

**TAX AVOIDANCE IN TANZANIA MAINLAND:
THE LAW AND PRACTICE OF ANTI – AVOIDANCE
PROVISIONS UNDER THE INCOME TAX ACT NO.11 OF 2004**

By

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**A Dissertation Submitted in Partial Fulfillment of the Requirements for Award of
the Degree of Master of Laws (LL.M.) Commercial Law of Mzumbe University.**

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CERTIFICATION

We, the undersigned, certify that we have read and hereby recommend for acceptance by the Mzumbe University, a dissertation entitled: ***TAX AVOIDANCE IN TANZANIA MAINLAND: THE LAW AND PRACTICE OF ANTI - AVOIDANCE PROVISIONS UNDER THE INCOME TAX ACT NO.11 OF 2004***, in partial fulfillment of the requirements for award of the degree of Master of Laws of Mzumbe University.

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DEDICATION

To my Late Parents **Severina Kangalawe** and **Halfan Mlonganile** for the fruitful foundation they laid for me in this world. May their souls continue to rest in eternal peace, Amen.

LIST OF ABBREVIATIONS AND ACRONYMS

APA	Advanced Pricing Agreement
BRELA	Bureau for Registration and Licensing Authority
DANIDA	Danish International Development Assistance
ERMS	Enterprise wide Risk Management System
GDP	Gross Domestic Product
IDA	International Development Association
IRD	Inland Revenue Department
ITA	Income Tax Act
KRA	Kenya Revenue Authority
MNCs	Multi National Corporations
NGO	Non Governmental Organization
OECD	Organization of Economic Corporations and Development
PAYE	Pay As You Earn
RADDEX	Revenue Administration Digital Data Exchange
TBS	Tanzania Bureau of Standards
TFDA	Tanzania Foods and Drugs Authority
TIC	Tanzania Investment Centre
TID	Tax Investigation Department
TIN	Taxpayer Identification Number
TPA	Tanzania Ports Authority
TPRI	Tanzania Pesticides Research Institute
TRA	Tanzania Revenue Authority
TRAMED	TRA Monitoring and Evaluation Database
UN	United Nations
USD	United State Dollar
VAT	Value Added Tax
ZRA	Zambia Revenue Authority

STATUTES AND CASE LAW

STATUTES

Constitution of the United Republic of Tanzania of 1977, 2008 Edition,

Income Tax Act No 11, 2004 Revised 2008

Tanzania Revenue Authority Act No. 11 of 1995

Tax Revenue Appeals Act No. 15 of 2000

The Companies Act no. 12 of 2002

The Land Act No. 4 of 1999

The Stamp Duty Act, Cap. 189 R.E. 2006

The Village Land Act No. 5 of 1999

Value Added Tax Act No. 24 of 1997

CASE LAW

AD V.CTZ (EATC) 89

Calico Industries v. Pyraliesmail Premji (1983) TLR,28

CIR v. Newman (1947) 159F 2nd 848

Commissioner General TRA v. Samuel John Ezekiel Tax Appeal NO. 13 of 2005
(unreported)

DTP v. Commissioner General, Appeal no.5 2006 (unreported)

IRC v. Duke of Westminster (1936), AC.1

Millard v. FTC (1962) 108 CLR 336

Unilever Kenya ltd v. Commissioner of Income Tax (2005) KLR

WT Ramsay Ltd v. IRC (1981)1ALL ER 865

ABSTRACT

It is expected by the society that they pay tax to raise government revenues so that in return the society is provided with all the services from the government, these are social services , maintaining law and order, ensuring defence and hosting other undertakings which the state feels are better be provided by itself, like health services. Tax payment is not a new idea in Tanzania mainland because it has had taxation system since the turn of the century all with the aim of being a handmaid for raising revenues to meet government expenditure.

As stated above the society have their expectations when paying tax, however there are many tax payers who evades taxes not withstanding that there are penalties for that act simply because they feel that the government is not performing well in providing the society with social needs and end up using revenue on other issues. Not all citizens have positive attitude to the act of paying tax, this may be caused by many factors most of which are caused by the government itself by failing to provide social services to the satisfaction of the citizens. Therefore citizens would wish to use any means either to reduce the Tax burden or evade paying tax.

The desire to avoid payment of tax need not bring a surprise particularly in developing countries like Tanzania. In the usual case it will amount to no more than a sensible use of the available exemptions and reliefs which are provided in all tax legislation. In other cases, where sums avoided are greater, the methods adopted by the tax planning industry to escape the fiscal net may take on a complexity that is beyond the comprehension of most individuals and may involve schemes which are divorced from reality. Tax avoidance is the use of legal methods to modify an individual's financial situation in order to lower the amount of income tax owed. This is generally accomplished by claiming the permissible deductions and credits. This practice differs from tax evasion, which is illegal.

Taxation in Tanzania is based on law, under the Constitution of the United Republic of Tanzania no tax of any kind shall be imposed save in accordance with a law enacted by the parliament or procedure lawfully prescribed and that have the force of a law or by virtue of a law enacted by the parliament.

In this study, most of the issues on tax avoidance have been addressed and analyzed including the loopholes that still exist to attract taxpayers to plan to avoid tax and solutions to problem.

Reviewing tax laws regularly is of most importance so as to be in line with the fast changing world in business environment like e-commerce, and different means of money transfers like the mobile banking. There is a need to have Tax Laws free from ambiguities in that they should not create loopholes that will attract more and more Tax avoidance acts as it is with transfer pricing provision under the Income tax Act.

There is need to improve good governance so that the legitimacy of the government is enhanced, adequate resources need to be provided to promote voluntary taxpayer compliance. Although tax avoidance has the same cost to the nation as it is with the tax evasion, tax avoidance is generally tolerated even encouraged some times. Judicial decisions on legality of tax avoidance have ensured that there is no stigma for indulging in the tax avoidance as it is for tax evasion.

However, tax avoidance is equally complex and expensive exercise. Those with no means to hire tax planners are left to suffer in silence the tax burdens they cannot appreciate thus resorting into invoking ways to attack the tax system including corrupt practices by bribing tax officers. It has also been noted that ignorance of tax laws in Tanzania also results from legislative process not being inclusive enough. Enacted Laws are really well disseminated to the public as the passing of tax laws are also bureaucratic and secretive thus TRA still have a duty of advocating for tax laws to

public in particular promotion of tax payer education programs that are being conducted by the TRA. Lack of adequate accountability for the Government has impacted negative attitude on tax payers' compliance to tax. The Government is perceived to be corrupt as per major corruption scandals in 2008 that were revealed forcing the Prime minister to resign.

Tax laws should be harmonized so as to do away with the current multiplicity of tax laws which defeats taxpayers' positive perception to tax laws. Multiplicity of tax has been the factor for tax payers to concentrate on ways to escape the tax burden by any means be it legal or illegal. Tax laws in Tanzania do not encourage taxpayers to comply voluntarily with taxes.

This study recommends for amendment to section 33 of the Income Tax Act so that it can specify methodology for determining what constitutes an arm's length price, there should be in place provisions requiring taxpayer to prepare transfer pricing documentation. At the same time the government should timely act on the enactment of tax instruments whenever loopholes are detected by TRA and other stakeholders.

Not only that but also TRA should issue the practice note to clarify what approach it will follow to give effect to the transfer pricing provisions.

Tax systems should expand tax base and reduce tax rates because the expansion of the tax base would reach to the extent of full collection of tax and at the same time tax system to reduce multiplicity of Tax laws in the system.

There should be a tool in place that would make tax authorities to have access to information especially for cross border transaction for transfer pricing issues, this will help Tax authorities in finding data on transfer pricing when determining whether the transaction price is in accordance with the principles on Transfer Pricing.

It becomes difficult for tax officers to gather information for determining the relationship of the transacting companies at a particular time especially where they multinational corporations.

TABLE OF CONTENTS

CERTIFICATION	i
DECLARATION AND COPYRIGHT	ii
ACKNOWLEDGEMENTS	iii
DEDICATION	iv
LIST OF ABBREVIATIONS AND ACRONYMS	v
STATUTES AND CASE LAW	vi
ABSTRACT	vii
TABLE OF CONTENT	xi
LIST OF TABLES	xiv
CHAPTER ONE	1
INTRODUCTION	1
1.1. Background of the Problem	1
1.2. Statement of the Problem	7
1.3. Research Hypothesis	8
1.4. Objective of the study	8
1.4.1. General objective	8
1.4.2. Specific objectives	8
1.5. Significance of the Study	9
1.6 Justification of the Study	9
1.7 Delimitations	10
1.8 Literature Review	10
1.9. Definition of Terms	14
1.10. Scope of the study	16
1.11. Area of the study	16
1.12. Research Methodology	16
1.12.1. Types of research applied in the study	16

1.12.2. Sampling and sampling procedure	17
1.12.3. Sample Size	17
1.12.4. Sources of data	17
1.12.5. Data collection method.....	18
1.12.5.1 Primary data.....	18
1.12.5.1.1. Questionnaire.....	18
1.12.5.2. Secondary data.....	18
1.12.5.2.1. Documentary Review	18
1.12.5.2.2. Electronic sources.....	19
1.12.6. Data processing and analysis	19
1. 12. 8. Ethical Consideration	19
CHAPTER TWO	20
FRAMEWORK OF INCOME TAX LAW IN TANZANIA MAINLAND	20
2.1 Introduction	20
2.2 The Current Income Tax Framework.....	22
2.2.1 A Charge to Tax:	22
2.2.2. The Basis of Taxation.....	23
2.2.3 Taxable Entities and Rules of Taxation.....	26
2.2.4. Tax Payment Procedure.....	29
2.5 Adherence to Tax	33
2.7 Conclusion	37
CHAPTER THREE	38
TAX AVOIDANCE IN TANZANIA MAINLAND AND ANTI AVOIDANCE PROVISIONS	38
3.1. Introduction	38
3.2. Methodology of Tax Avoidance.....	38
3.2.1 Income splitting.....	38

3.2.2 Income or asset shifting	39
3.2.3 Sheltering of Income	39
3.2.4 Deferring tax liability	40
3.2.5 Capitalization of income.....	40
3.2.6 Conversion of capital expenditure into Current expenses	41
3.2.7 Dividend stripping	41
3.2.8 Transfer pricing	41
3.3 Anti- Avoidance Provisions	42
3.3.1 General Anti-avoidance provisions	42
3.3.2 Specific Anti - Avoidance Provisions	43
3.4 Causes of Tax Avoidance and Enforcement of Anti- Avoidance Provision	46
3.4.1 Tax Payment and the taxpayer’s obligation	48
3.4.2 Tax audit procedures	48
3.4.3 Availability of comparable information	48
3.4.4 Availability of Competent authority.....	49
3.4.5 Cooperation with other authorities	49
3.4.6 Conclusion.....	50
CHAPTER FOUR	51
FINDINGS AND ANALYSIS OF DATA.....	51
4.1. Introduction	51
4.2. Presentation and Analysis of Data.....	51
4.3. Conclusion.....	54
CHAPTER FIVE.....	56
CONCLUSION AND RECOMENDATIONS	56
5.1. Summary.....	56
5.2. Conclusion.....	57
5.3. Recommendations	58
REFERENCES	61

APPENDIX 64

LIST OF TABLES

Table 4.1: Summary of responses observing that the existing Tax Legal framework is unsatisfactory and that tax avoidance schemes should be discouraged in the tax system. 52

Table 4.2: Summary of responses observing that Transfer pricing provisions and other anti-avoidance provisions under the Income tax Act are ineffective and that electronic transactions are not adequately covered. 53

Table 4.3. Summary of responses on positive perception to tax laws a factor in reducing tax avoidance acts, responses on fairness of tax administrators, and government accountability to its subjects..... 54

CHAPTER ONE

INTRODUCTION

1.1. Background of the Problem

Tax is a monetary charge imposed by the government on persons, entities, or properties to yield public revenue which are in turn used by the government to provide social services to its subjects. Most broadly, the term embraces all governmental impositions on the person, property, privileges, and enjoyment of people and includes duties, imports and excise.¹ Efficiency and effectiveness of any government to provide social services to its citizen depend on efficiency and effectiveness on enforcing tax laws by which planned revenue is collected. Any state, therefore, should have a legal regime that imposes taxes and at the same time providing mechanisms for control of tax avoidance as well as tax evasion.

Tanzania had a modern tax system since the 20th century. It was introduced by European colonial powers that took charge of the administration of the territory after the Berlin Conference of 1885. The first tax ordinance was issued on 1897 which introduced hut and poll tax.² The aim was to compel African population get involved in money economy and incidentally raise revenue as mostly the budgetary expenses of these colonial administration were financed by the grants from the imperial government.³ These did not last long as the territory was later declared a trust of League of Nations; therefore it was handed over to British.

Income taxation was first introduced by the British in 1940. The first Income Tax Legislation was based on a model Colonial Income Tax Ordinance which was

¹ Black's Law Dictionary (1968) 4th Edition. West Publishing Company p 1628

² Liffé J. A (1969) Tanganyika Under the German Rule p 16

³ Luoga F.D.A A Source Book of Income Tax Law in Tanzania p 11

essentially a simplified version of the United Kingdom Tax Legislation as it existed in about 1920⁴.

Luoga⁵ has given a classical answer to the question of the need of taxation in the society that taxation is the hand maid for raising revenue to meet the government expenditures. Although the government is bound to provide for all social services, maintain law and order yet the responsibility for the existence and functioning of the government falls on every citizen who are supposed to contribute to support the government. However, citizens cannot demand from the government benefits equivalent to what they have contributed as taxes.

Not all citizens have positive attitude to the act of paying tax, this may be caused by many factors most of which are caused by the government itself by failing to provide social services to the satisfaction of the citizens. Therefore citizens would wish to use any means either to reduce the Tax burden or evade paying tax.

The desire to avoid payment of tax need not bring a surprise particularly in developing countries like Tanzania. In the usual case it will amount to no more than a sensible use of the available exemptions and reliefs which are provided in all tax legislation. In other cases, where sums avoided are greater, the methods adopted by the tax planning industry to escape the fiscal net may take on a complexity that is beyond the comprehension of most individuals and may involve schemes which are divorced from reality. The potential tax avoided by these schemes is considerable and to combat their effectiveness the revenue authority have two main weapons at their disposal. The first is legislative and it takes the form of enactments directed against specific avoidance

⁴ Ibid at p 3.

⁵ Ibid at p 7.

schemes and the second weapon is to challenge in court the legal efficacy of avoidance schemes.⁶

Tax avoidance is the use of legal methods to modify an individual's financial situation in order to lower the amount of income tax owed. This is generally accomplished by claiming the permissible deductions and credits. This practice differs from tax evasion, which is illegal.

There are several methodologies used to avoid tax, to mention the few these are;

- i. Splitting income between more than one taxpayer preferably among the family members so as to reduce the marginal rate of tax chargeable thereon.
- ii. Income or asset shifting to another person or entity in which the tax payer has a beneficial interest and which is chargeable to less tax.
- iii. Sheltering of Income which involves the smart assessors which reduces their tax liability, for example maintaining head office in tax free zones.
- iv. Deferring tax liability by issuing loans, disposing assets by way of nontaxable dispositions to effect deferral until sometime in future the payment of tax on income currently being earned.
- v. Capitalization of income is another method of avoiding tax whereby income is converted into capital which may remain untaxed or taxed at a lesser tax rate.
- vi. Sometimes taxpayer may arrange to change Capital expenditure into current expenditure like a company allowing the director to go on a business trip with family which is actually a vacation.
- vii. Dividend stripping, a solvent company is bought by a share holding company, then large dividend is declared and shares are sold at a less than market value to the former shareholder which then is used as a basis for tax refund claim.
- Viii. Transfer pricing is also another mode of avoiding tax provided that it is done at arm's length among associates.

⁶ Chris Whitehouse, (1992) REVENUE LAW Principles and Practice p 591.

There are so many other schemes that are used to avoid tax in Tanzania, The Tax authorities are said to make efforts time after time to reduce these schemes for better collections of government revenues.

The Tanzania Revenue Authority (TRA) established by law as a semi-autonomous government agency is responsible for the administration and collection of central government taxes in Tanzania. The TRA is aware of the problem of Tax avoidance and noncompliance to tax generally and has been addressing these problems most of the time in its corporate plans.⁷

Taxation in Tanzania is based on law, under the Constitution of the United Republic of Tanzania no tax of any kind shall be imposed save in accordance with a law enacted by the parliament or procedure lawfully prescribed and that have the force of a law or by virtue of a law enacted by the parliament.⁸ Therefore tax laws are enacted in the belief that tax payers will comply with but still people find it proper to avoid tax and they feel not ashamed, probably this is forced with Tanzania's historical background on Taxation as noted by several authors that the history of taxation in Tanzania has led to a situation that many people and companies see no shame in avoiding paying Tax.

In this study, most of the issues on tax avoidance have been addressed and analyzed including the loopholes that still exist to attract taxpayers to plan to avoid tax and solutions to problem.

It has been noted that although tax avoidance has the same effect to the nation as it is with tax evasion, tax avoidance has always been tolerated, even encouraged sometimes. In the case of *CIR v Newman*⁹, the court felt it quiet appropriate to say that there was

⁷ Kibuta,O, (2011) Tax Compliance in Tanzania-Analysis of Law & Policy affecting Voluntary Tax Payer Compliance p 4

⁸ Article 138 of the Constitution of the United Republic of Tanzania 1998 Edition

⁹ (1947) 159F 2nd 848

nothing sinister in so arranging one's affairs so as to minimize tax liability for no one owes any public duty to pay more than what the law demands. It is for this reason that the practice of tax avoidance is sometimes considered as legally allowed. However, this does not mean that the tax authorities will allow the practice. Similarly, there is no law that prevents anyone from changing his business organization from a sole proprietorship into a partnership or limited liability company. Whereas tax consideration may manipulate the change in the form of business organization, there may be other good reasons to justify the change such as the need to raise more capital for business expansion or attract necessary skills.

It may also represent lawful tax planning where assets are leased instead of ownership because the higher lease rent is allowable over a shorter period instead of the smaller amount of depreciation allowance claims over a longer period of time.¹⁰

In all these cases there is no contravention of any law. The taxpayer merely looks at the existing legal framework to structure his business transactions to realize the maximum tax savings thus reducing the national income while they make more profit. Some companies that come to invest in Tanzania mainland they tend to plea that they have taken loan abroad because there is low interest than in Tanzania but most of those banks they claim to have taken loans are part and parcel of the investing company, at the same time tax authorities are not able to trace this relationship between the two institutions due to lack of that capacity to dig information from abroad because there are no effective laws binding them on foreign contracts.¹¹

Some construction corporations do use laborers instead of employees all in all to avoid tax because they find that an employee will need many payments like PAYE and Social security funds unlike with the laborers and these laborers will not inform the authorities

¹⁰ Information from one of the Respondents during interview

¹¹ Ibid

simply because they are in need of that job and no law is binding on them or the contractor from having laborers instead of employees.

Internationally some countries have enacted some new legislations with anti-avoidance provisions to curb this problem.

From 1992 Tanzania faced serious fiscal problems arising from the gap between inactive revenues and public expenditures swollen by large government expenditures. Despite the establishment of the Tax Revenue Authority (TRA) in 1996, Tax collection revenue remained dismally low in 1997/98; Tanzania's tax revenue of 12.4 percent of GDP was among the lowest in the region. Tax dodging was endemic as a result of institutional weakness in the TRA, poor infrastructure, and old-fashioned business process.¹²

The International Development Association (IDA) financed Tax Administration project in Tanzania was planned to raise revenues without increasing tax rates by improving the tax collection capacity of the Tanzania government. The focus of the project was on improvements in tax administration, legal framework, and expansion of the tax base. As a result the annual revenue collected by TRA increased to US\$ 1.7 billion in 2005/06 from 1.1 billion in 2002/03. US\$ 600 million per year two and a half times the total annual.¹³

Tax evasion and avoidance ultimately have a negative effect of minimizing revenues available for social and economic development of any country, Tanzania inclusive.

The Government through TRA has been taking various measures to ensure that compliance is enhanced. A new Income Tax Act 2004 (revised in 2008) was enacted to replace the outdated Income Tax Act 1973 in order to be in line with the ever changing economic and technological environment.

¹² <http://go.worldbank.org/JCCBFWAMQ0>

¹³ Ibid

The law tightened tax avoidance loopholes which could not be easily tackled under the previous legislation. This was done by introducing general and specific anti-avoidance provisions in the Income Tax Act, 2004.

TRA is said to have substantially invested in staff capacity building especially in specific areas such as Audit skills in order to effectively audit Multinationals Companies (MNCs), manufacturing, mining and tourism. This is aimed at tackling the challenges associated with tax planning and avoidance. However Tax avoidance has remained upright till now despite all the above efforts by tax authorities.

1.2. Statement of the Problem

The problem in this study is the everlasting existence of tax avoidance schemes in Tanzania mainland. Tax avoidance is not liable to be punishable in law and whenever the practice is being detected by tax authorities, the way out is to make adjustment of tax to be paid by a particular taxpayer with penalty and propose amendment of the law in order to block the loopholes and weaknesses that allow the possibility of tax avoidance.

Despite of several amendments done in the Income Tax Act, tax avoidance schemes are still practiced giving rise to loss of revenues by the government. For example, it is reported that, it is reported that Tanzania losses USD.109 million to USD.127 million a year due to transfer pricing alone.¹⁴

The Income Tax Act has General Anti-Avoidance provision (Section 35) and specific provisions (Section 33 and 34) designed to control tax avoidance practices. But despite the existence of such provisions tax avoidance practices are still in the field benefitting large taxpayers at the expense of many low earners.

¹⁴ Interfaith Standing Committee on Economic Justice and Integrity of Creation (2012) The One Dollar Question: How Can Tanzania Stop Losing So Much Revenue p17

In this research the researcher did look into the effectiveness of the ant avoidance provisions and their enforcement by the Tanzania Revenue Authority.

1.3. Research Hypothesis

The Tax regime in Tanzania mainland is coupled with number of challenges in effectively controlling tax avoidance loopholes in the tax laws hence unsatisfactory revenue collections for government expenditures.

1.4. Objective of the study

1.4.1. General objective

The primary objective of this study is to examine the efficacy of anti-avoidance provisions under the Income Tax Act in Tanzania mainland.

1.4.2. Specific objectives

Other specific objectives that follow, analyze loopholes in tax laws that attract tax avoidance. These are;

To examine the effectiveness of General and Specific Anti-Avoidance provisions

Section 35 of the Income Tax Act, 2004 is a General Anti-Avoidance provision which empowers the Commission to make adjustment when he is of the opinion that an arrangement is tax avoidance arrangement. Sections 33 and 34 are specific anti-avoidance provisions dealing with transfer pricing and dividend stripping. Despite the fact that there exist such provisions in the law, still there are some gaps which are possible for tax payers to apply and minimize the tax to be paid. How the TRA is able to intervene and control tax avoidance in the fast changing world of science and technology in electronic commerce.

To examine fairness of tax administrators, justification of tax laws, accountability of the government and how multiplicity of taxes encourages tax avoidance.

That tax laws are considered to be unjust and that since the government is expected to provide necessities to the citizen, what the government provides is not adequate in comparison with what is collected from tax payers. Furthermore, it is believed that multiplicity of taxes encourages most taxpayers to find ways to rescue their income through the available loopholes.

1.5. Significance of the Study

This study is of significance in that it exposes the weaknesses and strength in the current Institutional Legal Framework on taxation thus inspiring advocacy for reforms to foster the growth of National income. The study also identifies the weakness in the current legal framework and measures to improve the law so as eliminate tax avoidance loopholes in the legal framework.

Furthermore the study will add knowledge to the public domain on Tax Laws specifically on tax avoidance and tax evasion as well the challenges facing TRA and other stakeholders in implementing the laws against tax avoidance and tax evasion, and making deep the researcher's knowledge on the area of study.

1.6 Justification of the Study

This study has been undertaken as a requirement for partial fulfillment for the award of Master of Laws Degree of the Mzumbe University. Legal framework governing tax avoidance has not been thoroughly studied in Tanzania though since the 1990's private sector became the driving master of the state economy. In 2004, a new Income Tax Act, 2004 was enacted. The Act contains both general and special provisions that are aimed at combating tax avoidance practices. However, to the present there is no thorough study that has been done to assess the impacts of the new developments under the

existing law. This study undertakes to fill the gaps which exist in the context of Income Tax Act in Tanzania Mainland.

1.7 Delimitations

The issue of time and finance was a limiting factor in choosing the geographical area and population to be studied. However, it is hoped that the area and population chosen are representative of the actual situation of tax avoidance in Tanzania mainland.

1.8 Literature Review

Worldwide there are number of authors that have written on tax avoidance schemes. Below are some brief summaries of some of authors' works on issues pertaining tax avoidance. These are divided into two groups; theoretical and empirical literatures.

Chris Whitehouse and Elizabeth Stuart (1992)¹⁵ have discussed the issues of tax avoidance particularly the 'Ramsay principle' tax planning and ant- avoidance legislation. The authors try to tell the public and the authorities that the desire to avoid payment of tax is not a surprising event. That it is just a sensible use of the available exemptions and reliefs which are provided in all tax legislation. However, the authors admit that sometimes the tax planning industry can take on a very complex manner which can be divorced from reality.

Furthermore the authors give the revenue authorities only two main weapons in combating tax avoidance, which is through amendment of the law or legislation that takes the form of enactments directed against specific avoidance scheme. The second weapon given by the two authors is the Revenue authority to challenge in courts of law the legal efficacy of avoidance schemes.

¹⁵ Whitehouse, C. and Elizabeth Stuart, *Revenue Law Principles and Practice*, 10th Edition p.591

The authors have pointed out that in the past revenue authorities won very few victories through this second weapon, they go on discussing the case of *IRC v. Duke of Westminster*¹⁶ where the court held in favor of the person who had avoided tax. The authors goes on saying that later on the position of courts had somehow changed, thus they cited the case of *WT Ramsay Ltd v. IRC*¹⁷ and other similar cases that their decisions had sounded the death knell to artificial avoidance schemes whereby the judge in the Ramsay case, Lord Wilberforce, expounded the new approach to tax avoidance schemes.

The authors work shows how old the issue of tax avoidance is, and how courts have been used to solve problems of tax avoidance all over the world. This work will also find out how courts in Tanzania mainland have been involved in solving issues of tax avoidance and find out how the time to amendments of tax laws have helped to reduce this artificial avoidance schemes.

Arnold Homer and Rita Burrows (2001-02)¹⁸ have written on UK Tax system. The two authors discuss how various courts decisions have significantly strengthened the revenue authority powers to counter what it seems as unacceptable means of avoiding tax. They state that in UK there is in place a legislation relating to tax avoidance whereby most of the legislation granting reliefs in tax has ant avoidance measures within it, and most of ant avoidance legislation enables the Revenue authority to obtain information from third parties. Their work will help in this study to find out how effectiveness are the ant avoidance provisions in the Tanzania main land Income Tax Act.

¹⁶ (1936), AC.1

¹⁷ (1981) 1 All ER 865

¹⁸ Homer, A. Tolley's Tax Guide, 2001-02 Chapter 45 Main anti avoidance provisions p709

Luoga (2000)¹⁹ has discussed several aspects of tax including tax evasion and tax avoidance. He has gone further to discuss the principle methods of tax avoidance and tax evasion in line with defining the two terms. Not only that but also he has discussed on the common criteria used to determine tax avoidance. Luoga has also given some statutory mechanisms for preventing tax avoidance and evasion, provisions found in the Income Tax Act of 1973. However the income Tax Act of 1973 was repealed by Income Tax Act of 2004 of which the current amendment are of the year 2008. The researcher will go further in discussing the provisions in the Income Tax Act that still have problems in their applications thus attracting taxpayers to use the same to minimize tax to be paid.

Kibuta (2011)²⁰ has focused primarily on tax compliance in Tanzania taking examples from different neighboring countries. He has also touched on issues of tax avoidance and tax evasion. Kibuta contends that the government losses much revenue due to nonpayment of tax and that nonpayment are caused by means of different kinds thus making it difficult to combat the same. The author argues that for the tax compliance to be successful requires combination of strategies; voluntary tax payment and effective measures to compel non compliant persons to pay their taxes because a slight loose in enforcement can attract many tax compliers to join the non-compliant. He has also discussed on the successful House of Lords' decisions in *Ramsay v. IRC* (supra) and the alike decisions that recognized that drafters of legislations can not foresee all numerous schemes by which taxes can be avoided so as to come up with a watertight legislation capable of preventing non compliance. The researcher in the present work will go further in looking into some loopholes in the Income Tax Act, 2004.

¹⁹ Luoga, F. A Sourcebook of Income Tax Law in Tanzania pp 35-49

²⁰ Kibuta, O. Tax Compliance in Tanzania, Analysis of Law & policy affecting Voluntary Tax payer Compliance.P.

Number of researches has been done on the area of Tax evasion than on Tax avoidance. However, Ngowi (2002)²¹ has researched on determinants of Tax evasion in a Developing country- The case of Tanzania. In his work he admits that there is considerable controversy regarding the definition and scope of tax evasion and that the two concepts are often distinguished on legal basis. Ngowi²² goes on examining the main determinants of tax evasion in revenue Collection. He however, point out that from the legal point of view, tax evasion and avoidance have similar effects as both cause a reduction in fiscal regime.

Masamaki (1997) ²³ also has explained a little on Tax avoidance as the legitimate use of tax loopholes in order to minimize one's tax liability as opposed to tax evasion which is an unlawful act of dodging the statutory tax obligations, and that it can be done with or without collusion between the Taxpayers and the tax officials.

Masamaki gives also another distinction of the two terms as based on oral ground that others regard Tax Avoidance and Tax Evasion as a range extending from tax planning to fraud.²⁴ It has been observed that generally tax evasion is caused by factors like high tax rates, multiplicity of taxes, the way the Government spends its funds on social services, misuse of tax exemptions.²⁵ This study has gone in detail to establish the main factors for tax avoidance with a view to coming up with a sustainable solution to the same.

²¹ Ngowi, F. The main Determinants of Tax Evasion in a Developing Country-The case of Tanzania, MBA Dissertation, September 2000 University of Dar es salaam. P16

²² Ibid,p. 17

²³ Masamaki T, Evasion of Corporate Tax: An Analysis of Pertinent factors. A Dissertation paper submitted in Partial fulfillment of the requirements for the Master of Business Administration (MBA) Degree award of the University of Dar es salaam p10

²⁴ Ibid p10

²⁵ Ibid p27

1.9. Definition of Terms

Definition of 'tax' or 'taxation' has always been quoted from the Oxford English Dictionary by several authors who have written on taxation; under the said dictionary tax has been described as a compulsory contribution to the support of government levied on persons, property, income, commodities and different transactions. **Cooley** has also defined taxes as the enforced contributions from persons and property levied by the state by virtue of its sovereign power for the support of government and for all public need. **Kibuta**²⁶ notes that taxation has a nature of being compulsory.

All taxation is based on law. In the Constitution of United Republic of Tanzania Article 138(1) prohibits taxation except in accordance with laws duly enacted by the legislative authority. It provides that; '*No tax of any kind shall be imposed save in accordance with a law enacted by the Parliament or pursuant to a procedure lawfully prescribed and having the force of law or by virtue of a law enacted by the Parliament.*'

Tax avoidance and tax evasion have a similar object of reducing or eliminating tax liability. Luoga²⁷ notes that the only major distinction between the two terms is illustrated by the different consequences imposed in the event of an unsuccessful attempt by a taxpayer.

In the case of evasion the consequences are criminal in nature and lead to imposition of a fine or incarceration or both while avoidance involves only payment of tax plus interest because tax avoided is considered as a debt due from the taxpayer to the government

Tax avoidance has negative effect of minimizing revenues available for social and economic development of any country, Tanzania inclusive. The government through

²⁶ Kibuta, O.(2011) Tax Compliance in Tanzania; Analysis of Law and Policy affecting voluntary Tax Payer Compliance. p10

²⁷ Luoga, F. (2000) A Source book of Income Tax Law in Tanzania. p 35

TRA has been taking various measures to ensure that compliance to tax payment is enhanced. The Income Tax Act of 1973 was repealed and replaced by the Income Tax Act of 2004 of which again has been amended several times in order to be in line with the ever changing economic and technological development. Tax laws are enacted on the assumption that taxpayer will comply with them.

'*Tax avoidance*' refers to use of perfectly legal methods of arranging one's affairs so as to pay lesser tax. It involves utilizing loopholes in tax laws and exploiting them with legal parameters.²⁸ '*Tax evasion*' on the other hand involves a taxpayer's deliberate contravention of the tax law(s) in order to minimize or eliminate tax liability altogether (pay no or little tax respectively by breaking the law). Tax evasion is the application of fraudulent practices in order to minimize or eliminate tax liability usually involves nondisclosure of income, rendering of false returns and claiming unwarranted deductions.

In the circumstance, courts have held the view that no legal obligation rests upon a taxpayer to pay a greater amount of tax than the one he is legally required to pay under the taxing legislation. In the famous case of *Duke of Westminster v IRC*,²⁹ Lord Tomlin held that every man is entitled to arrange his affairs so that the tax attaching him under the appropriate law is less than it would otherwise be.

There are several methods of avoiding tax that includes transfer pricing, income splitting, dividend stripping, sheltering of income and capitalization of income. This study was aimed at looking how the Income Tax Act, 2004 is to control these practices. The definitions and practical aspects of these practices are discussed extensively in chapter three.

²⁸ Ibid p.37

²⁹ (1936) AC 1

1.10. Scope of the study

The scope of this research is confined within the Income Tax Act no. 11 of 2004, in particular general and specific anti- avoidance provisions. These are sections 35, which deals with powers of the commissioner to counteract tax avoidance arrangements by making necessary adjustment, sections 33, 34 and 57 on transfer pricing, income splitting and income or dividend stripping respectively.

1.11. Area of the study

The geographical focal point of inquiry is Tanzania Mainland. An attempt has been made to use data from the TRA, TIC, BRELA and other places where stakeholders were available and were ready to cooperate.

1.12. Research Methodology

1.12.1. Types of research applied in the study

This is a field research that underscored and find out whether tax avoidance schemes increase year after year and the impact of that increase. To a lesser extent, it involved a historical research in sense that it traced and pointed out how tax avoidance schemes have affected financial interests of the government in Tanzania mainland. The same has been conducted using various methods.

The first method is documentary research of which entails collection of and review of policy documents, legislation, research reports and recorded information from public debates which are relevant to this study. Documentary research also has involved the identification and critical examination of literature which is available on the subject so as to establish the state of knowledge on tax avoidance and its mitigating factors within the law. The sources of literature and documentary included institutional libraries and internet for electronic information.

1.12.2. Sampling and sampling procedure

The selection of respondents based on random sampling. The selection priority focused on professionalism and expertise where by relevant authorities such as the Tanzania revenue authority (TRA) in particular the education departments, Tanzania Investment Centre (TIC) were visited due to their significance and proximity to shareholders of tax matters, similarly some Legal firms specialized with taxation Law. Basically, the selection of respondents has focused on collecting information and data relating to impact of tax avoidance in the national income, how it is detected by tax authorities and whether assessment done to those who are found to have avoided tax are complied with by those involved in avoiding tax.

Purposive sampling method has been used because the respondents are qualified tax assessors, auditors, lawyers and tax tribunal members who are experienced in tax issues. In addition, convenience sampling method has also been employed.

1.12. 3. Sample Size

Since the research was conducted in Tanzania mainland, the targeted population was located in Dar es Salaam region. Given the objective of the research, the targeted population was ten legal practitioners specialized in Tax Law, ten Tax assessors, ten accountants and ten Taxpayers. Other information was gathered from University/college Libraries in Dar es Salaam and Law Reform Commission Library. Through this sample size, the researcher managed to gather sufficient information relevant to the study.

1.12.4. Sources of data

The researcher has deployed both primary and secondary sources. Primary data has been useful as it testifies the reality as well as reveals as to what extent the problem of the study exists practically. Secondary data through case law, articles, journals, books and other relevant materials exposed the existing gap to the researcher thus helping to scrutinize what has been said by other researchers, and through them the researcher has focused on and addressed the existing loopholes and their practical solutions.

1.12.5. Data collection method

The type of data determined the mode of its collection. Primary data has been collected by way of questionnaire and interview while secondary data has been gathered by way of reviewing different literatures and works of other researchers.

1.12.5.1 Primary data

The researcher has conducted a field research at the TRA, BrickHouse Law Associates, BRELA, TIC, and Practicing advocates, Tax officers and taxpayers and questionnaires were used as data collection technique.

1.12.5.1.1. Questionnaire

Questions have been designed and distributed to the respondents for answers. With a view of granting more freedom to the respondents, these were in form of unstructured or open ended questions. It also contained structured or closed ended questions that provided limited spaces to answer by the respondents. The respondents are individuals, institutions, organizations and the judiciary with personnel possessing firm legal expertise and experience as well as tax law matters.

1.12.5.2. Secondary data

1.12.5.2.1. Documentary Review

A detailed library research has been conducted in which the problem has been analyzed through the examination and study of statutes, text books, journals, articles and case law on the related study and other relevant material available. The researcher visited libraries of Mzumbe University in Morogoro, University of Dar es Salaam, Law Reform commission, High Court of Tanzania library at Dar es Salaam and Institute of Tax Administration in Dar es Salaam.

1.12.5.2.2. Electronic sources

The researcher had access to some website and search engines concerning tax avoidance provisions with substantial information on the impact of tax avoidance. Through this method it has been possible to make a comparative study to foreign jurisdiction in finding out the way they regulate the tax avoidance provisions in their jurisdictions. Through this tool the international legal framework on anti-avoidance schemes have been observed so as to draw necessary lessons for purpose of improving the Tanzanian's legal framework on the subject.

1.12.6. Data processing and analysis

The data has been collected in qualitative form and thus analyzed through descriptive method. Under this method responses from respondents have been analyzed in order to get their opinions or comments on the legal framework governing Tax Avoidance in Tanzania. Through this method examination has been made on respondents' observations and their implications in the current legal framework. Finally a conclusion has been made on the implications of respondents' observations on the Tax Legal framework and in particular Tax avoidance provisions in Tanzania.

1.12. 8. Ethical Consideration

The researcher did abide with the rules of ethics including that of using time properly so as not to expel respondents. Respondents being academicians and government officials had no time to waste.

CHAPTER TWO

FRAMEWORK OF INCOME TAX LAW IN TANZANIA MAINLAND

2.1 Introduction

For a long time tax has been a major source of government revenue for most countries in the world. Income tax is one of the greatest sources of government revenue. The structure is generally composed direct and indirect taxes. Direct taxes are normally what referred to as Income taxes. They include corporate tax, PAYE and withholding tax. Indirect taxes include tax on domestic goods and services like the Value Added Tax, Exercise Taxes, taxes on imported goods etc. Tax collection in Tanzania is still below the international standards of being above 30% of the GDP and currently it amounts to around 18% of the GDP. One of the reasons for low collection of tax is tax avoidance and tax evasion. Tax avoidance practices reflect the strength or the weaknesses of the legal framework of Taxation of any tax regime.

This Chapter provides an analysis of the legal framework of income taxation in Tanzania. Before venturing into the current trend, it is important to trace a historical background of income taxation upon which the current framework is founded.

Income Tax During and After the Colonial Period:

Before independence, taxes were not main source of revenue for colonial government. Most of colonial government expenditure was financed by the imperial government. This is one of the reasons as to why Income Tax was never introduced in Tanganyika until 1940s. Thus, the first income tax legislation was based on a model of Colonial Income Tax Ordinance which was essentially a simplified version of the UK's tax legislation that existed in the 1920s with modification to meet the needs of colonialist in the territory. During this period income tax was primarily intended for European option

of population. Africans were taxed through import and excise duties mainly because of their low income and literacy level.³⁰

In 1948 the British created the East African High Commission as a statutory corporation to administer and provide in Kenya, Uganda and Tanganyika (The High Commission Territories) certain inter-territorial services³¹ including tax matters. The Commission synchronized all tax legislation in East African territories by enacting the East African (Income Tax Management) Act, 1952.³² This was a managing instrument. It did not go into matters pertaining tax rates and allowances. They were determined by individual territories. This Act was repealed and replaced by the 1958 Act. According to the scheme of the 1958 Act the tax was levied on residents of East Africa upon their income from sources within East Africa. Income from sources outside East Africa was taxed to the extent that such income was remitted to and received in East Africa.³³ This law continued to operate even after independence of the East African Territories.

Following the signing and coming into existence of the East African Community in 1967, the 1958 Act was revised in 1970. In December, 1973 the East African Income Tax Department was split up. Each country assumed the responsibility of running its own income tax matters by creating independent tax departments. Thus, Tanzania enacted the Income Tax No.33 of 1973 which became in force in January, 1974.

During this period, territorial governments were responsible to administer and collect income taxes while other taxes such as customs and excise duty were under the East African Community. Following the disintegration of East African Community in 1977 all tax matters become under the government of the United Republic of Tanzania. Of all East African countries, Tanzania is said to be the most affected country by the

³⁰ Luoga, F. A (2000) A Sourcebook of Income Tax Law in Tanzania, p.7

³¹ Ibid

³² Ibid

³³ Ibid

disintegration of the Community. This was due to the reason that while each territory had to remain with its workforce to design and implement tax policy, Tanzania had no trained manpower compared to Kenya and Uganda.³⁴

Thus, prior to 1996 when the Tanzania Revenue Authority was established, tax administration was under three departments namely the Income Tax Department, Customs and Excise Department and Sales Tax and Inland Revenue Department under the Ministry of Finance.

Several reforms were introduced to curb this problem, different departments were merged. However, a collection performance result was not reached. Later on in 1996 Tanzania Revenue Authority was established and charged with responsibility of assessing, collecting and accounting of the central government taxes.

2.2 The Current Income Tax Framework

The current income tax framework of Tanzania is provided for by the Income Tax Act, No. of the 2004. The law provides, among other things, the charge to tax, the basis of taxation, taxable entities and procedure for paying tax. Under this part, we explore these titles with a view to making a connection of the same and tax avoidance practices that are discussed in chapter two.

2.2.1 A Charge to Tax:

A charge to tax simply means an imposition of income tax on a tax payer. Before the taxpayer is charged tax on his income, it must be established that the respective taxpayer has a chargeable income for that particular year of income. Chargeable income is that income arrived at after deduction of expenditure and any other exclusions provided by law.

³⁴ Ibid p 4

By virtue of the provisions of section 4 of the Income Tax Act, income tax is imposed and charged to income of every person during the year of income in respect of (i) total income for year of income, (ii) repatriated income for a domestic permanent establishment and (iii) final withholding tax received during the year of income. Thus, tax which should be paid by a taxable person during the year of income must be the sum of tax payable in item (i), (ii) and (iii). However, it is important to note that tax on item ii is payable by a domestic permanent establishment of a non-resident person.

By virtue of section 5(1) of the Income Tax Act, the total income of the person must be the sum of person's chargeable income for the year of income from employment, business and investment less any deduction allowed for the year of income.

2.2.2. The Basis of Taxation

In every tax system; the question of who is a subject of income tax legislation must be answered in clear terms. It is important to note that for a person to be a subject of a give tax system there must exist a connecting factor/basis that establishes the relationship between the system (jurisdiction) and that person. That connecting factor must be clearly stipulated in a tax legislation upon which tax is sought to be imposed other tax payers may use the existing loopholes to avoid tax.. The most common basis/ factors used by tax legal systems to tax persons in their jurisdiction are:-

- i. Citizenship or Nationality
- ii. Domicile
- iii. Country of source and country of Destination; and
- iv. Residence

Citizenship/Nationality

Because of our political affiliation to our nation; we are liable to pay tax to our governments; so that is able to provide social services.

It is a traditional obligation that every citizen or national to help/support the state through taxation whether the citizen is living within or outside the state.

It is an easy test to be applied. However it also has a side effect in that it may be used to evade tax by emitting nationality in a tax haven. The question of dual-nationality should not be left an attended.

Domicile

Domicile is a legal concept. It is a connecting factor which links a person with a particular legal system. Domicile can be by birth or by choice. The most important things to be established are that a person must be a resident in the country and that his resident must be his permanent home.

Domicile of origin is acquired by virtue of being born in that country. It does not deal with citizenship. A person may be a citizen of one country and domiciled in another country.

Domicile of choice is one chosen by a person himself after abandonment of domicile of origin. Domicile of choice involves two elements; one, is the fact of presence within the jurisdiction; and two the present intention on the part of individual to maintain his permanent home in the jurisdiction.

Country of Source and Country of destination

Country of source means the country from which income is derived or accrued from. By this basis; tax is imposed on income whose source is from that country through employments, investments and business. It doesn't matter whether a person is a citizen or not.

Country of Destination means a country to which income is repatriated or exported. This applies to all citizens/nationals of a given state. In Tanzania; the Income Tax Act 2004 imposes tax on the income earned by her residents who work in foreign countries; or carry on or receive income from investments in foreign countries. Tanzania in this case is a country of destination of such income and treats foreign income like domestic source income.

Residence

Residence is the main basis of income taxation in Tanzania. Section 66 of the income Tax Act provides the rules and criteria for determining “ residence” in the United Republic with respect to a person for income tax purposes. The provisions cover residence of an individual; a partnership; a trust and a corporation.

It is firmly established that tax Acts impose territorial limits. It is a general rule that in order there to be a liability to income tax in Tanzania; it should be established that the source from which payment is derived is located in Tanzania; or the person who is to be taxed must be a resident person in the United Republic during the year of income.

Once it is established that a person is a resident person during a particular year of income; he will be liable to pay tax for all income received during the year of income irrespective of its source. If a person is not a resident during the year of income, no income will be imposed on his income except that income whose source is in Tanzania.

It is also important to establish residential status of a taxpayer because the rules on calculation of taxable income demands that consideration should be given inclusions and allowable deductions. For example, the law provides that in respect of a non-resident, some deductions are not permissible. These include expenditure incurred abroad. Also on the issues of tax reliefs, some of them may not be available to non-resident. Eng. Investments capital allowances, inter-corporate dividend are restricted to resident corporations.

2.2.3 Taxable Entities and Rules of Taxation

While there are general rules of taxation, it is important to look at specific rules of taxation for specific taxable entities. This is important because it is through these established specific rules that taxpayers are camouflaging their identity with a view to avoiding tax.

In Tanzania tax is levied on income from employment, income from business and income from investment, therefore taxable persons include entities and individuals. The rules of taxation and even tax payment procedure depend on the type/characteristic of the taxable person. An entity can be a corporation or a trust and charitable organization, a corporation is loosely defined to mean any incorporated or unincorporated body of persons or association.

Taxation of an Individual

The income of an individual in Tanzania may come from employment, business, investment, foreign source income, pension income, rental income, capital gains and any other income earned.

Under the employment income, the general rule is that income from is gains or any profit from employment, that is salary, allowances, gratuity, benefits in kind and all other forms of remuneration or compensation for the employment.³⁵ However there are some exceptions as per the second schedule of the Income Tax Act³⁶ on employment is mostly paid by the employer under pay As You Earn. (PAYE)

Moreover, Income from investment is also liable to Tax as per the Income Tax Act.³⁷ When the individual receives interest from a financial institutions, the bank withholds tax by deducting 10% of the interest and sends it to TRA, again on dividends, the

³⁵ Income Tax Act, Cap 332 R.E. 2008 s. 7

³⁶ Ibid Second Schedule

³⁷ Ibid s. 9

company that pays dividends withholds tax by deducting 10% for companies not registered with Dar es salaam Stock Exchange or 5% for a registered company otherwise the individual will have to file return if the tax has not been withheld.

An individual's income from Business is also taxed and the rule is that gains or profit from conduction of business includes service fee, incomings for trading stock, gains from the realization of business assets or liabilities of the business, amounts derived from the realization of the person's depreciable assets of the business, amounts received as considerations for accepting a restriction on capacity to conduct the business, gifts and other ex-gratia payments received by the person in respect of the business other amounts derived in conducting the business.³⁸

If an individual is not employed and has a business income, he is required to pay tax by instalments like other installment taxpayers by filing his returns on appropriate date as per the law. For this case, amount tax payable depends on how the taxpayer self assess his business. This taxpayer is at liberty to enjoy the loopholes of the law and avoid tax by way of income splitting, transfer pricing and sheltering of income.

Taxation of a Trust

Taxation of a Trust is done by adding together income from business and income from investment to get a Trust's total income. If the trust is a charity then there are special rules for calculating income. A Trust may account for its business income on either a cash basis or on accruals basis, all trusts are under self assessment system. The Trust may have an obligation to withhold tax from those it pays. If the trust is resident in Tanzania, the distribution of trust to its beneficiaries are exempt from tax if the trust is not resident in Tanzania then the beneficiary must include the distribution of the trust as part of their or its income.³⁹

³⁸ Ibid s. 8

³⁹ Ibid s. 52

Taxation of a Partnership

Partnership income from a business of a resident or non-resident partnership for a year of income shall be the chargeable income of the partnership for the year of income from the business calculated as if the partnership were a resident partnership. A partnership loss from a business of a resident or non-resident partnership for a year of income shall be the loss of the partnership for the year of income from the business.⁴⁰

Taxation of a Corporation

A corporation is liable to tax separately from its shareholders. Normally the mounts derived and expenditure incurred jointly or in common by the managers or shareholders for the purposes of a corporation that lacks legal capacity are treated as derived or incurred by the corporation and not any other persons while assets owned and liabilities owed jointly or in common by the managers or shareholders for the purposes of a corporation that lacks legal capacity are treated as owned or owed by the corporation and not any other person.⁴¹

Taxation of Charitable Organization or religious Organization

These charitable organizations are treated as conducting a business with respect to its functions provided for under the charitable organization Act.⁴² For the purposes of calculating the income of a charitable organisation or religious organisation for any year of income from its charitable business, all gifts and donations received by the organization are included together with any other amounts required to be included under other provisions of this Act and deduction is on amounts applied in pursuit of the organisation or religious organisation's functions by providing reasonable benefits to resident persons or, where the expenditure on the benefits has a source in the United

⁴⁰ Ibid s. 49

⁴¹ Ibid s. 53

⁴² Charitable Organizations Act No.7 of 1994 s.8 (2)

Republic, persons resident anywhere; and 25 percent of the organisation or religious organisation's income from its charitable business and any investments.⁴³

Taxation of Clubs and Trade Associations

The activities of a club, trade association or similar institution are treated as a business and for the purposes of calculating the club, association or institution's income for a year of income from that business, entrance fees, subscriptions and other amounts derived from members during the year of income are included. Where three-quarters or more of the amounts to be included in calculating the income of a members club or trade association for a year of income from the business are derived from members of the club or association, the income from that business shall be exempt and shall not constitute chargeable income of the club or association.⁴⁴

The income Tax Act, provides a range of tax exemptions to some of the income, to mention the few; pensions or gratuities granted in respect of wounds or disabilities caused in war, scholarship or education grants, amounts derived by way of alimony, maintenance or child support under judicial order or written agreement, amount derived by way of gifts, bequest or inheritance save for income under sections 7(2), 8(2), or 9 (2), amounts from assets that are not for business, depreciable assets, investment asset or trading stock, income derived from investments exempted under the Export processing Zones Act and so many others.⁴⁵

2.2.4. Tax Payment Procedure

Procedure applicable to persons differs with regard to the method of payment that the person is required to use. The method required to be used by persons are withholding method, installment method and assessment method.

⁴³ Income tax Act, Cap 332 R.E. 2008 s. 64

⁴⁴ Ibid s. 65

⁴⁵ Ibid second schedule (1)

Generally every person is required to pay tax on installment and on assessment, this implies that the two methods are used by every person, while the withholding method is available to those who are required to withhold tax. These are employers who make a payment that is to be included in calculating the chargeable income from the employment, persons paying investment returns (those paying dividends, interest, natural resource payments, rent or royalty) ⁴⁶

Payment of tax by withholding

Income tax payable by withholding is payable within seven days after the end of each calendar month,⁴⁷ withholding tax is done by employers under pay As You Earn (PAYE) on bank interest where an individual receives interest from financial institution the respective banks do withhold tax and send it to TRA. Companies also do withhold tax when an individual receives dividend. The withholding tax payment applies also to payment of fees for technical services in mining operations and to payment of insurance premiums from Tanzania to a nonresident person.⁴⁸ It is the duty of the person making payment who is supposed to withhold the said tax under this category.

It is believed that withholding tax arrangement is intended to maximize tax collection by trapping the tax at the source of payment be it salary, dividend, royalty, rent or others. This helps to reduce the possibility of tax evasion by the recipient of the said payment.

Another psychological advantage, to both the tax authority and the tax payer. He says that for the tax payer, he or she avoids the agony of receiving money and then having to surrender it to tax authority with experience when in financial need can be quite

⁴⁶ Ibid s. 81

⁴⁷ Ibid

⁴⁸ Ibid Section 83(1),(a),(b)

alarming. On the side of the tax authority, the advantage is on avoiding the aggravation that comes with dealing directly with taxpayer when demanding the required tax.⁴⁹

Payment of tax by installments

The income tax payable by installment is payable on or before the last day of the third, sixth, ninth and twelfth months of the year of Income.⁵⁰ In the case of single installment the tax is payable before the title to an interest in land or building is transferred. Normally single installment method applies to a person who derives a gain in conducting an investment from the realization of interest in land or buildings situated in the united Republic.⁵¹

Payment of tax by Assessment

There are several types of assessment which can be made under this procedure of tax payment. These are as follows;

Self assessments, estimated normal (best judgment rule), provisional assessment, estimated provisional assessment, Jeopardy assessments, adjusted assessment, additional assessment and other forms of i.e. clerical audit assessment.

Under this payment mode an individual or an entity files return for the year of income to the Commissioner, the commissioner may accept such return and assess the entity on that basis as to what amount of tax the entity is liable.⁵² Therefore, under this self assessment mode, the assessment shall be treated as made on the due date for filing the return of the income. This is called self assessment. However, the Commissioner if has reasonable cause to believe that such return is not true and correct, he can determine according to the best of his judgment, the amount of income to that individual and

⁴⁹ Kibuta, O.(2011) Tax Compliance in Tanzania, Analysis of law and policy affecting Voluntary Tax Payer compliance p.133

⁵⁰ Ibid s.88

⁵¹ Ibid s.90

⁵² Income Tax Act Cap 332 R.E. 2008 s.94

assess the tax to be paid.⁵³ If the person has not filed return of income for any year, the commissioner under is entitled by Law to determine the income of the individual for that year according to the best of his judgment and assess tax accordingly.⁵⁴ And that can not affect otherwise any liability incurred by the individual under the law in consequence of failure to file a return.⁵⁵

The other mode of assessment is the Jeopardy assessment. Under this if the commissioner believes the facts and the circumstances of a case indicating that the collection of tax will be jeopardized by delay, he may immediately assess the tax plus penalties and interests if any, he is not required to provide the taxpayer with any notice.⁵⁶ The circumstances that may cause the commissioner to use this method are like when the tax payer becomes insolvent, taxpayer arrested with substantial, apparent unreported income, is about to leave the country and go into hiding immediately, taxpayer is about to place his property beyond reach of the government by concealing it, moving it to the ownership of another person.

Under section 96 of the Act, the commissioner may also adjust an assessment made under section 94 and 95 so as to adjust the assessed person's liability to tax.

Under the assessment mode, the Commissioner is required by the law to serve the taxpayer with a notice of assessment⁵⁷ by pointing out the Commissioner's assessment of income and tax payable, the manner in which the assessment is calculated, reasons as to why the Commissioner has made the assessment, date on which tax payable must be paid and the time, place and manner of objecting to the assessment.

⁵³ Ibid sub section 4 (b)

⁵⁴ Ibid subsection 5

⁵⁵ Ibid subsection 7

⁵⁶ Ibid s.95

⁵⁷ Ibid s. 97

2.5 Adherence to Tax

It is a practice of the Tax Authorities in most of the countries to use a combination of voluntary tax payment and enforced tax collections in an attempt to make sure that every tax payer pays tax as required.⁵⁸ In Tanzania the most commonly used method is the enforced collection. Despite the fact that of the three tax statutes discussed above, the Income Tax Act contains more voluntary payment provisions, the tax authority (TRA) practice and most of the laws do not display that voluntary tax payment is an approach of equal weight. The TRA overall objective is to promote Voluntary adherence to tax to the highest level as possible.⁵⁹

Under the Income Tax Act⁶⁰ the law requires all persons acquiring income from business or investment or from employment but not subject to withholding under the law to make payment of tax in four quarterly installments.⁶¹ The law goes further in providing the dates and months on which installment payments should be effected that is on the last day of March, June, September and December.⁶² Taxpayers what they are required is just to file a statement declaring the amount of Income they expect to earn for a year few months prior to the end of the preceding year and the estimated amount they declare becomes the basis on which all the installments will be paid.

There also other statutes which have incorporated voluntary payment of tax, example the Land Act,⁶³ here taxes required in Land transaction are supposed to be effected at the time of the transaction or else the transaction will not be registered.

⁵⁸ Kibuta, O. Tax Compliance in Tanzania Analysis of Law and Policy affecting Voluntary Tax Payer Compliance. p.141

⁵⁹ Tanzania Revenue Authority Act

⁶⁰ Income Tax Act no 11 of 2004 R.E.2008

⁶¹ Ibid s. 88(1)

⁶² Ibid s. 88(2)

⁶³ The Land Act no 4 of 1999

Under the Stamp duty Act⁶⁴ also no instrument for which stamp duty chargeable can be registered or used in evidence where no proof of stamp duty is produced and the Companies Act⁶⁵ on sales of shares or other changes occurring in the company not to be registered unless all taxes payable have been effected.

Despite of those voluntary provisions, still most tax payers do not feel the touch of complying with tax. Most of them are busy in planning to evade or avoid tax instead of being adhering to what the Tax Authority requires. Kibuta⁶⁶ points out that the withholding tax payment mechanism has remained an effective tax collection arrangement due to its ability to reduce the tax evasion and easing the taxpayer's psychological burden related to cash and direct payment which affects the pockets immediately.

In Tanzania, TRA uses both persuasion and reckoning in order to reinforce voluntary tax payment. The Tax payer education program is used to sensitize taxpayers to meet their tax obligations in a voluntary way.

Seminars, radio and television broadcasts and workshops are being held all over the country trying to win the hearts and minds of taxpayers.⁶⁷ However, there are wide ranges of penalties for non-adherence to tax payment under the Tax laws. Whenever non adherence to tax payment is discovered by the tax authorities the defaulters are dealt with by being prosecuted or by imposition of fiscal penalties.

However, TRA mostly do use the power to attach and sell assets, power to issue urgency notices, attach bank accounts and to prosecute for tax breaches. In the exercise

⁶⁴ The Stamp Duty Act of 1972

⁶⁵ The Companies Act no. 12 of 2002

⁶⁶ Kibuta, O. Tax compliance in Tanzania, Analysis of the Law and policy affecting Voluntary tax payer compliance. p.143

⁶⁷ Ibid p. 142

of these powers TRA is expected to act fairly and Kibuta⁶⁸ argues that there is a need for assessing the fairness of the said compliance measures. He goes on admitting that it is not easy to measure the fairness of the fairness of tax collection because fairness is a matter of individual perception.

There are some few basics that are considered to be vital in forming an opinion of fairness, these basics include; transparency in the application of tax laws, consistency and impartiality in decision making or actions taken; allowing for sufficient taxpayer input in reaching tax decisions; respect for the right to challenge decision or action taken and respect for adjudication bodies. Existence of these basics in a particular tax system ensures that there is fairness in the administration of tax.

One way to ensure that there is transparency in the application of tax laws is for the government to and tax administration to ensure that everyone who ought to pay tax is paying tax. A problem noted in Tanzania is that is the narrow tax base⁶⁹ in that tax is collected from a very small section of society.

Despite the fact that the Government is aware of the situation still reluctant to attack other sectors like rural sector and bring those other sector in the tax net. Minimal efforts or no efforts at all to expand the Taxpayer registration program to people deriving income from informal sector. Narrow tax base results into selective taxation and undermines transparency in the application of tax laws. The two things are mostly caused by substantial tax exemptions allowed by the Government. It had been recommended that the government should remove the exemptions so that tax base is broadened.

⁶⁸ Ibid p.145

⁶⁹ DANIDA, Project document, Danish support to Tanzania Revenue Authority phase II2003/04-2007/08 Danida Tanzania.213,October, 2003, p.7

Most tax payers' perception is that there is sufficient consistency and impartiality in decisions made or actions taken by the Tax Authority in Tanzania. The TRA is coupled with robotic application of tax laws even when it leads to absurd results.

On fairness to the TRA, there is visible respect for the right to challenge decisions or actions taken by the TRA. Taxpayers are enabled administratively to complain to the superior officer against the actions of tax officer. There in place tax objection and tax appeal procedures laid down in the tax laws and TRA has administrative arrangement to facilitate the same.

However, in filing objection, the taxpayer is required to deposit one third of the disputed tax.⁷⁰ Despite the fact that this condition of prepayment breaches the principle rule of presumption of innocence and hinder some tax payers to exercise their right to appeal, this condition is justified by reasoning that, while allowing for the right to dispute tax assessment, there is higher interest in ensuring that the flow of Government revenue is not jeopardized by litigation.⁷¹ It is also argued that the condition of prepayment reduces the risk of appeal to be used to delaying payment of tax that is due but in a real sense this increases resistance to tax as it carry away the trust that must exist between taxpayers and tax administration.⁷²

Moreover, in tax statutes there are provisions that that allows for tax refunds. This is done where there is over payment of tax.⁷³ These provisions cement the principle that subjects of tax should pay no more than what the law requires, however the experience has shown that recently the process for refund takes long time than it was at the time these provision were put in place.

⁷⁰ Tax Revenue Appeals Act, section 12(6)

⁷¹ Kibuta, O. Tax Compliance in Tanzania, Analysis of Law and Policy Affecting Voluntary Tax Payer Compliance. p.148

⁷² Ibid

⁷³ Value Added Tax Act ss. 16 and 17

2.7 Conclusion

Tax avoidance and Tax evasion are all considered to be Tax Planning. As discussed earlier, tax avoidance is the legal way to minimize tax liability without contravention of the law in order to minimize tax liability. As shown above, most tax statutes are comprehensive on themselves but the problem here is the perception of the tax payers on tax. Tax payers expect viable change in the society in terms of the return from the government on provision of social services to them. Despite the fact that tax framework has tried to encourage voluntary taxpaying still there is a need for the tax authority to use more than one approach in encouraging voluntary.

CHAPTER THREE
TAX AVOIDANCE IN TANZANIA MAINLAND AND ANTI - AVOIDANCE
PROVISIONS

3.1. Introduction

Tax avoidance continues to be a major concern to fiscal authorities around the world and Tanzania is no exception. Tax avoidance is done from due point of weakness of the existing legal framework. Therefore tax avoidance needs arrangements by the experts who have skills of reducing the amount of tax without breaking the law. The exercise to this effect is called “tax planning”. Tax avoidance techniques are more advanced in developed countries compared to developing countries in which tax avoidance methodologies are few. This chapter discusses tax avoidance techniques that are employed by taxpayers to avoid tax.

3.2. Methodology of Tax Avoidance

There are several methods of avoiding payment of taxes, to mention the few;

3.2.1 Income splitting

It is done when one person tends to divide/split his income to another person. It is a method of reducing family’s or associates/partners income tax in jurisdiction that employs a progressive taxation. In situations where one member of a household earns considerably more than another, they will likely be in higher bracket, and thus, have to pay more income tax. Income splitting works by shifting some of the income to the lower earner, and thus, shifting the higher earner to a lower tax bracket. A good example is where a wealth individual spreading his income by forming partnerships restricted to family members thus avoiding progressive individual rates but the income of the said partnership still comes to him as a head of family and the real owner of the firm.⁷⁴

⁷⁴ Luoga, F. A (2000) A Sourcebook of Income Tax Law in Tanzania. p 39

Certain features of the Income Tax Act, 2004 like free threshold, progressive tax rates, taxation of husband and wife separately contribute to the attractiveness of income splitting. This entails splitting of income between more than one taxpayer preferably among the family members so as to reduce the marginal rate of tax chargeable thereon.

3.2.2 Income or asset shifting

This technique is achieved through the shifting of income or income producing asset to another person or entity in which the tax payer has beneficial interest and which is chargeable to less tax. Such person or entity ought to have preferential tax treatment.

For example in the case of **AD v CITZ (EATC) 89**: Mr. AGS created a trust to assist poor and needy Muslims. He appointed himself and his two son's trustees. According to the trust, conducted in the business of the trust and provided all the revenue and property to the trust. Although the setup has all the hall marks of avoiding tax, the commissioner failed in an attempt to assess the trustees on the profits made by the trust. The court held that only the trust was assessable to tax.

The Tanzania tax regime creates number of taxable persons who are, because of their nature of business or operations, entitled to various tax reliefs and exemptions such charitable organizations, that includes hospitals, schools, Non Governmental Organizations just to be mention but a few. Persons who own assets that generate income susceptible to income tax are tempted and tend to shift ownership of these assets to their organizations that enjoy tax reliefs and exemptions. But in turn these assets continued to be enjoyed by the same person.

3.2.3 Sheltering of Income

This is when income is sheltered to another country where tax liability is very low. Other method of sheltering income is the use of shelters implicit in the domestic tax scheme such as the generous capital cost allowances; invest allowances, liberal deductions offered to agricultural and mining sector. For example, the Second Schedule

to the Income Tax Act, 2004 provides exemptions to various schemes including mining and agriculture sector. Most of investors have been avoiding tax by sheltering their income into those activities. Furthermore, tax exemptions are now provided under the Government's Kilimo Kwanza" initiative which aims to promote commercialization and new technology in farming.⁷⁵

3.2.4 Deferring tax liability

Deferred tax liability means that the company postpones its tax liability from the present period to a future period. Taxable differences give rise to deferred tax liabilities. This can be achieved by issuing loans or dealing with assets, dispose of them by way of nontaxable dispositions to effect deferral until sometime in the future, the payment of tax on income currently being earned.

3.2.5 Capitalization of income

It is when the income is connected into capital which may remain untaxed or taxed at a lesser rate; or in some form of intangible benefits to the recipient; the receipt of which will be untaxed, for example the tax payer may arrange for his income to come to him as capital receipt in the following ways:-

- (a) Letting property on lease at a large premium and a much reduced rent.
- (b) Selling securities before dividends are distributed and purchasing them after wards.

- (a) Non declaration of dividends despite large profit made and profit ploughed back into the capital company as capital. This technique is called "*the transformer or leveling divide*".

⁷⁵ Interfaith Standing Committee on Economic Justice and the Intergirity of Creation, One Dollar Billion Question: How Can Tanzania Stop Losing so much Tax Revenue? Pg.35

3.2.6 Conversion of capital expenditure into Current expenses

Sometimes taxpayer may arrange to change Capital expenditure into current expenditure like a company allowing the director to go on a business trip with family which is actually a vacation.⁷⁶

3.2.7 Dividend stripping

It is where a company that has reserves accumulated tax profit is purchased and profits are fully distributed as dividend and the company is resold at a loss and the loss is deductible to the new acquirer.

When someone sells shares before a dividend payment and buys them again after payment in order to avoid paying tax on dividend (*Longman Business Dictionary*).

It is a process when an investor would invest just before dividend is declared and would sell the shares after receiving dividend. When shares are bought before dividend is declared ought to be bought at a high price when it is expecting that dividend is about to be declared. By selling it immediately after declaration of dividend, a short term capital loss is incurred. This loss is set off against a short term capital gain, thereby reducing capital liability.

Net value falls in proportion to the dividend declared. The sale price becomes less than the purchase price.

3.2.8 Transfer pricing

It generally, refers to the setting, analysis, documentation, and adjustment of charges between related parties for goods, services, or use of property. Is an arrangement between persons who are associate, in which they quantify apportion and allocate amount to be included or deducted in calculating income between the persons as is necessary to reflect the total income or tax payable that would have arisen for them if the arrangement had been conducted at the arm's length.

⁷⁶Ibid

The principle developed by the provisions in the section is that transactions between associates (connected persons) are to be conducted at arm's length. This means that the transaction in the arrangement between connected persons should have the financial characteristics of a transaction between independent persons under the same or similar circumstances where each person will strive to obtain the utmost benefit from the transaction.

Section 33 provides the mechanisms, by which the Commissioner adopts the arm's length principle to quantify, apportion and allocate amounts involved in the transaction based on conditions, which would have existed between unconnected persons.

3.3 Anti- Avoidance Provisions

Every tax jurisdiction is always concern with tax avoidance. Every tax jurisdiction struggles to ensure that tax avoidance is controlled by employing various anti-avoidance provisions in tax legislation. There are two types of anti-avoidance provisions namely General Anti Avoidance and Specific Anti Avoidance provisions.

3.3.1 General anti-avoidance provisions

The introduction of GAAR regulation recognizes that it may not always be feasible for the tax enforcement authority or even the judiciary to address the unforeseen implications of transactions carried out for tax purposes and also the need to provide some semblance on the matter of tax avoidance. Section 35 of the Income Tax Act, 2004 is a General Anti-Avoidance Rule (GAAR). It deals with powers of the Commissioner to counteract tax avoidance arrangements by making appropriate adjustments.

Section 35(1) of the Act is designed to defeat tax avoidance schemes not brought by any of specific provisions of the Act. The subsection provides that notwithstanding anything in the Act, when the Commissioner is of the opinion that an arrangement is a tax avoidance arrangement, the Commissioner may, by notice in writing, make appropriate

adjustments as regards to person's tax liability to counteract any avoidance or reduction of tax.

The intention of the provisions is to make tax avoidance arrangements void and grant the Commissioner the authority to make appropriate adjustments in the calculation of the person's income and bring to charge the tax amount that would have been lost if the adjustments were not made.

As we have seen above, there are many ways through which taxpayers may take advantage of the weakness or loopholes in the law to arrange their affairs with a view of minimizing their tax liabilities. Of all the methodologies of avoidance that we have seen above, it is only three of them namely income splitting, transfer pricing, and dividend stripping that are covered by specific provisions of the Income Tax Act.

3.3.2 Specific Anti Avoidance Provisions

These are provisions of law that are targeting specific type of transactions. Good example of these provisions is:

- (i) Section 34 of the Income Tax Act; It deals with matters of Income Splitting. The section empowers the Commissioner to counteract effects of income splitting in order to prevent any reduction of the tax payable amount as the result of splitting of the income. By that section the Commission may do the following:
 - (a) Adjust any amount to be included or deducted in calculating income of each person;
 - or
 - (b) Re-characterize the source and type of any income, loss, amount or payment to prevent any deduction in tax payable as a result of splitting income.

A good example in this matter is the case of *Millard V FCT (1962) 108 CLR 336* an agreement was made between a licensed book maker and a family company under which it was agreed that the Company should take

over and carry on the book maker's business and Lent forth the book maker would carry on his activities as an agent of the company. The Commissioner assessed the bookmaker on the basis that the sums paid by him into the Company's account were included in his taxable income.

- (ii) Section 33 deals with matters of transfer pricing: The section provides the mechanisms, by which the Commission adopts the arm's length principle to quantify, apportion and allocate amounts involved in the transaction based on conditions which would have existed between unconnected persons. However the noted drawback to this section is that The Act does not specify any methodology for determining what constitutes an arm's length price. There is no explicit requirement in the legislation for the taxpayer to prepare transfer pricing documentation, although section 33 does require that the persons who are involved in the relevant transaction should "quantify, apportion and allocate amounts to be included or deducted in calculating income between the persons as is necessary to reflect the total income or tax payable that would have arisen for them if the arrangement has been conducted at arm's length". This could be taken to imply that adequate documentation must be available to support the pricing of transactions between associates. A good example on this is China where Departmental Practice notes on transfer pricing was issued in December 2009 and the same provides for issues of Documentation.⁷⁷

In Tanzania the Income Tax Regulations 2004⁷⁸ provides that section 33 "shall be construed in such a manner as best secures consistency with the transfer pricing guidelines in the Practice Notes issued by the Commissioner pursuant to section 130 of the Act". However, as noted earlier the TRA has not issued a Practice Note to clarify

⁷⁷ China Departmental and practice Notes No. 46, issued in December, 2009 retrieved from www.kpmg.com/CN/en/issues retrieved on 8th January 2012, The IRD encourages enterprises as a matter of good practice, to document transfer pricing without necessarily incurring disproportionate compliance costs. The IRD notes record keeping requirements of section 51 and points out that enterprises carrying on business in Hong may be called upon by IRD to justify their transfer prices and the amount of profits or losses returned for tax purposes in the event of an inquiry, audit or investigation.

⁷⁸ The Income Tax Regulations (2004) Regulation 6.

what approach it will follow to give effect to the transfer pricing provisions (although it has indicated that a Practice Note will be issued in due course). In the meantime, the TRA has stated that it will apply internationally agreed arm's length principles as set out in the UN and OECD Transfer Pricing Guidelines.

Furthermore, TRA has indicated that it will follow the ruling in the Kenyan tax case on transfer pricing (Unilever Kenya Limited – see Kenya section), which applied the OECD transfer pricing principles.⁷⁹

In addition to section 33, the general deductibility section within the Act, section 11, provides that expenditure must be incurred wholly and exclusively in the production of income from the business. It would also be possible for the TRA to challenge the deductibility of an expense under this section if, for example, it considered the amount to be excessive or unsupported by suitable evidence.

In respect of a controlled foreign company, the Tanzanian transfer pricing rules allow the companies to apply transfer pricing if it is deemed to be an associate of the local entity, according to the definition of associate. However, a controlled foreign corporation is not itself deemed to be a resident of Tanzania for tax or transfer pricing purposes.

As noted above, the TRA has indicated that it will issue a practice note to provide guidance on the application of the transfer pricing legislation, but no such guidance has yet been issued. The tax return form does require a taxpayer to disclose transactions with related parties, although this information tends to mirror the details already provided in a company's financial statements.

⁷⁹ Raby N. *International Transfer Pricing* 2009

There have not yet been any legal cases based on the current legislation. A number of TRA challenges are currently under objection and these may end up being tested through the courts.

(iii) Section 57 of the Income Tax Act deals with matters of Income or Dividend Stripping. The section provides the tax treatment of distribution made by an entity to an acquirer in the course of an income or dividend stripping arrangement as follows:

(a) Where an acquirer or an associate of the acquirer of an entity makes a payment whether or not in respect of the acquisition of the entity to another person who was a member in the entity or an associate of that other person the payment shall be treated as the distribution by the entity made to the original member of the entity;

(b) Where the entity makes a distribution to the acquirer after the acquisition which reflects the income of the entity, the chargeable distribution amount shall be reduced by the amount paid by the acquirer to the original member or associate of the original member.

This specific provision is designed to counter dividend stripping arrangement and lessen taxation advantages that were sought to be enjoyed before enactment of the Income Tax Act, 2004. However, like for any other specific anti avoidance sections, there are no detailed regulations for dividend stripping the effect being that effective enforcement of these rules depends on the wisdom, knowledge and prudence Tax Revenue Authority personnel.

3.4 Causes of Tax Avoidance and Enforcement of Anti- Avoidance Provision

Having anti avoidance provisions in the law, despite their weaknesses, is one question and their effective enforcement is another question of the most concern. Effective enforcement of the law depends on number of factors namely, the capacity/competency

of the enforcing authority, availability of enforcing rules, certainty of the obligations that they create to both taxpayers and tax authority and other important resources. But again the success of the enforcement mechanisms depends on whether the identified enforcement mechanisms have effects to the courses of the problem; tax avoidance. It said that any attempt to avoid tax is caused by one or combination of the following factors: -

- i) High marginal tax rates and frequent changes in tax rates such as excise and import duty, withholding tax etc. because taxpayers may consider distribution of their incomes unfair and may attempt to make a unilateral adjustment for equity by non-compliance through tax evasion. Some reports show that a one percent point increase in the tax rate leads to a 3.8% increase in tax evasion.⁸⁰
- ii) Administrative inefficiency, collusion with taxpayers and bribery of tax officials. Financial constraints, inadequate working tools and lack of staff motivation do not encourage tax compliance. Income may go untaxed and tax collection is delayed for various reasons. For example see the work of **Odd-Hedge Fjeldstad** “*Tax Evasion and Corruption in Local Government in Tanzania: Alternative Economic Approaches*”⁸¹
- iii) Inadequate training and experience of tax administrators coupled with lack of exposure to business practices may limit tax officials’ ability to expose complex international and intercom any tax avoidance schemes and check on stock manipulations or proper accounting in long term contracts.

⁸⁰ Jorgen L and Lars M. W “Tax Evasion in Kenya and Tanzania: Evidence from Missing Imports” Working Paper Series (2007), Orebro University-Sweden; available at www.oru.se/PageFiles/15374/wp2007-08.pdf

⁸¹ A working paper of Chr. Michelsen Institute, available at www.bora.cmi.no/dspace/bitstream/10202/330/1/WP%201996_14%20Odd%20Helge%20Fjeldstad-07112007_1.pdf

- iv) Too many taxes (multiplicity of taxes) are difficult to comply with correctly due to lack of knowledge of the detailed provisions of all the tax laws, too many due dates and too much return to complete, accounting staff shortages and different complexities in the laws etc. There are more than 30 tax laws in Tanzania. There is a need to rationalize the tax regime further.

It worth of noting that any approach to anti avoidance must also take into account the need to control these factors that stimulates tax avoidance practices.

3.4.1 Tax Payment and the taxpayer's obligation

Under the general and specific anti-avoidance provisions and the self-assessment regime, the burden of proof is on the taxpayer to ensure what is reported by him reflects true record of his business transactions conducted at the arm's length. And the assumption of the law is that what is declared by the taxpayer is presumed to be true unless proved otherwise. It requires sufficient time to audit the accounts of the taxpayer and establish whether or not what have been presented are genuine records of the taxpayer on the arm's length principle.

3.4.2 Tax audit procedures

No specific procedures have been laid down by the TRA in relation to identified tax avoidance methodology. Investigations, and currently queries on various tax avoidance issues form part of the normal TRA audit process. Moreover, there is no dedicated anti avoidance unit within the TRA and queries are handled by the Large Taxpayers Department or Domestic Revenue Department as part of the normal process of reviewing a taxpayer's income tax affairs.

3.4.3 Availability of comparable information

Anti tax avoidance rules and, the transfer pricing rules are the basis for determining an acceptable transfer pricing methodology (although no specific methodologies are

prescribed). As mentioned above, the TRA has indicated that it will apply internationally agreed arm's length principles as set out in the UN and OECD Transfer Pricing Guidelines.⁸² Availability Information on the performance of companies in Tanzania is only readily available in the form of published or filed financial statements, with practical observance being more consistently followed by public companies and financial institutions. More detailed information is not generally available publicly. As a result, the use of Tanzanian comparable is not possible. The TRA has not indicated whether it will accept the use of financial databases used elsewhere in the world, and given the lack of practice in this area, it is possible that this issue has not yet been considered.

There is no indication at present that certain types of transactions or industries are at higher risk of investigation than others. However, to date, the key area of focus by the TRA has been intra group management fees (basis of calculation of the fee and evidence of services actually being provided) and interest free funding.⁸³

3.4.4 Availability of Competent authority

The lack of experience coupled with potentially difficult administrations in wider Africa means that competent authority claims and/or reliance on MAP to resolve disputes will be problematic.

3.4.5 Cooperation with other authorities

TRA has intensified communication with neighboring countries of Zambia, Kenya, Uganda, Malawi and Rwanda in exchange of information on cross border transactions through the introduction of Revenue Administration Digital Data Exchange (RADDEX).⁸⁴ Significantly this aims at improving cross border data exchange for goods which are destined to neighboring countries and reduce tax evasion through

⁸² Ibid

⁸³ Ibid

⁸⁴ TRA, Corporate Tanzania, The Business, Trade and Investment Guide 2010/2011 p. 174

dumping of transit goods. It is also expected that the application of multiple approaches in tackling tax evasion such as simplification of tax laws, reduction of tax rates, tax education, audits and investigations will enhance tax compliance.

However, although customs and income tax are under the same authoritative body, they are administered by separate departments within the TRA and there is currently limited direct sharing of information between the two. However, is expected that this may change in the future.⁸⁵ The TRA has indicated that it will follow OECD and UN transfer pricing guidelines.

The TRA has not yet teamed up with any other tax authorities for the purpose of undertaking a joint investigation into transfer pricing. On rare occasions, they have taken advantage of the information sharing provisions in double tax treaties.⁸⁶

3.4.6 Conclusion

In the world of taxation, avoidance means escaping tax liability legally. Some businesses tend to reduce their taxable income through unregulated, excessive operational expenses. It remains the duty of TRA to influence the government to review, generally the tax regime, the law and policies with a view to encouraging taxpayers to fill obliged to pay tax freely. It remains the duty of TRA to initiate the process of strengthening the law with a view to eliminating tax avoidance practice that will include enacting detailed regulations to enforce the loose anti avoidance provisions.

⁸⁵ Ibid

⁸⁶ Ibid

CHAPTER FOUR

FINDINGS AND ANALYSIS OF DATA

4.1. Introduction

In this part, the responses to the questionnaire and interview with regard to tax avoidance in Tanzania are presented and analyzed. The researcher circulated twenty questionnaires to taxpayers, Tax officers and accountants, also government institutions (TRA, TIC, BRELA) and a private Law firm (BrickHouse Law Associates) and professionals such as advocates. The researcher circulated Thirty (30) questionnaires to respondents. The researcher also made an interview with ten (10) respondents who included taxpayers, Accountants, tax assessors and some people from TRA Education Department. Therefore in this study a total of forty (40) stakeholders participated as respondents to questionnaire and interview made by the researcher. This comprised of ten tax officers, ten law practitioners, ten accountants and ten taxpayers.

4.2. Presentation and Analysis of Data

This chapter presents the results of the study. It is mainly based on the views and opinions expressed in the questionnaire and from the interview done by the researcher of this report. A complete copy of the questionnaire is annexed and a breakdown of the responses received is presented in the Table below.

Majority of (70%) of respondents do not find the existing legal lame work on tax matters to be satisfactory and that there is need to regularly review tax laws so as to go hand in hand with increasing changes in business environment like e-commerce, and different means of money transfers like the mobile banking. There is a need to have Tax Laws free from ambiguities in that they should not create loopholes that will attract more and more Tax avoidance acts. However, most taxpayers especially companies and some tax officers did not propose strongly to the discouraging of tax avoidance arrangements of which was actually expected from the two group due some interests they have in it.

Table 4.1: Summary of responses observing that the existing Tax Legal framework is unsatisfactory and that tax avoidance schemes should be discouraged in the tax system.

S/N	Respondents	Responses that it unsatisfactory	Responses that Tax avoidance arrangements should be discouraged
1.	Tax officers	60%	40%
2.	Legal Practitioners	70%	60%
3.	Accountants	80%	50%
4.	Tax Payers	60%	30%

As to the issue of the ant avoidance provisions, particularly the transfer pricing provisions under the Income Tax Act are effective and whether the up to date methods of businesses notably electronic transactions are adequately covered, most of the respondents (70%) replied negatively and most of them have pointed out clearly that the provision on transfer pricing is not clearly defined, it contains a lot of ambiguities. That Principal Agent relationship is not clearly defined.

Furthermore, most of the respondents observed that taxation of electronic transaction is a big challenges as there no adequate expertise on the area. Other respondents have suggested that there is a need to have provisions that would make easy for tax authorities to have access to information especially for cross border transactions particularly in transfer pricing. However, there are some respondents who have pointed out that currently most of the TRA activities are on line. This is true but mostly in the mode of collecting tax not on strictly applying transfer pricing conditions.

Table 4.2: Summary of responses observing that Transfer pricing provisions and other anti-avoidance provisions under the Income tax Act are ineffective and that electronic transactions are not adequately covered.

S/N	Respondents	Response that transfer pricing Provisions under the Income tax Act is not clearly defined	Responses that anti-avoidance provisions under the income tax Act are ineffective	Response that electronic transactions are not adequately covered
1.	Tax officers	70%	70%	90%
2.	Legal Practitioners	60%	60%	80%
3.	Accountants	80%	70%	90%
4.	Tax payers	90%	90%	90%

There also some responses on the perceptions by taxpayers to the existing tax laws in that whether taxpayer's positive perception to tax laws can help to minimize avoidance schemes. Also there are responses on the efforts made by TRA in minimizing tax avoidance arrangements and issues of fairness of tax administrators, justification of tax laws and accountability of the Government. Majority of respondents, that is 80% responded that if taxpayers positively perceive tax laws then few of them will be struggle to find those loopholes so that to avoid tax hence more revenue to the government. They have pointed out that massive of tax avoided is a creature of unguided attitude and lack of equal exchange at the payment level. 70% of respondents they see no fairness in the tax administrators although few of them are satisfied with the situation, while 90% doubts the accountability of the Government to the taxpayers. Below is a summary of responses.

Table 4.3. Summary of responses on positive perception to tax laws a factor in reducing tax avoidance acts, responses on fairness of tax administrators, and government accountability to its subjects.

S/N	Respondents	Positive perception of tax Laws can reduce tax avoidance acts	Inadequate fairness of tax administrators and unjustifiable tax laws contributes to more schemes of tax avoidance	Inadequate accountability of the Government to its subjects facilitates more acts of avoiding tax.
1.	Tax Officers	80%	50%	80%
2.	Legal practitioners	70%	70%	70%
3.	Accountants	60%	60%	50%
4.	Tax payers	90%	90%	90%

Lastly, there was a question on the possibility to criminalize Tax avoidance as it is with tax evasion. This was in the premises that when the tax authorities are struggling to attack loopholes in the tax laws, the taxpayers in the other hand are fighting to establish new mechanism either by force of with just cause, but to the present situation of corruption no all tax avoidance acts are justifiable. Few of the respondents said yes to tax avoidance being criminalized while cautioning on the world wide definition of tax avoidance. That Tanzania is not operating in a vacuum, thus there is wide range of interchangeably transacting with other international frontiers in business thus inviting some sought of confusion to tax system. Therefore, only 30 percent of the respondents have positively responded to the tax avoidance being made a criminal act.

4.3. Conclusion

The above findings have demonstrated the inadequacy of the existing tax legal framework in curbing tax avoidance in particular under the Income Tax Act. There are in place some measures to curb tax avoidance under the income Tax Act, but they seem not effective due to the same being unclear thus inviting abuse of the same by tax payer and tax administrators who would finds a chance to enrich themselves through corruption practices.

Another challenge that has been observed is the is the issue of electronic commerce, in this world of science and technology, amendment of laws to curb the loopholes need to be promptly acted upon as soon as the TRA detects the same. Moreover Tax payer education programs are still needed to promote voluntary taxpayer compliance.

CHAPTER FIVE

CONCLUSION AND RECOMENDATIONS

5.1. Summary

From the study the position is that the legal framework governing tax matters and in particular tax avoidance in Tanzania mainland currently is somehow in a better position that it was before the amendment of the Income Tax Act of 1973. There has been major changes in the tax arena and in particular in the area of Income tax despite the fact that the world is changing so fast in Science and technology thus requiring regular amendments of tax laws of which is also costing the government.

Another issue is the way TRA tries its level best to detect some loopholes in tax laws but the government tend to delay in taking the necessary steps and the TRA is not the only organ is vested with power to formulate the tax tools like policy, policy tools and set targets. And in case of enacting tax laws it is not part of the TRA's duties.

TRA has played a good role in curbing tax avoidance, however there are still some more efforts needed to reduce tax avoidance plans under the Income Tax Act as will be suggested herein below.

Multiplicity of tax has been found to be one of the factors that tax payer hate paying tax thus noncompliance to tax issues which lead to reduction of revenue for the Government to operate.

Loopholes are still available, in particular under section 33 of the income Tax Act, observance has been made that the provision is not clear hence creating disturbances to tax payers and the tax administrators in that tax becomes uncertain.

Tax laws are noted to be unjustifiable, tax administrators are considered not to be fair to all tax payers while at the same time the government is blamed for being unaccountable to its subjects.

Furthermore, tax avoidance has proved to have great effects to revenue collections especially on large projects like mining, construction and tourism where there is huge and profitable transactions involvement. It is suggested that regular review of the laws will help minimize rooms to play with by these taxpayers.

5.2. Conclusion

The existing legal framework on tax matters is not adequately effective.

There is need to regularly review tax laws so as to go hand in hand with increasing changes in business environment like e-commerce, and different means of money transfers like the mobile banking. There is a need to have Tax Laws free from ambiguities in that they should not create loopholes that will attract more and more Tax avoidance acts as it is with transfer pricing provision under the Income tax Act.

There is need to improve good governance so that the legitimacy of the government is enhanced, adequate resources need to be provided to promote voluntary taxpayer compliance. Although tax avoidance has the same cost to the nation as it is with the tax evasion, tax avoidance is generally tolerated even encouraged some times. Judicial decisions on legality of tax avoidance have ensured that there is no stigma for indulging in the tax avoidance as it is for tax evasion.

However, tax avoidance is equally complex and expensive exercise. Those with no means to hire tax planners are left to suffer in silence the tax burdens they cannot appreciate thus resorting into invoking ways to attack the tax system including corrupt practices by bribing tax officers. It has also been noted that ignorance of tax laws in Tanzania also results from legislative process not being inclusive enough. Enacted Laws are really well disseminated to the public as the passing of tax laws are also bureaucratic and secretive thus TRA still have a duty of advocating for tax laws to public in particular promotion of tax payer education programs that are being conducted

by the TRA. Lack of adequate accountability for the Government has impacted negative attitude on tax payers' compliance to tax. The Government is perceived to be corrupt as per major corruption scandals in 2008 that were revealed forcing the Prime minister to resign.

Tax laws should be harmonized so as to do away with the current multiplicity of tax laws which defeats taxpayers' positive perception to tax laws. Multiplicity of tax has been the factor for tax payers to concentrate on ways to escape the tax burden by any means be it legal or illegal. Tax laws in Tanzania do not encourage taxpayers to comply voluntarily with taxes.

5.3. Recommendations

The following are necessary recommendations in reforming the existing legal framework for the purpose of creating a friendly legal regime tax matters in Tanzania;

The Income Tax Act under section 33 should be amended to specify methodology for determining what constitutes an arm's length price, there should be in place provisions requiring taxpayer to prepare transfer pricing documentation. At the same time the government should timely act on the enactment of tax instruments whenever loopholes are detected by TRA and other stakeholders.

There is no in place transfer pricing guidelines in most of the countries in Africa including Tanzania. It is thus recommended that TRA should issue the practice note to clarify what approach it will follow to give effect to the transfer pricing provisions. Regulation⁶ of the Income tax Regulations 2004 provides that section 33 shall be construed in such a manner as best secures consistency with the transfer pricing guidelines in the practice notes to be issued by the commissioner pursuant to section 130.

To date TRA has not issued a practice note to clarify what approach it will follow to give effect to the transfer pricing provisions. In the meantime TRA has decided that the international agreed arm's length principles as set in the OECD transfer pricing guidelines will be applied. Moreover the TRA has indicated that it will follow the ruling in the Kenya tax case on Transfer Pricing principles.

It is true that the OECD provides for the broadest and most measurable Transfer Pricing standards and African countries that do not have formal Transfer pricing legislation or guidelines do sometimes refer to them but only if the application is in their favor. Sometimes this may cause a strange interpretation of the OECD guidelines thus creating more confusion on Tax laws for Tax Laws are supposed to be certain for smooth administration that will not question the integrity of the tax administrators.

Furthermore, uncertainty about Transfer Pricing rules in African countries has been a concern for foreign companies and therefore for Tanzania to continue winning more and more Investors section 33 of the Income Tax Act no. 11 of 2004 (Cap 332 Revised Edition 2008) in terms of the Transfer Pricing at arm's length principle. Our neighboring country Kenya whose case law we have been urged to apply has already in place the regulations on transfer pricing passed on May 11, 2007. The regulation provides methods for determining the arm's principle.

Tax systems should expand tax base and reduce tax rates because the expansion of the tax base would reach to the extent of full collection of tax and at the same time tax system to reduce multiplicity of tax laws in the system.

Multiplicity of tax laws in the system is a major allurements for the taxpayer to find means to escape the paying of those taxes. Taxpayer need to find tax system in the country being a friendly one rather than an enemy to his or her Income. Foreign companies are currently interested to invest in Tanzania and other African countries for investment has been a major catalyst for the development of the national economy,

Tanzania need also to create a user friend environment for foreign and national investments, and one of the areas to attract more foreign investment is the tax regime. Tax base should be extended to rural areas too and the TRA to strengthen its tools for more revenue collections than introducing more and more forms of taxes thus inviting most taxpayers to play with the loopholes they detect and sometimes to forge those loopholes in a corrupt way.

There should be a tool in place that would make tax authorities to have access to information especially for cross border transaction for transfer pricing issues as it is with the VAT on Revenue Administration Digital Data Exchange program.

The fast changing world in science and technology has promoted a lot to the growth of electronic transactions. TRA has managed to launch mobile phone payment system, this electronic payment has been effective from June 13th 2011, and there is in place the TRA Monitoring and Evaluation Database (TRAMED) which allows the implementing agents to input their annual plan and corresponding implementation report for consolidation.

Not only that, but also there is an Enterprise wide Risk Management System (ERMS) for best practice standard for effective results on risk management, now why not have in place a tool for that which would make easy tax authorities to have access to information especially for cross border transaction for transfer pricing issues as it is with the VAT on Revenue Administration Digital Data Exchange program.

This tool will help Tax authorities in finding data on transfer pricing when determining whether the transaction price is in accordance with the principles on Transfer Pricing for it becomes difficult for tax officers to gather information for determining the relationship of the transacting companies at a particular time especially where they multinational corporations.

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APPENDIX

APPENDIX I:

COPY OF QUESTIONNAIRE

1. Personal Particulars

Name:.....

Postal Address:.....

Physical Address:.....

Phone no:.....Mobile:.....

Occupations:.....

2. Questions

Tax avoidance in General

(i) Given the continuing artificial tax avoidance schemes

a. Do you think that the existing legal framework is satisfactory?

Yes.....

No.....

b. Do you think that tax avoidance schemes should be discouraged in taxation system

Yes.....

No.....

c. Further comments, if any:

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.....

(ii) Are the available anti avoidance provisions in the Income tax Act effective?

a. Yes.....

b. No.....

(iii) If so, what special provisions are needed?

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(iv) What are your comments concerning transfer pricing provisions under the Income Tax Act?

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Are up-to-date business methods, notably electronic transactions, adequately covered?

- a. Yes.....
- b. No.....
- c. comment

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(v) Do you think that tax payer's positive perception to tax laws can help to minimize tax avoidance schemes?

- a. Yes.....
- b. No.....

Comment.....
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(vi) Do you think that TRA has made enough efforts in minimizing tax avoidance schemes?

a. Yes.....

b. No.....

Comment.....

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(vii) Do you think that criminalizing tax avoidance as it is with tax evasion will help in increasing revenue collections?

a. Yes.....

b. No.....

Comment.....

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(viii) From the legal framework of taxation laws in Tanzania mainland point of view, what do you think contributes more to the increase of tax avoidance schemes?

1. Please express any views you may have on the question of tax avoidance effects to the revenue collections:

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2. Additional comments (Please attach additional sheets if necessary):

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