate and transform it
v. Gateway will update respective revenue system through their web services.

There are many advantages of revenue gateway system in tax payment modes. The advantages of Revenue Gateway payment mode are hereby accounted for:

i. the Gateway save time to taxpayers in payment process

ii. It improves accounting and analysis of Government revenue collection;

iii. It minimizes human intervention; improved data integrity and speed up documentation process.

iv. It enhances security - as concentrator of payment messages flow.

v. It reduces costs - as TRA shall maintain one interface to all commercial banks which will be easier to manage and maintain.

vi. Payment procedures are made ease for taxpayer and receive acknowledgement every time when TRA receives payment.

16.5.2 Payment through mobile phone and other modes

This is a system whereby taxpayers pay taxes through mobile phone such as M-pesa, Tigo Pesa, Airtel Money and Max Malipo. [377]For utilizing this service, taxpayers are advised to fulfil the following requirements:-

i. A taxpayer must be a subscriber and registered. Taxpayers are kindly advised to contact the selected agents scattered throughout the country.

[377] Section 56 (1) (c) of Tax Administration Act, Act No. 10 of 2015

ii. After being registered a taxpayer will be required to load money to his/her Agents Account.

After having fulfilled the requirements for paying tax through the stated systems, taxpayers are advised to follow the instructions given by the service provider. Taxes which may be paid through mobile include personal income tax, presumptive taxes, motor vehicle taxes and fees

16.5.3 Payment of Tax Manually

The following are the procedures, which Taxpayers are required to follow during making tax payment.[378]

i. Visit the nearest TRA office/Centre.
ii. Obtain the tax assessment/charge together with control number.
iii. Collects a payment notice, Deposit slip, and fill in the appropriate particulars (Name of Taxpayer, type of tax, TIN, GFS code Number, Amount of tax to be paid, Date of payment and Signature of the person making payment.
iv. Submit the same to the Bank/Teller and make payment.
v. Obtain the copy of Bank payment notice and Deposit slip for his/her record.

[378] Section 56 (1) (a) of Tax Administration Act, Act No. 10 of 2015

16.6 Summary

Generally, from this chapter we have understood the concept of tax accounting as process of preparing tax returns and other documents for the purpose of determination of tax liability.

The process aims at tracking the income and expenses generated by the taxpayer to help him or her to determine the amount of tax payable.

Hence under this aspect the tax laws demand the submission of true and accurate tax returns, maintenance of records and documents, allow auditing and investigation as well as access to premises for determining the correct tax liability.

The tax returns are associated with the declaration of the income so as to assess the tax liability of the tax payer. The taxpayer or commissioner general under certain circumstances prepares them. There are normal returns, provisional and occasional returns depending on their preparation circumstances.

Tax returns should be submitted timely because failure to do attract penalties. They can be submitted manually or vide TRA

web and their procedures are different depending on the method of submission.

Tax payment system is so crucial in determining the voluntary compliance. If it is complicated, the taxpayers can be provoked to fail. Hence, there are three modes of tax payments in Tanzania. These are banking system, mobile system and manual system.

However, for avoiding corrupt practices, nowadays it is demanded to use mobile and banking system rather than manual system.

16.7 Review Questions

1. What do you understand by the terms tax accounting and tax returns?
2. Identify and describe reasons for tax accounting
3. Identify and describe types of tax returns
4. What are legal requirements of tax returns
5. Discuss the mode of submission of tax returns applicable in Tanzania
6. Discuss strengths and weaknesses of online submission of tax returns.

7. Discuss the tax payment systems applicable in Tanzania

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CHAPTER SEVENTEEN

TAX PLANNING

17.0 Introduction

Tax planning is the analysis of a financial situation or plan from a tax perspective. The purpose of tax planning is to ensure tax efficiency, with the elements of the financial plan working together in the most tax-efficient manner possible. Tax planning is an important part of a financial plan, as reducing tax liability and maximizing eligibility to contribute to retirement plans are both crucial for success.

This chapter is going to introduce you to concept of tax planning and it is different from the tax avoidance and tax evasion. In addition, the chapter shall enlighten on issues on nature, types, significance as well as prerequisites of the tax planning and how to go about the tax planning process for its efficiency and productivity.

17.1 Objectives

At the end of this chapter students should have: -

- Acquired knowledge and understanding of the basic concepts of tax planning.

- Acquainted with knowledge on the prerequisites of the tax planning.
- Developed ability to describe nature and importance of tax planning.
- Developed ability to describe how you go about tax planning.
- Acquainted with ability to discuss categories of tax planning.

17.2 Tax Planning

Tax planning is a process individuals, businesses, and organizations use to evaluate their financial profile, with the aim of minimizing the amount of taxes paid on personal income or business profit.[379]

Tax planning is a way by which taxpayer or taxable person arranges his or her financial affairs in such a manner that without breaking up any law he or she takes full advantage of all exemptions, deductions and reliefs allowed by law so that his or her tax liability will be reduced.[380]

[379] Read more at http://www.investorglossary.com/tax-planning.htm
[380] Read more at http://www.fingyan.com/what-is-tax-evasion-tax-avoidance-and-tax-planning/

Generally, tax planning is the analysis of one's financial situation from a tax efficiency point of view so as to plan one's finances in the most optimized manner.[381]

Tax planning is a legal way of reducing income tax liabilities however, caution has to be maintained to ensure that the taxpayer isn't knowingly indulging in tax evasion or tax avoidance.

17.3 Categories of tax planning

Various methods of Tax Planning may be classified as follows[382]:-

17.3.1 Short Term Tax Planning

Short Term Tax Planning means the planning thought of and executed at the end of the income year to reduce taxable income in a legal way.

For example, suppose, at the end of the income year, an assessee finds his taxes have been too high in comparison with last year and he intends to reduce it.

Now, he may do that, largely by making proper arrangements to get the maximum tax. Such plan does not involve any long-term commitment, yet it results in substantial savings in tax.

381 See more at https://www.bankbazaar.com/tax/tax-planning.html
382 Read more at http://incometaxmanagement.com/Pages/Tax-Management-Procedure/5-1-Meaning-of-Tax-Planning.html

17.3.2 Long Term Tax Planning

Long range tax-planning means a plan chaled out at the beginning or the income year to be followed around the year. This type of planning does not help immediately as in the case of short range planning but is likely to help in the end.

17.3.3 Permissive Tax Planning

Permissive Tax Planning means making plans, which are permissible under different provisions of the law. Planning of taking advantage of different incentives and deductions, planning for availing different tax concessions entails permissive tax planning.

17.3.4 Purposive Tax Planning

It means making plans with specific purpose to ensure the availability of maximum benefits to the assessee through correct selection of investment, making suitable programme for replacement of assets, varying the residential status and diversifying business activities and income.

17.4 Nature of Tax Planning

Tax planning encompasses many different considerations, including the timing of income, purchases and other expenditures; the selection of

investments and types of retirement plans; and a person's filing status and common deductions.[383]

Tax planning constitutes devising strategies throughout the year in order to minimize tax liability. It is the practice of making adjustments so as to reduce one's tax liability to the least possible amount.[384]

Tax planning is legitimate when a taxpayer or taxable person does it within the letter and the spirit of the law. However, some arrangements attract attention to determine whether they are lawful.[385]

Tax planning is different form tax avoidance in the sense that tax planning is organising tax affairs in the most tax effective way within the intent of the law. In contrast, tax avoidance schemes involve the deliberate exploitation of the tax system.[386]

Tax planning and financial planning are closely linked, because taxes are such a large expense item as tax payer or taxable person goes through life. If taxpayer or taxable person becomes really successful, taxes will probably

383 Read more at Tax Planning http://www.investopedia.com/terms/t/tax-planning.asp#ixzz4bn7dTSUC
384 Read more at http://financial-dictionary.thefreedictionary.com/Tax+planning
385 See more at https://www.ato.gov.au/General/Tax-planning/Tax-planning-vs-tax-avoidance/
386 Ibid

be single biggest expense over the long haul. So planning to reduce taxes is a critically important piece of the overall financial planning process.[387]

Effective tax planning entails analysing investment instruments, expenditures, and other factors such as filing status for their tax liability impact. Accounting, finance, banking, and insurance firms all emphasize slightly different aspects of tax planning in accordance with the types of services they provide and the laws governing their industries.

When tax planning is done inside the frameworks defined by the respective authorities, it is fully legal and in fact a smart decision. However, using shady techniques to avoid tax payments is illegal and you may get into trouble for doing so.[388]

Tax saving practices includes tax avoidance, tax evasion and tax planning. Out of these taxes, planning is the only legal manner of reducing your tax liabilities. The government offers the different opportunities to save on taxes with the intention of reducing tax burden on a taxpayer through legal income tax planning methods.[389]

17.5 Significance of Tax Planning

387 See more at https://turbotax.intuit.com/tax-tools/tax-tips/General-Tax-Tips/Tax-Planning-for-Beginners/INF26192.html
388 See more at https://www.bankbazaar.com/tax/tax-planning.html
389 See more at https://www.bankbazaar.com/tax/tax-planning.html

Basic tax planning strategies aimed at reducing the amount of taxable income may increase the gap and thus refund. In some cases, these strategies benefit taxpayer or taxable person in other ways, offsetting future costs for health care or providing for retirement. Though some aspects of tax law can be complicated, even a beginner can focus on taxable income reduction.[390]

Tax planning allows a taxpayer to make the best use of the various tax exemptions, deductions and benefits to minimize their tax liability over a financial year.[391]

Tax planning is resorted to maximize the cash inflow and minimize the cash outflow. Since tax is kind of cast, the reduction of cost shall increase the profitability. Every prudence person, to maximize the return, shall increase the profits by resorting to a tool known as a tax planning.[392]

Tax planning can also help you take advantage of tax rate differentials between years. However, if tax rates rise in a subsequent year, extra caution may be necessary.[393]

390 Read more Green Financial Advice Limited, Tax Planning Guide Tips, 2016/17
391 Ibid
392 Ibid
393 Read more at https://tanzaniataxlaws.co.tz/tax-planning/

Tax planning can also help you prevent, or minimize, the impact of the alternative minimum tax by preserving the tax benefit of many of your deductions.[394]

12.6 Prerequisites for undertaking tax planning

Tax Planning should be done by keeping in mind of the following factors[395]:-

The planning should be done before the accrual of income. Any planning done after the accrual income is known as Application of Income and it may lead to a conclusion of that there is a fraud.[396]

Tax Planning should be resorted at the source of income.

Tax planning should consider the choice of an organization, i.e. taxable entity. Business may be done through a Proprietorship concern or firm or through a company.[397]

The choice of location of business, undertaking, or division also plays a very important role in planning process for it to produce the efficiency in business.[398]

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394 Read more at https://www.uc.edu/content/dam/uc/hr/bewelluc/downloads/Presentations/Tax%20Strategies.pdf

395 See R. W., Maas, Tax Minimisation Techniques, Oyez Longman Publishing Limited, London, 1983, 10 16.

396 Ibid

397 Read more Green Financial Advice Limited, Tax Planning Guide Tips, 2016/17

398 Ibid

The residential status of a person is matter of consideration for tax planning. Therefore, a person should arrange his stay in India such a way that he is treated in the country.[399]

Choice to buy or lease the assets is an issue of tax planning. Where the assets are bought, depreciation is allowed and when asset is leased, lease rental is allowed as deduction.[400]

Capital structure decision also plays a major role. Mixture of debt and equity fund should be balanced, to maximize the return on capital and minimize the tax liability. Interest on debt is allowed as deduction whereas dividend on equity fund is not allowed as deduction.

17.6 How to go about tax planning

Tax planning is very crucial for any taxpayer or taxable person. However, it is a process, which must be taken carefully to ensure its efficiency and productivity. Here are some tips on how to go about tax planning.

17.6.1 Start a filing system

Start a filing system to organize your documents. Any successful tax planning strategy requires you to maintain records of all transactions and receipts that may affect your tax return.

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399 Read more Green Financial Advice Limited, Tax Planning Guide Tips, 2016/17

400 See Hector s, Deleon, The Fundamentals of Taxation, (Manila Philippines: Rex Book Store, 1984), p.52

This helps to keep track of important documents and avoid forgetting about transactions that occur months before the tax filing deadline.

17.6.2 Understand tax deduction requirements

Before you get too far along in the tax year, you should evaluate all available IRS deductions and the requirements to claim them. By doing this beforehand, you can be proactive in preparing to claim a deduction at the end of the year.

For example, if you know you are heading back to school soon and will need a loan to pay your tuition, it may be better to take out a student loan rather than using a credit card. This is because you can deduct the interest that accrues on a student loan, but not on a credit card, even if used for educational purposes.

17.6.3 Evaluate the tax credits offered

Tax credits offer a significant opportunity to save money on income taxes since they reduce your actual tax bill on a dollar-for-dollar basis. The types of tax credits offered each year change more frequently than deductions. Credits are often available for a limited time and cover specific types of expenses.

17.7 Tax Planning Strategies

Tax planning strategies can defer some of your current year's tax to a future year, thereby freeing up cash for investment, business or personal use. This can be accomplished by timing when you pay certain expenses, or controlling when your income is recognized.

Tax planning must include strategies to deduct, defer and divide. The concept of effective tax planning can have a different meaning and emphasis depending upon your personal circumstances.

The three 'D's' to investing are deduct, defer and divide. You must be able to understand all of these important functions in order to do effective tax planning.

17.7.1 Deduct

A deduction is a claim to reduce your taxable income. A deduction will reduce your tax bill by an equal amount to your marginal tax rate. Some common deductions include

17.7.2 Defer

A deferral strategy is to try to push having to pay tax now into future years. Deferring tax means you might eliminate the tax this year but you will eventually have to pay the tax down the road.

Generally, tax deferral has 2 advantages: -

(1) It is better to pay a dollar of tax tomorrow than it is to pay a dollar of tax today and

(2) Tax deferral typically puts the control of when you have to pay the tax in the hands of the tax payer instead of revenue authority and various investment income strategies are the most common forms of tax deferral for the 'average'

17.7.3 Divide

Often called income splitting, dividing taxes implies the ability to take an income and spread it among a number of different taxpayers. For example, it you have one-person paying tax on 70,000 vs. having 2 people (say husband and wife) paying tax on 35,000 each, you would rather have the second scenario. Unfortunately, you cannot arbitrarily decide who is going to claim what amounts for income. There are, however, strategies to divide income within the rules

17.8 Summary

In the foregoing chapter, we have learnt that tax planning is the preparation to pay tax completely, correctly and economically. Escaping from taxation and lessening the payment of a tax by legal means are also deemed as tax planning. Tax planning has to be done before and during doing

business. The purpose of tax planning is to ensure tax efficiency, with the elements of the financial plan working together in the most tax-efficient manner possible.

Tax planning is an important part of a financial plan, as reducing tax liability and maximizing eligibility to contribute to retirement plans are both crucial for success. When tax planning is done inside the frameworks defined by the respective authorities, it is fully legal and in fact a smart decision.

However, using shady techniques to avoid tax payments is illegal and you may get into trouble for doing so. Effective tax planning entails analysing investment instruments, expenditures, and other factors such as filing status for their tax liability impact.

Accounting, finance, banking, and insurance firms all emphasize slightly different aspects of tax planning in accordance with the types of services they provide and the laws governing their industries.

17.9 Review Questions

1. What do you understand by the term tax planning?
2. Describe the categories of tax planning
3. What are the nature, scope and relevance of tax planning?
4. What are necessary conditions to be born in mind when undertaking tax planning?
5. Discuss how to go about tax planning successfully and efficiently.

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CHAPTER EIGHTEEN

ASSESSMENT OF TAX IN TANZANIA

18.0 Introduction

Assessments of taxes are fundamental to tax collection. Every state or jurisdiction that taxes income has laws to impose the tax and a system to assess and collect it.

An assessment is the result of the process of ascertaining a taxpayer's taxable income and calculating the tax payable on that income. Therefore, in this chapter we are going to learn the concept of assessment, reasons for the assessment, types of assessment and their circumstances.

18.1 Objectives

At the end of this chapter students should have: -

- Attained knowledge and understanding of the meaning and rationale behind assessment of tax.
- Accustomed with understanding various types of assessment of tax embedded in tax statutes of Tanzania.
- Advanced ability to describe circumstances under which each type of assessment is undertaken according to tax statutes of Tanzania.

- Established ability to discuss whether self-assessment of tax is more worth compared to other assessments..

18.2 Assessment

Tax assessment being a difficult area of work it is but imperative that the assessing authority should be provided with adequate powers for encountering tax evaders. The assessing officers in this respect have been given wide powers in that regard.

It also aids in honest tax disclosures to avoid the rising concerns of tax evasion, which had panicked the economy of the country thereby giving rise to a parallel-unaccounted economy.

18.2.1 Assessment of tax

Assessment of tax is the process of evaluating income of taxpayer or taxable to determine the amount of tax payable to the revenue authorities in a particular state or jurisdiction.[401] Therefore, assessment of tax occurs when an income, transaction, or property value must be determined for the purpose of taxation.

Section 3 of the Tax Administration Act[402] defines assessment to mean determination of amount of tax liability made under tax law by

[401] http://www.investopedia.com/terms/a/assessment.asp
[402] Act No. 10 of 2015

Commissioner General or by self-assessment and matters in the first schedules are inclusive.

18.2.2 Basis of assessment of tax

Assessment of tax is the creature of tax statute.[403] According to the reasoning of the case of **Batagol v. Federal Commissioner of Taxation,**[404] whereby the court if the tax statute demands assessment of tax in order to determine the tax liability of taxpayer or taxable person. Hence, assessment refers to ascertainment of tax payable as determined or ascertained in each respective tax law.[405]

Assessment of tax usually is based on records and information of taxpayers or taxable person's business. When the records and information are nowhere to be seen or not available, the assessment will be estimated based on the best judgment rule.

Assessors of tax

According to wording of section 3 of the Tax Administration Act, assessment can be done by the taxpayer or taxable person himself or herself as per section 46 of Tax Administration Act[406] and or Commissioner

403 Income Tax Department, Various Assessment under Income Tax Law, Ministry of Revenue Finance of India, 2015
404 *Batagol v Federal Commissioner of Taxation* (1963) 109 CLR 243
405 Cambridge English Dictionary
406 Act No. 10 of 2015

General under certain circumstances as per section 47 and 48 of Tax Administration Act[407]

18.3 Types of Assessment

A key part of the assessment process is the completion and lodgement of an income tax return.[408] This requires taxpayers or their agents (and sometimes third parties) to provide information to the tax authorities about their income, deductions, and any tax offsets to which they are entitled. The task of completing income tax returns requires taxpayers (or their agents) to apply the income tax laws properly to their affairs.

The length, scope and nature of income tax law, and the style of the administrative systems to support the law, mean that this can be a difficult task for some. Depending on the type of assessment system, the roles and responsibilities of taxpayers, agents, third parties and the Tax Office can vary.

18.3.1 Self-assessment

Self-assessment implies the determination of amount of tax liability made under a tax law through lodging tax returns and accounts by the person

407 Ibid
408 Government of Australia, Discussion paper on Review of Aspects of Income Tax Self-Assessment

who is liable to pay tax. Under self- assessment, the taxpayer or taxable person is obliged to file tax returns.[409]

Essentially the assessment would evidently mean determination of the quantum of taxable turnover and the quantum of taxable amount payable by the taxpayer himself or herself.

The taxpayer is required to make a self-assessment and pay the tax on the basis of the returns furnished. Any tax paid by the taxpayer under self-assessment is deemed to have been paid.

The Self-Assessment System applies where a taxpayer determines his own tax liability and pays the tax on specified due dates.[410] Under this system, an entity or individual is initially required to file its own estimate of income, calculate tax at appropriate tax rate and pay the estimated annual tax by quarterly instalments.[411]

Within three months from the end of the year of income, the entity shall file a return of income and audited accounts stating its actual income, tax on the income amount and actual tax payable on the assessment for the

[409] Section 46 of the Tax Administration Act, Act No. 10 of 2015

[410] Commonwealth of Australia Joint Committee of Public Accounts 1993, *An Assessment of Tax, Report 326*, 1993, Commonwealth of Australia, Canberra, p.63 citing Commissioner of Taxation's 1984 Annual Report, at p.8.

[411] Practice Notice No. 09 of 2013, Self-Assessment for Entities, Tanzania Revenue Authority, November, 2013

year of income.[412] An entity or individual shall pay the balance of the tax due or claim refund of overpaid tax on the date of filing the return.

18.3.2 Jeopardy assessment

Jeopardy assessment refers to the determination of amount of tax liability when the taxpayer or taxable person fails to file tax returns as required by the law on the due date or underwent bankruptcy, cessation of business activity or leaves the country indefinitely.

This assessment is done upon failure of self-assessment or incorrect self-assessment or self-assessment done contrary to the tax law obliging to do so.[413]

Circumstances under which the commissioner general can make jeopardy assessment are enshrined under section 91(3) of the Income Tax Act and 40(3) of Tax Administration Act. These are: -

i. where taxpayer or taxable person fails to lodge or file the tax returns on due date

It was seen the case **CIT v. Gian Singh**[414] where the defendant neglected to submit a return on income. He did not object or appeal against the

[412] Section 91(1) of the Income Tax Act, CAP 332 RE 2008 as amended by section 122 of Tax Administration Act, Act No. 10 of 2015
[413] Section 47 and 40(3) of the Tax Administration Act, Act No. 10 of 2015
[414] 3 EATC 24

assessment. Having failed to pay tax due after the demand note was served; the Commissioner sued him for the tax and penalties. The defendant claimed that the assessments were excessive.

The court held that inter alia the Commissioner may raise an estimated assessment in the absence of a return even through non-delivery of the return is due to circumstances such as being lost in the post.

ii. where the taxpayer or taxable person runs bankrupt

iii. where the taxpayer or taxable ceases to undertake economic activity taxable in Tanzania

iv. where Commissioner considers appropriate to do so

Under jeopardy assessment, the Commissioner may, by notice in writing served on the person, require the person to file, by the date specified in the notice, a return of income for the year of income or part of the year of income.

This is discretionary power of the commissioner to make such assessment notwithstanding the commissioner must use best judgment rule in doing so.[415]

[415] Section 47 (2) of the Tax Administration Act, Act No. 10 of 2015

Jeopardy assessment shall not relieve taxpayer or taxable person to file tax returns unless it is specified so in the notice by the Commissioner General however filing of tax returns shall not affect the jeopardy assessment.

It shall be valid for the period specified by the Commissioner General in the notice of assessment. Where it covers period of self-assessment, tax paid in jeopardy assessment shall be credited to the tax payable in the self-assessment.[416]

18.3.3 Adjusted Assessment

This is determination of amount of tax liability made under a tax law by the Commissioner General after other assessment to have been made prior. This is done to ensure the correctness of amount of tax liability payable by the taxpayer to which assessment refers.[417]

If it is discovered that income has been omitted, the self-assessment has become insufficient or that any allowance or relief given is, or has become excessive, an adjusted assessment may be issued to recover the tax lost or could have been lost if the assessment is not adjusted.

[416] Section 47, ibid
[417] Section 48 (1), ibid

Self-assessment puts the obligation and responsibility of calculating an entity's' income and tax payable amounts on the entity.[418] However, the Commissioner shall ensure that an assessment made by the entity is correct and consistent with the intention of the Act.

Section 48 of Tax Administration Act[419] empower the Commissioner General to make adjustment on an assessment made under section 94 of Income Tax Act[420] (self-assessment) so as to adjust the entity's tax liability in such manner as according to the Commissioner's best judgment and information reasonably available, the assessment shall be consistent with the intention of the tax law.

18.4 Best Judgment Rule in Assessment

In a best judgment assessment, the assessing officer should really base the assessment on his best judgment i.e. he must not act dishonestly, vindictively, or capriciously. There are two types of judgment assessment:

i. Compulsory best judgment assessment made by the assessing officer in cases of non-co- operation on the part of the assessee or when the assessee is in default as regards supplying information.

418 ibid
419 Act No. 10 of 2015
420 CAP 332 RE 2008

ii. Discretionary best judgment assessment is done even in cases where the assessing officer is not satisfied about the correctness or the completeness of the accounts of the assessee or where the assessee has regularly and consistently employed no method of accounting.

If the Commissioner General has reason to believe that any income chargeable to tax has escaped assessment for any assessment year assess or reassess such income and also nay other income chargeable to tax which has escaped assessment and which comes to his notice in course of the proceedings or any other allowance, as the case may be.

The object and the purpose of the Best Judgment are to arrive at a fair and proper estimate of the turnover of the dealer. The best judgment does not mean enhancement in turnover of the dealer. The assessee should be provided with adequate opportunity of meeting the case which is sought to make an assessment order.

Best judgment rule should be undertaken under consideration of various issues stipulated in the section 94 of Income Tax Act[421] and 47 and 48 of

[421] CAP 332 RE 2008

Tax Administration Act[422] such as intention of tax law, information available fairness and reasonableness of the assessment.

According to the case of **Gunda Shubbayya v. CIT**[423] the phrase "***according to the best of his judgment***" it means that the Commissioner must have materials on which to base his assessment. The assessment must not be capricious and the Commissioner is not entitled to make the guess without evidence.

18.5 Finality of assessment

Section 48 (4) of the Tax Administration Act[424], the Commissioner may adjust an assessment under within five years after original assessment. After five years of income assessed to lapse, the law to re-open the assessment tightens the commissioner's hands for assessment.

It was stated in the case of **State of Punjab v. Anapurna Impex Pvt. Ltd**[425], that, when once the period of limitation expires, the immunity against being subject to assessment sets in and the right to make assessment gets extinguished. There is no question of deferring assessment which had already become time-barred.

422 Act No. 10 of 2015
423 (1939) 71 TR 21
424 Act No. 10 of 2015
425 46 VST 549 (P&H)

It was discussed well in Indian case **Silver Spring Spinner (India) V. State of Tamil Nadu and another**[426], for the year 99-2000 dealer was assessed on 12.11.04. On 22.4.2005 he was sent notice for reassessment.

The contention of the petitioner is that the reassessment notice therefore, was barred by limitation, having been issued on April 22, 2005, whereas the period of five years for assessment year 1999-2000 expired on March 31, 2005.

The section was amended on 1.7.2002 providing limitation for assessment of five years from date of assessment as against five years from end of year to which assessment related, which is not retrospective. Where the court held that amendment made before end of the expiry of un-amended provision applies.

In the case of **Ann Lane v. Supervisor of Assessments of Montgomery County**[427] it was said that the "date of finality" is a point of assessment from which tax assessors determine the value of property as of that date.

This is the way to reduce uncertainty is by giving earlier finality to taxpayers who have tried to do the right thing, by shortening the period in which their assessment can be amended to increase their liability. Once

[426] 46 VST 359 (Mad)
[427] No. 41, September Term 2015

the commissioner can no longer re-open their assessments, taxpayers can stop worrying about whether they 'got it right.

However, section 48 (5) of the Tax Administration Act[428] provides for the exception to the finality of assessment. There are circumstances where the commissioner general is not bound by the finality rule of assessment. These circumstances are mentioned hereby: -

i. Fraud existence in original assessment
ii. Willful neglect of information in original assessment
iii. Serious omission by taxpayer or on his behalf

18.6 Summary

In this foregoing chapter, we have learnt that Tax assessment being a difficult area of work it is but imperative that the assessing authority should be provided with adequate powers for encountering tax evaders.

Assessment includes determination of the amount of taxable income as well as the amount of tax payable by an assessee. The assessment of tax is mandatory procedure for the tax

[428] Act No. 10 of 2015

administration and enforcement in most jurisdictions including Tanzania.

Under tax laws of Tanzania assessment of tax is done by either the taxpayer or taxable person or commissioner general. These two persons are the ones with power to make assessment according to the tax laws. When they make assessment, those assessments become differently categorically. Each assessment is made under certain conditions or circumstances.

The taxpayer or taxable person through lodging tax returns on the due dates as required by the tax laws makes self-assessment. However, they must do so accurately. If they can't, it is open for another kind of assessment to be undertaken.

Adjusted assessment is made by the Commissioner General to ensure the correctness of amount of tax liability assessed by the taxpayers or taxable persons. He does so when he considers that there is omission of information or reports or

concealment of information which led to the inaccurate tax liability amount.

The Commissioner General cannot adjust amount of tax liability determined by the tax revenue appeals board or tribunal. Where the taxpayer of taxable person fails to file tax return on due dates, runs bankrupt, ceases to undertake activity in Tanzania or otherwise considered, the Commissioner General makes jeopardy assessment.

In both jeopardy and adjusted assessments, the Commissioner General is required to use best judgment rule which is in need of consideration of information reasonably available and intention of tax law.

However, the re-opening of assessment already done is subjected to time limitation of five years to determine the finality of the assessment. Yet such time limitation cannot apply where there was fraud, willful neglect or serious omission in the original assessment.

18.7 Review Questions

1. Define assessment and explain basis of assessment of tax.
2. Critically discuss the best judgment rule in tax assessment.
3. Mention and explain clearly circumstances under which jeopardy assessment can be made.
4. Describe the rule of finality of assessment of tax in Tanzania.
5. Under which circumstances and by who adjustment of assessment of can be made in Tanzania.

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CHAPTER NINETEEN

POWERS AND OBLIGATIONS OF COMMISSIONERS FOR TAX

19.0 Introduction

Commissioner for tax for this chapter includes Commissioner-General, Deputy Commissioner General, Revenue Commissioner, and Commissioner for income tax and Taxation Officer vested with all or any of the powers, and functions of the Commissioner. They have been empowered to act and enforce tax laws in Tanzania. They are within the tax authority, which is under ministry of finance and economic affairs.

The Commissioner-General shall be the chief executive officer of the Authority and, subject to the general supervision and control of the Board, shall be responsible for the day-to-day operations of the Authority, the management of funds, property and business of the Authority and for the administration, organization and control of the other officers and staff of the Authority.

Therefore, in this chapter we are going to learn powers and obligation of commissioners for tax while executing their own functions according to the provisions of the law.

19.1 Objectives

At the end of this chapter students should have: -

- Attained knowledge and understanding of the basic concepts of powers and obligations in relation to taxation and tax laws.
- Accustomed with understanding on reasons behind prescription of powers and obligations to commissioner for tax.
- Advanced ability to identify and describe various powers and obligations of commissioner for tax in Tanzania as related to the tax laws.
- Established ability to discuss whether discretionary powers vested to commissioner for tax leads to miscarriage of tax justice.

19.2 Powers

These are rights, abilities, or authorities to perform certain acts.[429] Power also refers to ability to generate a change in a particular legal relationship by doing or not doing a certain act.[430]

[429] West's Encyclopedia of American Law, 2nd edition, The Gale Group, Inc. 2008
[430] Black's Law Dictionary Free Online Legal Dictionary 2nd Ed.

Power of commissioner for tax can be defined to mean an authority to do some act in relation to interpretation, administration and enforcement of tax laws or to the creation, making, or revocation of tax decision or ruling therein.

The powers of the commissioners for tax are creatures of the tax statutes. The law creates them. However, these powers may be discretionary in nature or not depending on the wording of the statute provision upon such power.

Regardless of being discretionary, the powers of the commissioners should be exercise judiciously. Such limitation is based on the principles of natural justice and the law conferring those powers.

This was reflected in the case of **Karibu Textile Mills Ltd v. Commissioner General**[431] that commissioner's discretion to grant waiver of payment of tax assessed must be exercised judiciously.

19.3 Powers of Commissioners for tax

These powers are conferred to the commissioner for tax in order to facilitate the interpretation, administration and enforcement of the tax

[431] [2008] 2 TTLR 197

laws. The powers are emanated from Income Tax Act, VAT Act, Tax Administration Act, Tanzania Revenue Authority Act to mention but a few.

- **Power to determine objection of assessment**

The commissioner general may determine and decide upon admission of the objection or call any evidence as may be necessary so as to help the determination of the objection.[432]

Upon the determination, the commissioner may amend the assessment or refuse to amend but must give reasons for the decision thereon as the principle of natural justice requires the need of giving reasons for the decision made as concreted.

The duty to give reasons was seen in the case of **Nimrod E Mkono v Commissioner General,[433]** which came to the rescue of the situation after ruling out that even though different tax Acts are silent in requiring the Commissioner General to give reasons for his decisions, according to the principle of natural justice, giving out reasons will cure arbitrariness in his decisions.

- **Power to issue or revoke practice notes**

[432] Section 52 of Tax Administration Act, Act No. 10 of 2015
[433] ([2004] 2TTLR 169)

The commissioner General has the power to issue practice notice for the purpose of ensuring the consistency in the administration of tax laws and provide guidance to the person affected by the specified law.[434] However he or she can revoke when there is inconsistency between the practice notes issued for avoiding their conflicts that may affect administration of tax laws.

- **Power to issue and revoke private and class rulings**

The commissioner General has the power to issue or revoke any ruling on any tax matter which is sought for understanding of its administration of tax law. Such ruling shall be in writing when issued or revoked.[435]

- **Power to compound offence**

The Commissioner may, at any time prior to the commencement of court proceedings compound the offence; and order the person to pay a sum of money specified by the Commissioner but not exceeding the amount of the fine prescribed for the offence.[436]

However this power is qualified for its exercise as the law prescribes that the commissioner may do so only before court proceedings and when the taxpayer admits the commission of the offence in writing. The decision of

[434] Sections 9 and 10 of Tax Administration Act, Act No. 10 of 2015
[435] Sections 13 and 14 of Tax Administration Act, Act No. 10 of 2015
[436] Section 119 of the Income Tax Act, CAP 332 RE 2008

compounding offences shall be in writing, served to offender and shall be final hence not subjected to any appeal and may be enforced as an order of the high court.

- **Power to delegate functions to tax officers**

The commissioner may authorize an officer to exercise any of his powers and duties under this Act other than the power to remit interest and penalties.[437]Commissioner may delegate his function in the administration of tax laws to the tax officers.[438] However, the law prohibits delegation to experts sought by commissioner.

- **Power to engage expert and request assistance from public officers**

The law has empowered the commissioner to seek expertise, assistance or protection from officer of the public institution in the discharge of legal functions or performances of duties enshrined in the tax laws or in the administration of the tax laws.[439] For instance, commissioner may seek assistance from police officer during investigation of the premises of the taxpayers.

[437] Section 127 of the Income Tax Act, CAP 332 RE 2008
[438] Section 16 of the Tax Administration Act, Act No. 10 of 2015 and section 16 of Tanzania Revenue Authority Act, CAP 399 RE 2006
[439] Section 18 and 19 of the Tax Administration Act, Act No. 10 of 2015

- **Power to issue, amend, cancel or replace TIN**

The commissioner for tax has is having the power to issue, cancel or amend or replace tax identification number when there is death of holder or winding up, fiction of taxpayer, misidentification of holder of certificate.[440] It is exercise when taxpayer notifies the commissioner in writing about the application or changes to be effected thereon.

- **Power to extend time of filing tax return**

The commissioner General has been empowered to extend time for filing time of return when the taxpayer failed to file within the time prescribed. However, this power is only invoked when the taxpayer applies to the commissioner to do.[441] Moreover, this is discretionary power of the commissioner that means he or she may or may not extend the time but according to principles of natural justice the exercise of power must be judiciously.

- **Power to appoint another person for preparation of tax return**

The commissioner General may appoint another person to prepare tax return and filing the same to him when there is failure to file the return on

[440] Section 23 and 25 of the Tax Administration Act, Act No. 10 of 2015
[441] Section 39 of the Tax Administration Act, Act No. 10 of 2015

time.[442] However, the person doing so must use information in possession of Commissioner.

- **Power to be granted free access for taxation**

The commissioner is empowered to be granted the free access to any premise, house, vessels, documents, goods, aircrafts, or any other asset.[443] Such power is absolute in the sense that he or she has to be granted free access even without prior notice to the owner or controller of the premise. However, free access to dwelling house must be between 09:00 am to 6:00 pm.

- **Power to obtain information or call for evidence**

The commissioner for tax has the power to obtain information from a person who is not liable for tax.[444] It is the power of requiring such person to produce information, document or enter appearance for purpose of examination. In exercising such power the commissioner must write notice to require the person to do as directed.

The mandate to call for evidence to determine well the objection of assessment is conferred to the commissioner by the law itself. This heightens the power to obtain information for tax decision making. It was

[442] Section 40 the Tax Administration Act, Act No. 10 of 2015
[443] Section 43 of the Tax Administration Act, Act No. 10 of 2015
[444] Section 44 of the Tax Administration Act, Act No. 10 of 2015

also discussed and concluded in the case **Akiba Commercial Bank Ltd v. Commissioner General**[445] that the Commissioner is mandated to call for any evidence when disposing of an objection.

- **Power to make and adjust assessment of tax**

The commissioner is empowered by the law to make adjustment upon the assessment of tax made by the taxpayer so as to correct the assessment of tax and determining the correct amount of tax payable by the tax payer.[446] However, the law prescribed that the adjustment to be made shall be undertaken according to commissioner's best judgment rule which requires consideration of the information available and intention of the tax law.

- **Power to audit or investigate on person's tax affairs**

The commissioner for tax is empowered to undertake auditing or investigation of taxpayers so as to determine the history of non-compliance, business conducted by the taxpayer and amount of tax payable and other relevant matter.[447] Such audit or investigation may be conducted for the purpose of more than one tax law.

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[445] [2008] 2 TTLR 148

[446] Section 96 of Income Tax Act CAP 332 RE 2008 and section 48 of the Tax Administration Act, Act No. 10 of 2015

[447] Section 45 of the Tax Administration Act, Act No. 10 of 2015

- **Power to register or deregister for VAT**

The Commissioner General may register applicant for VAT upon fulfilling the conditions required by the law[448] as well as by notice, cancel the registration of a person who is no longer required to be registered for value added tax[449]

19.4 Obligations

Obligation refers to duty or responsibility that a person has to perform basing on the law or agreement or custom. The law or agreements create obligations. They require a person specified to do certain things or not to do certain things. Obligations may be substantive or procedural in nature.

They may be substantive in the sense that they require a person what should be done or not be done. They are procedural in the sense that they require how the act should be done or not. Therefore obligation can be both **'what obligation'** and **'how obligation'**

Obligations of commissioners for tax are the responsibilities and duties that they must do or not do during interpretation, administration and application of tax laws for the purpose of taxation.

448 Section 29 (3) of VAT Act, Act No. 5 of 2014
449 Section 41, ibid

The law creates them. They require commissioners to do some things during execution of functions. They also prohibit the commissioners some things at the time of performance of functions assigned. They moreover limit the exercise of powers conferred to him or her by the tax law.

19.1 Obligations of Commissioners for tax

There are various obligations of commissioners for tax created by the tax laws in Tanzania. They are range from Income tax Act, Tax Administration Act, VAT Act to mention but a few. Such obligations are described hereunder:-

- **Obligation to give reason for decision**

It is the principle of natural justice that any decision made affecting citizen ought to have been accompanied by the reasons for the decision. This principle of right to be given reason is confirmed in the tax laws also upon the commissioner during making various tax decisions. For instance section 52 (3) of the Tax Administration Act[450], when the commissioner general determine the objection of assessment of tax admitted must give reason for the decision to be made or already made.

[450] Act No. 10 of 2015

This principle of giving reason for the decision also was accentuated in the case of **Nimrod E Mkono v Commissioner General.**[451] It came to the rescue of the situation after ruling out that even though different tax Acts are silent in requiring the Commissioner General to give reasons for his decisions, according to the principle of natural justice, giving out reasons will cure arbitrariness in his decisions.

- **Service of notice of assessment of interest and penalties**

Commissioner shall serve a written notice of assessment on the person, which notice may be incorporated with a notice that includes information such as assessment made, manner of calculation of assessment, reasons for assessment, date of payment of assessed interest or penalties, time, manner and place of objection of the assessment.[452]

- **Service of notice of assessment of income tax**

When the commissioner for income tax has made the assessment for income tax payable by the tax payer, he or she is obliged by the law to service the notice of assessment to the tax payer describing assessment

[451] ([2004] 2TTLR 169)
[452] Section 103 (4) of the Income Tax Act, CAP 332 RE 2008 and section 81 (5) of the Tax Administration Act, Act No. 10 of 2015

made, manner of assessment, amount assessed for payment, date of payment of assed tax and objection when preferred by the tax payer.[453]

It was also deliberated in the case **M/s Wartsila (T) Ltd v. Commissioner General**[454]indicated the necessity of service of notice of assessment done by commissioner to the taxpayer so as to be aware of the assessment and determine whether he can pay or not or object the said assessment.

- **Hearing the taxpayer on tax decision**

It is the principle of Natural justice that no one should be condemned unheard. Hence guilt determination of person comes after hearing. This principle has no exception to the tax arena.

Hence the commissioner when deciding certain tax matters raised by the taxpayer, he ought to hear the taxpayer. This was surfaced in the case of **Karibu Textile Mills Ltd v. Commissioner General**[455] where it was determined that failure of Commissioner General to hear a tax payer on objections to assessed taxes amounts to reach of principles of natural justice.

[453] Section 97, ibid
[454] [2008] 2 TTLR 107
[455] [2008] 2 TTLR 197

- **Collection of tax**

The Commissioner General shall collect value added tax due under VAT Act on a taxable import at the time of import according to section 8 (3) of Value Added Tax Act.[456]

- **Notification of decision on deferment**

The commissioner has to duty to communicate his decision on application made by taxable person on deferment of tax. This communication is done through notification in written form within certain period of time. As provided under section 11 (6) of the VAT Act[457], the Commissioner General shall, within fourteen days of receiving the application, notify the applicant of the decision to approve or reject the application.

19.5 Summary

Generally, in this chapter we have learnt that powers and obligations are vested to commissioner for tax to promote the enforcement and administration of tax laws with justice thereon.

[456] Act no. 5 of 2014
[457] Act No. 5 of 2014

Commissioner for tax under this chapter includes commissioner general, revenue commissioner, commissioner for income tax and other tax officer who is vested with commissioner's power. They all deal with administration of tax laws. Powers and obligation conferred to commissioner for tax are creatures of tax statutes. They are created by law and unmade by laws. Hence, they do not come from the blue sky.

Powers and obligations granted to commissioners for tax are enshrined in the Income Tax Act, Value Added Tax Act, Tax Administration Act to mention but a few. Some of those powers are to make and adjust assessment of tax, handle and determine their objections, register and deregister for VAT, issue or cancel the TIN, delegate powers to tax officers, request assistance and expert, audit and investigate, to be granted free access to the premise of taxpayer, to call for information or evidence to mention but a few.

Most of these powers are discretionary as per the wording of the tax statutes; they are to be exercised judiciously through being obliged to comply with the principles of natural justice as right to be given reasons for the decision. This is according

to the decision of **Nimrod E Mkono versus Commissioner General** whereby the court rule out that even though different tax Acts are silent in requiring the Commissioner General to give reasons for his decisions, according to the principle of natural justice, giving out reasons will cure arbitrariness in his decisions.

Moreover, the commissioners for tax are not only granted with powers but also obligations requiring them to fulfill during discharge of their duties. Some of those obligations are hearing the taxpayer during decision making, grant right to be represented to the taxpayer, collection of tax, notice of assessment and notice of deferment.

19.6 Review Questions

1. Critically explain reasons and justification for the powers and obligations of tax commissioners.
2. Mention and explain clearly with authorities' powers granted and obligations to the tax commissioners.
3. Increase of discretionary powers to tax commissioners is directly proportional to the increase of arbitrariness, which

perishes tax justice. Discuss the statement with relevant authorities.

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CHAPTER TWENTY

RIGHTS AND OBLIGATIONS OF TAXPAYERS

20.0 Introduction

In any modern society that adheres to rule of law and human rights, taxpayers are citizens that are entitled to a number of basic rights as well as obligations in relation to their government and its agencies.

Revenue authorities are no exception and most countries have legislation governing taxpayer's rights and obligations in relation to taxation.

Henceforth, this chapter aims at imparting knowledge of rights and obligations of taxpayers to the students to determine whether these rights are statutory protected and enforced.

20.1 Objectives

At the end of this chapter students should have: -

- Attained knowledge and understanding of the basic concepts of taxpayers.
- Accustomed with understanding on how the rights and obligations of taxpayers are reflected in tax laws of Tanzania.
- Advanced ability to discuss the rights and obligations of taxpayers.

- Established ability to describe the extent of guarantee of rights of taxpayers and their enforcement in Tanzania.

20.2 Taxpayers

Taxpayer is the one who bears the tax liability for any particular transaction. Even though a partnership may receive income, each individual partner is liable for the taxes on that income.[458] Taxpayers are persons responsible to pay tax in the state or jurisdiction.[459]

Taxpayer refers to an individual or entity that is obligated to make payments to state or government taxation agencies.[460] The term taxpayer generally describes one who pays taxes.

Nearly all adults in the most states are subject to some form of taxation and, therefore, most adults are taxpayers. The term taxpayer often refers to the workforce of a country who pays for government projects through taxation. Nearly all government-funded projects are funded by the taxpayers, which can cause some controversy depending on the project.

20.3 Rights of tax payers

Rights of taxpayers are legal principles of freedom or entitlement that is rights are the fundamental normative rules about what is allowed to

[458] Webster's New World Law Dictionary, 2010, Wiley Publishing, Inc., Hoboken, New Jersey
[459] Cambridge English Dictionary
[460] http://www.investopedia.com/terms/t/taxpayer.asp#ixzz4FV10WsK7

taxpayers or owed to them, according to some legal system of particular tax jurisdiction. They are statutory rights as have been prescribed by the law upon taxpayers.

20.3.1 Right to Information

In order to facilitate tax compliance taxpayers are entitled to have up-to-date information on the operation of the tax system and the way in which their tax is assessed.

All taxpayers can expect that the information provided to them should reflect the complexity of the tax situation, thereby enabling them to understand better their tax affairs.

Therefore, it is the duty of tax authorities to use a variety of means to fulfill this obligation such as information pamphlets, taxpayers' charters, the telephone oral statements, video guides.

In Tanzania can also be effected through issuance of practice notice as per section 9 and private and class ruling upon interpretation of tax laws as per section 11 and 26 of Tax Administration Act.[461]

[461] Act No. 10 of 2015

20.3.2 Right to representation in tax matters

Section 27 of tax administration act provides this right to be represented in any legal matter involving tax disputes. Hence, tax payers are allowed to be represented legalistically during the determination of the tax disputes with the tax authorities in Tanzania.

20.3.3 Right to object and appeal tax decisions

Since right to appeal is the constitutional right under article 13(6) (a) of the constitution of United Republic of Tanzania[462], the right of object and appeal against any decision of the tax authorities applies to all taxpayers. It applies to almost all decisions made by the tax authorities, whether as regards the application of the law or of administrative rulings, provided the taxpayer is directly concerned.

This is also confirmed in sections 66 (5) (b) on lodging returns and assessment, 84 (4) (b) on refund of extra payment, 11(8) on deferral of value added tax on imports and 32(3) (b) upon rejection of application for registration of Value Added Tax Act[463] and section 97 (e), 101 (2) (a), 103(4) (e) on assessment of Income Tax Act[464] and section 51 and 53 of Tax Administration Act[465]

[462] CAP 2 RE 2002
[463] Act No. 5 of 2014
[464] CAP 332 RE 2008
[465] Act No. 10 of 2015

20.3.4 Right to pay correct amount of tax

Taxpayers should pay no more tax than is required by the tax legislation, taking into account their personal circumstances and income.

This is effected through allowing taxpayer to apply for the refund when the tax paid exceeds the net amount of tax payable according to the law according to sections 83 and 84 of Value Added Tax Act[466], section 126 of Income Tax Act[467] and section 71 of Tax Administration Act.[468]

20.3.5 Right to certainty

Taxpayers also have a right to a high degree of certainty as to the tax consequences of their actions. Of course, certainty is not always possible. For example, taxpayers may not always know in advance the effect of rules that are dependent on the facts and circumstances in a particular case.[469]

In addition, tax authorities may not be obligated to provide the taxpayer with certainty in relation to the application of anti-abuse provisions aimed at taxpayers seeking to circumvent the intent of the legislation. However, tax authorities should handle tax affairs impartially and apply tax laws and procedures consistently.

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[466] Ibid
[467] CAP 332 RE 2008
[468] Act No. 10 of 2015
[469] Paragraph 2.21 of Taxpayers' rights and obligations – A survey of the legal situation in OECD countries, OECD's Committee of Fiscal Affairs Working Party Number 8, 1990

20.3.6 Right to confidentiality and secrecy

The information available to the tax authorities on the affairs of a taxpayer is confidential and will only be used for the purposes specified in tax legislation.[470]

Tax legislation usually imposes very heavy penalties on tax officials who misuse confidential information and the confidentiality rules that apply to tax authorities are far stricter than those applying to other government departments.

This is evidenced under section 140 of Income Tax Act[471] and section 21 of Tax Administration Act[472] which provides on non-disclosure of documents received to any person except allowed by the law. It prohibits officers not disclose such documents or information to a court, tribunal or other person.

20.4 Obligations

Existence of rights corresponds to existence of obligations. There is a set of behavioural norms expected of taxpayers by Governments. These expected behaviours are so fundamental to the successful operation of taxation systems that they are legal requirements in many, if not most,

[470] Paragraph 2.26, ibid
[471] CAP 332 RE 2008
[472] Act No. 10 of 2015

countries. Without this balance of taxpayers' rights and obligations, taxation systems could not function effectively and efficiently.

20.4.1 Obligation to register for tax

Registration for tax is mandatory to every person upon attaining the registration threshold[473] of 100 million in the period of twelve months and above or 50 million in period of six months ending at the end of the previous months.[474]

20.4.2 Obligation to file tax returns timely

A taxpayer has the duty to file his tax return and pay proper taxes on time. Should he fail to do so, he will be subject to fine and surcharge on top of the tax due.

Section 91 of Income Tax Act[475]as amended by section 122 of Tax Administration Act[476] creates such obligation by providing that every person shall file with the Commissioner not later than three months after the end of each year of income a return of income for the year of income.

[473] This refers to the minimum level of taxable turnover above which a person is required to register for VAT
[474] See section 28, ibid and regulation 14 of Value Added Tax (General) Regulations, GN 225 of 2015
[475] CAP 332 RE 2008
[476] Act No. 10 of 2015

20.4.3 Obligation to be honest

Taxpayer honesty is therefore fundamental to the operation of any tax system and all systems have investigatory powers with penalties and sanctions in place to cater for an instance where a taxpayer is does not comply. Accordingly, taxpayers should always exercise reasonable care and diligence in attempting to comply with their tax obligations.

20.4.4 Obligation to be co-operative

Co-operative behaviour on the part of most taxpayers allows the Government to run the taxation system at a relatively low cost and minimizes unnecessary intrusion into taxpayer affairs and those of third parties. Hence, taxpayers are encouraged to co-operate with relevant revenue authorities in attempting to comply with their tax obligations.

20.4.5 Obligation to provide accurate information

Taxpayers should provide accurate information to revenue authorities in accordance with the laws of relevant taxing jurisdictions.[477] Taxpayers having difficulty in complying with this obligation should be encouraged to discuss their circumstances with their revenue authority, as it may be possible to allow additional time in some cases.

[477] Section 37 (1) and 41 of Tax Administration Act, Act No. 10 of 2015

20.4.6 Obligation to keep and maintain records

Taxpayers should keep the records required by the laws of relevant taxing jurisdictions.[478] Such records also allow the revenue authority to verify that the information provided by a taxpayer is accurate.

However, specifications of what records have to be kept and for what length of time so that transaction details can be traced and verified are of paramount important. This is provided under section 35 of Tax Administration Act.[479]

20.4.7 Obligation to pay tax on time

Taxpayers should always endeavour to pay their taxes in accordance with the laws of relevant taxing jurisdictions.[480] Taxpayers who are having difficulties in complying with this obligation should be encouraged to discuss their circumstances with their revenue authority, as it may be possible to allow additional time for payment in some cases.[481]

20.4.8 Obligation to allow free access to premises

Taxpayers are obliged to allow free access of Commissioner General for inspection of the premises of taxpayers for tax purpose. However, the

[478] Section 35(2) of Act No. 10 of 2015
[479] Ibid
[480] See section 40 and 54 of Tax Administration Act, Act No, 10 of 2015
[481] See section 55 of Tax Administration Act, Act No, 10 of 2015

Commissioner General should inform the taxpayers prior unless under certain circumstances taxpayer should grant that access without notice.[482]

20.4.9 Obligation to pay tax which was not paid before

Taxpayers are obliged to pay the unpaid tax debt in previous years of income. They were required to pay but they did not pay. Failure to do so attracts a suit for recovery of unpaid tax as debt to the government in competent court and creation of charge of assets of the taxpayers. [483]

20.5 Summary

In this chapter, we have seen that rights and obligations of taxpayers are important and inseparable in any modern society with effective means of tax compliance.

Thus whilst it is acceptable to reduce tax liability by legitimate tax planning, governments make a distinction between this form of tax planning and forms of tax minimization which clearly go against the intent of the legislator.

Taxpayers are also entitled to a reasonable measure of assistance from the tax authorities so that they receive all the reliefs and deductions to which they are entitled.

[482] See section 42, ibid
[483] See section 59 and 61, ibid

Taxpayers are also entitled to up-to date information, refund of exceeded amount of tax, certainty and equity as well as confidentiality of their information unless under the circumstances allowed by the law.

However, rights of the taxpayers are corresponded to the obligations to smoothen tax collection and administration in the country. These obligations are creatures of the tax laws.

Some of those obligations are registration, timely payment of tax and lodging tax returns, honest and cooperation and grant of access to premises when required to allow as well as pay the unpaid debt of tax not yet paid whose non-compliance leads to suit for recovery, withholding, charge creation as prescribed by the law.

20.6 Review Questions

1. Define taxpayers
2. Describe rights and obligations of taxpayers as provided in the tax laws of Tanzania
3. What do you think on the guarantee of the rights of taxpayers in the tax laws of Tanzania?

4. Are those rights and obligations of taxpayers enshrined in the tax laws sufficient to promote voluntary tax compliance in Tanzania?

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CHAPTER TWENTY ONE

TAX OFFENCES AND PENALTIES IN TANZANIA

21.0 Introduction

Tax offence occurs when people abuse the tax and superannuation systems through intentional and dishonest behaviour with the aim of obtaining a financial benefit. It encompasses a broad spectrum of non-compliant activity that can result in sanctions, such as fines or imprisonment. They range ranges from deliberate offences, such as failing to report cash wages in order to avoid tax, to the use of complex offshore secrecy arrangements to evade tax.

This chapter involves tax offence poses a risk to the community not just from the loss of revenue but because of the links to organized crime, identity crime and money laundering, which can have far-reaching effects for victims. Hence, tax penalties and interests are among of strategies that work together to provide a strong tax and super system that is an unattractive target for tax offences.

21.1 Objectives

At the end of this chapter students should have: -

- Developed the concept and meaning of tax offence, penalty and interest.
- Acquainted with knowledge on offences under tax laws of Tanzania.
- Familiarised with penalties and interest upon offences under tax laws in Tanzania.
- Apprehended the assessment of interests and penalties on the tax offences in Tanzania.
- Comprehended whether penalties and interest cater the needs of imposition of their imposition in the tax laws of Tanzania

21.2 Tax Offences

Tax offences are the violation or breach of tax laws, which are punishable.[484] Contravening the provisions of tax laws may result to offences.

This involves procedures until conviction of a person and the respective tax recovery mechanisms for various offences. Failure to comply with various provisions of tax laws requirements may attract penalties and interest in tax recovery.

[484] Collins English Dictionary, (2014), 12th Edition, HarperCollins Publishers

❖ Non-compliance with tax laws

Any person who fails to comply with a provision of this Act, which leads to underpayment of tax, commits an offence and shall be liable on summary conviction except when it is provided otherwise in the Act.[485]

❖ Failure to pay tax

Any person who without reasonable excuse fails or dodges to pay any tax on or before the date on which the tax is payable commits an offence and shall be liable on summary conviction.[486]

❖ Making false or misleading statements

Any person who makes false or misleading statement or omits to make true and accurate information which results to underpayment of tax commits an offence and shall be liable on summary conviction.[487]

A person is said to make a false or misleading statement if he makes a statement to a tax officer which is false or misleading in a material particular or omits to include in the statement made to the tax officer, any

485 Section 104 of Income Tax Act, CAP 332 RE 2008 and section 82 of Tax Administration Act, Act No. 10 of 2015
486 Section 105 of Income Tax Act, CAP 332 RE 2008 and section 83 of Tax Administration Act, Act No. 10 of 2015
487 Section 106 of Income Tax Act, CAP 332 RE 2008 and section 84 of Tax Administration Act, Act No. 10 of 2015

matter or thing without which the statement is misleading in a material particular.

- **Impediment of tax administration**

Any person who obstructs or attempts to obstruct any officer of TRA or imped administration no tax administration to execute his duties without reasonable excuse commits an offence.[488]

- **Procurement of unlawful payment**

Any officer of TRA acting in performance of duties of office attempts to procure reward or payment which he or she is unlawfully entitled to defraud tax payment commits an offence.[489]

- **Impersonation of TRA officer**

Any person who is not authorized in tax laws, collects or attempts to collect any amount of tax payable under the tax law commits an offence.[490]

- **Aiding or abetting**

488 Section 107, Income Tax Act, CAP 332 RE 2008 and section 85 of Tax Administration Act, Act No. 10 of 2015

489 Section 108 (1) of Income Tax Act CAP 332 RE 2008 and section 87 (1) of Tax Administration Act, Act No. 10 of 2015

490 Section 108 (2) of Income Tax Act CAP 332 RE 2008 and 87 (2) of Tax Administration Act, Act No. 10 of 2015

Any person who knowingly or recklessly aids, abets, conceals or induces another person to commit an offence under tax law commits an offence.[491]

- **Failure to maintain documents**

Any person who fails to maintain proper documents as required by a tax law commits an offence which attracts a penalty for each month or part month during which the failure continues.[492]

- **Failure to use electronic fiscal device**

Any person who fails to acquire or use electronic fiscal device or issue fiscal receipt or fiscal invoice commits an offence and shall be liable on conviction of fine or imprisonment or both.[493]

- **Offences by entities**

When entity commits an offence under tax laws, any person who is manager at the time of commission of offence shall be treated to have committed the offence unless the person has exercise reasonable degree of care, diligence and skills in preventing the commission of the offence.[494]

- **VAT offences**

491 Section 109 of Income Tax Act CAP 332 RE 2008 and 89 of Tax Administration Act, Act No. 10 of 2015
492 Section 98 of Income Tax Act, CAP 332 RE 2008
493 Section 86 of Tax Administration Act, Act No. 10 of 2015
494 Section 88 of Tax Administration Act, Act No. 10 of 2015

Any person who fails to register for VAT as required by VAT Act while he or she has met the requirement for registration commits an offence.[495]

Any registered person who ceases to be liable for value added tax fails to notify the commissioner General for cessation or changes of circumstances or change of ownership or interest or transfer as required by law commits an offence.[496]

Any person who holds himself as taxable person under VAT Act while he or she is not commits an offence.[497]

- **Stamp duty offences**

Any person who draws, signs or deals with any instrument, bill of exchange, cheque, promissory note that has not been duly stamped commits an offence.[498]

Any person who votes or attempts to vote or under any proxy or issue share warrant not duly stamped commits an offence.[499]

495 Section 90 (1) (a) of Tax Administration Act, Act No. 10 of 2015
496 Section 90(1) (b-e) of Tax Administration Act, Act No. 10 of 2015
497 Section 90(1) (f) of Tax Administration Act, Act No. 10 of 2015
498 Section 91 (1) (a) of Tax Administration Act, Act No. 10 of 2015
499 Section 91 (1) (b-c) of Tax Administration Act, Act No. 10 of 2015

Any person who cancels stamps as required by the law or executes or assists to execute preparation of instrument that breaches stamp duty Act, fails to give receipt, which is properly stamped commits offence.[500]

Any person appointed to sell stamps disobeys lawful direction of Commissioner General or not appointed to sell stamps does so or fails to comply with terms of agreement made under stamp duty Act commits offence.[501]

21.3 Interest

Interest means a payment for the use of money and includes a payment made or accrued under a debt obligation that is not a repayment of capital, any gain realized by way of a discount, premium, swap payment or similar payment.[502]

Interests are assessed by Commissioner General since he has been empowered by the tax law to do so to the person who is liable under the tax laws. However, after assessment Commissioner General must notify the taxpayers indicating assessment made and reasons thereon.[503] There

500 Section 91 (1) (d-f) of Tax Administration Act, Act No. 10 of 2015
501 Section 91 (1) (g-i) of Tax Administration Act, Act No. 10 of 2015
502 Section 3 of Income Tax Act, CAP 332 RE 2008
503 Section 103 of Income Tax Act, CAP 332 RE 2008 and section 81 of Tax Administration Act, Act No. 10 of 2015

are different types of interests are levied for various kinds of delays/defaults

- **Interest for underestimating tax payable**

Instalment payers who estimate their income tax payable for the year of income are expected to show high level of accuracy in estimation. Failure to estimate tax within the allowed limits, hence result into underestimation, shall attract interest. The amount of interest that an instalment payer shall pay for each period shall be calculated at the statutory rate and compounded monthly.[504]

- **Interesting for failure to pay tax.**

If any amount of tax imposed under any tax law remains unpaid after due dates as required by the respective tax law or regulation, attracts interest. The interest shall be charged at the statutory rate on the amount of tax outstanding at a given time. In case, a withholding agent fails to pay the withholding tax due, he may not recover from the withholdee an interest payable due to this failure.[505]

504 Section 99 of Income Tax Act, CAP 332 RE 2008 and section 75 of Tax Administration Act, Act No. 10 of 2015

505 Section 100 of Income Tax Act, CAP 332 RE 2008 and section 76 of Tax Administration Act, Act No. 10 of 2015

21.1 Penalties

Penalty is a comprehensive term with many different meanings. It entails the concept of punishment corporal or pecuniary, civil or criminal although its meaning is usually confined to pecuniary punishment.[506]

Tax penalties are punitive measures that the tax laws imposes for the performance of an act that is prohibited, or for the failure to perform a required act.[507] This can include fine, imprisonment, forfeiture and other provided by the law.

Penalties are assessed separately by Commissioner General since he has been empowered by the tax law to do so, to the person who is liable under the tax laws. However, after assessment Commissioner General must notify the taxpayers indicating assessment made and reasons thereon.[508]

❖ Failure to maintain documents

Failure to maintain proper documents as required by a tax law attracts a penalty for each month or part month during which the failure continues. The penalty in case of individual shall be 1 currency point and for a body

506 William C. Burton, (2007), Burton's Legal Thesaurus, The McGraw-Hill Companies, Inc
507 West's Encyclopaedia of American Law, (2008), 2nd edition, The Gale Group, Inc.
508 Section 103 of Income Tax Act, CAP 332 RE 2008 and section 81 of Tax Administration Act, Act No. 10 of 2015

corporate shall be 10 currency points. The commissioner on a just and reasonable basis shall determine the amount of tax attributable for a certain period and the manner of apportionment of tax assessed.[509]

❖ Penalties for failure to file tax return

Failure to file return or pay tax on due dates attracts penalty for each month or part of month during which failure continues.[510] The amount of penalty is taken as the higher of the following:

- 2.5% of the amount of tax assessed with respect to the tax return less tax paid by start of the period towards that amount, or
- In case of an individual, 5 currency points, and for a body corporate is 15 currency points

Note: The penalties apply separately for a failure to file an estimate/provisional return and for a failure to file a final return.

❖ Penalty for making false or misleading statements

[509] Section 98 of Income Tax Act CAP 332 RE 2008 and section 77 of Tax Administration Act, Act No. 10 of 2015

[510] Section 78 of Tax Administration Act, Act No. 10 of 2015

False or misleading statements may result to tax shortfalls and this attracts penalties.[511] The penalties are as follows:

- where the statement or commissions is made without reasonable excuse, penalty shall be 50% of the tax shortfall
- Where the statement or omission is made knowingly or recklessly, penalty shall be 100% of the tax shortfall.

Note: The penalty shall be increased by 10% for the second or subsequent repetition and shall be reduced by 10% if the person voluntarily discloses the statement prior to its discovery by tax the tax officer or the next tax audit of the person

❖ **Penalty for aiding and abetting.**

A person who aids, abets, counsels or induces another person to commit an offence contravenes the provisions of the law. Upon conviction, this person shall be liable for a penalty of 100% of the tax shortfall.[512]

21.4 Summary

[511] Section 101 of Income Tax Act CAP 332 RE 2008 and section 79 of Tax Administration Act, Act No. 10 of 2015

[512] Section 102 of Income Tax Act, CAP 332 RE 2008 and section 80 of Tax Administration Act, Act No. 10 of 2015

In this chapter we have been able understand meaning of terms offence, interest and penalties as per the context of tax laws of Tanzania.

As it is principally known that NULLA CRIME SINE LEGE that means there is no crime or offence without law. Hence, tax offences are creatures of tax laws. The tax laws create them.

We have been able to identify and explain the various offences under Income Tax Act, Value Added Tax Act, Tax Administration Act and Stamp Duty Act as they substantive tax laws hence they create rights and duties whose violation lead to tax offences.

Some of common identified and learnt offences are failure to pay tax, maintain records and documents, registration, use electronic fiscal device or issue fiscal receipt or fiscal invoice for taxation purpose, aiding or abetting commission of original tax offences, corrupt practices and impersonation.

However, there some circumstances under which entities can commit offences and liability of their managers in relation offences committed during his managerial duration unless there

was reasonable care, diligence and skills exercise to prevent the commission of the offence.

The tax laws also have imposed various interests and penalties upon the offences committed. These penalties are described in form of fines and imprisonment. Nevertheless, forfeiture and payment of money can be invoked in some circumstances in relation to offences committed.

Therefore, the purpose of imposition of interests and penalties are to deter the person who fails to comply with the tax laws as well as to compensate the unpaid tax for various purposes in the state.

21.5 Review Questions

1. Differentiate between fine, interest and penalty.
2. Explain the reasons and justification for the imposition of interest and penalty
3. Discuss on the assessment of interests and penalties under tax laws of Tanzania.
4. Identify various offences under tax laws in Tanzania with their punishment.

5. Discuss on the reasonability and fairness of the penalty imposed on the various tax offences in Tanzania.

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CHAPTER TWENTY TWO

TAX ADMINISTRATION IN TANZANIA

22.0 Introduction

Tax administrations operate in societies that are rapidly changing and have to fulfil increasing demands and growing expectations from their stakeholders, including new demands from taxpayers for sophisticated government services.

Tax administrations must develop a contemporary vision. Rapid economic developments and ever-higher expectations on the part of taxpayers make it necessary for a tax administration to redefine its strategic course. There is need of laying down relationship with taxpayers in a system of rights and obligations.

Therefore, in the chapter we are going to learn various aspects about tax administration. The chapter shall cover the concept of tax administration, scope of tax administration, functions of tax administration, principles of functioning of tax administration, Tanzania revenue Authority as well as its effectiveness.

22.1 Objectives

At the end of this chapter students should have: -

- Learnt the concept of tax administration and its jurisprudence.
- Been conversant with understanding on nature, scope and core tasks of the tax administration.
- Advanced understanding on the principles that govern the operation and functioning of the tax administration authorities.
- Habituated with the evaluation skills on the effectiveness of the Tanzania Revenue Authority in implementation of its functions.

22.2 Tax Administration

Tax administration means management, conduct, direction, and supervision of the execution and application of the internal revenue laws or related statutes or equivalent laws and statutes and tax conventions within the country.[513]

Therefore, tax administration includes assessment, collection, enforcement, litigation, publication, and statistical gathering functions under such laws, statutes, or conventions related to tax matters.[514]

513 See, https://definitions.uslegal.com/t/tax-administration/. Accessed on 27th March 2017 at 1539 hours
514 See, ibid

Generally, tax administration means the implementation and enforcement of tax laws or statutes. Tax administration is the process of the supervision and enforcement of the tax compliance. It is there to make sure the taxpayers or taxable person pays tax according to the stipulation of the law. It includes the institutions and functioning for making sure the taxpayers pay timely and effectively as demanded by the tax statutes.

22.3 Scope of Tax Administration

The focus of tax administration depends on the fact that most government revenues are lost due to inefficient and ineffective administration mechanisms, poor taxation policy and improper management in encouraging tax morale and voluntary tax compliance. It is indisputable fact that tax administration is very important in the whole process of improving government revenues.[515]

The crucial aspects of tax administration, which tax authority, need to assess their cause and effects towards effective tax administration. Key attributes of tax administration apart from tax morale and voluntary tax compliance are sensitization about the importance of paying taxes in order to enable government to provide quality social services to the public.

[515] See, F. B. Ng'eni, Tax Administration in Tanzania: An Assessment of Factors Affecting Tax Morale and Voluntary Tax Compliance towards Effective Tax Administration, International Journal of Finance and Accounting, Vol. 5 No. 2, 2016, pp. 90-97

It is notable that tax is a main source of government revenue, such that recommendations for improving its administration are of importance to the policy makers and implementers across the world.

Henceforth, the core tasks of a tax administration are centred on the implementation and enforcement of tax legislation and regulations. These activities include identification and registration of taxpayers, processing of tax returns and third-party information, examination of the completeness and correctness of tax returns, assessment of tax obligations, (enforced) collection of taxes and provision of services to taxpayers.

22.4 Functions of Tax Administration

The core business of tax administrations is the levying and collection of taxes imposed by law. It is important that tax administrations establish a clear definition of their core business from the outset and make it known to their stakeholders. The core functions of a tax administration include inter alia: -

- registration of taxpayers, including detection of non-registration and false registration;
- processing of tax returns, withholdings and third-party information;
- verification or examination of the correctness and completeness of received information (including audit activities);

- process of enforced debt collection;
- handling of administrative appeals and complaints
- provision of service and assistance to taxpayers; and
- detection and prosecution of tax fraud

22.5 Tax Administration Authorities

Most countries have one single tax administration for direct and (most) indirect taxes, but there are still countries with separate organizations responsible for collecting direct and indirect taxes.[516]

Many countries have separate organizations for taxes and customs. In some countries, the customs administration is tasked with administering excise duties; in others, this is the task of the tax administration.[517]

Tax Administration authorities may have improved efficiency, but at the possible cost of undermining growth prospects by being inadequately accountable and too often driven by a single performance target.

Although there are trade-offs between user-friendliness and compliance, perceptions exist that in some instances user-friendliness has actually diminished in some of the countries.

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516 See Fjeldstad, O.-H., et al. 2004. Budgetary processes and economic governance in Southern and Eastern Africa. Literature review. NEPRU Working Paper NWP 95 (September). Windhoek: Namibia Economic Policy Research Unit

517 See Taliercio, R. Jr. 2002. Designing performance: The semi-autonomous revenue authority model in Africa and Latin-America. Washington, DC: The World Bank.

The responsibilities for collecting taxes and operating customs are integrated in other countries in one single tax and customs administration.[518]

Tax administration authorities have the complex duty to be **efficient** in minimizing distortions that affect growth policies that favour the poor, **effective** in raising revenue, and **equitable** in building on and reinforcing political legitimacy.[519] They eliminate or minimize arbitrary, inefficient, and corrupt practices that undermine growth and that weaken state legitimacy and capacity.[520]

The authorities have an important role in developing a tax regime that is transparent, effective, and conducive to economic growth led by private investment and international trade.[521]

22.6 Functioning of Tax Administration Authorities

The primary responsibility of a tax administration is to collect the proper amount of tax due to the government at the least possible cost to the public as well as administration of tax laws.

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518 See Ghura, D. 1998. Tax revenue in Sub-Saharan Africa: Effects of economic policies and corruption. IMF Working Paper 98/135, Washington, DC: International Monetary Fund

519 See McCourt, W. and M. Minogue (eds.) 2001. The internationalization of public management. Reinventing the third world state. Cheltenham, UK: Edward Elgar

520 See Taliercio, R. Jr. 2004. Administrative reform as credible commitment: The impact of autonomy on revenue authority performance in Latin America. World Development 32(2):213–232

521 See Slemrod, J. (ed.). 1992. Why people pay taxes. Tax compliance and tax enforcement. Ann Arbor: The University of Michigan Press

In order to administer the tax laws of the country successfully, there must be a careful balance between the various responsibilities and principles for any authority with power of tax administration.[522]

22.6.1 Public Interest

In addition, administering the tax laws of a country should serve the **public interest**, i.e. it should meet the needs of the government and the people of the country served by the government.

22.6.2 Public Confidence and Esteem

In order for the agency charged with administration of the laws to serve the public interest properly, the agency and its employees must have the **confidence and esteem** of the public they serve.

22.6.3 Fairness and Integrity

In addition, it is essential that a tax administration carry out its responsibilities in a manner, which warrants the highest degree of public confidence in the organization's **efficiency, integrity and fairness**.

22.6.4 Participation

In some cases, tax administration may also be responsible for drafting tax legislation. If it is not directly responsible for drafting legislation, it should

522 See https://www.ibfd.org/sites/ibfd.org/files/content/pdf/Handbook_Tax_Administration_sample.pdf. Retrieved on 27th March 2017 at 16:14 hours

at least be **involved** in determining the administrability of proposed provisions of the tax law.

22.6.5 Cost Efficiency

Taxpayers should also receive good value for the money spent by the tax administration in administering the tax laws, i.e. the tax administration should operate as **efficiently and cost effectively** as possible.

22.6.6 Free from Corruption

In addition to receiving value for their money, the public would expect that the tax administration and its employees would be **free from any type of corruption or undue influence**.

22.6.7 Confidentiality

Any disclosure of tax information should be within strict guidelines established in the law and only for the purpose of the proper administration of the tax laws.[523]

Taxpayers should be able to expect that their tax information will remain private and there should be legal and employment-related consequences for improper disclosures by any employee of the tax administration.

[523] Section 21 of the Tax Administration Act, Act No. 10 of 2015

Every employee of the tax administration needs training regarding the confidentiality of tax information and the consequences for improper disclosures.

22.6.8 Improved Customer Service

Too much emphasis on raising revenue and less on customer service and taxpayers' rights can lead to a lack of confidence on the part of the public in a tax administration's ability to manage its responsibilities properly. Lack of confidence in the tax administration, which administers the law, can also lead to reduced levels of voluntary compliance with the law.

22.6.9 Voluntary Compliance

Voluntary compliance is the belief on the part of the tax-paying public that the tax administration respects the rights of taxpayers and operates on the principles of integrity and honesty.

For there to be confidence in the tax system, people must believe that it is a fair system administered in an even-handed manner. For these reasons, it is important for the tax administration to provide the proper mix of customer service and fair enforcement of the tax laws.

22.7 Tax Administration in Tanzania

The Tanzania tax structure is composed of direct and indirect taxes, all administered by the Tanzania Revenue Authority (TRA). However, for the

case of Zanzibar, the administration of Union taxes, which include customs duty, excise duty on imports and the income tax, is under TRA, while the Zanzibar Revenue Board administers the rest of local taxes.[524]

The local taxes in Zanzibar include VAT, which is the main local tax, collected by the ZRB. The other local taxes, which are under the administration of ZBR, are the Stamp Duty, paid by businesses that are not registered for VAT, Hotel Levy and the Entertainment Tax. Others are the Excise Duty on locally manufactured goods and fees from various business licenses.[525]

22.8 Tanzania Revenue Authority

The Tanzania Revenue Authority (TRA) is a government agency of Tanzania, charged with the responsibility of managing the assessment, collection and accounting of all central government revenue. A semi-autonomous body operates in conjunction with the Ministry of Finance and Economic Affairs.[526]

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524 See, http://www.tanzaniagateway.org/business/output.asp?articleid=48&cat=How%20to%20Pay%20Taxes&catID=18. Accessed on 27th March 2017 at 16: 33 hours

525 See, ibid

526 See, Braütigam Deborah, Odd-Helge Fjeldstad & Mick Moore (2008). "Mass taxation and state-society relations in East Africa" (PDF). Taxation and State-Building in Developing Countries: Capacity and Consent.

22.8.1 Establishment

Act of Parliament No. 11 of 1995 established the Tanzania Revenue Authority (TRA). It started its operations on 1st July 1996. In carrying out its statutory functions, TRA is bound by law, and is responsible for administering impartially various taxes of the Central Government.

22.8.2 Vision and Mission

The TRA has the vision of increasing Domestic Revenue through Enhancement of Voluntary Tax Compliance. This vision considers a modernized tax administration as one that has a strong enforcement capacity delivered by highly qualified, motivated and committed staff.[527]

TRA's mission is to be an effective and efficient Tax administration; this promotes voluntary tax compliance by providing high quality customer service with fairness and Integrity through competent and motivated staff.[528]

22.8.3 Functions of TRA

TRA Act established TRA[529] and became operational in July 1996 with the following functions[530]:

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527 See http://www.commonwealthgovernance.org/partners/tanzania-revenue-authority/. Accessed on 27th March 2017 at 17:01 hours

528 See http://www.bakertillydgp.com/knowledge-centre/useful-links/tanzania-revenue-authority/. Accessed on 27th March 2017 at 16: 46 hours

529 See section 4 of CAP 399 RE 2006

530 See section 5, ibid

a) Assessment, collection & accounting for government revenue

b) Administration of revenue laws[531]

c) Advising government on fiscal policy

d) Promoting voluntary tax compliance

e) Improvement of quality of service

f) Counteracting Fraud – tax evasion

g) Produce trade statistics and publications

22.8.4 Effectiveness of TRA

Tanzania Revenue Authority in its effort to ensure the achievements of its objectives as required by the Government of the United Republic of Tanzania has been establishing Corporate Plan of five years each.[532]

It normally shows the roadmap of what is to be achieved and provide key performance indicators which helps in monitoring and assessing the level of achievement and possibly assisting in establishing the corrective action or the way to improve the situation that is likely to hinder the achievement of the desired results.[533]

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531 See section 15 of the Tax Administration Act, Act No. 10 of 2015

532 See Dittenhofer, M. (2001). Internal auditing effectiveness: An expansion of present methods. Managerial Auditing Journal, 16(8), 443 –450

533 See Ahmad, N., Othman, R. & Jusoff, K. (2009). The effectiveness of internal audit in Malaysian public sector. Journal of Modern Accounting and Auditing, 5(9), 784-790

Tax collection always involves some exercise of discretion; the creation of a powerful, revenue authority not subject to adequate external constraints could expose other segments of taxpayers to extortion. The tax relationship will only work well if the taxpayer has some kind of protection against extortion, notably substantive taxpayers' rights.[534]

Furthermore, if the autonomy of the revenue authority from the Ministry of Finance is established in conditions that create ill feeling between the two, or provide few incentives to cooperation, then tax and budgetary policy may be compromised.[535]

Another challenge is in the application of the concept of autonomy to an organization that handles large sums of money. Managerial autonomy to run a tax agency on a day-to-day basis in ways that make sense from a perspective of its special functions seems very sensible.[536]

534 See Fjeldstad, O.-H. 2003. Fighting fiscal corruption: Lessons from the Tanzania Revenue Authority. Public Administration and Development 23(No. 2, May):165–175

535 See Mann, A. 2004. Are semi-autonomous revenue authorities the right answer to tax administration problems in developing countries? A practical guide. Washington, DC: U.S. Agency for International Development.

536 See Ghura, D. 1998. Tax revenue in Sub-Saharan Africa: Effects of economic policies and corruption. IMF Working Paper 98/135, Washington, DC: International Monetary Fund

The problems lie at the level of political control. The top managers of a tax agency cannot be left free to dispose of its income as they wish. They should be responsible to someone or, preferably, to some institution.[537]

The problem with revenue authorities in some African countries is that the label autonomy faces disguise the fact that they have been answerable to only one person, often the President.[538]

22.9 Summary

In the above chapter, we have cultured ourselves with notion that tax administrations operate in societies that are rapidly changing and have to fulfil increasing demands and growing expectations from their stakeholders, including new demands from taxpayers for sophisticated government services. In addition, we have understood that tax administration means the implementation and enforcement of tax laws or statutes.

In addition to that, we have stretched out our knowledge on the core business of tax administrations as the levying and collection of taxes imposed by law. It is important that tax administrations establish a clear definition of their core

537 See Kidd, M. & Crandall, W. 2006. Revenue authorities: Issues and problems in evaluating their success. IMF Working Paper WP/06/240. Washington DC: International Monetary Fund.
538 Ibid

business from the outset and make it known to their stakeholders.

Moreover, we have known that tax administration authorities have the complex duty to be efficient in minimizing distortions that affect growth policies that favour the poor, effective in raising revenue, and equitable in building on and reinforcing political legitimacy.

Furthermore, it has been born in our mind that Tanzania Revenue Authority in its effort to ensure the achievements of its objectives as required by the Government of the United Republic of Tanzania has been establishing Corporate Plan of five years each.

Nevertheless, we have discovered that, if the autonomy of the revenue authority from the Ministry of Finance is in conditions that create ill feeling between the two, or provide few incentives to cooperation, then tax and budgetary policy may be compromised.

Another challenge is in the application of the concept of autonomy to an organization that handles large sums of money. Managerial autonomy to run a tax agency on a day-

to-day basis in ways that make sense from a perspective of its special functions seems very sensible.

22.10 Review Questions

1. How can you define the term tax administration?
2. Describe the nature, scope and core tasks of tax administration.
3. What are the principles that guide tax administration authorities with in their functioning?
4. Discuss the challenges that Tanzania Revenue Authority encounters in execution of its functions according to the revenue laws.

22.11 References

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Tanzania Revenue Authority Act, CAP 399 RE 2006

Tax Administration Act, Act No. 10 of 2015.

CHAPTER TWENTY THREE

VOLUNTARY TAX COMPLIANCE IN TANZANIA

23.0 Introduction

One of the key attributes of tax administration is the tax morale and voluntary tax compliance, which involves sensitization about the importance of paying taxes in order to enable government to provide quality social services to the public. It is notable that tax is a main source of government revenue, such that recommendations for improving its administration are of importance to the policy makers and implementers across the world.

This chapter aims at imparting knowledge on the voluntary tax compliance and its related matters. We shall have chance to understand the concepts tax compliance and voluntary tax compliance. In addition, we will have opportunity to know the determinants of voluntary tax compliance as well as its enforcement mechanisms.

23.1 Objectives

At the end of this chapter students should have: -

- Learnt the concepts of tax compliance and voluntary tax compliance.

- Been conversant with understanding on nature and essence of voluntary tax compliance.
- Advanced understanding on the determinants of the voluntary tax compliance.
- Familiarised with knowledge on the enforcement and improvement of the voluntary tax compliance in Tanzania.

23.2 Tax Compliance

Tax compliance means taxpayers have a legal obligation to comply with the tax laws, just as they are obligated to comply with all rules that carry the force and effect of law. Penal sections of the tax code reinforce this obligation.[539]

Tax compliance is very important in the whole process of collecting tax revenues. It is of particular importance as compared to self-assessment and electronic commerce, which are strongly given high attention currently.[540]

Monitoring tax compliance is very important and requires proper maintenance of taxpayer current accounts and management information

[539] See Ame, A, Chaya, P and John, P (2013) "Under financing in Local Government Authorities of Tanzania, Causes and Effects; A case of Bahi District Council" Global Journal of Human Social Sciences Economics; Vol. 13; Issue 1

[540] See Ame, A, Chaya, P and John, P (2013) "Under financing in Local Government Authorities of Tanzania, Causes and Effects; A case of Bahi District Council" Global Journal of Human Social Sciences Economics; Vol. 13; Issue 1

systems, which include both taxpayers and third-party agents involved in the tax system as well as appropriate and prompt procedures to detect and enforce tax payment promptly.

23.3 Voluntary Tax Compliance

This is an assumption or principle that taxpayers will comply with tax laws and, more importantly, accurately report their income and deductions honestly.[541]

The "voluntary" nature of taxation relates to the method of submitting and paying income tax obligations. Under a voluntary compliance system, the assumption is that most of the population will fail to pay its full tax burden, either by mistake or by deliberate attempts at tax evasion.[542]

Therefore, the government's position is that voluntary compliance means that taxpayers behave in a way required by law, but without direct compulsion from the tax authorities.

23.4 Nature of Voluntary Tax Compliance

541 Read more: Voluntary Compliance Definition | Investopedia http://www.investopedia.com/terms/v/voluntarycompliance.asp#ixzz4cUmRdiFn

542 See Australian Taxation Office – ATO (1998), "Improving Tax Compliance in the Cash Economy", Commonwealth of Australia, Canberra.

Voluntary tax compliance programme refers to any programme to facilitate legalisation of a taxpayer's situation vis-à-vis funds or other assets that were previously unreported or incorrectly reported.[543]

Countries may introduce VTC programmes for a variety of purposes including raising tax revenue; increasing tax honesty and compliance; and/or facilitating asset repatriation for the purpose of economic policies, especially when the country is in an economic crisis.

Such programmes come in a variety of forms and may involve voluntary disclosure mechanisms, tax amnesty incentives and/or asset repatriation.[544]

In many cases, voluntary tax compliance programmes proceeds after a highly political decision reacting to the immediate economic or fiscal situation of the country. In such circumstances, the programme may be at short notice.[545]

23.5 Determinants of Voluntary Tax Compliance

543 See Baker, R, et al (2014) "Trade Mis-invoicing and the impact of Revenue Loss in Ghana, Kenya, Mozambique, Tanzania and Uganda" Global Financial Integrity (GFI), International Development Cooperation

544 See Bird, R. M (2015) "Improving Tax administration in developing Countries" Journal of Tax Administration; Vol. 1 (1)

545 See Bird, R. M (2015) "Improving Tax administration in developing Countries" Journal of Tax Administration; Vol. 1 (1)

Over the years, various governments have simply tried to increase the level of tax compliance by adopting an intransigent attitude towards all taxpayers and by applying laws and regulations to sanction and fine evaders.

These means of enforcement proved to be without a significant success. Towards the end of the 20th century, governments have realized that a change can increase the amount of taxes collected.

Thus, using adequate strategies based on understanding the reasons, which drive compliance decisions is of greater help than strictly applying laws and regulations.

23.5.1 Tax Altitude and Perception

In their continuous interaction with authorities, taxpayers develop certain beliefs and attitudes according to which they choose to comply with the tax law or not.[546]

Hence, other important determinants of compliance behaviour that express the social distance between taxpayers and tax authorities are the motivational postures.[547]

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546 See Alm, James, Gary H. McClelland and William D. Schultze (1992) 'Why do people pay taxes?', Journal of Public Economics 48(1): 21-38

547 See Alm, James, Gary H. McClelland and William D. Schultze (1999) 'Changing the social norm of tax compliance by voting', Kyklos 52(2): 141-171

23.5.2 Fair Tax System

The voluntary compliance system is far from the only viable system of income taxation. The so-called fair tax system focuses imposing use taxes i.e. the more goods and services a person uses, the more taxes he or she pays.[548]

Nevertheless, fair use systems often impose a heavier burden on low-income taxpayers because they pay a higher proportion of their income use taxes. For this reason, fair use taxes may be regressive and aggressively unfair.[549]

23.5.3 Simple Tax System

Under a simple tax system, the tax authorities would calculate taxes, credits and deductions and provide taxpayers with a copy of the completed return.[550]

Taxpayers who agree with the tax authorities' calculations could simply accept the return, while taxpayers who disagree could file their own returns.[551]

548 See Gammel, N and Hasseldine, J (2014) "Tax payer's behavioural Responses and Measures of Tax compliance Gap"; A critique; Working Paper

549 See James, S and Alley, C (2004) "Tax Compliance, Self-assessment and tax administration" Working Paper.

550 See Daude, C, Gutierrez, H and Melguizo, A (2013) "What drives tax morale? A focus on emerging Economies" Review of Public Economic Journal; Issue 207 (4) pp9-40

551 See Daude, C, Gutierrez, H and Melguizo, A (2013) "What drives tax morale? A focus on emerging Economies" Review of Public Economic Journal; Issue 207 (4) pp9-40

The simple tax system would also ensure nearly 100 per cent compliance, since the tax authorities would be supplying tax returns rather than individual citizens.[552]

23.5.4 Tax Structure

The structure of tax system can also hinder taxpayers' willingness to comply, if they perceive the system as being too bureaucratic, with a high tax burden, and a high number of taxes.[553]

23.5.5 Certainty of Tax Laws

The uncertainty of tax law due to multiple changes generates itself a lack of certainty in the filing behaviour and punishment aversion. Hence, most taxpayers hire tax lawyers and preparers. They give expert advice on the correct filling in of the tax returns. Tax law is difficult to understand and gives birth to uncertainty not only for ordinary citizens but also for tax authorities.[554]

23.6 Enforcement of Voluntary Tax Compliance

552 See http://www.optimataxrelief.com/voluntary-compliance-mean-regards-taxes/
553 See Andreoni, James, Brian Erard and Jonathan S. Feinstein (1998) 'Tax compliance', Journal of Economic Literature 36(2): 818-860
554 See Baldry, Jonathan C. (1987) 'Income tax evasion and the tax schedule: Some experimental results', Public Finance 42(3): 357-383

Facilitating compliance involves strengthening key elements such as improving services to taxpayers by providing them with clear instructions, understandable forms, and assistance and information as necessary.[555]

Improving compliance requires a mix of both measures as well as additional measures to deter non-compliance such as establishing a reasonable risk of detection and the effective application of penalties.[556]

23.6.1 Tax Awareness

Notwithstanding, penalties can be used as one of the methods of enforcing tax compliance but creating tax awareness to tax payers is very significant in sensitizing them to fulfil tax obligations effortlessly.[557]

In addition, awareness of tax laws, business experience and the integrity of employees together with training needs are very important in compliance process.[558]

Henceforth, some taxpayers do comply with tax laws not only because they want to comply, simply because they understand the importance of tax and

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[555] See Abiola, J and Asiweh, M (2012) "Impact of tax administration on Government revenue in a Developing Economy; A case study of Nigeria" International Journal of Business and Social Science.

[556] See Adebisi, J. F and Gbegi, D.O (2013) "Effect of tax avoidance and tax evasion on personal income tax administration in Nigeria" American Journal of Humanities and Social Sciences; Vol. 1, No. 3; pp125-134.

[557] Ibid

[558] Ajzen, Icek (1993) 'Attitude theory and the attitude-behavior relation'. In Dagmar Krebs and Peter Schmidt (eds.), *New directions in attitude measurement* (pp. 41-57). New York: de Gruyter.

tax compliance for the prosperity of the nation. For this reason, tax awareness is very important and can help to engulf tax evasion and tax avoidance.[559]

23.6.2 Proper use of tax based revenue or funds

Proper use of public funds has strong influence on enhancing tax morale and compliance for taxpayers.[560] The system of fairness, trust and a sense of acceptance or belonging among citizens who share a unified, national identity may bear very significant consequential situations and alternative acts of social conduct that mitigate non-compliance.[561]

Tax payment is constitutional obligation of the citizens, but bad behaviour of the government officials can enforce taxpayers to shift to shadow economy. In addition, institutional arrangement of the public governance can affect tax morale as well.

23.6.3 Improved Public Services

Age, religion, gender, educational level and employment status drive tax compliance. There is an argument that satisfaction of the quality of social

559 See Adenugba, A. A and Ogechi, C. F (2013) "The effect of Internal Revenue generation on Infrastructural Development; A study of Lagos State Internal Revenue Service" Journal of Education and Social Research; Vol.3 (2).

560 See Aiko, R. J (2013) "Tanzania Citizens' perceptions and attitude towards Taxation, Tax enforcement and tax officials" Afrobarometer Briefing Paper No. 122

561 See Christian, Charles W. (1994) Voluntary compliance with the individual income tax: Results from the 1988 TCMP study. Washington, DC

public services provided by the government has high impact on the tax morale and tax compliance.[562]

Also, improved social institutions such as tax morale, voice and accountability, the rule of law, government effectiveness and reducing corruption help to reduce shadow economy activities.[563]

Therefore, the perception among citizens that the taxes they pay are not spent on public services is the key for the demoting the voluntary tax compliance in the country. This perception erodes residents' confidence in the capacity of local councils to supply essential services that, in turn, affects their willingness to pay taxes.[564]

23.6.4 Clear and Transparent Tax Policies

The authority should establish clear and transparent operating policies to be well adhered by tax collectors. It is clear that independent revenue administrations must have mandate and being fully responsible for their own recruitment, training, and salary structure in order to control general conduct of the tax collectors.[565]

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562 Ibid

563 Ibid

564 See Alabede, J. O, Ariffin, Z. Z and Ichis, K. M (2011) "Individual tax payers' attitude and compliance behavior in Nigeria; The moderating role of financial and risk preference" Journal of Accounting and Taxation; Vol. 3 (5) pp91-10

565 See Alm, J and Martinez-Vazquez, J (2003), "Institutions, Paradigms, and Tax Evasion in Developing and Transition Countries," in Martinez-Vazquez and Alm, eds., Public Finance in Developing and Transitional Countries

Henceforth it is now clear that tax revenue collections through clear and transparent tax policies can be improved by lessening shadow economy activities, raising awareness to tax payers, encouraging voluntary tax compliance and building trust to citizens in order to inbuilt tax morale in their hearts.[566]

23.7 Way forward to improve Voluntary Tax Compliance in Tanzania

Voluntary tax compliance is very important in the whole process of tax administration in Tanzania. Awareness of tax laws, business experience, integrity of employees and training needs influences voluntary tax compliance

Due to the importance of voluntary tax compliance, it is recommended effort on awareness of tax laws to all taxpayers in order to improve government revenues.

Tax knowledge is very important in promoting voluntary tax compliance. In order to enhance domestic tax collections, tax authorities need to promote tax education and integrating tax education in Tanzanian school curriculum for enhancing voluntary tax compliance and building tax morale.

566 Ibid

Tax knowledge can help taxpayers to know the importance of tax and hence keep proper record of accounting for determining tax payments.

In addition, information communication technology (ICT) has strong influence on the performance of tax administrators in collecting tax revenues in Tanzania.

ICT contributes significantly on the tax collections in the large taxpayers' department of Tanzania Revenue Authority (TRA). ICT has improved processing returns in time, minimising operational costs and timely access of customers' tax records.

Therefore, tax authorities should focus of improving ICT infrastructure in order to easy tax collection mechanisms and boost government revenue.

The Authority has to widen up a number of taxpayer sensitization seminars and workshops on various tax laws. The idea of enhancing tax collections is not to increase tax rate rather to enforce customs and tax administration and to incorporate SMEs operations on the tax policy in order to increase government revenue.

In addition, TRA should ensure that Customs and Excise department in strongly committed to collect all government revenue through taxes and the reforms in the department are successful. It is therefore a challenge to the government to proceed with tax reforms in order to identify new

sources of tax revenues and increase efforts on fighting against corruptions.

Moreover, TRA management should work strongly and promoting effectiveness and efficiency in the department in order to achieve the targeted revenue collection.

Enhance human resource capacity and organization-review in the departmental structure, maintain high level of staff integrity in tax revenue collection, eradicating dumping of transit goods by conducting risk based verification audits, preventing smuggling across all Tanzanian borders by conducting surprise visits to most risk areas, proper valuation and classify locally imported and transit goods by identifying sensitive commodities.

Account for each tax assessment by identifying overdue assessments and make timely follow up to recover the assessed tax, prevent revenue leakage from exemptions, account for all cargo arriving at the port, airport and border stations by developing a system that will record inward and outward movement of goods.

23.8 Summary

In the above chapter, we have understood that tax compliance is very important in the whole process of collecting tax

revenues. It is of particular importance as compared to self-assessment and electronic commerce, which gives high attention currently. It has come to our mind that voluntary compliance means that taxpayers behave in a way required by law, but without direct compulsion from the tax authorities.

In addition, we have learnt that voluntary tax compliance involves programme that facilitates legalisation of a taxpayer's situation vis-à-vis funds or other assets that were previously unreported or incorrectly reported.

However, it has into our knowledge that using adequate strategies based on understanding the reasons, which drive compliance decisions, is of greater help than strictly applying laws and regulations.

Generally, facilitating compliance involves strengthening key elements such as improving services to taxpayers by providing them with clear instructions, understandable forms, and assistance and information as necessary.

23.9 Review Questions

1. What do you understand by the term tax compliance? How is different from voluntary tax compliance?
2. How can the tax administration authorities enforce the voluntary tax compliance effectively?
3. Describe the determinants of voluntary tax compliance with vivid examples.

23.10 References

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CHAPTER TWENTY FOUR

TAX DISPUTE SETTLEMENT IN TANZANIA

24.0 Introduction

There is no doubt that different legal systems nowadays do interact between each other both mandatory, unavoidable and voluntarily. Just like any other country, tax disputes in Tanzania are inevitable. Whenever there is law governing human interaction and state regulation, disputes are inevitable due to character, background, purpose and enforcement of regulations. Hence, tax administration in Tanzania is also a victim of disputes.

24.1 Objectives

At the end of this chapter students should have: -

- Learnt the concepts of tax dispute and tax dispute settlement.
- Been conversant with understanding on strengths and weaknesses of the settlement machinery of tax dispute in Tanzania.
- Advanced understanding on procedures and necessary requirements for objecting tax assessments in Tanzania.

- Familiarised with knowledge to discuss jurisdictions of each adjudicating body of tax disputes according to laws established them.

24.2 Tax dispute

Relationship between the taxpayer and the tax authority can sometimes turn sour, especially when the two are in disagreements on the tax assessment raised. Such disagreements are tax disputes.

The hitches of tax laws and another is the pressure from the government on the taxing authority to make sure it meets certain tax revenue targets is among of the reasons, which lead to the rise of tax disputes in any tax jurisdiction.[567]

In addition, complex tax laws, cultural attitudes of not paying taxes, aggressive assessments, which are resulted from Tanzania Revenue Authority pressure in meeting set out targets, are some of the reasons as to why tax disputes become entrenched.[568]

24.3 Tax dispute settlement

[567] Mgaya Gotrib, (2012), The tax disputes resolution system in Tanzania: a scrutiny of its effectiveness and challenges, Journal of African and international law (ISSN 1821-620X), Volume 5 Issue 1

[568] Msuya, F, (2014), an urge to cast a glance at our tax dispute resolution mechanism, Wakili Bulletin, Tanganyika Law Society, at page 13

Tax Dispute settlement is the process, which involves resolving tax disputes which has arisen in course of administration and enforcement of tax statutes. The parties are taxpayers and revenue or tax authorities. This is formal procedure of adjudicating the tax disputes.

The settlement of tax disputes between taxpayer and tax administrator and his officer enforce taxpayers' rights.[569] Disputes over excise taxes can be resolved both administratively and judicially.[570]

Whilst the aim of any tax authority is to prevent unnecessary disputation, those disputes inevitably arising need to be resolved fairly, expeditiously and according to the law.

24.4 Tax Dispute Settlement in Tanzania

There are various bodies, which the law established to resolve the disputes arising from administration, interpretation and implementation of tax statutes in Tanzania. These bodies are creatures of statutes.

They some of them are quasi-judicial bodies while other is judicial body however they use adjudication method in the settlement of disputes of tax. The Tax Administration Act and Tax Revenue Appeals Act, Appellate

[569] Milda Stankevičiūtė,(2010), Interaction between Lithuanian and Austrian legal systems: tax dispute resolution procedure, at page 309

[570] Edward L Froelich, (2014), The Tax Disputes and Litigation Review, 2nd Edition, Law Business Research Ltd, United States

Jurisdiction Act and Rules made thereon govern the tax disputes settlement bodies.

The need for Tanzania to drive its economic independence through taxes of high value. The taxpayers and the tax authority should see themselves as partners who aim to achieve a common goal of national development through collection of taxes.[571]

In so doing, the tax authority is not be allowed to take unfair advantages dealing with taxpayers. To put it simply, claiming the right amount of tax to be charged should not be such a terrifying phenomenon to the taxpayers.

24.4.1 Commissioner General

Commissioner General is the chief executive officer of the Authority and, subject to the general supervision and control of the Board, shall be responsible for the day-to-day operations of the Authority, the management of funds, property and business of the Authority. The position is presidential appointee.[572]

However, in tax disputes settlement Commissioner General under normal circumstances regarding appeals means commissioner for Customs, Large

[571] Msuya, F, (2014), an urge to cast a glance at our tax dispute resolution mechanism, Wakili Bulletin, Tanganyika Law Society, at page 13

[572] Section 16 of Tanzania Revenue Authority Act, CAP 399 RE 2006

Taxpayer Department, and Domestic Revenue. However, managers of the respective area of jurisdiction exercise administration on appeals.

24.4.1.1 Jurisdiction

Tanzanian tax laws allow any person who feels aggrieved to request a formal change to an official decision regarding tax assessment made by the Commissioner General.[573] Any person who disputes an assessment made upon him may, by notice in writing to the Commissioner General, object to the assessment.

Frankly speaking this jurisdiction is unfair to tax payer basing on the natural justice principle of no one can be judge on his own cause because the dispute is referred to be resolved by the same Commissioner General that the taxpayer is complaining about. The assessment that the taxpayer is disputing would be from the Commissioner and again the taxpayer can object to the same office of Commissioner General.

24.4.1.2 Procedures

- **Notice of objection**

A notice of objection shall contain a statement in precise form, of grounds in respect of which the objection to an assessment made, and needs filing

[573] Section 51 (1) of Tax Administration Act, Act No. 10 of 2015

to the Commissioner General within thirty days from the date of service of the notice of the assessment.[574]

- **Late objection lodging**

A taxpayer may fail to file an objection against tax assessment in time. However, the law still provides the chance for this person to file an objection after expiry of the period. The commissioner may then admit or refuse the objection depending on the satisfaction or dissatisfaction with the reasons surrounding this lateness.[575]

In the case of **Nimrod E Mkono v Commissioner General**[576] that ruled out that even though different tax Acts are silent in requiring the Commissioner General to give reasons for his decisions, according to the principle of natural justice, giving out reasons will cure arbitrariness in his decisions.

The commissioner may admit the late filed objection under the following grounds:

i. If the Commissioner General is satisfied that the reason for lateness is absence of the taxpayer from the United Republic,

[574] Section 51 (1) of Tax Administration Act, Act No. 10 of 2015
[575] Section 51 (2) and (3), ibid
[576] [2004] 2TTLR 169

ii. If the Commissioner General is satisfied that the reason for lateness is sickness

iii. Other reasonable cause upon satisfaction by the Commissioner General

- **Grounds of objection**

A taxpayer who feels that the Commissioner General misapplied the law, came to an incorrect factual finding, abused his powers, was biased, considered evidence which he should not have considered or failed to consider evidence that he should have considered in making an assessment, may object against such an assessment.

- **Necessary condition for objection**

Where there is a notice of objection to an assessment, the person objecting shall, pending the final determination of the objection to an assessment by the Commissioner General pay the amount of tax that is not in dispute or one third of the assessed tax, whichever amount is greater.[577]

The Commissioner General shall refuse to admit the notice of objection to assessment of tax due to the following reasons:-

[577] Section 51 (5) of Tax Administration Act, Act No. 10 of 2015

i. The notice does not comply with the requirements prescribed by the law
ii. The notice does not raise any question of law or fact in relation to the assessment
iii. The relief sought cannot be granted in law or equity
iv. The objection is time barred
v. the objection is otherwise misconceived

- **Determination of Objection**

The Commissioner General may, upon being satisfied that there exist good reasons warranting reduction or waiver of tax payable direct that a lesser amount or waive the required tax deposited.[578]

The Commissioner-General shall determine the objection as filed, or call for any evidence as may appear to be necessary for the determination of the objection and may amend assessment in accordance with objection or further evidence or refuse to amend.[579]

However, reasons must accompany refusal, as principle of natural justice requires. In the case of **Nimrod E Mkono v Commissioner General**[580] that ruled out that even though different tax Acts are silent in requiring the

[578] Section 51 (6) of Tax Administration Act, Act No. 10 of 2015
[579] Section 52, ibid
[580] [2004] 2TTLR 169

Commissioner General to give reasons for his decisions, according to the principle of natural justice, giving out reasons will cure arbitrariness in his decisions.

Any person who is aggrieved with the refusal by the Commissioner General to admit the notice of objection may appeal to the Board against the refusal and the decision of the Board on whether or not the notice of objection be admitted by the Commissioner General shall be final.[581]

However, no body shall entertain such appeal. Appellant has to deposit to the Commissioner General the amount of tax assessed, that is not in dispute or one third of the amount of tax assessed, whichever is greater. In addition, together with the interest due as a result of late payment of the tax in respect of which the notice of late payment of the tax in respect of which the notice of objection issued, there can be hearing of the appeal.

24.4.2 Tax Revenue Appeals Board

- **Establishment**

Tax Revenue Appeals Board (TRAB) is a quasi-judicial institution. Administratively the Board is an independent department under the **Ministry of Finance and Economic Affairs.**

[581] Section 53 (1), ibid

It is established to hear and determine civil disputes arising from revenue laws administered by the Tanzania Revenue Authority (TRA).

- **Jurisdiction**

Section 7 of the Tax Revenue Appeals Act provides for the jurisdiction of the Board[582] that provides that the Board shall have sole original jurisdiction in all proceedings of a civil nature in respect of disputes arising from the revenue laws administered by the Tanzania Revenue Authority.

- **Time to appeal**

A party aggrieved by decision of TRA may lodge an appeal when a notice of appeal served upon the Commissioner General within thirty days (30)[583] following the date on which a notice of final determination of assessment of tax served on the appellant.

The appeal lodged with the Board within forty-five (45) days[584] following the date on which the notice of final determination of assessment of tax served on the appellant.

- **Delay of appeal**

[582] CAP 408 RE 2002
[583] Rule 4 (2), of Tax Revenue Appeals Board Rules, GN No. 57 of 2001
[584] Rule 6 (1), ibid

If one misses the deadline to appeal to the Board within stipulated time, may apply to the Board to extend the time within which to file an appeal. However, the Board may extend if satisfied that the failure by a party to give notice of appeal, lodge an appeal or to effect service to the opposite party occasioned by absence from the United Republic, sickness or other reasonable cause.[585]

- **Procedures**
  - **Notice of intention to appeal**

A person who wishes to appeal to the Board shall file to the Board a written notice of intention to appeal[586] within thirty days from the date of services of the notice of final assessment of tax or notice as to the existence of liability to pay any tax, duty, fees, levy or charge.[587]

The said notice shall state whether it is for appeal against the whole or part of tax assessed or the existence of liability to pay any tax, duty, fees, levy or charge. The said notice shall state whether it is for appeal against the whole or part of tax assessed or the existence of liability to pay any tax, duty, fees, levy or charge. [588]

[585] Rule 9 of Tax Revenue Appeals Board Rules, GN No. 57 of 2001
[586] Rule 4 (1), ibid
[587] Rule 4 (2), ibid
[588] Rule 4 (3), ibid

A notice of intention to appeal shall conform the Form TRB. 1 and shall be signed by or on behalf of the Appellant. Where the Secretary has received a notice of intention to appeal, he shall endorse on it the date received and register all relevant particulars.[589]

- **Statement of appeal**

Lodging a statement of appeal at registry of the Board shall institute an appeal to the Board by within forty-five days from the date of service of notice of the final assessment.[590]

Every appeal shall conform in Form TRB. 2. Upon receipt of appeal, the Secretary shall endorse on it the date on which he received it.[591] The appellant shall when, instituting an appeal to the Board pay the appropriate amount of fees.[592]

- **Attachment to appeal**

A person who institutes an appeal to the Board shall attach the following documents with an appeal[593]:-

i. The statement constituting the appeal

[589] Rule 4 (4), ibid
[590] Rule 6 (1), ibid
[591] Rule 6 (2) of Tax Revenue Appeals Board Rules, GN No. 57 of 2001
[592] Rule 8 (1), ibid
[593] Rule 7, ibid

ii. A copy of a notice of objection to an assessment submitted to the Commissioner General by the appellant.

iii. A copy a notice issued by the Commissioner General regarding the existence of liability to pay any tax, duty, fees, levy or charge.

iv. Where the appeal relates to refusal by the Commissioner General to admit a notice of objection, statement containing the refusal to admit such objection.

v. Where the appeal relates to :-

a. Calculation by the Commissioner General of the amount due for refund, drawback or repayment of tax, fee, duty, levy or charge; The Appellant shall attach a copy of refusal by the Commissioner General to make any refund or repayment.

b. the decision by the Commissioner General to register, or refusal to register, any trader for the purpose of the Value Added Tax Act

vi. The Appellant shall attach a copy of a statement containing the decision of the Commissioner General.

vii. Evidence of payment of appropriate fees.

- **Hearing**

A hearing of appeal shall be in public unless a party to the proceedings otherwise applies and the Board directs that the proceedings or part of it, be heard in camera.[594]

24.4.3 Tax Revenue Appeals Tribunal

- **Establishment**

Tax Revenue Appeals Tribunal (TRAT) is a quasi-judicial institution established by the Tax Revenue Appeals Act.[595]

Administratively the Tribunal is an independent department under the Ministry of Finance, which deals with tax appeals emanating from the decision of Tax Revenue Appeals Board.

- **Procedures**
  - **Notice of intention to appeal**

A person aggrieved by the decision of the Board may appeal against that decision to the Tribunal by filing a notice of intention to appeal within fifteen (15) days from the date of the decision.[596]A copy served to the opposite party within fifteen days.[597]

[594] See section 22 of the Tax Revenue Appeals Act, CAP 408 RE 2002
[595] CAP 408 RE 2002
[596] Rule 4 (1) of Tax Revenue Appeals Tribunal Rules, GN No. 56 of 2001
[597] Rule 4 (2), ibid

A notice of intention to appeal shall correspond the Form TRT. 1 and shall be signed by or on behalf of the Appellant.[598]

- **Statement of appeal**

Lodging a statement of appeal shall institute an appeal to the Tribunal within thirty days from the date of service of the decision and proceedings of the Board.[599] An appeal shall be in form TRT.2[600] The appellant shall when, instituting an appeal to the Board, pay the appropriate amount of fees.[601]

- **Attachment to appeal**

A person who institutes an appeal to the Tribunal shall attach the following documents with an appeal[602]:

i. A certified copy of the proceedings of the Board.
ii. A certified copy of the decision of the Board.
iii. A copy of decision of the Commissioner General which gave rise to appeal to the Board
iv. A copy of the notice of intention to appeal to the Tribunal.

[598] Rule 4 (3), ibid
[599] Rule 6 (1), ibid
[600] Rule 6 (2), ibid
[601] Rule 7, ibid
[602] Rule 6 (3), ibid

- **Extension of time to appeal**

When appellant delays to appeal to the Tribunal within stipulated time, he or she may apply to the tribunal to extend the time within which to file an appeal.

Tribunal where it deems it just and equitable and having regard to the nature of the intended appeal and after the opposite party given opportunity to be heard, by order extend the period within which the appellant may institute the appeal to the Tribunal.[603]

- **Hearing**

A hearing of appeal shall be in public unless a party to the proceedings otherwise applies and the Board directs that the proceedings or part of it, be heard in camera.[604]

24.4.4 Court of Appeal of Tanzania

Article 117(1) of Constitution of the United Republic of Tanzania of 1977 as amended established the court of appeal of Tanzania. It has no original jurisdiction on any matter in the country.

603 Rule 8 of Tax Revenue Appeals Tribunal Rules, GN No. 56 of 2001
604 Rule 15, ibid and Section 22 of Tax Revenue Appeals Act, CAP 408 RE 2002

However, it is the final and supreme court in Tanzania in the administration of justice. It was in 1979 established for the first time.

- **Jurisdiction**

Any person who is aggrieved by the decision of the Tribunal may be preferred an appeal to the Court of Appeal. In addition, Appeal to the Court of Appeal shall lie on matters involving questions of law only.[605]

- **Conditions**

Where an objector prefers an appeal to the Board or to the Tribunal, any tax deposited as required by the law, shall continue to remain deposited with Commissioner General pending the final determination of the appeal.

- **Procedures**

Appeal to the Court of Appeal shall lie on matters involving questions of law only and the provisions of the Appellate Jurisdiction Act and the rules made thereunder shall apply *mutatis mutandis* to appeals from the decision of the Tribunal.[606]

24.5 Summary

[605] See section 25 of the Tax Revenue Appeals Act, CAP 408 RE 2002
[606] See section 25, ibid

In this chapter, we have learnt that tax disputes are there to exist so long as there is enforcement and administration of tax. Moreover, the tax dispute settlement is important so as to enforce and exercise rights and discharge duties of the taxpayers and tax authorities. Establishment of settlement machinery of tax dispute is not a big deal if this machinery is so weak to the extent there is injustice.

In Tanzania, we have Commissioner General, Tax Revenue Appeals Board, Tax Revenue Appeals Tribunal and Court of Appeal of Tanzania as adjudicating bodies that deal with the determination of tax disputes according to their competence prescribed by the law.

These bodies are creatures of the laws in tax disputes settlement according to Tax Revenue Appeals Act CAP 408 RE 2002, Appellate Jurisdiction Act CAP 141 RE 2002 and Tax Administration Act, Act no 10 of 2015.

These laws are ones providing for powers, jurisdiction and procedures for the determination of tax disputes. However there rules which were made for procedural purpose in tax dispute

settlement such as Tax Revenue Appeals Board Rules, GN No. 57 of 2001 and Tax Revenue Appeals Tribunal Rules, GN No. 56 of 2001 and Court of Appeal Rules of 2009.

24.6 Review Questions

1. What do you understand by the terms tax disputes and tax dispute settlement.
2. Identify and describe settlement bodies of tax dispute in Tanzania.
3. Explain the procedures stipulated by the law for objection to assessment of tax.
4. Discuss strengths and weaknesses of tax dispute machinery in Tanzania.

24.7 References

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CHAPTER TWENTY FIVE

TAXATION AND JUSTICE

25.0 Introduction

In any modern society, the principles for judging tax justice will necessarily apply to a tax system that is formidably complex and inaccessible. There is a level of judgment, which the citizen can bring to bear on these matters without first having mastered technical details. Throughout the ages and around the world, taxation has had enormous influence on the structuring of society and the status of the individual within society. Today, taxation presents one of the greatest potential threats to individuals and their rights to life, liberty, and pursuit of their own happiness.

Therefore, in this hereby chapter, we are going to teach some justice issues related to taxation. In addition, we will have opportunity to know the concept of taxation, its nature, characteristics and rationales. Moreover, we shall have understanding on the elements of just taxation as well as taxation in the free society. Henceforth, it is conceptual and reasoning based chapter with intention to stretch your understanding on taxation and justice issues.

25.1 Objectives

At the end of this chapter students should have: -

- Learnt the concept of taxation and justice.
- Been conversant with understanding on nature, characteristics of taxation.
- Advanced understanding on the elements of just taxation.
- Familiarised with rationale and side effects of taxation.

25.2 Taxation

Taxation is one of the most important obligations of any society regardless of being developed or less developed. Governments have been collecting taxes ever since the beginning of civilization.

A tax is a financial charge levied on an individual or legal entity by a state or nation. Failure to pay this charge is punishable by law. According to Black's Law legal dictionary, a tax is a pecuniary burden laid up an individual or property to support a government.

An economist view on taxes is that a tax is a transfer of resources from the private sector to the public sector and without references to any special benefits received.

25.3 Rationale of Taxation

Taxation is the earliest and most prevalent form of government interference with the economic life of individuals and business enterprises. The right of the chief authority to collect taxes, and the general policy which determines who is to be taxed, how much the tax shall be, and for what purposes it shall be levied has always been a controversial issue.[607]

The tremendous increases in public spending accompanying recent depressions and war periods have brought the question of taxation to the mind of each citizen.[608]

Moreover, the extension of the powers of governments and the creation of modern greater states has necessitated larger revenue for the administration of states. As such, the development of general taxation was inevitable.[609]

The main goal of taxation has generally been to generate revenue for a government. As society as progressed however, taxes have also been used more to redistribute wealth from the rich to the poor, and have been used in order to influence the behaviour of people.

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607 See http://www.abyssinialaw.com/study-on-line/item/1066-general-theories-and-principles-of-taxation.

608 Ibid

609 Ibid

Welfare, food stamps, and subsidized housing would be some examples of redistribution of wealth. Taxes on things like cigarettes and gambling, and tax deductions on things like owning a house and having a spouse, are examples of where taxes that influences the personal lives of people.

25.4 Characteristics of Taxation

First, there is the **tax is regressive**. Here the distribution of property or income, whatever it was before the tax, is less equal by operation of the tax.[610]

A regressive tax is one where everyone pays the same amount of tax regardless of their income or their ability to pay, or a tax of which the tax rates decreases as the taxable amount increases.

This result in a greater tax burden for those with a low ability to pay tax (the poor) compared to those with a higher ability to pay (the rich).

The obvious illustration is a tax levied only on the poor and not on the wealthier. However, regressive taxes may also include taxes that are equal in dollar amount as between the poor and the wealthier.

[610] See Harry Kalven, Jr. & Walter J. Blum, "The Anatomy of Justice in Taxation," University of Chicago Law Occasional Paper, No. 7 (1973).

A universal head tax, of a given amount, would necessarily reduce the after-tax shares of the poor as compared with the after-tax shares of the wealthier.

The second type is **the tax, which is progressive**. Here the distribution of property or income, whatever it was before the tax, is made equal by operation of the tax.[611]

Progressive tax is a tax, which taxes more with increase in income. This means that tax rates increase with increase in income. This approach is known as vertical equity.

A tax on income or wealth in which the rates are graduated upward would necessarily reduce, after taxation, the shares of the more wealthy as compared to the shares of the less wealthy.

The third type of tax is that which is neither regressive nor progressive. It may be designated "**neutral" or "proportionate**"; it would leave the relative shares of property and income unchanged before and after taxes.[612]

25.5 Nature of Taxation

611 Ibid
612 Ibid

Taxes were generally thought of as the indispensable method of financing government. What the government did with the tax money afterward was not seen as relevant to assessing the justice of how it was raised.[613]

Taxation is the price we pay for government services. A tax is a compulsory payment by individuals to government. Taxes are always coercive i.e. the idea of voluntary taxation is oxymoronic.[614]

If taxes were voluntary contributions, then many persons would quite likely not want to pay their share unless they knew that everyone else would pay their share.

Then in addition, voluntary taxes would be subject to the possibility that government might only protect those who contributed to its operations.

Legitimate government activity consists of defence and protection of life, liberty, and property. Every amount of taxes must provide an equivalent legitimate benefit, or else taxes become theft.[615]

Taxes raised for purposes other than defence and protection become a way for government to control citizens. Taxation can, and has, become a tool of fiscal and monetary management and a means for redistributing wealth.

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613 See Harry Kalven, Jr. & Walter J. Blum, "The Anatomy of Justice in Taxation," University of Chicago Law Occasional Paper, No. 7 (1973).

614 See Edward W. Younkins, Taxation and Justice, available at http://www.quebecoislibre.org/000930-11.htm

615 Ibid

The purpose of reallocating money via taxation is to distribute it differently than free market transactions would.

Taxation thereby becomes a means to thwart individuals' minds by using their money contrary to their judgment. When taxes are used to redistribute wealth and support social programs, they not only divert resources from other useful purposes, they also become a power contest between organized interest groups.[616]

Special interest groups and lobbyists pressure Congress to pass tax laws conducive to their own self-interests. Various special treatments make economic decisions dependent upon arbitrary tax rules instead of on economic factors. Business decisions are toward tax advantages.

25.6 Elements of Tax Justice

The idea of taxes raises questions of justice and morality regarding the nature of government, its proper objectives, its use of force in obtaining its revenues, and the distribution of the tax burden. Taxes can control citizens.

25.6.1 Taxation vis-à-vis Inequality

The economic inequality is result of non-inclusive, inequitable and unaccountable tax systems characteristic of most countries in Africa. Tax

[616] See Harry Kalven, Jr. & Walter J. Blum, "The Anatomy of Justice in Taxation," University of Chicago Law Occasional Paper, No. 7 (1973).

systems play a key role in redistributing wealth. The tax system itself is the key lever to address inequality by redistributing income from the rich to the poor by taxing the rich more heavily and directing public spending to benefit poor people.

Many governments under pressure to increase tax collection are relying on indirect taxation including VAT[617], which as studies has shown if not well-applied can further exacerbate income inequality. There is need to counter and reverse the trend towards regressive tax policies and push for progressive tax policy reforms such as the use of **wealth taxes.**

Wealth tax is a tax based on the market value of assets owned. These assets include, but are not limited to, cash, bank deposits, shares, fixed assets, private cars, assessed value of real property, pension plans, money funds, owner occupied housing and trusts. An ad valorem tax on real estate and an intangible tax on financial assets are both examples of a wealth tax. Not all countries have this type of a tax.

[617] The buyer generally pays the tax but the seller is responsible for collecting and remitting the tax to the appropriate authorities. A sales tax is a regressive tax because the burden of paying the tax falls proportionately more heavily on taxpayers with a lower income. Most sales taxes are designed as consumption taxes, i.e. as taxes on consumer expenditure

Examples of a wealth tax include property, land, and capital gain tax represents wealth taxes. Most African countries do not have wealth taxes or have very limited wealth taxes and this leaves the rich largely untaxed.

25.6.2 Taxation vis-à-vis Confiscation

If the element of coercion makes it easy to distinguish taxation from charity, the same element makes it awkward to distinguish the coercion of taxation from confiscation.[618]

It is a fundamental principle of our society, enshrined in constitutions, that private property is not for public purposes by the state without just compensation; yet these same constitutions explicitly confer the power to tax.[619]

The similarity is obvious; there is a taking by the state without compensation in both cases. Nevertheless, the difference is more troublesome to isolate than one would expect. It appears to reside essentially in the difference between taking money and taking specific property.[620]

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618 Ibid

619 See *Williams, Walter E. (6 August 2008). Government theft, American-style WorldNetDaily*

620 See Harry Kalven, Jr. & Walter J. Blum, "The Anatomy of Justice in Taxation," University of Chicago Law Occasional Paper, No. 7 (1973).

What is surprising is that this difference becomes so value laden; taxation is at least a neutral word, while confiscation is pejorative in the extreme.[621]

Taxes can be set so high that the taxpayer has to dispose of specific property or simply turn it over to government in order to satisfy his tax obligation.[622]

This perception is at the core of the notion of confiscatory taxation. Indeed, revolutionary regimes have sometimes used the format of 100 per cent taxation as the very vehicle of confiscation.

25.6.3 Taxation vis-à-vis Government services

There is argument based on so-called benefit theory that if we could not literally employ voluntary charges for government service, we should do the next best thing.[623]

How could the government provide services of protection to the people devoid of taxation? By selling protection to the people? Oh! No. There would be administrative difficulties in estimating what to charge various groups; there would be the inescapable free-rider problem once a large number had elected to buy protection.

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621 *See* Murray N. Rothbard, The State versus Liberty", excerpt from chapters 22-25 of The Ethics of Liberty (LewRockwell.com, 2007)

622 *See* Samuels, L.K. (2013), In Defense of Chaos: The Chaology of Politics, Economics and Human Action Review, Apple Valley, CA Coden Press, pp. 308–309

623 Ibid

In addition, there would be the awkwardness of requiring the very poor to pay for protection or go without it and there would be the spill over effects in the larger community if any sector refused to buy police protection or were unable to do so.[624]

Some taxes, rather than user charges, are apparently necessary if government is to function. Therefore, the proposal was to apportion taxes based on estimates of total benefits received from government.

Nevertheless, benefit theory turned out to share most of the difficulties of relying directly on user charges, especially the embarrassment of fixing the proper charge on the poor.[625]

In addition, upon serious scrutiny, most government services conferred benefits in too diffuse a fashion to permit the formulation of a tax schedule based upon them.

25.6.4 Taxation in religion

No major religion has a detailed or comprehensive tax system, but almost all of them have some command to pay taxes. In Christianity, when Caesar imposed taxes on Jesus, he said, "render to Caesars things that are Caesars

[624] See Harry Kalven, Jr. & Walter J. Blum, "The Anatomy of Justice in Taxation," University of Chicago Law Occasional Paper, No. 7 (1973).
[625] Ibid

and render to God things that are Gods." (Mark 12:17). Judaism similarly stresses the importance of paying taxes.[626]

Islam, while not having a prescribed system of taxation, the Khalifia's did impose different kinds of taxes. Zakat is more a redistributive measure of Islam, and while loosely may fit the definition of a tax, since it is not mandatory, it is not a tax.[627]

Though some people might consider it mandatory with the punitive aspect coming in the next life, Abu Bakar did actually mandate Zakat, which would make it a tax, but the next Caliph's did not follow his lead.[628]

Currently only Saudi Arabia and Pakistan have a legislatively required Zakat, but other Muslim countries do have a voluntary Zakat, which the government issued. Jayzah was a tax that was imposed on non-muslims but was essentially the same as Zakat.[629]

Sometimes the Jayzah was kept below the Zakat, in order to discourage conversion to Islam, an example of taxes being used to influence people's behavior. Khiraj was a tax issued by Umer that was imposed on arable land.[630]

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626 See http://www.thinkersforumusablog.org/archives/5115
627 Ibid
628 Ibid
629 See http://www.thinkersforumusablog.org/archives/5115
630 Ibid

25.7 Consequences of Taxation

Taxes are destructive. They tend to destroy the power of individuals to create and keep what they have created. In particular, progressive taxation dampens incentives to produce goods and services and deters capital accumulation. The graduated income tax discourages excellence through the periodic retraction of rewards. Progressive taxation thus burdens society's most productive members.[631]

By reducing the opportunity cost of consumption relative to investment, the government causes consumption activities to be favoured over saving and investment activities i.e. acts of investment can be traced back to acts of saving.

Taxes reduce citizens' levels of living. For every amount spent by the government, individuals have one less dollar to spend for themselves. Taxes, especially those that are progressive and or that are spent for illegitimate activities, contradict the principles of freedom and justice that country was built upon.[632]

631 See Edward W. Younkins, Taxation and Justice, available at http://www.quebecoislibre.org/000930-11.htm

632 See Harry Kalven, Jr. & Walter J. Blum, "The Anatomy of Justice in Taxation," University of Chicago Law Occasional Paper, No. 7 (1973).

Moreover, tax increases reduce the price of leisure. It follows that many people will decide to work less and spend more time in leisure activities.[633]

Furthermore, as the government collects and redistributes more funds, there is an increased incentive to attempt to become a recipient of government transfer payments.[634]

Also, the more government benefits one group at the expense of others, the less respect citizens have for tax laws and the less likely they are to feel obligated to pay their share of taxes.

Then too, a tax and spend program tends to undermine the spirit of helpfulness and voluntary charity on the part of citizens. The more functions assumed by the government, the weaker the belief that helping one's neighbour is a proper voluntary action of the individual.[635]

25.8 Taxation in Free Society

There is possibility of tax structure to be compatible with freedom, natural rights, and liberties philosophies. The purpose of the state is to provide

633 Ibid
634 See Edward W. Younkins, Taxation and Justice, available at http://www.quebecoislibre.org/000930-11.htm
635 Ibid

only those benefits necessary to prevent harm and keep peace that apply equally to all members of the community.[636]

More specifically, a free and orderly society requires state force to deal with aggression and fraud and a court of final resort to settle disputes that were insoluble through private means.[637]

Private judicial arrangements of conciliation, mediation, and arbitration and private defence agencies can accomplish a great deal. However, there remains the need for a coercive court of final appeal to enforce judgments and protect individual rights.[638]

The legitimate functions of the state require funding. These include defence, peacekeeping, preventing and protecting individuals from force and fraud, and maintaining a just, common, and equal system of administering justice and settling disputes.[639]

In other words, the state should provide a stable system of governance that protects life, liberty, and property while maintaining due process of law for its citizens.

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[636] See Harry Kalven, Jr. & Walter J. Blum, "The Anatomy of Justice in Taxation," University of Chicago Law Occasional Paper, No. 7 (1973).
[637] ibid
[638] See Edward W. Younkins, Taxation and Justice, available at http://www.quebecoislibre.org/000930-11.htm
[639] Ibid

Therefore, tax laws should only raise the revenues necessary to fund the legitimate purposes of the government. Voluntary associations performs non-essential functions. Tax law is not a tool for implementing social policy.[640]

25.9 Summary

In the above chapter, we have developed our knowledge on the concept that throughout the ages and around the world, taxation has had enormous influence on the structuring of society and the status of the individual within society. Today, taxation presents one of the greatest potential threats to individuals and their rights to life, liberty, and pursuit of their own happiness.

In addition, we have equipped ourselves with knowledge on the issue that taxation is the earliest and most prevalent form of government interference with the economic life of individuals and business enterprises. The right of the chief authority to collect taxes, and the general policy which determines who is to be taxed, how much the tax shall be, and

[640] See Harry Kalven, Jr. & Walter J. Blum, "The Anatomy of Justice in Taxation," University of Chicago Law Occasional Paper, No. 7 (1973).

for what purposes it shall be levied has always been a controversial issue.

Moreover, we have learnt about the characteristics of taxation. These are regressiveness, progressiveness and proportionality. The idea of taxes raises questions of justice and morality regarding the nature of government, its proper objectives, its use of force in obtaining its revenues, and the distribution of the tax burden. Taxes can control citizens.

Therefore, tax laws should only raise the revenues necessary to fund the legitimate purposes of the government. Voluntary associations performs Non-essential functions. Tax law is not a tool for implementing social policy.

25.10 Review Questions

1. Discuss the rationale behind taxation
2. What are the characteristics of taxation?
3. Describe the elements of just taxation.
4. Illustrate the taxation in free society.
5. Argue for or against taxation with vivid examples.

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http://www.thinkersforumusablog.org/archives/5115\

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CHAPTER TWENTY SIX

EVOLUTION OF INTERNATIONAL TAXATION

26.0 Introduction

International taxation evolves in response to globalization, capital mobility, and the increased trade in services, and introduces international tax practitioner, student and researcher to the theory, practice, and international examples of the changing landscape. This chapter entails various concepts of international taxation as well as accounting for the growth and development of international taxation.

26.1 Objectives

At the end of this chapter students should have:-

- Acquired knowledge and understanding of the basic concepts of international taxation.
- Acquainted with understanding on the reasons for the growth of international taxation**.**
- Developed ability to describe nature and overview of international taxation.
- Developed ability to describe the phases for the evolution of the international taxation.

26.2 International Taxation

International taxation is the determination of tax on a person or business subject to the tax laws of different countries or the international aspects of an individual country's tax laws as the case may be.[641]

Many governments tax individuals and/or enterprises on income. Such systems of taxation vary widely, and there are no broad general rules.[642] These variations create the potential for double taxation, where the same income taxed by different countries and no taxation where income is not taxed by any country. Income tax systems may impose tax on local income only or on worldwide income.

Generally, where worldwide income taxed, reductions of tax or foreign credits provided for taxes paid to other jurisdictions. Limits universally imposed on such credits.[643]

Multinational corporations usually employ international tax specialists, a specialty among both lawyers and accountants, to decrease their worldwide tax liabilities.[644]

26.3 Overview of International Taxation

641 See Shafik Hebous (2011) "Money at the Docks of Tax Havens: A Guide", CESifo Working Paper Series No. 3587, p. 9

642 See Lymer, Andrew and Hasseldine, John, eds., The International Taxation System, Kluwer Academic Publishers (2002)

643 See Thuronyi, Victor, Kim Brooks, and Borbala Kolozs, Comparative Tax Law, Wolters Kluwer Publishers (2d ed. 2016)

644 See Kuntz, Joel D. and Peroni, Robert J.; U.S. International Taxation

No single tax structure can possibly meet the requirements of every country. The best system for any country should be determined taking into account its economic structure, its capacity to administer taxes, its public service needs, and many other factors.[645]

Nonetheless, one way to get an idea of what matters in tax policy is to look at what taxes exist around the world. The level and structure of taxes, and the way in which taxing patterns have changed in recent years reviewed here based on data collected for some recent years for 168 countries, representing every region of the world.[646]

Both opportunity and choice appear to affect international tax levels. Countries with access to rich natural resource revenues tend to have higher tax ratios than otherwise comparable countries, though such revenues may also be highly volatile, reflecting commodity price changes.

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[645] See Malherbe, Philippe, Elements of International Income Taxation,Bruylant (2015)

[646] There are many problems in assembling such data. For example, although we shall focus here largely on national taxes, it should be noted that the data coverage in this sample varies. For 55 countries in the sample, only central government is included, while for 69 countries, general government, including regional and local government, is covered. For 17 countries, the sources do not make it clear which governments are included. Data are analyzed for the most recent year for which they are available for each country -- usually 1998. The length of the time series used to investigate the changes in this pattern also varies by country, based on data availability. The data were collected for a period averaging about six years, usually in the mid-1990's. The data reported in this section are based on work done by William Fox for a background report for the United Nations. (Some later sections of this module also draw on this report, as yet unreleased, which was prepared by R. Bird, W. Fox, and M. McIntyre.) GDP data were obtained from the IMF World Economic Outlook Database at www.imf.org/external/pubs/ft/weo/2002/ol/data/index.htm. Revenue data were obtained from IMF Country Reports at www.imf.org/external/country/index.htm and OECD Revenue Statistics CDRom, 1965-2000, dated 2001.

Tax ratios in higher income countries appear to reflect more choice than chance. Some, such as Sweden and the Netherlands, have large and centralized governments and others, such as the United States and Switzerland, have smaller and more decentralized governments.[647]

The manner in which countries raise taxes differs as widely as do the amounts they raise. The pattern of taxes found in any country depends upon many factors such as its economic structure, its history, and the tax structures found in neighbouring countries.

Choice also plays a part, as different countries may also attach different importance to such commonly accepted characteristics of a good tax system as fairness, economic effects and collection costs. Nonetheless, it is again useful to consider briefly average patterns as one approach to tax policy in any one country.

Generally, some countries may lack effective governance structures. Such countries need to develop and implement effective and efficient tax systems if they are to be able to provide for the needs of their people and

[647] See Bernheim, Douglas B., 2002. "Taxation and Saving," in Alan J. Auerbach and Martin Feldstein, eds., *Handbook of Public Economics*, vol. 3 (Amsterdam: North-Holland).

to participate effectively in the world economy. Another group of countries may have made substantial progress in meeting development goals.[648]

There countries may still face significant problems in tax policy due to globalization and other factors. Although even the less-developed countries may face fiscal challenges due to heavy dependence on trade taxes, those countries with a developing economy must also cope with potentially troublesome and important problems in the income tax area.

While globalization and other factors may lead to further convergence of tax systems, the evidence to date suggests that the size and structure of taxation in most countries will continue to dominate largely by domestic rather than global factors.[649]

26.4 History of International Taxation

There was a time, before customs unions, free trade treaties, GATT, and other post-WW1 institutions, when international aspects of taxation confined to tariffs and treaties.

[648] See Bird, Richard M. and Barbara D. Miller, 1989. "The Incidence of Indirect Taxation on Low-income Households in Jamaica," *Economic Development and Cultural Change*, 37 (January): 393-409.
[649] See Chattopadhyay, Sumen and Arindam Das Gupta, 2002. "The Compliance Cost of the Personal Income Tax and its Determinants," National Institute of Public Finance and Policy, New Delhi.

Innovations in transportation began to open up the trade in goods. Colonization and the heartland/hinterland political realities set up systems of trade in services.[650]

International taxation generally passed through various phases since world war one. Each phase dominated by the principles of its own.

26.4.1 Colonisation period

The first period dominated by the concept of the right to tax as flowing from benefits conferred by the taxing state. An emphasis was on source-based taxation.[651]

The major principle underlying the international tax regime in this period was the idea that taxing jurisdiction based on benefits conferred by the taxing state.[652]

This may seem surprising since in the domestic context the shift from personal property taxation to income taxation accompanied by a shift in the underlying rationale of taxation from benefits to ability to pay.

650 See Charles E. McLure, Tax Competition: Is What's Good for the Private Goose Also Good for the Public Gander?,39 NAT'LTAX J. 341 (1986).
651 See Michael J. Graetz & Michael M. O'Hear, The "Original Intent" of U.S. InternationalTaxation,46 DUKE L.J. 1021 (1997)
652 See Dennis J. Ventry, Jr., Equity Versus Efficiency and the U.S. Tax System in Historical Perspective, in TAX JUSTICE: THE ONGOING DEBATE 25

26.4.2 Nationalistic or Independence period

The second period dominated by the concept of capital export neutrality. An emphasis was on residence-based taxation. This shift marked the emergence of a new orthodoxy that was to become dominant in the 1960s and 1970s, and that was still evident.[653]

This period was about a profound change in the nature of the principle underlying international taxation. Gone was the old emphasis on benefits and fairness instead, the argument henceforward based on the economic concept of efficiency, which in the international context translated into neutrality and in particular, capital export neutrality.

26.4.3 Free market period

This is the third period. The principal ides dominating developments in this period was the need to preserve the competitiveness of the economy in an increasingly globalized marketplace.[654]

Tax competition especially competition for headquarters of multinational firms, was considered either as a positive development or at least as something the countries had to contend with. The new phenomenon of tax arbitrage based on exploiting differences in the tax rules of two countries

653 See Charles E. McLure, Jr., Substituting Consumption-Based Direct Taxation for Income Taxes as the International Norm, 45 NAT'L TAX J. 145 (1992)

654 See H. David Rosenbloom, The David R. Tilling hast Chapter: International Tax Arbitrage and the "International Tax System," 53 TAX L. REV. 137 (2000).

to create double non-taxation likewise considered a normal expression of different country interests.

This resulted in an emphasis on source-based taxation, albeit with significant exceptions designed to attract foreign capital into the country and a decrease in residence-based taxation.[655]

26.4.4 Globalisation period

The fourth period has started that is marked by a continuous attempt to coordinate residence and source taxation to prevent both double taxation and double non-taxation.[656]

This type of coordination is a different kind of response to globalization than the typical competitive move of the third period, and therefore justifies marking developments as a new period.[657]

In addition, the need to attract increasingly mobile foreign capital led the countries to reduce source-based taxation of foreign investment income, while at the same time the increased emphasis on source taxation and

655 See James R. Hines, Jr., The Case Against Deferral: A Deferential Reconsideration, 52 NAT'L TAX J. 385 (1999).
656 See Michael J. Graetz & Alvin C. Warren, Jr., Integration of the U.S. Corporate and Individual Income Taxes: An Introduction ,TAX NOTES TODAY (Sept. 27, 1999) (LEXIS, FEDTAX lib., TNT file, elec. cit., 1999 TNT 186-89)
657 See Michael J. Graetz, Taxing International Income: Inadequate Principles, Out-dated Concepts, and Unsatisfactory Policies, 54 TAX L. REV. 261 (2001);

budgetary pressures led to increased source-based taxation of business income.[658]

26.4.5 Cooperation period

This period marked by a different response to globalization than unilateral competition acting in concert with our major trading partners to reduce both double taxation and double non-taxation.[659]

Because the emphasis is on concerted action, this move promises a way out from the need to balance international tax policy goals with competitiveness considerations.

It thus has the potential of beginning a truly different approach to integrating international tax regimes. The most obvious examples of the new principle of cooperation in practice are the OECD's harmful tax competition initiative.[660]

The OECD's harmful tax competition initiative aimed at both preferential tax regimes within OECD member countries and at the tax havens. The

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658 See Michael
J. Graetz & Paul W. Oosterhuis, Structuring an Exemption System for Foreign Income of U.S. Corporations,54 NAT'L TAX J. 771 (2001).

659 See Philip R. West, Foreign Law in U.S. International Taxation: The Search for Standards,3 FLA. TAX REV. 147 (1996)

660 See Organization for Economic Co-operation and Development, Harmful Tax Competition: An Emerging Global Issue (Apr. 9, 1998).

E.U.'s initiative likewise aimed at preferential regimes within the E.U. and at the taxation of interest earned by E.U. residents.[661]

Preferential regimes flourish outside the OECD, the cooperation of the tax havens is limited, and the Savings Directive does not apply to non-residents.

26.5 Growth of international taxation

The increased integration of the world capital markets has strong implications for the taxation of income from capital. In general, if factors become more mobile they are potentially less desirable as a source for government revenue.[662]

In fact, in the extreme case, such as the state system, the ability of individual states to tax capital income is severely constrained, since capital can move freely across state borders.

While globalization and other factors may lead to further convergence of tax systems, the evidence to date suggests that the size and structure of

[661] See The Code of Conduct was set out in the conclusions of the Council of Economics and Finance Ministers (ECOFIN) meeting on December 1, 1997. Code of Conduct for Business Taxation, 1998 O.J. (C 2) 3-5.

[662] See Michael J. Graetz & Itai Grinberg, Taxing International Portfolio Income, 56 TAX L. REV. 537 (2003);

taxation in most countries will continue to dominate largely by domestic rather than global factors. [663]

Free movements of goods and capital across national borders have important implications for both direct and indirect taxation. Some of the implications of different treatments of resident capital income originating abroad and non-resident capital income originating at home and the implications of different treatments of exports and imports under the indirect tax system.[664]

26.6 Summary

In the foregoing chapter, we have learnt that international taxation is the determination of tax on a person or business subject to the tax laws of different countries or the international aspects of an individual country's tax laws as the case may be.

Governments usually limit the scope of their income taxation in some manner territorially or provide for offsets to taxation relating to extraterritorial income.

[663] See William P. McClure & Herman B. Bouma, The Taxation of Foreign Income from 1909 to 1989:How a Tilted Playing Field Developed, 43 Tax Notes 1379

[664] See Avi-Yonah, Reuven S. "All of a Piece Throughout: The Four Ages of U.S. International Taxation." Va. Tax Rev. 25, no. 2 (2005): 313-38

The manner of limitation generally takes the form of a territorial, residence-based, or exclusionary system. Some governments have attempted to mitigate the differing limitations of each of these three broad systems by enacting a hybrid system with characteristics of two or more

Generally, international taxation evolves on how to balance the desire to prevent both double taxation and complete tax avoidance with sustaining the competitive position of international businesses.

However, the emphasis shifts from source to residence to source and back to residence again as well as combined principles, the underlying balance does not shift very significantly, and the various theories advanced appear more as convenient support for pre-existing policy preferences than the real reason for policy changes.

International taxation and its implications for convergence in long run income growth rates are analysed in the context of an endogenously growing world economy with perfect capital mobility.

Under tax competition, the residence principle will maximize national welfare; the optimal long run tax rate on capital incomes from various sources will be zero in all countries and long term per capita income growth rates will be equalized across countries.

Under tax coordination, becomes irrelevant while and will continue to hold. In other words, optimal tax policies are growth equalizing with and without international policy coordination.

26.7 Review Questions

1. What is international taxation?
2. Describe an overview of the international taxation
3. Discuss the evolution of the international taxation
4. What are factors that led to the growth of international taxation?

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Shafik Hebous (2011) "Money at the Docks of Tax Havens: A Guide", CESifo Working Paper Series No. 3587

CHAPTER TWENTY SEVEN

JURISDICTION OF INTERNATIONAL TAXATION

27.0 Introduction

International taxation has become too complex an issue. It has made the legal circles rethink the jurisprudence of tax jurisdiction. Innovation in applying settled legal dictum is the need of the hour. Every state may tax their subject.

However, an issue raised when there is an incidence of tax levied by two countries on the same property or person. Most countries tax their residents on their worldwide income and tax non-residents on their income earned within the country. Therefore, we are going to cover the principles of jurisdiction of international taxation in this chapter.

27.1 Objectives

At the end of this chapter students should have: -

- Learnt the concept of international taxation and jurisdiction.
- Been conversant with understanding on reasons behind for international taxation.
- Advanced understanding on principles of jurisdiction of international taxation.

- Familiarised with factors that determines the personal connection validating international taxation.

27.2 International Taxation

The observed responsiveness of international economic activity to its taxation carries direct implications for the formation of international tax policy and indirect, but no less important, implications for the formation of domestic tax policy.

Indeed, given the extent to which international considerations influence domestic tax choices, it is not clear whether countries are any longer able to pursue purely domestic tax policies.

27.2.1 Concept

International taxation is the body of legal provisions of different countries that covers the tax aspects of cross border transactions. It is concerned with direct taxes and indirect taxes.

All the controversies relating to international taxation are about interpretations and implementation of the provisions of domestic law and the treaties and conventions concerning double taxation avoidance.

The integration of world capital markets carries important implications for the design and impact of tax policies.[665] Governments do not adopt policies that are consistent with these forecasts.

Corporate income faces taxes at high rates by wealthy countries, and most countries either exempt foreign-source income of domestic multinationals from tax, or else provide credits rather than deductions for taxes paid abroad.

Furthermore, individual investors can use various methods to avoid domestic taxes on their foreign-source incomes, in the process also avoiding taxes on their domestic-source incomes.[666]

Countries may simultaneously want to tax the worldwide capital income of domestic residents, implying that any taxes paid to foreign governments should be merely deductible from domestic taxable income.

27.2.2 Background of international taxation

The international interaction of tax systems goes back since at least the First World War as an important element in international finance and investment.

[665]Richman, P.B. (1963), Taxation of Foreign Investment Income: An Economic Analysis (Johns Hopkins Press, Baltimore)

[666]Razin, A., and E. Sadka (1991b), "International tax competition and gains from tax harmonization", Economics Letters 37:69-76

With the growth of state taxation of income, including business income or profits, each state had to adapt its tax measures to its international payments and investment flows.

Conflicts and differential treatment between states led to pressures from business for the elimination of international double taxation. Although early hope so far comprehensive multilateral agreement allocating jurisdiction to tax dashed, a loose system for the coordination of tax jurisdiction was laboriously constructed.

27.3 Jurisdiction of international taxation

Jurisdiction to tax is all about power, and a state generally has the power to tax income if the assets and activities that generated it are located within its borders.[667]

The jurisdiction to impose income tax based on either the relationship of the income to the taxing state or the relationship of the taxpayer to the taxing state based on residence or nationality.

Each country has its own tax rules. Rules differ in tax rates, income bases, timing of income recognition and approach to taxation. A sovereign country in principle enjoys unrestricted powers to design and implement taxes.[668]

[667] Committee of Experts on International Cooperation in Tax Matters Seventh Session, Introduction to International Double Taxation and Tax Evasion and Avoidance, E/C.18/2011/CRP.11

[668] Azimuddin Law Associates, International Taxation: Resident and Non-Resident Considerations – Pakistan, 2016

Therefore, a resident of one country earning income in another country will find herself potentially subject to tax on the same income both in the home country and in the country of business.[669] When the same income taxed twice, it is double taxation.

Even though there are no rules of international law to limit the extent of any country's tax jurisdiction, a country generally does not impose a tax unless the business transaction or its participants have a significant connection with the country.

27.4 Jurisdictional principles of international taxation

Generally, a country will tax its citizens on their worldwide income and also the income and gains at source. The source principle envisages that a country will tax their citizens and also non-resident person's incomes and gains in the country.[670]

The issue of jurisdiction arising from residence and source is one of the main issues on international taxation. There are two basis kinds of jurisdictional connection:

[669] Professor Huddart, International Taxation, Pennsylvania State University, 1995–2005

[670] http://www.biswajitsarkar.com/international_taxation.php accessed on 3rd August 2016 at 0818 hours

27.4.1 Principle of residency

It is principle of jurisdiction of international taxation, which based on personal bond. It results in unlimited tax liability; taxpayer taxed on its world income, not taking into consideration the source of the income.[671]

It is principle of jurisdiction where there is taxation of persons who belong to a country and work, enter into transactions, or have property or income abroad.

The personal bond of an entity is where there is central management and where the incorporation of such entity took place. The personal bond of individual features itself on citizenship, permanent residence, and habitual place of abode and centre of vital interest.

Generally, countries which tax income only at the recipient's domicile or residence follow the global system of taxation i.e. all income from whatever source derived, that accrue to the same taxpayer, are taxed together as a single mass of income.[672]

Most Anglophone countries follow this system. Under the global system, the jurisdictional connection is the personal status of the taxpayer. The

[671] Marcius, International Taxation Basics, 2011, at page 8

[672] Frenkiel J., Basic Concepts of International Taxation, Working Paper Number 3540, National Bureau of Economic Research, Cambridge, 1990.

global system taxes the worldwide income of a taxpayer regardless of its geographical source.

27.4.2 Source principle

It is jurisdictional principle of international taxation based on economic bond. It results in limited tax liability, the taxpayer is taxed only on its income derived from and assets located in the given country.[673] Usually there is no distinction is made between individuals and companies for defying the source of income.

The basis of this jurisdictional principle is where there is the taxation of persons from outside a country who work, enter into transactions, or have property or income in the country.

Under the source principle, a state's claim to tax income based on the State's relationship to that income. For example, a State would invoke the source principle to tax income derived from the extraction of mineral deposits located within its territorial boundaries.

The jurisdictional connection is the source of income not the personal status of the taxpayer. It is only income from what are considered to be domestic sources is taxed, such as, property situated in the country, or income derived therefrom, income produced by an activity (employment

[673] Marcius, International Taxation Basics, 2011, at page 10

on business) carried on the country, and transactions carried out in the country, for example, the sales of goods, the transfer of property, etcetera.

The taxation of non-residents requires the definition of source, because taxing non-residents on global-source income would vastly exceed a country's ability to collect tax as well as to violate accepted international jurisdictional norms.[674]

Under the source jurisdictional principle, state taxes all income earned from sources within its territorial jurisdiction. This is because source taxation is generally justified on the ground that the State has contributed to the creation of the economic opportunities that allow the taxpayer to derive income generated within the territorial borders of the State.

The essence of the system is the concept that there are qualitative differences in different kinds of income.[675] Thus, each different kind taxed under different rules and at different rates.

27.5 Summary

Generally, in this chapter we have learnt that jurisdiction to impose international taxation bases on the sovereignty principle

[674] Richard J. Vann, International Aspects of Income Tax, Tax Law Design and Drafting, Volume 2, International Monetary Fund, 1998

[675] Reuven S. A., International Tax as International Law, Law & Economics Working Papers Archive: 2003-2009, Art. *7,* University of Michigan Law School Scholarship Repository, 2004

of state under international law. Hence, due to this principle, each state has its own tax rules.

Rules differ in tax rates, income bases, timing of income recognition and approach to taxation. A sovereign country in principle enjoys unrestricted powers to design and implement taxes

There are main two principles used as basis for international taxation such as residency principle and source principle. These principles are based on the relationship that exist between the state and either the person to be taxed or income to be taxed.

Under residency principle, there is international taxation person because such person has personal connection with the state or jurisdiction that imposes tax. Residence focuses on permanent establishment, habitual place of abode, citizenship, place of vital interests of individual person and place of incorporation and central management place of legal person. These factors create personal bond between the taxpayer and tax authorities of a state justify taxation.

Under source principle, where the income subject to tax originate or is produced justify that place to have authority to tax such income. Hence, the relationship exists between income produced and state where such income produced.

This principle justifies international taxation regardless of residence of the person because the state has contributed to the generation of income of person taxable.

Therefore, most countries today apply a combination of these two jurisdictional principles. For example, a country which taxes its citizens or residents on their world income and taxes income derived by non-residents from sources within its territorial jurisdiction.

27.6 Review Questions

1. Define the terms jurisdiction and international taxation.
2. Mention and explain clearly jurisdictional principles of international taxation.
3. Discuss the reasons for international taxation.
4. Enumerate factors that determine personal bond of person for imposition of international taxation

27.7 References

Azimuddin Law Associates, International Taxation: Resident and Non-Resident Considerations – Pakistan, 2016

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CHAPTER TWENTY EIGHT

INTERNATIONAL DOUBLE TAXATION AND ITS ELIMINATION

28.0 Introduction

In this chapter, we are going to discuss the meaning, concepts and sources of international double taxation. In addition, we are going to acquaint with methods applicable to eliminate international double taxation. The aim is to familiarize students with knowledge of international double taxation, how does it come about and how it can be eliminated.

28.1 Objectives

At the end of this chapter students should have: -

- Learnt basic knowledge on double taxation and international double taxation.
- Acquainted with understanding on reasons for international double taxation.
- Accustomed with the ability to describe the mechanism applicable in eliminating international double taxation.

28.2 Double taxation

Double taxation is a situation which occurs when same income, property or transaction is taxed twice either in the same jurisdiction or different jurisdictions.[676]

It is imposition of tax or levy upon the same taxable income, property or transaction. Double taxation occurs when tax base is taxed more than once within the same tax jurisdiction or different ones.

The phenomenon of double taxation occurs, not because of the different structures of the tax systems, but due to the distinct concepts that underlie the imposition.[677]

Since the imposition of taxes is a duty of each State, and the settlement and collection is the competence of the legislature of that State can be reached from the situation as certain income is subject to taxation in the country of origin, as the destination of the income in question.

The same can happen with a particular wealth: to claim tax on her and the State in whose territory the property is subject to taxation as the residing owner of the property in question (or whose citizen they are).

28.3 International double taxation

[676] Cambridge Business English Dictionary, Cambridge University Press
[677] See Buziernescu R.,(2009) Taxation, Universitaria Craiova, at p.150

International double taxation is the imposition of tax upon the same income subjected to tax in two or more different tax jurisdictions for an identical or same period or year of income in respect of the same person or his agent.

In addition, international double taxation is subjecting direct to the same tax and taxable materials for the same period, by the tax authorities from different countries.[678]

International double taxation occurs when the tax authorities of two or more states collect taxes concurrently with the same basis or the same impact in such a way that a person may bear a heavy tax obligation than if it would be subject to a single fiscal authority.

This can happen either because income earned in a foreign country may be subject to tax both home and foreign governments, or income might be subject to two taxes, for example, where income paid out as dividends is subject to both corporation tax and personal income tax.

Thus international double taxation indicates an excessive taxation for the taxpayer and an obstacle to capital movements, the process of increasing

[678] See Radu M.E, (2012), International double taxation, ELSEVIER LTD, at p. 1

cooperation between countries and increasing the economic and financial relations between them.

28.4 Reasons for international double taxation

Many jurisdictions have developed competitive investment incentive packages in order to attract both local and foreign capital. With the increasing liberalization of international trade and investment policies and cooperation among nations, the income arising from international transactions is likely to suffer international double taxation.

Therefore, there are various reasons that lead to arise of international double taxation and they are going to be explained hereunder:-

28.4.1 Residence-Residence Conflict

According to determination of residence for purpose of taxation, a person be it natural being or artificial being can be resident in more than one jurisdictions, states or countries. Residence is determined by presence, habitation, incorporation and so forth in a country period in a financial year.

For instance, corporation may be treated resident of certain state because incorporated in that state, however it can also be treated resident in another state because it is managed centrally in that other state. Hence, both states may decide to tax this corporation.

Also, an individual may be treated resident of Tanzania because he or she was present in Tanzania for 183 days or more in same financial year but same individual may be treated a resident of Kenya because he or she lived in Kenya many years and had close ties (national) to her (Kenya). Therefore, this individual taxed in both countries that are Tanzania and Kenya.

28.4.2 Source-Residence Conflict

International double taxation arises when one jurisdiction decides to tax income of person because of it is the source of that income while the other jurisdiction may decide to tax the same income because of residence or nationality principles.[679]

As prescribed under section 6 (1) (a) of Income Tanzania Act[680], residence of individual shall be used to impose tax irrespective of source of income. Hence, under this provision, source of income and residence can both be used to tax the same income.

For instance, Britain businessperson taxed in Tanzania because he derived his income from Tanzania while be taxed in Britain because he is national or resident of Britain.

[679] See Buziernescu R.,(2009) Taxation, Universitaria Craiova, at p.150
[680] CAP 332 RE 2008

Therefore, it these two jurisdictions decide to tax on the same income of such individual on the bases of source and residence, the said income double taxed internationally.

28.4.3 Source-Source Conflict

Invoking source principle of taxation depending on the domestic tax legislations of two different states can lead to international double taxation.[681]

This conflict can arise due to the domestic principles of determination of sources of income in the particular states. States may vary on what amounts to source of income in their jurisdictions. These can be where sales take place and where transfer of goods for sales takes place.

In Tanzania, determination of source of income governed under section 67 of Income Tax Act[682] that states that has income whose source in the United Republic treated separately from any income or loss from that employment, business or investment that has a foreign source.

For instance State A consider itself as source of income if sale takes place within the office located in its jurisdiction and state B considers also the

681 See Radulescu, D.M. (2011), Fundamentals of Law, Bucharest: Universul Juridic (Chapter 9
682 CAP 332 RE 2008

source of income if transfer of possession of goods subjected to sale takes place within its jurisdiction.

Therefore, when these two states decide to tax income of sales on two different principles of source of income, the said sales income becomes victim of international double taxation.

28.5 Methods of eliminating international double taxation

It is vital for countries find out and apply necessary mechanisms and policies that will alleviate if not remove the undesirable effects of international double taxation of income.

Double taxation can be avoided either by unilateral legislative action, by the conclusion of bilateral or multilateral agreements between different countries.[683]

Avoidance of double taxation by unilateral legislative action is more difficult, because every country is interested in how to achieve higher tax revenue. Through those means, it is possible to grant tax relief and allow cooperation in training and tax administration to promote the free flow of capital, technology and skilled technical personnel. These means aim at removing impediments to international trade and investment.

[683] International agreements are regulated by section 128 of Income Tax Act CAP 332 RE 2008

28.5.1 Tax reliefs

Tax relief is any program or incentive that reduces the amount of tax owed by an individual or business entity.[684] Tax relief intends to reduce the tax liability of an individual or business entity.

Tax reliefs implies that income derived by a resident in a foreign country and subject to taxation in that country shall be deducted from the taxable income of the bulk in the country of residence shall take into account all revenue earned by taxpayers.[685]

The relief given by the country in which the claimant is resident and may or may not wholly relieve the foreign tax. The granting of unilateral relief is often a "last resort" or desperation measures where two countries are not able to enter into the more desirable bi-lateral agreement usually for political or other reasons.

In Tanzania under section 77 of Income Tax Act[686], resident person may claim foreign tax reliefs for a year of income for any foreign income to the extent which is payable with respect to person's foreign income.

[684] Read more: tax relief definition | investopedia http://www.investopedia.com/terms/t/tax-relief.asp#ixzz4fds9bdbs

[685] Misu N. B, and Tudor F, International Double Taxation- Cause and Avoidance, ECONOMICA, at p. 150

[686] CAP 332 RE 2008

However, such tax credits calculated separately for each year of income and shall not exceed the average rate of Tanzania income tax of the person for the year of income applied to the person's taxable foreign income.

28.5.2 Tax Exemption

It is exclusion of income subjected to tax purpose from taxed.[687] The income that was supposed be taxed by authorities becomes free from that taxation. It occurs when a State exempts from taxation certain items of income derived by its residents in another State.[688]

Tax exemption may be so in accordance with its domestic legislation or by treaty.[689] Domestic legislation typically would grant the exemption without reference to the State where the income generated, whereas an exemption granted by treaty would be limited to treaty States.[690]

28.5.3 Tax Credit

It is mechanism which considers that tax paid by resident in foreign state or jurisdiction shall be deducted only up to the limit of the internal tax jurisdiction or state that would be due to an income equal to that achieved in that foreign country or jurisdiction.[691]

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687 See Committee of Experts on International Cooperation in Tax Matters, (2011), Manual for the Negotiation of Bilateral Tax Treaties, Geneva, E/C.18/2011/CRP.11

688 See Condor, I. (1999), International Double Tax Avoidance, Bucharest: Monitorul Oficial, R.A

689 See section 10 and 2nd Schedule of Income Tax Act CAP 332 RE 2008

690 See section 128 of Income Tax Act, CAP 332 RE 2008

691 See Cristea A (2008) How to avoid double taxation, published at http:\/\/www.consultingreview.ro\

It occurs when the residence country of the beneficiary treats the foreign taxes within certain statutory limits. When the foreign tax share is less than its domestic share, only the surplus of internal tax share is payable over the residence country of the beneficiary. When the foreign tax is higher than the domestic tax, the residence country will not levy any tax.

In tax, credit lies to sense that foreign country tax paid for income received in the territory by a resident of another country deducted directly from the tax-calculated total in the country of residence.[692] This tax is calculated taking into account the overall taxable income obtained by the sum of the taxable income in both countries.

28.6 Summary

In this chapter we have seen that international double taxation is inevitable so long as international trade and investment continues and domination of state sovereignty unless states decide to alleviate or reduce the problem.

International double taxation is a situation whereby same income, transaction or property taxed twice either within the same state or by different states or jurisdictions. International double taxation arises due to residence, source and residence-

[692] See Gravelle P. (1988), Tax Treaties: Concepts, Objectives and Types, in Bulletin I.B.F.D., Amsterdam, at p. 522

source conflicts as the bases for imposition of tax in states or jurisdictions.

Elimination of international double taxation is important to remove impediment to international trade and investment. This can be unilaterally, bilaterally or multilaterally through domestic legislations as well as treaties between states.

Avoidance of double taxation by unilateral legislative action is more difficult, because every country is interested in how to achieve higher tax revenue. Tax reliefs, credits and exemptions are most applicable methods for elimination of international double taxation.

28.7 Review Questions

1. Define double taxation and international double taxation.
2. Identify and describe main causes of international double taxation.
3. Discuss main methods used in eliminating international double taxation

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CHAPTER TWENTY NINE

TRANSFER PRICING

29.0 Introduction

Transfer pricing for multinational enterprises is, is one of the most interesting areas within international tax law. With on-going economic globalization, intergroup cross-bowler transactions are becoming increasingly important, and transfer pricing is now the key issue for profits allocation among multinational group companies.

This chapter is equipped with the concepts of transfer price, transfer pricing and their rationales. However, it does not leave us without giving an opportunity to know nature, evolution, principle and methods of transfer pricing.

29.1 Objectives

At the end of this chapter students should have: -

- Learnt the concept of transfer prices and transfer pricing with their importance.
- Been conversant with understanding on nature, and evolution of the transfer pricing.

- Advanced understanding on the principle and methods used for transfer pricing internationally.

29.2 Transfer prices

A transfer price is the price at which divisions of a company transact with each other, such as the trade of supplies or labour between departments. Transfer prices apply when individual entities of a larger multi-entity firm are treated and measured as separately run entities. A transfer price is also a transfer cost.[693]

Transfer prices serve to determine the income of both parties involved in the cross- border transaction. The transfer price therefore tends to shape the tax base of the countries involved in cross-border transaction.[694]

29.3 Transfer pricing

Transfer pricing is the general term for the pricing of cross-border, intra-firm transactions between related parties.

Transfer pricing refers to the rules and methods for pricing transactions between enterprises under common ownership or control.[695] Thus, transfer pricing is the system of laws and practices used by countries to ensure that

[693] Read more: Transfer Price Definition | Investopedia http://www.investopedia.com/terms/t/transferprice.asp#ixzz4cd5XtrbM

[694] Ibid

[695] See *OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations 2010, Paris: OECD Publishing. 2010*

goods, services and intellectual property transferred between related companies are appropriately priced, based on market conditions, such that profits are correctly reflected in each jurisdiction.

Transfer pricing therefore refers to the setting of prices at which transactions occur involving the transfer of property or services between associated enterprises (multinational enterprises). These transactions are "controlled" transactions, as distinct from "uncontrolled" transactions between companies that, for example, are not associated. They operate independently on an arm's length basis in reaching terms for such transactions.

29.4 Nature of Transfer Pricing

Transfer pricing does not conflate with fraudulent trade mis-invoicing, which is a technique for concealing illicit transfers by reporting falsified prices on invoices submitted to customs officials.[696]

It follows that, with the need to set such prices being a normal incident of how multinational enterprises must operate, "transfer pricing" by itself does not necessarily involve tax avoidance.

696 See *Cooper, Joel (2016). Transfer Pricing and Developing Economies: A Handbook for Policy Makers and Practitioners Washington, DC: World Bank. pp. 18–21*

It is where the pricing does not accord with applicable norms internationally or at domestic law that we are entering into areas more properly called "mispricing", "incorrect pricing", "unjustified pricing" or similar, and where issues of tax avoidance and evasion may arise.

When the various parts of the organisation are under some form of common control, it may mean that transfer prices are not subject to the full play of market forces and the correct arm's length price, or at least an "arm's length range" of prices needs to be arrived at.

29.5 Importance of Transfer Pricing

Transfer pricing rules generally provide companies with the flexibility to set the conditions surrounding their intercompany transactions. Planning allows taxpayers to optimize the allocation of income within the group.

At the same time, noncompliance with transfer pricing rules can be costly for multinational companies. Noncompliance can lead to double taxation, interest on tax underpayment and substantial penalties. It can also result in extended disputes with tax authorities, including litigation.

Transfer prices are important especially for large, decentralized corporations where each division reports its own profits and losses separately. The transfer price is usually roughly the same as the market price for the good or service.

Therefore, transfer pricing is one of the reasons why globalisation has increased and why operating in more than one territory can be beneficial for firms looking to minimise their overall tax liability.[697]

The economic reason for associated entities charging transfer prices for intra-group trade is to be able to measure the performance of the individual entities in a multinational group.

The individual entities within a multinational company group are separate profit centres and transfer prices are required to determine the profitability of the entities.

29.6 Evolution of Transfer Pricing

The USA transfer pricing regulations of 1994 and the risk of severe penalties, even in case of non-deliberate deviations from the arm's length principle, have resulted in both the USA and foreign groups revising their transfer pricing methods.

Countries with less sophisticated tax systems and administrations ran the risk of absorbing the effect of stronger enforcement of transfer pricing in developed countries, and, in effect paying at least some of the MNEs tax

[697] See, http://www.economicsonline.co.uk/Business_economics/Transfer_pricing.html. Accessed on 28th March 2017 at 15:53 hours

costs in those countries. In order to avoid this, many countries have introduced new transfer pricing rules since that time.

As a response to increasing public concern regarding the practice, and what to what many regarded as a failure or absence of self-regulation, the OECD introduced its Transfer Pricing Guidelines in 1995.[698]

These rules provided guidelines on cross-border services, intangibles, costs contribution arrangements and advance pricing arrangements. These were further modified in 2010 to provide guidance on what transfer pricing method would be appropriate in a variety of circumstances.

The underlying philosophy is that pricing of transferred resources should reflect how prices might be determined if the parts of the multinational were not connected which can be summarised as the 'arm's length' principle (ALP).[699]

The first investigated case that tested the 'arm's length' principle in the UK was in 2008, and involved the provision of extended warrantees by Dixons Insurance Services Limited – operating in the Isle of Man - to other

698 See, ibid
699 See, ibid

members of the same group including Dixon's stores, Currys and PC World.[700]

It was found that group profits were inflated and that the provision of insurance services within the group was not based on the 'arm's length' principal.

By 2014, over 50 countries had adopted some form of transfer pricing rule based on the 'arm's length' principle. In the wake of considerable media attention notably focusing on US giants such as Starbucks, Apple, Amazon and Google, the OECD continues to refine its approach and to develop further guidelines, and will complete its review by 2015.[701]

Because of the potential for cross-border controlled transactions to distort taxable income, tax authorities in many countries can adjust intragroup transfer prices that differ from what would have been charged by unrelated enterprises dealing at arm's length. Transfer pricing regulations govern the pricing of transactions between related group companies.

Rationally, an entity having a view to its own interests as a distinct legal entity would only acquire products or services from an associated entity if

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700 See http://www.economicsonline.co.uk/Business_economics/Transfer_pricing.html. Accessed on 28th March 2017 at 16:00 hours.

701 See more at: http://www.journalofaccountancy.com/issues/2013/oct/20137721.html#sthash.CohTQ4g6.dpuf

the purchase price was equal to, or cheaper than, prices being charged by unrelated suppliers.

This principle applies, conversely, in relation to an entity providing a product or service; it would rationally only sell products or services to an associated entity if the sale price was equal to, or higher than, prices paid by unrelated purchasers.

Prices should on this basis gravitate towards the so-called "arm's length price", the price which two unrelated parties would agree to a transaction.

The OECD Committee on Fiscal Affairs continues to monitor developments in transfer pricing, in particular developments in the use of profit-based methods and in comparability matters.[702]

The EU Commission has also developed proposals on income allocation to members of MNEs active in the European Union since 2001. Some of the approaches considered have included the possibility of a "common consolidated corporate tax base" and "home state taxation".[703]

29.7 Principle of Transfer Pricing

The transactions between two related parties must be based on the "arm's length principle" (ALP). The term "arm's length principle" itself is not a term

[702] See, for more detail, http://ec.europa.eu/taxation_customs/taxation/company_tax/common_tax_base/index_en.htm
[703] Ibid

specifically used in Article 9, but is well accepted by countries as encapsulating the approach taken in Article 9, with some differing interpretations as to what this means in practice. The principle laid out above in the UN Model has also been reiterated in the OECD Model Convention and the OECD's 1995 and now 2010 Transfer Pricing Guidelines.[704]

Under the arm's length principle, transactions within a group are compared to transactions between unrelated entities to determine acceptable transfer prices.[705]

Thus, the marketplace comprising of independent entities is the measure or benchmark for verifying the transfer prices for intra-entity or intra-group transactions and their acceptability for taxation purposes.

The rationale for the arm's length principle itself is that because the market governs most of the transactions in an economy it is appropriate to treat intra-entity or intra-group transactions as equivalent to those between independent entities.

Under the arm's length principle, the allocation of expenses and profits with respect to intra-group transactions is tested and adjusted, if the transfer

704 See more at http://www.un.org/esa/ffd/tax/2011_TP/TP_Chapter1_Introduction.pdf. Retrieved on 28th March 2017 at 16:39 hours

705 Ibid

prices are found to deviate from comparable arm's length transactions. The arm's length principle is argued to be acceptable to everyone concerned as it uses the marketplace as the norm.[706]

An argument in favour of using the arm's length principle is that it is geographically neutral, as it treats profits from investments in both source and residence jurisdictions in a similar manner.

However, this claim of neutrality is conditional on consistent rules and administration of the arm's length principle throughout the jurisdictions in which an international enterprise operates.

In the absence of consistent rules and administration, international enterprises may be provided with an incentive to avoid taxation through transfer pricing manipulation.[707]

29.8 Transfer Pricing Methods

Several acceptable transfer-pricing methods exist, providing a conceptual framework for the determination of the arm's length price. No single method is considered suitable in every situation and the taxpayer must

[706] See more at http://www.un.org/esa/ffd/tax/2011_TP/TP_Chapter1_Introduction.pdf. Retrieved on 28th March 2017 at 16:39 hours

[707] Ibid

select the method that provides the best estimate of an arm's length price for the transaction in question.[708]

29.8.1 Comparable Uncontrolled Price (CUP)

The CUP method compares the price charged for a property or service transferred in a controlled transaction to the price charged for a comparable property or service transferred in a comparable uncontrolled transaction in comparable circumstances.

29.8.2 Resale Price Method (RPM)

The resale-price method determines the price to be paid by a reseller for a product purchased from an associated enterprise and resold to an independent enterprise.

The purchase price is set so that the margin earned by reseller is sufficient to allow it to cover its selling and operating expenses and make an appropriate profit.

29.8.3 Cost Plus (C+, CP)

The cost-plus method is used to determine the appropriate price to be charged by a supplier of property or services to a related purchaser or buyer.

708 See http://www.wto.org/english/tratop_e/cusval_e/cusval_e.htm

The price is determined by adding to costs the supplier incurred an appropriate gross margin so that the supplier will make an appropriate profit in the light of market conditions and functions he or she performed.

29.8.4 Profit comparison methods

These methods seek to compare the level of profits that would have resulted from controlled transactions with the return realised by the comparable independent enterprise.

The TNNM compares the net profit margin realised from the controlled transactions with the net profit margin realised from uncontrolled transactions.

29.8.5 Profit-split methods ("PSM")

Profit-split methods take the combined profits earned by two related parties from one or a series of transactions and then divide the profits using a defined basis that is aimed at replicating the division of profits that would have been anticipated in an agreement made at arm's length. Arm's length pricing is therefore derived from both parties by working back from profit to price.

29.9 Summary

In the foregoing chapter, we have learnt that transfer pricing is a method of pricing goods and services transferred within a multinational or trans-national company in order to reduce tax burdens and maximise profits. The purpose of transfer pricing is to push profits into territories either where the tax rates are more favourable, or where more loopholes exist to be exploited.

Transfer pricing is in the cross hairs of tax policy as it relates to the competing objectives of three parties: the revenue-maximizing objective of the domestic tax authority, the revenue-maximizing objective of the foreign tax authority, and the tax-minimizing objective of the taxpayer.

We have learnt that there are five major transfer-pricing methods. The first three methods above i.e. CUP, RPM and Cost-Plus are often called "traditional transaction" methods and the last two are called "profit-based" methods although as noted above, there is growing acceptance of the practical importance of the profit-based methods.

All these methods are widely accepted by national tax authorities. It must be noted that the transfer pricing regulations provide for the use of additional methods applicable to global dealing operations like the Comparable Uncontrolled Transactions (CUT) method.

This method is similar to CUP in that it determines an arm's length royalty rate for an intangible by comparison to uncontrolled transfers of comparable intangible property in comparable circumstances.

Moreover, it has to our knowledge that as a response to increasing public concern regarding the practice, and what to what many regarded as a failure or absence of self-regulation, the OECD introduced its Transfer Pricing Guidelines in 1995.

29.10 Review Questions

1. Differentiate between transfer price and transfer pricing
2. Discuss the importance of transfer pricing.
3. Account for the evolution of transfer pricing and its rules internationally.
4. Describe the methods of transfer pricing

5. Explain the arm's length principle as applicable in transfer pricing.

29.11 References

OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations 2010, Paris: OECD Publishing. 2010

Cooper, Joel (2016). Transfer Pricing and Developing Economies: A Handbook for Policy Makers and Practitioners Washington, DC: World Bank. pp. 18–21

http://www.economicsonline.co.uk/Business_economics/Transfer_pricing.html. Accessed on 28th March 2017 at 15:53 hours

http://ec.europa.eu/taxation_customs/taxation/company_tax/common_tax_base/index_en.htm Accessed on 28th March 2017 at 16:00 hours.

CHAPTER THIRTY

MODEL TAX CONVENTIONS

30.0 Introduction

The model tax conventions are accords or treaties reached between various states that serve as a guideline for establishing tax agreements among themselves. This chapter involves tax treaties tend to reduce taxes of one treaty country for residents of the other treaty country to reduce double taxation of the same income.

30.1 Objectives

At the end of this chapter students should have: -

- Attained knowledge and understanding of the meaning of model tax convention and account for growth of model tax conventions.
- Accustomed with skills to compare and contrast between UN Model Tax Convention and US Model Tax Conventions
- Advanced ability to describe strengths and weaknesses of the selected Model Tax Conventions.
- Established ability to discuss the binding nature of the Model Tax Conventions.

30.2 Tax Conventions or treaties

A tax treaty is a formally concluded and ratified agreement between two independent nations (bilateral treaty) or more than two nations (multilateral treaty) on matters concerning taxation normally in written form.[709]

Tax treaties are international agreements entered into by countries. They conform general international law on treaties codified in the Vienna Convention on the Law of Treaties. They are double taxation conventions or double tax agreements.

Bilateral treaties refers to the treaty is entered into between two countries while multilateral treaties are treaties entered into between two or three countries.

Most tax treaties are bilateral, that is, involve two countries only, and cover income and capital taxes, though there are some examples of multilateral tax treaties.

30.3 Background of tax conventions

The history of tax treaties goes back to the League of Nations, pressed to deal with the problem of double taxation after income taxes became

[709] Cotha S Srinivas, Introduction to International Taxation, retrieved from https://www.sircoficai.org/downloads/cpe-materials/01_Introduction-to-International-Taxation.pdf

important during the First World War and which developed a number of models for use in negotiation of bilateral tax treaties.

The major modern successor to these models is the OECD Model Tax Convention on Income and on Capital (the OECD Model), which itself has gone through various versions.[710]

Of especial interest to developing and transition countries is the 1980 UN Model Double Taxation Convention (the UN Model), which was based on the 1977 OECD Model but designed to take into account the special interests of developing countries.[711]

30.4 Jurisprudence behind model tax conventions

The general objectives of bilateral tax treaties therefore include the protection of taxpayers against double taxation with a view to improving the flow of international trade and investment and the transfer of technology.

They also aim to prevent certain types of discrimination as between foreign investors and local taxpayers, and to provide a reasonable element of legal

[710] The current version dates from 1992 and is in looseleaf format (updated 1994, 1995, and 1997); the earlier versions were the Draft Double Taxation Convention on Income and Capital (1963) and Model Double Taxation Convention on Income and Capital (1977).

[711] United Nations Model Double Taxation Convention Between Developed and Developing Countries (1980) (ST/ESA/102), reprinted in Klaus Vogel, Klaus Vogel on Double Taxation Conventions (1991). For documentation of the influence of the UN Model on treaties, see Willem Wijnen & Marco Magenta, The UN Model in Practice, and 51 Bull. Int'l Fiscal Doc. 574 (1997)

and fiscal certainty as a framework within which international operations can confidently be carried on.

The purpose of bilateral tax treaties is typically expressed in their preamble to be the avoidance of double taxation and the prevention of fiscal evasion.[712] As most countries contain within their domestic law provisions to prevent double taxation of their residents in the most common case, the main operation of tax treaties in this respect is for other types of double taxation that can arise as elaborated below.

The prevention of fiscal evasion primarily refers to cases where taxpayers fraudulently conceal income in an international setting and rely on the inability of tax administrations to obtain information from abroad.

30.5 Selected Model Tax Conventions

30.5.1 The OECD Model Tax Convention

This Model Convention seeks, wherever possible, to specify for each situation a single rule. On certain points, however, it was thought necessary to leave in the Convention a certain degree of flexibility, compatible with the efficient implementation of the Model Convention.

[712] The OECD and UN Models leave the contents of the preamble to be dealt with in accordance with the constitutional procedure of the negotiating states. The U.S. Model, supra note 12, uses this common formulation.

Member countries therefore enjoy certain latitude, for example, with regard to fixing the rate of tax at source on dividends and interest and, the choice of method for eliminating double taxation

(a) Background

It is an accord reached between member states of the Organization for Economic Cooperation and Development (OECD), which serves as a guideline for establishing tax agreements.[713]

The OECD Model Tax Convention was born half a century ago when the Fiscal Committee of the Organisation for European Economic Co-operation (OEEC), which later became the OECD, published a first draft installment of how a model treaty on international taxation might look.[714]

(b) Binding nature

The convention consists of articles, commentaries, position statements and special reports on evolving tax issues.[715] Its primary application is in guiding the negotiation of bilateral treaties between two or more countries.

(c) Scope

[713] OECD Model tax convention, BusinessDictionary.com, Retrieved August 03, 2016, from BusinessDictionary.com website: http://www.businessdictionary.com/definition/OECDmodel-tax-convention.html

[714] OECD (2008), Model Tax Convention on Income and on Capital, seventh edition of the condensed version, Paris, August 2008

[715] OECD Model Tax Convention, 2014

Convention shall apply to persons who are residents of one or both of the Contracting States.[716] Conventions that are more recent usually apply to "residents" of one or both of the Contracting States irrespective of nationality.

Some conventions are of even wider scope because they apply more generally to "taxpayers" of the Contracting States; they are, therefore, also applicable to persons, who, although not residing in either State, are nevertheless liable to tax on part of their income or capital in each of them.

This Convention shall apply to taxes on income, business profits[717] and on capital imposed on behalf of a Contracting State or of its political subdivisions or local authorities, irrespective of the manner in which they are levied.[718]

(d) Purpose

The OECD model has established itself as the means of settling the most common problems that arise in the field of international taxation.[719] By

[716] Article 1 of OECD Model Tax Convention, 2014

[717] According to article 7(1) of OECD Model Tax Convention 2014, Business profits means profits of an enterprise of a Contracting State shall be taxable only in that State unless the enterprise carries on business in the other Contracting State through a permanent establishment situated therein. If the enterprise carries on business as aforesaid, the profits that are attributable to the permanent establishment in accordance with the provisions of paragraph 2 may be taxed in that other State

[718] Article 2(1) of OECD Model Tax Convention 2014

[719] Jeffrey Owens and Mary Bennett OECD Centre for Tax Policy and Administration, OECD Model Tax Convention See more at: http://www.oecdobserver.org/news/archivestory.php/aid/2756/OECD_Model_Tax_Convention.html#sthash.rcyfi1WV.dpuf

enabling a certain harmonisation of double tax treaties, it guides bilateral negotiations and helps settle disputes on a uniform basis.

The extensive and regularly updated commentaries that accompany the model provide guidance on the accepted interpretations of the main text and have come to serve as a very useful reference to taxpayers, tax administrations and the courts, whether in OECD member countries or elsewhere around the world.

The OECD Model Tax Convention provides the basis for the negotiation and interpretation of more than 3000 tax treaties that make up a network that co-ordinate the income and corporate tax systems of most countries with the objective of removing tax barriers to cross-border trade and investment.

(e) Residence determination

Residence has to do with permanent establishment[720], habitual place of abode, centre of vital interest, nationality of individual person, place of central management and place of incorporation of legal person.

The term "resident of a Contracting State" means any person who, under the laws of that State, is liable to tax therein by reason of his domicile,

[720] "Permanent establishment" means a fixed place of business through which the business of an enterprise is wholly or partly carried on as per article 5 of OECD Model Tax Convention 2014

residence, place of management or any other criterion of a similar nature, and also includes that State and any political subdivision or local authority thereof.[721]

This term, however, does not include any person who is liable to tax in that State in respect only of income from sources in that State or capital situated therein

30.5.2 The UN Model Tax Convention

The United Nations Model Convention generally favours retention of greater so called "source country" taxing rights under a tax treaty i.e the taxation rights of the host country of investment as compared to those of the "residence country" of the investor.

This is an issue of special significance to developing countries, although it is a position that some developed countries also seeks in their bilateral treaties.

(a) Application

Convention shall apply to persons who are residents of one or both of the Contracting States.[722] However, nationals of a Contracting State shall not be subjected in the other Contracting State to any taxation or any

[721] Article 4(1) of OECD Model Tax Convention 2014
[722] Article 1 of United Nations Model Double Taxation Convention Updated in 2011

requirements connected therewith which is other or more burdensome than the taxation and connected requirements to which nationals of that other State in the same circumstances, in particular with respect to residence, are or may be subjected.[723]

Stateless persons who are residents of a Contracting State subjected in either Contracting State to any taxation or any requirement connected therewith which is other or more burdensome than the taxation and connected requirements to which nationals of the State concerned in the same circumstances, in particular with respect to residence, are or not subjected.[724]

(b) Purpose

The United Nations Model Convention represents a compromise between the source principle and the residence principle; it gives more weight to the source principle.

The United Nations Model Convention intends to equip decision-makers in countries with the information they need to understand the consequences of these differing approaches for their country's specific situation.

[723] Article 24 (1) of United Nations Model Double Taxation Convention Updated in 2011
[724] Article 24 (2), ibid

It intends to facilitate the negotiation, interpretation and practical application of bilateral tax treaties based upon its provisions.

(c) Binding nature

The provisions of the Model Convention are not themselves enforceable. Its provisions are not binding and not formal recommendations of the United Nation.

(d) Scope

The Convention shall apply to taxes on income and on capital imposed on behalf of a Contracting State or of its political subdivisions or local authorities, irrespective of the manner in which they are levied.[725]

They taxes on income and on capital all taxes imposed on total income, on total capital, or on elements of income or of capital, including taxes on gains from the alienation of movable or immovable property, taxes on the total amounts of wages or salaries paid by enterprises, as well as taxes on capital appreciation.[726]

The Convention shall apply also to any identical or substantially similar taxes that imposed after the date of signature of the Convention in addition to, or in place of, the existing taxes. The competent authorities of the

[725] Article 2(1) of United Nations Model Double Taxation Convention Updated in 2011
[726] Article 2(2), ibid

Contracting States shall notify each other of significant changes made to their tax law.[727]

(e) Income from immovable property taxation

Income derived by a resident of a Contracting State from immovable property situated in the other Contracting State taxed in that other State.[728]

Immovable property shall have the meaning, which it has under the law of the Contracting State in which the property in question is situated.

The term in any case includes either property accessory to immovable property, livestock and equipment used in agriculture and forestry. Also, rights to which the provisions of general law respecting landed property apply, usufruct of immovable property and rights to variable or fixed payments as consideration for the working of, or the right to work, mineral deposits, sources and other natural resources; ships, boats and aircraft shall not be regarded as immovable property.[729]

(f) Business profits taxation

[727] Article 2(4), ibid
[728] Article 6 (1), ibid
[729] Article 6(2) of United Nations Model Double Taxation Convention Updated in 2011

The profits of an enterprise of a Contracting State shall be taxable only in that State unless the enterprise carries on business in the other Contracting State through a permanent establishment situated therein.[730]

If the enterprise carries on business as aforesaid, the profits of the enterprise may be taxed in the other State but only so much of them as is attributable to:-

(a) That permanent establishment

(b) Sales in that other State of goods or merchandise of the same or similar kind as those sold through that permanent establishment.

(c) Other business activities carried on in that other State of the same or similar kind as those effected through that permanent establishment.

(g) Dividends taxation

Dividends paid by a company, which is a resident of a Contracting State to a resident of the other Contracting State, may be taxed in that other State. However, such dividends may also be taxed in the Contracting State of which the company paying the dividends is a resident and according to the

[730] Article 7, ibid

laws of that State, but if the beneficial owner of the dividends is a resident of the other Contracting State.[731]

(h) Interest taxation

Interest[732] arising in a Contracting State and paid to a resident of the other Contracting State may be taxed in that other State. However, such interest may also be taxed in the Contracting State in which it arises and according to the laws of that State, but if the beneficial owner of the interest is a resident of the other Contracting State, the tax so charged shall not exceed certain per cent[733] of the gross amount of the interest. The competent authorities of the Contracting States shall by mutual agreement settle the mode of application of this limitation

(i) Elimination of double taxation

Vide tax exemption, state shall allow exemption or a deduction from the tax on the income of that resident an amount equal to the tax paid in that other State when income is derived from other state and if the items of income can be deducted accordingly.

[731] Article 10, ibid

[732] The term "interest" as used in this Article means income from debt claims of every kind, whether or not secured by mortgage and whether or not carrying a right to participate in the debtor's profits, and in particular income from government securities and income from bonds or debentures, including premiums and prizes attaching to such securities, bonds or debentures.

[733] The percentage is to be established through bilateral negotiations

Such deduction shall not exceed that part of the tax, as computed before the deduction is given, which is attributable to such items of income derived from that other State.[734]

Where in accordance with any provision of the convention income derived or capital owned by a resident of a contracting State is exempt from tax in that State, such State may nevertheless, in calculating the amount of tax on the remaining income or capital of such resident, take into account the exempted income or capital.[735]

Also vide tax credit, state shall allow as a deduction from the tax on the income of that resident an amount equal to the income tax paid in that other State. As a deduction from the tax on the capital of that resident, an amount equal to the capital tax paid in that other State where a resident of a Contracting State derives income or owns capital, which, in accordance with the provisions of this Convention, may be taxed in the other Contracting State.[736]

Such deduction in either case shall not, however, exceed that part of the income tax or capital tax, as computed before the deduction is given, which

[734] Article 23A(2) of United Nations Model Double Taxation Convention Updated in 2011
[735] Article 23 A(3), ibid
[736] Article 23B(1) of United Nations Model Double Taxation Convention Updated in 2011

is attributable, as the case may be, to the income or the capital, which may be taxed in that other State.

30.5.3 US Model Tax Convention

This model convention is intending to facilitate elimination of double taxation with respect to taxes on income without creating opportunities for non-taxation or reduced taxation through tax evasion or avoidance.

(a) Scope

This Convention shall apply only to persons who are residents of one or both of the Contracting States except provided otherwise.[737]

This Convention shall not restrict in any manner any benefit now or hereafter accorded by laws of the contracting parties and agreement of states who are contracting parties.[738]

This Convention shall apply to taxes on income imposed on behalf of a Contracting State irrespective of the manner in which they are levied.[739]

There are taxes on income all taxes imposed on total income, or on elements of income, including taxes on gains from the alienation of property.[740]

[737] Article 1(1) of the United States Model Income Tax Convention
[738] Article 1(2), ibid
[739] Article 2(1), ibid
[740] Article 2(2) of the United States Model Income Tax Convention

This Convention also shall apply to any identical or substantially similar taxes imposed after the date of signature of this Convention in addition to, or in place of, the existing taxes.

The competent authorities of the Contracting States shall notify each other of any significant changes made in their taxation laws or other laws that relate to the application of this Convention.[741]

(b) Resident determination

Resident of a Contracting State means any person who, under the laws of that Contracting State, is liable to tax therein by reason of his domicile, residence, citizenship, place of management, place of incorporation, or any other criterion of a similar nature, and also includes that Contracting State and any political subdivision or local authority thereof.[742]

This term does not include any person whose tax is determined in that Contracting State on a fixed-fee, "forfeit" or similar basis, or who is liable to tax in respect only of income from sources in that Contracting State or of profits attributable to a permanent establishment in that Contracting State.

(c) Income from immovable property

[741] Article 2(4), ibid
[742] Article 4 (1), ibid

Income derived by a resident of a Contracting State from real property (immovable property), including income from agriculture or forestry, situated in the other Contracting State may be taxed in that other Contracting State.[743]

The term "real property" or "immovable property" shall have the meaning, which it has under the law of the Contracting State in which the property in question is situated. The term shall in any case include property accessory to real property (immovable property), livestock and equipment used in agriculture and forestry. Also, rights to which the provisions of general law respecting landed property apply, usufruct of real property (immovable property) and rights to variable or fixed payments as consideration for the working of, or the right to work, mineral deposits, sources and other natural resources. Ships and aircraft shall not be regarded as real property (immovable property)[744]

(d) Interest taxation

Interest arising in a Contracting State and beneficially owned by a resident of the other Contracting State shall be taxable only in that other Contracting State.[745]

[743] Article 6(1) of the United States Model Income Tax Convention
[744] Article 6(2), ibid
[745] Article 11 (1), ibid

(e) Dividend taxation

Dividends paid by a company that is a resident of a Contracting State to a resident of the other Contracting State may be taxed in that other Contracting State.[746]

(f) Taxation of business profits

Profits of an enterprise of a Contracting State shall be taxable only in that Contracting State unless the enterprise carries on business in the other Contracting State through a permanent establishment situated therein.[747]

If the enterprise carries on business as previously mentioned, the profits that are attributable to the permanent establishment according to article 7(2) may be taxed in that other Contracting State.

(g) Royalties taxation

Royalties arising in a Contracting State and beneficially owned by a resident of the other Contracting State shall be taxable only in that other Contracting State.[748]

(h) Gains taxation

[746] Article 10, ibid
[747] Article 7 (1) of the United States Model Income Tax Convention
[748] Article 12(1), ibid

Gains derived by a resident of a Contracting State from the alienation of real property (immovable property) situated in the other Contracting State may be taxed in that other Contracting State.[749]

(i) Income from employment

Salaries, wages and other similar remuneration derived by a resident of a Contracting State in respect of an employment shall be taxable only in that Contracting State unless the employment is exercised in the other Contracting State.

If the employment is so exercised, such remuneration as is derived therefrom may be taxed in that other Contracting State.[750]

30.6 Summary

Generally from this chapter, we have learnt since international trade and investments increases, the interaction between the countries has also been increase.

However, this is interfered by the sovereignty principle of states, which empower them to tax according to their rules. Due to variation of taxation rules of international aspects, there was need to have model convention for tax treaties so

[749] Article 13, ibid
[750] Article 14,ibid

as to reduce double taxation in the meantime to promote economic integration and trade affairs.

These model tax conventions furnish decision-makers in countries with the information they need to understand the consequences of these differing approaches for their country's specific situation. It intends to facilitate the negotiation, interpretation and practical application of bilateral tax treaties based upon its provisions.

Despite that, they are differently; they relate in some aspects such as residence determination and taxation of income and gains from employment, investment, business and other economic activities.

Their purposes are similar to large extent as well as their scope in terms of persons and taxes covered under those conventions. In addition, both do not bind the parties as they act as guideline for the facilitation of the negotiation and formulation of bilateral treaties between the two contracting member states.

However, among of the major weakness to both model tax conventions is that they do not cover value added tax or consumption tax. Their focus is income tax while recent there is high move of the consumption tax imposed by the different nations, which may lead to double taxation.

30.7 Review Questions

1. What do you understand by the terms model tax conventions.
2. Identify and describe reasons for establishment of the model tax conventions
3. Compare and contract UN model tax and US model tax conventions.
4. Discuss strengths and weaknesses of selected model tax conventions

30.8 References

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