



**THE NATIONAL BOARD OF ACCOUNTANTS
AND AUDITORS TANZANIA (NBAA)**

B4 Public Finance & Taxation I



Intermediate Level

B4
**PUBLIC FINANCE AND
TAXATION I**
STUDY TEXT

NBAA



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FOREWORD

The National Board of Accountants and Auditors in Tanzania is a professional body in Tanzania, established under the Auditors and Accountancy Registration Act No 33 of 1972 as amended by Act No 2 of 1995. The Board has been charged among other things, the responsibility to promote, develop and regulate the accounting profession in the country.

In fulfilling its role, NBAA has revised its national accountancy examination scheme and syllabi for students aspiring to sit for Accounting Technician and Professional Examinations. For effective implementation of these syllabi and improve examination results, the Board has prepared study materials for all subjects to assist both examination candidates and trainers in the course of learning and teaching respectively.

The study guides have been prepared in the form of text books with examples and questions to enable the user to have comprehensive understanding of the topics. The study guides cover the wide range of the topics in the syllabi and adequately cover the most comprehensive and complete knowledge base that is required by a learner to pass the examinations.

These study guides for each subject from ATEC I to final Professional Level will ensure that learners understand all important concepts, know all the workload involved and provide practice they need to do before examinations. The guides have right amount of information with plain language -easy-to-understand, plenty of practice exercises and sample examination questions which are set in a competence based approach.

Competency based study guides have been developed aiming at developing a competent workforce. The guides emphasize on what the individual can do in a workplace after completing a period of training. The training programme therefore is directly related to the expectations of the employer.

These study guides which have been developed under competence based approach are characterized by the following features:-

1. Focus on outcome – The outcomes shown in every topic are relevant to employment industry
2. Greater workplace relevance – the guides emphasize on the importance of applying knowledge to the tasks to be performed at a workplace. This is different from traditional training where the concern has been expressed that theoretical or book knowledge is often emphasized at the expense of the ability to perform the job.
3. Assessments as judgments of competence – The assessment will take into consideration the knowledge, skills and attitudes acquired and the actual performance of the competency.

Study guides are also useful to trainers specifically those who are teaching in the review classes preparing learners to sit for the professional examinations. They will make use of these study guides together with their additional learning materials from other sources in ensuring that the learners are getting sufficient knowledge and skills not only to enable them pass examinations but make them competent enough to perform effectively in their respective workplace.

NBAA believes that these standard study guides are about assisting candidates to acquire skills and knowledge so they are able to perform a task to a specified standards. The outcomes to be achieved are clearly stated so that learners know exactly what they have to be able to do, and on the other hand trainers know what training is to be provided and organizations as well know the skills level acquired by their expected accountants.

The unique approach used in the development of these study guides will inspire the learners especially Board's examination candidates to acquire the knowledge and skills they need in their respective examinations and become competent professional accountants in the labor market thereafter.

Pius A. Maneno
Executive Director

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STUDY GUIDE

A Public finance

1. Introduction to public finance

- a) Define public finance.
- b) Explain the functions of the government.
- c) Differentiate between public goods and private goods.

2. Public expenditure

- a) Identify the structure and composition of government expenditure.
- b) Describe public sector expenditure management tools (budget, parliamentary process, and accounting and audit).

3. Government Revenue

- a) Examine the nature and types of non-tax government revenue.
- b) Analyse the nature and the objectives of taxation.
- c) Explain the principles of taxation.
- d) Explain the concepts of economic efficiency and equity of taxation.
- e) Explain the incidence of taxation.

B Tax Administration

1. Tax Law, Administration and Practice (General issues)

- a) Analyse the role of the Tanzania Revenue Authority.
- b) Examine the tax appeals machinery in Tanzania.
- c) Distinguish between tax avoidance and tax evasion.
- d) Explain the tax administration provisions relating to tax consultants in the Income Tax Act, 2004.

2. Procedures for Payment of Tax

- a) Describe tax procedures for:
 - i. taxes payable by instalment (estimated taxes)
 - ii. tax payable on assessment
 - iii. tax payable by withholding agents
- b) State due dates for payment of tax.
- c) Calculate the penalty for not maintaining documents/records.
- d) Calculate penalty for not filing a statement of estimated tax and return of income.
- e) Calculate interest for late payment of tax.
- f) Calculate interest for under estimating tax.
- g) Describe procedures to recover unpaid tax.

3. Offences

- a) Describe offences as provided for in Income Tax Law.

4. Return of Income and Statement of Estimated Tax Payable by Instalments

- a) Identify persons liable to file return of income (ROI).
- b) Establish due date for filing ROI.
- c) Explain statement of estimated tax payable by instalments.
- d) Explain consequences for non-filing.
- e) Describe the concept and application of single instalments payer.
- f) Explain returns from withholding agents.
- g) Describe the application of returns to skills and development levy (SDL).

5. Types of Assessments

- a) Explain the concept and types of assessment (self-assessment, jeopardy assessment, adjusted assessment).
- b) Apply the principles of assessment on interest and penalties.

C Income tax laws

1. Introduction to income Taxation

- a) Define the concepts underlying income taxation in Tanzania.
- b) Explain the concept of total income.
- c) Explain presumptive income taxation and its application in Tanzania.

2. Business income

- a) Identify items included in calculation of chargeable income from business.
- b) Identify items excluded in calculation of chargeable income from business.
- c) Explain the rules relating to realisation of assets and liabilities.
- d) Determine the incomings and cost of assets and liabilities.
- e) Describe the general principle of deductions in computing business income.
- f) Identify the allowable deductions.
- g) Identify the non-allowable deductions.
- h) Establish business chargeable income.

3. Employment income

- a) Identify items included in calculation of chargeable income from employment.
- b) Identify items excluded in calculation of chargeable income from employment.
- c) Identify the allowable deductions.
- d) Describe the general principle of deductions in employment income.
- e) Establish income from employment.

4. Investment income

- a) Identify items included in calculation of chargeable income from investment.
- b) Identify items excluded in calculation of chargeable income from investment.
- c) Identify the allowable deductions.
- d) Identify the non-allowable deductions.
- e) Establish investment chargeable income.

D Value added tax

1. An overview of the VAT system

- a) Explain the nature and characteristics of Value Added Tax (VAT).
- b) Describe the Tanzanian VAT System.
- c) Provide historical background of VAT.
- d) Explain the concept of consideration for supply.
- e) Describe supply made within the scope of VAT.
- f) Distinguish between composite and multiple supplies.
- g) Describe the scope and coverage of VAT.
- h) Apply the Registration and deregistration rules.

2. Administrative provisions under vat law

- a) Describe returns, notices and other records under VAT.
- b) Describe the consequences of not meeting the filing and payment requirements.
- c) Describe the offences and penalties under the VAT Act 1997.
- d) Describe the electronic fiscal devices system, its benefits and the possible revenue risks involved.
- e) Mention the statutory records to be maintained by VAT registered traders.

3. Vat payments and repayments

- a) Apply the provisions of VAT Act and regulations in computation of input tax.
- b) Apply the provisions of VAT Act and regulations in computation of output tax and VAT liabilities.
- c) Explain the concept of partial exemption.
- d) Compare and contrast the methods of apportionment of input tax.
- e) Classify VAT repayment claims.
- f) Describe the refund procedures to diplomats and other relieved persons.

E Customs

1. Customs

- a) Describe source of customs tax laws.
- b) Explain customs entry and clearance procedures for imports.
- c) Explain the customs entry and clearance procedures for exports.
- d) Differentiate between prohibited and restricted goods.
- e) Explain the customs valuation methods.
- f) Calculate duties and taxes collected through customs.
- g) Explain customs procedures for prevention of smuggling.
- h) Determine offences in customs operations.
- i) Explain techniques for enforcement of customs laws.
- j) Describe recovery measures used to collect unpaid duties.

Features of the book

'The book covers the entire syllabus split into various chapters (referred to as Study Guides in the book). Each chapter discusses the various Learning Outcomes as mentioned in the syllabus.

Contents of each Study Guide

- ☐ **'Get Through Intro'**: explains **why** the particular Study Guide is important through real life examples.
- ☐ **'Learning Outcomes'**: on completion of a Study Guide, students will be able to understand all the learning outcomes which are listed under this icon in the Study Guide.

The Learning Outcomes include:

- ✓ **'Definition'**: explains the meaning of important terminologies discussed in the learning Outcome.
- ✓ **'Example'**: makes easy complex concepts.
- ✓ **'Tip'**: helps to understand how to deal with complicated portions.
- ✓ **'Important'**: highlights important concepts, formats, Acts, sections, standards, etc.
- ✓ **'Summary'**: highlights the key points of the Learning Outcomes.
- ✓ **'Diagram'**: facilitates memory retention.
- ✓ **'Test Yourself'**: contains questions on the Learning Outcome. It enables students to check whether they have assimilated a particular Learning Outcome.
- ☐ **'Self Examination Questions'**: exam standard questions relating to the learning outcomes given at the end of each Study Guide.

EXAMINATION STRUCTURE

The syllabus is assessed by a three hour paper based examination. 5 conventional questions of 20 marks each need to be solved.

The examination will consist of two sections.

Section A	One compulsory question
Section B	Four questions out of Six

STUDY GUIDE A1: INTRODUCTION TO PUBLIC FINANCE

■ Get Through Intro

Public finance is an important branch of economics which deals with the functions and responsibilities of the government in the economy. It evaluates the role of the government in the areas of income, expenditure, administration and control of public authorities with a view to benefit the public.

According to The Ministry of Finance (MoF) of the United Republic of Tanzania, the Ministry of Finance and Economic Affairs manages the overall revenue, expenditure and financing of the government of the United Republic of Tanzania. It also provides advice to the government on the financial affairs of Tanzania, which helps in supporting the government's social and economic objectives. The ministry also oversees budget preparation and execution and is responsible for formulating and managing revenue policies and legislations. It reports directly to the Parliament.

This Study Guide explains the meaning of public finance describes the functions of the government and discusses the difference between public goods and private goods.

Knowledge of public finance is very important as after qualifying, whether you are engaged in the public sector or the private sector, you will be able to comply with tax laws and principles effectively.

■ Learning Outcomes

- a) Define public finance.
- b) Explain the functions of the government.
- c) Differentiate between public goods and private goods.

1. Define public finance.**[Learning Outcome a]****1.1 Meaning**

Public finance is made up of two terms: 'public' and 'finance', which need to be understood individually, before we understand the meaning of 'public finance'.

Public refers to a group of individuals, like individuals of a country, city, etc. Finance refers to monetary resources. Money in physical form as well as credit form are examples of money.

Therefore, **public finance refers to the monetary resources of the public**, which are managed by public bodies like the central government, state government etc.

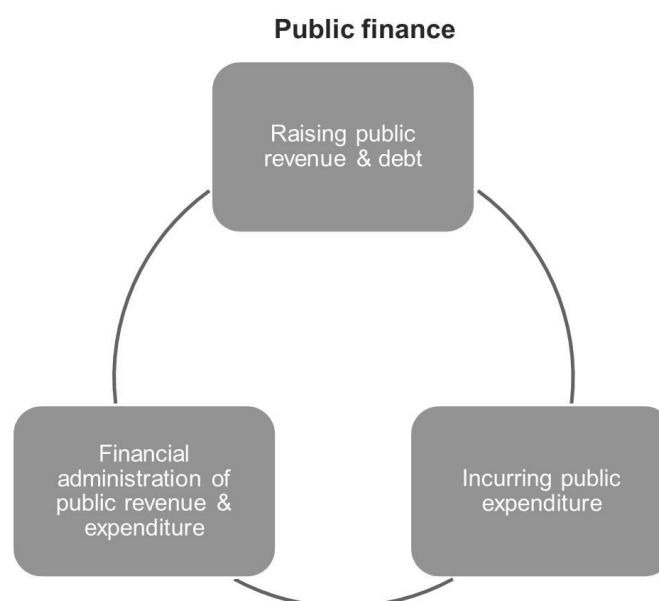
The government, which is a public body, provides goods and services (like education, transport services, infrastructure, health care, etc. that individuals cannot provide) to the public at large. The government pays for the production and distribution of the goods and services by collecting taxes (from the public) and borrowing from the financial markets (if taxes are not sufficient).

There are various definitions of public finance. However, the essence of the definitions can be summarised as follows: public finance is an important branch of economics which deals with the functions and responsibilities of the government in the economy. **Public finance evaluates the role of the government in the areas of income and expenditure (including administration and control) of public authorities with a view to benefiting the public.**

Public bodies collect resources from public through:

- **public debt**, i.e. raising capital finance from the public by issuing debt instruments like bonds
- **public revenue**, i.e. receipt of income from all sources - through taxes as well as borrowings

Public revenue is utilised to provide public goods and services (this is discussed in detail in **Learning Outcome 3**). This is called **public expenditure**. Public finance also covers the mechanisms and processes of raising public debts and public revenue and incurring public expenditure. This is called financial administration.

Diagram 1: Public finance

Therefore, the study of public finance includes:

- the collection of resources in the form of taxes, debts, etc. from the public;
- the effective and efficient allocation of the resources (in the form of various public goods and services) for public; and
- the administration of the public revenue and expenditure.

It is a study of how the public body raises finance in the form of taxes and borrowings from the public and incurs public expenditure with a view to achieving its social and economic objectives.



Case Study

A study of expenditures pattern of Tanzania over the period 2006-07 to 2008-09 indicates an increase in development expenditure from 6.2% of Gross Domestic Product (GDP) in 2006-07 to 7.9% in 2008-09. GDP is Gross Domestic Product which is the market value of goods and services produced within a country in a given period of time.

Development expenditure mainly includes allocation of funds to social and economic services and hence it can be concluded that expenditure towards social and economic objectives has increased over the years.

(Source: MOFEA Budget Execution Reports- Summary of Central Government Operations).

The above indicates that additional resources are directed towards development expenditure (as compared to recurrent expenditure like wages and interest costs) which will help in achieving social and economic objectives.

The government's decision on allocation of resources has a significant impact on the society. Misuse or wrong allocation or mismanagement of public funds can affect the development of the society. The government has to maintain balance among different sectors of the economy while determining allocation of resources.

1.2 Public finance versus private finance

In order to understand public finance better, we need to understand how it is different from private finance.

Public finance and private finance are based on the same fundamental principles and share certain similarities, such as aiming for optimum use of limited resources, requiring efficient administration etc. However, they are also different in many respects. Some of the differences are discussed below:

Public finance	Private finance
Meaning	
Public finance evaluates the role of the government in the areas of income and expenditure (including administration and control) of public authorities with a view to benefiting the public.	Private finance refers to the monetary resources of an individual economic unit. It includes the income and expenditure as well as the debt of individuals and business entities.
Objective	
The aim of public finance is to benefit the public; and is utilised for the society as a whole.	The aim of private finance is to bring about benefits to individual economic units like individuals, entities etc.
Nature of investments	
The government, which administers public finance, is a perennial body. Hence, it invests in funds that have long term gestation periods (like development of iron industry) which would bring about future economic benefits.	On the other hand, private finance is held by individuals and who aim to make short term profits. Therefore, they invest their money majorly on short term investments.
Sources of income	
The government has innumerable sources of income like levy of taxes, printing currencies, raising loans internally as well as externally from bodies like world bank etc. The government can also call upon the resources of the society as a whole, in case of emergencies.	The sources of finance for private entities are limited in comparison. The extent of availability of finance depends upon the ability of an individual / entity to raise money. Moreover, credit limit or loans are sanctioned based on the individual / entity's repaying capacity.
Obligatory / elective nature	
It is compulsory for individuals to contribute to the government in the form of taxes, other levies etc. Moreover, the government can, if necessary, compel citizens to contribute, even by force.	A private entity / individual cannot compel others to extend finance to the entity/individual.

Continued on the next page

Beneficiaries	
The revenue collected by the government goes back to its citizens in one form or the other. However, the person who paid the taxes may not be the one who receives the benefits. In other words, the provider of finance may not be the same individual / entity that receives the benefit from it.	In the case of private finance, the person/entity that provides the finance usually gets the benefits.
Secrecy	
Details of public finance, such as the contributors, the amount of contributions, the income and the expenditure, are made public.	In the case of private finance, these details can be withheld from the general public; to some extent, the individuals and entities have a right to secrecy regarding their sources of finance, incomes and expenditures.

1.3 Importance of public finance

1. Ensuring economic and financial stability

Public finance is used to ensure economic and financial stability in an economy. Economic stability is the absence of excessive fluctuations in the economy, whereas financial stability can be achieved by efficient allocation of resources by appropriate policy making. For example, an increase in direct taxes will reduce the money available with the people to purchase goods and services and will, in turn, help to reduce inflation. On the other hand, increase in public expenditure during depression helps to increase demand for goods and services, which is otherwise very low during periods of depression.



Example

The table below gives a brief view of the fiscal position of Tanzania for three years:

% of GDP			
	2006-07	2007-08	2008-09
Total Revenue	19.4	22.8	20.5
Own Revenue	14.4	15.9	15.9
Grants	5.0	6.9	4.6
Total Expenditure	23.5	22.8	25.2
Deficit	4.1	0.0	4.7
Net Financing	5.9	1.7	0.3

Source: MOFEA Budget Execution Reports- Summary of Central Government Operations Document (2009 Public Financial Management Performance Report on Mainland Tanzania)

It can be seen from the above table that the fiscal performance of Tanzania has improved between 2006-07 and 2007-08. This is on account of an increase in the domestic revenue which has grown from 14.4% of GDP to 15.9% of GDP. Expenditure has reduced from 23.5% of GDP to 22.8% of GDP during this period. Deficit has therefore reduced from 4.1% of GDP to nil between 2006-07 and 2007-08. However, one risk that the government faces is that almost one third of its revenue comes from external grants.

Public finance helps to reduce the economic imbalances on account of unequal distribution of income and wealth among the public. For example, the government imposes heavy income taxes on higher income groups and uses the tax to provide subsidised food and cheap housing to lower income groups.

2. Optimum utilisation of resources

Public finance ensures optimum utilisation of scarce resources by adopting suitable monetary policies.



Tip

Optimum allocation of resources is discussed in case study on 'study of expenditures pattern of Tanzania over the period 2006-07 to 2008-09' above

3. Effective tool to tackle unemployment

Public finance is an effective tool to tackle unemployment - for example, the government sets up fiscal policies which increase employment opportunities.

4. Capital formation

Public finance involves providing infrastructure like railways, road-ways, improved transportation etc. This kind of capital expenditure, in turn ensures increase in capital formation, which brings about long-term benefits to the public in general.

5. Improved income and services of economy

Public finance involves raising funds from the public. Furthermore, investments in such funds is sometimes linked to a reduction in the amount of tax paid by the general public. This helps in increasing the income and savings of an economy, thereby helping in its development.



Test Yourself 1

Explain the term public finance and highlight the role of public finance in the development of an economy.

2. Explain the functions of the government.

[Learning Outcome b]

2.1 Functions of government in public finance

The primary functions of a government (relating to public finance) in any economy include:

1. Providing basic utility services and promoting social and economic development

The government is mainly engaged in providing public utility services like electricity, telephone, roads and highways, transportation facilities, etc. to the public. Such services are provided at economical rates so that these can be availed by the common man. The government generally establishes its own monopoly over the supply of such services, with a view to avoid consumer exploitation. In the process of providing such services, the government **invests in social and economic capital**.

2. Encouraging capital formation

Industrialisation is the key to development of an economy. This is brought about by investing in heavy infrastructure such as machinery and tools, chemicals, iron and steel etc. Such investments carry high risks, and the returns can be gained only in the long run. Therefore, the private sector rarely makes such investments. Thus it becomes the responsibility of the government to make investments in these sectors, which ultimately enables the economy to improve its capital formation.

3. Complementing private investment

As already discussed, economic development requires industrialisation which is brought about when an economy invests in industrial goods. The private sector also invests in industrial goods. However, wherever there is insufficient investment by the private sector, the government steps in and makes good the shortage. This ensures a balanced development of the economy with the government investing in less profitable sectors or backward areas where private investment is not forthcoming.

4. Providing an environment conducive to development

The government encourages private investment in areas of economic development by setting up basic industries and providing financial assistance by promoting the development of banks, etc.

5. Conserving and efficiently utilising natural resources

Economic development depends on the efficient and effective utilisation of its natural resources like oil, minerals, aquatic life and forestry. Many economies, especially the developed and developing economies, are often faced with underutilisation as well as inefficient utilisation of its natural resources. The government, therefore, intervenes to develop as well as conserve the natural resources.

The economy in Tanzania has a two- tier system: the Central Government and the Local Governments. The Local Governments are either urban Authorities (city or municipal councils) or rural Authorities (district councils).

2.2 Functions of central government

The Ministry of Finance and Economic Affairs (central government):

- manages the overall revenue, expenditure and financing of the government of the United Republic of Tanzania; and
- provides the government with advice on the broad financial affairs of Tanzania in support of the government's economic and social objectives.

The main functions of the central government include preparing the government budget and monitoring its execution.

The budget contains the government's fiscal revenue and expenditure and details of the financing policies and plans. Fiscal policy refers to the actions governments take in **setting their level of public expenditure** and determining how this level of expenditure is to be spent.

The responsibilities of the ministry of finance include:

- preparing the central government budget,
- developing tax policy and legislation,
- managing government borrowings on financial markets,
- determining expenditure allocations to different government institutions,
- transferring central grants to local governments,
- developing regulatory policy for the country's financial sector in cooperation with the Bank of Tanzania, and
- representing Tanzania in international financial institutions.

2.3 Functions of local government authorities in Tanzania

Local government authorities (LGA) also play a vital role in the public finance sector in Tanzania as:

- approximately 5% of all public revenues are collected by LGA; and
- approximately 20% of public finance is expended by LGA.

Local government authorities have the responsibility of providing three types of public services in Tanzania:

1. Concurrent functions (locally provided “national” public services)

Local government authorities provide public services like primary education, local health service, agriculture extension and livestock development, water supply and local road maintenance. These public services (amounting to almost 75% of local government spending in Tanzania) are funded by the central government.

2. Exclusive local government functions

Public services provided by LGA include street cleaning, maintenance of local parks/ markets etc. Since benefits from these services are enjoyed by the local people, the entire responsibility of these functions is assigned to local governments. These public services are majorly funded by the local government authorities. However, if the local government revenue system is unable to fund the services, these local government activities are funded from the unconditional, equalizing General Purpose Grant.

3. Local government administration

Public services provided by LGA include various minor local functions like community affairs, local environmental protection, etc. which are not 'exclusively local'. Local administration requires 'local planning, local financial management, etc.' All such activities are majorly funded from central government resources.

LGA can carry out the above functions only if there is a proper system for planning, budgeting and managing their finances.



Test Yourself 2

Explain the functions of a government relating to public finance, in a developing economy.

3. Differentiate between public goods and private goods.

[Learning Outcome c]

Goods mean output produced by an economy, i.e. the collective output of individual economic units like individuals, entities, etc. Goods are further classified as public goods and private goods. Each of these is explained below.

3.1 Public goods

1. Meaning

Public goods and services are produced by the government sector with a view to satisfying public needs. For example, national safety, public healthcare, clean air etc.

2. Characteristics

Public goods have two principle characteristics - **non- exclusion and non- rival consumption**. Each of the characteristics is explained below:

(a) Non- exclusion

Non- exclusion means that it is impossible to prevent people from using the goods / service or the cost of restricting the use of the goods to selected persons is exorbitant.



Example

When the government builds a bridge over a river, it will not be feasible for the government to prevent certain individuals from using the bridge. Furthermore, if the use of the bridge is restricted to some selected group of persons, the cost of the bridge would be very exorbitant..

(b) Non- rival consumption

Non- rival consumption means that:

- the use of goods by one individual does not reduce the quantum of goods available to others; or
- the same goods can be used simultaneously by a number of people.



Example

Clean air, roads, street lighting etc. can be classified as public goods. Air is freely available and an individual does not own air. It is not possible for an individual to prevent another from using air (so it is not non-excludable) and also use of air by one individual does not reduce its availability to another (hence it can be said that it is non- rivalrous).

One important point that should be understood here is that all goods which are made available by the government are not public goods. The reason is that government is often involved in providing services like television, radio, electricity, water, etc. which can be availed on the payment of a price. Hence, these goods do not exhibit the feature of 'non-exclusion' as the government can prevent the use of the service to individuals who do not pay for the service.

3.2 Private goods

Private goods are generally produced by the private sector. For example, electronic goods, consumer durables, motor vehicles etc. However, as discussed above, they can also be produced by the government.

Private goods have the characteristics of pricing and exclusion. Each of them is explained below.

1. Pricing

Private goods are sold in the market for a price based on price mechanisms. A user needs to pay the price of the private goods in order to be able to enjoy their benefits; those individuals who do not pay the price are excluded from using the goods.

2. Exclusion

Those who do not pay the price can be excluded from using the product. Furthermore, private goods and services can be rejected; for example, if an individual does not like a particular pair of shoes in a shop, he can choose not to buy those shoes and use his money to buy something else.



Example

Food items are an example of private goods. Annie can buy a banana only if she pays the price quoted by the seller, for the banana. Furthermore, Beth cannot purchase it if she does not pay for it. Also, if Annie does not want a banana, she need not purchase it.

3.3 Private goods versus public goods

Public goods	Private goods
Public goods and services are generally provided by the government with a view to satisfying public needs . For example, national safety, public healthcare, clean air etc. are public goods.	Private goods are generally produced by the private sector with a view to satisfy individual needs . For example, electronic goods, consumer durables, motor vehicles etc. are private goods.
Public goods have the characteristic of non-exclusion i.e. it is impossible to prevent people from using the goods / service or the cost of restricting the use of the goods to selected persons is exorbitant.	Private goods have the characteristic of exclusion i.e. it is possible to prevent people from using the goods / services.
Public goods always have the characteristic of non-rival consumption i.e. the use of goods by one individual does not reduce the quantum of goods available to others or the same goods can be used simultaneously by a number of people. For example, street lighting.	Private goods may not have the characteristics of non-rival consumption i.e. the use of goods by one individual does not reduce the quantum of goods available to others or the same goods can be used simultaneously by a number of people. For example radio broadcast services provided by private players.
Public goods do not exhibit the characteristics of pricing as public goods come for free.	Private goods have the characteristics of pricing i.e. they can be availed only in return for money or money's worth.



Test Yourself 3

Determine whether the following goods are 'public goods', and give reasons for your answer.

1. National defence
2. Broadcast of radio services by government

Answer to Test Yourself

Answer to TY 1

Public finance includes two terms 'public' and 'finance'. Public refers to the group of individuals like individuals of a country, city, etc. Finance refers to the monetary resources. Therefore, **public finance refers to the monetary resources of the public**, which are managed by public bodies like the central government, state government etc. .

The Government, which is a public body, provides goods and services (like education, transport services, infrastructure, health care, etc. that individuals cannot provide) to the public at large. The government pays for the production and distribution of the goods and services by collecting taxes (from the public) and borrowing from the financial markets (if taxes are not sufficient).

Public finance is an important branch of economics which deals with the functions and responsibilities of the government in the economy. **Public finance evaluates the role of government in the areas of income and expenditure (including its administration and control) of public authorities with a view to benefit the public.**

Public bodies collect resources from public through **public debt** and **public revenue**. Public revenue is utilised to provide public goods and services. This is called as **public expenditure**. Public finance also covers the mechanisms and processes of raising public debts and public revenue and incurring public expenditure. This is called as financial administration.

Public finance is the study of how a public body raises finance in the form of taxes and borrowings to incur public expenditures.

It includes:

- the collection of resources in the form of taxes (from public);
- the effective and efficient allocation of the resources for public; and
- the administration of the public revenue and expenditure.

Role of public finance in the development of an economy:

1. The main role of public finance is to ensure economic and financial stability in an economy. Economic stability is the absence of excessive fluctuations in the economy, whereas financial stability can be achieved by efficient allocation of resources by appropriate policy making.
2. Public finance ensures optimum utilisation of scarce and limited resources by adopting suitable monetary policies.
3. It is an effective tool to tackle unemployment, i.e. the government sets up fiscal policies which increase employment opportunities.
4. It helps to reduce economic imbalances on account of unequal distribution of income and wealth among the public. For example, the government imposes heavy income taxes on higher income groups and uses the tax to provide subsidised food and cheap housing to lower income groups.
5. Public finance involves raising funds from the public. Furthermore, such investment in such funds are sometimes linked to tax benefits for general public. This in turn helps in increasing the income and savings of an economy, thereby helping in its development.

Answer to TY 2

The primary functions of a government relating to public finance in a developing economy include:

1. Encouraging capital formation

Industrialisation is a key to development of an economy. This is brought about by investing in infrastructure such as machinery and tools, chemicals, iron and steel, iron and steel industry. Such investments carry high risks and returns are available only in the long run. Therefore private sector rarely makes such investment. government takes the responsibility to make investment in this sector. In the process the economy improves its capital formation

2. Complementing private investment

Economic development requires industrialisation which is brought about when an economy invests in the industrial goods. The process of investment in industrial goods is carried out by the private sector. However wherever there is insufficient investment by private sector, the government intervenes and makes good the shortage. Furthermore this also ensures a balanced development of the economy by government investing in less profitable sectors or backward areas where private investment is not forthcoming.

3. Making atmosphere conducive to development

The government encourages private investment in areas of economic development by providing basic industries and by providing financial assistance, by developing banks, etc.

4. Conserving and efficiently utilising natural resources

Economic development depends on the efficient and effective utilisation of its natural resources like oil, minerals, aquatic life and forestry. Developing economies are often faced with underutilisation as well as inefficient utilisation of its natural resources. government therefore intervenes to develop as well as conserve the natural resources.

Answer to TY 3

National defence

This is a public good as it has the characteristic of non-exclusion as well as non-rival consumption. Non-exclusion means that it is impossible to prevent some people from using national defence. It displays the characteristic of non-rival consumption as the use of public defence by one individual does not reduce the quantum available to others. Furthermore, the benefit of public defence is available simultaneously to a number of people.

Broadcast of radio services

This can be a free service or a paid service. If it is a free service, then it has the character of non-exclusion as well as non-rival consumption as any individual having a radio can benefit from the radio service. Therefore it will be a **public good**.

However if it is a 'paid service', it would not fit in with the definition of a public good as although it is produced by the government, it will have the characteristic of pricing as well as exclusion.

- Pricing: the radio services come for a price. A user needs to pay the price of the radio service in order to be able to benefit from it; those individuals who do not pay the price are excluded from enjoying the radio service.
- Exclusion: those who do not pay the price can be excluded from using the radio service. Furthermore, the radio service can be rejected if an individual does not like the service - he can choose not to buy the service and use his money to buy something else.

Therefore it will be a **public good**.

Quick Quiz

1. Public finance evaluates the role of the government in the area of revenue and expenditure of public authorities.
A True
B False
2. How does the government pay for production and distribution of goods and services like education, transport services, healthcare, infrastructure etc. that it provides to society?
A By collecting taxes from the public
B By borrowing from financial markets
C Both A and B
D None of the above
3. _____ and _____ are the characteristics exhibited by public goods.
4. _____ and _____ are the characteristics exhibited by private goods.
5. All goods provided by government are public goods. State whether this statement is:
A True
B False

Answers to Quick Quiz

1. The correct option is **A**.

Public finance evaluates the role of the government in the area of revenue and expenditure of public authorities.

2. The correct option is **C**.

The government pays for production and distribution of goods and services like education/ transport services/ healthcare, infrastructure etc. which it provides to the society by collecting taxes from the public and also by borrowing from financial markets (if taxes are insufficient).

3. Non-exclusion; non-rival consumption

4. Pricing; exclusion

5. The correct option is **B**.

All goods which are made available by the government are not public goods. The reason is that the government is often involved in providing services like television, radio, electricity, water, etc. which can be availed on the payment of a price.

Self-Examination Questions

Question 1

Identify the characteristics exhibited by public goods and explain how they differ from the characteristics exhibited by private goods.

Question 2

Explain the main functions of the local government of Tanzania with regards to public finance.

Answers to Self Examination Questions

Answer to SEQ 1

Public goods are produced by the government sector with a view to satisfying public needs. Public goods have two principle characteristics: **non- exclusion and non- rival consumption**.

Non- exclusion means that it is impossible to prevent people from using the goods / services or the cost of restricting the use of the goods to selected persons is exorbitant.

Non- rival consumption means that:

- the use of goods by one individual does not reduce the quantum of goods available to others; or
- the same goods can be used simultaneously by a number of people.

Private goods are generally produced by the private sector, and have the characteristics of pricing and exclusion.

Pricing means private goods are sold in the market for a price, based on price mechanisms. A user needs to pay the price of private goods in order to be able to benefit from them.

Exclusion means those who do not pay the price can be excluded from using the product.

From the above, it is clear that private goods cannot exhibit the characteristic of non-exclusion, which is the characteristic of public goods only. However, the characteristic of non-rival consumption can be exhibited by private goods. Services like television and radio, which are provided by private players, are examples of this category.

Answer to SEQ 2

Local government authorities have the responsibility of providing three types of public services in Tanzania:

1. Concurrent functions (locally provided “national” public services)

Local government authorities provide public services like primary education, local health service. These public services (amounting to almost 75% of local government spending in Tanzania) are funded by the central government.

2. Exclusive local government functions

Public services provided by LGA include street cleaning, maintenance of local parks / markets etc. These public services are majorly funded by the local government authorities. However, if the local government revenue system is unable to fund the services these local government activities are funded by the central government through the unconditional, equalizing General Purpose Grant.

3. Local government administration

Public services provided by LGA include various minor local functions like community affairs, local environmental protection, etc. which are not ‘exclusively local’. All such activities are majorly funded from central government resources

Additional reading material

In order to be able to understand the Learning Outcomes of this chapter, it is necessary to study the following concepts if you are not already familiar with them.

1. Explain the meaning of macro-economic policy.



Definition

Macroeconomics is the field of study that examines the economy of a nation as a whole.

More specifically, it broadly studies the factors that affect the total demand for goods / services in an economy. These factors are:

- **Consumption** (the total value of goods and services purchased by individuals and businesses);
- **Investment** (the total amount of money invested into businesses);
- **government expenditure** (the total amount of money spent by the government on goods and services);
- **Employment level** (the total number of people working)
- **Price stability** (the level at which prices of goods and services remain stable over time) and
- **Supply of money** (the level of money that is needed to purchase goods and services in an economy).

Macroeconomics identifies these factors as the forces that **shape the condition of a country's economy**. Broadly speaking, **the condition of an economy equates to the level of demand for the goods and services being produced in that economy**.

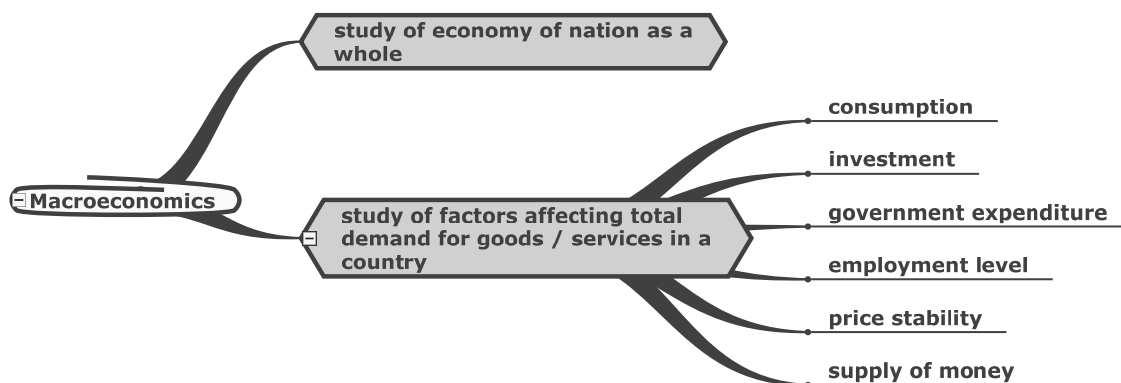
Furthermore, macroeconomics also involves the **types of policies that governments can set to influence these factors**. The underlying rationale is that by influencing these factors, governments can in turn influence the condition or shape of the economy.



Example

Governments often cut taxes so that individuals and businesses will have more money to purchase goods and services. This action is normally taken at a time when the government feels that there is an insufficient level of demand for a country's goods and services.

SUMMARY



1. Macro-economic policy



Definition

Macro-economic policy is government policy which is designed to achieve certain macro-economic goals such as full employment, price stability, economic growth, etc.

Common macroeconomic policies are fiscal and monetary.

Overall, macroeconomics has four main policy objectives:

(a) Economic growth

Economic growth refers to an increase in the real value of production and income. Economic growth for a country occurs when its real **Gross Domestic Product (GDP) rises** annually at a constant price. GDP measures the annual output (the total value of all the goods and services) that a country produces.

(b) Full employment

Full employment is said to occur when the supply of labour (i.e. all those employed plus all those seeking jobs) equals the demand for labour (i.e. all those employed plus all unfilled job vacancies). The macro-economic objective of full or higher employment is congruent with the objective of economic growth.

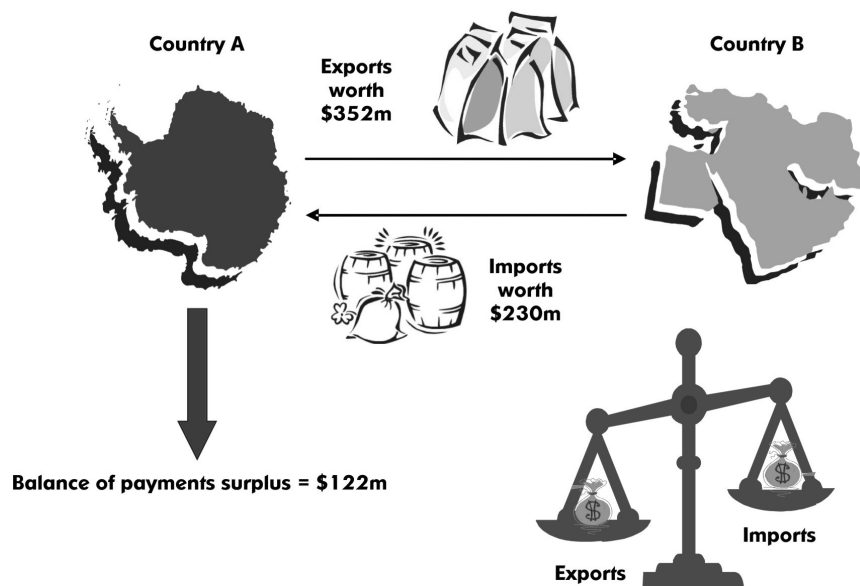
(c) Price stability

Price stability is the main objective of the monetary policy. Price stability is said to occur when the price of goods and services remains **constant over a period of time**. It means no rapid inflation or deflation takes place. Price stability ties into the concept of controlling inflation (when the price of goods / services rises over a period of time), and is not essentially the same as zero inflation. It can be a balanced level of low-moderate inflation.

(d) Balance of payments equilibrium

One of the key objectives of the macroeconomic policy is to maintain a satisfactory balance of payments position. Individuals, businesses and governments buy locally produced goods and services as well as those produced in other countries. Therefore, there is a flow of money in and out of a country as countries export (sell their goods and services to other countries) and import (buy goods and services from other countries). When a country imports more than its exports, it creates a **balance of payments deficit**. When the reverse occurs, there is a **balance of payments surplus**.

Balance of payments surplus

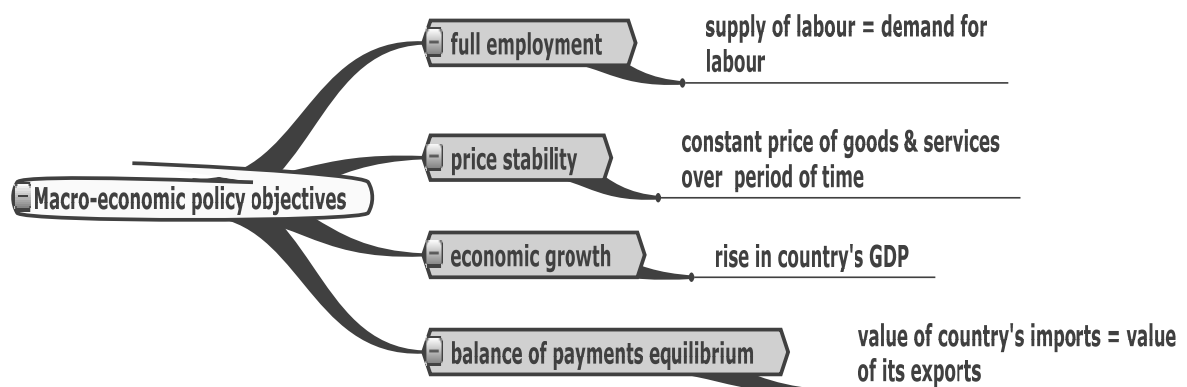


The ultimate aim of all governments is to have an economy with:

- full employment;
- no inflation;
- economic growth; and
- a balance of payments equilibrium (when the value of a country's imports equals its exports).

However, no government has been able to achieve all four of these objectives at the same time. The main reason for this is that these factors are so closely interlinked that gains in one objective are normally offset by losses in another. This concept will be explained in greater detail in the following sections.

SUMMARY



2. Explain the impact of the level of business activity on individuals, households and businesses.

The macro-economic variables are **the main determinants of the level of business activity**. Examples:

- GDP - gross domestic product (market value of all goods and services produced),
- Inflation (increase in cost of production which results in an increase in the price of a product)
- Level of interest rates
- Levels of employment
- Exchange rates
- Consumer price index (measure of the average price of consumer goods and services purchased by households)

The four macro economic objectives have never been achieved optimally and many economists believe this is possible only in theory. The main reason is because of how closely interlinked these factors are.



Example

The **unemployment rate and the inflation rate** have an inversely proportional relationship. This means that as one rate increases, the other automatically decreases. Generally, this is because as the unemployment rate decreases, more people find work. This translates into more money being spent on purchasing goods and services. This increases the demand for goods and services, thereby causing their prices to rise.

Higher economic growth and balance of payment equilibrium are contradictory goals. When an economy is growing fast, consumer spending tends to be high. Hence, import growth picks up relative to exports, leading to a worsening trade deficit. In such circumstances, the government has to deflate the economy, implying a low rate of growth.

Higher economic growth and low inflation are also conflicting objectives of a macro-economic policy. If an economy grows too quickly, especially if it is due to excessive consumer spending, then demand will surpass supply and accordingly prices will rise. Likewise, the steps taken to keep inflation low, like relatively high interest rates, can often restrict growth via reduced consumer spending and investment. It is difficult to achieve both aims.

Although all four of the macro-economic objectives have never been achieved simultaneously, many governments have been successful in achieving two or more at the same time (e.g. increasing GDP and the employment rate). When this happens, the level of demand for a country's goods and services is on the increase along with the level of business activity in the country. The country's economy is then said to be in an **expansion mode**.

However, no economy has been able to sustain an expansion phase for an indefinite time period. Typically, economies are **cyclical in nature**. They fluctuate, going from periods of expansion to periods of recession.

A business cycle is periodic, but irregular. It consists of fluctuating movements in the economic activity, measured by fluctuations in the main determinants of the level of business activity.

A **business cycle** consists of four phases:

- Contraction (a slowdown in the pace of economic activity, i.e. recession)
- Trough (the lower turning point of a business cycle, where a contraction turns into an expansion i.e. depression)
- Expansion (speeding-up the pace of economic activity i.e. recovery)
- Peak (the upper turning point of a business cycle i.e. boom)

1. Recession

An economy is said to be in a period of recession when **demand for the goods and services it produces is declining or low**. A recession means a fall in the level of real national output. During this period, the rate of economic growth is negative and national output declines, leading to a contraction in employment, incomes and profits. When this occurs, businesses typically **produce a lower level of goods and services**. This translates into either **lower wages or lower work opportunities for individuals**, which also leads to **lower incomes for households**.

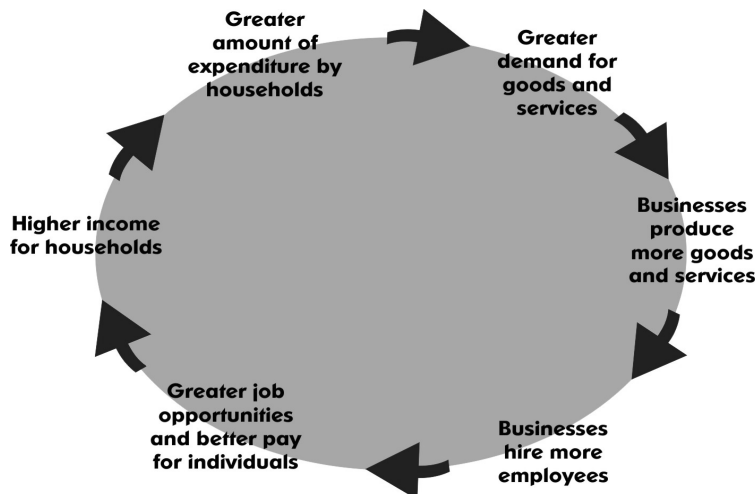
2. Depression

Trough is the lowest point or the most depressed stage of the business cycle. It is a more severe downturn than recession. If recession continues for a long time, the economy moves into a depression. It gives rise to unemployment and inflation. This stage is considered a turning point towards an economy expansion.

3. Expansion

An economy is deemed to be in the expansion stage of the economic cycle when gross domestic product (GDP) is rapidly increasing.

Economy expansion



The above diagram explains that if an economy is in expansion mode, it will benefit the individuals, households and businesses of that country.

- **Businesses** will benefit from there being **greater demand for the goods and services** they are producing. This in turn will lead them to want to **produce more goods and services** for which they will need to **hire more employees**.
- This greater demand for labour will correspond to **individuals being paid better** (as businesses will be competing to hire employees) and having **more job opportunities and options**.
- The greater pay and opportunities individuals have will translate into **households having higher incomes** and thereby being able to **afford greater amounts of and more expensive goods and services**.

4. Boom

A period of rapid economy expansion is considered to be a boom/peak phase. Peak is the end of the economy's expansion. At this stage, the economy has reached the highest level of production. It results in huge increase in output and GDP. In turn, employment, real wages, investments, business profits, etc. also increase. Sometimes this leads to demand-pull or cost-push inflation. However, a boom is usually followed by a slight recession. An organisation would prefer never to reach a peak as it is a turning point towards contraction.

Overall, as a general rule, most individuals, households and businesses **benefit from an increase** in the business activity level of an economy and become **worse off when this level starts to decline**.

3. Discuss the effect of the following economic concerns on various economic units:

- i. Inflation
- ii. Unemployment
- iii. Stagnation
- iv. International payments disequilibrium

Impact of economic issues

1. Inflation



Definition

Inflation relates to how prices for goods and services continuously and considerably rise over time. The inflation rate refers to the percentage increase that has occurred for the rise in the price for goods and services.

Deflation

Deflation is the opposite of inflation. Deflation occurs when the annual inflation rate falls below zero percent (a negative inflation rate); resulting in an increase in the real value of money. It refers to a sustained decline in the price level of goods and services. Deflation usually increases the purchasing power of the people. The cycle of declining demand and rising unemployment often leads to an **economic depression**.

Stagflation

Stagflation is used to define an economy that has inflation, a slow or stagnant economic growth rate and a relatively high unemployment rate accompanied by a rise in prices, i.e. inflation. It occurs when the economy is not growing but the prices are rising.

Inflation is measured by taking the total price for a determined bundle of goods and services. The total price for the same bundle of goods and services is again taken at a later date (usually one year later).

- The **amount** of total price increase corresponds to the amount of **inflation**.
- The **percentage** by which the total price has increased corresponds to the **inflation rate**.



Example

Suppose the total price for a bundle of goods and services in year 1 is Tshs100,000 and the total price for the same bundle of goods and services in year 2 is Tshs108,000.

The inflation rate here is 8% $[(\text{Tshs}108,000 - \text{Tshs}100,000) / 100,000]$.

The main effect of inflation is that it makes goods and services **more expensive to purchase** as time progresses. Therefore, if inflation is expected, a consumer is always better off buying a good or service now, than at some point in the future.

Inflation is an everyday fact of life for most economies. The impact it has on individuals, households and businesses is as follows:

- **Individuals:** the price of goods and services individuals purchase to maintain their lifestyles will increase. If an individual's income has not correspondingly increased then he will not be able to maintain the same lifestyle going forward. Therefore, most organisations give their employees an annual increase based upon inflation.

- **Households:** similarly, households whose income has not kept pace with inflation will not be able to afford the same lifestyle going forward.



Example

Suppose a household's annual income and expenditure is Tshs100,000 in year 1. During year 1, the inflation rate stands at 5%. If the household's annual income remains Tshs100,000 in year 2, then spending the entire amount will only get them goods and services that were **worth Tshs95,000 in year 1**.

- **Businesses:** inflation corresponds to an **increase in the cost of raw materials** needed to produce their goods or services. If they are not able to pass this cost on to their customers, then their profitability will decrease.



Example

Screw1 is an organisation that manufactures screwdrivers. Their main raw material is aluminium. It costs Screw1 approximately Tshs1,000 to make a screwdriver, which it then sells for Tshs2,000. However, an increase in the price of aluminium has meant that it now costs Tshs1,500 for Screw1 to make a screwdriver.

But given the vast number of cheap screwdrivers that are imported from China, Screw1 is unable to increase the price and pass on the additional cost to its customers. Therefore, Screw1's profitability declines by 50%.

SUMMARY



2. Unemployment

Unemployment is said to exist when the **supply of labour exceeds the demand for labour**. It occurs when there are individuals who are willing and able to work but cannot find full time employment. The unemployment rate refers to the percentage of the workforce that falls into this category.

As mentioned previously, full employment (or a zero percent unemployment rate) is one of the four main macroeconomic objectives for a government. However, full employment can never be achieved. This is because at least one of the four types or factors of unemployment listed below will always exist:

- (a) **Demand-deficient unemployment:** occurs when the supply of labour (number of people who want to work) is greater than the demand for labour (number of jobs available).
- (b) **Seasonal unemployment:** occurs because of a certain season or time of year.



Example

Ski resort communities have a high unemployment rate during the summer season as the main business occurs in the winter months.

- (c) **Frictional unemployment:** refers to the period during which able and willing individuals have left one job and are searching for another.
- (d) **Structural unemployment:** the nature of goods and services that an industry produces will change over the course of time, which in turn changes the structure of the industry. If the skill set of an individual working in that industry does not change in accordance with this, then he / she will soon be unemployed in that industry.



Example

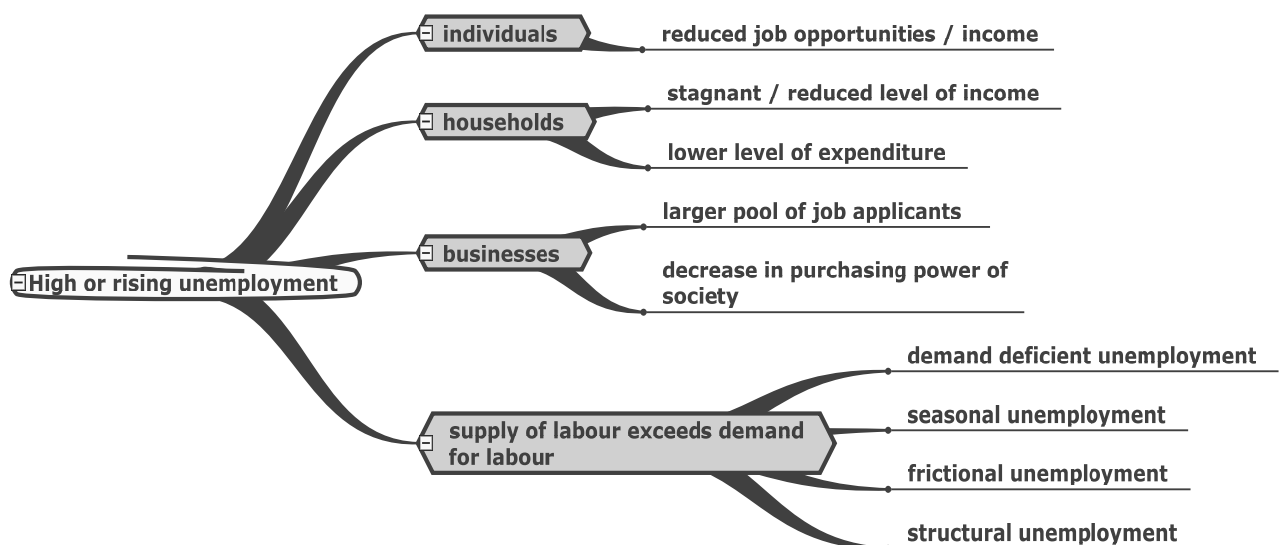
In the 1970s, several regions in the UK were dominated by labour intensive manufacturing industries such as steel, textiles and coal mining. In the 1980s, when these regions began to be dominated by service industries, the unemployment rate in areas such as Sheffield, Manchester and Glasgow rose to 20%, as many workers found that their particular skill set was no longer in demand.

When the unemployment rate rises, the total number of people who do not have jobs also rises. This is because the number of workers who are willing to work at a prevailing rate but are unable to find a suitably paying job also increases.

The impact that this has on individuals, households and businesses is as follows:

- **Individuals:** this means that the **number of job opportunities available to them decreases**, as does the **prospect for greater pay packages** (as there are more people than jobs). It also means that individuals are forced to reduce their spending levels during these times, as they face greater job insecurity.
- **Households:** if the main income earner(s) becomes unemployed it translates into a loss of income, which in turn means a **lower level of expenditure**. Again, as with individuals, households also typically lower their expenditure on goods and services.
- **Businesses:** having an economy with a high unemployment rate has certain advantages and disadvantages. One of the advantage is that there is a **larger pool of applicants to choose from** if there is a need to hire additional labour. However, the disadvantage is that the **purchasing power of a society decreases** (which may mean that fewer people purchase the goods and services).

SUMMARY



3. Stagnation

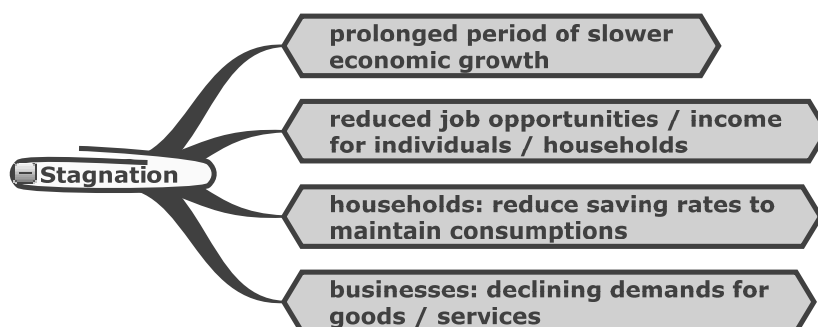
Economic stagnation means a prolonged period of significant slower-than-potential economic growth.

It is said to occur in an economy when the **GDP is declining**. The “stag” part of the term refers to the stagnating or declining output of an economy. Research shows that economic growth of less than 2% or 3% is considered stagnation. Periods of stagnation are **undesirable** for individuals, households and businesses.

- **Individuals:** the declining output of goods and services results in a **reduced demand for labour by businesses**. This will typically translate into **reduced job opportunities and income** in a period when the price of goods and services is on the rise.
- **Households:** during the period of stagnation, the growth of household disposable income becomes stagnant. As a result, it is necessary for households to reduce their saving rates in order to maintain consumption levels.

- **Businesses:** stagnation is again **undesirable**. The declining output of an economy is normally accompanied by an overall **declining demand for goods and services**. This typically leads to many businesses having to resort to cost cutting exercises such as reducing the number of employees.

SUMMARY



4. International payments disequilibrium

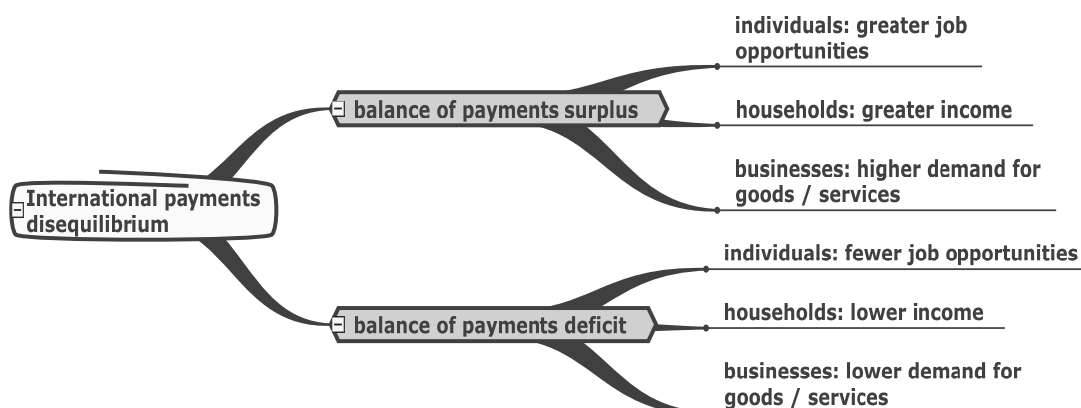
As mentioned before, a balance of payments or international payments disequilibrium occurs when the **value of a country's imports does not equal the value of its exports**. If the value of imports is greater, the country has a deficit; and if the value of exports is greater, the country has a surplus.

The effect that this has on individuals, households and businesses is as follows:

A surplus generally benefits the economy as whole as it reflects a **high demand for the goods and services being produced**, whereas a deficit causes loss to the economy.

	Impact of surplus	Impact of deficit
Individuals	This higher demand for the goods and services leads to greater opportunities for individuals' jobs and their income . This higher income generally leads to greater expenditure on goods and services.	Fewer job opportunities which lead to less expenditure on goods / services.
Households	The higher income of the main wage earner(s) typically translates into greater expenditure on goods and services.	Lower income which gets translated into less expenditure on goods / services
Businesses	Greater demand for their goods and services typically translates into greater profitability. This typically leads to businesses expanding or increasing the goods and services they offer, leading to greater employment.	Lower demand for goods / services results in lower profits, and leads to business contraction.

SUMMARY



STUDY GUIDE A2: PUBLIC EXPENDITURE

■ Get Through Intro

In the 19th century, public expenditure was insignificant as the scope of public finance related only to maintaining law and order and ensuring security of the nation through the defence function. However, in the 20th century, the scope of public expenditure has widened to include meeting social and economic objectives. Thus, public expenditure plays an important role in the economic growth of a nation as well in achieving social objectives.

Public expenditure policy in Tanzania is formulated by way of a process called Public Expenditure Review (PER) and is a continuous process since 1998-99. Members from the Ministry of Finance, Presidents Office for Planning and Privatisation, Public Service Management and Regional Administration, Local Governments, Tanzanian Revenue Authority and Bank of Tanzania participate in this process. The PER process includes focus on budget process, evaluating budgets against actual performance and taking necessary action wherever required.

The overall objective of the current PER / Medium Term Expenditure Framework for a three year period is to improve budget management, and the main focus is:

- to improve predictive value of the budget
- to enhance budget sustainability
- to promote prioritization of expenditure objectives and allocative efficiency in line with the national Poverty Reduction Strategy
- to ensure increased shift of donor finance towards broader budget support which streamlines external support behind a Government-led process
- to strengthen an output-oriented budget that focuses on Service Delivery improvements

This Study Guide discusses the meaning of public expenditure, identifies the structure and composition of government expenditure and analyses the public sector expenditure management tools.

■ Learning Outcomes

- a) Identify the structure and composition of government expenditure.
- b) Describe public sector expenditure management tools (budget, parliamentary process, and accounting and audit).

1. Identify structure and composition of government expenditure.**[Learning Outcome a]**

As discussed in Study Guide A1, public revenue is collected to make payments towards public expenditure. In this Learning Outcome we shall understand some more aspects of public / government expenditure.

1.1 Meaning of public expenditure**1. Traditional school of thought**

The traditional school of thought believed that public expenditure should be restricted to the amounts which were absolutely necessary i.e. only on activities like defence and maintenance of law and order. It was believed that the state should spend minimum amounts on economic and social development; the private sector should, in fact, expend on those counts.

2. Modern school of thought

The modern school of thought, which is now prevalent, advocates that the private sector should not be involved in social welfare. In fact, the state should expend on the defence of the country, maintenance of law and order and also on social welfare i.e. providing water, electricity, transportation facilities, education etc. Thus, this school of thought advocates state intervention in social and economic development activities. Therefore, the scope of public expenditure has grown considerably over the last two centuries.

Government or public expenditure can be defined as the spending by public authorities like central, state and local authorities on various activities for achieving social and economic objectives. It also includes amounts spent for protecting citizens and amounts incurred to satisfy the general common needs of the public at large. Thus, it brings about social as well as economic development of the state.

1.2 Principles of public expenditure

The main principles of public expenditure are:

1. **Maximum social benefit:** it is necessary that all public expenditure be **utilised for the general welfare of the society** at large, and not for the benefit of a particular section of the society.
2. **Economy:** public expenditure has to ensure economy, i.e. **all wasteful and unprofitable expenditure has to be avoided**. It should be ensured that the tax-payer is not burdened to the extent that his savings are affected.
3. **Approved expenditure:** it is necessary to ensure that public expenditure is **approved by a competent authority** and that funds are used for the purpose for which they were approved.
4. **Flexibility:** it is necessary that an element of flexibility exists so that **expenditure can be varied according to needs and circumstances**.

1.3 Structure and classification of public expenditure

There is no fixed basis for classifying public expenditure. In fact, public expenditure has been classified by applying different criteria / bases, as advocated by various economists. Some of the bases of classification are explained below:

1. Classification based on necessity

This classification was advocated by Professor Mill. He classified public expenditure as necessary and optional, and advocated that the state may undertake 'optional' expenditure.

2. Classification based on nature

This classification is based on the nature of the expenditure. Public expenditure is incurred for individuals or groups of individuals.

It is classified as fixed and variable expenditure.

- (a) **Fixed expenditure** is that portion of public expenditure which is fixed and has no relationship to the quantum of usage of services. For example, defence expenses, amounts incurred on street lighting etc. Major portion of the expense incurred is fixed in nature; however, it does have an element of variability in it.
- (b) **Variable expenditure** is that portion of public expenditure which is variable i.e. the amount incurred has a direct relationship with the quantum of usage of services. For example amounts incurred for postal service, railway services etc.



Example

Although most of the expenses incurred for postal services are variable in nature, it also has an element of fixed expense, as additional postmen are not employed for an increase of only a few letters.

Therefore almost all public expenditure has elements of fixed and variable within them.

3. Classification based on urgency

This classification based on the urgency of usage is as follows:

- (a) **Necessary expenditure** is expense which cannot be avoided (like defence expenses).
- (b) **Useful expenditure** is expense which can be postponed for some time (like construction of an additional bridge over a river).
- (c) **Superfluous expenditure** is expense which can be avoided altogether as it is neither useful nor profitable.

4. Classification based on productivity

This classification of government expenditure is as follows:

- (a) **Productive expenditure** relates to expenditure which causes increase in national income due to development / more efficient usage of national or human resources of the economy (e.g. expenditure for setting up an industrial estate in a city).
- (b) **Non-productive expenditure** relates to expenses which do not cause increase in national income (e.g. war expenses).

1.4 Structure and composition of government expenditure is influenced by the following factors:

1. Structure of the economy

Structure of the economy is an important factor which influences government expenditure. For example, an agriculture-dominated economy may require more expenditure on the agricultural sector to bring about development in the sector.

2. Technological factors

Technological factors also influence the composition of public expenditure. For example, a technologically backward economy would need more government funds for inventions in technology.

3. Environmental factors

Environmental factors like say higher pollution in particular areas may lead to water contamination, and hence more funds may be required to be diverted to provide clean water.

4. Demographic factors

Demographic factors like life expectancy, population growth, proportion of old- age population etc. will affect the amount of expenditure in these areas.

5. Economic development

Economic development in the society also plays an important part in determining the composition of public expenditure. For example, in a low income country, more funds will have to be diverted to increasing productivity.

1.5 Structure of Government Expenditure in Tanzania

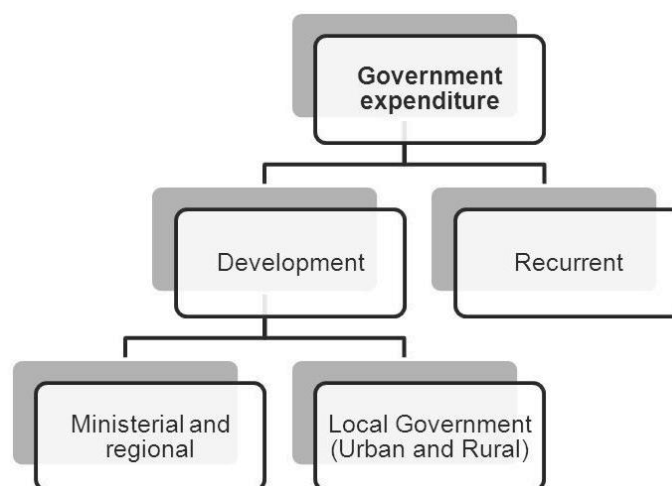
Public expenditure in Tanzania is broadly classified into two main heads: recurrent and development expenditure.

1. **Recurrent expenditure** is expenditure incurred for the day to day operations of the government like salaries and wages of employees and other overheads, healthcare services, education etc.
2. **Development expenditure** is expenditure incurred towards improving infrastructure like roads, bridges, supply of electricity and water etc.

This expenditure is further divided into Ministerial and Regional and Local government expenditure.

1. **Ministerial and regional expenditure** is the expenditure for which the responsibility is on the Ministers of Central Government.
2. **Local government expenditure** is incurred by the local authorities like municipalities for the local jurisdiction.

Diagram 1: Structure of government expenditure in Tanzania



Economic Classification of Expenditures in Tanzania

	(% of GDP)		
	2006/07	2007/08	2008/09
Total expenditure	23.50	22.80	25.20
Recurrent expenditure	17.30	12.70	17.30
- Wages and salaries	5.10	5.00	6.0
- Interest payments	1.10	1.20	0.90
- Goods and services transfer	11.10	6.60	10.50
Development Expenditure	6.20	7.90	7.90
- Domestically financed	2.60	2.50	3.40
- Foreign- financed	3.60	5.40	4.50

(Source: MOFEA Budget Execution Reports- Summary of Central Government Operations)

It can be seen from the above table that development expenditure has increased over the years, which means that more funds are allocated towards social and economic objectives.

Following table gives details of budgeted and actual expenditures in Tanzania:

		In billions (Tshs)		
		2006/07	2007/08	2008/09
1	Original total budgeted expenditure (excluding interest payments and foreign financed development expenditures)	2,656.20	2,949.4	3,734.5
2	Actual total expenditure (excluding interest payments and foreign financed development expenditures)	2,441.6	2,941.7	3,667.0
3	Absolute difference	(214.6)	(7.7)	(67.5)
4	Percentage deviation	(8.1%)	(0.3%)	(1.8%)

(Source: MOFEA, Year- end Budget Execution Reports)

It can be seen from the above table that out of the three years, actual expenditure deviated from budgeted expenditure by more than 5% only in 2006/07.



Test Yourself 1

What are the main principles of public expenditure?

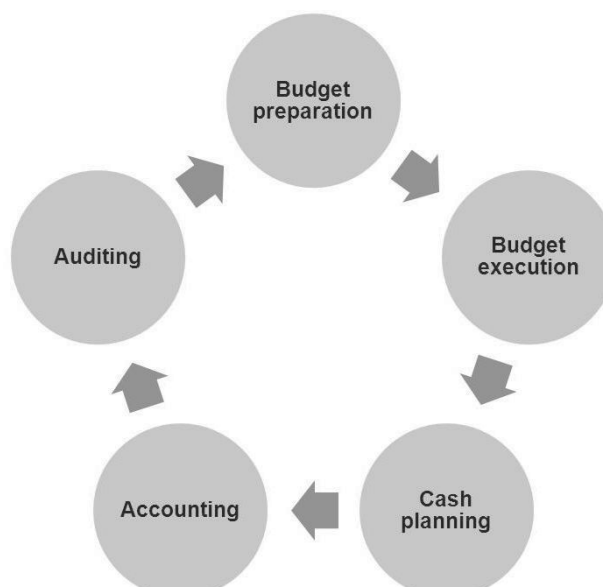
2. Describe public sector expenditure management tools (budget, parliamentary process, and accounting and audit).

[Learning Outcome b]

One of the important functions of the government is to collect resources from the economy and use them for implementing policies relating to achievement of social and economic objectives. The economic objectives can be met only if the resources are used efficiently and effectively. Management of public expenditure is very critical for any economy. Public expenditure is the means through which public policies are implemented. Misallocation or misuse of public funds can pose serious problems to the society. Tax payers are concerned about the amount they pay to the government in the form of taxes and the benefits that they receive from the government in return.

Efficient management of public expenditure is necessary in order to ensure credibility of the government. Economists / analysts working on fiscal policies need to understand thoroughly how the expenditure side of public finance is managed. Public expenditure management is concerned primarily with the budgeting total revenue and expenditure, allocation of resources among various sectors and efficiency of execution of budgets. Budgets should take into account all the expected expenditures which are to be met as per the decisions made by the government at the stage of planning itself, and should focus on priority areas.

Diagram 2: Tools of Public Expenditure Management



2.1 Efficient public expenditure management can be achieved with the help of the following tools:

1. Accuracy in budget preparation

Budget planning and preparation is very critical to good public expenditure management. While formulating a budget, it is **necessary to obtain consistent and reliable data on past public expenditures** in order to budget for the current period. **Past experience should be taken into account** so that past errors may be rectified.

A number of other factors need to be taken into account to ensure a sound budget:

- (a) Completeness of coverage of all expected expenditure
- (b) Usage of realistic and reasonable assumptions
- (c) Usage of realistic projections for expected revenue
- (d) Inclusion of provision for change in costs
- (e) Inclusion of provision to meet unexpected expenditures

It is necessary to ensure proper control over total expenditure and minimise the cost of budget management. **Productive efficiency and efficient allocation of resources** also helps in public expenditure management.

Disclosure of all relevant public revenue and expenditure information is important for accountability of government and to reduce corruption.

Public participation in the budget process for a pre-defined part will also help in better accountability and transparency.

Priority areas need to be identified at the time of budget preparation itself so that funds are not spent excessively on non- priority areas. It is also necessary that proper classification is made between implementing agency (administrative function), purpose of expenditure (functional classification) and use of expenditure (economic classification).

2. Budget execution

Once the budget is approved at the Central Government level, the responsibility of execution generally lies with the ministries and other appointed agencies. The ministries should ensure that they adhere to the spending limits laid down by the Central Government and regularly report to the government. Monitoring is generally done at the central level on an aggregate basis and appropriate responsibility should be placed for the monitoring. It is necessary for the Ministry of Finance to ensure that it obtains reliable data on expenditure from the executing agencies at regular intervals and analyse it effectively. This will help in overall control of expenditure.

Factors that are important in budget execution are whether the targets are likely to be met and whether the expenditure is likely to exceed budgets. It is important that the monitoring process is such that expenditure incurred will be within the budgeted amount and appropriate measures, if required, are taken to control expenditure.

3. Cash planning

Adequate cash planning is necessary so that the government is able to meet budgeted expenses and unexpected expenditures without resorting to additional borrowings. It also helps in ensuring that the budget targets are met and the economic policies are implemented smoothly. Even though the budget has been prepared well and with adequate planning, liquidity problems may arise as the timing of cash inflows and outflows may vary. In order to ensure timely availability of cash for meeting expenditure, the government needs to prepare an annual cash flow forecast (bifurcated month-wise) at the beginning of each year.

It can take into account the past experience and future projections while preparing the cash flow forecast. If a shortfall of cash is expected in a particular month, the government can either postpone the expenditure or make arrangement for collecting additional revenue. The monthly projected cash flow should be updated with actual figures on a regular basis so that it helps in achieving budgeted targets. Quick updating of information is possible only with a well- established reporting system.

4. Well-defined expenditure policies

Policies that are well defined need to be framed along with projections of estimated expenditure to be incurred in relation to those policies.

5. Information on public revenue

It is necessary to inform the citizens about the sources and amounts of public revenue and how these are managed by the government since the quantum of revenue determines the amount available for public expenditure. This will help citizens to monitor how public funds are being used and managed.

6. Public expenditure tracking

The tracking of public funds will ensure that funds are used for the purpose for which they were allocated and were intended to be used. This tracking must be quantitative as well as qualitative. Quantitative tracking is in the form of verifying records whereas qualitative tracking may be in the form of assessing from beneficiaries their opinion on the quality of services, technical reviews etc.

7. Accounting

The accounting categories and classification for budgeting as well as actual accounting should be common at the Central Government level so that accurate analysis is feasible. Accounting needs to be done on a timely basis and should be reliable. Appropriate processes for analysis of the accounts should be established.

8. Audit

An independent authority should be responsible for undertaking the audit of the entire process of public expenditure management.

2.2 Public expenditure management in Tanzania

In 2001, staff of the World Bank and the International Monetary Fund (IMF) carried out an assessment of public expenditure management (PEM) system in Tanzania. The assessment showed that significant improvements have been made by Tanzania to the budget execution and reporting systems by:

- Controlling accumulation of new arrears by enforcing a commitment control system
- Developing internal audit function in a systematic manner
- Strengthening the fiscal reporting system
- Enhancing accountability and transparency

Weaknesses identified were: external audit system has not been sufficiently strengthened and delays in submission of external audit functions persist; also PEM staff skills and capacity gaps at local government level need to be addressed.



Test Yourself 2

Describe the role of budgeting as a public sector expenditure management tool.

Answers to Test Yourself

Answer to TY 1

Main principles of public expenditure are as follows:

1. **Maximum Social Benefit:** it is necessary that all public expenditure is utilised for the general welfare of the society at large and not for the benefit of a particular section of the society.
2. **Economy:** public expenditure has to ensure economy, i.e. all wasteful and unprofitable expenditure has to be avoided and it has to be ensured that the tax- payer is not burdened to the extent that his savings are affected.
3. **Approved expenditure:** it is necessary to ensure that public expenditure is approved by a competent authority and that funds are used for the purpose for which they were approved.
4. **Flexibility:** it is necessary that an element of flexibility exists so that expenditure can be varied according to needs and circumstances.

Answer to TY 2

The role of budgeting as a public sector expenditure management tool is as follows:

1. Accuracy in budget preparation

Budget planning and preparation is very critical to good public expenditure management. While formulating a budget, it is **necessary to obtain consistent and reliable data on past public expenditures** in order to budget for the current period. **Past experience should be taken into account** so that past errors may be rectified.

A number of other factors need to be taken into account to ensure a sound budget:

- (a) Completeness of coverage of all expected expenditure
- (b) Usage of realistic and reasonable assumptions
- (c) Usage of realistic projections for expected revenue
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Quick Quiz

1. Government or public expenditure can be defined as the spending by public authorities like central, state and local authorities on various activities for achieving _____ and _____ objectives.
2. State the main principles of public expenditure.
3. Public expenditure is classified by applying different criteria / bases, as advocated by various economists. State whether this statement is:

A True
B False
4. The classification of public expenditure as constant and variable expenditure is based on the _____ of the expenditure.
5. _____ or _____ of public funds can pose serious problems to the society.

Answers to Quick Quiz

1. Social, economic
2. The main principles of public expenditure are maximum Social Benefit, economy, approved expenditure and flexibility
3. The correct option is **A**.

Public expenditure is classified by applying different criteria / bases, as advocated by various economists.

4. Nature
5. Misallocation, misuse

Self Examination Questions

1. Explain various factors affecting the structure and composition of government expenditure.
2. Describe the structure of government expenditure and World Bank's assessment of public expenditure in Tanzania.

Answers to Self Examination Questions

Answer to SEQ 1

Structure and composition of government expenditure is influenced by the following factors:

1. Structure of the economy is an important factor which influences government expenditure. For example, an agriculture-dominated economy may require more expenditure on the agricultural sector to bring about developments in the sector.
2. Technological factors also influence the composition of public expenditure. For example, a technologically backward economy would need more government funds for inventions in technology.
3. Environmental factors like higher pollution in particular areas may lead to water contamination; hence more funds may be required to be diverted to provide clean water.
4. Demographic factors like life expectancy, population growth, proportion of old- age population etc. will affect the amount of expenditure in these areas

Economic development in the society also plays an important part in determining the composition of public expenditure. For example, in a low income country, more funds will have to be diverted towards increasing productivity.

Answer to SEQ 2

Structure of government expenditure

Public expenditure in Tanzania is broadly classified into two main heads: recurrent and development expenditure.

Recurrent expenditure is expenditure incurred for the day to day operations of the government like salaries and wages of employees and other overheads, healthcare services, education etc.

Development expenditure is expenditure incurred towards improving infrastructure like roads, bridges, supply of electricity and water etc.

This expenditure is further divided into Ministerial and Regional and Local Government Expenditure.

1. Ministerial and regional expenditure is the expenditure for which the responsibility is on the Ministers of Central Government.
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Assessment of public expenditure in Tanzania

In 2001, staff of the World Bank and the International Monetary Fund (IMF) carried out an assessment of public expenditure management (PEM) system in Tanzania.

The assessment showed that significant improvements have been made by Tanzania to the budget execution and reporting systems by:

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STUDY GUIDE A3: GOVERNMENT REVENUE

Get Through Intro

In case of a company, revenue is the income derived from sale of goods or services and in case of non-profit organisations, revenue is in the form of donations or membership fees etc. In other words, revenue is income received by an organisation. Revenue is very important for financial statement analysis. The performance of an organisation is measured in terms of net profit earned by the organisation (profit = net sales less expenses) as well as in terms of the top-line i.e. revenue earned by the company.

Government needs funds to perform various functions to achieve economic and social objectives. These funds are referred to as public revenue. Government receives revenue from various sources like taxes, fees, grants etc; tax revenue is the major source of revenue for any government. Revenue obtained by Government from sources other than tax is called Non-Tax revenue.

This Study Guide discusses the nature and type of non-tax government revenue, nature and objectives of taxation, principles of taxation, concepts of economic efficiency and equity of taxation and incidence of taxation.

Learning Outcomes

- a) Examine the nature and types of non-tax government revenue.
- b) Analyse the nature and the objectives of taxation.
- c) Explain the principles of taxation.
- d) Explain the concepts of economic efficiency and equity of taxation.
- e) Explain the incidence of taxation.

1. Examine the nature and types of non- tax government revenue.**[Learning Outcome a]**

Non-tax revenue is generated through various sources. They differ in terms of nature and types as follows:

1. Grants or aids

Grants can be defined as the non- repayable voluntary transfer of resources.

The grants could be of the following types:

- Grants provided by the central government to state government for specific objectives
- Grants provided by foreign countries to the Central/ State Governments (also called as foreign aid). Foreign aid may be given to support social causes, for contribution during emergencies/ natural calamities, for strengthening ties with the country or for commercial purposes.

2. Debts from other governments or banks/ funds

When public expenditure exceeds public revenue, governments resort to borrowings.

Borrowings may be from:

- foreign countries or
- internal borrowings from the private sector in the form of debentures or bonds etc or
- internal borrowings from central bank of the country

3. Income from investments made by the Government

Governments invest excess funds in bonds, mutual funds of other insitutions. The revenue that is earned by governments from such investments is in the form of interest or dividend.

4. Revenue from public enterprises

Government sets up public sector enterprises, which are owned and controlled by the government. The profit earned by such public sector enterprises is a source of revenue for the government. Furthermore when the public sector enterprise income from sale of its non-current asset, it is revenue for government, although it is a one- time revenue and is not a recurring income.

5. Royalties

Royalty is received by the government when it allows private enterprises to use government/ public assets or intellectual property. Royalty is generally charged as a percentage of revenue derived from the use of the asset or a percentage of the unit price of the product sold. Example: Private sector enterprise has to pay royalty to the government to extract natural resources like petrol/ crude oil from government owned lands.

6. Fees and penalties

Governments charges fees for a number of services it renders to the general public. For example fees for issuing driving license/ passports, fees for generating copies of official documents, fines/ penalties levied for breaking traffic rules etc.

7. User fees

The government charges fees for use of its assets / services provided by the government. For example a toll is charged for the use of roads/ highways.

8. Subsidies received from other countries/ banks

Government receives subsidies from international banks/ monetary funds which are an indirect source of revenue for the government.

9. Rent

Government may earn revenue by way of renting of owned buildings or by renting out parking space etc. A local authority like municipality may rent out some empty space to the central government on requirement.



Tip

The non-tax revenue of Tanzania constituted 8% of total government revenue in the year 2003-04.



Test Yourself 1

Explain four sources of non-tax government revenue.

2. Analyse the nature and objectives of taxation.

[Learning Outcome b]

Tax is a financial charge imposed by the government. The fundamental purpose of taxation is to finance government expenditure. The imposition of taxation by governments withdraws money from the economy, and their expenditure returns the money to the economy.

Taxes are the most important source of public revenue and are necessary for the functioning of the government. Funds collected by way of tax are utilised by the government to provide various infrastructure/ facilities to the taxpayer; however benefits of such public expenditure by the government is enjoyed even by those people who are not liable to pay taxes.

Following are the essential elements of any tax:

- It is generally payable in money
- It is a proportion or a percentage
- It is levied on persons
- It is levied by the government
- It is levied in order to cater to public purpose

2.1 Nature of taxation

Revenue from taxation may be in several forms:



Example

The main taxes employed within the UK are as follows:

Tax	Suffered by
Revenue taxes	
Income tax	Individuals Partnerships
Corporation tax	Companies
National Insurance Contributions	Individuals Partners Employers Self employed
VAT	Final consumer
Capital taxes	
Capital gains tax	Individuals Partnerships (Companies pay corporation tax on their gains)
Inheritance tax	Individuals

Continued on the next page

1. Revenue Tax

(a) Income tax

It is a tax levied on the income of an individual.

Income can be from any sources such as:

- (i) income from earnings (e.g. employment income / trade profit)
- (ii) income from pensions
- (iii) income from other benefits (e.g. rental income)
- (iv) income from savings (e.g. interest income)
- (v) income from investments (e.g. dividend income)

Income tax is calculated on earned income (i.e. income from employment) as well as on income from savings etc. Income from various sources is pooled together and tax is charged on the aggregate income after deducting the relevant personal allowance. Taxpayers who are employed pay income tax on their earnings under the statutory Pay As You Earn (PAYE) scheme.

(b) Corporation tax

It is the tax payable by companies on their 'chargeable profits'. There are numerous provisions relating to corporation taxes which are dealt with at length in Section D of this Study Text.

(c) National Insurance Contributions (NIC)

After the Second World War, National Insurance Contributions were introduced to fund the establishment of retirement pensions, sickness benefit and the National Health System. National Insurance Contributions are a system of taxes which are paid by employees and employers on the basis of their weekly earnings. The money generated is used to provide social security.

(d) VAT

VAT is Value Added Tax. It is the tax which is paid on the value added. This tax is levied at each stage of production. VAT is a consumption tax paid by customers in addition to the price of the product.

2. Capital taxes

(a) Capital Gains Tax

When a person sells an asset that is in his / her possession, the profit arising from such sale is chargeable to tax as capital gains.

Therefore, capital gains tax liability arises when a 'chargeable person' makes a chargeable disposal of a chargeable asset.

For example, Adam sells his business asset at a profit of £5,000. So, the amount of profit i.e. £5,000 is chargeable to capital gains tax.

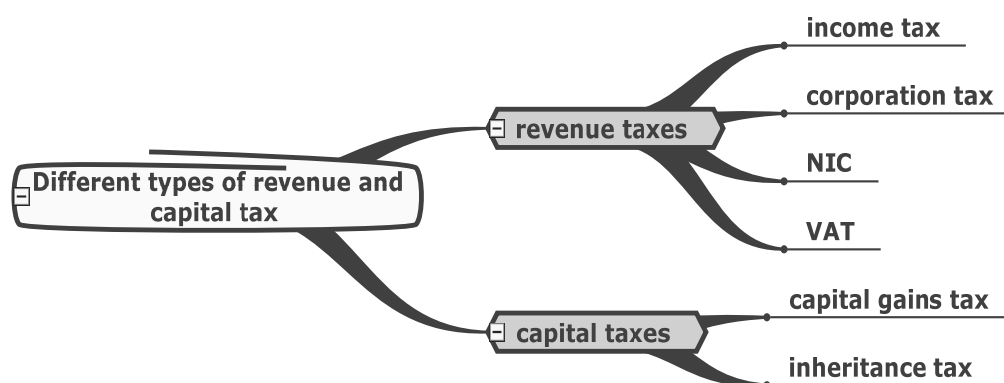
(b) Inheritance Tax

When a person is in possession of an asset, and on his death the ownership of such an asset is transferred, the value of the transferred asset is chargeable to inheritance tax, subject to certain tax free thresholds.

Therefore, inheritance tax liability arises when the value of chargeable property is transferred by a chargeable person.

Such tax liability also arises when, during the lifetime of the owner, the asset is given as a gift to any other person unless the person holds the asset for a period of seven years or more, in which case it becomes an exempt transfer.

SUMMARY



2.2 Objectives of taxation

The main objective of taxation for the government is to make provision for funds to meet public expenditure for achieving economic and social objectives.

1. Economic objectives

The government imposes taxation policies to:

(a) Encourage

- saving by individuals
- taking risks in investments by entrepreneurs
- entrepreneurs building their own businesses
- donations to charities
- investment in industrial buildings (e.g. factories, warehouses etc.)

(b) Discourage

- motoring e.g. to minimise pollution
- smoking and alcohol
- office buildings

A government does not intend taxes to be neutral, but to be used to encourage or discourage certain activities.

2. Social purpose of taxation

Politicians use taxation policies to encourage social justice; however, there are many different ideas as to what constitutes social justice. For example, the taxation system within the UK would suggest that it operates on an equitable basis.

3. Other objectives of taxation include:

- Encouragement of domestic industry and discouraging imports: the government may increase custom duties on imports which will increase the price of imported goods and will in turn help government to control import of goods.
- Income redistribution: this refers to bridging the gap between the rich and the poor and reducing inequality. This is done by levying higher tax on the richer sections of society. These funds are used for the welfare of the poorer sections to reduce the disparity between different sections of society.
- Economic stability: this refers to reducing the effect of inflation/ depression. For example, an increase in direct taxes will reduce the money available with the people to purchase goods and services and will in turn help to reduce inflation, whereas increase in public expenditure during depression helps to increase demand for goods and services, which is otherwise very low during depression.
- Protection of particular sectors/ industries: the government may levy lower rates of taxes or give tax concessions to particular sectors/ industries to protect or promote their growth.

2.3 Tax administration in Tanzania

Tax administration in Tanzania has a three- tier structure:

- The central government taxes are administered by The Tanzania Revenue Authority (TRA).
- The domestic consumption taxes in Zanzibar are administered by the Zanzibar Revenue Board.
- The local taxes are administered by the local authorities.

Central Government taxes are the major revenue earners for the Government and contribute to about 90% of domestic revenue.

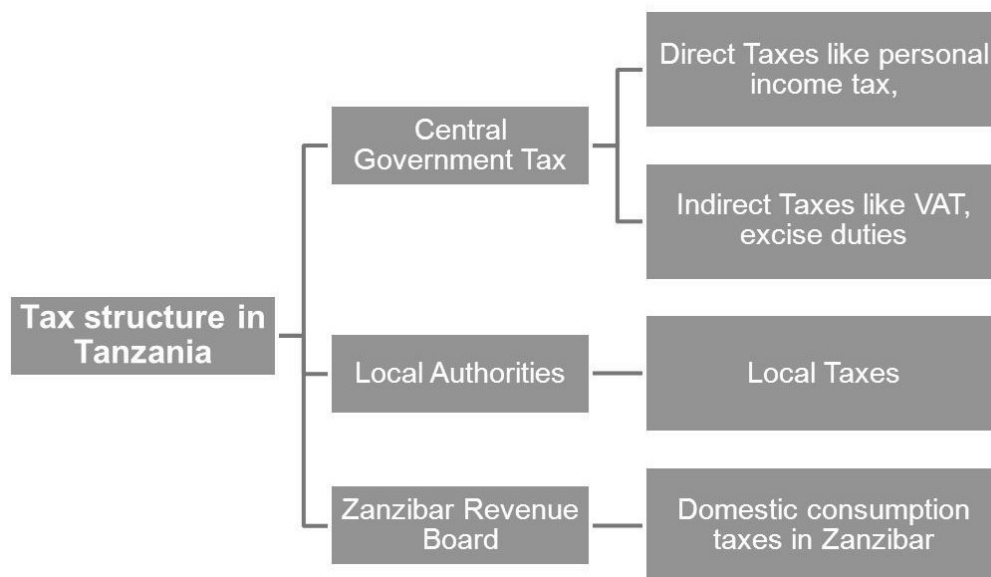
The TRA is responsible for collection and accounting of Central Government taxes. The United Republic of Tanzania Constitution recognises two parts of the Union: viz Zanzibar and Mainland Tanzania. Taxes have been accordingly bifurcated into union and non- union taxes. TRA collects the union taxes and Zanzibar Revenue Board collects the non- union taxes in Zanzibar.



Example

Taxes on income imposed under the Income Tax Act 2004 and custom duties under the East African Customs Management Act 2004 are union taxes, whereas domestic consumption taxes including the Value Added Tax, Excise Duties, hotel levies, stamp duties, motor vehicle taxes, and other charges are non-union taxes.

Diagram 1: Tax structure in Tanzania



Test Yourself 2

Describe in detail the objectives of taxation.

3. Explain the principles of taxation

Explain the concepts of economic efficiency and equity of taxation

[Learning Outcomes c and d]

3.1 Classification of taxes

Taxes are generally classified as direct tax and indirect tax.

Direct tax is generally the tax on the income of the person and the burden of tax is borne by the tax payer only whereas in case of indirect tax, the burden can be passed on to another person.



Example

Income tax is a direct tax. It is levied as a percentage of the income of a person and has to be borne by the person who is taxed and he cannot pass on the burden to anyone else whereas in case of VAT (which is an indirect tax) the burden can be passed on to the consumers by way of a higher price.

3.2 Classification of bases of levying taxes

The basis on which taxes are levied, can also be bifurcated into following three categories:

- **Progressive taxation:** a tax such as the income tax demonstrates the progressive principle. As income rises so does the proportion of tax i.e. the rate of tax rises as well as the amount of tax. This can be considered as just and fair, as the higher tax payments are made by those with higher incomes. Taxes which take a higher percentage of the incomes of higher income earners are said to be progressive.



Example

In case of income tax, a tax payer pays no tax upto 10 Tshs of income, pays 20% tax for the income between 10 Tsha and 20 Tsha and pays 30% tax for income above 20 Tshs. In this case, it can be seen that a tax payer will pay more amount (in actual terms) as well as higher percentage of tax as the income rises.

- **Regressive taxation:** This is the tax where, as the amount of income increases, percentage of tax is reduced. So in this case, a tax payer in the high income group may be paying more taxes in absolute terms but the percentage of income is falling.



Example

Poll tax existing in the United Kingdom was such that tax payer earning 10,000 pounds and 5,000 pounds had to pay the same amount of tax say 500 pounds. This meant that a person earning 10,000 pounds would be paying 5% tax whereas a person earning 5,000 pounds would be paying 10% tax.

- **Proportional taxes:** In this case, as the tax payer's income increases, he pays more tax but the amount that is paid as percentage of the tax payer's income remains unchanged.



Example

All tax payers have to pay say two percent of their income as education cess tax then it is proportional tax. Any increase in income does not increase the percentage of tax; same percentage is charged for all tax payers

3.3 Principles of taxation

Taxation system should adhere to certain basic principles so that it can function effectively.

- the tax system should be fair (that is a person should be taxed according to his ability to pay),
- the provisions of tax should be clearly specified without any ambiguity,
- it should be easy to understand to the common man,
- it should be efficient and cost of compliance should be minimum.

The main principles of a good tax system are:

- **Equality:** This is the most important principle of taxation. It means that the tax system should be framed depending on the ability of the people to pay tax that is the richer sections or the high- income group should be subjected to higher tax while relatively less tax should be imposed on the low income group
- **Economy:** A good tax system will ensure that the cost of collecting and paying tax as well the compliance cost is minimum. For example, if there are many procedures for payment of tax and filing of related documents or if a number of visits are required by the tax payer to the tax office, then the tax system is said to be uneconomical.

In a broader sense, if very high tax is levied on the income of the tax payer, it will discourage savings and the productive capacity of the economy will go down, which will be uneconomical for the country.

Taxes on products like alcohol, cigarettes etc are considered as economical because they fetch revenue to the government as well as increase the price of those products which will discourage their consumption.

- **Certainty:** It means that tax that each tax payer is required to pay should be certain and there should be no ambiguity. The amount to be paid, timing of payment, procedure for payment should all be certain and known to the tax payer. There should be no element of ambiguity in the taxation provisions as this may lead to corruption (if any element of taxation can be controlled by the will of the government authorities).

Certainty is also required from the point of view of the government in terms of the estimated amount to be collected from various taxes and the time frame when the same will be collected.

- **Efficiency:** This means that the revenue collected from the tax payers in the form of tax should be sufficient to meet the government expenditure. However the government has to ensure that in order to raise sufficient revenue to meet expenditure, it does not overburden the tax payers such that the productive capacity is affected.
- **Understandable:** Tax system should be simple and should be such that it can be understood by common man. This will help curb corruption.
- **Benefit principle:** Taxation system should be such that persons who benefit from goods/ services provided by the government and which are primarily funded through taxation, should pay for it.
- **Convenience:** The tax system should be so designed that it causes minimum inconvenience to the tax payers in respect to payment of tax, record- keeping, filing of returns, audits etc.

Generally indirect taxes like VAT are convenient to the consumers because a consumer pays for them when he makes purchases and at a time when he can afford to because he chooses his own time of purchasing.

- **Fairness / equity:** Taxation system should ensure that no special treatment is meted out to specific political or other interest groups.
- **Demand management:** In times of depression in the economy, demand for goods and services is low; government can help increase demand by reducing taxes on goods/ services and consequently, reducing prices.
- **Elasticity:** Government should be able to increase revenues from taxation if required in case of an emergency for eg: a surcharge levied on income- tax can considerably increase government revenue during the period of emergency
- **Flexibility:** This is a necessary criterion for elasticity. Unless the tax system is flexible that is it can be modified to suit new conditions, revenue cannot be increased.
- **Diversity:** There should be a number of taxes both direct and indirect so that all the people who can afford to contribute are subjected to tax.
- **Broad basing:** This principle requires that taxes should be spread as wide as possible over the sections of population/ economy, to minimise individual tax burden.
- **Earmarking:** Tax revenue from a specific source should be used for the purpose for which it is collected when a direct link can be established between the tax collected and the expenditure for eg toll collected for road maintenance.

Taxation system should be such that it **contributes towards the social and economic objectives** of the society.



Tip

Tax policies are formulated with an aim to increase government revenues. They are framed on the basis of clear principles such as:

- (a) savings and investments
- (b) fairness
- (c) equality
- (d) enhancing work efficiency



Test Yourself 3

Explain the classification of taxes based on how they are levied.

4. Explain the incidence of taxation

[Learning Outcome e]

One of the important concepts of taxation is the incidence of tax. Taxes are not always borne by the person who pays the tax; in many instances the burden of tax is shifted to another person.

Tax incidence is said to be on the person who ultimately bears the burden of tax whereas impact of tax is on the person from whom government collects money in the first instance. It is important for the government to know who ultimately bears the tax in order to achieve equality in taxation.



Example

James **bought** a shirt for the consideration of Tshs5,000. The shop owner gives James the suit in return for payment of Tshs 5,000. VAT of Tshs1,000 is included in the cost of the suit. In this case James will bear the VAT expense, although the shopkeeper will pay the VAT to the tax authorities.

Tax incidence is on James and the tax burden is on the shopkeeper.

Burden of tax may be shifted from one person to another; shifting finally ends in incidence. A person on whom tax is levied may shift the burden of tax on another person either entirely or partly or he may not be able to pass on the burden at all.

- Forward shifting of tax takes place if burden of tax falls entirely on user and not on the manufacturer/supplier of the goods or service;
- Backward shifting occurs when the price of the product/ service remains same but the cost of tax is borne by the manufacturer.
- In certain cases, there would be no shifting of tax at all.

Tax incidence depends on the price elasticity of demand and supply.

- Price elasticity of demand is the responsiveness of the quantity demanded of a good or service to a change in its price or in other words it is the percentage change in quantity demanded to a one percentage change in price.
- Price elasticity of supply is the responsiveness of the quantity supplied of a good or service to a change in its price.

**Example**

An excise duty of Tshs5,000 is charged on the manufacture of motorcycles. If the product is price inelastic (that means if the price is increased, there would only be a small loss in demand that will be compensated by the additional revenue by increase in price), then the manufacturer will be able to pass on the entire burden of tax on the consumers. The incidence of tax will be on the consumer.

If the product is price elastic (that means if the price is increased, loss in demand would be more than the revenue earned by increase in price), then the manufacturer will not be able to pass on the entire tax burden to the consumers and the tax burden may have to be shared. Incidence of tax will be on both the manufacturer and the consumer.

**Example**

Contribution is made to social security scheme for all employees by the employers however the incidence of tax does not fall on the employer as it is reduced by the employers from the salary of the employee.

**Example**

Demand for cigarettes is more or less inelastic that means even if the price increases, demand for cigarettes remains more or less unchanged. If a higher tax is imposed by the government, the manufacturers will increase the price equal to the entire amount of increased tax. If the demand for cigarettes remains unchanged even after the increase in price, then it can be said that the incidence of increased tax is on the buyer.

The study of tax incidence is important because the objective of the tax system is not merely to raise a certain amount of revenue but to raise it from those sections of society who are capable of bearing the tax. Hence it is important for the policy makers to know who is ultimately bearing the tax.

The tax system of an economy generally comprises of direct tax and indirect tax. In case of direct tax, the burden of tax is borne by the person who pays the tax so the incidence of tax is very simple. Question of incidence primarily arises in case of indirect tax.

Indirect tax is tax where the burden is shifted from the tax payer to the consumer and the price is affected by the tax. Generally tax on commodities is an indirect tax; however that may not necessarily be true in all cases.

Generally the incidence of direct tax like income – tax falls on the richer sections of society. However a good tax system requires a proper balance between direct and indirect tax.

If the amount of tax is small, a manufacturer may not be keen to pass on the burden to the consumers however he will do so in case of a high amount of tax. Similarly if the labour and capital is freely available to the manufacturer, he will be in a position to shift the incidence of tax to the consumer.

**Test Yourself 4**

A tax of 1% is charged on every onion produced by a farmer. Explain in what circumstances the farmer will be able to pass on the entire tax to the consumers?

Answers to Test Yourself**Answer to TY 1**

Non-tax revenue is generated through various sources. Four main sources of non-tax revenue are as follows:

(a) Grants or aids

Grants can be defined as the non-repayable voluntary transfer of resources.

The grants could be of the following types:

- Grants provided by the central government to state government for specific objectives
- Grants provided by foreign countries to the Central/ State Governments (also called as foreign aid). Foreign aid may be given to support social causes, for contribution during emergencies/ natural calamities, for strengthening ties with the country or for commercial purposes.

(b) Debts from other governments or banks/ funds

When public expenditure exceeds public revenue, governments resort to borrowings.

Borrowings may be from:

- foreign countries or
- internal borrowings from the private sector in the form of debentures or bonds etc or
- internal borrowings from central bank of the country

(c) Income from investments made by the Government

Governments invest excess funds in bonds, mutual funds of other institutions. The revenue that is earned by governments from such investments is in the form of interest or dividend.

(d) Revenue from public enterprises

Government sets up public sector enterprises, which are owned and controlled by the government. The profit earned by such public sector enterprises is a source of revenue for the government. Furthermore when the public sector enterprise income from sale of its non-current asset, it is revenue for government, although it is a one-time revenue and is not a recurring income.

Answer to TY 2

The main objective of taxation for the government is to make provision for funds to meet public expenditure for achieving economic and social objectives.

1. Economic objectives

The government imposes taxation policies to:

(a) Encourage

- saving by individuals
- taking risks in investments by entrepreneurs
- entrepreneurs building their own businesses
- donations to charities
- investment in industrial buildings (e.g. factories, warehouses etc.)

(b) Discourage

- motoring e.g. to minimise pollution
- smoking and alcohol
- office buildings

A government does not intend taxes to be neutral, but to be used to encourage or discourage certain activities.

2. Social purpose of taxation

Politicians use taxation policies to encourage social justice; however, there are many different ideas as to what constitutes social justice. For example, the taxation system within the UK would suggest that it operates on an equitable basis.

3. Other objectives of taxation include:

- Encouragement of domestic industry and discouraging imports: the government may increase custom duties on imports which will increase the price of imported goods and will in turn help government to control import of goods.
- Income redistribution: this refers to bridging the gap between the rich and the poor and reducing inequality. This is done by levying higher tax on the richer sections of society. These funds are used for the welfare of the poorer sections to reduce the disparity between different sections of society.
- Economic stability: this refers to reducing the effect of inflation/ depression. For example, an increase in direct taxes will reduce the money available with the people to purchase goods and services and will in turn help to reduce inflation, whereas increase in public expenditure during depression helps to increase demand for goods and services, which is otherwise very low during depression.

Protection of particular sectors/ industries: the government may levy lower rates of taxes or give tax concessions to particular sectors/ industries to protect or promote their growth.

Answer to TY 3

The basis on which taxes are levied, can also be bifurcated into following three categories:

- **Progressive taxation:** a tax such as the income tax demonstrates the progressive principle. As income rises so does the proportion of tax i.e. the rate of tax rises as well as the amount of tax. This can be considered as just and fair, as the higher tax payments are made by those with higher incomes. Taxes which take a higher percentage of the incomes of higher income earners are said to be progressive.
- **Regressive taxation:** This is the tax where, as the amount of income increases, percentage of tax is reduced. So in this case, a tax payer in the high income group may be paying more taxes in absolute terms but the percentage of income is falling.
- **Proportional taxes:** In this case, as the tax payer's income increases, he pays more tax but the amount that is paid as percentage of the tax payer's income remains unchanged.

Answer to TY 4

The farmer will be able to pass on the entire burden of tax on the consumers if the product is price inelastic (that means if the price is increased, there would only be a small loss in demand that will be compensated by the additional revenue by increase in price). In case the price of the product inelastic, the farmer may be able to shift the burden of tax only partly on the consumer or may not be able to shift at all.

Quick Quiz

1. Tax incidence depends on:
 - A Price elasticity of demand and supply
 - B Price of goods
 - C Quantum of goods supplied
 - D Rate of taxation
2. Toll charged by the government for the use of roads is _____:
3. _____ taxation is the tax where, as the amount of income increases, percentage of tax is reduced.
4. Principle of equality of taxation requires that every person should pay the same amount of tax
 - A True
 - B False

5. The concept that persons earning more should pay more taxes is an example of

- A Ability to Pay Principle
- B Benefit Principal

Answers to Quick Quiz

1. The correct option is **A**

Tax incidence depends on the price elasticity of demand and supply..

2. public revenue.

3. **Regressive**

4. The correct option is **B**

The principle of equitable taxation does not mean that every person should pay the same amount of tax nor at the same rate. It means that the tax system should be framed depending on the ability of the people to pay tax that is the richer sections or the high- income group should be subjected to higher tax while relatively less tax should be imposed on the low income group.

5. The correct option is **A**.

Ability- to-Pay Principle states that taxes should be imposed based on ability of the tax payer to pay taxes which means that persons earning more should pay more taxes.

Self Examination Questions

Question 1

Explain the concept of incidence of taxation.

Question 2

Explain the principle of economy of taxation

Answers to Self Examination Questions

Answer to SEQ 1

One of the important concepts of taxation is the incidence of tax. Taxes are not always borne by the person who pays the tax; in many instances the burden of tax is shifted to another person. Tax incidence is said to be on the person who ultimately bears the burden of tax whereas impact of tax is on the person from whom government collects money in the first instance.

Burden of tax may be shifted from one person to another; shifting finally ends in incidence. A person on whom tax is levied may shift the burden of tax on another person either entirely or partly or he may not be able to pass on the burden at all.

One of the factors determining tax incidence is the price elasticity of demand and supply.

- Price elasticity of demand is the responsiveness of the quantity demanded of a good or service to a change in its price or in other words it is the percentage change in quantity demanded to a one percentage change in price.
- Price elasticity of supply is the responsiveness of the quantity supplied of a good or service to a change in its price

Answer to SEQ 2

This principle states that the every tax should be framed in such a manner that is takes out of the pockets of the people as little as possible, over and above what it brings into the public treasury. A good tax system will ensure that the cost of collecting and paying tax as well the compliance cost is minimum. For example, if there are many procedures for payment of tax and filing of related documents or if a number of visits are required by the tax payer to the tax office, then the tax system is said to be uneconomical.

In a broader sense, if very high tax is levied on the income of the tax payer, it will discourage savings and the productive capacity of the economy will go down, which will be uneconomical for the State.

Taxes on products like alcohol, cigarettes etc are considered as economical because they fetch revenue to the government as well as increase the price of those products which will discourage their consumption.

STUDY GUIDE B1: TAX LAW, ADMINISTRATION AND PRACTICE (GENERAL ISSUES)

■ Get Through Intro

In this Study Guide we will discuss the meaning and difference between tax avoidance and tax evasion.

It is essential to know the difference between the two because the law makes various provisions relating to the taxability of different types of income. You should be aware of the risk associated with tax evasion and avoidance. Committing either one of these is likely to have different consequences.

This Study Guide highlights the importance of understanding the difference between the two, because tax avoidance is permitted by law but tax evasion is illegal.

As a tax consultant, you should have thorough knowledge of the difference between them so that your client does not unwittingly commit tax evasion. In addition, you should advise your client on how to effectively and legally reduce the tax liability.

■ Learning Outcomes

- a) Analyse the role of the Tanzania Revenue Authority.
- b) Examine the tax appeals machinery in Tanzania.
- c) Distinguish between tax avoidance and tax evasion.
- d) Explain the tax administration provisions relating to tax consultants in the Income Tax Act, 2004.

1. Analyse the role of Tanzania Revenue Authority.**[Learning Outcome a]**

TRA was established on 31st July 1995 as an autonomous agency of the government of Tanzania; it became operational in 1st July 1996 under the supervision of the Ministry of Finance and Economic affairs. The general aim of establishing TRA was to bring efficiency in revenue administration and collection.

Since 1996 The Tanzania Revenue Authority has been performing the following functions as prescribed in the establishment Act -The Tanzania Revenue Authority Act, Section 5(1)(a):

- To implement tax laws in order to assess, collect and account the collected tax revenue;
- To ensure effective, fair and efficient administration of union tax laws;
- To monitor and ensure the collection of other taxes not collected by it but the revenue is for union government.
- To advise the Minister and other relevant organs regarding suitability of fiscal policy;
- To encourage voluntary tax compliance;
- To increase taxpayers' services given by revenue departments to increase revenues collection;
- To take actions against tax evasion and avoidance;
- To provide trade statistics and publications on a quarterly basis; and
- To perform other functions as direct by the minister of finance.

2. Examine the tax appeals machinery in Tanzania.**[Learning Outcome b]**

Tanzanian tax laws allow any person who feels aggrieved to request a formal change to an official decision regarding tax assessment made by the Commissioner General.

A taxpayer who feels that the Commissioner General misapplied the law, came to an incorrect factual finding, abused his powers, was biased, considered evidence which he should not have considered or failed to consider evidence that he should have considered in making an assessment, may object against such an assessment.

2.1 Appellate machineries

Basically there are three appellate machineries where a taxpayer may appeal in case he disagrees with Commissioner General's decision.

1. Appeals to the Tax Reference Appeals Board

The functions of the Tax Reference Appeals board are:

- to hear and determine civil disputes arising from revenue laws administered by the TRA and
- conducting seminars regarding tax appeals system to tax payers.

The law provides that, any person who is aggrieved by the final determination of the assessment of tax by Commissioner General may appeal to the Board. The Board shall accept the objection under the following conditions:

- (a) A notice of appeal is served upon the Commissioner General within thirty days following the date on which a notice of final determination of assessment of tax is served on the appellant; and
- (b) The appeal is lodged with the Board within forty-five days following the date on which the notice of final determination of assessment of tax is served on the appellant.
- (c) The notice should give all details relating to the tax assessment and further correspondences made between the CG and the taxpayer



Example

Beta Plc has received a tax order notice dated 3 September 2013 from the TRA on 23 September 2013. The order raised a tax demand of Tshs200,000 towards non-payment of income tax on rent earned by the company. The company decided to appeal to the Tax Reference Board. Beta Plc would have to serve the notice of appeal upon the Commissioner General.

The board shall accept the objection under the following conditions:

- Beta served the notice of appeal upon the Commissioner General not later than 22 October 2013; and
- The appeal is lodged with the Board not later than 7 November 2013; and
- The notice should give all details relating to the tax assessment and further correspondences made between the CG and the taxpayer

2. Appeals to the tribunal

After proceeding of the Board reaches the decision, a taxpayer may still feel that he/he is not contented with the decision of the board. A taxpayer who feels aggrieved by the decision of the Board may appeal against the decision to the Tribunal. The appeal against the Tribunal shall be under the following conditions:

- (a) The appeal should be made within thirty days from the date of the decision of the board, and the appellant shall serve notice to the opposite party within fifteen days following the date on which the notice of appeal was filed to the Tribunal.
- (b) The Board or Tribunal may extend the limit of time set by the law if it is satisfied that the failure by a party to give notice of appeal, lodge an appeal or to effect service to the opposite party was occasioned by the following reasons:

3. Appeals to the court of appeal

Any person who is aggrieved by the decision of the tribunal may preferred an appeal to the Court of appeal where an objector prefers an appeal to the Board or to the Tribunal, any tax deposited as required by the law, shall continue to remain deposited with Commissioner General pending the final determination of the appeal.

2.2 Appeals procedure

If a person decides to object then he/she shall file a notice of objection with the Commissioner General with 30 days from the date of service of the notice of the assessment. The notice of objection shall contain a statement in precise form of grounds in respect of which the objection to an assessment is made.

In order for the notice of assessment to be admitted by the Commissioner General, the person objecting shall, pending the final determination of the objection to an assessment by the Commissioner General pay the amount of tax which is not in dispute or one third of the assessed tax, whichever is greater.

On receipt of the notice of objection the Commissioner General may:

- Admit the notice of objection to assessment of tax or
- Refuse to admit the notice of objection to assessment of tax.

The following circumstances will lead the Commissioner General to refuse to admit the notice of objection of assessment:

- (a) A notice was not given in writing,
- (b) Grounds are not clear, and or time barred,
- (c) The amount not in dispute was not paid.
- (d) The notice does not raise any question of law or fact in relation to the assessment
- (e) The relief sought cannot be granted in law or equity.
- (f) The objection is time based
- (g) The objection is otherwise misconceived

Any person who is aggrieved with the refusal by the Commissioner General to admit the notice of objection may, on depositing with the Commissioner General the amount of tax assessed which is not in dispute or one third of the tax assessed, whichever is greater, together with the interest due as a result of late payment of the tax in respect of which the notice of objection is issued, appeal to the **Board** against the refusal and the decision of the Board on whether / not the notice of objection be admitted by the Commissioner General shall be final.

Upon admission of a notice of objection, the Commissioner General may;

- (a) Amend the assessment in accordance with the objection and serve a notice of final assessment to the objector
- (b) Amend the assessment in the light of any further evidence that has been received or
- (c) Refuse to amend the assessment

Where the notice of objection is amended in light of further evidence or when the notice of objection is refused, the Commissioner General shall serve the objection with a notice setting out the reasons for the proposal.

On receipt of this notice the objector shall, within 30 days make submission in writing to the Commissioner General on his agreement or disagreement with the proposed amendment or refusal.

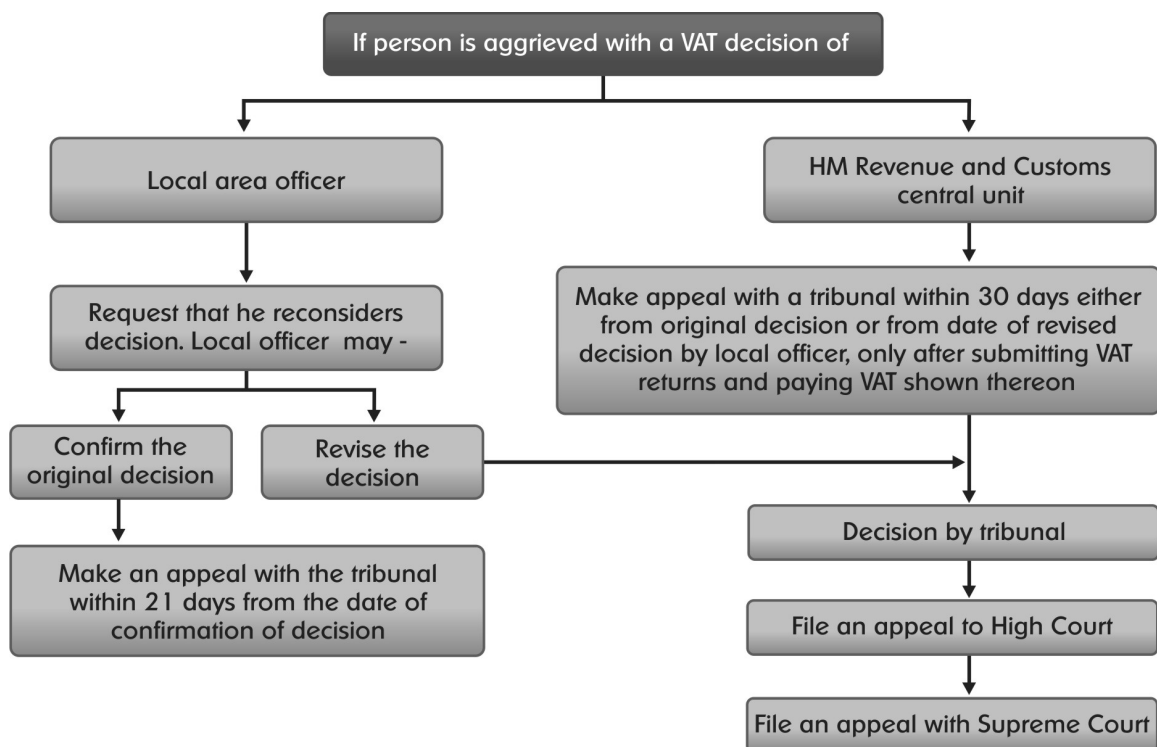
Upon receipt of this submission the Commissioner General may;

- (a) Determine the objection in light of the proposed amended assessment or proposed refusal and any submission made by the objector or
- (b) Determine the objection partially in accordance with the submission by the objector
- (c) Determine the objection in accordance with the proposed amendment or proposed refusal

Where the objector has not responded to the Commissioner General's proposal to amend the assessment or proposal to refuse to amend the assessment served, the Commissioner General shall make the final assessment of tax and serve the objector with the notice of final assessment.

A party who is aggrieved by the decision of the Board may appeal against the decision to the tribunal within 30 days from the date of the decision and shall serve notice to the opposite party within 15 days following the date on which the notice of appeal was filed to the **Tribunal**.

Diagram 1: Appeals procedure



3. Distinguish between tax avoidance and tax evasion.

[Learning Outcome c]

For many years individuals have found imaginative ways of avoiding liability to tax. Large companies employ highly skilled tax planners in a bid to legally reduce their overall tax liability. There have been many instances of individual's under-declaring their income to reduce their tax liability. The question here is whether these activities constitute tax avoidance or tax evasion.

Tax evasion is a deliberate act by an individual or company to mislead, misinform or otherwise mis-state their tax position to the Tanzanian Income tax authorities in order to evade taxes. **Tax evasion is illegal** and is punishable by hefty fines and imprisonment.

Tax avoidance is legal. It involves the arrangement of individuals' or companies' tax affairs in a way which reduces the tax liability. For example, using incentivised tax savings schemes OR establishing an offshore company in a tax haven or by forming a limited company to avail of more favourable tax deductions.

Tax incidence can be reduced through tax avoidance or tax evasion. Tax evasion and avoidance are pervasive in all countries worldwide and tax systems are striving towards reduction.

3.1 Tax evasion



Definition

Tax evasion involves efforts by individuals, firms, trusts and other entities to evade the payment of taxes by breaking the laws. It is an intentional and fraudulent attempt to escape payment of taxes in whole or part.

Tax evasion usually entails taxpayers deliberately misrepresenting or concealing the true state of their affairs to the tax authorities to reduce their tax liability, and includes, in particular, dishonest tax reporting (such as under declaring income, profits or gains; or overstating deductions).

3.2 Tax avoidance



Definition

Tax avoidance is the legal exploitation of the tax region to one's own advantage to attempt to reduce the tax payable using means that are within the law while making a full disclosure of the material information to the tax authorities.

Tax avoidance is any legal way of reducing the amount of tax payable – involving a sensible arrangement of the taxpayers' affairs so as to minimise the liability to tax. All activities must remain legal at all times. It is the utilisation of "tax loopholes" within the legislation in an ingenious way, thereby affording the tax payer, legally, a favourable tax position.

Sometimes avoidance is considered as amoral dodging of one's responsibilities to society or right of every citizen to find all the legal ways to avoid paying too much tax. There is no moral obligation to paying maximum tax. One is supposed to pay not more and not less than what the law says. Examples of tax avoidance are: tax deductions, changing one's business structure through incorporation, or establishing an offshore company in a tax haven.

(Ref. IRC v. Duke of Westminster (1936) 19 TC 490, 1936AC1; Ayshire Pullman Motor Services and Ritchie v. IRC (1929) 14 TC 754)



Definition

Tax resisters are the ones who refuse to pay tax because they do not want to support the government or some activities carried out by the government and sometimes breaking the law do so-hence practicing tax evasion.

Some tax resisters may donate their unpaid tax to charities and/or some make creative deductions; their basis for resisting is not against the tax laws, neither are they motivated by the desire to keep their money. The issue is they don't want to pay for what they oppose (e.g. against huge defence budget)



Definition

Some have suggested **tax avoision** for people who adopt the tax avoidance techniques in the service of tax resistance – thereby doing tax resistance legally-hence practicing tax avoidance.

3.3 Differences between tax evasion and tax avoidance

Essentially, the difference between tax avoidance and tax evasion is legality.

Tax avoidance is legally exploiting the tax system to reduce current or future tax liabilities by means not intended by parliament. It often involves artificial transactions that are contrived to produce a tax advantage.

Tax evasion is illegal crime in almost all countries and subjects the guilty party to penalties such as fines or even imprisonment while tax avoidance is not punishable.

3.4 Responsibility of the accountant

An accountant has responsibilities to:

1. individual clients
2. employer
3. income tax authorities

In addition, he has a responsibility to act in the public interest.

From time to time these duties may conflict. Questions of judgement may be involved in resolving these conflicts. An accountant may suspect that a taxpayer, for whom he is acting, is not being honest with regard to declarations of income or in the provision of information. The accountant will have to act with integrity and uphold the following Code of Ethics and Conduct.

The Code of Ethics and Conduct provides a framework within which to make these judgements.

The Code requires members to comply with the following principles:

- (a) integrity
- (b) objectivity
- (c) professional competence and due care
- (d) confidentiality
- (e) professional behaviour.

4. Explain the tax administration provisions relating to tax consultants in the Income Tax Act, 2004.

[Learning Outcome d]

The Tanzanian Tax system is a self-assessment one where taxpayers are obliged to self-declare their taxable activities and pay tax accordingly. However experience shows that self – assessment, is not a simple straight forward affair, the complexity of tax legislations and even the time required to file various returns by tax payers, they are given the option of filing a return with the assistance of a tax consultant. The most common role of tax consultants is to help people prepare and file their tax returns. This can be a valuable service, as failing to do so properly can leave a taxpayer liable to paying penalties.



Definition

Tax Consultants (or professional, practitioner, advisor) is a person recognized by TRA as sufficiently qualified to provide professional service consistent with tax legislation.

A person shall not practice or (in return of a payment) hold out to be an Income Tax Consultant unless the person is an approved tax consultant. The provision prohibits any person, including authorized accountants, or auditors to practice as tax consultants until the Commissioner for domestic revenue legally registers such person. Indeed TRA exercises elaborate oversight functions on tax consultants. Tax consultant's duties include representing taxpayers before a tax administration concerning tax payers' rights, privileges or liabilities and preparing documents to be filed before the tax Authority. In order to ensure that tax practitioners' are capable of playing the role expected of them, their conducts is typically regulate under the law in different countries.

Self Examination Questions

Question 1

What are the principles which a member has to comply with?

Question 2

Which is legal and permitted, tax avoidance or tax evasion?

Answers to Self Examination Questions

Answer to SEQ 1

The Code of ethics requires members to comply with the following principles:

- (a) integrity
- (b) objectivity
- (c) professional competence and due care
- (d) confidentiality
- (e) professional behaviour

Answer to SEQ 2

Tax avoidance is legal and permitted whereas tax evasion is illegal.

Tax evasion usually entails taxpayers deliberately misrepresenting or concealing the true state of their affairs to the tax authorities to reduce their tax liability, and includes, in particular, dishonest tax reporting (such as under declaring income, profits or gains; or overstating deductions).

Tax avoidance is the legal exploitation of the tax region to one's own advantage to attempt to reduce the tax payable using means that are within the law while making a full disclosure of the material information to the tax authorities.

STUDY GUIDE B2: PROCEDURES FOR PAYMENT OF TAX

■ Get Through Intro

While complying with the Income Tax Act 2004, following the due dates is very important as any delay in filing returns and paying tax can lead to heavy penalties.

This Study Guide discusses in detail the methods of tax payments, contents and due dates for submission of statements of estimated tax payable, as well as consequences of not complying with the Income Tax Act 2004.

As a tax consultant, you will need this information to advise clients on how to minimise penalties. A thorough understanding of this topic is important for your examination, as well as in your professional life.

■ Learning Outcomes

- a) Describe tax procedures for:
 - i. taxes payable by instalment (estimated taxes)
 - ii. tax payable on assessment
 - iii. tax payable by withholding agents
- b) State due dates for payment of tax.
- c) Calculate the penalty for not maintaining documents/records.
- d) Calculate penalty for not filing a statement of estimated tax and return of income.
- e) Calculate interest for late payment of tax.
- f) Calculate interest for under estimating tax.
- g) Describe procedures to recover unpaid tax.

1. Describe tax procedures for:
 - i. taxes payable by instalments (estimated taxes);
 - ii. tax payable on assessment and
 - iii. tax payable by withholding agents
 State due date for payment of the tax

[Learning Outcomes a and b]

1.1 Taxes payable by instalments

Normally, business and investor taxpayers are required to pay their taxes in instalments; and employees who are employed by non-resident employers are also required to pay their taxes in instalments because the employers are not required to withhold the taxes (Section 88(1)); unless permitted by the Commissioner of Domestic Revenue to not pay taxes by instalments (Section 89(7)).

The calculation of amount of the instalments starts with estimation of tax payable of a person at the start of the year.

The computation of tax payable requires that the taxpayer estimate his or her future gross income, deductible expenditures etc. and properly uses tax rates to determine it. Then, the taxpayer uses the formula given in the Income Tax Act 2004 to compute how much of the estimated tax payable should be paid in each instalment.

Generally, taxpayers might pay their tax liabilities in 4 instalments i.e. on or before the last day of the 3rd, 6th, 9th and 12th months of the year of income (Section 88(2)). However, when a taxpayer does not have an accounting period of 12 months, the instalments should be made every 3 months and the last one at the last day of the year (Section 88(2)).

Specifically, the amount of each instalment of income tax payable by an instalment payer for a year of income is calculated according to the following formula:

$$\frac{[A - C]}{B}$$

Where:

A is the estimated tax payable by the instalment payer for the year of income at the time of the instalment;

B is the number of instalments remaining for the year of income including the current instalment; and

C is the sum of any income tax paid during the year of income, but prior to the due date for payment of the instalment, by the person by previous instalment, single instalments and non-final withholding taxes (Section 88(3)).

However, taxpayers with estimated tax payable for a year of income of Tshs50,000 or less are not required to pay taxes in instalments (Section 88(4)).

Additionally, resident taxpayers engaged in agricultural business make no payments in the 1st and 2nd instalments but in the 3rd instalment pay 75% of estimated tax payable and the balance payable in the 4th instalment.

Therefore, when the estimated tax payable is accurately estimated, the final tax liabilities after deducting previously paid taxes by way of instalments and withholding may be small.



Example

Carter Ltd whose accounting period ends on 31 December each year estimated that in 2013 it was going to make a total income of Tshs20,000,000. After filing the statement of estimated tax payable on time and paying the first and second instalment, the company changed the estimated taxable income to Tshs30,000,000 and also paid non-final withholding taxes amount to Tshs1,000,000.

Required:

If the tax rate was 30%, estimate the amount that was paid in the 1st, 2nd, 3rd and 4th installment and state the due date of each instalment.

Answer

- (i) The due date of the **first instalment** will be on or before 31 March 2013 and tax payable along with filing the statement of estimated taxes would be Tshs, given by:

[A – C]

B

A is the estimated tax payable by the instalment payer for the year of income at the time of the instalment = Tshs6,000,000

B is the number of instalments remaining for the year of income including the current instalment = 4 instalments and

C is the sum of any income tax paid during the year of income, but prior to the due date for payment of the instalment, by the person by previous instalment, single instalments and non-final withholding taxes (Section 88(3)) = Nil

Therefore the instalment amount would be $\text{Tshs6,000,000} / 4 \text{ instalments} = \text{Tshs15,000,000}$.

- (ii) In the **second instalment**

A = Tshs6,000,000,

B = 3 instalments

C = Tshs1,500,000; the amount paid in the first instalment

Therefore the amount of the second instalment would be $(\text{Tshs6,000,000} - \text{Tshs1,500,000}) / 3 \text{ instalments} = \text{Tshs1,500,000}$. The amount was payable on or before 30 June 2013.

- (iii) After revision of the estimated amount the value of

A = Tshs9,000,000,

C = Tshs4,000,000 from $(\text{Tshs1,500,000} + \text{Tshs1,500,000} + \text{Tshs1,000,000})$ i.e. two instalments and taxes paid at the source, and

B = 2 instalments.

Therefore the amount of the **third instalment** is $(\text{Tshs9,000,000} - \text{Tshs4,000,000}) / 2 = \text{Tshs2,500,000}$. The amount is payable on or before 30 September 2013.

- (iv) While in the last instalment the value of

A = Tshs9,000,000,

B = 1 instalment and

C = Tshs6,500,000 from $\text{Tshs1,500,000} + \text{Tshs1,500,000} + \text{Tshs1,000,000} + 2,500,000$.

Therefore the amount of the **last instalment** would be $(\text{Tshs9,000,000} - \text{Tshs6,500,000}) / 1 = \text{Tshs2,500,000}$ payable on or before 31 December 2013.



Example

Halogen Ltd whose accounting period ends on 31 December each year estimated that in 2013 it was going to make a total income of Tshs20,000,000.

After filing the statement of estimated tax payable on time and paying the 3rd instalment, the company changed the estimated taxable income to 30,000,000.

Required:

If the tax rate was 30% and the company deals with agriculture business, estimate the amount that was paid in the 1st, 2nd, 3rd and 4th instalment and state the due date of each instalment.

Answer

- (i) For agriculture businesses the first and second instalments are all zero
- (ii) The amount of third instalment would be 75% of Tshs6,000,000 = Tshs4,500,000 payable on 30 September 2013.
- (iii) The fourth instalment includes all the remaining estimated tax payable of Tshs4,500,000 i.e. Tshs1,500,000 from original estimate plus Tshs3,000,000 for the extra revised estimate. Therefore Tshs4,500,000 should be payable on 31 December 2013.



Test Yourself 1

Robots and Assembler Design Makers Ltd whose accounting period ends on 31 December each year estimated that in 2013 it was going to make a total income of Tshs20,000,000.

If after filing the statement of estimated tax payable on time and paying the first and second instalment, the company changed the estimated taxable income to Tshs10,000,000 and also paid non-final withholding taxes amounting to Tshs1,000,000.

Required:

If the tax rate was 30%, estimate the amount that were paid in the 1st, 2nd, 3rd and 4th instalment and state the due date of each instalment.

1.2 Payment of tax payable on assessment

Tax assessments involve calculating taxable income and application of tax rates on the taxable income to determine tax payable for the year and deduction of tax credit from tax payable for the year to determine tax payable on assessment.

Normally, there are three categories of assessments: self-assessment, jeopardy assessment and adjusted assessment.

Self- assessment occurs when taxpayers estimate their tax payable themselves or with the help of tax consultants and file return on income as required i.e. not later than 6 months after the end of each year of income (Section 91(1)).

However, even when an entity fails or is not required to file a return of income for a year of income then when a return is filed, an assessment is treated as made on the due date for filing the return (Section 94(2)). The tax payable shown in that return on income is known as **tax payable on the assessment** which is payable on the same day (Section 94(1)).



Example

Dinverto Ltd whose accounting period ends on 31 December each year estimated that in 2013 it was going to make a total income of Tshs20,000,000, and paid the estimated tax payable as required. Then, after the year end the actual taxable income turned out to be Tshs30,000,000 and the tax rate was 30%.

Required:

- (a) Determine tax payable assessment.
- (b) State the due date on payment of tax payable on assessment.

Answer

- (a) Total taxes paid by way of instalment were Tshs6,000,000 while the correct amount was Tshs9,000,000. Therefore the tax payable on assessment would be Tshs3,000,000.
- (b) Tax payable on assessment is payable at the same time when filing the return on income. The due date for payment of tax payable on assessment is on or before 30 June 2014.

1.3 Tax payable by withholding agents

It should be recalled that withholding taxes are taxes collected and paid to the TRA by payers, and not by recipients of the amount. These payers are collectively known as withholding agents. They are withholding agents because the burden of paying the taxes falls on the recipients of the amount, not them. The withholding agents include resident employers who make a payment that is to be included in calculating the chargeable income of an employee from the employment (Section 81(1)), resident payers of dividend, interest, natural resource payment, rent or royalty if these payments have sources from the United Republic (Section 82(1)).

Furthermore, a resident person who: in conducting a mining business pays a service fee to another person in respect of management or technical services provided wholly and exclusively for the business, pays to a non-resident an insurance premium with a source in the United Republic, pays to a resident or non-resident a service fee with a source in the United Republic; or pays money transfer commission to a money transfer agent, should withhold income taxes (Section 83(1)).

Also, resident corporations whose budget is wholly or substantially financed by the Government budget subvention are required to withhold tax when making a payment in respect of goods supplied by a resident person in the course of conducting business (Section 83A). When withholding amounts are not withheld, the withholding agents or the withholdees are supposed to pay the taxes not withheld on due date (Section 84(4)). The withholding agents paying the amount that could have been withheld might recover the same from the withholdees (Section 84(7)).

However, payments made by individuals not doing business, interest paid to a resident financial institution, or payments that are exempt amounts or paid to an approved retirement fund, rent paid to a resident person for the use of an asset other than aircraft, land or buildings, and interest payable to a non-resident bank by a strategic investor except for interest payable on any loan taken by a strategic investor from an associated or related company are not subject to withholding taxes (Section 82(2) and Section 83(2)).



Example

Elite Ltd withheld taxes on employees' salaries, amounting to Tshs10 million on 3 January 2013 for December 2012 salaries, and on dividends amounting to Tshs8 million which were paid to shareholders on 28 February 2013.

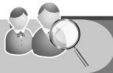
State the due dates the withheld taxes should be paid to TRA

Income taxes withheld by withholding agents should be paid to TRA within 7 days after the end of each calendar month. Therefore the withholding taxes on salary will be due on 7 February 2013, within 7 days after the end of January 2013 and the due date for taxes on dividends will be on 7 March 2013, within 7 days after the end of February 2013.

2. Calculate the penalty for not maintaining documents/records.**Calculate penalty for not filing a statement of estimated tax and return of income.****(Learning Outcomes c and d]**

Taxpayers who do not maintain proper documents for a year of income, file an estimate for a year of income on time or file a return of income for a year of income on due date are liable for a penalty for each month and part of a month during which the failure continues calculated as the higher of :

- (a) 2.5 percent of the difference between the income tax payable by the person for the year of income and the amount of that income tax that has been paid at the start of the start of the month; or
- (b) Tshs10,000 in the case of an individual or Tshs100,000 in the case of a corporation (Section 98(1)).

**Example**

Jolen Ltd whose accounting period ends on 31 December each year estimated that in 2013 it was going to make a total income of Tshs20,000,000. The company filed the statement of estimated tax payable on 5 May 2013 and return on income on 30 August 2014 showing tax payable of Tshs7,000,000 but all installments were paid on time and the tax payable on assessment was paid on 30 August 2014.

If the tax rate was 30%, compute tax penalties for failure to file statement of estimated tax payable and return on income on time.

The penalty for failure to file statement of estimated tax payable and return on income for corporates is the **higher of:**

- (i) 2.5% of the difference between the income tax payable by the person for the year of income and the amount of the income tax that has been paid by the start of the month; or
- (ii) Tshs100,000.

The income tax payable by the person was Tshs6,000,000, and the amount paid at the start of the month in which failure continued was Tshs1,500,000 for the first instalment. Therefore the higher of

- 2.5% of Tshs4,500,000= Tshs112,500 or
- Tshs100,000

Penalty is calculated as Tshs112,500. This penalty is applicable for each month and part of a month in which failure continued i.e. April and May 2013, therefore the total penalty is calculated as Tshs112,500 x 2 months = Tshs225,000.

Assume the income tax payable on assessment by the person was Tshs7,000,000, and the amount paid at the start of the month in which failure continued was Tshs6,000,000.

In this case the penalty is calculated as the higher of

- 2.5% of Tshs1,000,000 = Tshs25,000 or
- Tshs100,000

Therefore penalty is Tshs100,000. This penalty is applicable for each month and part of the month in which failure continued i.e. July and August 2014.

Therefore the total penalty is Tshs200,000.

Also failure of withholding agent to file a statement of withheld amount as needed by the Act is liable for a penalty for each month or part of the month during which the failure continues; calculated as the higher of::

- (a) The statutory rate applied to the amount of income tax required to be withheld from payments made by the agent during the month to which the failure relates; or
- (b) Tshs100,000 (Section 98(2)).



Test Yourself 2

Selcon Ltd withheld taxes on employees' salaries amounting to Tshs10,000,000 on 3 January 2013, and on dividends to the tune of Tshs8,000,000 which were paid to shareholders on 28 February 2013.

Required:

- State the due dates of filing the withholding tax statements if the company uses calendar year as its accounting year.
- Calculate the penalty for failure to file the withholding tax statements if it were filed on 3 August 2013 if the statutory rate was 10%.

3. Calculate interest for late payment of tax. Calculate interest for under-estimating tax.

(Learning Outcomes e and f)

3.1 Interest for late payment of tax

Taxpayers who fail to pay tax on or before the date on which the tax is payable are liable for interest for each month or part of a month for which any of the tax is **outstanding** calculated as the statutory rate plus 5% per annum, compounded monthly, applied to the amount outstanding at the start of the period (Section 100 (1)).

Further, taxpayers who had been granted extension period of tax payments by the Commissioner but fail to pay taxes as agreed, the extension period becomes void (Section 100(2)).

The formula for calculating interest is given by: $I = P [(1 + R)^N - 1]$, where;

I = Interest charge

P = Unpaid taxes

R = monthly interest charge rate

N = number of periods in which taxes were unpaid.



Example

Aiwick Ltd whose accounting period ends 31 December each year estimated that in 2013 it was going to make total income of Tshs20,000,000. The company filed the statement of estimated tax payable on 5 May 2013 and paid the first instalment on the same date

Required:

If the tax rate was 30% and statutory rate was 10%, compute the interest for failure to pay tax on time.

Workings: Estimated tax payable $30\% \times \text{Tshs}20,000,000 = \text{Tshs}6,000,000$, the first instalment is Tshs1,500,000.

Interest for failure to pay tax = $P [(1 + R)^N - 1]$, where;

P = unpaid taxes i.e. Tshs1,500,000,

R = monthly statutory rate plus 5%, i.e. $(10\% + 5\%) / 12 = 1.25\%$ and

N = number of periods in which failure continued = 2 months.

Therefore the interest is Tshs37,734.

3.2 Interest for under-estimating tax

Taxpayers who are required to pay taxes in instalments are expected to use accurate data and the difference between the estimated tax payable made in original or revised estimate and correct tax payable should be insignificant. **Under-estimation of estimated tax payable in instalment** happens when the estimated or revised income tax payable for a year of income is less than 80% of the correct amount (Section 99(1)). This is considered as a significant difference.

The under-estimation of estimated tax payable by instalment attracts interest for each month or part of a month from the date the first instalment for the year of income is payable until the due date by which the person must file a return on income for the year of income (Section 99(2)).

The interest is computed using **statutory rate**, compounded monthly, applied to the excess of: the total amount that would have been paid by way of instalments during the year of income to the start of the period had the person's estimate or revised estimate equalled the correct amount over the amount of income tax paid in instalments during the year of income to the start of the period (Section 99(3)).

The formula for calculating interest for under-estimation is given by: $I = P [(1 + R)^N - 1]$, where;

I = Interest charge,

P = difference between instalment calculated using actual and estimated tax payable,

R = monthly statutory rate and

N = number of periods from the first instalment up to the day the return on income is supposed to be filed.



Example

Hedra Ltd whose accounting period ends on 31 December each year estimated that in 2013 it was going to make a total income of Tshs20,000,000. The company filed the statement of estimated tax payable on 5 May 2013 and return on income on 30 August 2014 showing tax payable of Tshs9,000,000 but all instalments were paid on time and the tax payable on assessment was paid on 30 August 2014.

Required:

- If the tax rate was 30% and statutory rate was 10%, determine whether there is under-estimation of tax payable in instalments.
- If yes compute the interest for under-estimation.

Workings: Estimated tax payable = 30% x Tshs20,000,000 = Tshs6,000,000

- Under-estimation occurs when 80% of the correct tax payable i.e. 9,000,000 = Tshs7,200,000 is larger than the estimated amount i.e. 6,000,000. Therefore there is under-estimation.

- Interest for under-estimation = $P [(1 + R)^N - 1]$, where;

P = difference between instalment calculated using actual i.e. Tshs2,250,000 and estimated tax payable i.e. Tshs1,500,000 = Tshs750,000 ,

R = monthly statutory rate, i.e. 10%/12 = 0.833% and

N = number of periods from the first instalment i.e. 31 March 2013 up to the day the return on income is supposed to be filed i.e. 30 June 2014, equal to 15 months.

Computing in the above formula the interest is Tshs99,421.



Test Yourself 3

Under the ITA 2004, taxpayers who fail to pay tax on or before the due date are payable are liable for interest for each month or part of a month for which any of the tax is outstanding. This interest is calculated at:

- The statutory rate plus 1% per annum, compounded monthly
- The statutory rate plus 1% per annum, compounded quarterly
- The statutory rate plus 5% per annum, compounded monthly
- The statutory rate plus 5% per annum, compounded quarterly

4. Describe procedures to recover unpaid tax.

(Learning Outcome g)

The first method of recovering unpaid tax is through suing the tax debtor for the amount and attempting to recover it in any court of competent jurisdiction (Section 110). Another way of collecting unpaid taxes is to create charges over assets of the tax debtor (Section 112(1)). The charge is created by serving a tax debtor a notice in writing specifying the details of the tax debtor, the assets charged, the extent of the charge, the tax to which the charge relates and details regarding the Commissioner's power of selling the assets (Section 112(2)).

The assets are charged to the extent of the tax payable, interest accrued and any costs of charge and sale (Section 112(3)). The charge over an interest in land or buildings is completed by the Commissioner filing an application of the charge to register; and in any other case, the charge is completed by serving a notice on the tax debtor (Section 112(4)). The charge over asset may be withdrawn if only the tax debtor pays the amount in full (Section 112(5)).



Definitions

'Costs of charge and sale' with respect to assets means any expenditure incurred or to be incurred by the Commissioner or an authorised agent under this Section with respect to creating or releasing a charge over the assets; or with respect to taking possession of, holding and selling the charged assets.

Section 112(10)

'A tax debtor' is person who has not paid his/her tax liabilities or tax payable when they are due.

Section 112(2)

Also the Commissioner may sell the charged assets after properly notifying the tax debtor through a notice (Section 113). The notices should identify the charged assets, method and timing of sale, and if the assets are tangible it should communicate the intention of the Commissioner to take possession of the assets.

The possession of the tangible assets might be directly or through an authorised agent, at any time after the notice is served. Then after selling of the charged assets, the money should be used to pay the costs of charge and sale of the assets, then to pay the tax due and interest accrued with respect to that tax and any remainder should be paid to the tax debtor (Section 113(5)). In case the money realized is not enough to settle the unpaid taxes, the Commissioner takes other steps to collect the taxes.

The last action the Commissioner can do to recover the unpaid taxes is to prevent a tax debtor from leaving the country. The prevention is done through the Director of Immigration, ordering the Director to prevent the person from leaving the United Republic for a period of 72 hours from the time the notice is served on the Director by the Commissioner (Section 114 (2)); the decision by the High Court for the longer period of travel ban (Section 114(4)). The prevention may be removed only when the tax debtor pays or takes satisfactory steps towards payment of the taxes (Section 114(3)).



Test Yourself 4

The last resort to a Commissioner under the ITA 2004 to recover taxes unpaid taxes from a tax debtor is to:

- A** prevent a tax debtor from leaving the country
- B** force the Tax debtor to file for bankruptcy
- C** institute a legal suit for a criminal activity
- D** recover the unpaid taxes from the family of the tax debtor

Answers to Test Yourself

Answer to TY 1

- (a) The due date of the first installment will be on or before 31 March 2013 and tax payable along with filing the statement of estimated taxes would be given by:

$$\frac{[A - C]}{B}$$

Where **A** Tshs6,000,000, **B** 4 instalments and **C** Nil.

Therefore the instalment amount would $6,000,000/4 = \text{Tshs}15,000,000$

- (b) In the second instalment the value A would be Tshs6,000,000, C, Tshs1,500,000 amount paid in the first instalment and value of B is 3 instalments. Therefore the amount of the second instalment would be $(\text{Tshs}6,000,000 - \text{Tshs}1,500,000)/3 = \text{Tshs}1,500,000$. The amount was payable on or before 30 June 2013.
- (c) After revision of the estimated amount value of A changed to Tshs3,000,000, C to Tshs4,000,000 from $(\text{Tshs}1,500,000 + \text{Tshs}1,500,000 + \text{Tshs}1,000,000)$ i.e. two instalments and taxes paid at the source, and value of B is 2 instalments. Therefore the amount of third instalment was $(\text{Tshs}3,000,000 - \text{Tshs}4,000,000)/2 = \text{Tshs}500,000$. Therefore nothing will be payable on or before 30 September 2013.
- (d) While in the last instalment the value of A would be Tshs3,000,000, value of B would be 1 instalment and the value of C would be Tshs4,000,000 from $\text{Tshs}1,500,000 + \text{Tshs}1,500,000 + \text{Tshs}1,000,000$. Therefore the amount of the last instalment would be $(\text{Tshs}3,000,000 - \text{Tshs}4,000,000)/1 = \text{Tshs}-500,000$. Again nothing is payable on or before 31 December 2014.

Answer to TY 2

(a) Due dates of filing the withholding tax statements

All withholding agents are required to file statements of accounting for the amount withheld within 30 days after the end of each 6 month calendar period. Therefore, the person should file the statement on or before 30 July 2013 for these payments, and should again file it on or before 30 January 2014.

(b) Penalty for failure to file the withholding tax statements

The penalty is the higher of 10% of Tshs18,000,000 and 100,000. The higher is Tshs1,800,000. Therefore, the total penalty is $\text{Tshs}1,800,000 \times 2 = \text{Tshs}3,600,000$.

Answer to TY 3

The correct option is **C**.

Under the ITA 2004, taxpayers who fail to pay tax on or before the due date are payable are liable for interest for each month or part of a month for which any of the tax is outstanding. This interest is calculated at the statutory rate plus 5% per annum, compounded monthly.

Answer to TY 4

The correct option is **A**.

The last action the Commissioner can do to recover the unpaid taxes is to prevent a tax debtor from leaving the country. The prevention is done through the Director of Immigration, ordering the Director to prevent the person from leaving the United Republic for a period of 72 hours from the time the notice is served on the Director by the Commissioner

Quick Quiz

1. Which of the following payments may not be subject to withholding taxes?
 - A Dividends
 - B Rents
 - C Interest
 - D None of the above
2. The following taxpayers must file statement of estimated tax payable except:
 - A All employers
 - B All employees
 - C Business persons
 - D None of the above
3. Which of the following statement(s) is incorrect with reference to filing return on income?
 - A Return on income is filed before or at the end of the 3rd month after the beginning of the year of income
 - B Return on income contains income tax payable on assessment
 - C Return on income must be signed by its preparer
 - D All of the above
4. What is the value of single instalment taxes when furniture with costs of Tshs2,000,000 is realized for Tshs3,000,000 in a furniture store of a resident person?
 - A 1,000,000
 - B Tshs100,000
 - C Tshs150,000
 - D None of the above
5. Musa Ltd and the resident person had Tshs10,000,000 estimated tax payable, the amount of the final instalment will be:
 - A Tshs3,000,000
 - B Tshs10,000,000
 - C Tshs2,500,000
 - D Tshs750,000
6. Which of these statements is/are correct concerning penalty for failure to keep records?
 - A Applies to SMEs taxpayers
 - B Depends on the length of time, amount payable and fixed amount
 - C Taxpayers with tax payable do not have to pay penalty even when they do not keep records
 - D All of the above
7. Consider the following information:
 - Capital gain from realization of investment assets Tshs10,000,000
 - Capital losses from realization of investment assets Tshs4,000,000The amount of tax paid on transfer of ownership by resident to a non-resident person will be:
 - A Tshs600,000
 - B Tshs1,200,000
 - C Tshs1,000,000
 - D None of the above

Answers to Quick Quiz

1. The correct option is **D**.

All of the items can be taxed at the source unless they are exempted from income tax.

2. The correct option is **D**.

Normally, business and investor taxpayers are required to pay their taxes in instalments and employees who are employed by non-resident employers are also required to pay their taxes in instalments because the employers are not required to withhold the taxes (Section 88(1)). Paying taxes in instalments imply filing estimated tax payable, in that sense only and only employees of resident employers may not file the statement if they are not engaged in business or investment activities.

3. The correct option is **A**.

Returns of income are based on actual performance of taxpayers and they normally need to be filed not later than 6 months after the end of each year of income.

4. The correct option is **D**.

Single instalment applies on the realization of investment assets at a gain but sales of furniture in a furniture store are not investment activities; rather they are businesses activities.

5. The correct option is **C**.

The amount of each instalment will be $\text{Tshs}10,000,000/4 = \text{Tshs}2,500,000$

6. The correct option is **B**.

Taxpayers who do not maintain proper documents for a year of income are liable for a penalty for each month and part of a month during which the failure continues; calculated as the higher of:

- 2.5 percent of the difference between the income tax payable by the person for the year and the amount of the income tax that has been paid at the start of the start of the month; or
- Tshs 10,000 in the case of an individual or Tshs 100,000 in the case of a corporation (Section 98(1)).

Therefore even with zero tax payable the non-compliant taxpayer has to pay the fixed amount of either Tshs10,000 or Tshs100,000 per month.

7. The correct option is **A**.

The single instalment tax rate for resident person is 10% of the gain, and for non-resident taxpayers is 20% of the gain. These taxes must be paid before transfer of ownership documents.

Self Examination Questions

Question 1

Shose Ltd carries on a trading business in Zanzibar. In April 2007, the company prepared its 2006 return of income with a taxable income of Tshs 40 million. The last return prepared by Shose Ltd was for the year of income 2005, for which the return was lodged reporting a loss. Shose and his sister Mai, are only directors of the company. Before the due date for filing the return, Shose and Mai urgently flew to mainland Tanzania to handle their mother's funeral. They came back to Zanzibar in August 2007 and found that an adjustment for the year of income 2006 in the amount of Tshs 10,000,000 had been issued to the company under Section 96 of Income Tax Act 2004 on 5 August 2007.

Shose was considering lodging an objection against the adjustment on the assessment. However, on 30 September 2007, the Commissioner gave a notice to the company under Section 103 of ITA 2004 that he has assessed for penalties for the year of income 2006 in respect of its late filing of return of income.

Required:

- Explain the powers of the Commissioner to raise an adjusted assessment under Section 96 of the Income Tax Act 2004.
- Define a "tax debtor" as per Section 113 (9) of the Income Tax Act 2004.

Question 2

For the accounting period ended 31 March, 2002, the Eagle Company Limited furnished the provisional return and paid the taxes thereon of Tshs20,000,000 within the statutory due dates.

On 30 June 2002 the Commissioner served the Company a notice requiring it to furnish its 2002 regular return within 40 days of the date of service of that notice.

The Company however did not respond to the Commissioner's notice and as a result on 15 July 2003, the Commissioner made a best judgment assessment on the Company of twice the income that was declared by the Company in its provisional return.

Required:

Assuming the Eagle paid the full taxes due for the 2002 year of income on 20 July 2003; determine the total tax paid on that date if the statutory rate was 10%.

Question 3

Timago Co. Ltd is engaged in manufacturing of different types of leather bags and cases. Its total number of employees is 100 for which the company paid Tshs15,540,000 to Tanzania Revenue Authority as PAYE collections for the period beginning January 2006 to June 2006. The company filed the statement of withholding taxes for the period on 30 September 2006.

Required:

Compute the penalty (if any) with regard to filing a statement of withholding taxes as per Section 98(2) of the Income Tax Act, 2004. (where applicable, the statutory interest rate is 20% per annum).

Answers to Self Examination Questions**Answer to SEQ 1**

- (a) The Commissioner can adjust all returns on income at any time prior to the expiry of 3 years following the year of income it relates to, the year the notice of assessment is issued or filed in case of delayed return on income, when they are prepared fraudulently to evade or delay tax payments or negligently therefore it is inaccurate (Section 94(6) and 96(2)).

Thereafter, the originally assessment would be replaced by the adjusted assessment to the amount adjusted by the adjustment (Section 96(5)). However, the Commissioner cannot adjust assessment sanctioned by competent court if the sanction is still in force (96(1)).

- (b) Tax debtor refers to a person who has failed to pay tax payable on due dates.

Answer to SEQ 2**Workings:**

- a) Tax payable on assessment Tshs20,000,000

- b) Penalty for failure to file tax returns on time:

- Start 10 August 2002 due date of the jeopardy assessment.
- Ending 15 July
- Number of months 12

The penalty for each month is the higher of 2.5% of Tshs20,000,000 i.e. Tshs500,000 and Tshs 100,000. The higher is Tshs500,000; therefore total penalties were Tshs6,000,000.

c) Interest for under-estimation:

- Estimation occurs when 80% of the correct tax payable i.e. 40,000,000 = Tshs32,000,000 is higher than the estimated amount i.e. 20,000,000. Therefore there is under-estimation.

- Interest for under-estimation = $P [(1 + R)^N - 1]$, where;

P = difference between instalment calculated using actual i.e. Tshs10,000,000 and estimated tax payable i.e. Tshs5,000,000 = Tshs5,000,000 ,

R = monthly statutory rate, i.e. $10\%/12 = .833\%$ and

N = number of periods from the first instalment i.e. 30 June 2001 up to the day the return on income was supposed to be filed i.e. 9 August 2002, equal to 14 months.

Therefore the interest was Tshs616,008.34.

- d) Interest for failure to pay tax payable on assessment on due dates (assumed the amount could have been paid on 9 August 2002).

Interest for failure to pay tax = $P [(1 + R)^N - 1]$, where;

P = unpaid taxes i.e. Tshs20,000,000,

R = monthly statutory rate plus 5%, i.e. $(10\% + 5\%)/12 = 1.25\%$ and

N = number of periods in which failure continued is 12 months from 10 August 2001 to 20 August 2002.

Therefore the interest is Tshs3,215,090.35.

Therefore the total tax paid on 20 August was Tshs29,831,098.69

Answer to SEQ 3

All withholding agents are required to file statements of accounting for the amount withheld within 30 days after the end of each 6 month calendar period. Therefore, the person should file the statement on or before 30 July 2013 for these payments, and should again file it on or before 30 January 2014.

Therefore, the penalty is the higher of 20% of Tshs15,540,000 and Tshs100,000. The higher of the two amounts is Tshs3,108,000.

Therefore, the total penalty is Tshs1,800,000 x3 = Tshs9,324,000.

STUDY GUIDE B3: OFFENCES

■ Get Through Intro

Even though certain offences and penalties have been dealt with in the previous Study Guides, it is still important for this section to focus on specific provisions in the Income Tax Act 2004 that deals with offences and the penalties for such offences. In a self assessment system, it is important for various offences to be known so that taxpayers organize their affairs to ensure maximum compliance.

■ Learning Outcomes

- a) Describe offences as provided for in Income Tax Law.

1. Describe offences as provided for in Income Tax Law.**[Learning Outcome a]****1.1 Offence of failure to comply with the Act**

It is an offence to fail to comply with any provisions of Income Tax Act 2004; where there is no specific penalty for that offence, the penalty will be:

- a) where the failure results or, if undetected, may have resulted in an underpayment of tax in an amount exceeding shillings 500,000, to a fine of not less than shillings 100,000 and not more than shillings 500,000; and
- b) in any other case, to a fine of not less than shillings 25,000 and not more than shillings 100,000 (Section 104(1)).

It is an offence not to acquire or use electronic fiscal device or issue fiscal receipts or fiscal invoice. On conviction the offence attracts a penalty of not less than shillings 1,000,000 or to imprisonment for a term not exceeding 3 years (Section 104(2)).

It is an offence not to issue electronic fiscal receipt or manual receipt whichever applicable, not to keep record for five years from the year they relate, and not to translate documents into official languages. The offence attracts 5% of the value of the manually receipted (when electronic fiscal receipt is required) or un-receipted amount for the first time offenders and 10% of the same amount for the second time offenders (Section 80A). While for the third time onwards, offenders are required to pay the penalty under Section 104.

1.2 Offence of failure to pay tax

It is an offence not to pay taxes on or before due dates without reasonable excuse. On summary conviction, the offence shall be liable to:

- (a) where the failure is to pay tax in excess of shillings 500,000, to a fine of not less than shillings 250,000 and not more than shillings 1,000,000, imprisonment for a term of not less than three months and not more than one year or both; and
- (b) in any other case, to a fine of not less than shillings 50,000 and not more than shillings 250,000, imprisonment for a term of not less than one month and not more than three months or both (Section 105).

1.3 Offence of making false or misleading statements

It is an offence to make false, misleading statements or omit paramount information of material nature to the Commissioner. Upon conviction the offence attracts the following penalties:

- (a) where the statement or omission is made without reasonable excuse and:
 - (i) if the inaccuracy of the statement were undetected, may have resulted in an underpayment of tax in an amount exceeding shillings 500,000, a fine of not less than shillings 250,000 and not more than shillings 1,000,000, imprisonment for a term of not less than 3 months and not more than 1 year or both; and
 - (ii) in any other case, a fine of not less than Tshs50,000 and not more than shillings 250,000, imprisonment for a term of not less than 1 month and not more than 3 months or both.
- (b) Or where the statement or omission is made wilfully or negligently and:
 - (i) if the inaccuracy of the statement were undetected, may have resulted in an underpayment of tax in an amount exceeding shillings 500,000, to a fine of not less than shillings 500,000 and not more than shillings 2,000,000, imprisonment for a term of not less than 1 year and not more than 2 years or both; and
 - (ii) in any other case, to a fine of not less than shillings 100,000 and not more than shillings 500,000, imprisonment for a term of not less than 6 months and not more than 1 year or both (Section 106).

1.4 Offence of impeding tax administration

It is an offence to obstruct or attempts to obstruct an officer of the Tanzania Revenue Authority acting in the performance of his or her duties; fails to produce documents or attend an examination by the tax officer when required; or impedes or attempts to impede the administration. The offence attracts a fine of not less than shillings 100,000 and not more than shillings 2,000,000, imprisonment for a term of not more than 2 years or both (Section 107).

1.5 Offences by authorised and unauthorised persons

- (a) It is an offence for any person either is an officer of the Tanzania Revenue Authority or any other person who directly or indirectly asks for or takes, any payment or reward whatsoever in connection with any of the officer's duties, not being a payment or reward that the officer is lawfully entitled to receive.
- (b) It is an offence for both authorised and unauthorised persons to agree to permit, conceal, connive or engage in any act aiming at defrauding the government with respect to any matter, including the payment of tax.

Either of the above offence attracts a fine of not less than shillings 500,000, imprisonment for a term of not less than 1 year and not more than 3 years or both (Section 108(1)).

Furthermore, it is an offence to divulge confidential official information illegally and the offence attracts a fine not exceeding shillings 1,000,000, imprisonment for a term not exceeding one year or both (Section 108(2)).

1.6 Offence of aiding or abetting

It is an offence to knowingly or recklessly aid, abet, conceal or induce another person to commit an offence (the "original offence"). When convicted, the offence attracts the following penalty:

- (a) where the original offence involves making false statements or omissions and if the inaccuracy of the statement were undetected, may have resulted in an underpayment of tax in an amount exceeding shillings 500,000, a fine of not less than shillings 500,000 and not more than shillings 2,000,000, imprisonment for a term of not less than one year and not more than two years or both; and
- (b) in any other case, a fine of not less than shillings 100,000 and not more than shillings 500,000, imprisonment for a term of not less than 6 months and not more than 1 year or both (Section 109).



Test Yourself 1

Under the Income Tax Act 2004, what is the maximum penalty for not issuing a receipt in a transaction?

- A** 5% of the value of the manually receipted (when electronic fiscal receipt is required) or un-receipted amount for the first time offenders
- B** 10% of the value of the manually receipted (when electronic fiscal receipt is required) or un-receipted amount for the first time offenders
- C** Penalty of not less than shillings 1,000,000 or to imprisonment for a term not exceeding 3 years
- D** Penalty of not less than shillings 1,000,000

Answer to Test Yourself

Answer to TY 1

The correct option is **A**.

Under the Income Tax Act 2004, the offence of not issuing receipts attracts 5% of the value of the manually receipted (when electronic fiscal is required) or un-receipted amount for the first time offenders.

Self Examination Question**Question 1**

In order to make sure there is smooth tax administration, tax law often imposes a number of offences against which taxpayers could be charged.

Required:

You are required to assess any three offences prescribed by the Income Tax Act 2004.

Answer to Self Examination Question**Answer to SEQ 1**

The offences prescribed by the Income Tax Act 2004 include:

- a) Failure to pay tax (Section 105)
- b) Offence of failure to comply with the Act (Section 104)
- c) Offence of aiding or abetting (Section 109)
- d) Offence of impeding tax administration (Section 107)
- e) Offences by authorised and unauthorised persons (Section 108)
- f) Offence of making false or misleading statements (Section 106)

STUDY GUIDE B4: RETURN OF INCOME AND STATEMENT OF ESTIMATED TAX PAYABLE BY INSTALMENTS

■ Get Through Intro

Taxes may be paid by either filing returns (this means the taxpayer submitting all relevant information to the TRA and paying tax accordingly) through withholding and Pay As You Earn (PAYE) systems (this means that the tax is withheld from the taxpayer's income source and sent to the TRA directly by the payer) or through the installment system.

This Study Guide provides various procedures relating to these three means of income tax payment.

■ Learning Outcomes

- a) Identify persons liable to file return of income (ROI).
- b) Establish due date for filing ROI.
- c) Explain statement of estimated tax payable by instalments.
- d) Explain consequences for non-filing.
- e) Describe the concept and application of single instalments payer.
- f) Explain returns from withholding agents.
- g) Describe the application of returns to skills and development levy (SDL).

1. Identify persons liable to file return of income (ROI). Establish due dates for filing ROI.

[Learning Outcomes a and b]

The Income Tax Act requires a taxpayer to file a final tax return to TRA. Filing a return means making a statement to TRA's Domestic Revenue Department of the income sources and the tax a person is supposed to pay under the law. A return must be filed with supporting documents to verify the authenticity of the statement in case the TRA audits or investigates the return.

Unlike the statement of estimated tax payable, which is a provisional return based on estimation, the final return of income is based on actual performance of taxpayers.

Returns of income are historical as they show the true financial performance of a person and must be accompanied by audited financial statements. Similar to the statements of estimated income, the returns of income are based on self-assessment.

1.1 Contents of the return of income (ROI)

A return of income of a person for a year of income shall specify:

- the person's chargeable income for the year of income from each employment, business and investment and the source of that income;
- the person's total income for the year of income and the income tax payable with respect to that income under Section 4(1)(a);
- in the case of a domestic permanent establishment of a non-resident person, the permanent establishment's repatriated income for the year of income and the income tax payable with respect to that income.
- any income tax paid by the person for the year of income by withholding, instalment or assessment for which a tax credit is available
- the amount of income tax payable after taking tax credit
- any other information that the Commissioner may prescribe

In addition, the return should include a declaration that the return is complete and accurate, be signed by the person and a Certified Public Accountant in Public Practice (CPA-PP) when the CPA-PP helps taxpayers in its preparation.

Also the taxpayer should attach any withholding certificates supplied to the person with respect to payments derived by the person during the year of income, any statement provided to the person from the CPA-PP; and any other information that the Commissioner may prescribe. Finally, returns on income of corporations should be prepared or certified by a certified public accountant in public practice.

1.2 Persons liable to file return of income (ROI)

Actually, all taxpayers are required to file a return on income **except** a resident individual who has no income tax payable or whose income for the year of income consists exclusively from (either or both sources):

- income from any employment where the employer withholds 'Pay As You Earn' tax or
- gains from realisation of assets where taxes are paid in the form of a single instalment (Section 92).

Also, a non-resident person without a domestic permanent establishment who has no income tax payable for the year of income or whose income tax payable for the year of income consists exclusively of gains from realisation of assets where taxes are paid in the form of a single instalment is not required to submit a return on income (Section 92).

1. Nil and excess tax credit returns

Unless a person is exempt from filling tax returns, a return on income must be filed on the due date even when one has no taxable income: that return is known as a nil tax return. On the other hand tax paid during the year may exceed the annual tax payable; in that case there will be a tax credit. The excess may be refunded within 45 days after the person claims the amount or may set off against any unpaid tax. In fact the claim must be made in writing within three years of the later of:

- the end of the year of income during which the events occurred that gave rise to the payment of the excess; or
- the date on which the excess was paid.

1.3 Due date of filing returns on income

The due date of filing returns on income is on or **before the end of six months after the end of each year**. Where a taxpayer fails or is not required to file a return of income for a year of income, then until such time as a return is filed, an assessment will be treated as made on the due date for filing the return.

However, the taxpayer may request extension of the time required to file tax returns to the Commissioner. The Commissioner might allow the extension which **must not exceed 60 days** from the original due date of the tax returns.

TRA has issued a calendar (TRA tax calendar) to remind taxpayers and stakeholders of the important dates of filing tax returns, making tax payments and other important events. This calendar should help in planning your tax affairs.



Important

A complete example of the return on income is given at the end of this Study Guide. Though the given return is for entity taxpayers, there are also returns on income for individual taxpayers available at <http://www.tra.go.tz/index.php/forms/151-domestic-revenue-forms>.



Example

Robots Ltd who has an accounting period ending 31 December each year, estimated that in 2013 it was going to make a total income of Tshs20,000,000 and paid estimated tax payable as required. Then, after the year end, the actual taxable income turned out to be Tshs30,000,000 and the tax rate was 30%.

Establish the due date of filing the return on income.

Returns on income are filed on or before 6 months after the year end, so the due date of filing ROI is on or before 30 June 2014.

2. Explain statement of estimated tax payable by instalments

[Learning Outcome c]

The statement of estimated tax payable is a provisional return which a taxpayer is required to complete and file to the Commissioner within three months from the beginning of the year of income (which for individuals shall be the calendar year) (Section 89(1)).

These statements include the following information:

- Estimation of the person's chargeable income for the year of income from each employment, business and investment and the source of that income and the person's total income for the year of income and the income tax to become payable with respect to that income;
- In the case of a domestic permanent establishment of a non-resident person, the permanent establishment's repatriated income for the year of income and the income tax to become payable with respect to that income;
- Estimated tax payable for the year and any foreign tax relief which will be claimed by the person, and be signed by the person stating whether to the best of their knowledge and belief the estimate is true and correct; and have attached to it any other information that the Commissioner may prescribe.



Important

A complete example of the statement of estimated tax payable is given at the end of the Study Guide (**see form 2**). Though the given statement is for entity taxpayers, there is also the statement of estimated tax payable for individual taxpayers available at <http://www.tra.go.tz/index.php/forms/151-domestic-revenue-forms>.

Failure to file this statement by the taxpayers might lead to penalties and the Commissioner of domestic revenues would estimate tax payable by non-complying taxpayers (Section 89(7)). The amount estimated by the Commissioner should be used in calculating instalment amount (Section 89(8)).

When the statement of estimated tax payable is filed or issued by the Commissioner as the case may be, it becomes enforceable for the that year of income unless it is revised by the taxpayer by filing a statement of **revised estimate** of tax payable (Section 89(5)). This statement should be accompanied by reasons why the estimates of tax payable have changed. Thereafter, the revised estimate of tax payable comes in force from the date it is filed and used in calculating future instalment amounts (Section 88(6)).

3. Explain consequences for non-filing of return of income.

[Learning Outcome d]

The Income Tax Act 2004 imposes interest, penalties and even prison sentences to noncompliant taxpayers. This aims at increasing compliance with tax laws. Liability for interest and penalties with respect to a particular failure are calculated separately, in addition to any other tax, and does not relieve any person from liability to criminal proceedings.

Taxpayers who do not maintain proper documents for a year of income, file an estimate for a year of income on time or file a return of income for a year of income on the due date are liable to a penalty. These offences and related penalties have already been discussed in Study Guide B3

4. Describe the concept and application of single instalments' payer.

[Learning Outcome e]

The Income Tax Act 2004 requires a person who derives a gain from the realisation of an interest in land or buildings situated in the United Republic, shares or securities held in resident entity to pay income tax by way of single instalment (Section 90(1)).



Definition

A person who owns an interest in land or building shall be treated as realising the asset when the person parts with ownership of such interest including when the asset it is sold, exchanged, transferred, distributed, cancelled, redeemed, destroyed or surrendered and in the case of interest of an entity when it ceases to exist, immediately before the entity ceases to exist.

Income Tax Act 2004, Section 39

4.1 Computation of capital gains

Capital gains income is calculated as follows: value of consideration received or accruing as a result of the realisation of the interest in land or buildings **less** cost of acquisition **less** expenditure incurred on any improvement to the asset **less** expenditure incurred wholly and exclusively in connection with the realisation of interest in land and building, such as stamp duty, registration charges, legal fees and brokerage.

4.2 Applicable rate

The single instalment tax rate for resident person is 10% of the gain, and for non-resident taxpayers is 20% of the gain. These taxes must be paid before transfer of ownership documents and therefore before the titles are transferred from one person to another. The Registrar of Titles shall not register such a transfer without the production of a certificate from TRA certifying that the single instalment has been paid or is not payable.

In addition to the single instalment at the time of realisation of investment assets, taxpayers involved in the following businesses pay single instalment at 5% of the gross payment (Section 90(5)):

- a non-resident instalment taxpayer who receives a payment in conducting a business of land, sea or air transport operator or chatterer
- where no part of the above business is conducted through permanent establishment of the person situated in the United Republic
- and the payment is received in respect of; the carriage of passengers who embark or cargo, mail or other moveable tangible assets that are embarked in the United Republic, other than as a result of transshipment; or rental of containers and related equipment which are supplementary or incidental to carriage of transportation businesses (Section 90(3)).

These payments must be made before the ship, vehicle or aircraft is cleared for customs purposes (Section 90(6)). The vehicle, ship or aircraft in respect of which the payment shall be received shall not be permitted to clear customs and leave the United Republic unless a tax certificate has been issued by the Commissioner showing that the single instalment has been paid.

4.3 Exemptions

The following are excluded from capital gains and hence exempt from single instalment payment:

- If the residence has been owned continuously by the individual for three years or more and lived in by the individual continuously or intermittently for a total of three years or more; and the interest was realised for a gain of not more than shillings 15,000,000. If he makes a gain of more than Tshs15 million, then he will have to reduce the gain by Tshs15 million (i.e. the excess of Tshs15 million will be taxed).
- An interest in land held by an individual that has market value of less than shillings 10,000,000 at the time it is realised and has been used for agricultural purposes for at least two of the three years prior to realisation.
- Payments received in respect of carriage of fish by a foreign aircraft are not subject to a single instalment payment (Section 90(4)).

An instalment payer shall be entitled to tax credit for a year of income of an amount equal to the income tax paid by way of single instalment for the year of income



Example

Robots and Assembler Design Ltd, a resident company, disposed an investment asset i.e. shares for Tshs2,000,000 which had a cost of Tshs1,000,000 and net costs before disposal of Tshs100,000. The person incurred selling costs of Tshs800,000 and transport expenses of 100,000.

Required

Describe how tax on capital gain will be collected.

Gain or loss on realisation of assets = Incomings less cost of the assets less realisation expenses. Therefore, Gain on realisation = Tshs2,000,000 – Tshs800,000 – Tshs100,000 – Tshs1,000,000 = Tshs100,000.

Since there is gain on that disposal of share, the gain will be taxed as single instalment at the time of realisation. Therefore, Tshs10,000 (from 10% of Tshs100,000) should be paid before the transfer of ownership is done.

5. Explain returns from withholding agents.

[Learning Outcome f]

5.1 The withholding tax system

In order to ease tax collection and hence reduce both tax administration cost as well as compliance costs of tax payers, many tax systems including Tanzania have adopted a system of tax deduction at source. This system is known as withholding tax system.

In this system the amount of tax is retained/ withheld by one person when making payments to another person in respect of goods supplied or services rendered by the payee. For instance, instead of collecting taxes from hundreds of employees, the tax authority demands payment of tax from a single employer who is withholding PAYE before paying employees' salaries.



Definition

A person receiving or entitled to receive a payment from which income tax is required to be withheld is known as a withholder. On the other hand, a person who is required to withhold income tax from a payment made to a withholder is referred to as the withholding agent.

5.2 Advantages of withholding taxes

- The system minimises the possibility of evasion or underreporting of income because the agent will file the correct tax and details for fear of penalties
- A steady flow of government revenue is guaranteed
- The method is convenient to the taxpayers as they are spared of huge tax bills at the end of the year and hence are freed from the need to file returns and other administrative costs.
- It is economical for the Revenue Authority as it does not incur any costs in the collection of the taxes

5.3 Payments that are subject to withholding taxes

The following payments are subject to withholding taxes:

- Payment that is to be included in calculating the chargeable income of an employee from the employment of a resident employer
- Payment of investment return including dividend, interest, natural resource payment, rent or royalty. However the withholding tax does not apply when payments are made by individuals unless made for conducting a business
- Payment in respect to service fee and contract payments
- Payment for technical or management services made by resident person to another resident person in mining business and payment made by resident person for a service fee or an insurance premium with a source in United Republic to a non-resident person. However, individuals who are not in business cannot withhold taxes, and exempt amount is not subject to withholding payment.
- Payment made by government and its institutions in respect to supply of goods and services
- Payment in respect of money transfer commission paid or payable to money transfer agents

5.4 Type of withholding payments

There two types of withholding payments

- i. Final Withholding payments and
- ii. Non-final withholding payments.

Non final withholding tax is taxed at the source and in the hands of the tax payer. It does not relieve a person from further tax. Therefore, the income is also included in the computation of taxable income and tax liability but the tax paid is deducted in the computation of tax payable.

Final withholding payments are those which are taxed only at the source and their tax liability under income tax is satisfied. This kind of withholding tax is treated as discharging the recipient's tax liability, and no tax return or additional tax is required on taxed income. The classification of final or non-final withholding payments depend on whether the parties involved are resident or non-resident, persons or natural person i.e. individual doing business or investment, foreign or domestic.

The following are final withholding payments:

- (a) Dividends paid by:
 - (i) a resident corporation;
 - (ii) non-resident corporation to a resident individual, other than a dividend received by an individual in conducting a business;
- (b) Interest paid by financial institution to a resident individual where the interest is paid with respect to a deposit held with the institution, other than interest received by the individual in conducting a business; or foreign source interest paid to a resident individual;
- (c) Rent paid to a resident individual under a lease of land or a building and associated fittings and fixtures, other than rent received by an individual in conducting a business; or foreign source rent paid to a non-resident individual;

- (d) Interest paid to a unit trust.
 - (e) Management or technical service fees paid by a resident person to another resident or service fee or an insurance premium with a source in Tanzania paid by resident person to a non-resident person rather than through domestic permanent establishment in conducting mining business.
 - (f) Interest paid to a unit trust.
 - (g) Capital gains from realisation of interest in land or building (or both) when received:
- **By resident individuals** whose income consists exclusively of either or both of income from any employment or capital gains from realisation interest in land and building in Tanzania and
 - **By non-resident persons** without domestic permanent establishments whose their income consists exclusively of either or both of income from capital gains from realisation interest in land and building in Tanzania are not required to file tax returns, consequently the gains are final withholding payments.

5.5 Filing requirements by withholding agents

Withholding agents are required to pay income taxes withheld to TRA within 7 days after the end of each calendar month. In addition, the withholding agents are required to file (to the Commissioner) statements accounting for the amount withheld within 30 days after the end of each 6 month calendar period (Section 84(1)). The statements should show: payments made by the agent during the period that are subject to withholding, the name and address of the withholder, income tax withheld from each payment; and any other information that the Commissioner may prescribe (Section 84(2)).

Furthermore, a withholding agent is required to prepare and serve separately for each period a withholding certificate to the withholder. The certificate shall cover a calendar month and is served within 30 days after the end of the month. The statement should include, the name and address of the withholder; income tax withheld from each payment; and any other information that the Commissioner may prescribe.

In the case of employment income, a withholding certificate covers the part of the calendar year during which the employee is employed; and served by 30th January after the end of the year (assuming calendar year) or, where the employee has ceased employment with the withholding agent during the year, no more than 30 days from the date on which the employment ceased.



Important

A complete copy of tax withholding statements as well as withholding certificate are available at the end of the Section: form 2 and 3, taken from <http://www.tra.go.tz/index.php/forms/151-domestic-revenue-forms>.



Example

Robots and Assembler Design Makers Ltd withheld taxes on employees' salaries, amounting to Tshs10,000,000 on 3 January 2013, and on dividends amounting to Tshs8,000,000 which were paid to shareholders on 28 February 2013.

Required:

State the due dates of filing the withholding tax statements if the company uses calendar year as its accounting year.

All withholding agents are required to file statements accounting for the amount withheld within 30 days after the end of each 6 month calendar period. So, the person should file the statement on or before 30th July 2013 for these payments, and should again file it on or before 30 January 2014.



Test Yourself 1

Magic Company Limited is a newly formed company carrying out agricultural business and the withholding agent. It has decided that its accounting period will start from 1 July 2013 and end on 30 June 2014.

Required:

State the due dates for filing the withholding tax statements.

6. Describe the application of returns to skills and development levy (SDL).

[Learning Outcome g]



Definition

Skills Development Levy (SDL) is a levy imposed to promote learning and development in Tanzania and is driven by an employer's salary bill.

The funds are to be used to develop and improve skills of employees. Skills Development Levy (SDL) is charged based on the gross pay of all payments made by the employer to the employees in the particular time. Payments include salaries, wages, payments in lieu of leave, fees, commission, bonuses, gratuity, any subsistence travelling, entertainment or other allowance received by an employee in respect of employment or service rendered. In general everything chargeable under PAYE is also taken into account when calculating SDL.

Liability for SDL is to any employer employing at least four employees (these include permanent employees, part time employees, secondary employees, casual labourers etc.). Unlike PAYE the SDL is due and payable by an employer. The rate applicable for SDL is 5% of the total emoluments paid to all employees during the month.

The employer is obliged to prepare a monthly return indicating the actual amount of SDL and submit to the TRA office on or before the 7th day of the month following the month of payroll. In addition the employer is required to prepare and remit half year certificates which tally with the monthly returns submitted during the period.

It is important to note that the payment of SDL goes together with PAYE on or before the 7th day of the month following the month of payroll and the same return of income used by other withholding agencies to account for this tax withheld within 30 days after the end of each 6 month calendar period.



Test Yourself 2

Incidence of Skills Development Levy in Tanzania is on:

- A The employee
- B The employer
- C The employee and employer
- D None of the above

Answers to Test Yourself

Answer to TY 1

All withholding agents are required to file statements accounting for the amount withheld within 30 days after the end of each 6 month calendar period. So, the person should file the statement on or before 31 January 2015 these payments, and should again file it on or before 31 July 2015.

Answer to TY 2

The correct option is **B**.

Skills Development Levy (SDL) is a levy imposed to promote learning and development in Tanzania and is driven by an employer's salary bill.

Self Examination Questions**Question 1**

Mombasa Raha is a Kenyan company with no domestic permanent establishment Tanzania, in 2010 it brought Harambee star to play a match with Kilimanjaro star. The company made Tshs30,000,000 from that trip in Tanzania only and incurred a cost to the tune of Tshs4,000,000 for fuels and staff expenses, and a further 1,000,000 for renting a parking space.

Required:

Discuss how the company will be taxed in 2010 in respect to the income earned in Tanzania.

Question 2

Discuss briefly about the Skills Development Levy (SDL) and on whom it is levied.

Answers to Self Examination Questions**Answer to SEQ 1**

Since the company is assumed to have no domestic permanent establishment, it must make a single instalment of 5% of the gross payment received, before it leaves the border, 5% of Tshs30,000,000 = Tshs1,500,000. As it is unlikely that it will come again to Tanzania, the Commissioner might issue/request a jeopardy assessment of the income earned in Tanzania. However, the company has a tax credit of the tax made as single instalment.

Answer to SEQ 2

Skills Development Levy (SDL) is a levy imposed to promote learning and development in Tanzania and is driven by an employer's salary bill.

The funds are to be used to develop and improve skills of employees. SDL is charged based on the gross pay of all payments made by the employer to the employees in the particular time. Payments include salaries, wages, payments in lieu of leave, fees, commission, bonuses, gratuity, any subsistence travelling, entertainment or other allowance received by an employee in respect of employment or service rendered. In general everything chargeable under PAYE is also taken into account when calculating SDL.

Liability for SDL is to any employer employing at least four employees (these include permanent employees, part time employees, secondary employees, casual labourers etc.. The rate applicable for SDL is 5% of the total emoluments paid to all employees during the month.

The employer is obliged to prepare a monthly return indicating the actual amount of SDL and submit to the TRA office on or before the 7th day of the month following the month of payroll. In addition the employer is required to prepare and remit half year certificates which tally with the monthly returns submitted during the period.



TANZANIA REVENUE AUTHORITY

RETURN OF INCOME MADE ON BEHALF OF AN ENTITY

YEAR OF INCOME:

To:

TIN:

NOTE

This return is submitted under the provisions of Section 91 of the Income Tax Act, 2004. You are hereby required to furnish the return of income not later than six (6) months after the end of the year of income, showing your total worldwide income if you were resident in Tanzania or income the source of which is Tanzania if you were not resident during the year You are required to make payment of the income tax still to be paid for the year of income based on the declared income.

Please, read the notes carefully in the appendix before filling in the form.

There are penalties for not filing a tax return or for filing false return.

Date of issue:

Issuing office:

P.O. Box:

Tel: Fax:

E-mail address:

GENERAL INFORMATION/ENTITY'S PARTICULARS

1 TIN:

Name of entity:

2

3 Residential status (Please tick the appropriate box):
Resident ☐ **Non-Resident** ☐

Postal Address:

4 P.O. Box Posta

Physical Address:

5 Street/Location Plot No. B

Contact Numbers:

6 Phone number Second Phone

Third Phone Fax number

7 E-mail address:

From: Day Month Year To: Day

Month Year

8 Period covered by this return (basis period):

----------------------	----------------------	----------------------	----------------------	----------------------	----------------------

COMPUTATION OF INCOME AND TAX

	Business Income	Taxable income	Tax payable TZS
9	Business Income (other than Agriculture & Mining)		
10	Mining Business Income		
11	Loss brought forward from Mining		
12	Net Mining Business Income (10-11)		
13	Agricultural Business Income		
14	Loss brought forward from Agricultural Business Income		
15	Net Agricultural Business Income (13-14)		
16	Technical services (Mining)		
17	Transport for non-resident operators/charterers		
18	Insurance premium for non-resident		
19	Service fees (e.g. management fee, professional fee) for non-resident		
20	Total Business Income (9+12+15+(16 to 19))		
	Investment Income		
21	Dividends		
22	Dividends (DSE listed)		
23	Interest/Discount		
24	Rent		
25	Royalties		
26	Natural resource payment		
27	Capital gain		
28	Other investment (specify in separate schedule)		
29	Total Investment Income (from 21 to 28)		
30	Total of Business and Investment Income (20+30) and Tax		
31	Repatriated Income of a Domestic Permanent Establishment and Tax		
32	Final withholding payments		
33	Total Tax (30+31+32)		
34	Tax deducted at source		
35	NET TAX PAYABLE (33-32-34)		
36	DUE DATE		

DECLARATION

I hereby declare that the information I have given on this form and any accompanying accounts/documents are correct, complete and contain a full and true statement of the entity's income to the best of my knowledge and belief.

Title: Mr ☐ Mrs ☐ ☐ ☐

First Name Middle Name Surname
Position
Signature..... Date

In accordance with the provision of Section 135(1) of the Income Tax Act, 2004 I declare that I prepared or assisted in the preparation of this return and to the best of my knowledge, the return and attachments thereof present a true and fair view of the financial position of the entity.

Title: Mr ☐ Mrs ☐ Ms ☐

First Name Middle Name Surname
Position
(Certified Public Accountant)
Signature Date

Appendix 1

FINANCIAL INFORMATION ON THE ENTITY'S BUSINESS INCOME
(Trade, Profit & Loss Account)

1	Sales or turnover	
2	Opening stock	
3	Purchases	
4	Production cost	
5	Closing stock	
6	Cost of goods sold (2+3+4-5)	
7	Gross profit (1-6)	
8	Other income (specify in a separate schedule)	
9	Gross income (7+8)	
10	Expenses:	
11	Professional, technical, management and legal fees	
12	Salaries and wages	
13	Repairs and maintenance	
14	Advertising and promotion	
15	Interests	
16	Transport	
17	Depreciation allowance	
18	Other expenses (specify in a separate schedule)	
19	TOTAL EXPENSES	
20	NET PROFIT/LOSS	
21	Add: Non-allowable expenses – specific deductions (specify in a separate schedule)	
22	NET INCOME	

BALANCE SHEET INFORMATION

ASSETS

Fixed assets:

23	Land and buildings	
24	Plant and machinery	
25	Motor Vehicles	
26	Intangible assets (Good will, Patent rights, etc.)	
27	Other fixed assets (specify in a separate schedule)	
28	Total fixed assets (from 23 to 27)	
	Current assets:	
29	Debtors	
30	Bank	
31	Stocks	
32	Other current assets (specify in a separate schedule)	
33	Total current assets (29+30+31+32)	
34	TOTAL ASSETS (28+33)	

LIABILITIES**Current liabilities:**

35	Short term loan	
36	Creditors	
37	Bank overdraft	
38	Other current liabilities (specify in a separate schedule)	
39	Total current liabilities (35+36+37+38)	
40	Long term loan with interest	
41	Long term loan without interest	
42	TOTAL LIABILITIES (39+40+41)	
43	NET ASSETS (34-42)	

SHAREHOLDERS EQUITY

44	Paid-up capital	
45	Profit & loss appropriation account	
46	Reserve account	
47	Total equity (44+45+46)	

INFORMATION ON WITHHOLDING TAX
(Payments subject to Withholding Tax under Section 86)

48 Gross amount paid TZS	49 Tax withheld and remitted to TRA TZS	50 Net amount paid TZS

TRANSACTION BETWEEN RELATED COMPANIES

51	Total sales to related companies in Tanzania	
52	Total sales to related companies outside Tanzania	
53	Total purchases from related companies in Tanzania	
54	Total purchases from related companies outside Tanzania	
55	Other payments to related companies in Tanzania	
56	Other payments to related companies outside Tanzania	
57	Loans to related companies in Tanzania	
58	Loans to related companies outside Tanzania	
59	Loans from related companies in Tanzania	
60	Loans from related companies outside Tanzania	

61 INFORMATION ON THE ENTITY

(Please, tick the appropriate box)

		YES	NO
61.1	Is the Auditor's/Accounting officer's report qualified?		
61.2	Is the entity dormant?		
61.3	Is the entity a Tanzania resident as a result of its place of effective management in Tanzania (if not incorporated in Tanzania)?		
61.4	Is the entity incorporated, established or formed in the United Republic of Tanzania, but exclusively a tax resident of another country as a result of the application of a treaty for the avoidance of double taxation?		
61.5	Does the entity have a participation right in a controlled foreign company (CFC)?		
61.6	Is this return in respect of a branch of a foreign company?		

62 Particulars of Bank accounts

Name of Bank	Branch	Address	Account No.	Type of account

63 Particulars on shareholders:**63.1 Particulars on shareholders of the entity**

Name of shareholder	Number of shares held	Emolument during the accounting period

63.2 Shareholding/members' interest in other entities

Name of shareholder	TIN	Percentage interest	Emolument during the accounting period

64 Particulars of partners

	Name of the partner	Status of partner (tick the appropriate)	
A		Active	Inactive
B		Active	Inactive
C		Active	Inactive
D		Active	Inactive

65 Particulars of distribution between partners of the profits and losses:

Partner	Salary	Interest on capital if any	Basic distribution of balance of profits	Amount of partners share of balance of profit
A				
B				
C				
D				

Appendix 2**TAXABLE FOREIGN INCOME SCHEDULE**

Sources	Losses TZS	Taxable TZS	Exempt TZS	Foreign Tax Credits TZS (submit proof)
Foreign trading				
Foreign services				
Foreign investments				
Other foreign income				
TOTALS				

SCHEDULE FOR FOREIGN DIVIDENDS

Description	TZS
Dividend received/accrued (excluding Withholding Tax)	
Withholding Tax	
Gross foreign dividend (including Withholding Tax)	
Exempt foreign dividends	
Interest claimed	
Interest carried forward	
Total	

FOREIGN TAX CREDIT IN RESPECT OF FOREIGN DIVIDENDS

Description	TZS
Aggregated tax credit balance	
Add: Current year's credit	
Loss: Credit offset against current year's taxable income	
Total credit forfeited	
Credit amount carried forward	

INTERNATIONAL TRANSACTIONS

Description	TZS
Acquisition from connected person/s in an international transaction of goods and services – total amount paid/incurred	
Supplied to connected person/s in an international transaction of goods and services- total amount received/accrued	

FOR OFFICIAL USE ONLY:

RETURN OF INCOME
MADE ON BEHALF OF AN ENTITY

TIN:

							X			
--	--	--	--	--	--	--	---	--	--	--

Year of income:

--	--	--	--

Name of taxpayer:

Data entry:

Name of Officer Designation

Signature: Date:

Authorization:

(Please, tick the appropriate box)

Approved

☐

Not approved

☐☐

Return is not signed

☐

Return is incomplete

☐

Return contains arithmetic errors

☐

Application of wrong tax rates

☐

Schedules not attached

☐

Other reasons:

.....

Name of Officer Designation

Signature: Date:

NOTES FOR THE TAXPAYER**General:**

In accordance with Section 91 of the Income Tax Act, 2004, every person shall file with the Commissioner not later than six month after the end of year of income a return of income for the year of income.

An entity means a partnership, trust or corporation (Section 3).

The allowable contributions to charitable institutions are those not exceeding 2% of the entity's income from the business calculated without a deduction of that contribution (Section 16).

Schedule required to be attached with the return:

- Computation for depreciation allowance of depreciable assets
- Computation of non-allowable expenses, to include such expenses like
 - ❖ Donation in excess of 2% of person's contribution to charitable organizations
 - ❖ Interest demand under Section 12(3) of the Income Tax Act, 2004
 - ❖ Expenditure on improvement disallowed under Section 14 of the Income Tax Act, 2004
 - ❖ Capital expenditure other than capital allowance on depreciable assets
 - ❖ Consumption expenditure
 - ❖ Excluded expenditure
 - ❖ Agriculture business
 - ❖ Mining business
 - ❖ Charitable business

The documents supporting declarations shall be retained for a period of five (5) years from the end of the year of income or years of income to which they are relevant (Section 80).

The return is to be completed by the General Manager or other Principal Officer of a body or persons.

If it is a partnership the return is to be completed by the precedent acting partner or where no partner is resident in Tanzania by the attorney agent, manager or factor of the partnership resident in Tanzania.

If you have any difficulty in completing this return you are requested to contact your nearest Tax Region.

Row 9 to 20:

Business income: This is a figure arrived at after computing the Entity Financial Information which is part of the return.

Row 21 to 29:

Investment income deals with foreign investment and/or local investment.

Row 21 and 22:

Dividends that are taxable in the hands of corporation are those received by a resident corporation who holds less than 25% of shares in the resident corporation distributing those dividends, and which does not control either directly or indirectly 25% or more of voting power in the corporation (Section 54).

Row 23:

Interest/Discount income includes e.g. banks, other interest gains and losses from exchange fluctuations. Also include intra group interest, which represent interest and loan relationship.

Tax rates:

RATES OF INCOME TAX FOR ENTITIES		
Tax source	Resident	Non-Resident
Corporate Tax	30%	30%
Total income of a domestic permanent establishment		30%
Repatriated Income of branch		10%

WITHHOLDING/INVESTMENT TAX RATES		
Tax source	Resident	Non-Resident
Dividends to companies controlling 25% of shares or more	0%	10%
Dividends from DSE listed company	5%	5%
Dividends from other companies	10%	10%
Other withholding payments	15%	15%
Interest	10%	10%
Royalties	15%	15%
Technical services (Mining)	5%	15%
Transport non-resident operator/charterer without permanent establishment		5%
Rental income	10%	15%
Insurance premium	0%	5%
Natural resource payment	15%	15%
Service fees		15%
Capital gain for disposal of entity's asset	10%	20%

EXEMPTION ON DISPOSAL OF INVESTMENT ASSETS

Agricultural land – Market value of less than TZS 10,000,000		
DSE registered company's shares held by a resident and non-resident if shareholding of 25% or less		
Shares held by a resident company running another company with shareholding of 25% or more		

LATE SUBMISSION OF RETURN/PAYMENT WILL BE SUBJECTED TO PENALTIES.

GIVING FALSE INFORMATION IN THE RETURN, OR CONCEALING ANY PART OF THE ENTITY'S INCOME OR TAX PAYABLE, CAN LEAD YOU TO BE PROSECUTED.



TANZANIA REVENUE AUTHORITY

WITHHOLDING TAXES STATEMENT AND PAYMENT OF TAX WITHHELD (Please, read the notes carefully before filling the form.)

YEAR:

--	--	--	--

TIN:

--	--	--	--	--	--	--	--	--	--	--

Period: (Please tick the appropriate box)
☐

From 1 January to 30 June

☐

From 1 July to 31 December

WITHHOLDING TAX ON

Name of Withholder:

--

Postal Address:

P. O. Box

--

Postal City

--

Contact Numbers:

Phone number

--

Second Phone

--

Third Phone

--

Fax number

--

E-mail address:

--

Physical Address:

Plot Number

--

Block Number

--

Street/Location

--

Name of Branch

--

Name of Withholder: TIN:

--	--	--	--	--	--	--	--	--	--	--

[illegible]

NOTES:

1. Submission of the return is due within thirty (30) days after the end of each six month calendar period (Section 84(2) of the Income Tax Act, 2004).
2. For each type of Withholding tax a separate form shall be filled and submitted.
3. You should submit a NIL-statement in case no payment was made or credited or payment was made but no tax withheld for some reasons.
4. Withholding tax is deductible from Pension, Interest, Natural Resources Payment, Annuities, Royalties, Service Fees and Rent.
5. Service Fee means payment to the extent to which, based on market values, it is reasonably attributable to services rendered by a person through a business of that person or a business of any other person and includes a payment for any theatrical or musical performance, sports or acrobatic exhibition or any other entertainment performed, conducted, held or given paid to non-resident person.
6. You are advised to consult the TRA office in the case of Withholding Tax in connection with payments other than mentioned above before the amounts are released.
7. You are required to furnish a certificate to the person to whom the payment was made stating the amount of the payment and the amount of tax deducted (Section 85 of Income Tax Act, 2004).
8. If you fail to deduct and pay the tax you will become liable to pay the amount and interest thereon as if it was tax due and payable by you and the provisions relating to recovery of tax will be applied against you.
9. In addition heavy pecuniary or imprisonment penalties are prescribed under the Act for failure to deduct and pay the tax or submit a statement or provide certificate.

Form distribution:

Original: To TRA Office
Copy: To be retained by the Withholder



TANZANIA REVENUE AUTHORITY

No:

CERTIFICATE/REMITTANCE SLIP IN RESPECT OF WITHHOLDING TAX ON SERVICE FEES

Name of TAXPAYER/WITHHOLDER.....

 TIN:

--	--	--	--	--	--	--	--	--	--

 Name of

--	--	--	--	--	--	--	--	--	--

.....

 TIN:

--	--	--	--	--	--	--	--	--	--

I hereby certify that, I have this date of.....Month of.....20..... deducted prior to payment of Service Fees in favour of the Commissioner of Domestic Revenue Department/Large Taxpayers Department withheld from the above named person as follows:

Gross Amount in USD.....TZS.....

Tax withheld at % USD.....TZS

This payment is for the period covered from.....20.....

I further certify that the above withholding Tax has been/shall be REMITTED to the Regional Manager
...../ Large Taxpayers Department in the monthly schedule of 20.....

Name: Designation:

.....
Signature

Date

Name: Designation:

.....
Countersignature (withholdee)

Date

Official Stamp.....

To be completed in triplicate:

- (1) Original to Customer
- (2) Duplicate to TRA Office
- (3) Triplicate – Retained by withholder

STUDY GUIDE B5: TYPES OF ASSESSMENTS

■ Get Through Intro

This Study Guide is concerned with administration of the income taxes as given in the Income Tax Act 2004.

Specifically, it covers how taxes are assessed as well as the types of assessments. In addition, this Study Guide provides for the principles of assessment on interest and penalties.

This Study Guide discusses in detail the due dates for tax payments and return filing as well as interest and penalties applicable. It also explains how Commissioner of Income Tax can inquire into a person's self-assessment return.

As a tax consultant, you will need this information to advise clients on how to minimise penalties. A thorough understanding of this topic is important for your examination, as well as in your professional life.

■ Learning Outcomes

- a) Explain the concept and types of assessment (self-assessment, jeopardy assessment, adjusted assessment).
- b) Apply the principles of assessment on interest and penalties.

1. Explain the concept and types of assessment (self-assessment, jeopardy assessment, adjusted assessment).

[Learning Outcome a]

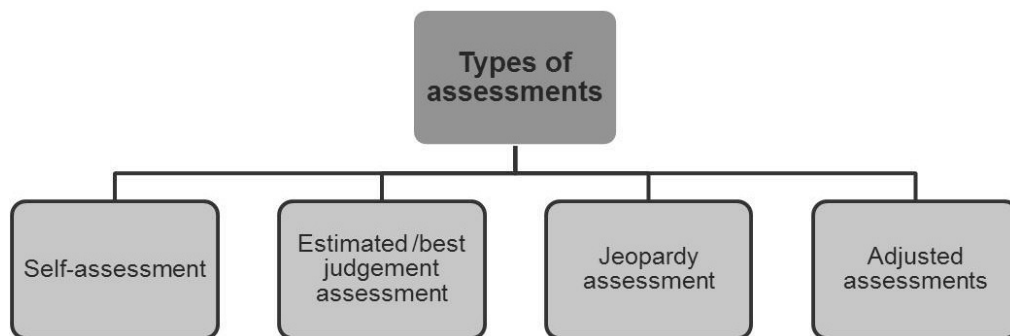
1.1 Explain the concept of assessment

Tax assessments involve calculating taxable income and application of tax rates on the taxable income to determine tax payable for the year and deduction of tax credit from tax payable for the year to determine tax payable on assessment.

1.2 Types of assessment and due dates for payment of tax payable on assessment

Normally, there are three categories of assessments: self-assessment, jeopardy assessment and adjusted assessment.

Diagram 1: Types of assessment



1. Self-assessment

Self- assessment occurs when taxpayers estimate their tax payable themselves or with the help of tax consultants and file return on income as required i.e. not later than 6 months after the end of each year of income (Section 91(1)). However, even when an entity fails or is not required to file a return of income for a year of income then when a return is filed, an assessment is treated as made on the due date for filing the return (Section 94(2)). The tax payable shown in that return on income is known **as tax payable on the assessment** which is payable on the same day (Section 94(1)).

2. Estimated /best judgement assessment

Nevertheless, a return of income filed by individual taxpayers might be accepted or adjusted according to the best of his judgement by the Commissioner, if the Commissioner has reasonable cause to believe that such return is not true and correct (Section 94(4)). Furthermore, the Commissioner may provide best judgement assessment when an individual taxpayer fails to file return on income on time or even when the individual was not required to file the return on income (Section 94(5)). The best judgement assessment is accompanied with the reasons why the Commissioner has made the assessment, the date by which the tax payable on the assessment must be paid; and the time, place and manner of objecting to the assessment (Section 97).

3. Jeopardy assessment

On the other hand, jeopardy assessment happens when the Commissioner requires a person to file return on income by the date specified in the notice disregarding the normal date of filing tax returns i.e. later than 6 months after the end of each year of income, or he himself; the Commissioner, prepares it based on his best judgement (Section 95(3)). The Commissioner may do this:

- (a) when a person becomes bankrupt,
- (b) when a business is wound-up or goes into liquidation,
- (c) when a business is about to leave the United Republic indefinitely,
- (d) when a business is otherwise about to cease activity in the United Republic;
- (e) when the Commissioner otherwise considers it appropriate.

Moreover, the amount still to be paid is also known as tax payable on the assessment, and the affected persons will be exempted to file the normal return on income i.e. self- assessment when the jeopardy assessments cover the whole year. So in case it covers just part of the year of income, the person will be required to file return on income for the whole of the year in self- assessment model as discussed above but the person is granted tax

credit for tax paid on jeopardy assessment (Section 95(3)). Jeopardy assessment is therefore a protective assessment against revenue loss against such events that make it unlikely for proper assessment to be done and tax to be paid if the Commissioner waits for the normal due dates for payment of tax.

Income tax paid on jeopardy assessment is available as tax credit against the tax payable on assessment made for the full year of income (s 95.4) if such taxpayer is still available for payment of tax.

4. Adjusted assessments

Finally, adjusted assessments happen when either self-assessments or jeopardy assessments are adjusted by the Commissioner (Section 96(1)). The Commissioner can adjust all returns on income at any time prior to the expiry of 3 years following the year of income they relate to, the year the notice of assessment is issued or filed in case of delayed return on income, when they are prepared fraudulently to evade or delay tax payments or negligently so they are inaccurate (Section 94(6) and 96(2)). Thereafter, the original assessment would be replaced by the adjusted assessment to the amount adjusted by the adjustment (Section 96(5)). However, the Commissioner cannot adjust assessment sanctioned by competent court if the sanction is still in force (96(1)).



Example

Sinora Ltd who has an accounting period ending 31 December each year estimated that in 2013 it was going to make total income of Tshs20,000,000, and paid the estimated tax payable as required. Then, after the year end the actual taxable income turned out to be Tshs30,000,000 and the tax rate was 30%.

Required:

- Determine tax payable on assessment
- State the due date on payment of tax payable on assessment

Answer

- Total taxes paid by way of instalment were Tshs6,000,000 while the correct amount was Tshs9,000,000. So tax payable on assessment would be Tshs3,000,000.
- Returns on income are filed on or before 6 months after the year end, so the due date of filing ROI is on or before 30 June 2014. Tax payable on assessment is payable at the same time when filing the return on income. The due date for payment of tax payable on assessment is on or before 30 June 2014.

2. Apply the principles of assessment on interest and penalties.

[Learning Outcome b]

2.1 Assessment of interest and penalties

Taxpayers who fail to keep records; file estimated tax payable and return on income on time; and fail to pay taxes on due dates are liable to penalties and interests. These penalties and interests are calculated **separately** and do not relieve the non-compliant taxpayers of any criminal prosecutions of commission of offences (Section 103 (3)). Normally, these penalties and interests are communicated to the taxpayers through notice of assessment of the interest or penalties, showing how they are computed, the date by which the interest or penalties are payable; and the time, place and manner of objecting to the assessment (Section 103 (4)).

1. Penalty for failure to maintain documents or file statement or return of income

Taxpayers who do not maintain proper documents for a year of income, file an estimate for a year of income on time or file a return of income for a year of income on due date are liable to a penalty for each month and part of a month during which the failure continues; calculated as the higher of :

- 2.5 percent of the difference between the income tax payable by the person for the year of income and the amount of that income tax that has been paid at the start of the month; or
- Tshs10,000 in the case of an individual or Tshs100,000 in the case of a corporation (Section 98(1)).



Example

Jupiter Ltd who have an accounting period ending 31 December each year estimated that in 2013 it was going to make a total income of Tshs20,000,000. The company filed the statement of estimated tax payable on 5 May 2013 and return on income on 30 August 2014 showing tax payable of Tshs7,000,000 but all instalments were paid on time and the tax payable on assessment was paid on 30 August 2014.

Required:

If the tax rate was 30%, compute tax penalties for failure to file statement of estimated tax payable and return on income on time.

Answer

The penalty for failure to file statement of estimated tax payable and return on income for a corporate is the higher of:

- (a) 2.5 percent of the difference between the income tax payable by the person for the year of income and the amount of that income tax that has been paid at the start of the month; or
- (b) Tshs100,000.
- (i) The income tax payable by the person was Tshs6,000,000, and the amount paid at the start of the month was Tshs1,500,000 for the first instalment. Therefore, 2.5% of Tshs4,500,000 = Tshs112,500.

Comparing the above value with Tshs100,000 we take the higher value which is Tshs112,500.

This penalty is applicable for each month and part of the month in which failure continued i.e. April and May 2013, so the total penalty is Tshs225,000.

- (ii) The income tax payable on assessment by the person was Tshs7,000,000, and the amount paid at the start of the month in which the failure continued was Tshs6,000,000. So the higher of 2.5% of Tshs1,000,000 = Tshs25,000 and Tshs100,000 is Tshs100,000. This penalty is applicable for each month and part of the month in which the failure continued i.e. July and August 2014, so the total penalty was Tshs200,000.

In accordance with Section 98(2), failure of withholding agent to file a statement of withheld amount as needed by the Act is liable for a penalty for each month or part of a month during which the failure continues; calculated as the higher of:

- (a) The statutory rate applied to the amount of income tax required to be withheld from payments made by the agent during the month to which the failure relates; or
- (b) Tshs100,000



Test Yourself 1

Hewit Ltd withheld taxes on employees' salaries amounting to Tshs10,000,000 on 3 January 2013, and on dividends of Tshs8,000,000 which were paid to shareholders on 28 February 2013.

Required:

- (a) State the due dates of filing the withholding tax statements if the company uses the calendar year as its accounting year.
- (b) Calculate the penalty for failure to file the withholding tax statements if they were filed on 3 August 2013 and if the statutory rate was 10%.

2. Interest for understating estimated tax payable by instalment

Taxpayers who are required to pay taxes by instalments are expected to use accuracy data and the difference between the estimated tax payable made in original or revised estimate and the correct tax payable should be insignificant. The difference is deemed significant hence **under-estimation of estimated tax payable by instalment** happens when the estimated or revised income tax payable for a year of income is less than 80% of the correct amount (Section 99(1)).

The under estimation of estimated tax payable by instalment attracts interest for each month or part of a month from the date the first instalment for the year of income is payable until the due date by which the person must file a return on income for the year of income (Section 99(2)).

Section 99 (3 provides that the interest is computed using the **statutory rate**, compounded monthly, applied to the excess of:

- the total amount that would have been paid by way of instalments during the year of income to the start of the period had the person's estimate or revised estimate equalled the correct amount over
- the amount of income tax paid by instalments during the year of income to the start of the period.

The formula for calculating interest for underestimation is given by:

$$I = P [(1 + R)^N - 1], \text{ where}$$

I = Interest charge,

P = difference between instalment calculated using actual and estimated tax payable,

R = monthly statutory rate and

N = number of periods from the first instalment up to the day the return on income is supposed to be filed.



Example

Corell Ltd who has an accounting period ending 31 December each year estimated that in 2013 it was going to make a total income of Tshs20,000,000. The company filed the statement of estimated tax payable on 5 May 2013 and return on income on 30 August 2014 showing tax payable of Tshs9,000,000. All instalments were paid on time and the tax payable on assessment was paid on 30 August 2014.

Required:

- (a) If the tax rate was 30% and statutory rate was 10%, determine whether there is underestimation of tax payable by instalments.
- (b) If yes compute the interest for under estimation.

Answer

Estimated tax payable 30% of Tshs20,000,000= Tshs6,000,000

- (a) Underestimation occurs when 80% of the correct tax payable i.e. 9,000,000 = Tshs7,200,000 is larger than the estimated amount i.e. 6,000,000. So there is underestimation.

- (b) Interest for under estimation = $P [(1 + R)^N - 1]$, where;

P = difference between instalment calculated using actual i.e. Tshs2,250,000 and estimated tax payable i.e. Tshs1,500,000 = Tshs750,000 ,

R = monthly statutory rate, i.e. $10\%/12 = .833\%$ and

N = number of periods from the first instalment i.e. 31 March 2013 up to the day the return on income is supposed to be filed i.e. 30 June 2014, equal to 15 months.

Therefore the interest is Tshs99,421

3. Interest for failure to pay tax

In accordance with Section 100(1), taxpayers who fail to pay tax on or before the date on which the tax is payable are liable for interest for each month or part of a month for which any of the tax is **outstanding** calculated as the statutory rate plus 5% per annum, compounded monthly, applied to the amount outstanding at the start of the period. Furthermore, for taxpayers who had been granted extension period of tax payments by the Commissioner but fail to pay taxes as agreed, the extension period becomes void (Section 100(2)).

The formula for calculating interest is given by: $I = P [(1 + R)^N - 1]$, where;

I = Interest charge,

P = Unpaid taxes,

R = monthly interest charge rate, and

N = number of periods in which taxes were unpaid.



Example

Ivan Ltd who has an accounting period ending 31 December each year estimated that in 2013 it was going to make a total income of Tshs20,000,000. The company filed the statement of estimated tax payable on 5 May 2013 and paid the first instalment on the same date.

Required:

If the tax rate was 30% and statutory rate was 10%, compute the interest for failure to pay tax on time.

Answer

Estimated tax payable $30\% \times \text{Tshs}20,000,000 = \text{Tshs}6,000,000$, the first instalment is Tshs1,500,000.

Interest for failure to pay tax $= P [(1 + R)^N - 1]$, where;

P = unpaid taxes i.e. Tshs1,500,000,

R = monthly statutory rate plus 5%, i.e. $(10\% + 5\%) / 12 = 1.25\%$ and

N = number of periods in which failure continued i.e. 2 months.

Therefore the interest is Tshs37,734.

Test Yourself

Answer to TY 1

- All withholding agents are required to file statements accounting for the amount withheld within 30 days after the end of each 6 month calendar period. So, the person should file the statement on or before 30th July 2013 for these payments, and should again file it on or before 30 January 2014.
- The penalty is the higher of 10% of Tshs18,000,000 and Tshs100,000. The higher is Tshs1,800,000. Therefore, the total penalty is $\text{Tshs}1,800,000 \times 2 = \text{Tshs}3,600,000$.

Quick Quiz

- Which of the following payments may not be subject to withholding taxes?

- Dividend
- Rent
- Interest
- None of the above

Answer to Quick Quiz

- The correct option is **D**.

All of the items can be taxed at the source unless they are exempted from income tax.

Self Examination Questions**Question 1**

Shose Ltd carries on a trading business in Zanzibar. In April 2007, the company prepared its 2006 return of income with a taxable income of Tshs40 million. The last return prepared by Shose Ltd was for the year of income 2005, for which the return was lodged reporting a loss.

Shose and his sister Mai are the only directors of the company. Before the due date for filing the return, Shose and Mai urgently flew to mainland Tanzania for their mother's funeral. They came back to Zanzibar in August 2007 and found that an adjustment for the year of income 2006 for the amount of Tshs10,000,000 had been issued to the company under Section 96 of ITA 2004 on 5 August 2007.

Shose was considering lodging an objection against the adjustment on the assessment. On 30 September 2007, the Commissioner gave a notice to the company under Section 103 of ITA 2004 that he has assessed for penalties for the year of income 2006 in respect of late filing of its return of income.

Required:

- (a) Explain the powers of the Commissioner to raise an adjusted assessment under Section 96 of the Income Tax Act 2004.
- (b) Define a "tax debtor" as per Section 113 (9) of the Income Tax Act 2004.

Answer to Self Examination Questions**Answer to SEQ 1**

- (a) The Commissioner can adjust all returns on income at any time prior to the expiry of three years following the year of income they relate to, the year the notice of assessment is issued or filed in case of delayed return on income, when they are prepared fraudulently to evade or delay tax payments or negligently so they are inaccurate (Section 94(6) and 96(2)). Thereafter, the original assessment would be replaced by the adjusted assessment to the amount adjusted by the adjustment (Section 96(5)). However, the Commissioner cannot adjust assessment sanctioned by competent court if the sanction is still in force (96(1)).
- (b) In accordance with Section 113 (9) of the ITA 2004, tax debtor is a person who has failed to pay tax payable on due dates.



TANZANIA REVENUE AUTHORITY

WITHHOLDING TAXES STATEMENT AND PAYMENT OF TAX WITHHELD (Please, read the notes carefully before filling the form.)

YEAR:

--	--	--	--

TIN:

--	--	--	--	--	--	--	--	--	--	--	--

Period: (Please tick the appropriate box)

☐ From 1 January to 30 June

☐ From 1 July to 31 December

WITHHOLDING TAX ON
Name of Withholder:

Postal Address:

P. O. Box

Postal City

Contact Numbers:

Phone number

Second Phone

Third Phone

Fax number

E-mail address:

Physical Address:

Plot Number

Block Number

Street/Location

Name of Branch

Name of Withholder: TIN:

--	--	--	--	--	--	--	--	--	--	--

[illegible]

NOTES:

1. Submission of the return is due within thirty (30) days after the end of each six month calendar period (Section 84(2) of the Income Tax Act, 2004).
2. For each type of Withholding tax a separate form shall be filled and submitted.
3. You should submit a NIL-statement in case no payment was made or credited or payment was made but no tax withheld for some reasons.
4. Withholding tax is deductible from Pension, Interest, Natural Resources Payment, Annuities, Royalties, Service Fees and Rent.
5. Service Fee means payment to the extent to which, based on market values, it is reasonably attributable to services rendered by a person through a business of that person or a business of any other person and includes a payment for any theatrical or musical performance, sports or acrobatic exhibition or any other entertainment performed, conducted, held or given paid to non-resident person.
6. You are advised to consult the TRA office in the case of Withholding Tax in connection with payments other than mentioned above before the amounts are released.
7. You are required to furnish a certificate to the person to whom the payment was made stating the amount of the payment and the amount of tax deducted (Section 85 of Income Tax Act, 2004).
8. If you fail to deduct and pay the tax you will become liable to pay the amount and interest thereon as if it was tax due and payable by you and the provisions relating to recovery of tax will be applied against you.
9. In addition heavy pecuniary or imprisonment penalties are prescribed under the Act for failure to deduct and pay the tax or submit a statement or provide certificate.

Form distribution:

Original: To TRA Office
Copy: To be retained by the Withholder



TANZANIA REVENUE AUTHORITY

STATEMENT OF ESTIMATE/REVISED ESTIMATE OF TAX PAYABLE BY INSTALMENT MADE ON BEHALF OF AN ENTITY

YEAR OF INCOME:

--	--	--	--

To:

--

TIN:

--	--	--	--	--	--	--	--	--	--	--	--

NOTE

An estimate/ revised estimate of tax payable to be made by an entity under Section 89 of the Income Tax Act, 2004. You are required to furnish the estimate of income for the year within three (3) months of the beginning of your accounting date or after the preceding calendar year.

Please, read the notes carefully in the appendix before filling in the form.

There are penalties for not/late filing an estimate or for giving false information.

Date of issue:

Issuing office:

P.O. Box:

Tel: Fax:

E-mail address:

GENERAL INFORMATION

1 TIN:

--	--	--	--	--	--	--	--	--	--	--	--

2

Name of entity

--

Postal Address:

3 P. O. Box

--

Posta

--

Contact Numbers:

4 Phone number

--

Second Phone

--

Third Phone

--

Fax number

--

5 E-mail address

--

6 Person's status and category of taxation (Please tick the appropriate box):

Resident ☐	Non-Resident ☐
-----------------------------------	---------------------------------------

7 Accounting date: Day Month **8 Particulars of bank accounts:**

Name of Bank	Branch	Address	Account No.	Type of account

ESTIMATE OF INCOME AND TAX

(Do not include final withholding payments)

9	Business income	
10	Investment income	
11	Total estimated income (sum 9+10)	
12	Tax on total estimated income	
13	Repatriated income from a Domestic Permanent Establishment	
14	Tax on repatriated income from a Domestic Permanent Establishment	
15	Total tax payable (12+14)	
	Deductions:	
16	Withholding tax actually paid (Do not include final Withholding Tax)	
17	Foreign Tax Credit	
18	Single instalment tax paid	
19	Total of deductions (Sum 16 to 18)	
20	Tax payable by instalment (15 minus 19)	

21 Instalments payable:

	1 st instalment	2 nd instalment	3 rd instalment	4 th instalment
Amount				
Due Date				

DECLARATION

I hereby declare to the best of my knowledge and belief that the above estimate is true and correct.

Title: Mr ☐ Mrs ☐ Ms ☐

--	--	--

First Name

Middle Name

Surname

Position

Signature.....

Date/

Day	Month	Year

FOR OFFICIAL USE ONLY:

NOTICE OF ESTIMATE/REVISED ESTIMATE OF TAX PAYABLE BY INSTALMENT MADE ON BEHALF OF AN ENTITY

TIN:

							X			
--	--	--	--	--	--	--	---	--	--	--

Year of income:

--	--	--	--

ASST No:

--

Name of taxpayer:

Address:

ORIGINAL TAX CHARGED	AMENDED TAX CHARGED	AMENDED DISCHARGED	TAX PAYABLE/ REPAYABLE

Instalments payable:

	1 st instalment	2 nd instalment	3 rd instalment	4 th instalment
Amount				
Due Date				

Name of Officer (Data entry):

Designation:

Signature: Date:

Appendix

NOTES FOR THE TAXPAYER

General:

In accordance with Section 88 of the Income Tax Act, 2004 every person (an 'Instalment payer') who derives or expects to derive any chargeable income during a year of income from business or investment or from an employment, which has not suffered Withholding Tax under Section 81 of the Act, is required to file a return of an estimate of tax payable for the year of income.

An entity means a partnership, trust or corporation.

A revised estimate of tax may be made under Section 89(1) of the Income Tax Act, 2004. The revised estimate will automatically cancel the original estimate or will be deemed to be an amendment to an estimate made by the Commissioner under the same Section 89(8) of the Income Tax Act, 2004.

Due date of furnishing the return shall be:

- In the case of a person whose year of income is twelve month period beginning at the start of a calendar month on or before the last day of the third month of the year of income; or
- In the case of a person whose year of income is other than calendar year, at the end of each three month period commencing the beginning of the year of income; or
- For persons conducting agricultural business involving seasonal crops in the United Republic, by the end of September of the year of income.

The due date of payment falls at the end of 3rd, 6th, 9th and 12th month from the beginning of the accounting period.

Calculation of quarterly instalment of income tax payable by an instalment payer for a year of income is calculated according to the following formula.

$$\frac{(A-C)}{B}$$

Where:

A: = is estimated tax payable at the time of instalment;

B: = is the number of instalments remaining for the year including the current instalment;

C: = is the sum of any:

- (a) Income tax paid during the year of income, but prior to the due date for payment of the instalment; and
- (b) Income Tax withheld during the year prior to the due date for payment of the instalment; and
- (c) Defaulted Withholding Tax which is liable for payment by the withholding agent

or

For the person conducting agricultural business involving seasonal crops in the United Republic, the amount of the first and second instalments for the year of income shall be NIL, 3rd instalment 75% of estimate and the balance shall be payable on the 4th and last instalment.

WARNING:

If payment is not received by the due date the unpaid amount will be subjected to late payment penalties.

Tax rates

RATES OF INCOME TAX FOR ENTITIES		
Tax source	Resident	Non-Resident
Corporate Tax	30%	30%
Repatriated Income of branch		10%

WITHHOLDING/INVESTMENT TAX RATES		
Tax source	Resident	Non-Resident
Dividends to companies controlling 25% of shares or more	0%	10%
Dividends from DSE listed company	5%	5%
Dividends from other companies	10%	10%
Other withholding payments	15%	15%
Interest	10%	10%
Royalties	15%	15%
Technical services (Mining)	5%	
Transport (aircraft/shipping) non-resident operator/charterer without permanent establishment		5%
Rental income	10%	15%
Insurance premium	0%	5%
Natural resource payment	15%	15%
Service fees		15%
Capital gain for disposal of entity's asset	10%	20%

EXEMPTION ON DISPOSAL OF INVESTMENT ASSETS

Agricultural land – Market value of less than TSH 10,000,000		
DSE listed company's shares		
Shares held by a resident company running another company with shareholding of 25% or more		

LATE SUBMISSION OF ESTIMATE/PAYMENT WILL BE SUBJECTED TO PENALTIES.

GIVING FALSE INFORMATION IN THE ESTIMATE, OR CONCEALING ANY PART OF THE ENTITY'S INCOME OR TAX PAYABLE, CAN LEAD YOU TO BE PROSECUTED.

**Appendix 2****TAXABLE FOREIGN INCOME SCHEDULE**

Sources	Losses TZS	Taxable TZS	Exempt TZS	Foreign Tax Credits TZS (submit proof)
Foreign trading				
Foreign services				
Foreign investments				
Other foreign income				
TOTALS				

SCHEDULE FOR FOREIGN DIVIDENDS

Description	TZS
Dividend received/accrued (excluding Withholding Tax)	
Withholding Tax	
Gross foreign dividend (including Withholding Tax)	
Exempt foreign dividends	
Interest claimed	
Interest carried forward	
Total	

FOREIGN TAX CREDIT IN RESPECT OF FOREIGN DIVIDENDS

Description	TZS
Aggregated tax credit balance	
Add: Current year's credit	
Loss: Credit offset against current year's taxable income	
Total credit forfeited	
Credit amount carried forward	

INTERNATIONAL TRANSACTIONS

Description	TZS
Acquisition from connected person/s in an international transaction of goods and services – total amount paid/incurred	
Supplied to connected person/s in an international transaction of goods and services- total amount received/accrued	

STUDY GUIDE C1: INTRODUCTION TO INCOME TAXATION

■ Get Through Intro

This Study Guide introduces to the concept of taxation and the use of presumptive taxation in Tanzania. The focus of this Study Guide is primarily the Income Tax Act 2004.

■ Learning Outcomes

- a) Define the concepts underlying income taxation in Tanzania.
- b) Explain the concept of total income.
- c) Explain presumptive income taxation and its application in Tanzania.

**1. Define the concepts underlying income taxation in Tanzania.
Explain the concept of total income.****[Learning Outcomes a and b]**

The following terms are very important for income taxation. They will be referred to from time to time in the rest of this book.

1.1 Income

In an effort to define the term "income tax", we need to ascertain the exact meaning of the term "income". Indeed, whether income is an accurate measure of tax paying ability depends on how income is defined. However it has been difficult to give a concise and all embracing definition of income, and any attempt to define the term merely creates considerable problems of semantics and hence litigation and possibly confusion.

The Act has considered it expedient not to define income but rather to enumerate all the possible sources of income that are liable to income taxation.

**Definition**

Income is defined to mean a person's income from any employment, business or investment and an aggregation of such income as calculated in accordance with the Income Tax Act

ITA 2004 sec 3

As it can be seen the above definition does not really define income but describes it in terms of its various sources. This leaves the term income not defined in the Income Tax Act, however, several definitions have been offered as described below:

**Definition**

The Hicksian concept of income defines income as the maximum value which a man can consume during the period and still expect to be as well off at the end of the period as he was at the beginning. The term "to be well off [equity] as at the beginning" refers to capital maintenance which calls for inflation adjustment of the earlier figure. 'Hicksian income' is the standard concept of income as traditionally used by accountants and also by the more thoughtful economists. Income, thus defined, must not contain any element of capital.

Hicks, (1939)

Another definition that has been found to be theoretically ideal and free from anomalies is the Haig-Simons definition of income, based on the work by American economists Robert M. Haig and Henry Simons.

The basic Haig-Simons definition of income is the value of what one could consume in that year, while keeping the wealth constant. It is the value of all consumption in a given year plus the change in net worth.

Notice that it's not what a person does consume in a year which is the basis for Haig-Simons income; it's what she could consume if she chose to keep the value of her wealth constant. So it is based on potential consumption, not actual consumption. The idea is that how well-off a person is should be measured by how much she could afford to consume each year. According to Haig and Simons the measure of one's income should be not what one actually did with it (spend it or save it), but what one could do with it.

For many reasons, both practical and political, the actual definition of income in the income tax code falls considerably short of that definition. A full Haig-Simons concept of income, for example, would include the value of ALL consumption and ALL changes in net worth. As we have seen and will continue to see, in actual practice the definition of income used on the ITA is quite different.

Others define income as some benefit, monetary or otherwise, which an individual "enjoys" periodically. This definition is somehow incomprehensible since it is hard to define enjoyment.

Despite difficulty in defining the term income, economists refer to the Hicks definition to provide ways of measuring income, while accountants use realisation concept to measure income for a particular period.

1. Equity or economic concept of income

The definition provided by Hick, (1939) requires calculation of capital at the beginning of the period and at the end of the period. From basic accounting knowledge the equity or capital is the difference between total assets and total liabilities.

Hence, any incremental amount from the earlier capital amount is deemed to be income, strictly to attain what Hicks intended it must be after inflation adjustment of the earlier equity. Since taxation is paid on cash basis, any tax based on this definition might be perceived unfair as the associated income is not actually received.

2. Realisation or accounting concept of income

This concept is more popular and widely adopted by tax officials, and tax practitioners in income based tax system in the world. According to this concept, income arises only at the time of sale, disposal or exchange of a product or goods, which creates the income or gain.

Therefore income is not realised earlier at the production stage during which period an asset is held while its values or prices rise (inflationary gains).

3. Classification of income

The following are classification of income:

(a) Cash income and benefit / income in kind

Cash income is income received or to be received in monetary terms e.g. salary, interest, dividend etc. Income in kind on the other hand is the income received in non-monetary terms such as as free house, car, air time and a driver. Income in kind may further be categorised into convertible and non convertible income.

- (i) Convertible income is where the benefit may be converted into money or money's worth.
- (ii) Non-convertible income in kind is where the benefit cannot be converted into money or money's worth.



Example

(i) Convertible income

A bonus of 100 bags of cement may be converted into cash by selling in cash or may be exchanged for another product say floor tiles

(ii) Non-convertible income

Free lunch or free use of employer's motor vehicle

(b) Exempt income or income exempt

Exempt income is income not taxed because the source is exempt. The income does not form part of the total income to be included in the income tax return. A good example is occupying own premises, and utilizing own agricultural produce.

Income exempt is income accrued or derived from a source that forms part of the tax base, but because of some specific/particular circumstances by the operation of any regulation, law, order or rule, such income is exempt from income tax; for example, minimum threshold for employment income, the salary of the president of the URT, scholarship income etc.

However both, exempt income and income exempt are not taxable.



Example

Income exemption

The following income has been exempt from income tax under the Income Tax Act 2004:

- Presidential income both of Tanzania and Zanzibar;
- Income earned by government or its agencies in performing government activities;
- Amounts derived by any person entitled to privileges under the Diplomatic and Consular Immunities and Privileges Act to the extent provided in that Act or in regulations made under that Act;
- Income earned by public servants in a foreign country paid by the government;
- Foreign source income earned by non resident person or income of a spouse or child of a public servants working abroad where the spouse is resident in the United Republic solely by reason of accompanying the individual on the employment;
- Income earned by the East Africa Development Bank; the Price Stabilization and Agricultural Inputs Trust; the Investor Compensation Fund under the Capital Markets Regulatory Authority; and The Bank of Tanzania;
- Amounts derived during a year of income by a primary co-operative society Registered under the Co-operative Societies Act; solely engaged in activities as a primary co-operative engaged in either: agricultural activities, including activities related to marketing and distribution; construction of houses for members of the cooperative; distribution trade for the benefit of the members of the cooperative; savings and credit society; and whose turnover for the year of income does not exceed Tshs50,000,000;
- Pensions or gratuities granted in respect of wounds or disabilities caused in war and suffered by the recipients of such pensions or gratuities;
- A scholarship or education grant payable in respect of tuition or fees for full-time instruction at an educational institution;
- Amounts derived by way of alimony, maintenance or child support under a judicial order or written agreement;
- Amounts derived by way of gift, bequest or inheritance, except amount earned by the estate of the deceased from business and investment or employment of the deceased;
- Amounts derived in respect of an asset that is not a business asset, depreciable asset, investment asset or trading stock;
- Amounts derived by way of foreign living allowance by any officer of the government that are paid from public funds and in respect of performance of the office overseas;
- Income derived from investments exempted under the Export Processing Zones Act;
- Amount derived from investments exempted under any written laws for the time being in force in Tanzania Zanzibar;
- Rental charges on aircraft lease paid to a non-resident by a person engaged in air transport business;
- Amounts derived by a crop fund established by farmers under a registered farmers cooperative society, union or association for financing crop procurement from its members;
- Gratuity granted to a Member of Parliament at the end of each term;
- Income earned by Dar es Salaam Stock Exchange [DSE];
- Income earned by holders of gaming licenses;
- And the fidelity fund established under the Capital Markets and Securities Act.

(c) Earned income and unearned income

Earned income is realised income e.g. salary and business profit while unearned income includes capital gain not realised from sales but simply an increase in value of assets. Income is earned when you have done something substantial to be entitled to receive it as provision of services, goods or passage of time.



Definition

"Person" means an individual or an entity;

"Individual" means a natural person;

"To assess" is the determination of the taxable income through computation and adjustment of accounting profit for example in business income;

"To charge" is to apply tax rate on the assessed value;

Entity means a partnership, trust or corporation

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

"Partnership" means any association of individuals or bodies corporate carrying on business jointly, irrespective of whether the association is recorded in writing;

"Year of Income" for every person shall be the calendar year but the company may change to another year of income upon on tax payer application and Commissioner of domestic revenue for approval

ITA Section 3, 20

1.2 Total income

The total income of a person is the sum of the person's chargeable income for the year of income from each employment, business and investment less any reduction allowed for the year of income. When a person has unrelieved loss in the year of income and in two previous consecutive years of income the total income means his/her turnover in that year.



Definitions

An individual's income from an employment for a year of income shall be the individual's gains or profits from the employment of the individual for the year of income.

ITA Section 7

"Business" includes: a trade, concern in the nature of trade, manufacture, profession, vocation or isolated arrangement with a business character. It can be a past, present or prospective business, but excludes employment and any activity that, having regard to its nature and the principal occupation of its owners or underlying owners, is not carried on with a view to deriving profits;

ITA Section 3

A person's income from a business for a year of income is the person's gains or profits from conducting the business for the year of income. It does not matter for income tax purposes whether the business is legal or illegal or however short-lived, the income would still be liable to taxation.

A person's income from an investment for a year of income is the person's gains or profits from conducting the investment for the year of income.

ITA Section 9

1.3 Tax residence

Residence has not been defined in the Income Tax Act 2004; it provides criteria for a person to qualify to be a resident for a particular period for individual, partnership, trust and corporation.

1. Test of residence of an individual

An individual is resident in the United Republic for a year of income in the following cases:

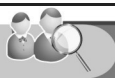
- (a) when she/he has a permanent home in the United Republic and is present in the United Republic during any part of the year of income;
- (b) if she/he has no permanent home, is present in Tanzania during the year of income for a period amounting in aggregate to 183 days or more (in accordance with a case law this excludes arrival and departure day);
- (c) if the aggregate days in the year of income is less than 183, but he/she is present in the United Republic during the year of income and in each of the two preceding years of income for periods averaging more than 122 days in each such year of income; simple average $(Y1 + Y2 + Y3)/3$ is used; or
- (d) is an employee or an official of the Government of Tanzania posted abroad during the year of income.

Therefore, a Tanzanian citizen may or may not be resident in Tanzania for tax purposes. However, an individual who at the end of the year of income has been resident in Tanzania for two years or less in total during the whole of the individual's life for purpose of calculation of chargeable income is considered non resident.



Definition

Permanent home is any place any individual is free and not restricted to reside, not necessary his/her own house may be a hotel, rented house etc



Example

Mr. Limbu has a permanent home in Tanzania but was abroad for several years and is still living abroad.

Required:

Determine the residential status of the taxpayer.

Answer

Though he has a permanent home in Tanzania and is a Tanzanian citizen, he will not be considered non-resident because he is staying abroad.



Example

In 2010, Mr. Sadiki, who has no permanent home in Tanzania came to Tanzania for holiday and stayed for 200 days.

Required:

Determine the residential status of Mr. Sadiki for the year of income 2010.

Answer

Since his stay in Tanzania during the year 2010 was of over 183 days, he will be regarded resident in Tanzania during the year of income. However, since he has been resident in Tanzania for two years or less in total during the whole of his life for purpose of calculation of chargeable income, he is considered non- resident.



Example

Mr. Bure has no permanent home in Tanzania. He has been frequently visiting the country for business purposes. In 2013 he stayed for 120 days, and in 2012 and 2011 he stayed in Tanzania for 140 and 100 days respectively.

Required:

Determine the residential status of Mr. Bure.

Answer

Since Mr. Bure was present in Tanzania for an average of less than 122 days for the year of income and the two preceding years i.e. years 2013, 2012 and 2011, average $(120+140+100)/3=120$ days he is treated as non-resident for the year 2013.



Example

Mrs Kessy is employed by a Tanzania private entity and has been seconded in Rwanda since 2007. Mrs. Kessy did not come to Tanzania during the year of income 2010.

Required:

Determine the residential status of Mrs Kessy for the year of income 2010.

Answer

Since Mrs Kessy is not a government official, regardless of her citizenship she is considered a non-resident in Tanzania during the year of income 2010.

2. Test of residence of a partnership

A partnership is a resident partnership for a year of income if at any time during the year of income a partner is a resident of the United Republic.

3. Tests of residence of a trust

A trust is a resident trust for a year of income if:

- (a) it was established in the United Republic and
- (b) at any time during the year of income, a trustee of the trust is a resident person; or
- (c) at any time during the year of income a resident person directs or may direct senior managerial decisions of the trust, whether the direction is or may be made alone or jointly with other persons or directly or through one or more interposed entities.



Example

Assume that Mayfair Trust is a registered trust in Tanzania. In 2011 all of Mayfair trustees were non-residents, however the CEO of the trust is a resident individual.

Required:

Determine the residential status of the trust for the year of income 2011.

Answer

Since the trust was established in Tanzania, by registration under a Tanzania law, and directed by resident person CEO, the trust is resident for 2011.



Example

Assume that Mayfair Trust was not registered trust in Tanzania but it operates in Tanzania. In 2010 all the trustees, including the CEO were resident individuals.

Required:

Determine the residential status of the trust.

Answer

Since the trust was not registered in Tanzania the trust is treated as non-resident for the year 2010 though all its trustees were resident in Tanzania during the year.

4. Tests of residence of a corporation

A corporation is a resident corporation for a year of income if:

- (a) it is incorporated or formed under the laws of the United Republic; or
- (b) at any time during the year of income the management and control of the affairs of the corporation are exercised in the United Republic. The control of a company is exercised at the meeting of directors.



Definitions

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

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

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

2. Explain presumptive Income Taxation and Its Application in Tanzania.

[Learning Outcome c]

2.1 What is presumptive tax system

Small traders, who operate mostly without keeping proper business records, are charged income tax by **presumptive tax system** based on the annual turnover of their business. **Presumptive tax system** involves the use of indirect means to ascertain tax liability, which differ from the usual rules based on the taxpayer's accounts.

In Tanzania individuals are taxed based on their annual turnover. The taxpayers under this system are not obligated to prepare and submit audited accounts to the TRA. However, they may opt not to adopt the system and prepare audited accounts and pay tax based on profits.

Presumptive methods of taxation are thought to be effective in reducing tax avoidance as well as equalizing the distribution of the tax burden.



Definition

The term "**presumptive**" is used to indicate that there is a legal presumption that the taxpayer's income is no less than the amount resulting from application of the indirect method. As discussed below, this presumption may or may not be rebuttable.

The concept covers a wide variety of alternative means of determining the tax base, ranging from methods of reconstructing income based on administrative practice, which can be rebutted by the taxpayer, to true minimum taxes with tax bases specified in legislation.

Taube and Tadesse(1996).

2.2 Conditions which qualify for presumptive tax system

1. The taxpayer must be a resident individual
2. The annual turnover of the business does not exceed the threshold **of Tshs20 million.**
3. The individual's income for a year of income consists exclusively of income from a business having a source in the United Republic. If income is derived from other sources such as employment and/or investment the presumptive scheme cannot be used.
4. The individual does not elect to disapply this provision for the year of income.

2.3 Rates of tax under presumptive taxation

Under this system, tax payable is established depending on the level of record keeping of the taxpayer. Failure to keep complete records necessitates establishment of tax payable by estimation settled between the TRA officers and taxpayers. The turnover bands and their tax rates are as stipulated below:

Annual Turnover	Tax payable when records are incomplete	Tax payable when records are complete
Where turnover does not exceed Tshs4,000,000	Nil	Nil
Where turnover exceeds Tshs4,000,000 but does not exceed Tshs7,500,000	Tshs100,000	2% of the turnover in excess of Tshs4,000,000
Where turnover exceeds Tshs7,500,000 but does not exceed Tshs11,500,000	Tshs212,000	70,000+2.5% of the turnover in excess of Tshs7,500,000
Where turnover exceeds Tshs11,500,000 but does not exceed Tshs16,000,000	Tshs364,000	170,000+3.0% in excess of Tshs11,500,000
Where turnover exceeds Tshs16,000,000 but does not exceed Tshs20,000,000	Tshs575,000	305,000+3.5% in excess of Tshs16,000,000

Self Examination Questions

Question 1

	Celina	Chichi	Christie
2010	184 days	188 days	242 days
2011	127 days	127 days	-
2012	4 days	91 days	127 days
2013	148 days	148 days	123 days

Required:

For each individual, explain whether she is resident/not resident in the years of income 2010, 2011 and 2013.

Question 2

Differentiate among the following terms:

- (a) To charge and assess;
- (b) Exempt income and income exempt;
- (c) A person and an individual;
- (d) Benefit in kind and in cash;
- (e) Entity and corporations.

Question 3

How do you determine the residential status of a Chinese company which has been operating in Tanzania since January 2011?

Answers to Self Examination Questions**Answer to SEQ 1**

	Celina	Chichi	Christie
2010	Resident (was in URT more than 183 days in the YOI)	Resident (was in URT more than 183 days in the YOI)	Resident (was in URT more than 183 days in the YOI)
2011	Non resident (present less than 183 days and not present in 2009)	Non resident (present less than 183 days but not present in 2009)	Non resident (never present in URT in the YOI)
2012	Non resident (average days for 2012, 2011 and 2010 less than 122)	Resident (average days for 2012, 2011 and 2010 more than 122)	Non resident (not present in 2011)
2013	Non resident (average days for 2013, 2012 and 2011 less than 122)	Resident (average days for 2013, 2012 and 2011 equal to 122)	Non resident (not present in 2011)

Answer to SEQ 2

- (a) To assess is to determine the taxable income through computation and adjustment of various sources of income while to charge is to apply the tax rate on the assessed value.
- (b) Exempt income and income exempt are both not taxable. Exempt income is income not taxed because the source is exempt. While income exempt is income not taxed because of the application of the law, order or rule or because of certain circumstances, it is derived from a taxable source (e.g. president of the URT salary). Exempt income does not form part of the total income to be included in the income tax return.
- (c) A person means an individual or an entity such as a company or trust whereas an individual means a natural person.
- (d) Benefit in kind is income received in non-monetary terms such as free use of employer's motor car, accommodation. Benefit in cash on the other hand is income received or to be received in monetary terms e.g. salary, interest, dividend etc.
- (e) An entity is a broader term that means a partnership, trust or corporation. A corporation means any company or body corporate established, incorporated in the United Republic or elsewhere, an unincorporated association or other body of persons, a government, a political subdivision of a government, a parastatal organisation, a public international organisation and a unit trust but excludes a partnership.

Answer to SEQ 3

In order to determine the residential status of a Chinese company which has been operating in Tanzania since January 2011 the following factors needs to be considered:

- (a) Whether the Chinese company incorporated or formed under the laws of the United Republic; if yes then it is a resident
- (b) Whether the management and control of the affairs of the corporation exercised during the year of income were conducted in the United Republic of Tanzania. If yes, then the Chinese company would be a resident.

STUDY GUIDE C2: BUSINESS INCOME

Get Through Intro

This Study Guide is specifically aimed at elucidating items which are included in computation of taxable income from business and those items which are excluded when computing. Business income results from contract for services' activities. These are activities of sole traders, partnership and corporate taxpayers.

The Study Guide employs sections in Income Tax Act 2004 and cases laws to enable you to establish at correct taxable business income. Knowledge of determining business income is essential in understanding how business persons are taxed. Sections from Income Tax Act 2004 are being referred throughout this Study Guide.

Learning Outcomes

- a) Identify items included in calculation of chargeable income from business.
- b) Identify items excluded in calculation of chargeable income from business.
- c) Explain the rules relating to realisation of assets and liabilities.
- d) Determine the incomings and cost of assets and liabilities.
- e) Describe the general principle of deductions in computing business income.
- f) Identify the allowable deductions.
- g) Identify the non-allowable deductions.
- h) Establish business chargeable income.

1. Identify items included in calculation of chargeable income from employment.
[Learning Outcome a]

1.1 Component of business

Normally, business is demonstrated by presence of **contract for service** as discussed before.

Shortly, that **contract for service** (sole trading or businesses) occurs when a contractor hires his own employees, provides and maintains his own tools or equipment; the contractor paid by reference to the volume of work done; have invested in the enterprise and bore the financial risk; have the opportunities of profit or the risk of loss; and the relationship is not permanent (Ready Mixed Concrete (South East) Ltd v Minister of Pensions and National Insurance [1968] 2 QB 497).

Likewise, in *McManus v Griffiths* (1997) 70 TC 218 case the judge suggested in deciding whether a person was employed (**contract of service or self-employed (contract for service)**) we should consider the substance of the contractual arrangements rather than their form or the parties' labels (incorporated companies).



Definition

'**Business**' includes a trade, concern in the nature of trade, manufacture, profession, vocation or isolated arrangement with a business character; and a past, present or prospective business, but excludes employment and any activity that, having regard to its nature and the principal occupation of its owners or underlying owners, is not carried on with a view to deriving profits.

Section 3

The Act does not define the term **manufacturing**. Therefore, we can only base on case laws. One of the best case laws which attempted defining this term is the case between *Teejan Beverages Ltd vs State Of Kerala* and Ors S.R.O. No. 1729 of 1993.



Example

Teejan Beverages Ltd vs State Of Kerala and Ors S.R.O. No. 1729 of 1993.

In this case, the appellant was issued with Government letter exempting her from paying sales tax on the ground that she was involved in manufacturing or purification of bottled water because manufacturing of any goods was exempted from the taxes.

However, the letter was later revoked by the government on the basis that purification of water does not satisfy the meaning of manufacturing given in the sale taxes. Hence, the person appealed.

The court definition of **manufacturing** does not include packing of goods, polishing, cleaning, grading, drying, blending or mixing different varieties of the same goods by mixing with chemicals or gas, fumigation or any other process applied for preserving the goods in good condition or for easy transportation".

Hence, manufacturing occurs only when raw materials are used (converted) in producing another product which is commercially distinct from the raw materials.



Definition

'**Manufacturing**' refers to production of goods commercially different from the raw material used

***Teejan Beverages Ltd vs State Of Kerala* and Ors S.R.O [1993] TC.1729**

Similarly, no definition of trade is given in the Act. However, case laws have provided indicators " **badges of trade** " which can be used to tell whether a trade is being conducted.

These indicators include:

- (a) **methods of acquisition**; assets acquired through inheritance or gifts might indicate no trade motive than those acquired through purchases (Taylor v Good [1974] 49TC277).
- (b) Second, length of the period of ownership; purchasing and selling an asset in haste might indicate trading while holding the assets for long period may indicate investment (Marson v Morton and Others [1986] 59TC381).
- (c) Third, frequency or number of similar transactions by the same person; too many similar transactions might imply trade (CIR v Livingston and Others [1926] 11TC538).
- (d) Fourth, doing supplementary work on or in connection with the asset realised to increase saleable condition might indicate trading (CIR v Livingston and Others [1926] 11TC538).
- (e) **Fifth**, circumstances that were responsible for the realisation; forced realisation for example in emergency might indicate absence of trade (CIR v Livingston and Others 11TC538).
- (f) **Sixth** profit motive; reason for transaction involved being gain profit from it rather than holding it as an investment (Salt v Chamberlain [1979] 53TC143).
- (g) Also nature of assets involved; if the nature of the assets involved is not always involved in trade might not indicate not trade. These assets include purchase of shares might highly indicate investment than trading and purchasing of classic cars may be for person consumption than trading while purchase of chemical for example might definitely indicate trade (CIR v Fraser [1942] 24TC498).
- (h) Finally, existence of similar trade transaction, the closer the proximity of the transaction undertaken to the existence trade transactions the more it can be taken to be a trade transaction (Harvey v Caulcott [1952] 33TC159).



Definition

'Trade' is an act of providing goods or services to others in exchange for a reward.

Cambridge dictionary

However, in many cases presences of these badges of trade do not indicate presence or absence of trade. Therefore, all facts surrounding the transaction should be considered. For instance, the definition of business above includes even "**isolated** arrangement with a business character" which might mean trading.

For instance, in a case of CIR v Fraser [1942] 24TC498; Fraser bought a large consignment of whisky and sold it at profit, using the above indicators the transaction could be none trade transaction. However, the court decided that "The purchaser of a large quantity of a commodity like whisky, greatly in excess of what could be used by himself, his family and friends, a commodity which yields no pride of possession, which cannot be turned to account except by a process of realisation, I can scarcely consider to be other than an adventurer in a transaction in the nature of a trade. Most important of all, the actual dealings of the respondent with the whisky were exactly of the kind that take place in ordinary trade."



Definitions

'Profession' any type of work that needs special training or a particular skill, often one that is respected because it involves a high level of education.

Cambridge dictionary

'Vocation' is a type of work that you feel you are suited to doing and to which you should give all your time and energy, or the feeling that a type of work suits you in this way and indicates a calling. Vocations include religion or high-minded service to others, a bookmaker and a jockey, authors, dramatists and professional singers.

Graham v Green [1925] 9TC309

1.2 Business income items which are chargeable

Income in connection with businesses income (contract for service) means:

- (a) service fees;
- (b) incomings for trading stock;
- (c) gains from the realisation of business assets or liabilities of the business
- (d) Gains from realisation of the person's depreciable assets of the business;
- (e) amounts derived as consideration for accepting a restriction on the capacity to conduct the business;
- (f) gifts and other *ex gratia* payments received by the person in respect of the business;
- (g) amounts derived that are effectively connected with the business and that would otherwise be included in calculating the person's income from an investment; and
- (h) Other amounts including reverse of amounts as bad debts, bad debts writing off, discount allowed, fluctuations in foreign exchanges and seizures of untaken deposits and advances (Section 8(2)).

2. Explain the rules relating to realisation of assets and liabilities.

[Learning Outcome c]

Realisations of assets are dealt with Section 39. According to this Section an asset is said to have been realised when:

- (a) the person parts with ownership of the asset including when the asset is sold, exchanged, transferred, distributed, cancelled, redeemed, destroyed, lost, expired or surrendered. This part does not apply to assets of deceased individuals.
- (b) in the case of an asset of a person who ceases to exist, excluding a deceased individual, immediately before the person ceases to exist;
- (c) in the case of an asset other than a Class 1, 2, 3, 4, 5, 6 or 8 depreciable asset or trading stock, where the sum of the incomings for the asset **exceeds** the cost of the asset;
- (d) in the case of an asset that is a debt claim owned by a financial institution, when the debt claim becomes a bad debt as determined in accordance with the relevant standards established by the Bank of Tanzania and the institution writes the debt off as bad;
- (e) in the case of an asset that is a debt claim owned by a person other than a financial institution, the person reasonably believes the debt claim will not be satisfied, the person has taken all reasonable steps in pursuing the debt claim and the person writes the debt off as bad;
- (f) in the case of an asset that is a business asset, depreciable asset, investment asset or trading stock, immediately before the person begins to employ the asset in such a way that it ceases to be an asset of any of those types;
- (g) in the case of a foreign currency debt obligation, when such debt is actually paid;
- (h) in the case of an asset owned by an entity whose the underlying ownership of an entity changes by more than 50% as compared with that ownership at any time during the previous three years, the entity would be treated as realising any assets owned by it immediately before the change.

From the definition of realisation of assets above, it can be said that an asset is realised when it is written off from accounting records because of transaction that lead to transfer of risks and rewards associated with the asset. Also, realisation of assets occurs when a transaction leads to reduction of value of assets because of significant change in risks and rewards over an asset there is realisation of the assets. However, decrease in value of assets because of depreciation or impairment loss does not result in realisation of assets because the decrease does not result from transaction. Yet, besides realisation of assets through transactions it is possible to realise an asset on occurrence of events like fire, thieves and others mentioned above.



Definitions

'Underlying ownership', in relation to an entity, means membership interests owned in the entity, directly or indirectly through one or more interposed entities, by individuals or by entities in which no person has a membership interest; or in relation to an asset owned by an entity, means the asset owned by the persons having underlying ownership of the entity in proportion to that ownership of the entity.

Section 3

'Asset' means a tangible or intangible asset and includes currency, goodwill, know-how, property, a right to income or future income and a part of an asset.

Section 3

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

Section 3

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

- (a) trading stock or a depreciable asset;
- (b) an interest in land held by an individual that has a market value of less than 10 million shillings at the time it is realised and that has been used for agricultural purposes for at least two of the three years prior to realisation;
- (c) the beneficial interest of a beneficiary in a resident trust; and
- (d) shares and securities listed on the Dar es Salaam Stock Exchange that are owned by a resident person or by a non-resident person who either alone or with other associates controls less than 25% of the controlling shares of the issuer company.

Section 3

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

Section 3

'Entity' means a partnership, trust or corporation.

Section 3

'Foreign currency debt claim' means a debt claim that is denominated in a currency other than Tanzanian shillings.

Section 3

On the other hand realisations of liabilities are regulated by Section 40(2) of the Income Tax Act 2004. Actually liabilities of a person are deemed realised when:

- (a) the person ceases to owe the liability including when the liability is transferred, satisfied, cancelled, released or expired. This part does not apply to liabilities of deceased individuals
- (b) in the case of a liability of a person who ceases to exist, excluding a deceased individual, immediately before the person ceases to exist;
- (c) in the case of a foreign currency debt obligation, when such debt is actually paid.
- (d) in the case of a liability of an entity whose underlying ownership of an entity changes by more than 50% as compared with that ownership at any time during the previous three years, the entity is treated as realising any liabilities owed by it immediately before the change; and
- (e) in the case of a liability owed by a resident person, immediately before the person becomes a non-resident person, other than liabilities owed by the person through a permanent establishment situated in the United Republic immediately after becoming non-resident.

3. Determine the incomings and cost of assets and liabilities.**[Learning Outcome d]****3.1 Incomings from realisation of assets and incurring liabilities**

Specifically, incomings from realisation of an asset of a person means amounts derived by the person in respect of owning the asset including amounts derived from altering or decreasing the value of the asset; and amounts derived under the asset including by way of covenant to repair or otherwise; and amounts derived or to be derived by the person in respect of realising the asset (Section 38). While the incoming from incurring liabilities are the amount derived from incurring the liability (Section 40(1) (b)).

**Definition**

'Amount derived' means a payment received by a person or that the person is entitled to receive;

Section 3**Example**

Robots and Assembler Design makers borrowed money from a bank for the purpose of her business. The loan amount was Tshs14,000,000 but she received Tshs10,000,000 after deduction of bank charges and loan insurance.

Required:

Determine the incoming from incurring the business liability.

Answer

The incoming of liability is the amount received or to be received from the loan, in this case the incoming is Tshs10,000,000.

3.2 Costs of assets and liabilities

Costs of assets or liabilities represent its monetary values. According to Section 37 and Section 40 costs of assets or liabilities constitute a total of:

1. expenditure incurred by the person in acquiring the asset including, where relevant, expenditure of construction, manufacture or production of the asset;
2. expenditure incurred by the person in altering, improving, maintaining and repairing the asset;
3. expenditure incurred by the person in realising the asset or liabilities;
4. incidental expenditure incurred by the person in acquiring and realising the asset or liability; and
5. any amount to be directly included in calculating the person's income; or that is **an exempt amount or final withholding payment of** the person; but excludes consumption expenditure, excluded expenditure and expenditure to the extent to which it is directly deducted in calculating the person's income or included in the cost of another asset or liability.

Furthermore, the cost of trading stock should not include repair, improvement or depreciation of depreciable assets; and determined under the absorption-cost method (Section 37(1)).

Furthermore, trading stocks should be valued consistently using either the **first-in-first-out method or the average-cost method**, and these method can be used valuating non-trading stock fungible assets (Section 37(2)).



Definitions

'Absorption-cost method' means the generally accepted accounting principle under which the cost of trading stock is the sum of direct asset costs, direct labour costs and factory overhead costs.

Section 37(7)

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

Section 3

'Incidental expenditure' incurred by a person in acquiring or realising an asset or liability includes: advertising expenditure, taxes, duties and other expenditure of transfer; and expenditure of establishing, preserving or defending ownership of the asset or liability, and the expenditure referred to any related remuneration for the services of an accountant, agent, auctioneer, broker, consultant, legal advisor, surveyor or valuer.

Section 37(7)



Example

The following information relates to the production of certain trading stocks. Your duty is to determine the costs of a single stock if 100,000 of them were produced.

Raw materials	Tshs6,000,000
Labor	Tshs2,000,000
Depreciation costs	Tshs700,000
Repairs	Tshs1,000,000
Other factory overhead	Tshs2,000,000

The costs of trading stocks should not include depreciation or repair costs, so the cost of producing that batch was Tshs10,000,000. Using average cost method the cost of a single stock would be Tshs100.

Still, the costs of inherited assets from deceased individuals are the market values of that asset at the time of such acquisition (Section 37(4)). Likewise, a cost of non-domestic asset of a person who becomes a resident of the United Republic for the first time is the market value of the asset immediately before becoming a resident (37(5)). Also there are other ways of determining costs and incoming of assets resulting from realisation of assets as discussed below:

1. Realisation with retention of asset

When, a person realises an asset of the business in any of the manners described in (d) to (h) above, the realisation is name realisation with retention of assets. However, the person is treated as having parted with ownership of the asset and deriving an amount in respect of the realisation equal to the market value of the asset at the time of the realisation; and the person is treated as reacquiring the asset and incurring expenditure of the same amount (Section 42).

2. Transfer of asset to spouse or former spouse

When there is transfer of assets to spouse or former spouse because of divorce settlement or bona fide separation agreement, an individual transferring the assets is treated as deriving an amount in respect of the realisation equal to the net cost of the asset immediately before the realisation; and the spouse or former spouse receiving the assets is treated as incurring expenditure of the same amount in acquiring the assets (Section 43). However, this Section works on at the discretion of the couple and the couple should apply for this application in writing (Section 43).

3. Transfer of asset to an associate or for no consideration

Except in divorce settlement, any transfer of asset to an associate or for no consideration is treated as realisation of assets at the greater of the market value of the asset or the net cost of the asset immediately before the realisation; and the recipient is treated as acquiring the assets at the same value (Section 44(1)).

Nevertheless, when the transfer involves business asset, depreciable asset or trading stock, by way of transfer of ownership of the asset to an associate of the person and

- (a) either the person or the associate is an entity;
- (b) the asset or assets are business assets, depreciable assets or trading stock of the associate immediately after transfer by the person;
- (c) at the time of the transfer the person and the associate are residents; and the associate or, in the case of an associate partnership, none of its partners is exempt from income tax;
- (d) there is continuity of underlying ownership in the asset of at least 50 %; and
- (e) both the person and the associate in writing applied to use this method.

The person making the transfer is treated as deriving an amount in respect of the realisation equal to the net cost of the asset immediately before the realisation and the associate acquiring the assets at the same value (Section 44(2)).



Definitions

'Net cost of a depreciable asset' at the time of its realisation is equal to its share of the written down value of the pool to which it belongs at that time apportioned according to the market value of all the assets in the pool .

Section 44(3)

'Associate' in relation to a person, means another person where the relationship between the two is :

- (a) that of an individual and a relative of the individual, unless the Commissioner is satisfied that it is not reasonable to expect that either individual will act in accordance with the intentions of the other;
- (b) that of partners in the same partnership, unless the Commissioner is satisfied that it is not reasonable to expect that either person will act in accordance with the intentions of the other;
- (c) that of an entity and:
 - (i) a person who either alone or together with an associate or associates under another application of this definition; and whether directly or through one or more interposed entities, controls or may benefit from 50 percent or more of the rights to income or capital or voting power of the entity; or
 - (ii) under another application of this definition, is an associate of a person to whom subparagraph (i) applies; or
- (d) in any case not covered by paragraphs (a) to (c), such that one may reasonably be expected to act, other than as employee, in accordance with the intentions of the other.

Section 3

4. Involuntary realisation of asset with replacement

In case of involuntary realisation of assets either by involuntary sell, exchange, transfer, distribution, cancellation, redeem, destroy, loss, expiry or surrender and replace the asset involuntary realised within a year; the person can be assumed deriving an amount in respect of the realisation equal to: the net cost of the asset immediately before the realisation; plus the amount, if any, by which amounts derived in respect of the realisation exceed expenditure incurred in acquiring the replacement asset.

Addition, the person is assumed incurring expenditure in acquiring the replacement asset equal to the net cost of the asset immediately before the realisation plus the amount, if any, by which expenditure incurred in acquiring the replacement asset exceed amounts derived in respect of the realisation (Section 45). Yet, this Section applies only to taxpayers who apply to the Commissioner to use it.

3.3 Realisation by separation

Excluding where an asset is transferred under finance lease where the parties derive and incur market value of assets immediately before transfer of the assets (Section 32(5)); where rights or obligations with respect to an asset owned by one person are created in another person including by way of lease of an asset or part thereof, permanently the person is treated as realising part of the asset but is not treated as acquiring any new asset or liability; and when the creation is temporary or contingent, the person is not treated as realising part of the asset or liability but as acquiring a new asset (Section 46).



Definition

'Lease' means an arrangement providing a person with a temporary right in respect of an asset of another person, other than money, and includes a licence, *profit-a-prendre*, option, rental agreement, royalty agreement and tenancy.

Section 3

3.4 Apportionment of costs and incomings of assets

Apportionment problem happens when multiple assets are transferred at the same time or in a single deal/price. In that case, we might be interested in knowing the costs of individual assets. According to Section 47 when multiple assets are acquired or realised the market values of assets at the time of acquisition should be used to apportion the amount incurred or derived. While, when an asset is partly realised the net cost of the asset immediately before the realisation should be apportioned between the parts of the asset realised and the part retained according to their market values immediately after the realisation (Section 47(3)).



Example

Robots and Assembler Design Ltd acquired the following assets after paying a single price of Tshs20,000,000:

Asset	Market value at the time of acquisition
Car	Tshs7,000,000
Tractor	Tshs6,000,000
Office furniture	Tshs.2,000,000

Required:

Calculate costs of each asset.

Answer

The costs of assets should be apportioned on the market value at the time of acquisition as shown below;

Asset	Tshs	Costs apportioned Tshs
Car	7,000,000	14,583,333
Tractor	600,000	1,250,000
Office furniture	2,000,000	4,166,667
Total	9,600,000	20,000,000

3.5 Gains from the realisation of businesses assets and liabilities

Now we know what constitute costs of assets or liabilities and incoming from realisation of assets or incurring of liabilities. So we can determine gain from realisation of business assets or liabilities. However, those incomings which are exempt amounts or a final withholding payment or incomings from sales of stocks should be excluded (Section 38). The incomings from sales of trading stocks are excluded in computation of gain from realisation of businesses assets because they are used in the calculation of business income and they are legally not business assets.



Definition

'Gain' from realisation of an asset or liability is the excess of the incomings for the asset or liability over the cost of the asset or liability at the time of realisation.

Section 36 (1)



Example

Robots and Assembler Design makers disposed a business asset for Tshs2,000,000 after incurring selling costs of Tshs800,000 and transport expenses of 100,000.

Required:

If the cost of the asset was Tshs400,000, determine gain or loss from the realisation of the assets.

Answer

Gain or loss of realisation of assets = Incomings less cost of the assets less realisation expenses. Therefore, gain = Tshs2,000,000 – Tshs800,000 – Tshs100,000 - Tshs400,000 = Tshs700,000.

3.6 Reverse of amounts including bad debts

Business transactions can be reversed by business taxpayers for various reasons. First, when there is overturning of transactions already recorded in financial statements as sales returns or purchase return culminating into a refund, reduces sales or purchase figure previous recorded in the financial statements. Second, disclaiming of accrued expenses which don't culminate into refund must be eliminated in the business expenses. Finally, failing to realise accrued income items overstate business revenues, therefore, accrued items not realised must be deducted for instance in bad debt written off (Section 25).

There are no restrictions or conditions which must be satisfied before a reverse can occurs. For instance, taxpayers can write off a debt after taking all necessary steps to cover it unsuccessful, consequently the taxpayer feels that the debt might not be recovered and the amount written off is tax deductible expenses (Section 25(5) (b)). However, when a taxpayer is a financial institution, the taxpayer can only write off a debt after satisfaction of standards established by Bank of Tanzania (Section 25(5) (a)).



Test Yourself 1

Kigongo Company Limited was incorporated in Tanzania and commenced its business on 1 February 2005 as a retailer of audio-visual products in Tanzania. It has drawn up its first accounts to 31 December 2005, the draft of which together with the additional information was as follows:

	Notes	Tshs'000	Tshs'000
Sales	1	950,000	
Dividends	2	5,000	
Interest income	3	12,000	
Contractual penalties	4	5,000	972,000
Expenses:			
Directors fees	5	320,000	
Salaries		300,000	
Interest expenses	6	80,000	
Rent and rates		220,000	
Legal and professional fees	7	20,000	
Contributions to retirement fund	8	15,000	
Depreciation	9	120,000	
Travelling and entertainment		22,000	
Provisions	10	28,000	
Insurance		18,000	
Sundries	11	10,000	1,153,000
Loss for the year			(186,000)

Additional notes:

1. Sales figure includes Tshs1,000,000 for sale of furniture which was used by the company.
2. The company had bought some shares from City Stock Exchange. These were shares of Sungura Cement Company which distributed dividends during the period.
3. The Company earned Tshs8,000,000 as interest from its bank deposits and another Tshs4,000,000 from a director to whom the company had extended a personal loan. The Director used the loan to acquire a building in Kenya.
4. The amount was received as a result of a business contract which the other party breached it.
5. Directors fees were paid to the following persons:

Mr. A.	Tshs200,000,000
Mrs. A (wife of Mr. A)	Tshs50,000,000
Mr. B. (Mr. A's brother)	<u>Tshs70,000,000</u>
	<u>Tshs320,000,000</u>

6. Interest paid to bank on overdraft Tshs20,000,000
Finance charge on hire purchase agreements Tshs50,000,000
Interest on failure to pay previous years
Value added taxes Tshs10,000,000
Tshs80,000,000

7. Audit fees Tshs10,000,000
Legal fees for staff contracts and retirement funds Tshs6,000,000
Amount paid to Tender Board members to facilitate winning a bid Tshs4,000,000
Tshs20,000,000

8. Employees contributions Tshs7,500,000
Employer's contributions Tshs7,500,000
Tshs15,000,000

The contributions were made to an approved retirement fund.

9. The company acquired the following assets:

On 15 February 2005 – Furniture and equipment	Tshs100,000,000
On 15 February 2005 – Computers and accessories	Tshs300,000,000
On 1 September 2005 – Motor car (station wagon)	Tshs200,000,000

The computers were acquired on hire purchase terms for 12 months. The down payment of Tshs120,000,000 was made on 15 February 2005 and the first monthly instalment of Tshs20,000,000 was due on 15 February 2005 and the first monthly instalment of Tshs20,000,000 was due on 15 March 2005. The cash price of the computers was Tshs300,000,000.

10. Provision for debtors (specific) Tshs11,000,000
Provision repairs (estimated) Tshs8,000,000
Provision for stock obsolescence Tshs9,000,000
Tshs28,000,000

11. Sundries included a traffic fine of Tshs3,500,000. The balance was general consumables used by the office.

Required:

Identify items included in chargeable business income for the year 2005

4. Identify items excluded in calculation of chargeable income from businesses.**[Learning Outcome b]****4.1 Excluded business income**

According to Section 8(3) of the Income Tax Act 2004, exempt business income, final withholding payments and non-business income should be excluded in computing business income. Both exempt income and final withholding income items were covered in the employment income Section. So in this Section they are not discussed. Please take time to peruse them. In addition receipt from realisation of capital assets should be excluded as well because they are used in computing gain from realisation of assets.

**Test Yourself 2**

Kigongo Company Limited was incorporated in Tanzania and commenced its business on 1 February 2005 as a retailer of audio-visual products in Tanzania. It has drawn up its first accounts to 31 December 2005, the draft of which together with the additional information was as follows:

	Notes	Tshs'000	Tshs'000
Sales	1	950,000	
Dividends	2	5,000	
Interest income	3	12,000	
Contractual penalties	4	5,000	972,000
Expenses:			
Directors fees	5	320,000	
Salaries		300,000	
Interest expenses	6	80,000	
Rent and rates		220,000	
Legal and professional fees	7	20,000	
Contributions to retirement fund	8	15,000	
Depreciation	9	120,000	
Travelling and entertainment		22,000	
Provisions	10	28,000	
Insurance		18,000	
Sundries	11	10,000	1,153,000
Loss for the year			(186,000)

Additional notes:

- Sales figure includes Tshs1,000,000 for sale of furniture which was used by the company.
- The company had bought some shares from City Stock Exchange. These were shares of Sungura Cement Company which distributed dividends during the period.
- The Company earned Tshs8,000,000 as interest from its bank deposits and another Tshs4,000,000 from a director to whom the company had extended a personal loan. The Director used the loan to acquire a building in Kenya.
- The amount was received as a result of a business contract which the other party breached it.
- Directors fees were paid to the following persons:

Mr. A.	Tshs200,000,000
Mrs. A (wife of Mr. A)	Tshs50,000,000
Mr. B. (Mr. A's brother)	Tshs70,000,000
	Tshs320,000,000

6.	Interest paid to bank on overdraft	Tshs20,000,000
	Finance charge on hire purchase agreements	Tshs50,000,000
	Interest on failure to pay previous years	Tshs10,000,000
	Value added taxes	Tshs80,000,000

7.	Audit fees	Tshs10,000,000
	Legal fees for staff contracts and retirement funds	Tshs6,000,000
	Amount paid to Tender Board members to facilitate winning a bid	Tshs4,000,000
		Tshs20,000,000

8.	Employees contributions	Tshs7,500,000
	Employer's contributions	Tshs7,500,000
		Tshs15,000,000

The contributions were made to an approved retirement fund.

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10.	Provision for debtors (specific)	Tshs11,000,000
	Provision repairs (estimated)	Tshs8,000,000
	Provision for stock obsolescence	Tshs9,000,000
		Tshs28,000,000

11. Sundries included a traffic fine of Tshs3,500,000. The balance was general consumables used by the office.

Required:

Identify items excluded in chargeable business income for the year 2005

5. Describe the general principle of deductions in business income.

Identify the allowable deductions.

Identify the non-allowable deductions.

[Learning Outcomes e, f and g]

Then after knowing elements which constitute business income the next step is to understand deductible business expenses. In fact it is very important to understand these allowable expenses because they affect how much is left for business income taxes.

In general all expenses incurred 'wholly and exclusively' in the production of business income are allowable expenses (Section 11(3)). Therefore, only expenditure incurred for sole purposes of producing business income are allowable expenses and expenditure incurred not wholly and exclusively for business purposes are not allowable.



Example

In *Boarland V Kramat Pulai Ltd* [1953] 35 TC case, the company claimed costs of publishing and circulating a political pamphlet concerning a critical evaluation of government policies. It was decided by judge Dankwerts J that the costs of the article was not wholly and exclusive expended on production of income, though there was some business benefits from the article.

Hence, it was concluded that the costs claimed contravened the statutory requirement that the expenditure should be used **wholly and exclusive** for business purposes to be allowable deduction; because there was non-business purpose on that transaction, the wholly expenses involved was deductible.



Definition

'Wholly' refers to the quantum of money and the word 'exclusively' refers to the purpose

Romer L.J

Therefore, expenses incurred for dual purposes are normally not allowed deductible even when there is significant portion of expenditure incurred wholly and exclusively for the purposes of the trade, profession or vocation. In **case between Bowden v Russell & Russell [1965] 42 TC 301** the taxpayers travelled from the UK to the US for both business and private purposes i.e. vocation with his wife, and the taxpayer accepted that there trip was for dual purpose. Though, the taxpayer claimed only expenses used in the business purposes, the whole expenses were disallowed because the expenses were incurred both for private and businesses against the so '**wholly and exclusively**' requirements.



Definition

"Dual-purpose" expenditure is an expenditure that is incurred for more than one reason.

However, when there is **definite** portion of expenditure incurred wholly and exclusively for business purposes can be established, the amount can be deducted even if the entire amount of expenses were not incurred for production of income (Wildbore v Luker [1951] 33 TC 46). The taxpayer claimed whole of public house rate in which some areas were used as an office. It was decided that a definite portion of the rate related to business was deductible. Consequently, a cost of running a car for example can be apportioned when the car is used both for private and trade purpose.

Similarly, when expenditure is wholly and exclusively incurred in producing business purposes but the taxpayers deliver an incidental benefit, the expenditure should still be allowed (Bentleys Stokes & Lowless V Beeson [1952] 33 TC 491. For instance when a person travel to national park on business trip might derive an incidental benefits, but the whole expenditure of travelling is allowable.

However, deduction of capital, consumption and excluded expenditures is not allowed (Section 11). Yet, the capital expenditures on depreciable assets are deductible in form of depreciable annual allowance under the third schedule Income Tax Act 2004. Therefore, depreciation charges calculated under taxpayers' accounting policies are not allowed too.



Definitions

'Consumption expenditure' means any expenditure incurred by any person in the maintenance of himself, his family or establishment, or for any other personal or domestic purpose.

Section 11(5)

"Expenditure of a capital nature" means expenditure that secures a benefit lasting longer than twelve months; or incurred in respect of natural resource prospecting, exploration and development.

Section 11(5)

'Excluded expenditure' means:

- (a) tax payable under this Act except skills and development;
- (b) bribes and expenditure incurred in corrupt practice;
- (c) fines and similar penalties payable to a government or a political subdivision of a government of any country for breach of any law or subsidiary legislation;
- (d) expenditure to the extent to which incurred by a person in deriving exempt amounts or final withholding payments;
- (e) distributions by an entity or
- (f) Mining operation" should not include exploration activities conducted outside the mining licence area which shall be accumulated and allowed when the commercial operations commence.

Section 11(5)

Distribution by an entity:

- (a) means:
 - (i) a payment made by the entity to any of its members, in any capacity to the extent that the amount of the payment exceeds the amount of any payment made by the member to the entity in return for the entity's payment; or
 - (ii) any re-investment of dividends which enhances the value of shares
 - (iii) any capitalisation of profits;

Continued on the next page

- (b) includes a payment made by the entity to one of its members on cancellation, redemption or surrender of a membership interest in the entity, including as a result of liquidation of the entity or as a result of the entity purchasing a membership interest in itself;
- (c) excludes a payment of the type referred to in paragraph (a) (i) or (b):
 - (i) to the extent to which the payment is directly included in calculating the member's income or in calculating a final withholding payment, other than by reason of being a distribution; and
 - (ii) without limiting any amount treated as a distribution by paragraph (a)(ii), that consists of the issue of further membership interests in the entity to the entity's members in approximate proportion to the members' existing rights to share in dividends of the entity; and
- (d) in the case of a controlled foreign trust or corporation, is interpreted in accordance with Section 75.

Section 3

The rest of this part describes how various items are determined to be or to be wholly and exclusively incurred for businesses purposes.

5.1 Interest expense

Interests bearing external financing activities are normal in any business venture. Therefore, interest expenses incurred on a finance debt obligation which is incurred wholly and exclusively and the amount is employed during the year of income or was used to acquire an asset that is employed during the year of income wholly and exclusively in the production of income from the business is deductible (Section 12(1) (a)). Likewise, interest incurred on non-monetary debts is also deductible when the debt obligation was incurred wholly and exclusively in the production of income from the business (Section 12(1)(b)). However, when interest incurred on foreign currency debt obligation is deductible only when they are actually paid (39(g)).

Nevertheless, interest expenses incurred wholly and exclusive in production of business income for **exempt-controlled resident entity** are restricted. In fact, interest expenses deducted by **an exempt-controlled resident entity** must not exceed sum of interest equivalent to debt-to-equity ratio of 7 to 3 (Section 12(2)). In case of changes in debt or equity amounts; the amount of the equity or debt should be the average of balances of amount of debt or equity at the end of each period (Section 12(4)).



Definitions

'An exempt-controlled resident entity' for a year of income if it is resident and at any time during the year of income 25% or more of the underlying ownership of the entity is held by entities exempt under the Second Schedule, approved retirement funds, charitable organisations, non-resident persons or associates of such entities or persons.

Section 12(4)

'Debt' means any debt obligation excluding: a non-interest bearing debt obligation, a debt obligation owed to resident financial institution and a debt obligation owed to a non-resident bank or financial institution on whose interest tax is withheld in the United Republic. While **'equity'** includes: paid up share capital, paid up share premium and retained earnings on an unconsolidated basis determined in accordance with generally accepted accounting principles.

Section 12(5)

'Period' means a month or part of month

Section 12(5)

'Parastatal organisation' means: a local authority of the United Republic, a body corporate established by or under any Act or Ordinance of the United Republic other than the Companies Act, and any company registered under the Companies Act where –

- (a) in the case of a company limited by shares, not less than 50 percent of the issued share capital of the company is owned by the Government or an organisation which is a parastatal organisation under this definition; or

Continued on the next page

- (b) in the case of a company limited by guarantee:
 - (i) the members of the company include the Government or an organisation which is a parastatal organisation under this definition; and
 - (ii) such members have undertaken to contribute not less than 50 percent of the amount to be contributed by members in the event of the company being wound up.

Section 12(5)

5.2 Trading stock allowance

Costs of goods sold are tax deductible business expenses. They are calculated by taking the opening value of trading stock of the business for the year of income; plus expenditure incurred by the person during the year of income that is included in the cost of trading stock of the business; less the closing value of trading stock of the business for the year of income (Section 13(2)). The closing stock should be valued **at the lower of the cost of the trading stock of the business at the end of the year of income; or the market value** of the trading stock of the business at the end of the year of income (Section 13(4)).



Definition

The **opening value of trading stock** of a business for a year of income is the closing value of trading stock of the business at the end of the previous year of income.

Section 13(3)

5.3 Repair and maintenance expenditure

Revenue expenses incurred on repair and maintenance of depreciable assets owned and employed by the person wholly and exclusively in the production of income from the business are deductible. But, expenditures incurred to improve lives of assets or repairs and maintenance of capital nature should be capitalised in the costs of assets rather than be deducted as revenue expenses (Section (14)(2)).

5.4 Agriculture improvement, research development and environmental expenditure

Agriculture improvement, research development and environmental expenditure are deductible expenses when incurred for business purposes (Section 15 (1)). In addition mining business might make a provision allowance account under environmental expenditure and apply for their deductions to the Commissioner; if approved they become deductible expenses (Section 15(3)).



Definitions

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

Section 15(2)

'Environmental expenditure' means subject to subsection (3) expenditure incurred by the owner or occupier of farm land for the prevention of soil erosion; or in connection with remedying any damage caused by natural resource extraction operations to the surface of or environment on land.

Section 15(2)

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

Section 15(2)

From definitions of agriculture improvement expenditure, the expenditure can be deducted by a person conducting agriculture business while, environmental expenditure are deductible by both those in agriculture and mining businesses for the reason explained in the definitions. Finally, the research and development expenditure can be deducted by any type of business.

**Definition**

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

Section 19(4)

5.5 Capital receipts

Receipts from capital transactions i.e. sales of fixed and investment assets are normally included in business income. However, proceeds from sale of depreciable assets would be treated in computation of gain from realisation of depreciable assets as required in the schedule of the Income Tax Act 2004. Likewise, receipts from disposal of investment income should be used in calculating investment capital gain and the investment income not in computing business income.

5.6 Foreign currency exchange gain

Gain or losses from foreign exchanges if related to business transactions are taxable income and deductible expenses respectively. Yet the computation of foreign exchange gains should be done when there is actual receipt of the foreign currency. Because it is at that point the foreign currency debt is realised (Section 40(2)(c)).

5.7 Insurance claims

When there are receipts from insurance compensation relating to depreciable assets; they should be treated as incoming from realisation of the depreciable assets and used from computation of gain or loss from realisation of depreciable assets. Also insurance compensation relating to investment assets are used in computing capital loss or gain from that investment assets. However, any receipt of insurance against current assets, business losses and other accident are taxable business income.

5.8 Losses on realisation of business assets and liabilities

Losses from realisation of a business asset of the business that is or was employed wholly and exclusively in the production of income from the business; a debt obligation incurred in borrowing money, where the money is or was employed or an asset purchased with the money is or was employed wholly and exclusively in the production of income from the business; or a liability of the business other than a debt obligation incurred in borrowing money, where the liability was incurred wholly and exclusively in the production of income from the business are all deductible expenses (Section 18).

5.9 Losses from a business or investment

Similarly losses incurred by businesses with exceptional of partnership or a foreign permanent establishment are deductible expenses. These losses include any unrelieved loss of the year of income of the person from any other business and any unrelieved loss of a previous year of income of the person from any business (Section 19(1)).

Additionally, unrelieved losses from other foreign source losses can be deducted only in calculating the person's foreign source income and unrelieved losses from agriculture business can only be deducted from calculating business income from agriculture. While, unrelieved losses incurred on petroleum operations can only be deducted from the person's income derived from contract area and in case of loss incurred on mining operations the loss can only be deducted from the person's income derived from mining area.

**Definition**

'Loss' of a year of income of a person from any business or investment is the excess of amounts deducted in calculating the person's income from the business or investment over amounts included in calculating such income.

Section 19(4)

'Unrelieved loss' means the amount of a loss that has not been deducted in calculating a person's income.

Section 19(4)

5.10 Legal and accountancy charges

Expenses incurred in preparation of financial accounts and tax returns are generally allowable expenses. However, legal and expenses incurred in tax appeal are not deductible (*Smiths Potato Estates Ltd v Bolland* 1948 30 TC 267). In that case, the judge argued that they not incurred wholly and exclusive in production of income but in ascertaining tax liabilities therefore the expense were disallowed.

5.11 Business entertainment and gifts

Expenses and gifts incurred in entertaining employees in relationship to their employment are generally allowed as they constitute employment income. But, those expenses incurred for non-employee persons are disallowed expenditures if they are not wholly and exclusively incurred for businesses purposes.

5.12 Pension scheme contributions and other employee benefits

Payment made to both approved and unapproved pension schemes and other employee' benefits are deductible businesses expenses so long as they payments are included in calculations of employment income (Income Tax Regulation 4). In addition, any employment benefits as training costs and redundancy incurred by employers are deductible expenses provided they are included in employees' income.

5.13 Legal and other expenses

Legal and other expenses in connection with normal business activities and they are incurred wholly and exclusive for business purpose are deductible expenses. However, those expenses incurred in connection of acquisition of capital assets should be capitalised in the costs of assets and therefore they are not deductible expenses (Section 37).

5.14 Other losses and defalcations

Only losses from trade activities incurred wholly and inclusive for businesses purposes are allowable expenditures. These losses might include fire, burglary, accident and loss of profits and when there is insurance against them insurance costs are deductible too. However, losses arising from loss of capital assets are not straight deductible from business income. They have either to go to the computation of gain or loss from realisation of business, depreciable or investment assets. But, insurance expenses against depreciable assets are allowable expenses.

On the other hand, when employees defraud their employers the loss incurred is deductible expenses, while defalcations by directors, sole traders or partners in partnership are not deductible (**Curtis v J & G Oldfield Ltd** [1925] 9 TC 319). In this case, the judge argued that misappropriations of assets by persons in control of businesses are allocations of profit of the businesses not trade activities of the businesses; therefore these losses are not deductible.

5.15 Bad and doubtful debts

Businesses' bad debts of revenue nature are deductible expenses when they become bad and actually written off (Section 25(4); Section 39). Therefore, general and specific provision for bad debts is not deductible expenses. Furthermore, a bad debt arising out of business activities and its associated costs is not allowable (*Curtis v J & G Oldfield Ltd* [1925] 9 TC 319).

5.16 Contribution and donations

Contribution and donations made by taxpayers are generally not incurred wholly and exclusively for business purposes. Then generally all these expenses should not be deducted. However, contribution and donations made under Section 12 of the Education Fund Act and amount paid to local government authority, which are statutory obligations to support community development projects, are deducted 100%. Conversely, deduction of amount contributed to a charitable institution or social development project should not exceed 2% of the person's income from the business calculated without such deduction (Section 16(2)).



Definition

'Charitable organisation' means a resident entity of a public character that satisfies the following conditions:

- (i) the entity was established and functions solely as an organisation for: the relief of poverty or distress of the public, the advancement of education or the provision of general public health, education, water or road construction or maintenance; and
- (j) the entity has been issued with a ruling by the Commissioner under Section 131 currently in force stating that it is a charitable organisation or religious organisation.

Section 64(8)

Others donations and contributions can only be deducted if they are incurred wholly and exclusively for the purposes of business. For instance, contributions to trade organisations can be deductible if the trade association furthers the businesses of its members (*Lochgelly Iron and Coal Co Ltd v Crawford* [1913] 6 TC 267). Similarly, contribution to charitable organisations of clothes with businesses' advertisements or to support exhibition might qualify as deductible expenses (*Morley v Lawford* [1928] 14 TC 229). Also costs incurred on businesses entertainment for the purposes of business might be allowable expenses (*Bentleys Stokes & Lowless v Beeson* [1952] 33 TC 491).

5.17 Depreciation allowances for depreciable assets

Depreciation allowance for depreciable assets owned and employed by the person during the year of income wholly and exclusively in the production of the person's income from the business the allowances granted under the Third Schedule of the Income Tax Act 2004 is allowable expenses (Section 17); this part is covered in the next Section. So, depreciable allowance of depreciable assets basing on taxpayer's accounting policies is not deductible.



Test Yourself 3

Describe the general principle of deductions in computing business income.

6. Establish business chargeable income.

[Learning Outcome h]

By now we have learnt that not all income from business are taxable, some are final withholding payments, some are exempt income and some simply not related to business. Also we saw how to identify allowable deductions and non-deductible expenses when computing business income. This Section deals with how to establish chargeable income from business. The business income of sole trade is can be computed on cash or accrual basis unless specifically required by tax laws, while corporations compute their business income on accrual basis.



Definition

'Chargeable business income' of resident person, includes all his or her income for the year of income irrespective of the source of the income, while **chargeable income** of non-resident persons income only to the extent that the income has a source in the United Republic. Finally, **chargeable income** of a resident corporation which has perpetual unrelieved loses for the last consecutive two years is the turnover of such corporation for a year of income, except those in agriculture, health or education businesses.

Section 6

However, all business persons prepare their accounting records using General Accepted Accounting Practices (GAAPs). So for tax purposes, we do not establish new financial statements. But we adjust profit or losses shown by the accounting statements by adding items which are not taken into accounting by GAAPs and deducting items which are not allowed by tax laws but included by the GAAPs. The statement below can help us when computing taxable employment income.

Computation of chargeable business income

Items	Tshs
Profit or loss as per account	XX
Add: None allowable expenses	
Depreciation	XX
Fines and penalties	XX
Less: None business income	
Capital receipts	(XX)
Gain on disposal of fixed assets	
Add:	(XX)
Business income not included	
Compensation	XX
Less: Business expenses not deducted	(XX)
Taxable business income	



Example

Kigongo Company Limited was incorporated in Tanzania and commenced its business on 1 February 2005 as a retailer of audio-visual products in Tanzania. It has drawn up its first accounts to 31 December 2005, the draft of which together with the additional information was as follows:

	Notes	Tshs'000	Tshs'000
Sales	1	950,000	
Dividends	2	5,000	
Interest income	3	12,000	
Contractual penalties	4	5,000	972,000
Expenses:			
Directors fees	5	320,000	
Salaries		300,000	
Interest expenses	6	80,000	
Rent and rates		220,000	
Legal and professional fees	7	20,000	
Contributions to retirement fund	8	15,000	
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Travelling and entertainment		22,000	
Provisions	10	28,000	
Insurance		18,000	
Sundries	11	10,000	1,153,000
Loss for the year			(186,000)

Additional notes:

1. Sales figure includes Tshs1,000,000 for sale of furniture which was used by the company.
2. The company had bought some shares from City Stock Exchange. These were shares of Sungura Cement Company which distributed dividends during the period.
3. The Company earned Tshs8,000,000 as interest from its bank deposits and another Tshs4,000,000 from a director to whom the company had extended a personal loan. The Director used the loan to acquire a building in Kenya.
4. The amount was received as a result of a business contract which the other party breached it.
5. Directors fees were paid to the following persons:

Mr. A.	Tshs200,000,000
Mrs. A (wife of Mr. A)	Tshs50,000,000
Mr. B. (Mr. A's brother)	Tshs70,000,000
	Tshs320,000,000

6.	Interest paid to bank on overdraft	Tshs20,000,000
	Finance charge on hire purchase agreements	Tshs50,000,000
	Interest on failure to pay previous years	Tshs10,000,000
	Value added taxes	Tshs80,000,000
7.	Audit fees	Tshs10,000,000
	Legal fees for staff contracts and retirement funds	Tshs6,000,000
	Amount paid to Tender Board members to facilitate winning a bid	Tshs4,000,000
		Tshs20,000,000
8.	Employees contributions	Tshs7,500,000
	Employer's contributions	Tshs7,500,000
		Tshs15,000,000

The contributions were made to an approved retirement fund.

9. The company acquired the following assets:

On 15 February 2005 – Furniture and equipment	Tshs100,000,000
On 15 February 2005 – Computers and accessories	Tshs300,000,000
On 1 September 2005 – Motor car (station wagon)	Tshs200,000,000

The computers were acquired on hire purchase terms for 12 months. The down payment of Tshs120,000,000 was made on 15 February 2005 and the first monthly instalment of Tshs20,000,000 was due on 15 February 2005 and the first monthly instalment of Tshs20,000,000 was due on 15 March 2005. The cash price of the computers was Tshs300,000,000.

10.	Provision for debtors (specific)	Tshs11,000,000
	Provision repairs (estimated)	Tshs8,000,000
	Provision for stock obsolescence	Tshs9,000,000
		Tshs28,000,000

11. Sundries included a traffic fine of Tshs3,500,000. The balance was general consumables used by the office.

Required:

(a) Establish chargeable business income for the year 2005 after ignoring depreciation allowance.

Solution:

Building on the above arguments, the taxable loss will be Tshs19,000 from:

	Tshs '000'	Tshs '000'
Loss for the year as per account	(186000)	(186000)
Add: Non allowable expenses		
Interest on failure to pay VAT	10000	
Tender Board member payments	4000	
Employee contribution	7500	
Provisions	28000	
Traffic fines	3500	
Depreciation	120000	173000
Less: Non business income		
Sales of furniture	1000	
Dividend	5000	6000
		(19000)

Answers to Test Yourself**Answer to TY 1**

Sale figure of Tshs1,000,000 from sales of furniture is capital receipt so not included in business income. Assuming Sungura Cement Company is a resident one, the dividend income of Tshs5,000,000 will be final withholding income, besides dividend of that kind is likely to be investment income. The remaining items are chargeable business income.

Answer to TY 2

Generally, an expenditure is not deductible when it is not wholly and exclusively for business for purposes. In this question, interest for failure to pay VAT on time, amount paid to tender board members to facilitate winning a bid, employee contribution to retirement fund, depreciation, traffic fines and provisions are not deductible expenses. The rest of the expenses are wholly and exclusively for business purposes.

Note, however, that depreciation allowance computed as per third schedule is deductible expenses.

Answer to TY 3

Shortly, only expenditure incurred for sole purposes of producing business income are allowable expenses and expenditure incurred not wholly and exclusively for business purposes are not allowable unless are allowed by the tax laws.

Quick Quiz

1. In computation of income from business of resident sole traders, the following items should be included except:
 - A Sales.
 - B Service fees.
 - C Interest income.
 - D None of the above.
2. The following items are taxable business income except:
 - A Rents.
 - B Sales of capital assets.
 - C Debt recovery.
 - D All of the above.
3. Which of the following statement(s) is incorrect with reference to expenses deductions?
 - A Only those incurred wholly and exclusively for businesses purposes are deductible
 - B Depreciation allowances computed on third schedule is deductible
 - C Salaries to employees are generally deductible
 - D All of the above
4. What is incoming of assets realised by destruction by fire?
 - A Full cost of the asset destroyed
 - B Market values of the asset
 - C Net costs of the assets
 - D None of the above
5. Musa and the resident individual had the following income:
 - Business income Tshs3,000,000
 - Investment income Tshs3,000,0000
 - Business income from Kenya Tshs4,000,000
 - Employment income Tshs10,000,000

His chargeable income will be:

- A Tshs20,000,000
- B Tshs16,000,000
- C Tshs10,000,000
- D All of the above

6. Which of these statements is/are incorrect?

- A Bad debts are normally deductible expenses
- B Specific provision for bad debts are deductible expenses
- C Pension to unapproved pension funds are deductible
- D All of the above

7. Consider the following income:

- Opening stock Tshs10,000,000
- Closing stock at cost Tshs4,000,000
- Closing stock as market price Tshs3,000,000
- Purchase Tshs30,000,000

The amount of closing stock will be:

- A Tshs10,000,000
- B Tshs4,000,000
- C Tshs3,000,000
- D Tshs36,000,000

Answers to Quick Quiz

1. The correct option is **D**.

All of the items should be included as business income. However, interest paid by financial institution to a **resident individual** where the interest is paid with respect to a deposit held with the institution is final withholding payment, other than interest received by the individual in conducting a business; or foreign source interest paid to non-resident individual. So it is not known whether the interest came from business or investment.

2. The correct option is **B**.

Capital receipts are not included direct in the computation of business income rather they are used in computing gain or loss from realisation of the assets. .

3. The correct option is **A**.

Though the general rules of expenses deduction requires expenses should be wholly and exclusively incurred for businesses, but other expenses are deductible even if they are not wholly and exclusively incurred for business purposes. For example, contribution to education under Education Fund Act is deductible though not incurred wholly and exclusively for businesses purposes.

4. The correct option is **D**.

Unless the assets are insured, they owners would receive nothing when they are destroyed by fires.

5. The correct option is **A**.

Dividend income can be final withholding income but not always. Particularly, dividends paid by a resident corporation or non-resident corporation to a resident individual resulting from investment activities

6. The correct option is **B**.

Provision for bad debts not matter whether is general or not is not deductible while contribution to unapproved pension is deductible expenses when the contribution is part of employment income.

7. The correct option is **C**.

The closing stock should be valued at the lower of costs i.e. Tshs4,000,000 or market price Tshs3,000,000. The lower is the market price of Tshs3,000,000.

Self Examination Questions

Question 1

Connossa Andrew's Limited (CAL) is a manufacture of wood products, vanish, glue and wood preservatives. Its Profit and Loss Account for the year 2010 information is as follows:

CANNOSA ANDREW'S LIMITED
PROFIT & LOSS ACCOUNT FOR THE YEAR ENDED 31ST DECEMBER, 2010

	Notes	Tshs
Sales		686,678,300
Less: Cost of Sales	1	631,191,047
Gross Profit		55,487,253
Less: Operating Expenses		
Administrative Expenses	2	100,710,048
Selling Expenses	3	89,595,126
Financial charges	4	21,925,128
Audit Fees		22,718,79
Management Fees		12,000,000
		226,502,180
Operating Profit (Loss)		(171,014,927)
Other Income	5	38,004,308
		(133,010,619)
Profit (Loss) Brought Forward (Tax Adjusted)		(61,837,765)
Prior year's accounting Adjustment		(84,482,935)
Accumulated Profit (Loss) C/F		(279,331,319)

Notes:

Note 1:

- (a) Ending inventory excludes Tshs5,666,777 being loss of stock due to an employee's negligence.
(b) Cost of Sales:

The valuation of stock was based on market value. The value of ending inventory was found to exclude the goods on transit costing Tshs25,000,000, whose market value is Tshs31,191,047

Note 2: Administrative Expenses

Salaries and Wages	9,439,851
Overtime	3,111,947
Pension and NSSF	2,974,341
Leave pay and terminal Benefits	1,398,078
Sports Expenses	3,616,312
Uniforms	578,700
Travelling Expenses	4,692,221
Medical Expenses	2,037,859
Professional Expenses	2,124,837
Building Repair and Maintenance	2,501,449
Entertainment/Business promotion	14,823,312
Bad Debts provision	93,470
Hotel Accommodation and House Rent	1,778,542
Land Rent Expenses	49,398
Payroll Levy	358,630
Printing and Stationery	3,297,083
Telephone, Telex, and Postage	3,980,299
Vehicle Running Expenses	1,064,862

Insurance	1,357,553
Political parties contributions	1,007,450
Board Meeting Expenses	4,753,205
Donations and Gifts	1,972,938
Casual Wages	1,725,131
Incentives	1,473,741
Vehicles Hire Expenses	5,429,800
Workmen's compensation	38,610
Training and Recruitment	12,991,413
Fires and Penalties	23,747
Depreciation	6,019,822
Repairs and Maintenance - Furniture	1,082,322
Books and Periodicals	355,765
Electricity and Water	2,103,777
Other Expenses	197,031
Staff Meetings	94,800
Repair and Maintenance - vehicle	2,161,752
Total	100,710,048

- (a) Pension contributions include a monthly amount of Tshs150,000 being contributions for 2 employees who lost their limbs during the war between Tanzania and Uganda.
- (b) Terminal benefits include Tshs500,000 for retrenchment of two employees.
- (c) Professional Expenses include Tshs401,000 legal fees incurred on the requisition of an additional goodwill for the storage of logs Tshs3,543,123 for the acquisition of the Treasury loan, which was used by the Director to go abroad on vacation and Tshs1,232,456 for preparing revised accounts to negotiate a back duty settlement.
- (d) Business promotion includes Tshs13,520,620 incurred for the construction of a new laboratory building for experiments designed to improve the quality of the company products. The Lab was being used from 30.5.2010.
- (e) Insurance includes Tshs766,323 being a premium under a policy insuring the company against loss of profits consequent upon breakdowns of plant and machinery.
- (f) Donations include Tshs1,000,000 granted to Uyola vocational Centre.
- (g) Training and Recruitment includes Tshs12,000,000 for 3 years Master of Science Programmes for Mr Chagula an IT manager of the company. It was agreed with Mr Chagula that after completion of his course, he has to service the company for not less than 4, before he decides to quit the company.
- (h) Repair and Maintenance of motor vehicles includes Tshs2,000,000 repairs on a vehicle damaged in an accident. The company however, expects to recover the same from its insurers.

Note 3:

Selling expenses	Tshs
Motor Vehicle Expenses	15,234,311
Trading License	373,590
Office Accommodation	806,362
Export Duty	23,000
Stamp Duty	4,325,425
Salaries Wages and Incentives	11,492,524
Travelling and Hotel Expenses	1,376,488
Trade Fair Expenses	1,315,490
Advertisement and Publicity	2,328,666
Discount on Sales	22,334,014
Other Selling Expenses	18,143,332
Provision for Bad and Doubtful Debts	8,479,074
Hired Transport	3,362,850
Total	89,595,126

- (a) CAL had entered into a contract with the Precision Company Limited for the supply of ten delivery trucks. It however, decided to cancel this contract and had to pay Tshs8,326,124 as damages for the cancellation. This has been included in motor vehicle expenses.

- (b) Stamp Duty includes Tshs3,461,789 being a composition fee. The Commissioner for Customs had compounded an offence following an infringement by the company of the Customs Regulations on the importation of raw materials.
- (c) Other selling Expenses include:

Tshs6,577,000 paid to sales personnel being salaries for future services. These employees had their services terminated before these future services were rendered. The company therefore had to write off the amount. The company had to incur legal costs of Tshs627,000 in an unsuccessful attempt to recover these salaries from the employees. This amount has also been included under other selling expenses. Tshs7,800,000 being a sum paid to a retired Director in consideration of agreeing not to carry on business dealing with products manufactured by CAL. Tshs426,000 being legal costs on litigation which ensued after two customers with held payment on account of inferior workmanship.

Note 4:

Financial charges	Tshs
Interest on Treasury loan	12,556,899
Interest on overdraft	6,317,176
Bank charges	3,051,053
Total	21,925,128

- (a) The Treasury loan was for the purchase of plant and machinery
- (b) The overdraft was for the purchase of timber logs.

Note 5:

Other income	Tshs
Miscellaneous income	30,421,981
Gain (loss) on Disposal of Fixed Assets	1,171,575
Rent Received	4,170,567
Interest on loans	1,037,116
Interest on Fixed Deposit	1,203,069
Total	38,004,308

- (a) The company has contracts with a number of selling agents. One of the agents cancelled his contract during 2010 and paid CAL Tshs1,600,000 as compensation. This is included in miscellaneous income.
- (b) Also included under miscellaneous income is compensation, of Tshs25,000,000. During 2003 CAL disclosed secret processing of one of its products to BIT Company Limited which from then onwards acquired the sole right of producing and marketing that product in Tanzania. In consideration for this disclosure, CAL received the compensation.
- (c) Rent is received from a sister Company which is occupying CAL's extra factory space. Assume this is gross rent.

Interest on loans is in respect of small advances made to employees. The company has a policy of charging a token interest on such advances.

Required:

Establish the total taxable for the year of income 2007 after ignoring capital allowance.

Question 2

In year 200X, the Commissioner for Large Taxpayers received a return of income of KK Limited showing a net profit of Tshs214,136 computed after making the following deductions:

	Tshs
Sales	273,970,710
Cost of sales	150,000,355
Gross Profit	123,970,355
Operating expenses	27,000,000
Other expenses	96,756,219
Net income	214,136

Included in the other expenses item is a list of the following:

- (a) Exchange loss of Tshs42,143,000 on the importation of raw materials
- (b) Compensation to terminated employees – Tshs618,500
- (c) Amortised amount to replace a roof – Tshs4,733,000
- (d) Payments made to remove erroneous terms of a loan contract- Tshs821,000
- (e) Penalties for VAT – Tshs3,500,000
- (f) Managing Director's personal visitors entertainment expenses – Tshs3,880,000
- (g) Political parties contributions - Tshs1,007,450
- (h) Board meeting expenses – Tshs4,753,205
- (i) Incentives – Tshs1,473,741
- (j) Treasury loan used by Director to go abroad on vacation – Tshs3,543,123
- (k) Cost to prepare revised accounts – Tshs1,232,456
- (l) Construction cost of a new laboratory – Tshs13,520,620
- (m) Cancellation of contract – Tshs8,326,124
- (n) Salaries for future services – Tshs6,577,000
- (o) Legal cost for unsuccessful recovery of salaries from terminated employees – Tshs627,000

Assume you are in charge of one of the Audit Teams at the Large Taxpayers Department and the Commissioner for Large Taxpayers has assigned you the tax file of KK Limited.

Required:

Establish the taxable income of company for the year.

Question 3

Bush, Bushek and Michapo are partners in one enterprise dealing in transport business. Their business income statement for the year 2004, has the following results:

	Tshs	Tshs
Revenue	208,000,000.00	
Other income	400,000.00	
Total Income		208,400,000
Less: Operating Expenses		
Depreciation allowance	10,800,000.00	
Fuel and Oils	90,000,000.00	
Spares, repairs & maintenance	14,000,000.00	
Licenses	300,000.00	
Interest	5,600,000.00	
Salaries and wages	26,000,000.00	
Stationery	800,000.00	
Tyres and tubes	55,500,000.00	
Miscellaneous expenses	8,000,000.00	211,000,000
Net loss for the year		2,600,000

Additional information is given as follows:

- (a) The partners equally spent 10% of fuel and oils used for office vehicles for private purposes.

- (b) Analysis of salaries and wages:

- (i) Drivers Tshs7,000,000
- (ii) Office Attendant Tshs3,000,000
- (iii) Bush Tshs8,000,000
- (iv) Bushek Tshs4,000,000
- (v) Michapo Tshs4,000,000

- (c) Analysis of miscellaneous expenses:

- (i) Office cleaning Tshs350,000
- (ii) Weigh bridge fines Tshs3,500,000
- (iii) Total tax paid by partners Tshs3,300,000
- (iv) Office electricity Tshs250,000
- (v) Tip to Police to allow speeding car Tshs600,000

(d) The Partners share profits/losses equally

(e) Other Income: This represents interest on drawings paid by Michapo

(f) Interest analysis:

- (i) Interest on bank overdraft Tshs5,000,000
 (ii) Interest on loan paid to Bush Tshs600,000

(g) Bushek's personal account showed Tshs2,000,000, 3,000,000 and 5,000,000 as income received from Royalty, Dividend and Realisation respectively. A non-resident corporation paid dividend, realisation I part payment of sale of a building for Tshs20,000,000. The building that costed Tshs4,000,000 in year 2000 and used for residence was sold to Mr. John in 2004.

(h) Asset acquisition during the year were:

Land rover	Tshs10,000,000
Tractor	Tshs40,000,000
Pick up	Tshs7,500,000
Land cruiser	Tshs35,000,000

All these were used in the partnership business. The depreciation basis as at 31/12/2003 after pooling assets based on the Income Tax Act, 2004 showed the following:

Class	I	II
Value	50,000,000	123,000,000

Required:

Establish the partnership chargeable profits/losses after ignoring depreciation allowance.

Answers to Self Examination Questions

Answer to SEQ 1

	Tshs	Tshs
Losses for year as per account		(279,331,319)
Add: None allowable expenses		
Bad debt provision	93,470	
Political parties contribution	1,007,450	
Donational and gifts	1,972,938	
Fines and penalties	23,747	
Depreciation	6,019,822	
Prior year adjustment	84,482,935	
Director vacation	3,543,123	
Business promotion-laboratory	13,520,620	
Provision for bad debt	8,479,074	
Composition fees	3,461,789	122,604,968
Less: None business income		
Gain on disposal of fixed assets	1,171,575	
Miscellaneous income-secret	25,000,000	26,171,575
Less: Business expenses not deducted		
Loss of stock	5,666,777	5,666,777
Add: Business income not included		
Insurance receivable	2,000,000	
Goods on transit	25,000,000	27,000,000
Losses before deduction of charity contribution		(161,564,703)

Note:

- (a) Loss of stock are wholly and exclusively incurred in production of business income.
- (b) Exclusion of goods in transit overstates the costs of goods sold.
- (c) Good will is not a depreciable asset so its related costs can be deductible expenditure.
- (d) Deduction in respect of donation to Uyola Vocational centre is limited to 2% of the profit before its deduction, since the company had loss; the whole amount of Tshs1,000,000 is not deductible.
- (e) Motor vehicle repairs of Tshs2,000,000 is allowed in the sense that when the insurance compensation is also taxable income on accrual basis.
- (f) Compensation from copy right agreement is capital expenditure, therefore not business income.

Answer to SEQ 2

The taxable income of the company was Tshs36,975,329 as shown below:

	Tshs	Tshs
Net income as per account		214,136
Add: None allowable expenses		
Amortized roof	4,733,000	
VAT penalties	3,500,000	
Managing director' vistsors	3,880,000	
Political part contributions	1,007,450	
Treasury loan	3,543,123	
Construction of new laboratory	13,520,620	
Salaries for future services	6,577,000	36,761,193
Taxable income		36,975,329

Note:

- (a) Managing director's personal entertaining costs and treasury loan are assumed to have not been included in his/her employment income. So are not wholly and exclusively incurred for business income.
- (b) Salaries for future services are a loan though term 'salary' therefore not wholly and exclusively incurred in producing the current year income.
- (c) A construction cost of a new laboratory is capital expenditure therefore not deductible.

Answer to SEQ 3

The partnership chargeable income was Tshs46,000,000.

	Tshs'000	Tshs '000
Net loss for year as per account		2,600
Add not allowable expenses		
Fuel and oils	9,000	
Partners salaries	16,000	
Weigh bridge fines	3,500	
Depreciation	10,800	
Partners tax	3,300	
Police tips	600	
Interest loan to Bush	600	43,800
Less: Non business income		
Other income- Michapo drawing	400	400
Taxable partnership income		46,000

Note:

- (a) Salaries to partners are distribution of partnership to partners therefore not allowed.
- (b) Loan from partners to partnership is recognisable arrangement but its interest is distribution to partners (Section 48(6)).

STUDY GUIDE C3: EMPLOYMENT INCOME

Get Through Intro

Total Income includes income from employment, businesses and investment. Employment income considers all income from an employment. Specifically, this Study Guide elucidates items which are included in computation of taxable income from employment and those items which are excluded when computing an individual's employment income. Further, it deals with valuation of employment benefits in kind.

This Study Guide will enable you to establish the correct taxable employment income. Knowledge of determining employment income is essential in understanding how employees are taxed. It is also important to know this computation to avoid breaking tax laws either by failing to collect employment taxes when they are supposed to be collected or burdening employees with incorrect employment taxes. Sections from Income Tax Act 2004 are being referred to throughout this Study Guide.

Learning Outcomes

- a) Identify items included in calculation of chargeable income from employment.
- b) Identify items excluded in calculation of chargeable income from employment.
- c) Identify the allowable deductions.
- d) Describe the general principle of deductions in employment income.
- e) Establish income from employment.

1. Identify items included in calculation of chargeable income from employment.
[Learning Outcome a]

1.1 Component of employment

Employment includes in particular:

- a position of an individual in the employment of another person;
- a position of an individual as manager of an entity other than as partner of a partnership;
- a position of an individual entitling the individual to a periodic remuneration in respect of services performed; or
- a public office held by an individual, and includes past, present and prospective employment

Section 3



Definitions

'Employee' means an individual who is the subject of an employment conducted by an employer;

Section 3

'Employer' means a person who conducts, has conducted or has the prospect of conducting the employment of an individual.

Section 3

Normally, employment is demonstrated by presence of **contract of service** or employment. The **contract of service** exists when an employer dictates what an employee should do and how, in return for period payments.



Example

In a case of *Ready Mixed Concrete (South East) Ltd v Minister of Pensions and National Insurance* [1968] 2 QB 497 it was decided that contract of service might exist when:

- (i) an employee agrees that, in consideration of a wage or other remuneration, he will provide his own work and skill in the performance of some service for his master.
- (ii) He agrees, expressly or impliedly, that in the performance of that service he will be subject to the other's control in a sufficient degree to make that other master.
- (iii) The other provisions of the contract are consistent with its being a contract of service.

Control was associated with power of the employer to decide things to be done, the way in which it shall be done, the means to be employed in doing it, the time when and the place where it shall be done.

However, in the same case it was suggested that **contract for service** (sole trading or businesses) occurs when a contractor hires his own employees, provides and maintains his own tools or equipment; the contractor is paid by reference to the volume of work done; has invested in the enterprise and bore the financial risk; have the opportunities of profit or the risk of loss; and the relationship is not permanent.

Likewise, in *McManus v Griffiths* (1997) 70 TC 218 case the judge suggested in deciding whether a person was employed (**contract of service or self-employed - contract for service**) we should consider the substance of the contractual arrangements rather than their form or the parties' labels (incorporated companies).



Example

In *F S Consulting Ltd v McCaul* (2002) case it was decided that the owner of F S Consulting Ltd, Mr Frank Simpson earned income under contract of service not contract for service. Mr Simpson was a computer consultant and the sole director and shareholder of F S Consulting Ltd. During the relevant time of the contract Mr Simpson supplied his services to the F S Consulting Ltd who supplied them to an agency called Topper Recruitment Limited (Topper) who supplied them to Better Investments Plc (Better). It was disputed that Mr Simpson was **an employee** of Better Investment Plc. The judge asserted that:

- Mr Simpson did agree, in consideration of remuneration, to provide his own work and skill to Better and it was also part of the arrangements that the standard working week was 37.5 hours. Any absence of Mr Simpson had to be agreed and approved in advance by Better (although in fact there were no difficulties)
- Mr Simpson was a man of skill and experience and so it would not be expected that Better would tell him how to do his work; however, Mr Simpson was part of a team made up mainly of employees of Better and of which the project manager was an employee of Better. The project manager controlled what was to be done and when it was to be done although he left it to Mr Simpson to decide how it should be done. Also, the contract between the appellant and Topper provided that Mr Simpson had to take all necessary instructions from Better and comply with Better's rules, regulations and procedures
- In the performance of his work Mr Simpson was also subject to Better's control to the extent that the contract between the Appellant and Topper provided that it could be terminated immediately if Better terminated its agreement with Topper because of the incompetence, unsuitability or unprofessional conduct of Mr Simpson
- Mr Simpson did not hire his own employees; the members of his team were mainly permanent employees of Better and one other consultant who had entered into his own contract with Better
- Mr Simpson did not provide and maintain his own tools and equipment; he used the mainframe computer and other equipment provided by Better
- Mr Simpson was not paid by reference to the volume of work done but by reference to the number of hours he worked
- Mr Simpson did not invest in any enterprise and he did not bear any financial risk; he had no opportunity of profit and no risk of loss. All his invoices were paid
- The relationship between Mr Simpson and Better had some element of permanency as it lasted for two and a half years from December 1998 to June 2001
- While working for Better Mr Simpson only provided work for Better and for no other client. Before working for Better he worked for two other clients and since leaving Better he has worked for one other client but has never worked for more than one client at a time
- Mr Simpson was integrated into the structure of Better to the extent that he worked closely with its employees; also the project manager was an employee.

Therefore, Mr Simpson was an employee of Better.

1.2 Employment income items

Income in connection with employment income (contract of service) means:

1. Wages, salary, payment in lieu of leave, fees, commissions, bonuses, gratuity or any subsistence, travelling, entertainment or other allowance received in respect of the employment or services rendered;
2. Reimbursement by an employer of personal expenditure by the employee or an associate of an employee;
3. Payments for the employee's agreement to any conditions of the employment;
4. Retirement contributions and retirement payments paid by an employer on behalf of employees;
5. Payment for redundancy or loss or termination of employment relating to the year of payment;
6. Other payments made in respect of the employment including benefits in kind (Section 7(2)).



Test Yourself 1

Robots and Assembler Design makers employed Ms. Rachel Makona as the Company Accountant with effect from 1 January 2009. By the time the company submitted a statement of employment income for year 2010, the following information was revealed to her as her monthly emoluments:

Basic monthly salary	Tshs600,000
Transport allowance monthly	Tshs250,000
Lunch allowance monthly	Tshs150,000
Medical allowance monthly	Tshs100,000

The employer housed her for free. The market value of rental at that area was Tshs400,000 per month and the expenditure claimed by the company for that premises was Tshs150,000. The contribution made monthly by the employee was Tshs50,000 as rent. Beside the emoluments stated above, the employee had the following benefits:

- (i) Self driven car for private use, which is 3000 cc, brand new. The company claims expenditure of car maintenance.
- (ii) Loan advances of Tshs3,000,000 payable in 15 monthly instalments and free of interest. Statutory rate was 10% per annum.
- (iii) Other benefits included electricity Tshs30,000 and water Tshs25,000 per month.

The employer was contributing 15% of basic salary to the approved retirement fund, while the employee contributed 5%.

Though her employment services were terminated on 31 December 2010, the company paid her Tshs30,000,000 as termination benefits (compensation for lost employment).

Other income she received in 2010 was Tshs300,000 interest from CRDB Bank, Tshs1,500,000 – lease amount from Milk Shake Company for the building she leased to the company since 2008.

Required:

Identify items included in chargeable employment income for the year 2010.

1.3 Taxation of benefits in kind as employment income

Quantification of employment benefits in kind are dealt with in Section 27 of the Income Tax Act 2014. Generally, benefits in kind are valued on market values of the benefits, but with exception of car benefits, beneficial loans and house benefits. These three benefits have specific approaches concerning their valuations. Therefore, this Study Guide explains these approaches in detail.

1. Private uses of motor car

When an employee uses an employer's car for official purposes, it results in no taxable income. However, there is taxable benefit when the employee uses the car for private purposes, provided the employer claims maintenance and ownership allowances of the car when computing his/her taxable income (Section 7(3) (e)). In that case, the car benefit is the value given as per the table below.

As you can see, the value of car benefit depends on engine size of cars and age of the car; the age is counted from the first registration of the car in the United Republic of Tanzania.

Engine Size of Vehicle	Quantity of payment per annum	
	Vehicle less than 5 years old	Vehicle more than 5 years old
Not exceeding 1000cc	Tshs250,000	Tshs125,000
Above 1000cc but not exceeding 2000cc	Tshs500,000	Tshs250,000
Above 2000cc but not exceeding 3000cc	Tshs1,000,000	Tshs500,000
Above 3000cc	Tshs1,500,000	Tshs750,000



Tip

When examiners want to test this part the table may or may not be provided, so spending a little time memorising it may pay in the examination.



Example

Refer to the information of Test Yourself 1 of Robots and Assembler Design makers.

Required:

Establish the taxable car benefit in kind of Ms. Rachel Makona for the year 2010.

Answer

From the information available in the question, the car is brand new and operates at 3,000 cc. Therefore from the table above, the annual car benefit is calculated as Tshs1,000,000.

2. Beneficial loans

When an employer provides staff loans at lower interest rates compared to statutory rates or interest free loans; recipient employees enjoy taxable income. The taxable income is the whole of the forgone interest in the case of interest free loans and when the lower interest rate is offered the benefit would be calculated based on the relinquished part of interest rate.

However, no taxable benefit is derived when the loan made by an employer to an employee is for less than 12 months **and** the aggregate amount of the loan and any similar loans outstanding at any time during the previous 12 months do not exceed 3 times the month's basic salary (Section 27(1) (b)).



Definition

'Statutory rate' in relation to a calendar year means the prevailing discount rate determined by the Bank of Tanzania;

Section 3

In short taxation of beneficial interest one needs to know the following important aspects

- Check whether the loan made by an employer to an employee is for less than 12 months **and** the aggregate amount of the loan and any similar loans outstanding at any time during the previous 12 months do not exceed 3 times the month's basic salary. If yes, no taxable benefit arises from the loans given. Otherwise, go to the next steps.
- The loans are given to employees because they are just employees, otherwise loans provided in normal course of business at market terms are not employee beneficial loans.
- The benefit bases on the forgone interest rate which can be statutory rate when the loans concerned are interest free, otherwise the benefit is statutory rate less interest paid by employees.
- $\text{Interest} = \text{Outstanding amount} \times (\text{statutory rate} - \text{interest rate paid}) \times \text{time}/12$



Example

Refer to the information of Test Yourself 1 of Robots and Assembler Design makers.

Required:

Calculate the loan benefit of Ms. Rachel Makona for the year 2010.

Solution

The loan made by the employer to the employee is for more than 12 months (in this case 15 months term) also the aggregate amount of the loan and any similar loans outstanding at any time during the previous 12 months exceed 3 times the month's basic salary (Tshs3,000,000 is greater than 3 times basic salary i.e. Tshs600,000).

So the beneficial loan is taxable.

As the loan balance did not change, the formula of simple interest can be used to determine the forgone interest.

So Interest = Principle x time/12 x saved interest rate = Tshs3,000,000 x 12/12 x 10% = Tshs300,000

But, the actual computation of the interest can be based on average or reducing methods when the loan balance or principal keeps changing during a year because of periodic payments as the income tax laws do not specify which method should be used. These methods are discussed briefly below.

(a) Computation of interest using average method

In this method, the principal amount is taken as simple average of opening and closing balances of the staff loan. Then the taxable loan benefit is given by the product of this average value and the statutory rates after deducting any interest paid by the borrower.

**Example**

Employees of A Ltd have been entitled to 4% annual interest loans of Tshs60,000,000 since 2005. A new employee got the loan on 1 July 2013 and agreed to pay it in 60 monthly instalments starting 1 August 2013. If the employee's basic salary was Tshs2,000,000 and statutory rate for the year 2013/14 was 12%, establish the taxable employment loan benefits using average method.

This loan benefit is taxable as it has a period of more than 12 months; besides, the amount of the loan exceeds 3 times the month's basic salary.

Date		Tshs
1 July 2013	Loan given	60,000,000
30 June 2014	60,000,000-12,0000	48,000,000
		108,000,000
Average loan balance	108,000,000/2	54,000,000
Loan duration during the year 12 months		
Taxable loan benefit	54,000,000x(12%-4%)x12/12	4,320,000

(b) Reducing balance method

This method uses the actual outstanding balances over the course of the loan terms. So, it is important to find out the outstanding balance every time after making periodic payment and the length of time the balance is outstanding. The period can be in months or days as both days and months might produce comparable results. All other procedures of computing taxable loan benefit remain the same in this method.

**Example**

Continuing the above example of A Ltd

Use the same information and establish the taxable employment loan benefits using the reducing method.

Date	Amount outstanding in Tshs	Duration in months	Interest benefit in Tshs
1 March 2014	60,000,000	1/12	400,000.00
1 April 2014	59,000,000	1/12	393,333.33
1 May 2014	58,000,000	1/12	386,666.67
1 June 2014	57,000,000	1/12	380,000.00
Total interest			1,560,000.00



Test Yourself 2

Refer to the information of Test Yourself 1 of Robots and Assembler Design makers.

Required:

Establish the loan benefit of Ms. Rachel Makona for the year 2010 **using reducing balance method**.

3. Living accommodation benefit

There is taxable employment benefit when an employee lives in a subsidized house and the employee claims maintenance and ownership allowances in his/ her tax returns (Section 27(1)(c)). This valuation of taxable house benefit in kind includes any furniture or other contents provided by an employer for residential occupation by an employee during a year of income. Actually, the taxable benefit is the lower of (i) and (ii) – given below - after being reduced by any rent paid for the occupation by the employee.

- (a) the market value rental of the part of the premises occupied by the employee for the period occupied during the year of income; and
- (b) the greater of:
 - (i) 15% of the employee's total income for the year of income, calculated without accounting for the provision of the premises and, where the premises are occupied for only part of the year of income, apportioned as appropriate;
 - (ii) and expenditure claimed as a deduction by the employer in respect of the premises for the period of occupation by the employee during the year of income;



Definition

The total income of a person is the sum of the person's chargeable income for the year of income from each employment, business and investment less any reduction allowed for the year of income under Section 61 relating to retirement contributions to approved retirement funds

Section 5 (1)



Example

Hewit Ltd employed Ms Tracy Jones as the Company Accountant with effect from 1 January 2009. By the time the company submitted a statement of employment income for year 2010, the following information was revealed to her as her monthly emoluments:

Basic monthly salary	Tshs600,000
Transport allowance monthly	Tshs250,000
Lunch allowance monthly	Tshs150,000
Medical allowance monthly	Tshs100,000

The employer housed her freely. The market value of rental at that area was Tshs400,000 per month and the expenditure claimed by the company for that premise was Tshs150,000. The contribution made monthly by the employee was Tshs50,000 as rent. Beside the emoluments stated above, the employee had the following benefits.

- (i) Self driven car for private use, which is 3000 cc, brand new. The company claims expenditure of car maintenance.
- (ii) Loan advances of Tshs3,000,000 payable after 15 monthly and free of interest. Statutory rate was 10% per annum.
- (iii) Business income of Tshs1,000,000 and investment income of Tshs500,000
- (iv) Other benefits included electricity Tshs30,000 and water Tshs25,000 per month.

Continued on the next page

Workings

Establishment of total income before house benefit in kind

Items	Tshs	Tshs
Basic salary	600,000 x12	7,200,000
Transport allowance	250,000 x12	3,000,000
Lunch allowance	150,000 x 12	1,800,000
Medical allowance	100,000 x 12	1,200,000
Car benefit as above	1,000,000	1,000,000
Loan benefit as above	300,000	300,000
Electricity	30,000 x12	360,000
Water	25,000 x12	300,000
Employment income		12,760,000
Add: Business income		1,000,000
Add: Investment income		500,000
Total income		14,260,000

House benefit is the lower of:

- (a) the annual market value Tshs4,800,000
- (b) the greater of:
 - (i) 15% of Tshs14,260,000 = Tshs2,139,000
 - (ii) Tshs1,800,000.

This is reduced by monthly contribution made during the year of Tshs600,000 (Tshs50,000 x12). So the house benefit without deduction of monthly contribution was Tshs2,139,000. It is the lower of Tshs4,800,000 and Tshs2,139,000. **The ultimate house benefit was Tshs1,539,000.**

1.4 Redundancy, or loss or termination benefit paid in arrears

In accordance with Section 7(4), while calculating an individual's gains or profit from payment for redundancy or loss or termination of employment, any payment received in respect of a year of income which expired earlier than five years prior to the year of income in which it was received, or which the employment or services ceased, if earlier such payment shall, for the purposes of calculation of the tax payable thereon, should be allocated in following manner:

- the payments should be **allocated equally** between the years of income in which it is received or,
- if the employment or services ceased in an earlier year between such earlier year of income and **the five years** immediately **preceding** such earlier year of income.

Actually, each such portion, allocated to any such year of income, is deemed to be income of that year of income in addition to any other income in that period (Section 7(4)).

In short the allocation process of redundancy, or loss or termination benefit paid in arrears can be summarized into four major steps:

1. Decide the earlier period between the year of receipt, or which the employment (services) ceased.
2. Total **redundancy, or loss or termination benefits** relating to periods **earlier** than five years prior to **the earlier of** the year of receipt, or which the employment/ services ceased.
3. Divide the total above by 6, allocate the amount to **5 years** immediately preceding such earlier year of income in step a above and in that **earlier period**.



Example

Mr. Jaffer was employed by Kahama Mining Corporation Ltd since 2000. His monthly salary was Tshs960,000 per month with effect from 1st. Mr. Jaffer was also provided with free residential house accommodation by the employer and the resulting benefit was correctly determined to be Tshs200,000 per month; and employer claimed ownership allowances.

However, he was terminated on 31 December 2010 and paid a lump sum compensation of Tshs18,560,000 on termination of his contract of employment on September 2013. The amount was earned equally throughout ten years of employment.

Required:

You are required to establish his taxable income and state which year it will be taxable

Solution

- (a) The earlier period between the year of receipt i.e. 2013, or which the employment or services ceased i.e. 2010, is 2010.
- (b) Total redundancy, or loss or termination benefits relating to periods earlier than five years prior to 2010, i.e. before 2005 i.e. 2000-2004 is equal to $\text{Tshs}1,856,000 \times 5 = \text{Tshs}9,280,000$.
- (c) Divide the total above by 6, then allocate the amount to 5 years immediately preceding 2010 in step 'a' above and in 2010. That is, allocate Tshs1,546,667 to 2010, 2011, 2012, 2013, 2014, and 2015. The amount allocated will be taxed in the period allocated.
- (d) Finally, the remaining balance (from 2005 to 2010) of termination benefit will be taxed on cash basis on the date of receipt i.e. September 2013.

1.5 Taxation of employment termination benefits

Likewise taxation of employment termination benefits has three special treatments. First, when a fixed employment contract is terminated before its expiration and the affected employee gets termination benefits; taxable termination benefits should not exceed the amount which would have been received in respect of the unexpired period (Section 7(5) (a)). Also this amount is assumed to have accrued evenly in such unexpired period.

Second, when an employment contract which has unspecified term and provides for compensation on its termination, the compensation thereon is deemed to have accrued in the period immediately following such termination at a rate equal to the rate per annum of the gains or profits from such contract received immediately prior to such termination (Section 7(5)(b)).

Finally, when an employment contract is for an unspecified term and does not provide for compensation on its termination thereof, any compensation paid on the termination thereof is deemed to have accrued in the period immediately following such termination at a rate equal to the rate per annum of the gains or profits from such contract received immediately prior to such termination, but the amount so included in gains or profits must not exceed the amount of three years' remuneration at such rate (Section 7(5)(c)).



Example

Continuing the example of Mr. Jaffer

You are required to establish his taxable termination benefit and state when i.e. year it will be taxable if:

- The contract of employment was for ten years.
- The contract of employment was for unspecified term and provides for termination benefits
- The contract of employment was for unspecified term and does not provide for termination benefits.

Continued on the next page

Solution

When the contract is for specified term the taxable benefits of termination should not exceed the amount that could have been received in absence of termination of the contract in an unexpired period. In this case the amount is $(\text{Tshs}960,000 + \text{Tshs}200,000) \times 5 \text{ years} \times 12 \text{ months} = \text{Tshs}69,600,000$. So as the amount received is lower than Tshs69,600,000 the whole amount will be taxable termination benefits.

However, it should be allocated equally in the five remaining years from 2006 to 2010. So each year is allocated with Tshs3,712,000 from Tshs18,560,000/5. In case of unspecified employment contract but which provides for termination compensation benefit, the taxable benefit should not exceed annual employment income immediately before termination. As the termination happened on 31 December 2005, the annual employment income should be based on this year. So the taxable amount should not exceed Tshs13,920,000. Consequently, the taxable termination benefits were Tshs13,920,000 and deemed to have accrued in the next year; 2006.

Finally, when the contract is for an unspecified term and does not provide for termination benefits, in case termination benefit is received, the maximum taxable amount should be 3 times the annual employment income immediately before the termination. In this case it should not exceed $\text{Tshs}13,920,000 \times 3 = \text{Tshs}41,760,000$. So as this amount is higher than Tshs18,560,000, the amount received should be taxed in 2006.

2. Identify items excluded in calculation of chargeable income from employment.
[Learning Outcome b]

2.1 Excluded employment income

According to Section 7(3) of the Income Tax Act 2004, the following income earned by employees from their employments is not taxable:

- (a) exempt amounts and final withholding payments;
on-premises cafeteria services that are available on a non-discriminatory basis;
- (b) medical services, payment for medical services, and payments for insurance for medical services to the extent that the services or payments are;
 - (i) available with respect to medical treatment of the individual, spouse of the individual and up to four of their children; and
 - (ii) made available by the employer (and any associate of the employer conducting a similar or related business) on a non-discriminatory basis;
- (c) any subsistence, travelling, entertainment or other allowance that represents solely the reimbursement to the recipient of any amount expended by him wholly and exclusively in the production of his income from his employment or services rendered;
- (d) benefits derived from the use of motor vehicle where the employer does not claim any deduction or relief in relation to the ownership, maintenance or operation of the vehicle;
- (e) benefit derived from the use of residential premises by an employee of the Government or any institution whose budget is fully or substantially out of Government budget subvention;
- (f) payment providing passage of the individual, spouse of the individual and up to four of their children to or from a place of employment which correspond to the actual travelling cost where the individual is domiciled more than 20 miles from the place of employment and is recruited or engaged for employment solely in the service of the employer at the place of employment;
- (g) retirement contributions and retirement payments exempted under the Public Service Retirement Benefits Act;
- (h) payment that it is unreasonable or administratively impracticable for the employer to account for or to allocate to their recipients and;
- (i) allowance payable to an employee who offers intramural private services to patients in a public hospital; and housing allowance, transport allowance, responsibility allowance, extra duty allowance, overtime allowance, hardship allowance and honoraria payable to an employee or the Government or its institution whose budget is fully or substantially paid out of Government budget subvention.

In addition, board members sitting allowance is exempted because it is deemed as reimbursement of members' time (Income Tax Act 2004, Practice Note No. 11/2004) as well as gifts, tips, prizes, incentives and voluntary payments made to an employee **with no reference** to the employment as acknowledging faithfulness, and consistency and readiness of the employee (Income Tax Act 2004, Practice Note No. 11/2004; Ball v Johnson 1971; Cooper v Blakiston HL 1908, Calvet v Wainwright (1947).

1. Exempt income



Tip

Exempt income items are normally given in the schedules reproduced below to assist you in understanding exempt employment income, please take time to familiarize yourself with this schedule, particularly paying attention to employment income.

(Second Schedule and Section 52 and 86)

(a) The following amounts are exempt from income tax:

- (i) amounts derived by the President of the United Republic or the President of the Revolutionary Government of Zanzibar from salary, duty allowance and entertainment allowance paid or payable to the President from public funds in respect of or by virtue of the office as President;
- (ii) amounts derived by the Government (including Executive Agency established under the Executive Agencies Act, 1997) or any local authority of the United Republic or by the Revolutionary Government of Zanzibar or any local authority of Zanzibar except amounts derived from business activities that are unrelated to the functions of government;
- (iii) amounts derived by any person entitled to privileges under the Diplomatic and Consular Immunities and Privileges Act to the extent provided in that Act or in regulations made under that Act;
- (iv) amounts derived by an individual from employment in the public service of the government of a foreign country provided:
 - the individual is a resident person solely by reason of performing the employment or is a non-resident person; and
 - the amounts are payable from the public funds of the country;

(v) foreign source amounts delivered by:

- an individual who is not a citizen of the United Republic and who is referred to in paragraph (d); or
- a spouse or child of an individual referred to in subparagraph (i) where the spouse is resident in the United Republic solely by reason of accompanying the individual on the employment;

(vi) amounts derived by:

- the East Africa Development Bank;
- the Price Stabilization and Agricultural Inputs Trust;
- the Investor Compensation Fund under the Capital Markets Regulatory Authority; and
- The Bank of Tanzania.
- Dar es salaam Stock of Exchange

(vii) amounts derived during a year of income by a primary cooperative society:

- registered under the Co-operative Societies Act;
- solely engaged in activities as a primary cooperative in one of the following fields:
 - ✓ agricultural activities, including activities related to marketing and distribution;
 - ✓ construction of houses for members of the cooperative;
 - ✓ distribution trade for the benefit of the members of the cooperative;
 - ✓ savings and credit society; and whose turnover for the year of income does not exceed Tshs.50,000,000;

(viii) pensions or gratuities granted in respect of wounds or disabilities caused in war and suffered by the recipients of such pensions or gratuities;

- (ix) a scholarship or education grant payable in respect of tuition or fees for full-time instruction at an educational institution;
- (x) amounts derived by way of alimony, maintenance or child support under a judicial order or written agreement;
- (xi) amounts derived by way of gift, bequest or inheritance, except as required to be included in calculating income under Sections 7(2), 8(2) or 9(2)
- (xii) amounts derived in respect of an asset that is not a business asset, depreciable asset, investment asset or trading stock;
- (xiii) amounts derived by way of foreign living allowance by any officer of the Government that are paid from public funds and in respect of performance of the office overseas;
- (xiv) Income derived from gaming by a gaming licensee who has paid gaming tax under Gaming Act;
- (xv) income derived from investment or business conducted within the Export Processing Zone, and Special Economic Zone during initial period of ten years;
- (xvi) income derived from investments exempted under any written laws for the time being in force in Tanzania Zanzibar;
- (xvii) rental charges on aircraft lease paid to a non-resident by a person engaged in air transport business;
- (xviii) amounts derived by a crop fund established by farmers under a registered farmers cooperative society, union or association for financing crop procurement from its members;
- (xix) gratuity granted to a Member of Parliament at the end of each term; and Cap.79
- (xx) the fidelity fund established under the Capital Markets and Securities Act
- (xxi) Amounts derived from gains on realization of asset by a unit holder on redemption of a unit by a unit trust.
- (xxii) payment of withholding' tax on dividend arising from investment in the Export Processing Zone and Special Economic Zone during initial period of ten years; and
- (xxiii) payments of withholding tax on rent payable by an investor licensed under the Export Processing Zone and Special Economic Zone during initial period of ten years, provided that the rent is payable to an investor licensed under the Economic Processing Zones or the Special Economic Zones."
- (xxiv) Distributions of a resident trust or unit trust shall be exempt in the hands of the trust's beneficiaries (Section 52)
- (xxv) Rent which does not exceed Tshs500,000, received by a resident individual (the "landlord") in respect of residential premises situated in the United Republic that are leased by another individual as the residence of that other individual and the rent is not received by the landlord in conducting a business (Section 86(4)).

2. Final withholding payments



Definition

'Final withholding payments' are payments which are taxed only at the source by withholding the tax by the payers of the payments.

Section 86

These payments are normally excluded in computation of income from employment, investment or businesses. The following payments are final withholding payments as per Section 86(1):

- (a) Dividends paid by a resident corporation or non-resident corporation to a resident individual resulting from investment activities.

- (b) Interest paid by financial institution to a **resident individual** where the interest is paid with respect to a deposit held with the institution, other than interest received by the individual in conducting a business; or foreign source interest paid to non-resident individual.
- (c) Rent paid to a resident individual under a lease of land or a building and associated fittings and fixtures, other than rent received by an individual in conducting a business; or foreign source rent paid to non-resident individual.
- (d) Service fees paid to a resident person who is conducting a mining business in respect of management or technical services provided wholly and exclusively for the business by another resident persons and money transfer commission to a resident money transfer agent.
- (e) Payments made to non-resident persons other than through a domestic permanent establishment of the person that are subject to withholding taxes.
- (f) Interest paid to a unit trust.
- (g) Dividends distributed by a resident corporation not in a virtue of its ownership of redeemable shares (Section 54(1)).



Test Yourself 3

Pristine Ltd employed Ms. Rachel Makona as the company accountant with effect from 1 January 2009. By the time the company submitted a statement of employment income for year 2010, the following information was revealed to her as her monthly emoluments:

Basic monthly salary	Tshs600,000
Scholarship for full time study	Tshs250,000
Lunch allowance monthly	Tshs150,000
Medical allowance monthly	Tshs100,000

The employer housed her freely. The market value of rental at that area was shs. 400,000 per month and the expenditure claimed by the company for that premise was Tshs150,000. The contribution made monthly by the employee was Tshs50,000 as rent. Beside the emoluments stated above, the employee had the following benefits.

- (i) Self driven car for private use, which is 3000 cc, brand new. The company does not claim expenditure of car maintenance.
- (ii) Loan advances of Tshs1, 000,000 payable in 10 monthly installments and free of interest. Statutory rate was 10% per annum.
- (iii) Other benefits included electricity Tshs30,000 and water Tshs25,000 per month.

The employer was contributing 15% of basic salary to the approved retirement fund, while the employee contributed 5%.

Though her employment services were terminated on 31 December 2010, the company paid her Tshs30,000,000 as termination benefits (Compensation for lost employment).

Other income she received in 2010 was Tshs300,000 interest from CRDB Bank, Tshs1,500,000 – lease amount from Milk Shake Company for the building she leased to the company since 2008. And the medical and lunch allowances are available to all employees on non-discriminatory basis.

Required:

Identify excluded items from employment income.

3. Identify the allowable deductions.**Describe the general principle of deductions in employment income.****[Learning Outcomes c and d]**

Voluntary contribution of any amount to education establishment made under Section 12 of the Education Fund Act by an employee is deductible expenses in determining his or her taxable employment income (Section 16(3)).

In addition, employees can deduct pension contributions made by themselves or their employers on employees' behalf (or for the employees' spouses) to approved pensions. Actually the law allows deduction of pension contribution **made by the individual; or an employer of the individual** to approved pension funds **where the contribution is included** in calculating the individual's income from the employment (Section 61(1)). However, the reduction claimed by an individual for any year of income should be **the lower of the actual contribution or the statutory amount required** (Section 61(2)).

**Definition**

'Retirement contribution' means a payment made to a retirement fund for the provision or future provision of retirement payments.

Section 3**Definition**

'Retirement fund' means any entity established and maintained solely for the purposes of accepting and investing retirement contributions in order to provide retirement payments to individuals who are beneficiaries of the entity.

Section 3**Definition**

'Statutory contribution' is when the total contribution to an approved retirement fund required by statute in relation to an employee is in excess of Tshs2,400,000 per year, the amount of that obligation or in any other case, Tshs2, 400,000.

Income Tax Regulation 10**Definition**

'Approved retirement fund' means a resident retirement fund having a ruling under Section 131.

Section 3

The amounts of contributions made by employee/employer to the approved retirement funds are reduced from the gross pay when calculating the PAYE. The amount of this reduction is equal to the lower of-

- The total of the employee; or employer contributions where it is included in calculating the monthly pay made to approved retirement funds; and
- The statutory contribution to the fund.

Step to compute the deduction

Step 1: Determine the total contribution to an approved retirement fund required by statute in relation to an employee and compare with the statutory amount of Tshs2,400,000. Choose the higher value.

Step 2: In case there is no inclusion of employer's contribution in employees taxable income, an employee should either deduct his contribution or employer's contribution which is advantageous to deduct

If the employer does not include his contribution in taxable employment income, in second step just compute the deduction based on the employee's contribution

Step 3: In the final stage compare Step 1 and Step 2, and then select the lower amount as deduction for contributing to an approved pension fund



Example

Refer to the information of Test Yourself 1 of Robots and Assembler Design makers.

Required:

Establish deduction in respect of contribution to approved pension fund when:

- (a) There is no inclusion of employers' contribution in employee's taxable income
- (b) There is an inclusion of employer's contribution in employee's taxable income
- (c) The total contribution to an approved pension scheme is assumed to be Tshs.2, 600,000.

Solution

- (a) Total contributions to an approved retirement fund required by statute in relation to an employee was $\text{Tshs}20\% \times 600,000 \times 12 = \text{Tshs}1,140,000$; which is lesser than Tshs2,400,000 per year. Therefore, the statutory amount was Tshs2,400,000.

In the second step an employee should either deduct his contribution of 5% or employer's contribution of 15% of his salary. Based on the tax advantage angle, it is in his advantage to deduct employer's contribution to reduce income available to pay as you earn. In that case, the employer contributed $\text{Tshs}15\% \times 600,000 \times 12 = \text{Tshs}1,080,000$ on behalf of the employee.

In the final stage, compare Tshs2,400,000 and Tshs1,080,000, and then select the lower amount as deduction for contributing to an approved pension fund. Therefore the deduction is equal to Tshs1,080,000.

- (b) Total contribution to an approved retirement fund required by statute in relation to an employee was $\text{Tshs}20\% \times 600,000 \times 12 = \text{Tshs}1,140,000$; which is lower than Tshs2,400,000 per year. Therefore, the statutory amount was Tshs2,400,000.

Since the employer does not include his contribution in taxable employment income, in second step just compute employee's contribution that is $\text{Tshs}5\% \times 600,000 \times 12 = \text{Tshs}360,000$.

In the final stage compare Tshs2,400,000 and Tshs360,000, and then select the lower amount as deduction for contributing to an approved pension fund. Therefore the deduction is equal Tshs360,000.

- (c) Total contribution to an approved retirement fund required by statute in relation to an employee was Tshs2,600,000; which is higher than Tshs2,400,000 per year. Therefore, the statutory amount was Tshs2,600,000.

Since the employer does not include his contribution in taxable employment income, in second step just compute employee's contribution, that is $\text{Tshs}5\% \times 600,000 \times 12 = \text{Tshs}360,000$.

In the final stage compare Tshs2,600,000 and Tshs360,000, and then select the lower amount as deduction for contributing to an approved pension fund. Therefore the deduction is equal Tshs360,000.

You can see we have always chosen the actual amount contributed to approved pension regardless of whether the statute contribution exceeded Tshs2,400,000 or not.



Tip

When the question is silent about whether employer includes or does not include his contribution in computation of employment income, assume he does not. Most employers do not include their contribution to reduce tax burden of their employees as the contribution goes directly to approved fund, not to employees. Including it increases the tax burden without real increase in monetary benefits.

4. Establish chargeable income from employment.**[Learning Outcome e]**

By now we have learnt that not all incomes from employment are taxable, some are final withholding payments, some are exempt income and some simply are not related to employment. Also we saw how employment income in kind is calculated and learnt the determination of allowable deductions when computing employment income. This Learning Outcome deals with how to establish taxable income from employment. The employment income is generally computed on cash basis unless specifically required by tax laws.

**Definition**

In a '**cash basis**' income is derived or earned when payment is received or made available to the person.

Section 22(a)

'**Chargeable business income**' of resident person, includes all his or her income for the year of income irrespective of the source of the income, while **chargeable income** of non-resident persons income only to the extent that the income has a source in the United Republic.

Section 6

The statement below can help us when computing taxable employment income.

Computation of chargeable employment income

Items	Tshs
Salary	XX
Bonus	XX
Transport	XX
Meals	XX
House benefit	XX
Loans	XX
Less:	
Contribution to education fund	(XX)
Contribution to approved fund	(XX)
Taxable employment income	XXX

**Example**

Refer to the information of Test Yourself 1 of Robots and Assembler Design makers.

Required:

Establish chargeable income from employment for the year 2010.

Using the format presented earlier the total employment income was as follows:

Item	Tshs	Tshs
Basic monthly salary	600,000 x12	7,200,000
Transport allowance monthly	250,000 x 12	3,000,000
Lunch allowance monthly	150,000 x12	1,800,000
Medical allowance monthly	100,000x12	1,200,000
Car benefit	1,000,000	1,000,000
Electricity	30,000 x12	360,000
Water	25,000 x12	300,000
Loan benefit as calculated previously	300,000	300,000
Less: Contribution to approved fund by an employee as above		(360,000)
Income before house benefit		14,800,000
Add: House benefits Working 1		1,845,000
Taxable employment income		16,645,000

Continued on the next page

Working

House benefit is the lower of:

The annual market value Tshs4,800,000 (Tshs400,000 x 12 months)
the greater of:

- 15% of (Tshs14, 800,000 + Tshs1,500,000) = Tshs2,445,000
- Tshs1,800,000.

Reduced by monthly contribution made during the year of Tshs600,000 (Tshs50,000 x12). So the house benefit without deduction of monthly contribution was Tshs2,445,000, it is the lower of Tshs4,800,000 and Tshs2,445,000. The ultimate house benefit was Tshs1,845,000.

Note that interest received from CRDB bank is final withholding payment and rent on leased property was not final withholding payment as it was not a residential house of a resident individual.

Answers to Test Yourself**Answer to TY 1**

With exception of interest from CRDB Bank and rent from Milk shake company all other is employment income.

Answer to TY 2

You can use either of the methods. We use reducing balance as presented in the table below; the interest changeable income was:

Dates	Amount (A) in Tshs	Repayment	Time	Interest =A x time x saved interest
31.1.2005	3,000,000	200,000	0.08	25,000
28.2.2005	2,800,000	200,000	0.08	23,333
31.3.2005	2,600,000	200,000	0.08	21,667
30.4.2005	2,400,000	200,000	0.08	20,000
31.5.2005	2,200,000	200,000	0.08	18,333
30.6.2005	2,000,000	200,000	0.08	16,667
31.7.2005	1,800,000	200,000	0.08	15,000
31.8.2005	1,600,000	200,000	0.08	13,333
30.9.2005	1,400,000	200,000	0.08	11,667
31.10.2005	1,200,000	200,000	0.08	10,000
30.11.2005	1,000,000	200,000	0.08	8,333
31.12.2005	800,000	200,000	0.08	6,667
Total interest				190,000

Answer to TY 3

The excluded items are: scholarship income as it is exempt income, loan benefit because it does not exceed 3 times the basic salary; loan term is less than 12 months; and car benefit because the company does not claim car allowances.

Medical allowances might still be taxable though it is available to all employees on non-discriminatory basis because only medical services are exempted from tax. Likewise, meal allowances are not exempt from taxes but on-premises cafeteria services that are available on a non-discriminatory basis are exempt allowances.

Quick Quiz

1. In computation of income from employment, benefits in kind are:

- A** Generally included at their market value.
- B** Are exempted income.
- C** Are excluded income.
- D** All of the above.

2. The following items are taxable employment income except:
- A Rent paid by employer on behalf of employees.
 - B Food to all employees at a hotel.
 - C Hospital expenses refunded to an employee.
 - D None of the above.
3. Which of the following statement(s) is/are incorrect with reference to beneficial loan?
- (i) Loans provided at market terms are not taxable employment income
 - (ii) Loans provided at concession interest rates by a bank to an employer: the forgone interest is taxable employment income
 - (iii) When a loan balance does not exceed 3 times the basic salary, the interest forgone is exempted income.
- A (i) and (ii)
 - B (ii) and (iii)
 - C Only (iii)
 - D All of the above
4. Under the Income Tax Act, car benefits are valued at:
- A Full cost
 - B Market value
 - C Running and maintenance costs
 - D None of the above
5. Which of the following statements is incorrect?
- A Dividend income is final withholding income
 - B Rent income is not employment income
 - C Pension contribution to approved retirement fund is allowable employment income deductible expenses
 - D All of the above
6. Which of these statements is/are incorrect?
- (i) If employers claim deduction in respect of house ownership, the house benefit is taxable
 - (ii) If employers claim deduction in respect of car ownership, the car benefit is deductible
 - (iii) If the employers include interest received from beneficial loans in their business income, the interest forgone is exempt income.
- A Statements (i), (ii) and (iii)
 - B Statement (i)
 - C Statements (iii) and (ii)
 - D All of the above
7. Rose earned the following income in 2010:
- Basic salary Tshs10,000,000
 - Subsistence allowance on business trip Tshs4,000,000
 - Scholarship income from her employer Tshs5,000,000
 - Business income Tshs20,000,000
- The amount of employment income will be:
- A Tshs10,000,000
 - B Tshs30,000,000
 - C Tshs15,000,000
 - D Tshs19,000,000

Answers to Quick Quiz

1. The correct option is **A**.

Generally benefit in kind is valued at its open market value unless a special method is available in the Income Tax Act 2004 as the valuation of car benefit, house benefit and beneficial loans.

2. The correct option is **D**.

Rent expenses paid on behalf of employees is taxable employment income and food provided to all employees on non-discriminatory basis in a hotel not at premises and refund for medical expenses is taxable, in absence of further information about how medical care is provided by an employer.

3. The correct option is **C**.

No taxable benefit is derived when the loan made by an employer to an employee is for the less than 12 months *and* the aggregate amount of the loan and any similar loans outstanding at any time during the previous 12 months do not exceed 3 times month's basic salary (Section 27(1) (b)).

4. The correct option is **D**.

Car benefits are valued using cars' cc capacity and age as by the table given in the Income Tax Act 2004.

5. The correct option is **A**.

Dividend income can be final withholding income but not always; particularly, dividends paid by a resident corporation or non-resident corporation to a resident individual resulting from investment activities.

6. The correct option is **C**.

Taxation of beneficial loans depends on whether the loan made by an employer to an employee is for the less than 12 months *and* the aggregate amount of the loan and any similar loans outstanding at any time during the previous 12 months do not exceed 3 times month's basic salary (Section 27(1) (b)), not on whether the interest charged is included in business income.

Also the car benefit is taxable, not deductible.

7. The correct option is **A**.

Business income is not part of employment income, and scholarship income is exempt income while the subsistence amount is earned wholly and exclusive in production of employment income; therefore not taxable.

Self Examination Questions

Question 1

- (a) Mr. Boma was employed by the British Council in Dar es Salaam from 1.1.2002 to 31.12.2011. The following terms and conditions of employment were offered to him:

- (i) His gross salary per month was Tshs2,600,000.
- (ii) He was entitled to 100% gratuity on the basic salary for each successful completed year of service.
- (iii) The Council also provided Mr. Boma with the following:
 - Free use of the Council's old motor vehicle valued at Tshs10,000,000, with 2,000 cc. The Commissioner for Income Tax has accepted this valuation of the car. Mr. Boma was provided with a car for the whole year and the company claims allowance for ownership and maintenance.
 - One night-security guard for ensuring night security of the house allocated to him. The guard is on the Council's payroll at a monthly wage of Tshs50,000.
 - A residential house for the whole of the year 2011 for which he paid a token rent amounting to Tshs20,000 per month and the company does not claim capital allowance in respect of the house.
 - Mr. Boma has two children who were enrolled at the International School of Tanganyika. During the year 2011 the British Council subsidized the school fees and board expenses for the two children amounting to Tshs4,000,000 in total.

Required:

Establish the total taxable gains or profits from employment for Mr. Boma for the year of income 2011.

Question 2

Mr. Jaffer had secured a five years employment contract with Kahama Mining Corporation Ltd. His monthly salary was Tshs960,000 per month gross with effect from 1st January, 2010. Mr. Jaffer was also provided with free residential house accommodation by the employer who did not claim ownership allowance. After serving the employer for 2½ years his contract was terminated (by the employer) on 30th June, 2012 because he was suspected of being involved in illegal gold smuggling. He was paid a lump sum compensation of Tshs18,560,000 on termination of his contract of employment. His contract provided for payment of compensation on termination of employment.

Required:

Establish the taxable income of Mr. Jaffer for the year of income 2012.

Question 3

Mr. Hamnazo is a resident employee of Tatua Company Ltd from 1 January 2004. The following information relates to his affairs:

- (i) His monthly receipts include basic salary, transport, lunch and medical allowances to the tune of TAS 500,000, TAS 425,000, TAS 175,000 and TAS 50,000 respectively.
- (ii) Transport allowance of TAS 425,000 for nine people totaled TAS 3,825,000; and has been given to Mr. Hamnazo including each child and his spouse because he lives more than 45 km from the place of employment.
- (iii) Self driven car of above 3000 cc was given to him for private use. Expenditure on the car is claimed against taxable income of Tatua Company Ltd.
- (iv) Mr. Hamnazo was given an interest free loan of TAS 4,000,000 payable in two calendar years on monthly instalments (assume statutory interest rate of 15% per year).
- (v) Other per month benefits enjoyed by Mr. Hamnazo includes electricity and water amounting to TAS 300,000 and TAS 240,000 respectively.

Required:

Establish the monthly taxable income for Mr. Hamnazo for the first month of 2004.

Answers to Self Examination Questions**Answer to SEQ 1**

Items	Tshs
Gross salary	31,200,000
Gratuity	2,600,000
Security guard	600,000
School subsidized	4,000,000
Total employment income	38,400,000

Note:

Housing benefits and car benefits are excluded because the company does not claim ownership allowance.

Answer to SEQ 2

Since the contract term was 5 years and Mr Jaffer was employed for only 2 1/2 , the unexpired contract period was 2 ½ , which equals to 30 months. So Tshs960,000 x30= Tshs28,800,000 could had been earned from the contract if the contract was not terminated.

Since the amount received i.e. Tshs18,560,000 is lesser than that could have been received i.e. Tshs28,800,000; the whole amount received should be apportioned evenly over the unexpired period of 30 months.

Therefore, every month will be allocated Tshs618,667, and Tshs3,712,000 (Tshs618,667 x 6 months) would be taxable for the year ending 31 December 2012,

Hence, the taxable income for the year is Tshs11,520,000 plus Tshs3,712, 000= Tshs15,232,000

Answer to SEQ 3

Items	Tshs
Salary	500,000
Transport	425,000
Lunch	175,000
Medical	50,000
Transport for nine people	425,000
Car benefit	83,333.3
Loan (PRT) for January	50,000.0
Electricity	300,000
Water	240,000
Total monthly income	2,248,333

Note:

- (i) The transport allowance of Tshs425,000 amounted to commuting costs which are not wholly and exclusively earned for generating employment income. The law exempt payment providing passage of the individual, spouse of the individual and up to four of their children to or from a place of employment which correspond to the actual travelling cost where the individual is domiciled more than 20 miles from the place of employment and is recruited or engaged for employment solely in the service of the employer at the place of employment.
- (ii) The loan benefit has been calculated based on the original value i.e. TSH 4,000,000 because in January no repayment is done until 31 January.
- (iii) The self-driven car is assumed to be new.

STUDY GUIDE C4: INVESTMENT INCOME

Get Through Intro

Investment income comes from holding an asset for a certain period in anticipation of getting periodic income /and or getting capital gain from its realisations. It is very closely related to business activities, but it differs in two aspects: it is just a minor undertaking of a person and there is no close link to business activities. This Study Guide is specifically aimed at elucidating items which are included in computation of investment income and those items which are excluded when computing investment income.

In doing so, it covers sections in the Income Tax Act to enable you to establish correct taxable investment income. Sections from Income Tax Act 2004 are being referred to throughout this Study Guide. Knowledge of determining investment income is essential in understanding how investors are taxed.

Learning Outcomes

- a) Identify items included in calculation of chargeable income from investment.
- b) Identify items excluded in calculation of chargeable income from investment.
- c) Identify the allowable deductions.
- d) Identify the non-allowable deductions.
- e) Establish investment chargeable income.

1. Identify items included in calculation of chargeable income from investment.**[Learning Outcome a]****1.1 Investment activities**

Income from investment activities is also taxable income. It is important to differentiate when someone is doing business or investment because of difference in tax rates. Unlike a business person who expects benefiting from regular or many frequent transactions, someone making an investment normally takes a long term view of his/her activities. For example, shareholders of a corporate might hold shares for expectation of getting periodic dividends and long term capital gains after disposing of the shares. However, share brokers in most cases buy shares in order to profit from short term rises or falls in share prices. So if the share brokers get dividends or capital gain from realisation of shares, these incomes are more likely to be business incomes than investment income.

Furthermore, another important distinction between business and investment activities is that business activities are normally the major occupations of a person while investment activities are subsidiary ones. Take an example of interest income; the interest income received by an individual from a saving or fixed deposit account might be investment income, while, the interest income received by financial institutions or money lenders is definitely business income. Likewise, rent income received by property management company is business income, the same income received by a trading company owning a few properties may be investment income.

Finally, it is important too to look at the substance of the income, not the form of it. For instance, interest received from the business accounts is business income not investment income. Also income from short term investments using business funds are business income not investment income as income from letting extra business space.

**Definition**

'Investment' means the owning of one or more assets of a similar nature or that are used in an integrated fashion, on similar terms and subject to similar conditions, including as to location and includes a past, present and prospective investment, but does not include a business, employment and the owning of assets, other than investment assets, for personal use by the owner.

Section 3**1.2 Investment income items**

According to Section 9 (1) of the Income Tax Act 2004, the following items are investment income.

- Dividend
- Distribution of a trust
- Gains of an insured from life insurance
- Gains from an interest in an unapproved retirement fund
- Interest
- Natural resource payment
- Rent
- Royalty
- Net gains from the realisation of investment assets of the investment
- Amounts derived as consideration for accepting a restriction on the capacity to conduct the investment

**Definition**

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

Section 3



Definitions

'Royalty' means any payment made by the lessee under a lease of an intangible asset and includes payments for:

- (a) the use of, or the right to use, a copyright, patent, design, model, plan, secret formula or process or trademark;
- (b) the supply of know-how including information concerning industrial, commercial or scientific equipment or experience;
- (c) the use of, or right to use, a cinematography film, videotape, sound recording or any other like medium;
- (d) the use of, or right to use, industrial, commercial or scientific equipment;
- (e) the supply of assistance ancillary to a matter referred to in paragraphs (a) to (d); or
- (f) a total or partial forbearance with respect to a matter referred to in paragraphs (a) to (e), but excludes a natural resource payment.

Section 3

'Natural resource' means minerals, petroleum, water or any other non-living or living resource that may be taken from land or the sea.

Section 3

'Natural resource payment' means any payment, including a premium or like amount, for the right to take natural resources from land or the sea or calculated in whole or part by reference to the quantity or value of natural resources taken from land or the sea.

Section 3

'Interest' means a payment for the use of money and includes a payment made or accrued under a debt obligation that is not a repayment of capital, any gain realised by way of a discount, premium, swap payment or similar payment.

Section 3

1. Net gain from realisation of investment assets



Definition

'Investment asset' means shares and securities in a corporation, a beneficial interest in a non-resident trust and an interest in land and buildings but does not include:

- (a) business assets, depreciable assets and trading stock;
- (b) a private residence of an individual that has been owned continuously for three years or more and lived in by the individual continuously or intermittently for a total of three years or more, other than a private residence that is realised for a gain in excess of 15,000,000 shillings;
- (c) an interest in land held by an individual that has a market value of less than 10,000,000 shillings at the time it is realised and that has been used for agricultural purposes for at least two of the three years prior to realisation; and
- (d) shares or securities listed on the Dar es Salaam Stock Exchange that are owned by a resident person or a non-resident person who either alone or with other associate controls less than 25% of the controlling shares of the issuer company.

Section 3

As we saw in the Study Guide on business income, there is taxable capital gain when costs of investment asset are lower than the incomings from its realisation. However, it is not individual investment asset gains which are included in the computation of investment income but net gain from realising investment assets.

The net gain from realisation of investment assets is calculated as follows:

- (a) Total of all gains from the realisation of investment assets during the year
- (b) Less
 - (i) Total of all losses from the realisation of investment assets of the investment during the year;
 - (ii) Any unrelieved net loss of any other investment of the person for the year.
 - (iii) Any unrelieved net loss of an investment for a previous year of income (Section 36(3)).



Definition

'Unrelieved net loss' of an investment for a year of income is the excess of losses over gains from the realisation of investment assets of the investment during the year of income.

Section 36(6)

However, capital loss from foreign sources can only be netted off with capital gain from foreign sources (Section 36(4)). Also, capital losses from realisation of investment assets should only be used to reduce capital gain from investment of assets. Also investment loss can be used against investment income.

So in case where there is no capital gain, foreign capital gain, investment income in whatever situation, the capital losses or investment losses should be brought forward. But, where the ownership structure of an entity changes by more than 50% in comparison with the structure of the entity three years ago, the business' loss is not deductible; if after the changes the entity changes its investment it had been carrying 1 year before the changes within two years after the change (Section 56(2)).



Example

Robots and Assembler Design makers Ltd acquired properties for Tshs50,000,000 in 2010. They also paid for legal charges amounting to Tshs5,000,000 on the date of acquisition. The properties had been let out to resident individuals who pay Tshs20,000,000 as rent every year. However, the company incurred Tshs5,000,000 and Tshs100,000 per annum for major and minor maintenance respectively.

Required:

If the properties are investment assets, and were sold on 31 December 2013 for Tshs100,000,000 after incurring selling cost of 2% of the proceeds, compute the capital gain or loss from realisation of the assets.

The capital gain is Tshs38,000,000

	Tshs	Tshs
Proceeds of sales		100,000,000
Less: Expenses		
Cost of acquisition	50,000,000	
Major repairs	5,000,000	
Legal charges	5,000,000	
Selling costs	2,000,000	62,000,000
Capital gain		38,000,000



Example

Continuing the examples of Robots and Assembler Design makers Ltd

Required:

If the properties are investment assets, and were sold on 31 December 2013 for Tshs40,000,000 after incurred selling cost of 2% of the proceeds, compute the capital gain or loss from realisation of the assets.

The unrelieved loss is Tshs20,800,000 which will be carried forward.

Continued on the next page

	Tshs	Tshs
Proceeds of sales		40,000,000
Less: Expenses		
Cost of acquisition	50,000,000	
Major repairs	5,000,000	
Legal charges	5,000,000	
Selling costs	800,000	60,800,000
Capital gain		(20,800,000)



Example

Continuing the examples of Robots and Assembler Design makers Ltd

Required:

If the properties are investment assets, and were sold on 31 December 2013 for Tshs100,000,000 after incurred selling cost of 2% of the proceeds, compute the capital gain or loss from realisation of the assets if the company had unrelieved loss of Tshs20,800,000.

Answer

	Tshs	Tshs
Proceeds of sales		100,000,000
Less: Expenses		
Cost of acquisition	50,000,000	
Major repairs	5,000,000	
Unrelieved loss	20,800,000	
Legal charges	5,000,000	
Selling costs	2,000,000	82,800,000
Capital gain		17,200,000

The capital gain is Tshs17,200,000



Example

Smith Ltd disposed of an investment asset for Tshs2,000,000 which had a cost of Tshs1,000,000 and net costs before disposal of Tshs100,000. The person incurred selling costs of Tshs800,000 and transport expenses of 100,000.

Required:

Determine gain or loss from the realisation of the assets.

Answer

Gain or loss on realisation of assets= Incomings less cost of the assets less realisation expenses. Therefore, Gain on realisation = Tshs2,000,000 – Tshs800,000 – Tshs100,000 - Tshs1,000,000= Tshs100,000.

**Test Yourself 1**

Magic Company Limited is a newly formed company carrying out agricultural production. During the first year of its operations in 200X, it purchased the following depreciable assets:

- (i) Computers and data handling equipment, which were used by the company secretary and the accounts department; 2 computers, purchased at Tshs900,000 each.
- (ii) Three 25 seater minibuses which were used to shuttle staff were purchased, each at Tshs15,000,000; and two more 50 seater buses were added during the year at a value of Tshs80,000,000 in total.
- (iii) 2 bulldozers each costing Tshs10,000,000; one second hand Dustan pickup for Tshs5,000,000; one brand new saloon car for Tshs18,000,000; furniture and fittings costing in total Tshs7,500,000 were acquired during the same year of business.
- (iv) The company also purchased two lawn mowers, which were used in keeping the surroundings clean at Tshs450,000 each.
- (v) During the year, the following agricultural equipment, which arrived at Mtwara port, were cleared immediately and transported to Songea to commence farming work.
 - One CAT Comatus Caterpillar Tshs40,000,000; 5 Fuso tractors @ Tshs12,000,000 each.
 - Harrows and one planter all costing Tshs6,00,000; three heavy-duty Isuzu trucks costing Tshs180,000,000 in total
 - A grain storage warehouse and rice milling building were constructed and completed at a cost of Tshs5,000,000 and Tshs2,000,000 respectively and were put into use on 15 May, 200X.
 - One helicopter for taking tourists to the top of Mountain Kilimanjaro was purchased for Tshs40,000,000
 - The adjusted income from business without depreciation allowance for Magic Company Limited for year 200X was Tshs253,206,180.

During the year, Magic Company Limited also conducted the following transactions:

- (i) Received dividend from TTT Limited, a resident corporation, amounting to Tshs5,500,000. Magic Limited owns 45% of the shares of TTT Limited.
- (ii) Dividends amounting to Tshs2,500,000 were received from HP Williamson Limited, which is listed on the DSE, and is owned 20% by TIKa Limited, a non-resident company.
- (iii) Dividends amounting to Tshs1,550,000 received from Chuwa Company Limited, a resident corporation.
- (iv) Magic Company Limited has its office on Ali Hassan Mwinyi Road; the office was underutilized. The company decided to rent the front part of its office to Juma Bakari, a businessman, who used it as a shop. Mr. Bakari paid Tshs800,000 as rent.
- (v) During the year the company received Tshs300,000 as rent from Mr. Chagula, a Tanzanian, with respect of a house occupied by Mr. Chagula situated at Mabibo – Dar es Salaam.
- (vi) Also the company received a royalty from Mazimbu Limited amounting to Tshs4,500,000 out of lease of videotapes used for promotion.
- (vii) During the year, Magic Company Limited sold 5 hectares of land, which was at Mikocheni and received Tshs20,000,000. This land was purchased for Tshs3,000,000 in 1980. 3 years prior to its sale, this land had been used as agricultural land.

Required:

Identify items included in investment income for the year 200X.

2. Identify items excluded in calculation of chargeable income from investment.**[Learning Outcome b]****2.1 Excluded investment income**

According to Section 8(3) of the Income Tax Act 2004, exempt investment income, final withholding payments and non-investment income should be excluded in computing investment income.

**Tip**

Both exempt income and final withholding income items have already been covered under Study Guide C3. Please take time to peruse them. In addition, receipt from realisation of capital assets should be excluded as well because they are used in computing gain from realisation of investment income assets.

**Test Yourself 2**

Refer to Test Yourself 1 for the information

Required:

Identify items excluded in chargeable investment income for the year 200X.

3. Identify the allowable deductions.**Identify the non-allowable deductions.****[Learning Outcomes c and d]****Allowable deductions**

As it was for business income, taxable investment income is established after deducting allowable deductions. Almost all the criteria for allowing or not allowing expenses we saw in business income apply here as well. In short, only expenses incurred 'wholly and exclusively' in the production of business income are allowable expenses (Section 11(3)). Therefore, only expenditure incurred for sole purposes of producing investment income are allowable expenses and expenditure incurred not wholly and exclusively for business purposes is not allowable.

Non-allowable deductions

Likewise, deduction of capital, consumption and excluded expenditures are not allowed (Section 11). Also, unlike business persons who are allowed to deduct depreciation annual allowance under the third schedule of Income Tax Act 2004, investors cannot claim depreciation charges on their investment assets. Therefore, depreciation charges of investment assets calculated under taxpayers' accounting policies are not allowed too.

**Test Yourself 3**

Continuing the example of Robots and Assembler Design makers Ltd

Required:

If the properties are investment assets, and were sold on 31 December 2013 for Tshs100,000,000 after incurring selling cost of 2% of the proceeds, establish the investment income for the year ending 2013 if the company had unrelieved loss of Tshs20,800,000.

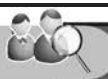
4. Establish investment chargeable income.**[Learning Outcome e]**

By now we have learnt that not all income from investment are taxable, some are final withholding payments, some are exempt income and some are simply not related to investment. Also we saw how to identify allowable deductions and non-deductible expenses when computing investment income.

This section deals with how to establish chargeable income from investment activities. The investment income of a sole trader can be computed on cash or accrual basis unless specifically required by tax laws, while corporations compute their investment income on accrual basis.

**Definition**

'**Chargeable investment income**' of resident person, includes all his or her income for the year of income irrespective of the source of the income, while **chargeable income** of non-resident persons income only to the extent that the income has a source in the United Republic. Finally, **chargeable income** of a resident corporation which has perpetual unrelieved losses for the last consecutive two years is the turnover of such corporation for a year of income, except those in agriculture, health or education businesses.

Section 6**Example**

Refer to Test Yourself 1 for the information

Required:

Establish chargeable investment income for the year 200X.

Answer

The taxable investment income will be Tshs21,800,000 from:

	Tshs '000	Tshs '000
Royalty	4,500,000	
Rent from Mr Chagula	300,000	4,800,000
Capital gain from selling land		
Proceeds	20,000,000	
Less: Costs	3,000,000	17,000,000
Investment income		21,800,000

Answers to Test Yourself**Answer to TY 1**

Dividends, royalty, capital gain from sale of land and rent from Mr Chagula received by the company are generally investment income. However, rent received from Juma Bakari has close association with the company office so it is correct to classify it as business income.

Answer to TY 2

- Dividend received from TTT Limited is final withholding payments
- Dividend from HP Williamson Limited can be either exempt income if Magic Company Limited owns less than 25% of HP Williamson Limited's shares because HP Williamson Limited is listed on Da es salaam Stock Exchange; or the dividend can be final withholding payment if the previous condition does not hold
- Dividend from Chuwa Company Limited is final withholding payments

- However, only an interest in land held by an individual that has a market value of less than 10,000,000 shillings at the time it is realised and that has been used for agricultural purposes for at least two of the three years prior to realisation is exempt assets. So capital gain from realisation of land at Mikocheni is taxable investment income because it was earned by the corporation and its market value exceeded Tshs10,000,000.

Answer to TY 3

The investment income is Tshs36,200,000

	Tshs	Tshs
Proceeds of sales		100,000,000
Less: Expenses		
Cost of acquisition	50,000,000	
Major repairs	5,000,000	
Unrelieved loss	20,800,000	
Legal charges	5,000,000	
Selling costs	2,000,000	82,800,000
Capital gain		17,200,000
Other Investment income		
Annual rents		20,000,000.00
Less: minor repairs		1,000,000.00
		19,000,000.00
Total investment income		36,200,000.00

Self Examination Questions

Question 1

In computation of income from business of resident individual, the following items should be included except:

- A Sales.
- B Service fees.
- C Interest income
- D None of the above

Question 2

The following items might be taxable investment income except:

- A Rents.
- B Dividends.
- C Debts recovery
- D All of the above

Question 3

Which of the following statement(s) is incorrect with reference to expense deductions?

- A Mainly those incurred wholly and exclusively for investment purposes are deductible
- B Depreciation allowances computed on third schedule is deductible
- C Salaries to employees are generally deductible
- D All of the above

Question 4

What is the value of incomings of investment assets realised by transfer to spouse on divorce agreement?

- A Full cost of the asset realised
- B Market values of the asset
- C Net costs of the assets
- D None of the above

Question 5

Musa and the non-resident individual had the following income:

- Interest income Tshs3,000,000
- Dividend income from resident corporation Tshs3,000,000
- Sales of private furniture Tshs4,000,000
- Employment income Tshs10,000,000

His chargeable investment income will be:

- A Tshs20,000,000
- B Tshs16,000,000
- C Tshs10,000,000
- D Tshs3,000,000

Question 6

Which of these statements is/are incorrect concerning the investment income of an exempt controlled resident entity?

- A Revenue expenses are normally deductible expenses
- B Salary expenses are deductible expenses
- C All interest expenses incurred wholly and exclusively for production of investment income are deductible
- D All of the above

Question 7

Consider the following information:

- Capital gain from realization of investment assets Tshs10,000,000
- Capital losses from realisation of investment assets Tshs4,000,000
- Other investment income Tshs3,000,000
- Business income Tshs30,000,000

The amount of chargeable investment income will be:

- A Tshs6,000,000
- B Tshs3,000,000
- C Tshs9,000,000
- D Tshs39,000,000

Answers to Self Examination Questions**Answer to SEQ 1**

The correct option is **D**.

All of the items should not be included as investment income. Because, interest paid by financial institution to a **resident individual** where the interest is paid with respect to a deposit held with the institution is final withholding payment, and sales and services are all business income.

Answer to SEQ 2

The correct option is **D**.

Interests, dividends and debts recovered can be taxable investment income when they are not specifically exempted.

Answer to SEQ 3

The correct option is **B**.

No depreciation charge allowances are available to investment assets apparently, because the investment assets are deemed to appreciate in value instead of depreciating. So, any depreciation charged in respect of depreciable assets is not deductible expenses.

Answer to SEQ 4

The correct option is **C**.

When there is transfer of assets to spouse or former spouse because of divorce settlement or bona fide separation agreement, an individual transferring the assets is treated as deriving an amount in respect of the realisation equal to the net cost of the asset immediately before the realisation; and the spouse or former spouse receiving the assets is treated as incurring expenditure of the same amount in acquiring the assets (Section 43).

Answer to SEQ 5

The correct option is **D**.

Only interest paid by financial institution to a **resident individual** where the interest is paid with respect to a deposit held with the institution, other than interest received by the individual in conducting a business; or foreign source interest paid to non-resident individual is final withholding payment.

Also dividends distributed by a resident corporation not by virtue of its ownership of redeemable shares are final withholding payments. On the other hand, employment and business income is not investment income, so only interest received by non-resident individual is taxable in this situation.

Answer to SEQ 6

The correct option is **C**.

Interest expenses incurred wholly and exclusively for production of investment income of an exempt-controlled resident entity must not exceed the sum of interest equivalent to the debt-to-equity ratio of 7 to 3.

Answer to SEQ 7

The correct option is **C**.

The chargeable investment income is Tshs9,000,000 from Tshs10,000,000 - Tshs4,000,000 + Tshs3,000,000. Business income is not part of investment income.

STUDY GUIDE D1: AN OVERVIEW OF THE VAT SYSTEM

■ Get Through Intro

Value Added Tax (VAT) is one of the most important sources of government revenue in Tanzania. So, proper understanding and implementation of the VAT laws is paramount.

In this Study Guide, the characteristics and historical background of VAT are introduced. Furthermore, the concept of supply, consideration for supply, type of supplies, scope of VAT and VAT regulations and deregistration rules are explained. Throughout this Study Guide, reference of sections is being made to Value Added Tax Act 1997, unless stated otherwise.

Knowledge of supply, type of supplies, composite and multiple supplies, registration and deregistration rules are important in computation of correct input and output taxes and therefore VAT liabilities.

■ Learning Outcomes

- a) Explain the nature and characteristics of Value Added Tax (VAT).
- b) Describe the Tanzanian VAT System.
- c) Provide historical background of VAT.
- d) Explain the concept of consideration for supply.
- e) Describe supply made within the scope of VAT.
- f) Distinguish between composite and multiple supplies.
- g) Describe the scope and coverage of VAT.
- h) Apply the Registration and deregistration rules.

1. Explain the nature and characteristics of Value Added Tax (VAT).**Describe the Tanzania VAT system.****[Learning Outcomes a and b]****1.1 Nature of Value Added Tax (VAT)**

The nature of Value Added Tax (VAT) is such that it follows supply chains of taxable goods and services. This nature means each party in a supply chain of taxable goods or services pays VAT on his/her purchases; and when the person is a taxable person, collects VAT on his/her taxable sales. These taxable sales include sales and purchases of most goods and services.

For instance, a supply chain of mobile phones might include wholesaler importers, other wholesalers who buy from the importers, retailers and finally, the final users. At the stage of importation, the importers pay VAT on imported mobile phones; the VAT is known as input tax as part of customs taxes. But, upon selling the mobile phones to other wholesaler's importers charges VAT on sales known as output taxes. The output taxes collected by the wholesaler importers are the input taxes paid by the other wholesalers. However, the other wholesalers charge VAT when selling the mobiles to the retailers, who also collect output taxes from the final users.

By its nature every taxable person in the chain of supply is required personally to remit the value added taxes liability in a particular month to a revenue authority. The amount paid to the authority is the difference between output tax and input tax in that month.

Alternatively, the amount can be computed by applying the VAT rate on the difference between **the selling price before VAT and purchase price before VAT**. Nevertheless, the total VAT paid by all taxable persons in the chain of supply is equal to the input taxes paid by the final users or the output taxes collected by the retailers. Consequently, VAT is a tax on consumption as it is borne by the final users of taxable goods and services.

1.2 VAT system in Tanzania

Tanzania VAT system is also a consumption type, taxing all taxable transactions whether involving capital or revenue expenditures. It follows the same nature of the VAT system described above. Consumption tax system encourages investment as input taxes incurred on purchase of capital goods are deductible in computation of value added tax liabilities.

Meanwhile, the consumption encourages saving and penalizes consumption, particularly consumption of taxable goods and services. Another important part of Tanzania VAT system is tax rates. According to the system, taxable goods can be taxed either at standard rate i.e. 18%, zero rate i.e. 0% or at a reduced rate; 55% of 18% i.e. 9.9%.

Probably, the three VAT rates are easier to implement. Moreover, Tanzanian VAT system requires taxpayers to self-assess their tax liabilities each month and simultaneously file VAT returns and pay any owned VAT liabilities. Finally, the system also does not tax every transaction as only taxable supply of goods and services in Tanzania Mainland are taxable. Other goods are either exempted from VAT or outside the scope of VAT.

**Definitions**

'Taxable persons' are traders either individuals, partnerships, corporations or branches registered to collect and pay VAT to Tanzania Revenue Authority

Section 9

A **'taxable supply'** is everything which is not exempt or outside the scope of VAT.

Section 5

'Input tax' is taxes paid by taxable person when buying taxable goods and services from other taxable persons

Section 16

'Output tax' is taxes collected by taxable persons when selling taxable goods and services or **'output tax'** means the tax chargeable on a taxable supply

Section 3



Example

Consider the following table with missing values. The table traces a supply chain of tobacco products from farmers in Tabora to retailers of cigarettes in Mwanza.

Suppliers/Buyers	Purchase or production costs- without VAT	Selling price Without VAT	VAT liabilities (Output less input)
	Tshs million	Tshs million	Tshs million
Farmers	200	200	0
Manufacturers	200	600	108
Wholesalers	600	a	108
Retailers	b	1,500	c
Smokers	d	e	f

- (i) The farmers are to be exempted from VAT as unprocessed tobacco is exempt supply; so no VAT liabilities.
- (ii) The manufacturers pay no input taxes to farmers but finished goods i.e. cigarettes are taxable supplies hence they collect output taxes of Tshs600 million $\times$ 18% = Tshs108 million
- (iii) The wholesalers of the cigarettes pay input taxes of Tshs108m to the manufacturer. If they paid Tshs108 million to TRA, from **VAT liabilities = output taxes less input taxes**, their output taxes would be Tshs216 million so their selling price without VAT 'a' would be Tshs1,200 million (calculated as $\text{Tshs216 million} / 18\%$).
- (iv) The selling price of wholesalers are the purchase prices of retailers so 'b' is Tshs1,200 million
- (v) The output taxes of retailers is Tshs270 million (calculated as $\text{Tshs1,500} / 18\%$) while its input taxes is Tshs216, therefore 'c' is Tshs54 million (Tshs270 million – Tshs216 million).
- (vi) The purchase price of smokers is Tshs1,500 million i.e. 'd'. The smokers do not sell the cigarettes to anyone else, so no VAT liability i.e. 'e' and no VAT liabilities i.e. 'f' as they are not taxable persons.
- (vii) But, the VAT paid by smokers to retailers i.e. Tshs270m is equal to taxes paid by others in the supply chains i.e. Tshs108 million + Tshs108 million + Tshs54 million = Tshs270 million.

2. Provide historical background of VAT.

[Learning Outcome c]

VAT was first introduced in France by Director of the France Tax Authority in 1954 to replace sales taxes. As VAT, sale taxes were intended to be charged to final consumers, but buyers were asked whether they were final consumers or not. So once you could prove that you were not intending to consume the products you could easily avoid sales taxes.

Unlike sales taxes, VAT requires sellers to collect output taxes of their sales of taxable goods and services without asking buyers about their intention of use of their purchase, and sellers deduct their input taxes from the output taxes. This requirement may encourage taxable suppliers to collect output taxes and remove the need of asking whether buyers are final consumers or not as all buyers would pay full price including VAT, irrespective of their position in the value chain. But, final consumers would not recover the taxes but others would recover them in the normal process of accounting for VAT. However, even without collecting output taxes, a taxable person can claim the input taxes paid when purchasing taxable goods and services.

Additionally, a government incurs partial loss in case one person in the chain evades taxes, while in sale taxes the government gets 100% when a retailer evades taxes. For example, suppose total VAT on taxable goods was Tshs1000 of which Tshs500 was paid by a wholesaler and 500 by a retailer. Assuming that the wholesaler evades paying the taxes but the retailer did not; the government would lose only Tshs500, as it could collect Tshs500 from the retailer. Finally, at the introduction of the VAT, VAT tax rates were few which made the tax simpler than sales taxes. In short, VAT introduction ensured high tax revenue for the France government.

Over several years, several governments adopted the VAT system including European Union, UK, Uganda, and Tanzania. In Tanzania, VAT was adopted in 1998 as part of tax reforms. As it was in France, it replaced the Sales Tax Act, 1976 (Section 72(1)) and hotel levies, entertainment tax and stamp duties for taxable persons (Section 73, 74 and 75). On its inception VAT rates were standard rated of 20% and zero rated, but some goods and services were exempted. But, in 2009 the standard rate was reduced to 18% and in 2012 a new rate of 55% of 18% was introduced to some supplies made to some persons with special relief.



Test Yourself 1

Discuss the benefits of VAT over sales taxes.

3. Explain the concept of consideration for supply. Describe supply made within the scope of VAT.

[Learning Outcomes d and e]



Definitions

'A **consideration**' is anything given for a supply. Furthermore, when the consideration excludes value added tax is called taxable value

VAT Act 1997, Section 13

A '**supply**' can be defined as something, goods or services available for another person either for consideration or otherwise.

3.1 Consideration and taxable value of local supplies

Supplies made within the scope of VAT not only include sales of goods and services but also gifts of goods or services, loans of goods, leasing or letting of goods, appropriation of goods for personal use or otherwise in the furtherance of businesses (Section 5). The consideration of supply affects the value of value added taxes as it is the value where the VAT rates are applied to get the taxes. It can include money or goods which themselves may be supplies.

In case of whole monetary payment the consideration for a supply is the amount paid which includes VAT, but the **taxable value** on the supply excludes VAT paid (Section 13(1)(a)). When non-monetary payments e.g. barter trade is made the consideration of supplies is the open market value (excluding VAT) of the goods given for the supplies (Section 13(1) (b)).



Definition

An '**open market**' value of supply is the value which such goods or services would fetch in the ordinary course of business between the supplier and recipient or any other person concerned in the transaction completely independent of each.

Section 13

The open market value assumes that the recipient pays freight, insurance, and other costs related to the goods for transporting to the buyer; the seller pays all other taxes except VAT; and the payment covers rights to use the goods or services so the buyer is not subject to patent right infringements.

In accordance with Section 13(3), a supply in the open market between a supplier and a recipient independent of each other pre-supposes that:

- (a) the value is the sole consideration; and
- (b) the value is not influenced by any commercial, financial or other relationship, whether by contract or otherwise, between the supplier or any person associated in any business with him and the recipient, or any person associated in any business with him (other than the relationship created by the transaction of the supply in question); and
- (c) no part of the proceeds of any subsequent re-supply, use or disposal of the goods will accrue, either directly or indirectly to the supplier or any person associated in any

Generally, buyer and seller are not independent from each other when one or both invest in each other businesses, or they have joint investments or they are controlled by a third person (Section 13(5)). However, the consideration indicated in the contract can be adjusted when tax rate changes or a change in classification of the supply e.g. from standard to zero rated happens; but the change is only allowed when goods are not yet delivered or services not yet provided (Section 64).



Example

Joshua Co. Ltd distributed goods worth Tshs20,000,000 for free to a charitable organization. Thereafter, an officer from Tanzania Revenue Authority suggested that the company should account for VAT on the gifted goods. The company agreed but it is not sure about taxable value of the gifted goods.

Though the goods were offered for free, the company should pay VAT on the market value of the gifted goods i.e. Tshs20,000,000. This market value is presumably excluding VAT as independent parties are likely to include VAT if they are not VAT registered taxable persons.

3.2 Consideration and taxable value of imported goods and services

In addition to the costs of goods, the taxable value of imported goods must include insurance, freight, import duty, excise duty and any other tax or levy payable on the goods except VAT (Section 14(1)). However, the taxable value of the imported service is only the open market prices of the supply as no insurance, freight or other expenses are involved in importation of services (Section 14(2)).



Example

Joshua Co. Ltd imported goods worth Tshs20,000,000 from London, after paying freight of Tshs2,000, 000; insurance for Tshs1,000,000 and Tshs200,000 for clearance at a UK port. Determine the taxable value for VAT purpose given the import duty as 25%, excise duty of 20% and VAT rate of 18%.

The taxable value of imported goods is the value of the goods after including other expenses and taxes except VAT according to customs valuation model. Therefore the taxable value of imported goods is computed as follows:

Items	Tshs'000
Costs	20,000
Freight	2,000
Insurance	1,000
Clearance	200
Total before import duties	23,200
Import duties 25%	5,800
Valued before excise duty	29,000
Excise duty 20%	5,800
Taxable value	34,800
VAT 18%	6,264

4. Distinguish between composite and multiple supplies.

[Learning Outcome f]

There is a little problem of categorizing a supply into either standard rated, zero rated or exempt supplies when it involves a supply of a single good or service. Yet, there is a challenge in deciding whether there is a single composite supply hence, single tax liabilities, or multiple supplies hence, multiple tax liabilities, when goods and services are supplied in bulk. For instance, assume a taxable person sells books which are exempt supplies and offers free transportation to buyers which are standard rated supplies. During cases like this it is important to decide whether there were single supplies of books or there were two separate supplies of books and supplies of transport. Mainly, the decision can be made using case laws particularly Card Protection Plan Ltd (Case C-349/96).

Continental Assurance Company sold a package of goods and services known as Card Protection Plan Ltd (CPP) to customers. The package included: keeping records of customer information; property tags for keys and luggage; world-wide medical assistance; delivery of emergency cash and tickets; car-hire discounts; insurance effected under a block policy against unauthorised use of credit card; and insurance effected under a block insurance policy to cover communication costs in the event of loss of valuables.

There was a disagreement whether the package was a single supply of insurance which was exempt supply or multiple supplies of standard rated supplies. The UK tax revenue authority ruled out that the supplies consisted of multiple standard rated supplies but the company argued that the supplies were mainly single composite supply of insurance which is exempted. Therefore it consistently appealed to the House of Lords. During the

case, the House of Lords adopted five criteria suggested by European Court of Justice to determine whether the Card protection plans were single supplies of exempt nature or multiple supplies of taxable nature. These criteria were:

- (i) Consider **all components** of a transaction involved paying particular attention to the substances and realities surrounding the transactions.
- (ii) A supply of **a service** must normally be regarded as distinct and independent.
- (iii) Supply of composite services should be dissected to see its **essential/principal** components; what customers buy and ancillary components. Division should be on economic point of view, no artificial split of a single supply of service should occur.
- (iv) When there is only a **single principal** service supplied i.e. other composites are **ancillary services**, there is single composite supply.
- (v) A single price should not be used to indicate whether a single composite supply or multiple supplies have occurred. It should depend on the intention of customers: if separate services were wanted by the customers, multiple supplies should be deemed to occur even when a single price was paid.



Definition

An '**ancillary service**' is defined as something that does not constitute for customers an aim in itself but is a means of better enjoying the principal service supplied.

Consequently the House of Lords decided that common sense should be used to avoid artificially splitting a single composite supply of services or goods. In the Insurance Card Protection Plan Ltd Case, the essential or integral features of the scheme were to obtain insurance cover against loss arising from the misuse of credit cards or other documents; other features were ancillary and incidental to the main features. Subsequently, the House of Lords decided that the company was supplying a single supply of exempt services i.e. insurance.

Therefore, in arriving at the decision one should understand the components of transactions and should be careful not to artificially split them. Then, the principal verses the ancillary test should be used as the customers normally buy the principal's components, not the incidental ones. Moreover, single or multiple prices is not a decisive criterion; charging a single price for distinct supplies cannot make them single supply, similarly charging separate prices for a single composite supply cannot make the supply separate.



Example

Assume a taxable person who sells books and offers free delivery services to buyers. The buyers pay a single price of Tshs50,000 per book. Is the supply single, composite or multiple supplies of books and delivery services?

Using the case law above, the essential or integral features of the supply is a book which is exempted supply and transport services which is standard rated supplies. Basing on that argument, the supply can be argued to be multiple supplies of books and transport services though a single price is paid. Therefore, the costs should be apportioned on a fair and justifiable base which can either be cost or market value.

5. Describe the scope and coverage of VAT.

[Learning Outcome g]

The scope and coverage of VAT is explained in the Value Added Tax Act 1997. It contains provisions for taxable and exempt commodities. It further explain the time of supply, how the value of taxable supply is determined and taxed, etc. The scope of VAT Act extends to the provisions applied for the treatment of VAT paid in Tanzania Zanzibar and Tanzania Mainland.

5.1 VAT in Tanzania Mainland and Zanzibar

The two parties to the Republic of Tanzania have two distinct value added tax laws: The Value Added Tax Act No. 4 of 1998 in Tanzania Zanzibar and The Value Added Tax Act 1997, Chapter 148 in Tanzania Mainland. In many cases these laws are similar but each emphasises its distinct VAT scope.

However, this Section deals with the Value Added Tax Act 1997, Chapter 148 in Tanzania Mainland. In that Act, VAT registered traders are obligated to add value added tax on their sales of taxable goods and services provided the sales are made to further their businesses (Section 3(1)). Furthermore, the customs department

collects VAT on importation of taxable goods and when VAT registered traders import taxable services, output taxes on that transaction is payable under **reverse charge**.

Because of different laws, taxpayers residing in Tanzania Mainland may find themselves paying VAT in Tanzania Zanzibar, and vice versa. But, when a taxpayer residing in Tanzania Mainland pays VAT in Tanzania Zanzibar, the person is treated as if he/she has already paid the VAT on the goods, provided the VAT rates in Tanzania Mainland and Zanzibar are identical (Section 3(2)). So no VAT will be charged again on the importation of the goods from Tanzania Zanzibar.

In case the VAT rate in Tanzania Zanzibar is lower than that of Tanzania Mainland say 15% vs. 18%, the taxpayer would pay the tax not paid in Tanzania Zanzibar i.e. 3% when importing the goods into Tanzania Mainland (Section 3(3)). Thus, the goods should normally be taxed at the current ruling rates in Tanzania Mainland, however taxpayers cannot claim the excess of the Tanzania Zanzibar's rate e.g. 20% over that of Tanzania Mainland i.e. 18% when importing the goods into Tanzania Mainland.

Nonetheless, regardless of whether the VAT rates in the two regimes are equal or not, taxpayers in Tanzania Mainland may claim the input taxes paid in Tanzania Zanzibar (Section 16(2)).

At the same time, some value added taxes collected on goods manufactured in Mainland Tanzania but exported directly to Tanzania Zanzibar are remitted to Tanzania Zanzibar Treasury by Tanzania Revenue Authority (Section 3(4)). This treatment of value added taxes remitted to Tanzania Zanzibar Treasury is replicated by The Value Added Tax Act No. 4 of 1998 Section 3(4) for goods manufactured in Tanzania Zanzibar and directly imported into Tanzania Mainland.



Example

Consider a certain company which bought a motorcycle VAT inclusive from Tanzania Zanzibar. The motorcycle was imported into Tanzania Mainland through Dar es Salaam port. How much VAT would be payable on its importation if the VAT rate in Tanzania Zanzibar was 18%?

The importation of goods in Tanzania Mainland from Tanzania Zanzibar is taxable both for import duties and VAT. But VAT is only charged when the goods were not charged in Zanzibar or the VAT rate in Tanzania Zanzibar is lower than Tanzania Mainland. In this case the unpaid taxes must be paid at the time of importation. Therefore, as the tax rates in both places are the same i.e. 18% no VAT is payable on the importation of the motorcycle.

5.2 Classification of supplies

Supplies are grouped into taxable, exempt, and supplies outside the scope of value added taxes. The proper application of value added tax system largely depends on classification of supplies because taxing exempt supplies may impose value added taxes when it should not.

Also computations of input taxes deductible depends significantly on these classifications (Section 16). Moreover, determination of when a trader is required either to apply for registration or deregistration depends on reaching a threshold of taxable supplies (Section (2)). The exemption and zero schedules may help in understanding these classifications.

1. Taxable supplies



Definition

'Taxable supplies' are supplies other than exempt and supplies out of scope.

VAT Act 1997, **Section 5**

These supplies as previous said includes taxable sales, gifts, loans of goods, leasing or letting of goods, appropriation of goods for personal use or otherwise and importation of taxable services and goods. Furthermore, taxable supplies are subdivided into standard rated supplies, and zero rated.

Standard rated supplies (18%)



Definition

'Standard rated supplies' refers to all supplies which are taxed at 18% or at reduced rate (9.9%).

Technically, they include all supplies which are not zero rated supplies, exempted supplies, nor those outside the VAT system. The list of standard rated supplies is huge but not listed in the VAT Act 1998.

Zero rated supplies



Definition

'Zero rated supplies' refers to a situation in which the rate of tax applied onto the supplies is zero.

Section 9

Zero rated supplies are the second type of taxable supplies which differ from the standard rated supplies on tax rates; the standard rated supplies are taxable at 18% while the zero rated supplies are taxed at 0%. Consequently, zero rated supplies bear no value added taxes. The zero rated supplies are given the updated first schedule of the VAT Act, 1997 which is being reproduced below.

List of zero rated supplies: First schedule

1. Exportation of goods and services from the United Republic of Tanzania provided evidence of exportation is produced to the satisfaction of the Commissioner.
2. The supply of goods, including food and beverages, for consumption or duty free sale on aircraft or ships on journeys to destinations outside the United Republic of Tanzania.

Notes:

For the purposes of this schedule:

- (a) Goods are treated as exported from the United Republic of Tanzania if they are delivered or made available to an address outside the United Republic of Tanzania as evidenced by documentary proof acceptable to the Commissioner;
- (b) all supplies of services are treated as being supplied in the place where the supplier belongs as defined in subsection (4) of Section 7 except supplies of services, which may be treated as exported, subject to documentary proof acceptable to the Commissioner as follows:
 - (i) Services relating to land shall be treated as being exported, only when the land, in respect of the services supplied, is situated outside the United Republic of Tanzania.
 - (ii) Supply of services and ancillary services relating to cultural, artistic, sporting, scientific, educational, entertainment, fairs and exhibitions, including the supply of services of organizers of such activities shall be treated as being exported only when such services are physically carried out outside the United Republic of Tanzania; Also, the supply of service of valuation of, and work on movable tangible property and the supply of ancillary transport activities such as loading and unloading, handling and similar activities shall be treated as being exported only when such services are physically carried out outside the United republic of Tanzania; Moreover, the supply of services connected with immovable property, including: the services of experts and estate agents; the provision of accommodation in the hotel sector or in sectors with a similar function such as holiday camps or sites developed for use as camping sites and the granting of rights to use immovable property and services for the preparation and coordination of construction work, such as the services of architects and of firms providing on-site supervision, shall be treated as being exported only when the immovable property is located outside the United Republic of Tanzania. And, the supply of services rendered by an intermediary acting in the name and on behalf of another person shall be treated as being exported only when the underlying transaction is supplied outside the United Republic of Tanzania.

Also, the supply of services of consultants, engineers, lawyers, accountants and other similar services, as well as data processing and the provision of information, shall be treated as being exported only when such services are supplied to a person other than a related person who is established or has his permanent address or usually resides outside the United Republic of Tanzania, provided that such services are not related to business established or to be established in the United Republic of Tanzania. Finally, the supply

of telecommunication services, radio and television broadcasting services shall be treated as being exported only if effective enjoyment of such services takes place outside the United Republic of Tanzania.

3. The supply which comprises of the transport of or any service ancillary to transport of or loading, unloading, wharfage, shore handling, storage, ware housing and handling, supplied in connection with goods in transit through the United Republic of Tanzania, whether such services are supplied directly or through an agent to a person who is not a resident of the United Republic of Tanzania.
4. The supply of services which comprise the handling, parking, pilotage, salvage or towage of any foreign going ship or aircraft while in Tanzania Mainland.
5. The supply of services which comprise of repair, maintenance, insuring, broking or management of any foreign going ship or aircraft.
6. Deleted by Act No.10 of 2002 s.7.
7. The supply of agricultural produce intended for export by co-operative unions and community based societies registered with the Tanzania Revenue Authority.
8. The supply by a local manufacturer of tractors for agricultural use, planters, harrows, combine harvesters, fertilizer distributors, liquid or powder sprayers for agriculture, spades, shovels, mattocks, picks toes, forks and rakes, axes and other tools of a kind used in agriculture, horticulture or forestry.
9. The supply by a local manufacturer of fertilizers, pesticides, insecticides, fungicides, rodenticides, herbicides, ant sprouting products and plant growth regulators and similar products which are necessary for use in agricultural purposes.
10. The supply by a local manufacturer of:
 - (a) Fishing nets and accessories; and
 - (b) Out boat engines for fishing.
11. The supply by a local manufacturer of veterinary medicines, drugs and equipment which have been approved by the Minister responsible for health upon recommendation of the Tanzania Food and Drugs Authority.
12. The supply by a local manufacturer of :
 - (a) human medicines, drugs and equipment which have been approved by the Minister responsible for health upon the recommendation of the Tanzania Food and Drugs Authority;
 - (b) articles designed for use by the blind or disabled;
 - (c) mosquito coils;
 - (d) Sanitary pads.
13. The supply of sacks by a local manufacturer of sacks
14. The supply of edible oil by a local processor of edible oil using local oil seeds.
15. The supply of layers mash, broilers mash and hay by a local manufacturer of animal or poultry feeds.
16. The supply of locally produced milk and milk related products produced by local manufacturers using locally produced milk



Example

A Mkulima was struggling with classification of his famous animal feedings 'majani makavu' as known in Swahili or 'hay'. Advised by his friends he is convinced that hay is unprocessed agriculture produce therefore exempt supplies. Was he right?

No he was wrong; hay is specifically mentioned in the first schedule as zero rated supplies to allow farmers to recover their input taxes.



Example

A newly established pharmacy was concerned with the classification of medicines as it is keen to claim input taxes that it incurs every day. The pharmacy is buying its products from a manufacturer at Mwenje area. The managing director quickly downloaded the VAT Act 1998 and went on to the first schedule. Then she decided to include sales drugs in determining VAT threshold. Comment on this treatment.

The treatment was incorrect as only supplies of local manufacturer of drugs are classified as zero rated supplies.



Test Yourself 2

Determine whether the following supplies are zero rated supplies or not:

- (a) Supplies of Tanga flesh (processed milk)
- (b) Supplies of sanitary pads to a girls' secondary school
- (c) Supplies of imported fertilizers to farmers.

2. Exempts supplies

Certain supplies of goods and services are exempt from value added taxes. Thus they are supplied without taxes as zero rated supplies. Yet, any input taxes related to exempted supplies made are not deductible (Section 10(2)) while input taxes incurred on purchasing zero rated goods are deductible.

Also when a taxable person sells only exempt supplies, he is not required to register for VAT even if the registration threshold limit is reached. Sellers of zero rated must register for VAT in case the supplies exceed the VAT threshold registration limit. The exempt supplies are given in the second schedule of the VAT Act 1997 and it is reproduced below.

List of exempt supplies and imports: Second schedule

1. Food, crops and livestock supplies

- (1) Livestock - live cattle, swine, sheep, goats, game, poultry and other animals of a kind generally used for human consumption.
- (2) Animal products - unprocessed edible meat and offal of cattle, swine, sheep, goats, game and poultry (including eggs), except – pate, fatty livers of geese or ducks and any other produce prescribed by the Minister by regulation.
- (3) Unprocessed dairy products - cow or goat milk.
- (4) Fish - all unprocessed fish, except shellfish, and ornamental fish.
- (5) Unprocessed agricultural products - edible vegetables, fruits, nuts, bulbs and tubers, maize, wheat and other cereals, meal flour, tobacco, cashew nuts, coffee, tea, pyrethrum, cotton, sisal, sugarcane, seeds and plants thereof.

Notes:

- (i) For the purposes of this item goods shall be regarded as unprocessed if they have undergone only simple process of preparation or preservation such as freezing, chilling, drying, salting, smoking, stripping or polishing.
 - (ii) None of the above can be exempted when they are supplied in the course of catering by a restaurant, cafeteria, canteen or like establishment except where such items are supplied in Tanzania Peoples Defence Forces designated canteens.
- (6) Locally grown tea whether in the form of made tea, blended or packed tea.
 - (7) Locally grown coffee whether in the form of roasted, grounded or instant coffee.

2. Pesticides, fertilizers, etc.

The supply of fertilizers, pesticides, insecticides, fungicides, rodenticides, herbicides, anti-sprouting products, and plant growth regulations, and similar products which are necessary for use in agricultural purposes.

3. Health Supplies

- (a) Health and medical services by a registered medical practitioner, optician, dentist, hospital or clinic.
- (b) Human medicines, drugs and requirement which have been approved by the Minister responsible for Health upon recommendation of the Pharmacy Board.
- (c) Deleted by Act No.2 of 1998.
- (d) Articles designed for use by the blind or disabled. (5) Mosquito coils.
- (e) Sanitary pads, diapers, urine bags and hygienic bags.

4. Educational supplies

Educational services provided by an establishment registered by the Government.

5. Veterinary supplies

- (a) The supply of veterinary services by a registered veterinary practitioner.
- (b) The supply of veterinary medicines, drugs and equipment which have been approved by the Minister responsible for Health upon recommendation of the Pharmacy Board.

6. Books and newspapers

- (a) Books, booklets, maps or charts.
- (b) Newspapers, journals, magazines or periodicals.

7. Transport services

- (a) Transportation of persons by any means of conveyance other than air charter, taxi cabs, rental cars, boats or boat charters.
- (b) The supply of service for loading and offloading of imported goods to a locally plying ship provided that VAT on offloading service of imported goods from foreign coming ship have been paid.

8. Housing and land

- (a) The sale or leased of an interest in land and shall not include a building thereon.
- (b) The sale of used or leasing residential buildings by the Tanzania Building Agency.

Notes: For the purposes of this item "land" does not include any buildings thereon.

9. Financial and insurance services

- (a) The provision of insurance services.
- (b) The issue, transfer, receipt of or other dealing with money (including foreign exchange) or any note or order for the payment of money.
- (c) The provision of any loan, advance or credit.
- (d) The operation of any current, deposit or savings account.
- (e) The issue, allotment or transfer of ownership of equity or security such as shares in companies and members interest in corporations and in participatory security such as unit trusts.
- (f) The issue, payment, collection or transfer of ownership of any note or order of payment, cheque or letter of credit or notification of the issue of a letter of credit.
- (g) The issue, drawing, acceptance or transfer of ownership of a debt or security including debentures, mortgages, loans and other debts in money.
- (h) The supply or importation of currencies and travellers cheques to a registered bank, bureau de change and other financial institutions.
- (i) The payment of contributions by employees and employers to a social security fund or scheme.

10. Water

The supply of water, except bottled or canned or similarly presented drinking water.

11. Funeral services

- (a) The transportation and disposal of human remains.
- (b) The arrangements for disposal of the remains of the dead.

12. Petroleum products

- (a) Aviation spirit, spirit type jet fuel and kerosene type Jet fuel (Jet A-1)
- (b) LPG gas and LPG cylinders.
- (c) Petrol (MSP and MSR), diesel (GO), kerosene (IK), heavy furnace oil (HFO), industrial diesel oil (IDO) and AVGAS.
- (d) Bitumen.

13. Agricultural implements

Tractors for agricultural use, planters, harrows, combine harvesters, fertilizer distributors, liquid or powder sprayers for agriculture, spades, shovels, mattocks, picks, hoes, forks and rakes, axes and other tools of a kind used in agriculture, horticulture or forestry, mowers and Hay and Nascor Pellet feed.

14. Tourist services

Tourist guiding, game driving, water safaris, animal or bird watching, park fees and tourist charter services and ground transport.

15. Postal supplies

The supply of postage stamps.

16. Aircraft

- (a) Aircraft, aircraft engines, parts and maintenance.
- (b) Lease of aircraft.

17. Fishing gear

- (a) Nylon fishing twine, Fishing nets and accessories;
- (b) Outboat engines for fishing.

18. Games of Chance

The provision or conduct of games of chance by means of National lottery, casinos, slot or gaming machines, internet casino or SMS lottery.

19. Computers

The supply of computers, printers, parts and accessories connected thereto and Electronic Fiscal Devices.

20. Yarn (Deleted, Finance Act 2007 s. 36)**21. Packing material** (Deleted by Act No. 15 of 2003 s.58).**22. Winding Generator and liquid elevators**

Liquid elevators and parts thereof including winding generator up to 30 kW. battery charges, special bearings, gear box yaw component, wind mill sensors brake hydraulics, flexible coupling, brake, calipers, wind turbine controllers and rotor blades.

23. Photovoltaic and Solar Thermal

Solar energy system components including panels/modules solar charge controllers, solar inverter, solar batteries, solar pumps, solar refrigerators, solar lights, vacuum tube solar collectors, plastic solar collector, linear acnators for tracking system, concentrating solar collectors, fresnel lenses, solar cookers, solar water heaters, solar water distillation units, solar cooling system components and crop dryers.

24. Fire fighting equipment

The supply of fire extinguishers whether or not charged.

25. Burning Jelly

The supply of jelly oil as burning energy.

26. Natural Gas and Equipment

Including Compressed Natural Gas (CNG), Compressed Natural Gas Cylinders, Compressed Natural Gas Vehicles conversion kits, Compressed Natural plants Equipments, Natural Gas pipes (Transportation and distribution pipes), Compressed Natural Gas Storage cascades, Compressed Natural Gas Special transportation Vehicles, Natural gas metering equipments, Pipe-line fitting and valves, Compressed Natural Gas Refuelling or filling equipments, Gas receiving Units, Flare gas system, Condensate tanks and leading facility, System piping and pipe rack, Air and Nitrogen System, Condensate stabilizer, System piping on piperack, Instrumentation and Gas cookers designed for natural gas.

27. Agricultural services

- (a) The Supply of services of land preparation, cultivation, planting and harvesting of crops.
- (b) The supply of intra-transport service from the farm to the processing plant of sugar cane, sisal or tea.
- (c) The supply of breeding services.

28. Dairy, dairy products and equipment

Heat insulated cooling tanks and aluminium jerry cans, milk pumps, milk hoses, milk pasteurisers, butter churns, cream separators, homogenizers, cheese vat and cheese pressers, compressor used in refrigerating equipment, storage tanks, tankers fitted with a cooling device, air condition machines incorporating a refrigerating unit and a valve for reversal of the cooling cycle.

29. Services relating to mobile phones

- (a) Supply of service of transferring a prepaid mobile phone airtime voucher from a dealer other than a service provider to the user of a mobile phone.

30. Livestock farming

Oil cakes (mashudu), layers mash, broilers mash and hay.

31. Packaging material

Packaging material for fruit juice and dairy products.

**Example**

A financial services company had a turnover of over Tshs20 billion but not registered for VAT. Yet, the incurrence of VAT on purchasing goods and services has led to an argument between board members whether or not to apply for the registration. Particularly the company supplies banking and insurance services. Can the company save taxes through claiming input taxes it pays on purchase of its goods and services?

As both supplies of banking and insurance services are exempted, the bank cannot register nor claim input taxes. So the saving of input taxes through this way is impossible.

**Test Yourself 3**

Determine whether the following supplies are exempt supplies or not:

- (a) Supplies of Tanga flesh (processed milk)
- (b) Supplies of sanitary pads to a girls' secondary school
- (c) Supplies of imported fertilizers to farmers.

3. Supplies outside the scope of VAT

A supply is out of VAT system if it results from an activity which is not an economic activity. For instance, salaries, other government taxes, appropriation of cash from businesses and other supplies made by non-VAT registered traders. There is no list of supplies which are outside the scope of VAT.



Definition

'Economic activity' includes any activity of producers, traders and persons supplying services including mining and agricultural activities and activities of the professions, also the exploitation of tangible or intangible property for the purpose of obtaining income there from on a continuing basis.

UK VAT directive 2006/112

4. Value added tax special relief



Definition

'VAT relief' is a tax relief granted to bodies and persons due to social, status and economic reasons in order to equitably provide quality services.

Tanzania Revenue Authority, 2013

Therefore, special VAT relief are not supplies but a form of VAT exemption given to some persons who do not pay, or pay less VAT than others when buying standard rated goods and services because they are exempted (Section 11(1)). The current VAT system offers either 100% or 45% relief to special exempted persons. The following updated list of special relief shows which person is either exempted 100% or 45%.

List of special relief supplies and imports: Third schedule

Relieved Persons/Organisations	Rate of Relief (%)
1. Supplies to or importation of goods or services by diplomats or a diplomatic mission that is accredited by the United Republic of Tanzania for the official purposes of that mission, where the foreign country provides reciprocal treatment to diplomats and the diplomatic mission of Tanzania in that country	100%
2. (1) Supplies or importation of goods or services under a technical aid or donor funded agreement as far as that agreement provides for relief from taxation in the United Republic of Tanzania. (2) The relief granted under sub-item (1) shall limit the number of non-utility vehicles to the satisfaction of the Commissioner in relation to project submitted.	100%
3. Importation or supply of goods or services to project funded by the Government relating to infrastructure and utilities development.	100%
4. Travellers' or deceased's personal effects - Imported goods in respect of which relief of duty is available under Customs Laws.	100%
5. Supply of specified goods to the Armed Forces.	100%
6. The supply to a registered medical practitioner, optician, dentist, hospital or clinic, or to a patient, of equipment designed solely for medical or prosthetic use including ambulance and mobile health clinics.	45%
7. The supply to a registered veterinary practitioner of equipment designed solely for veterinary use.	45%
8. The importation by or supply to a registered licensed drilling, mining, exploration or prospecting company of equipment to be used solely for exploration or prospecting activities.	100%
9. The importation by or supply to a registered licensed exploration or prospecting company, of goods which if imported or supplied would be eligible for relief from duty under the customs laws and services for exclusive use in exploration or prospecting of petroleum or gas.	100%

10. (1) Supply of specified goods for sale in the Tanzania Defence Forces duty free shops. (2) The armed Force duty free shops shall: (a) Be required to submit to the authority their annual plans detailing quantities of goods to be produced before commencement of Government fiscal year; and (b) Account for utilized relief on goods procured.	100%
11. (1) The importation or local purchase of goods or services, by or on behalf of a registered religious or institution, which are intended to be used solely by the organisation or institution for: (a) the advancement of religion; (b) for relieving persons from the effects of natural calamities, hazards or disaster; and (c) The development, maintenance or renovation by the organisation of projects relating to health, education, training, water supply, infrastructure or any other projects relating to advancement of the community. (2) The importation or local purchase by charitable community based or other non-profit driven organisations of household consumables for subsequent supply to orphanage, day care centres and schools. (3) The organization or institution shall before obtaining the relief granted under paragraph (1) and (2), submit to the Revenue Authority a letter confirming the existence of the project or projects in question from the District Commissioner in its area and from the umbrella organization, if any. (4) The relief under this paragraph shall be granted upon submission of proof that the goods or services relieved are to be used exclusively for the purpose of the project. (5) The registered religious, charitable community based or other non-profit driven organisation or institutions shall be required to submit to the Authority their annual plans detailing each of the projects intended for implementation before the commencement of the Government fiscal year. (6) The registered religious, charitable community based or other non-profit driven organisation or institutions shall be obliged to account for the utilized relief on goods or services. (7) For the purpose of this part, household consumable means food, clothing and toiletries.	100%
12. The importation by or supply to the Red Cross Society of Tanganyika of goods or services which are solely to be used in the performance of its statutory functions.	100%
13. The importation by or supply of goods or services to any organisation holding a special Agreement with the Government of the United Republic of Tanzania or established under an Agreement to which the Government of the United Republic of Tanzania is a party so long as that Agreement provides for relief from taxation.	100%
14. The importation by or supply of goods or services for water and sewage infrastructure development to water and sewage authorities and institutions or scheme or agent or concessionaries thereof contracted for purpose of providing water and sewerage services to public in the urban and rural areas.	100%
15. The supply of raw and packaging materials to a registered manufacturer of spectacles lenses.	100%
16. The supply to the investor licensed under the Export Processing Zones Act, 2002 of goods and services for use as raw materials, equipment and machinery including all goods and services directly related to manufacturing in the Export Processing Zones, but does not include motor vehicles, spare parts and consumables.	100%
17. The supply of building materials and construction service by the developer licensed under the Export Processing Zones Act.	100%
18. The importation or supply to the investor licensed under the Special Economic Zones of raw materials and goods of capital nature directly related to manufacturing in the Special Economic Zones including ambulances, fire fighting vehicles and fire fighting equipment.	100%
19. The importation by or supply to a registered water drilling company of goods to be used solely for water drilling.	45%
20. The importation by or supply to a registered pharmaceutical manufacturing company, of goods to be used solely in the manufacturing of human medicines.	45%
21. The supply of goods by domestic manufacturers for sale in a duly licensed duty free shop.	45%
22. The supply of destination inspection services to the Tanzania Revenue Authority.	100%

23. The importation or local purchase of a generator or water pump for use by a farmer in irrigation, a charcor "malambo or fishpond on condition that such farmer submits to the Tanzania Revenue Authority a confirmation from a Director of a Local Government Authority that such generator or water pump shall be used for the purpose of irrigation, fishing or keeping livestock".	100%
24. The importation by or supply of capital goods to any person.	100%
25. The importation by or supply of railway locomotives, rolling stocks, parts and accessories to a registered railways, company, corporation or authority.	100%
26. The importation by or supply of fire fighting vehicles to the Government or Government Agencies.	100%
27. The importation by or supply to the Bank of Tanzania of goods or services which are solely to be used in the performance of its statutory functions.	45%
28. The importation of ethanol, dyestuff and thickening agent by a local manufacturer of burning jelly.	45%
29. Importation by or supply of green houses to horticulture growers and agri-net.	45%
30. (1) Supply of goods and services to organized farms and farms for the purpose of building as irrigation canal construction of road networks, godowns and similar storage. (2) Supply of spare parts for combined harvesters, threshers, rice dryers, mills, planters, trailers, power tillers, tractors, grain conveyors, sprayers and harrows to a farmer. (3) The relief provided in sub item (1) shall only apply to goods and services approved by the minister responsible for agriculture after inspection of the area have been done by the agriculture officer.	100%
31. The importation or supply of tractors tyres.	100%
32. The importation or supply of tractor trailer and supply of spare parts for tractor trailer.	100%
33. The importation by, or supply to, a local textile manufacturer, of goods or services which are exclusively used in the manufacturing of textile by using locally grown cotton.	100%



Example

A financial services company had a turnover of over Tshs20 billion but is not registered for VAT. Yet, the incurrance of VAT on purchasing goods and services has brought an argument between board members whether or not to apply for the registration. Particularly the company supplies banking and insurance services. Can the company save taxes through applying for special relief?

No banks or financial institution services are generally relieved through exemption, so the supplies are exempted but not the persons. However, they may be exempted when buying or importing capital goods, for instance.



Test Yourself 4

Examine the following transactions and decide if you, can claim VAT special relief under the third schedule.

- (a) Importation of car
- (b) Importation of tractor trailer
- (c) Importation of capital goods

6. Apply the registration and deregistration rules.

[Learning Outcome h]

6.1 Registration rules and VAT registration threshold

Many taxable persons are registered after their taxable turnover exceeds the VAT threshold, which is currently Tshs40,000,000. The VAT tax threshold is made of taxable supplies and reverse charges on importation of services into mainland Tanzania and it excludes any taxable supplies of extraordinary nature; for example disposal of fixed assets. The extraordinary taxable supplies should be excluded from the VAT threshold because they may not occur in the future, rendering application for de-registration.



Important

The VAT threshold is calculated by either totaling taxable turnover to check if taxable turnover before VAT **exceeds or is likely to exceed** Tshs40,000,000 in a period of 12 **consecutive** months or Tshs10,000,000 in a period of 3 **consecutive** months (Government notice NO.176 paragraph 3(1)).

Exceeds, likely to exceed and consecutive are key terms in calculation of VAT threshold.

The word 'exceed' requires a person to total his/her historical taxable supplies for either the past 12 months or 3 months whichever is applicable.

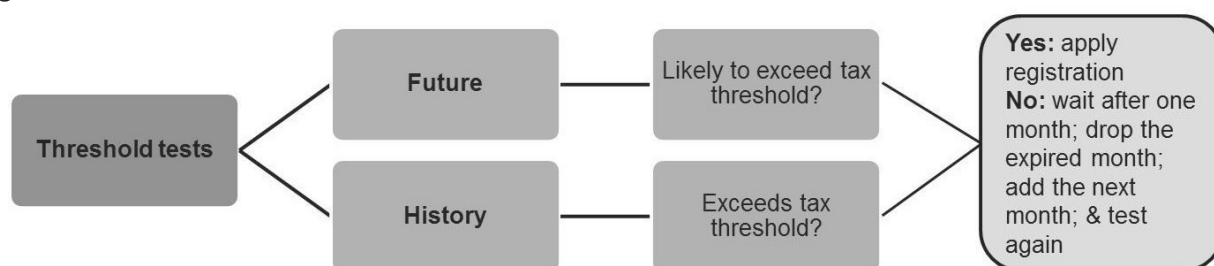
'Is likely to exceed' requires totaling future taxable supplies for the next 12 months or 3 months period.

So there are two points of view in the calculation process: the past 12 or 3 months and the future 12 months or 3 months period. Further this period should be continuous 12 or 3 months.

The continuous period resembles a rolling budget with either 12 or 3 months in each budget period. For example, if the previous 12 months is taken say as December 2013, the period would include: December 2012 to November 2013. If the total taxable supplies were below Tshs40,000,000 the taxpayer is not required to apply for registration.

After the end of December 2013 the test should be conducted again to see whether the threshold has been exceeded or not. The process works in the same way when future and 3 months turnover is checked. Once the threshold has been reached or is expected to be met, traders should apply for registration within 30 days (Section 19). The process is summarised in the diagram below.

Diagram 1: Threshold tests



Nevertheless, few traders volunteer to be taxable persons and some traders in spare parts, hardware, mini supermarkets, petrol stations, mobile phone shops, sub wholesale shops, bar and restaurants, pharmacy stores and electronic shops are forced to register regardless of their taxable supplies.



Example

A graduate of a University wants to start a business in March 2014. He expects to sell Tshs7,000,000 and Tshs3,000,000 taxable and exempt supplies each month respectively. Using a three month period, when will he be required to apply for VAT registration?

The graduate will be required to register for VAT immediately after starting business because his taxable supplies is likely to exceed Tshs10,000,000 per quarter. He may register within thirty days after starting the business.



Example

Consider the following sales information from non-taxable persons for the last twelve months.

Month	Amount Tshs
September 2011	3,000,000
October 2011	2,000,000
November 2011	1,500,000
December 2011	2,500,000
January 2012	20,000,000
February 2012	3,000,000
March 2012	1,000,000
April 2012	4,000,000
May 2012	2,000,000
June 2012	3,000,000
July 2012	2,800,000
August 2012	4,000,000
September 2012	3,000,000

Included in the information are exempt sales of Tshs300,000 each month and a sale of office furniture in January 2012 for Tshs18,000,000. However, the person was advised by an official from Tanzania Revenue Authority to register for VAT based on the fact that his annual revenues i.e. Tshs51,800,000 exceeded Tshs40,000,000. Advise him about that VAT registration.

In this case the trader should reject the advice given to him because with exclusion of both unusual sales i.e. sales of furniture and exempt supplies the annual sales are just Tshs

6.2 Deregistration rules

Taxable persons might apply for deregistration when taxable turnover falls below the VAT threshold i.e. Tshs40,000,000, or their turnover falls below the limit for taxable turnover, or the person goes bankrupt, dies or the business is liquidated or sold. Whenever one of those factors occurs, the concerned person should inform the Commissioner general in writing within 30 days (Section 21).

However, deregistration takes effect after the acceptance of deregistration application and payment of VAT on all goods and assets held by the persons (Section 21(1)). Moreover, the goods of the person applying for deregistration are deemed supplied by him and VAT is payable on them before deregistration unless the business is sold as a going concern to another taxable person; or the VAT on the deemed supply does not exceed Tshs5,000 (Section 21(3)).



Example

Consider the following stocks and other asset information from a taxable person who wants to apply for deregistration by disposing of his business as a going concern. Determine his final VAT liabilities.

Assets	Amount Tshs
Stock	3,000,000
Fixed assets	2,000,000
Debtors	1,500,000

In this case, there is output tax to be accounted for as a result of deregistration because the business would be sold as a going concern.

Answers to Test Yourself

Answer to TY 1

VAT, sale taxes were intended to be charged to final consumers, but buyers were asked whether they were final consumers or not. So once you could prove that you were not intending to consume the products you could easily avoid sales taxes.

Unlike sales taxes, VAT requires sellers to collect output taxes of their sales of taxable goods and services without asking buyers about their intention of use of their purchase, and sellers deduct their input taxes from the output taxes. This requirement may encourage taxable suppliers to collect output taxes and remove the need of asking whether buyers are final consumers or not as all buyers would pay full price including VAT, irrespective of their position in the value chain. But, final consumers would not recover the taxes but others would recover them in the normal process of accounting for VAT. However, even without collecting output taxes, a taxable person can claim the input taxes paid when purchasing taxable goods and services.

Answer to TY 2

- (a) The supplies of Tanga flesh is not zero rated supplies though the milk is locally manufactured. The transaction is deemed zero rated when it is made by the manufacturer of the milk.
- (b) The supplies of sanitary pads made by a local manufacturer is zero rated supplies but general supplies of sanitary pads is not zero rated supplies
- (c) The importation of fertilizers is not zero rated.

Answer to TY 3

- (a) The supplies of Tanga flesh is not exempt supplies as the milk is processed.
- (b) The supplies of sanitary pads are exempt supplies.
- (c) The importation of fertilizers is also exempt.

Answer to TY 4

- (a) No relief is provided on importation of car under the third schedule.
- (b) Yes, importation of tractor trailers has 100% VAT special relief.
- (c) Yes, also importation of capital goods has 100% VAT special relief.

Quick Quiz

1. Tanzania adopted the VAT system:
 - A To record tax consumption of goods and services.
 - B To encourage savings.
 - C To replace sales taxes.
 - D To enhance revenues
2. Tanzania VAT system has the following features, except:
 - A Taxing all goods and services
 - B Having three VAT rates.
 - C Discouraging investment.
 - D Encouraging saving
3. Why is the Tanzania VAT system called a consumption system?
 - A It taxes the final consumers
 - B All the burden of VAT falls on the final consumers
 - C Taxes both revenue and capital expenditures
 - D None of the above
4. On 30 June 2012 Juma bought taxable goods for Tshs10,000 VAT exclusive which was not delivered to him until 3rd July when the VAT had changed to 18% from 20%. How much did VAT Juma pay for his purchase?
 - A Tshs1,800
 - B Tshs2,000

5. What is the market value of imported services?
- A Its open market value
 - B Its open market value including VAT
 - C Its open market value including transport and insurance costs of service providers
 - D All of the above
6. Rose Ltd sells goods in bulk to its customers. The following statistics are available for one of its product:
- Costs of un-bottled water (exempt supplies) Tshs1,000
 - Cost of processed foods (standard rated supplies) Tshs10,000
 - Selling prices of foods including VAT Tshs15,000
- The amount of VAT is the selling price; which will be:
- A Nil
 - B Tshs2,288
 - C Tshs2,109
 - D None of the above

Answers to Quick Quiz

1. The correct option is **D**.

The main aim of the introduction of VAT was to increase tax revenue collection.

2. The correct option is **A**.

The system does not tax all goods and services, only taxable supplies are affected by the VAT system.

3. The correct option is **B**.

It is consumption taxes because all of the VAT burden lands on the final consumers who consume the taxable supplies.

4. The correct option is **B**.

Under VAT system the goods are assumed to be delivered to the buyers at the sellers' place of business, so no adjustment can be made for that transaction because of changes in VAT rates.

5. The correct option is **A**.

The market value of imported services is its open market value.

6. The correct option is **B**.

The supply is composite supplies of standard rated products which cannot be split artificially, so using the VAT fraction rate of 18/118, the output taxes collected are Tshs2,288.

Self Examination Questions

Question 1

Ndumba imported a VAT taxable item from Japan. On the arrival of the cargo, Ndumba could not produce valid documents acceptable by the Customs Department. For that case, the Customs Officers came out with the following values for such an imported item:

Values for identical items:

- A Tshs 40 million
- B Tshs 50 million
- C Tshs45 million

Values for similar items:

- D** Tshs30 million
- E** Tshs35 million
- F** Tshs60 million

The cargo is subject to 25% import duty, 10% excise duty and 18% VAT.

Required:

- (i) Compute the amount of import duty, excise duty and VAT on importation of this item.
- (ii) State the tax point for VAT on imports.

Question 2

According to the VAT Act 1997, 'taxable supplies' means any supply of goods or services made by a taxable person in the course of or in furtherance of his business after the start of the VAT.

Required:

What are the four specific activities included in that definition?

Question 3

- (i) Differentiate between exempt supplies and zero rated supplies.
- (ii) Mention four categories of supplies under the TVAT is concerned.

Answers to Self Examination Questions**Answer to SEQ 1**

- (i) Based on the customs valuation, the imported value will be based on the value of identical goods. However, when there are several prices the lowest price is selected. In this case the lowest price is Tshs40m million. Then the import duty will be $25\% \times \text{Tshs}40,000,000 = \text{Tshs}10,000,000$.

The excise duty will be based on $\text{Tshs}40,000,000 + \text{import duty} = \text{Tshs}40,000,000 + \text{Tshs}10,000,000 = \text{Tshs}50,000,000$. Therefore the excise duty is $10\% \times \text{Tshs}50,000,000 = \text{Tshs}5,000,000$. Finally, the VAT on importation is based on $\text{Tshs}40,000,000 + \text{import duty} + \text{excise duty} = \text{Tshs}40,000,000 + \text{Tshs}10,000,000 + \text{Tshs}5,000,000 = \text{Tshs}55,000,000$. Consequently, the VAT on the imported goods will be $= 18\% \times \text{Tshs}55,000,000 = \text{Tshs}9,900,000$.

- (ii) The tax point for the VAT on import is the time when custom taxes are due and payable.

Answer to SEQ 2

Taxable supplies include taxable sales, gifts, loans of goods, leasing or letting of goods, appropriation of goods for personal use or otherwise and importation of taxable services and goods.

Answer to SEQ 3

- (i) Exempt and zero rated supplies are related in the sense that in both cases no actual VAT is charged. However, exempt supplies do not form part of VAT registration threshold in determining whether a taxpayer should register for VAT. On the other hand zero rated supplies form part of VAT registration threshold.

Consequently, suppliers of exempt supplies only will never file for VAT registration while suppliers of zero rated supplies are registered upon attaining the VAT threshold. Finally, input taxes related to exempt supplies made by a taxable person are not deducted, in contrast, input taxes related to zero rated supplies made are deductible.

- (ii) Supplies can be divided into four major categories which include:

- Standard rated supplies,
- Zero rated supplies,
- Exempt supplies and
- Supplies outside the scope of VAT.

STUDY GUIDE D2: ADMINISTRATIVE PROVISIONS UNDER VAT LAW

Get Through Intro

This Study Guide describes VAT returns, notices and other records as required under VAT ACT 1997. Also it explains consequences of not complying with these procedures. Further, it elucidates penalties and offence for failing to comply with VAT Act 1997.

Knowledge of computing VAT liabilities, statutory records, Electronic Fiscal Devices (EFDs) and payments of VAT on time is important in ensuring smooth compliance of the tax law. In addition, knowledge of when tax non-compliance occurs is helpful in determining the resultant consequences.

Learning Outcomes

- a) Describe returns, notices and other records under VAT.
- b) Describe the consequences of not meeting the filing and payment requirements.
- c) Describe the offences and penalties under the VAT Act 1997.
- d) Describe the electronic fiscal devices system, its benefits and the possible revenue risks involved.
- e) Mention the statutory records to be maintained by VAT registered traders.

1. Describe returns, notice and other records under VAT.**Describe the consequences of not meeting the filing and payment requirements.****[Learning Outcomes a and b]****1.1 Tax returns and notices**

Taxable persons are required to account for VAT every prescribed accounting period. The accountability is done through lodgement of a tax return and payment of the VAT liabilities if any by the last working day of the month after the end of the prescribed accounting period to which it relates (Section 26).

1. Tax returns

Tax returns are forms which show all supplies of goods or services made by and to a taxable person, the importation of goods, tax deductions or credits and other business related information as VAT registration number. Nowadays the filling of VAT returns can be done online through the authority's website i.e. **www.tra.go.tz** and payment of VAT if any can be done through mobile and online banking to save time and penalties.

2. Notice

The notices are means of communication made by a Commissioner to taxable persons. They may communicate penalties (Section 27), interests (Section 26), prescribed period (Section 26) or in case of recovering unpaid taxes, demanding payments (Section 32) and communicating other information. However, taxpayers can also communicate with the Commissioners through notice, for instance sending the Commissioner notice of appeal (Section 20(3)).

**Definition**

The '**prescribed accounting period**' for a taxable person shall be the calendar month containing the effective date of registration and each calendar month after that, unless the Commissioner, by notice in writing, determines another prescribed accounting period for the taxable person (Section 26(2)).

VAT Act 1997, Section 26(2)**1.2 Consequences of not meeting filing and payment requirement**

Penalties and interest are two consequences of not meeting the filing and payment requirements. These penalties and interests are not mutual exclusive; paying penalties does not relieve non-compliant taxpayers from paying interests (Section 27(3)). The penalties for not filing VAT return or payment of taxes on due date for the first month of failure is the higher of Tshs50,000 or 1% of the tax shown as payable in respect of the prescribed accounting period covered by the return.

Then, the penalty for failure to file VAT return or pay taxes on time for the prescribed periods or part of a period after the first month of failure, is the higher of Tshs100,000 or 2% of the tax shown as payable in respect of the prescribed accounting period covered by the return, for each period or part of it (Section 27(1)). The penalties are payable immediately after receipt of the notice of assessment of penalties.

**Example**

The following data is taken from a taxable person's sale and purchase book; and contains sales and purchase information for October 2013. Your duty is to compute deductible input taxes using standard method, output taxes and tax penalties if the VAT liability was paid on 31 March 2014 despite filing VAT return on time. Assume BOT is 12% per annum.

Items without VAT	Tshs
Sales of books	1,000,000
Sales of bottled water	400,000
Sales of bread to a primary school	6,000,000
Purchase of flour from a farmer	1,000,000
Purchase of electricity	500,000
Payment of salaries	7,000,000
Purchase of bottled water	3,000,000
Transportation of flour by a VAT registered person	100,000

Continued on the next page

Using the steps elaborated in the previous Study Guide, the deductible input tax is Tshs560,432.429 and total penalty is Tshs350,000 from:

- Total taxable supplies (Tshs400,000+Tshs6,000,000= Tshs6,400,000) and exempt supplies is Tshs1,000,000.
- Total supplies Tshs7,400,000.
- Input taxes incurred $18\% \times (\text{Tshs}500,000 + 3,000,000 + 100,000) = \text{Tshs}648,000$. No input taxes are incurred when buying flour because of exemption; and salaries is outside the scope of VAT.
- Ratio of total taxable supplies i.e. Tshs6,400,000 over total supplies i.e. Tshs7,400,000 is 86.487%.
- Deductible input taxes are given by product of the total input taxes i.e. Tshs648,000 and 86.487% i.e. $\text{Tshs}648,000 \times 86.487\% = \text{Tshs}560,432.429$. So the rest of the input taxes are not deductible.
- The output tax is $18\% \times (\text{Tshs}6,000,000 + \text{Tshs}400,000) = \text{Tshs}1,152,000$
- VAT liability is output taxes /less input taxes= $\text{Tshs}1,152,000 - \text{Tshs}560,432.429 = \text{Tshs}591,567.571$
- Note: sale of books is exempt supplies
- The due date of filing tax return and paying tax for the month of October 2013 is 30 November 2013 assuming it is the last working day of November 2013. So the penalties start on 1 December 2013 and end on 3 March 2014.
- The first the penalty is Tshs50,000 being greater than Tshs5,915.67, and then the monthly penalties are Tshs100,000 being greater than Tshs11,831.34 (see the table below).

	November	December	January	February	March	Total Penalties
Penalties		50,000	100,000	100,000	100,000	350,000

Furthermore, when VAT liabilities are not paid on the due date, non-compliant taxpayers are charged interest on the outstanding balance. The outstanding balance includes unpaid taxes, penalties and interest (28(1)).

The interest should be compounded at the end of each prescribed accounting period, or part of such period for which the taxes remain unpaid at commercial bank lending rate of the Central Bank together with a further 5% per annum (Section 28(2)). Therefore, the formula for compounding interest is very useful here.

This formula calculating interest is given by: $I = P [(1 + R)^N - 1]$, where;

I = Interest charge,

P = Unpaid taxes,

R = monthly interest charge rate, and

N = number of periods in which taxes were unpaid.



Test Yourself 1

The following data taken from a taxable person's sale and purchase book; which contains sales and purchase information for October 2013.

Items without VAT	Tshs
Sales of books	1,000,000
Sales of bottled water	400,000
Sales of bread to a primary school	6,000,000
Purchase of flour from a farmer	1,000,000
Purchase of electricity	500,000
Payment of salaries	7,000,000
Purchase of bottled water	3,000,000
Transportation of flour by a VAT registered person	100,000

Required:

You are required to compute deductible input taxes using standard method, output taxes, interests and tax penalties if payment of VAT liabilities and VAT return were made on 3rd March 2014.

2. Describe the offences and penalties under the VAT Act 1997.**[Learning Outcome c]**

The following are few of the offences and penalties under VAT Act 1997 for tax non-compliance.

1. It is an offence to not register for VAT, contravening any terms of the registration and falsely holds himself to be taxable when he is not. This offence is taxable with a penalty of not than Tshs200,000 or imprisonment of between 2 and 12 months or both; fine and sentence are available (Section 44(1)).
2. It is an offence to not issue fiscal receipts and a penalty is liable of not than Tshs1,000,000 or imprisonment not exceeding 12 months or both; fine and sentence are available (Section 29(3)).
3. It is an offence not to inform the Commissioner of any change in business circumstances within 30 days; a penalty of not than Tshs100,000 is payable (Section 44(3)).
4. It is an offence if a VAT return is not submitted in time or taxes not paid on due date. Upon conviction a person is liable for a penalty not exceeding Tshs200,000 or sentence between 2 to 12 months (Section 45).
5. Any person who in purported compliance with any requirement under the Act, knowingly makes a return or other declaration, furnishes any document or information or makes any statement, whether in writing or otherwise, that is false in any material particular, commits an offence. On conviction person is liable for a penalty not exceeding Tshs500,000 or sentence between 3 to 24 months or both fine and sentence (Section 46(1)).
6. It is an offence to involve in fraud or take steps that fraudulently involves evading taxes or recovering taxes. Upon conviction person shall, in addition to payment of tax which would have been paid, pay a fine twice the amount of tax involved or two million shillings, whichever amount is greater, or to imprisonment for a term of 2 years or to both (sentence 47(1)).
7. It is an offence to handle untaxed goods or services. Upon conviction a penalty of the greater of 6 times the taxes and Tshs1,000,000 or a sentence of between 6 to 36 months or both fine and penalty can be applied (Section 47(2)). Also the goods involved are liable for forfeiture (Section 47(3)).

3. Describe the electronic fiscal devices system, its benefits and the possible revenue risks involved.**[Learning Outcome d]**

As part of improvement of tax administration and tax revenue through proper accounting records, taxable persons are required to issue electronic fiscal receipts through Electronic Fiscal Devices (EFDs) (The Value Added Tax (Electronic Fiscal Device) Regulation, 2010). The electronic fiscal devices are normally connected through a GPRS modem at Tanzania Revenue Authority enabling recording of all sales transactions at the authority servers.

The EFDs must be acquired by the taxable persons but the costs of first batch of the EFDs are provided by the government for free, where taxpayers are allowed to deduct the costs as input taxes (Value Added tax (Electronic Fiscal Devices) Section 28).

The authority categorises EFDs into:

1. **Electronic Tax Register (ETR):** the device is used by retail businesses that issue receipts manually,
2. **Electronic Fiscal Printer (EFP):** the device is used by computerised retail outlets. It is connected to a computer network and stores sale transactions or details made in its fiscal memory,
3. **Electronic Signature Device (ESD):** the device is designed to authenticate by signing any personal computer (PC) produced financial document such as tax invoice. The device uses a special computer program to generate a unique number (Signature).



Definitions

‘Electronic Fiscal Device (EFD)’ means a machine designed for use in business for efficient management controls in areas of sales analysis and stock control system and which conforms to the requirements specified by the laws.

Tanzania Revenue Authority, 2013

‘First batch’ is the first purchase of order of electronic fiscal devices by taxable persons not applicable of the subsequent purchase of the electronic fiscal devices.

Value Added Tax (EFDs) Section 28(3)

Each EFD has the following features:

1. First, they have viable fiscal seals to prevent tampering with the EFDs, when any sign of tampering with seals is seen it should be promptly reported to the authority.
2. Second, all have fiscal memory to store data; once data is entered it cannot be altered, but when an error occurs a person should issue another fiscal receipt and make the error adjustment at the end of the month after providing the proof of the error.
3. Third, all have unique serial number within the fiscal memory and the number identifies the owner of an electronic fiscal device.
4. Fourth, all have unique specifications followed when operating their software and hardware.

The EFD offer the following benefits to both taxable persons and the authority:

1. Computerising the tax auditing process as data are stored electronic; this results into spending little time on auditing using computers and software auditing techniques even on larger data.
2. With introduction of electronic signature devices, the authorities and taxable persons use less time when issuing tax documents as electronic fiscal receipts.
3. The availability of accounting records at taxable persons’ place of businesses; EFDs and the authority servers may reduce disputes between officers and taxable persons during audit as the evidence can be easily compared. Furthermore, the EFDs issue automatic self-enforcing Z report daily after every 24 hours; The Z-report is obtained by pressing a button on the device at the end of each business day; the report reports all transactions of the day and their total.
4. It might reduce tax evasion resulting from falsification of accounting records when the EFDs are used by taxable persons, because the data are irreversible.
5. They have in-built fiscal memory which cannot be erased by mechanical, chemical or electromagnetic interferences.
6. Transmits tax information to TRA system automatically. This will save a lot of administrative time and costs.
7. They issue fiscal receipt/invoice which is uniquely identifiable, enabling taxpayers to comply with tax laws.
8. They have at least 48 hours power backup, and it can use external battery in areas with no electricity supply. They therefore can work where there are frequent power cuts.
9. They save configured data and records on permanent fiscal memory automatically;
10. They have tax memory capacity that stores data for at least 5 years, which is a benefit to taxpayers because they are required to keep records at least for 5 years.

4. Mention the statutory records to be maintained by VAT registered traders.**[Learning Outcome e]**

All VAT registered traders are required to keep the following records:

- 1. Electronic fiscal receipts:** these are receipts issued by Electronic Fiscal Devices (EFDs). All supplies made by taxable persons are accompanied with electronic fiscal receipts given out to buyers and copies kept by the taxable persons. But, due to the introduction of EFDs, the copies are automatically kept in the machines for at least five years.
- 2. Records of issue of credit notes:** taxable persons should issue the credit notes when supplies are cancelled, price amended or goods are returned.
- 3. Accounting records:** complete accounting records may include balance sheets, income statements, cash flows statements, electronic fiscal receipts, credit notes, debit notes, creditors books, debtors books, sale purchase books, and others accounting documents relating to businesses' activities.
- 4. VAT registration documents:** Taxable persons should keep their Certificate of Registration, Taxpayer Identification Numbers and VAT registration numbers and indicate those numbers in any correspondence with TRA.
- 5. VAT account:** Each taxable person should keep VAT account showing how much input taxes were paid, output taxes were collected and VAT was paid to TRA in a particular month.

Answer to Test Yourself**Answer to TY 1**

The deductible input taxes are Tshs560,432.429, output taxes were Tshs1,152,000, VAT payable was Tshs591,567.571, penalties were Tshs350,000, and interest was Tshs34,241.26:

- Total taxable supplies (Tshs400,000+Tshs6,000,000= Tshs6,400,000) and exempt supplies is Tshs1,000,000.
- Total supplies Tshs7,400,000.
- Input taxes incurred $18\% \times (\text{Tshs}500,000 + 3,000,000 + 100,000) = \text{Tshs}648,000$. No input taxes are incurred when buying flour because of exemption and salaries is outside the scope of VAT
- Ratio of total taxable supplies i.e. Tshs6,400,000 over total supplies i.e. Tshs7,400,000 is 86.487%.
- Deductible input taxes are given by product of the total input taxes i.e. Tshs648,000 and 86.487% i.e. $\text{Tshs}648,000 \times 86.487\% = \text{Tshs}560,432.429$. So the rest of the input taxes are not deductible.
- The output tax is $18\% \times (\text{Tshs}6,000,000 + \text{Tshs}400,000) = \text{Tshs}1,152,000$
- VAT liability is output taxes less Input taxes= $\text{Tshs}1,152,000 - \text{Tshs}560,432.429 = \text{Tshs}591,567.571$
- Note: sale of books is exempt supplies
- The due date of filing tax return and paying tax for the month of October 2013 is 30 November 2013 assuming it is the last working day of November 2013. So the penalties start on 1 December 2013 and end on 3 March 2014.
- The first the penalty is Tshs50,000 being greater than Tshs5,915.67, and then the monthly penalties are Tshs100,000 being greater than Tshs11,831.34 (see the table below).

	November	December	January	February	March	Total Penalties
Penalties		50,000	100,000	100,000	100,000	350,000

- (k) $I = P [(1 + R)^N - 1]$, where;

I = Interest charge,

P = Unpaid taxes, 591,567.571;

R = monthly interest charge rate, 1.416667%; and

N = number of periods in which taxes were unpaid, 4 months.

When substituted in the formula the interest charge is determined as Tshs34,241.26.

Quick Quiz

- Which one of the following statements is correct?
 - Costs of EFDs are always deductible input taxes
 - It is optional to buy EFDs
 - EFDs can enhance tax revenues and reduce non-compliance
 - All of the above
- The penalties paid by taxable person :
 - Can be deducted as input taxes.
 - Are payable immediately.
 - Include interests.
 - Can be deducted as input taxes and also include interests
- Which of the following statements is correct with reference to EFDs?
 - They compute input taxes
 - They compute output taxes
 - They determine VAT liabilities
 - None of the above

Answers to Quick Quiz

- The correct option is **C**.
When EFDs are used properly revenue collection can increase as they make tax evasion difficult.
- The correct option is **B**.
Penalties are payable immediately after receipt of notice of assessment.
- The correct option is **D**.
The devices can do any of the mentioned actions, but even with EFDs, human manpower is still needed.

Self Examination Questions**Question 1**

The following information is available from M/s Ngulambe stores, a retail grocery located on Kilwa road, Dar es Salaam, which is a taxable person.

- Purchases made / expenses paid, during the prescribed accounting period of January 1999.

Item	Value	VAT	VAT inclusive
Cooking oil	80,000	16,000	96,000
Bags for packing wheat	17,500	3,500	21,000
Electricity	15,000	3,000	18,000
Sugar	55,000	11,000	66,000
Telephone	20,000	4,000	24,000
EFD receipts books	25,000	5,000	30,000
Transportation of milk	150,000	30,000	180,000
Refrigerator	100,000	20,000	120,000
Wheat flour	400,000	Exempted	400,000
Green vegetables	150,000	Exempted	150,000
Beer and spirit	300,000	60,000	360,000
Soft drinks	150,000	30,000	180,000
Milk	180,000	Exempted	180,000

2. Also during the same prescribed accounting period the following supplies were made:

Item	Payments received
Cooking oil	60,000
Sugar	45,000
Toilet soap	63,000
Laundry soap	51,000
Wheat flour	200,000
Green vegetable	160,000
Beer and drinks	290,000
Soft drinks	160,000
Milk	200,000
Transportation of goods	250,000

The following information is also available:

- Gross takings for beer and spirit supplies include deposits for bottles taken out by customers amounting to Tshs10,000 as security for safe return of the said bottles.
- There was a cash loss of payments received in respect of supply of soft drinks of Tshs20,000, which have not been included in the payments.
- One crate of beer worth Tshs18,000 was taken for personal consumption by the owner of the grocery store. The amount was not included in the payments received during the month.
- Milk worth Tshs20,000 was returned by a customer during the month for various reasons. This has not been subtracted from the gross takings shown above.
- No cash discount during the month.
- A deposit for purchases of crates of beer by a customer amounting to Tshs20,000 has not been included in the gross takings.

Required:

- (a) Calculate output tax collected for the month of January.
- (b) Compute input tax to be claimed for credit during January by using the standard method.
- (c) Calculate amount to be remitted to the Commissioner for VAT, stating the due date.

Question 2

Mr. Vinod commenced a business of butchery and sale of meat products to various hotels and schools in Dar es Salaam since January 1999. Mr. Vinod is a taxable person and in January 2001 made available to you his records for the month of February 1999.

After the computation of input and output taxes, it was discovered that Mr. Vinod had credit balance (repayment or refund) of Tshs10,000,000 in that period.

Required:

- (a) State the due date for lodging the return and payment of the tax.
- (b) Compute any interest or penalty due to him if he filled the VAT return on 30 January 2001.

Question 3

Sakina Supermarket Ltd is a value added tax (VAT) registered operator and carries on the business of a supermarket on a cash basis. The company's records show the following income and expenditure for the month of November 2006:

	Tshs	Tshs
Cash Sales		
General goods		170,000,000
Maize meal and sorghum for human consumption		28,000,000
		198,000,000
Opening stock	300,000,000	
Purchases for cash and on credit;		
General goods	120,000,000	
Maize meal and sorghum for human consumption	20,000,000	
	440,000,000	
Closing stock	280,000,000	160,000,000
Gross profit		38,000,000
Expenditure		
Advertising	2,000,000	
Rent of premises	5,000,000	
Salaries	18,000,000	
Other expenses (subject to VAT)	6,000,000	31,000,000
Profit for the month		7,000,000

Required:

- Determine the VAT payable or VAT refundable for the month of November 2006 for Sakina Supermarket Ltd.
- State the due date for submission of the VAT return and payment of the VAT due for November 2006.

Answers to Self Examination Questions**Answer to SEQ 1**

(a)

Item	Adjusted Payments Received	Output Taxes
	Tshs	Tshs
Cooking oil	60,000	9,152.54
Sugar	45,000	6,864.41
Toilet soap	63,000	9,610.17
Laundry soap	51,000	7,779.66
Wheat flour	200,000	-
Green vegetable	160,000	-
Beer and drinks	318,000	48,508.48
Soft drinks	180,000	27,457.63
Milk	180,000	-
Transportation of goods	250,000	38,135.59
Total output taxes		147,508.48

Note:

- Deposit for bottles is not supplies, it is like a guarantee that the customer will return the bottles; so Tshs10,000 has been deducted from the sales amount of beer and spirits.
- Cash loss has been added because it includes VAT.
- Personal consumption of beer also is added to the sum as self supply.
- Sales return is deducted.
- Purchase deposit is added because the time of supply is when cash is received if it is the earliest point.
- Milk, wheat flour and green vegetables are exempt supplies.
- VAT fraction has been used to compute output taxes; the sales figures are VAT inclusive.

(b)

Item	Adjusted payments received	Output taxes	Supplies excluding VAT
	Tshs	Tshs	Tshs
Cooking oil	60,000	9,152.54	50,847
Sugar	45,000	6,864.41	38,136
Toilet soap	63,000	9,610.17	53,390
Laundry soap	51,000	7,779.66	43,220
Wheat flour	200,000	-	200,000
Green vegetable	160,000	-	160,000
Beer and drinks	318,000	48,508.48	269,492
Soft drinks	180,000	27,457.63	152,542
Milk	180,000	-	180,000
Transportation of goods	250,000	38,135.59	211,864
Total supplies			1,359,491.53
Total taxable supplies			819,491.53
Ratio of taxable/total supplies			0.60
Total input taxes given in the question			182,500
Deduction input taxes			110,009.66

(c)

VAT payable	Tshs
Output taxes	147,508.47
Less input taxes	110,009.66
	37,498.81

The amount is payable before the end of February 1999 probably 28th if it the last working day of that month.

Answer to SEQ 2

- (a) The due date of payment of VAT and filing tax return was on 31 March 1999 assuming it is the last working day of the month.
- (b) The person will pay no interest because the return had refund, but is liable for penalty for not filling the return on time. In this case Tshs50,000 is payable in April, and Tshs100,000 is payable in each month up to 30 January 2001. Consequently the total penalty is Tshs950,000.

Answer to SEQ 3

(a) VAT refund

	Tshs
Output taxes	3,060,000.00
Less: Input taxes	20,554,545.45
	(17,494,545.45)

Workings:

Input taxes calculations

Taxable purchase	Tshs
General goods	20,000,000.00
Advertising	2,000,000.00
Rent of premises	5,000,000.00
Others	6,000,000.00
Total purchase	133,000,000.00
Total input taxes at 18%	23,940,000.00
Taxable supplies/total supplies	0.86
Deductible input taxes	20,554,545.45

Notes:

- Maize meal and sorghum for human consumption are exempt supplies
 - Salary is outside the scope of VAT
 - Opening stock includes goods purchased in previous periods, already accounted for in the respective month of purchase.
 - Standard method is used and the figures are assumed to be VAT exclusive.
- (b) The due date for submission of the VAT return was before or on 31 December 2006 if that date is the last working day of the month.

STUDY GUIDE D3: VAT PAYMENTS AND REPAYMENTS

Get Through Intro

After knowing types of supplies, one needs to know how input taxes are computed and when input taxes can be deducted as explained in the characteristics of VAT. This Study Guide deals with conditions necessary for deduction of input taxes and methods used in computation of input taxes in case of partial exempt supplies. Also, it deals with computation of output taxes, repayment and payment of VAT liabilities and procedures of refund to VAT relieved persons.

This knowledge is important when computing value added taxes, dealing with VAT relieved persons or claiming VAT refunds from Tanzania Revenue Authority.

Learning Outcomes

- a) Apply the provisions of VAT Act and regulations in computation of input tax.
- b) Apply the provisions of VAT Act and regulations in computation of output tax and VAT liabilities.
- c) Explain the concept of partial exemption.
- d) Compare and contrast the methods of apportionment of input tax.
- e) Classify VAT repayment claims.
- f) Describe the refund procedures to diplomats and other relieved persons.

1. Apply the provisions of VAT Act and regulations in computation of input tax.**[Learning Outcome a]****1.1 Conditions for input tax deduction**

Input taxes include all VAT paid on acquiring taxable goods or services (Section 16). Only taxable persons can deduct their input taxes when computing their tax liabilities. However, the deduction is allowed when the following conditions are met:

1. There is a relationship between input taxes and taxable supplies made by a taxable person (Section 16(1)(b)). That is the input taxes are deductible only when they were incurred on purchasing taxable supplies which were also subsequently sold as taxable supplies. Consequently, input taxes paid on acquiring exempt supplies or taxable supplies which are subsequently sold as exempt supplies are not deductible.
2. The incurrence of input taxes should be proved by electronic fiscal receipts, or any other evidence to the satisfaction of a Commissioner, or court of law (Section 16(4)). Furthermore, an authentication of Zanzibar treasury is required before input tax incurred in Tanzania Zanzibar is deducted (Section 16(2); Government Notice NO. 177 Regulation 6(1)).
3. The deduction is time barred after expiration of six months from the issue of electronic fiscal receipts or other evidence (Section 16(5)).
4. Input taxes on motor vehicle and business entertainment are not deductible (Government Notice NO. 177 Regulation 3 and 4). However, Government Notice NO. 177 Regulation 4 provides the following:

Any tax incurred by a taxable person on business entertainment shall, unless that business entertainment is in relation to:

- (a) the ordinary course of a business which continuously or regularly supplies entertainment for a consideration, or
- (b) the provision to an employee of food, non-alcoholic beverage, accommodation or transportation for use wholly and exclusively for the purposes of the employees business,

Be excluded from any claim, deduction or credit made under the Act.

Likewise, Government Notice NO. 177 Regulation 3 (2) allows deduction of input taxes when the cars can carry only 1 person or at least 12 people, driver inclusive. In the case of goods carrying cars, their carrying capacities should be at least 3 tonnes of unladen weight or they should be constructed for a special purpose other than the carriage of persons and having no accommodation for persons. Likewise, input taxes on cars sold as stock in businesses, hiring or letting are deductible.

**Definitions**

'Business entertainments' are: provision of food and drink, theatre or concert tickets, accommodation, entry to sporting events and facilities, or the use of capital assets such as yachts and aircraft for the purpose of entertaining to a customer or prospective customer or the provision to any employee of any form of alcoholic beverages, tobacco, amusement, recreation, or hospitality.

Government Notice Number 177 Regulation 4(2)

'Motor car' is any motor vehicle with at least 3 wheels which is constructed or adapted mainly for carrying passengers or it has to the rear of the driver's seat roofed accommodation which is fitted with side windows or which is constructed or adapted for the fitting of side windows.

Government Notice Number 177 Regulation 3(2)

2. Explain the concept of partial exemption.**Compare and contrast the methods of apportionment of input tax.****[Learning Outcomes c and d]**

After assessing the first condition, one can deduce that when input taxes are incurred for both exempt and taxable supplies, the input taxes should be apportioned. Then, those deemed to relate to taxable supplies made are deductible whereas those deemed to relate to exempt supplies are not deductible.

Generally, taxable persons who sell both exempt and taxable supplies are called '**partial exempt traders**' because they are partially allowed to deduct their input taxes. These persons are allowed to choose one of the partial input taxes computation methods given by Government Notice No. 177 Regulation (7). According to this regulation, the choice is between standard method and attribution method but once selection is made, it has to be used for a whole accounting period.

2.1 Standard method

The regulation has provided five steps to follow when using this method of apportionment (Government Notice NO. 177 Regulation 8(1)).

These steps are:

1. Compute total taxable supplies VAT exclusive and exempt supplies in a particular month.
2. Add the total taxable supplies and exempt supplies above.
3. Compute input taxes incurred in that month for purchasing taxable and exempt supplies excluding input taxes incurred on purchase of car and businesses entertainment.
4. Find the ratio of total taxable supplies in step 'a' over total supplies i.e. taxable supplies plus exempt supplies in step 'b'.
5. Deductible input taxes are given as the product of the total input taxes in step 'c' and ratio in step 'd' or:

$$\frac{\text{Taxable supplies}}{\text{Total supplies}} \times \text{Total input tax}$$

The standard method as seen above is simple to use as it just follows the steps above and does not require complex accounting records because only separation of taxable and exempt supplies made in a particular month is required. However, the simplicity comes at the expenses of accuracy of computation of input taxes because there is limited clear relationship between deductible input taxes and taxable supplies made. Also it may not be appropriate for big businesses with complex accounting records; these businesses can benefit from the second method.

**Example**

The following data taken from a taxable person's sale book and purchase book; and contains sales and purchase information for October 2013.

Required:

Compute deductible input taxes using standard method.

Items without VAT	Tshs
Sales of books	1,000,000
Sales of bottled water	400,000
Sales of bread to a primary school	6,000,000
Purchase of flour from a farmer	1,000,000
Purchase of electricity	500,000
Payment of salaries	7,000,000
Purchase of alcohol for employees	8,000,000
Purchase of bottled water	3,000,000
Transportation of flour by a VAT registered person	100,000

Continued on the next page

Answer

Using the steps elaborated before, the deductible input taxes is Tshs**560,432.429** from:

- (a) Total taxable supplies (Tshs400,000+Tshs6,000,000= Tshs6,400,000) and exempt supplies is Tshs1,000,000.
- (b) Total supplies Tshs7,400,000.
- (c) Input taxes incurred $18\% \times (\text{Tshs}500,000 + 3,000,000 + 100,000) = \text{Tshs}648,000$. No input taxes are incurred when buying flour because of exemption and salaries is outside the scope of VAT
- (d) Ratio of total taxable supplies i.e. Tshs6,400,000 over total supplies i.e. Tshs7,400,000 is 86.487%.
- (e) Deductible input taxes are given as the product of the total input taxes i.e. Tshs648,000 and 86.487% i.e. $\text{Tshs}648,000 \times 86.487\% = \text{Tshs}560,432.429$. So the rest of the input taxes are not deductible.
- (f) Note, input tax on business entertainment i.e. alcohol is not deductible.

**Test Yourself 1**

Assume you were approached by a taxable person who needs help with the computation of input.

The following information is made available to you.

Sales / Purchases VAT exclusive	Tshs
Importation of standard rated services	8,000,000
Purchase of motor car for CEO	10,000,000
Payment of interest bills	5000,000
Purchase of drugs for humans from a local manufacturer	3,000,000
Purchase of taxable goods	10,000,000
Sales:	
Sales to Kenya	20,000,000
Retail taxable sales	30,000,000
Sales of drugs for humans	10,000,000

Required:

Using the standard method, compute the input taxes.

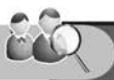
2.2 Attribution method

The attribution method tries to trace how purchased goods and services are to be used. Once subsequent uses of goods and services are established, input taxes can be easily categorized into those related to exempt supplies, taxable supplies and to both taxable and exempt supplies (Government Notice NO. 177 Regulation 8(3)): The regulation provides the following steps when the attribution method is chosen:

1. Classify input taxes in a particular period into:
 - (a) Category "A" input taxes directly attributable to taxable supplies.
 - (b) Category "B" input taxes attributable to exempt supplies [exempt input tax], and
 - (c) Category "C" input taxes attributable to exempt and taxable supplies. E.g. input taxes incurred on transporting both exempt and taxable purchases.
2. Find the ratio of total taxable supplies over total supplies as in the standard method
3. Multiply the ratio in step 'b' above and the amount in Category C in step 'a'.
4. Compute input taxes deductible as input in Category A + input tax in step 'c' or deductible

$$= (A + C) \times \frac{\text{Taxable supplies}}{\text{Total supplies}}$$

This method provides more appropriate input tax deduction than the standard method because input taxes are linked directly to supplies made. But, it requires complicated record keeping to separate input taxes into those related to taxable supplies, exempt supplies and to both of them. Also it is a little bit complicated than the standard method. Therefore, only larger traders may prefer this method.



Example

The following data taken from a Swan Co (taxable person) sale and purchase books; which contains sales and purchase information for October 2013.

Items without VAT	Tshs
Sales of books	1,000,000
Sales of bottled water	400,000
Sales of bread to a primary school	6,000,000
Purchase of flour from a farmer	1,000,000
Purchase of electricity	500,000
Payment of salaries	7,000,000
Purchase of bottled water	3,000,000
Transportation of flour by a VAT registered person	100,000

Required:

Compute deductible input taxes using the attribution method.

Answer

Using the steps elaborated above the deductible input taxes is Tshs**617, 838.3** from:

- Total taxable supplies (Tshs400,000+Tshs6,000,000= Tshs6,400,000) and exempt supplies is Tshs1,000,000.
- Total supplies Tshs7,400,000.
- Classification of input taxes incurred into Category A= $18\% \times 3,000,000 = \text{Tshs}540,000$. Category B= $18\% \times \text{Tshs}100,000 = \text{Tshs}18,000$, Category C= $18\% \times 500,000 = \text{Tshs}90,000$. No input taxes are incurred when buying flour because exemption and salaries are outside the scope of VAT.
- Ratio of total taxable supplies i.e. Tshs6,400,000 over total supplies i.e. Tshs7,400,000 is 86.487%.
- Multiply the ratio in step 'd' above and the amount in Category C in step 'c', $86.487\% \times \text{Tshs}90,000 = \text{Tshs}77,838.3$.
- Deductible input taxes is input tax in Category A i.e. Tshs540,000 + input tax in step 'c' i.e. Tshs77,838.3= Tshs617, 838.3. So the rest of the input taxes are not deductible.



Test Yourself 2

Refer to the information in Test yourself 1.

Required:

Using the attribution method, compute the input taxes.

2.3 Annual adjustment and adjustment of input taxes for partial exempt traders

All partial traders are required to make adjustment of input taxes every year of income using the method selected in that period (Government Notice NO. 177 Regulation 7(3)). Moreover, the adjustment is also required when a partial exempt taxable person is deregistered from the start of the year to the time of deregistration (Government Notice NO. 177 Regulation 7(4)).

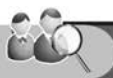
Therefore, the input taxes deducted using the above methods is provisional which is adjusted either using annual adjustment or the adjustment at the time of deregistration. The adjustment is done to reconsider the accuracy of computation of input taxes during a year or any length of period before registration is cancelled. For instance, when attribution method is selected the classification of input taxes is based on intentional use of purchased goods or services; the intentions may be different from actual uses of the goods or services.



Definition

'Annual adjustments' refer to recalculation of input taxes over the period of one year done by partial exempt traders using their method of choice.

An adjustment considers total input taxes, taxable supplies and exempt supplies over that period. For example, in annual adjustments, the total annual taxable supplies, annual exempt supplies, total annual supplies and annual input taxes would be used in standard method instead of monthly total. Moreover, in attribution method, the total annual input taxes should be classified into category A, B and C. Likewise, deregistration supplies and input taxes should be totaled up from the beginning of accounting to the time of deregistration.



Example

A Ltd has been VAT registered since 2002. In 2012, the company claimed input taxes amounting to Tshs20,000,000 using the attribution method. The total annual input taxes incurred were Tshs32,000,000, annual taxable supplies worth Tshs80,000,000 and annual exempt supplies were Tshs20,000,000. The annual input taxes could be classified as Tshs15,000,000 into category A, Tshs2,000,000 into category B, and the rest into category C.

Required:

How much should be the annual adjustment?

Answer

Using the steps elaborated previously the annual adjustment is calculated as Tshs7,000,000.

- (a) Total taxable supplies are Tshs80,000,000 and exempt supplies are Tshs20,000,000.
- (b) Total supplies Tshs100,000,000.
- (c) Classification of input taxes incurred into Category A= Tshs15,000,000. Category B= Tshs2,000,000, Category C= Tshs15,000,000.
- (d) Ratio of total taxable supplies i.e. Tshs80,000,000 over total supplies i.e. Tshs100,000,000 is 80%.
- (e) Multiply the ratio in step 'd' above and the amount in Category C in step 'c', $80\% \times \text{Tshs15,000,000} = \text{Tshs12,000,000}$.
- (f) Deductible input taxes is input taxes in Category A i.e. Tshs15,000,000 + input tax in step 'e' i.e. Tshs12,000,000 = Tshs27,000,000. So the annual adjustment is Tshs27,000,000 - Tshs20,000,000 = Tshs7,000,000 in favour of the company.

2.4 Deduction of input tax paid before VAT registration and after deregistration

Government Notice NO. 177 Regulation 5(1) allows deduction of input taxes incurred prior to VAT registration provided in case of goods; the goods should have been received within 6 months before registration and the goods must be still owned and possessed by the person.

Moreover, input taxes paid within six months before registration on purchase of services are deductible provided the service is attributable to taxable supplies and businesses for which the person is now registered for VAT. Likewise, input taxes on purchase of services connected with cancellation of VAT registration are deductible when they are incurred within 6 months from the date of deregistration (Government Notice NO. 177 Regulation 5(2)).



Example

Maj Co Ltd incurred the following input taxes before being taxable on 1 December 2013, but the company directors wonder whether the input taxes are deductible or not. The following taxes were paid:

- (a) Paid input taxes in January 2013 to a law firm while suing a former employee for fraud
- (b) Paid input taxes while purchasing taxable goods in June 2013, but only $\frac{3}{4}$ of the goods have been sold.
- (c) Paid input taxes in transporting exempt supplies to the company godown, but only $\frac{1}{2}$ of the supplies have been sold.

In this case, the input tax paid in January is time barred because it was not incurred within 6 months before the registration. The input taxes on unsold i.e. $\frac{1}{4}$ of the taxable goods are deductible as the goods were still owned and possessed by Maj Co Ltd.

Finally input taxes on exempt supplies are not deductible even if the goods were still in the company's possession and ownership if the attribution method is used.

2.5 Importation of services

Government Notice NO. 177 Regulation 3(2)] requires importers of taxable services to act as purchasers as well as suppliers of the services under a **reverse charge**. The role of purchasers allows importers to claim input taxes on importation of services in normal ways, while the role of suppliers requires the importers to account the output taxes on the importation as if they supplied the services to themselves; therefore the importers of taxable services should deduct output taxes before paying their bills. In addition, the value of imported services must form part of taxable supplies when calculating VAT registration thresholds.



Definition

'Imported services' mean any services supplied to a Tanzania Mainland resident by a person from outside Tanzania Mainland.



Example

Continuing the example of Swan Co

Let us compute the deductible input taxes using standard method. Also compute the output taxes. Using the steps elaborated previously the deductible input taxes were **Tshs560,432.429** and output taxes collected were **Tshs1,242,000** from:

- Total taxable supplies (Tshs400,000+Tshs6,000,000= Tshs6,400,000) and exempt supplies is Tshs1,000,000.
- Total supplies Tshs7,400,000.
- Input taxes incurred $18\% \times (\text{Tshs}500,000 + 3,000,000 + 100,000) = \text{Tshs}648,000$. No input taxes are incurred when buying flour because of exemption and salaries is outside the scope of VAT
- Ratio of total taxable supplies i.e. Tshs6,400,000 over total supplies i.e. Tshs7,400,000 is 86.487%.
- Deductible input taxes are given by product of the total input taxes i.e. Tshs648,000 and 86.487% i.e. $\text{Tshs}648,000 \times 86.487\% = \text{Tshs}560,432.429$. So the rest of input taxes are not deductible.
- Output tax collected is $18\% \times (\text{Tshs}400,000 + \text{Tshs}6,000,000 + \text{Tshs}500,000) = \text{Tshs}1,242,000$
- Note, the value of imported services is not used in apportionment of input taxes but its VAT is included both in input taxes and output taxes collection.

3. Apply the provisions of VAT Act and Regulations in computation of output tax and VAT liabilities.

[Learning Outcome b]

The output taxes are calculated using either tax rates or VAT fraction. Output taxes are product of taxable value and tax rates; which can be 18%, 0% or 9.9%. So it is important for you to determine the taxable value (sales value before VAT) and tax rates applicable on those supplies. On another hand, the VAT fraction is useful in computing output taxes and even input taxes when the value of supplies include VAT by multiplying VAT fractions and the tax consideration VAT inclusive.

Following the introduction Electronic Fiscal Devices (EFD) no special methods of calculation of output taxes exist for retailers (VAT ACT, Electronic Fiscal Devices ACT 2010, Section 31).



Definition

VAT fraction = $\text{tax rate} / (100 + \text{tax rate})$



Test Yourself 3

Continuing the example of Swan Co

Required:

You are required to compute VAT payable using standard method of partial exempt traders.

4. Classify VAT repayment claims.**[Learning Outcome e]**

VAT repayments refer to a situation where taxable persons are being refunded their taxes by the authorities because their input taxes exceed their output taxes in a particular period (Section 17(1)). However, the Commissioner can make the refund not more than 30 days after the later of: the due date for lodgment of the return for the last prescribed accounting period in the half year or receipt of the last outstanding tax return due for any prescribed accounting period falling within that half year (Section 17(2)).

**Definition**

'Half year' means any successive period of six calendar months commencing in the month for which a repayment return is first submitted.

Section 17(7)

So non-consecutive credit balances might be netted off with debit balances;

**Example**

If a taxable person had credit balance i.e. VAT repayments of Tshs20,000,000 in July 2012 but had a debit balance i.e. VAT payment of Tshs30,000,000 in August 2012, he would only pay Tshs10,000,000 to TRA after deducting the previous credit balance of Tshs20,000,000.

However, taxable persons who expect regular credit balance without possibilities of debit balance can claim VAT repayments monthly (Section 17(3)).

On the other hand, all VAT refunds are classified into Gold, Silver and non-gold -silver categories to improve efficiency of VAT refunds. The Gold category includes traders who expect credit balance i.e. regular payments which are paid by the authority within 30 days from the date of application without auditing. But they must have reliable accounting records at least for 2 years, they must not be involved in tax fraud, have good compliance history and undergo auditing once year. Therefore, the gold category has the lowest perceived risk of tax non-compliance.

Silver category includes traders who have regular payments which do not meet the criteria of gold category. Their first two claims are refunded within 30 days of lodging without audit, but the third claim can only be refunded after audit of the current and the two previous claims. Therefore, the silver category has the moderate or known perceived risk of tax non-compliance.

Finally, the non-gold and non-silver includes taxable persons who are not in the first two categories which might include non-regular paying persons. All claims from the last category are audited before being refunded. Therefore, the category has high or unknown perceived risk of noncompliance.

5. Describe the refund procedures to diplomats and other relieved persons.**[Learning Outcome f]**

Relieved persons are required to meet certain conditions before getting the VAT relieved. With exception of persons discussed below the rest of the relieved persons must fill forms VAT 220/223/224 in duplicate from TRA Regional Offices and submit them to the offices for approval before making any local purchase (<http://www.tra.go.tz/index.php/value-added-tax-vat/104-vat-relief>).

The forms indicate the quantities and values of the goods or services to be acquired at a specified date. They pay VAT when they purchase standard rated goods and services. The forms VAT 220/223/224 are also applicable in case of importation of capital goods. However, the importer should provide explanation of the intended capital goods and submit the forms to customs offices together with the bill of lading, invoice, packing list and any other documents helpful in confirmation of nature and ownership of the capital goods.

Then, the description of the goods would be compared to Harmonised System Code (HS Code) of customs; upon satisfaction the application of relief on importation of capital goods might be approved. The approval serves as evidence of relief when the goods are imported. So no VAT is payable on importation.

5.1 Investors with certificate from Tanzania Investment Centre (TIC)

Similarly, investors registered under the Tanzania Investment Centre (TIC) have to complete form VAT/220/223/224 while applying for the relief of ordered materials. Their applications are accompanied by a letter from TIC confirming the existence or registration of the project, proposed list of goods/materials that are to be imported, proforma invoice/ invoice, packing list, bill of lading, airway bill, consignment note. In the case of building materials, the proposed list of goods must be certified by a registered quantity surveyor.

Thereafter, the application details are compared to the nature and size of the project; if the officers are satisfied the relief is approved. The approval serves as the evidence of relief when the goods are imported at a particular date.

5.2 Mining and explorations, drilling companies

Also mining companies are required to complete form VAT 220/223/224 before getting VAT relief. Their applications are accompanied by copies of mining licenses, a list of materials and equipment duly endorsed by the Commissioner for minerals and TIN certificates. But, when additional information is needed the Customs and Excise officer in charge of that region must inspect mines before approval of the relief.

The applications of relief are approved after information submitted is accepted, and the approval serves as the evidence of relief when the goods are imported at a particular date. The registered licensed drilling, mining, exploration or prospecting companies present their licenses issued by appropriate authorities, copies of a valid business licence and proforma invoice to obtain VAT relief.

5.3 Diplomats and diplomatic missions

However, diplomats pay VAT to their local suppliers when purchasing local taxable goods and services. Thereafter, they claim refund by completing form VAT 207 every month. Moreover, the applications must be accompanied with Electronic Fiscal Devices (EFDs) receipts, passed through the head of the mission and endorsed by the Ministry of Foreign Affairs and International Co-operation before presenting them to the domestic revenue department.

Yet, diplomatic missions do not pay VAT when buying locally, but they have to apply for relief before making the purchases. The applications are made by completing the form VAT 222, which must be endorsed by the Ministry of Foreign Affairs and International Co-operation before presenting them to the Domestic Revenue Department. After approval, the diplomatic missions should submit original copies to suppliers where they buy taxable goods and services, and the supplies should retain the copies for their records. However, in urgent conditions the Diplomatic Mission may pay VAT when buying taxable goods and services and claim the goods by completing form VAT 207 as diplomats.

Nonetheless, the Diplomats and Diplomatic missions complete separate forms VAT 222 applying for relief of VAT on payment for electricity, security services and telephones. The application is made at the beginning of each financial year. After approval the applicants are required to submit a copy of the form to suppliers of electricity, security services and telephones when they buy the supplies within the covered period.

5.4 Technical aid agreements or donor/government-funded projects

Similarly, technical aid agreements or donor/government-funded projects complete application forms VAT 220/223/224 in duplicate to apply for VAT relief before buying taxable goods and services. The applications are submitted to TRA Regional Offices. Also the applications should be accompanied with a schedule showing the quantities and values of the goods or services and proforma invoice.

Also when technical aid with tax agreements with the government or donor/government-funded projects what to import goods, they should complete form VAT 220/223/224. The forms would include details of what is to be imported and place of the project. Before submitting the applications, they should be endorsed by the main Ministry under which the project concerned is related. Moreover, they should be accompanied with the bill of lading, invoice, packing list and any other relevant documents to confirm ownership of the goods. The approval process involves securitizing agreements offering the VAT relief. The approval serves as the evidence of relief when the goods are imported at a particular date.

5.5 Armed Forces and operators of TPDF Duty Free Shops

Armed Forces prepare an annual requirement of local purchase for each Armed Force and complete forms VAT 220/223/224. Then, the forms are submitted to the regional manager for approval together with proforma invoices; after approval the Armed Forces are required to buy from local manufacturers of goods or from their branches. Suppliers do not charge VAT for their supplies to the Armed Forces but keep one form of VAT 220/223/224 as proof of VAT relief. Where the armed forces want to import goods, their goods are imported through customs bonded warehouse and removed only for Armed Forces' uses without VAT.

Similarly, operators of Tanzania People Defence Force (TPDF) duty free shops submit forms VAT 220/223/224 in quadruplicate (original, to the supplier of goods; duplicate, to be retained by TRA; triplicate, to be retained by TPDF and quadruplicate a book copy) to TRA Regional Offices together with proforma invoices, copies of business license and copies of agreements between the operators of duty free shops and the TPDF.

Thereafter, the applications may be approved and the application forms serve as evidence of VAT relief when operators of Duty Free Shops buy sugar, corrugated iron sheets, steel bars and cement from local suppliers. Furthermore, purchasing officers of TPDF Duty Free Shops have identity cards issued by the TPDF. Operators of TPDF duty free shops import goods; the goods are entered into Customs Bonded Warehouse and removed only for uses of military personnel.

5.6 Religious Organisations and Charitable Organisations

Registered religious, charitable community based, or non-profit driven organizations or institutions submit their annual plans showing the coming projects at the start of a Government's fiscal to the Tanzania Revenue Authority. In addition, they complete forms VAT 220/223/224, and lodge them with the TRA regional manager together with letters from district Commissioners confirming the existence of the institutions, the project in which the requested goods will be used and a proforma invoice issued by the supplier of goods, which clearly indicates VAT chargeable.

Then, upon acceptance of the applications, the applicants are issued with the forms which enable them to purchase goods without paying VAT but the supplier keeps the forms as evidence of VAT relief. However, as far as NGOs and religious organizations are concerned, the VAT relief use Treasury Vouchers and Cheques system (TVC) which cover local purchases of electricity and telephone services. The purchase of these goods and services include VAT but, the organizations claim for refunds using forms VAT 220/223/224.

However, the relieved organizations explain how the VAT relief had been used; in return a Commissioner when satisfied with the annual accountabilities issues a certificate of credibility. The certificate of credibility is a necessary condition for VAT relief; no relief can be given without it. Also, only religious organizations are exempted from payment of VAT when importing motor vehicles.

Furthermore, charitable organizations apply for taxes on importation of goods to a Commissioner through letters by district Commissioners which prove the existence of the project and the charity. The letter should be accompanied by certificate of registration, letters from the ministry of home affairs, ministry of justice and constitutional affairs, administrator general office or any other legal document, confirming the legality of the charity. Other attachment includes bill of lading/airway bill, invoice, packing list, TIN and any other document confirming ownership of the imported goods. Upon acceptance of the application, the applicants are given exemption letter and the copies are sent to the points of entry of the goods.

5.7 Registered medical practitioners, opticians and dentists

Registered medical practitioners, opticians and dentists are granted VAT relief when they present copies of certificate of registration from the Medical Council of Tanganyika, business licenses and the certificate of registration from the Optical Council of Tanzania.

Private registered hospitals/clinics get VAT relief when they present copies of the certificate of registration from the Advisory Board for Private Hospitals and Voluntary Agencies. Registered veterinary practitioners provide copies of the certificate of registration issued by the Tanzania Veterinary Board and business licence before getting VAT relief. Registered manufacturers of pharmaceutical products provide copies of the certificate of registration / incorporation issued by the Ministry of Trade and Industries, license to manufacture pharmaceuticals issued by the Tanzania Food and Drugs Authority and business licenses to get VAT relief.

5.8 Provider of water and sewerage services, registered water drilling companies and duty free shops

Provider of water and sewerage services for public present a copy of a valid business license, agreement for the contracts with government, proforma invoice for locally purchased goods and importation documents to obtain VAT relief. Moreover, registered water drilling companies present a copy of a valid business license, proforma invoice for locally purchased goods and importation documents to get VAT relief. Finally, duty free shops present a copy of a valid business licence, proforma invoice for locally purchased goods and importation documents to get VAT relief.

5.9 Passenger's Baggage, personal effects and deceased's personal effects

Passengers' personal goods and **deceased's personal effects imported** not for resale may be granted VAT exemption at the discretion of a proper officer. In general, the application of VAT exemption should be accompanied by passport, importation documents, and death certificates of deceased's personal effects.

Answers to Test Yourself

Answer to TY 1

Using the steps elaborated in the Study Guide the deductible input taxes were Tshs2,699,999.99.

- (a) Total taxable supplies (Tshs20,000,000+Tshs30,000,000=Tshs50,000,000) and exempt supplies is Tshs10,000,000.
- (b) Total supplies Tshs60,000,000.
- (c) Input taxes incurred $18\% \times (\text{Tshs}8,000,000 + 10,000,000) = \text{Tshs}3,240,000$. No input taxes are incurred when buying drugs from a local manufacturer because of zero rated supply, VAT on purchase of motor car is prohibited and interest bills are exempt supplies.
- (d) Ratio of total taxable supplies i.e. Tshs50,000,000 over total supplies i.e. Tshs60,000,000 is 83.333%.
- (e) Deductible input taxes are given by product of the total input taxes i.e. Tshs3,240,000 and 83.333% i.e. $\text{Tshs}3,240,000 \times 83.333\% = \text{Tshs}2,699,999.99$ and the rest of input taxes are denied.

Answer to TY 2

Using the steps elaborated in the Study Guide the deductible input taxes were **Tshs2,699,995.2**:

- (a) Total taxable supplies (Tshs20,000,000+Tshs30,000,000=Tshs50,000,000) and exempt supplies is Tshs10,000,000.
- (b) Total supplies Tshs60,000,000.
- (c) Classification of input taxes incurred into Category A= $18\% \times 10,000,000 = \text{Tshs}1,800,000$. Category B= Tshs0, Category C= $18\% \times 8,000,000 = \text{Tshs}1,440,000$. No input taxes are incurred when buying drugs from a local manufacturer because of zero rated supply, VAT on purchase of motor car is prohibited and interest bills are exempt supply.
- (d) Ratio of total taxable supplies i.e. Tshs50,000,000 over total supplies i.e. Tshs60,000,000 is 83.333%.
- (e) Multiply the ratio in step 'd' above and the amount in Category C in step 'c', $83.333\% \times \text{Tshs}1,440,000 = \text{Tshs}1,199,995.2$.
- (f) Deductible input tax is input taxes in Category A i.e. Tshs1,800,000 + input tax in step 'c' i.e. Tshs1,199,995.2= **Tshs2,999,995.2**. So the rest of input taxes are not deductible.

Answer to TY 3

Using the steps elaborated in the Study Guide the deductible VAT liability was Tshs591,567.571:

- (a) Total taxable supplies (Tshs400,000+Tshs6,000,000= Tshs6,400,000) and exempt supplies are Tshs1,000,000.
- (b) Total supplies Tshs7,400,000.
- (c) Input taxes incurred $18\% \times (\text{Tshs}500,000 + 3,000,000 + 100,000) = \text{Tshs}648,000$. No input taxes are incurred when buying flour because of exemption and salaries are outside the scope of VAT
- (d) Ratio of total taxable supplies i.e. Tshs6,400,000 over total supplies i.e. Tshs7,400,000 is 86.487%.
- (e) Deductible input taxes are given by product of the total input taxes i.e. Tshs648,000 and 86.487% i.e. $\text{Tshs}648,000 \times 86.487\% = \text{Tshs}560,432.429$. So the rest of input taxes are not deductible.
- (f) The output taxes is $18\% \times (\text{Tshs}6,000,000 + \text{Tshs}400,000) = \text{Tshs}1,152,000$
- (g) VAT liability is Output taxes less Input taxes= $\text{Tshs}1,152,000 - \text{Tshs}560,432.429 = \text{Tshs}591,567.571$
- (h) Note, sale of books are exempt supplies

Quick Quiz

1. Which of the following statements is true about input taxes?
 - A All input taxes are deductible
 - B Only input taxes relating to taxable supplies made are always deductible
 - C Input taxes incurred in Zanzibar are not deductible.
 - D Only taxable persons deduct input taxes
2. Which of the following is true for input taxes incurred in respect of exempt supplies?
 - A Always not deductible at all
 - B Some part may be deductible using standard method
 - C Not included in computation of input taxes
 - D All of the above
3. Input taxes incurred for entertaining customers is:
 - A Always not deductible
 - B Deductible when customers pay for the entertainment
 - C Deductible when customers account for the output taxes
 - D All of the above
4. Under the attribution method for partial exempt traders:
 - A Full prices of supplies are used
 - B Full prices of supplies excluding VAT are used.
 - C Market values of goods and services are used
 - D None of the above
5. Which one of the following statements is correct with respect to the provisions in the VAT Act?
 - A Attribution method is better than standard method
 - B Selected method should be used in all cases
 - C A partial exempt trader can choose either of the methods
 - D All of the above
6. Which of these statements is correct?
 - A Annual adjustments are done by all taxable persons
 - B Annual adjustments are done every year
 - C Only partial traders do annual adjustments
 - D All of the above
7. Rose was de-registered in 2012. Then within 6 months after the de-registration, she incurred Tshs20,000 as input taxes in purchases of stocks. The amount of input tax deductible will be:
 - A Tshs0
 - B Tshs4,000
 - C Tshs3,600
 - D Tshs3,050

Answers to Quick Quiz

1. The correct option is **D**.

Only taxable persons deduct their input taxes; non-VAT registered person cannot deduct their input taxes. However, some of the input taxes related to taxable supplies may not be deducted if there is evidence to prove payment, or standard method of input tax calculation is selected.

2. The correct option is **B**.

When the standard method of partial exempt traders is used, some of the input taxes related to exempt supplies might be deducted because the method of apportion of total input taxes uses sales ratio to those related to exempt and taxable supplies.

3. The correct option is **B**.

Input taxes incurred in entertaining customers are deductible only when customers pay for the entertainment so output taxes are collected on the supplies.

4. The correct option is **B**.

The attribution method uses the selling prices of taxable supplies, VAT exclusive and exempt supplies in separating input taxes.

5. The correct option is **C**.

The attribution method is better than the standard method in attributing input taxes to their uses of goods and services, but some trader may find attribution method is better than standard method and vice versa. So, it is always the trader who selects one of those methods in a particular year.

6. The correct option is **C**.

Only partial exempt traders do annual adjustments at the end of the year, when tax rate changes or when there is VAT de-registration.

7. The correct option is **A**.

Since the person is no longer registered she cannot claim any input taxes when purchasing goods thereafter, but the person can deduct any input taxes on acquiring services within 6 months after de-registration, which are directly related to the VAT deregistration.

Self Examination Questions

Question 1

The following information is obtained from a VAT return of a VAT registered trader for the month of March 2011:

Item	Tshs
Standard rated supplies	693,389,718
Zero rated supplies	44,681,840
Special Relief supplies 100%	28,814,253
Exempt purchases – Local	56,191,133
Exempt purchases –Imports	40,667,516
Non creditable purchases	8,278,408
Standard rated purchases	866,433,445
Standard rated imports	202,158,772

Required:

(a) Calculate the VAT payable/refund due for the month, on the assumption that:

- (i) There were no exempt supplies made during the month
- (ii) Exempt supplies for the month totaled Tshs612,058,750

(b) Mention three instances that will constitute "Business entertainment" under the Value Added Tax Act, 1997, under each of the following:

- (i) Employee
- (ii) Customer

Question 2

The figures provided below were extracted from the cashbook of a VAT registered trader for the month of August 2006.

Purchases	Value (Tshs)
Leather [imported]	3,000,000
Paper	3,200,000
Glue	20,000
Cardboard Sheet	3,000,000

Sales	Value (Tshs)
Hand bags: Leather imported	2,000,000
Children's books	2,000,000
Newsprint	9,000,000
Diaries	5,000,000
Newsprint [export]	2,000,000

Required:

From the information provided above, as a tax auditor, calculate the amount of VAT due to TRA or due to be refunded to the trader. Assume 18% VAT rate.

Question 3

Kuntu Company Ltd is engaged in the manufacturing of tobacco for exportation and domestic consumption. During the financial year ended December 31, 2007 it had the following information:

	Tshs million
Purchases [VAT at 18%]:	
Importation of machine for tobacco processing CIF value	
CIF value	700
Import duty 10%	7
Other purchases	400
Supplies:	
Export sale of processed tobacco leaves	5,200
Sale of VAT exempt supplies	300
Local sale of processed tobacco leaves	200
Other non-tobacco leaves sales	60
Input tax:	
Directly attributable to zero rated sales	220
Directly attributable to exempt supplies	20
Directly attributable to standard rated taxable supplies	40
Not directly attributable to exempt or taxable supplies	40

Required:

What is the total net amount of VAT payable to or repayable from the Tanzania Revenue Authority (TRA) using the attribution method? Show clearly the apportionment of the input VATs.

Answer to Self Examination Questions
Answer to SEQ 1

(a)

- (i) Input taxes incurred in that month = (Tshs866,433,455 + Tshs202, 158,772) x 18% = Tshs192, 346,601 after excluding non-creditable purchases. If no exempt supplies are made during the month the whole amount is deductible. So the VAT refund is Tshs693,389,718 x 18% less Tshs192,346,601 = Tshs67,536,451.76
- (ii) In case of exempt supplies of Tshs612,058,750 the input taxes must be apportioned. As there is no direction of which method of the two should be used, any method can be used to compute deductible input taxes. In this question, we select the standard method.

Therefore the deductible input taxes = Total input taxes x taxable supplies/ total supplies

$$= \text{Tshs}192,346,601 \times \text{Tshs}93,389,718 + 44,681,840 + 28,814,253 / (\text{Tshs}693,389,718 + \text{Tshs}44,681,840 + \text{Tshs}28,814,253 + \text{Tshs}612,058,750)$$

$$= \text{Tshs}105,715,090.3.$$

$$\text{Therefore VAT liabilities} = \text{Tshs}124,810,149.24 - \text{Tshs}105,715,090.3 = \text{Tshs}19,095,058.94$$

(b)

(i) Employee

Entertainment includes provision to any employee in any form of alcoholic beverages, tobacco, amusement, recreation, or hospitality.

(ii) Customer

Entertainment includes provision of food and drink, theatre or concert tickets, accommodation, entry to sporting events and facilities, or the use of capital assets such as yachts and aircraft for the purpose of entertaining a customer or prospective customer.

Answer to SEQ 2

- (a) Input taxes incurred in that month = (Tshs3,000,000 + Tshs3,200,000 + Tshs20,000 + 3,000,000) x 18% = Tshs1,659,600.

- (b) As there is no direction of which method of the two should be used, any method can be used to compute deductible input taxes. In this question, we select the standard method.

- (c) So deductible input taxes = Total input taxes x taxable supplies/ total supplies =

$$(\text{Tshs}1,659,600 \times (\text{Tshs}2,000,000 + \text{Tshs}5,000,000)) / (\text{Tshs}2,000,000 + \text{Tshs}5,000,000 + \text{Tshs}2,000,000 + \text{Tshs}9,000,000 + \text{Tshs}2,000,000) = \text{Tshs}580,860$$

- (d) Output taxes = Tshs(2,000,000 + 5,000,000) x 18% = Tshs1,260,000.

- (e) Therefore VAT liabilities = Output taxes less deductible input taxes = Tshs679,140.

Answer to SEQ 3

The attribution follows the following steps:

- (a) Calculate total taxable supplies $\text{Tshs}5,200\text{m} + \text{Tshs}200\text{m} = \text{Tshs}5,400\text{m}$
- (b) Calculate total exempt supplies $\text{Tshs}300 + 60\text{m} = \text{Tshs}360$
- (c) Total supplies $\text{Tshs}5,760$
- (d) Classification of input taxes incurred in Category A = $\text{Tshs}260\text{m}$, Category B = 20m , Category C = 40m
- (e) Ratio of total taxable supplies i.e. $\text{Tshs}5,400\text{m}$ over total supplies i.e. $\text{Tshs}5,760$ is 93.75%
- (f) Multiply the ratio in step 'e' above and the amount in Category C in step 'd', $93.75\% \times \text{Tshs}40\text{m} = \text{Tshs}37.5$
- (g) Deductible input tax is input tax in Category A i.e. $\text{Tshs}260$ + input tax in step 'c' i.e. $\text{Tshs}37.5\text{m} = \text{Tshs}297.5\text{m}$. So the rest of the input taxes are not deductible

STUDY GUIDE E1: CUSTOMS

■ Get Through Intro

Customs departments play a major role in collecting government tax revenues. The taxes come from taxing imported and exported goods. While the value of exported goods can be easily determined by the exporting country, the value of imported goods is a bit challenging to all customs departments in the world.

To resolve the valuation faced by custom, customarily six methods of calculating value of imported goods have been agreed internationally. These are transaction value of imported goods, transaction value of identical goods, transactional value of similar goods, deductive method, computed method and fall back method.

This Study Guide deals with operation of customs tax laws, application of customs valuation methods and computation of customs taxes.

Knowledge of customs tax laws is important in ensuring compliance with the customs tax laws and efficient administration of the laws.

■ Learning Outcomes

- a) Describe source of customs tax laws.
- b) Explain customs entry and clearance procedures for imports.
- c) Explain the customs entry and clearance procedures for exports.
- d) Differentiate between prohibited and restricted goods.
- e) Explain the customs valuation methods.
- f) Calculate duties and taxes collected through customs.
- g) Explain customs procedures for prevention of smuggling.
- h) Determine offences in customs operations.
- i) Explain techniques for enforcement of customs laws.
- j) Describe recovery measures used to collect unpaid duties.

1. Describe source of customs laws.

[Learning Outcome a]

Customs and excise department of Tanzania Revenue Authority collects all import and export taxes. These taxes include excises duties, value added tax on imports, import duties and export duties. Consequently, the department implements Value added tax Act, 1997; Electronic Fiscal Devices Act, 2010; The East African Community Customs Management Act, 2004; The East African Community Customs Management (Amendment) Act, 2011, The Excise Management and Tariff Act, Chapter 147; Protocol on the Establishment of the East African Customs Union, The East African Community Customs Union (Rules of Origin) Rules, Electronic Fiscal Devices Regulation, 2010, East Africa Community Customs Management (Duty Remission) Regulations, 2008; East Africa Customs Management Regulations, 2010; East Africa Customs Management (Compliance and enforcement) Regulations, 2012. In addition, practice notes, case laws and directives made by the council of East Africa Community and relevant principles of international laws are sources of customs tax laws. Throughout this study guide, any reference to section refers to the East African Community Customs Management Act 2004.

With exception of the value added tax laws, other customs tax laws are implemented at the East Africa Community level because all customs in the community are managed under the East Africa Community Customs Management Act, 2004. Therefore all East Africa community Partner states such as. Tanzania, Rwanda, Burundi, Kenya and Uganda are required to abide by these laws.

2. Explain the customs entry and clearance procedures for imports

[Learning Outcome b]

Customs entry and clear procedures for imports depend whether the goods or persons have arrived by an aircraft, a vessel, vehicle, pipeline or overland. This section explains procedures concerning the arrival of goods or persons through these means of arrival.



Definitions

Goods include all kinds of articles, wares, merchandise, livestock, and currency, and where any such goods are sold under this Act, the proceeds of such sale.

Making entries for imported goods means declaration of the goods, lodging the declaration and making either a payment of the duties, deposit as required or offering security for the duties owed (Section 2(2) of the East African Community Customs Management (Amendment) Act, 2011).

2.1 Arriving by aircraft or vessel

All aircraft or vessel from foreign country to an East Africa country must only arrive through a port and go directly to a place of mooring or unloading (Section 21).

In addition, in direction of proper officer a vessel or aircraft can moor or unload its cargo anywhere at the port (Section 22).

However, they may land or stop at any place when the aircraft or vessel is lost or wrecked or is compelled to land or stop because of accident, stress of weather or other unavoidable cause. But, the master or agent of the aircraft or vessel must make report of such aircraft or vessel and of its cargo and stores to the nearest officer or administrative officer in a reasonable time (Section 28).



Definitions

Port means any place, whether on the coast or elsewhere, appointed by the council by notice in the Gazette, subject to any limitations specified in such notice, to be a port for the purpose of the Customs laws and in relation to aircraft, a port means a customs airport.

Proper officer means any officer whose right or duty it is to require the performance of or to perform, the acts referred in the East Africa Customs Management Act 2004.

Cargo includes all goods imported or exported in any aircraft, vehicle or vessel other than such goods as are required as stores for consumption or use by or for the aircraft, vehicle or vessel, its crew and passengers, and the bona fide personal baggage of such crew and passengers.

After stopping at the port, no one except the port pilot, the health officer, or any other public officer in the exercise of his or her duties and duly authorised should enter the vessel before a proper officer without the permission of the proper officer (Section 23). Moreover, a report of aircraft or vessel, and of its cargo and stores, and of any package for which there is no bill of lading must be made within 24 hours of arrival to a proper officer (Section 24). The reports should clearly distinguish goods in transit, transshipment, to remain on board for other ports in the partner states, and any goods for re-exportation on the same aircraft or vessel (Section 24(2)). Also when the vessel is less than 250 tons register, the report must be made before a bulk is broken unless the opening of the bulk is allowed by a proper officer (Section 24(3)).

The masters or agents of any aircraft or vessel are held liable for any act of tempering with goods or making a misleading report (Section 24(6)). Also, they are responsible to answer all questions and provide documents concerning aircraft or vessel, its cargo, stores, baggage, crew, and passengers to an officer (Section 25(1)). Finally, upon arriving at a port they should disembark and deliver the names of passengers who are disembarking and not disembarking and when required the names of the master, officer and crews and a clearance report to a proper officer (Section 25(1) (c) and (d)).

Further, the master of vessel should ensure all goods reported for discharge at a port, or place specially allowed by the proper officer, duly unloaded and deposited in a transit shed or a customs area otherwise he/she might pay duty on the goods (Section 27 and 33). Actually, the unloading must take place at time and place designated for loading (Section 33(1)). Moreover, goods can be unloaded from an aircraft or a vessel into another vessel and taken directly to an approved place of unloading or at a sufferance wharf. Where goods are for re-exportation they can be loaded into another vessel or aircraft waiting re-exportation (Section 33(2)).

After unloading of goods from the arriving vessel or aircraft the goods remains under the control and responsibilities of the owners of the aircraft or vessel until the goods are taken out of transit shed or Customs area (Section 26(1)). Unless, the goods are delivered to a transit shed whose owner is an agent of the importing aircraft or vessel the owner of the transit shed in that case is responsible and accountable for the goods (Section 26(2)). Consequently, any loss resulting from loss of goods within transit shed or failing to subsequently deliver the goods is either responsibility of the owner or agent of an aircraft or vessel or the owner of a transit shed, in turn they may pay duties of the lost goods or pay costs for the reshipment or for the destruction of any condemned goods (Section 26(3)).



Definitions

Transit shed means any building or premises appointed by the Commissioner in writing for the deposit of goods subject to customs control.

Customs area means any place appointed by the Commissioner under Section 12 for carrying out customs operations, including a place designated for the deposit of goods subject to customs control.

Goods subject to customs control includes: imported goods including through the post office, from the time of importation to the time they are delivered for home consumption or re exportation whichever is the earliest; goods under duty drawback from the time of the claim until exportation; good subject to any export duty from the time the goods are brought from any port for exportation until exportation; goods subject to any restriction of exportation from the time they are brought to port until exportation; goods which are with the permission of the proper officer stored in a customs area pending exportation; goods on board any aircraft or vessel whilst within any part or place in the partner states; imported goods subject to duty where there is a change of ownership of such person from an exempt person to a nonexempt person; goods which have been declared for or are intended for transfer to a partner state and seized goods.

Customs warehouse means any place approved by the Commissioner for the deposit of unentered, unexamined, abandoned, detained, or seized, goods for the security thereof or of the duties due thereon.

Thereafter, unloaded or landed goods would be transported to a customs area and may be deposited into a transit shed or in a customs warehouse and the goods may be taken out of the transit shed or in a customs warehouse after being accounted for in writing (Section 33(3) and (4)). After accountability the goods should be taken out of the transit shed or in a customs warehouse through designated routes only (Section 33(5)).

2.2 Administration of customs warehouses

Goods deposited in a customs warehouse are liable for rent and other expenses (Section 42(3)). They must be removed within 30 days after deposit from the customs warehouse but the times may be extended where the goods are imported by an East African Country, or diplomatic mission or aid agencies (Section 42(2)). The

removal of goods from the customs warehouse is made after payment of all duties, expenses, rent, freight, and other charges (Section 42(8)). Otherwise, the Commissioner must give notice by publication that the goods are removed within 30 days from the date of the notice. After the expiration of the 30 days the goods should be treated abandoned and liable for sale by public auction or any other means fit to the Commissioner (Section 42). However, in case of perishable goods, or are animals, the goods may be sold without notice at any time after deposit in the customs warehouse (Section 42(1)).

The Commissioner has two option to the goods deemed abandoned: sale or destroy. The sale option is only chosen when the expected proceeds can cover all duties, expenses, rent, freight, and other charges as guarding, removing (Section 42(6) and Section 43). Where the goods are disposed the proceeds should pay for; **the duties, if any; then the expenses of removal and sale; the rent and charges due to the customs; the port charges; and the freight and any other charges (Section 42(4))**. When there is a balance after the above payments, the balance should go to the custom revenues if the goods were prohibited or restricted goods which their terms were breached otherwise the balance will go to the owner of the goods if the owner applies within a year from the date of sale (Section 42(5)).

On the another side, the buyer is required to pay a non-refundable deposit of 25% of the bid price in cash at the fall of the hammer and back the balance by a bank guarantee or pay by a banker's cheque within 48 hours after the sale without failure otherwise the bid would lapse. And the goods should be removed from warehouse within 3 days otherwise rent will be payable (Section 207 of The East African Community Customs Management Regulations, 2010).

2.3 Arrival Overland

Likewise, arriving vehicles with or without dutiable goods from outside East Africa Countries should use only designated ports except where they are allowed by a proper officer to use other places (29(1)). Immediately after arriving at a person in charge of a vehicle must report to the officer at the port; truly account for the vehicle or any goods in writing; responding to the questions asked by the proper officer; produce all documents required by the officer (Section 29). It is only after making entry of the goods and the vehicles or clearance given, the goods and the vehicles can be taken out of the customs area (Section 29(2)). In case of a person arriving over land from outside the East Africa Countries if she/ he has any goods in possession follow similar procedures as the person arriving by a vehicle but she/he to report the officer stationed at the customs house nearest to the point at which he or she crossed the frontier (Section 31).

While, when a train arriving from outside the East Africa countries and carrying goods subject to customs control, a person in charge of the railway station at that port must deliver to the proper officer copies of all invoices, way-bills, consignment notes or other documents received by him or her and relating to the goods subject to customs control conveyed by that train and consigned to that station or required to be entered at that port (Section 30(1)). The person in charge of the railway station at that port unless permitted in writing by a proper officer, should not permit or deliver to the consignee or any person goods subject to customs control required to be entered at that port and conveyed to that station in any train to be removed from the transit shed or customs area appointed for such station, or be forwarded to any other railway station (Section 30(2) and (3)). But, when not allowed in writing by the Commissioner, an owner or user of a private railway siding or any other person should not receive railway wagons containing goods subject to customs control into a private railway siding (Section 30(4)).

2.4 Entry, Examination and Delivery of imported goods

The whole of the cargo of an aircraft, vehicle or vessel which is unloaded or to be unloaded must be entered by the owner within 21 days after the commencement of discharge. Moreover, a proper officer may extend time for entry of vehicles on arrival for goods entered for home consumption, warehousing, transshipment, transit; or export processing zones (Section 34(1)). Failures of making entries within specified time may cause a proper officer to require the agent of the vessel or aircraft to remove the goods to customs warehouse (Section 34(4)). Moreover, the goods should be removed from the first point of entry in a partner state within 14 days to avoid rent charges (Section 34(5)). So to save time and money, entries of goods can be made before they arrive at the port of discharging (Section 34(3)) but in whatever case documents supporting the goods entered must be submitted at the time of entry (Section 34(2)).



Definition

Export processing zone means a designated part of customs territory where any goods introduced are generally regarded, in so far as import duties and taxes are concerned, as being outside customs territory but are restricted by controlled access.

In the absence of the proper documents the importer of the goods should make a declaration which may allow him/her to enter the goods for home consumption, or for warehousing (Section 37). However, the importer may be required to pay customs duties on estimated taxes and extra deposit before taking for home consumption (Section 38(2)). After determination of the correct customs duties amount the importer may either pay the difference if the deposit and the previous provisional taxes fall short of the correct taxes or be refunded for the excess of the deposit and the previous provisional taxes over the correct customs taxes (Section 38(3)). Finally, the surplus stores of any aircraft or vessel may, with the permission of the proper officer, be entered for home consumption or for warehousing (Section 35) and all entered goods may be examined in the presence of owner to check the accuracy of entries (Section 41) .

However, some items as mail bags and postal articles in the course of transmission by post, personal baggage of the passengers, or members of the crew, of any aircraft or vessel; human remains; diplomatic bags may be unloaded and delivered without entry. Also bullion, currency notes, coin, or perishable goods, may be unloaded without entry when the owner furnish the necessary entry within 48 hours of the time of delivery (Section 36).

2.5 Clearance by Pipeline

The operator of the should record and report the nature and quantities of goods imported or exported through a pipeline and also provides such apparatus and appliances for measures and records as suggested by the Commissioner (Section 32).

2.6 Passenger Clearance

A passenger arriving from a foreign country may be required to make declaration of his/her goods (Section 46). Likewise, as for aircrafts a passenger from an aircraft or a vessel should disembark only from it at appointed place. In addition, any person including who is disembarking at that port or place; who is returning ashore, who has any uncustomed goods; the crew of an aircraft or vessel who are leaving that aircraft or vessel either temporarily or for any other reason, and wish to remove their baggage or part thereof, from that aircraft or vessel; any passenger who is temporarily leaving that aircraft or vessel and wishes to remove therefrom his baggage, or any part thereof or any other person who may be required by the proper officer to do so; should go direct to the examination baggage room and remain there until permitted removing (Section 44(2)). Then, the person can use either green or red channel to exit the port.



Definitions

Green channel means that part of the exit from any customs arrival area where passengers arrive with goods in quantities or values not exceeding those admissible.

Red channel means that part of the exit from any customs arrival area where passengers arrive with goods in quantities or values exceeding passenger allowance.

Consequently, the green channel is for passengers with nothing to declare or with baggage consisting of only goods within the prescribed passenger allowance and the red channel is for passengers carrying dutiable or restricted goods and for crew members of vessels or aircrafts (Section 45).

3. Explain the customs entry and clearance procedures for exports

[Learning Outcome c]



Definition

Export means to take or cause to be taken out partner states i.e. East Africa Community Members States.

Customs entry and clearance procedures for exports depends whether goods are required to be accounted i.e. entered in a prescribed form for customs' purpose or not. Owners of cargoes, masters, drivers or agents of aircrafts, vessels or vehicles are required entering the particulars of the goods and their aircrafts, vessels or vehicles in prescribed forms before goods are loaded into the means of transports for exports or use as stores for aircrafts or vessels (Section 73, 74,75,79 and 83). In addition, in case of aircraft or vessels goods for export must be loaded only at an approved place of loading or from sufferance wharf (Section 75(c)) and they can only depart the places after getting clearances (Section 88). While exporters of goods by vehicles or overland is required reporting to the officer stationed at the customs house nearest to the intended departure boarders and account for any goods in possessions and be ready for interrogations by proper officer (Section 83 and 84).



Definitions

Sufferance wharf means any place, other than an approved place of loading or unloading at which the Commissioner may allow any goods to be loaded or unloaded.

However, when goods involved are bonded goods or stores for aircrafts or vessels apart from accounting for them, the export may be required to pay export duties when applicable (Section 82 and 79) or pay security lieu of the duties (Section 78). The bonded goods include warehoused, restricted, goods on which duty drawback may be claimed and dutiable goods intended for transshipment (Section 78(1)).



Definitions

Duty drawback means a refund of all or part of any import duty paid in respect of goods exported or used in a manner or for a purpose prescribed as a condition for granting duty drawback.

Transshipment means the transfer, either directly or indirectly, of any goods from an aircraft, vehicle or vessel arriving in a partner state from a foreign place, to an aircraft, vehicle or vessel, departing to a foreign destination.

In contrast, personal baggage, goods belonging to members of the crew, of any aircraft or vessel, goods intended for sale or delivery to passengers, or members of the crew, of any aircraft, mail bags and postal articles, or any goods after successful application of owner and payment of duties/provision of security may be boarded and exported without entry when allowed by a proper officer (Section 76).



Definition

Dutiable goods mean any goods chargeable with duty.

4. Differentiate between prohibited and restricted goods

[Learning Outcome d]

It is important to differentiate between prohibited goods and restricted ones because their treatments are different and they affect the importation and exportation of goods. Goods are prohibited when their importation, exportation and carriage coastwise are currently prohibited by any regulation in any East African country (Section 2(1)).

While goods are restricted when their importation, exportation, transfer, and carriage coastwise are required to follow certain conditions specified in customs laws (Section 2(1)). Consequently, prohibited goods are totally forbidden and cannot be transferred or owned by any person in the partner states whereas in the case of restricted goods when required conditions are fulfilled the goods can be transported or owned by any person.

Now, the list of prohibited and restricted goods is given in the second schedule and third schedule of the East Africa Customs Management Act 2004 (Section 18, 19 and 70). The list is reproduced below. It can be deduced from the list why certain goods are either restricted or prohibited.

- First, dealing with criminal activities; false money, counterfeit currency notes, counterfeit goods of all kinds and narcotic drugs for example are prohibited goods because in addition to destroying economies, they proceeds can be used to finance criminal activities such as terrorism.
- Second, preserving our culture; pornographic materials for instance are prohibited to protect our African culture.
- Third, public health and safety; distilled beverages containing essential oils or chemical products, hazardous wastes and their disposal and all soaps, used tyres for light commercial vehicles and passenger cars and cosmetic products containing mercury are prohibited on the concern of public health and safety.

- Furthermore, environment conservation; certain agricultural and industrial chemicals and industrial chemicals, and plastic articles of less than 30 microns for the conveyance or packing of goods for example are prohibited because they are harmful to the environment.
- Fifth, security- for example importation and exportation arms and ammunition specified under Chapter 93 of the Customs Nomenclature are restricted for to control insecurity so arms can only be owned after fulfilment of certain conditions.
- Sixth, complying with international agreement- restriction over importation or exportation or carriages of endangered species of World Flora and Fauna and their products is in accordance with CITES March 1973.

However, prohibitions or restrictions do not apply when goods are on transit or re-export, transshipment, stored in aircraft or vessel unless the goods include false money and counterfeit currency notes and coins and any money not being of the established standard in weight or fineness or is generally prohibited regardless whether is not intended to be consumed in partner states as drugs (Section 20 and 72).



Definition

On transit is a movement of goods imported from a foreign place through the territory of one or more of the partner states, to a foreign destination.

4.1 List of prohibited goods

1. All goods the importation of which is for the time being prohibited under this Act or by any written law for the time being in force in the partner State.
2. False money and counterfeit currency notes and coins and any money not being of the established standard in weight or fineness.
3. Pornographic materials in all kinds of media, indecent or obscene printed paintings, books, cards, lithographs or other engravings, and any other indecent or obscene articles.
4. Matches in the manufacture of which white phosphorous has been employed.
5. Any article made without proper authority with the Armorial Ensigns or Coat of Arms of a partner state or having such Ensigns or Arms so closely resembling them as to be calculated to deceive.
6. Distilled beverages containing essential oils or chemical products, which are injurious to health, including thijone, stararise, benzoic aldehyde, salicyclic esters, hyssop and absinthe. Provided that nothing in this paragraph contained shall apply to "Anise and Anisette" liquers containing not more than 0.1 per centum of oil of anise and distillates from either pimpinella anisum or the star arise allcium verum.
7. Narcotic drugs under international control.
8. Hazardous wastes and their disposal as provided for under the base conventions.
9. All soaps and cosmetic products containing mercury.
10. Used tyres for light Commercial vehicles and passenger cars.
11. The following Agricultural and Industrial Chemicals:

(a) Agricultural Chemicals

- 2.4 - T
- Aldrin
- Caplafol
- Chlordirneform 1 Chlorobenxilate 1 DDT
- Dieldrin
- 1.2 - Dibroacethanel (EDB)
- Flouroacelamide
- HCH
- Hiplanchlor
- Hoscachlorobenzene

- Lindone
- Mercury compounds
- Monocrolophs (certain formulations)
- Methamidophos
- Phospharmion
- Methyl - parathion
- Parathion

(b) Industrial Chemicals

- Crocidolite
- Polychlorinated biphenyls (PBB)
- Polychlorinated Biphenyls (PCB)
- Polychlorinated Terphenyls (PCT)
- Tris (2,3 dibromopropyl) phosphate
- Methylbromide

12. Counterfeit goods of all kinds.

13. Plastic articles of less than 30 microns for the conveyance or packing of goods.

14. Worn underwear garments of all types

15. All goods the exportation of which is prohibited under this Act or by any written law for the time being in force in the Partner States.

4.2 List of restricted goods

1. All goods the importation of which is for the time being regulated under this Act or by any written law for the time being in force in the Partner State.
2. Postal franking machines except and in accordance with the terms of a written permit granted by a competent authority of the Partner State.
3. Traps capable of killing or capturing any game animal except and in accordance with the terms of a written permit granted by the Partner State.
4. Unwrought precious metals and precious stones.
5. Arms and ammunition specified under Chapter 93 of the Customs Nomenclature.
6. Ossein and bones treated with acid.
7. Other bones and horn - cores, unworked defatted, simply prepared (but not cut to shape) degelatinized, powder and waste of these products.
8. Ivory, elephant unworked or simply prepared but not cut to shape.
9. Teeth, hippopotamus, unworked or simply prepared but not cut to shape.
10. Horn, rhinoceros, unworked or simply prepared but not cut to shape
11. Other ivory unworked or simply prepared but cut to shape.
12. Ivory powder and waste.
13. Tortoise shell, whalebone and whalebone hair, horns, antlers, hooves, nail, claws and beaks, unworked or simply prepared but not cut to shape, powder and waste of these products.
14. Coral and similar materials, unworked or simply prepared but not otherwise worked shells of molluscs, crustaceans or echinoderms and cattle-bone, unworked or simply prepared but not cut to shape powder and waste thereof.
15. Natural sponges of animal origin.
16. Spent (irradiated) fuel elements (cartridges) of nuclear reactors.

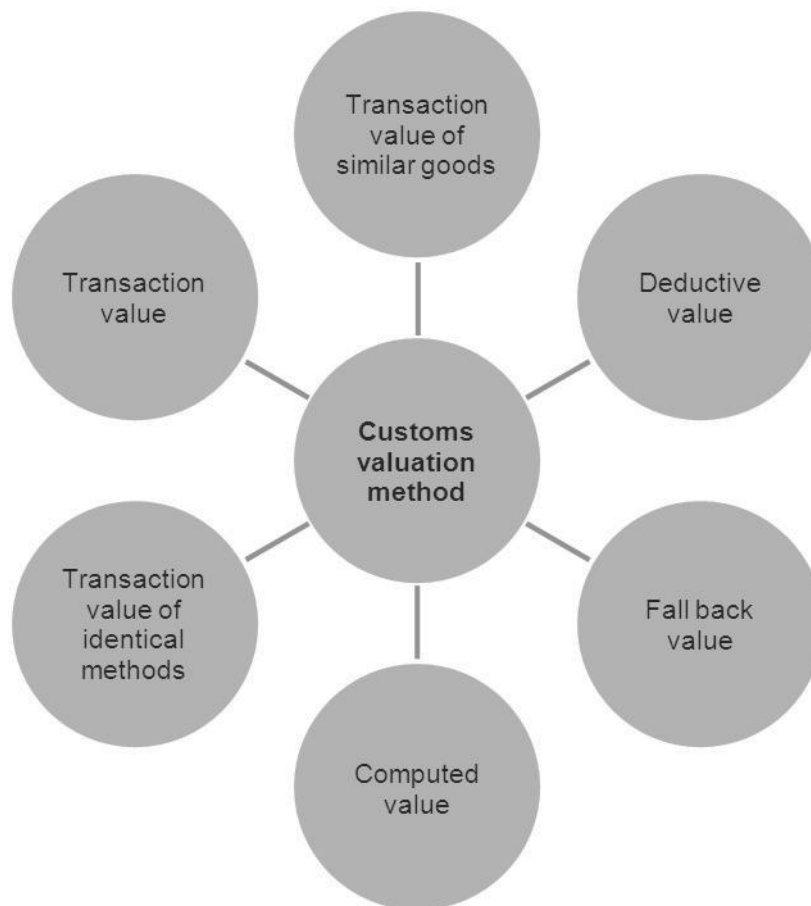
17. Worked ivory and articles of ivory.
18. Bone, tortoise shell, horn, antlers, coral, mother-of pearl and other animal carving material, and articles of these materials (including articles obtained by moulding).
19. Ozone Depleting Substances under the Montreal Protocol (1987) and the Vienna Convention (1985).
20. Genetically modified products.
21. Non-indigenous species of fish or egg of progeny.
22. Endangered Species of World Flora and Fauna and their products in accordance with CITES March 1973 and amendments thereof.
23. Commercial casings (Second hand tyres).
24. All psychotropic drugs under international control.
25. Historical artefacts.
26. Goods specified under Chapter 36 of the Customs Nomenclature (for example, percussion caps, detonators, signalling flares).
27. Parts of guns and ammunition, of base metal (Section XV of the Harmonised Commodity Description and Coding System), or similar goods of plastics under Chapter 39 of the Customs Nomenclature.
28. Armoured fighting vehicles under heading No. 8710 of the Customs Nomenclature.
29. Telescope sights or other optical devices suitable for use with arms, unless mounted on a firearm or presented with the firearm on which they are designed to be mounted under Chapter 90 of the Customs Nomenclature.
30. Bows, arrows, fencing foils or toys under Chapter 95 of the Customs Nomenclature.
31. Collector's pieces or antiques of guns and ammunition under heading No. 9705 or 9706 of the Customs Nomenclature.
32. All goods the exportation of which is regulated the East African Community Customs Management Act 2004 or of any law for the time being in force in the Partner States;
33. Waste and scrap of ferrous cast iron;
34. Timber from any wood grown in the Partner States;
35. Fresh unprocessed fish (Nile Perch and Tilapia);
36. Wood charcoal.
37. Used automobile batteries, lead scrap, crude and refined lead and all forms of scrap metals
38. The following goods shall not be exported in vessels of less than two hundred and fifty tons register
 - warehoused goods
 - goods under duty drawback
 - Transhipped goods

5. Explain the customs valuation methods

[Learning Outcome e]

There are six methods which can be used to compute custom value of imported goods. The customs value of imported goods is the value of goods for the purposes of levying ad valorem duties of customs on imported goods. These methods are transaction value, transaction value of identical goods, transaction value of similar goods, deductive value, computed value and fall back value. The methods are sequential used starting the first method, when it fails or not trusted, the second method is adopted also when the second method is not appropriate, the third method is adopted and so on. With the exception of deductive and computed value methods where the importer can ask for reverse of the order (Paragraph 9(3)). The following Section describes each of these methods.

Diagram 1: Customs valuation method



5.1 Transaction value

Transaction value refers to actual price of the goods imported between independent buyers and sellers. The transaction value is taken to be custom value of imported goods when the buyer is free to choose how to use or sell the goods subject to legally imposed restrictions and the price is not significantly affected by the sellers' restrictions. Furthermore, the price should include all values attached to it by the sellers and the sellers should not receive anything from subsequent re-sale of the goods. Additionally, all costs paid by importer/buyer for the goods should be included (or apportioned when not wholly used in the goods) in the transactions value with exception to buying commission. The buying commission means fees paid by importer to the importer's agent for the service of representing the importer abroad in the purchase of the goods being valued. Finally, cost of transport of the imported goods to the port or place of importation into the importing country except where the importation is made by air; loading, unloading and handling charges associated with the transport of the imported goods to the port or place of importation into the importing country; and the cost of insurance are part of **customs value of imported goods**.

Moreover, the price should be free from buyers and sellers relationship even if the parties are related. However, when the parties to the imported goods are related, the importer should show that the transaction value is approximate to the price of identical or similar goods imported around the same time between unrelated parties.

The importer also might require comparing the transaction value to the transaction value of identical goods or similar goods as explained below when the importer and exporter are related.

The importer and exporter are related when they are officers or directors of one another's businesses, legally recognised partners in business, an employer and employee relationship, any person directly or indirectly owns, controls or holds 5% or more of the outstanding voting stock or shares of both of them, one of them directly or indirectly controls the other, both of them are directly or indirectly controlled by a third person, together they directly control a third person or are members of the same family. However, sole agents, distributors and sole concessionaires dealing with others are normally considered independent unless they have previously discussed conditions.



Example

Consider a person who have received a gift from the UK, he had only to pay for insurance, freight and other importing taxes to Tanzania. What is the transaction value of the gift?

Since the goods involved is a gift given free of charge, there is no transaction value of the imported goods. Consequently the gift can alternatively be valued using the transaction value of identical goods.

5.2 Transaction value of identical goods

The transaction value of identical goods is used as an alternative when the transaction value of imported goods is inappropriate. However, transaction value of identical goods and the goods being valued should all have been imported at the same time, same commercial level.

In case of the transaction value of identical goods at the same commercial level and/or same quantity is unavailable best adjustments should be made to adjust for factors as discount resulting from purchasing in large quantities. Specifically, the transaction value of identical goods in this case may base on, a sale at the same commercial level but in different quantities; a sale at a different commercial level but in substantially the same quantities; or a sale at a different commercial level and in different quantities. Thereafter, the adjustments for quantity factors only, commercial level factors only or both commercial level and quantity factors as case may be made.

Also, when the transaction value of identical goods includes costs of; transport of the imported goods to the port or place of importation into the importing country except where the importation is made by air; loading, unloading and handling charges associated with the transport of the imported goods to the port or place of importation into the importing country; and the cost of insurance, the value should be adjusted to consider cost differences as distances and transport modes of the imported goods. Finally, in case of identification of several transaction values of identical goods, the lowest value should be used to value the imported goods.



Definition

Goods are identical when they have the same physical characteristics, quality and reputation even when they have minor differences between them. Furthermore, the goods must have been produce in the same country by the same person unless the goods produced by the same person are unavailable others' goods can be used. The identical goods do not include goods which incorporate or reflect engineering, development, artwork, design work, and plans and sketches for which no adjustment of the values can be made.



Example

Consider an import of goods in 20 units whose transaction value is not acceptable. Yet, the transaction value of identical goods is Tshs30,000,000 but the identical goods were in 200 units. In this case the exporter's price list of identical goods if available might be used to value the imported goods of 20 units though sales was not done in 20 units to adjust for discount available in bulk purchase. When the price list of identical goods is not available, the next methods should be used.

5.3 Transaction value of similar goods

Where the two first methods are unacceptable, the customs value of imported goods might be measured using the transaction value of similar goods. In fact, the applicability of the transaction value of similar goods is exactly the same as the application of transaction value of identical goods, they differ only on "similar goods" for the former and "identical goods" for the latter.



Definition

Goods are similar when although not alike in all respects; have like characteristics and like component materials which enable them to perform the same functions and to be commercially interchangeable. Factors as the quality of the goods, their reputation and the existence of a trademark may help in determining similarity of goods. Furthermore, the goods must have been produce in the same country by the same person unless the goods produced by the same person are unavailable others' goods can be used. The similar goods do not include goods which incorporate or reflect engineering, development, artwork, design work, and plans and sketches for which no adjustment of the values can be made.

5.4 Deductive value

Where the previous methods are not sufficient in valuing the imported goods, the deductive value may be appropriate. Under this method the value of the imported goods should be the unit price at which the imported goods or identical or similar imported goods are sold in the greatest aggregate quantity, at or about the time of the importation of the goods being valued or the earliest date within 90 days after the importation of the imported goods; between independent persons in the importing country. However, after deductions of the following items:

- (a) Commissions, mark-ups or any expenses charged in the importing country;
- (b) Transportation expenses, insurance and associated costs incurred within the importing country;
- (c) Cost of transport of the imported goods to the port or place of importation into the importing country; loading, unloading and handling charges associated with the transport of the imported goods to the port or place of importation into the importing country; and the cost of insurance; and
- (d) The customs duties and other national taxes payable in the importing country by reason of importation or sale of the goods

However, when the imported goods, identical or similar imported are sold in the importing country after further process, the importer may requests the Commissioner to value the imported goods based on the unit price at which the imported goods, after further processing, are sold in the greatest aggregate quantity between independents persons in the importing country after deduction of the value added by such processing and the deductions items discussed before.



Example

Consider the following price list of goods sold in an importing country after including Tshs3 covering profit, Commissioner, transport and customs taxes:

Units sold	Price per unit
20	Tshs10
30	Tshs8
60	Tshs7
100	Tshs5

The greatest number of units sold at a price is 100 so the unit price in the greatest aggregate quantity is 5 and the transaction value of imported goods should Tshs2.

5.5 Computed value

The next method is computed value. The computed value method determine the value of imported goods based on its cost of productions in the exporting country and costs of transportation, insurance and handling to the importing country. Specifically, the costs of imported goods under computed value method is the total of:

- (a) the cost or value of materials and fabrication or other processing employed in producing the imported goods;
- (b) an amount for profit and general expenses equal to that usually reflected in sales of goods of the same class or kind as the goods being valued which are made by producers in the country of exportation for export to the importing country;
- (c) The cost of transport of the imported goods to the port or place of importation into the importing country except where the importation is made by air; loading, unloading and handling charges associated with the transport of the imported goods to the port or place of importation into the importing country; and the cost of insurance.

Subsequently, access to accounting records based on GAAPs is important in applying this method, which can be done through requiring a producer or any person especially when is not resident in the importing country to produce such access. Also, a tax authority can verify the information produced by manufacturer in another country after an agreement with the producer and the another allow such an investigation.

5.6 Fall back value

As the last attempt to value the imported value, a customs authority might use fall back value. This method requires using reasonable means consistent with the principles and general provisions of customs laws and on the basis of data available in the importing country. **It can also base on previously determined customs values or by relaxing conditions of previous methods.** As the method is so judgemental the importer may request written information when this method is used to value the imported goods. Consequently, the fall back value does not base on:

- (a) The selling price in the importing country of goods produced in the country;
- (b) A system which provides for the acceptance for customs purposes of the higher of two alternative values;
- (c) The price of goods on the domestic market of the country of exportation;
- (d) The cost of production other than computed values which have been determined for identical or similar goods in accordance with computed value method above;
- (e) The price of the goods for export to a country other than importing country;
- (f) Minimum customs values; or
- (g) Arbitrary or fictitious value

Summary

Methods	Calculate on the basis of value of imported goods basing on	Go to next method when
Method 1	The transaction value	There has been no sale of goods
Method 2	Transaction value identical goods	There are no identical goods
Method 3	Transaction value of similar goods	There are no similar goods
Method 4	Deductive value method	There are no sales of identical or similar goods
Method 5	Computed value method	This production cost information is unavailable
Method 6	Fall back method	N/A

6. Calculate duties and taxes collected through customs

[Learning Outcome f]

The purpose of determining customs value of imported goods is to charge taxes on the imported goods when they are taxable. Customs department charges three main types of taxes on imported goods,

- customs and import duties,
- excises duties and
- value added taxes on imported goods.

These taxes apply on Cascadian ways i.e. first customs import duties is charged on total values of imported goods as discussed above. Then, the value of customs import duties form part of the costs of the goods which is used to determine the excises taxes. Then the total value (including customs import duties) therefore is used to find the excises taxes, then the value excises taxes also is added to the costs of the goods to find the value added taxes. Consequently, the value on which value added tax is based including not only the customs value of imported goods but also the value of customs import and excise duties.



Definitions

Customs import duties are taxes charged on importation of goods not produced in East Africa Community.

Excises duties are normally, taxes on certain excises goods within the countries, but importing excises goods is also taxable.

The following table presents how customs taxes systems operates

Item	Value Tshs
Price/value of the imported goods	xx
Add: Freight	xx
Insurance	xx
Customs value of imported goods	yy
Customs import duties ($ID\% \times YY$)	ww
Total (yy+ww)	zz
Excise duties ($ED\% \times zz$)	kk
Total (zz+kk)	cc
Value added tax ($VAT\% \times cc$)	vv

Where, ID% is import duties tax rate of imported goods; ED% is excise duty tax rate of imported goods; and VAT% is value added tax rate of imported goods.



Test Yourself 1

Red Rose Ltd recently has imported goods from China. The costs related to the goods are the following:

Direct material (per unit)	Tshs6
Direct labour (per unit)	Tshs4
Variable overheads (per unit)	Tshs2
Number of units imported	8,000 units
Selling price to Red Rose Ltd	Tshs15
Freight expenses in China	Tshs500,000
Freight to Dar es salaam	Tshs1,000,000
Insurance to Dar es salaam	Tshs600,000
Clearance agency fees –Dar es salaam port	Tshs100,000

Required:

If the customs import duties rate was 20% excise duty tax rate was 5% and value added tax rate was 18% compute the customs value of imported goods and taxes payable thereof.

7. Explain customs procedures for prevention of smuggling

[Learning Outcome g]



Definition

Smuggling is an act of importing, exporting or carrying coastwise, or transferring or removing into or out of a country of goods with intent to defraud the customs revenue or to evade any prohibition or restriction on, regulation or condition as to such importation, exportation, carriage coastwise, transfer, or removal, of any goods.

Smuggling is not only expensive but also create unfair in tax systems where smugglers pay no taxes. So customs departments they may use following procedures or powers to prevent smuggling and enforce customs tax laws:

- Signalling any vessel or aircraft to stop or land for inspection and require the master of the vessel to facilitate the boarding (Section 149).
- To require any aircraft or vessel that is not registered in a partner state to leave the partner state within 24 hours (Section 150).
- To enter upon and patrol and pass freely along any premises other than a dwelling house or any building. Moreover, they may direct any aircraft, vessel, or vehicle to any place convenient for search and for any time as the officer deem necessary (Section 151).
- To board and search any aircraft or vessel within a partner state and may examine, lock-up, seal, mark, or secure, any goods on the aircraft or vessel. Moreover, the proper officer may require goods to be unloaded, or removed, at the expense of the master of such aircraft or vessel. In case access is not given, force may be used to gain the access (section152).
- To stop any vehicle or on transit vehicle sought to carry any uncustomed goods, search it or require goods to be unloaded at the expense of the owner of the vehicle. Also force can be used to gain access when necessary (Section 153).
- To ask any person entering or leaving a country about his or her luggage or anything carried in it. When the person is leaving or entering the country by a vehicle a proper officer may ask question to the driver or any person in charge of the vehicle about the vehicle, goods in it, and documents related to the vehicle and the goods (Section 154).
- To search any person who is suspected of having any uncustomed goods but, a woman officer should search a female suspect and a male suspected must be searched by male officer. If any uncustomed goods found should be forfeited (Section 155).

- (h) To arrest with police coordination when necessary any person who is doing, has done, or believed to have done an offence within the last year (Section 156).
- (i) To enter and search any building at any time suspected of holding uncustomed goods. Besides, requiring from the owner, or occupier of the building any books, documents or anything which the customs laws require the owner or occupier to keep. And either examine, make copies, seize them, ask questions about them, require container opened, take samples, lock up, seal or secure the building, room, place, tank or container. Uncustomed goods found in the search might be captured and taken away (Section 157)
- (j) To ask for search warrant from any magistrate to search a building/ premises for uncustomed goods with police officer assistance (Section 158).
- (k) To inspect and require immediate production of accounts documents related to suspected smuggling activities or undervaluation of uncustomed goods (Section 159).

8. Determine offences in customs operations
Explain techniques for enforcement of customs laws.

[Learning Outcome h and i]

The following is comprehensive list though not exhaustive of offences according to East Africa Customs Management Act 2004 it. Criminalizing these acts help in enforcing customs laws.

1. Engagement in corruption practices, upon conviction the parties involved is subjected to a sentence not exceeding 3 years (Section 9).
2. It is an offence to disclose any information obtained during performance of customs duties except in court of law providing witness, a penalty of not more than 2500 dollars or sentence not more than 3 years or both on conviction (Section 9(4)).
3. It is an offence to trespass or leave without following required procedures any customs area or customs airport or bring or take out any goods from the areas. In any contravention, the person, vehicle or goods involved might be detained for investigation also a fine of not more than one 1000 dollars is payable and any goods involved forfeited (Section 15).
4. It is an offence to conspire with others to commit crimes a sentence of not more than 5 years is imposed after convictions (Section 193).
5. It is a crime to shoot at any aircraft, vessel or vehicle, or an officer on duty and the crime attract imprisonment not exceeding 20 years (Section 195(1)).
6. It is also a crime to act against custom laws or carry any goods liable for forfeiture while armed after conviction a sentence of not more than 10 years may be imposed (Section 195(2)).
7. A person who commits a crime under this Act is disguised any way and while being so disguised, is found with any goods liable for forfeiture under this Act, commits an offence, shall be punishable by imprisonment for a period of not exceeding 3 years.
8. It is a crime committing a crime while disguised or carrying any goods liable for forfeiture while disguised a sentence not exceeding 3 years is imposed after conviction (Section 194(3)).
9. It is an offence to staves, breaks, destroys or throws overboard from any aircraft, vessel or vehicle any goods for the purpose of preventing the seizure or securing of any goods; or rescues any person arrested for any offence; or in any way obstructs.
10. It is an offence illegally removing any customs seal from a ship, an aircraft, vehicle, train or package, and the offender may go to jail for term not exceeding 3 years or pay a fine not exceeding 2500 dollars or to both (Section 195).
11. It is an offence to procure or induces, or authorises another person to procure or induce, any other person to commit or assist in the commission of any offence under customs laws on conviction a sentence not exceeding 1 year may be imposed (Section 196).
12. It is an offence to warn offenders who might have been apprehended without the warning on conviction a sentence not exceeding 2 years or a fine not exceeding 2,500 dollars or both (Section 197).

13. It is an offence to impersonalize a proper officer; on conviction a sentence not exceeding not 3 years is imposed besides other punishments on other offences (Section 198).
14. It is an offence not stopping a vessel or aircraft when required to do so by proper officer upon conviction a penalty not exceeding 2000 dollars and the vessel forfeited if it has less than 250 tons exceeding two thousand register. While, a fine not exceeding 5000 dollars and the aircraft or vessel detained until the fine is paid or security given is payable where an aircraft or of a vessel of 250 tons register or more is involved in this offence (Section 149(4)).
15. It is an offence concealing, smuggling, throwing overboard, destroying or staving any goods to prevent seizure; or importing, or carrying coastwise, or exporting any goods contrary to the East Africa Community Management Act 2004. Upon conviction a penalty not exceeding 7000 dollars and goods and the vessel forfeited if it has less than 250 tons exceeding two thousand register. While, a fine not exceeding 10,000 dollars and the aircraft or vessel detained until the fine is paid or security given is payable where an aircraft or of a vessel of 250 tons register or more is involved in this offence . Also in case of vehicle the person in charge of the vehicle is fined a penalty not exceeding 5000 dollars and the vehicle and goods forfeited (Section 199).
16. It is offence to imports, export, acquire, unload, or carry coastwise any prohibited, uncustomed or any restricted goods contrary to required conditions (b) unloads after importation or carriage coastwise. After conviction a penalty of 50% of the dutiable value involved is payable or a term not exceeding 5 years or both (Section 200).
17. It is an offence to imports or exports any concealed goods to deceive any officer. Upon conviction sentence not exceeding 5 years or to a fine equal to 50% of the value of the goods involved is payable (Section 202).
18. It is an offence making a false statements, providing incorrect/counterfeits information, obtaining any drawback, rebate, remission, or refund, or duty illegally, interfering illegally goods under customs, bringing into a partner state without lawful excuse any blank or incomplete invoice, bill head, or other similar document, capable of being filled up and used as an invoice for imported goods. After conviction a sentence not exceeding 3 years is served or a fine not exceeding 10,000 dollars is payable (Section 203).
19. It is an offence failing or refusing producing accounting records (Section 204).
20. It is an offence to cuts away, casts adrift, destroys, damages, defaces, or in any way interferes with, any aircraft, vessel, vehicle, buoy, anchor, chain, rope, mark, or other thing on customs enforcements. A fine not exceeding 2,500 dollars is payable after conviction (Section 205).
21. It is an offence failing to reports a discovery of any uncustomed goods on land or floating upon, or sunk in, the sea, to the nearest officer. After conviction a penalty not exceeding 2,500 dollars is payable besides forfeiting the goods involved (Section 206).
22. It an offence to aid, abets, counsel or procure the commission of any offence the doer commit the same offence and attract the same penalties under the offence (Section 208).
23. It is an offence seizing goods liable for forfeiture for personal gains, upon conviction a sentence not exceeding 3 years is served or a fine not exceeding 2000 dollars or to both (Section 213).
24. It is an offence declining to act as agent of a commissioner by giving false or misleading statement, or wilfully conceals any material fact upon conviction a fine not exceeding 2,500 dollars or sentence not more than 3 years or to both is imposed (Section 131 (7)).
25. It is an offence to imports, acquires, exports or carries coastwise any prohibited goods or any restricted goods against required conditions and uncustomed goods in whatever forms (Section 200). The penalty for this offence is a sentence not more than 5 years or a fine equal to 50% of the dutiable value involved, or both. Furthermore, in case of monetary penalty, the goods involved must be forfeited (Section 201).
26. Failure to leave the partner state as required without reasonable excuses attract, a penalty of not exceeding 2000 dollars and the vessel being forfeited if it has less than 250 tons register. Whereas, a fine not exceeding 5000 dollars and the aircraft or vessel detained until the fine is paid or security given is payable where an aircraft or of a vessel of 250 tons register or more is involved in this offence (Section 150(2)).
27. It is an offence to fail to provide food and accommodation of officer who is searching the vessel or aircraft for long period a fine of not exceeding 1000 dollars is payable (Section 152(3)).

28. It is an offence to tamper with goods which are found on vessel or aircraft a penalty of equal to 10% of the dutiable value of the goods is payable (Section 152(6)).
29. It is offence to impersonate a proper officer and opens, breaks, or in any way interferes with any lock, seal, mark or other fastening placed any building, room or place a sentence not exceeding 3 years is imposed of penalty not exceeding 2500 dollars is payable (Section 157). When goods disappear in a sealed premise the owner or occupier is liable to penalty of 25% of the value of the goods or to imprisonment for a term not exceeding five years (Section 157(5)).



Important

Uncustomed goods includes dutiable goods on which the full duties due have not been paid, and any goods, whether dutiable or not, which are imported, exported or transferred or in any way dealt with contrary to the provisions of the Customs laws;

9. Describe recovery measures used to collect unpaid duties. Explain techniques for enforcement of customs laws.

[Learning Outcome j and i]

When customs taxes become due and payable but taxpayers fail to make good of it customs department has a number of options to recover the taxes due, including the following to enforce customs tax laws:

1. Instituting a civil legal debt claims on court of laws (Section 130(1)).
2. Detaining goods under customs control until duties are paid and after two months of detention goods might be sold to cover the duties (Section 130(2)).
3. Levying distress over goods, chattels and effects, material for manufacturing or plant of a factory, premises, animals, vehicles or other property of the debtors or their agents or other related persons when a duty is payable after court proceeding or a penalty is not paid one month after the due date of payment (Section 130(3)). The items distressed can be kept at owner's costs for 14 days or till the taxes and keeping costs are paid before those 14 days, otherwise the goods might be sold (Section 130(6)). Subsequently, the proceeds from the sale first goes to payment of the taxes due, second, to payment of any fine imposed for non-payment of the taxes, if any, third to payment of the expenses or other charges for levying of distress and for the sale and finally the balance of the proceeds if any, goes to the owner when the owner make application of the residual the Commissioner within 12 months from the date of the sale of the item (Section 130(7)).
4. Appointing any person to be an agent of another person, where the former owes or is about to pay money to the latter, holds money for or on account of the latter, holds money on account or some other person for payment to the latter, has authority from some other person to pay money to the latter holds dutiable goods belonging to the latter. However, the appointed person if think cannot act as agent must inform the Commissioners of that decision by giving reasons. The appointed agent might be required to provide an account of any moneys or goods held by him/her within thirty 30 days from the date of notice. In addition, the notice may require the agent pay duty owed within thirty days of the date of service of the notice on him or her, or, of the date on which any moneys came into his or her hands or become due by him or her to his or her principal, whichever is the earlier. Failure to pay the duty as required, the owed duty become the liability of the appointed from the date when such duty should have been paid (Section 131).
5. Holding land or buildings as security for the duty or tax payable (Section 132).

Answers to Test Yourself

Answer to TY 1

Items	Tshs
Transaction value of the goods imported is Tshs80000 x15	1,200,000
Add: Total freights	1,500,000
Insurance	600,000
Customs value of imported goods	3,300,000
Customs import duties 20% xTshs3,300,000	660,000
	3,960,000
Excise duties 5% xTshs3,960,000	198,000
	4,158,000
Value added tax 18% xTshs4,158,000	748,440

So the customs value of imported goods is Tshs3,300,000 and total taxes payable on importation is Tshs1,606,440.

Self Examination Questions

Question 1

Mizengwe Importers Ltd (MIL) of Tanga Tanzania, imported goods that are as per East African Community Customs Management Act (EACCMA) 2004, restricted goods. MIL did observe all requirements regarding importation of restricted goods. Such goods arrived at Tanga Port on January 3, 2009. The Commissioner of Customs gave several notices and decided to sell the goods by public auction. The goods were sold for Tshs22,700,000. MIL had the following obligations to settle:

Duties due to customs	Tshs12,500,000
Port charges of	Tshs4,500,000
Freight and other charges	Tshs13,800,000
Expenses of removal and sale of goods of	Tshs2,600,000
Clearing and forwarding charges	Tshs670,000
Rent and charges due to customs	Tshs8,800,000

Required:

- Given the above receipts and obligations, determine how the proceeds of sale may be distributed
- To whom the balance, if any, is supposed to be paid to?

Question 2

Tabora Gold Traders of Tabora Tanzania imported a used goods from Taiwan. The cost of the car includes:

- Cost (FOB) USD 3,500
- Sea freight USD 1,800
- And insurance USD 50

Upon arrival of the car at Dar es Salaam, Harbour on March 29, 2009 the customs offices issued assessment that in fact was based on the customs value that is higher than the actual CIF value by 10%. The following rates were applicable at the date of assessing the car for duty and taxes purposes.

- Import duty on the car 20%
- Excise duty on the car 5%
- Value Added Tax 18%
- Exchange rate Tshs1350 per USD

Required:

- (a) Compute the customs value in USD had the customs office not uplifted the value of the goods.
- (b) Compute total duties and taxes payable based on uplifted value in Tanzania shillings.

Question 3

Define the following terms as applied in reference to the East African Community Customs Management Act, (EACCMA) 2004.

- (i) Sufferance Wharf
- (ii) Duty Draw back
- (iii) Export Processing Zone (EPZ)

Answers to Self Examination Questions**Answer to SEQ 1**

- (i) There is order of payment is presented in the table below.

Items	Tshs
Proceeds	22,700,000
Order of payments	
Duties	12,500,000
Balance	10,200,000
Removal and sales expenses	2,600,000
Balance	7,600,000
Rent and other expenses at warehouse	7,600,000
Balance	-
Port charges	-
Freight charges	-
Others expenses	-

- (ii) There is no balance left as the proceeds cannot cover all of the expenses.

Answer to SEQ 2

- (i) Customs values of imported goods without uplifting is **USD 3,500+USD 1800 +USD 50= USD5, 350.**
- (ii) The total tax paid based on uplifted value in Tshsis **3867504**

Items	USD
Customs value of imported goods-uplifted	5,885
Customs import duties 20% x \$5,885	1,177
	7,062
Excise duties 5% x \$1,177	353
	7,415
Value added tax 18% x \$7,415	1,334
Total tax paid in USD	2,864
Total tax paid in Tshs	3,867,504

(Note – Figures rounded off)

Answer to SEQ 3

- (i) Sufferance wharf means any place, other than an approved place of loading or unloading at which the Commissioner may allow any goods to be loaded or unloaded.
- (ii) Duty drawback means a refund of all or part of any import duty paid in respect of goods exported or used in a manner or for a purpose prescribed as a condition for granting duty drawback.
- (iii) Export processing zone means a designated part of customs territory where any goods introduced are generally regarded, in so far as import duties and taxes are concerned, as being outside Customs territory but are restricted by controlled access.

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