

**INTRODUCTION
TO PUBLIC
FINANCE AND
TAXATION**

Haruni J. Mapesa &
Joseph S. Kiria

2019

TANZANIA

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**INTRODUCTION TO PUBLIC FINANCE
AND TAXATION
TEXTBOOK**

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FOREWORD

This book introduces foundation topics on public finance and a broad range of topics in taxation theory and laws. A number of taxation Acts have been covered. Tax Acts such as the Income tax Act 2004 as amended, the VAT Act 2014, The EPZ Act 2002, TIC Act 1997, and other miscellaneous tax laws in Tanzania are interpreted and discussed in details. Examples and illustrations are provided as guide to interpretation and application of the tax laws. The topics are discussed in details to provide optimal benefits to readers. The book provides a good number of quantitative worked examples and a rich bank of questions at the end of each chapter which give chance for the readers to practice the knowledge and skills gained in the chapter and thus enhancing the competences of readers and practitioners. The book also contains a complete set of sample examinations as mock for university students taking taxation and for accounting professional candidates.

The importance of public finance and taxation knowledge to economists, finance, accountants, businessmen and other professionals cannot be over emphasised. A clear understanding of theories, concepts, computations, and tax laws outlined in this book is valuable to students, individual citizens, business community, tax consultants, and tax authorities' officials. Tax knowledge is also important for overall voluntary tax compliance in a country and economic growth of a nation. Public Finance on the other hand provides valuable knowledge to policymakers, budget preparers, controllers, civil societies and business community.

The authors recognise the dynamics in the subject of Public Finance and Taxation, they thus invite contributions and comments to enable them improve the quality of the subsequent editions of the book.

PREFACE

The importance of public finance and taxation knowledge to economists, financial analysts, accountants, businessmen and other professionals cannot be over emphasised. A clear understanding of theories, concepts, computations, and tax laws outlined in this book is valuable to students, individual citizens, business community, tax consultants, and tax authorities' staff for smooth compliance and implementation of fiscal policy in a country. Tax knowledge is also important for overall voluntary tax compliance in a country and economic growth of a nation. Public finance on the other hand provides valuable knowledge, decision making ability and competence to policymakers, legislators, budget preparers, controllers, civil societies and business community.

This book introduces foundation topics on public finance and a broad range of topics in taxation theory and tax laws in Tanzania. The book intends to fill a gap that exists as a result of several developments in public revenue and expenditure policy reforms and changes in fiscal policy and tax laws in Tanzania. New tax laws have been enacted such as the Tax Administration Act 2015, and existing laws have been repealed (e.g. Value Added Tax 1997) and replaced with new tax laws (e.g. the Value Added Tax Act of 2014). Similarly, there have been several legislative developments in the existing tax laws which amend existing tax laws. All these reforms necessitate for amendment of existing tax textbooks and/or development of new taxation textbooks that would provide comprehensive material on the interpretation and application of the new tax laws and the amended tax laws. This book fills this gap and the book comes at a time when lecturers, university students, professionals, and practitioners are in urgent need of such books. Most of the books written before these changes are outdated and cannot provide adequate guidance on the interpretation and application of the new and amended tax laws and current trends in public finance administration.

Thus, this textbook provides a detailed discussion on the Income Tax Act 2004 (including amendments made by the Finance Act 2017), the Value Added Tax (VAT) Act 2014 (including amendments made by the Finance Act 2017). The Tax Administration Act 2015 and other tax laws in Tanzania are interpreted and discussed in details. Examples and illustrations are provided as a guide to interpretation and application of the tax laws. The topics are discussed in details to provide clear understanding of basic facts, concepts and issues to readers. The book provides a good number of quantitative worked examples in some chapters and revision questions at the end of each chapter. These questions give the readers opportunity to translate the knowledge and skills gained in the chapter. To practice the book also contains complete sets of sample examinations as mock for university students taking taxation subjects and for accounting professional bodies' examination candidates. The book is organised into two parts, namely Part One and Part Two. Part One of the book deals with introductory topics in public finance and Part Two deals with topics in theories of taxation and tax laws in Tanzania. The public finance part of the book contain four topics, namely introduction to public finance; national income accounts; market imperfection and the role of the government; and public expenditure, budgets and public debts. The second part of the book which deals with taxation theory and tax laws in Tanzania contains twelve chapters, namely theory of taxation; tax administration in Tanzania, introduction to Income Tax Act 2004; Taxable income from employment; taxable income from businesses; depreciation allowances and inclusions; taxable investment income; returns of income and tax assessments; Value Added Tax; international taxation; other tax laws administered by the Tanzania Revenue Authority and the last chapter is local government taxes. The references used by the authors are placed after the end of chapters. The book ends with a rich bank of sample examinations in public finance and taxation profession.

The authors recognise the dynamics in the subject of Public Finance and Taxation, they thus invite contributions and comments to enable them improve the quality of the subsequent editions of the book.

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CHAPTER ONE
INTRODUCTION TO PUBLIC FINANCE

PART I: PUBLIC FINANCE

CHAPTER ONE

INTRODUCTION TO PUBLIC FINANCE

Introduction

This chapter introduces the concept and nature of public finance. Specifically, it covers definition, scope and division of the public finance; role of the government in an economy and distinction between private and public finance. The chapter also provides a brief description of the tools of public finance in achieving its intended objectives. The role of the government in an economy is also introduced. Introduction to fiscal policy measures and tools is presented to provide foundation for the subsequent topics in the textbook.

Learning outcomes

After successful completion of this chapter readers should be able to:

- ❖ Describe the meaning and nature of public finance
- ❖ Describe the divisions of public finance
- ❖ Distinguish between private finance and public finance
- ❖ Describe the traditional and economic role of government in society
- ❖ Discuss the role of public finance in an economy
- ❖ Explain the instruments used in fiscal policy

The definition of Public Finance

According to economics literature, public finance can be defined as the science which deals with the manner in which public authorities acquire and allocate resources to various sectors of economy.

Scope of Public Finance

According to *laissez-faire* philosophy, public finance deals with a limited field of analysing the ways the treasury operates. That is, the field does not basically deal with deciding on the basic allocation of economic activities between public and private sector but rather it is mainly about the way in which operations of the treasury interfere with the working of the private sector of the economy and the way in which to keep such interference harmoniously and to the minimum.

Public finance deals with the finance of the public as an organised group under the institution of the government. Therefore, it deals only with the finances of the government, which encompasses raising and disbursement of government funds. Public finance also deals with policies and activities for regulating the overall economic variables such as employment rates, interest rates, investments, price levels, economic growth rates, markets for goods and services and other macro-economic variables. The objectives of public finance are allotation of resources; adjustments in the distribution of income and wealth; and stabilisation of prices and employment.

Divisions of Public Finance

Public finance can be divided into and explained by the following theories:

The Theory of Public Revenue

Public revenue theory deals with sources of government revenue such as taxation and other non-tax revenues, such as grants, profits from public undertakings, fees, fines, dividends, royalties, and interest receipts.

Theory of Public Expenditure

Public expenditure theory deals with how the government allocate the various revenues into various expenditures. It also deals with the financial flows of the economy and its influences on demand and supply patterns.

Financial Administration

Financial administrations deal with all financial activities that ensure the public funds are used efficiently and for the purposes intended. Activities in financial administrations include public budget preparation, approval (its passing), implementation, auditing etc.

Stabilisation, Growth and Distributive Justice

This part of public finance addresses the issues pertaining to price stability in a country and growth of all economic activities. The role of the government is to establish policies and regulations that control prices and ensure balanced growth of economic activities. Aspects of appropriate redistribution of income are also covered in this division of public finance.

Public Revenue

The theory of public revenue recognises the following as types and sources of government revenues:

- ❖ Taxes
- ❖ Borrowing (both foreign and local)
- ❖ Retained profit: Profit from public enterprises
- ❖ Administrative revenue; this include fines by courts, and police traffic penalties
- ❖ Foreign funds in form of grants, aid, (Project grants, and/or Programme grants)
- ❖ Other sources: Dividends, Royalties, Fees, Charges, Voluntary contributions, and State lottery.

Distinction between Private and Public Finances

Private finance means the financial affairs and policies of an individual economic unit. It deals with how individual economic entities (corporations, partnerships and households) obtain funds to finance the operating and investment activities. Public finance means finance that concerns a society, community, and nation as a whole. It refers to the process, theories, policies and laws of soliciting and using funds for financing economic and social activities of a society or nation as a whole. The objective of private finance is to obtain profits out of operations, while the objectives of public finance are to finance government operations in providing public goods and services.

Role of the Government in the Economy

The traditional roles of governments are based on Laissez-faire philosophy. According to this philosophy the role of the government is not to interfere with the working of market forces but to limit its own activities to the minimum possible. Such minimum role of government is limited to the following:

- ❖ To protect the society against internal disruption, and ensure that effective law and order prevail. Therefore, the state is traditionally responsible for creating administrative organs, judicial and police set-ups.
- ❖ To protect society against foreign aggression.
- ❖ To create and run social overheads or infrastructural facilities where private sector has failed to do so due to commercial non-viability.

Role of Public Finance in the Economy

The focus of public finance in the economy is to achieve the following:

- ❖ To facilitate resource pooling and capital formation
- ❖ Technological progress
- ❖ Resource allocation
- ❖ Redistribution of income (income and wealth redistribution)
- ❖ To facilitate efficient use of resources, e.g. to discourage wasteful competition
- ❖ To regulate the market where competition is inefficient due to decreasing costs.
- ❖ Provision of social goods because of their joint-ness of their consumptions and merit goods because of ignorance and externalities.
- ❖ Solutions to market mechanism (systems) failure to bring about full employment, price level stability, socially required rate of economic growth.

Tools of Public Finance

The tools of public finance are policy instruments, commonly used as vehicles in facilitating public finance in the economy. It is important that the effective tools of public finance be designed and used with judicious discretion and with thoughtful planning. In its content, any such tool must conform to the principle of maximum social advantage. The principle deals with the question of the size of public budget, the level at which the state should operate, and the boundaries of state activities. The purpose should be to design the policy and operations of the state so as to *achieve maximum possible advantage* for the society as a whole. The common policy instrument is fiscal policy.

Fiscal Policy

Fiscal policy can be defined as covering many different types of public expenditure and different ways of financing them. It refers to changes in taxes and government expenditures. It is a direct way through which the government can influence tendency of the economy by changing the level and direction of government spending, tax instruments and rates. Fiscal policy instruments are categorised by purpose as reflationary fiscal policy and deflationary fiscal policy.

Reflationary Fiscal Policy

Government uses reflationary policy in times of general down turn in economic activities (recession). Reflationary fiscal policy is used to boost the level of economic activities in the economy. This can be achieved by lowering taxes in some ways or increasing government expenditures. Approaches used should be non-distortionary taxation and productive expenditure.

Non-distortionary taxation

Tax serves as incentive for savings in the present and encourages future consumptions hence positive effect on the economy. Taxes which encourage savings are therefore good for economic growth. Tax policy on domestic goods and services (VAT, excise duties and others) should be designed and amended from time to time to ensure no distortion on the consumption and saving patterns of economic units and households.

Productive expenditure

Productive expenditure ends up in the production function of the private sector. They increase returns to investment, thereby fostering economic growth. Expenditure on construction of roads, machinery and equipment, laws and order are good examples of productive expenditure. Productive expenditure influences the marginal product of private capital and hence boosting growth. Expenditures on public order, and safety, expenditure on education, health, transport, communication

housing and community amenities and social security benefits have far reaching effect on economic growth.

Deflationary Fiscal Policy

Deflationary fiscal policy is used to manage an economy which is growing at above its capacity, and which is likely to cause inflation and/or balance of payment problems. Deflationary fiscal policy measures may involve increasing taxes to reduce disposable income (income after tax) and/or decreasing government spending. Progressive tax system is the common approach used to increase tax on income and profits.

Economic Functions of the Government

The economic functions of the government fall into three major categories allocation, distribution, and stabilisation functions.

Allocation Function

Government represents people and therefore aims to save the interest of the people by allocating them with resources and services they need. In order to facilitate this function government uses budgets as the main tools. Through the budgetary process and especially during parliament budget sessions the needs of the people are presented to the government. Through budget the government allocates the expected resources to various budgeted needs.

The allocation function of the government involves a systematic distribution of limited quantity of resources over various operations for consumption and investments over the period of time. The government has a duty to allocate resources to the public through provision of public goods and services. The goods and services commonly provided by governments include: Construction and maintenance of roads, railways, health, education, defence administration of justice and other service that are essential for the society.

Distribution Function

Government policies aimed at changing the final distribution of goods and services across consumers, usually with the intention of realising a "fairer" apportionment of consumption/income/wealth. Thus, distribution function is concerned with the measures to be taken for bringing about an equitable distribution of income in the economy.

Government performs distribution function in the economy in order to reduce income inequality among individual in the society. This is done through "progressive income tax system" where by a high income earners pay a higher tax rate and lower income earners pays lower tax rate.

The government also distributes income through supporting poor individuals and provision of subsidies to selected sectors of the economy. Public provision of goods or services (such as health care, education and food) to certain individuals alters the consumption of goods and services to such individuals and therefore removes inequalities in the country.

Stabilisation Function

The stabilisation function explains the macroeconomic aspect of budgetary policy. In other words, the stabilisation function deals with the use of budgetary policy as a means of maintaining high employment rate, a reasonable degree of price stability, exchange rate stability, correcting negative externalities, protecting infant industries, stability in economic growth, with allowances for effects on trade and balance of payments. The major instruments of stabilisation policy are monetary and fiscal policy

Chapter Summary

The main ideas presented in this chapter are summarized below:

- ❖ Public finance is a science which focuses on effective and efficient management of public revenues and expenditure. It deals with appropriate strategies, tools and techniques for acquisition and distribution of resources to various economic sectors of a nation. The ultimate objective is to ensure maximum satisfaction of public needs and wants.
- ❖ Public finance deals with the art and science of creating policies and activities that regulate the overall economic variables such as employment rate, interest rates, investments, price levels and stability, economic growth rates and market for goods and services.
- ❖ The major concerns of governments are to ensure economic efficiency and effectiveness in resource pooling, capital formation, technological progress, resource allocation, distribution, and stabilisation. Through budgetary process the government allocates the available resources to various needs, establishes policies which ensure fair distribution of national income to all groups in the society. Fiscal and expenditure policies in turn can affect the level of economic activities which has an important bearing on maintaining economic stability.

End of Chapter One Revision Questions

- 1) Briefly describe what it means by Public Finance
- 2) Briefly describe the divisions of public finance
- 3) Discuss the rationale of government intervention in the economy
- 4) Mention and briefly explain any four appropriate fiscal measures that a government may use to bring about stability in the economy.
- 5) What are the roles of public finance in developing countries like Tanzania?
- 6) What is the difference between public sector and private sector?

CHAPTER TWO

PUBLIC SECTOR AND NATIONAL INCOME ACCOUNTS

Introduction

This chapter deals with the methods of determining a national income and the importance of national income statistics in public finance and national economic decisions. At the household level one can determine the household income by taking the aggregate value of all incomes in monetary terms earned by all members of the household such as salaries and wages, sale of household produce (e.g. crops), profits from family business, dividends from shares in a corporation, interest from a bank and financial institutions and others. In same vein it is possible to determine the income of the whole nation or society for a specified period of time by looking at the nation or society as composed of individual economic units whose income is determinable. We cover several issues in this chapter around methods of determining national income, the role of the government in circular flow of income, the influence of the government on gross domestic income and national income, and the benefits of having national income statistics in economic decisions.

Learning Outcome

After successful completion of this chapter readers should be able to:

- ❖ Explain the major methods of calculating national income
- ❖ Describe the importance of national income accounts to public finance decisions
- ❖ Identify the ways through which the government can influence national income
- ❖ Describe the circular flow of income in an economy and the role of the government

Meaning of National Income

National Income is a total value of a country's final output of all new goods and services produced in one period. Normally, this period consists of one year, as a year is neither too short nor too long a period. National product is usually used synonymous with National Income, and it is often considered the true net national income of the country.

National Income Accounting

National Income Accounting is the set of rules and definitions for measuring economic activity in the aggregate economy, that is, in the economy as a whole. National income accounting is the way of measuring aggregate production. The purpose of National Income Accounting is to obtain some measure of the performance of the aggregate economy. In macroeconomics we study phenomena for which there are natural analogues in the real world. However, the phenomena are constructs informed by theory. You cannot observe the price level or gross national product (GNP). In empirical work, however, we do have to measure these variables. Gross Domestic Product (GDP) is the total value of all final goods and services produced in an economy in a one-year period. It is the single most used economic measure. GDP is output produced within a country's borders. Gross National Product (GNP) is the aggregate final output of citizens (Nationals) and businesses of an economy in one year. GNP is for example equal to GDP plus receipt of factor income from the rest of the world and net of payments of factor income to the rests of the world.

Methods of Calculating National Income

There are three (3) methods of accounting for national income:

1. Income Approach
2. Expenditure Approach
3. Output/ Value added approach

Income Approach

This method approaches national income from the distribution side. In other words, this method measures national income at the phase of distribution and appears as income received by individuals and economic units of the country. Thus, under this method national income is obtained by summing up of the incomes of all individuals of a country. Individuals earn incomes by contributing their own services and the services of their property such as land and capital to the national production. Therefore national income is calculated by adding up the rent of land, wages and salaries of employees, interest on capital, profit of entrepreneurs (including undistributed corporate profits) and income of self-employed people. This method of estimating national income has a greater advantage of indicating the distribution of national income among different income groups such as landlords, owners of capital, workers and entrepreneurs. Income approach includes:

- i. Wages and Salaries (W): This is also known as compensation of employees including income of the self-employed. This is represented by letter "W" in the income equation. It includes wages and salaries paid by businesses and government to workers.
- ii. Operating surplus which include Profits, Rent and interest.....(R)+(I)+(P)

The variable "R" which stands for rent is a type of income received by landlords. Rents are paid by households, businesses and government. The variable "I" stands for interest which is income derived by way of interest payments to households on their bank deposits or bonds. The variable "P" stands for profit. Profit can be classified into proprietors' income and corporate profits. Proprietors' incomes are their reported net profits while corporate profits are corporations' net earnings after business expenses. Corporate profits are divided into (i) corporate income taxes (ii) distributed dividends and (iii) retained (undistributed) profits.

- iii. Provision for Depreciation / Capital consumption.....(D)

Capital consumption allowances which are represented by letter "D", are the total costs of the wear and depreciation of the capital stocks. Capital stocks include: machinery, tools, plants, roads, buildings, trains, railways etc within an economy usually within a given year. Depreciation is added because it is regarded as part of undistributed profit.

The Income approach reports GDP at factor costs because calculations are based on factor payments (See Table 2.1)

$$GDP (FC) = W + P + R + I + D \dots\dots\dots (1)$$

Factor costs: are the actual production costs of goods and services. These include all the factors of production such as labour, capital, energy that are used to produce a given quantity of output in an economy. Thus the term GDP at factor cost refers to the total final output of all final goods and services produced within the national frontiers of a country which are based on the actual costs of production.

Table 2.1: Illustration of the income approach of computing Gross Domestic Product

S/No	Item	Amount (Tsh. Billion)
1.	Compensation of Employees (W)	6,165
2.	Proprietors' Income (I)	582
3.	Rental Income (R)	153
4.	Corporation Profits (P)	1023
5.	Net Interest (I)	839
6.	Indirect taxes minus subsidies	782
7.	Capital consumption (D)	1,303
	Gross domestic product	10,847

Example 2.1

The following table presents statistical information drawn from certain country. From this table determine the GDP using the income approach and show the percentage contribution of each component of income to total economy. (Figures in Billions).

S/No	Income component	Amount (Tsh. Billion)
1	Compensation of Employees	7,900
2	Proprietors' Income	1,050
3	Rental Income	66
4	Corporation Profits	1,590
5	Net Interest	603
6	Indirect taxes minus subsidies	962
7	Net business transfer payments	95
8.	Surplus of government enterprises	-15

Answer 2.1

The GDP can be obtained by adding the payments to all factors of production that is, salaries and wages, interest, profits, taxes and depreciation. From the above given information GDP is determined as follows:

S/No	Income component	Amount (Tsh. Billion)	Percentage of National Income
1.	Salaries and Wages (Compensation of Employees)	7,900	64.48
2.	Profits (Proprietors' Income- individual and Households)	1,050	8.57
3.	Rents (Rental Income)	66	0.54
4.	Profits (Corporation Profits)	1,590	12.98
5.	Investments (Net Interest)	603	4.92
6.	Net Taxes (Indirect taxes minus subsidies)	962	7.85
7.	Net business transfer payments (Income of others)	95	0.78
8.	Surplus of government enterprises (Profits/losses)	-15	-0.12
	GDP	12,251	100

Expenditure Approach

This approach is basically based on output and focuses on finding the total output of a nation by determining the total amount of money spent. This is preferred by economists because like income approach the total value of all goods is equal to the total amount of money spent on goods.

Expenditure Approach consists of:-

- ❖ Consumption (C)
- ❖ Investment (I)
- ❖ Government Purchases (G)
- ❖ Net Exports (Xn) = X - M

Where:

- ❖ C=Households' spending on durable and non-durable goods and services.
- ❖ G=Government purchases include spending by all levels of governments on finished goods and services. All government transfers are excluded.
- ❖ I=Gross Private Domestic Investment include all final purchases of tools, equipment, and machinery by businesses, all (private) construction including new homes, and changes in inventory.
- ❖ Note: Purchase of stocks and bonds and depositing money in a bank are not considered as investment.
- ❖ (X - M) = Net Export: The difference between a country's sales to other countries (exports (X)) and its purchases from other countries (imports (M)).

These components give rise to the following equation:

$$GDP = C + I + G + (X - M) \dots \dots \dots (2)$$

The GDP under expenditure approach is valued at market prices. Market prices are the prices at which goods and services are sold in various markets to households and firms. GDP at market price therefore refers to the total value of all final goods and services produced within the national frontiers of a country that are valued at market prices. Table 2.2 provides an illustration on how GDP is determined using the expenditure method.

Table 2.1: Illustration of the expenditure approach for computing Gross Domestic Product

S/No	Expenditure category	Symbol	Amount (Tsh Billions)
1.	Personal consumption expenditure	C	7,674
2.	Gross private domestic investment	I	1,624
3.	Government purchase of goods and services	G	2,054
4.	Net exports of goods and services	X-M	-505
	Gross Domestic Product (GDP)		10,847

Example 2.2

The following table presents hypothetical data on aggregate national expenditure of two countries of Tanzania and United States of America for the year 2015. Using the given information in the table determine the Gross Domestic Product (GDP) of the two countries in that year using the expenditure method.

Category of expenditure	Individual expenditure (US \$ Billions)		Total expenditure per category	
	Tanzania	U.S	Tanzania	U.S
Consumption (C):				
Durable Goods	137.8	1,218.9		
Non-durable goods	457.9	2,564.2		
Services	686.2	7,336.5	1,281.9	11,119.6
Investments (I):				
Fixed investments	118.2	2,004.2		
Changes in inventory	2.1	58.1	120.3	2,063.3
Government Expenditure (G)				
Central Government	158.7	1,214.3		
Local Government	68.5	1,848.5	227.2	3,068.8
Net Export/(Import)				
Import	98.8	2,184		
Export	155	-2,744	-56.2	-559

Solution to example 2.2

GDP by the expenditure approach is given by the formula:

$$GDP = C + I + G + (E - I)$$

Tanzania:

Taking the total figures for each component from the table (4th column), GDP can be calculated as follows;

$$GDP = 1,281.9 + 120.3 + 227.2 - 56.2 = \$ 1,573.2 \text{ Billions}$$

U.S

$$GDP = 11,119.6 + 2,063.3 + 3,068.8 - 559 = \$ 15,684.8 \text{ Billions}$$

Output Method/ Value Added Method

The approach measures the total money value of goods and services produced by summing the value of goods and services by an industry and deducting the costs of goods and services. The output approach focuses on finding the output of a nation by directly finding the total value of all goods and services a nation produces. Because of the complication of the multiple stages in the production of a good or service, only the final value of a good or service is included in the total output. This avoids an issue often called double counting; where in the total value of a good is included several times in the national output by counting it repeatedly in several stages of production.

Example 2.3

In the production of meat, the value of good from the farm was Tsh. 10,000; this meat was sold to the butcher which then sells the same to supermarket at Tsh. 30,000. The supermarket sold the same meat to individual consumers at Tsh. 60,000.

Answer 2.3

The value that should be included in the final national output should be Tshs. 60,000, not the sum of all those numbers, i.e. Tshs. 100,000. The values added at each stage of production over the previous stage are respectively Tshs.10, 000; Tshs. 20,000, and Tshs. 30,000. This sum gives an alternative way of calculating the value of final output.

The three different methods of estimating NI are equivalent in the sense that they yield that same results.

Circular Flow of Income and Expenditures

The circular flow of income is a model of the economy in which the major exchanges are represented as flows of money, goods and services etc. between economic units. The flows of money and goods exchanges in a closed circuit and correspond in value, but run in the opposite direction. The circular flow analysis is the basis of National Accounts and macroeconomic variables.

Types of circular flow models

Basically there are four circular flow models namely two sector model, three sector model, four sector model and five sector model.

National income accounts for two sector model

In this model the national income is measured in reference to two sector economies which are households and business sector.

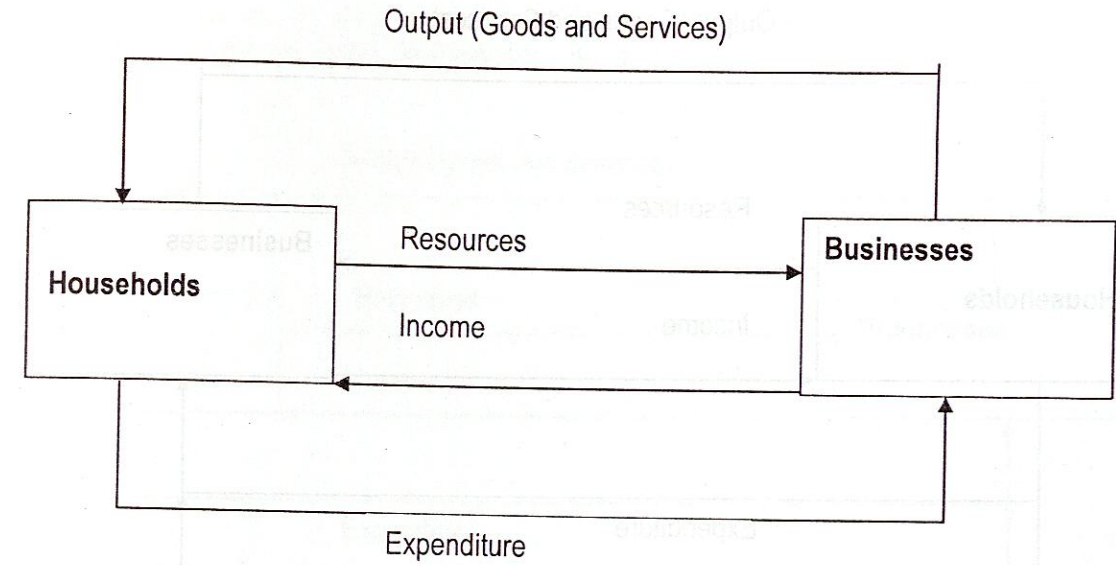


Figure 1: Two sector circular flow model of income

Assumptions of the two sector model

- ❖ No government interventions
- ❖ No international trade
- ❖ All productions occur in business sector
- ❖ All firms are corporate
- ❖ Households owns factors of production; that is land, labor, capital and entrepreneurship
- ❖ Business distributes a profit in terms of dividends payments.

In this model Net National Product (NNP), National Income (NI), Personal Income (PI) and Disposable National income (DNI) will be the same. Only Gross National Product (GNP) will differ by the amount of depreciation of capital expenditure.

$$\begin{aligned} \text{National income} &= \text{Personal Consumption} + \text{Total net investment} \\ \text{NI} &= C + I \end{aligned}$$

National income account for the three sector model

This model measures the national income comprising three sectors which are household, business and financial institutions. In this model it is assumed that all productions occur in a business sector and firms are corporations and financial institutions (banks) provide finances to support investments to corporations. Households' savings on the other hand provide additional loanable funds to banks.

$$\begin{aligned} \text{National income} &= \text{Savings} + \text{Consumption} + \text{Investment} \\ \text{NI} &= S + C + I \end{aligned}$$

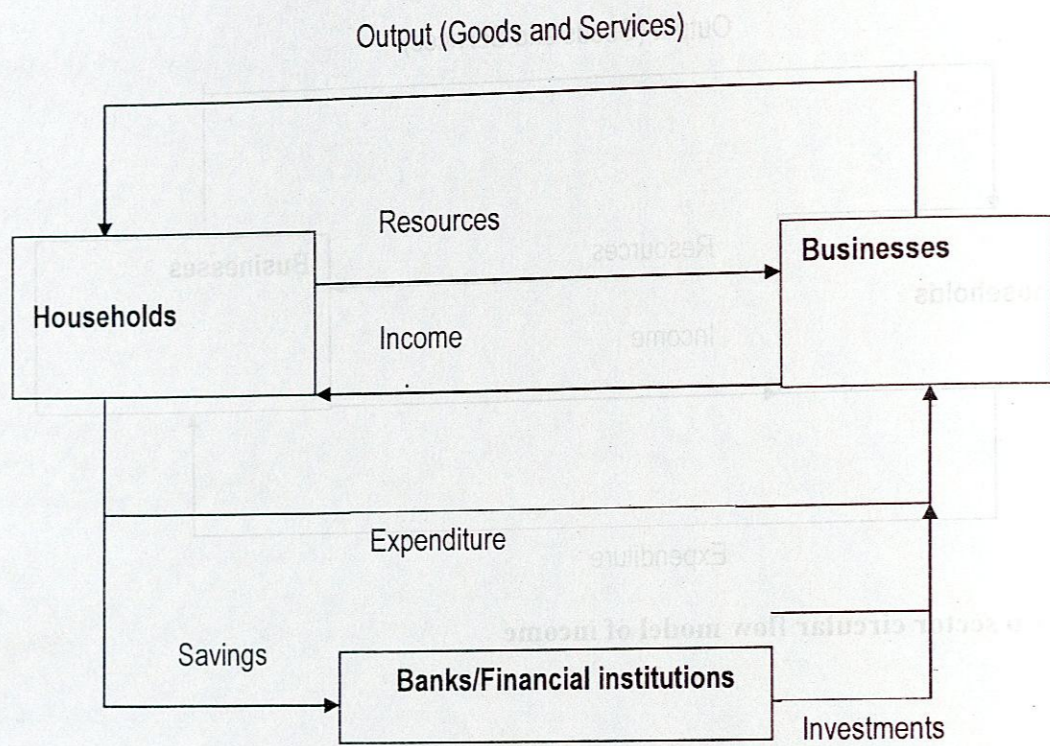


Figure 2: Three sector circular flow model of income

National income account for the four sector model
 The four sector model includes households, business sector, financial institutions (banks) and government.

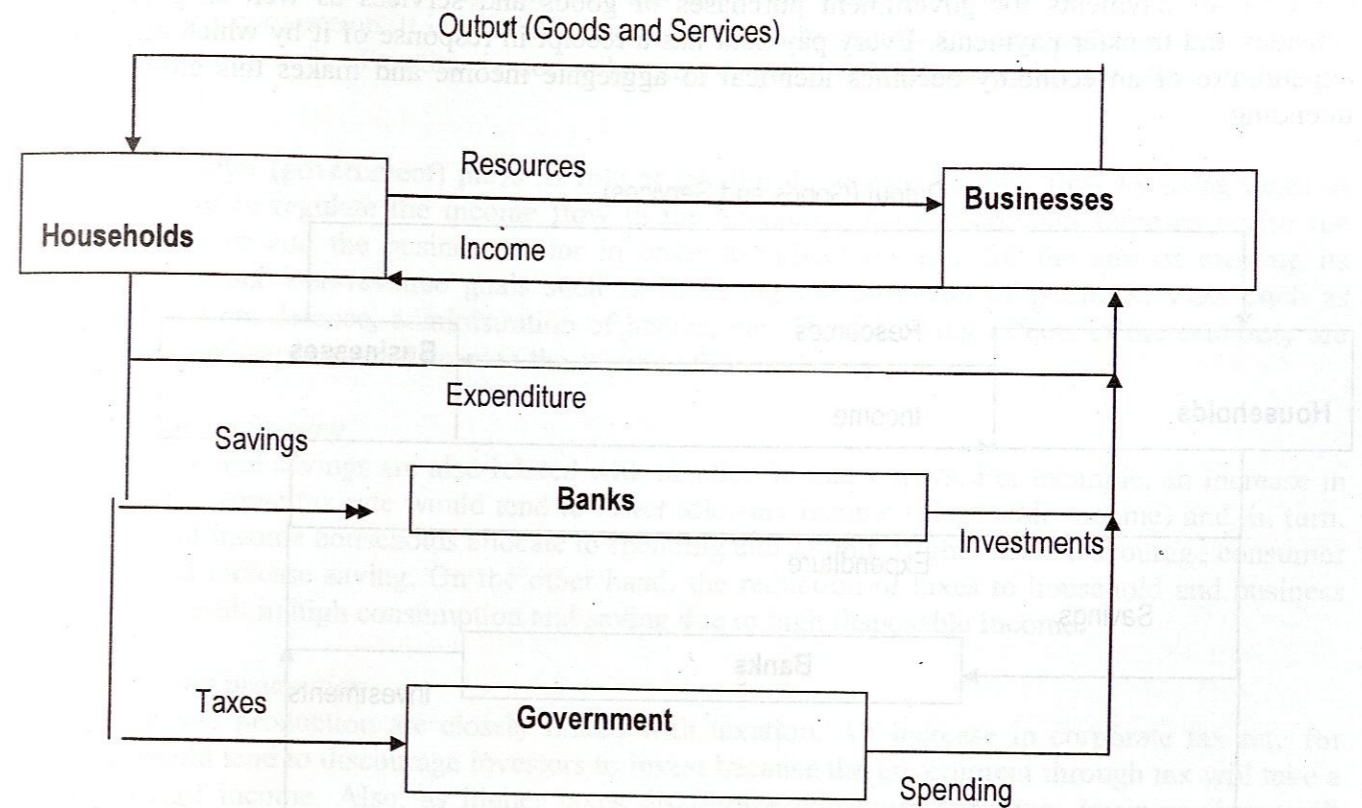


Figure 3: Four sector circular flow model of income

National income account for the five sector model

It includes household sector, business sector, financial institutions, government sector and foreign sector. The income received from the government sector flows to producing and household sector in the form of payments for government purchases of goods and services as well as payment of subsidies and transfer payments. Every payment has a receipt in response of it by which aggregates expenditure of an economy becomes identical to aggregate income and makes this circular flow unending.

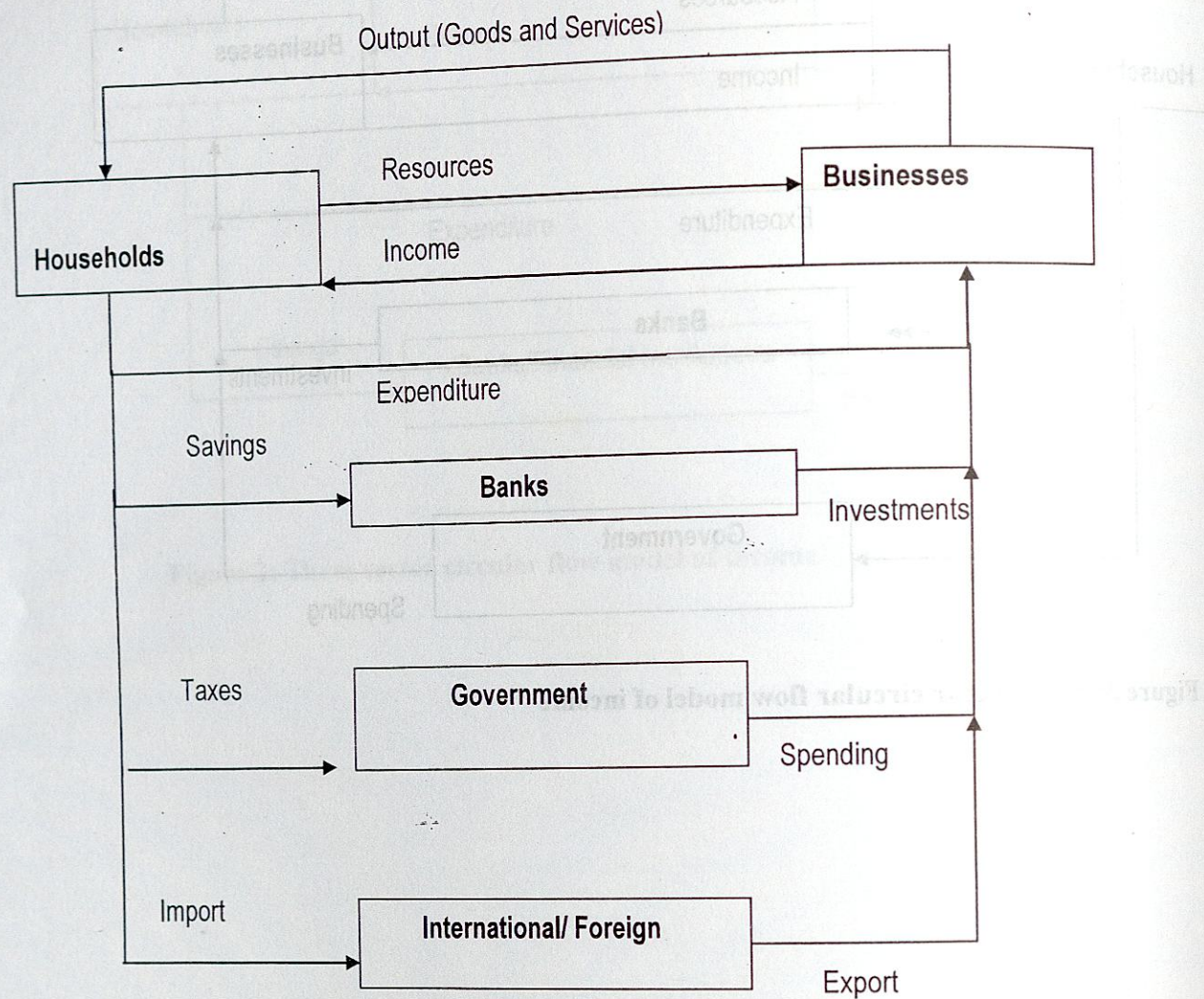


Figure 4: The Five sector circular flow model flow of income

Components of the Circular Flow

Taxation

Taxation comes from compulsory contributions from the targeted incomes or consumption of an individual or a corporation. It is normally imposed by the government to individuals (households) or firms (business sector). Taxation is normally carried out in two forms which are direct taxes and indirect taxes.

The public sector (government) plays its role of taxation in income circular flow by using taxes as the instrument to regulate the income flow in the economy. The government imposes tax to the household sector and the business sector in order to collect revenue for the aim of meeting its revenue goals and non-revenue goals such as financing the provision of public services such as health, education, defence, administration of justice, etc. The following effects in the economy are the outcomes of imposition of taxes to the sectors of the economy:

Consumption and saving

Consumption and savings are also related with taxation in many ways. For example, an increase in the personal income tax rate would tend to lower after-tax income (disposable income) and, in turn, the amount of income households allocate to spending and saving. Higher taxes discourage consumer spending and increase saving. On the other hand, the reduction of taxes to household and business sectors will result in high consumption and saving due to high disposable income.

Investment and production

Investment and production are closely linked with taxation. An increase in corporate tax rate for instance would tend to discourage investors to invest because the government through tax will take a huge share of income. Also, as higher taxes discourage consumer spending, business firms will generally cut back on production rather than being stuck with unsold inventories of output. In turn, the rate of production will decrease. On the other hand, the decrease in corporate tax rate would tend to encourage investors to invest more because the business sector will remain with high income in their hands, and also production will increase because of the availability of high demand from households after remaining with high disposable income. All these are done by the government so as to encourage investment and hence economic growth.

Employment

Due to the discouragement of investments and cut of production in some firms as a result of increased taxes to the business sector and the household sector, most of the people will be unemployed. This results in low income to the household sector. In turn the demand for goods and services will decrease. On the other hand, when the government reduces the corporation tax or provides tax relaxation, investors remain with high income and use it in investment activities, hence more employment opportunities. All these effects of taxation in income flow circular happen when the government is trying to meet its revenue and non-revenue goals such as stabilisation of the economy, distribution of income, discouraging of the consumption of harmful goods and collection of market imperfection.

Government Spending

Whether the public sector acquires privately produced goods and services for distribution or produces the output itself, government spending as well as government taxation result in the public sector's claim over a portion of society's relatively scarce economic resources; thus becoming unavailable for private use and private production. As a rule, the government sector provides the private sector with goods and services that the market generally does not or cannot provide. For

example, private business firms generally will not provide goods and services to customers who do not pay yet benefit from their availability. If such goods and services are provided at all, it is generally done by the public sector. They are called public or collective goods and services because individuals "collectively" benefit from their availability whether or not they pay. National defence is an example of a public good provided by the central government. A change in the level of government spending affects the economy's flows. If the government sector were to step up its demand for goods and services produced by businesses, resource employment would increase, as would the levels of household and business income, spending and saving. Tax receipts may even rise without a change in tax rates as households and businesses pay more taxes on higher incomes.

As with a reduction in taxes, an increase in government spending will generally economic activity and the associated flows. Similarly, a slowing or reduction in government spending (or an increase in taxes) would tend to slow the economy's flows as well. An important fiscal function of the government is to stabilise the economy's private spending and production flows to avoid too rapid or too slow a growth in the economy, price instability and unemployment. The government contributes to the stability of the economy when the level of its spending runs counter to the level of economic activity. For example, as the economy turns down with a slowing in the flows of production and consumption, a deliberate increase in government spending and/or a decrease in taxation will tend to stimulate the economy's flows. However, when the economy is expanding rapidly, a deliberate reduction of government spending and or increases in taxes work to slow the economy's flows. Not all government spending moves in a direction opposite to that of the economy. Some programs, such as national defence, social security benefits and transfer payments, and interest payments on past government borrowing tend to grow unrelated to the cyclical swings in the economy.

Borrowing

The circular flow of income model highlights borrowing as one among the rôle played by the government sector. When government sector buys a portion of gross domestic product such as national defence, education, health services which are financed from taxes collected, sometimes tax revenue falls short of these expenditures. This situation forces the government sector to seek for other sources of income to finance its expenditures, therefore the public sector is also prone to borrow through the financial markets.

Government borrowing is the demand for loans (e.g. obtained through the financial markets) by the government sector to finance government expenditure over and above taxes. Governments usually borrow by issuing securities, government bonds and bills; sometimes they practise domestic borrowing (money comes from lenders within the country) and foreign borrowing (money comes from foreign lenders).

Although government borrowings are important, high government debts have a negative effect on long term economic growth of a nation. When government debt grows, private investment shrinks, lowering future growth and future wages. The logic is that if the government borrows more, they will have to compete for funds with private sector, so the more the government borrows the higher the interest rate on loan-able funds leading to low demand for loans from private sector. More government borrowings mean more interest expenses to pay in the future. As a result the government will have to increase taxes so as to collect more revenue to pay off debts instead of investing in important sectors for development of the nation.

Exports and Imports payments

The public sector is involved in foreign sector through exports and imports of goods and services. It is involved when it charges tax to exporters and importers which include custom duties and tariffs so as to raise the revenue of the country. When exports exceed imports there is favourable balance of payments and when imports exceed exports then the opposite occurs. In the later case the total flow is smaller and less income is available for consumption expenditures, saving, taxes, and investment expenditure and government purchases.

Role of the Government in GNP and NI

The government can influence the Gross National Product (GNP) and National income (NI) in a number of ways, which includes:

Maintaining Political Stability and Good International Relations

Political stability means the absence of violence and terrorism. It further means good political policies, procedures, rules and regulations and a strong and stable defence of the nation. The country with political stability attracts or creates conducive environment for investments. Maintaining stability means increasing the level of investment and employment hence income of the nation is raised.

The foreign countries are more convinced to invest more in countries which are free from social and political unrest. This is because they expect more returns from countries with stable political well-being. Furthermore, good relations of the country with other nations created by the government calls for more investment by not only the nations but also multinational corporations and non-governmental organisations. International relations increase the exports by expanding the market through international trade for exchanging goods among nations.

Maintaining Favourable Balance of Payments

The balance of payments is an accounting statement that records transactions for trade in goods, services, and financial assets between a country's residents and the rest of the world. The balance of payment transactions consist of receipts and payments on international trade. They represent credit entries that bring foreign exchange into the country and debit entries that record an outflow of foreign exchange outside the country. Balance-of-payments data usually are reported quarterly in national publications and also are published by the International Monetary Fund.

The roles of government are to ensure the modern global economy with well-developed financial markets and large-scale capital flows are encouraged in a country's cross border trades. Financial assets play an important role in the analysis of the balance of payments. The lifting of controls on the movement of capital and financial flows has been fundamental in promoting world trade and eventually greater incomes. The unrestricted movement of capital allows governments, businesses, and individuals to invest capital in other countries, thus promoting not only foreign direct investment but also portfolio investment in the capital market leading to the growth of GNP and NI. For example, governments may try to keep the national currency overvalued so as to keep foreign exchange cheap. Other examples are price ceilings, negative real interest rates and rent controls. Therefore, the government encourages financial programming with the essence of finding the right combination of monetary, fiscal, and structural policy measures that improve the balance of payments without damaging other important macroeconomic variables, including output and employment.

Promoting favourable balance of trade

The balance of trade, or net exports, is the total value of a country's exports in a given time period minus the total value of its imports. Typically, favourable balance of trade happens when exports exceed imports, and unfavourable balance of payments is when imports exceed exports. Many other factors are also relevant; such as the structure of imports and exports, the total time the balance has been in surplus or deficit, and the current stage of the business cycle. The balance of trade, or net exports, is a component of both the GNP and GDP. If net exports rise, GNP will also rise, and if net exports fall, so will GNP. Many governments use various resources under their disposal to promote the favourable balance of payments; for example, a government may decide to raise the import duty on imports to discourage imports and reduce excise duty to promote production within the country hence encourage exports. Also, the government can discourage the exportation of raw material and continue to improve and increase the level of foreign investment. This helps the country to move away from trade deficit relatives to the business cycle and economy. In recession, countries choose to export more, creating jobs and demand. In strong expansion, countries would import more, providing price competition, but without providing goods beyond the economy's ability to meet supply. Thus, a trade deficit is not good during a recession but may help during an expansion.

Improvement in the Banking System

A responsible and well regulated banking system is essential to any economy. Governments through central bank can use monetary policies to improve the banking systems. In order to ensure that a banking system is more resilient and customers obtain banking services with confidence governments should introduce reforms to the banking sector to make banks more resilient to shocks, easier to fix when faced with difficulties and reduce the severity of financial crises. The Tanzania banking sector for instance embarked on a plan for financial liberalization in 1992 in order to sustain its economic growth. This has been accomplished through the mobilization of financial resources as well as by increasing competition in the financial market and by enhancing the quality and efficiency of credit allocation. As a result of the liberalization, the banking sector in Tanzania has been booming, particularly over the last fifteen years.

Local banks primarily service local customers while foreign banks tend to operate as subsidiaries of large groups, such as Citigroup and Barclays, using strategies oriented to the international market. As a consequence, foreign banks focus on international customers and national clients who prefer to keep their deposits in foreign currencies. There are four categories of banks oriented towards different markets and clientele operating in Tanzania: local private banks, regional banks, international banks and multinational banks. Overall, the outlook for the banking industry in Tanzania is very positive and there are appealing opportunities for new comers to the sector. Currently, there is a positive trend in lending to SMEs that is producing greater confidence in their growth potential among financial institutions and, more generally, in the economy as well, which is generating a positive spiral.

Increasing Quality of Human Capital

Human capital is the stock of knowledge, habits, social and personality attributes including creativity embodied in the ability to perform labour so as to produce economic value. Human capital refers to the knowledge, skills, attitude, physical and managerial effort required to manipulate capital, technology and land among other things to produce goods and services for human consumption. For human resource to develop there should be investment in health services and facilities, on job training, formally organised education at elementary, secondary and higher levels, and migration of individuals to adjust to changing job opportunities development. Government efforts to increase quality of human capital plays a major role in increasing the NI and GNP as it leads to increase in per capita income, savings, investment hence development.

Improvement of Institutional Infrastructures

The government also plays a big role in GNP and NI through improving the institutional infrastructures such as higher learning institution as well as health centres and hospitals. The government invests much in higher learning institutions since education is an economic good as it is not easily obtainable and thus needs to be apportioned. Also, economists regard education as both a consumer and capital good; it is being regarded as an engine of growth and key to development in every society based on its quality. Government invests in education, on the job training and work experience of the labour force which yield income and other benefit over a long time such investments provide returns to the individual as well as country hence improve the living standards of the people, increase level of employment and increase GNP and NI. Government investment in the health sector leads to improvements of the living standards of the people, decrease in mortality rates and increase level of production as majority of the people will be healthy and involved in production leading to higher GNP and NI.

Promote and Maintain Production Standard of Goods and Services

The government influences the GNP and NI through promoting and maintaining production standards of goods and services. For instance in Tanzania, agents such as Tanzania Bureau of Standards (TBS), Tanzania Food and Drugs Authority (TFDA) are used by the government to ensure that only quality and standard goods are traded within the country hence promoting high standards of living for its citizens. This may also ensure quality goods are exported hence increase in net export.

Improve Physical Infrastructures of the Country

The government plays a great role in promoting the growth of GNP and NI through constructions of physical structures such as roads, railways and buildings. These infrastructures are very essential in promoting economic development as they enable easy accessibility of different areas of the country hence promote trade, communication and attract foreign investment within the country hence lead to growth in NI and GNP.

Promote Investment

The government should ensure that there is favourable investment environment. In Tanzania for instance the Tanzania Investment Centre (TIC), Zanzibar Investment Promotion Agency (ZIPA), and Export Processing Zone Authority (EPZA) are involved in promoting the business environment in Tanzania. They provide both tax and non-tax incentives with an objective of increasing investment in the priority sector of manufacturing, agriculture, trade, tourism, mining and forestry. The ultimate goal is increase investments which in turn provide employment and increase country exports and thus GNP and NI.

Government Tools for Promoting GNP and NI

There are several tools that are used by governments in promoting and maintaining Gross National Product and National Income of a country. They include following:

Monetary Policy

This is the process by which the monetary authority of a country controls the supply of money, often targeting an inflation rate or interest rate to ensure price stability. Of all the instruments in the government, monetary policy is by far the most powerful. Unfortunately, it is also the most imprecise. The government can do some fine control with tax policy to move capital between investments by granting favourable tax status. On the whole, governments tend to go for large, sweeping changes by altering the monetary landscape.

Goals of the monetary policies include promoting economic growth and stability, increase level of employment and maintain favourable exchange rates with other countries. The government control money through expansionary or contraction monetary policies whereby expansionary policy is used during recession and to reduce unemployment to increase money supply within economy while contraction monetary policy is used during inflation. Hence, through monetary policies the government influences the GNP and NI of the country.

Currency Inflation Control

Governments are the only entities that can legally print their respective currencies. Sometimes the government tends to inflate its currency since it provides a short-term economic boost as companies charge more for their products leading to higher profits hence growth and expansion of companies, increase employment, increase per capita income and high living standards. It also reduces the value of the government bonds issued in the inflated currency and owned by investors. This tends to influence the GNP and NI of the country.

Fiscal Policy and Interest Rate

Interest rates are another popular weapon even though they are often used to counteract inflation. This is because they can spur the economy separately from inflation. Dropping interest rates via the central bank as opposed to raising them encourages companies and individuals to borrow more and buy more. Unfortunately, this leads to asset bubbles where, unlike the gradual erosion of inflation, huge amounts of capital are destroyed.

Bailouts

Bailouts can skew the market by changing the rules to allow poorly run companies to survive. Often, these bailouts can hurt shareholders of the rescued company and/or the company's lenders. In normal market conditions, these firms would go out of business and see their assets sold to more efficient firms in order to pay creditors and - if possible - shareholders. Fortunately, the government only uses its ability to protect the most systemically important industries like banks, commercial crops producers, and insurers.

The Importance of NIA Data in Policy and Development Analysis

The development of NIA statistics provide the potential for converting economic policy making from a rule-of-thumb-based guessing game to a quantitatively based science. Policy remains, in part, a normative decision process, and rival politicians, as advocate of conflicting policy agendas, frequently assess the economy's performance differently and argue for divergent policies, even when citing the same NIA data. People's disagreements often are based on the distribution of income as opposed to its average level. Nevertheless, quantitative assessments of the economy and its growth bring discipline to the discussion. The importance of accurate and accessible NIA implies that all economic processes are manageable.

Limitation of National Income Accounts (NIA)

Per capita GDP is frequently used as a measure of welfare, both for indicating the rate of improvement over time and for comparisons across nations. Yet per capita GDP is an imperfect indicator of welfare of the representative individual. GDP does not account for nonmarket production in the household—for example, meal preparation, cleaning, laundry, and childcare. Therefore, when these activities are, because of greater labor force participation, shifted to the market—as restaurant

meals and semi-prepared foods in grocery stores, cleaning and laundry services, and day care—the change in the value of production is overstated due to the decline in nonmarket (household) production. Second, gray market and illegal activities—such as production and distribution of marijuana or gambling—can be significant sources of sustenance in economies but are not included. Third, in benign climates, clothing and heating are less costly, so comparing across countries (or across regions within the same large country) will distort the relative level of well-being. Fourth, government services, because not subject to a market test, will typically be worth less than they cost, even though cost is used as a measure of value. Fifth, per capita income—an average measure—can be a misleading image of the representative resident's well-being if the distribution of income is very unequal. A better measure is the median income level and, for many analytic purposes, the income level by quintiles of the income distribution; however, such distributional measures cannot be directly obtained from GDP data and population and require separate surveys.

Chapter Summary

This chapter has discussed methods of determining national income and the importance of national income statistics in public finance and national economic decisions. We summarise here few issues covered in this chapter:

- ❖ National Income is a total value of a country's final output of all new goods and services produced in one period.
- ❖ National Income Accounting is the set of rules and definitions for measuring economic activity in the aggregate economy that is in the economy as a whole. National income accounting is the way of measuring aggregate production.
- ❖ The purpose of National Income Accounting is to obtain some measure of the performance of the aggregate economy.
- ❖ GDP is output produced within a country's borders. Gross National Product (GNP) is the aggregate final output of citizens (Nationals) and businesses of an economy in one year. GNP is equal to GDP plus receipt of factor income from the rest of the world and subtracts payments of factor income to the rests of the world.
- ❖ There are three (3) methods of accounting for national income: Income Approach; Expenditure Approach, Output/ Value added approach. These methods are equivalent in that they yield similar results.
- ❖ The circular flow of income is a model of the economy in which the major exchanges are represented as flows of money, goods and services etc. between economic units.
- ❖ The flows of money and goods exchange in a closed circuit and correspond in value, but run in the opposite direction. The circular flow analysis is the basis of National Accounts and other macroeconomic variables.
- ❖ Basically there are four circular flow models namely two sector model, three sector model, four sector model and five sector model.
- ❖ The sectors in the circular flow models are the households, the firms/ businesses, banks/financial institutions, government, and international sector (Exports and imports)
- ❖ The major components in the circular flow models are: Taxation; consumptions and savings; investments and productions; employments; government spending; borrowing; exports and import payments.
- ❖ Governments can influence gross national product (GNP) and national income (NI) in a number of ways, which includes: Maintaining Political Stability and Good International Relations; Maintaining Favourable Balance of Payments; Promoting Favourable Balance of trade; Improvement in the Banking System; Increasing Quality of Human Capital; Improvement of Institutional Infrastructures; Promoting and Maintain Production Standard of Goods and Services; Improve Physical Infrastructures of the Country; Promote Investment.
- ❖ The major tools used by governments to influence the GDP include: Monetary policy, fiscal policy, and currency inflation control.
- ❖ The development of NIA statistics provide the potential for converting economic policy making from a rule-of-thumb-based guessing game to a quantitatively evidence based science and ultimately NIA helps in ensuring that economic processes are manageable.
- ❖ Per capita GDP is frequently used as a measure of welfare, both for indicating the rate of improvement over time and for comparisons across nations. However, per capita GDP is an imperfect indicator of welfare of the representative individual. GDP does not account for nonmarket production in the household.

End of Chapter Two Revision Questions

1. What do you understand by national income accounts?
2. To what extent are national income accounts important in economic decision making process?
3. Describe the methods for calculating national income and examine why the 3 methods are considered equivalent.
4. Explain what it means by circular flow of income.
5. In the circular flow of expenditure and income, why must the value of total production in an economy equal the value of total income?
6. Discuss the major components of the circular flow of income.
7. Describe the role of the government in promoting gross national income and national income.
8. Describe the tools used in promoting GNP and NI. To what extent are the tools effectively used in Tanzania?
9. Explain why imports are subtracted in the expenditure approach while calculating GDP.
10. National income accounting is a set of methods and principles used for measuring an economy's overall performance, focusing especially on the overall level of production of goods and services. Discuss why it is important to analyses the National Income Accounts of a country
11. Using the expenditure and the income approach calculate the gross domestic product from the following set of numbers and show that both methods leads to same figures (Figures in Tsh Million).

Item	Amount
Consumption	5,000,000
Investments	1,000,000
Depreciation	600,000
Profits	900,000
Exports	500,000
Compensation of employees	5,300,000
Government purchases	1,000,000
Direct taxes	800,000
Savings	1,100,000
Imports	700,000

12. Explain the concepts of leakages and injection from the circular flow of income.
13. If the Tanzania Bureau of Statistics added up the values of every good and service sold during the year, would the total be larger or smaller than GDP?
14. Describe the four major components of expenditures in GDP and write the equation used to represent the relationship between GDP and the four expenditure components.

15. What is the different between the value of a firm's final product and the value added by the firm to the final product?
16. For the total value of expenditures on final goods and services to equal the total value of income generated from producing those final goods and services, all the money that a business receives from the sale of its product must be paid out as income to the owners of the factors of production. How can a business make a profit if it pays out as income all the money it receives?
17. How does the value added of a business differ from the profits of a business?
18. Why is GDP an imperfect measure of economic well-being? What types of production does GDP not measure? Even if GDP included these types of production, why would it still be an imperfect measure of economic well-being?
19. Which of the following are likely to increase measured GDP, and which are likely to reduce it?
 - a. The traction of people attending universities increase.
 - b. There is a decrease in people eating at restaurants
 - c. Stricter tax enforcement cause fewer people to hide income.
20. Use the following data to answer the following questions (all figures in billions of Tshs)

Item	Amount
Government Purchase of goods and services	17,216
Exports	10,963
Receipts of factor income from the rest of the world)	3,827
Depreciation	9,908
Net fixed Investment	6,882
Imports	14,758
Inventory change	565
Corporate Income Taxes	2,652
Consumption Expenditures	67,394
Social security Contributions	7,027
Undistributed Corporate Profits	1,303
Government Transfers and interest payments	13,663
Personal Interest Payment	2,862
Personal Taxes	12,357
Indirect Business Taxes	6,646
Payments of factor income to the rest of the world.	

- a) What is the Gross Domestic Product?
- b) What is Gross National Product?
- c) What is Net Domestic Income?

CHAPTER THREE

MARKET ECONOMY AND GOVERNMENT INTERVENTION

Introduction

This chapter deals with the economic role of the government in allocating resources and goods and services under free market economy. The chapter covers aspects of public goods, quasi-public goods and private goods. The chapter also describes the various forms and characteristics of market structures, and the rationale for government intervention to alleviate the problems caused by failure of the free market economy to allocate resources and income among different sectors and within sectors of the economy.

Learning Outcomes

After completing this chapter readers should be able to:

- ❖ Describe the characteristics of public goods
- ❖ Describe the various forms of market organizations
- ❖ Describe what it means by market imperfections
- ❖ Explain the causes of market failures in an economy
- ❖ Describe the rationale for government intervention in any economy

Public Goods and Private Goods

Certain goods can be consumed on discriminatory manner due to the principle of exclusion of the market which make them priced product. Thus, those who cannot pay for the market price are prevented or excluded from consuming (i.e. these goods are divisible). On the other hand, there are goods which by their nature each individual has access to their consumption. Thus, the use of such goods does not reduce its availability to others (i.e. they are indivisible), e.g. security (defence) and order, street lighting etc.

Pure Public Goods

Public goods are indivisible goods whose benefits cannot be priced, and therefore, to which the principle of exclusion does not apply. On the other hand, *pure private goods* are completely divisible and to them the principle of exclusion applies in full measure.

Externalities

Pure public goods are characterised by the existence of externalities, that is, economic effects which flow from their production or use to other parties of economic units not initially intended. Such economic effects, also known as spill-over effects, neighbourhood effects or third party effect arise on account of interdependence of economic units via inputs or output relationships.

Marginal cost.

Marginal cost of pure public goods is zero or close to zero. Thus, additional member of the society can be benefited without appreciably adding to its total cost.

Average Cost

Pure public goods are characterised by decreasing costs due to economies of scale. Usually they are provided in large scale (to cover wide area or many people), hence less average costs of operating.

Public Goods and Government Intervention

The existence of pure public goods and quasi-public goods creates need for government intervention. The rationale for government intervention in providing these goods is discussed below:

Provision of pure Public goods

Public sector should be entrusted with this job because if left in the hands of the private sector, the system is likely to suffer from inefficiency. The market mechanism can supply only a priced good and users of public goods cannot be forced to *reveal* their demand preferences.

Provision of Quasi Public Goods

Role of government should be limited to providing those quasi -public goods which are more public. Those which are predominantly private should be left to the private sector and market mechanism. One example of such goods is infrastructure. Infrastructure (roads, electricity power stations, railways) should be provided by government on the argument that such facilities are commercially-non viable and require huge resources beyond the capacity of private sector.

Merit Goods

Due to overriding importance, provision of merit goods such as education and health services helps the economy in attaining a high level of efficiency and contributes to achieving of basic objectives of the government. The government should take a leading role of providing such services or goods or facilitating the provision of such services. Thus, they should not be left to market mechanism of the private sector. Alternatively to increase efficiency, the state may encourage greater production and consumption of a merit good through *state provision, regulation, and subsidies*.

Free-riders

Free-riders are actors who take more than their fair share of the benefits or do not shoulder their fair share of the costs of their use of resources, involvement in a project, or economic activity. The free rider problem arises when attempting to prevent it from taking place, or at least limit its effects. Suppliers are faced with a problem of *free riders*. This means actors or participants in the market cannot easily reveal their preferences because they cannot be excluded from the consumption by other people due to joint-ness in consumption (regardless of whether one pays or not).

Addressing the problem of free-riders

There are several ways of addressing the free-rider problem. This includes government provision of goods and services which have a free-rider problem. The government can make this provision involuntary and finance (through taxation) for the production of such public goods. The other way of addressing free-rider problem is through subsidies. The government may subsidize production of a public good in the private sector. Unlike government provision, subsidies may result in some of competitive market.

Market Economy and its Failures

The market economy, when certain conditions are met, serves to secure an efficient use of resources in providing private goods. Consumers must bid for what they wish to buy and must reveal their preferences to producers. In trying to maximize their profit, producers will produce what consumers want to buy and will do so at least cost. Market may be subjected to imperfect competition, production may be subject to decreasing costs, and consumers may lack sufficient information. For this reason, the market mechanism is not ideal as a mean of providing private goods as it might be. Before discussing the nature of market failure and the need for government intervention in the market economy let identify the various market organisations under the free market economy.

Market Organisations

Market organisations are ways through which product or services market operates. That is, the way buyers and sellers or market participants interact in free market economy. Markets are in two models depending on firm behaviour and market structures.

Perfect Competition market Model

Perfect or pure competition market exists where demand for the product of individual firm is markedly elastic. Assumptions of perfect competition market include: large number of buyers and sellers; seller (producer firm) is a price taker; freedom of entry and exit; perfect knowledge; homogeneous commodity (or closely so/similar); free mobility of resources.

Imperfect Competition Market Model

Imperfect competitions markets are composed of two major market structures, namely pure monopolies and the oligopolies. Under the pure monopoly the market is characterised by having a single supplier of the goods and services while under the oligopoly market there are two or very limited number of buyers or sellers of a particular product or service. In some circumstances the market may be composed of a single buyer of goods and services. Under each of the above market structures the prices and quantity supplied and demanded are generally dependent on the decision of the monopoly.

The concept, nature and causes of market failures

Market failures (imperfections) are situations which disable markets to work smoothly in the economy. These are market problems which disable market to work smoothly in the economy as a tool of allocating resources and satisfaction of people's needs. Markets fail to work smoothly due to inconformity of public goods features and markets principles requirements. Also, markets fail to work as planning mechanism. Sometimes the nature of goods and services required by people in different societies make the markets mechanism inefficient and in effective.

These are market problems which disable market to work smoothly in the economy as a tool of allocating resources and satisfaction of people's needs.

Markets fail to work smoothly due to characteristics of public goods which make them unsuitable to the market principles requirements. Elsewhere, market has failed to work as planning mechanism. In a nutshell, free market tends to operate inefficiently due to:

- ❖ Existence of public goods and absence of law of constant returns
- ❖ Existence of monopoly

- ❖ Future uncertainties
- ❖ Incomplete information (both technical and economic)
- ❖ Deliberate attempts by sellers to influence demand forces through selling techniques

Markets as Planning Mechanism and the Role of Government

Normally the market mechanism as planning tool in an economy may lead to the following failures:

❖ Monopolies

- ❖ Situation where there exists only one seller in the market
- ❖ Monopoly is not an effective tool of public policy
- ❖ Monopoly raises prices by restricting output
- ❖ This behaviour provides reason for government expenditure (state intervention) for anti-trust activity (Antitrust Policy)
- ❖ Antitrust Policy, it is where public opinion is against any policy that appears to impinge upon the rights defined in the law (constitution).

- ❖ Wasteful competition among producers or suppliers of a particular good and service.
- ❖ Failure of free market as a device for vocational planning.
- ❖ Uncontrolled private enterprise may lead to location of investments which is incompatible with the public interest.
- ❖ Failure to accelerate desired rate of growth
 - Insufficiency of investment (private investment-PI) in free market
 - Hence, governments often involve themselves in expenditure designed to accelerate the rate of growth

❖ Stabilisation

- Market economy is prone to trade cycles, i.e. successive periods of inflation and unemployment
- Government provide machinery for smoothing out such cycles to avoid inflation and unemployment

Implications of Government Interventions

Much public expenditures, including recurrent expenditures can contribute positively to economic growth (Traditional Keynesian Macroeconomics theories). High levels of government consumptions are likely to increase employment, profitability, and investment multiplier on aggregate demand. Therefore, according to Keynesian macroeconomics, government spending raises aggregate demand, leading to increased output depending on the size and effectiveness of expenditure multipliers. However government interventions have negative implications. Higher taxes or further borrowing required to finance growing government expenditure inhibit growth. High taxes serve as disincentives for households to invest, take risk and find jobs. Borrowing can affect private investment, since government accesses funds that could otherwise have been invested in the private sector, thus crowding out private investment. A continuous expansion of government moves expenditure into less and less productive activities. Eventually, government becomes too large and carries out activities for which it is ill-suited.

Chapter Summary

This chapter has discussed the implications of market failure and the economic role of the government in allocating resources and goods and services under free market economy. Key issues in the chapter include the following:

- ❖ *Pure Public goods* are indivisible goods whose benefits cannot be priced, and therefore, to which the principle of exclusion does not apply. On the other hand, *pure private goods* are completely divisible and to them the principle of exclusion applies in full measure.
- ❖ Pure public goods are characterised by the existence of externalities, that is, economic effects which flow from their production or use to other parties of economic units not initially intended.
- ❖ Role of government should be limited to providing those quasi -public goods which are more public. Those which are predominantly private should be left to the private sector and market mechanism.
- ❖ Market organisations are ways through which product or services market operates. The way buyers and sellers or market participants interact in free market economy are referred to as market organisations.
- ❖ Market failures are market problems which disable market to work smoothly in the economy as a tool of allocating resources and satisfaction of people's needs. Markets fail to work smoothly due to characteristics of public goods which make them unsuitable to the market principles requirements.
- ❖ Market economy is prone to trade cycles, such as inflation and unemployment, thus some of the justifications for government intervention in an economy is to provide machinery for smoothing out such cycles to avoid inflation and unemployment.

End of Chapter Three Revision Questions

1. What does it mean by market imperfections?
2. What are the two major types of market structures? Explain the characteristics of each.
3. Why is the free market mechanism not necessarily a good planning tool in an economy?
4. What are social goods? Briefly discuss the theory of providing such goods
5. The market often fails, but the government often does not succeed in correcting the failures of the market. The recognition of the limitation of the government implies that the government should direct its focus only to those areas in which the market failures are most significant and where there is evidence that the government intervention can make a significant difference. Describe the different schools of thought and perspectives on the roles of the government in the economy.

CHAPTER FOUR

PUBLIC EXPENDITURE, BUDGETS, AND PUBLIC DEBT

Introduction

This chapter deals with public expenditure, public budget and public debt. The chapter examines theories of public expenditure and factors influencing the growth of government expenditure. In this chapter we also focus on the public debt, its growth and its implication to an economy and future generation. The chapter also deals with nature, and the process of preparing governments budgets in Tanzania.

Learning outcomes

After completing this chapter readers should be able to:

- ❖ Describe the theories of public expenditure
- ❖ Describe the factors determining the growth of public expenditure
- ❖ Describe the major classification of public expenditure
- ❖ Describe the principles of good government expenditure
- ❖ Describe what is a government budget
- ❖ Explain the types of government budgets
- ❖ Explain the role of fiscal policy in stabilizing the economy
- ❖ Explain the meaning of public debt
- ❖ Explain the factors giving rise to public debt
- ❖ Explain the benefits of public debt
- ❖ Explain the consequences of high public debt
- ❖ Describe the methods of repaying public debt

Public Expenditure

Public expenditure refers to the expenses which a government incurs for maintenance of government activities and operations, law and social order, security, defence, regulation of the economy, and in helping other countries.

Theories of Public Expenditure

There are two theories which explain the behaviour of government expenditure. These theories are the Wagner's Law of increasing state activities, and the Wiseman-Peacock Hypothesis.

The Wagner's law of increasing state activities

Adolph Wagner was an economist who existed in the nineteenth century. He analysed data on public sector expenditures of several European Countries and USA. He ultimately came out with a theory which later was known as Wagner's law of increasing state activities. According to this theory, there are *inherent tendencies* for the activities of different layers of a government such as central and local governments to increase expenditures both intensively and extensively. The following reasons support inherent long-term tendency of increasing public expenditure.

- ❖ Expansion in the traditional functions of the government
- ❖ Increase in coverage of the government activities (widening scope)
- ❖ The need to provide and expand the sphere of public goods
- ❖ Growing population
- ❖ Increasing urbanisation
- ❖ Prices tendency to go up
- ❖ The size and nature of public service necessitates an ever increasing specialisation
- ❖ Modern government considers it a part of its duty to protect the economy from the 'failures' of market mechanism.

Wiseman-Peacock Hypothesis

Peacock and Wiseman were British economists in early 1960s. They studied the time pattern of public spending in developed countries for several years. They developed a thesis which indicated that public expenditure does not increase in a smooth and continuous manner, but in jerks fashion. Using empirical data for the British economy after 1890, they observed that the relative growth of the British public sector has occurred on a step like rather than a continuous-growth basis. Thus, at times, social or other disturbance takes place, creating a need for increased public expenditure which the existing public revenue cannot meet.

Demand-Supply of government Services theory (Consumer theory)

Modern economists suggest that public expenditure is driven by demand for goods and services from the public and a response to what the society can supply. Thus, there is a growing demand for private goods which necessitates a corresponding demand for public goods as well e.g. demand for education.

Factors Influencing a Country's size of Government Expenditure

There are several factors which determine the changes in the size of government expenditure. These factors include the following:

- ❖ The concept of welfare state (a need to promote social welfare)
- ❖ Growth of population
- ❖ Rise in price level
- ❖ Economic development (changes) purposes
- ❖ Political role and other Diplomatic functions (spending by democratic institutions), e.g. salaries and other allowances to MPs
- ❖ Supporting the public organisations in order to make them exist.
- ❖ Security purpose (military) and order.

Kinds and classification of Public expenditure

There are two major ways of classifying public expenditures, namely accounting classification and economic classification. The two classifications are discussed below:

Accounting classification

Government expenditure can be classified with reference to the department for which expenditure is incurred (departmental expenditures – hospital department, education department etc) or according to nature of expenditure (heading: Stationery, Wages and Salaries, Water). Accounting classification enables the government to maintain effective control and check over public expenditure and possible leakages and wastage, diversion and appropriations. Such a classification is good for auditing and for safeguarding against misappropriations.

Criticisms of accounting classification

The accounting classifications do not help to understand the effects of different malpractices, e.g. effects of misappropriations. Hence, it is difficult to formulate appropriate expenditure policy. The distinction between obligatory (or legally committed) expenditure and optional expenditure can only highlight the constraints under which the government's budgetary policy has to work (but not full economic impact). Thus, it cannot bring out fully the possible effects of different expenditure policies

Economic classification

Public expenditure can be economically classified into three types; namely productive expenditure and unproductive expenditure; transfer and non-transfer expenditures, recurrent, and development expenditures. This classification is based on the effects of various government activities and policies formulated to support such activities.

Productive and Unproductive Expenditure

It emphasises that while some expenditures are in the nature of *consumption*, others are in the nature of *investment* and help economy in improving its productive capacity. Laissez-faire philosophy recognises that the only productive public expenditures are those which are incurred to create and maintain social overheads. Expenditures on administration, defence, justice, law and order, and the maintenance of the government/state are unproductive.

Criticisms of productive and unproductive classification

Basically the government is a part and parcel of the economy as a whole and must be considered as such. Hence, whether an asset is added to the ownership of the government or to that of private sector should not be the determining factor in deciding about the productiveness or otherwise of any public expenditure. There are many assets which do not yield income to the government, but which would be really necessary for the productive efficiency of the economy, e.g. Public parking, water works and similar goods and services. Such goods must be viewed as productive (although on normal commercial considerations they are not) expenditure.

Transfer and Non-transfer Expenditure

Transfer expenditure (or payment) is a payment without corresponding receipt of goods and services by the state (government), e.g. interest payments, old age pensions and unemployment benefits. *Non-transfer expenditure* is that by which the government pays for its purchase or use of goods and services, e.g. expenditure on defence, education and the like. These are considered as real expenditures or investment expenditure.

Recurrent and Development Expenditure

Types and classification of government expenditure can also be analysed and categorised on the basis of recurrent expenditure and development expenditure.

Recurrent expenditure

This is expenditure for maintaining day to day activities of the government and its institutions. It comprises consumption expenditure, wages, salaries, and subsidies.

Development expenditure

This is expenditure for maintaining investment activities for further maintenance of public activities. It includes direct government involvement in production and undertaking economic infrastructure. It covers expenditure on construction and acquisition of long term assets on water, power, transport, communications, hospitals, schools and others.

Security and Service Expenditure

Security expenditure is expenditure on police and security, arms and arms preparations, equipping for both internal and external security and aggressive reasons, maintenance of the police, arms and prisons. Services expenditure is expenditure on items such as social services like education, health and sanitation, economic infrastructures like roads, water, power, communication and others.

Canons of Government Expenditures

Canons of government expenditures are principles that govern the public expenditure decisions. They reflect the philosophy of a judicious use of public funds with associated legal propriety. They are either administrative or economical. The following are some of the canons of good government expenditure:

Canon of Economy

The resources of the economy are always scarce compared with its need; therefore, no wastage should be permitted.

Canon of Sanction

This principle says that no public funds should be used without proper authorisation and further that funds must be used only for the purpose for which they have been sanctioned.

Canon of Benefit

This is clearly related to the canon of economy. Thus, any expenditure is to be viewed against the benefits that will accrue from it.

Canon of Surplus

Government should try to be prudent and aim at meeting its current expenditure needs out of its current revenues. That is, government should avoid deficit budgeting, at least the persistent one. It should not over-spend and run into a debt.

Government Budgets

A budget is commonly understood as a forecast of expenditures that will have to be met in a given financial year and revenues to be raised to meet those expenditures. This result in the establishment of desirable totals for expenditures and revenues coupled with plans to ensure that the actual operations are kept within the prescribed limits. It also involves instant comparisons of actual revenues and expenditures against the budget throughout the period under review. To the government a budget is a statement of proposed expenditures and expected revenues for the coming fiscal year together with data of actual expenditures and revenues for the current and past years.

Attributes of a Good Budget

A good budget is one which is able to satisfy certain conditions, and is formulated according to certain well drawn principles. For example, such principles require that budgets should be accompanied by an account of the performance of the fiscal policies and programmes of the government during the previous year. This provides a necessary basis for deciding as to what was to be done, what has been accomplished and what more should be aimed at and in what directions. The budget proposal should also be accompanied by an analytical description of the current economic situation of the country and the position of the treasury.

Classification of Budgets

Government budgets are classified in a number of ways. These include economic, functional, and accounting classifications.

Economic classification

Economic classification is the classification of expenditure and the mode of its financing in terms of economic categories, e.g. expenditure on wages and salaries, receipts from borrowing, etc. This classification enables to gather a variety of economic information relating to generation of savings, investment, consumption, creation of financial assets and liabilities, etc from various budgetary items

Functional classification

Functional classification refers to the types of functions which the government performs or the services which it provides, such as, economic services, social services, defence services and the like.

Economic and Functional classification of budget vs Accounting (or Traditional approach) classification

Economic and functional classification of the budget can prove very helpful in arriving at various decisions for achieving different goals in the economy particularly, when authorities are actively engaged in regulating it in accelerating the process of its economic growth and imparting distributive justice. In traditional approach, accounts are classified into categories corresponding to individual ministries, departments and sections; and within each, there are further heads and sub-heads. Traditional approach towards budgetary accounting is *designed for an effective legislative control over the executive, and to meet the requirements of fiscal management*. Therefore, it is an excellent aid to government auditors and an effective check against misappropriation of funds and other fraudulent practices. However, the following shortcomings subject traditional approach to inefficiencies, and therefore, less preferred:

- ❖ There is a lack of correspondence between the purpose and the account head
- ❖ Does not provide information required for the formulation of fiscal policy
- ❖ Does not provide a basis for assessing the effect of alternative budgetary policies and operations and for devising improvements therein.

Due to these inefficiencies, a system of economic and functional classification of the budget on the one hand, and the introduction of programme and performance budgeting, on the other are very essential.

Types of Budget

There are three types of government budgets, namely balanced budget, deficit budget and surplus budget.

Balanced Budget

The budget is balanced if its *total* revenue equals its *total* expenditure, with some qualifications. Thus, by qualifications, borrowings (both long term and short term, internal and external) are *not* included in revenue. Similarly, to make the concept of balanced budget internally consistent, repayments of the loans should not be counted towards the current year's deficit, though interest payments on those loans should be so counted. In other words, we should look at the net change in the public debt rather than at the new borrowings.

Arguments for Balanced Budget

- ❖ Effective check upon any extravagance of authorities. Balanced budget is preferred especially due to the tendency of the governments to resort to wasteful unnecessary expenditure.
- ❖ Deficit budget adds to the currency and money supply in the country and thereby strengthens inflationary pressures. It is argued that tax effort by the authorities meets with some resistance by the taxpayers. Accordingly, this acts as a check on undue and wasteful expenditure proposals of the authorities.
- ❖ A government finds it much easier to extend its expenditure if it is to be financed through a deficit. Thus, people are willing to lend to the government if offered high enough rate of return on government loans. High interest cost may prevent a government from borrowing unnecessarily. But there is no such check if the deficit is financed through creation of currency. Moreover, since deficit budgets create inflationary pressures, the authorities find their expenditure mounting up.

Arguments against Balanced Budget

- ❖ The inflationary impact of a deficit budget does not depend upon only the presence or absence of deficit. It also depends on size of the deficit in relation to the overall size of the National Income and its Persistence.
- ❖ There can be situations in which a budgetary deficit would be only reflationary in character and would be only helping the economy in recovering from a depression.
- ❖ The change in the purchasing power of money depends upon demand for supply of goods and services by both the public and private sectors. A surplus or deficit budget may be partly or fully counter-balanced by the opposite behaviour of the private sector.
- ❖ These challenges are consistent with Keynes' argument that '*...an attempt to balance the budget results in its imbalance and vice versa*'

Deficit Budget

A deficit budget exists when government expenditure exceeds government revenue in a particular budget year. That is the government is expected to spend more on public goods and services than it is going to collect from its revenue sources. The deficit is normally financed through borrowings.

Arguments for deficit budget

Deficit budget helps the economy in fighting a depression. It can be used to raise the level of economic activities and income. Governments are encouraged to resort to deficit financing since direct saving capacity of the people is limited; therefore, the authorities find it easier to finance the deficit for purpose of financing the growth of public sector.

Criticisms of deficit budgeting

Theory of balanced budget multiplier shows that with appropriate qualifying conditions even a balanced budget can raise the level of economic activities and income provided the size of the budget is increased proportionately.

Ways of financing deficit budget

Government may borrow from the financial market to finance its budget deficit. It can borrow from internal sources or external sources. Internally the government can borrow from financial institutions such as banks, pension funds, insurance companies, or can borrow from households. This is normally achieved through issuing treasury bills or government bonds. This procedure is equivalent to transferring the resources straight from the private hands in to those of the government. The government can as well borrow from external sources. External sources include foreign loans from

other countries, International Financial Institutions (IFIs) such as the World Bank, African Development Bank, IMF, and many others. The government can also resort to printing money. This technique can be used for re-allocating of the economy's resources and thus accelerating the pace of economic growth; in other words, to control a depression.

Surplus Budget

A surplus budget exists when government revenues exceeds government expenditures in particular budget year. That is the government is expected to collect from various sources of revenues more than its expenditures on public goods and services. Surplus budgets are normally accompanied by creating savings or reserves. However, experience has shown that very few countries in the world have surplus budgets. This is due to the fact that public needs are generally in excess of resources available. In Tanzania deficit budgeting has persistent and there has been no instance of surplus budget in recent historical times.

Budgetary Policy and its Objectives

For whatever type of a budget a government chooses in a particular year, there are objectives which the government wishes to achieve. These include controlling inflation, stimulating demand and addressing recession among others. In this section the objectives of budget policy are discussed.

Budgetary policy and inflation

Taxes imposed by governments tend to reduce total demand. When stability in economy is sought, and where there is inflation, the government will be able to bring about a reduction in total demand. Higher taxes reduce disposable income and thus reducing inflation. Surplus budget could be an appropriate policy.

Budgetary policy and aggregate demand

Discretionary policy measures may be taken to affect the level of aggregate demand. The government may increase expenditure if demand is to increase. Alternatively, it can reduce tax rates which may give rise to increased demand. Such adjustments of expenditure and taxes may directly or indirectly affect the consumption and investment in the private sector

Budgetary policy and built in responses

Changes in the economic activities may also affect public expenditure and tax revenue. The level of expenditure under any given programme, say education, health, etc may vary with economic activity, most likely in the cases of employment benefits and welfare, more significantly revenue obtained from a given tax rate will either increase or decrease with changes in the levels of income.

Budgetary Process in Public sectors in Tanzania

The Tanzania budgetary process in public sectors' of Tanzania is implemented by several institutions (actors) and governed by several laws, guidelines, and circular issued from time to time by the government through the Ministry of Finance and Economic Planning.

Laws Governing the Budget Preparation in Tanzania

The budget process is governed by a number of laws which enforce the process regulate format, timing and procedure as well as the allocation of formal powers and rights in the budget process. These laws are:

- ❖ Constitution of the United Republic of Tanzania of 1997 (as amended). The constitutions of the United Republic of Tanzania provide that government budgets should be prepared on

annual basis. The president shall cause the budgets to be prepared by various institutions and organs and he shall approve the same after being discussed and passed by the parliament as a bill.

- ❖ Public Finance Act, 2001 (as amended in 2004). This provides procedures for budget preparation and requires government institutions to participate in the budget preparation. The act also provides for Accounting Officers (Ads) with the responsibility of approving spending of the government in accordance with the finance act. The act empowers the minister for finance to issue budget guidelines and the responsibility of supervising the budget process.
- ❖ The Local Government Finance Act, 1982 (as amended). The Act requires local government authorities to prepare budget in line with ministry of finance guidelines and circulars. It also provides authorised Accounting Officer to collect and spend government money in line with approved budgets.
- ❖ Finance Act: The finance act is an act which approves the collection and the use of government money in a particular year. After the budget has been approved by parliament for every financial year becomes a bill. This must be approved by the president to become a finance act. The finance act of every year provides for sources of revenues, means of collecting the revenues and procedures for government spending. No government money can be spent without the finance act.

Major Actors in the Tanzania Budgetary Process in Public Sectors

A number of individuals and public institutions are involved in the annual preparation and implementation of the Tanzania budgetary process in public sectors. The following are the major actors in the Tanzania budgetary process.

The Tanzania Revenue Authority

The Tanzania Revenue Authority (TRA) is the central body for the assessment and collection of tax revenue and administration of all tax laws. The authority provides advice on matters related with government revenue in Tanzania mainland and Zanzibar. The authority is normally involved in budgeting in the aspects of providing advisory services on tax policy reforms, accounting for government revenues, introduction and replacement of tax laws, revenue projections and other roles.

President and Cabinet

The Cabinet through the Minister for Finance and Economic Affairs (MOFEA) is responsible for presenting the budget before the legislature for approval. The various cabinet ministers also present their respective sector budgets for their ministries, departments and agencies (MDAs) for debate and approval by the legislature. The Cabinet has the responsibility of defending the budget and ensuring that it is passed by the legislature.

Ministry of Finance

The Ministry of Finance and Economic Affairs (MOFEA) plays a central role in the budget process. MOFEA makes projections, sets ceilings for budget allocations, negotiates priorities with all departments, collects revenues, and disburses funds. The Ministry also plays an important controlling function through the Accountant General, who is responsible for ensuring that all financial transactions and reporting are done according to the proper regulations.

Budget Guidelines Committee

The Budget Guidelines Committee includes representatives from MOFEA, Public Service Management, and the Prime Minister's Office - Regional Administration and Local Government (PMO-RALG). This committee is responsible for developing the planning and budget Guidelines.

Donors

Given the sizeable contribution of foreign aid to Tanzania's budget, donors also have an impact on the way in which the budget is prepared and implemented. Donors (also called development partners or DPs) participate in consultations that inform budget formulation, disburse funds, and monitor public spending and expenditure systems.

Parliament

The main responsibilities of Parliament in relation to the budget process are: scrutinizing the budget through various standing committees; adopting or rejecting the budget in Parliament; monitoring the implementation of the budget and the performance of the MDAs; and overseeing the use of public funds. Although the Parliament can refuse to adopt the budget presented by the executive; the consequences of this step are profound including the possibility of the Presidential constitutional power to dissolve the Parliament as a procedure response.

Controller and Auditor General

The Controller and Auditor General (CAG) is the supreme audit institution in Tanzania. The CAG is responsible for, among other things, ensuring that the expenditure of public monies has been properly authorised and applied for the intended purposes. It should also ensure that economy, efficiency and effectiveness have been achieved in the use of public resources. The CAG has extensive powers to subpoena officials and to obtain information. The wilful obstruction of the work of the CAG, or failure by any public official to provide the CAG with access to any item of information, constitutes a criminal offence.

Private Sector

In addition to contributing the majority of domestic tax revenue, the private sector plays a consultative role in the budget process. Most notably, the private sector participates actively in an annual consultation on the revenue framework, which occurs before the budget is formulated each year. Their concerns are often taken on board when designing or revising tax policies.

Civil Society

Civil society plays a number of different roles in the budget process, though its formal role is limited to a consultative one. The formal role of civil society has been participation in the Public Expenditure Review (PER) and related processes. Informal roles include analysing public budgets, producing simplified and popular versions of the budget and related documents, playing a watchdog role, tracking expenditure at the local level, and advocating for improvements in terms of specific requests and overall transparency and accountability. Civil society's informal roles are arguably more useful particularly when combined with strategic use of media and citizen engagement.

Key Stages of the Tanzania Budgetary Process in Public Sectors

The budget process is a cyclical process that is on-going throughout the year. It is comprised of stages which feed into one another in a circular process. There are four main phases:

- ❖ Budget formulation (Planning how to spend the money)
- ❖ Debating and Approval of the Budget
- ❖ Budget Execution (Spending the money)
- ❖ Oversight

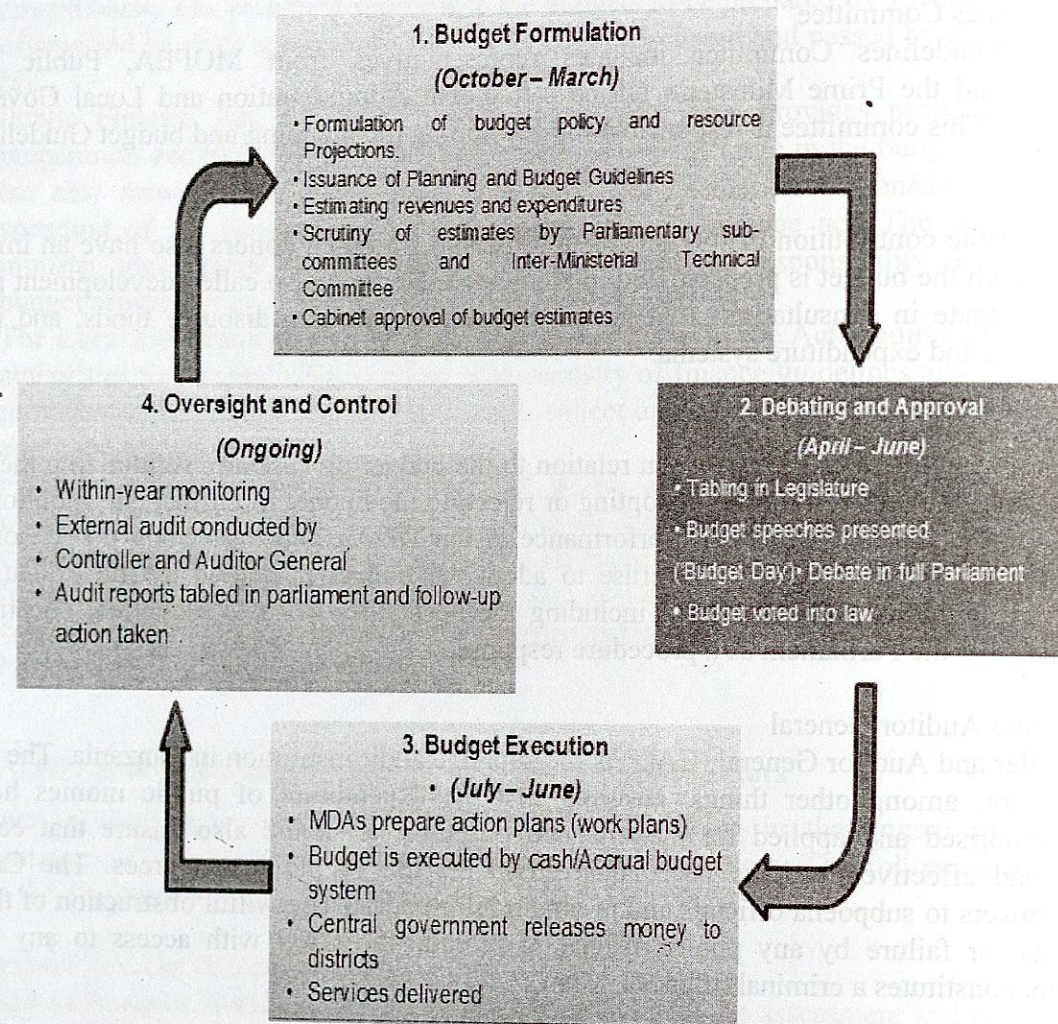


Figure 1: Key stages of budgetary process in Tanzania public sectors

- ❖ The various phases of the budget process overlap. At any given point in the year, there may be multiple phases of the budget process occurring. For instance, while the coming year's budget is being prepared, the current year's budget is being executed, and the previous year's budget is being scrutinized and audited. This means there are multiple opportunities for intervention at any point during the year.
- ❖ Budget Formulation (October – March)
- ❖ The budget formulation stage is when decisions are made about *planning to spend the money*. This stage may be thought of in terms of three phases:
 - Formulation of budget policy and resource projections
 - Issuance of planning and budget guidelines
 - Estimating revenues and expenditure by MDAs, Regions and LGAs

Budget Policy Formulation and Resource Projections

This involves forecasting the size of the economy and expected revenues, in order to determine the budget frame. Forecasting of tax revenues is carried out by the Ministry of Finance and Economic Affairs (MOFEA) in collaboration with the Tanzanian Revenue Authority (TRA).

The Budget Guidelines Committee conducts a macro-economic review by taking the previous performance on revenue collection and trend of expenditure and economic fluctuations resulting

from economic imbalances in order to get a base of formulating next year's budget. The review information comes from an appropriation account, statement of revenue, statement of vote account and statement of asset and liabilities.

The review report on previous performance of government budget will be submitted to the Economic Committee of the Cabinet (ECC) for the provisional approval. The ECC after approving the reviewed paper, instructs the Treasury to formulate estimate for revenue collections and expenditure for the next coming financial year.

Issuance of budget guidelines

After the ECC has scrutinised and approved the National Economic review, the Treasury initiates the process by issuing a Treasury circular (Estimate Invitation Circular- EIC) to all accounting officers authorised to collect revenue or spend public funds to prepare estimates of revenue collection and expenditure for the coming year.

The circular (EIC) so issued is the Treasury circular no. 1 gives guidelines on how to prepare these estimates. The EIC contain the following;

- ❖ The budget format
- ❖ The deadline for submission of estimates
- ❖ The document to be used

In this circular is given a limit known as the Treasury Ceiling beyond which an Accounting Officer should not exceed his estimates amount for his vote.

Estimating Revenues and Expenditure

On receipt of the Treasury Circular the Accounting Officer and Receiver of Revenue who thereafter submit it to their Sub-accounting officers, Warrant holders, Collector of Revenue, Sub- collectors of revenue and functional officers.

Estimates are prepared from the lower level upwards and consolidated into draft estimates at each level.

- ❖ Draft estimates prepared by functional officers are submitted to their Warrant holders where they are consolidated into District draft estimates.
- ❖ District draft estimates are submitted and consolidated into Regional/Ministerial/Department estimates
- ❖ The District development commission, District or Regional Development Committee approve development expenditure estimates in regions.
- ❖ Respective budget committee in districts, regions and ministries scrutinises recurrent expenditure budgets.
- ❖ Ministerial draft estimates are submitted to the Treasury directly where as regional draft estimates are submitted to the Treasury through Prime Minister's office.
- ❖ The budget Division of the Treasury consolidates all draft estimates received from regions, Ministries and departments into Territorial Draft Estimates

Debating and Approval of the Budget (April – June)

The authorisation of estimates, in this case refers to provision of an authority by Parliament to allow the government collect its revenue from approved sources and spend the money in the execution of government activities.

The Treasury submits the Territorial Draft Estimates to the ECC for discussion and approval. The Territorial Draft Estimates is again submitted to the Finance and Economic Committee (FEC) of the National Assembly by the finance minister for another discussion and approval.

Finally the details of the entire estimates are printed into volumes of estimate book.

- ❖ Volume I: Revenue collection estimates
- ❖ Volume II: Recurrent expenditure
- ❖ Volume III: Statutory expenditure
- ❖ Volume IV: Development expenditure

After deliberation on the estimates by the Finance and Economic Committee, the estimates are drafted into parliamentary bill (i.e. Appropriation bill and Finance bill) by the Parliamentary draftsman for discussion and approval. The approved bill will be presented to the National Assembly by the minister of finance for discussion and if approval is given then the budget is authorised by the National Assembly and forwarded to the president of the United Republic of Tanzania for his assent and hence become Finance and Appropriation Act.

Budget execution (July – June)

The execution of the parliamentary Act starts with the release of voted funds to Accounting officers and other spending agencies. In Tanzania budget execution (spending the money) begins each year on 1 July and ends on 30 June of the following year.

Following the approval of the national budget by Parliament, MDAs are supposed to prepare detailed action plans, or work plans, which explain how they plan to implement their activities in the coming budget year. The action plan is supported by a procurement plan, which describes when procurement steps are expected to start and finish, and a monthly disbursement or cash flow plan, which describes when funding or disbursement of funds is required by the institution. Budget execution in Tanzania is based on a cash budget system.

Oversight and Control (On-going)

There are various ways in which budget execution is monitored, controlled and evaluated. These processes are critical for enhancing accountability. Budget monitoring is or should be a continuous process which starts immediately after approval of the budget by parliament and disbursement of funds to the implementing agencies by Ministry of Finance and Economic Affairs (MOFEA). These various ways for oversight and control are;

- ❖ Internal audit
- ❖ External audit
- ❖ Social audits

Internal Audits

Internal audits are carried out by internal audit departments within the implementing agencies and government units, departments, and institutions. Every government institution has an audit unit whose role is to review all financial and non-financial transactions with objectives of ascertaining, if such transactions conform to rules, regulations, policies and budget guidelines.

External Audit

The Accounting Officers of all MDAs must report to the Controller and Auditor General (CAG) within three months of the close of the financial year. Their reports must include an account of expenditure against appropriated amount, an indication of revenue collection, details of assets, and a statement of the MDAs performance in delivering its outputs (against the performance criteria listed in the Estimates of Revenue and Expenditure).

Medium Term Expenditure Framework (METF) in Tanzania

In Tanzania the Medium Term Expenditure Framework (MTEF) was reformed in 1998. The main objectives of the MTEF are:

- Improve macroeconomic balance, especially fiscal discipline
- Better inter- and intra-sector resource allocation
- Greater budgetary predictability for line ministries
- More efficient use of public monies
- Greater political accountability for public expenditure outcomes through more legitimate decision making processes
- Greater credibility of budgetary decision making (political restraint)

Strengths of the Tanzania Budgetary Process

The budgetary process in Tanzania has several features which makes it strong and reliable. These include the following features:

Flexibility: The budgetary process of Tanzania is flexible in the sense that the proposed estimates (Appropriation and Finance bill) submitted in the National Assembly can be adjusted. Once the budget is approved (Ambit of Vote) the Parliament may make further approval of Supplementary Appropriation.

Review process: The process of budget formulation begins with reviews and evaluation of previous budgets in order to establish different macro-economic policies, and priorities. This enables to measure the performance, weakness and strengths of the previous budgets which help in proper allocation of resources.

Accountability is ensured in the process of oversight and control: The constitution authorises the Controller and Auditor General (CAG) to assist Parliament in its oversight role over the budget and spending processes. The CAG determines and reports on whether the use of public funds by MDAs complies with the relevant laws and regulation. The Public Accounts Committee (PAC) and the Local Authorities Accounts Committee (LAAC) have responsibility for scrutinising and responding to audit reports by the CAG. The CAG has extensive powers to subpoena officials and to obtain information. The wilful obstruction of the work of the CAG, or failure by any public official to provide the CAG with access to any item of information, constitutes a criminal offence in terms of the Public Finance Act s.44 (1).

The budget process sets visions and missions of the nation as a whole: The budget formulation sets visions through the process of formulation of budget policy objectives, priorities and resource projections based on macroeconomic performance review. The macroeconomic targets considered in the budget are periodically reviewed and updated to reflect the impact of recent developments in the projected performance of the national economy and on the set fiscal programme for the year.

Weakness of the Tanzania budgetary process

The budgetary process in Tanzania is said to have several feature which can be deemed as major cause for its weaknesses. The features include:

Bureaucratic in nature: It undergoes a lot of processes before being approved or submitted to the parliament for debate. For the budget of Tanzania to reach the stage of being drafted it passes a lot of processes, it involves different actors from Village and Street (Mitaa) level to National level.

Time consuming: The whole process consumes much time as it involves several stages from formulation stage (October to March of the next year) to Debating and approval (April to June).

The process can be biased: In the process of drafting the budget, the views and opinions of the public are sometimes not taken into consideration from regional to national level. This is because government officers who are much involved on the whole process, they prepare budget with their own benefits thus making the budget biased and discriminatory on the part of the public.

Budgetary process does not support quick decision: Since the budget acts as the guideline for financial decision making, the process may result in delaying decision making while other issues are very sensitive and important which need quick decisions to be made.

The process is expensive: The budgeting process costs as much as 25% of the available development funding, by one estimate – and resources are not always available for it.

Fiscal Policy

Fiscal policy consists of steps and measures which the government takes, both on the revenue and expenditure sides of its budget. It involves adjustments in tax rates and types of taxes. Fiscal policy has several implications on economic growth, stability and distribution of income.

Fiscal Policy and Stability

Economic instability refers to the recurring of cyclical phases of upward and downward cumulative movement in income, employment, output, prices etc. To a greater extent fiscal policy can be effectively used by the government to neutralize the destabilizing forces through the following theoretical framework:

Fiscal Policy and Depression

Depression is caused by a *deficiency of effective demand*. Fiscal policy can be used to address the problem through/by increasing public expenditure; and encouraging private expenditure. Similarly, fiscal policy can be used during boom to control demand through: Restricting public expenditure and limiting/curbing private expenditures.

Fiscal Policy and Inflation

Inflation is caused by many factors including mismatch between production and consumption, thus resulting in high prices of goods and services. Fiscal policy measures can control inflation by its effects on disposable income. Fiscal policy measures leading to reduction of income on individuals and corporations reduces the pressure on available goods and services thus lowering the prices in the economy. Taxes do act to some extent as built-in stabilisers curbing expenditure and demand.

Limitations of the role of fiscal policy in underdeveloped countries and possible measures

Developing economies lack adequate flexibility and tend to develop pockets of inflationary pressures. Therefore, the government has to devise more specific measures of taxation and expenditure, coupled with additional selective credit control, to help the economy. In relation to foreign trade also, exports and imports are likely to suffer from low elasticity and, therefore, the use of customs duties and subsidies has to be supplemented with physical quotas, licences, and others.

Fiscal Policy and Economic growth

Budgetary flows form an important portion of the flow-of-funds of an economy. Hence, has a profound role in directing the working of economy. Each country would like to grow and prosper. For this reason, steady increase in national income and employment is very desirable. Therefore, stability of the economy is important in that it helps in achieving this objective because investment decisions are affected more favourably under conditions of stability. Note that an investor is

interested in not only the rate of return but also in safety and stability of the economy. With stability the consumption expenditure does not fall below a certain minimum level and forms a cushion (moderates) against economic contraction.

Conflicting role of fiscal policy measures

There is always a conflict between stability and growth. The conflict is clearer in the case of underdeveloped countries. In these countries, there is an express need to accelerate the process of capital accumulation for which, therefore, it is the capital goods sector and the social overheads which are to be given priority. Furthermore, capital goods industries are generally capital-intensive and generate proportionately lower employment. On the other hand, if labour-intensive industries are encouraged so as to create more employment, there will be an increase in consumption demand without a corresponding increase in capital formation and the result would be a deceleration of the growth rate.

Public Debt

Public debt refers to borrowings by governments to finance expenditures not covered by current tax revenues and other government revenues sources. It is the total of the nation's debts. It is the total financial obligations incurred by all governmental bodies of a nation, (i.e. the financial obligations of a central government and local governments). The state indicates how much public spending is financed by borrowing instead of tax collections. Public debt arises when a government borrows from either internal sources or from external sources to finance its deficit budget.

Factors Giving Rise to Public Debt

A government like any other economic unit collects revenue and spends it. Alongside, it is a fact that its revenue and expenditure flows may not match each other during any given time interval. There may be a sudden spurt in government expenditure. There may be wars, or natural calamities in which case the government would be forced to incur much larger expenditure and may run into a debt. Modern governments do not subscribe to the philosophy of avoiding a surplus or deficit budget for its own sake. Rather they are ready to use them as a matter of policy. This approach is sometimes referred to as that of functional finance in which the government is ready to have repeated surplus or deficit budgets for achieving a variety of objectives including those of economic growth and stabilisation. It is widely believed that the government of a developing economy should play an active role in the development of the economy. In this view, budgetary policy is an important and effective tool in accelerating the process of capital accumulation and economic growth. This may be done through borrowing and investing those funds in various projects.

Classification of Public Debt

Public debt can be classified according to the following categories:
Internal and external debt

Internal (Domestic debt)

Domestic debt is the amount of money raised by the Government, in local currency and from its own residents. Generally, domestic debt consists of two categories, which are Bank and Non-Bank borrowing.

External debt (Foreign debt)

The external loans are raised from foreign countries or international institutions. These loans are repayable in foreign currencies. External loans help to take up various developmental programs in developing and underdeveloped countries. These loans are usually voluntary. An external loan

involves, initially a transfer of resources from foreign countries to the domestic country, but when interest and principal amount are being repaid a transfer of resources takes place in the reverse direction.

Productive and Non-productive debt

Productive Debt

Public debt is said to be productive when it is raised for productive purposes. It is used to add to the productive capacity of the economy. If the borrowed money is invested in the construction of railways, irrigation projects, power generations or any other activity related to production we say it is a productive debt and provides a continuous flow of income to the government. The interest and principal amount is generally paid out of income earned by the government from these projects. Productive loans are self-liquidating, generally, such loans should be repaid within the lifetime of property, and such loans do not cause any net burden in the communality.

Unproductive debt

Unproductive debts are those which do not add to the productive capacity of the economy. Unproductive debts are not necessarily self-liquidating. The interest and the principal amount may have to be paid from other sources of revenue, generally from tax collection, and therefore, such debts are a burden to the community. For example, public debt used for war, famine relief, floods, earthquake and social services. However, such expenditures are not always bad because they may lead to improving well-being of the community. But such loans are net burden to the community since they are repaid generally through additional taxes.

Short, medium and long term debt

Short-Term debt

Short-term debt matures within duration of 3 to 9 months. For instance, in Tanzania, Treasury Bills of 91 days and 182 days are examples of short-term debts incurred to cover temporary shortages of funds. Interest rates are generally low on such loans.

Medium-Term debt

The Government may borrow funds for medium term needs. These funds can be used for development and non-development activities. The period of medium-term debt is normally for a period above one year and up to 5 years. One of the main forms of medium-term debt is by way of market loans.

Long-Term debt

Long-term debt has a maturity period of ten years or more. Generally, the rate of interest is high. Such loans are raised for developmental projects sometimes to meet other long-term needs of public authorities.

Rationale for the Growth of Public Debt in Tanzania

Factors which have contributed to the growth of the public debt in Tanzania are both internal and external in nature. These include:

- ❖ Oil price shocks, the continuous droughts, exposure to climatic and price risks, human, animal and crop disease are important causes of the growth of public debts and downward income mobility and poverty.
- ❖ Unfavorable terms of trade and an economic occurrence where more imports than their total export per capital are.

- ❖ The influx of refugees. The highest refugee concentrations are in some of the poorest countries in the world. A large number of such movements are into Least Developed Countries (LDCs). The presence of refugees compounds the already prevailing economic, environmental, social and, at times, political difficulties in these countries. Often such countries are confronted by a combination of all four of these factors.

Justification for Government Debt

The Government spends money to finance various activities include construction of infrastructure, defence of a national boundaries, provision of social services such as health, education, maintenance of security, payments of salaries for employees and other contingent events.

To meet these expenditures the Government needs to have financial resources (revenue). Essentially the Government would use its domestic revenue arising from tax and other sources. However, these resources may not be enough to meet these expenditures. Expenditures might be greater than revenue hence creating a gap known as deficit. To bridge this gap the Government is forced to borrow from either internal or external sources referring to as Budget Financing. Sometimes the Government may have balance of payments problems, whereby the country's exports are less compared to imports. The Government may borrow to solve this problem through balance of payment financing (BOP).

Generally speaking, the government too, like individuals, desires to live within its means and dislike to be under debt. But sometimes occasions arise when the government is forced to seek for loans. For instance, when there is a deficiency in aggregate demand and income, output and employment are falling rapidly, the state raises loans for investment expenditure and fills up the deflationary gap. If the state faces any calamity such as flood, earthquake, draught, etc., it cannot meet these emergencies out of the normal receipts. So, the state has to borrow funds. Other instances which necessitate the government to borrow are war for a short or for a long period, or there is internal disorder in the country leading to economic instability.

Impact of Public Debt to an Economy

The burden that arises from a large public debt is the need to impose large tax collection for payments of principal loans and interest. Normally, the tax payers should be prepared to pay high taxes to enable the government to repay its borrowings and sustain the current government expenditures. Future generations can be faced with the responsibility of paying the accumulated public debt, thus a possibility of paying high taxes in order to finance previous years' debts and current expenditure. This situation is possible when funds were not spent in long term investment activities to increase the earning potential of the economy. In some cases high public debt limits flexibility in future government budgets and sometimes failure to cope with emergencies and disasters.

External Debt and Economic Growth

When a country's debt level is expected to exceed the country's repayment ability with some probability in the future, expected debt service is likely to be an increasing function of the country's output level. Thus, some of the returns from investing in the domestic economy are effectively "taxed away" by existing foreign creditors; also investment by domestic and foreign investor is discouraged. A high level of external debt can also reduce a government's incentive to carry out structural and fiscal reforms, since any strengthening of the fiscal position could intensify pressures to repay foreign creditors. This creates tension on debt repayments. As the size of the public debt increases, there is growing uncertainty about actions and policies that the government will resort or

impose to in order to meet its debt servicing obligations, with adverse effects on investment such as on increased taxes.

High Debt Shocks

High debt shocks appear to affect growth through their dampening effects on both physical capital accumulation and total factor productivity growth. Doubling debt reduces both growth in per capita physical capital and growth in total factor productivity. Lower total external debt levels are associated with higher growth rates. Further, when distinguishing between public external debt and private external debt the negative relationship between total external debt and economic growth is driven by the incidence of public external debt levels.

Benefits of Public Debt in the Economy

Despite the fact that high debt have severe economic short, still public debt plays a significant role in economic growth of an economy. The following are some of the roles of public debt in an economy:

Promotes the growth of financial systems

Public debt is a key contributor to the growth of financial system of the economy. Economic activities result in corresponding financial transactions. Accordingly, financial requirements of the economy increase both absolutely and in relation to the national income. Financial assets may be divided in to 'inside money' and 'outside money'; therefore, existence of government debt becomes a precondition for the existence of developed financial system of the economy.

Promotes savings

Public debt encourages the saving effort of the economic units in an economy. A developing economy (country) is characterised by a shortage of capital resources. Since the saving capacity of the majority is low. The authorities have to take appropriate measures to step rates of saving and investment in the economy. If the public reduces its own consumption and lends its savings to the government, the result will be a net increase in the rate of savings. This may happen if people voluntarily save more under the temptation of an interest income. When the authorities borrow from the central bank of the country there will be addition to aggregate money supply in the country. This causes an addition to demand and an upward pressure on prices.

Controls inflation

Most governments' market borrowings only divert funds from the market into the hands of the government. As a result there is no net addition to aggregate demand and hence no increased pressure on prices. However, the validity of this advocate is questionable on the basis of the following basic facts: Even if public debt does not add to aggregate demand, it is bound to be inflationary because the economy's productive resources get diverted from the production of consumption goods into that of capital goods. Borrowings used for war activities, for meeting natural calamities and for other relief measures are most likely to be inflationary in their impact because they are basically consumption-oriented. When a government borrows from the central bank, there is an addition in money supply which in turn adds to demand and pushes up prices. Holding of public debt can also lead to an addition in demand and inflationary pressures, e.g. banks rate government securities as highly liquid which can be cashed at time without much of capital loss. This assured liquidity position, therefore, tempts them to increase their loans and advances and thus add to inflationary pressures in the market.

Methods of Debts Repayments

There are several ways through which the government can repay its debts. The main methods which are adopted to pay off or reduce the public debt are as follows:

Sinking Funds

Sinking Fund is very important method for the redemption of public debt. It is a fund which is created out of the general revenue for paying off the loans every year. The debtor country during the life of debt sets apart a portion of the current revenue every year. When the sum thus accumulated becomes equal to the loan raised, it pays off the entire debt in one instalment.

Terminable Annuities

If a debtor country wishes to repay a permanent debt, it may do so by fixing instalments over a period of years. These instalment repayments are known as *annuities*.

Utilisation of Surplus Budget

If during a particular year, the country has surplus budget, it can be utilised in reducing the burden of the debt. Surpluses can be used for redeeming the public debt, but favourable budgets are not common with the debtor countries. If at all there is any surplus any year; it is generally so small. It cannot make any significant reduction in the national debt.

Redemption by the Purchase of Government Stock

A Government can also lessen the burden of debt by the purchase of its own stocks in the market. These stocks can be brought by fresh borrowing at low rates or by the utilisation of surplus revenues.

Debt Conversion

Another important method for reducing the burden of the public debt is to convert a loan bearing a high rate of interest into another with a lower rate of interest. Debt conversion is not repayment; it is only the exchange of new debt for old one. If a government has contracted a loan when the rate of interest was high, it can reduce the annual interest payment by converting the old loan into a new loan.

Capital Levy

Another important method which has been suggested by economists for wiping off the public debt is the establishment of a special debt redemption levy. The government can introduce a special tax on accumulated wealth or capital of the people at a progressive rate and with the money thus raised pay off all the existing debts. The advocates of capital levy believe that it is not possible to reduce the burden of debt by means of a sinking fund or surplus revenues or by annuities.

Surplus Balance of Payments

A government can pay off debt by increasing exports and reducing imports. The surplus balance can be used to lessen the burden of debt.

Writing off loans

The government can also request the credited countries to write off loan. This means requesting for remission of the loan completely by the giving part.

Chapter Summary

This chapter has covered aspects of public expenditure structure policy, public budget and public debt. The chapter has examined theories of public expenditure and factors influencing the growth of government expenditure. The chapter can be summarised in the following key points:

- ❖ Public expenditures are expenses which a government incurs for maintenance of government activities and operations. Expenditure incurred on maintaining peace and order, security, defence, education, health and regulation of the economy are examples of government expenditure items.
- ❖ Public expenditure can be classified in two major ways, namely accounting classification and economic classification. Accounting classification makes reference to the department for which expenditure is incurred (departmental expenditures – Hospital department, education department etc) or according to nature of expenditure (Heading- Stationery, Wages and Salaries, Water). Economic classification of public expenditure categorises public expenditure into three types; namely productive expenditure and unproductive expenditure; transfer and non-transfer expenditures, recurrent, and development expenditures.
- ❖ Recurrent expenditure: This is expenditure for maintaining day to day activities of the government and its institutions. It comprises consumption expenditure, wages, salaries, and subsidies.
- ❖ Development expenditure: This is expenditure for maintaining investment activities for further maintenance of public activities. It includes direct government involvement in production and undertaking economic infrastructure. Expenditure on construction and acquisition of long term assets on water, power, transport, communications, hospitals, schools and others.
- ❖ Canons of Government Expenditures: Canons of government expenditures are principles or conditions that govern the public expenditure decisions. They reflect the philosophy of a judicious use of public funds with associated legal propriety.
- ❖ Cannons of government expenditure include: the canon of economy, surplus, sanction and benefit.
- ❖ Government budget is a forecast of expenditures that will have to be met in a given financial year and revenues to be raised to meet those expenditures. It is a statement of proposed expenditures and expected revenues for the coming fiscal year together with data of actual expenditures and revenues for the current and past years. Government budget leads to the establishment of desirable totals for expenditures and revenues coupled with plans to ensure that the actual operations are kept within the prescribed limits.
- ❖ Government budget is of three types, namely balanced budget, deficit budget and surplus budget.
- ❖ Balanced budget exists when expected government total revenue equals its *total* expenditure. In this context the government is neither expected to expand nor to decline.
- ❖ A deficit budget exists when government expenditure exceeds government revenue in a particular budget year. That is the government is expected to spend more on public goods and services than it is going to collect from its revenue sources. The deficit is normally financed through borrowings.
- ❖ A surplus budget exists when government revenues exceed government expenditures in particular budget year. That is the government is expected to collect from various sources of revenues more than its expenditures on public goods and services. Surplus budgets are normally accompanied by creating savings or reserves.
- ❖ The Tanzania budgetary process in public sectors of Tanzania is implemented by several institutions and governed by several laws, guidelines, and circulars issued from time to time by the government through the ministry of Finance and Economic Planning. Institutions involved in the budgetary process include: the president and the cabinet; Ministry of Finance

and economic planning; Tanzania Revenue Authority; Budget Guideline committee; Parliament; Controller and Auditor General; Ministries and departments; Regions and Local government Authorities; Prime Ministers' office, Civil societies and Private sector organisations.

- ❖ Public debt is the borrowings by governments to finance expenditures not covered by current tax revenues and other government revenue sources. It is the total of the nation's debts. It is the total financial obligations incurred by all governmental bodies of a nation.
- ❖ Public debt can be classified according to the following categories: Internal and external debt.
- ❖ *Internal (Domestic debt)*: Domestic debt is the amount of money raised by the Government, in local currency and from its own residents. Generally, domestic debt consists of two categories, which are Bank and Non-Bank borrowing.
- ❖ *External debt (Foreign debt)*: The external loans are raised from foreign countries or international institutions. These loans are repayable in foreign currencies. External loans help to take up various developmental programs in developing and underdeveloped countries.
- ❖ Public debt is said to be productive when it is raised for productive purposes. It is used to add to the productive capacity of the economy. If the borrowed money is invested in the construction of railways, irrigation projects, power generations or any other activity related to production we say it is a productive debt and provides a continuous flow of income to the government.
- ❖ Unproductive debts are those government debts which do not add to the productive capacity of the economy. The interest and the principal amount of debt may have to be paid from other sources of revenue, generally from tax collection, and therefore, such debts are a burden to the community.
- ❖ Public debt is a key contributor to the growth of physical infrastructure, savings and financial system of the economy.
- ❖ The burden of large public debt is the need to impose large tax collection for payments of principal loans and interest. Normally, the tax payers should be prepared to pay high taxes to enable the government to repay its borrowings and sustain the current government expenditures. Future generations have a possibility of paying high taxes in order to finance previous years' debts

End of Chapter Four Revision Questions

1. Briefly describe the following terms:
 - a) Public finance
 - b) Public debt
 - c) Fiscal policies
2. Mention and briefly explain any four appropriate fiscal measures that government may use to bring about stability in the economy.
3. What are the roles of Public finance in developing like that of Tanzania?
4. The market often fails, but the government often does not succeed in correcting the failures of the market. The recognition of the limitation of the government implies that the government should direct its focus only to those areas in which the market failures are most significant and where there is evidence that the government intervention can make a significant difference. Discuss the different schools of thought and perspectives on the roles of the government in the economy.
5. With examples in Tanzania context explain how changes in public debt affects inflation rates?
6. Explain how budgetary policies can affect the level of unemployment in a country.
7. With examples in Tanzania context explain the factors determining changes in government expenditures.
8. Describe four methods used by governments to finance a budget deficit. Briefly explain the cannons of government expenditures?
9. With examples give an account of the major sources of public funds in Tanzania and briefly explain the limitation of each.
10. Public Finance deals with public revenues, budgets, administration, approval and implementation. Discuss the extent to which this process is effective in Tanzania, and show areas (institutions) of weaknesses and strengths in the process.
11. Discuss what it means by public debt? To what extent is the Tanzania government managing its public debt?
12. Discuss the various methods through which governments can use to repay its debts.
13. Discuss the benefits and effects of high public debt to developing economies like Tanzania.

PART II: TAXATION THEORY, LAWS AND PRACTICES IN TANZANIA

Meaning of Taxation

Tax can be defined as a compulsory sum payable by an individual or a firm to the government for the use of its services. It is a financial burden imposed on the taxpayer by the government. The basic reason for taxation is the need for the government to raise funds to finance its activities. Taxation is connected with two problems: how to raise funds for the provision of public goods which a market economy cannot easily provide e.g. defence, law and order, etc. and how to allocate these funds to various public services.

Objectives of Taxation in an Economy

Taxes are levied on the foundation of how well they are consistent with the government's policy. The main objectives of taxation are:

- Redistribution of income and economic power
- Reduction in the consumption of demerit goods. Taxation is used as a means of consumption of harmful goods to ration and individuals e.g. high taxes on some countries etc.
- Compensatory fiscal policy - the instrument of marginal changes in favour of the economy to produce goods and services and the private and public sectors.
- To collect money to finance social goods and merit goods because some of the characteristics which make them desirable for market provision.
- To spend money on supporting the poor.

CHAPTER FIVE

THEORY OF TAXATION

Introduction

This chapter deals with the rationale and implication of imposing taxes in an economy. The chapter discusses the principles of good tax systems, the major classes of taxes, and the effects of taxation in any economy. The chapter provides basic facts which should be considered by tax policy makers whenever designing tax laws and policies.

Learning Outcomes

- ❖ After successful completing this chapter readers should be able to:
- ❖ Describe the meaning of tax
- ❖ Explain the objectives of imposing taxes in an economy
- ❖ Describe the major classification of taxes
- ❖ Differentiate between direct tax and indirect tax
- ❖ Describe the principles of a good tax system
- ❖ Explain the effects of taxes in an economy
- ❖ Principles of apportioning government burden
- ❖ Explain the incidence and impact of tax
- ❖ Explain the theories of tax shifting
- ❖ Describe the factors determining the taxable capacity of a country
- ❖ Explain the meaning of tax base, tax yield and tax rate

Meaning of Taxation

Tax can be defined as a *compulsory levy* payable by an economic unit to the government without any corresponding entitlement to receive a *definite benefit in goods or services*; in other words, without a direct *quid pro quo* from the government. The basic reason for taxation is the need to control private expenditure or to allow the government to use its scarce resources without causing inflation. Taxation is concerned with two problems: How to raise finance for the provision of *social goods and merit goods* which a market economy cannot easily provide, e.g. defence, law and order and stabilisation of the economy that is seeking to address price instability, poverty, unemployment, environmental issues and others.

Objectives of Taxation in an Economy

Taxes are chosen on the foundation of how well they are consistent with other objectives of government policies. The main objectives of taxation are:

- ❖ Redistribution of income and economic powers
- ❖ Reduction in the consumption of demerit goods. Taxation is used as tool for discouraging consumption of harmful goods to nation and individuals, e.g. high taxes on alcohols, tobacco, some cosmetics, etc
- ❖ Compensatory fiscal policy-the inducement of marginal changes in private consumption so as to maintain private consumption in order to maintain the balance between the ability of the economy to produce goods and services and the private and public demands of the goods and services.
- ❖ To collect money to finance social goods and merit goods because some of these goods have characteristics which make them less suitable for market provision
- ❖ To spend money on supporting the poor

- ❖ To take steps to correct certain failures of the market and to act successfully as a planning mechanism.
- ❖ To promote-economic growth
- ❖ To fight economic shocks-Through tax policies designed to smooth out market system shocks (inflation, unemployment etc)
- ❖ To bring favourable Balance of Payment (BoP)- through increased import duties, exemptions on exports, etc
- ❖ To manage investment trend and inducing consumption behaviour. Offering special tax incentives to special specific sectors (industries) and regions.
- ❖ To protect domestic industries and quality of products. This is normally achieved through high import duty and suspended duty to discourage importation of substandard goods.

Classification of Taxes

Taxes are classified into three major categories. Firstly, on the bases of legal incidence and economic incidence; secondly, is on the basis of the nature of tax levying (charging) method i.e. progressive, proportion, and regressive; and thirdly, taxes can be classified on the basis upon which tax is levied, i.e. Income, expenditure and wealth.

Classification of Tax based on incidence

Direct Taxes

Direct taxes are those taxes whose legal and economic incidences are on the same person. That is the person who is legally charged with tax is the same person who suffers the economic loss due to tax. With direct taxes there is no possibility of shifting the tax burden (economic loss) to other person(s). Individual or economic entities suffer directly on direct taxes such as PAYE, Corporation tax, property tax and others. Direct taxes are easy to collect and allow an element of income redistribution. There is consideration for the ability-to-pay. Direct taxes bring adequate social and economic justice. They can also be used to reduce income and wealth inequalities. However, direct taxes have some demerits. One of which is difficulties in measuring or estimating degree of progression needed due to difficulties in measuring ability to pay and the subjective nature of the marginal utility of income. Direct tax also fails in capturing employees/income from informal sector. Sometimes the cost of preventing evasion may be high and more burdensome.

Indirect taxes

Indirect taxes are taxes whose legal incidence and economic incidence are on two or more different persons depending on transferability of the tax economic loss or burden. The tax law can legally charge one person but the economic burden (incidence) of such tax is shifted to another person or can be shared by many persons in the consumption or production chain. Indirect taxes are taxes on consumption of goods and services, tax on consumer expenditure. Examples of indirect taxes are Value Added Tax-VAT, import duty, sales tax, and excise tax.

The *merits of indirect taxes include*: Convenience. Taxpayers pay in bits and generally during transactions of sales and purchases. Indirect taxes are usually hidden in the prices of goods and services; hence the pressure is not felt so much. Chances of tax evasion are less if there is proper administration (difficult or impossible to evade). Indirect taxes are a powerful tool in promoting the production and investment activities of the economy, i.e. they can guide the economy in its resource allocation. Indirect taxes rates are flexible and their coverage can be quite selective and can be

modified more readily to suit the occasion. One good example of the flexibility in indirect taxes are the customs duties

However, just like direct taxes, indirect taxes have some demerits. These include: Regressive in nature (violate ability to pay principle), and so unjust to the poor. Indirect tax feed inflationary forces. They take away a part of the purchasing power of the taxpayer and that has the effect of reducing demand and prices. On the other hand, indirect taxes begin with adding to the sale prices of the taxed goods without affecting the purchasing power in the first place. The result is that, inflationary forces are fed through higher prices, higher costs, and wages and again higher prices burden. Indirect taxes are charged on consumer expenditure, e.g. VAT. They are also charged on the activities of the entity.

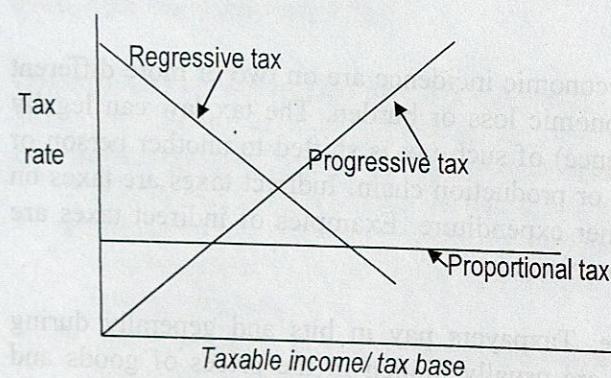
Classification of Tax Based on Charging Methods

Proportion Tax: Taxes are considered or classified as proportional if the average charge rate of tax remains constant regardless of changes in income or tax base. That is, there is a fixed percentage of income which is taken as tax. The Corporation tax in Tanzania is a good example of proportion tax, charged at the rate 30% on income.

Progressive Tax: It is a tax whose tax rate increases as income increases or as the tax base changes. This means that, the amount of tax to be paid increases more than proportionately with income. For instance, a tax payer with an income of Tsh. 200,000 can be charged at the rate of 20%, while a tax payer with an income of say Tsh. 500,000 is charged at the rate of 30%. A good example of progressive tax in Tanzania is the employment income tax known as Pay As You Earn (PAYE).

Regressive Tax: It is a tax with an average charge rate falls as income or tax base increases. For instance a taxpayer with an income of Tsh. 300,000 can suffer the tax burden on his income at the rate of 15% while a taxpayer with an income of Tsh. 600,000 suffers the amount at the rate of 7.5%. A good example is the excise tax on goods such as cement, salt, sugar, etc. Poor and rich pay the same amount of tax. The tax payable forms a declining proportion as income increases.

Figure 1: Graphical representation of proportion, progressive and regressive taxes.



Specific Tax: These are taxes whose rate is based on the tax base weight or size e.g. 200/= for every one tone of sugar. Items charged *specific rates* are for instance cigarette, wine, spirits, beer, and petroleum products.

Ad-valorem Tax: Tax based on value of the tax base e.g. 20% of the sales value. Taxes on international trade are good examples. Import duty, levied on *ad valorem rate* on the CIF value of goods imported, e.g. 0% on agricultural tractors, fertilizers, on raw materials imported, etc; 10% on semi-processed goods and 25% on final consumer goods. Excise duty, charged either on *specific* or *ad valorem* rate on importation of certain consumer goods., e.g. 10% on saloon cars, station wagons etc.

Classification of Tax According to Tax Base

Tax base means what is being taxed and what is not. Under this basis we have the following classes:

Income tax: taxed based on the amount of income earned or received by taxpayers at specific period of time e.g. corporate tax, PAYE for employee etc. Income base taxes are most popular taxes all over the world.

Wealth tax: taxed based on wealth accumulated by taxpayers. Examples are capital gain tax, property taxes, etc. Sometimes wealth taxes can be easily measured and administered, for example land rent taxes which are based on square meters. Also, wealth tax can be used to tackle tax avoidance in the tax system, for instance, if you buy shares in corporate entity you will only be taxed when you sell or receive dividends. On the other hand, some of wealth taxes are difficult to administer; issues such as inflation, valuation of properties without being sold for council taxes make the wealth tax complex to determine and administer.

Expenditure or Consumption tax: taxed based on taxpayers spending their income or wealth accumulated. For example, value added taxes and excise duties on purchase of alcohol and cigarette. Expenditure taxes, unlike income and wealth taxes relate to taxes on consumption from an economy. Thus, we do not have to worry about valuation of income in expenditure taxes; and since taxpayers are taxed only if they spend the income or Wealth, they are somehow encouraged to save.

Principles of Taxation

Principles or sometimes referred to as canons of taxation are attributes of good tax systems. These principles were suggested and developed by early economist including Adam Smith of United Kingdom (Wealth of Nations, 1776). This economist through research and intensive study of public finance and tax systems in developed economies found that in order for tax policies to be successful and receive general acceptance from general public and tax payers they need to conform to these attributes. However, it does not necessarily mean that a tax system or law or policy must conform to all of these principles, but great care must be taken so that a tax law meets a good number of these principles. These principles are as presented below:

The principle of equality

The meaning of this principle is *equality of sacrifice*. That is, amount of tax that needs to be paid is proportional to the respective ability of the taxpayer. The principle suggests adopting *progressive taxation* whereby people with higher income are required to pay higher rates of taxation and vice versa (*vertical equity*). Similarly, people with the same income should be taxed at equal rates (*horizontal equity*). Equality of persons should reasonably focus on relevance, neutrality, and progressiveness.

Tax differentiation must be based upon a relevant difference between the two taxpayers. A relevant difference is one which pertains to the relation of each of these taxpayers to the government and to the payment of taxes, e.g. difference in their annual income.

Justice in taxation can be achieved only if taxpayers are assured of impartial treatment, i.e. impartial between one person and another (similar treatment for similar persons). Impartiality might seem to require identical treatment for everyone, in the first place, but this would ignore many relevant differences in circumstances. Hence, it is unjust to treat taxpayers alike when their relevant circumstances are different, and it is likewise unjust to treat them differently when their circumstances are the same. For instance, corporate income tax is said to be un-neutral toward corporations as against partnership.

Profit against interest and distributed income against undistributed income
Progressive taxation is a measure that aims at equality of taxation, i.e. taxation that discriminate taxpayers according to quantity of taxpayers' income or wealth. It aims at equality of taxpayers after taxation. It is a rational discrimination in the public interest.

The Principle of Certainty

Certainty of tax refers to time of payment, manner of payment and amount payable. Therefore, taxes should be certain and not arbitrary; that is, clear and plain to the contributor and every other person. Otherwise, the taxpayer may be subject to expensive administration. Uncertainty in taxation may encourage corruption (and so the principle is regarded to be important).

According to Smith, taxes should be intelligible (comprehensible or understandable) to the taxpayer. This recognises the *principle of simplicity* as an important value. The tax base should be plain in terms of tax base, computation of tax liability, statutory due dates and sanctions associated with the tax.

The Principle of Convenience

Every tax has to be levied at the time or in the manner in which it will most likely be convenient for a taxpayer to pay it. The principle states that, "the time of payment and manner of payment should be convenient to the taxpayer." For example, it is convenient to pay taxes on income when one is getting his wage or income, and consumption taxes at the time of spending.

The Principle of Economy

Taxes should be economical, that is, not too expensive to collect and not unduly obstructive and discouraging to the taxpayer. Collection costs should not exceed the amount of tax collected. In other words, the administrative costs that are incurred in the exercise of collecting taxes should be minimum compared to revenue collected.

Revenue (maximum) Principle

Later writers added this principle to Smith's canons of taxation. It is based on the argument that, a perfect tax (that meets the above criteria) which does not bring in money has no financial usefulness. Taxes should therefore be adequate. That is, the best revenue source is the one which yields the most revenue. It is highly important that public revenues be sufficient to maintain essential governmental functions. Inadequate taxes may mean unbalanced budgets which in turn may be the cause of inflation. Therefore, according to this principle, the first question to ask about a new tax is 'how much will it yield.'

Canon of productivity

This is also known as canon of fiscal adequacy. The principle maintains that a tax system should be able to yield enough revenue for the treasury and the government should have no need to resort to deficit financing.

Canon of buoyancy

The tax revenue should have an inherent tendency to increase along with an increase in national income, even if the rates and coverage of taxes are not revised.

Canon of flexibility

It should be possible for the authorities without undue delay, to revise the tax structure, both with respect to its coverage and rates, to suit the changing requirements of the economy and of the treasury.

Canon of simplicity

Tax system should not be too complicated that makes it difficult to understand and administer thereby resulting to problems in interpretation and legal disputes.

Canon of diversity

It is risky for the State to depend upon too few source public revenue. Therefore, if the tax revenue comes from diversified sources, then any reduction in tax revenue on account of any one may be very small. However, too much multiplicity of taxes is to be avoided.

Principles of Distribution of the Tax Burden

Distribution of the tax burden is the process of allocating what the government spends on various goods and services to its beneficiaries. What the government spends must be paid for. It could be in form of taxes or user fees and charges. Some of the principles economists have thought about what can be used to distribute the government expenditure or burden are as described below.

The Principle of Benefits Received

It is the rule of paying for what one gets (as applied in commercial world). It is argued that this simple rule of paying for what one gets should be applied to the goods and services supplied by the government as well as to those supplied by the private sector. Supporters of this approach argue that if those who receive government benefits will pay for them, it would relieve government from extra burden. However, this principle is having some criticisms, one of which is measurement problem, i.e. how to measure benefit received. No definite measurement of benefits possible. Thus, it is difficult or there is no very clear way of accounting for the benefits from many government goods and services due to: Services are rendered for the benefit of all, and the particular interest of any taxpayer is not determinable. Many of the benefits of the government are indirect, e.g. public charity may directly benefit relieved clients but it may also indirectly benefit others. Benefits may be greater or less than the cost to the government. There is no clear consensus as to whether the rich receive more benefit from the government than the poor, or vice versa. The benefit concept is ambiguous and it encompasses several more or less distinguishable types, e.g. direct and separable benefit; the subjective benefit associated with the satisfaction of an individual's preference; the objective benefit that one enjoys along with others.

The Ability-to-Pay Principle

The ability to pay principle suggests that taxpayers should be charged taxes according to their economic ability to pay such taxes. Those with high income or wealth for instance should be charged more taxes than those with low income or wealth. This principle is considered more proper (natural and appropriate) in distributing governmental taxes. Criticisms of the ability to pay principle include measurement of ability to pay. Like benefits received, does not easily lend itself to measurement. No general agreement as to what should be the measuring rod; some advocate *property* or *wealth* as the proper criterion; others prefer *net income*; two or all three of these. *The problem with net income*

approach is the definition of net income. Others would like to qualify net income with allowances for dependents. Some would also differentiate between various sources of income and ascribe more ability to property income than to services income. Ability to pay does not give quantitative answers to the question "how fast ability advances as income advances."

Equal and Proportional Sacrifice

Under this principle, everyone would be required to make a contribution, but small contributions from the poor would be assumed to equal in sacrifice the large contributions from the rich. In other words, some levy would be approved on smaller incomes, up to the point perhaps where the sacrifice would equal that involved in levies on the larger incomes. The principal objection to all sacrifice theories is that the utility of income is either immeasurable or, as a practical matter, not amenable to any precision in measurement. It has been contended that sacrifice is a subjective matter and that it differs from individual to individual, even among those in the same economic circumstances.

Power of the individual approach

Emphasis is laid on one's capacity to bear responsibilities. Accordingly, one is expected to shoulder as much of the public burden as his capacity permits. This principle could be applied in a non-monetary economy, which, would call for direct service to the common goods and would expect more from the powerful man than from the decrepit. It also may be argued that receipt of income or the possession of wealth represents ability because it contains elements of privilege.

The Social Expediency Principle

This theory asserts that every tax proposed must pass the test of practicability. The key idea is that in distributing the tax burden pressure from economic, social and political groups must be taken into account. In most cases every group in an economy tries to protect its own interest and thus authorities are forced to reshape tax structure to accommodate these pressures. In addition administrative set ups must be efficient enough to allow collection of the tax at a reasonable costs and yielding adequate revenues. Different practicable taxes and different practicable rates have to be considered with reference to their possible effects on the working of the economy. However building a tax system solely on consideration of expediency may results in a number of weaknesses and drawbacks. Taxation provides a powerful set of policy tools to authorities and is effectively used as for remedying economic and social illness of societies such as income inequalities, regional disparities, unemployment, cyclical fluctuations and others.

Effects of Taxes in the Economy

It is assumed by economists that a competitive market economy with sufficient factor mobility would result in an *optimum allocation* of its productive resources. *Optimum allocation* is defined as the one in which the relevant marginal conditions are satisfied (marginal revenues should equal to marginal costs). A tax law may shift the existing resource allocation. Hence, there is the possibility of a sub-optimal allocation of resources between different industries. Allocative effects may be on income distribution, labour, or capital.

Allocative effects of indirect taxes on income distribution

Indirect taxes have some effects on distribution of income and wealth due to the fact that market mechanism itself generates ever-widening income inequalities. Indirect taxation is pro-inflationary and widens income and wealth inequalities in the economy. This in turns shifts demand relatively in favour of luxuries which, ordinarily, a less developed economy cannot afford. Therefore, indirect taxation of commodities should be highly selective with reference to coverage and rates.

Allocative effects of taxes on capital

The allocative effects of taxes on capital depend on the risk-ness of investment. A more risky investment is the one the return from which is subject to greater variations. A more risky venture should therefore carry a higher expected return to compensate for that extra risk. Therefore, an income tax that reduces the compensation for a risky venture may cause two effects: In terms of substitution effect, more risky ventures would become less acceptable to investors, and capital resources would be reallocated in favour of less risky ventures. The substitution effect is much stronger if income tax is progressive instead of proportional.

Effects of taxes on capital assets

Different capital assets do not yield income at the same rate and some assets have no yield at all. An annual tax on capital brings about a shift in the relative attractiveness of different capital assets. Capital resources would tend to move out of less attractive in to more attractive forms of investment. Another form of capital taxation is that of gift. That is when capital owner transfers its ownership during his lifetime without a payment; the transfer is subject to a tax which may be imposed on the giver with reference to the value of the gift or the paying capacity of the giver.

Effect of direct taxation on supply of labour

In progressive income tax, both average and marginal rates of tax increase with increasing income and the marginal rate rises faster than the average one. Thus, at a given wage rate, as a worker earns more, the after tax wage rate falls. Therefore, the substitution effect, among other things, depends upon the progression of income-tax and the wage rate. So, a greater progression and a higher wage rate would cause a greater reduction in labour supply. As in the case of direct taxes, indirect taxes also reduce the real income of the labour. Therefore, both taxes have the same effect on supply of labour provided that both taxes impose the same tax liability on each taxpayer.

The Incidence and Impact of Tax

When the government imposes tax there are two issues which arise, namely impact and incidence of tax. The impact and incidence are sometimes referred to as legal incidence and economic incidence respectively. Tax incidence and impact of tax are key concept to be considered when designing tax policy and tax laws. The acceptability of a tax will depend on who is going to legally pay tax (legal incidence) and who is finally going to be affected in terms of fall in income (economic incidence).

Impact of tax

Tax impact is the first point of contact with the taxpayers. It is sometimes referred to as the legal incidence of tax. The impact of tax is upon those who have the statutory responsibility of paying tax to the government collecting agent or authority. For instance, VAT in Tanzania is legally imposed on VAT registered traders. Thus the VAT registered trader bears the impact of VAT.

Incidence of a tax

Incidence of a tax, on the other hand, is defined as the tax's final resting place. It is sometimes referred to as economic incidence of tax. The incidence of tax is upon those economic units which finally bear the economic burden of it and which are not able to pass it to others. Incidence lies upon that final source from which the tax money comes. Tax incidence reflects the burden of tax, the decline in real income that is suffered as result of tax imposed. For instance, for VAT the incidence is on the buyer (consumer) of the product. For direct taxes the Incidence is on the income receiver (earner or recipient). Such person's income always is being reduced by the exact amount of tax, e.g. PAYE. In the case of indirect taxes, Incidence can be either on the buyer or the seller, or both

shared. For example, tax incidence on tax imposed on tobacco products is on the smoker and likewise for alcohol the tax incidence thereon is on the drinker.

Tax Shifting

A particular tax such as excise duty is likely to be borne by a large number of economic units. A single unit of tax excise duty collected on one unit of an item of production may be shifted and finally shared by a number of economic units. Tax shifting may pass several stages and the final incidence of a tax is scattered. The burden of a tax can be shifted, partially or fully. This is normally by means of *price variations*, e.g. prices may be raised in the sales transactions or may be lowered in purchase transactions. If sales transactions of a taxed good or service come to an end, then there is no possibility of shifting the incidence, and if the tax is on a commodity, service or/and item which ceases to exist (i.e. for final consumption/no further stages), then there would be no incidence of the tax upon anyone because the tax would not be collected in this case.

Forward and backward shifting

A tax may be shifted either through a sales transaction or through a purchase transaction by way of price variation. Forward shifting is affected through sales transactions (price variation). If a producer is asked to pay a tax, say an excise duty on his/her product; he/she may increase the sale price of the product. In this case, the producer is collecting a portion of the tax from his/her customer and is shifting a portion of tax burden forward. Backward shifting is effected through the vehicle of purchase transactions. This happens if producer reduces purchase prices of inputs. This may be facilitated by forcing (convincing by producer) suppliers of raw materials or other inputs to accept lower prices.

Theories of Tax Shifting

These are developed to address issues on who pays the tax in the final analysis. That is, on whom the final incidence of tax rests. The following are prominent approaches to the issue:

The Concentration Theory

This approach maintains that there is an inherent tendency for the taxes to be absorbed by certain income classes. According to *Physiocrats* and *Classical* economists, it is only those who are appropriating a 'surplus' who could bear the taxes in the economy. To this understanding, other classes (except peasants) are not producers of surplus since in their case the value of the final output is only equal to the value of inputs.

The Diffusion Theory

This theory states that 'if we believe in the interdependence of various economic units in the economy and if we believe that the wage rates are not setting at subsistence so that the surpluses exist throughout, then it follows that a tax imposed at one place could shift to other sectors of the economy'. It is also added that because of the constant interaction of sales/purchase transactions, eventually it becomes impossible to trace the final incidence of any tax and in reality all taxes get diffused in the economic system.

Demand and Supply Theory

This is the most accepted approach in explaining the incidence of a tax. Under this theory tax incidence can be shifted only through sales/purchase transactions and only through a revision of the prices. A price revision is possible and is determined by the relative values of demand and supply elasticity. A tax, can therefore, be shifted only through a shift in the demand and/or supply curves and the sharing of the incidence will be determined by the demand and supply elasticity. The general rule is that irrespective of whether the statutory liability of a tax (the impact of a tax) rests upon the

buyer or the seller, the share of the tax borne by the seller will be larger if the elasticity of demand is larger; and the share of the tax borne by the buyer will be larger if the elasticity of supply is larger. Actually, the tax burden will be shared between the buyer and the seller in the ratio of the elasticity of supply and demand.

Taxable Capacity

Taxable capacity is defined as the maximum amount, which citizens of a country can contribute towards the expenditure of the government without undergoing unbearable strain. It is the upper limit of squeezability. It is the maximum amount of taxation that can be raised and spent to produce the maximum economic welfare in the economy.

Factors affecting taxable capacity

The tax capacity of a country depends on the following factors:

- ❖ The population size and the rate of growth
- ❖ The size and growth of gross domestic product (GDP)
- ❖ Method of taxation: A well designed tax system would offer diversity.
- ❖ Income stability: If the income is uncertain and subject to fluctuations the taxable capacity would as well be affected.
- ❖ Political stability: A country that enjoys political stability provides conducive environment for its people to work (and also induce foreign investors) and contribute toward the GDP
- ❖ The level and structure of trade (openness of the economy-subsistence vs market economy).
- Inflation: Inflation tends to lower the purchasing power of the people. Therefore during inflation individuals will tend to spend more out of their incomes in order to remain at the same standard of living. This reduces the level of income available for other purposes, i.e. saving and investment. Consequently, inflation has adverse effect on taxable capacity.

Tax Base, Tax Yield and Tax Rate

Tax Base

Each tax has a base upon which it is levied. Tax base can be defined as an object whose existence or occurrence incepts the idea that tax should be imposed. It is the legal description of the object with reference to which the tax is payable. Thus, legal description of the object to which the tax applies such as net income of an individual, the value of the property, etc. For example, the base of income tax is income; the base of VAT is the production, distribution, consumption; the base of an excise duty is production, packing or processing of a specific good etc. For levying or charging purpose, taxes are classified as either *specific* or *ad valorem*. Specific taxes are levied basing on the volume (weight or size) of the tax base. *Ad valorem* taxes are levied on the value of the tax base. Thus, popular examples of tax bases include: income, sales, wealth, production, distribution, consumption, and people.

Tax yield

Tax yield is the amount of tax collectible from a tax system. It is the net amount of revenue collected after deducting collection costs. It is important that public revenues be sufficient to maintain essential governmental functions. Taxes should be adequate. That is, the best revenue source is the one which yields the most revenue. Inadequate taxes may mean unbalanced budgets which in turn may be the cause of inflation.

Tax Rate

Taxes have a rate or series of rates. Tax rate is the amount of tax usually expressed in percentage form, levied on per unit base. Thus the term is used to denote the amount of a tax per unit of the tax base. Tax rates may be *progressive, proportional, or regressive*.

Progressive tax structure

A progressive tax is one which takes an increasing proportion of income as income rises, i.e. proportion of income going to in tax rises with income. In other word, tax rate rises as the tax base increases.

Proportional tax system

It takes a constant proportion of income. Thus, tax rate remains unchanged for each unit of the tax base

Regressive tax system

This system takes a declining proportion of income as income rises, i.e tax rate diminishes as the base increases

De-regressive taxation

This is used to distinguish between certain forms of progressive rates. De-regressive progression occurs when there is a declining degree of progression as the tax base increases. Forms of de-regression are: Certain amount of tax base is exempted, and a single rate is applied to the rest. Where the rate schedule does not rise fast enough as the tax base increases, i.e. where the degree of progression is not constant throughout so that the addition to tax rate becomes slower as the tax base increases.

Arguments for and Against Progressive, and Proportional Tax Systems

Progressive tax considers ability-to-pay and the corresponding sacrifice which taxation involves. Benefits received principle does not necessarily imply a progressive tax rate especially when welfare activities of the government are considered. Specifically, supporters argue that it discourages wasteful consumption. The richer should be more heavily taxed to avoid misuse of the nation's productive resources, e.g. if not taxed heavily are likely to increase their consumption of luxuries. Source of equality; in the absence of progressive taxation the richer will become still richer and inequalities would increase. This may create ill-effects in terms of social and political unrest.

Proportional taxes on the other hand endanger the health and productivity of the economic units. Proportional taxes act as built-in stabiliser in modern free enterprise exchange economy. That is, the tax system acts as a moderator against an excessive upward or downward movement in income and prices, e.g. since the poor are taxed less heavily, and since the poor have a high marginal propensity to consume, it provides a firm base for a minimum effective demand in the country. As income increases, it is higher incomes which are taxed more, and during a depression, the higher income earners get large tax relief. Opponents of progressive taxation argue that economic progress cannot be ensured unless people work hard for it; and for hard work they must have adequate economic incentives.

Tax Policy

Tax policy is a government perspective on tax matters. Tax policies provide a guide on the structure of taxes and the economic activities of the Government. Tax policy seeks to ensure that taxes are working out in harmony with government objectives. Tax policy aims at promoting economic

growth; creating an investment friendly environment; and generating sufficient finances to fund government services.

Responsible tax policy formulation requires that tax policy be rational and have wider benefits in mind. Any indication of favoritisms in the tax policy and in the tax system undermines public confidence in government and generates resistance to the taxes imposed by government. On the other hand, where there is public confidence in the fairness of taxation the cooperation between the tax administration and the tax payers is enhanced and thus raising the level of voluntary tax compliance. It is very critical that taxes are fairly imposed and that the public must see that fairness exhibited both: in content of the tax laws and in the administration of the tax laws.

Features of Good Tax Policy

A good tax policy should have the following three features:

Amount to be collected by government

Ideally, the tax collected should be enough to meet public spending needs and contribute to fiscal stability, but not so big as to encourage the government itself to be wasteful or to appropriate money that could be better used in private hands.

Distributive effect of the tax burden among actual

A good tax policy should be fairly distributed among taxpayers. The tax burden should be fair. The potential advantage of using tax policy is to help achieve other public policy goals such as encouraging business to locate in certain regions (eg. poorer regions), invest in particular underserved sectors; or redistributing income or wealth from one group of citizens to another.

Minimization and control of the potential adverse economic costs of taxation

Both taxpayers and legislators would want to know about the efficiency of the tax administration. How much money that is raised is absorbed in the collection process? What are indirect costs of raising revenue?: taxing any activity almost inevitably discourages it. For example, taxing coffee exports may bias the whole economy in an inefficient way, against producing coffee for export. It is probably more efficient simply to spread the tax burden more widely.

Chapter Summary

This chapter has dealt with the rationale and implication of imposing taxes in an economy. The chapter has discussed the events or activities which give rise to imposition of taxes, principles of good tax systems, the major classes of taxes, and the effects of taxation in any economy. The key points presented in this chapter can be summarised as follows:

- ❖ Tax can be defined as a *compulsory charge* payable by an economic unit or citizens to the government without any corresponding entitlement to receive a *definite benefit in goods or services*.
- ❖ Government imposes taxes for any of the following objectives; Redistribution of income and economic powers; Reduction in the consumption of demerit goods. Means of collecting money to finance social goods and merit goods; promote-economic growth, to maintain economic stability (inflation, unemployment etc); bring favourable Balance of Payment (BoP); protect domestic industries and quality of products.
- ❖ Taxes are classified into three major categories; namely on the bases of legal incidence and economic incidence; on the basis of the nature of tax levying (charging) method i.e. progressive, proportion, and regressive; and on the base upon which tax is levied, i.e. Income, expenditure and wealth.
- ❖ Direct taxes are those taxes whose legal and economic incidences are on the same person. That is the person who is legally charged with tax is the same person who suffers the

economic loss due to tax. With direct taxes there is no possibility of shifting the tax burden (economic loss) to other person(s). Individual or economic entities suffer directly on direct taxes such as PAYE, Corporation tax, property tax and others.

- ❖ Indirect taxes are taxes whose legal incidence and economic incidence are on two or more different persons depending on transferability of the tax economic loss or burden. The tax law can legally charge one person but the economic burden (incidence) of such tax is shifted to another person or can be shared by many persons in the consumption or production chain. Indirect taxes are taxes on consumption of goods and services, tax on consumer expenditure. Examples of indirect taxes are Value Added Tax-VAT, import duty, sales tax, and excise tax.
- ❖ Principles of taxation are attributes of good tax systems. The well-known principles of taxes are principle of equality of sacrifice, principle of certainty; principle of convenience; principle of economy; principle of productivity; principle of flexibility; principle of simplicity and principle of diversity.
- ❖ When government impose taxes in an economy normally leads to several effects. These include shifting of the existing resource allocation pattern. There is the possibility of a sub-optimal allocation of resources between different industries. A locative effect may be on income distribution, labour, and investment on capital and capital assets.
- ❖ Tax impact is the first point of contact with the taxpayers. It is the people who bear the responsibility of paying tax to the authorities, i.e. those who have the statutory responsibility of paying tax to the government collecting agent or authority.
- ❖ Incidence of a tax is the tax's final resting place. It is those economic units which finally bear the economic burden of tax. Incidence lies upon that final source from which the tax money comes.
- ❖ Tax base can be defined as an object whose existence or occurrence incepts the idea that tax should be imposed. It is the legal description of the object with reference to which the tax is payable.
- ❖ Tax yield is the amount of tax collectible from a tax system. It is the net amount of revenue collected after deducting collection costs. It is important that public revenues be sufficient to maintain essential governmental functions.
- ❖ Tax policy is a government perspective on tax matters. Tax policies provide a guide on structure of taxes.
- ❖ Tax policy intends to promote the economic policies of the Government or to prevent them working out of harmony with government objectives. Taxation policy aims at: Promoting economic growth; creating an investment friendly environment; generating sufficient finances to fund government services

End of Chapter Five Revision Questions

1. Briefly explain the following concepts:
 - (a) Tax base
 - (b) Tax Capacity
 - (c) Tax structure
 - (d) Tax incidence
 - (e) Tax impact
2. Explain the Principles of an optimal tax system.
3. What are the main differences between direct and indirect taxes?
4. Explain how changes in tax rates or policy affect labour and investments in an economy.
5. 'However unpopular taxation may be, governments today are compelled to impose them'.

Required:

- i. Identify various reasons as to why the Tanzania Government is compelled to impose tax on its citizens
- ii. For each reason so identified explain:
 - The tax which is used to achieve the stated objective
 - How such a tax is expected to achieve the identified reason
6. Identify and discuss the arguments for and against indirect form of taxation
7. There is no need for the Government of Tanzania to raise revenue for the provision of goods or services for economic development through taxation. These activities should be left to the private sector, since the price mechanism is the best device in providing goods and services for development" Do you agree with the above statement? Give any four reasons to support your answer.
8. Elasticity of demand and supply is an important determinant of the effects of taxation in the economy. Discuss this statement.
9. Briefly explain the extent to which taxes can be used to counteract inflationary pressures.
10. Discuss the applicability of the theories of tax shifting in Tanzania.
11. Explain why different countries have different taxable capacities.

CHAPTER SIX

TAX ADMINISTRATION IN TANZANIA

Introduction

Tax administration in Tanzania is mainly vested under the Tanzania Revenue Authority (TRA) under the supervision of the ministry of finance and economic development. Tax administration is mainly concerned with implementation of tax laws on issues such as registration of tax payers under various tax laws, tax assessments, tax audit, enforcement of tax laws, offences, penalties, collection of taxes, accounting for taxes, and dispute resolution. This chapter deals with tax administration in Tanzania on issues such as taxpayer services, taxpayer identification number, tax assessments, tax audit and investigation, dispute resolution, tax payment and recovery, and tax refund and remission. Other matters on tax administration are non-compliance matters on tax laws. The major reference resource on tax administration matters is the Tax Administration Act of 2015.

Learning Outcomes

After completing this chapter readers should be able to:

- ❖ Explain the functions and roles of Tanzania Revenue Authority
- ❖ Describe the purpose of Taxpayer Identification Number
- ❖ Describe the various tax assessments administered by the TRA
- ❖ Describe the objective of tax audit and investigation
- ❖ Describe the procedures involved in tax dispute resolution
- ❖ Describe the manner and procedures for payment of tax to TRA
- ❖ Describe the procedures involved in processing tax refund
- ❖ Describe overdue tax recovery measures used by the Commissioner General
- ❖ Describe taxpayer modernization programmes of TRA and the expected benefits
- ❖ Describe tax avoidance and evasion practices in Tanzania

Establishment and Functions of Tanzania Revenue Authority (TRA)

The Tanzania Revenue Authority was formed by the Act of Parliament No. 11 of 1995, and started its operation on 1st July 1996. It was formed in order to bring the functions of the government revenue collection under one umbrella; imparting some degree of autonomy to the function with expectation of increasing revenue collections, improving voluntary compliance, minimizing collection costs, widening the tax base and controlling evasion and fraud. Under the establishing Act the authority is charged with the functions of: Assessing, collecting and accounting for all Central Government revenues and administering and give effective laws relating such revenues, monitoring, overseeing and co-coordinating administration of revenue laws of the central government in the jurisdiction of the URT, advising the government on matters related to fiscal policy, the implementation of the policy and tax compliance to the highest degree possible. Other functions of TRA include production of trade statistics and publications, improving the quality of services to the taxpayers and counteract fraud and other forms of tax evasion.

Prior to the establishment of TRA, tax administration was highly compartmentalized. Actors in the revenue administration for customs and exercise, income tax and sales tax were uncoordinated, each working independently and disjoint.

Organisation Structure of TRA

The Tanzania Revenue Authority is operationally organised in four revenue departments and seven support departments under the overseeing of the Commissioner General assisted by Deputy Commissioner General. The four revenue departments are Customs and Excise, Domestic Revenue, Large Tax payers and Tax investigation departments. The support departments are the Internal Audit, Taxpayer services and Education, Research and Policy, Board Secretariat and Legal services, Human Resources and Administration, Finance, Information and Communication Technology.

Domestic Revenue Department

This department is headed by Commissioner for domestic revenues. The department administers taxes and charges such as: Income tax for individuals and corporations, Value Added Taxes (VAT), Excise Duty on locally produced/manufactured goods, Motor vehicle registration and transfer tax, Skills and Development Levy (SDL), Driving License fees, Port Services Charges, Airport charges and Stamp Duty.

Customs and Excise Department

This department is headed by Commissioner for customs and Excise department. The department administers taxes and charges on international trade, which are import duty, Excise duty on imported goods and VAT on imports. Other responsibilities are to control prohibited and restricted goods or materials imported through borders, seaports and airports. It compiles Trade Statistics and facilitation of International trade. The main tax laws administered under this department are the East African Customs Management Act 2004, Value Added Tax 2014, Excise Management and Tariff Act and others.

Large Taxpayers Department

Large Taxpayers Department serves as one stop shop for large corporate taxpayers. Taxpayers under this department are those whose businesses are considered complex leading to complex tax affairs. Taxpayers registered under this department are companies whose aggregate payment of VAT, Income tax and Excise Duty exceeds Tsh. 400 million per annum or annual turnover of Tsh. 12 billion per annum.

Tax investigation Department

This department is charged with the responsibility of identifying cases of tax fraud and tax evasion, through investigations and recommending for criminal prosecution. The overall aim of the department is to improve compliance with tax laws as well as maintaining high level of professionalism in doing day-to-day activities to ensure that revenue targets are reached and surpassed.

Stakeholders of TRA

TRA stakeholder include: Taxpayers; Government Ministries, government departments and its agencies; Courts of laws; Tax consultants and clearing & Forwarding Agents, Tax Appeals Boards and Tribunal; Financial Institutions; Private Sector Institution (Organisation); Development Partners; Non-Governmental Organisation; and General Public.

Duties and Responsibilities of TRA

To administer tax laws through:

- ❖ Assessing tax liability of companies and individuals
- ❖ Collection of taxes
- ❖ Accounting of the tax revenues

To monitor, oversee and coordinate all tax administration activities to ensure:

- ❖ Fairness
- ❖ Efficiency and
- ❖ Effective tax management

To advise the government on tax laws and administration

To promote voluntary tax compliance

To take effective steps to counteract fraud and tax evasion

Obligations of the Tanzania Revenue Authority

In discharging its responsibilities of collecting government revenues, TRA observes a number of obligations to its taxpayers and other stakeholders:

- ❖ To issue correct tax assessment in accordance with tax laws
- ❖ To collect taxes according to the existing tax laws, regulations and procedures
- ❖ To provide high quality services to taxpayers and stakeholders
- ❖ To provide handle all inquiries from taxpayers and stakeholders so as to enable them discharge their obligations
- ❖ To handle all complaints from taxpayers and stakeholders with a view to providing solutions and enable TRA to improve services
- ❖ To educate taxpayers and stakeholders on their rights and obligations, issue tax form and provide timely and accurate information in simple languages
- ❖ To cooperate with Tax Appeal Board/Tribunal and court of laws by ensuring timely attendance and provision of evidence in order to resolve tax disputes.
- ❖ To provide professional training on tax matters to taxpayers and stakeholders.
- ❖ To provide advice to the government and other government organs on matters pertaining to fiscal policy and its implementation.

The Tanzania Revenue Authority is vested with the responsibility of administering and giving effects to all tax laws in Tanzania in accordance with the provisions of the Tanzania Revenue Authority Act Cap 399. The Commissioner General may delegate his functions to tax officers in relation to tax laws. In carrying out the functions and duties of TRA the TRA officers are issued identify cards which bears the logo of the Authority and a passport size photograph of the tax officer. The tax officers or authorised officers must wear and produce at all times the identity cards when executing their official duties.

Taxpayer Identification Number (TIN)

Procedures for obtaining Taxpayer Identification Number

Section 22 of the Tax Administration Act 2015 requires all people who are potentially liable to tax by reason of carrying on business or investment to apply for Taxpayer Identification Number within fourteen days from the date of commencing the business. The Commissioner General is also empowered to require any person to apply for a Tax Identification Number within the period he may determine. The application for Taxpayer Identification Number must be in the prescribed form, and must be supported with documentary evidences of the person's identity and filled in the prescribed manner.

The purposes of the Taxpayer Identification Number are to identify and recognise taxpayers on regular basis. Thus, it is supposed to be quoted by taxpayers in any claim, notice, return, statement or any other document submitted the TRA or used for purpose of a tax law.

Cancellation of the Taxpayer Identification Number

There are several circumstances which may cause the Taxpayer Identification Number to be cancelled. Section 25 of the TAA, 2015 stipulates the following circumstances:

- ❖ Where the bearer of the number is dead or, in the case of a body corporate, is wound up;
- ❖ A person described in Taxpayer Identification Number certificate is fictitious;
- ❖ The identity of a person holding the certificate is different from the identity of a person to whom the certificate was issued;
- ❖ The person to whom the Taxpayer Identification Number certificate was issued is a holder of another number;
- ❖ There is reasonable ground to warrant a cancellation of the Taxpayer Identification Number.

Official Communication between Taxpayers and Tanzania Revenue Authority

Part IV of the Tax Administration Act 2015 provide for official communications and documentation. This part of the act describes the languages to be used in official communication, the manner of the forms and notices to be issued both electronic and hard ones.

Official languages

The official language for the purposes of communicating tax matters between taxpayers and the Tanzania Revenue Authority are Kiswahili and English. All taxpayer therefore must prepare their returns and other relevant supporting documents in either Kiswahili or English. In the event a taxpayer has furnished information in a language other than Kiswahili or English the Commissioner General may in writing require the taxpayer to provide an official translation of the document.

Authorised TRA Documents

Any documents issued by the Commissioner General under a tax law is sufficiently authenticated if the name or title of the Commissioner General or of the authorised officer of the authority is printed, signed and stamped or in the case of electronic documents, imbedded in a document by way of electronic signature and a declaration made by a person under a tax law is sufficiently authentically dully signed by that person.

Documents Filed with Commissioner General

A paper document filed by a tax payer to the Commissioner General under any of the tax law is considered to have been filed and received when:

- ❖ Physically delivered to the office of the authority and received by an officer of TRA
- ❖ Sent by way of a registered post to an office of the authority, and ten days after posting
- ❖ Sent at any other place as the Commissioner General may specify.

Regular Information to the Commissioner General

Taxpayers are supposed to furnish information to the Commissioner General on regular basis. Such information is referred to as tax returns. Taxpayers must file returns as provide for under the various tax laws. That is different tax laws provide the manner and timing of the returns to be furnished to the Commissioner General. However, all returns to the Commissioner General must be prepared and submitted with due regard to the following issues:

- ❖ The tax return filled by an individual must declare that the return is complete and accurate and signed by a person who made it.

- ❖ The tax return must be signed by a manager and a certified public accountant in public practice of the entity in case of an income return and must declare that the return is complete and accurate and ;
- ❖ Signed by a person who prepared the tax return or an attachment to a tax return on behalf of another person;
- ❖ Where a person who prepared the return or an attachment to the return is not satisfied with the information contained in the document relevant for the preparation of the return or attachment, the person should furnish that other person with a statement in writing stating the reason for his dissatisfaction and proceed to sign the return noting that the signature is subject to such statement.

Tax Audit and Investigation

The Tax Administration Act 2015 under section 45 provides for tax audit and investigation. This section empowers the Commissioner General to carry out tax audit or investigation to any tax payer on tax affairs for any year of income or any information as he finds appropriate. The following are some of issues subject to audit or investigation by the Commissioner General:

- ❖ A person's history of compliance or non-compliance with any tax law;
- ❖ The amount of tax payable by the taxpayer;
- ❖ The class of business or other activity conducted by the taxpayer;
- ❖ Any other matter that the Commissioner General considers relevant for ensuring that collection of tax is due.

The TAA, 2015 further empowers the Commissioner General to audit or investigate the taxpayer from time to time even on matters that audit or investigation was carried out in previous periods. Similarly tax audit or investigation can be carried out for purposes of more than one tax law.

Tax assessment

Assessment is defined under the Tax Administration Act to mean a determination of the amount of tax liability made under a tax law by the Commissioner General or by way of self-assessment. There are three types of assessment under the TAA, 2015, namely Self-assessment; jeopardy assessment; and adjusted assessment.

Self-Assessment

Self-assessment is a type of assessment which is made by the taxpayer himself. This is accomplished by the taxpayer filling the necessary information in the tax return before submitting to TRA offices. There are different tax returns as provided for under various tax laws. Examples are the Income tax return, VAT return, withholding tax return etc (as required by tax laws). The assessment made by the taxpayer can only be adjusted by the Commissioner General.

Jeopardy Assessment

Jeopardy assessment is a type of assessment made by the Commissioner General. This is normally carried following the occurrence of some circumstances or event, namely:

- ❖ Where tax has become payable under respective tax laws;
- ❖ Where a person have failed to file tax return on time as required by a tax law;
- ❖ A taxpayer is about to leave the country permanently or temporary and such event may cause tax to be evaded;

- ❖ The happening of such event or subject matter as the Commissioner may specify in the notice of assessment

Adjusted assessment

This type of assessment is made by the Commissioner General on taxpayers. The TAA, 2015 empowers the Commissioner General to adjust an assessment to ensure that the taxpayer is liable for the correct amount of tax in the circumstances to which the assessment refers. The assessment can be made when the taxpayer has failed to pay any tax payable by reason of failure to keep proper books of accounts, records or documents as required under the tax law, or incorrectness of the books, records or documents; or failure to make or delay in making any return required under a tax law or the incorrectness or inadequate or return. The Commissioner General will use best judgement and available information in making an adjusted assessment.

Dispute Resolution on Tax Matters

The TAA, 2015 provides for procedures in resolving disagreements between the Commissioner General and taxpayers. Section 51 of the TAA, 2015 provides that a person, who is aggrieved by a tax decision made by the Commissioner General, may object the decision by filing an objection to the Commissioner General, within thirty days from the date of service of the tax decision. However, the taxpayer may apply to the Commissioner General for extension of time for filing the objection. The objection to a tax decision must be in writing and should state the ground upon which it is made. Upon filing the tax objection the Commissioner General will consider the following matters on the tax objection:

- ❖ Tax amount not in dispute must be paid within thirty days from the date of service of the tax decision or one third of the assessed tax decision whichever amount is greater; otherwise the objection will not be considered;
- ❖ Reduction in tax or waiver when the Commissioner General is satisfied that there are good reason for doing so;
- ❖ Amend the assessment in accordance with the objection and further evidence that has been received;
- ❖ Refuse to amend the assessment.

Whatever decision reached by the Commissioner General this must be communicated to the taxpayer in writing, setting out the reason for the intention or decision. Upon receipt of the notice from the Commissioner General the objector will within thirty days from the receipt of the notice make in writing to the Commissioner General on his agreement or disagreement with the amended assessment or refusal.

Appeals against objection decision

A person who is aggrieved by an objection decision or other decision or omission of the Commissioner General may appeal to the Tax Appeals Tribunal in accordance with the Tax Revenues Appeals Act.

Payment of Tax and Recovery of Tax

The taxpayer is supposed to pay tax as provided for under the various tax laws in Tanzania. Different tax laws provide the manner and time for payment of the various taxes to the Tanzania Revenue Authority. For instance, the Income Tax Act 2004 describes the time for payments of taxes from various sources of income such as employment, investment, and business. The Value Added Tax Act 2014 similarly provides the time of payment of value added tax to TRA. Other tax laws make provision for the time of payment of tax to the Tanzania revenue authority. However, in this section

we make reference to some provisions from the Tax Administration Act 2015 on payment of tax and tax recovery measures adopted by the Commissioner General.

Manner and Place of Paying Tax

The taxpayer is required to pay tax at any TRA tax office or at any bank approved for that purpose by the Commissioner General. Payments for tax can also be made through mobile phones payment systems. Payment can be made in cash, by cheque or direct account transfer. However, in the event a cheque is dishonoured the payment of tax is deemed to be ineffective. The TAA, 2015 also empowers the Commissioner General to operate an electronic payment system for taxpayer's account. In this system the Commissioner General can make rules prescribing when the tax becomes payable, the tax paid, and other matters similar to matters prescribed under any tax law.

Recovery of Tax from Taxpayers

When tax payable to the Tanzania Revenue Authority has not been paid on or before the due dates or by dates specified in a notice, the Commissioner General can make recovery of such tax in several ways:

- ❖ Proceeding before a court of competent jurisdiction;
- ❖ Create a charge in favour of the Government over assets owned by the taxpayer;
- ❖ Order the Director of Immigration Services to prevent that person from leaving the United Republic until tax is paid if the taxpayers is about to flee the country;
- ❖ Use reasonable force to restrain the use of assets such as the goods, vehicles, vessels, premises, place, buildings, rooms, items of plant in any factory or any other assets;
- ❖ Serve on a third party debtors who owes money to the taxpayer a notice in writing requiring that person to pay the money to the Commissioner General;
- ❖ Serve an order to the manager or person who was the manager of the entity which fails to pay tax over the period of twelve months prior to the entity default requiring him to be jointly and severally liable with the entity for payment of the tax (However, this may not apply if the manager exercised the degree of care, diligence, and skills that would have been exercised in preventing the failure to pay tax);
- ❖ Serve a notice in writing a person who has been appointed a receiver, specifying an amount that appears to be sufficient to provide for any tax due or that will become due by the taxpayer whose assets come into the receiver's possession;
- ❖ Serve a notice to the agent of the non-resident in writing requiring the agent who is in possession of an asset owned by the non-resident taxpayer to pay tax on behalf of that taxpayer.

Remission and Refund of Tax

The Tax Administration Act 2015, provide provisions which allow remission and refund for tax arising from the various tax laws. Section 70 of the TAA, 2015 provides that the Minister responsible for Tanzania Revenue Authority in consultation with the Commissioner General may remit interest payable by a person imposed under any tax law. The extent of remission is limited to an amount not exceeding 50 per cent of the interest payable by a person. Remission is also allowed on the whole or part of penalties payable by a person imposed under any tax law to a tax.

The TAA, 2015 under section 71 provide provisions for tax refund. Refund of tax arises when a taxable person paid an amount in excess of the tax payable. The Act requires the taxpayer to apply for refund in writing indicating the correct tax calculation and with supporting documents as evidences for the claim. Upon receipt of the application the Commissioner General shall consider and make a refund decision on an application. The decision on the refund application will depend on

the evaluation of the evidences submitted and with other available information with the Commissioner General. Upon satisfaction the Commission General may: Reject the application, request for further information as may be reasonable in order to make final decision, agree to refund the money paid in excess in part or in full. The Commissioner General will serve the applicant with a written notice of the refund decision within ninety days from the receipt of the refund application. However, the Commissioner General can refund the paid money in excess by applying the excess to offset any tax due from the taxpayer under any tax law; and refund the balance, within fourteen days of making the decision.

The Commissioner General is empowered to demand any amount erroneously paid as refund (S. 74 of TAA, 2015). The amount erroneously paid as refund shall be recovered as if it were a tax in relation to which the amount was erroneously refunded. However, this may apply when the demand is made by the Commissioner General within five years from the date of such erroneous refund.

Taxpayer Services Modernisation Initiatives of Tanzania Revenue Authority

The Tanzania Revenue Authority has been implementing several modernisation programmes whose objectives are to enhance efficient and effectiveness in revenue collection, reduce tax evasion, create an environment conducive to investment and business, enhance private-public partnership spirits at the same time promote broad based participation in production and trade, facilitate trade in international markets. A number of taxpayer modernisation initiatives have been introduced by TRA. However, we only highlight a few modernisation initiatives in the department of domestic revenue which we consider the modernisation to be of great interest to students, business men, accountants, tax experts and consultants.

Modernisation Technologies under the Domestic Tax Administration

TRA has instated a number of modernisations in the domestic revenue tax administration. These include: TANCIS, E-filing of VAT returns, Electronic Fiscal Devices (EFD), Central Motor vehicle Registration System (CMVRS), Computerised Drivers' License System (CDLS), Electronic Tax Payment through Mobile Phones.

E-filing of VAT Returns

This system enables the taxpayer to fill a VAT return form and submit it to TRA electronically. The aim of implementing the e-filing module is to improve integrity of taxpayers' returns by capturing data at source and submit the same to TRA electronically. The system also eases documentation, reduces transaction processing time and enables taxpayers to conduct business without their physical presence at TRA offices.

Electronic Fiscal Device (EFD)

The EFD machines were effectively introduced by the government through TRA in July 2010. The objective of introducing EFD machines was to ensure that taxpayers acquire and use EFD machines on every sale made, increase tax collections, simplify tax administration, and ease tax compliance. EFD machines intend to eliminate manual receipting and invoicing among taxpayers. Users of EFDs are supposed to issue fiscal receipt/invoice, keep records of all transactions and ensure that the end of the day all sales are transmitted to TRA through 'Z' reporting system.

Benefits of EFDs

The benefits of using EFDs can be grouped into those specifically for Trader, buyers, and those for government.

Benefits to Traders

- ❖ EFD provides business security for traders as all information entered into the machine is stored in a fiscal memory that cannot be altered.
- ❖ Traders can keep track of all business transactions.
- ❖ Enhances fairness in tax assessment since all tax information is automatically transmitted to TRA system.
- ❖ Modern way of keeping records after immigration from manual register.
- ❖ Provides for easy retrieval of sales reports on daily, weekly or monthly basis.
- ❖ Provides for permanent storage of data.
- ❖ A trader can use EFD machines for other services such as effecting payments and as communication tool.
- ❖ Simplifies refund as information is contained in fiscal document.
- ❖ Reduces number of objections and disputes.
- ❖ Minimizes pilferage commonly practiced by shop attendance.

Benefits to Buyers

- ❖ The receipts issued by EFD machine provide for legal benefit of ownership of goods procured.
- ❖ Provides for assurance that tax has been remitted to the government.
- ❖ Taxes paid by consumers of goods and services enables the government to provide social and economic needs.
- ❖ Demanding for receipt is a legal obligation of the buyer hence by acquiring a receipt a buyer will have fulfilled the requirement of the law.

Benefits to Government

- ❖ Taxes collected through EFD machines enable the government to provide social services.
- ❖ Provides basis for fair assessment of taxes payable.
- ❖ Easy monitoring of taxes.
- ❖ Provides easy and cost effective means of collecting taxes.
- ❖ Enables the government in economic planning and revenue forecasting by sectors.

Persons obliged to use EFDs

The electronic Fiscal Devices are supposed to be used by both VAT registered traders and Non-VAT registered traders whose annual turnovers amounting to 14 million and above. The taxpayers include, mentioning a few, manufacturers, wholesalers, retailers of all kinds. Other persons may be appointed by the commissioners to be eligible persons for EFD.

Penalties for failure to comply with EFD regulations

The laws require every person who qualifies to use EFD machine to ensure that the machine is bought and used in a manner required. Any person who goes contrary to the requirements of the laws shall be penalised accordingly.

Regulation 20 -22 of the EFD regulation provide an offence for failure to use and acquire EFDs. Any person who fails to comply with the regulation commits an offence and upon conviction is liable to fine of not less than Tsh. 3 million or to imprisonment for a term not exceeding 12 months or to both fine and imprisonment. The regulation further provides for penalties of fine, or imprisonment, or both for person who fraudulently uses an EFD in a manner aimed at misleading the system or the commissioner. Upon conviction a person shall in addition to tax payments which would have been paid, pay a fine twice the amount of tax involved or four million shillings which ever amount is the greater or to imprisonment o term not exceeding three months or both.

Electronic Tax Payment System Through Mobile Phones

TRA launched a system of electronic payments of taxes through mobile phones with effect from June, 2011. This system allows the taxpayer under the presumptive tax regime and property taxpayer pay personal income tax and property tax through mobile phones. It reduces the queues at TRA offices and banking halls for payment of such taxes.

The Computerised Drivers' License System

The introduction of this system has modernised the issuance of Drivers' License through automation. The CDLS facilitates access and exchange of information amongst institutions, facilitates maintenance of reliable data, provides readily accessible drivers' license database for easy monitoring of compliance with Traffic Regulation and enhances revenue collection.

Tax Compliance in Tanzania

One of the challenges for any tax authority is to enhance voluntary compliance minimizes tax evasion and avoidance. This is a particular problem in developing countries like Tanzania, as there is poor culture of payment of taxes. Compliance literally means fulfilment of some requirement to be it legal, social, cultural, institutional or any other obligation. That is, fulfilment by taxpayers of their tax obligations through paying their rightful taxes and following all the required procedures as stipulated under the laws which they are registered.

TRA is responsible with ensuring that tax administration environment achieves maximum compliance and revenue yield. In order to maximize revenue yield, tax compliance is very important, i.e., taxpayers should, either voluntarily or involuntarily, abide by the requirements of tax laws. These tax laws are intended to achieve either revenue objectives or non-revenue objectives of taxation

Aspects of Tax Compliance

- ❖ Registration of business to TRA for Tax Identification Number (TIN)
- ❖ Filing various returns and documents by the statutory due dates, accompanied by reporting correct income or tax due and avoiding understatement.
- ❖ Payment of the correct tax on or before the statutory due dates (Filing without payment is not sufficient).
- ❖ Tax avoidance, mitigation and planning are form of non-compliance practice.

Types of Tax Compliance

- ❖ Voluntary compliance
- ❖ Forced compliance
- ❖ Induced compliance

Voluntary Tax Compliance

Situation whereby taxpayers and their advisors faithfully abide by the requirements of the tax laws without compulsion. Voluntary tax compliance saves the government the costs of revenue collection, promotes the realisation of other tax policy, it also guarantees steady flow of revenue for development.

Forced Tax Compliance

Forced tax compliance involves punitive measures on defaulters. With forced tax compliance the government collecting agent is required to use force to recover the tax revenues. Government organs such as police and the courts are used to collect the tax revenues. Less superior to voluntary compliance, and may result in high cost of tax administration

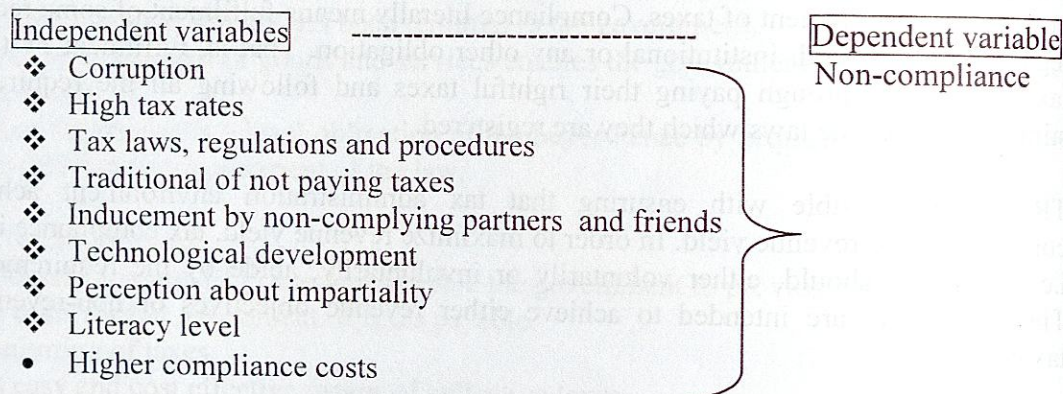
Induced Tax Compliance

Induced tax compliance arises when taxpayer realise tangible benefits from their taxes; for example good roads, hospitals, water supply and schools, they get induced to taxes.

Factors Contributing to Non-compliance

The following tax compliance model is designed to explain relationship between different variables (independent variables) and non-compliance (dependent variable). That is, the model analyses different causes of and the extent of their contribution to non-compliance

Tax compliance model



Benefits of Voluntary Tax Compliance

Voluntary tax compliance saves the government the costs of revenue collection. It promotes the realisation of other tax theory (non-revenue goal). It Guarantees steady flow of revenue for development and taxpayers avoid unnecessary penalties. Forced tax compliance is less superior to voluntary compliance and may result in to high cost of tax administration.

Measures to Enhance Voluntary Tax Compliance

Maximum voluntary compliance may be achieved through a number of measures. Education to taxpayers through interview, radio, and TV's, seminars, workshops, training, publications, etc

Theories of Tax Compliance

These are theories that attempt to explain why people cheat on their taxes, and therefore, non-compliance. They explain the foundation of non-compliance as amplified by the variables of compliance model.

Economic Theory

Economists argue that people would commit evasion when expected utility of their criminal act exceeds its expected disutility (some sort of cost-benefit relationship). This theory, however,

overlooks the habit of the people who feel happy for not paying tax regardless of the gain or loss which they get from evasion.

Psychological Theory

Psychologists believe (assume) that human behaviour would affect payment of taxes. In this case variables like probability of detection and size of fines would cause non-compliance through attitude and perceptions. Weakness of this theory is that it does not consider other factors that cause people not to comply with tax payments.

Sociological Theory

Sociologists argue and believe that taxpayers live and work in society and social forces shape behaviour of individuals. In this case, if in society there is a certain malpractice behaviour, say cheating, corruption and similar acts, then everyone will behave in the same way if there is an opportunity to do so. In contrast, if the society is clean, there is a possibility that everyone will pay tax accordingly for fearing social disapproval.

Tax Avoidance Practices in Tanzania

Tax avoidance is the practice and technique whereby one so arranges his business affairs such that he pays little or no tax at all but without contravention of the tax law. Tax avoidance includes the following practices: Measures which reduce, postpone, or relieve any liability to income tax or alter the incidence of income tax; and taking advantage of any weaknesses and loopholes; deficiencies and loose clauses or vague clauses in the tax legislation.

When tax avoidance is detected by the tax authority the only solution is to amend the law to eliminate the weaknesses and loopholes which allow the possibility of avoidance. It is legally allowed/accepted, but it does not mean that the tax authority will allow the practice. Where an arrangement is void, the Commissioner is given power under section 8 of the Tax Administration Act 2015, to adjust the assessable income of any person so as to counteract any tax advantage obtained by that person. If a tax avoidance scheme relies on misrepresentation, deception and concealment of the full facts, the avoidance is misnomer; and the scheme would be more accurately described as fraud.

Tax Evasion Practices in Tanzania

Tax evasion is the deliberate contravention of the tax law(s) in order to minimize or eliminate tax liability (i.e. pay no or little tax by breaking the law). It involves the application of fraudulent practices in order to minimize or eliminate tax liabilities; therefore it is illegal. The starting point is always that a liability has already arisen, so concern is how to eliminate or reduce it.

Tax evasion practices

Tax evasion practices include the following:

- ❖ Making a false return of income by omitting or understating income or overstating expenses
- ❖ Making a false statement in return affecting tax liability, e.g. false declaration
- ❖ Giving false information on any matter affecting tax liability
- ❖ Preparation or maintenance of false books of accounts or records (parallel books)
- ❖ Application of fraud, e.g. manipulation of stock sheets and valuations, destruction of accounting records, non-issue of receipts, etc

Consequences of Tax Avoidance and Evasion

The main consequences of tax avoidance and evasion are as follows:

- ❖ Loss of government revenue leading to non-realisation of budget plans and objectives for economic and social development
- ❖ Non realisation of other non-revenue goals of taxation, e.g. inequality in taxation (progressive versus regressive tax structures).

General causes of tax avoidance and evasion

In general terms tax avoidance and tax evasion are caused by the following factors:

- ❖ High marginal tax rates and frequent changes in tax rates
- ❖ Administrative inefficiency, collusion with taxpayers and bribery of tax officials: Inadequate training and experience of tax administrators coupled with lack of exposure to business practices may limit their abilities to analyse complex issues, e.g. international schemes
- ❖ Multiplicity of taxes: It is difficult to comply correctly with too many taxes, e.g. due to lack of knowledge of the detailed provisions of all the laws; too many statutory due dates; too many returns to complete, etc.
- ❖ Low prospect of detection and punishment: The lower the chance of detection, the more likely the taxpayers are to join the game. Ensure sufficiently deterrent punishment
- ❖ Deficiencies in the legal structure of the tax laws and complexity which allow tax avoidance
- ❖ Traditional and cultural tendency to hate and evade tax (low tax morality)
- ❖ Wasteful manner in which the revenue is spent and lack of clear benefits to taxpayers through improved social services

Practices which minimize tax avoidance and evasion

Tax avoidance and evasion can be minimized when tax authorities resort to the following measures and actions:

- ❖ Keeping the marginal tax rates low, realistic and not subject to frequent changes
- ❖ Promote administrative efficiency, e.g., by providing better tools, motivating staff, etc.
- ❖ Technical staff training, e.g., tax laws; accountancy; exchange visits with other countries
- ❖ Avoid multiplicity of taxes by retaining the major taxes only
- ❖ Serious punishment to evaders and corrupted tax officials
- ❖ Judicious expenditure of revenue by the government because where tax monies are well spent, may improve voluntary compliance

Chapter Summary

This chapter has covered aspects of tax administration on selected issues such as taxpayer services, Taxpayer Identification Number, tax assessments, tax audit and investigation, dispute resolution, tax payment and recovery, and tax refund and remission. Tax administration matters provided under this chapter have been drawn from the Tax Administration Act of 2015. The summary of key issues presented and discussed in this chapter is presented here:

- ❖ The Tanzania Revenue Authority was formed by the Act of Parliament No. 11 of 1995, and started its operation on 1st July 1996. The authority is charged with the functions of: Assessing, collecting and accounting for all Central Government revenues and administering production of trade statistics and publications, improving the quality of services to the taxpayers and counteract fraud and other forms of tax evasion.
- ❖ Taxpayer Identification Number (TIN): The Tax Administration Act 2015 requires all people who are potentially liable to tax by reason of carrying on business or investment to apply for Taxpayer Identification Number within fourteen days from the date of commencing the business. The application for Taxpayer Identification Number must be in the prescribed form, and must be supported with documentary evidences of the person's identity and filled in the prescribed manner. The purposes of the Taxpayer Identification Number are to identify and recognise taxpayers on regular basis. The TIN is supposed to be quoted by taxpayers in any claim, notice, return, statement or any other document submitted the TRA or used for purpose of a tax law.
- ❖ The Tax Administration Act 2015 provides for tax audit and investigation. The act empowers the Commissioner General to carry out tax audit or investigation to any tax payer on tax affairs for any year of income or any information as he finds appropriate.
- ❖ Tax assessment is defined under the Tax Administration Act 2015 to mean a determination of the amount of tax liability made under a tax law by the Commissioner General or by way of self-assessment. There are three types of assessment under the TAA, 2015, namely: Self-assessment; jeopardy assessment; and adjusted assessment.
- ❖ Taxpayers are required to pay tax at any tax office or at any bank approved for that purpose by the Commissioner General. Payments for tax can also be made through mobile phones payment systems. Payment can be made in cash, by cheque or direct account transfer.
- ❖ The Tax Administration Act 2015 allows remission and refund for tax arising from the various tax laws. The Minister responsible for Tanzania Revenue Authority in consultation with the Commissioner General may remit interest payable by a person imposed under any tax law.
- ❖ The Tanzania Revenue Authority has been implementing several modernisation programmes. The objectives of the modernisations are to enhance efficiency and effectiveness in revenue collection, reduce tax evasion, create an environment conducive to investment and business, enhance private-public partnership spirits at the same time promote broad based participation in production and trade, facilitate trade in international markets. A number of taxpayer modernisation initiatives have been introduced by TRA. These include: TANCIS, E-filing of VAT returns, Electronic Fiscal Devices (EFD), Central Motor vehicle Registration System (CMVRS), Computerised Drivers' License System (CDLS), Electronic Tax Payment through Mobile Phones.
- ❖ Tax evasion is the deliberate contravention of the tax law(s) in order to minimize or eliminate tax liability (i.e. pay no or little tax by breaking the law). It involves the application of fraudulent practices in order to minimize or eliminate tax liabilities; therefore it is illegal.
- ❖ Tax evasion practices include the following: Making a false return of income by omitting or understating income or overstating expenses; Making a false statement in return affecting tax liability, e.g. false declaration; Giving false information on any matter affecting tax liability;

Preparation or maintenance of false books of accounts or records (parallel books); Application of fraud, e.g. manipulation of stock sheets and valuations, destruction of accounting records, non-issue of receipts, etc.

- ❖ General causes of tax avoidance and evasion in Tanzania include: High marginal tax rates and frequent changes in tax rates; Administrative inefficiency, collusion with taxpayers and bribery of tax officials; Multiplicity of taxes; Low prospect of detection and punishment; Deficiencies in the legal structure of the tax laws and complexity which allow tax avoidance; Traditional and cultural tendency to hate and evade tax (low tax morality)

End of Chapter Six Revision Question

1. What are functions and responsibilities of the Tanzania Revenue Authority?
2. What are modernisation programmes adopted by TRA and what are the expected benefits.
3. Describe the major aspects of voluntary tax compliance?
4. With examples, account for poor voluntary tax compliance in Tanzania.
5. In your views what should be done to enhance voluntary tax compliance in Tanzania.
6. Explain the main theories that explain non-tax compliance. To what extent are the theories able to explain the situation in Tanzania context?
7. What are the main types and method of international Tax evasion? What suggestions would you give to minimize them?
8. What is the difference between tax evasion and tax avoidance?
9. What are the main causes of tax evasion?
10. Identify general practices through which a taxpayer can eliminate or minimize tax liability through avoidance and evasion.
11. Identify any five provisions under the Income Tax Act 2004 that are designed to combat tax avoidance, clearly stating the type of avoidance which is intended to be fought by the said provisions.
12. Identify and describe different practices that a Multinational company can use in avoiding or evading tax in Tanzania and explain how the ITA, 2004 can be used to combat those practices (i.e. relevant provisions).
13. Explain how multinationals can use transfer pricing to evade tax
14. What is tax planning? Explain why tax planning is not tax evasion.

CHAPTER SEVEN

INTRODUCTION TO INCOME TAX

Introduction

This chapter deals with the introductory issues on income tax. It is a stepping stone to the next chapters in this book. The chapter covers aspects of income chargeable to income tax, exempt income to income tax, residential status of tax payers, and year of income. Income tax in Tanzania is governed by the Income Tax Act of 2004 as amended from time to time by the annual finance acts. In this chapter we deal with the provisions of the Income tax Act that impose income tax to the stated sources of income at the applicable rates, the tax bases and sources of income which are exempt from income taxes, year of income for tax purposes, and residential status of a taxpayers.

Learning Outcomes

After completing this chapter readers should be able to:

- ❖ Describe income chargeable to income tax
- ❖ Describe total income under the Income Tax Act 2004
- ❖ Determine the residential status of a person
- ❖ Describe the meaning of year of income for tax purposes
- ❖ Identify conditions of residence of tax payers for tax purposes
- ❖ Describe exempt income under the Income Tax Act 2004

Income Chargeable to Income Tax

Section 4 of ITA 2004 is the main charging section under the Income Tax Act 2004. By definition, 'charging' means imposition of income tax or levy or subjection of particular source of income or person to income tax. Charge to tax under section 4 is *limited* to:

- Total income for a year of income.
- Repatriated income of a domestic permanent establishment (defined under section 3 of ITA 2004) for a year of income.
- Final withholding tax payments during the year which satisfies the needs of the Commissioner and thus needs no further assessment i.e., are regarded as final withholding payments e.g., interest from savings bank account for individuals.

Therefore, amount of income tax payable for a year of income by a taxable person is the *sum* of the total income; repatriated income of a domestic permanent establishment and final withholding payment.

Example 7.1

A-Z is a subsidiary of a non-resident corporation (a domestic permanent establishment) which earned income for certain year of income as follows:

Income from business..... Tsh. 1200m
Dividend from TOL..... Tsh. 50m

TOL is a company listed in the DSE Company and the dividends suffered 5% final withholding tax deduction. The subsidiary's repatriated income for the year of income was determined to be Tsh. 350.0m. A-Z Inc. tax for the year would be calculated as follows:

Corporation tax on Business income; Tsh. 1,200m x 30%..... Tsh. 360.0m
Tax on repatriated Income Tsh. 350 x 10%.....Tsh. 35.0m
Final withholding tax on dividends: ... Tsh. 50m x 5%.....Tsh. 2.5m

Total tax Tsh. 397.5m

Total Income Chargeable to Income Tax

Subsection (1) of section (5) of the act defines 'total income' as the sum of the person's chargeable income from *business, investment and employment*.

Income tax is charged on a person's total income for a year of income. A person's total income for a year of income is calculated by aggregating the income from business, employment and investment. However these three components of income should be calculated separately in accordance the provisions of the income tax Act 2004. The calculation for each these components of income shall be discussed in the next chapters (Income from employment, business and business).

Example 7.2

For the year of income 2015, Mr. Juma received net income from employment of Tsh. 59.0m; from business Tsh. 200m and from investments Tsh. 50m. Then Mr. Juma's total income for tax purposes would be:

Employment Income..... Tsh. 59.0m
Business Income Tsh. 200.0m
Investment Income..... Tsh. 50.0m
Total income..... Tsh. 309.0m

Scope of chargeability of Taxable Income of a Person

The scope of chargeability of income tax depends very much on the residential status of a person (individual or entities). Section 6 of the Act provides the extent of chargeability on the chargeable income of a person for year of income (from any employment, business or investment).

- In the case of resident person: The person's income from employment, business or investment for the year of income irrespective of the source of the income. This means that resident persons are taxed on income earned both in United Republic of Tanzania and outside Tanzania. In other words both income from foreign sources and home sources are taxed at the applicable rate in the year of income.
- In the case of non-resident person: Person's income from the employment, business or investment for the year of income, but only to the extent that the income has a source in the United Republic of Tanzania.

From the ITA 2004 all income earned from foreign sources and from Tanzania sources are both taxed if the corporation or individual is a resident person. For non-resident person the only income which is taxed is the one whose source is in Tanzania.

Example 7.3

ABC Ltd is a resident corporation. For the year of income 2015 it earned income as follows:

Country	Business Income	Investment Income
Rwanda	Tsh. 50,000,000	15,000,000
Kenya	100,000,000	20,000,000
Zambia	25,000,000	65,000,000
Tanzania	500,000,000	120,000,000
Total worldwide income	675,000,000	220,000,000

From the above information, the taxable income would be determined as follows:
Since the corporation is a resident corporation of Tanzania, then;

Total worldwide income of ABC:	
Total business income.....	675,000,000
Total investment income.....	220,000,000
Total taxable income.....	895,000,000
Taxation procedure:	
Worldwide income.....	895,000,000
Less: Tanzania Income (To be taxed at 30%)....	620,000,000 x 30%.....124,000,000
Foreign Income.....	275,000,000
Tax on foreign income; at 30% thereof (275,000,000 x30%).....	82,500,000
Total tax on both foreign income and Home income for ABC.....	206,500,000.

This foreign income is taxed as per S.77 of ITA, 2004. (i.e a tax credit is given if income was taxed in the foreign countries).

Determination of Residential Status of a Taxable Person

The law under section 66 of ITA 2004 provides the rules and criteria for determining the residential status of a person with respect to a person for income tax purposes. The Act provides for residence of individuals, partnerships, trusts, and corporations. The conditions for each of these are discussed here below:

Residential status of an individual: *According to section 66 (1) of the Income Tax Act 2004, an individual is a resident in the United Republic of Tanzania (URT) for a year of income if the individual:*

- ❖ Has a permanent home in the URT and is present in the URT during *any part* of the year of income; This rule requires the individual to have a permanent home and physically present in the United Republic of Tanzania during any part of the year for whatever period duration of the year of income. The term permanent home is normally considered as having a place where one frequents and can dwell permanently or for considerable time it could be a house, a hut, a room in a hotel etc.
- ❖ Is present in the URT during the year of income for a period or periods amounting *in aggregate to 183 days of more or more; this rule applies when an individual does not have a permanent home but was physically present in the United Republic of Tanzania during the year of income for the stated period.*
- ❖ Is present in the URT during the year of income and *in each of the two preceding years of income for periods averaging more than 122 days in each such year of income?*
- ❖ Is an employee or an official of the government of the URT posted abroad during the year of income? This rule does not require the employee to be physically present in URT during the year of income.

These rules are exclusive and independent of each other.

Example 7.4

Mr. Masanja is a citizen of the United Republic of Tanzania but has no permanent home. But he went to USA since 2010 for greener pastures. However, Mr. Masanja normally comes to Tanzania for vacation and other private matters. In 2012 he stayed in URT for 200 days; in 2013, 2014 and 2015 he stayed for 150, 170, and 120 days respectively.

Required: Determine the residential status of Mr Masanja for the year of Income 2012, 2013, 2014 and 2015.

Solution to example 7.4

Residential status of Mr. Masanja for the year of income 2012;

Number of days present in URT 200.

Minimum average number of days for a person to be a resident is 183 days; since Mr Masanja stayed for 200 days which is greater than the minimum number of days, therefore he was a resident person in the year of income 2012.

Residential status of Mr. Masanja for year of income 2013

Number of days present in URT..... 150 days, then Mr. Masanja was not a resident in 2013 because the number of days spent in URT was less than the minimum average number of 183 days.

Residential status for year of income 2014

Number of day in URT= 170 days, then Mr. Masanja was not a resident in 2014 because the number of days spent in URT was less than the minimum average number of 183 days.

Residential status for year of income 2012;

Number of days in URT= 120 days, this is again less than 183 days however the average number of days spent by Mr. Masanja in URT for the last two preceding year exceeds 122 [(150+170)/2=160 days] therefore Mr. Masanja was a resident person in the year of income 2015.

Resident Partnership: *According to section 66 (2) of ITA 2004, a partnership is a resident partnership if at any time during the year of income a partner is a resident of the URT.*

Corporation: A corporation is a resident corporation if:

- ❖ It is incorporated or formed under the laws of the URT
- ❖ At any time during the year of income the management and control of the affairs of the corporation are exercised in the URT

Resident Trust: If it was established in the URT;

- ❖ 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.

Permanent establishment: Permanent establishment means a place where a person carries on business and includes:

- ❖ A place where a person is carrying out business through an agent (other than a general agent of independent status acting in the ordinary course of business as such).
- ❖ A place where a person has used or installed, or is using or installing substantial equipment or substantial machinery;
- ❖ A place where a person is engaged in construction, assembly or installation projects for six months or more, including a place where a person is conducting supervisory activities in relation to such project.

Domestic permanent establishment: Means all permanent establishments of a non-resident individual, partnership, trust or corporation situated in the United Republic.

Trust: means an arrangement under which a trustee holds assets but excludes a partnership and a corporation

Trustee: Means an individual or body corporate holding assets in a fiduciary capacity for the benefit of person or for some object permitted by law. Such individual or body corporate includes:

- ❖ Any executor, administrator, tutor or curator (guardian, warden, keeper);
- ❖ Any liquidator, receiver, trustee in bankruptcy, or judicial manager;
- ❖ Any person having the administration or control of assets subject to limited interest;

- ❖ Any person who manages the assets of an incapacitated individual; and
- ❖ Any person who manages assets under a private foundation or other similar arrangements.

Year of Income for Tax Purposes

Income tax is determined and payable on annual basis. The length of the year of income for tax purposes is twelve months. After a period of twelve months taxpayers are required to determine the income chargeable to income tax and pay the tax required accordingly. According to section 20 of the Income Tax Act 2004, year of income means the calendar year. The period of twelve months is from January to December of each year. The Act requires all taxable persons to determine the taxable income earned in the period of twelve months and make payments accordingly.

Approval of Year of income other than the calendar year

Section 20(2) of ITA provides that where an entity shows that there is a compelling need requiring the entity not to follow the calendar year or determine its tax payable as per calendar year or changing from one accounting date to another, the entity may apply in writing to the Commissioner General for approval to change from the calendar year or the previously approved year of income. The Commissioner General will communicate to the entity the determination of the entity's application in writing.

Conditions for changing the year of income

The approval for changing the year of income from the calendar year is subject to some conditions. The Income Tax Act provides that the entity applying for change in the entity's year of income should show compelling need for the change of the year of income. The Commissioner will approve the change only where it is satisfied that the whole or a portion of the entity's income cannot be correctly reported for any year of income under the current accounting cycle or there is substantial business need to make the change. The Commissioner will not approve an application for change where it is of view that the purpose or one of the purposes of the change is to avoid or reduce tax. For example, a change may be requested that may put the person in a position to benefit from reduced tax rate or change in certain tax policy decisions.

Transitional Year of Income

The Income Tax Act 2004 (S.20 (5)) provides that where an entity's year of income changes, such change should not exceed the period of 18 months. That is, the year of income should be of the length of up to 12 months or 18 months. In case the transitional accounting period is less than 12 months, the income should be treated as income of the year in which the accounting period ends.

If the new accounting period is of more than 12 months, and ends in the year following that in which a 12 month's accounting period would have ended, the income is to be apportioned over the period, viz. for the 12 months to the old accounting date and the balance to the new period, and profit assessed as if the accounts had been made up for 12 months to the old date and for the shorter period to the new.

If an entity wishes to change its accounting period (Year of Income) from 31st September of each year to 31st March of each year and for the year 2015 (i.e. 30th September, 2015) accounts for 18 months period are made up to 31st March, 2016, then two-thirds (12 months) of the income of the

accounting period is to be assessed for the year of income 2015 (the old year of income) and one-third (6 months) for the year of income 2016 (the new year of income).

Year of Income of a Foreign Permanent Establishment

The ITA, 20014 (S20 (6)) provides that the year of income for every person's foreign permanent establishment shall be the same as the year of income of its owner. For example, where a resident company with foreign permanent establishment makes accounts on 30th June, then the accounting date of that foreign permanent establishment shall be 30th June so as to coincide with the accounting date of that resident company (the owner).

Year of Income of a Non-Resident Entity

The ITA 2004 (S.20 (7)) provides that the year of income for every non-resident partnership, trust or corporation shall not exceed the period of twelve months for which the entity makes up its accounts if it is not the calendar year. Otherwise the year of income shall be the calendar year.

Year of Income for Starting Business

Under the provisions of ITA (S.20 (8)) the initial year of income of a person shall be the period of twelve months or less. However, the Commissioner may approve a period of not exceeding eighteen months. Where the first accounts of a new business are for a period of 12 months ending on a date other than 31st December, that is where two calendar years are covered, the profits are, nevertheless, to be treated as income for the year of income in which the accounting period ends.

Where the first accounts are for the period of less than 12 months, the profits are to be treated as income of the business for the year of income in which the accounting period ends. Where they are for a period greater than twelve months, a twelve months' proportion of the profits shall be treated as income of the year of income in which the accounting period ended, and the balance of the profit as that of the year of income in which the initial broken period ended.

Example 7.5

A new business prepares its first accounts for a period of 15 months ended on 31st January 2014, that is, for a period of November 2012 to 31st January 2014. The business made a profit of Tsh. 1,000,000,000 over the period.

Apportionment of Income

- ❖ The proportion of profits for 12 months should be treated as income for the year of income for the year of income in which the accounting period ends, i.e year 2014
- ❖ The portion of profits for 3 months (the balance) should be treated as income for the year of income in which the initial broken period ended, (i.e year 2013)

The apportionment should be as follows:

Year 2013 (3 months): Tsh. 200,000,000 [3/15 X 1,000,000,000]

Year 2014 (12 months): Tsh. 800,000,000 [12/15 x 1,000,000,000]

The profits are to be assessed in the respective years of income apportioned.

Year of Income for Ceasing Business

A business which is ceasing from doing business and whose final accounting period ends within the final year of income, or where the final accounting period exceeds 12 months, then the profits are to be assessed for the year on the basis of twelve month's proportion. Otherwise, if the final accounting period is for less than 12 months and ends in the year of income following the preceding accounting year ended, the profits are to be treated as the income of the final year in the same way as the profits of the initial accounting period of a new business is treated as the income of the first year. Where the final accounting period is for 12 months, the income is to be treated as that of the final year of income.

Example 7.6

A ceasing business prepares its last accounts for a period of 15 months ended on 31st March 2016, that is, for a period of January 2015 to 31st March 2016. The business made a profit of Tsh. 2,000,000,000 over the period. The accounting period of the business is the calendar year.

Apportionment of Income

- ❖ The proportion of profits for 12 months shall be treated as income for the year of income for the year of income in which the business ceases, i.e year 2016
- ❖ The portion of profits for 3 months (the balance) shall be treated as income for the year of income in which the final broken period ended, (i.e year 2015)

The apportionment shall be as follows:

Year 2015 (3 months): Tsh. 400,000,000 [$3/15 \times 2,000,000,000$]

Year 2016 (12 months): Tsh. 1,600,000,000 [$12/15 \times 2,000,000,000$]

Income Exempt under the ITA 2004

The general machinery for exemptions is provided in sections 10; 52; 54; and 2nd Schedule of the Act. However, the general provisions are section 10 and 2nd schedule of the Income Tax Act 2004.

Power of the Minister to Exempt Income from Tax

Section 10 of the ITA, 2004 provides that the Minister, by notice in the gazette may exempt from tax any income or classes of income accrued or derived in the URT or amend the 2nd schedule.

Income Distributed by a trust

Distribution of a resident trust or unit trust is exempted on the recipient/beneficiary of that trust. However, if it is a non-resident trust, such beneficiary will not be exempted. This is provided for under section 52 of the ITA, 2004.

Distribution of dividends

A dividend distributed by a resident corporation to another resident corporation is taxed at reduced rate at five per cent if the corporation receiving the dividends holds 25 per cent or more of the shares in the distributing corporation, and controls either directly or indirectly, 25 per cent or more of the voting power in the corporation. This is provided for under section 54 of the ITA, 2004.

The list of exempt income under the 2nd Schedule in the Income Tax Act 2004

The second schedule of the income tax Act 2004 lists individuals and corporation that are exempted from income tax. Examples of exempt income under the 2nd schedule include:

- ❖ Amounts derived by the President of URT as duty allowances, entertainment, etc
- ❖ Amounts derived by the government or any local authority of the United Republic of Tanzania or by virtue of the office or by the Revolutionary Government of Zanzibar or any local authority of Zanzibar except amounts derived from business activities that are unrelated to the functions of the government.
- ❖ Amounts derived by diplomats
- ❖ Amounts derived by East African Development Bank
- ❖ Income of a primary co-operative Society
- ❖ Scholarship or education grant payable as tuition fee for full time training
- ❖ Amounts derived by way of alimony, maintenance or child support under a judicial order or written agreement
- ❖ Pension or gratuities granted in respect of wounds or disabilities caused in war and suffered by the recipients of such pensions or gratuities.
- ❖ Amount 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.
- ❖ Amount derived in respect of an asset that is not a business assets, depreciable asset, investment asset or trading stock.
 - (The list is not exhausted, for more exemptions see 2nd of the Income Tax Act 2004 as amended)

Arguments for Exemptions of some Income

Exemptions available in the income tax Act aims at achieving the following objectives:

- ❖ To promote investment and economic growth
- ❖ To promote social and political objectives (i.e. to enable availability/provision of social services and political considerations such as exempting diplomats)
- ❖ Philanthropic considerations (welfare matters and charitable issues, e.g. where the objective of the activity is to help disabled)
- ❖ Public interest argument
- ❖ Unofficial or unintended exemptions as the law is unable to reach and every taxpayer or income due to practical difficulties (shortage of manpower, low yield of revenue, determination of income difficulties, lack of reliable addresses, etc).

Argument Against Exemptions

Several criticisms are advanced against granting exemption of income to individuals and corporations or body corporate. Such criticisms include the following:

- ❖ Source of inequality in the tax system because they are granted on selective or discriminatory basis, and thus violate the most important equity and simplicity principles of a good tax system.
- ❖ May cause serious revenue losses to the government
- ❖ Source of complexities in the tax legislation

Chapter Summary

This chapter has covered issues of income chargeable to income tax, tax, residential status of tax payers, and year of income, exempt income to income. The key points discussed under this chapter can be summarised as follows:

- ❖ Income tax in Tanzania is governed by the Income Tax Act of 2004 as amended from time to time by the finance acts passed by parliament in every financial year.
- ❖ Income chargeable to income tax under the income tax Act 2004 is categorised into three major categories, namely Total income for a year of income; Repatriated income of a domestic permanent establishment for a year of income. Final withholding tax payments.
- ❖ Total income as per income tax Act is the sum of the person's chargeable income from *business, investment and employment*.
- ❖ A person's total income for a year of income is calculated by aggregating the income from business, employment and investment. However, these three components of income are calculated separately in accordance the provisions of the income tax Act 2004.
- ❖ Income tax is charged on persons depending on their residential status. In the case of resident person the person's income from employment, business or investment for the year of income irrespective of the source of the income. This means that resident persons are taxed on income earned both in United Republic of Tanzania and outside Tanzania. In the case of non-resident person, taxes are charged on income from the employment, business or investment for the year of income which was earned or has a source in the United Republic of Tanzania.
- ❖ Income tax is determined and payable on annual basis. The length of the year of income for tax purposes is twelve months which means the calendar year with twelve months from January to December of each year.
- ❖ Where there are compelling reasons for entity to prepare its accounts for a period other than the calendar year, the entity is supposed to apply to the Commissioner General. Upon satisfaction the Commissioner General may allow an entity not to follow the calendar year or determine its tax payable in a different period or changing from one accounting date to another.
- ❖ Income exempt from tax under the income tax act 2004 are provided for under section 10, 52, 54 and the 2nd schedule of the act.

End of Chapter Seven Revision Question

1. Define 'permanent establishment' as per Income Tax Act 2004.
2. Section 4 of the ITA 2004 is referred to as the 'main charging section'. Why is this called so?
3. Discuss the various purposes of exemptions from income taxation with reference to the specific exemption clauses in the Income Tax Act 2004.
4. Petty traders cum street vendors are generally not in the Income Tax or local government tax roll. Recent efforts have been made to try to tax these petty traders by using presumptive tax rates.
5. What difficulties do the tax authorities encounter in their tax assessment and collection campaign?
6. "The government should abolish exemption provisions immediately". Do you agree?. Give reasons for your answer.
7. What is the significance of classifying a person as resident in the URT for Income tax purposes?
8. State the conditions for residence of a 'person' as specified under section 66 of the Income tax Act, 2004.
9. What is the meaning of "Management and Control" as used under the determination of the residential status of a body of persons under ITA 2004?
10. Differentiate the term 'total income' from 'chargeable income' as provided for under the Act.
11. Define and differentiate the term permanent home from permanent establishment.

CHAPTER EIGHT

TAXABLE INCOME FROM EMPLOYMENT

Introduction

This chapter discusses incomes that are classified as employment income under section seven (S.7) of the income tax Act 2004. The chapter discusses the determination of appropriate taxable income and employment income which are exempt from tax. The main sections under discussion in this chapter are section seven, twenty seven and the second schedule of the Income Tax Act 2004.

Learning Outcomes

After completing this chapter readers should be able to:

- ❖ Describe the meaning of employment Income
- ❖ Distinguish between contract for service and contract of service
- ❖ Describe the components of employment income
- ❖ Identify employment income exempt from tax
- ❖ Determine income from benefits in-kind
- ❖ Compute total income from employment
- ❖ Describe the Pay As You Earn system

Meaning of Employment

The Income Tax statute defines the term employment under section 3 to mean:

- ❖ A position of an individual into the employment of *another person*.
- ❖ A position of an individual as *manager* of an entity other than a partner of a partnership.
- ❖ A position of an individual entitling the individual to *periodic remuneration* in respect of service performed.
- ❖ A *public office* held by an individual, and includes a past, present and prospective employment.

From the above definition the major characteristic of employment is the rendering of services. However, it is also equally an established fact that not all services' rendering activities constitute employment. Some services' rendering activities constitute business and hence income in respect of such services would not be taxable as employment but rather as business income. Thus, in defining the word employment an important question that emerges is what the difference between services rendered that constitute employment, and services rendered which constitute business.

In answering the above question judicial authority suggests that in order for employment to arise, services must be rendered under a contract of service. And if services are rendered under a contract for services, such services constitute business and not employment and the rules discussed in this section would not apply.

A contract of service, as opposed to a contract for services, is characterised by the presence of an office, which is a "subsisting, permanent, substantive position, which has an existence independent of the person who fills it. Employment is also attributed by absence of frequent contracts and the presence of the master and servant relationships.

The Act shows that a manager is an employee and thus receives employment income. The position of a manager includes a director of a company and any person on whose directions and instructions the entity is required or accustomed to act. Effectively this therefore means that Members of Board of Directors and trustees of a trust are employees of the entity and the rules discussed here would apply to such persons as well. On the other hand, the following features give rise to business income (Contract for service): No elaborate employer to employee relationship exists, an agency agreement for a particular assignment, and once the agreed assignment ceases the contract ends, and fresh contract may be negotiated.

Components of Income from Employment

Section 7 of the ITA 2004 defines income from employment to mean the individual's gains or profits from the employment. This includes direct cash emoluments and benefit in kind:

Cash emoluments

- ❖ Salaries wages, fees, commission, payment in lieu of leave, bonuses, gratuity or any subsistence, travelling or entertainment or other allowance received in respect of employment or service rendered.
- ❖ Payment providing any discharge or reimbursement of expenditure incurred by the individual or his associate.
- ❖ Payment for the individual's agreement to any conditions of the employment
- ❖ Retirement contributions and retirement payments.
- ❖ Payment for redundancy or loss or termination of employment
- ❖ Other amounts as may be required under Division II of Part III of ITA, 2004.

Payment made to the employee as to conditions of employment

The leading principle is that in order for something to be taxed as income from employment or service rendered *causa causans* (cause or source) for such payment must be employment. These would include such payments as: Payments received under *restrictive covenants*, such as those requiring employees not to compete with the employer upon retirement or dismissal; Contributions made by the employer towards the employee's retirement benefits fund (whether to *approve* or *unapproved* retirement fund).

Retirement contributions and payments

Contributions made by employer (employer's portion) to the employee's retirement fund (for unapproved pension fund) are taxable and should be added to the employee's payroll as part of employment income.

Payment for redundancy or termination of employment

Payments for redundancy or compensation for loss of employment and payment such as salary arrears, gratuity and other emoluments are sometimes earned in one year but received in different year. Section 7 (4) of the Income Tax Act describes the procedure for determination of taxable earnings from these sources. The procedures include:

- ❖ Amount earned should be charged (taxed) on an 'earning basis' and not on a 'receipt basis'.

- ❖ If the cash emolument relates to a year of income which expired earlier than 5 years prior to the year of income of payment, then such emolument is not taxable in its year of service but it has to be divided into six equal parts and then one part is taxed in the year of income of payment (receipt) and the remaining parts each in 5 immediately preceding years of income.

Steps in computing taxable income from termination of employments benefits:

1. Find out the total arrears received.
2. Of the total arrears, find out how much arrears are more than 5 years old (if arrears are from different years).
3. Divide the answer under step 2 by 6.
4. Tax one part ($1/6^{\text{th}}$) in the year of payment (receipt) and the remaining 5 part each in the immediately preceding 5 years of income.

Example 8.1

Mr. John received salary arrears amounting to 1,200,000/= on 31/12/2007. This amount was in respect of the year of income 2001.

The taxable income from this amount can be determined as follows:

- Assessable amount and years in which they are taxable: Since the arrears relate to a year of income (service) 2001 which expired earlier than 5 year ago from the year of payment (2007), they are not to be taxed in the year of service. They should be split into 6 equal parts ($1,200,000/= \div 6 = 600,000/=$).
- Amount of 600,000/= should be taxed in the year of income 2007, and in each of the 5 preceding years, i.e. 2006, 2005, 2004; 2003, 2002.

Note: Arrears which are 5 year or less than 5 years old are taxed in their respective years of income (service) and not in the year of income payment (receipt).

Amount received as compensation for termination of any contract of employment [Section 7 (5)]

- i. Where such contract is for specified term and provides for compensation [S. 7 (5) (a)]: Taxable amount (compensation) shall not exceed the amount which would have been received in the unexpired period and shall be deemed to have accrued evenly in such unexpired period. (i.e. compensation will not be taxed in the year of receipt but in the unexpired period of such contract)
- ii. Where term of contract is not specified but provides for compensation [S. 7 (5) (b)]: shall be deemed to have accrued in the period immediately following such termination at a rate equal to the rate per annum (the same annual rate) of the emoluments from such contract received immediately prior to such termination.
- iii. Where contract is for an unspecified term and does not provide for compensation [S. 7 (5) (c)]:

Taxable amount (compensation) shall be as in (ii) above but the amount to be included as taxable compensation shall not exceed the amount (annual emoluments) of 3 years remuneration at the same such rate.

Example 8.2

In each of the following cases calculate the amount of compensation for tax purpose, and state the years in which they are taxable.

- a) Mr. Timoth is on a five-year teaching contract at a salary of Tsh. 554,000/= per month with effect from 1.1.2012. After serving for two years his contract was terminated, and a lump sum compensation of Tsh. 9,930,000/= was paid to him.

- b) Assume that the term of Mr. Timoth's contract did not specifically provide for compensation on termination. His monthly salary was set at Tsh. 577,200/= per month, and after serving for three years his contract was terminated and a lump sum compensation of Tsh. 19,944,000/= was paid to him.
- c) Mr. AJUA was employed as Assistant Accountant of ABC Ltd with effect from 1.1.2004 at a salary Tsh. 165,000/= per month his term of contract is not specified and also does not provide compensation on termination. He was terminated on 31.12.2004 and a lump sum compensation of Tsh. 5,760,000/=.

Solution to Example 8.2

- a) Contract is to specified term and provides for compensation s. 7(5) (a)
 - ❖ Assessable or taxable amount: SHALL NOT EXCEED:
 - ❖ Amount to be received in the unexpired period assuming that the contract was not terminated
 - ❖ Such amount accrues evenly
 - ❖ Taxable in the year(s) immediately following termination
 - ❖ Compare amount from unexpired period against amount provided from compensation.

Therefore

- ❖ Term of contract: 5 years [1.12012 – 2016]
- ❖ Termination (after 2 years) = 31.12.2013
- ❖ Unexpired period (from 1.1.2014 – 31.12.2016) = 3 years = 36 months
- ❖ Salary from unexpired period:

Monthly salary	Tsh. 554,000
3 years (unexpired) x 554,000/=	554,000 x 36 months = Tsh. 19,944,000/=

Note: this should be the maximum amount to be taxed in him form compensation.

Amount which would have been received in the unexpired period = 19,944,000

- ❖ Compare this figure against amount provided for compensation = Tsh. 19,944,000 Vs Tsh 9,930,000
- ❖ Take the lesser i.e. Tsh. 9,930,000 = amount for compensation
- ❖ Assessment: Note: Is deemed to have accrued evenly in the unexpired period of the contract i.e. from 2004 – 2006 (using the same annual rate).

Therefore, annual compensation = Tsh. 9,930,000/3 years = Tsh. 3,310,000

YOI	2013	NIL (year of termination)
YOI	2014	Tsh. 3,310,000
YOI	2015	Tsh. 3,310,000
YOI	2016	Tsh. 3,310,000

Note: If amount of company was higher than they would being with unexpired period i.e. Tsh. 554,000 x 3 months = Tsh. 19,944,000 (say 21 ml) then taxable compensation is the lower i.e., Tsh. 19,944,000

- b) Where term of contract is not specified, provide for compensation S. 7(5) (b).
 - ❖ Assessment/taxable compensation shall be deemed to have accrued evenly in the period immediately following termination.
 - ❖ Term of contract: not specified
 - ❖ Termination (after 3 years) 31.12.2014
 - ❖ Employed w.e.f., 1.1.2012

- ❖ Period immediately following termination start: 1/1/2015 onward
- ❖ Contract provides for a salary Tsh. 577,200 pm
- ❖ This amount is assumed to accrue evenly and it will be used as a base of allocating amount of compensation given i.e. Tsh. 19,944,000 over different years until the whole lump sum compensation is exhausted/.....
- ❖ Assessment compensation and respective years of income:

Amount of compensation	Tsh. 19,944,000
Monthly salary = Tsh. 577,200	
Annual salary = Tsh. 577,200 x 12	Tsh. 6,926,400
YOI 2004	NIL
YOI 2005	Tsh. 6,926,400
YOI 2006	Tsh. 6,926,400
YOI 2007 (Bal)	Tsh. 6,091,200
	Tsh. 19,944,000

- C) Unspecified term and does not provide for compensation s. 7(5) (c)
- Taxable compensation
 - Shall be deemed to have accrued evenly at the same monthly/annual rate in the period immediately following termination BUT SHALL NOT exceed 3 years remuneration at the same such rate

Solution to example 8.2

- ❖ Terminated on 31.12.2014
- ❖ Therefore, a compensation of Tsh. 5,760,000 is deemed to accrue from 1.1.2015 at the annual rate of Tsh. 1,980,000 (i.e. 165,000 p.m. x 12 months)
- ❖ Taxable amount is restricted to 3 years remuneration using the annual rate of Tsh. 1,980,000
 - o Annual salary is cases 1 x 2 is used basis of allocation
- Case – Basis of compensation.
- ❖ 3 years remuneration (1,980,000 x 3 years) Tsh. 5,940,000 vs Tsh. 5,760,000 computed take the lesser

Therefore assessment is as follows:

Amount liable	Tsh. 5,760,000
Annual rate (165,000 x 12)	Tsh. 1,980,000
YOI 2014	NIL
YOI 2015	Tsh. 1,980,000
YOI 2016	Tsh. 1,980,000
YOI 2017	Tsh. 1,800,000
	Tsh. 5,760,000

Indirect payment

Subsection (1) of section (29) treats a person who indirectly benefits from any payment as if he was the payee of that payment, i.e. the payment will be assessed on him as if it was his income. This provision creates may create loophole for inclusion of such payments as deal condolences paid by the employer either to the employee or to his relatives and other burial expenses paid by the employer.

Benefits in Kind

Motor Vehicle Benefit

The motor vehicle/car benefit is specified under section 27 (1) of ITA, 2004. The conditions are as indicated below:

- ❖ Where employer provides a motor vehicle to an employee for personal/private use

- ❖ Employer incurs all the necessary expenses to maintain the vehicle.
- ❖ Whether employer is entitled to claim those maintenance expenses.
- ❖ Adjust accordingly where a vehicle is used for both purposes, i.e. partly for employment and partly for personal use.
- ❖ Annual benefit depends on the *age and engine size (c.c)* of the vehicle as provided for under the 5th Schedule of the ITA, 2004.

Table 1: Quantification of Motor Vehicle benefit as per 5th Schedule of ITA, 2004

Engine size	Quantity of payments	
	Vehicle less than 5 years old	Vehicle more than 5 years old
Not exceeding 1000 cc	Tsh. 250,000	Tsh. 125,000
Above 1000cc but not exceeding 2000cc	Tsh. 500,000	Tsh. 250,000
Above 2000cc but not exceeding 3000cc	Tsh. 1,000,000	Tsh. 500,000
Above 3000cc	Tsh. 1,500,000	Tsh. 750,000

Example 8.3

Mr. MHASIBU, a resident employee was employed by ABC Ltd, since 1st January 2010 as an Accountant. During the year, among other benefits he was provided with a brand new car (3000 cc). The car use (as estimated by the Commissioner) was 1/3 official use and 2/3 private use. The company (employer) was claiming expenditure for the maintenance of the car.

Quantification of car benefit

- ❖ Taxable benefit is limited to private use proportion only
- ❖ Brand new implies less than 5 years old
- ❖ Under 5th schedule, taxable value is 1,000,000/= (i.e motor vehicle less than 5 years and cc above 2000 but not exceeding 3000).
- ❖ However, it is taxable only if employer is entitled or allowed to claim expenditure for maintenance of the car. If no such right, then car benefit is exempted from taxation (to the employee enjoying the benefit).
 - o Therefore, car benefit = 1,000,000 x 2/3 = 666,667

The Loan Benefit [Section 27 (1) (b)]

- ❖ Taxable amount is the excess of the interest that would have been paid during the year of income in which the payment is made if interest were payable at the statutory rate over the interest paid (charged at free or at subsidized rate) during the year under the loan (applying loan agreement interest rate)
- ❖ For such benefit to arise, the loan must be of twelve months or more.
- ❖ Total loan should exceed three months basic pay. No taxable loan benefit if such total loan and any similar loan outstanding during the previous twelve months do not exceed three months basic salary.

Example 8.4

Assume that the company advanced Mr. MHASIBU 3,000,000/= as a loan payable in 24 equal instalments and free of interest (assume statutory rate of interest is 14% per annum charged on total loan). Assume also a monthly salary of 600,000/=.

Calculating loan benefit

- ❖ Payable on 24 equal instalments (i.e. more than 12 months)
- ❖ Tsh. 3,000,000/= exceeds three (3) months basic salary which is $600,000/ = \times 3 = 1,800,000$. This figure is less than the amount of the loan, therefore there is loan benefit.

There are two methods of computing the loan benefit; namely the average method and the declining balance method.

The declining balance method: This takes into account the decline in the loan balance due to monthly instalment payments.

Outstanding balance	Statutory interest rate	Period (1/12)	Monthly loan benefits
3,000,000.00	0.14	0.08	34,986.00
2,875,000.00	0.14	0.08	33,528.25
2,750,000.00	0.14	0.08	32,070.50
2,625,000.00	0.14	0.08	30,612.75
2,500,000.00	0.14	0.08	29,155.00
2,375,000.00	0.14	0.08	27,697.25
2,250,000.00	0.14	0.08	26,239.50
2,125,000.00	0.14	0.08	24,781.75
2,000,000.00	0.14	0.08	23,324.00
1,875,000.00	0.14	0.08	21,866.25
1,750,000.00	0.14	0.08	20,408.50
1,625,000.00	0.14	0.08	18,950.75
Total benefit			323,620.50

❖ Average methods

$$\text{Annual loan benefit} = (\text{Beginning balance} + \text{ending balance}) / 2 \times \text{rate} \times \text{period}$$

$$= (3,000,000 + 1,625,000) / 2 \times 14\% \times 1 = 323,750$$

Therefore, loan benefit is 323,750/=, slightly higher than under the declining method (323,620.50).

❖ The Housing Benefit [Section 27 (1) (c)]

Arises where employer provides premises (including any furniture or other contents) to employee for residential occupation. Taxable housing benefit equals to A or B, whichever is less, reduced by any rent paid for the occupation by the employee, where-

- A. Is the rental market value of the part of the premises occupied by the employee for the period occupied during the year of income; and
- B. Is the greater of:
 - I. 15% of the employee's total income, calculated without accounting for the provision of the premises and, where the premises are occupied for only part of the year of income, apportioned as appropriate, and
 - II. Expenditure claimed as a deduction by the employer in respect of the premises for the period of occupation.

Example 8.5

Assume that Mr. MHASIBU is provided with fully furnished house during the year of income whose rental market value was Tsh. 200,000 per month. Assume further that the company was claiming expenditure in respect of the premises to the Commissioner to the tune of Tsh. 150,000 per month. Also, assume that his annual total income (without housing benefit) was Tsh. 11,826,617

Computation of housing benefit:

- ❖ Housing Benefit (HB) is the lesser between A and B
- ❖ A: Market value = $200,000 \times 12 = 2,400,000$
- ❖ B: The greater of 1 and 2 :
 - 1. 15% of 11,826,617 = 1,773,993
 - 2. Claimable expenditure ($150,000 \times 12$) = 1,800,000
- ❖ The greater between 1 and 2 is 1,800,000
- ❖ Housing benefit is the lesser between A and B (i.e. 2,400,000 vs 1,800,000) therefore = 1,800,000

Further assume the following:

- ❖ He occupied only two rooms of the house which were estimated by the Commissioner to form 25% of the whole house.
- ❖ He occupied the house for nine (9) months only, thereafter moving to his own house.
- ❖ He was paying a nominal rent of Tsh. 20,000 p.m to the employer (note: for the portion occupied)

Housing Benefit would be:

- ❖ A: Market value = $200,000 \times 25\% \times 9 = 450,000$
- B: The greater of 1 and 2:
 1. $15\% \times 11,826,617 \times 25\% \times 9/12 = 332,624$
 2. Claimable expenditure ($150,000 \times 25\% \times 9$ months) = 337,500
- ❖ The greater between 1 and 2 is 337,500
- ❖ The lesser between A and B is 337,500
- Less: Rent paid ($20,000 \times 9$) = (180,000)
- Housing benefit = 157,500

Example 8.6

Ms MABELE is a full time director employed by Mtandao Ltd, a private company at a salary of Tsh. 4,320,000 per annum. The following information is made available to you during the year of income 2015.

- ❖ Free use of car (1500 cc and 3 years old)
- ❖ Other benefits in the form of a gardener and a watchman than were both on the company's payroll at Tsh. 100,000/= p.m each during the period he occupied the premises
- ❖ The company through cheque in the name of Ms MABELE paid for her personal domestic electricity bills for the whole period she occupied the employer's premises, in total Tsh. 80,400/=
- ❖ She occupied a company house for four months only paying a nominal rent of Tsh. 20,000 per month. The rental market value of the premises was established at Tsh. 600,000/= per annum

Required:

Compute the taxable gains or profit from her employment for the year of income 2015

Solution to example 8.6

Salary	4,320,000
Electricity (direct cash benefit)	80,400
Car benefit (see 5 th schedule)	500,000
Gardener's salary (200,000 x 4)	400,000
Watchman's salary (200,000 x 4)	400,000
Total gains or profits from employment without HB	<u>5,700,400</u>
Add: housing benefit (W1)	<u>120,000</u>
Total gains from employment	<u>5,820,400</u>

W1: Computation of Housing Benefit

- A: Rental market value (600,000 x 4/12) 200,000
 - B: Greater of 1 and 2 –
 1. $15\% \times 5,700,400 \times 4/12 = 285,020$
 2. Claimable expenditure NIL
 - The greater between 1 and 2 is 285,020
 - The lesser of A and B is A 200,000
- Less: Rent paid (20,000 x 4) = 80,000
Housing Benefit 120,000

Other Taxable Employment Benefits

Section 7 of the ITA, 2004 also include the following as taxable employment benefits:

- ❖ Cafeteria services (lunch box, lunch allowance) when given on discriminatory basis
- ❖ Medical services when given on discriminatory basis.
- ❖ Insurance premiums paid by the employer for an assurance or insurance policy of the employee,
- ❖ School fees for the employees children
- ❖ The provision of gas, electricity, water, telephone, a gardener, a watchman and payment of any bill for the employee
- ❖ When shares are sold to the employee at a subsidized price that is below the open market price or where shares are issued for free.

Gifts and Similar Receipts

Gifts or any voluntary payments are not income of the recipient because they have no moral or legal rights over their transfer, i.e. employers do not normally offer gifts in return for employment services. However, this does not necessarily put gifts outside the charging section. Therefore, any gift or voluntary payments received by virtue of employment is liable to tax as benefits from employment. The following are provided as examples:

- Payment of dress or cloth such as Khanga or Vitenge or T-shirts presented to each employee to commemorate company's anniversary or workers or other official day is liable to tax as benefit from employment because it is received by virtue of employment
- Sum paid to an employee upon completion of certain years of services (this will be taxed as part of his emoluments by way of bonus)

Note: Sometimes such sum is known as "golden handshakes"

- This does not qualify as compensation, but rather a "thank", i.e., payments for the loss of office
- These are deemed income liable to tax

Tips received by waiters or taxi drivers from patrons or passengers respectively (note that they are given by virtue of their employment. For such gifts to be taxed, must be paid to the employee by the employer. Gifts excluded (exempted) from taxation include. 'Prize', birthday presents.

Alimony Allowance

Paragraph 1 (i) of the 2nd Schedule of the Act provides for exclusion of amounts derived by way of alimony, maintenance or child support under a judicial order or written agreement. But if such allowance is not under judicial order or written agreement, or separation is not permanent, it will be taxed under "deemed income" principle. Deemed income concept means that there are certain types of gains which under normal circumstances would not be said to constitute income. However, the Act creates a fiction of law and deems such receipts as taxable income.

Exempted Income from Employment

The Second Schedule of the Act provides for general exemption (i.e. exempt amounts from employment, business and investment). For the purpose of employment income, the Act provides for exclusions under subsection 3 of section 7 [i.e. S. 7 (3)] when calculating individuals income from employment (note other exemption provisions are provided under the 2nd Schedule of the Act). Excluded payments or benefits (gains or profits) include are:

- ❖ Exempt amounts (e.g. benefit of domestic services from a member of the family value of self-occupied premises, benefit of any agriculture or handcraft product by an individual himself, etc) and final withholding payments (S.86 ITA, 2004);
- ❖ *On premises* cafeteria services that are available on a non-discriminatory basis;
- ❖ Medical services, payment for medical services, and payment for insurance for medical services to the extent that the services or payments are available with respect to medical treatment of the individual, spouse of the individual and up to four of their children; and made available by employer on a non-discriminatory basis.
- ❖ Any subsistence, travelling, entertainment or other allowance that represents solely the reimbursement to the recipient of any amount expended by him wholly and exclusively in the production of his income from his employment or services rendered (i.e. any allowance that is wholly and exclusively used by the employee for employment purpose)

- ❖ Scholarship or education grant payable in respect of tuition or fee for full-time instruction at an education institution (see paragraph 1 (i) of the 2nd Schedule, this exemption does not cover part time instructions).
- ❖ Final withholding payments (for individuals, final withholding payments include dividends paid by resident corporation, interest on a deposit with financial institution and rent on premises; see S. 86 of ITA, 2004).
- ❖ Benefits derived from the use of motor vehicle where the employer does not claim any deduction or relief in relation to ownership, maintenance, or operation of the vehicle.
- ❖ Benefits derived from the use of residential premises by an employee of the government or any Institution whose budget is fully or substantially out of Government budget subvention;
- ❖ Payment providing passage of the individual, spouse of the individual and up to four of their children to or from a place of employment which corresponds to the actual travelling cost where the individual is domiciled more than 20 miles from service of the employer at the place of employment.
- ❖ Salary and other allowances for the president.
- ❖ Payment that is unreasonable or administratively impracticable for employer to account for or to allocate to their recipients.
- ❖ Retirement contributions and retirement payments exempted under the Public Services Retirement Benefits Act (i.e. amount of 2,400,000/= stated under S.61 (2); and less any deduction under section 61(i.e. retirement contribution to approved retirement fund).

Approved Retirement Funds

As provided under Regulation 8(1), there are five approved retirement funds in Tanzania namely

- ❖ The Parastatal Pension Fund (PPF) established under the Parastatal Pensions Act, 1978.
- ❖ The National Social Security Fund (NSSF) established under the National Social Security Fund Act, 1997.
- ❖ The Public Service Pension Fund (PSPF) established under the Public Service Retirement Benefits Act, 1999 and
- ❖ The Local Government Provident Fund (LAPF) established under the Local Government Provident Fund Act, 2000.
- ❖ Government Employees Pension Fund (GEPF).

Example 8.7

Ms AKISA is employed by International School of MOROGORO from 1.1.2008
The following terms, conditions and particulars relate to her employment during the year of income 2015:

- (i) Her salary per month is Tsh.1,300,000.
- (ii) She was entitled gratuity equivalent to 25% of his basic salary for each successful completed year of service
- (iii) The school provided her with the following benefits:
 - Free use of school's motor vehicle, bought six years ago (Toyota Corolla, 1000cc).The Commissioner has accepted three quarter of the use as representing free use of the car
 - One night security guard who is on the school's payroll at monthly wage of Tsh.250,000

- Electricity, gas, telephone and water bills amounting to Tsh.300,000 p.a. All these benefits were paid directly to the utility companies since they were addressed to the name of employer
 - A residential house for the whole year for which she paid a token rent amounting to Tsh.10, 000 per month. It is estimated that the market rental value of this house is Tsh. 160,000 per month
- (iv) Other sums met by the employer during the year included:
 - Tsh. 50,000 per month as entertainment allowance. She however was not required to account for the amount
 - Monthly duty allowance Tsh.120,000
 - She was given Tsh.30, 000 per month to meet his traveling expenses. She was spending about 25% of such for performing his official duties
 - Free medical services under the arrangement that required the employer to pay medical bills for Ms. AKISA, her husband and up to four children. For the year of income 2015, this bill amounted to Tsh. 300,000
 - Tsh. 130,000 per month to an insurance company for policy covering her life
 - (v) She had two children who are enrolled at the same school. During the year, the school subsidized the school fees and board expenses of the two children amounting to Tsh.2,000,000 in total
 - (vi) After successful of year 2015, her contract was not renewed due to employer's financial crisis. To this effect, she was paid a lump sum of Tsh.2,000,000 as compensation

Required:

Calculate the total taxable income for Ms. AKISA for the year of income 2015 and tax liability if her tax bracket is 25%

Solution to Example 8.7

Determination of Total taxable income of Ms AKISA for the year of income 2015

Salary – 12 months	12x 1,300,000	15,600,000
Gratuity	25% x 1,300,000 x 12	3,900,000
Motor vehicle benefit	125,000 x 3/4	93,750
Security Guard	250,000 x 12	3,000,000
Utility bills (Electricity, water and gas)		300,000
Entertainment allowance	50,000 x 12	600,000
Duty allowance	120,000 x 12	1,440,000
Travelling expenses	30,000 x 12	360,000
Medical allowances		NIL
Insurance policy- life	130,000 x 12	1,560,000
School fees subsidy		2,000,000
Compensation for termination of contract		2,000,000
Sub-total before- HB		30,853,750
Housing Benefit (Note 1)		1,800,000
Total taxable income		32,653,750/
Tax liability 25% there-off		8,163,437.50

NOTE 1: Housing benefit: The lower between

- i. Market rental..... 160,000 x 12= 1,920,000

- And
- ii. The greater of
 $15\% \times 30,853,750 = 4,628,062.50$
 And amount claimed = 0
 Take the greater i.e. 4,628,062.50
 The lesser between 1,920,000 and 4,628,062.50 is = 1,920,000
 Reduced by the amount of rent paid by employee = $1,920,000 - 120,000 \times (10,000 \times 12) =$

Example 8.8

Mr. Wang a Chinese expert was employed by the Juwe Mining Corporation (NMC) a private resident company on expatriate terms, to construct the Kiwira Coal mine Complex in Mbeya. He came to the United Republic on the 1st February 2014 and started working with the company on the following day. From the following information, you are required to compute his taxable income for 2014 year of income.

- He was being paid duty allowance of Tsh. 300,000/= p. m. and a salary of Tsh. 600,000/= p. m.
- For the one month he was in China, he was working with the Government of China which had paid him equivalent Tsh. 500,000/= for the month
- The firm provided him a car (3000cc, of 2010) from the day he arrived in the United Republic. This was wholly used for employment
- For the first two months of his stay in the United Republic, he was accommodated in a hotel. The firm paid a total of Tsh. 1,500,000/= for full board
 After then, he was provided with fully furnished house. The firm had installed the furniture in the house which belonged to the NIC limited which cost Tsh. 6,000,000/=. It was paying a monthly rent of Tsh. 800,000/= p. m. for the house to the NIC and was deducting a token rent of only Tsh. 50,000 p. m. from Mr. Wang salary. Half of the house was used as an office, and the company was entitled to claim repair and maintenance expenditure.
- According to the contract of employment, he had a right of going on leave once annually. However, due to his important role in the project, the firm decided to pay him on 30.5.2014, Tsh., 1,000,000/= in consideration of him foregoing his 2014 annual leave
- On several occasions he had, on behalf of company, to tender some consultancy services to the State Mining Corporation. As thus the employer company paid him a token sum of Tsh. 500,000/= as thanks for the services as he gave the firm a considerable amount of revenue, in the form of consultancy fees from the State Mining Corporation.
- Water bills for the year totalling Tsh. 80,000/= and were fully met by the employer. The bills stood in the name of the employer. Electricity bills (which stood in the name of the employee) totalling Tsh. 50,000/= were also met by the company.
- A night watchman earning Tsh. 80,000/= employed by the company for the house. However, he was only responsible for part of the house used for employment purpose. This watchman was also provided with a house by the company.
- When he came to the United Republic, he came with a number of equipment to be used in his work. He had purchased them in China and as such the firm reimbursed him a total of Tsh. 900,000/=.
- The company paid the following annual membership fees for him:
 - Tsh. 60,000/= as membership fee to the Lion Hotel swimming pool.
 - Tsh. 100,000/= as membership fee to Mining Experts
 - Tsh., 10,000/= to Officers mess

- Tsh. 200,000/= to the Yatch club

- Though he was working in Mbeya, he used to come to DSM during the weekends. The firm was also paying for his trips to and from Mbeya. In the year of income 2014 Tsh. 2,300,000/= were used for those trips.
- On the basis of his contract, the company provided him with free lunch which worth 10,000/= each and two crates of beer for each month. He had taken only 30 lunches for 2014. A crate of beer by year 2014 was Tsh. 25,000/=
 - On one of the trips to DSM he toured Urafiki textile, where as a present he was given complimentary of 6 pieces of 'kitenge' dressing materials each worth Tsh. 5,000/=
 - At the end of each year he is paid a gratuity of Tsh. 1,500,000/=

Solution to Example 8.8

Mr. Wang: Computation of taxable income For the Year of Income 2014 (Figures in Tsh.)

Duty allowance (3,000,000 x 11)	33,000,000
Salary (600,000 x 11)	6,600,000
Salary China (not employed in Tz)	NIL
Car benefit (fully for employment)	NIL
Hotel expenses	1,500,000
Furniture $6,000,000 \times \frac{1}{2} \times \frac{9}{12}$	2,250,000
Leave pay (payment in lieu of leave)	1,000,000
Consultancy fees	500,000
Water bills $80,000 \times \frac{1}{2} \times \frac{9}{12}$	30,000
Electricity $50,000 \times \frac{1}{2} \times \frac{9}{12}$	18,750
Watchman salary (employment purpose)	NIL
Equipment (for employment purpose)	NIL
Membership fees	
- swimming pool	60,000
- Oysterbay	40,000
- Yatch Club	200,000
	not for employment
Trips to/from DSM	2,300,000
Lunch $10,000 \times 30$	300,000
Bear 2 crates = $2 \times 25,000 \times 11$	550,000
Present - Kitenge (urafiki)	NIL
Gratuity	1,500,000
Gain from employment without HB	20,148,750
Add: Housing benefit (N1)	683,667
Total taxable income of	<u>20,832,417</u>

Note one (N1): Housing Benefit

A: Market Rent value	$800,000 \times 9 \times \frac{1}{2}$	3,600,000
B: (i) $15\% \times 20,148,750 \times \frac{1}{2}$		1,513,367
(ii) Expenditure Claimed by Employer		NIL
- The greater between (i) and (ii)		1,513,367
Housing Benefit = lesser of A & B		1,133,367
Less Rent paid by Wang ($50,000 \times 9$)		450,000
Net Housing benefit		<u>683,667</u>

Example 8.9

Professor PAYE is employed as a full time lecturer at MZUMBE University in Tanzania. During the year of Income 2016, he was provided the following facilities (Figures in Tsh):

- ❖ Fully furnished house with a market rental of 450,000 p.m. The employer claimed Tsh. 350,000 p.m as maintenance cost of the premises. However, he was contributing 2% of his salary as rent p.m.
- ❖ A Tsh. 50,000,000; 5 years loan at an annual rate of 5%. For the first 6 months of 2016 and 9% p.a. thereafter until maturity.
- ❖ A brand new car with a capacity of 2500cc for both private use and University purposes in the ration of 3:4 respectively.
- ❖ The university contributed 20% of his salary to an unapproved pension fund of HINDU MENDAL, and he was contributing 5% to the same scheme.
- ❖ His salary scheme indicated that for the first three months of 2016 Tsh., 6,000,000 p.m. and to be increased by 10% after every 3 months.

Required:

Determine taxable employment income and tax liability if his tax bracket is 30% for the year of income 2016.

(Assume that the BOT interest rate is 17% p.a ; the employer claimed maintenance costs of the car)

Solution to Example 8.9

Determination of taxable employment Income and tax liability of Professor PAYE for the year, of income 2016 (Figures in Tsh)

Particulars		Amount Taxable
Basic salary	First three months= 3 x 6,000,000= 18,000,000 Second three months; 1.1 x6,000,000 = 6,600,000 x 3 Months= 19,800,000 Third three months: 6,600,000 x1.1= 7,260,000 x 3= 21,780,000; Then Last Three months: 1.1 x 7,260,000= 7,986,000 x 3=23,958,000.	83,538,000.00
Loan benefit	Note 1.	5,000,000.00
Motor car benefit	Note 2	428,571.43
Contribution to unapproved fund	20% x 83,538,000=	16,707,600.00
Sub-total before Housing benefit		105,674,171.00
Housing Benefit	Note 3	3,729,240.00
Total taxable employment income		109,403,411.00

Notes:

Note 1: Loan benefit

Loan benefit: Interest rate: 17%-5%= 12% x 50,000,000 x 6/12= 3,000,000

17%-9%= 8% x 50,000,000x 6/12= 2,000,000

Total= 5,000,000

Note 2: Motor car benefit

From the ITA, 2004 in the Fifth Schedule; Annul benefit for this car category is 1,000,000, reduced to the proportion of the private use of the car of 3:4; 1,000,000 x 3/7= 428,571.43

Note 3: Housing benefit.

The lower of

- a. 15% x 105,674,171= 15,851,125.6 or
- b. The greater between:
 - i. Market rental= 450,000
 - ii. Maintenance cost claimed: 350,000
Take the greater i.e. 450,000 x 12= 5,400,000
Compare with a) above we take the lower, i.e. 5,400,000
Reduced by rent paid by employee= 2% x 83,538,000= 1,670,760
Housing benefit therefore..... 3,729,240.00

Example 8.10

Professor KNUDS KJETT has been a Professor of Accounting and Marketing and head of the Research and Publication Committee of the School of Business of Mzumbe University. The University has a housing scheme, under which it provides accommodation to its staffs who then suffer an 8% deduction on their salaries as rent. The following information is also available.

- a) KNUDS KJETT was employed under expatriate terms which provided for among other things a salary of Tshs. 6,000,000 per month and free housing. The total bills in this house for the year 2015 (electricity, telephone and water) was shs.1,360,000
- b) He was appointed by the Centre for the promotion of Exports from Developing countries to carry out a market survey in Tanzania on the market for developed countries and products for exports to Europe. He was paid the full costs of the study and an additional fee of Tshs. 5,000,000. This study was carried out during the months of March and April, 2015
- c) On a part time basis, he was offering consultancy services to Morogoro Business and Management Consultants firm. For this, he was paid Tshs.200, 000 per hour. During 2015 he spent 50 hours with the firm.
- d) His birthday coincided with Easter, 2015. During the 2015 Easter celebrations, the University awarded him a birthday present worth shs.920, 000. In addition, another present was given to him by his fellow workers. This was valued at shs.840,000
- e) He was required to appear in the quarterly meetings of the University Senate. The University paid him shs.800, 000 for attendance of such meetings. During 2015, he attended all such meetings held while he was still in employment
- f) A distribution of surplus made from short courses a consultancy carried out at the University during 2014 was made in May 2015 to all the workers. Professor KNUDS KJETT received shs.6, 000,000 from this distribution.
- g) He was provided with a car (2500cc) which was wholly used for domestic purposes by his wife. This car was purchased by the University for Tshs. 12,000,000 in year 2011
- h) As part of the contract of employment, the employer was required to contribute an amount equivalent to shs.300, 000 per month to a private pension scheme established in the Netherlands. The scheme was not approved by the Commissioner.
- i) He received interest from the NBC of Tshs. 3,600,000 and a dividend from a local company of shs.2, 200,000. No withholding tax was deducted at source
- j) Upon completion of his contract, the University met the expenses of 4million for transporting him and his belongings back home to India.

Required:

Calculate the total taxable income of Professor KNUDS KJETT for the year of income 2015

Solution to Example 8.10

Determination of total taxable income of Professor KNUDS KJETT for the year 2015

Employment Income

Salary 6,000,000 x12	72,000,000
Utility Bills (Water, electricity and Telephone)	1,360,000
Birth Day- Easter Presents	NIL
Senate Meeting allowances: 800,000 x4	3,200,000
Distribution of surplus made from short courses an consultancy by University	6,000,000
Motor vehicle benefit: (as per fifth schedule of the ITA 2004)	1,000,000
Amount Contributed to in approved pension scheme in India: 300,000 x 12	3,600,000
Transport allowance back home to India	NIL
Sub Total before Housing Benefit	87,160,000
Housing Benefit: Note 1	4,800,000
Sub total	91,960,000

Business Income:

Amount received from centre for promoting export	5,000,000
Consultancy fee payment from Morogoro Business Management (200,000 x 50 hour)	10,000,000
Sub total	15,000,000

Investment Income: (Subject to Final withholding tax)

Interest received from NBC	3,600,000
Dividend from company shares	2,200,000
Sub-total	5,800,000
Total taxable Income	112,760,000

Computation of Housing Benefit:

NOTE 1: Housing benefit: The lower between

i. Market rental..... 400,000 x 12= 4,800,000

And

ii. The greater of

15% of total income= 15% x 112,760,000= 16,914,000

And amount claimed= 0

Take the greater i.e. 16,914,000

The lesser between 4,800,000 and 16,914,000 is = 4,800,000

Determination of Tax Liability of Individuals

Individuals include sole traders and salaried people who are taxed at progressive individual Income tax rate, which varies from the lowest marginal rate of 13% to the top marginal rate of 30%. However, for non-resident individual the applicable rate is 20%, which is charged on total income. Table 1 indicates the tax rates applicable to various income brackets for salaried people. However, these rates are normally revised and changed in every budget session and indicated in Finance Act of each year, thus they are not static.

Table 2: Individual Tax Rates Applicable in Mainland Tanzania

Annual Income	Tax Rate
Where total income does not exceed Tsh. 2,040,000	NIL
Where total income does exceed Tshs. 2,040,000 but does not exceed 4,320,000	9% of the amount in excess of Tsh. 2,040,000
Where total income does exceed Tshs. 4,320,000 but does not exceed 6,480,000	Tsh. 205,200/= plus 20% of the amount in excess of 4,320,000
Where total income does exceed Tshs. 6,480,000 but does not exceed 8,640,000	637,200/= plus 25% of the amount in excess of 6,480,000/=
Where total income exceeds Tshs. 8,640,000	Tshs. 1,177,200/= plus 30% of the amount in excess of Tshs. 8,640,000

Source: Finance Act 2016

Example 8.10

Mr . John Hamis and Maduhu Masawe are employees of Mzumbe University. Mr. John is employed as Driver while Mr. Maduhu is employed as a lecturer. For the year of income, 2016, the monthly salaries were Tsh. 250,000 and Tsh. 2,500,000 respectively.

Required: determine their tax payable for year 2016.

Solution to example 8.10.

Tax payable for Mr. John Hamis for Year of Income 2016:

Total income for the year: Tsh. 250,000 x 12..... Tsh. 3,000,000/=

Using Table 1(Individual tax rates applicable to in Mainland Tanzania) above tax payable would be: (3,000,000 -2,040,000) x 9%= 960,000 x9% = Tsh. 86,400.

Tax payable for Mr. Maduhu Masawe Year income 2016

Total income for year. Tsh. 2,500,000 x 12= Tsh. 30,000,000.

Tax payable= Tsh. 1,177,200/= plus 30% of the amount in excess of Tsh. 8,640,000

Tsh. 1,177,200/= plus 30% (Tsh. 30,000,000 – Tsh. 8,640,000)

= Tsh. 1,177,200 + Tsh. 6,408,000/=

= Tsh. 7,585,200/=

Therefore, taxable payable for Mr. Maduhu is Tsh. 7,585,200/=

Table 3 presents the applicable rates for various turnover bands for small traders. Some of the small traders do not keep record; still others do maintain proper and complete records. All of these traders are taxed based on their annual turnovers.

Table 3: Turnover Bands and their Tax Rates Applicable in Mainland Tanzania

Annual Turnover	Tax payable where records are incomplete	Tax payable where records kept are complete
Where turnover does not exceed Tsh. 4,000,000	Nil	Nil
Where turnover exceeds Tsh. 4,000,000 but does not Tsh. 7,500,000	Tsh. 100,000	2% of turnover in excess of Tsh. 4,000,000
Where turnover exceeds Tsh. 7,500,000 but does not Tsh. 11,500,000	212,000	70,000 + 2.5% of turnover in excess of Tsh 7,500,000
Where turnover exceeds Tsh. 11,500,000 but does not Tsh. 16,000,000	Tsh. 364,000	170,000 + 3.0% in excess of Tsh. 11,500,000
Where turnover exceeds Tsh. 16,000,000 but does not Tsh. 20,000,000	575,000	305,000 + 3.5% of amount in excess of 16,000,000

Source: Finance Act 2012

Example: 8.11

Mr. Tarimo and Sanga hold small business in Dar es Salaam. Mr. Tarimo deals with restaurant business and Mr. Sanga deals with whole sale of rice and other agricultural products. Mr. Tarimo keeps complete records and Mr. Sanga does not. For the year of income 2016 total turnover was Tsh. 20,000,000 and Tsh. 15,000,000 for Tarimo and Sanga respectively.

Required:

Determine the tax payable for both Tarimo and Sanga for the year of income 2016.

Solution to example 8.11:

Using the turnover bands and applicable rates for small traders (see Table 2 above) the tax payable can be computed as follows:

Mr. Tarimo: Since he keeps complete records the computation would be:

$$305,000 + 3.5\% (20,000,000 - 16,000,000) = 305,000 + 140,000 = \text{Tsh. } 445,000$$

Mr. Sanga: Since he does not keep complete records, the computation would be

Turnover is between Tsh. 11,500,000 and Tsh. 16,000,000, and then tax payable is Tsh. 364,000.

Pay As You Earn System in Tanzania

Operational requirement of PAYE

Under section 81, a resident individual or entity is required to withhold tax in respect of all taxable payments made to his employees. And since under section 7 a benefit in kind provided by the employer is also deemed to be a payment, such withholding is required to cover such benefits as well. Normally, withholding must be done on the gross amount since there are very few expenses that can be deducted from employment income, due to the strict condition that demands that for an

expense to be allowable it must be one that was wholly and exclusively incurred in the production of the employment income. The only significant deduction, which all employers and employees must take cognisance of is the one provided for under section 61. That section demands that in those cases where the contributions of the employer are included in the payroll, than a deduction should be granted for the employees total emoluments, in respect of the month's contributions made by both the employee as well as the employer to an approved retirement fund. The tax rates therefore should be applied on the income net of the deduction in respect of these two items.

The net effect of this is that in arriving at the month's taxable income an employer should deduct the employee's contribution to an approved retirement fund. The regulations and practice notes issued by TRA consider NSSF, PSPF, ZSSF and any other statutory fund, as approved funds.

Other Requirements on PAYE

The tax withheld in any month must be remitted to the Commissioner General within seven days of the month following the month of such withholding. In this regard the employer should always bear in mind the excluded days' concept. Where the employer fails to withhold he is still required to pay the tax that he should have withheld as required above. In such a case both the employer and the employee will be jointly and severally liable for the payment of such tax. The employee is required to pay tax payable by a defaulting employer within the same seven-day time limit. Defaulting employers who are made to pay the tax not withheld are entitled to recover such tax from the employees. Employers are required to give certificates to the employee specifying the amount paid to him and the tax withheld by 30th January of the following year, or within 30 days of cessation of employment. Employers are also required to file half-year returns to the commissioner specifying the payment made during the period; names and addresses of withholders; and tax withheld. Such returns must be submitted within 30 days after the end of every six-month calendar period.

Chapter Summary

This chapter has discussed the determination of taxable income from employment as provided for under section seven (S.7) of the income tax Act 2004. The chapter provides illustrations and worked examples on how tax from employment is calculated. The chapter can be summarised as follows:

- ❖ The Income Tax statute defines the term employment under to mean: A position of an individual into the employment of *another person*; a position of an individual entitling the individual to *periodic remuneration* in respect of service performed, a *public office* held by an individual, and includes a past, present and prospective employment.
- ❖ The manager or director of an entity is an employee and thus receives employment income.
- ❖ Taxable income from employment includes the individual's gains or profits from the employment. This includes direct cash emoluments and benefit in kind.
- ❖ Cash emoluments include salaries wages, fees, commission, payment in lieu of leave, bonuses, gratuity or any subsistence, travelling or entertainment or other allowance received in respect of employment or service rendered. Taxable benefit in kind includes housing benefit, motor car benefit, loan benefit, medical benefits and others.
- ❖ Employment income taxes are deducted at source by all employers. This means that all employers are tax collecting agents and are supposed to deduct tax from employment income and remit to TRA within seven days after the end of the month for which the deductions are related.

End of Chapter Eight Revision Questions

1. Define the term employment for tax purpose, clearly citing necessary conditions for employment to arise as opposed to contract for service.
2. Define employment for tax purposes, clearly identifying necessary conditions for employment to arise as opposed to business.
3. Identify receipts/incomes/benefits, which are not taxable as employment income as provided under subsection 3 of section 7 of the ITA, 2004. Give reasons (where applicable) for such exemptions.
4. "Where the employer provides his employee with a house for residential purposes, the employee is liable to tax on the housing benefit" (Section 27 of ITA 2004). *State* the formula for the determination of the value of housing benefit for income tax purposes.
5. Mr. MORISI, a resident employee was employed by ABAC Ltd since 1st January 2010 as Accountant. For the year 2015, he was provided a fully furnished house whose rental market value was 200,000/= per month and the company was allowed to claim rental expenditure amounting to 150,000/= per month. During the year, he was provided a four years old car of 3000cc. The car use was estimated by the Commissioner for Income Tax (CIT) as 1/3rd official use, and 2/3rd private purpose. The company was claiming expenditure for repair and maintenance of this car.
 - a) During the year, the company advanced him 30,000,000/= as a loan payable in two years at a subsidized interest rate of 5% per annum (assume statutory rate of interest of 14% per annum for the year of income 2015).
 - b) He contributed 15% of his basic salary every month to NSSF and he was contributing 5% of his basic salary to the same fund.
 - c) The employer also paid for him scholarship fees of 10,000,000/= which was for full time course.
 - d) He is also holding a part-time consultancy work to private firm belonging to his father in law, where he is being paid a monthly salary of 1,000,000/=.
 - e) The term of his service agreement with the company provided for payment to him, so as not to work for any competitor after his retirement. In return for this covenant, the company paid him 2,000,000/= in December 2015.
 - f) He is holding Savings account with CRDB. On 30th September, 2015 he received 2,685,000/= as interest from his savings account.
 - g) His monthly salary was fixed at 3,600,000/=.
 - h) The employer also met the following bills during the year
 - Electricity 650,000/=
 - Gas 710,000/=
 - Water 321,950/=

Required: From the above information, calculate the total taxable income of Mr. MORISI for the year of income 2015 as stipulated in the ITA, 2004.

6. Mr. Ahmed is employed as the Chief Accountant of Changarawe Hardware Co. Ltd at a salary of Tsh. 72,000,000 per annum. He is provided with fully furnished house since 1.1.2014, which was leased by his employer at Tsh. 24,000,000 per annum. Commissioner has also established that this is the true market rental value for this particular house. Mr. Ahmed agreed to pay Tsh. 7,200,000 per annum as rent. He is also entitled to unlimited use of the employer's car. The car provided to him is fully used by his wife for domestic purposes and shuttling children to school. This is a new edition. Toyota RAV 4 with 3,500 cc. and it was bought brand new three years ago. Other incomes from other sources for the year are as follows:
 - He received a dividend of Tshs. 7,200,000 from DIMON Ltd where he held 3,600 ordinary shares
 - Also, he received interest amounting to Tshs. 2,500,000 from his savings account with NMB, Morogoro branch.

Required:

- (i) Calculate his total taxable income for the year 2014
- (ii) Assume that one of the rooms in the house (which forms 1/3rd of the total house) was used by him for office purposes and also that he left to his bungalow at Kihonda Morogoro at the end of September 2014. Calculate his total taxable income for the year.

7. Professor SRINIVAS MADISHETI is a Professor of Accounting and Marketing and head of the Research and Publication Committee of the School of Business of University of Dar es Salaam. The University has a housing scheme, under which it provides accommodation to its staff who then suffer an 8% deduction on their salaries as rent. The following information is also available.

- k) Professor Srinivas was employed under expatriate terms which provided for among other things a salary of Tsh. 6,000,000 per month and free housing. The total bills in this house for the year 2015 (electricity, telephone and water) was Tsh.1,360,000.
- l) He was appointed by the Centre for the promotion of Exports from Developing countries to carry out a market survey in Tanzania on the market for developed countries and products for exports to Europe. He was paid the full costs of the study and an additional fee of Tsh. 5,000,000. This study was carried out during the months of March and April, 2015.
- m) On a part time basis, he was offering consultancy services to Magomeni Business and Management Consultants firm. For this, he was paid Tsh.200,000 per hour. During 2015 he spent 50 hours with the firm.
- n) His birthday coincided with Easter, 2015. During the 2015 Easter celebrations, the University awarded him a birthday present worth Tsh.920, 000. In addition, another present was given to him by his fellow workers. This was valued at Tsh.840, 000.
- o) He was required to appear in the quarterly meetings of the University Senate. The University paid him Tsh.800, 000 for attendance of such meetings. During 2015, he attended all such meetings held while he was still in employment.
- p) A distribution of surplus made from short courses and consultancy carried out at the University during 2014 was made in May 2015 to all the workers. Professor Srinivas received Tsh. 6, 000,000 from this surplus distribution.
- q) He was provided with a brand new car (2500cc). The car was wholly used for domestic purposes by him and his wife. This car was purchased by the University for Tsh. 50,000,000 in year 2011.
- r) As part of the contract of employment, the employer was required to contribute an amount equivalent to Tsh.300, 000 per month to a private pension scheme established in the Netherlands. The scheme was not approved by the Commissioner.
- s) He received interest from the NBC of Tsh. 3,600,000 and a dividend from a local company of Tsh.2, 200,000. No withholding tax was deducted at source.
- t) Upon completion of his contract, the University met the expenses of 4million for transporting him and his belongings back home to India.

Required:

Calculate the total taxable income of Professor Srinivas for the year of income 2015.

CHAPTER NINE

TAXABLE INCOME FROM BUSINESSES

Introduction

This chapter discusses the determination of incomes from businesses for tax purposes. The chapter starts by discussing what constitutes business, the major features of income derived from business, business income exempt from taxation and computation of taxable business income. The main section under discussion in this chapter is section eight of the income tax Act-ITA, 2004.

Learning Outcome

After completing this chapter readers should be able to:

- ❖ Describe the meaning of Business
- ❖ Describe the characteristics of Trade
- ❖ Determine total income from business
- ❖ Compute taxable profits from business.
- ❖ Determine partnership income and taxable income of partners

Meaning of Business

Business is defined as any form of trade, profession; or vocation but does not include employment. According to paragraph (a) of subsection 1 of section 4 of ITA, 2004, income tax is charged and payable for each year of income by every person who has TOTAL INCOME for the year of income. Total income is defined under section 5 (1) to mean 'sum of the person's chargeable income for the year of income from each employment, business, and investment. In ordinary meaning business is meant to include purchase and sale of goods in an attempt to make profits. However, for income tax purpose, S. 3 of ITA 2004 defines business as any form of:

- ❖ Trade;
- ❖ Profession; or
- ❖ Vocation

Business income does not include income from employment (contract of service or service rendered). Therefore, for income tax purpose, trade, profession or vocation are treated as having the same meaning, i.e., any income arising from either of this is a business income.

Business income from Trade

Section 3 of ITA 2004 interprets "trade" as including every trade, manufacture, or concern in the nature of trade. A trade may be construed to be a venture of speculative nature, pecuniary risk, and a commercial enterprise that seeks to create profits or income.

Business Income from Profession

The act does not interpret the word profession. However, for income tax purpose the ordinary meaning has been accepted. Thus, it involves the idea of an occupation requiring either purely intellectual skills or any manual or technical skills as in painting; repairing/maintaining/assembling

of equipment; or an assignment or occupation in a particular field which requires study and expertise like accountancy. Therefore, profession is different from trade in that one needs to possess intellectual skills or technical know-how skills.

Business income from Vocation

The act does not interpret the word vocation, which can be explained as a strong impulse or calling or inclination to follow a particular activity or career, i.e. such person is self-employed for income tax purpose. It is an occupation or trade or business in which one engages in more or less regularly and neither profit motive nor formal/systematic activity exists. However, for income tax purpose any excess over outgoings is taxable.

Characteristics of Trading

The following characteristics describe the present or absence of trade:

- ❖ Profit-seeking motive: Presence of profit-seeking motive is a strong evidence of trading activity.
- ❖ Manner in which the asset is acquired: If the asset was acquired by purchase, whereby he is a dealer in the same line or articles, then it is likely to be trading.
- ❖ The nature of assets acquired and quantity: Purchase for private consumption, investment or resale may be justified by the nature and quantity/volume of the item.
- ❖ The length of time (period of ownership): The interval of time between purchase and sale and what happens to it during that period is relevant.
- ❖ Supplementary work on purchased item to make it more attractive to customers
- ❖ The method in which the sale is effected or secured: A person carrying on a trade would seek sales outlets (sales organisations) and potential customers by way of advertising or soliciting customers
- ❖ Frequency of transactions in similar commodities
- ❖ Trading interests in the same/similar field: If a person has already carried out a business in certain commodities it may be possible to argue that any transactions which he undertakes in relation to such commodities are connected to his former business

Identification of Business Motives

In order to recognise whether a business exists so that business income tax can be charged, an activity or business should be tested against the following attributes:

- ❖ Nature of activity: An activity should constitute features of a trade, profession or vocation
- ❖ Nature of the accruing income (S. 11): Capital income, e.g., sale of an asset; or revenue income, from that particular activity such as trading stock
- ❖ Expenses deducted (S. 11): Test whether expenses deducted were incurred "wholly and exclusively" in the production of that income

Business Assets

Business asset means an asset to the extent to which it is employed in a business and includes a membership interest of a partner in a partnership but excludes.

- ❖ Trading stock a depreciable asset;
- ❖ Interest in land held by an individual that has a market value of less than 10,000,000/= at the time it is realised and that has been used for agricultural purpose for at least two of the three years prior to realisation.
- ❖ Beneficiary's interest in a resident trust:

- ❖ Shares in a corporation where receipt of dividend in respect of shares is exempted in the hands of the shareholder under section 54(2).
- ❖ Shares and securities listed on the DSE that are owned by a resident person, by non-resident person who either alone or with other associates controls less than 25% of the controlling shares of the issuer company.

Depreciable Business Asset

Depreciable asset means an asset employed wholly and exclusively in the production of income from a business and which is likely to lose value because of wear and tear, obsolescence or passing of time but excludes goodwill, an interest in land, a membership interest in any entity and trading stock.

Sources of Income from a Business

Gains and profits from Business

According to section 8 of the ITA 2004, a person's income from business for a year of income is the person's gains or profits in conducting the business for the year of income. Subsection 2 of section 8, lists down what should be included in calculating business income:

- ❖ Service fees
- ❖ Incomings for trading stock
- ❖ Gains from realisation of business assets or liabilities of the business (Division III of Part III, i.e., s.36)
- ❖ Amounts required being included under paragraph 4 of the third schedule on the realisation of depreciable assets.
- ❖ Amounts derived as consideration for accepting a restriction on the capacity to conduct the business.
- ❖ Gifts and other ex-gratia payments received by the person in respect of the business.
- ❖ Amounts that are effectively connected with the business and that would otherwise be included in calculating the person's income from an investment or employment.
- ❖ Other amounts required to be included under rules governing amount used in calculating the income tax base, partnerships, trusts, corporation, retirement funds, and permanent establishments.

Other Incomes under Business

The following are deemed as incomes under business income:

- ❖ Gains or profits of a partner is a sum of remuneration payable (salary); Any interest on capital payable to him; Less any interest payable by him to the partnership; and his share of total income of the partnership as stipulated in section 48 of ITA, 2004.
- ❖ Any sum under any insurance against loss of profits, or received by way of damages or compensation for loss of profits is taxable in the year of income in which it is received [s.4 (b)]

Where-

- Any expenditure or loss has been deducted; or
- A deduction in respect of any reserve or provision to meet any liability has been made; and in later year of income the whole/part of such expenditure /loss/liability is recovered/released (for liability) or retention of such reserve or liability becomes unnecessary, then such sum is taxable in the year income in which it is recovered/released/no longer required.

- ❖ Excess of sales of particular pool of depreciable assets under the 3rd schedule over the total of opening written down value (WDV) no addition during the year (see also S.8 (2) (d) of ITA, 2004.

Computing Taxable Profits of a Business

Conditions of Deductible Expenses under Income Tax Act

Section 11 of the Income Tax Act provides the general principles for allowable deduction in order to arrive at taxable business Income. This section is very important in computing income for tax purpose because income liable to tax is not the same as profits/incomes determination under financial accounting principles e.g. some expenses may be allowed (deducted) to arrive at accounting profits while the same may be disallowed to arrive at taxable income.

The general principle of “wholly and exclusively incurred...” requires that, to arrive at total income chargeable to tax, deduct only those expenditures or losses which are *wholly and exclusively incurred* in the direct production of such income. That is, expenditure allowed must be of revenue nature. On the other hand, disallow (do not deduct) those expenditures or losses which are not wholly and exclusively incurred in the direct production of such income. In this case, all expenditures of capital nature (e.g., advertisement of capital nature, expenditure on acquisition of long term assets for use in the business, exhaustion of capital.) should not be allowed as deduction for tax purposes.

Examples of Expenses Deductible under Income Tax Act

Section 11 (2) of the income tax Act 2004 provides for the deduction of expenditure “wholly and exclusively” incurred in the production of such income (business or investment) in that year of income. Such expenses allowed include:

- ❖ Interest (s. 12): Interest incurred during a year of income under debt obligation that is wholly and exclusively incurred in the production of business or investment income is allowable provided:
 - ❖ The debt obligation was incurred in borrowing money which was employed during the year of income or was used to acquire an asset that is used wholly and exclusively in the production of such income.
 - ❖ The debt obligation was incurred wholly and exclusively in the production of such income, in any case.
 - ❖ For a limit amount of deduction for an exempt-controlled resident entity, see, S.12 (2) to S. 12 (4)
- ❖ Trading stock (S. 13): Trading stock of the business to be deducted is determined as SUM of trading stock during the year of income and any expenditure that is included in the cost of trading stock MINUS value of closing stock during the year of income. Closing stock is the lower of the cost of the stock at the end of the year of income or market value of such stock at the end of the year of income.
- ❖ Repair and maintenance expenditure (s.14): This includes repair or maintenance of depreciable assets owned and incurred wholly and exclusively in the production business income. Note that any expenditure that intends to improve an asset (e.g. increasing life span; production or quality capacity, etc.) is not allowed but rather this is included in the cost of the asset (expenditure of capital nature).
- ❖ Agriculture, research and development and environmental expenditure (S. 15)
These include:

- Agricultural improvements (agricultural/livestock/fish farming improvements): Clearing the land and excavating irrigation channels; or Planting perennial crops or trees bearing crops (not annual/seasonal crops).
- ❖ Environmental expenditure:
Expenditure incurred by owner or occupier of farmland for prevention of soil erosion.
- ❖ Research and development expenditure: Expenditure in the process of developing business products or processes includes expenditure incurred by the company for the purpose of an initial public offer (IPO) and the first listing on the Dar-es-Salaam Stock Exchange.
- ❖ Gifts to public and charitable Institutions(s. 16):
 - Contributions during the year to charitable institutions or social development project; or donation under s.12 of the Education Fund Act, 2001.
 - Note that deduction available for a year of income shall not exceed 2% of person’s income of the business calculated without a deduction of such contribution.
- ❖ Depreciation allowances for depreciable assets (s. 17): These allowances are granted under the 3rd schedule of the Act provided that such assets are used wholly and exclusively in the production of such business income in that year of income.
- ❖ Losses on realisation of business assets and liabilities (s.18; and also Division III of Part III) provided that:
 - Asset is or was employed wholly and exclusively in the production of business income;
 - Obligation incurred (borrowing), where such money was used in the business or to purchase an asset that is used wholly and exclusively in the business.
 - Direct business Liabilities other than debt obligation.
- ❖ Losses from a business or investment other than partnership or a foreign permanent establishment (s. 19):
 - Deduct unrelieved loss of the year from any other business or investment
 - Deduct any unrelieved loss of a previous year from any business or investment
 - For definitions of “loss” and “unrelieved loss” see s.19 (4).

Business Expenses Not Deductible under Income Tax Act

Section 11 (I) and 11 (3) of the income tax Act 2004 provides for expenditures which are not allowed when determining taxable business income. These sections disallow certain items of expenditure (those “not wholly and exclusively” incurred) to be deducted in the course of arriving at taxable income.

- ❖ No deduction is allowed for consumption expenditure or excluded expenditure incurred by a person [s. 11 (1) (a)]. Consumption expenditure is defined under section 11 (4) to mean any expenditure incurred by a person to maintain himself, his family or establishment, or for any other personal or domestic purpose. Excluded expenditure under the same subsection 4 means tax payable under ITA; bribes and expenditure incurred in corrupt practice; and fines and similar penalties payable to government or a political subdivision for the breach of any law or subsidiary legislation; final withholding payments; or distribution by an entity.
- ❖ No expenditure is allowed of capital nature. This is an expenditure that secures a benefit lasting longer than twelve months. Purchase of non-current assets are not allowed expenditure for tax purposes.

Exceptional Business Expenditures

Some expenses are very necessary but not allowable for various reasons most of them derived from the case laws, and or logics. Consider the following cases:

- ❖ Personal and domestic expenditure (food, clothes, etc.) although necessary is not deductible expenses. It is indirectly incurred in the production of the income but also specifically prohibited by Section 11(1) (a). However, even if it was not prohibited by this section, still it would not qualify because this is an appropriation of income (i.e. it is difficult to control/restrict a person on how to spend his income especially when such person intends to avoid "loss" in a form of tax).
- ❖ Loss though default by a Director is not allowable on the similar grounds as above [(see also s.11 (4) (c) under "excluded expenditure"].
- ❖ Accountancy and taxation professional fees are allowable by discretion. These are not directly incurred in the production of the income but rather after the income has been earned in order to know the correct income, i.e., in order to conform to tax law requirements, accounts must be prepared and audited and also tax computations must be prepared for submission to the authority. In these cases, professional assistance/fees is recognised as valuable. This is a similar case to research and development expenditure.
- ❖ Consultancy fees on back duty investigation is not allowed [see also s.11 (4) (c) under "excluded expenditure"].
- ❖ Any criminal or civil penalty or fine incurred for infringement of the law and related legal cost to defend the suit are not deductible because are not commercial outlay. They arise because such a person is guilty of the law out of his dishonesty or negligence [(s.11 (4)(c) under "excluded expenditure").
- ❖ Maintenance and advertising outlays made to third party are not allowable although are for genuine business purposes.
- ❖ Business license fees are not allowable.
- ❖ Contributions to general public (voluntary, subscriptions and donations) if are concerned with health services; education; water and road repair or maintenance provided that they do not exceed 2% of gross taxable income are allowable (s.16).
- ❖ Repairs or improvement of capital nature are not allowed (They are not ordinary revenue expenditure) [see provision 2 of section 14].

Tax Rates Applicable to Businesses and Corporations

The total income of a corporation, trust, unapproved retirement fund or domestic permanent establishment of a non-resident person is taxed at of 30%. Corporations with perpetual unrelieved losses for 3 consecutive years are taxed at 0.3% of annual turnover in the third year of perpetual unrelieved loss. Listed corporation in the Dar es Salaam Stock Exchange, with at least 30% shares issued to the public are taxed at the rates is 25% for three consecutive years from the date of listing. Mining corporations or petroleum corporations are taxed at the rate of 30%. The repatriated income of a domestic permanent establishment of a non-resident person is taxed at the rate of 10%.

Normally, tax rate changes from time to time through the Finance Act. The Finance Act will normally specify the specific date upon which the new tax rates take effect. Sometimes the Finance Act may not specify the date upon which the new tax rates take effect, then the changes are treated as having effect from the start of the calendar year after the Act changing the rate receives Presidential assent.

The effective dates of new tax rates may not coincide with the start of the tax payers' year of income; meaning that the income of the tax payer in a year of income will be subject to two different tax rates because it was earned when two different tax rates applied. Paragraph three of the first schedule of

ITA, 2004 provides the total income of the person's income shall be apportioned between the part of the year of income accruing before the change and the remaining part after the change according to the number of days in each part. The part of income attributable to the part of the year before the change will be taxed at the rate applicable before the change and that attributable to the remaining part shall be taxed at the rate applicable after the change.

Computation of Taxable Business Income: Examples

Computation of taxable business income is done by considering the relevant sections which identify incomes considered as taxable income for tax purposes and expenditure allowed by the income tax Act 2004. When accounts are prepared under accounting principles then such accounts must to be adjusted to obey the rules of the income Tax Act provisions by adding back all expenditures not allowed and subtracting all incomes that were included but the Act does not recognise them as business income. Addition is also made for allowable expenses under ITA, 2004 but not regarded as business expenditure under accounting principles.

Example 9.1

The following is the profit and loss account of Mr. Mkude who is engaged in manufacturing business for the period from 1st January 2015 to 31st December 2015.

	Tsh.	Tsh.
Gross profit	40,000,000	
Other income:		
Bank saving interest	450,000	
Insurance compensation		
- Loss of profit	2,000,000	
Trade bad debts recovered	850,000	
Gross rent from residential house	1,500,000	44,800,000
Less: expenses		
Salaries and wages	4,800,000	
General expenses (Note 1)	2,600,000	
Telephone and electricity	900,000	
Depreciation	800,000	
Income tax	1,000,000	
Motor car expenses (Note 2)	5,000,000	
Bad and doubtful debts (Note 3)	500,000	
Repairs (Note 4)	850,000	
Promotion and advertisement (Note 5)	700,000	18,150,000
Net profit		<u>26,650,000</u>

Additional information

- (1) General expenses include the following:
 - (i) Travel expenses for Mr. Mkude to Nairobi for holiday Tsh. 500,000
 - (ii) Medical expenses for Mr. Mkude Tsh. 100,000
 - (iii) Legal costs and stamp duty on acquisition of a godown in October, 2015 Tsh. 900,000.
- (2) Mr. Mkude estimates that 20% of the motor car expenses represented personal and private use.
- (3) Bad and doubtful debts:

The whole amount represented a general provision for bad and doubtful debts.
- (4) Repairs:

The amount was incurred on a used building purchased for use in the business as a godown .

- (5) Promotion and advertising: The amount includes Tsh. 100,000 being the cost of advertising sign board installed along Madaraka Road.

Required:

Compute total taxable income for Mr. Mkude's business in the year of income 2015.

Solution to Example 9.1

Computation of total taxable income of Mr. Mkude's Business for the year of income 2015

		26,650,000
Net Profit as per accounts		
Add back: Disallowable deductions:		
Travel expense on holiday to Nairobi	500,000	
Medical expenses	100,000	
Motor vehicle expenses (Private)	1,000,000	
Bad and doubtful debts	500,000	
Advertisement- Sign board	100,000	
Depreciation	800,000	
Income tax	1,000,000	
		4,000,000
		30,650,000
Sub total		
Less : Allowable deductions:		
Bank savings interests	450,000	
Rent from residential house	1,500,000	
		(1,950,000)
Total taxable business income		28,700,000
Other taxable income:		
Rent from residential house		1,500,000

Example 9.2

ABACOMBI Tours Ltd runs a tourist trade in Manyara. The following information has been extracted from the company's books and is made available to you for scrutiny as a tax expert for the tax year 2015.

I. Expenses deducted during the period:

- Salaries and wages	Tsh. 18,400,000
- Telephone and electricity	1,200,000
- Insurance	10,000,000
- Repairs and maintenance	20,000,000
- Advertising and promotion	2,800,000
- Depreciation	3,160,000
- Professional charges	8,000,000
- Management and consultancy fees	24,000,000
- Travelling and transport	16,000,000
- Motor vehicle expenses	26,000,000
- General administration	1,400,000

II. Net loss during the same period after deducting deductions under I above was (30,960,000/=)

III. Additional information relating to the period:

(a) Telephone and electricity

- Local and international calls	Tsh. 240,000
- Purchase of second hand switch-board	800,000
- Repairs of intercom	160,000

(b) Repairs and maintenance

- Cost of fire extinguisher	10,000,000
- Uniforms for staff	4,000,000
- Cost of fire alarm system	5,000,000
- Repairs of shed and painting	1,000,000

(c) Advertising and Promotion

- Newspaper advertising	400,000
- Tourist sightseeing	1,600,000
- Large Neon sign: Hotel name	800,000

(d) Depreciation charges

- Loose tools	160,000
- Fixed assets	3,000,000

(e) Professional charges

- Audit and Accountancy fees	2,000,000
- Registration of Property	5,000,000
- Tax Penalty	1,000,000

(f) General and Administration

- Bad debts written off	400,000
- Donation to a political party	300,000
- Provision for uncollectible accounts	240,000
- Exchange loss on foreign loan	460,000

(e) The 3rd schedule depreciation allowances for depreciable assets have been agreed at Tsh. 24,000,000

Required:

Calculate the company's business income for tax purpose for the accounting period covered by this information

Solution to Example 9.2

Determination of taxable income for ABACOMBI Tours Ltd for the year 2015

Net loss as per accounts		(30,960,000)
Add back disallowable expenses:		
Switch board	800,000	
Fire extinguisher	10,000,000	
Fire alarm system	5,000,000	
Tourist sight seeing	1,600,000	
Registration of property	5,000,000	
Tax penalty	1,000,000	
Donations to political parties	300,000	
Provisions for uncollectible accounts	240,000	
Depreciations	3,160,000	
Sub-total		27,100,000
Less: Allowable deductions		
Depreciation allowances for depreciable assets	(24,000,000)	(24,000,000)
Net Loss for the year		(27,860,000)

Taxation of Partnership Income

A partnership is an entity formed by group of people from two (2) to a maximum of twenty (20) doing business together. Partnership income (partnership as a legal person) from a business of

resident or non-resident partnership is calculated on the same basis as when computing business income i.e. the normal "add back disallowable" and "deduct allowable" to arrive 'adjusted' profit for tax purpose. However, partnership as a firm is not subjected to income tax, i.e. adjusted partnership income is spread to individual partners (on the basis of sharing ratios). Therefore, partners' income (after making all necessary adjustments) is taxed under Table 2 of the First Schedule of the ITA 2004 (using individual income tax rates).

It is further noted that a partnership is not a separate legal entity from the partners who comprise it as distinct to the position of a company and its shareholders. It is this basis that under Section 48(6), arrangements between a partnership and its partners are recognised other than:

- ❖ Loans made by a partner to the partnership and any interest with respect thereto; and
- ❖ Services provided by a partner to a partnership, including by way of employment, and service fees or income from employment payable with respect thereto.

The general position of the law is that a person cannot enter into agreement with himself. Accordingly a partnership cannot legally employ a partner since the partnership would in effect be employing himself. For tax purposes, an agreement by the partnership to pay a salary to the partner is treated merely as part of the overall agreement as to sharing the profits. The same position applies to interest paid by a partnership upon a partner to a partnership are taken into account in determining a partner's loans and services provided by a partnership are taken into account in determining a partner's share of income from partnerships.

, the gains or profit of a partner i.e. partners' income is a SUM of:

- ❖ Salary payable to him/spouse;
- ❖ Any interest on capital payable to him;
- ❖ Any commission payable to him/spouse;
- ❖ His/her share of total partnership income (adjusted);

LESS:

- ❖ Any interest payable by him on partnership (loan)
- ❖ Share of partnership loss (if there is a loss)

Example 9.3

Assume a partnership between C and D, the partnership provides that C is to be paid a salary of 10,000,000 p.a. D advanced a loan to the partnership and is entitled to an interest of Tsh. 4,000,000 p.a. The balance of profit or losses (after charging C's salary and D's interest on loan) is to be shared equally. Assume that the partnership profit after payments of salary and interest on loan is Tsh. 16,000,000.

Required: Determine the partners' share of partnership income.

Solution example 9.3

Partnership income: Partnership Profits	16,000,000
Add back: Partners salary	10,000,000
Partners interest	4,000,000
Partnership income.....	30,000,000

Distribution of partnership income among partners

	C	D
Salary.....	10,000,000	
Interest on loan.....		4,000,000
Share of profits (30m- 14m)	8,000,000	8,000,000
Total taxable Income	18,000,000	12,000,000

Example 9.4

M/s Quality Builders Enterprise is a partnership of three professional building contractors. On 1st January 2015, there were three partners, namely Abdi, Bernard, and Charles sharing profits or losses in the ratios 3:1:1 respectively. The partnership's income and expenditure for the calendar year 2015 showed a net profit of 555,820,000/= as given below. The firm closed its first twelve months accounts on 31st December 2015.

Quality Builders Enterprise

Income and Expenditure Account for the year ended 31st December, 2015

Gross contract income	Tsh.	642,000,000
Profit on sale of motor vehicle		800,000
Interest (1)		600,000
		<u>643,400,000</u>
Less:		
Salaries to partners@ 12 M/= p.a.	Tsh.	36,000,000
Interest on capital		
Abdi	4,000,000	
Bernard	3,000,000	
Charles	2,000,000	9,000,000
Interest on loan – Charles (commercial rate)		5,600,000
Life insurance premiums to partner's life policies		30,000
Depreciation on assets		1,750,000
Partnership office rent		720,000
Motor vehicle expenses (2)		2,500,000
Commission – Bernard		3,600,000
Staff salaries, labour costs		20,000,000
Supplies and materials		6,000,000
Sundry expenses (3)		15,000
Telephone, Telex, Postage (4)		350,000
Electricity and power (5)		<u>15,000</u>
		<u>87,580,000</u>
Net Profit		<u>555,820,000</u>

Additional information

1.0 Interest includes

Savings account.....	200,000
Fixed Deposit.....	<u>400,000</u>
	600,000

2.0 Motor vehicle expenses: 25% relates to private use and benefits of the partners

3.0 Sundry expenses: The amount includes:-

Cost of a pick -up for the chairman of the Tender Committee Tsh. 2,000,000. This was a necessary cost in order to secure a vital contract for the firm

Tax consultant's fee for a successful appeal against estimated 2015 assessment issued on the partners for late filing of their return of income Tsh. 15,000

4.0 Telephone, telex and postage: Tsh. 50,000 relates to private telephone call for partners.

5.0 Electricity and power: Tsh. 5,000 relates to electricity bills paid for partners' private residence and

Required:

Determine the taxable income and tax liability of each partner assuming a tax bracket of 20% is applicable to the partners.

Solution Example 9.4

Determination of taxable income of ABC- Quality Builders enterprise partnership for the year 31st December, 2015.

Net Profit as per accounts		555,820,000
<i>Add back disallowable expenses:</i>		
Motor vehicle expenses (private)	625,000	
Cost of pick-up	2,000,000	
Tax consultant fee	15,000	
Electricity (private portion)	5,000	
Telephone	50,000	
Salaries to partners	36,000,000	
Interest on capital	9,000,000	
Insurance premiums	30,000	
Depreciations	1,750,000	
Commission	3,600,000	
		53,075,000
		608,895,000
<i>Deduct: Non business income and allowable deductions</i>		
Profit on sale of asset	800,000	
Interest (total)	600,000	
Depreciation allowance (class I 37.5% on Pick up)	750,000	(2,150,000)
Adjusted taxable profit		606,745,000

Allocation of partnership income among partners

	Total Adjusted profit		606,745,000
<i>Deduct:</i>			
Salaries to partners	36,000,000		
Interest on capital	9,000,000		
Commission -B	3,600,000		(48,600,000)
Distributable profits			558,145,000
<i>Share of profits:</i>			
A (3/5)			334,887,000
B (1/5)			111,629,000
C (1/5)			111,629,000
<i>Allocation of total income to partners</i>			
	A	B	C
Salary	12,000,000	12,000,000	12,000,000
Interest on CAP	4,000,000	3,000,000	2,000,000
Commission		3,600,000	
Interest on loan			5,600,000
Share of profits	334,887,000	111,629,000	111,629,000
Taxable income	350,887,000	130,229,000	131,229,000
Tax liability (20% thereof)	70,177,400	26,045,800	26,245,800

Taxation of Insurance Business

If any person conducts general insurance business, life insurance or any other type of business, must calculate the income for the general insurance business, the life insurance business and other business separately.

General Insurance Business

Section 58 of the ITA 2004 provides the manner of accounting for and methods of calculating income from general insurance business activities. The income derived or loss incurred by a person from conducting general insurance business shall be accounted for separately from the income or loss any other activities of the person. General insurance businesses are activities of insurance other than life insurance business activities. Section 58(1) provides that a person's activities in conducting a general insurance business shall be treated as a business separate from any other activity of the person.

All general insurance business is "short term" in the sense that an insurer guarantees the premium rate and other conditions for a period of a year only, or sometimes for a few years. Payments of premiums for general insurance paid to and proceeds from general insurance paid by a person in respect of the insurance of any risk in the United Republic have a source in the United Republic.

Amount to be included as Income

Section 58(2) provides the method of calculating income of general insurance business. In calculating the income of a person for a year of income from general insurance business, the following shall be included:

- ❖ The premiums derived during the year of income by the person as an insurer;
- ❖ The premiums derived during the year of income by the person as re-insurer;
- ❖ Proceeds derived under any contract of re-insurance in respect of proceeds incurred
- ❖ Other amounts as provided for under other provisions of the Act, which are, the amounts derived by the person in conduction the insurance business as stipulated under section 8 of the Act.

Amount to be deducted

The deductions will include: the total amount of liability incurred in respect of premiums on reinsurance; the actual amount of the liability incurred in respect of any claims during the year of assessment in respect of that business of general insurance, less the value of any claims recovered or recoverable under any contract of general insurance. Other amounts to be deducted are as provided for in other provisions of the Act, Such as section 16, gifts to public and charitable institutions, section 17, depreciation allowances for depreciable assets, section 18 losses on realisation of business assets and liabilities and section 19 losses from a business, which are, discussed elsewhere under those sections.

At the end of each accounting period of such business there will be some unexpired portion of the risk which must therefore be made in the account and is allowed in computing profits for corporation tax purposes; the appropriate allowance being a question of fact in each particular case. However, though this provision is an estimate it has to be reasonable, realistic and as accurate as possible based on prior years' experience and known current facts of the business.

The taxable income arising from short term income activities is generally calculated in the same way as the taxable income arising from other business activities, with premium derived included in gross income and claims incurred allowed as a deduction. However, the following characters of short term insurance activities impose special treatment:

❖ Income recognition rules

Income-recognition rules must take into account the fact that some premiums received during a year of income will cover risks for a period after the end of that year (unexpired risks). These premiums are not regarded as earned until the following year of income.

❖ Deduction recognition rules

Deduction-recognition rules must take into account the following three types of claims that may arise during a tax year for a general insurance business. The first type of claims is one that arises and paid out during the year of income. This is allowed as expenditure. The second type is one that arises during the year, but that has not been paid out as at the end of the year of income. This claim is also allowable. The third type is claim that is unreported as at the end of the year of income as it relates to an event that has occurred but not reported. This may be allowed under an accrual tax accounting system on the basis that the happening of the event the liability.

❖ Contingency reserves

Insurance companies retain a contingency reserve to meet the exceptional level of claims that may arise from a catastrophe. Tax accounting is concerned with the accurate measurement of net gains on annual basis. The establishment of a contingency reserve does not represent a sufficiently certain liability to be recognised for income tax purposes.

Example 9.5

RXY Insurance Company Ltd is carrying on general insurance business. The company also re-insures certain risks in Company AZB outside the United Republic.

The financial statements of RXY Insurance Company for the year 2006 showed the following:

Total premiums derived sh. 5,200million/=. This amount included sh. 400 million/= premiums received during a year of income which will cover risks for a period after the end of year 2006 (unexpired risks). Outward reinsurance was 2,500million/=. Rental income was sh. 100million/=. Interest on deposits with the financial institutions was sh. 100/= million. Gross claims incurred were 1,100 million; this included claims that were incurred but not reported of sh. 600 million. Commission payable sh. 700million/=. Operating and other expenses incurred in conducting the insurance business sh. 200million/=.

Reinsurance proceeds received during the year form company AZB were sh. 500 million/=

Required: Calculate the taxable income of RXY Insurance Company for the year of income 2006.

Solution Example 9.5

The income derived or loss incurred from conducting general insurance business shall be calculated separately from the income or loss from any other activities of the person.

Determination of the taxable Income for RXY Insurance Company Ltd.

Include:

(In Million Sh.)

Premiums derived as insurer (5,200ml= - 400ml/=)	Tsh. 4,800
Proceeds derived from reinsurance	500
Total income	5,300
Less:	
Premiums incurred on reinsurance	2,500
Claims paid (Proceeds incurred)	1,100
Expenses	200
Total deductions	3,800
Income from insurance activity	1,500
Interest income	100
Rental income	100
Total taxable I income	800

Premium paid for un-expired risks are disregarded for this year and will be included in the following year.

The outward reinsurance that RXY Company Ltd. Paid to AZB Company (non-resident) is subject to withholding tax of 5% as per the requirements of section 83(1)b read together with the first schedule of the Income Tax Act para 4(c)(iii).

Life Assurance Business

Life insurance" means insurance of any of the following classes;

- ❖ Insurance where the specified event is the death of an individual who is the insured or an associate of the insured;
- ❖ Insurance where: -The specified event is an individual who is the insured or an associate of the insured sustaining personal injury or becoming incapacitated; and - the insurance agreement is expressed to be in effect for at least five years or without limit of time and is not

terminable by the insurer before the expiry of five years except in circumstances prescribed by the regulations.

- ❖ Insurance under which an amount or series of amounts is to become payable to the insured in the future; and
- ❖ Re-insurance of insurance referred to under paragraphs (a) to (c)

Life insurance business: means the business of an insurer in effecting, issuing and carrying out life insurance. Life insurance business shall be treated as a separate business.

Section 59(1) provides that a person's activities in conducting a life insurance business shall be treated as a business separate from any other activity of the person. Payments on proceeds of life insurance and retirement payments paid by a resident person or a domestic permanent establishment and any premium or retirement contribution paid to a resident person or a domestic permanent establishment to secure such a return have a source in the United Republic.

Calculation of a life insurance business income

Section 59(2) provides the manner of calculating the income of a life insurance business of a person for the year of income as follows:

Amounts to be included

In calculating the income of a person for a year of income from a life insurance business any amounts to be included under other provisions of the Act shall be included except:-

- ❖ Premium derived during the year of income by the person as insurer, including as re-insurer, in conducting the business; and
- ❖ Proceeds derived during the year of income by the person under any contract of re-insurance in respect of proceeds incurred by the person as insurer, including as re-insurer in conducting the business.

Premiums derived during the year of income by the person as an insurer, including as re-insurer in conducting the business shall not be included as well as proceeds derived under any contract of re-insurance in respect of proceeds incurred as insurer, including as re-insurer in conducting life insurance business. These are not to be treated as incomings of the person.

Other amounts shall be included as provided for under other provisions of the Act, which are, the amounts derived by the person in conducting the insurance business as stipulated under section 8 of the act.

Amounts to be deducted

Expenses, which are allowable for deduction, are only those of managing the business's investments (including commissions) that are deductible under other provisions of the Act such as depreciation allowances for depreciable assets under section 17, losses on realisation of business assets and liabilities under section 18, and losses from the investments under section 19.

The person is prohibited to deduct the proceeds incurred during the year of income in conducting the business as insurer including as re-insurer and premiums incurred under any contract of re-insurance in respect of the proceeds. These shall not be included in the cost of any asset or liability of the person.

Example 9.6

KAKAI Insurance Company is a conducting a life insurance business. KAKAI Company reinsured some of the policy risk with company MAMIS. In addition KAKAI Company has made investments in buildings, which are being rented, and treasury bills which matured in the year 2015. The

financial statements of KAKAI Company for the year of income 2006 showed the following information:

Total premiums derived for life insurance policies were sh. 900,000,000/= Total proceeds incurred were sh. 400,000,000/=. Total proceeds derived from Company MAMAS were sh. 200,000,000/= while total premiums incurred under the contract of reinsurance were sh. 50,000,000/= Management expenses were sh. 20,000,000/=

Interest derived from treasury bills were sh. 50,000,000/=; and rental income received was sh. 500,000,000/= expenses incurred in earning the rental income were sh. 50,000,000/=

Required: Calculate the taxable income of KAKAI Insurance Company for the year 2015.

Solution to Example 9.6

The income derived or loss incurred from conducting life insurance business shall be calculated separately from the income or loss from any other activities of the person. The premiums and proceeds derived during the year and proceeds and premiums incurred shall not be used in calculating the income of KAKAI Insurance (as per section 59(2)(a) company for the year of income 2015 from a life insurance business.

So, in this case only income from the company's investments will be calculated for the year of income 2015 allowing all the management expenses. (section 59(2)(b)).

Included amount	Tsh.
Interest income	50,000,000/=
Rental income	500,000,000/=
Total investment income	550,000,000/=
<i>Less:</i>	
Expenses incurred in earning the investment	
Rental income	50,000,000/=
Commission paid for obtaining tenants	50,000,000/=
Management expenses	20,000,000/=
Total expenses	120,000,000/=
Taxable income from life insurance business.....	430,000,000/=

Taxation of Retirement Contribution Funds

Meaning of Retirement Contribution Fund

Retirement contribution means a payment made to a retirement fund for the provision or future provision of retirement payments; "retirement fund" means any entity established and maintained solely for the purposes of accepting and investigation retirement contributions in order to provide retirement payments to individuals who are beneficiaries of the entity; Retirement payment means a payment, by way of a lump sum, pension or commuted pension, made by a person to:

- ❖ An individual in the event of the individual's retirement; or
- ❖ A relative of an individual in the event of the individual's death;

Calculation of the Income of a Retirement Fund

Section 62 of the Act provides the method of calculating income of a retirement fund. Subsection (4) deals with the treatment of retirement contributions received by the fund and retirement payments made by the fund as follows:

- ❖ Retirement contribution received by fund shall not be included in the calculation of the income of a retirement fund and shall not be an incoming of the fund, and
- ❖ Retirement payments shall not be deductible and are not included in the cost of any asset or liability of the fund.

In calculating the income of retirement fund for a year of income there shall not be included retirement contributions received nor deducted retirement payment made by the fund. Investments income and expenses are only considered in computing taxable incomes of retirement contributions. Income tax of an approved retirement fund when it ceases to be an approved retirement fund.

Section 62(4) provides that where a retirement fund ceases to be an approved retirement fund during a year of income, its income tax payable under section 4(1)(a) that is on total income shall be increased by the differential in the corporation tax caused by the following:

The difference between all the retirement contributions received by the fund for or on behalf of resident individuals including the total income of the fund during the period from its most recent approval as an approved retirement fund to when it ceased to be so approved, and all the retirement payments made by the fund from its most recent approval to when it ceased to be so approved in respect of individuals who were residents during that period.

Example 9.7

Jogoo Pension Fund was an unapproved pension fund established in year 2010 and in year 2013 the fund was approved by the commissioner as an approved pension fund. In September, 2015 the fund ceased to be an approved pension fund.

During year 2015, it received contributions on behalf of resident individuals at the rate of sh. 200,000,000 per month, and other contributions to the fund from non-residents were at the rate of sh. 100,000,000 per month. The retirement payments made before September 2015 were 200,000,000, but during the year Tsh. 450,000,000 retirement payment were made to resident individuals.

Jogoo Pension fund also received rent of sh. 90,000,000. Minor repairs were made to the rented building of sh. 2,500,000 and security expenses paid of sh. 600,000. Administrative expenses were Tsh. 35,000,000. The fund's accounting date is 31st December.

Required: Calculate the total tax payable in year 2015.

Solution to example 9.7

Determination of taxable Income of Jogoo Pension fund

Investment income	
Rent received	Tsh. 90,000,000
Less repairs	Tsh. 2,500,000
Security	Tsh. 600,000
Sub- total	Tsh. 3,100,000
Net investment income	Tsh. 86,900,000
Contributions (October – December 2015)	
From resident individuals (Tsh. 200,000,000 x 3)	Tsh. 600,000,000
Other contributions (sh. 100,000,000 x 3)	Tsh. 300,000,000
Total contributions	Tsh. 900,000,000
Retirement payments	
Total payments	Tsh. 450,000,000
Made before October 2005	Tsh. 200,000,000
Difference	Tsh. 250,000,000

Difference in income tax payable (sec. 62(a) and (b))
 = (900,000,000 – 250,000,000) x 30%
 = Tsh. 650,000,000 x 30% = Tsh. 195,000,000/=

Total income sh. 86,900,000 + 650,000,000 = Tsh. 736,900,000/=
 Total tax at 30%..... Tsh. 221,070,000/=

Retirement Payments

According to ITA 2004 (S. 63) retirement payment means payment by way of lump sum, pension or commuted pension, made by a person to an individual in the event of the individual's retirement or to a relative of an individual in the event of the individual's death. Payments of retirement from approved pensions to and individual are exempt under the 2nd schedule of the ITA, 2004. However, payments of retirement from unapproved fund are taxable gains as per section 63(2) of the ITA 2004. Under this section gains from an interest in an unapproved retirement fund means the extent to which retirement payments made by an unapproved retirement fund in respect of an interest in the fund exceed retirement contributions paid to the fund in respect of the interest.

Example 9.8

Mr. Amos contributed a total amount of Tsh. 350,000,000 over the period of ten year to Silver Pension fund a non-resident an unapproved fund. On 31st December, 2016 he received from this pension fund an amount of Tsh. 550,000,000 as retirement payments.

Required: Compute Mr. Amos taxable gain from this retirement payments

Solution to example 9.8

Gross retirement payment received	Tsh. 550,000,000
Less, Contribution paid	Tsh. 350,000,000
Taxable gain derived there from	Tsh. 200,000,000

Taxation of Income of a Domestic Permanent Establishment

A domestic permanent establishment is defined (S.3 of ITA) as all permanent establishment of a non-resident individual, partnership, trust or corporation situated in the United Republic of Tanzania. On the contrary foreign permanent establishment means all permanent establishment of an individual, partnership, trust or corporation that are situated in any other country in which the individual, partnership, trust, or corporation is a resident but excludes a domestic permanent establishment.

The ITA, 2004 further defines permanent establishment as place where a person carries on business and includes:

- ❖ A place where a person is carrying on business through an agent, other than a general agent of independent status acting in the ordinary course of business as such;
- ❖ A place where a person has used or installed, or is using or installing substantial equipment or substantial machinery; and
- ❖ A place where a person is engaged in a construction, assembly or installation project for six months or more, including a place where a person is conducting supervisory activities in relation to such a project.

Tax liability of a domestic permanent establishment of a non-resident person

The ITA, 2004 (S.70 (1)) provides the tax liability of a domestic permanent establishment should be calculated as if it is a resident person, independent of the owner. In other words a domestic permanent establishment is to be treated as an independent person but associated to the owner and resident in a country where it is situated. Thus, the income tax payable for a year of income by a non-resident who has a domestic permanent establishment shall be the sum of tax payable on total income under section 4(1) of the ITA, 2004 and the repatriated income of the permanent establishment.

Example 9.9

ABC is a non-resident person with domestic permanent establishment in Tanzania. For the year of income 2016 the domestic permanent establishment derived a total income of Tsh. 650,000,000. The domestic permanent establishment repatriated income of Tsh. 200,000,000.

Required: Determine the tax liability of the non-resident person with the domestic permanent establishment for the year 2016.

Solution to example 9.9

Total income (S.4 (1))	Tsh.... 650,000,000 x 30%.....	Tsh. 195,000,000
Repatriated Income (S.4 (1)(b))	Tsh.. 200,000,000 x 10%.....	Tsh. 20,000,000
Total tax payable.....		Tsh. 215,000,000

Determination of repatriated Income of a Domestic Permanent Establishment

The calculation of the repatriated income of a domestic permanent establishment is provided for under section 72(1) of the ITA, 2004. The formula stated in the sections is:

A+B-C

Where:

- A. Is the net cost of assets of the permanent establishment at the start of the year of income plus the market value of capital contributed to the permanent establishment by the owner during the year;
- B. Is net total income of the permanent establishment for the year of income; and
- C. Is the net cost of assets of a permanent at the end of the year of income plus, where the establishment has no total income for the year of income, any unrelieved loss for the year of income referred to in section 19(4) of the ITA, 2004.

However, the assessable repatriated income of a domestic permanent establishment has a limit.. According to section 72(2) of the ITA, 2004 the repatriated income of the domestic permanent establishment is limited to:

- ❖ The net total income of a permanent establishment for a year of income plus the balance of the permanent establishment's accumulated profits account at the end of the previous year of income; less
- ❖ Where the permanent has no total income, any unrelieved loss for the year of income.

Repatriated amount over and above the limit is not taxed.

Example 9.10

ABCD is domestic permanent establishment of a non-resident person. For the year of income 2016, the entity earned a total income of Tsh. 200,000,000, and the accumulated profit balance was Tsh. 18,000,000 at the year end. The entity repatriated an amount of Tsh. 190,000,000.

Required: Calculate the tax liability on repatriated income.

Solution to example 9.10:

Total Income for the year 2016	Tsh. 200,000,000.
Less: Tax there on (30%)	Tsh. 60,000,000.
Net total income	Tsh. 140,000,000.
Plus balance of accumulated profit	Tsh. 18,000,000
Sub Total	Tsh. 158,000,000
Less: Unrelieved loss	Tsh. NIL
Max limit of taxable repatriated income	Tsh. 158,000,000.
Compare with actual amount repatriated.	Tsh. 190,000,000

Take the maximum limit (the amount above this limit is not taxed i.e. 190m -158m =32m).

Thus tax liability on repatriated income is 10% x 158,000,000= Tsh. 15,800,000

Chapter Summary

This chapter has discussed the determination of taxable incomes from businesses. The key issues presented in this chapter can be summarised in key points as follows:

- ❖ Business is meant to include purchase and sale of goods in an attempt to make profits. It also includes Trade; Profession; or Vocation.
- ❖ A person's income from business for a year of income is the person's gains or profits in conducting the business for the year of income.
- ❖ In calculating taxable business income the following are included: Service fees; Incomings for trading stock; Gains from realisation of business assets or liabilities of the business; Amounts derived as consideration for accepting a restriction on the capacity to conduct the business; Gifts and other ex-gratia payments received by the person in respect of the business; Amounts that are effectively connected with the business and that would otherwise be included in calculating the person's income from an investment or employment.
- ❖ The general principle of determining taxable income from business is that after adding all taxable business income deduct only those expenditures or losses which are *wholly and exclusively incurred* in the direct production of such income. That is, expenditure allowed must be of revenue nature. On the other hand, disallow (do not deduct) those expenditures or losses which are not wholly and exclusively incurred in the direct production of such income.
- ❖ Partnership income (partnership as a legal person) from a business of resident or non-resident partnership is calculated on the same basis as when computing business income i.e. the normal "add back disallowable" and "deduct allowable" to arrive 'adjusted' profit for tax purpose. However, partnership as a firm is not subjected to income tax, instead the adjusted partnership income is spread to individual partners (on the basis of sharing ratios) who are taxed on presumptive tax basis. This is provided for under the first schedule of the income tax act 2004.
- ❖ For entities conducting insurance business the income tax act that the income from general insurance business, life insurance or any other type of business, must be calculated separately.
- ❖ In calculating the income of a person for a year of income from general insurance business, the following shall be included: The premiums derived during the year of income by the person as an insurer; the premiums derived during the year of income by the person as re-insurer; proceeds derived under any contract of re-insurance in respect of proceeds incurred.
- ❖ In calculating the net taxable income from general insurance business the deductions allowed include; The total amount of liability incurred in respect of premiums on reinsurance; the actual amount of the liability incurred in respect of any claims during the year of assessment in respect of that business of general insurance, less the value of any claims recovered or recoverable under any contract of general insurance.
- ❖ Retirement fund" means any entity established and maintained solely for the purposes of accepting and investigation retirement contributions in order to provide retirement payments to individuals who are beneficiaries of the entity.
- ❖ In calculating the taxable income of retirement fund for a year of income the amount to be included excludes retirement contributions received and/or retirement payment made by the fund. Investments income and expenses are only considered in computing taxable incomes of retirement contributions.
- ❖ A domestic permanent establishment is defined as all permanent establishment of a non-resident individual, partnership, trust or corporation situated in the United Republic of Tanzania.
- ❖ Permanent establishment is a place where a person carries on business and includes: a place where a person is carrying on business through an agent, other than a general agent of independent status acting in the ordinary course of business as such; a place where a person

has used or installed, or is using or installing substantial equipment or substantial machinery; and a place where a person is engaged in a construction, assembly or installation project for six months or more.

- ❖ The tax liability of a domestic permanent establishment is calculated as if it is a resident person, independent of the owner. However, the income tax payable for a year of income by a non-resident who has a domestic permanent establishment shall be the sum of tax payable on total income and the repatriated income of the permanent establishment.
- ❖ The total income of a corporation, trust, unapproved retirement fund or domestic permanent establishment of a non-resident person is taxed at of 30%. Corporations with perpetual unrelieved losses for 3 consecutive years are taxed at 0.3% of annual turnover in the third year of perpetual unrelieved loss. Listed corporation to the Dar es Salaam Stock Exchange, with at least 30% shares issued to the public are taxed at the rates of 25% for three consecutive years from the date of listing. Mining corporations or petroleum corporations are taxed at the rate of 30%. The repatriated income of a domestic permanent establishment of a non-resident person is taxed at the rate of 10%.

End of Chapter Nine Revision Questions

1. The general principle of allow ability is based on phrase "wholly and exclusively incurred...."
Explain the meaning of this phrase.

2. With reasons identify and explain any items of expenditure that are necessary but not recognised by the general principle of allow-ability and any 3 unnecessary but obeyed by the principle.

3. Distinguish between employment and business.

4. Mrs ABC started a textile business since 1st January, 2003. The profit and loss account for the period that ended 31st December, 2014 contained the following information:

Sales	350,700,000	
Cost of goods sold	<u>253,500,000</u>	
Gross Profit	97,200,000	
Other incomes:		
Local Bank interest	3,000,000	
Insurance compensation (loss of profit)	300,000	
Bad debts recovered	200,000	
Gross rent from residential house	<u>1,200,000</u>	
		101,900,000
Less: Expenses:		
Salaries and wages	2,460,000	
Depreciation	1,200,000	
Income Tax	8,000,000	
Employer's contribution to NSSF	150,000	
Motor car expenses	6,300,000	
Advertisement	1,400,000	
Skills development levy	98,400	
Water and electricity	900,000	
Stationery	600,000	
Donations	2,600,000	
Business license	20,000	
Repairs and maintenance	500,000	
Interest paid	300,000	
Insurance premiums	900,000	
Net profit		<u>25,428,400</u>
		<u>76,471,600</u>

Additional information

- The amount of interest, Tsh. 3,000,000/= was credited to her account on 31st December, 2014.
- Mrs ABC had ten employees who were paid monthly salaries during the year. In addition to these employees she was also paying Tsh. 30,000/= p. m. to her husband who was always employed by her in the business. All these sums have been included in the amount shown as salaries and wages. Appropriate PAYE deductions were made from these sums
- Tsh. 8,000,000/= as Income Tax represented provisional tax estimates for the year of income 2014. Mrs ABC however, discovered that this was an underestimate and that she should have estimated the amount at Tsh. 15 million.
- Motor car expenses included 20% as an amount for private trips.
- Skills and Development levy (98,400) represented 4% of salaries and wages (2,460,000/=).
- Twenty five per cent (25%) of water and electricity expenses is an amount in respect of private residential premises.
- Stationery amounting to Tsh. 600,000/= included Mrs ABC Directors private correspondence to relatives and friends. This represented 12.5% of the amount charged against profits.

viii. The amount of Tsh. 2,600,000/= as donation included Tsh. 1,000,000/= donated to a newly formed darts club for the purchases of sports facilities. She is one of the club's executive committee members, and Tsh. 600,000/= was given to a newly formed political party in which is a member.

ix. ABC purchased one set of new furniture for Tsh. 500,000/= to replace old furniture that was written off. The whole purchase price of the new furniture has been shown in the P & L account as repairs and maintenance.

x. The amount of interest paid, Tsh. 200,000/= was an amount paid to a creditor for a loan given to her husband which was spent by him for buying different items for domestic use.

xi. Insurance premiums included Tsh. 800,000/= paid for a comprehensive insurance policy for business motor vehicles and Tsh. 100,000/= in total for life insurance policy of directors.

xii. Rent income was received on account of surplus business place which was occupied by a single family from 1st January, 2014 to 31st December, 2014. This amount has not been adjusted for tax purpose.

xiii. Depreciation allowances under the 3rd schedule of ITA 2004 (including depreciation for the furniture under item ix above) for the year amount to Tsh. 2,000,000/=.

Required:

Determine the total taxable income for Mrs ABC business for the tax year 2014.

5. The following is Trading and Profit and Loss account summarising information of partners Samwel, Kilion and Tadeo, named as SAKITA.

SAKITA TRADERS

Trading and Profit and Loss account for the year ended 31/12/2015

Stock b/d	30,000,000	Sales	252,720,000
Purchase	189,910,000	Discounts	1,360,000
Gross profit	63,170,000	Stocks c/f	29,000,000
		Gross profit b/d	63,170,000
		Rent received	4,800,000
Rent, insurance, rent	4,850,000		
Electricity	930,000		
Wages	14,800,000		
Repairs	1,060,000		
Vehicles maintenance	3,560,000		
Commission	3,730,000		
Depreciation	3,430,000		
Interest	1,930,000		
Loss on sale	160,000		
Advertisement	1,470,000		
Bad debts	1,600,000		
General expenses	1,930,000		
Travelling expenses	4,360,000		
Partners salaries	9,950,000		
Net profit	<u>4,190,000</u>		
	<u>67,970,000</u>		<u>67,970,000</u>

Additional Information:

- Partnership deals with ladies clothes
- One fifth (1/5th) of rent, rates and insurance-private occupation of business premises by Samwel
- Wages includes 200,000/= p. m. of Samwel's wife

- d) Interest includes interest on capital to partners of:
 - Tadeo Tsh. 400,000/=
- e) Commission, Tsh. 500,000/= was paid Mrs. Samwel during the year
- f) Loss on sale represents loss on sale of motor vehicle made during the year
- g) Partners' salaries (Tadeo 2,950,000; Kilion 3,000,000; Samwel 4,000,000)
- h) During the year shirts were stolen. Cheque for 2,000,000/= was received from Insurance. This had been credited in Partners drawing account

Required:

Calculate the partnership income of SAKITA Traders for the year of income 2015 for income tax purposes. Allocate the partnership's adjusted income among the partners.

6. Mr. AUDITOR commenced an Audit and Accountancy practice firm on 1.1. 2015. The following transactions relate to his new firm for the year ending 31.12.2015.

<u>Income:</u>	<u>In Tsh.</u>
Professional fee	28,000,000
Bank interest	300,000
Sale of private car	15,000,000
Insurance compensation	1,000,000
Bad debts recovered	500,000
Gross rent from residential house	1,730,000
Expenditures:	
Stationery	3,500,000
Salary wife	1,800,000
Registration fee of the firm	600,000
Other wages and salaries and secretarial fees	6,000,000
Contributions and donations	150,000
Business license	100,000
Rent and rates	7,500,000
Interest paid	2,000,000
Repairs and maintenance	4,000,000
Insurance	2,600,000
Motor car expenses and transport	1,600,000
Depreciation on assets	4,800,000
Net profit	9,830,000

The following additional information is provided to you

- a. Rent and rates:
 Rent for office..... sh. 5,000,000
 Rent and rates for private residence..... 2,500,000
- b. Repairs and maintenance:
 General office repairs and painting..... 1,300,000
 Repair of private residence700,000
- c. Interest paid:
 - On bank overdraft..... 600,000
 - On mortgage loan for private residence..... 1,250,000
- d. Insurance expenditure:

- Professional indemnity..... 600,000
- Personal accident..... 300,000
- Own life assurance premium 1,250,000
- e. Mr. AUDITOR has agreed with the Principal Assessor that 50% of the motor car expenses and transport should be disallowed.
- f. Mr. AUDITOR purchased the following assets for the firm during the year of income 2015.
 - One Toyota Hilux Pick-up at a cost of12,000,000
 - Office furniture and fittings at a cost of7,000,000
- g. Provisions:
 - Provisions for leave pay..... 1,500,000
 - General provisions – bad debt..... 20,000
 - Specific bad debts..... 80,000
- h. PAYE deducted on wife's salary for the whole year 2015 amounted to Tsh. 221,440
- i. Contributions:
 - NSSF membership (for employees)..... 100,000
 - NBAA/TAA membership and journals 30,000
 - Oysterbay Club- membership..... 20,000

Required:

Using ITA relevant provisions, compute the taxable income for Mr. AUDITOR for the year of income 2015.

7. NEEMA LTD was incorporated in Tanzania and commenced its business on 1st January 2016 as retailer of audio- visual products in Tanzania. It has drawn up its first accounts to December 2016, the draft of which together with the additional information was as follows:

	<u>Notes</u>	<u>TZS</u>	<u>TZS "000"</u>
		<u>"000"</u>	
Sales	1	950,000	
Dividends	2	5,000	
Interest income	3	12,000	
Contractual penalties	4	5,000	972,000
Expenses:			
Directors fees	5	320,000	
Salaries		300,000	
Interest expenses	6	80,000	
Rent and rates		220,000	
Legal and professional fees	7	20,000	
Contributions to retirement fund	8	15,000	
Depreciation	9	120,000	
Travelling and entertainment		22,000	
Provisions	10	28,000	
Insurance		18,000	
Sundries	11	10,000	(1,153,000)
Profit/ (Loss) for the year			(186,000)

Additional notes:

- Sales figure includes TZS 1 million for sale of furniture which was used by the company.
- The company had bought some shares from City Stock Exchange. These were shares of Sungura Cement Company which distributed dividends during the period.
- The company earned TZS 8 million as interest from its bank deposits and another TZS 4 million from a director to whom the company had extended a personal loan. The Director used the loan to acquire building in Kenya.

4. The amount was received as a result of a business contract which the other party breached it.

5. Directors' fees were paid to the following persons:

Mr. A	TZS 200,000,000
Mrs. A (wife of Mr. A)	TZS 50,000,000
Mr. B (Mr. A's brother)	<u>TZS 70,000,000</u>
	TZS 320,000,000

6. Interest paid to the bank on overdraft	TZS 20,000,000
Finance charge on hire purchase agreements	TZS 50,000,000
Interest on failure to pay previous years' value added tax	<u>TZS 10,000,000</u>
	TZS 80,000,000

7. Audit fees	TZS 10,000,000
Legal fees for staff contracts and retirement funds	TZS 6,000,000
Amount paid to Tender board members to facilitate winning a bid	<u>TZS 4,000,000</u>
	TZS 20,000,000

8. Employees contributions	TZS 7,500,000
Employer's contributions	<u>TZS 7,500,000</u>
	TZS 15,000,000

The contributions were made to an approved retirement fund.

9. The company acquired the following assets:

On 2 nd January 2016- Furniture and equipment	TZS 100,000,000
On 2 nd January 2016- Computers and accessories	TZS 300,000,000
On 3 rd January 2016- Motor car (station wagon)	TZS 200,000,000

The computers were acquired on hire purchase terms for 12 months. The down payment of TZS 120,000,000 was made on 2nd January 2016 and the first monthly installment of TZS 20,000,000 was due on 2nd February 2016. The cash price of computers was TZS 300,000,000.

10. Provision for debtors (specific)	TZS 11,000,000
Provisions for repairs (estimated)	TZS 8,000,000
Provisions for stock obsolescence	<u>TZS 9,000,000</u>
	TZS 28,000,000

11. Sundries included a traffic fine of TZS 3,500,000. The balance was general consumables used by the office.

REQUIRED

Based on the information available, determine the taxable income of Neema Company Limited and its tax liability for the year of income 2016.

21. The summary of income statement for the year ended 30th Sept 2015 for Mr. ANDROID business, showed the followings:

	TZS	TZS
Gross profit		50,000,000
Less;		
Salaries	20,000,000	
Employer's retirement scheme	4,500,000	
Rent and electricity	2,000,000	
Office stationery	500,000	

Repairs and maintenance	1,000,000	
Provision for bad debts	300,000	
Interest on loan and mortgage	200,000	
Accountancy fees	300,000	
Depreciation	500,000	
Motor vehicle expenses	2,000,000	
Provision for income tax	600,000	
Legal expenses	480,000	
Commissions	1,900,000	
Miscellaneous	800,000	35,080,000
Net profit		14,920,000

After you have gone through the ledger, the following additional details are discovered:

a) Salaries; This represents:

- TZS 7,500,000 salary to Android
- TZS 3,500,000 salary to office personnel and;
- TZS 9,000,000 salary to casual labourers.

b) Employer's retirement scheme – this is an unapproved scheme.

c) Repairs and maintenance:

Purchase of stationery	TZS 200,000
Renewal of electricity wiring	TZS 200,000
Repairs to roof	TZS 100,000
Wall repairing	TZS 80,000
Extension of the washroom	TZS 420,000

d) Legal expenses:

For defending a price increase offence	TZS 20,000
For renewing the tenancy agreement	TZS 30,000
For renewing contract with the Biashara consumers society to supply stock	TZS 80,000
For collection of trade debts	TZS 350,000

e) Miscellaneous expenses:

Donation to Muhimbili Mosque	TZS 100,000
Books donated to Msimbazi Primary school which is to be donated under S.12 of the Education Fund	TZS 150,000
Wedding expenses for Manager	TZS 150,000
Funeral expenses for employee	TZS 100,000
Subscription to the employer's association	TZS 200,000
Grants donated to TMK Vocational Centre	TZS 100,000

f) Provision for bad debts

A specific provision	TZS 180,000
A general provision	TZS 120,000

g) Depreciation charges:

Loose tools	TZS 100,000
Non - current assets (as per 3 rd Schedule)	TZS 400,000

9. The financial statement and tax records of ABCD Ltd, a foreign company operating in the United Republic of Tanzania for the year of income 2016 showed the following information.

- 1) The cost of the business assets at the close of the previous year of income was Tsh. 1,500,000,000.
- 2) The written down value of depreciable assets at the end of the year of income 2015 was shown as below:
 - Class I- Tsh. 8,000,000,000
 - Class II- Tsh. 5,000,000,000
 - Class III- Tsh. 2,000,000,000
 - Total: Tsh. 15,000,000,000
- 3) Capital introduced by the parent company during the current year of income was Tsh. 50,000,000,000.
- 4) Total income for the year of income 2016 for the branch was Tsh. 16,000,000,000.
- 5) Tax payable during the year of income at the rate of 30% was Tsh. 4,800,000,000.
- 6) No additions were made to the company's assets during the year.
- 7) Costs of other business (Other than depreciable assets) at the end of the year was Tsh. 800,000,000.
- 8) Accumulated profits account balances shows a credit amount of Tsh. 18,000,000,000

Required: Calculate the taxable income on repatriated income of the ABCD.

CHAPTER TEN

DEPRECIATION ALLOWANCES FOR DEPRECIABLE ASSETS

Introduction

This chapter deals with the computation of allowances for depreciable assets used by a business for business purposes. The chapter shows procedures for computing depreciation allowances for non-current assets permitted under the Income Tax Act 2004 other than the depreciation methods acceptable under the generally acceptable accounting principles or International Accounting Standards. The machinery for the determination of depreciation allowances for depreciable assets is provided by section 17 of the Income Tax Act 2004.

Learning Outcomes

After completing this chapter readers should be able to:

- ❖ Describe depreciable assets.
- ❖ Describe depreciation allowances.
- ❖ Explain the classes and pooling of depreciable assets.
- ❖ Determine the initial allowances for qualifying assets
- ❖ Compute depreciation allowances for various classes of assets
- ❖ Determine additional depreciation allowances
- ❖ Determination depreciation allowance for mining and petroleum operations

Depreciation Allowances

Depreciation allowance is defined as an allowance granted to a person for the year of income for each of the pools of depreciable asset equal to the depreciation of each pool calculated in accordance with subparagraphs 2 and 7 of the third schedule of the ITA, 2004.

Depreciable Assets

Assets employed wholly and exclusively in the production of income from a business, and which are likely to lose value because of wear and tear, obsolescence or the passing of time but excludes goodwill, mineral or petroleum rights and other interest in land, a membership interest in an entity and trading stock.

Depreciation basis

Depreciation basis for depreciable assets is the total of:

- ❖ Depreciation basis of the pool at the end of the previous year of income and
- ❖ Additions to the depreciation basis of the pool during the year of income

LESS:

- ❖ Incomings (sales) for the assets on the pool during the year of income. However the balance should not be below zero i.e. if sales exceeds opening balance plus additions during the year, it means there will be no depreciation basis, hence no depreciation allowance, but rather the excess is taxable business income (Para 4 of the 3rd schedule, ITA, 2004).

Depreciation Allowance Deduction

Section 17 of the ITA, 2004 provides that for the purpose of calculating a person's income from any business there shall be deducted in respect of depreciable assets owned and employed by a person during the year of income wholly and exclusively in the production of the person's income from the business. The depreciation allowance is calculated as per the Third Schedule of the ITA 2004.

Classification and Pooling of Depreciable Assets

Depreciable assets are classified into eight (8) classes. The 3rd schedule of Income Tax Act, 2004, as amended in 2016 classifies the depreciable assets as in the following Table:

Table 2: Classes of Depreciable Assets

Pool/Class	Assets	Rates
1	Computers and data handling equipment and peripheral devices, automobiles, buses and minibuses with seating capacity less than 30 passengers, goods vehicle with load capacity of less than 7 tones, construction and earthmoving equipment.	37.5%
2	Buses with a seating capacity of 30 or more passengers, heavy general purpose or specialised trucks, trailers and trailer-mounted containers; railroad cars, locomotives, and equipment; vessels, barges, tugs, and similar water transportation equipment; aircraft; other self-propelling vehicles; plant and machinery used in agriculture or manufacturing, specialised public utility plant, equipment, and machinery irrigation installations and equipment.	25%
3	Office furniture, fixtures and equipment, any asset not included in other classes.	12.5%
4	Deleted: Finance Act, 2016	
5	Buildings, structures, dams, water reservoir, fences and similar works of a permanent nature used in agriculture, livestock farming or fish farming.	20%
6	Buildings, structures, and other similar works of permanent nature other than those mentioned in class 5.	5%
7	Intangible assets.	1/useful life of the asset
8	Plant and machinery (including windmills, electric generators and distribution equipment) used in agriculture and electronic fiscal device purchased by a non-Value Added Tax registered trader.	100%
Mining or Petroleum operations FA, 2016	Depreciation allowance for depreciable assets and expenditures for mining or petroleum operations (Plant, machinery, vehicles, prospecting etc)	20% of expenditure in each year of income for five years.

As indicated in Table 2 above, Class I includes 'goods vehicles' with load capacity less than 7 tones. This suggests that such vehicles includes pucks-ups, motor vans (of all types) provided are goods vehicles less than 7 tones, fall under this class. Similarly, any saloon car (and all luxurious cars, e.g.:

Nissan Patrol for Managers etc.) fall under class I by virtue of 'automobiles' i.e., 4 wheel car usually for carrying less than 30 passengers. Class I also includes 'construction and earthmoving equipment' such as caterpillars, bulldozers and the like. However, tractors are classified under class II although seemingly resembles caterpillar.

Initial allowance

Initial allowance is an allowance granted to plant and machinery of specified category which are purchased by a business and put to their uses for the first time. Initial allowance is given at the rate of 50% on costs for plant and machinery with the following qualification:

- ❖ Used in *manufacturing processes* and *fixed* in a factory;
- ❖ Used in fish farming;
- ❖ Used for providing services to tourists and fixed in a hotel
- ❖ Added to classes 2 or 3 according to paragraph 1 (2) of the third schedule of ITA, 2004.

Initial allowance is given for qualifying assets. The allowance is at the rate of 50% of the cost of the assets that qualifies for initial allowance. The initial allowance is divided into two portions. The first portion is available in the year of income in which the assets is added to the person's pool of depreciable assets; and the remaining portion is available during the year of income following that in which the first portion is added, but not if the pool has been dissolved as per paragraph 4 of the third schedule of the ITA. The remaining balance of the cost is added to the pool in the respective class in the next years of income. The depreciation allowance in the second year shall be determined accordingly depending on the applicable rate of the class/pool of the assets.

Example 10.1

ABZ Ltd deals with tour services in Manyara National Parks. For the year 2015 it purchase a plant and machinery for Tsh. 50,000,000 and fixed it in one of its hotel in Babati.

Required:

Compute the depreciation allowance for this particular depreciable asset for 2015.

Solution to example 10.1

The applicable depreciation allowance for 2015 year of income is the initial allowance.

Qualification: Plant and machinery and was fixed in a hotel

This is computed as:

Cost of plant and machinery..... 50,000,000/=

Initial allowance: 50% x 50,000,000. = 25,000,000/=

Depreciation basis at the end of the year (2015)..... 25,000,000/=

Distribution of the initial allowance:

1st portion: 2015: ½ x 25,000,000= 12,500,000

2nd portion: 2016: ½ x 25,000,000= 12,500,000 (if pool was not dissolved).

The balance of cost of Tshs. 25,000,000 is added in the pool/class of plant and machinery (Class III, for this case) in the year 2016. Depreciation allowance for 2016 will be determined with due regard to the applicable rate in the class i.e. class III which is 12.5% x 25,000,000.

The concept of plant and machinery

The word plant and machinery is not defined in the Act (ITA, 2004), as such it has been controversial as to what should be included in within this meaning. Consequently, one must rely more on judicial authority (cases) to determine whether or not a structure constitute a plant and machinery. Generally, machinery includes everything which by its action produces or assists in production and that plant might be regards as that without which production could not go on (e.g.

sewing machine, bottling plant). Plant and machinery generally fall under class III except those used in the agriculture which fall under class VIII.

Determination of Depreciation Allowances

There are two main methods of computing depreciation allowances for depreciable assets. These are diminishing value method and straight line method.

Diminishing Value Method:

Diminishing Value method is used for classes 1, 2, 3 pools

Straight line Method:

Straight line method is use for classes 5, 6, and 7

Formula:

$$A \times B \times C / 365$$

Where-

- A Is the depreciation basis of the pool at the end of the year of Income;
- B Depreciation rate applicable to the pool; and
- C Number of days in the person's year of income

Realisation of Depreciable Assets

When a depreciable asset is sold during any part of the year, it may give rise to a taxable income or additional allowance. The method for assessing the taxable income on realisation is the excess of sales value over the depreciation basis of the pool at the end of the year (applicable to classes 1, 2, 3 pools which use diminishing value method) or written down value (class 5, 6 pools, which use straight line method).

Where the assets in a pool are all realised, the pool will be dissolved and the amount will be included as either taxable business income or will be granted as allowance to the taxpayer, i.e. where the difference is positive, it is taxable income whereas deficit/negative difference is an additional allowance.

Purchase under Hire Purchase Agreement

The difference between purchase price that would have been paid on cash basis and the price on hire purchase basis reflects an interest, which for tax purpose is an allowable expense. Therefore, allowance is granted on down-right purchase price (i.e. cash price).

Expenditure on Road Vehicle

There is a restriction of expenditure incurred to acquire a road vehicle other than a commercial vehicle to the extent the expenditure in excess of 15,000,000 shall not be recognised. This applies to saloon car and other luxuries cars. For this purpose, commercial vehicle means a road vehicle designed to carry loads of more than half a tone or more than thirteen passengers or a vehicle used in transportation or vehicle rental business, i.e., constructed or adapted for use and used for conveyance of goods in the course of trade or agriculture or for the conveyance in the course of transporting employees in the employment of the owner. If such a car is sold the amount should be restricted accordingly.

Additional Depreciation Allowance

If the depreciation basis at the end of the year of income (after allowing depreciation allowance) produces an amount that is less than 1,000,000/=, additional depreciation of the pool shall be calculated as equal to that amount.

Example 10.2

Year of income 2015 a company had depreciation basis b/f of 20,000,000 of which it was a class one type. It acquired 2 computers each at Tsh. 900,000/= and a pick-up for Tsh. 5,000,000/=. The company sold the pick-up at the end of the year and other equipment within the year at Tsh. 25,500,000/=. Compute the depreciation allowance for the year 2015.

Solution to example 10.2

Class I (37.5%)

Depreciation basis b/d.....	20,000,000
Additions:	
Computers and equipment (2 x 900,000).....	1,800,000
Dustan pick-up	5,000,000
Sub- total.....	26,800,000
Less: Sale (Pick up and other equipment).....	(25,500,000)
Depreciation basis before depreciation allowance.....	1,300,000
Depreciation allowance thereof (37.5%).....	(487,500)
Depreciation basis at the end of the year (WDV).....	<u>812,500</u>

The depreciation basis of this class is 812,500, this is less than 1,000,000. This necessitates calculation of additional depreciation of this particular pool (equal to that amount, i.e. Tsh. 812,500/=). Therefore, total depreciation allowance of the pool for the year is 487,500 + 812,500 = 1,300,000, thus dissolving the pool.

Depreciation Allowances for Mining and Petroleum Operations

The Income Tax Act 2004 as amended by the Finance Act 2016 provides special treatment for depreciable assets for mining or petroleum companies and operation. The Act requires creation of separate pools for depreciation allowances expenditure for each year of income. Depreciation allowance expenditure is defined in the third schedule of the ITA, 2004 (R.E 2016) to mean additions to the costs of depreciable assets owned and employed wholly and exclusively in the mineral or petroleum operations and expenditures other than financial costs on mining or petroleum operations or costs and expenditure which are directly attributable in calculating income from the operations.

The ITA , 2004 (R.E, 2016) under paragraph 5 of the third schedule indicates that the whole of depreciation allowance expenditure incurred in respect of mining or petroleum operations during years of income shall be placed in separate pools. Depreciation allowance granted with respect to a particular year of income is taken in that year and cannot be deferred to a later year (s) of income. The depreciation allowance is granted for depreciation allowance expenditure pooled for each year of income at the following rates:

Year of Income	Depreciation Allowance
First Year	20% of expenditure
Second Year	20% of expenditure
Third Year	20% of expenditure
Fourth Year	20% of expenditure
Fifth Year	20% of expenditure

Example: 10.3

MUBUYU Mining Corporation conducts is mining operation in one of the regions in Tanzania. For years of income 2016 and 2017 it incurred the following expenditure:

Year of income	Amount incurred (in Tsh.)
2016	150,000,000,000
2017	100,000,000,000

Required: Determine depreciation allowance for the year of income 2016 and 2017.

Solution to Example 10.3:

Determination of depreciation allowance for the MUBUYU mining company for 2016 and 2017
There are two pools to be created; namely 2016 depreciation allowance expenditure pool and 2017 depreciation allowance expenditure pool.

Depreciation allowance 2016:

Total expenditure on mining operations for 2016 is Tsh. 150,000,000,000
Depreciation allowance: 20% there of..... Tsh. 30,000,000,000
Total depreciation allowance for 2016..... Tsh. 30,000,000,000

Depreciation allowance for 2017:

Depreciation allowance on 2016. Depreciation allowance expenditure pool: 150,000,000,000 x 20%..... 30,000,000,000
Depreciation allowance on 2017. Depreciation allowance expenditure pool: 100,000,000,000 x 20%.. .20,000,000,000
Total depreciation allowance for 2017..... 50,000,000,000

Realisation of Depreciable Assets of Mining or Petroleum Operations

Realisation of mining or petroleum assets and operations expenditure may give rise to taxable income or allowance. The method for assessing the taxable income on realisation is the excess of incomings over the written down value of the pool of depreciable expenditure in the pool at the end of the year. When the written down value (WDV) of assets to be realised is greater than the incomings from realisation, an allowance shall be granted for that year of income equal to the difference. Written down value (WDV) is defined by the Act to mean costs included in the assets (depreciation allowance expenditure) less all depreciation allowances granted in respect of that asset at the beginning or end of the year.

Example: 10.4

GGM is a mining company registered in Tanzania to carry out mining operations. The following are mining operation expenditures for the most recent five year of income.

Years	2011	2012	2013	2014	2015
Gross amount (In Tsh.)	20 billion	30 billion	100 billion	120 billion	70 billion

Additional information:

- ❖ Mining operations expenditure for the year of income 2016 amounted to Tsh. 150 billion
- ❖ The mining operation assets and expenditure for 2011 and 2012 were all sold in 2016 for Tsh. 2 billion and Tsh. 10 billion respectively.

Required: Determine depreciation allowance of the company for the year of income 2016

Solution to example 10.4

Determination of depreciation allowance on mining operations for the GGM Company for the year 2016.

Mining operations expenditure pools (In Tsh.).

Year	2011	2012	2013	2014	2015	2016
WDV b/f (1/1/2016)	NIL	6 billion	40 billion	78 billion	56 billion	150 billion
Allowance for the year (20% of cost) 2016	NIL/Disso lved	6 billion	20 billion	24 billion	14 billion	30 billion
WDV 30/12/2016		NIL (dissolved)	20 billion	54 billion	42 billion	120 billion

Mining operations depreciation allowance for 2016 is 88 billion (20 +24+14+30).

Taxable gain on disposal:

Incoming on sale of expenditure from:

Year of income 2011 expenditure.....2 billion
Less WDV as at 1/1/2016.....0 billion.

Excess of incomings over WDV.....2 billion (This is an income to be included when determining total taxable income for 2016)

Year of Income 2012 expenditure, incomings..... 10 billion

Less: WDV as at 1/1/2016..... .6 billion

Excess of incoming over WDV..... .4 billion (This is taxable income for 2016)

Example 10.5

DIMOND Company Limited is a newly formed carrying out agricultural business. During the first year of its operations 2016, it purchased the following depreciable assets:

- (i) Computers and data handling equipment, which were used by the company secretary and accountants, 3 computers, were purchased at Tsh. 1,900,000 each.
- (ii) Three twenty-five seater minibuses which were used to shuttle staff were purchased, each at Tsh. 25,000,000; and five more 50 seater buses were added during the year at the value of Tsh. 180,000,000 in total.
- (iii) Four bulldozers each costing Tsh. 100,000,000; one second hand Dustan pick up for Tsh. 25,000,000; one brand new saloon car for Tsh. 28,000,000; furniture and fittings costing in total Tsh. 17,500,000 were acquired during the same year of business.
- (iv) The company also purchased four lawn mowers, which were used in keeping the surroundings clean at Tsh. 650,000 each.
- (v) During the year, the following agricultural equipment, which arrived at Mtwara port, were cleared immediately and transported to Songea to commence farming work:
 - Two CAT Comatus Caterpillar Tsh. 80,000,000 each; five Ferguson tractors each Tsh. 52,000,000.
 - Harrows and one planter all costing Tsh. 26,000,000; three heavy-duty Isuzu trucks costing Tsh. 280,000,000 in total.
 - A grain storage warehouse and rice milling building were constructed and completed at a cost of Tsh. 55,000,000 and Tsh. 52,000,000 respectively and were put into use on 15th May, 2016.

- One helicopter for taking tourist to the Mountain Kilimanjaro was purchased for Tsh. 240,000,000.
- The adjusted income from business without depreciation allowance for DIMOND Company Limited for year 2016 was Tsh. 1,053,206,180.00.

Required:

By applying the relevant provisions of the ITA 2004, compute for the DIMOND Company for year 2016 the following:

- Depreciation allowance
- Tax payable

Solution to Example 10.5

Suggested solution: Computation of depreciation allowance for Diamond Ltd for 2015

	Class I 37.5%	Class II 25%	Class III 12.5%	Class V 20%	Class VIII 100%
Depreciation basis b/d	NIL	NIL	NIL	NIL	NIL
Additions during the year:					
3 Computers	5,700,000				
3 mini-buses	75,000,000				
5 buses		180,000,000			
4 bulldozers	400,000,000				
Dustan	25,000,000				
Saloon car (restricted)	15,000,000				
Furniture and fittings			17,500,000		
4 Lawn mowers			2,600,000		
2 Caterpillars	160,000,000				
5 tractors		260,000,000			
Harrow and planter					26,000,000
Isuzu trucks		280,000,000			
Grain store				55,000,000	
Milling building				52,000,000	
Helicopter		240,000,000			
Sub-total	680,000,000	960,000,000	20,100,000	107,000,000	26,000,000
Less sales	-	-	-	-	-
Depreciation basis before depreciation allowances	680,000,000	960,000,000	20,100,000	107,000,000	26,000,000
Depreciation allowance	255,262,500	240,000,000	2,512,500	13,543,561.64*	26,000,000
Depreciation	424,737,500	720,000,000	17,585,500	93,456,438.36	NIL

basis at year end (WDV)					
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* Depreciation allowance for class five (V): Straight line method and formula is used:
 Number of day (May 15 to 31 Dec = 17 + 30 + 183 = 231 days) = 107,000,000 x 231/365 x 20% = 13,543,561.64

Total depreciation allowance as per above computation = 537,318,561.64

(b) Tax payable

Taxable income before depreciation allowances..... Tsh. 1,053,206,180.00

Less: Depreciation allowance..... (537,318,518.64)

Taxable income..... 515,887,661.36

Tax payable (30% thereof)..... 154,766,298.40

Example 10.6

UBENA Hotel (T) had constructed a modern eleven-storey tourist hotel building for 800mill/=. The construction of this hotel was completed on the 31.12.2015, and it was formally opened and certified by the Minister for Finance on the 1.1.2016, when it started operating at full capacity.

In addition to the main building, the hotel had during the same time constructed:

- A car park adjacent to the hotel structure for 30,000,000/=
- A swimming pool for 17,000,000/=
- Small huts for 21,000,000/=

These were used from the same date as the main hotel building

The hotel had the following assets, which were used from the day of its inception:

- ❖ Automatic laundry machine, installed in the basement for 12,000,000/=
- ❖ A cold storage plant for 20,000,000/=
- ❖ An air-conditioning plant for 22,150,000/=
- ❖ Cookers and other permanent kitchen wares 18,000,000/=
- ❖ Mobile serving wheel trays 2,800,000/=
- ❖ Cups, tools and other implements for 8,000,000/=
- ❖ Furniture 99,000,000/=

To keep the small huts clean three mowers costing 5,000,000/= each were purchased

In addition, during the year 2016, the hotel acquired and used the following:

- ❖ A Scania bus (35 seats) for 260,000,000/=. This was purchased on the 2nd April, 2016 but was used from the 1st of June, 2016.
- ❖ A second hand delivery van was purchased for 5,900,000/= during May, 2016.
- ❖ A new Rolls Royce for the General Manager was acquired for 180,000,000/= which was wholly used for business. The company also purchased a Range Rover for 140,000,000/=. this was used for the Hotel Accountant while on duties.
- ❖ In order to encourage the hotel industry, and hence tourism, the Ministry of Tourism awarded a hotel a twin otter aircraft, which was purchased for 1,700,000,000/=. The company incurred additional expenditure of 140,000,000/ to make the aircraft operational.
- ❖ Zilipendwa Orchestra was officially inaugurated on the 15th July 2016. This was solely for the entertainment of the hotel guests in UBENA Hotel. The music instruments had cost the hotel 21,000,000/=.

As a control against frequent power cut by TANESCO, a generator was purchased for 20,000,000/= during August. This was installed in the hotel on 15th August 2016.

The General Manager's Rolls Royce was sold on 10.11.2016 for 50mill/=

Required:

Calculate depreciation allowance admissible to UBENA Hotel (T) under the 3RD Schedule of ITA 2004 for the year of income 2016

Solution to Example 10.6

Computation of depreciation allowance admissible to UBENA Hotel for the year of income 2016

Classes	Asset	Amount
Class I	Opening Depreciation basis	-
	Additions for the year:	
	Roll Royce (restricted price)	15,000,000
	Range Rover (restricted price)	15,000,000
	Sub total	30,000,000
	Less: Sales (Roll Royce)	(50,000,000)
	Balance (taxable trading receipt)	20,000,000
	Class is dissolved:	
Class II	Opening Depreciation basis	-
	Additions for the year:	
	Air craft (Grant cost plus additional expenditure)	1,840,000,000
	Scania bus	260,000,000
	Sub -total	2,100,000,000
	Less: Sales	-
	Depreciation basis at the end of year	2,100,000,000
	Depreciation allowance (25% thereof)	525,000,000
	Depreciation basis carried forward	1,575,000,000
Class III	Opening Depreciation basis	-
	Additions for the year:	
	Automatic laundry machine	12,000,000
	A cold storage plant	20,000,000
	Air conditioning plant	22,150,000
	Electricity generator	20,000,000
	Sub -total	74,150,000
	Initial Allowance (50% thereof)	37,075,000
	First Portion in 2016 (1/2 x 37,075,000)	18,537,500
	Second portion in 2017 (1/2 x 37,075,000)	
	Depreciation basis carried forward	37,075,000
	Other assets in the class with no initial allowances	
	Cookers and kitchen-equipment	18,000,000
	Mobile Serving wheel trays	2,800,000
	Cups, tools, and implements	8,000,000
	Furniture	99,000,000
	Mowers (3@ 5,000,000)	15,000,000
Delivery van	5,900,000	
Music instruments	21,000,000	
Sub- total	169,700,000	
	Less: sales	-
	Depreciation basis at the end of the year	169,700,000

	Depreciation allowance (12.5% thereof)	21,212,500
	Depreciation basis carried forward	148,487,500
Class VI	Hotel building	800,000,000
	Car park	30,000,000
	Swimming pool	17,000,000
	Small huts	21,000,000
	Sub-total (all were used from the start of the year-365 days)	868,000,000
	Less : sales	-
	Depreciation basis at the end of the year	868,000,000
	Depreciation allowance (5% straight line method)	43,400,000
	Written down value at the end of the year	824,600,000

Summary of depreciation allowances for the year 2016:

Class I.....	(20,000,000)- Trading receipt
Class II.....	525,000,000
Class III (Initial allowance).....	18,537,500
Class III.....	21,212,500
Class VI.....	43,400,000
Total Depreciation allowance for the year 2016	608,150,000
Less: Taxable Trading receipt on sale of Roll Royce (class I).....	(20,000,000)
Net depreciation allowance admissible for the year 2016:	588,150,000

Example 10.7

TWENDEPAMOJA Company Limited is a resident company, which carries on business in the country as a class I Building contractor.

The depreciation bases of the pools of depreciable assets as at 1st January, 2016 were as follows:

Class I	Class II	Class III	Class IV	Class V	Class VI	Class VII
12,000,000/	1,500,000/	11,000,000/	NIL	NIL	NIL	NIL
=		=				

During January 2016 the company acquired the following:

- ❖ Two caterpillar tractors for Tsh. 100 million each.
- ❖ A second hand pick-up for Tsh. 20 million
- ❖ Fixtures and fittings Tsh. 79 million
- ❖ Constructed a building for the storage of imported building materials for Tsh. 500 million. This was built parallel (mutually) to another building to be used as an office, where the cost of the office was estimated at 20% of the total cost of the storage building. Commissioner, by exercising his discretionary power to the best of his judgment estimated the cost of constructing the office at Tsh. 150 million.

All these assets were used from 31st January 2016

On 1st June, 2016 the company decided to expand its business by establishing the plant for the manufacture of glass for windows and doors as well as tiles to be used in the company's business and for sale. For this purpose it purchased a new building for Tsh.400 million on 1st July 2016 from PENCOS, a construction company, whose cost of construction was Tsh.300 million.

Plant and Machinery to be installed in the building arrived on the same date and it was immediately installed in the building. The new factory plant and machinery had cost the company Tsh.60 million. The new factory commenced production on the 1st August 2016.

On 1st September 2016, the company acquired and used the following immediately:

- ❖ Two new Lorries at a cost of Tsh. 450 million in total
- ❖ A used Cessna Aircraft for business for Tsh. 350 million
- ❖ Mowers for cleaning the compound of the business premises for Tsh. 190 million
- ❖ An air condition system set for the storage building and the office for Tsh. 160 million in total
- ❖ Three (3) computers and their accessories to be used in the office, each 4 million

The following assets of the pool were sold during the month of December 2016

- ❖ Second hand pick-up for Tsh. 15 million
- ❖ Both caterpillars' tractors for Tsh. 160 million
- ❖ Lorries for Tsh. 520 million
- ❖ A used Cessna air craft for Tsh. 400 million

Required:

Compute depreciation allowance admissible to TWENDEPAMOJA Co. Ltd. for the year of income 2016 as required under the Third Schedule of ITA, 2004.

Solution to example 10.7

Computation of depreciation allowance admissible to TWENDEPAMOJA Co. Ltd for the year of income 2016.

Classes	Assets and amount	Depreciation allowance
Class I (rate 37.5%)		
Opening balance	12,000,000	
Additions for the year:		
Caterpillars	200,000,000	
Pick-up	20,000,000	
Computers	12,000,000	
Total	244,000,000	
Less: Disposal/ sales		
Pick up	15,000,000	
Caterpillars	160,000,000	
Total sales	175,000,000	
Depreciation basis for the year	69,000,000	
Depreciation allowance @ 37.5%	25,875,000	25,875,000
Depreciation basis c/d	43,125,000	
Class II (Rate 25%)		
WDV b/f	1,500,000	
Additions during the year		
Lorries	450,000,000	
Aircraft	350,000,000	
Total assets	801,500,000	
Less: Disposals/sales		

Lorries	520,000,000	
Air craft	400,000,000	
Total sales	(920,000,000)	
Balance (Taxable Trading receipt)	118,500,000	0.00
Depreciation basis at the end of year	0	
Class III (rate 12.5%)		
WDV b/f	11,000,000	
Additions		
Fixtures and fittings	79,000,000	
Plant and machinery	60,000,000	
Mowers	190,000,000	
Air condition system set	160,000,000	
Depreciation basis for the year	500,000,000.	
Depreciation allowance for the year @12.5%	62,500,000	62,500,000
Depreciation basis of the pool c/d	437,500,000	
Class VI		
Building materials Storage building (1/1/2016)	500,000,000	
Duration in days	335	
Depreciation allowance @ 5%	500,000,000 x 335/365 x 5%=	22,945,205.50
WDV c/d	477,054,794.50	
Second Building		
Duration in days	183	
Depreciation allowance @5%	400,000,000 x 183/365 x 5%	10,027,397.30
WDV c/d	389,972,602.30	
TOTAL DEPRECIATION ALLOWANCE		95,472,602.80

From the above computations the depreciation allowance admissible to the company is 95,472,602.80. However there will be taxable income/trading receipt arising from realisation of some assets in class II of Tsh. 118,500,000.00. This ultimately dissolves class II.

Chapter Summary

This chapter has provided procedures for computing depreciation allowances for non-current assets as per the Income Tax Act 2004. The depreciation allowances computations methods provided in this chapter are used instead of the well-known methods of computing the depreciation acceptable under the generally acceptable accounting principles or International Accounting Standards. A number of illustration and comprehensive examples have been provided in the chapter as demonstration on how depreciation allowances are determined for some selected business assets. The key issues under the chapter can be summarised as follow:

- ❖ The machinery for the determination of depreciation allowances for depreciable assets is provided by section 17 of the Income Tax Act 2004 and the third schedule of ITA 2004.
- ❖ Depreciable assets are assets employed wholly and exclusively in the production of income from a business, and which are likely to lose value because of wear and tear, obsolescence or the passing of time but excludes goodwill, mineral or petroleum rights and other interest in land, a membership interest in an entity and trading stock.
- ❖ Depreciable assets are classified into eight (8) classes. The 3rd schedule of Income Tax Act, 2004, as amended in 2016 provides the details of the classification of the depreciable assets. Each class is assigned a different depreciation rate ranging from 5% to 100% per annum.
- ❖ In addition to the annual depreciation allowance, the Act provides for an additional allowance for qualifying assets, known as the Initial allowance. The initial allowance is granted to plant and machinery which are purchased by a business and put to their uses for the first time. Initial allowance is given at the rate of 50% on costs for plant and machinery which is Used in *manufacturing processes* and *fixed* in a factory; Used in fish farming; and Used for providing services to tourists and fixed in a hotel.
- ❖ There are two main methods of computing depreciation allowances for depreciable assets, namely diminishing value method and straight line method.
- ❖ When a depreciable asset is sold during any part of the year, it may give rise to a taxable income or additional allowance. When the sales proceeds exceeds the written down value of the assets, a taxable income arises, and when the sales proceeds of the assets is less than the written down value of the assets an additional allowance is granted to the business.
- ❖ When the assets in a pool/class are all realised, the pool will be dissolved and the amount will be included as either taxable business income or will be granted as allowance to the taxpayer.
- ❖ The Income Tax Act 2004 as amended by the Finance Act 2016 provides special treatment for depreciable assets for mining or petroleum companies and operation. The Act requires creation of separate pools for depreciation allowances expenditure for each year of income.
- ❖ The depreciation allowance for mining or petroleum operations is granted for depreciation allowance expenditure pooled for each year of income at the rate of 20% per annum on straight line method.

End of Chapter Ten Revision Questions

1. Differentiate between depreciable assets and investment assets?
2. Differentiate between depreciation expense determined under International Accounting Standard and depreciation allowances determined under Income Tax Act 2004
3. Identify categories of depreciable assets qualifying for 'initial allowance'
4. Your tax client Kibanga Company Ltd. a resident company engaged in farming business seeks your advice on tax incentives (allowances) available to him on each of the following transactions. Support your answer with relevant calculations where necessary. The company prepared and closed its accounts on 31st December 2016:
 - a) The company made substantive expansion of its existing agricultural production processing plant at total cost of Tsh. 12,000,000. The expansion programme is an approved enterprise for the purpose of Tanzania Investment Act, 1997
 - b) The company made purchases of machinery and operating equipment to the old factory as follows:
 - (i) On 1st May 2016 purchased one Scania lorry for Tsh. 10,530,000, out of which Tsh. 2,530,000 is a cost of trailer
 - (ii) On 15th May 2016, the company received a coffee roasting machine costing Tsh. 1,500,000 from a Brazilian company as a grant. The company paid clearing and other charges amounting to Tsh.450,000
 - (iii) On 1st June 2016, the company purchased and installed machinery at a total cost of Tsh. 6,450,000 as follows:

- Central cooling machinery	2,600,000
- Boiler	2,000,000
- Leather machine	1,200,000
- Automatic hacksaw machine	400,000
- Hand drilling Macon	<u>250,000</u>
	<u>6,450,000</u>

However, the machinery were first put into use on 15th December 2016
 - (iv) On 1st October 2016 a saloon car was purchased for the Marketing Manager at a total cost Tsh.15,000,000
 - (v) A motorised fork lift truck was purchased f on the same date (1/10/2016) for Tsh. 7000,000 on hire purchase basis. The company deposited Tsh. 1,000,000 on the 1st October 2016 and paid Tsh. 550,000 for 12 months instalments. The forklift was put in to use on the same date.
- c) The company incurred additional expenditure in its farm on 1st November 2016 for the plantation of permanent crops as follows:
 - (i) Land clearing for the planting of coffee Tsh. 450,000
 - (ii) Construction of a bore hole for water supply at Tsh. 2,100,000
 - (iii) Construction of a godown to store animal feeds for Tsh. 12,560,000
 - (iv) Construction of farm house on the agricultural land in which the owner lives with his family
- d) Other transactions during the year:
 - (i) A used ship of more than 500 tons at a total cost of Tsh. 15,160,000. On 15th November 2016 the company incurred a total cost of Tsh. 3,670,000 for refitting the ship. The ship started operations of transporting coffee to Comoro Island on the same date
 - (ii) A light aircraft was purchased on the same date to assist in transportation of coffee Tanga port at a total cost of Tsh.6,150,000

5. Mikumi Safari Lodge is a newly formed company to carry out hotel and tour business. During year 2016, the company incurred the following capital expenditures:

I. Machinery, Equipment and Furniture:

	Tsh.
1. General	
• Generator	12,800,000
• Telephone Exchanger	14,400,000
2. Hotel and rooms	
• Office furniture	16,000,000
• Beds	28,800,000
• Mattresses	6,900,000
• TV Sets	33,600,000
• Carpets	7,200,000
3. Kitchen	
• Fridges and Freezers	5,500,000
• Equipment	30,000,200*
4. Laundry	
• Washing machine	14,572,667
• Irons	200,000
5. Swimming pool	
• Pump	1,600,000
6. Workshop	
• Implements(tools)	8,000,000
• Tour radios	20,000,000
II. Motor vehicles:	
• Staff bus	56,000,000
• Shopping van	32,000,000
• Tour land rovers	480,000,000
III. Buildings:	
• Brick huts (purchased old and used)	120,000,000
• Brick huts (new)	96,000,000
• New restaurant/bar/kitchen	128,000,000
• New swimming pool	40,000,000
• New laundry building	20,600,000
• Road construction to hotel	22,000,000
IV. Pre-operational expenses:	
• Blankets	20,000,000
• Bed sheets	3,600,000
• Bed covers	5,880,000
• Project write up	2,000,000

*Cost of equipment includes Tsh.14, 000,000 for cutlery

During the year 2016, the following transactions took place:

- 1) During January, the company's Board of Directors adopted an accounting policy of writing off linen in the year of purchase and cutlery and tools over period of two years.

- 2) During July, laundry machinery was replaced by new machinery worth Tsh.56 million. The old machinery was donated to Hindu Mandal Hospital. The hospital valued this machinery at Tsh.16 million.
- 3) A light aircraft was bought on credit for Tsh.600 million and was put into use from August. The loan was to be repaid after four years. Meanwhile, the creditor retained the right of repossessing the aircraft in case of default on the part of the company.
- 4) Gross profit for the first year was Tsh.1,120 million.
- 5) On the 2nd of December 2015, the Minister for Finance certified the construction of the hotel

Required: Determine the net taxable income for the year of income 2016.

6. The following assets were either owned or used by the TANZA CONSULT Company in its business for the year of income 2016.

- A: At Mwanza it had a beer manufacturing factory. For this purpose it had the following assets:
- (i) A factory building which was purchased new and unused from a building contractor 6 years ago for Tsh. 800 million/=.
 - (ii) A building for bottling plant. This is an old building constructed and used by the company for the past 25 years at a total cost of Tsh.1,200 million/= . However it is still in good working condition.
 - (iii) Towards the end of July 2015, a bottling machinery worth Tsh.1, 400 million/= was installed in the old building. With effect from the 3rd of August the new bottling plant became operational.

B: Farming business:-

For this business it possessed the following assets:-

Land of 500 acres used for barley farming. In this land it incurred the following expenditures during 2016:-

- ❖ Clearing of land, 300 acres, 30 million/= . This was followed by planting thereon barley during January 2016.
- ❖ Fences for 40 million/=.
- ❖ Water supply canals for 80 million.
- ❖ A building for storage of barley for 120 million/=
- ❖ A barley milling plant consisting of a mill building for 60 million/= and a milling plant of 70 million/=.
- ❖ A garage for the storage of agricultural machinery for 40 million/=

All these assets were used from 1st February, 2016.

C: Hotel business:-

During 2016 it purchased a new building from A-Z Ltd. for 800 million which was constructed for 600. This was used as hotel from 1st April 2016 after being inaugurated by the Minister for Finance on 31st March 2016. Machinery installed in the hotel cost 840 million/=.

Required:

Using relevant provisions in the ITA 2004 (As amended in 2016), calculate depreciation allowance admissible to TANZA CONSULT for the 2016 year of income.

7. Shell LTD is a petroleum company incorporated in Tanzania as a petroleum production company. The company started its exploration ad extraction since 2013. The expenditure on exploration, depreciable assets and other related expenditure since 2013 are as summarised below:

Year of income	2013	2014	2015	2016
Amount (Tsh.)	5,500,000,000	2,000,000,000	1,500,000,000	15,000,000,000

Additional information:

- All of the company depreciable assets and expenditure for 2013 were sold to another petroleum company BP for Tsh. 4,000,000,000 in 2016.
- Part of the assets and expenditures on petroleum operations for 2015 were destroyed by fire and an amount of Tshs. 2,000,000,000 were received from NIC insurance company as compensation for the loss in 2016.
- In December, 2016, the company made prepayment of Tsh. 10 billion for 2017 petroleum operations and expansion of plant.

Required:

Determine the depreciation allowance and taxable income for the Shell Company for the years of income 2015 and 2016.

- ABC Ltd is mining company operating in Tanzania. For year of income 2016 it sold two of its major equipment used in mining operations. One of these equipment was acquired for Tsh 2.5 billion and used for three year prior to 2016, and the other was acquired for Tsh. 1.3 billion and used for 2 years before being sold in 2016. The equipment were sold for Tsh. 1.5 billion and 2 billion respectively. The selling expenditure on the two equipment was Tsh. 50 million and Tsh. 100 million respectively.

Required: Determine the depreciation allowance or taxable income for the ABC Mining company for the year 2016 on the two equipment.

- A-D Insurance is a resident corporation dealing with general and life insurance business. It is an insured corporation and insurer in some cases depending on the insurance services cycle within its operation. On 31st December, 2005, A-D Insurance reported the following information:

Earnings:	TZS
Accounted premiums	150,000,000
Coded re- insurance premium	50,000,000
Life insurance premium	50,000,000
Investment income	40,000,000
Other underwriting income	12,000,000
Payments:	
Expenses for insurance claims	20,000,000
Re-insurer's share (claims)	5,000,000
Administrative expenses	10,000,000
Life insurance claims	15,000,000
Costs to improve assets	50,000,000

During an assessment period the following additional information were made available:

- ❖ 1/3 of TZS 240,000,000 of the premium was received was paid to A-D in the form of proceeds.
- ❖ A-D holds assets in the United Kingdom that have to be insured, hence, it paid premium to the Diamond Insurance a United Kingdom based corporation amounting to TZS 2 million.
- ❖ ½ of the total insurance claim above have not been reported in the accounts due to accounting errors of omission.

- ❖ A-D paid for its re-insurance to ABC Co. Ltd, another insurance company residing in Ghana where the corporation owns several assets with a value of TZS. 1,200,000.
- ❖ Life Insurance premium was received for these risks:

Death and personal injury at work	TZS.25,000,000
Education scheme	TZS.10,000,000
Old age scheme	TZS.15,000,000

Life insurance claims was for only two risks:

Education scheme	TZS.10,000,000
Old age scheme	TZS. 5,000,000

A-D holds 75% shares of the assets in the Diamond Insurance Co. While during the previous three years it had owned only 50% shareholding. It hence, realised a total of TZS 35,000,000 from that change

Required:

- Briefly explain the meaning of life insurance as applicable under the Income Tax Act, Cap 332.
- Calculate the net taxable income of the A-D Insurance Corporation as per the Income Tax Act, Cap 332.

- SERENA Hotel (T) had constructed a modern eleven-storey tourist hotel building for 1, 800mill/=. The construction of this hotel was completed on the 31.12.2016, and it was formally opened and certified by the Permanent secretary of the Minister for Finance on the 1.1.2017, when it started operating at full capacity

In addition to the main building, the hotel had during the same time constructed:

- A car park adjacent to the hotel structure for 30,000,000/=
- A swimming pool for 70,000,000/=
- Small huts for 10,000,000/=

These were used from the same date as the main hotel building

The hotel had the following assets, which were used from the day of its inception:

- Automatic laundry machine, installed in the basement for 22,000,000/=
- A cold storage plant for 20,000,000/=
- An air-conditioning plant for 21,500,000/=
- Cookers and other permanent kitchen wares 8,000,000/=
- Mobile serving wheel trays 1,800,000/=
- Cups, tools and other implements for 40,000,000/=
- Furniture 90,000,000/=

To keep the small huts clean three mowers costing 5,000,000/= each were purchased

In addition, during the year 2017, the hotel acquired and used the following:

- A min bus and normal bus for 100,000,000/= and 250,000,000 respectively. These were purchased on the 2nd June, but used from the 1st of September, 2017.
- A new delivery van was purchased for 18,000,000/= during March.
- A new Land Cruiser Prado for the General Manager was acquired for 180,000,000/= which was wholly used for his private purposes. While on duty, he used the hotel Range Rover, which was purchased for 100,000,000/=
- In order to encourage the hotel industry, and hence tourism, the Ministry of Tourism awarded a hotel a twin otter aircraft, which was purchased for 780,000,000/=

- KUTUMBUIZA Orchestra was officially inaugurated on the 15th June 2017. This was solely for the entertainment of the hotel guests, in SERENA Hotel. The music instruments had cost the hotel 240,000,000/=

As a control against frequent power cut by TANESCO, a generator was purchased for 150,000,000/= during February. This was installed in the hotel on 15th March, 2017

The General Manager's Prado was sold on 10.09.2017 for 100mill/=

Required:

Calculate depreciation allowance admissible to SERENA Hotel (T) under the 3rd Schedule of ITA 2004 for the year of income 2017.

150,000,000	240,000,000
150,000,000	240,000,000

CHAPTER ELEVEN

TAXABLE INCOME FROM INVESTMENTS

Introduction

Income from investment is one of the major sources of Income taxable under the Income Tax Act 2004. In this chapter we discuss the categories of income sources classified as income from investment. The main section of the income tax act that deals with income from investments is section 9 and Paragraph 4 of the first schedule of the income tax Act 2004. We use examples to clarify the treatment of various incomes from investments.

Learning Outcomes

After completing this chapter readers should be to:

- ❖ Describe the meaning of investment income as per income tax act 2004
- ❖ Describe the sources of taxable investment income
- ❖ Identify investment incomes exempt from income tax
- ❖ Describe allowable investment expenses for tax purposes
- ❖ Compute taxable investment income as per income tax act 2004

Meaning of Investment Income

Investment income arises from the conducting of an investment in any year of income. The conducting of an investment involves the owning of assets other than the assets for personal use by the owner. Such income must also be distinguished from business income. One main distinguishing feature between the two is that investment income normally involves the holding of an asset by its owner and the return due to the owner of the asset. It is normally a payment for the use of such an asset (Section 3 of ITA, 2004). It is essentially an income in respect of the use of property by others as opposed to income from the sale of property, which normally is classified as business or capital gains unless specifically classified otherwise by the ruling statute.

Income from the use of one's property by others however may also give rise to business income. Business income from investments happens for example where a person's activities consist mainly in the making and holding of investment assets for use by others, whether in land and buildings, for the purpose of receiving rents or in securities for the purpose of receiving interest or dividends and the principle part of his business is derived there from. Thus, interest received by a banker would be business income on the bank, since it is one of banker's main activities to provide money for the use by others. The interest received by a customer from a deposit he holds with a banker on the other hand is investment income.

It must however be acknowledged that there is no clear cut demarcation between the two and in practice the question whether a particular receipt is business or investment income continues to be an area of friction between the tax authorities and taxpayers.

Sources of Investment Income

Section 9 of the ITA, 2004 indicates that investment income arises when one is conducting the investment during the year of income. The main sources mentioned are: dividends, distribution of a

trust, gains of an insured from life assurance, gains from an interest in an unapproved retirement fund, interest, natural resource payment, rent or royalty. The section continues mentioning investment income to include gains from the realisation of investment assets, amount received in respect of accepting a restriction on the capacity to conduct the investment.

Taxable Dividends

A dividend is normally a distribution of the profits of a company whether such profits have been capitalized or not, and which entails a release of part of the company's assets to its shareholders. The Act defines a dividend as a distribution that is not a repayment of capital (Section 3 of ITA, 2004). It however widens the normally meaning of the word dividend by providing under the definition section that a distribution for this purpose includes:

- ❖ Any capitalization of profits.
- ❖ Re-investment of dividends that increases the value of the company shares.
- ❖ The excess of payments made by the company to its members, over Payments received by the company from such members.
- ❖ Payments made to members on cessation of membership interest including on liquidation.

Taxation on taxable dividends for both individuals and corporations is provided for under section 54 and paragraph 4 of the first schedule of the ITA, 2004. Section 54 (1) of ITA, 2004 provides that dividends distributed by a resident corporation shall be taxed in the hands of the corporation's shareholders in the form of final withholding tax (Section 86 of ITA, 2004). The applicable rate for this category of dividends is 10% (Para 4 first schedule; ITA, 2004 and FA, 2012). If dividend is distributed by a non-resident corporation, then such dividends should be included in calculating the income of the shareholders. Section 54 further shows that when dividend is distributed by a resident corporation to another resident corporation where the corporation receiving the dividend holds 25% or more of the shares in the corporation distributing the dividend and controls either directly or indirectly 25 per cent or of the voting powers in the corporation, the dividend will be taxed in form of withholding tax at the rate of 5% (Para 4 of first Schedule, ITA, 2004). Similar rates apply if corporation distributing the dividend is listed in Dar Es Salaam Stock Exchange.

Dividends exempt from income tax

The following types of dividend do not constitute a distribution of profits or a dividend and thus exempt investment income tax:

- ❖ Any repayment of capital.
- ❖ The issuance of bonus shares to existing members, in proportion to member existing shares in the company.

Taxable Interest Income

Interest under section 3 of the ITA, 2004 does not only include interest on the use of money, but includes interest on debt obligations, gains by way of discounts or premiums, payments under finance leases etc. Special attention therefore should be paid to the definition of interest as provided for under the defining section 3 as well as sections 32 (annuities, installment sales and finance leases) and debt obligation between the permanent establishment and the owner (S.71 (6)(b)(ii and ii).

Taxable Rent Income

This includes all income received for the use/ lease of tangible asset and includes any payment for the granting of such use or lease including premium or key money. It however does not include income on natural resources. It should be noted that rent received by a resident individual landlord on residential premises leased by an individual tenant is exempt, if such rent does not exceed Tsh. 500,000/= in a year and such individual does not conduct the business of renting of properties (Section 86 (4) a-c).

Taxable Royalty

Royalty is a payment made for the use of an intangible asset such as copyrights, patents, trademark, secret formulae or processes and know-how. A royalty by definition however does not include a natural resource payment. Under the definition of the word "royalty" includes those amounts received or a payment is made:

- ❖ To refrain the owner from using any of the above mentioned intangible assets, or
- ❖ For the use of industrial, commercial or scientific equipment.

Gains from the realisation of investment assets

The ITA 2004 (Section 37,38, 39 and 40) indicates that the gain from the realisation of investment is equals to the difference between the market value of the investment asset and its cost. The realisation that gives rise to an investment income must be a realisation of an investment asset and not business assets or depreciable asset or trading stocks. The Act shows that investment assets include:

- ❖ Shares, other than shares:
 - By resident parent in its resident subsidiary, or
 - Listed in DSM stock exchange, or
 - By a non-resident person controlling less than 25% of the controlling shares of the company.
- ❖ A beneficial interest in non-resident trust.
- ❖ Interest in land and buildings other than:
 - A private residence in use for three years or other than such a residence that realises a gain of more than 15mill/= (this however may be a business assets if owned by a person whose business involves the leasing of private residences);
 - An individual's land has been used for agricultural purposes for the past two years and whose market value does not exceed Tsh. 10mill/= at the time of realisation (this is neither a business nor an investment asset). The Act also show that while income received for the use of patent rights, copyright etc. is investment income, the income received from the realisation of the relevant intangible assets would not be taxable since the same are neither business nor investment assets. Also, all shares covered by the exception are neither business nor investment assets.

Taxation of Distribution of a Trust

A trust is a confidence reposed either expressly or impliedly in a person called the trustee for the benefit of another person or beneficiary. It is an arrangement whereby a person (settler) transfers certain properties (the corpus of the trust) to another person (trustee) on trust for the benefit of some other person or persons (beneficiary/beneficiaries). A trust is liable to income tax as a trust person. Any distribution (within the same meaning as discussed under distribution of dividends above) is

taxable as investment income. However, this is only applicable if the trust is a non-resident trust. If the trust is resident any distribution is exempt under section 52(1).

Taxation of Life Insurance Gains

Life assurances are concerned with the life of a person at his or her death or from a specified term. Thus, by their varieties, the sum assured may be payable either at the death of the assured or at a specified term or a combination of both. Section 60 (3) of the ITA, 2004 indicates that the taxable gain equals to the difference between the premiums paid and the proceeds received from the insurer. It should be noted that such gain is only taxable where the proceeds are paid by a non-resident insurer. In the case of term assurances, the Act does not tax gains from such policies which are for term of less than five years or in respect of which the insurer can terminate before the expiry of five years (Section 3).

Taxation of Income From an Unapproved Retirement Fund

Section 63 of the ITA 2004 states that gains from interest in an unapproved retirement fund are only taxable if paid by a non-resident fund. The taxable gain equals to the excess of the benefits received over the premiums paid to the fund. Pensioners receiving their pension from an approved retirement funds such as NSSF, PPF, PSPF, LAPF, and GEPF are exempt from income tax.

Example 11.1

Gains from an unapproved retirement fund in respect of a person who contributed a total of Sh. 28,000,000/= over the period of the person's membership of the fund and received retirement payment of sh. 46,500,800/= is calculated as follows:

Gross retirement payment received	Tsh.	46,500,800
Less, contributions paid	Tsh.	28,000,000
Taxable gains derived	Tsh.	18,500,800

Taxation of Natural Resource Income

Natural resources mean minerals, petroleum, water, or any other non-living or living resource that may be taken from land or sea. As per section 3 of ITA, 2004 gain or profits from natural resources includes any income:

- ❖ Payments, premiums or like amount for granting the right to take natural resources from land or sea, and
- ❖ Any other income calculated by reference to natural resources taken from land or sea.

Investment Restrictive Covenants

Section 9 (2c) any amounts received in consideration of accepting a restriction on conducting an investment is deemed to form part of the investment income of the person accepting the restriction.

Expenses Deductible on Investment Income

Allowances on investment income are rather narrow since the Act allows only expenditure incurred wholly and exclusively in the production of income from the investment. The capital allowances under the third schedule of the act are restricted to business income. All the other allowances under sections 13 to 18 are also restricted to business income. Expenses that may qualify under the whole and exclusive test would include; repairs and maintenance, interest, and other revenue expenses such as salaries and wages, electricity and water etc. Section 19 allows the deduction of a loss in one investment against the income of another investment.

Example 11.2

During the year 2015, KUJIAJILI Company Ltd. conducted the following transactions:-

- (i) Received dividend, from ABC Ltd., a resident corporation, Tsh. 11,000,000. KUJIAJILI Ltd. owns 40% of the shares of the ABC Ltd.
- (ii) Dividends amounting to Tsh. 5,000,000 were received from Beta Ltd., which is listed on the DSE, and is owned 20% by ADB Ltd. a non-resident corporation.
- (iii) Dividend amounting to Tsh. 10,550,000 received from Malaika Company Ltd., a resident corporation.
- (iv) The office of KUJIAJILI Company limited is underutilised. The company decided to rent the front part of its office to Mabele Joseph a shop businessman, who used it as a shop. Mr. Mabele Joseph paid Tsh. 2,800,000 as rent.
- (v) During the year the company received Tsh. 30,000,000 as rent from Mr. Masanja Ahmed, a Tanzanian with respect of a house occupied by him.
- (vi) Also the company received a royalty from TMC Ltd. amounting to Tsh. 24,500,000 out of lease of videotapes used for promotion.
- (vii) During the year, KUJIAJILI Ltd. sold 5 hectares of land, which was at Temeke and received Tsh. 550,000,000. This land was purchased for Tsh. 350,000,000 in 2005. Three (3) years prior to its sale, this land had been used as agricultural land.

Required:

By applying the relevant provisions of the ITA 2004, compute investment income for the KUJIAJILI Company for the year 2015.

Solution to example 11.2

Determination of taxable investment income of KUJIAJILI ltd for the year 2015

	Amount in Tsh.
i. Dividend from ABC Ltd (taxed at source at preferential rates. See 1 st Schedule, para 4 of ITA, 2004; however it is still taxed with other income, thus gross it up to 100% and then claim tax credit- 5%). 11,000,000/0.95	11,578,947.40
ii. Dividend from ADB (Listed at DSE) S.3 and para 4 of 1 st Schedule. (Gross it up to 100% and then claim tax credit on income deducted at source). 5,000,000/0.95	5,263,157.90
iii. Dividend from Malaika (Gross it up to 100% if taxed at source at 10% then set-off/claim tax credit of 10% deducted at source)	11,722,222.22
iv. Rent from Mabele Joseph (Part of office building)	2,800,000
v. Rent from residential house, occupied by Masanja	30,000,000
vi. Royalty from TMC Ltd -Videotapes	24,500,000
vii. Gain from proceeds of sale of land (s. 90)	200,000,000
Total taxable income from investment	285,864,327.52
Tax liability (at 30%)	85,759,298.26
Less: Tax credit on withholding tax at source (Note 1)	2,014,327.30
Net tax liability	83,744,971

Note 1: Computation Withholding tax at source: Gross Income –Net Income
 Withheld by ABC Ltd: 11,578,947.40 -11,000,000= 578,947.4
 Withheld by ABD Ltd: 5,263,157.90- 5,000,000= 263,157.90
 Withheld by Malaika: 11,722,222.22-10,550,000= 1,172,222.22
 Total = 2,014,327.30

Example: 11.3

Dr. Omary Maduhu is resident person and is an employee of Mzumbe University. He has been a good investor in financial assets over the last two years. For the year of income 2016, the following transactions occurred:

- ❖ On 1st January 2016 he bought a 12%, 5-YEARS Government bonds for Tsh. 200,000,000. This bond pays interest semi-annually.
- ❖ He bought six months Treasury bill of Tsh. 100,000,000 on 1st March, 2016. This bill was sold on a discount basis at 98%.
- ❖ A six months certificate of deposit (CD) with CRDB bank matured on 31st December, 2016. This CD was for Tsh. 5,000,000 with a rate of 8% p.a.
- ❖ Received dividends of Tsh. 25,000,000 from TOL a DSE listed company.

Required:

Determine the tax from investments income payable to TRA for Dr. Omary Maduhu for the year of income 2016. Assume that no taxes were withheld at source.

Solution to example 11.3

Determination of tax payable from investment income for Dr. Omary Maduhu, for the Year of Income 2016.

Details/Security	Computation	Amount
Interest on Government bond	Interest income: $6/12 \times 200,000,000 \times 12\% \times 2 = 24,000,000$ Taxed at 10% = $24,000,000 \times 10\% = 2,400,000/=$	2,400,000
Treasury Bill:	Discount basis: Income on this security is: Tsh. 100,000,000 - 98,000,000 (98% x 100,000,000/=) = 2,000,000/= Taxed at 10%: $10\% \times 2,000,000 = 200,000/=$	Tsh. 200,000
CD from CRDB	Interest: Tsh. 5,000,000 x 8% x 6/12 = Tsh. 200,000 Taxed at 10% = $10\% \times 200,000 = 20,000$	Tsh. 20,000
Dividends from TOL	Dividend received: 25,000,000 This is from a DSE listed company, it is taxed at 5% = $5\% \times 25,000,000 = 1,250,000/=$	Tsh. 1,250,000
	Total tax payable to TRA	Tsh. 3,870,000

Example 11.5

Mr. BULUBA is employed on a salary of Tsh. 80,000,000 per annum. Mr. Buluba also runs a part-time business; whose gross profits for the year ended 31st December, 2015 was Tsh. 223,600,000. Mr. Buluba's other income for the year 2015 was as follows:

- ❖ Dividend from DSE listed company..... 2,040,000
- ❖ Dividend from an unlisted company..... 2,040,000
- ❖ Rent..... 3,200,000
- ❖ Interest 800,000

In respect of employment, Mr. Buluba also enjoys the following benefits:

- i. Utilities (water, electricity, and telephone).....900,000 per month
- ii. Life insurance payable by the company..... 300,000 p.m.
- iii. Lunch allowanceTsh. 168,000 p.m.
- iv. Medical services to insurance of 90,000 p.m. available to all staff as per the company's staff regulations.
- v. A fully furnished residential quarter for which Mr. Buluba pays no interest, but the company claims a deduction of Tsh. 200,000 p.m. The market rent of the house in the area in Tsh. 400,000 p.m. while the costs of the house to the company were 18,000,000.

His business expenses for the year were as follows:

- ❖ Administrative expenses (including bad debts of 800,000; wages and salaries of Tsh. 40,000,000; Income tax 160,000).....90,000,000
- ❖ Traffic fines 80,000
- ❖ Donations to political allies' elections..... 20,000,000
- ❖ Donations to charitable organizations 16,000,000

Required:

Calculate Mr. Buluba's total income showing clearly the distinction between investment income, employment income and business income.

Solution to Example 11.5

Determination of total taxable income of Mr. Buluba, for the tax year 2011

<i>Business Income</i>	
Gross profit as per information	223,600,000
Allowable deductions:	
Administrative expenses (90,000,000 -160,000)	89,840,000
Donations to charitable organisations (should be less or equal to 2% of 133,760,000)	2,675,200
Total Business Income	132,524,800
<i>Investment Income</i>	
Dividend from DSE Listed Coy (Investment Income, taxed at low rates-5% as under First Schedule of ITA, para 4; and this is final withholding payment S.86)	NIL
Dividend from Unlisted Coy (Subject to withholding tax at source at 10% and is final withholding payment, S.86-Individual) no further assessment.	NIL
Rent on residential house	3,200,000
Interest (Subjected to W/T at source and is final withholding payment S.86, Para 4 1 st Schedule) no further assessment on this.	NIL
Total Investment Income	3,200,000

<i>Employment Income</i>	
Salary	80,000,000
Utilities (900,000 x 12)	10,800,000
Life insurance (300,000 x 12)	3,600,000
Lunch allowance (168,000 x 12)	2,016,000
Total employment income before housing benefit	96,416,000
Housing benefit (Note 1)	4,800,000
Total employment income	101,216,000

Note 1: Computation of Housing Benefit.

Take the greater of

- ❖ 15% (of Total income) 232,140,800 (96,416,000 + 3,200,000 + 132,524,800).....34,821,120 and
 - ❖ Amount claimed (200,000 x 12)..... 2,400,000
 - ❖ Take 34,821,120
- Compare with market rent (400,000 x 12)..... 4,800,000
Take the lesser which is 4,800,000.

Chapter Summary

This chapter has presented the categories of income sources classified as income from investment. The key points discussed in this chapter can be summarised as follows:

- ❖ Investment income arises from the conducting of an investments which involves the owning of assets other than the assets for personal use or business use by the owner.
- ❖ Investment income normally arises as a result of a payment for the use of such an asset is received. It is essentially an income in respect of the use of property by others as opposed to income from the sale of property, which normally is classified as business or capital gains unless specifically classified otherwise by the ruling statute.
- ❖ Income from the use of one's property by others may give rise to business income. This happens where a person's activities consist mainly in the making and holding of investment assets for use by others, whether in land and buildings, for the purpose of receiving rents or in securities for the purpose of receiving interest or dividends and the principle part of his business is derived there from.
- ❖ The main sources of investment income subject to taxation under the income tax act are, namely: dividends, interest, distribution of a trust, gains of an insured from life assurance, gains from an interest in an unapproved retirement fund, natural resource payment, rent or royalty and others.
- ❖ Taxation on taxable dividends for both individuals and corporations is provided for under section 54 and paragraph 4 of the first schedule of the ITA, 2004. The act provides that dividends distributed by a resident corporation shall be taxed in the hands of the corporation's shareholders in the form of final withholding tax. If dividend is distributed by a non-resident corporation, then such dividends should be included in calculating the income of the shareholders.
- ❖ Where the corporation receiving the dividend holds 25% or more of the shares in the corporation distributing the dividend and controls either directly or indirectly 25 per cent or of the voting powers in the corporation, the dividend will be taxed in form of withholding tax at the rate of 5%.
- ❖ Taxable interest under the income tax act include interest on the use of money, interest on debt obligations, gains by way of discounts or premiums, and payments under finance leases.
- ❖ Taxable rental income includes all income received for the use/ lease of tangible asset and includes any payment for the granting use or lease of land, building, cars and others physical assets. However, rent received by a resident individual landlord on residential premises leased by an individual tenant is exempt, if such rent does not exceed Tsh. 500,000/=in a year and such individual does not conduct the business of renting of properties.
- ❖ Taxable royalty included payment made for the use of an intangible asset such as copyrights, patents, trademark, secret formulae or processes and know-how.
- ❖ Taxable investment income is obtained by taking all taxable investment revenues less expenses that may qualify under the wholly and exclusively test. Such expenses include, repairs and maintenance, interest, and other revenue expenses such as salaries and wages, electricity and water solely connected with earning the investment income etc

End of Chapter Eleven Revision Questions

- What are investment assets?
- In reference to section 9(3) of the ITA, 2004, state the amounts that are excluded in calculating a person's gains and profits from conducting an investment.
- Income tax Act, 2004 distinguishes between employment income, business income and investment income. With examples explain why this distinction is important.
- SET (T) Ltd is a non-resident corporation with the following sources of income during the year of income ended December, 31 2016:
 - Sold shares of MAJIB Ltd a non-resident (Listed shares in DSE) whereby the company owns 25% of the controlling shares. These shares were bought at Tsh. 21,400,000 and sold for Tsh. 34,000,000.
 - Received bank interest in relation to fixed deposit with YXZ Bank Ltd of Tsh. 10,300,000/=.
 - Received Tsh. 10,000,000 for sale of land situated at Dar es Salaam. This land was acquired in 2010 for Tsh. 1,200,000. The corporation used it for agricultural purposes from 2010-2013.
 - Received dividend of Tsh. 7,000,000 from HK Ltd. This was a resident corporation where the company owned 28% of shares.
 - Paid dividend to WISE Ltd Tsh. 23,000,000. This is a non-resident corporation owning 35% of the shares of the company.
 - Received rent (in conducting business) of Tsh. 20,000,000. This came from an investment building located at Igunga, Tabora. This building was constructed at Tsh. 450,000,000. During the year, the company acquired furniture and fixtures for the building worth Tsh. 23,000,000. Apart from that, the company incurred Tsh. 30,000,000 to repair the building in order to increase its lifetime.
 - Sold 10,000 shares of MAJURA Ltd a resident corporation (unlisted in the DSE). These shares were acquired at Tsh. 300 each and sold for Tsh. 500 each.
 - Received dividend of Tsh. 32,000,000 from ABC Ltd, a non-resident company where SETC Ltd owns 40% of the shares of the company.
 - Sold residential house of the company which had been occupied for three years for Tsh. 25,000,000. The house was bought in Igunga for 7,000,000.
 - Dividends amounting to Tsh. 5,000,000 were received from CHEMA Ltd a non-resident corporation, which is listed in the DSE and 20% of its shares is owned by KET Ltd, a resident company.

Required:

With respect to SETS (T) Ltd, calculate total chargeable income and tax liability for the year of income 2016.

- Joshua E.L. is the Managing Director of Serengeti Ltd. His sources of income are:
 - Remuneration from Serengeti Ltd.
 - Rental income from residential block of flats
 - Interest income from bank registered in Tanzania
 - Dividends income from investments (shares and securities)
 - Capital gains on sale of investments (sale on shares and securities)

He is also a passive partner in a farming venture.

The following are details of Joshua's earnings and benefits for the twelve month year of income 2015:

From Serengeti Ltd.	
Salary (Basic)	Tsh.
Company vehicle of 1200 cc made in year 2000, cost	48,000,000
	22,000,000

Company house (market rent)	56,000,000
Utilities (water, electricity & telephone)	3,675,300
School fees for his children	2,700,000
Medical services insurance	2,845,000
Pension company contribution to un-approved retirement fund	4,800,000

In addition Joshua has an interest free loan from the company. The loan was taken on 1st January 2015 repayable in 15 months. The balance of the loan as at 31st December 2015 was Tsh. 3,000,000. The total amount of the loan was Tsh. 15,000,000. A statutory interest rate is 15% per annum. The medical services insurance was available to company directors only

Rental Income	Tsh.
Rent received in conducting business	42,050,000
Bond interest received	15,368,200
Rates paid	2,463,700
Repair and maintenance	9,248,100

There are eight flats. Joshua allows his brother to occupy one of the flats rent free. Air conditioners have been installed in the flats at a cost of Tsh. 24,000,000. There is a rental tax loss brought forward Tsh. 8,326,400 (unrelieved loss) from year 2014.

Interest Income:	Tsh.
Bank interest in conducting business	5,682,300
Dividend Income:	
Listed shares on the Dar es Salaam Stock Exchange (This comes from 5% ordinary shares of L Ltd, a non – resident corporation)	3,783,100
Unlisted shares (Ordinary shares of E Ltd a resident company)	20,000,000

Capital Gains:

Proceeds on sale of shares in Agro Timbers Ltd, a resident company listed in the Dar es Salaam Stock Exchange. He holds 20% of ordinary shares of the company which were acquired at a cost of Tsh.2,700,000. The proceeds amount to Tsh. 8,650,000.

Proceeds on sale of shares in Mbuni Ltd, a private non-resident company in which Joshua holds 5% of voting shares of Mbuni Ltd at a cost of Tsh. 3,500,000. Total proceeds were Tsh.17,500,000 and Tsh. 1,200,000 was paid to lawyers in respect of the sale of shares in Mbuni Ltd.

Withholding Tax at source.	Tsh.
On salary	14,693,800
On bank interest	568,230
On dividends	2,189,155

Joshua has permanent home in the United Republic and has always stayed in United Republic for at least 100 days in each calendar year since 2010.

Serengeti Ltd normally claims deduction in respect of motor cars provided to employees. However no claim was made with respect to motor car provided to Joshua during 2015. Serengeti Ltd. Claimed Tsh. 15,000,000 as a deduction with respect to the company house provide to Joshua.

Required:

In respect to Joshua E.L. for the year of income 2015 calculate:

- The chargeable income from rents and bonds.
- The chargeable disposal gain, if any, on the shares disposed of. Give explanations for your answers.
- His taxable income from all sources (total income), indicating by the use of "NIL" any items not requiring adjustment.

- (d) Calculate the next tax payable.
(CPA-T. adopted)

Table 4: FIFTH SCHEDULE OF ITA, 2004:

ENGINE SIZE OF VEHICLE	QUANTITY OF BENEFIT	QUANTITY OF BENEFIT
cc- carrying capacity	Vehicle less than 5 years old	Vehicle more than 5 years old
Not exceeding 1000cc	Tsh. 250,000	Tsh.125,000
Above 1000cc but not exceeding 2000cc	Tsh. 500,000	Tsh.250,000
Above 2000cc but not exceeding 3000cc	Tsh.1,000,000	500,000
Above 3000cc	Tsh.1,500,000	Tsh.750,000

Made under Section 27: This table provides additional information necessary in answering question 5 above.

CHAPTER TWELVE

RETURNS OF INCOME TAX AND TAX ASSESSMENTS

Introduction

This chapter deals with information that needs to be furnished by income tax taxable person to the Commissioner General from time to time, and assessments administered by Tanzania Revenue Authority. Returns of income and assessments of taxes are covered in both the Income Tax Act 2004 and the Tax Administration Act 2015. Returns of income tax are covered under section 89, 91 and 92 of the Income Tax Act, 2004. The Tanzania Administration Act 2015 on the other hand covers both returns and assessments of all types of tax laws. The relevant sections on tax returns and assessments under the Tax Administration Act are section 39 to 42 and Section 46 to 49 respectively. This chapter covers aspects of the contents and timings of the income tax estimated income returns, and final returns of incomes. It also covers aspects of tax assessments admissible and made by the Commissioner General on income tax. Aspects of punishable offences and irregularity committed by taxpayers, the consequences associated with such offences are also covered in details in this chapter.

Learning Outcomes

After successful completion of this chapter readers should be able to:

- ❖ Describe the meaning of returns of income for tax purposes.
- ❖ Describe the information contained in the provisional and regular return of income for a taxpayer
- ❖ Describe the meaning of tax assessment
- ❖ Describe the major types of tax assessments as per Tax Administration Act 2015.
- ❖ Describe the persons or incomes excluded from furnishing returns of income.
- ❖ Describe the major types of non-compliance to income tax act 2004.
- ❖ Assess and compute penalties and interests for non-compliance to income tax act 2004

Meaning of Returns of Income

The term 'return of income' is defined in section 3 of the Act to mean the 'meaning' ascribed to it by section 91. Basically, 'return' is any document or any other information required by the Commissioner from the taxpayer in any year of income. Therefore, a return may be a document; usually statutory books of accounts or information return (other documents containing useful information as an evidence to support particular information). Examples of information return include various vouchers and slips to support investment income, reserves such as share certificates, dividend slips, pay-in-slips, etc.

Section 91 of ITA, 2004 subject to sections 92 of the income tax acts and sections 39 and 48 of the tax administration act, requires every person to file with the Commissioner of income tax a return of income for the year of income not later than six months after the end of each year of income. This is the final or regular or actual return of income, i.e. after the end of the accounting period and final/books of accounts are completed.

Section 88 of the Income Tax Act 2004 deals with Income tax payable by quarterly instalments (whether from a business, investment or employment provided employer is not required to withhold

tax under section 81). This necessitates the first type of return of income which should be submitted as 'provision' before the final return. This is what is called 'statement of estimated tax payable/provisional return' as required under section 89 (1). When a taxpayer furnishes provisional return of income, he is automatically assessed and therefore the due dates for submitting provisional return and paying provisional tax are the same.

Due dates for paying taxes on provisional return other than withholding taxes are as follows:

- (i) Where a year of income of a person is twelve months period and coincides with the calendar year:
 - On or before the third, sixth, ninth and twelfth months of the year of income (i.e. 31st March, 30th June, 30th September and 31st December).
- (ii) In any other case (where year of income does not coincide with calendar year):
 - At the end of each three-months commencing at the beginning of the year of income. The year of income for every person means 'calendar year' [section 20].

Returns of Income Requirements

Section 91 (2) contains the contents of the return of income of a person for a year of income. The return must specify the following:

- ❖ Chargeable income from each employment, business and investment and the source of income.
- ❖ Total income and the income tax payable with respect to that income.
- ❖ For domestic permanent establishment of a non-resident person, the permanent establishment's repatriated income and the income tax payable
- ❖ Any income tax paid by withholding, instalment or assessment for which a tax credit is available under sections 87, 88, or 90
- ❖ Amount of tax still to be paid calculated from above as [(ii) + (iii)] – (iv)
- ❖ Any information as may be prescribed by the Commissioner

Notices Issued by the Commissioner General to file a return of income

Section 47 of the Tax Administration Act 2015 authorises the commissioner general to issue a notice in writing to serve a notice on the person requiring him to file a return of income by the date specified in the notice for the year of income or the part of the year of the income. This normally occurs prior to the date for filing a return of income when the following situations exist:

- ❖ A person becomes bankrupt, is wound up or goes into liquidation;
- ❖ Person is about to leave URT indefinitely;
- ❖ A person is about to cease activity in URT;
- ❖ Commissioner otherwise considers it appropriate

Income or Persons Excluded From Furnishing Returns

Some persons are not required by the income tax Act to furnish neither the provisional return (statement of estimated income) nor the final return. Such persons include the following:

- ❖ An income of resident individual who has no income tax payable;
- ❖ Income of resident individual whose income is either from employment (where employer is required to withhold tax under s.81) or derives a gain in conducting an investment from the realisation of an interest in land or buildings situated in URT ["Single instalment at time of realisation or receipt"-sections 90(1) and 92 (a) (bb)]
- ❖ A return of income of a non-resident person (other than one with a domestic permanent establishment) who has no income tax payable under s. 4 (1) (a) or consists exclusively of gains under S.90 (1)

Extension of Time to File a Return of Income

Section 39 of the TAA, 2015 allows the taxpayer to request the commissioner for an extension of time for filling of a return of income. Subject to a written application from the taxpayer and made within fifteen days before the due date for filing the return. The commissioner may extend the time which the return has to be filed in writing. The extensions shall not exceed 30 days from the original date where the estimate/returns were to be filed. The granting of an extension of time to submit tax return do not alter the dates for making payment of tax as specified in the Income tax Act, 2004 under which the return is filed.

Assessment of Tax Payable

Section 94 of the Income Tax Act 2004 together with section 47, 48 and 49 of the Tax Administration Act 2015 deals with assessments. The term 'Assessment' is defined in section 3 of the Income Tax Act 2004 to mean "an assessment under sections 94, of the Income Tax Act 2004 or sections 46, 47, 48 or 81 of the Tax Administration Act 2015". However, the term assessment is defined under section 3 of The Tax Administration Act 2015 to mean determination of the amount of tax liability made under a tax law by the Commissioner General or by way of self-assessment and it includes matters prescribed in the first Schedule. From the two Acts assessments therefore involves:

- ❖ Computation of income of a taxpayer; or
- ❖ Determination of the amount of income tax payable; or
- ❖ Entire procedure for imposing liability on the taxpayer as laid down in Income Tax Act 2004 and The Tax Administration Act 2015.

In widest sense the term assessment covers the whole process of scrutiny of the return of income, if any, submitted by the taxpayer, examination of his books of account, if necessary, and if any, up to the last step of issuing a notice of assessment showing the income assessed, the tax payable and the due date for payment. Thus, the entire procedure for assessing and imposing liability on the taxpayer requires three (3) steps to be completed:

- (i) Computation of the income assessable /taxable income;
- (ii) Computation of the income-tax payable by taxpayer on the basis of computed income in (i) and the appropriate rate; and
- (iii) To issue a notice of assessment showing the outcome and the basis of the assessment made on him. This notice shows details of income assessed, gross tax payable, the reliefs, if any, given the set-off or credit of tax deducted at source or already paid, net amount of tax payable and the due date of payment.

Types of Assessment under the Income Tax Act 2004 and Tax Administration Act 2015

The income tax Act 2004 together with the Tax Administration Act 2015 stipulates five types of assessments.

- ❖ Statement of estimated tax payable or provisional assessment [Section 89 of ITA, 2004]
- ❖ Self-assessment [section 94 of ITA, 2004 and section 46 of TAA, 2015]
- ❖ Jeopardy or accelerated assessment [Section 47 of TAA, 2015]
- ❖ Adjusted assessment [section 48 of TAA, 2015]
- ❖ Best judgment assessment [section 94 (4) (b) ITA, 2004]

Basis of Classification of Assessments

Types of assessments may be classified on the basis of the following:

- (i) Assessments by the Commissioner and assessment by taxpayer himself; or

- (ii) Returns submitted by the taxpayer or without such returns; or
- (iii) Acceptance of the income returned or amendment (or rejection) of the income returned by the taxpayer, i.e. best judgment assessments; or
- (iv) Assessments made to save possible loss of revenue on account of the occurrence of some event or accelerated due to certain peculiar circumstances of the taxpayer (i.e. Jeopardy or accelerated assessments); or
- (v) Regular assessments made for the first time; or
- (vi) Exceptional or irregular assessments made after completion of the original assessments (i.e. additional or amended assessments)

Statement of Estimated Tax Payable (Provisional Assessment)

The statement of estimated tax payable (provisional assessment) is required to be submitted by a taxpayer under subsection (1) of section 89 of the Income Tax Act, 2004. When a taxpayer has furnished a statement of estimated tax payable he is automatically deemed to have been provisionally assessed on the basis of estimates contained in such statement as provided in subsection (3) of section 89 of the Act. Thus, the responsibility of the taxpayer is over once he submits a statement of estimated tax payable. The Commissioner General is not required to inquire into the correctness or accuracy of the estimates of the income stated by the taxpayer though he will obviously watch the payment of tax required from such statement of income. As such, no formal order of assessments is required to be made by the Commissioner in these types of assessments, i.e. where the taxpayer submits a statement.

Section 89 (5) gives room to person who has submitted a statement of estimated tax payable to revise/amend a previously submitted statement of estimated tax payable under section 89 (1). Where, however, the taxpayer fails to comply with section 89(1) of the Act and fails to submit a statement of the estimated tax payable, sub-section (8) of section 89 of the Act authorises (empowers) the Commissioner General to estimate the income of such person and tax payable accordingly. Note that the Commissioner makes such assessments when he considers that such taxpayer has or will have income chargeable to tax for such year of income, and such estimate is based on the best judgment of the Commissioner.

Self-Assessment by Tax payers

Subsection (1) of section 94 ITA and section 48 (1) of the TAA deal with self-assessments. Where an entity (individuals are excluded) files a return of income for year of income an assessment shall be treated as made on the due date for filing the return of the income tax payable on total income (in this case, business income and investment income) and repatriated income. Entities are therefore required to include in the return and accounts submitted to the Commissioner General the computation of tax payable from the taxable income reflected in such returns. Note that the said tax computation is referred to as a *self-assessment* for income tax purpose, and the amount of tax shown as payable in the return is referred to as the *tax payable* on the assessment.

The concept of self-assessment, however, does not apply to individuals. Section 94 (4) requires the Commissioner to assess an individual upon filing the return of income. If he has accepted the return, then he should assess such person basing on such return. Here the Commissioner will make the normal *add back disallowable* and *deduct allowable* by using the return figures.

Best Judgment Assessment

When the Commissioner for income tax is satisfied that the return of income submitted by an individual is true and correct, he may accept the income returned and make an assessment under section 94 (4) (a). If the Commissioner is not satisfied that the return of income is correct and complete, he has the power to estimate income of the taxpayer to the best of his judgment and make an assessment accordingly. A best judgment assessment under both the ITA (section 94) and TAA (section 48-3) can be made with or without a return of income; with or without the regular books of accounts; with incomplete books of accounts; or with or without the presence of the taxpayer. A best judgment assessment is comparatively easy when the taxpayer has submitted a return of income and it is necessitated due the omission on the part of the taxpayer or due to return not being true and correct. A return may not be true and correct if the taxpayer has not maintained any books of accounts at all or where they are not reliable, incomplete or unacceptable to the Commissioner.

Subsection (5) of section 94 of the Act also deals with regular assessments, which are made on a best judgment assessment basis. It deals with those cases of individuals who do not submit returns of income as required under section 91 of the Act. According to this provision, it is immaterial whether the Commissioner has required the taxpayer to submit a return of income or not. Once the Commissioner is satisfied that an individual has income which is chargeable to tax and it is proved that the individual has defaulted in submitting his return of income in the year of income, Commissioner has the right to estimate his income to the best of his judgment and make an assessment accordingly.

Jeopardy or Accelerated Assessment

Section 47 of the Tax Administration Act, 2015 deals with persons (both, individuals and entities), who are about to leave the United republic permanently; be bankrupt, wounding up or going into liquidation; or cease an activity in the United Republic, or any circumstances which the Commissioner considers it appropriate to make such an assessment. The section is specifically enacted to safeguard revenue by authorising the Commissioner to make an accelerated assessment. If normal time for filing return is allowed and normal procedures are followed (as specified under section 94 of the Act), it will be very difficult for the commissioner to locate the taxpayer or collect the due income tax from a taxpayer who has already or is about to leave the jurisdiction of the United Republic (e.g. follow up may be restricted by general principles of private internal law).

Adjusted Assessment

Section 48 of the Tax Administration Act empowers the Commissioner to adjust any assessment made under section 94 of the ITA and 47 of the TAA that is, self-assessment, regular assessment made to an individual and jeopardy assessment in such manner as, according to the Commissioner's best judgment and information reasonably available. To adjust here, implies that the Commissioner may amend or issue an additional assessment where there is existing assessment made to any person. The section is giving powers to the Commissioner to lower or increase the already existing tax liability of any person. Section 48 (4) limits the time of making adjustment to be within five years after the due date of filing the return to which the assessments relate or in those cases where the Commissioner has required the submission of those returns.

Subsection 5 of section 48 of the TAA, 2015 however, empowers the Commissioner to adjust any assessment without time limit if the person whose assessment is being adjusted failed to file a return of income as required under section 91 of the income tax act or filed incorrect or fraudulent

information. This is made where the Commissioner believes that the assessment to be adjusted is inaccurate by reason of fraud by or on behalf of the assessed person.

Cases which will be the subject of additional assessment

- ❖ Gains or profits from any source of income liable to income tax should have been under-assessed; or
- ❖ Have been assessed at too low a rate of income tax; or
- ❖ Have been made the subject of excessive relief; or
- ❖ Excessive deficit (loss) has been computed; or
- ❖ Excessive deductions under the third schedule of the Act have been allowed

Provisions on Non Compliance to Income Tax

The provisions on non-compliance are found in Part X of the Tax administration Act, 2015 which runs from section 75 through section 90. The scope of our discussion is on income tax interest, penalties, and offences for non-compliance to income tax Act.

Types of Non-Compliance

- a) Failure to maintain proper documents or file a statement of estimate for year of income or file a return of income as per sections 80, 89(1) and 91 (1);
- b) Understating tax payable by instalment;
- c) Failure to pay tax on or before due date;
- d) Making false or misleading statements;
- e) Aiding and abetting

Interest and Penalties

Part X of the TAA, 2015 contains provision for interests and penalties for non-compliance tax law requirements. These include the following:

Penalties for failure to maintain proper documents

Section 77(1 & 2) of the TAA, 2015 provides that a person who fails to maintain proper documents as required by a tax law is liable for a penalty for each month or part of the month during which the failure continues. The penalty is 1 currency point for an individual or 10 currency point for a body corporate for each month of part of the month during the failure. For income tax purposes documents required could include invoices, debt and credit notes, sales records, purchases records, receipts and receipts books, and others as the Commissioner General may determine from time to time.

Penalties for failure to submit returns of income

Section 78 of TAA, 2015 contains penalties for failure to submit returns of income as required by any tax law. In the context of Income Tax Act 2004 failure to submit provisional returns (statement of estimated income) as required by section 89 (1) of ITA; or file a return of income as required under section 91(1) of ITA attracts a penalty. A person who fails to comply with any of the above requirements shall be liable. For each month and part of a month during which such failure continues the HIGHER of:

- 2.5% of the difference between the income tax payable for year of income and the amount of that tax that has been paid at the start of the month; OR
- In case of an individual, 5 currency points or in the case of a body corporate, 15 currency point.

Example 12.1

During the year of Income, Company ZEE Ltd failed to maintain proper receipts and filed a return of income showing business income of 20,000,000 on which tax of 6,000,000 was paid on 30th June 2016. There was no other income. On 15/10/2016 an audit that was carried out it was established that the Company's income was supposed to be 30,000,000 had the proper documents been kept.

Required:

Determine the applicable penalties on this non-compliance practice.

Solution to example 12.1

Type of failure: Failure to keep proper books of accounts (receipts) S. 77 of TAA, 2015

- ❖ Commencement: 1/7/2016
- ❖ Cessation: 15/10/2016
- ❖ Duration of failure : 4 months
- ❖ Computations; Monthly charge: $2.5\% \times (9,000,000 - 6,000,000) = 75,000/=$
- ❖ Compared with 10 currency point x Tsh. 15,000/= 150,000
- ❖ Then take the greater which is 150,000, thus we take $150,000 \times 4 = 600,000$
 - Therefore the total penalty payable on 15/10/2016 is Tsh. 600,000/=

Interests Imposed on Unpaid Income Taxes

The Tax Administration Act 2015 imposes interest for taxes which remain unpaid by the tax payer. There are two major types of interest, namely interest for understating the amount payable and interest for failure to pay tax on due dates.

Interest for Understating Tax Payable by Instalment

In instances where a taxpayer pays taxes in instalments, and that his estimate of income tax payable for a year of income under section 89 of ITA, 2004 (which will be used to calculate income tax instalments payable under section 88) is less than 80% of the income tax payable for a year of income as 'correct amount', such taxpayer will be liable for interest as provided for under section 75 of the TAA, 2015. For each month or part of the month from the date the first instalment for the year of income is payable until the due date by which the person is required to file a return of income under section 91 (1) of ITA, 2004.

Amount of interest payable is calculated as statutory rate, compounded monthly applied to the excess of-

- Total amount that would have been paid by way of instalment to the start of the period on 'correct amount' (as provided for under section 4(1)a and b),basis; over
- Amount of income tax paid by instalments to the start of the period

Example 12.2

The estimated income of ZX Co. Ltd for the year of income 2014 was as follows:

Business income.....	15, 000,000
Investment income.....	40, 000,000
Total Income.....	55, 000,000

The accounting date is 31st December. The estimated tax payable at 30% is 16, 500,000 paid in instalments on the due dates including 4,000,000 tax withheld on investment income.

The returns of income for 2014 year of income submitted on 30th June 2015 showed the following:

Business Income.....	35,000,000
Investment Income.....	40,000,000
Total income.....	75,000,000

The tax payable at 30% is 22,500,000, the correct amount

The estimated tax of $16,500,000/22,500,000 \times 100\% = 73.33\%$ this is than 80%, therefore the difference of 6,000,000 is liable for interest under S.75 of TAA, 2015.

Assume statutory rate of 20%

Determine the interest payable:

Interest: $I = P\{(1+r/12)^n - 1\}$

Where:

I= interest

P =principal, r= statutory rate; n is the number of months (i.e. from April 2014 to June 2015)

Thus, $I = 6,000,000 \{(1+20\%/12)^{15} - 1\}$

= Tsh. 1,688,294.66

Thus, interest on under-declared amount is Tsh. 1,688,294.66

Interest for failure to pay tax on or before due date

Section 76 of the Tax Administration Act 2015 imposes interest on tax which remains unpaid after the due date. The interest is computed by taking the statutory rate times the amount of tax which remains unpaid. The interest computed is to be paid to the Commissioner General together with the principal tax.

Example 12.3

The total income for BEZED Co. Ltd that has been declared for the year 2016 was Tsh. 60,000,000. The accounting date is December 31st. The tax payable in each of the four instalments was 4,500,000. The company filed an estimate of income and tax for the year and paid first instalment on 20th June, 2016 instead of 31st March, 2016.

Required:

Determine the applicable penalties and interest under the ITA, 2004 and TAA, 2015.

Solution to example 12.3

Type of failure: failure to lodge provisional return on time S. 78 of the TAA,2014.

❖ Commencement: 1/4/2016

❖ Cessation: 20/06/2016

❖ Duration : 3 months

❖ Computation: Monthly charge= $2.5\% \times 18,000,000 (30\% \times 60m) = 450,000$ compared with 15 currency point, i.e. $15 \times 15,000 = 225,000$ p.m. as per act ; take the greater i.e $450,000 \times 3months = 1,350,000/=$

❖ Interest on unpaid tax (1st Quarter): S.76, TAA (Rate = statutory rate p.a. = assume statutory rate is 12%)

❖ Commencement: 1/4/2016

❖ Cessation: 20/06/2016

❖ Duration : 3 months

❖ Computation: Formula for Interest (simple interest)= $P(r\%/12) \times \text{number of months}$

❖ Interest = $4,500,000(12\%/12) \times 3 = 135,000/=$

❖ Total tax payable on 20th June 2016= $1,350,000 + 135,000 + 4,500,000/=$

o = Tsh. 5,985,000/=.

Penalty for Making False or Misleading Statements

Section 79 of the Tax Administration Act 2015 imposes penalty for making false or misleading statements to the Commissioner General or to the tax officer which is material in a given tax matter. The penalty also is imposed to a person who omits to include in the statement made to a tax officer, any matter or things which makes the statement misleading in material particular. The penalty is fifty per cent of the tax shortfall (underpayment) if the statement or omission is made without reasonable excuse or seventy five per cent where a statement or omission is made knowingly or recklessly.

Penalty for Aiding and Abetting

Where a person wilfully or negligently aids, abets, conceals or induces another person to commit any offence under section 80 of the TAA, 2015, commits an offence and upon conviction is liable for a penalty equal to 100% of the shortfall (underpayment).

Offences on Income Tax under the Tax Administration Act 2015

Section 82 to 89 of the Tax Administration Act, 2015 provide for offences. The Act, apart from providing for interests and penalties as sanctions for contravention, it also criminalizes certain conduct. Thus, one may be liable for interest/penalty and criminal proceedings for the same failure or offence.

Types of Income Tax Offences under the Tax Administration Act 2015

- Failure to comply with the provisions of the Income Tax Act 2004 or TAA, 2015 is an offence under section 82 of the TAA, and the provision provides for the penalty for the person being summarily convicted.
- Failure to pay tax on or before due date without a reasonable excuse is an offence and such person will become criminally liable upon summary conviction as stipulated in section 83 of the TAA, 2015. The section also provides for the penalties applicable to the taxpayer.
- The offence of making false or misleading statements is provided for under section 84 of the TAA, 2015. The section also provides for the punishment upon summary conviction.
- Impeding tax administration or application of the Income Tax Act is an offence under section 85 of the TTA, 2015. The offence is committed by obstructing or attempting to obstruct an officer of the TRA to carry out his/her duties under the Income Tax Act or through failure to comply with a notice issued under the Act. The section also provides for penalties upon conviction.
- Section 86 of the TAA, 2015 creates offences for taxable person who fails to acquire and use electronic fiscal devices, or fails to issues fiscal receipts or fiscal invoices, or issues false invoices or fiscal receipts, or uses the electronic fiscal devices in a misleading manner, or causes or tempers with electronic fiscal receipts to work improperly commits an offence and upon conviction is liable to penalties as indicated in the section. Similarly, the section under subsection four provides that a person who fails to demand or report a denial of issuance of a fiscal invoice upon payments for goods or services, commits an offence and upon conviction is liable to a fine not less than 2 currency points and not more than 100 currency point.
- Section 87 of the TAA, 2015 creates offences on the part of TRA officers, other authorised and unauthorised officers. The section deals with asking or taking any payment or reward (bribe/corruption) by officers in the course of their duties and conduct that may cause the Government to be defrauded such as concealing information, etc. in the case of unauthorised officers. The section also deals with unauthorised offices that collect or attempt to collect taxes.
- Section 89 of the TAA, 2015 imposes an offense for aiding, abetting, concealing, aiding or inducing a person wilfully or negligently to commit an offence under the Income Tax Act. The section provides for the penalties upon conviction.

Example 12.4

ABC Ltd failed to file a statement on PAYE deducted, with the Commissioner General after the first six months period of year 2014, but filed it on 2nd October 2014. This statement was required to be filed by 31st July 2014 as per section 84 (2). It was therefore late by 3 months. Part of a month of October is taken as full month. Assume the statutory rate of interest for the year is 20%. Tax deducted and whose return was submitted in October was Tsh. 3,600,000/=.

Required:

Compute the applicable interest and penalties in this scenario.

Solution to example 12.4

Computation of penalties

Type of failure: Failure to lodge return on time (S. 78 TAA, 2015).

For August: $3,600,000 \times 2.5\% = 90,000$ compare with 15 currency point i.e. $15 \times 15,000 = 75,000$ take the higher; 90,000

September, 2014: $3,600,000 \times 2.5\% = 90,000$ compare with 75,000/= take the higher 90,000

October, 2014: $3,600,000 \times 2.5\% = 90,000$ compare with 75,000= take the higher 90,000

Thus total penalty amount is 270,000/=

Example 12.5

For the year of income 2015, Mkwepakodi Co. Ltd did not furnish provisional return of income and final return. The firm however, submitted the final return on 30th September, 2016 declaring income of 300 Million and paid the total tax due on the same date. The accounting period for the Mkwepakodi coincide with the calendar year.

Required:

Compute the total tax liability to be paid on that date Using the ITA 2004, and TAA, 2015 determine total tax liability paid on the date of assessment (Assume statutory interest rate of 20%)

Solution to example 12.5

- 1. Type of failure: failure to lodge provisional return. S.78 of TAA, 2015

Commencement: 1/4/2015

Cessation (time to file final return): 30/06/2016

Duration – 18 months

Principal tax: Tsh. $300,000,000 \times 30\% =$ Tsh. 90,000,000/=

Monthly penalty= $2.5\% \times 90,000,000 = 2,250,000$ compare with 15 currency points i.e $15 \times$ Tsh. 15,000= 75,000 p.m. take the greater 2,250,000

Total penalty = 15 months $\times 2,250,000 =$ Tsh. 33,750,000/=

- 2. Type of failure: failure to file final return. S.78 TAA, 2015

Commencement: 1/7/2016

Cessation: 30/9/2016

Duration= 3 months

Computation of penalty.

$2.5\% \times 90,000,000 \times 3$ months= 6,750,000

- 3. Type of failure: Failure to pay tax on time on quarterly instalments (interest S. 76 TAA, 2015)

Cessation= 30/09/2016

1st Installment. Commencement 1/4/2015: Principal tax : $(900,000,000 \times 0.3) =$ Tsh. 90,000,000

Quarterly amount= $90,000,000/4 =$ Tsh. 22,500,000

Number of months: 18 months

Interest on first quarter installment: Simple interest = $22,500,000 \times 20\%/12 \times 18$ months = 6,750,000/=

2nd Instalment. Commencement 1/7/2015) = $22,500,000 \times 20\%/12 \times 15$ months = Tsh. 5,625,000/=

3rd Installment Commencement. 1/10/2015 = $22,500,000 \times 20\%/12 \times 12$ months = Tsh. 4,500,000/=

4th Installment Commencement 1/1/2016 = $22,500,000 \times 20\%/12 \times 9$ months = 3,375,000/=

Summary of Tax Payable, in Tsh.

Principal tax	90,000,000.00
Penalty S.78, TAA.....	40,500,000.00
Interest.76, TAA	20,250,000.00
TOTAL.....	150,750,000.00

Chapter Summary

This chapter has covered returns that need to be furnished by taxable person to the Commissioner General from time to time. The chapter also has covered in details the various taxpayers' assessments on income tax administered by the Tanzania Revenue Authority. The key issues discussed in the chapter can be summarised in the following points:

- ❖ Return of income means any document or information required by the Commissioner from the taxpayer in any year of income.
- ❖ Return of income can be documents such as statutory books of accounts, statements containing useful information as an evidence to support particular information, vouchers and slips to support investment income, reserves such as share certificates, dividend slips, pay-in-slips, etc.
- ❖ There are mainly two types of returns, namely provisional return/statement of estimated income and final return/regular return.
- ❖ The tax administration Act requires every person to file with the Commissioner General a return of income for the year of income not later than six months after the end of each year of income. This is the final or regular or actual return of income, i.e. after the end of the accounting period and final/books of accounts are completed.
- ❖ The statement of estimated tax payable/provisional return' provides information on what the taxpayer expect to receive or generate and the taxable income there from. When a taxpayer furnishes provisional return of income, he is automatically assessed.
- ❖ The due dates for paying taxes on provisional return are as follows: Where a year of income of a person is twelve months period and coincides with the calendar year, on or before the third, sixth, ninth and twelfth months of the year of income (i.e. 31st March, 30th June, 30th September and 31st December). In any other case at the end of each three-months commencing at the beginning of the year of income.
- ❖ Returns of income furnished to the commissioner general by a person for a year of income may contain the following: Chargeable income from each employment, business and investment and the source of income; Total income and the income tax payable with respect to that income; Any income tax paid by withholding, instalment or assessment for which a tax credit is available. And other information as may be directed by the commissioner general.
- ❖ The term assessment is defined by Tax Administration Act 2015 to mean determination of the amount of tax liability made under a tax law by the Commissioner General or by way of self-assessment and it includes matters prescribed in the first Schedule. Assessments involves: Computation of income of a taxpayer; or determination of the amount of income tax payable; or Entire procedure for imposing liability on the taxpayer as laid down in Income Tax Act 2004 and The Tax Administration Act 2015.
- ❖ The income tax Act 2004 together with the Tax Administration Act 2015 stipulates five types of assessments, namely statement of estimated tax payable or provisional assessment, self-assessment jeopardy or accelerated assessment, adjusted assessment, best judgment assessment.
- ❖ There a several types of non-compliance to tax as provided for under the Tax Administration Act 2015, namely Failure to maintain proper documents or file a statement of estimate for year of income or file a return of income; understating tax payable by instalment; failure to pay tax on or before due date; making false or misleading statements; aiding and abetting.
- ❖ The Tax Administration Act 2015 provides for penalties for non-compliance to various tax acts. These include penalties for failure to maintain proper documents and penalties for failure to submit returns of income on time or not at all.

- ❖ The Tax Administration Act 2015 imposes interest for taxes which remain unpaid by the tax payer. There are two major types of interest namely interest for understating the amount payable and interest for failure to pay tax on due dates.

End of Chapter Twelve Revision Questions

1. The Commissioner may by notice in writing serve a notice on the person requiring him to file a return of income by the date specified in the notice for a year of income or the part of the year of income. Under what circumstances is the Commissioner for ITA, 2004 or TAA, 2015 allowed to exercise this power?
2. What is the distinction between terms "charge" and "assess" as used under ITA 2004?
3. Distinguish among interest, penalties and offenses as provided for under the Income Tax Act and Tax Administration Act 2015.
4. Discuss different types of assessments under ITA 2004 and TAA 2015. Under what circumstances will the Commissioner General issue the following assessment?
 - An adjusted assessment
 - Jeopardy assessment
5. Why the employees are generally exempted from being formally issued with notices of assessments? State the circumstances under which an assessment may be raised on an employee.
6. What is tax enforcement?
7. State for each action below the enforcement measures that the Commissioner General is going to take:
 - i. Under-declaration of estimated tax
 - ii. Late payment of tax
 - iii. Failure to maintain documents or file a statement of file return of income
 - iv. Making false or misleading statements.
 - v. Failure to demand electronic fiscal receipt
8. The twelve months accounting period of the Mwangalla Trading Company normally ends on the 31st October of the calendar year. For the year of income 2014, the company did not furnish its provisional; returns despite repeated reminders from the Commissioner. The company finally decided to furnish the final returns for 2014 on 15th June 2015 for income of Tsh. 200 million. The Commissioner made best judgment assessment for the year on 30th September 2015 of an income of Tsh. 400 million. Assuming the company intends to liquidate the full liability for the year of income 2014 on the 8th November 2015.
Required:
Compute the total tax due and payable on that date (Quote the relevant sections of the ITA 2004 or TAA, 2015 in answering the questions).
9. ABC Ltd was provisionally assessed to tax of Tsh.58, 500000 on the 15th April 2014 for the 2014 year of income, after having failed to furnish such a return despite having been required to do so by the Commissioner. The company's twelve months accounting period normally runs from 1st September of each Calendar year. On 1st December 2016 the Commissioner served the Company with notice requiring it to furnish the regular return of income for the year 2014 within 40 days of that date. The company paid the full taxes on the provisional return for the year 2014 on 15th June 2014. However it furnished the final return for the year on the 20th may 2017, which declared an income attracting tax of Tsh. 120,000,000. On 30th July 2017 Commissioner made an assessment on the Company for the year 2014 of Tsh. 260,540,000/=.
Required:
On the basis of ITA 2004 and TAA, 2015 provisions, calculate the tax payable by the Company (including interest and penalties) for the year of income 2014.

10. The accounting period of SETEBE Milling Company Ltd ends on 31st March of each year. The accountant of SETEBE Milling Co. did not furnish the provisional return on time as required by law for the year of income 2015. On the 15th March 2015 Commissioner General made a best judgment estimated provisional assessment for the accounting period of a tax of Tsh. 800,000,000. The full taxes on the provisional return were paid on 29th March 2015. On 1st September 2015 the Commissioner served a notice on the Company requiring it to furnish the regular return of income for the year of income 2015 within 30 days of the date of service of notice. The Company's accountant however, did not comply with this notice. As a result, on the 15th June 2016, the Commissioner made presumptive regular assessment on the company which was 50% more than the income estimated in the provisional return.
Required: Assuming the Company pays the full taxes due on the final return for the 2015 year of income on 10th July 2016
 - a) Determine the provisional taxes paid on 29th March 2015
 - b) Determine the taxes paid on 10th July 2016
11. The Morotex Company Ltd was served with a notice from the Commissioner General on 15.4.2016, requiring it to furnish a provisional return of income for the 2016 year of income. The firm however, did not respond to the CG's call. The CG's therefore made a best judgment assessment for the 2016 year of income on 30.5.2016 on 400 million/= income. The firm's accountant came to pay the total provisional taxes on 30.6.2016.
Required:
Calculate the total taxes paid by the Company as at that date.
12. For the year of income 2014, Kinjekitile Co. Ltd managed to furnish provisional returns and paid the provisional taxes within the due dates on 200million/=.
On 31st July 2015, it received a notice from the Commissioner General, requiring it to furnish a regular return for the year of income 2014 within 60days of the date of service of notice of assessment which was dated 15th July 2015 and posted on the same date. The firm however, submitted the return on 31.12.2015 declaring income of 300million/= and paid the total tax due on the same date.
Required:
 - (i) Total tax liability paid on that date
 - (ii) Total tax liability paid on that date assuming that firm declared an income of 250 million/=
12. ABC Company Limited's main line of business is milling. The company's 12 months accounting period ends on 30th June of the calendar year. For the year of income 2015, the company did not furnish provisional return despite being reminded to do so. Consequently on 31st December 2014, the Commissioner made a best judgment provisional assessment for the year of an income of 280 million/=. On 20th April 2015, the company paid the total provisional tax due as at that date. The remaining installment was also subsequently paid on its due date.
On 30th September 2015, the company was served with a notice from Commissioner calling for the final return for 2015, on or before the 15th of November 2015. The company however, submitted the final return on the 28th February 2017 declaring an income of 500million/=. The commissioner made an assessment on the furnished final return and accounts on 11th May 2017 of an income of 400million/=.
Required:
Calculate the tax payable:
 - a) On the provisional returns on 20th April 2015.
 - b) On the final return on the date the final assessment was made.

CHAPTER THIRTEEN

VALUE ADDED TAX

Introduction

This chapter deals with Value Added Tax (VAT). VAT in Tanzania is administered and governed by the Value Added Tax Act of 2014. This Act was enacted in 2014 to repeal the VAT Act 1997 which had operated since 1997. The chapter covers aspects of meaning of VAT, scope, benefits, registration procedures for VAT purposes, types of supplies, determination of input and output tax, VAT refunds, payment of VAT and appeals on VAT. The chapter also contains some worked examples on VAT problems.

Learning Outcomes

After completing this chapter readers should be able to:

- ❖ Describe the meaning of Value Added Tax
- ❖ Describe the application of Value Added Tax
- ❖ Describe the scope of Value Added Tax
- ❖ Describe the registration requirements
- ❖ Explain the benefits of Value Added Tax
- ❖ Explain the types of supplies for Value Added Tax purposes
- ❖ Prepare Value Added Tax Account
- ❖ Determine input and output Value Added Tax
- ❖ Explain the penalties and interests for non-compliance to Value Added Tax
- ❖ Compute penalties and interest for non-compliance to VAT.

Meaning of Value Added Tax (VAT)

VAT is tax on consumption on a wide range of goods and services. It is a tax that is also levied on importation of goods and services. VAT is the tax on the value that is added to goods and services by producers and traders at each stage in the production and distribution process. VAT is collected by VAT registered traders at various stages of production, manufacturing, distribution and consumption and periodically remitted to the Tanzania Revenue Authority.

Application of VAT

The basic principle of applying a VAT system requires that registered traders charge VAT on taxable goods and services sold by them (OUTPUTS). This tax charged on their sale is output tax. On the other hand, Registered person is charged VAT on goods/services including imports, he purchased from other traders (INPUTS). The tax charged on his purchases is input tax. Then, output tax LESS input tax is amount of VAT to be paid by the trader to the Government (TRA) if there is excess of output tax over input tax. Amount to be repaid (refunded) to the trader if input tax exceeds output tax. The Intention of this system (credit or invoice system) is to ensure that a cumulative effect (double payment of tax) is avoided as the value added at each stage is taxed only once.

Benefits of VAT

Value Added Tax has several benefits to the economy. Such benefits include the following:

Revenue Enhancement

More stable source of revenue because under the various stages of VAT system, supplies of goods and services are deemed to be taxable and therefore a desired amount of revenue can be generated. Being the tax on consumption it is least affected by fluctuations in economic activities.

Promotes exports

Under most VAT systems the tax paid on exports of goods and services is fully refundable. Exports are zero rated i.e. No tax is charged, but a registered person can reclaim tax on their inputs, which is not the case with sales tax system (so many bureaucratic procedures exist in sales tax systems).

Administrative benefits

The Structure of VAT is simple to administer unlike other indirect consumption and turnover taxes such as sales tax where due to complex structure there is an ample scope for evasion and corruption. VAT is self-pricing, which cuts down avoidance and evasion. The conflicting interests existing between the buyer and seller acts as anti-evasion feature e.g., if a seller understates the sales and thus underpaying tax then he reduces the amount of tax credit available to the buyer. Registered traders are required legally to issue and keep tax invoices, sales and purchases receipts and other books of accounts. This enables cross checking of /matching invoices received by purchasers against retained by sellers, easing tax audit activities.

Weaknesses of Value Added Tax (VAT)

Value added tax is said to have the following weaknesses or disadvantages:

Regressive

VAT falls more heavily on the low-income households than high income households. VAT is charged on goods and services bought by any consumer with no any regard to their income levels. Thus tends to affect more of the poor than the rich.

Inflationary

VAT system sets an environment in which the tax, prices and wages would feed on each other and therefore encouraging inflation. If care is not taken, inflation is likely to occur as prices and wages rise. However, measures to avoid persistent increase in prices due to VAT include: Implementation of prudent monetary and fiscal policies.

Problem of record keeping

Small firms/traders are unable to keep records. Thus, VAT poses a challenge on most SMEs.

Scope of VAT

VAT is chargeable on the supply of goods/services made by taxable persons in the course of their business except where they are specifically excluded under law. Under the VAT Act 2014 exempted supplies and imports include:

- ❖ Agricultural inputs and implements.
- ❖ Livestock,
- ❖ Dairy equipment
- ❖ Bee keeping implements
- ❖ Fisheries Implements
- ❖ Unprocessed agricultural outputs
- ❖ Health care services
- ❖ Educational supplies
- ❖ Unprocessed water supplies
- ❖ Public passenger transport

- ❖ Books and newspapers
- ❖ Funeral services
- ❖ Some financial services (Financial services provided free of charge, health insurance, life insurance, insurance for air craft's, and insurance for workers compensation)
- ❖ Immovable property e.g. land and Renting of residential houses
- ❖ Non-commercial activities carried on by a Government entity and its institutions
- ❖ Articles designed for people with special needs

(The list is not exhaustive, see First schedule VAT Act 2014, and FA, 2016).

The Value Added tax Act provides exemptions on categories of supplies because it is expected that there are positive significant impact in the growth of economy. Basic agricultural inputs (e.g., fertilizer, seeds, pesticides, ect.) and outputs, and veterinary services are exempted in order to improve animal husbandry.

Financial services and Insurance services are also exempted in order to promote access to finance.

Problems with exemptions under VAT Act

- ❖ Narrows the tax base, thereby necessitating the use of higher rate to raise the desired revenue.
- ❖ Erodes the neutrality principles i.e. it is no longer neutral to taxpayers and government.
- ❖ Existence of exemptions complicates tax administration, i.e. maintaining and working out refund cases.
- ❖ Equity principle is also violated – Discriminatory in nature.

VAT on retail traders

VAT ensures taxation of value added by all VAT registered entrepreneurs in the economy, hence increases VAT yield. It minimizes loss of revenue through tax evasion. It eliminates vertical integration and splitting of business which are motivated by tax avoidance. Facilitates cross-checking of business sales particularly sales between wholesales and registered retailers.

Rate of VAT

VAT is charged at a two positive rate of zero (0%) and eighteen percent (18%). VAT simplifies the administrative and compliance of tax leading to reduced costs. It is most neutral and avoids economic distortions i.e. the effective rate of tax for all supplies is the same, no substitutions (multiple rates distort both the consumer and producer invoices). All goods and services are taxed at the same rate of tax and thus traders are not tempted to make false declarations and misclassification of supplies or imports in order to evade tax. Experience has shown that there is limited number of refund cases.

Operational Aspects of VAT

There are two stages involved in the operation of VAT:

Liability to pay VAT

Liability falls on a trader who is registered by TRA. A registered trader will charge VAT on the taxable supplies of goods and services made by him to his customers i.e., Output tax. A registered trader himself will also be charged tax for the taxable goods and services supplied to him by other registered traders, i.e., input tax. At the end of each tax period, the registered trader is allowed to deduct input tax (tax on goods supplied to him) from the output tax (tax he has charged his customers), i.e., Output tax – input tax.

Payment of VAT to TRA.

VAT payable to TRA is the excess of output tax over input tax in the tax period. Excess of input tax over output tax is refundable to the registered trader by TRA. Normally this information is summarized in documents called VAT account. It simply gives the totals of input tax on one side and total of output tax on the other side. The net amount of value added tax payable by taxable person in relation to a tax period (one month) is obtained by taking total output tax minus total input tax. When the figure is positive, the tax payer must make payments to TRA equal to that amount, when it negative the taxable persons deserves a refund, when it is nil no payments is required. However, a nil figure does not relieve the tax payer from filling a tax return.

An illustration of VAT account

A VAT ACCOUNT PERIOD FROM 1ST MARCH TO 30TH MARCH, 2015

VAT Deductible- Input Tax	Tsh.	VAT Payable – Output Tax	Tsh.
Deductible VAT charged on purchases	500,000	VAT on invoiced sales	2,000,000
Deductible VAT on imports	1,000,000	VAT on cash sales	500,000
TOTAL INPUT TAX	1,500,000	TOTAL OUTPUT TAX	2,500,000
Total tax payable to Commissioner- TRA	1,000,000		
	2,500,000		2,500,000

Types of Supplies as per VAT Act 2014

A supply is anything done for a consideration i.e. whether supply of physical goods (eg. food stuffs, agriculture inputs) or service rendered. However, under law, anything which does not constitute a supply of goods but is done for a consideration is a supply of services. There are three types of supplies under the VAT Act 2014; Namely, taxable supplies, zero rated supplies, and exempt supplies.

Taxable Supplies

Taxable supplies are any supplies of goods and or services made by a taxable person in the course of his business. Example of taxable supply include: Gifts or loans of goods, Barter trade and exchange of goods, Processing or treating of another person's goods, Betting of any kind, Supply of power, heat or ventilation, professional services. The law provides that anything done for a consideration is taxable supply unless it is in the list of exempt supplies.

Zero rated Supply

Zero rated supply is a taxable supply that is chargeable at a rate of zero (0%). Trader supplying a zero rated supply charge VAT, but at a rate of 0%. The registered taxpayer is entitled to a refund of input tax paid on his purchases on such supplies. Zero rated supply provides complete relief. Examples of zero rated goods as provided in the VAT Act, 2014 are:

- ❖ Exportation of goods and taxable services from the URT provided that the evidence of exportation is available.

- ❖ The supply of goods, including food and beverages for consumption on aircraft or ships to destination outside URT.
- ❖ Supply of services which comprise the repair, maintenance, insuring or management of any foreign going ship or aircraft.
- ❖ A supply of goods for use in repairing, maintaining, cleaning, renovating, modifying, treating, or otherwise physically affecting an aircraft or ship engaged in international transport shall be zero-rated.
- ❖ A supply of aircraft's stores or ship's stores, for an aircraft or ship, if the stores are used for consumption or sale on the aircraft or ship during a flight or voyage that constitutes international transport.

Exempt Supplies

Exempt supplies are supplies which are not subject to VAT. No tax is charged on exempted supplies. Trader supplying exempt goods and services does not charge VAT to his customers. Also, he is not entitled to claim credit for any tax (input tax) he has paid on goods and services supplied to him. Provides partial relief i.e., exempt traders are relieved from VAT on value added but not VAT from his purchases. Example of exempt goods is unprocessed foodstuffs (livestock, agriculture products.) etc. The complete list and items under the exempt supplies are provided for under the schedule in the VAT Act 2014.

VAT Registration Requirements

A person shall, in respect of any month, be registered for value added tax from the first day of that month, if there is reasonable ground to expect that the person's turnover in the twelve months period commencing at the beginning of the previous month will be equal to or greater than the registration threshold. The law requires any person dealing with taxable goods and /or services whose taxable turnover exceeds or likely to exceed:

- One hundred million shillings in a period of twelve consecutive months, or
- Fifty million shillings in a period of six consecutive months to make an application for VAT registration. Failure to do so is an offence and upon conviction a trader is subject to fine or imprisonment.

The registration for VAT purposes for an entity is only once. That is the registration covers all economic activities undertaken by the person's branches or divisions. The registered person for VAT purposes is supposed to use the Tax Identification number (TIN) issued by TRA upon registration of the business. The TIN and the Value Added Tax registration number must be used or shown in all documents furnished to TRA and invoices issued to customers.

Cancellation of Registration

A registered person who permanently ceases to make taxable supplies shall apply for the cancellation of its registration in the manner prescribed in the regulations. The application for cancellation shall be made within fourteen days after the date on which the person permanently ceased to make taxable supplies. The law further provides that registered person who fails to maintain the registration threshold may apply for the cancellation of his registration in the manner prescribed in the regulations to the VAT Act.

The VAT Act empowers the Commissioner General Cancel registration. The Commissioner General may, by notice, cancel the registration of a person who is no longer required to be registered for value added tax, if the Commissioner General is satisfied that the person obtained registration by providing false or misleading information; or the person is not carrying on an economic activity; the

person has ceased to produce taxable supplies; or the person's taxable turnover falls below registration threshold. The cancellation of a person's registration shall take effect from the date set out in the notice of cancellation. A person whose registration has been cancelled must surrender the value added tax registration certificate. He ceases to be a registered person, ceases to use or issue any document such as tax invoices, adjustment note that identify him as registered person. The person must file a final VAT return and pay the taxes due not later than thirty days from the date of cancellation.

The VAT Act requires the Commissioner General to maintain and publish an up to date register of VAT registered persons in Mainland Tanzania. The register must include among other information:

- ❖ The name and address of the registered person
- ❖ The business or trading name or names under which the registered person carries on the economic activities;
- ❖ The Taxpayer Identification Number
- ❖ The Value Added Registration Number of the registered person
- ❖ The date on which the registration was conducted.

Time of Supply

This is the time when supply of goods or services is treated as having taken place. It is also called the tax point. The registered trader is supposed to account for VAT in his records at the rate of tax in force at the tax point. Thus tax becomes due and payable at the time when the registered trader:

- ❖ Supplies the goods or services to the purchaser, or
- ❖ Issues a tax invoice in respect of the supply or
- ❖ Receives payments for all or part of the supply.
 - Whichever time is the earliest.

Value of Taxable Supplies for VAT Purposes

The value of taxable supply is the consideration of the supply. The VAT Act consider consideration to means the sum of the following amounts-

- ❖ A person, whether direct or indirectly, in respect of, the amount in money paid or payable by any in response to, or for the inducement of the supply; and
- ❖ The fair market value of anything paid or payable in kind, whether directly or indirectly, by any person in respect of, in response to, or for the inducement of the supply.
- ❖ any duty, levy, fee, charge, or tax including value added tax imposed under this Act that is payable by the supplier on, or by reason of, the supply; and is included in or added to the amount charged to the customer;
- ❖ any amount charged to the customer that is calculated or expressed by reference to costs incurred by the supplier;
- ❖ any service charge that is automatically added to the price of the supply; and
- ❖ Any amount expressed to be a deposit paid when goods are sold in a returnable container and which may be refunded on the return of the container.

Value of imports for VAT purposes

The value of an import of goods shall be the sum of the value of goods for the purposes of customs duty under the East African Customs Management Act, whether or not duty is payable on the import. The amounts of any tax, levy, fee, or fiscal charge other than customs duty and value added tax payable on the import of the goods.

VAT on Imported Capital Goods

A registered person may, in the form and manner prescribed, apply to the Commissioner General for approval to defer payment of value added tax on imported capital goods. The Commissioner General is authorised to approve an application if satisfied that the person keeps proper records and files value added tax returns and complies with obligations under the VAT Act and any other tax law. A person who is approved under this section shall treat tax payable on taxable imports by the person as if it were output tax payable by the person in the tax period in which the goods were entered for home consumption. Other conditions on deferred VAT payable include:

- ❖ The person must also be provided with security required under the VAT Act
- ❖ The person is carrying on an economic activity;
- ❖ The VAT payable on such imports should be equal or greater than twenty million shillings
- ❖ The person's turnover is, or is expected to be made up of at least ninety per cent of taxable supplies.

VAT Payments on Imports

The VAT payable on imported goods shall be paid at the time of importation of such goods by the importer. The value added tax payable on a taxable import shall be paid where goods are entered for home consumption in Mainland Tanzania, in accordance with the provisions of the VAT Act and procedures applicable under the East African Customs Management Act. In any other case, where goods are imported for use in Mainland Tanzania, on the day the goods are brought into Mainland Tanzania and in the manner prescribed by the regulations to VAT Act or as per the EACM Act, 2004.

Tax Credit for Input VAT

A taxable person is allowed to claim tax credit on amount of input tax incurred by the person in course of the economic activities. Input VAT charged suppliers to the registered trader on goods, services or immovable property or on imported goods and services into mainland Tanzania by the person. The input tax that a person can claim must be accounted for together with the output tax in the same value added tax return in which the tax credit is claimed. Furthermore, a registered person cannot be allowed to claim input tax credit for acquisition of goods, services or immovable property to the extent that it is used to provide entertainment unless the person's economic activity involves providing entertainment in the ordinary course of the person's economic activity.

Application of Input and Output VAT

A registered trader is required to charge VAT on goods and services sold by him known as *Output Tax*. A registered trader himself will be charged tax for goods and services sold to him by other registered traders known as *Input Tax*. At the end of each period the registered trader is allowed to deduct input tax from the output tax. The excess of the output tax over the input tax is payable to TRA. The excess of input tax over output tax is refunded to the reg. trader by TRA.

Methods of Computing Deductible/Claimable Input VAT

The method of computing claimable/deductible input VAT for registered taxable person who supply both taxable supplies and exempt supplies (Partial exemption schemes) is provided for under Section 70 of the VAT Act.

Formula = $I \times T / A$

Where: I is total amount of input tax to which a credit is sought in the tax period

T= the value of all the taxable supplies made by the taxable person during the tax period

A= The value of all the supplies made by the taxable person during the tax period.

The procedure is as follows:

- ❖ Calculate the amount of total input VAT for the period
- ❖ Calculate the amount of total taxable supplies for the period
- ❖ Calculate the amount of all the supplies (Both taxable supplies and exempt supplies) for the period.
- ❖ Then use the formula accordingly to get the proportion of input VAT claimable for the period.

$$\text{Claimable Input VAT} = \frac{\text{Taxable Supplies} \times \text{Total Input}}{\text{Total Supplies}}$$

Conditions on Claimable Input VAT

The VAT Act puts a condition on the amount to be claimed as input VAT. Supplies made through an economic activity carried on at a fixed place outside Mainland Tanzania shall not be included in A or T in the formula, unless those supplies are made in Mainland Tanzania; and

- ❖ if T/A is greater than 0.90: the taxable person shall be allowed a credit for all of the input tax to which this section relates; and
- ❖ if T/A is less than 0.10: the taxable person shall not be allowed a credit for any of the input tax for the period.

Example 13.1

Assume that a taxable person indicates in his records purchases for the month of December, 2016 as indicated below. Determine VAT tax payable or refund for the month of December.

Purchases During the month of December, 2016

	Details	Value (Tsh.)	VAT (18%)	VAT Inclusive price (Tsh.)
1.	Soft drinks	1,000,000	180,000	1,180,000
2.	Beer	1,500,000	270,000	1,770,000
3.	Cigarettes	1,200,000	216,000	1,416,000
4.	Transportation of milk	200,000	36,000	236,000
5.	Milk cans	250,000	45,000	295,000
6.	Refrigerators	750,000	135,000	885,000
7.	Electricity	200,000	36,000	236,000
8.	Telephone	250,000	45,000	295,000
9.	Total	5,350,000	963,000	6,313,000

Also during the same month, the taxable person supplied goods with the following values as indicated below:-

		Value	VAT	VAT inclusive price
1.	Soft drinks	1,200,000	216,000	1,416,000
2.	Beer	1,800,000	324,000	2,124,000

3	Cigarettes	1,600,000	288,000	1,888,000
4	Wines	2,000,000	360,000	2,360,000
5	Milk	800,000	Exempt	800,000
6	Maize	600,000	Exempt	600,000
7	Total	8,000,000	1,188,000	9,188,000

Solution to Example 13.1

	Tshs.
Soft drinks	1,200,000
Beer	1,800,000
Cigarettes	1,600,000
Wines	2,000,000
Total	6,600,000

Step 1: The value of taxable supplies made during the month are:

Step 2: Value of all supplies is 8,000,000

Step 3: Input VAT on purchases made by the registered person is 963,000

Step 4: Using the formula

Test on the deductibility conditions: $6,600,000/8,000,000 = 0.825$, this is less than 0.9, and then apportionment of input VAT is allowed.

$$6,600,000/8,000,000 \times 963,000 = 794,475$$

Step 5: Amount of input to be claimed is Tsh. 794,475

Therefore Output tax – Input tax = 1,188,000 - 794,475

Tax payable to Commissioner = Tsh. 393,525.00

VAT Returns and Lodging Procedures

Every taxable person shall, in respect of each prescribed accounting period, lodge with the Commissioner General a tax return. For the purposes of the VAT Act, the prescribed accounting period for a taxable person is the calendar month containing the effective date of registration and each calendar month after that, unless the Commissioner, by notice in writing, determines another prescribed accounting period for the taxable person.

The return shall be lodged on the 20th day of a month after the end of the tax period in which it relates or within such other time as the Commissioner may in a particular case determine by notice in writing.

Documents and Records to be Maintained by VAT Registered Persons

A registered person who makes a taxable supply shall, no later than the day on which value added tax becomes payable on the supply under section 86 of VAT, 2014, issue a serially numbered true and correct tax invoice generated by electronic fiscal device for the supply, which shall be issued in the form and manner prescribed by the Minister; and include the following information-

- ❖ the date on which it is issued;
- ❖ the name, Taxpayer Identification
- ❖ Number and Value Added Tax
- ❖ Registration Number of the supplier;
- ❖ the description, quantity, and other relevant specifications of the things supplied;

- ❖ the total consideration payable for the supply and the amount of value added tax included in that consideration;
- ❖ if the value of the supply exceeds the minimum amount prescribed in the regulations, the name, address, Taxpayer Identification Number and value added tax registration number of the customer.

A taxable person shall keep record of all accounts, documents, returns, and other records that are required to be issued or given under this Act, or such as:

- ❖ Tax invoices and adjustment notes issued and received by the person;
- ❖ Customs documentation relating to imports and exports of goods by the person;
- ❖ Records relating to supplies of imported services to the person, whether or not those Supplies were taxable supplies;
- ❖ A value added tax account that records, for each tax period, all the output tax payable by the person in that period, or the input tax credit the person is allowed in that period, and all the increasing and decreasing adjustments that the person is required or entitled to make in that period; and,

The records to be kept by registered taxable person for VAT purposes shall be maintained for at least five years from the end of the tax period to which they relate; or until a later date on which the final decision is made in any audit, recovery proceedings, dispute, prosecution, or other proceedings.

VAT Refunds

VAT refunds are provided for under section 80- 84 of the VAT Act 2014. There are several circumstances which can give rise to refund of money from TRA to the tax payer for VAT purposes. Such circumstances include the following:

- ❖ When input VAT for a tax period exceeds output tax
- ❖ When the taxpayer (the registered trader) erroneously makes payment of VAT payable for a tax period over and above the required amount (Refund for overpayment)

VAT Refund when Input VAT Exceeds Output VAT

Section 67 of the VAT Act 2014 provides for the determination of VAT payable to TRA for a tax period. The procedure is to take total output tax subtracting with total input tax for the tax period. When the result is a positive amount, the amount should be paid to TRA for that tax period when the VAT return is being submitted (after making increasing and decreasing adjustments if any for transactions like returned goods, bad debts and other adjusting entry as per VAT Act S.71-72, 77). There are circumstances when the resulting figure is a negative amount, implying that input VAT for the period is greater than output tax for the period, after making all decreasing and increasing adjustments on VAT tax for the tax period. The VAT Act requires the taxpayer to carry forward the amount until the next tax period to be offset against the positive amount if any. If the negative amount has been carried forward for six tax periods consecutively without being reduced to less than the minimum amount prescribed in the regulation, the taxpayer may apply for a refund.

However, the VAT Act 2014 provide for circumstances which the taxpayer can apply for refund on negative net amount without carrying forward. Section 82 of the VAT Act, 2014 provide that a taxable person can apply for refund on negative amounts without carrying forward if fifty per cent or more of the person's turnover is or will be from supplies that are zero-rated or fifty per cent or more of the person's input tax is incurred on acquisitions or imports that relate to making supplies that are

or will be zero-rated or when the Commissioner General is satisfied that the nature of the person's business regularly results in negative net amounts.

VAT Refund for Overpayment

According to Section 83 of VAT Act 2014, the tax payer may apply for refund on the excess amount when that person has paid more than the net amount shown on the person's value added tax for the period. Similarly, the VAT Act allows the taxable person to apply for refund where the person has overpaid the net amount payable for a tax period due to erroneous calculations of the net amount payable for the tax period including on increasing or decreasing adjustments. The taxable person is allowed for refund without carrying forward to next periods.

Interaction Between Income Tax and Value Added Tax

When a registered person determines income tax, any value added tax payable for a supply should be treated as if it were not part of the consideration received by the supplier for the supply. In case the value added tax was included in deterring income tax, adjustments can be made accordingly. Input tax incurred by a person should be included in the calculation the expenses or outgoing, whether of income or capital nature, to the extent that the person was not allowed an input tax credit for that input tax. In other words when deterring taxable income, value added taxes, both input and output VA, should not be included in both taxable incomes and allowable expenditures, unless the taxpayer is not a registered person for VAT purposes.

Offenses, Penalties and Interests on VAT

Offenses, penalties and interest for failure to comply with provisions made under the Value Added Tax are provided for under part X the Tax Administration Act, 2015.

Failure to Keep Proper Business Records

Section 77 of the Tax Administration Act 2015, provides that a person who fails to maintain proper documents required by any law (e.g. VAT, 2014) is liable for a penalty for each month or part of the month during which the failure continues. The penalty for each month is 1 currency point in the case of an individual and 10 currency point for a body corporate (1 currency point equal to Tsh. 15,000/=).

Failure to Pay or Late Lodgement of VAT Returns

Failure to pay or late lodgement of any tax returns is provided for under Section 78 of the Tax Administration Act 2015. In the context of VAT returns, a taxable person who fails to submit a return or pay tax within the time allowed by or under the VAT Act (2014) is liable for a penalty for each month or part of the month during which the failure continues. The penalty is the higher between the following:

- ❖ 2.5% of the amount of tax assessable with respect to the tax return less tax paid at the start of the period toward that amount
- ❖ In the case of individual, 5 currency point or in the case of a body corporate, 15 currency point.

Interest on overdue VAT tax

Section 76 (1) of the Tax Administration Act 2015, provides that any amount of tax imposed under any tax law remains unpaid (both principal tax and penalty) after the date prescribed in a tax law or its regulation, attract an interest. The interest rate to be applied on the amount is the statutory rate applicable the time. The statutory rate is the commercial bank lending rate of the Central Bank. Interest payable under this section shall, while it remains unpaid, attract interests as if it formed part of the tax unpaid. In the context of value added tax, any amount of VAT payable to TRA which remains unpaid after the 20th day of the month following the month of the VAT return attracts an interest for each month during which the failure continues.

Failure to Issue a Tax Invoices and Receipts

A taxable person who fails to use and issue an electronic fiscal tax invoice or a receipt commits an offence and upon conviction is liable to a fine not less than 200 currency point and not more than 300 currency points or to imprisonment for a term not exceeding three years or both (S. 86 (1) of TAA, 2015).

Other VAT Offences under S.90 of TAA, 2015

Any person who –

- ❖ Being required to apply for registration under the VAT Act fails to do so within thirty days after becoming liable to apply; or
- ❖ Fails to notify the Commissioner General of ceasing to be liable for value added tax as required under the Value Added Tax; or
- ❖ Fails to notify the Commissioner General of a change in circumstances as required under the VAT Act;
- ❖ Fails to notify the Commissioners General of a transfer as required under the VAT Act; or
- ❖ Holds himself out as a taxable person under the VAT Act, where that person commits an offence and upon conviction is liable to the following consequences:

Where the failure or holding out is made knowingly or recklessly, a fine of not less than 100 currency points and not more than 200 currency point or imprisonment for a term of not less than one year and not than two years, or to both; or

In any other case, to a fine of not less than 50 currency points and not more than 100 currency point or imprisonment for a term of not less than one month and not more than three months, or to both.

False Returns and Statements S.79, TAA, 2015

Any person who in purported compliance with any requirement under the VAT Act, knowingly makes a return or other declaration, furnishes any document or information or makes any statement, whether in writing or otherwise, that is false in any material particular, or omits to include in the statement made to the tax officer, any matter which is misleading in material particular, commits an offence and upon conviction is liable to a penalty of fifty per cent of the short tax shortfall; or where the statements or omission is made knowingly or recklessly, seventy five per cent of the tax shortfall.

Penalty for Aiding and Abetting VAT Documents S.80 TAA, 2015

Any person who aids, abets, counsels or induces another person to commit an offence, commits an offence and upon conviction shall be liable to a penalty equal to hundred per cent of the tax shortfall.

Objections to VAT Decisions

A person, who is aggrieved by a tax decision made by the Commissioner General, may object the decision by filling an objection to the Commissioner General, within thirty days from the date of service of the tax decision (S. 51 of TAA, 2015). The tax objection must be in writing and should state the ground upon which it is made. Furthermore, the objection on a tax decision cannot be admitted if the tax payer has, within thirty days from the date of service of the tax decision, paid the tax which is not under dispute or one third of the assessed tax decision whichever amount is the greater. If the tax payer is not satisfied with the Commissioners General decision on the objection, has the right to appeal to the Tribunal Board according to the Tax Revenue Appeals Act.

Worked Examples on VAT

Example 13.2

Mr. KUJIAJILI is a registered trader for VAT with effect from 1/7/2015. The following are details for the first month of his operations.

- ❖ 2/7/2015 Sold goods to Bravo Ltd. For Tsh. 4,000,000 (VAT exclusive)
- ❖ 5/7/2015 Sold goods to Alovera Company for Tsh. 4,800,000 (VAT exclusive)
- ❖ 10/7/2015 Sold goods to Mood Ltd for Tsh. 2,860,000 (VAT inclusive)
- ❖ 15/7/2015 Sold goods to Kugis Brothers for Tsh. 8,000,000 (VAT inclusive)
- ❖ 6/7/2015 Purchased goods on credit from Morogoro Brothers for Tsh. 12,000,000 (Excluding VAT)
- ❖ 11/7/2015 Purchased goods for Tsh. 16,000,000 (VAT inclusive)
- ❖ 12/7/2015 Purchased goods for 200,000 (VAT exclusive)
- ❖ 25/7/2015 Imported washing machines worth Tsh. 2,000,000 (VAT exclusive)
- ❖ 28/7/2015 Paid telephone and electricity and worth 700,000.(VAT inclusive)

Required:

Assume that all purchases and sales were taxable supplies. Determine the company's VAT liability for the month of July 2015.

Solution to Example 13.2

Date	Transaction	Output			Input		
		Price (VAT Exclusive)	Price (VAT inclusive)	Output tax	Price (VAT Exclusive)	Price (VAT inclusive)	Input VAT
2/7/2015	Sales	4,000,000	4,720,000	720,000			
5/7/2015	Sales	4,800,000	5,664,000	864,000			
10/7/2015	Sales	2,423,729	2,860,000	436,271			
15/7/2015	Sales	6,779,661	8,000,000	1,220,339			
6/7/2015	Purchases				12,000,000	14,160,000	2,160,000
11/7/2015	Purchases				13,559,322	16,000,000	2,440,678
12/7/2015	Purchases				200,000	236,000	36,000
25/7/2015	Importation (Machine)				2,000,000	2,360,000	360,000
28/7/2015	Purchases (Utilities)				593,220	700,000	106,780
	Total	18,003,390	21,244,000	3,240,610	28,352,542	33,456,000	5,103,458

Note: To determine price exclusive of VAT if given price inclusive of VAT. Take the price inclusive of VAT divide by 1.18 (When VAT rate is 18%).

From the above computation:

Total output VAT 3,240,610
 Total input VAT..... 5,103,458
 Refund/Carry forward (Input VAT Claimable).....1,862,848

Example 13.3

The following are the transaction for GIMCO Financial Services Ltd. The amounts are stated inclusive of Value added Tax (VAT) where applicable.

<u>Revenues</u>	<u>Tsh.</u>
Commission receivable invoiced to Non-registered persons	7,624,400
Commission receivable invoiced to VAT-registered persons	13,889,500
Proceeds on sale of furniture to Non-registered VAT person	1,650,000
Residential rent received	500,000
Interest receive from NBC Ltd (Bank)	9,684,800
Fees receivable invoiced to VAT taxable persons	20,270,000
Credit notes received from suppliers (Non- VAT registered suppliers)	514,800
Settlement discount received (taxable persons)	239,800
Profit on sale of saloon car (non-commercial vehicle)	2,800,000
Office rent received from VAT registered persons	2,365,000
Insurance recovery paid by VAT registered persons	4,639,800
<u>Expenditure</u>	
Sundry office expenses (all taxable)	1,842,500
Interest paid to Non-VAT registered person	5,378,400
Salaries and Wages	10,583,900
Capital expenditure (on generator)	22,000,000

Required:

Categorise the above revenue transaction into the following categories and state the output taxable amount and the tax charged on them:

Exempt supplies

Zero –rated supplies

Standard rated supplies

Calculate the VAT payable or refundable for the VAT period of January, 2015, giving brief reasons where there is no input tax on expenses (VAT rates 18% and 0%).

Solution to Example 13.3

a)

<u>Revenues</u>	<u>Category</u>	<u>Taxable amount (Exclusive of VAT)</u>	<u>VAT charged</u>
Commission receivable invoiced to Non-registered persons	Standard rated	6,461,356	1,163,044
Commission receivable invoiced to VAT-registered persons	Standard rated	11,770,763	2,811,737
Proceeds on sale of furniture to Non-registered VAT person	Standard rated	1,398,305	251,695
Residential rent received	Exempt	500,000	-
Interest receive from NBC Ltd (Bank)	Standard rated	8,207,457.63	1,477,342.4
Fees receivable invoiced to VAT taxable persons	Standard rated	17,177,966.00	3,092,034
Profit on sale of saloon car (non-commercial vehicle)	Standard rated	2,372,881	427,119
Office rent received from VAT registered persons	Standard rated	2,004,237	360,763
Insurance recovery paid by VAT registered persons	Standard rated	3,932,033.9	707,766.10
Total		53,825,000	10,291,501

b) Computation of input tax

Sundry office expenses.....	1,842,500
Interest paid.....	5,378,400
Salaries and wages.....	NIL
Capital expenditure	22,000,000.
Total taxable purchases inclusive of VAT.....	29,220,900

Input tax 18/118 x 29,220,900 = 4,457,425.42

Note That:

Salaries and Wages not taxable

Apportionment of input tax:

Taxable supplies.....	53,825,000
Exempt Supplies.....	500,000
Residential rent.....	500,000
Total of all supplies.....	54,325,000

Proportion of input tax over output tax (0.9 /90% or more then all input tax will be allowed for a tax credit)

$$53,825,000/54,325,000 = 0.99$$

Thus all input tax can be claimed

VAT payable/Refund

Output VAT.....	10,291,501.00
Less: Input VAT.....	(4,457,425.42)

VAT Payable to TRA.....5,834,075.58

Example 13.4

Kujiajili Co. Ltd deals with Garments and was registered for VAT since July, 2010. For the calendar year 2016 the company accurately lodge the respective VAT returns up to October 2016. However, the return for November 2016 to April 2017 was all submitted on 1st May 2017. The VAT due for each month was as follows.

November, 2016	Tsh.	8,000,000
December, 2016		16,000,000
January, 2017		20,000,000
February, 2017		24,000,000
March, 2017		NIL
April, 2017		28,000,000

Specify the due date for each return

Calculate the total penalty due.

Calculate the total interest on unpaid tax (Assume the BoT statutory rate of interest is 12% p.a)

Solution to Example 13.4

Due dates for submission of VAT returns.

The VAT act requires that VAT returns be submitted not later than the 20th day of the month following the month of the respective return

Return month	Latest submission date (20 th day of)
November, 2016	20 th , December, 2016
December, 2016	20 th January, 2017
January, 2017	20 th February, 2017
February, 2017	20 th March, 2017
March, 2017	20 th April, 2017
April, 2017	20 th May, 2017

ii) Total penalty due (late lodgement of return) and interests on unpaid tax

Penalty = 2.5% of amount assessable per month or 15 currency point per month whichever the greater

Return month	From 20 th December, 2016	Months return remain un-submitted and respective penalties	January, 2017	February, 2017	March, 2017	April, 2017	May, 2017	Total
November, 2016	2.5% x 8,000,000 = 200,000 Compare with 15 currency point i.e 15 x 15,000= 225,000 greater, 225,000 per month or part of the month	225,000	225,000	225,000	225,000	225,000	225,000	1,350,000
December, 2016	-	2.5% x 16,000,000 = 400,000 Compare with 15 currency point i.e 15 x 15,000= 225,000 take the greater, 400,000 per month or part of the month	400,000	400,000	400,000	400,000	400,000	2,000,000
January, 2017	-	2.5% x 20,000,000 = 500,000 Compare with 15 currency point i.e 15 x 15,000= 225,000 take the greater, 500,000 per month or part of the month	500,000	500,000	500,000	500,000	500,000	2,000,000
February, 2017	-	600,000 compare with 225,000; take 600,000	600,000	600,000	600,000	600,000	600,000	2,400,000
March, 2017	-	0 compare with 225,000, take 225,000	225,000	225,000	225,000	225,000	225,000	900,000
April, 2017	-	No failure	-	-	-	-	-	450,000

Total penalty	225,000	625,000	1,125,000	1,725,000	1,950,000	1,950,000	7,600,000
Principal VAT Payable	8,000,000	16,000,000	20,000,000	24,000,000	NIL	1,950,000	1,950,000
Principal tax and penalty	8,225,000	16,625,000	21,125,000	25,725,000	1,950,000	1,950,000	28,000,000
Interest on unpaid tax (Simple interest as per S.76, TAA, 2015)	$[(12\%/12)] \times 6 \times 8,225,000$	$[(12\%/12)] \times 5 \times 16,625,000$	$[(12\%/12)] \times 4 \times 21,125,000$	$[(12\%/12)] \times 3 \times 25,725,000$	$[(12\%/12)] \times 2 \times 1,950,000$	$[(12\%/12)] \times 1 \times 1,950,000$	
Interest	493,500.00	831,250.00	845,000.00	771,750.00	39,000.00	19,500.00	3,000,000.00
Formula [p x r/12 x n]							

∴ $r = (12\% / 12)$; monthly rate applicable = 1%

From the above computation:
 Total penalty payable is 7,600,000/=
 Total interest on unpaid tax is 3,000,000.00
 Total principal VAT tax (Nov 2016, to April, 2017) = 96,000,000.00
 Therefore, total VAT payable/ liability is Tsh. 106,600,000.00

Chapter Summary

This chapter has discussed the application of the Value Added Tax (VAT) in Tanzania. The presented aspects include the scope, benefits, registration procedures, types of supplies, determination of input and output tax, VAT refunds, payment of VAT and appeals on VAT. The key points in the chapter can be summarised as follows:

- ❖ VAT is tax on consumption on a wide range of goods and services. It is levied on importation of goods and services. It is the tax on the value that is added to goods and services by producers and traders at each stage in the production and distribution process.
- ❖ The VAT system requires that registered traders charge VAT on taxable goods and services sold by them (Output tax) on their sale is output tax. On the other hand, registered person is charged VAT on goods/services purchased by him including imports, from other traders (Input tax). When there is an excess of output tax over input tax, the amount is to be paid by the trader to the Government (TRA). When there is negative figure between output tax and input tax the trader is supposed to claim a refund.
- ❖ VAT is charged at a single positive Rate of VAT, i.e. 18%.
- ❖ VAT is imposed on supplies. A supply is anything done for a consideration i.e. whether supply of physical goods or service rendered. There are three types of supplies under the VAT Act 2014; Namely Exempt supplies, Taxable supplies, and zero rated supplies.
- ❖ Taxable supplies are any supplies of goods and or services made by a taxable person in the course of his business. Example of taxable supply include: Gifts or loans of goods, Barter trade and exchange of goods, Processing or treating of another person's goods, Betting of any kind, Supply of power, heat or ventilation, professional services.
- ❖ Zero rated supply is a taxable supply that is chargeable at a rate of zero (0%). Trader supplying a zero rated supply charge VAT at a rate of 0%. The registered taxpayer is entitled to a refund of input tax paid on his purchases on such supplies.
- ❖ Exempt supplies are supplies which are not subject to VAT. No tax is charged on exempted supplies. Trader supplying exempt goods and services does not charge VAT to his customers. The complete list and items under the exempt supplies are provided for under the schedule in the VAT Act 2014.
- ❖ The registration for VAT purposes for an entity is only once. The registered person for VAT purposes is supposed to use the Tax Identification number (TIN) issued by TRA upon registration of the business. The TIN and the Value Added Tax registration number must be used or shown in all documents furnished to TRA and invoices issued to customers.
- ❖ A person must in respect of any month, be registered for value added tax from the first day of that month, if there is reasonable ground to expect that the person's turnover in the twelve months period commencing at the beginning of the previous month will be equal to or greater than the registration threshold (One hundred million shillings in a period of twelve consecutive months).
- ❖ The tax point is the time when supply of goods or services is treated as having taken place. The registered trader is supposed to account for VAT in his records at the rate of tax in force at the tax point. The tax becomes due and payable at the time when the registered trader: Supplies the goods or services to the purchaser, or Issues a tax invoice in respect of the supply or Receives payments for all or part of the supply; Whichever time is the earliest.
- ❖ The VAT payable on imported goods shall be paid at the time of importation of such goods by the importer. The value added tax payable on a taxable import shall be paid where goods are entered for home consumption in Mainland Tanzania.
- ❖ Every taxable person must in respect of each prescribed accounting period, lodge with the Commissioner General a tax return. The prescribed accounting period for a taxable person is the calendar month.

- ❖ A taxable person must keep record of all accounts, documents, returns, and other records that are required to be issued or given under this Act, or such as: Tax invoices and adjustment notes issued and received by the person; Customs documentation relating to imports and exports of goods by the person; records relating to supplies of imported services to the person, and others.
- ❖ VAT refunds are provided for under the VAT Act 2014. There are several circumstances which can give rise to refund of money from TRA to the tax payer for VAT purposes. This include when input VAT for a tax period exceeds output tax; when the taxpayer (the registered trader) erroneously makes payment of VAT payable for a tax period over and above the required amount .
- ❖ Offenses, penalties and interest for failure to comply with provisions made under the Value Added Tax are provided for under part X the Tax Administration Act, 2015.

End of Chapter Thirteen Revision Questions

- (1) Discuss on the different types of supplies.
- (2) What are the penalties prescribed by Tax Administration Act, 2015 (along with FA, 2016) for late lodgement of VAT returns by a taxable person?
- (3) Mention the major categories of exempt supplies under VAT Act 2014
- (4) Explain what a “partial exempt trader” is.
- (5) The following purchases and payments relate to Mr. Kihombo, a taxable person for the month of January 2016.

- ❖ He purchased live cattle at 11,875,000/=
- ❖ He purchased cans for packing processed meat at 1,654,000/=
- ❖ Heavy duty mincing machine 1,800,000/=
- ❖ Salt 180,000/=
- ❖ Cooking oil 180,000/=
- ❖ Transportation of live cattle 1,230,500/=
- ❖ Transportation of canned beef and sausages to customers 1,100,000/=
- ❖ Transportation of smoked (unprocessed) beef to customers 145,000/=
- ❖ Goods inwards register books 185,000/=
- ❖ He paid electricity, telephone and water bills amounting to 1,158,000/=, 137,800/= and 169,000/= respectively
- ❖ He purchased two weighting machines at a total cost of 1,150,500/=
- ❖ Two deep freezers from Mr. Abdi 1,950,000/=
- ❖ During the same period he made the following supplies to his customers:
- ❖ Unprocessed meat 1,965,000/=
- ❖ Sausages 1,720,000/=
- ❖ Canned minced beef 11,600,000/=
- ❖ Minced beef (not canned) 1,540,000/=
- ❖ Smoked beef 1,380,600/=
- ❖ Additional information:
- ❖ In return of the two deep freezers from Mr. Abdi, he supplied to him sausages and canned beef valued at 1,250,000/= and 1,150,000/= respectively. These were not included in the value of supplies made by him above.
- ❖ During the same period, he held a birthday party for his son. For this purpose, he took from his business minced beef (not canned) 1,320,000/= and 1,275,950/= respectively.
- ❖ On 28th January 2016, he supplied smoked beef 175,000/= and sausages 150,000/= on credit to Mr. John Said on an agreement that payment will be paid on 15th February 2016.

Required:

Calculate the amount of VAT paid by Mr. Kihombo for the month of January 2016

6. The purchases and sales both taxable and non-taxable (exempt) supplies of Twendepamoja LTD Company during the month of January 2016 were as follows:

	Tsh.	
Purchases at std rate	24,000,000	
Purchases at zero rate	4,000,000	
Sales at std rate	64,000,000	
Sales at zero rate	16,000,000	
Exempt sales	32,000,000	

Required:

Calculate the deductible input VAT and amount payable/refundable to/from TRA for the month of January 2016 for Twendepamoja LTD Company.

7. The following information is obtained from a VAT return of a VAT registered trader for the month of June 2016 (VAT inclusive whenever applicable):

Standard rated supplies	Tsh.	1,700,000,000	
Zero rated supplies			50,000,000
Exempt supplies		68,000,000	
Exempt purchases (import)		63,000,000	
Exempt purchases (local)		47,000,000	
Standard rated purchase	Tsh.	873,000,000	
Standard rated imports			210,000,000

Required:

.Calculate the amount payable/refundable to/from TRA for the month of June 2016.

The following information is extracted from VAT return of Morogoro Tobacco Ltd for the month of March 2016.

Purchases VAT std rate:

Import (processing machine)		
CIF value	Tsh.	70,000,000
Import duty 10%		7,000,000
Other purchases		4,000,000
Total purchases		<u>81,000,000</u>

(Note: VAT is not included)

Supplies (sales)

Export of processed tobacco		52,000,000
Sale of Fertilizers to farmers		3,000,000
Local sale of processed tobacco		2,000,000
Other sales (STD rated)		600,000
Total supplies		<u>57,600,000</u>

Required:

Amount of VAT payable / refundable as per VAT Act 2014

8. Mrs Paul carries on a business of a retail grocery in DSM since January 2001. The following information is available during the prescribed accounting period of July 2016.

Purchases made and expenses paid during the period which are *VAT exclusive* are as follows:

Item	Tshs.
Cooking oil	800,000
Bags for packing wheat	175,000
Electricity	150,000
Sugar	550,000
Telephone	200,000
Register books	250,000
Transportation of Milk	150,000
Refrigerator	270,000
Wheat flour	400,000
Green vegetable	150,000
Beer and spirits	300,000
Soft drinks	250,000
Fresh milk	200,000

Also, during the same prescribed accounting period, the following supplies were made by Mrs Paul: Gross payments received were VAT inclusive.

Item	Tsh.
Cooking oil	600,000
Sugar	450,000
Toilet soap	630,000
Laundry soap	510,000
Wheat flour	200,000
Green vegetable	160,000
Beer and spirits	290,000
Soft drinks	160,000
Fresh milk	200,000

The following additional information is also available:

- ❖ The amount of beer and spirits supplies includes deposits for bottles taken out by customers amounting to Tsh. 20,000/=
- ❖ There was cash loss of payment received in respect of supply of soft drinks, of which Tsh. 40,000. This has not been included in the payments received during the month.
- ❖ One crate of beer worth Tsh. 14,000/= was taken for personal consumption by the owner of the grocery. The amount was not included in the payment received during the month.
- ❖ Milk worth Tsh. 20,000/= was returned by customers during the month for various reasons. This has not been subtracted from the amount shown above.
- ❖ No cash discount were allowed or received during the month.

Required:

Calculate the OUTPUT tax payable for the month of July 2016, using the method provided under VAT Act 2014 and its Regulation.

9. Moro Consult Company is a real estate business established in Morogoro. The main source of income of the company is rental income on Commercial buildings; Residential buildings; and offices buildings rented to Embassies. Other sources of income include interest on money deposits with CRDB bank. The company also pays VAT for items purchased for repairs and maintenance of its buildings. The following information relates to the year, 2016 (Where applicable the amounts are VAT inclusive at 18%):

Rental income (Commercial).....	384,000,000
Rental income (Residential).....	292,000,000
Office rent (Embassies).....	420,000,000
Bank interest	128, 000,000
Other income	146,000,000
Input VAT.....	423,000,000

Required:

Calculate the refund or VAT payable to commissioner for VAT for the year 2016

ABC is a registered VAT taxpayer. He did not submit a return for April, May and June 2016 on the due dates until 15th November, 2016 with the payment of Tsh. 6,500,000 as VAT payable on each month. Other returns in respect of other months were submitted as required. Assume the prevailing statutory lending rate is 10%.

Required:

Compute penalty and interest and final liability from the above given information;

CHAPTER FOURTEEN

INTERNATIONAL TAXATION

Introduction

Many countries have developed competitive investment incentive packages in order to attract both local and foreign capital. With the increasing liberalisation of international trade and investment policies and cooperation among nations, a number of multinational companies with massive income arising from international transactions worldwide have increased. The ultimate resultant tax problem is for the income earned in foreign countries suffering double taxation. This chapter deals with double taxation, both local double taxation and international double taxations. It covers aspects of double taxation of residents and non-residents, the effects of double taxation, and methods for resolving double taxation problems.

Learning Outcome

After successful completion of this chapter readers should be able to:

- ❖ Describe double taxation
- ❖ Describe the circumstances which cause double taxation to arise
- ❖ Describe the effects of both local and international double taxation
- ❖ Describe the rationale for designing double taxation treaties
- ❖ Methods used by multinational companies to evade and avoid tax.

Meaning of Double Taxation

There are basically two types of double taxation, namely judicial double taxation and economic double taxation. Judicial double taxation or international double taxation is a phenomenon whereby the same income is taxed in two or more tax jurisdictions, in the same year of income, and on the same taxpayer. International double taxation arises when same income is taxed twice or more due to overlapping tax jurisdictions among different nations. Economic double taxation is a type of double taxation which arises when the same income is taxed more than once in the same tax jurisdiction (country). This type of double taxation arises due to overlapping tax laws of the same country.

Double Taxation

Economic double or sometimes referred to as domestic double taxation as defined above arises as a result of tax laws of the same countries imposing tax on the same income thus causing economic loss or hardship to taxpayers to the tax payer. There are several sources of income which may give rise to double taxation. These incomes include dividend income, inheritance, and gifts.

Normally, dividends are taxed, because corporations are considered separate legal entities from their shareholders. As such, corporations pay taxes on their annual earnings, just as individuals do. When corporations pay out dividends to shareholders, those dividend payments incur income-tax liabilities for the shareholders who receive them, even though the earnings that provided the cash to pay the dividends were already taxed at the corporate level. This is considered as double taxation because in reality corporations and shareholders are the same and so long as the corporation has paid income tax on profits earned no further tax should be imposed on income when distributed to owners.

Similar argument is extended for taxation of inherited assets, gifts, and income from trust units. The general assumption is that inheritance, gifts or trust are paid on wealth or income which was taxed when it was first earned. The transfer of wealth by way of inheritance, gift or distribution of trust (to beneficiary) from one person to another is perceived as double taxation of the same income because no value addition is made when such transfer is made. Thus, it is as double taxation.

Taxation Relief for Economic Double Taxation

The relief mechanism is easier for domestic double taxation. It does not require any international formal treaty or convention. It also can be granted in the form of personal allowances or relief e.g., portion of chargeable income being treated as tax free, or taxed at lower rates. Economic double taxation can also be dealt with by amending the overlapping tax laws which causes double taxation.

Judicial Double Taxation

The judicial or international double taxation arises from the operation of section 6 of the Income tax Act. Both individuals and non-individuals may have significant dealings with other countries. Under section 6 of the ITA, 2004 all resident persons in Tanzania are chargeable in respect of their income accruing in or derived worldwide. Foreign income arising from outside the United Republic is chargeable to tax to Tanzanian income taxation even if not remitted to Tanzania. The rules of derivation of income and its liability to income tax in Tanzania are almost the same as in many other countries such as United States, Canada, India, and Britain etc.

All income which arises in Tanzania is taxable whether or not it accrues to resident or non-resident persons. Income specified under section 6 of the Income tax Act 2004 is to be charged depending on whether or not the recipient is resident. Under section 6 where a non-resident person is liable to Tanzanian tax and is also liable to comparable foreign tax in his/her country of residence on the same income double taxation will arise and thus reducing the income of the income earners.

Effects of Double taxation

Economically and socially double taxation has the following effects:

- ❖ Discourages the free flow of resources and investment across countries.
- ❖ Possibility of tax avoidance and evasion, resulting in loss of government revenue.
- ❖ Financial hardship on corporations and individual tax payers due to reduction in disposable income

Rationale for double taxation treaties

It is necessary to formulate appropriate taxation and physical policies that will minimize the undesirable effects of international double taxation of income. By concluding as many international double taxation relief agreement as possible with the major trading partner nations 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. There is no doubt that double taxation is partly due to international co-operation. International co-operation is of crucial importance in order to achieve rapid economic and social development by: -

- ❖ Establishing bilateral and multilateral regional economic groupings to promote trade and investment, e.g., COMESA, SADC, EAC.
- ❖ Formulation of competitive investment incentive packages in order to attract both local and foreign capital.
- ❖ Concluding as many International double taxation relief agreements as possible with major trading partner nations. These agreements are intended to allow cooperation in *training and*

tax administration to promote: Free flow of capital, free flow of technology, free flow of skilled personnel.

Foreign Tax Relief

Section 77 of the Income Tax Act 2004 explains about Reliefs taxpayers can get from the international double taxation. According to subsection (1) subject to subsection (4), a resident person (other than a partnership) may claim a foreign tax credit for a year of income for any foreign income tax paid by the person to the extent to which it is paid with respect to the person's taxable foreign income for the year of income.

Approaches to Problems of Double Taxation

There are two popular methods used in addressing the problem of double taxation.

Granting relief

- ❖ International Double taxation relief
- ❖ Domestic Double taxation relief

International Double Taxation Relief

This refers to International tax relief granted through taxation agreement negotiated between Tanzania and other countries (being international calls for a need of cooperation between these countries in granting relief). The purpose is to give relief by way of exemption, credit and set offs, for tax suffered on income originating in these countries. It is very important because it may promote flow of trade, investments and encourage capital formation

Significance of International cooperation and relief from double taxation:

Double taxation relief has positive impact to both, taxpayer and economy. Due to high rates in most countries, double taxation may give rise to financial hardship, harmful effects on the exchange of goods and services, and may affect movement of capital, technology and skilled personnel.

Alternative Approaches to International Double Taxation

There are several methods that are used by governments in dealing with international double taxation. These include *laissez faire*, and relief agreements.

The Laissez Faire Approach:

The laissez faire approach is adopted when a country avoids administrative difficulties by ignoring taxation of international transactions. The Problem with laissez fair include: Loss of revenues, which deprive economy (financial and other resources are lost), adversely affects country's investment pattern because local investors will feel that they are discriminated against foreign investors. It also ignores one of the important principles of a good taxation system of equity.

Agreement Relief and International Cooperation

This involves granting relief for foreign tax without regard to whether the other taxing country is prepared to do so in similar circumstance. The relief is given by the country in which the claimant is resident. *Problem associated with this approach include:* Not favoured because it interferes with foreign tax jurisdiction and national sovereignty; It may be very expensive and yet most ineffective e.g., it may force tax official to travel outside the country to enforce tax legislations on some defaulters who have escaped the country (loss of time, money).

Bilateral and Mutual Agreement Relief: This is formal mutual international co-operation between different taxing jurisdictions.

Treaty Negotiation

This involves concluding international double taxation relief. It is a complex and tedious but a necessary process in order to conclude efficient treaties. It involves use of Organisation for Economic Co-operation and Development (OECD) and United Nations' models as a basis for treaties. Some of the major problems associated with treaties include: Taxation of specific sources of incomes and persons should be outlined e.g., Rent, shipping, royalty, students, Permanent Establishment (PE) It should be noted that not all permanent establishments are subjected to tax. e.g., PE for use of facilities for storage, a fixed place of business solely for purchasing goods and collecting information. The method of the foreign tax relief should be specified namely either credit method or exemption method.

Computation of the credit relief

The computation may require information from the other state hence the significance of the exchange of information clause.

Arbitration or resolution of disputes

Dispute is inevitable in any treaty. Therefore, efficient machinery should be established in order to deal with such disputes quickly and effectively.

Arbitration on International Tax Treaties

Arbitration is the machinery to solve disputes as may arise from time to time. There are two methods of arbitration, namely the authority and the technical standing committee.

The Authority

The Presidents of the two contracting states constitute the Authority. However there are some problems *associated with this method.* Presidents are unlikely to be experts in law and accountancy. Hence, not able to decide on technical issues, as a result they will tend to delegate technical issues and causing delays in decision making. Presidents have limited time for regular non-political meetings. Furthermore, there are possibilities of developing political 'impasse' that may paralyse and cripple the whole process of arbitration.

Technical Standing Committee

These are committee with competent persons in tax matters and deal with the scrutiny of double taxation treaties. They are more desirable because the Committee is composed of technical experts (lawyers, tax consultants, accountants), hence competent in deciding on technical issues. They (technicians) have enough time to deliberate on the disputes quickly (not constrained by political considerations).

Methods of Granting Relief

There are two methods of granting relief on international double taxation, namely the credit method and the exemption method.

The Exemption Methods

This method is applied when home jurisdiction exempts from taxation all incomes earned in a foreign country.

Credit method:

A relief is effected by way of deduction of set offs from the total tax liability. Credit relief can only be granted to resident persons who have paid foreign income tax or comparable tax on the same income which is derived from another foreign country. The credit method is more preferred.

Computation of Tax Credit under special arrangement

Steps:

Calculate total Income of resident person (all chargeable sources including foreign income)

As (1) above but exclude foreign income.

Use appropriate tax rates to:

Calculate total tax liability in (1) separately.

Calculate total tax liability in (2) separately.

Difference between tax liability under (1) and (2) represents Tanzanian tax on the foreign income, which qualifies as foreign tax credit for relief.

Compare results in (4) with actual foreign tax paid or payable.

The lesser = qualifying foreign tax credit.

Example 14.1

Assume the following facts:

Resident Corporation – ABC

Tanzania Business income 1,000,000

Business foreign income 12,000

Corporate tax rate 30% (TZ)

Foreign tax paid on 12,000 was 1,200/= i.e. 10% on foreign income.

Solution to Example 14.1.

Total income of such person from all sources:

From Tanzania 1,000,000

Add: Foreign income 12,000

Total Income 1,012,000

Total Tanzania tax (at 30%) 303,600

Total income of such person excluding foreign income.

From Tanzania 1,000,000

Foreign Income NIL

Total Income 1,000,000

Total Tanzania tax (at 30%) 300,000

c. (a) – (b) = Tanzania tax on foreign Income = 303,600 - 300,000 = 3,600.

Compare answer in (c) with actual foreign tax paid. i.e. 3,600 Vs 1,200

Take the lesser.

Tax credit relief = 1,200/=

Note:

There is a need to verify derivation rules and computation of total income under foreign legislation, hence determination of foreign tax paid.

The tax administrators of the country granting the relief theoretically and practically require adequate knowledge about foreign legislation. This is the case because lack of familiarity of the foreign tax legislation may result in rejection of foreign tax paid without adequate reasons or accepted without reason.

Tax Avoidance and Evasion Practices of Multinational Companies

Multinational companies are companies which operate in more than one country. They can operate a subsidiary or branch in foreign country. Multinational companies face different tax rates across different countries. In most cases they suffer double taxation. Some of the multinational companies use different techniques to reduce or eliminate the tax liabilities arising from their multinational operations. In this section we identify some of the techniques used by multinational companies and we also review strategies used by host countries in combating such practices

Tax Shelters

A tax shelter is a capital investment or expenditure on which the investor (taxpayer) is entitled to claim *substantial* capital allowances for tax purposes. The cost of the capital investment is normally written off within a short period of time. Tax shelter is more applicable in the industrial, mining and manufacturing sectors where heavy plant and machinery are required. Note that tax shelter merely *defers* the tax liability in to future when the write off of the capital cost through capital deductions claims/allowances is exhausted, i.e. does not quite result in to complete tax exemption or saving.

Use of Tax Havens

Tax havens are geographical regions or countries where the tax rates are deliberately kept very low or zero in order to attract investors and savings. Normally, these are disadvantaged areas due to factors such as drought, chaotic countries/political instability, etc. Facilities offered include free remittance, i.e. transfer of cash in to and out of the region/country is unrestricted; provision of efficient financial (banking and insurance); legal and consultancy services and no or little control or restrictions on investments.

Transfer Pricing

Transfer pricing refers to the allocation of profits for tax and other purposes between parts of a multinational corporate group. It is price for goods and services charged to other entities in the same corporate structure.

Objectives of Transfer Pricing

Multinational enterprises and corporations with local subsidiaries resort to transfer pricing in order to achieve the following objectives:

- Multinational enterprise could suffer double taxation on the same profits without proper transfer pricing
- Competition is another factor that forces multinational enterprises to engage in transfer pricing. Thus, in order to compete MNC's are required to make necessary transfer pricing arrangements in order to ensure that the entities within the corporate structure are not only profitable but can also compete.

- It is said that this is one of the basic business requirements if they really want to survive irrespective of the negative tax perspective it creates

Taxation Perspective of Transfer Pricing

Transfer pricing can be used to shift profits jurisdictions to low tax jurisdictions even if the MNC's carry out little business activity in that jurisdiction. This leads to trade distortions, as well as tax distortions. Transfer pricing can deprive governments of their fair share of taxes from global corporations.

Transfer Pricing and Tax Avoidance

Transfer pricing is guided by certain laid down rules. Only when these rules are violated the transfer pricing becomes a tax avoidance arrangement. For tax purpose, transfer pricing is a highly regulated business activity that ensures that it does go beyond the acceptable levels of practice and cause tax avoidance problems.

Transfer Pricing under OECD

To avoid problems associated with transfer pricing, the Organisation for Economic Co-operation and Development (OECD) countries have international guidelines on transfer pricing that are based on the arm's length principle- that a transfer price should be the same as if the two companies involved were independent, and not part of the same corporate structure. Note however that abuse of transfer pricing may be particular problem for developing countries like Tanzania, as companies may take advantage of it to get round exchange controls and to repatriate profits in a tax free form (currently, OECD Transfer Pricing Guidelines not operational in Tanzania).

Transfer Pricing and Arm's length Principle

For taxation purpose, business transactions by MNC's are required to reflect the price paid at arm's length, i.e. price paid to independent suppliers, those who are not part of the corporate structure.

Arm's Length Price

Section 33 of the ITA 2004 has adopted the arm's length price to be applied by associates in all dealings between them. Arm's length price is the internationally accepted transfer pricing standard which must be applied for tax purpose by multinational enterprises and tax administrations. Basically, it is the price at which a person would sell to another if the two persons were not connected or related to each other.

Conditions of Arm's length Principle

Any income arising from an international transaction shall be compounded having regard to arm's length price. Allowance for any expenses or interest shall be determined with regards to the arm's length price while determining taxable income of a subsidiary of a multinational enterprise. The cost or expense allocated or apportioned between two or more associated enterprises shall be at arm's length price.

Arguments for arm's length Principle

Arm's length principle avoids the creation of tax advantages or disadvantages that would otherwise distort the relative competitive position of the entity. It Promotes growth of international trade and investment by separating tax considerations from economic decisions.

Arguments against arm's length Principle

Some MNC's deal in the integrated production of highly specialised goods and/ or in the provision of specialised services. Such that it is difficult to establish Arm's length price for their products. Additionally, associated enterprises may engage in transactions that independent enterprises would not undertake, e.g. sale or license of intangibles. Thus, the Arm's length principle may result in administrative burden through evaluating significant numbers and types of cross border transactions, and verification of the same. Sometimes far placed geographical locations and confidentiality may cause difficulty in obtaining comparable data. Application of arm's length principle is generally based on a comparison of the conditions in a controlled transaction with the conditions in transactions between independent entities. Application is also dependent of economic circumstances. The principle may vary if the markets in which the independent and associated enterprises are operating are not comparable.

Chapter Summary

This chapter has covered aspects of double taxation, both local double taxation and international double taxations. In the chapter key issues can be summarised in the following points.

- ❖ There are two major categories of double taxation, namely judicial double taxation and economic double taxation.
- ❖ Judicial double taxation or international double taxation is a phenomenon whereby the same income is taxed in two or more tax jurisdictions in the same year of income, and on the same taxpayer.
- ❖ Economic double taxation is a type of double taxation which arises when the same income is taxed more than once in the same tax.
- ❖ There are several sources of income which attract economic double taxation. These incomes include dividend income, inheritance, and gifts.
- ❖ Economic double taxation can also be dealt with by amending the overlapping tax laws which causes double taxation.
- ❖ The international double taxation arises from the operation of the rules of derivation of income and liability to income tax in Tanzania and to many other countries.
- ❖ Economically and socially double taxation has several effects including; discouragement of the free flow of resources and investment across countries; promotes tax avoidance and evasion; financial hardship on corporations and individual tax payers due to reduction in disposable income
- ❖ International double taxation can be alleviated by making international double taxation relief agreements with major trading partner nations.
- ❖ There are two methods of granting relief on international double taxation, namely the credit method and the exemption method.
- ❖ Credit method of granting relief is implemented by way of deduction of set offs from the total tax liability. Credit relief can only be granted to resident persons who have paid foreign income tax or comparable tax on the same income which is derived from another foreign country.
- ❖ Multinational companies face different tax rates across different countries. In most cases they suffer double taxation.
- ❖ Multinational companies use transfer pricing to the allocate profits for tax and other purposes between parts of a multinational corporate group. The price for goods and services charged to other entities in the same corporate structure are generally inflated in order to reduce taxable profits in countries with high tax rates.

End of Chapter Fourteen Revision Questions

1. What do you understand by the phenomenon 'double taxation'?
2. Identify two types of double taxation and their possible causes
3. It is argued that conclusion of many international double taxation agreements is very important for the economic and social development of a country.
Appraise this argument
4. Identify and discuss various approaches to the problem of double taxation
5. Identify methods of granting double taxation relief, state which is more preferred and why?
6. Discuss two methods (machinery) of arbitration in the course of disputes arising from treaty negotiation
7. Evaluate how Tanzania benefits from a double taxation treaty with a country like U.K.
8. International juridical double taxation is the imposition of comparable taxes in two (or more) states on the same taxpayer in respect of the same subject matter and for identical periods. Elucidate this statement
9. During the year ended 31st March 2015, JOYOUS Ltd, a Tanzania resident company had trading profit of TZS. 18,000,000 and received a remittance on account of overseas profits of TZS 8,000,000 from its overseas branch located in German. The actual profits earned by the branch for the year ended 31st March, 2015 are TZS 10,000,000. These profits were taxed overseas at the rate of 35%:

Required:

Calculate JOYOUS L td's corporation tax liability for the year of income ended March 2015.

CHAPTER FIFTEEN

OTHER TAXES AND DUTIES ADMINISTERED BY TANZANIA REVENUE AUTHORITY

Introduction

This chapter deals with some selected taxes in Tanzania whose individual contribution to total taxes collected by TRA in Tanzania do not make a significant proportion like the Income Tax and Value Added taxes which have been discussed in details in this book. We provided brief discussions of these tax laws in Tanzania in order to give an overview of their application and implications to the economy. The objective is not to provide a comprehensive exposition of the operationalisation of the individual tax laws covered in this chapter, but to provide an overview of the basic facts and information on their imposition, scope, exemption, collection and other matters relevant for general understanding of the application these tax laws. Readers who are interested in a comprehensive and practical application of the tax laws covered in this chapter should consult specialised textbooks or publication on these tax laws. The tax laws covered in this chapter are: The Excise and Tariff Management Act; the Port Services Charges Act, the Airport Services Charges Act, the East African Customs Management Act, The Road and Fuel Toll Act; The Tanzania Motor Vehicle Registration and Transfer Act, the Stamp Duty Act, the Vocational Educational and Training Act, and the Hotel Act

The Excise Management and Tariff Act Cap 147

Introduction

The excise tax which is sometimes is called a duty of excise, is a special tax on the sale, or production for sale, of specific goods or a tax on a good produced for sale, or sold, within a country or licenses for specific activities. Excises are different from custom duties which are taxes on importation. Excises are inland taxes, whereas customs duties are border taxes. An excise is considered as an indirect tax which means that the producer or seller who pays the tax to the government is expected to try to recover or shift the tax by raising the price paid by the buyer. Excise taxes are typically imposed in addition to other indirect tax such as d Tax Value Added Tax (VAT). Excise taxes are distinguished from VAT in three ways namely:

- ❖ an excise typically applies to a narrower range of products;
- ❖ an excise is typically heavier, accounting for a higher fraction of the retail price of the targeted products; and
- ❖ an excise is typically a per unit tax costing a specific amount for a volume or unit of the item purchased, whereas VAT is an ad-valorem tax and proportional to the price of the good.

Good examples of excise duties are taxes on gasoline, fuels, tobacco, and alcohol.

Imposition of the Excise Duty

Any person who manufactures any excisable goods should be licensed by the Licensing Authority and must impose excise duty in according with Excise Management and Tariff Act, Capt 147. The

duty must be paid on excisable goods manufactured by the licensee at the rates and in the circumstances specified in the appropriate partner states legislations.

The Act provides for goods which are the subject of excise duty. These include: Tobacco products such as cigarettes, cigars and manufactured tobacco, alcohols in their varieties including beer, spirits, juices, canned water and other products.

Liability to Duty

Rates of duties are specified in Partner states legislation Act. Subject to the provisions of the excise laws, the duty shall be paid by a licensee on excisable goods manufactured by the licensee at the rates and in the circumstances specified in the appropriate partner state legislation. Provided that where any excisable goods on which duty has been paid are converted into other excisable goods liable to a higher rate of duty, whether specific or ad valorem, such converted excisable goods shall only be liable to duty at a rate equal to the difference between such higher rate of duty and the duty originally paid thereon.

Payment of Duty

Sec 56 of the excise act provides that where any excisable goods are liable to duty, such a duty shall constitute a debt due to the partner state and be charged on the goods in respect of which the duty is payable and such duty shall be payable by the licensee and may without prejudice to any other means of recovery, be recovered by legal proceedings brought by the Commissioner General in the name of the Commissioner General.

Recovery of Duty by Distress

Sect 57 of the Excise Act provides that where any duty is unpaid by a licensee after the time when in accordance with the provision of the laws, it is required to be paid the Commissioner General may authorise distress to be levied-

Upon the goods, chattels and effects of the licensee who should have paid the duty wherever such goods chattels and effects may be found; and

Upon the plant of any factory and upon any vessel, vehicle, animal or any other article, used in the manufacture, sale or distribution, of such excisable goods by such or possession of such licensee or of any person on behalf of or in trust for the licensee.

The warrant of distress shall be in the form set out in the third schedule to the Act and such warrant shall be authority to recover the amount of the duty specified in the warrant and for the purpose of levying such distress the person authorised under such warrant may, if necessary, break open any building or place in the daytime and may call to his assistance any police officer and such police officer shall render assistance accordingly.

The East African Community Customs Management Act 2004

Introduction

The East Africa Customs Management Act is an Act for making provisions for the management and administration of customs and related matters. It covers all customs and port matters referring to loading and unloading of cargo or goods on aircraft, motor vehicle, ship or vessel and pipeline in an approved place such as quay, jetty, wharf or other place approved by the commissioner such as customs airport, a dry port, a boarding station, and a bonded warehouse. The Act provides provision

to be adopted and administered by revenue authorities of member state in East Africa Community. The East African Community (EAC) is the regional intergovernmental organisation of the Republics of Burundi, Kenya, Rwanda, the United Republic of Tanzania, and the Republic of Uganda, with its headquarters in Arusha, Tanzania. It is a regional organisation mandated by the above five countries to spearhead the member countries' economic, social and political integration agenda.

Definition of key terms

Customs

Customs refers to an authority or agency in a country responsible for collecting customs duties and for controlling the flow of goods including animals, transports, personal effects and hazardous items in and out of a country. Depending on local legislation and regulations, the import or export of some goods may be restricted or forbidden, and the customs agency enforces these rules. The customs authority may be different from the immigration authority, which monitors persons who leave or enter the country, checking for appropriate documentation, apprehending people wanted by international arrest warrants, and impeding the entry of others deemed dangerous to the country.

Commercial goods not yet cleared through customs are held in a customs area, often called a bonded store or warehouse, until processed. All authorised ports are recognised customs area. Customs shall initiate policies on customs and related matters in the community and coordinate such policies in the partner states. Issues include:

- Common external tariff
- Enforcement of customs law
- Trade facilitation
- Rules of origin
- Compilation and dissemination of trade statistics
- Application and interfacing of information technology
- Training in customs related matters
- Quality control and enforcement of compliance
- Custom related negotiations
- Activities of the commissioners

Customs duty

Customs duty is a tax levied on imports (and, sometimes, on exports) by revenue authorities of a country in order to raise government revenues and/or to protect domestic industries from more efficient competitors from foreign countries. Customs duty is based generally on the value of goods or upon the weight, dimensions, or some other criteria of the item (such as the size of the engine, in case of automobiles). In most countries, customs charges are attained through government agreements and international laws. A customs duty (boarder tax) is a tariff or tax on the importation (usually) or exportation (unusually) of goods.

The scope of the EACM Act 2004

The Act is for the member states and covers all areas relating to cross border trade for goods and services covered under the Act. The Act covers all custom and port matters relating to loading and unloading cargo on any means of transport an approved play such as a key, jetty, wharf or other place approved by the Commissioner of Customs. The provisions of this Act provide that the Act should apply to any activity undertaken in co-operation by the Partner States in the field of customs management and trade and include:

Matters concerning trade liberalization;

Trade related aspects including the simplification and harmonization of trade documentation, customs regulations and procedures with particular reference to such matters as the valuation of goods, tariff classification, the collection of customs duties, temporary admission, warehousing, cross-border trade and export drawbacks;

Trade remedies and the prevention, investigation and suppression of customs offences;

National and joint institutional arrangements;

Training facilities and programmes on customs and trade;

Production and exchange of customs and trade statistics and information; and

The promotion of exports.

The Act also makes provisions on co-operation among partner's states in the following areas:

Adopting uniform, comprehensive and systematic tariff classification of goods with a specific description and interpretation in accordance with internationally accepted standards;

Adopting a standard system of valuation of goods based on principles of equity, uniformity and simplicity of application in accordance with internationally accepted standards and guidelines;

establishing common terms and conditions governing temporary importation procedures including the list or range of goods to be covered and the nature of manufacturing or processing to be authorised;

Implementing the customs requirements for re-exportation of goods;

Implementing the customs requirements for the transit of goods;

Harmonizing and simplifying customs and trade formalities and documentation and dissemination of information;

Harmonizing the customs requirements for the control of warehoused goods; and

Adopting common procedures for the establishment and operation of export promotion schemes and free ports.

The East Africa customs management act further provides for common treatment of imports, exports and goods on transfer. Some of the matters provided for by the Act are as presented below:

Prohibited trade: These are goods and services which cannot be imported in any of the partner states (second schedule of the Act). Examples include false money and counterfeit notes, pornographic materials, matches containing white phosphorous, any article not bearing a Court of Arms of any partner state, distilled beverage containing oils or chemicals products and narcotic drugs under international control.

Restricted trade: These are goods and services which must meet certain conditions before clearance through customs is given (See list in second schedule to the EAC Act 2004). The list includes:

- ❖ Ivory, elephant un-worked or simply prepared but not cut to shape
- ❖ Ivory powder and waste
- ❖ Teeth, hippopotamus, un-worked or simply prepared but not cut to shape
- ❖ Ossein and bones treated with acid
- ❖ Natural sponge of animal origin
- ❖ Unwrought metals, and precious stones
- ❖ Commercial casings (Second hand tyres)
- ❖ Prohibited and restricted exports:
- ❖ These are provided for under the third schedule of the EACM Act 2004. The list include but not limited to:
 - ❖ Waste and scrap of ferrous cast iron.
 - ❖ Timber from any wood grown in the partner states;
 - ❖ Fresh unprocessed fish (Nile Perch and Tilapia)
 - ❖ Wood charcoal

The Airport Service Charges Act, Cap 365

Introduction

The Airport Services Charges Act was imposed to cover charges for the passenger embarking aircraft at airport in Tanzania. It is applied to every passenger on every occasion on which he embark on an airport to begin a journey to continue with a journey to destination within or outside the United Republic of Tanzania.

Definitions of Key Terms

The following are some definitions of the key concept mentioned under this Act:

Airport: Means an area of land or water affording facilities for the take-off and landing of aircraft and appointed by the Minister to be an airport for the purposes of the Airport Services Charges Act;

Air transport undertaking: means an undertaking whose business includes the carriage by air of passengers for hire or reward.

Collection agent: means an agent appointed as agent under section 6 of the Airport Services Act,

Passenger: Does not include a member of the crew of the aircraft concerned, or of another aircraft owned, operated or managed by the same undertaking as owns, operates or manages the aircraft concerned, when on duty.

Imposition of the Airport Service Charge

Subject to section 4 of the airport service charge, provide for charge to be known as the air port service charge. The airport service charge is charged and is payable by:

Every passenger on every occasion on which he embarks on an aircraft at an airport to begin a journey, or to continue on a journey broken more than twelve hours prior to re-embarking, a charge to be known as airport service charge.

A passenger embarking on an aircraft at an airport within the United Republic who intends to travel to a destination within the United Republic shall pay an airport service charge of ten thousand shillings instead of instead of five thousand (These rates are subject to change in every Year's Finance Act).

Any passenger embarking on an aircraft at an airport within the United Republic who intends to travel to a destination outside the United Republic shall, whether or not a resident of the United Republic, pay in foreign convertible currency an airport service charge as shall be provided for in the Finance Act in year of Income.

The charge shall be a debt due to the Government and shall be paid prior to embarkation to a collection agent or to a revenue office appointed for that purpose.

Exemptions from the Airport Service Charge

Section (4) of this act provides exempt from liability to pay charge. The following individuals are exempted from paying the airport service charge:

Any child under the age of two years;

Any passenger embarking at an airport at which he is in transit: In accordance with the Act, a passenger is in transit at an airport if:

He disembarks at that airport from one aircraft and re-embarks there on the same or another aircraft; and between so disembarking and re-embarking he does not leave the airport; or he leaves the airport

where re-embarking is delayed for not more than twelve hours for technical reasons connected with the operations of the airline concerned or the aircraft to be used in continuing with the journey. A passenger, who pays the charge on the occasion of his embarking on an aircraft which returns to the airport of embarkation without first landing at any other place, shall be exempted from the charge on his embarking to resume his journey on the same or any other aircraft.

A passenger who embarks on an aircraft with accommodation for not more than five passengers for a journey for which neither the passenger nor any other person has paid any consideration for the passenger's carriage shall be exempt from the charge on the occasion of the embarkation.

Powers to Make Further Exemption

The Minister may, by order published in the *Gazette*, exempt any class of persons from the liability for the charge. The Permanent Secretary to the Treasury may, by order under his hand, exempt any person or persons from liability for the charge. An exemption under this provision may be granted generally or in respect of particular embarkations.

Appointment of Agents

Section 6(1) of the Act provides that every airline and every travel agent shall be an agent for the collection of the charge for an airport. The Minister may by notice published in the *Gazette* appoint such other collectors as he may deem necessary.

Collection of the charge and payment

In accordance with section 7 every agent shall collect the charge from all persons liable to pay the same upon the purchase of a ticket for air travel through an airport to any destination within or outside the United Republic, and shall remit to the Commissioner General on or before the last working day of the month following the month in which the collection was done. The Act further provide that every agent for an air transport undertaking shall collect the charge from all persons liable to pay the same while embarking at any airport in Mainland Tanzania in an aircraft owned, operated or managed by, or on charter to, that undertaking or the owner of that undertaking.

Penalty and Interest for Failure to Remit the Charge

Where a collection agent fails or neglects to remit the charges collected, within the period prescribed under the Act is liable to pay a penalty as provided for under section 78 of the Tax Administration Act 2015. When the charge remaining unpaid interest charge shall be determined as provided for under section 76 of the Tax Administration Act 2015. Other procedures on dealing with offences and non-compliance practices on the airport services Act are as provided for under Tax Administration Act 2015.

Issue of Receipt

Section 8 of the Airport Service Charge provides that every collection agent, and every servant or agent of a collection agent employed by the collection agent in that behalf, who collects the charge from a person liable to pay it shall; where such person is in possession of a ticket for the journey on which he is embarking, issue and attach to the portion of the ticket which is to be retained by the passenger a receipt in the prescribed form; and in any other case, issue a receipt in the prescribed form.

The Port Services Charges Act 1973 (Cap 264)

Introduction

The port services charge Act 1973 (Chapter 264) was imposed to cover charges for the passengers embarking on ships at ports. It is applied to every passenger on each occasion on which he embarks on a ship or a ferry, at a port in Tanzania.

Definitions of Key Terms

Port: Is an area of the sea or ocean which is partly enclosed by land or strong walls where ships load and unload goods or passengers. Examples of Ports include Dar es Salaam port, Mtwara port, Tanga port, Mwanza port, Bukoba port, and Bagamoyo port in Tanzania.

Charge: In this Act, means the amount of money paid by the passengers for the port service as imposed by section 3 of the Port service charge Act.

Collection agent: means an agent approved under section 6 to be the agent for the collection of the charge.

Ship: includes any vessel used for carriage of passengers.

The Port Service Act: is an Act to impose a charge upon passengers embarking on ships at ports.

Imposition of Port Service Charge

According to this section 3 of the Act, Port service charge shall be paid by every passenger on each occasion on which he embarks on a ship or a ferry, at a port in Tanzania. The port services charges are normally revised from time to time by the finance Act, but for the time being are as follows:

- ❖ For a journey to a destination within or outside the United Republic, a port service charge of five hundred shillings in the case of a resident;
- ❖ For a journey to a destination within or outside the United Republic, a port service charge of five US Dollars or its equivalent in convertible currency in any other case.

The charge shall be a debt due to the Government and shall be paid prior to embarkation to a collection agent.

Exemptions from Port Service Charge

The port services act provides for exemptions on some individuals. Section 4 of the act provides exemptions on passengers from liability to pay the port service charge;

- ❖ Any child under the age of two years;
- ❖ Any passenger embarking at a port at which he is in transit; a passenger is in transit at a port if he disembarks at such port from a ship and re-embarks on the same ship under the authority of the same ticket issued to him for the journey, prior to such ship's departure for a port outside the United Republic.
- ❖ Any passenger embarking on a ferry which plies at a distance of up to three kilometres from the port.

Power to Make Further Exemption

Section 5 of the port services charge Act provides that the Minister (Ministry of Finance) may, by order published in the Gazette, exempt any class of persons from the liability of the charge. The act also indicates that the Permanent Secretary to the Treasury may, by order under his hand, exempt any person or persons from the liability of the charge. An exemption may be granted generally or in respect of any particular embarkation.

Appointment of Agents

Section 6 of the port services charge act provides that the Minister may appoint any public officer or any other person to be the agent for the collection of the charge. Every ship owner or shipping agent shall be deemed to be a collecting agent appointed under section 6(1) for the port at which he operates.

Collection and Payment of Charge

Section 7 of the port services Act provides that every agent shall collect the charge upon the purchase of a ticket for ship travel through a port to any destination within or outside the United Republic. The amounts collected by way of the charge shall be remitted to the Commissioner General of Tanzania Revenue Authority on or before the last working day of the month following the month in which the collections were made.

Where a collection agent fails or neglects to remit the charges collected, within the period prescribed under the Act is liable to pay a penalty as provided for under section 78 of the Tax Administration Act 2015. When the charge and the penalty remaining unpaid interest charge shall be determined as provided for under section 76 of the Tax Administration Act 2015. Other procedures on dealing with offences and non-compliance practices on the port services Act are as provided for under the Tax Administration Act 2015.

Tanzania Motor Vehicle Act Cap 124

Introduction

The Motor vehicle tax registration and transfer Act of 1972 is an Act which imposes taxes and charges on registration of motor vehicles and transfer of motor vehicles from one owner to another. The Act is divided into two parts the first part deals with registration of motor vehicles and the second part deals with transfer of ownership of motor vehicles.

Definition of the key terms

Registration Tax: Means the tax imposed on motor vehicles upon registration.

Tax on Transfer: Means tax imposed on the motor vehicle upon transfer from one owner to another.

Transfer: Means any transaction whereby the property or any interest on property in the motor vehicle transferred from one person to another whether pursuant to any sale mortgage or any other arrangement whatsoever and whether or not such transfer is for any valuable consideration

Imposition of the motor vehicle registration and transfer act

The term imposition means a levy, fee or charge that is paid as a tax in respect of a motor vehicle registration or transfer of ownership. According to PART II of Motor Vehicle Act 2006 the charge of tax on Motor Vehicle has been imposed upon registration of the motor vehicles and PART III on transfer of motor vehicle.

Imposition of motor vehicle registration tax

Section 4(1) of the Motor Vehicle registration and transfer Act requires a tax to be imposed and collected on any motor vehicle or motorcycle on registration. The tax shall be paid as provided for under the 1st schedule of Motor Vehicle Act and is referred to as a motor vehicle registration tax.

Imposition of tax on transfer of motor vehicle

Section 7(1) of the Motor Vehicle Act requires the transfer tax to be imposed on the motor vehicles of any description other than tractors which is or has been registered under Road Traffic Act. Section 8 provides that there shall be charged, levied and collected a tax to be known as tax on transfer. The tax is imposed and payable by the transferee at the rate specified in the Second Schedule to the Act, upon the transfer of any motor vehicle to which the Motor Vehicle Act applies.

- ❖ In the case of a motor cycle, twenty-seven thousand shillings (sh. 27,000/=).
- ❖ In the case of a motor vehicle of carrying capacity of up to three tones, or sixteen passengers including the driver, the motor vehicle transfer tax shall be the tax payable in accordance with schedule below and in addition, thirty thousand shillings.

Exemptions on Motor Vehicle Registration Tax and Transfer Charges

Exemption on registration tax

The minister responsible for finance may if in his opinion it is in the public interest so to do by order published in the Gazette. The exemption may provide category or categories of motor vehicles for exemption from the registration tax imposed by the Act. The minister may also exempt any person or class of persons from payment of any registration tax in respect of any motor vehicle or any category or number of vehicles owned by that person or class of persons.

Exemption on Tax on transfer of motor vehicles

Section 10 of the Act authorises the minister for finance to exempt a category, a person or group of persons from paying transfer tax. The minister must be satisfied that it is in the public interest so to do, he must give an order and publish it in the government Gazette;

Powers of Licensing Authority

According to section 13 of the motor vehicle Act 1972 as amended it is lawful for licensing authority to refuse to register the motor vehicle or a transfer until the appropriate tax has been fully paid. The authority can call for any evidence by affidavit or otherwise in satisfying itself of the amount of tax payable and whether any vehicle, any person or any transaction is exempted from payment of any tax.

Payment of Registration and Transfer Tax

Section 14 of the motor vehicles act 1972 the licensing authority to whom any tax is paid under this Act shall give a receipt for it to the person paying the same. It is also provided that where any payment is made by cheque the licensing authority may refuse to give the receipt until after the cheque has been duly honoured for payment.

Penalties and Interest on Uncollected Tax and Offences

The provision on non-compliance practices on the Motor Vehicle Act are provided for under the Tax Administration Act 2015. However section 16 of the Motor Vehicle Act (Amendment of the Finance Act 2015) indicates that where a person is convicted of an offence under the Tax Administration Act with respect to tax payable under the motor vehicle Act, the court may in addition to any tax, penalty or fine imposed if the offence involves wilful non-payment or evasion of tax, may order that the motor vehicle in relation to which the tax was not paid or was evaded be forfeited to the United Republic.

The Vocational Educational and Training Act Cap 82

Introduction

The Vocational Education and Training Act were enacted by the Parliament in 1994 to guide the vocational education and training (VETA) system in Tanzania. The Act established the Vocational Education and Training Authority (VETA) as an autonomous government agency charged with an overall responsibility of coordinating, regulating, financing, providing and promoting vocational education and training in the country. The National Council Technical Education (NACTE) has the responsibility for coordinating regulating and accrediting technical skills providers. The Vocational Educational Authority is authorised to charge a levy known as the Skills and development Levy.

Imposition of the Skills and Development Levy

Section 4 of the vocational education and training Act provides that there shall be charged, levied, and payable to the Commissioner General at the end of every month, from every employer who has in his employment four or more employees, a levy to be known as the skills and development levy. The levy shall be the sum of money equal to six per centum of the total gross monthly emoluments payable by the employer to all his employees in respect of that month.

The Act further provides that amount to be included in gross monthly emoluments in relation to employees include: wages, salary, leave pay, sick pay, payment in lieu of leave, fee, commission, bonus, gratuity and any subsistence, travelling entertainment or other allowance paid to him by the employer in respect of his employment or service, and any amount so paid in respect of employment or services rendered by the employee in any month other than the month in which it is paid, shall be deemed to be emoluments in respect of the calendar month in which it is paid.

The levy imposed and paid pursuant to this Act, shall be an allowable deductions for the purpose of ascertaining the taxable income in accordance with section 11 of the Income Tax Act 2004

Exemption from the Skills and Development Levy

The skills and development levy under the Vocational Education and Training Act does not apply to the following entities:

- ❖ Government departments and to any public institution which is non-profit making and wholly financed by the Government
- ❖ Diplomatic Missions
- ❖ The United Nations and all its organisation
- ❖ International and other foreign institutions dealing with aid or technical assistance
- ❖ Training and Educational institutions
- ❖ Institutions of religious whose Employees are solely employed to administer places of worship, to give religious instructions or generally to minister religion
- ❖ Charitable organisations
- ❖ Central Government and local Government Authority
- ❖ Employment in farms.

Payment of the Skills and Development Levy (SDL)

The Act requires that every employer to pay the levy on or before the seventh day of every month to the Commissioner General the levy due in respect of the preceding month. Employers are required to calculate the actual amount and pay the amount to Commissioners General account to the respective Tax Region in which such employer is registered. The SDL payments shall be made in line with PAYE using the same bank-pay-slip. Employers are also required to prepare a monthly return and submit to the TRA office on or before the 7th day of the month following the month of payroll.

Applicable rates

The rate applicable for SDL is 5% of the total emoluments paid to all employees during the month. However, the applicable rate in Zanzibar is 4 %. The employees to be included are the permanent employees, part time employees, seconded employees, casual labourers etc.

Penalties and interest on uncollected Levy and Offences

The provision on non-compliance practices on the skills and development levy are provided for under the Tax Administration Act 2015. These include penalties and interest for late submission of return, late payment of levy, provision of false returns for SDL and others. Thus, section 76, 77,78, 79 and other sections of the Tax Administration Act, 2015 can be used by the Commissioner General on dealing with non-compliance practices on SDL.

The Stamp Duty Act 1972 (Cap 189)

Introduction

The Stamp Duty Act, 1972 came into operation on July 1, 1972. It replaced 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. Stamp Duty Act deals with charges on legal instruments for the purpose of authenticating them. A physical stamp or revenue stamp must be attached or impressed upon the document to denote that stamp duty have been paid before the document is legally effective. The instrument specified in the schedule to the Act, which are 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 the duty of amount that is specified or calculated in the manner specified in the schedule in relation to such instrument unless it is exempted.

Imposition of the Stamp Duty

Section 5 of the Stamp Duty Act specifies the persons to pay stamp duty. The stamp duty is payable by the person drawing, making, or executing the instrument.

Examples of such documents attracting stamp duty:

Lease Agreements. These documents are prepared and signed when you rent a property. Stamp Duty is calculated on the actual rent or market rent whichever is higher. The person who leases or rents the property (lessee or tenant) is responsible for paying Stamp Duty.

Acceptance to Option to Purchase / Sale & Purchase Agreements. These documents are prepared and signed when you buy or sell your property. Stamp Duty is payable on the actual price or market price whichever is higher. The buyer is responsible for paying Buyer's Stamp Duty. Where Seller's Stamp Duty is applicable, the seller is responsible for paying Seller's Stamp Duty.

Mortgages. These documents are prepared and signed when you obtain a loan from banks for your property purchase. Stamp Duty is payable on the loan amount. The person who obtains the loan (mortgagor) is responsible for paying the Stamp Duty on the mortgage document.

Share Transfer Documents. These documents are prepared and signed when you buy or sell shares. Stamp Duty is payable on the actual price or net asset value of the shares whichever is higher. The person who buys the shares (transferee) is responsible for paying Stamp Duty on the Share Transfer document. If you have a document that relates to more than one matter, it will be charged separately for each matter. This means that more than one set of Stamp Duty is to be paid on that document. Examples include: Sale and lease-back of property, Sale and buy-back of property, Lease with a contract for sale of fixtures and an instrument whereby more than one property is leased to the same tenant and where the terms and conditions for the lease of each of the properties are different

Administration of Stamp Duty and Time when instrument must be stamped

All chargeable instruments executed by any person in Tanzania Mainland must be stamped within thirty days of execution (S. 25 (a) and (b)). Once the document is signed and dated, Stamp Duty needs to be paid. Where any such instrument is brought to a proper officer for adjudication, it is supposed to be stamped within thirty days. The period from the presentation of the instrument to the proper officer until the notification to the person who presented it to the decision of the proper officer, is excluded in computing the stated period of thirty days; and every receipt, acknowledgement of a debt, promissory note and bill of exchange must be stamped on the date of execution or the date of the instrument. While, every chargeable instrument executed out of Tanzania

Mainland must be stamped within thirty days of its first arrival in Tanzania Mainland as provided in S. 26 (a) and (b) of the stamp duty act.

Exemptions on Stamp Duty

The exemption stipulated under the Act may be made by the Minister or by the Commissioner General of the Tanzania Revenue Authority.

Exemption by the Minister

Section 16 of the stamp duty Act of 1972 stipulates that the Minister may, by notice in the Gazette, exempt any chargeable instrument, or any category, class or description of such instruments, from stamp duty. Such exemption deems the instruments not chargeable.

Exemption by the commissioner general

Sections 17 of the stamp duty Act of 1972 stipulates that the commissioner General may direct or exempt stamp duty upon transaction or series of transactions which require a person to issue a number of chargeable instruments, payment by such person of such sum of money. Such sum shall be deemed to be compounded duty in respect of the instruments to which such order.

Examples of instruments exempt from stamp duty

Affidavit

- ❖ Affidavit or declaration in writing when made;
 - For the immediate purpose of being filed or used in any court or before an officer of any court; or
 - For the sole purpose of enabling any person to receive any pension or charitable allowance.
- ❖ Affidavit made for use before any Commission appointed by the President to hold an Inquiry.
- ❖ Statutory Declaration under section 89 of the Land Registration Act, or any Act amending or substituting that Act.

Agreement or Memorandum of Agreement

- ❖ Agreement or memorandum of an agreement
 - For or relating to the sale of goods or merchandise exclusively, not being a Note or Memorandum chargeable under No. 41
 - Made in the form of tenders to the Government for or relating to any loan.
 - Being a contract of service required to be made in writing by or under the Employment Act or the Merchant Shipping Act.
 - Made with the Government, the Community or any institution or corporation.
- ❖ Apprenticeship deed including every writing relating to the service or tuition of any apprentice, clerk or servant placed with any master to learn any profession, trade or employment.

Appraisalment or Valuation

- ❖ Appraisalment or valuation made for information of one party only, and not being in any manner obligatory between parties either by agreement or operation of Law.
- ❖ Appraisalment of crops for the purpose of ascertaining the amount to be given to a landlord as rent.

Bill of Lading

- ❖ Bill of lading when the goods therein described are received at a place within the limits of any port within the meaning of the Customs (Management and Transfer Tax) Act, and are to be delivered at another place within the limits of the same port.
- ❖ Bill of lading when executed out of Tanzania and relating to property to be delivered in Tanzania.

Bond

- ❖ Bond when executed by any person for the purpose of guaranteeing that the local income derived from private subscriptions to a charitable dispensary or hospital or any other object of public utility shall not be less than a specified sum per memorandum.
- ❖ Bail Bonds in criminal cases, recognisance to prosecute or give evidence, or recognisance for personal appearance or otherwise issued or taken by the police under the Criminal Procedure Act.

List of instruments subject to stamp duty as provided for under S.5 and the schedule to Stamp Duty Act

Instrument Description	Stamp Duty to paid
AFFIDAVIT, Including an affirmation or declaration in the case of persons by law allowed to affirm or declare instead of taking oath.	TSH. 500/=
AGREEMENT OR MEMORANDUM OF AGREEMENT	TSH. 500/=
AGREEMENT RELATING TO DEPOSIT OF TITLE DEEDS, HYPOTHECATION, PAWN OR PLEDGE,	TSH. 500/=
APPRAISEMENT OR VALUATION, made otherwise than under an order of the Court in the course of a suit:	TSH.500/=
Instrument of EXCHANGE OF PROPERTY	0.5% for the first TSH. 100,000/=, then 1% of value in excess of TSH. 100,000/=
LEASE, including an under-lease or sublease and any agreement to let or sublet:	1% of the annual reserved rent for lease of all durations
MEMORANDUM OF ASSOCIATION OF A COMPANY	TSH. 5,000/=
Instrument of PARTNERSHIP: (i) Where the capital does not exceed TSH. 10,000/=.	TSH. 1,000/=
(ii) Where the capital exceeds TSH. 100,000/= but does not exceed TSH. 1,000,000/=.	TSH. 2,000/=
(iv) In any other case. Dissolution of partnership.	TSH. 5,000/= TSH. 1,000/=
POWER OF ATTORNEY,	TSH. 500/=
TRANSFER (whether with or without consideration) (a) of shares in an incorporated company or other body corporate;	1% of the value of the shares approved by the Board
(b) of debentures whether the debenture is liable to duty or not;	1% 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% of the value of the shares approved by the Board.

The Road and Fuel Tolls Act 1985 (Cap 220)

Introduction

The Road and fuel Toll Act 1985 imposes and provides for the collection of tolls on the vehicular use of public roads, and for the matters related to Road and fuel tolls. The Act applies to all public roads in Tanzania. The Act also establishes a fund to be known as the Road Fund. The Fund is responsible for all monies collected as road and fuel tolls imposed on diesel and petrol, transit fees, heavy vehicle licenses, vehicle overloading fees, or from any other source at the rate to be determined by parliament from time to time. The Act further provides that at least ninety (90%) per cent of the money deposited in the fund shall be used for development, maintenance and emergency repair of classified roads and related administrative costs in mainland Tanzania in accordance with approved operational plans made.

Definition of key terms

The Road and Fuels Tolls Act provide some key terms which are worth noting in here for understanding it.

Classified road: means any public road including trunk roads, regional roads, urban roads and feeder roads;

Commissioner General: means the Commissioner General appointed under the Tanzania Revenue Authority Act.

Development: means the upgrading of a road to a new standard, including a new road or bridge construction, widening or rehabilitation of a road that has been left in poor condition for a long time; "emergency repair" means works required to open roads after a natural disaster;

Fuel: means petrol, whether super or regular, and diesel for use in the propulsion of a vehicle;

Road maintenance: means all works to preserve riding quality, road shape, drain, culverts, structures and bridges, spot improvement of bad spots to maintain accessibility; resealing, reshaping and regraveling;

Toll collector: means a collector of road and fuel toll;

Vehicle: includes every description of conveyance for the transport of human beings and goods.

Toll: are charges payable to the use of a bridge or road; also is a charge for long distance

Imposition of Road and Fuel Tolls

According to section 7 of the Road and Fuel Tolls Act provides that the road and fuel toll shall be paid by:

- ❖ Any person upon the purchase of fuel.
- ❖ The owner or driver of a vehicle bearing foreign registration upon passing a customs border post.
- ❖ The owner or driver of a vehicle carrying fuel in bulk upon passing a custom border post for use in Tanzania.
- ❖ Where the Minister determines pursuant to provisions of the act that in relation to any scheduled toll station other than a fuel filling station the road and fuel toll shall be paid upon a vehicle passing through a point along a public road or a public ferry within the scheduled toll station.

Exemption of the Road and Fuel Toll

Section 8 of the Road and fuel toll act provides that the minister may by the order published in the Gazette, exempt any person, body of persons or any vehicle or category of vehicles, from the application in relation to them of any of the provisions of this Act or the payment of any road and fuel toll, and such exemption may be general or restricted to any particular scheduled toll stations or periods, and may be on such conditions as the minister may impose.

Administration and Collection of the Road and Fuel Toll

Section 9 of the Road and Fuel Toll provides for the administration and payment of the road and fuel toll. The act requires for establishment of toll station or points at which the fuel and toll must be paid. Road and fuel tolls are payable upon sale of fuel and every bonded oil instilment shall be a station at which road and fuel tolls shall be paid and collected. The road and fuel toll is also payable by every vehicle crossing the border carrying fuel in bulk for use in Tanzania. The vehicle must stop at the paying point and the owner or person in charge of such vehicle shall pay the toll collector at that point the toll in respect of the fuel his vehicle is carrying. In case of the roads and fuel tolls

which are payable upon purchase of fuel, every filling station is a point at which road and fuel toll are paid and collected.

The act provides that every vehicle approaching and proceeding through a scheduled toll station other than a fuel filling station, must stop at the paying point in the station, and the owner or person in charge of that vehicle shall pay to the collector at that point the toll due and payable by him. In case of fuel filling station as paying points, every person purchasing fuel at the station shall be charged in respect of the fuel he purchases a sum of money combining the price of the fuel and collectable from him at that paying point. The toll shall be levied and paid in accordance with the rates prescribed in the First Schedule to this Act, and shall be paid each time a vehicle passes through the point within the scheduled toll station. Payment of the road and fuel toll in respect of vehicles bearing foreign registration are made in foreign convertible currency, on such rate as the minister, by order publishes in the Gazette.

Appointment of collectors of the Road and Fuel Toll

The Act provides that the Commissioner General is responsible for the administration and collection of the road and fuel tolls. For that reason the Act requires the Commissioner General to appoint such public officers to be toll collectors and assistant toll collectors who shall collect tolls at toll stations and perform such other functions and duties as may be specified by the Commissioner General. The Act further provides that every person or body of persons supplying fuel in bulk to a fuel filling station shall be toll collectors in relation to that station; and shall collect from the owner or operator in the fuel filling station the road and fuel toll payable in respect of the fuel he supplies to him together with the payment due to him for the supply of the fuel. The collector shall pay over the road and fuel tolls so collected to the Commissioner General in such manner as the Minister responsible for finance may prescribe from time to time. The amount of money subsequently realised as road and fuel toll by the owner or operator of a fuel filling station paid upon purchase of fuel by owners or drivers of vehicles shall be retained by such owners or operators of a fuel filling station as refund to for the money previously paid by him as road and fuel tolls to the toll collector.

Penalty and Offences

There are many non-compliance practices and offences on the Road and Fuel Toll Act which attract penalties and interest. Such non-compliance actions or practices include action done by any person who:

- ❖ Refuses to stop a vehicle at a toll station and to pay the toll.
- ❖ Fraudulently or forcibly drives a vehicle through a toll station or without paying the toll.
- ❖ Having collected any toll, the collector or agent fails or refuses to pay the toll to the Commissioner General or to any other authorised person.
- ❖ Sells or offers for sale, in an area in which roads and fuel tolls are paid upon purchase of fuel, any fuel in respect of which it is not required that any road and fuel toll be paid upon its purchase.
- ❖ Sells or offers for sale, in any area of Tanzania, any fuel upon the purchase of which road and fuel tolls are to be paid, without the road and fuel toll payable in respect of it having been previously paid, commits an offence and is liable, upon conviction, to a fine not exceeding five thousand shillings or to imprisonment for a term not exceeding six months, or to both such fine and imprisonment.
- ❖ And any other practices as may be determined by the Commissioner General.

The Road and Fuel Toll Act do not contains provisions for penalties, fines, and interests on non-compliance practices. The provisions on such non-compliance practices are provided for under part X of Tanzania Administration Act, 2015 (See for instance section 76-82 of the TAA, 2015).

The Hotel Levy Act, 1972 (Cap 105)

Introduction

The Hotel Act was enacted in 1972. The act has been revised from time to time as needs arise. The Act among other things provides for the establishment of hotels boards and the hotel levy. Under the establishment of Hotels Boards the Act provides the means through which the hotel board is established, appointments of members of the boards, powers of the board and other operational matters of the board. On the part of the hotel levy, the Act provides for the imposition of the levy, exemptions, payment procedures and other operational matters on the hotel levy.

Definition of key terms under the Hotel Act

Guest house: means any establishment intended for the reception of travellers or visitors, who may choose to stay in that establishment, and carried on with a view to profit or gain and includes:

- ❖ Any establishment which has accommodation for less than ten guests;
- ❖ Any such establishment which provides sleeping accommodation only or only in dormitories but have no regular meals.

Hotel: means any establishment intended for the reception of travellers or visitors who may choose to stay there and carry on with a view to profit or gain,

Hotel-keeper: means any person who is the holder of a valid license issued or deemed to be issued under the hotel Act.

Hotel levy" or "levy": means the hotel levy payable under section 26 or section 29 of the hotel Act.

Hotel charges: means the payment received, or deemed to have been received, by the hotel owner in consideration of the hotel accommodation occupied, or reserved for occupation, by any guest and breakfast, if any, and food if served to the guest.

Imposition of the hotels levy

Section 26 of the hotel act provides that every owner of a hotel or guest house shall pay, in respect of every guest, a levy of twenty per centum (20%) of the hotel charges. The levy must be paid by the owner in such manner and at any intervals which may be prescribed. The levy payable by a guest house owner shall be due to the Local Government Authority responsible for the area in question.

Exemptions of the Hotels Act

Section 25 of the hotel act provides that the minister responsible for Finance can exempt any hotel or guest house or class of hotel, owners from payment on a hotel levy in respect of any guest or class of guest house. The exemption must be made by order in the government gazette. The act further provides exemption under section 27 on VAT registered hotels or guest houses. This means that once the hotel or guest house is registered for VAT purposes the hotel levy does not apply.

Offences and Penalties

The hotel Act under section 32 provides for penalties for offences and non-compliance practices. The Act provides that where any owner of a hotel or guest house fails to pay the whole or part of the levy within the time prescribed or in the manner required by the regulation commits an offence. The

penalty is an additional levy equal to twenty five percent (25%) of the unpaid levy. This penalty (additional levy) is increased by 10% for every month (30 days) in which it remain unpaid.

Chapter Summary

This chapter has covered some selected tax laws in Tanzania other than the Income tax and the Value Added Tax. A brief discussion on selected tax laws in Tanzania has been made in order to give an overview of such taxes on their application and implications to the economy. The tax laws covered in this chapter are: The excise and Tariff Management Act; the Port Services Charges Act, the Airport Services Charges Act, the East African Customs Management Act, the Stamp Duty Act, the Vocational Educational and Training Act, and the Hotel Act. The key issues covered in this chapter can be summarised in the following points:

- ❖ The excise tax is a special tax on the sale, or production for sale, of specific goods or a tax on a good produced for sale, or sold, within a country or licenses for specific activities. Excise tax is considered as an indirect tax because the producer or seller who pays the tax to the government recovers or shift the tax by raising the price paid by the buyer.
- ❖ A manufacture of any excisable goods must be licensed by the Licensing Authority and must impose excise duty in according with Excise Management and Tariff Act, Capt 147. The duty must be paid on excisable goods manufactured by the licensee at the rates and in the circumstances specified in the Act.
- ❖ The East Africa Customs Management Act is an act for making provisions for the management and administration of customs and related matters. It covers all customs and port matters referring to loading and unloading of cargo or goods on aircraft, motor vehicle, ship or vessel and pipeline in an approved place such as quay, jetty, wharf or other place approved by the commissioner. Such places include customs airport, a dry port, a boarding station, and bonded warehouse.
- ❖ The East Africa customs management act further provides for common treatment of imports, exports and goods on transfer of East Africa Community Member States such as Tanzania, Kenya, Uganda, Rwanda, and Burundi.
- ❖ The Airport Services Charges Act covers charges for the passengers embarking aircraft at airport in Tanzania. It is applied to every passenger on every occasion on which he embark on an airport to begin a journey or to continue with a journey to destination within or outside the United Republic of Tanzania.
- ❖ The Airport services Act provides that every passenger on every occasion on which he embarks on an aircraft at an airport to begin a journey, or to continue on a journey broken more than twelve hours prior to re-embarking, must pay a charge to be known as airport service charge.
- ❖ The port services charge Act 1973 imposes charges for the passengers embarking on ships at ports. It is applied to every passenger on each occasion on which he embarks on a ship or a ferry, at a port in Tanzania. According section 3 of the act, Port service charge must be paid by every passenger on each occasion on which he embarks on a ship or a ferry, at a port in Tanzania. The port services charges are normally revised from time to time by the finance minister approved in the yearly finance acts.
- ❖ The port services act further provides that every agent shall collect the charge upon the purchase of a ticket for ship travel through a port to any destination within or outside the United Republic. The amounts collected by way of the charge shall be remitted to the Commissioner General of Tanzania Revenue Authority on or before the last working day of the month following the month in which the collections were made.
- ❖ The Motor vehicle tax registration and transfer Act of 1972 is an act which imposes taxes and charges on registration of motor vehicles and transfer of motor vehicles from one owner to

another. The Act requires a tax or charge to be imposed and collected on any motor vehicle or motorcycle on registration. The tax must be paid as provided for under the 1st schedule of Motor Vehicle Act and is referred to as a motor vehicle registration tax.

- ❖ In addition the motor vehicle tax registration and transfer act imposes tax on transfer of motor vehicles of any description other than tractors which is or has been registered under Road Traffic Act. The tax is imposed and payable by the transferee at the rate specified in the Second Schedule to the Act, upon the transfer of any motor vehicle to which the Motor Vehicle Act applies.
- ❖ The Vocational Education and Training Act were enacted by the Parliament in 1994 to guide the vocational education and training (VETA) system in Tanzania. The Act established the Vocational Education and Training Authority (VETA) as an autonomous government agency charged with an overall responsibility of coordinating, regulating, financing, providing and promoting vocational education and training in the country. The Vocational Educational Authority is authorised to charge a levy known as the Skills and development Levy.
- ❖ The vocational education and training act provides that, there shall be charged, levied, and payable to the Commissioner General at the end of every month, from every employer who has in his employment four or more employees, a levy to be known as the skills and development levy. The levy shall be the sum of money equal to six per centum of the total gross monthly emoluments payable by the employer to all his employees in respect of that month. The amount to be included in gross monthly emoluments in relation to employees include: wages, salary, leave pay, sick pay, payment in lieu of leave, fee, commission, bonus, gratuity and any subsistence, travelling entertainment or other allowance paid to him by the employer in respect of his employment or service.
- ❖ The Stamp Duty Act, 1972 came into operation on July 1, 1972 to deals with charges on legal instruments for the purpose of authenticating them. A physical stamp or revenue stamp must be attached or impressed upon the document to denote that stamp duty have been paid before the document is legally effective. The instrument specified in the schedule to the act are charged with the duty of amount that is specified or calculated in the manner specified in the schedule to the act in relation to such instrument unless it is exempted.
- ❖ The stamp duty is payable by the person drawing, making, or executing the instrument. Examples of instruments subject to stamp duty include: lease agreements, sale and purchase of property agreements, mortgage agreements, purchase of shares and transfer of shares documents, loans agreements, etc.
- ❖ The Road and fuel Toll Act imposes and provides for the collection of tolls on the vehicular use of public roads, and for the matters related to Road and fuel tolls. The Act applies to all public roads in Tanzania. The Act also establishes a fund to be known as the Road Fund.
- ❖ The Road and Fuel Tolls Act provides that the road and fuel toll shall be paid by; Any person upon the purchase of fuel; the owner or driver of a vehicle bearing foreign registration upon passing a customs border post; the owner or driver of a vehicle carrying fuel in bulk upon passing a custom border post for use in Tanzania.
- ❖ The Hotel Act was enacted in 1972 to deal with among other things the establishment of hotels boards and the hotel levy. Under the establishment of Hotels Boards the act provides the means through which the hotel board is established, appointments of members of the boards, powers of the board and other operational matters of the board. On the part of the hotel levy, the act provides for the imposition of the levy, exemptions, payment procedures and other operational matters on the hotel levy.
- ❖ The Hotel Act under section 26 provides that every owner of a hotel or guest house shall pay, in respect of every guest, a levy of twenty per centum (20%) of the hotel charges. The levy must be paid by the owner in such manner and at any intervals which may be prescribed. The

levy payable by a guest house owner shall be due to the Local Government Authority responsible for the area in question.

End of Chapter Fifteen Revision Questions

1. Describe the meaning of Excise tax.
2. Mention at least four products or goods upon which the Excise Management and Tariff Act imposes tax.
3. Distinguish between excise tax and customs tax.
4. What does it mean by customs duty?
5. Why do governments impose customs duty on imports and exports?
6. Provide a brief description of the scope of the East African Customs Management Act, 2004.
7. With examples distinguish between prohibited and restricted trade as per the East African Customs Management Act 2004.
8. Identify the persons upon whom the Airport Services charge is imposed and persons who are exempted.
9. Describe how the Airport Services Charges collected by the commissioner general
10. Describe the term port as defined under the Port Services Charge Act cap 264.
11. Identify the persons upon which the Port Services Charges Imposed.
12. Describe the procedures for the appointment of the collecting agents of the port services charges.
13. What do you understand by the term registration tax as applied under the Tanzania Motor Vehicle Act cap 124?
14. The Motor Vehicle Registration and Transfer Act cap 124 imposes two components of charges, namely the motor vehicle registration tax and motor vehicle transfer charges. Describe how the two are imposed.
15. Identify the persons or motor vehicle exempt under the Tanzania Motor Vehicle Registration and transfer act cap 124.
16. Describe the procedures on which the Skills and Development Levy is imposed as per Vocational Education and Training Act cap 82.
17. Provide examples of persons exempt on the Skills and Development Levy.
18. Describe the procedures for the payment of the Skills and Development Levy.
19. Describe what you understand by the stamp duty.
20. Describe the imposition and the exemption of the stamp duty as provided for by the Stamp Duty Act cap 189.
21. Describe items or persons upon which the Road and Fuel tolls Act imposed.
22. Describe how the Road and Fuel toll administered and collected.
23. Describe how the Hotel levy is imposed as per the Hotel Act cap 105.
24. Identify person exempt under the Hotel Act cap 105.

CHAPTER SIXTEEN

LOCAL GOVERNMENT AUTHORITIES' FINANCES

Introduction

Article 146 (1) of the Constitution of the United Republic of Tanzania (1977) provides that the purpose of having Local Government Authorities (LGAs) is to transfer authority to the local people. LGAs have been given power to participate and to involve the people in the planning and implementation of development programmes within their respective areas of jurisdictions. In order to accomplish their economic and social obligations LGAs need funds. Most of the funds come from either the central governments in form of grants or own sources in form of taxes, levies and charges. This chapter deals with the administration of major sources of income for LGAs. The sources of income dealt within the chapter include: Local rates, business licenses fees, local fees and charges, fines and penalties applicable in Local Government Authorities in mainland Tanzania.

Learning Outcome

After successful completion of this chapter readers should be able to:

- ❖ Identify the Legal Aspect of Tax Revenue Mobilization in LGAs
- ❖ Describe the major sources of LGAs revenue from own sources and central Government.
- ❖ Explain the collection methods applicable to the approved local rates, business licenses fees, local fees and charges, penalties and fines among LGAs in Tanzania.

Legal Aspect of the Local Authority Rates, Charges and Fees

The legal documents to be referred to in respect of local rates and non-tax revenue mobilization in LGAs in Tanzania include the following:

- i) *The Constitution of the United Republic of Tanzania 1977*
Article 145, which requires among other things, the enactment of legislation providing for sources of revenue for local government authorities.
- ii) *The Local Government Finances Act No.9 of 1982*
Part II of the Act deals with funds and resources of local government authorities and Part III deals with making of rates and collection of (Property Tax) rates.
- iii) *The Urban Authority Rating Act No.2 of 1983*
It empowers urban local government authorities to levy rates on immovable property and prescribes procedures to be followed.
- iv) *The Local Government Finances Act and the Local Government (Block Grant) Regulations*
set out operational procedures for Block Grants.
- v) *The Local Government Finances Act and the Finances Act 2004.*
- vi) *The Local Authority Financial Memorandum 2009.*

Major Local Rates in Tanzania

The introduction of new sources and changing of the rates of charge, can only be effected after the local authority has passed a by-law to that effect. The procedure for passing the by-law is as follows: A notice to the citizens to make a by-law is made by the Local Authority; consideration of any objections raised; By-law passed by resolution of the Local Authority Council; Approval of by-law by the Minister responsible for local authorities and; Implementation of the by-law by the respective local authority. There are several local rates imposed by LGAs in Tanzania. This section describes the nature and collection procedures and administration of some of these local rates.

Service Levy

The service levy is an important revenue source for local government authorities especially the urban local authorities. It is a turnover consumption tax imposed on the total turnover of all corporate bodies. The levy is currently set at 0.3% of the turnover of producers with turnover in excess of Tsh.20 million per annum.

Collection Methods:

Industrial or Service levy can be collected in any other three ways, namely direct remittances by taxpayers; Agency by TRA as this has in hand the necessary tax data; or by LGAs own collectors or agents;

Tax Administration of Service levy in LGAs:

This is concerned with the implementation of fiscal policy that is the process of identification and registration of taxpayers; Assessment of taxes; Collection mechanisms, and Enforcement. Good tax administration requires that everyone pays the right amount and that; All tax revenues should be properly brought to account by those who collect it. Strategies for enhancing revenue collection from the service levy include: Identification and registration of taxpayers, creation of awareness to taxpayers, creation of service levy register for all taxpayers liable under service levy, seeking information about turnover from each business entity, and proper internal control on collection and recording.

Local Authority Business Licenses, Fees and Permits

Local Government Authorities derive a substantial amount of money from business license, fees, and permits. The revenue derived from the local business license and permits help to finance the operations such as health, education, water, security and local infrastructure of Local Governments in Tanzania. They are also used as regulatory mechanism on local business activities. The legal framework for imposing fees on local business licenses and permits is derived from several Acts including the Business Registration Act 1972; Business Licensing Authority 1972; The Public Finance Act 2012; 2014, and the Local Government Finance Act 1982. LGAs charge license and permit fees on a number of transactions and activities. These include but not limited to; namely Market Fees, business license fees, construction permit, extraction of construction material and transportation. Some of the examples of license fees are presented here below.

Business License Fees

Local government authorities derive some of their revenues from license fees. Some of the licenses include: Business License; Intoxicating Liquor License; Tax and pick up licenses; Street vending and hawking license; Road License.

Other License Fees

LGAs impose and issue license fees on activities, including: Hunting license; Scaffolding license; Forestry products license; Tax, pick up and lorry license; Fisheries license; Dog license; Livestock license.

Property Rates

The property taxes are one of the major sources of government revenues in Tanzania. This The Local Government Finances Act No.9 of 1982 empowers a local authority to levy a rate based on the value of immovable property situated within its area of jurisdiction. On the other hand, the

Urban Authority Rating Act No.2 of 1983 empowers urban authorities to levy rates on immovable property and also sets the procedures to be followed in doing so. In utilising these legal provisions, local authorities have to enact by-laws on the basis of which they can levy taxes.

Administration of Property Rates:

The first step in instituting property rate is to identify the properties to be taxed and creating a properties register. Normally, the rate is imposed on all types of properties – commercial, industrial, institutional and residential. For tax purposes property valuations are carried out and valuation roll prepared. Valuation may be based on several methods, including; Market values, Replacement Cost methods, Annual Rental Value; Capital Value; Site Value, Artificial Basis of Computer Aided Mass Appraisal.

Assessment Procedures:

Assessment of property rates starts with valuation of all properties in the LGAs. The activity is conducted with professional valuer engaged or employed with LGAs. Once valuation of all rateable properties has been made and the relative value of each property known and put in record, the next step is to set a rate. This is done by applying a tariff that is a percentage to a valuation or rateable value.

Billing: Once the amount of tax to be paid by each property owner is known, bills are prepared and delivered to the taxpayer by the most reliable method. Also proper records have to be maintained for all bills sent out.

Enforcement Mechanism

The enforcement procedures are those within the law and include: confiscation on goods; Imprisonment of taxpayer; Attachment of rents; Charge of property; Seizure and sale of premises; Interest on late payment.

Strategies to Enhance Performance in License and Permits

In order to improve revenue performance for fees and licenses, every local government authority takes action on the following:

- Improve administrative capacity (Training) on assessing revenue base (Businesses, construction and extraction activities in the LGA).
- Ensure accurate collection and maintenance of up to date revenue data for each source of revenue (Maintain registers for each group of licenses and permits).
- Review revenue sources and revenue yields often to see whether it is growing or declining (trend analysis)
- Use comparative data between periods as well as between other local authorities of the same size (cross section analysis).
- Ensure that the system of assessing and collection of fees minimizes incidents of corruption and embezzlement of revenues (computerisation of such processes).
- Consider outsourcing revenue collection to private collectors to increase revenue from existing sources.
- Ensure existence of enforcement mechanisms to enforcement sanctions.

Local Fees and Charges

Fees and charges are the amount of money a service user pays for service provided by LGAs. The fee and charges are set in line with the amount it costs to provide that particular service. Local Government Authorities derive some amount of money from local fees and charges. The revenue derived from the local fees and charges assists LGAs in financing the operations such as health,

education, water, security and local infrastructure of Local Governments in Tanzania. The legal framework for imposing local fees and charges is derived the Local Government Finance Act 1982 and other government orders and guidelines issued by the Ministry of Finance. The revenues are derived from market fees and charges, sanitation fees and charges, and specific services. Specific examples of local fees and charges are: Sanitation fees; Sewerage system cleaning; health check-ups and inspections to service providers e.g. in hotels, butchers, shopkeepers, bars, and guest house; Bus stand fees, abattoir fee (Slaughtering animals), Auction mart (especially on animal markets), tender fees, clean waters service fees, School fees, Billboard fees, building minerals charges (sand and gravels) and others.

Local fees and charges are applied if it is possible to measure the consumption level of individuals or individual' households. In practice, fees and charges are usually imposed for one or more of the following reasons:

- A service may be a public or private good, but because it cannot be provided to all it is only fair to charge those who benefit from it.
- A service may involve an expensive or scarce resource requiring public consumption needs to be disciplined.
- There may be wide variations in individual consumptions, which relate more to choice rather than need.
- A service may be utilised for profitable commercial operations as well as the satisfaction of individual domestic needs.

Other sources of revenue in LGAs

Fines and Penalties

Fines and penalties are the amount derived from fines and penalties imposed on individuals and businesses for failure to comply with local rates, by-laws and/or other regulations. The revenues collected from fines and penalties are used to finance LGAs activities. LGAs also raise income through sale of properties owned by LGAs, renting of LGAs properties and buildings. Income can also be generated by letting facilities such as social halls, equipment, and social grounds.

The legal framework for imposing fines and penalties is derived in the Local Government Finance Act 1982 and the specific local rates by-laws which provide for specific penalties and fines for non-compliance.

Properties, Goods and Services

LGAs can also raise revenue by letting its own properties, Goods and Services. Revenue performance for income from LGAs investments such as on property, facilities, goods and services owned and administered by LGAs can be enhanced greatly if there are known renting and charging policies in place. Administratively revenue performance can be enhanced by:

- Preparation of policies on the letting/renting procedures and rates chargeable to the properties, Goods, facilities and services rendered by the LGA.
- Identifying and maintaining register for all LGAs investments assets such as premises/properties, facilities, goods and services.
- Maintenance of registers of users/customers of LGAs investment assets.
- Maintaining proper records for rent revenues received in a specified period of time (monthly or quarterly)
- Reviewing rates on rent to take into account changes in circumstances and inflation.

- Simplification of modes of payments, e.g. introducing electronic payment systems such as Maxi-malipo, and mobile phones.
- Improving revenue administration capacity (competent staff, equipment etc.).
- Proper internal controls on payments and recording of revenues.

Central Government Transfers/Grants and Donor Funds

Central government makes resources allocation to LGAs in form of grants or subsidies. These are appropriations from the central budget. They involve a transfer of cash although they may also involve the services of seconded staff or supplies from centrally purchased supplies. In addition to central government grants LGAs also get substantial amounts of money from donors and other development partners in order to expand services in particular areas which are seen as beneficial by the Central Government.

Types of Government Grants

The Government of the URT administers two types of grants, namely grants to finance sector services covering education, health, roads and water. The other type of grant is the Local Government Capital Development Grant which includes sector grants and capital development grant.

Grants to Finance Sector Services

Local authorities depend on almost a 100% grant to finance social services (education, health, water and sanitation) thus making them excessively dependent on the central government funding.

The grants earmarked to finance the social sectors are based on horizontal allocation formula as follows: *Education*: 100% based on the number of school aged children. The allocation of education grant pool is thus distributed among local authorities 100% in proportion to the number of school-aged children in each local authority. *Health*: 70% of the health grants pool is distributed to LGAs in proportion to population. 10% is distributed in proportion to the estimated number of the official medical vehicle route in a district (providing more resources to rural districts). Ten per cent is distributed in proportion to the estimated morbidity count in each LGA.

The Local Government Capital Development Grant (LGCDG) System

The Government administers Local Government Capital Development Grant (LGCDG) System which provides discretionary development funds to LGAs. For LGAs to qualify for funding under this system they must meet stringent minimum conditions (MC) and a set of minimum performance indicators. There are two grants within the LGCDG namely: The Capacity Building Grant (CBG) and the Capital Development Grant (CDG).

Donor Participation in LGAs

Donors work closely with the key local actors in addressing poverty reduction outcomes. Donors use the existing agreed national systems and processes to provide additional financial, technical and other support in the implementation of the poverty reduction strategy geared to achieve the Millennium Development Goals. They facilitate capacity building initiatives within the poverty reduction framework and participate in monitoring and evaluation.

Requirements to Access Donor Participation

Donor participation may be through either: Budget support under the Basket Funding Arrangements/System and/or; Specific programmes under vertical programmes. For an LGA to benefit from donor participation, it must provide evidence that:

- It is capable to raise the required counterpart funds which are normally 5% under the LGCDG system.
- The project being funded will generate sufficient revenues to meet the associated Operation and Maintenance (O& M) costs or alternatively.
- The LGA will be able to finance the O&M costs through taxes and/or user charges.
- The submission of a Funding Proposal.

Chapter Summary

LGAs have been given power to participate and to involve the people in the planning and implementation of development programmes within their respective areas of jurisdictions. Most of the funds for accomplishing the LGAs activities come from either the central governments in form of grants or own sources in form of taxes, levies and charges. This chapter has covered the tax sources of income for LGAs. The sources of income that have been covered in the chapter include: Local rates, business licenses fees, local fees and charges, fines and penalties applicable in Local Government Authorities in mainland Tanzania. We summarised the key issues in the chapter in the following points:

- ❖ Local Government Authorities derive a substantial amount of money from levies, business license, fees, and permits. The revenue derived from the local business license and permits help to finance the operations such as health, education, water, security and local infrastructure of Local Governments in Tanzania. They are also used as regulatory mechanism on local business activities.
- ❖ The legal framework for imposing fees on local business licenses and permits is derived from several Acts including the Business Registration Act 1972; Business Licensing Authority 1972; The Public Finance Act 2012; 2014, and the Local Government Finance Act 1982. LGAs charge license and permit fees on a number of transactions and activities. These include but not limited to; namely Market Fees, business license fees, construction permit, extraction of construction material and transportation.
- ❖ The service levy is an important revenue source for local government authorities especially the urban local authorities. It is a turnover consumption tax imposed on the total turnover of all corporate bodies. The levy is currently set at 0.3% of the turnover of producers with turnover in excess of Tsh.20 million per annum.
- ❖ The property taxes are one of the major sources of government revenues in Tanzania. The Local Government Finances Act No.9 of 1982 empowers a local authority to levy a rate based on the value of immovable property situated within its area of jurisdiction.
- ❖ Local government authorities impose license fees on several activities. Some of the licenses include: Business License; Intoxicating Liquor License; Tax and pick up licenses; Street vending and hawking license; Road License. Other license fees are on activities, including, hunting license; Scaffolding license; Forestry products license; Tax, pick up and lorry license; Fisheries license; Dog license and Livestock license.
- ❖ Fees and charges are the amount of money a service user pays for service provided by LGAs. The fee and charges are set in line with the amount it costs to provide that particular service. Examples of local fees and charges are: Sanitation fees; Sewerage system cleaning; health check-ups and inspections to service providers e.g. in hotels, butchers, shopkeepers, bars, and guest house; Bus stand fees, abattoir fee (Slaughtering animals), Auction mart (especially on animal markets), tender fees, clean waters service fees, School fees, Billboard fees, building minerals charges.
- ❖ The legal framework allows LGAs to imposing fines and penalties (The Local Government Finance Act 1982). LGAs enact specific local rates by-laws which provide for specific penalties and fines for non-compliance.
- ❖ LGAs can also raise revenue by letting its own properties, Goods and Services. This may include stadiums, conference halls, grounds, social hall, plant and machinery etc.
- ❖ LGAs receive grants/subventions from central government. These are appropriations from the central budget. They involve a transfer of cash although they may also involve the services of seconded staff or supplies from centrally purchased supplies.
- ❖ LGAs also get substantial amounts of money from donors and other development partners in order to expand services in particular areas which are seen as beneficial by the Central Government.

End of Chapter Sixteen Revision Questions

1. Identify and discuss the major sources of revenues among LGAs in Tanzania.
2. Identify the major Laws governing revenue collections in LGAs and discuss the extent to which the tax by-laws formulation process in LGAs is participatory.
3. Explain why LGAs impose local rates, business license and permit fees in their areas of jurisdictions.
4. Discuss how outsourcing has improved or limited the mobilization of business license and permit fees in LGAs.
5. Discuss the strategies used by LGA to improve the revenues from business licenses fees and permits.
6. Identify the major local fees and charges imposed by LGAs. Discuss their operational successes and challenges.
7. What are the criteria used in the setting of local fee and charges in LGAs?
8. Discuss the strategies used by LGA to improve the revenues collections from local fees and charges.
9. Explain why local authorities impose fines and penalties to taxpayers in their areas of jurisdictions.
10. Identify the major types of investments incomes in LGAs. Discuss their operational successes and challenges in collecting rent income on LGAs properties, facilities, social facilities, grounds and others.
11. Discuss the extent to which the narrow local rate base in most LGAs has limited the growth of revenue mobilization.
12. Discuss the strength and weaknesses of outsourcing in revenue collection in LGAs in Tanzania.
13. Identify and discuss the major factors limiting the maximization of revenue collection in LGAs. What are the possible remedial actions?
14. What are the potential benefits of the participatory approach to By-laws preparation and implementation in LGAs?

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TEST PAPERS

Test paper 1

SUBJECT: PUBLIC FINANCE AND TAXATION

INSTRUCTIONS:

1. THERE ARE FOUR QUESTIONS IN THIS PAPER
2. ANSWER ALL FOUR QUESTIONS
3. CALCULATORS MAY BE USED IN ANSWERING THE TEST PAPER
4. TIME ALLOWED IS THREE (3) HOURS.

QUESTION ONE (20 MARKS)

- a) Discuss the economic functions of the government (allocation function, distribution function and stabilisation function) (10 MARKS)
- b) With examples in Tanzania context discuss how government policies influence the GNP and the NI (National Income) of a country. (10 marks)

QUESTION TWO (20 MARKS)

Mr. OKEYO is employed by International School of MOROGORO from 1.1.2008. The following terms, conditions and particulars relate to his employment during the year of income 2013:

- (vii) His salary per month is Tsh.1,300,000
- (viii) He was entitled gratuity equivalent to 25% of his basic salary for each successful completed year of service
- (ix) The School provided him with the following benefits:
 - Free use of school's motor vehicle, bought six years ago (Toyota Corolla, 1000cc). The Commissioner General for Income tax has accepted three quarters of the use as representing free use of the car
 - One night security guard who is on the school's payroll at monthly wage of Tsh.250,000
 - Electricity, gas, telephone and water bills amounting to Tsh.300,000 p.a. All these benefits were paid directly to the utility companies since they were addressed to the name of employer
 - A residential house for the whole year for which he paid a token rent amounting to Tsh.10,000 per month. It is estimated that the market rental value of this house is Tsh. 160,000 per month.
- (x) Other sums met by the employer during the year included:
 - Tsh. 50,000 per month as entertainment allowance. He however was not required to account for the amount
 - Monthly duty allowance dhs.120,000
 - He was given Tsh.30,000 per month to meet his traveling expenses. He was spending about 25% of such for performing his official duties
 - Free medical services under the arrangement that required the employer to pay medical bills for Mr. OKEYO, his wife and up to four children. For the year of income 2013, this bill amounted to Tsh. 300,000.
 - Tsh. 130,000 per month to an insurance company for policy covering his life.
- (xi) He had two children who are enrolled at the same school. During the year, the school subsidised the school fees and board expenses of the two children amounting to Tsh.2,000,000 in total

- (xii) After successful of year 2013, his contract was not renewed due to employer's financial crisis. To this effect, he was paid a lump sum of Tsh.2,000,000 as compensation

Required:

Calculate the total taxable income for Mr. OKEYO for the year of income 2013 and tax liability if his tax bracket is 25% (20 MARKS).

QUESTION THREE (20 MARKS)

M/s Quality Builders Enterprise is a partnership of three professional building contractors. On 1st January 2016, there were three partners namely Abdi, Bernard, and Charles sharing profits or losses in the ratios 3:1:1 respectively. The partnership's income and expenditure for the calendar year 2016 showed a net profit of 555,820,000/= as given below. The firm closed its first twelve months accounts on 31st December 2016.

Quality Builders Enterprise

Income and Expenditure Account for the year ended 31st December, 2016

Cross contract income		Tsh. 642,000,000
Profit on sale of motor vehicle		800,000
Interest (1)		<u>600,000</u>
		643,400,000
Less:		
Salaries to partners@ 12 M/= p.a.		Tsh. 36,000,000
Interest on capital		
Abdi	4,000,000	
Bernard	3,000,000	
Charles	2,000,000	9,000,000
Interest on loan – Charles (commercial rate)		5,600,000
Life insurance premiums to partner's life policies		30,000
Depreciation on assets		1,750,000
Partnership office rent		720,000
Motor vehicle expenses (2)		2,500,000
Commission – Bernard		3,600,000
Staff salaries, labour costs		20,000,000
Supplies and materials		6,000,000
Sundry expenses (3)		2,015,000
Telephone, Telex, Postage		350,000
Electricity and power (4)		<u>15,000</u>
Net Profit		<u>87,580,000</u>
Notes		<u>555,820,000</u>

- Interest
 - Savings account..... 200,000
 - Fixed Deposit..... 400,000
 - 600,000
- Motor vehicle expenses
 - 25% relates to private use and benefits of the partners
- Sundry expenses
 - The amount includes:-
 - Cost of a pick -up for the chairman of the Tender Committee Tsh. 2,000,000. This was a necessary cost in order to secure a vital contract for the firm

- Tax consultant's fee for a successful appeal against estimated 2015 assessment issued on the partners for late filing of their return of income Tsh. 15,000
- Electricity and power Tsh. 5,000 relates to electricity bills paid for partners' private residence and 50,000 private telephone calls for partners

Required:

Determine the taxable income and tax liability of each partner assuming a tax bracket of 20% is applicable to the partners. (20 Marks)

QUESTION FOUR (20 MARKS)

UBENA Hotel (T) had constructed a modern eleven-storey tourist hotel building for 800mill/=. The construction of this hotel was completed on the 31.12.2015, and it was formally opened and certified by the Minister for Finance on the 1.1.2016, when it started operating at full capacity.

In addition to the main building, the hotel had during the same time constructed:

- A car park adjacent to the hotel structure for 30,000,000/=
- A swimming pool for 17,000,000/=
- Small huts for 21,000,000/=

These were used from the same date as the main hotel building

The hotel had the following assets, which were used from the day of its inception:

- Automatic laundry machine, installed in the basement for 12,000,000/=
- A cold storage plant for 20,000,000/=
- An air-conditioning plant for 22,150,000/=
- Cookers and other permanent kitchen wares 18,000,000/=
- Mobile serving wheel trays 2,800,000/=
- Cups, tools and other implements for 8,000,000/=
- Furniture 99,000,000/=

To keep the small huts clean three mowers costing 5,000,000/= each were purchased

In addition, during the year 2016, the hotel acquired and used the following:

- A Scania bus (35 seats) for 260,000,000/=. This was purchased on the 2nd April, but was used from the 1st of June
- A second hand delivery van was purchased for 5,900,000/= during May
- A new Rolls Royce for the General Manager was acquired for 180,000,000/= which was wholly used for business. The company also purchased a Range Rover for 140,000,000/=. this was used for the Hotel Accountant while on duties.
- In order to encourage the hotel industry, and hence tourism, the Ministry of Tourism awarded a hotel a twin otter aircraft, which was purchased for 1,700,000,000/=. The company incurred additional expenditure of 140,000,000/ to make the aircraft operational.
- Zilipendwa Orchestra was officially inaugurated on the 15th July 2016. This was solely for the entertainment of the hotel guests in UBENA Hotel. The music instruments had cost the hotel 21,000,000/=

As a control against frequent power cut by TANESCO, a generator was purchased for 20,000,000/= during August. This was installed in the hotel on 15th August 2016.

The General Manager's Rolls Royce was sold on 10.11.2016 for 50mill/=

Required:

Calculate depreciation allowance admissible to UBENA Hotel (T) under the 3RD Schedule of ITA 2004 for the year of income 2016.

QUESTION FIVE (20 MARKS)

Kujajili Co. Ltd deals with Garments and was registered for VAT since July, 2010. For the calendar year 2015 the company accurately lodge the respective VAT returns up to October 2015. However, the return for November 2015 to April 2016 was all submitted on 1st May 2016. The VAT due for each month was as follows.

Month	Tsh.
November, 2015	8,000,000
December, 2015	16,000,000
January, 2016	20,000,000
February, 2016	24,000,000
March, 2016	NIL
April, 2016	28,000,000

- Specify the due date for each return
- Calculate the total penalty due.
- Calculate the total interest on unpaid tax (Assume the BoT statutory rate of interest is 12% p.a)

Test paper 2

PUBLIC FINANCE AND TAXATION

INSTRUCTIONS:

- THERE ARE FIVE QUESTIONS IN THIS TEST PAPER
- ANSWER ALL FIVE QUESTIONS
- CALCULATORS MAY BE USED IN ANSWERING THE PAPER

QUESTION ONE (20 MARKS)

a) In most countries taxation are very much unpopular. This notwithstanding most governments are compelled to impose them?

Required:

i. Identify various reasons as to why the Tanzania Government is compelled to impose tax on its citizens (5 MARKS)

ii. For each reason so identified above explain: (5 MARKS)

- The tax which is used to achieve the stated objective
- How such a tax is expected to achieve the identified reason

b) Professor PAYE was employed as a full time lecturer at KULIPAHARI University in Tanzania. During the year of Income 2016, he was provided the following facilities:

- Fully furnished house with a market rental of 500,000 p.m. The employer claimed Tsh. 350,000 p.m. as maintenance cost of the premises. However, he was contributing 2% of his salary as rent p.m.
- A Tsh. 50,000,000; 5 years loan at an annual rate of 7%. Monthly equal repayments instalment of the loan was 1,000,000/=
- A brand new car with a capacity of 3000cc for both private use and University purposes in the ration of 3:4 respectively.
- The university contributed 20% of his salary to an unapproved pension fund of HINDU MENDAL, and he was contributing 5% to the same scheme.
- His salary scheme indicated that for the first three months of 2016 Tsh., 5,000,000 p.m. and to be increased by 5% after every 3 months. (Assume that the BOT interest rate is 17% p.a, the employer claimed maintenance costs of the car)

Required:

Compute the taxable employment income of Professor PAYE for year 2016 (10 MARKS).

QUESTION TWO (25 MARKS)

- Explain the general principal of “ Whole and exclusively incurred for business” as used in determining business income for tax purposes (5 marks)
- KIONGOZI Company Limited was incorporated in Tanzania and commenced its business on 1st January 2016 as retailer of audio- visual products in Tanzania. It has drawn up its first accounts to December 2016, the draft of which together with the additional information was as follows:

	Notes	TZS “000”	TZS “000”
Sales	1	950,000	
Dividends	2	5,000	
Interest income	3	12,000	
Contractual penalties	4	5,000	972,000
Expenses:			
Directors fees	5	320,000	
Salaries		300,000	
Interest expenses	6	80,000	
Rent and rates		220,000	
Legal and professional fees	7	20,000	
Contributions to retirement fund	8	15,000	
Depreciation	9	120,000	
Travelling and entertainment		22,000	
Provisions	10	28,000	
Insurance		18,000	
Sundries	11	10,000	(1,153,000)
Profit/ (Loss) for the year			(186,000)

Additional notes:

- Sales figure includes TZS 1 million for sale of furniture which was used by the company.
- The company had bought some shares from City Stock Exchange. These were shares of Sungura Cement Company which distributed dividends during the period.
- The company earned TZS 8 million as interest from its bank deposits and another TZS 4 million from a director to whom the company had extended a personal loan. The Director used the loan to acquire building in Kenya.
- The amount was received as a result of a business contract which the other party breached it.
- Directors’ fees were paid to the following persons:

Mr. A	TZS 200,000,000
Mrs. A (wife of Mr. A)	TZS 50,000,000
Mr. B (Mr. A’s brother)	<u>TZS 70,000,000</u>
	TZS 320,000,000

- | | |
|--|-----------------------|
| 6. Interest paid to the bank on overdraft | TZS 20,000,000 |
| Finance charge on hire purchase agreements | TZS 50,000,000 |
| Interest on failure to pay previous years’ value added tax | <u>TZS 10,000,000</u> |
| | TZS 80,000,000 |

- | | |
|---|----------------------|
| 7. Audit fees | TZS 10,000,000 |
| Legal fees for staff contracts and retirement funds | TZS 6,000,000 |
| Amount paid to Tender board members to facilitate winning a bid | <u>TZS 4,000,000</u> |
| | TZS 20,000,000 |

8. Employees contributions	TZS 7,500,000
Employer's contributions	<u>TZS 7,500,000</u>
	TZS 15,000,000

The contributions were made to an approved retirement fund.

9. The company acquired the following assets:	
On 2 nd January 2010- Furniture and equipment	TZS 100,000,000
On 2 nd January 2010- Computers and accessories	TZS 300,000,000
On 3 rd January 2010- Motor car (station wagon)	TZS 200,000,000

The computers were acquired on hire purchase terms for 12 months. The down payment of TZS 120,000,000 was made on 2nd January 2016 and the first monthly instalment of TZS 20,000,000 was due on 2nd February 2016. The cash price of computers was TZS 300,000,000.

10. Provision for debtors (specific)	TZS 11,000,000
Provisions for repairs (estimated)	TZS 8,000,000
Provisions for stock obsolescence	<u>TZS 9,000,000</u>
	TZS 28,000,000

11. Sundries included a traffic fine of TZS 3,500,000. The balance was general consumables used by the office

Required

Based on the information available, determine the taxable income of Kiongozi Company Limited and its tax liability for the year of income 2016. (20 Marks)

QUESTION THREE (20 MARKS)

a) Discuss on different types of supplies (5 MARKS)

b) Mr. Mkude carries on a business of a retail grocery in Morogoro since January 2001. The following information is available during the accounting period of July 2016.

a) Purchases made and expenses paid during the period which are VAT inclusive wherever applicable are as follows;

Item	Tsh.
Cooking oil	800,000
Bags for packing wheat	175,000
Electricity	150,000
Sugar	550,000
Telephone	200,000
Ta invoice books	250,000
Transportation of Milk	150,000
Refrigerator	270,000
Wheat flour	400,000
Green vegetable	150,000
Beer and spirits	300,000
Soft drinks	250,000
Fresh milk	200,000

b) Also, during the same prescribed accounting period, the following supplies were made by Mr. Mkude

Gross payments received VAT	exclusive:	Tsh.
Cooking oil		600,000
Sugar		450,000
Toilet soap		630,000
Laundry soap		510,000
Wheat flour		200,000
Green vegetable		160,000
Beer and spirits		290,000
Soft drinks		160,000
Fresh milk		200,000

The following additional information is also available:

- The amount of beer and spirits supplies includes deposits for bottles taken out by customers amounting to Tsh. 20,000/=
- There was cash loss of payment received in respect of supply of soft drinks, of which Tsh. 40,000. This has not been included in the payments received during the month.
- One crate of beer worth Tsh. 14,000/= was taken for personal consumption by the owner of the grocery. The amount was not included in the payment received during the month.
- Milk worth Tsh. 20,000/= was returned by customers during the month for various reasons. This has not been subtracted from the amount shown above.
- No cash discount were allowed or received during the month.

Required:

Calculate the OUTPUT/INPUT tax payable/refundable for the month of July 2016, using the method provided under the VAT Act 2014 and its Regulation (15 MARKS)

QUESTION FOUR (20 MARKS)

a. Tax incentives are very important in order to attract investors. However, attention should be directed to some other factors for successful investments" Identify factors, other than taxation that may influence investments (8 MARKS)

b. For the year of income 2015 (calendar year), Kinjekitile Co. Ltd managed to furnish provisional returns and paid the provisional taxes within the due dates. The estimated income for the year was Tsh. 200 million/=. On 31st July 2016, it received a notice from the CIT, requiring it to furnish a regular return for the year of income 2015 within 60 days of the date of service of notice of assessment which was dated 15th July 2016 and posted on the same date.

The firm, however, submitted the return on 31.12.2016 declaring income of 300million/= and paid the total tax due on the same date

Required: Compute the total tax liability paid on 31.12.2016 by the company (12 marks)

QUESTION FIVE (15 MARKS)

Public Finance deals with public revenues, budgets, administration, approval and implementation. Identify the major institutions/organs involved in the process and show their strengths and weaknesses in Tanzania context.

Test paper 3

PUBLIC FINANCE AND TAXATION

INSTRUCTIONS:

- THERE ARE FIVE QUESTIONS IN THIS TEST PAPER.
- ANSWER ALL FIVE QUESTIONS
- CALCULATORS MAY BE USED IN ANSWERING THE PAPER

QUESTION ONE (20 MARKS)

- Discuss the argument for and against public debt (10 marks)
- Discuss the factors contributing to non-compliance to tax laws in Tanzania (10 mark)

QUESTION TWO (30 MARKS)

MBA LTD is a multinational company based in U.S. This particular company intends to start operations in Tanzania and make a number of investment portfolios in various sectors of the economy. The company wishes to start its operation in January 2015, with an initial capital of USD 2,500 million. It will operate in the sector of manufacturing of cotton clothes, footwear and other leather products to be sold within Tanzania. The company also will also engage in selling petroleum products (fuels and gas) to local customers across the country. The company will import plant and machinery from U.S and some from Europe and Japan for a value of Tsh. 8,000 million. It will also import crude oil from Asia and make refinery plants in Tanzania.

The company will buy raw materials from local sources. Other local resources will include, labour, electricity, water and stationery. A total of 350 workers will be employed by the company. The wage bill is projected to be 4,000 million Tsh. for the first year and expected to increase at the rate of 10% per annum. Sales revenues are projected at Tsh. 40,000 million (without VAT) for the first year and expected to increase at the rate of 20% p.a. The company fixed assets are expected to have a value of Tsh. 500,000 million. Depreciation allowances are expected to be 37.5% p.a. on declining balance method. Purchases on raw material and other inputs are expected to be 50% of sales and of these 70% are taxable supplies for VAT purposes and the rest are exempt inputs supplies. However, all sales are taxable sales for VAT purposes. Other operating expenses are projected at Tsh. 5,000 million (excluding depreciation) and will be constant over the three years' period.

MBA LTD also intends to invest part of its funds in the financial markets in Tanzania in shares and in Bonds. Tsh. 200 million will be invested in local company shares and 300 million on 5-Years government bonds. Shares are expected to yield dividends equivalent to 15% of the value annually. Interest on government bonds are at the rate of 10% p.a. payable annually.

Required:

- The company management has approached you as a tax consultant; make a report to the management on all valuable information on applicable taxes to the company and the available tax reliefs, allowances and deductions. (8 Marks)
- Prepare a three years statement of projected taxable income of the company (10 Marks)
- Show computation whenever possible of all the tax liability of the company over the three years, assuming tax rates do not change over that time. (12 Marks)

Assume the following:

- Corporation tax rate 30%
- VAT rate 18%
- Withholding tax 10%
- Depreciation allowance on business assets 37.5%
- SDL 5%
- Road toll 100 Tsh. for 1 liter
- Import duty 10%
- Capital gains tax 10%
- In any other case make your own assumptions

QUESTION THREE (25 MARKS)

- Over time, most developing countries including Tanzania have resorted to tax incentives in order to attract foreign investors and promote investments in their countries. However, a lot of criticisms have been raised by scholars and the general public on the poor performance of tax incentives.

Required:

Discuss the argument for and against tax incentives for investments growth in developing countries. (10 Marks)

- In year 2016, the Commissioner of Large Tax payers received a return of income of UVUMILIVU Ltd showing a net profit of TZS 214,136 computed after making the following deductions:

	TZS
Sales	273,970,710
Cost of sales	150,000,355
Gross profit	123,970,355
Operating expenses	27,000,000
Other expenses	96,756,219
Net income	214,136

Included in other expenses item is a list of the followings:

- Exchange loss of TZS 42,143,000 on importation of raw materials
- Compensation to terminated employees – TZS 618,500
- Amortized amount to replace a roof – TZS 4,733,000
- Payments made to remove erroneous terms of a loan contract – TZS 821,000
- Penalties for VAT – TZS 3,500,000
- Political parties contributions – TZS 1,007,450
- Board meeting expenses – TZS 4,753,205
- Incentives – TZS 1,473,741
- Treasury loan used by the Director to go abroad on vacation – TZS 3,543,123
- Cost to prepare revised accounts – TZS 1,232,456
- Construction cost of a new laboratory – TZS 13,520,620
- Cancellation of contract – TZS 8,326,124
- Salaries for future services – TZS 6,577,000
- Legal cost for unsuccessful recovery of salaries from terminated employees – TZS 627,000

Assume you are in charge of one of the Audit Teams at the large Taxpayers Department and the Commissioner of Large Taxpayers has assigned you the tax file of UVUMILIVU Ltd.

Required:

Apply the provisions of the Income Tax Act, 2004 to determine the taxable income for, and tax payable by, UVUMILIVU Ltd. (15 MARKS)

QUESTION FOUR (25 MARKS)

Most multinational companies suffer double taxation on cross boarder transaction, especially where there are no tax treaties between countries of operations. Similarly, Multinational companies use various ways to reduce or evade tax liabilities internationally.

Required:

- a) Identify and discuss the major forms of double taxation experienced by multinational companies. (8 Marks)
- b) With examples discuss the various forms of tax avoidance and evasion that are likely to be used by such multinational companies? (9 Marks)
- c) Comment on the powers given to the Commission general of TRA/Minister for Finance in combating tax avoidance and evasion in Tanzania (8 Marks)?

Test Paper 4

SUBJECT: PUBLIC FINANCE AND TAXATION

INSTRUCTIONS

1. There TWO section in this paper. Section A and B which comprise FIVE questions
2. Answer ONE question from section A
3. Answer ANY THREE questions from section B
4. In total attempt FOUR questions
5. Marks are shown at the end of each question
6. Calculate your answer to the nearest two decimal points where necessary.
7. Show clearly all your workings in respective answers where applicable.

SECTION A

Compulsory Question

QUESTION ONE (40 MARKS)

22. Public finance deals with not only the way in which public treasury operates, but also deals with the repercussions of alternative policies which the treasury might adopt and accordingly deals with question of choice of these policies and operations. Public sector is viewed as a public household with objectives of allocation of resources; adjustments in the distribution of income and wealth; and stabilisation of prices and employment:

Required: Discuss the major divisions of public finance as a social science discipline. (08 Marks)

23. There are two common mechanics of public financing. Government provides some goods and services directly while others are funded publicly but provided privately.

Required:

What is the difference between these two mechanisms of public financing? (8 Marks)

24. Explain the concepts of leakages and injection from the circular flow of income. (6 marks)
25. Discuss the means through which the government can influence GDP and NI of a country like Tanzania (6 Marks)
26. Public expenditure should be incurred bearing in mind the main principles of public expenditure. Therefore, at the most fundamental level government spending decisions could be seen as part of the overall economic problem of allocating scarce resources amongst competing needs and requirements. Identify and discuss the main principles of assigning government expenditure across the different levels of the government. (4 Marks)
27. The growth and the size of public expenditure differ from country to country and from time to time. Discuss this statement in the context of Tanzania. (4 Marks).
28. A budget usually covers a period of one year, known as a financial or fiscal year, which may or may not correspond with the calendar year. The process is cyclical nature that is on-going throughout the year. It is comprised of stages which feed into one another in a circular process. Discuss the main budgetary phases in Tanzania: (4 Marks).

SECTION B:

THERE ARE FIVE QUESTIONS IN THIS SECTION, ANSWER ANY THREE QUESTIONS FROM THIS SECTION

QUESTION TWO (20 MARKS)

Professor MILIMA MREFU has been a Professor of Accounting and Marketing and head of the Research and Publication Committee of the School of Business of ABCD University. The University has a housing scheme, under which it provides accommodation to its staff who then suffer an 8% deduction on their salaries as rent. The following information is also available.

- u) Professor MLIMA was employed under expatriate terms which provided for among other things a salary of Tsh. 8,000,000 per month, but was increases at the rate of 2% after every four months. He is given a free house. The market rental for this house is estimated at 600,000 p.m. The total bills in this house for the year 2016 (electricity, telephone and water) was Tsh.1,500,000
- v) He was appointed by the Centre for the promotion of Exports from Developing countries to carry out a market survey in Tanzania on the market for developed countries and products for exports to Europe. He was paid the full costs of the study and an additional fee of Tsh. 15,000,000. This study was carried out during the months of March and April, 2016
- w) On a part time basis, he was offering consultancy services to Morogoro Business and Management Consultants firm. For this, he was paid Tsh.200,000 per hour. During 2016 he spent 50 hours with the firm
- x) His birthday coincided with Easter, 2016. During the 2016 Easter celebrations, the University awarded him a birthday present worth Tsh. 1,920,000. In addition, another present was given to him by his fellow workers. This was valued at Tsh. 2,840,000
- y) He was required to appear in the quarterly meetings of the University Senate. The University paid him 12% of his salary for attendance of each of such meetings. During 2016, he attended all such meetings held while he was still in employment.
- z) A distribution of surplus made from short courses and consultancy carried out at the University during 2016 was made in May 2016 to all the workers. Professor MLIMA received Tsh.12,000,000 from this distribution during 2016
- aa) He was provided with a car (2500cc) which was wholly used for domestic purposes by his wife. This car was purchased by the University as brand new for Tsh. 20,000,000 in year 2015.
- bb) As part of the contract of employment, the employer was required to contribute an amount equivalent to 15% of his salary per month to a private pension scheme established in INDIA. The scheme was not approved by the Commissioner. This was paid by the university for the months from June to December, 2016 only.
- cc) He received interest from the NBC of Tsh. 15,000,000 and a dividend from a local company of Tsh.7, 500,000. No withholding tax was deducted at source.
- dd) Upon completion of his contract, the University met the expenses of 10 million for transporting him and his belongings back home to India.

Required: Calculate the employment Income, Business Income, Investment income and total taxable income of Professor MLIMA for the year of income 2016. (20 Marks)

QUESTION THREE (20 Marks)

- a). Since its independent, Tanzania has experienced an increasing trend of its public expenditure without a corresponding public revenues leading to a high Public debt. Discuss the factors which have led to this trend overtime (10 Marks).
- b. Discuss the role of the major institutions involved in the budgetary process in Tanzania (10 Marks)

QUESTION FOUR (20 MARKS)

- a. Comment on the statement that "Taxation under the 'benefits theory' operates on the similar lines as prices function in a free market" (5 marks)
- b. Briefly explain the sacrifice theory and discuss its relationship with the ability to pay theory (5marks)
- c. The principle of benefit arises from the need that greatest beneficiaries should make the greatest tax contribution. This is indeed the essence of fairness. It finds common application in near public goods whereby only those who pay and consume the goods are liable for such taxation. With examples discuss the argument for and against of this principle in Tanzania context. (10 Marks)

QUESTION FIVE (20 MARKS)

It is a common practice for government revenue authorities in different countries to change tax rates or introduce new taxes in both direct and indirect taxes. Discuss the implication of changes in taxes on each of the following:

- a. Demand and supply of goods and services (5 marks)
- b. Savings of individuals and companies (6 Marks)
- c. Producer and consumer surplus (5 Marks)
- d. Tax impact on Consumption on wages and employment (4 Marks)

QUESTION SIX (20 MARKS)

- a. Differentiate between final and statement of estimated tax returns as per Income Tax Act 2004. Describe the contents of such returns. (6 Marks)
- b. Explain the implication of the various tax assessments admissible by the commissioner for income tax. (4 Marks)
- c. BRAVO Ltd twelve months accounting period ends on 30th June of the calendar year. For the year of income 2012, the company did not furnish provisional despite being reminded to do so from time to time. Consequently, on 31st December 2011, the commissioner made the best judgment provisional assessment for the year on income of Tsh. 500million and the company paid all the tax liabilities on this date. The remaining instalments were subsequently paid on their due dates. However, the company failed to file the final return on the due dates but did so on February 20th April 2013 and indicated a taxable income of 550 million. Assume BoT Interest rate of 16%.

Required:

- i. Compute the tax liability on the date the commissioner made best judgment on provisional assessment (4 Marks)
- ii. Summarise the tax information and tax liability applicable on the date the company filed the final return (4 Marks).
- d. Describe what constitute to investment income as per Income Tax Act 2004. (2 Marks)

Test Paper 5

PUBLIC FINANCE AND TAXATION

TIME ALLOWED: THREE HOURS.

GENERAL INSTRUCTION

1. There TWO section in this paper. Section A and B which comprise SEVEN questions
2. Answer ONE question from section A
3. Answer ANY FOUR questions from section B
4. In total attempt FIVE questions
5. Marks are shown at the end of each question
6. Calculate your answer to the nearest two decimal points where necessary.
7. Show clearly all your workings in respective answers where applicable.

SECTION A

Compulsory Question

QUESTION ONE (40 MARKS)

- a) There are various arguments for and against government intervention in the economic and social affairs of the people in a country. Some have argued that since the government is generally inefficient in resource utilisation, the private sector should be left to manage and provide the needs of the people in a country. Discuss this statement. (15 Marks)
- b) National income accounting is a set of methods and principles used for measuring an economy's overall performance, focusing especially on the overall level of production of goods and services. Discuss why it is important to analyse the National Income Accounts of a Country. (5 marks)
- c) With examples in Tanzania Context discuss the extent to which government policies influence GDP and National Income of a country, also show the limitations of GDP application (10 marks)
- d) Identify the principles of assigning expenditure across different levels of government (5 Marks)
- e) Discuss the various ways in which the government can use the budget surplus (5 Marks)

SECTION B

There are FIVE questions in this section. Answer any three questions.

QUESTION TWO (20 Marks)

Write short notes on the following taxation theory concepts: (20 Marks)

- a. Tax base (4 marks)
- b. Tax yield (4 marks)
- c. De-regressive taxation (4 Marks)
- d. Factors affecting taxable capacity of a country (8 Marks)

QUESTION THREE (20 MARKS)

- a. The EFD (Electronic Fiscal Devices) machines were effectively introduced by the government through TRA in July 2010. The objective of introducing EFD machines was to ensure that taxpayers acquire and use EFD machines on every sale made.

Required: Identify the key benefits on the use of EFD to Traders, buyers, and government (10 Marks)

- b. With examples discuss the distinction between ad-valorem tax and specific tax systems (10 Marks)

QUESTION FOUR (20 MARKS)

PROTEA Hotel (T) had constructed a modern eleven-storey tourist hotel building for 400mill/=. The construction of this hotel was completed on the 31.12.2014, and it was formally opened and certified by the Minister for Finance on the 1.1.2015, when it started operating at full capacity. In addition to the main building, the hotel had during the same time constructed:

- A car park adjacent to the hotel structure for 3,000,000/=
- A swimming pool for 7,000,000/=
- Small huts for 1,000,000/=

These were used from the same date as the main hotel building

The hotel had the following assets, which were used from the day of its inception:

- Automatic laundry machine, installed in the basement for 2,200,000/=
- A cold storage plant for 2,000,000/=
- An air-conditioning plant for 2,150,000/=
- Cookers and other permanent kitchen wares 800,000/=
- Mobile serving wheel trays 800,000/=
- Cups, tools and other implements for 400,000/=
- Furniture 9,000,000/=

To keep the small huts clean three mowers costing 50,000/= each were purchased

In addition, during the year 2015, the hotel acquired and used the following:

- A Scania bus for 2,600,000/=. This was purchased on the 2nd April, but was used from the 1st of June
- A second hand delivery van was purchased for 900,000/= during May
- A new Rolls Royce for the General Manager was acquired for 80,000,000/= which was wholly used for his private purposes. While on duty, he used the hotel Range Rover, which was purchased for 40,000,000/=
- In order to encourage the hotel industry, and hence tourism, the Ministry of Tourism awarded a hotel a twin otter aircraft, which was purchased for 70,000,000/=
- Tupendane Orchestra was officially inaugurated on the 15th July 2015. This was solely for the entertainment of the hotel guests, in Banana High Classic Hotel. The music instruments had cost the hotel 1,240,000/=

As a control against frequent power cut by TANESCO, a generator was purchased for 10,000,000/= during August. This was installed in the hotel on 15th August 2015

The General Manager's Rolls Royce was sold on 10.11.2015 for 30mill/=

Required:

Calculate depreciation allowance admissible to PROTEA Hotel (T) under the 3rd Schedule of ITA 2004 for the year of income 2015 (20 Marks).

QUESTION FIVE (20 MARKS)

(a) R Insurance Company Ltd is carrying on general insurance business. The company also re-insures certain risks in Company A outside the United Republic.

The financial statements of R Insurance Company for the year 2015 showed the following:

Total premiums derived sh. 5,200 million/=. This amount included sh. 400 million/= premiums received during a year of income which will cover risks for a period after the end of year 2015 (unexpired risks). Outward reinsurance was 2,500million/=. Rental income was sh. 100million/=. Interest on deposits with the financial institutions sh. 100/= million. Gross claims incurred were 1,100 million; this included claims that were incurred but not reported of sh. 600 million. Commission payable sh. 700 million/=. Operating and other expenses incurred in conducting the insurance business sh. 200million/=

Reinsurance proceeds received during the year from company A were sh. 500 million/=

Required: calculate the taxable income of R Insurance Company for the year of income 2015. (10 Marks).

(b) Jojo Pension Fund was an unapproved pension fund established in year 2010 and in year 2013 the fund was approved by the commissioner as an approved pension fund. In September, Year 2015 the fund ceased to be an approved pension fund.

During year 2015, it received contributions on behalf of resident individuals at the rate of sh. 200,000,000 per month, and other contributions to the fund from non-residents were at the rate of sh. 100,000,000 per month. The retirement payments made before September 2015 were 200,000,000, but during the year 450,000,000 retirement payment were made to resident individuals.

Jojo Pension fund also received rent of Sh. 90,000,000. Minor repairs were made to the rented building of Sh. 2,500,000 and security expenses paid of Sh. 600,000. Administrative expenses were 35,000,000. The fund's accounting date is 31st December.

Required: Calculate the total tax payable in year 2015. (10 marks)

QUESTION SIX (20 Marks)

a) Robots and Assembler Design Makers, a domestic permanent establishment of a non-resident entity, has the following information about its financial affairs for year ending 31st December 2015.

- i. Net cost of assets at the start of the year was Tsh.20,000,000
- ii. During year 2015 it issued 2,000 shares each at Tsh.1,000 but the market value of shares has since increased to Tsh.1,050.
- iii. Written down value of the depreciable assets at the end of the year was Tsh.10,000,000 and the values of other assets were Tsh. 5,000,000.
- iv. The company borrowed Tsh.3,000,000 from various lenders and the costs of liability were Tsh.1,500,000 during that year.
- v. The company has total income of Tsh.40,000,000 during the year before deducting previous unrelieved loss.
- vi. Corporate tax rate was 30% and tax rate for repatriated income was 10%.
- vii. The balance of accumulated profit account was Tsh.10,000,000 on the credit side.

Required:

- i). Calculate the tax liability of the company for the year ending 31st December 2015. (10 Marks)
- ii). Discuss the standards and methods used in setting transfer prices that are acceptable for taxation purposes (10 Marks)

THE END

ABOUT THE AUTHORS



DR. Haruni Jeremia Mapesa holds a PhD (Economics) from Sokoine University of Agriculture, MSc. Finance and Management from the University of Central England Birmingham (U.K.), CPA (T), Advanced Diploma in Certified Accountancy (ADCA) From The Institute of Development Management- Mzumbe (IDM). He is a Senior Lecturer in the Department of Accounting and Finance at the School of Business. He has actively taught Public Finance and Taxation, Corporate Finance, Financial Markets instruments and institutions, Auditing and Assurance services, and Management Accounting at undergraduate and postgraduate programmes since the commencement of his career at Mzumbe University in 2002. He has supervised numerous Master's Dissertations and PhD Thesis in Tanzania. Dr. Mapesa has written a number of articles and research reports in the field of finance and development economics. He has published such academic writings in international and local journals such as International Journal of Research in Economics Commerce and Management; Radix International Journal; the NBAA Journal of Accountants; Journal of Development Management Dynamics; Tanzania Journal of Development Studies; Economics Development Papers, and many others. He teaches Public Finance and Taxation, Corporate Finance in a number of Higher Learning Institutions in Tanzania. He is an active member of the National Board of Accountants and Auditors (NBAA), Tanzania.

Before joining Mzumbe University in 2002, Dr Mapesa worked with the National Social Security Fund as a Senior Accountant between 1999 and 2001. He and his wife Rhoda have four daughters Anna, Beatrice, Charity and Debora. Dr. Mapesa is renowned for engaging friends and colleagues in socio-economic development affairs at Mzumbe and Changarawe local communities.

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Dr. Joseph Simon Kiria is a full time academic member of staff, Mzumbe University School of Business. As an academic member, Kiria is fully engaged in core activities of the University of Training, Research and Consultancy. He has a vast knowledge in teaching accounting and finance subjects by virtue of his academic background. He has been lecturing Public Finance and Taxation for more than twelve years for courses offered at the undergraduate level and public sector budgeting and finance at the master's degree level.

Kiria earned his Advanced Diploma in Certified Accountancy (ADCA) from the former Institute of Development Management Mzumbe, now Mzumbe University, in 1995 and his MSc in Financial Management from the Glasgow Caledonian University (UK) in 2000. Dr. Kiria holds a PhD from the University of Hull in UK. His thesis primarily focuses on performance pattern in late EPZ countries and the influence of institutions and tax incentives on EPZ investors' location decision. Mr. Kiria also holds a CPA (T) and is a professional member of the National Board of Accountants and Auditors (NBAA) in good standing.

Dr. Kiria has published a number of scholarly articles, primarily on taxation and auditing in reputable journals. Some of the journals in which his articles have been published include; *The Accountant*, the professional journal of NBAA in Tanzania; *The Accountant Magazine*, journal of NBAA; *The Uongozi Journal of Management*, Mzumbe University; and *The Journal of National Audit Office of Tanzania*.

Kiria considers him liberal, and accepts critics fairly presented.

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