

**THE EFFECT OF E- COMMERCE ON TAX LAWS IN TANZANIA (THE
CASE STUDY OF INCOME TAX AND VAT LAWS ADMINITERED BY
THE TANZANIA REVENUE AUTHORITY**

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CERTIFICATION

The undersigned certifies that he has read and hereby recommends the acceptance by the Open University of Tanzania (OUT) a dissertation entitled The Effect of E-Commerce on Tax Laws in Tanzania (The Case Study of Income Tax and VAT Laws Administered by the Tanzania Revenue Authority). In partial fulfillment of the requirements of the award of degree of Masters of Laws in Information Technology and Telecommunications (LLM IT&T).

.....

Prof. Ian Lloyd

Supervisor

Date

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DECLARATION

I, Elisha Elias Shigella, do hereby declare that this dissertation is my own original work, and has not been presented to any other University for a similar award.

.....

Signed

.....

Date

DEDICATION

This work is dedicated to my lovely wife Neema; my son Baraka and my daughters Mercy Monica and Rhoda.

ACKNOWLEDGMENT

The success of this work has been a result of efforts contributed by various distinguished individuals and Institutions by devoting much of their precious time and resources to assist me in its accomplishment. Yet the Lord, Almighty GOD deserve my first priority acknowledgement for using all such people gloriously for me and for giving me the privilege of life, keeping me alive and guiding me as my sole shepherd throughout my struggle to make this study a reality.

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ABSTRACT

Income Tax and VAT laws are among several domestic legislations administered by the Tanzania Revenue Authority; which is a statutory body established in the year 1996¹ as a semi-autonomous body charged among other things with the major function of collecting and accounting for all taxes due to the central government. Like in many African countries, collection of taxes in Tanzania is governed by legislations dated back during colonial era² when were enacted to operate under conversional commerce as opposed to e-commerce. Income Tax being a direct tax on income and VAT being an indirect tax imposed on every goods or services consumed, the two taxes essentially touch whatever income is generated, and whatever goods and services produced, consumed or rendered, except where specifically exempted by law. This paper therefore seeks to examine what has been the effect of e-commerce in Tanzania in relation to the two types of taxes. Does it has corresponding effect to the laws governing collection of such taxes; what are the measures put in place for such laws to operate smoothly?, what are the noticeable obstacles in implementing such laws?; what is its impact to such tax laws and what is the solution?. These are some of the questions this paper seeks to answer and provide possible solution and recommendations to such issues associated with e-commerce prevalence in Tanzania in respect of the two proposed tax laws.

¹ Established by an Act of the Parliament no. 5 of 1995, CAP 399

² Most of the Legislations have undergone several modifications or amendments to suit the circumstance of country.

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ABBREVIATIONS

BPR	Business Process Reengineering
CFA	Committee on Fiscal Affairs
CLE	Continuing Legal Education
DTA	Double Taxation Agreement
EDI	Electronic Data Interchange
EFD	Electronic Fiscal Device
EFT	Electronic Fund Transfer
EU	European Union
ICT	Information Communication Technology
ISP	Internet Service Provider
OECD	Organization for Economic Cooperation Development
PE	Permanent Establishment
TCRA	Tanzania Regulatory Authority
TLS	Tanganyika Law Society
TRA	Tanzania Revenue Authority
UKITA	United Kingdom Telecommunication Authority
UN	United Nations
UNICINTRAL	United Nation Commission on International Trade Law
WCO	World Customs organization
WSIS	World Summit on the Information Society

LIST OF STATUTES

The Evidence Act Rev 2002

The Electronic and Postal Communications Act, 2010

The Income Tax Act, Cap 332

The Value Added Tax Act, cap 148

The Tanzania Communication Regulatory Authority Act, 2003

The Universal communications Services Access Act, 2006

The Broadcasting Services Act, 2003

Tanzania Communications (Licensing) Regulations, 2005,

The Tanzania Communications (Importation and Distribution) Regulations, 2005,

The Tanzania Communications (Radio Communications and Frequency Spectrum) Regulations, 2005;

The Tanzania Communications (Tariffs) Regulations, 2005,

The Tanzania Communications (Access and Facilities) Regulations, 2005,

The Tanzania Postal Regulations, 2005, the Tanzania Communications (Interconnection) Regulations, 2005,

The Tanzania Communications (Consumer Protection) Regulations, 2005,

The Tanzania Communications (Quality of Services) Regulations, 2005,

The Tanzania communications (Broadband services) Regulations, 2005,

The Tanzania Communications (contents) Regulations, 2005,

The Tanzania Communications (Telecommunications Numbering the Electronic Address) Regulations, 2005.

TABLE OF CASES

1. Trust Bank Ltd Vs Le-Marsh Enterprises Ltd and Others, TLR 2000
2. Celtel Tanzania Limited Vs Commissioner General TTLR 2005, Vol.1 pg.86

CHAPTER ONE

1.0 INTRODUCTION

1.1 An Overview of E-commerce in Tanzania

The information and communication technology evolution is affecting many nations around the world and forcing changes to business and socio-economic development plans, and reflecting major implications on the realization of the concept of globalization.³Tanzania is one among many developing countries in the World that has been advocating for legislative changes⁴ to cope with the current technological advancement.

Starting the early 1990sTanzania witnessed dramatic changes in the way of life in the society, this is marked by certain salient features of technological advancement related to the introduction of computer linked communications, such as the increased use of internet and mobile phones which brought dramatic challenges to the commercial relations that existed before. Currently there are twenty eight (28) internet service providers⁵in the country and there are more than six mobile phone companies leave apart electronic banking facilities offered by a variety of modern banks linked with Automatic Teller Machines and which currently has added an additional mobile money facility that enable mobile phones to interface with customer bank accounts (mobile phone baking).

³See the Journal by SherifKamel and Maha Hussein on Emergence of e-commerce on a developing nation a case of Egypt, available at <http://www.emeraldinsight.com/1463-5771.htm>

⁴See the Tanzania ICT Policy mission statement which states among other things the need to provide conducive legal and regulatory framework for public and private infrastructure investment in e-commerce capacity building.

⁵ See www.zoomtanzania.com/internetproviders dated 05/02/2013

Commercial ways of doing things has dramatically changed bringing in new relations and arrangements in transacting, for instance it has now become common for people to conclude contracts over internet or telephone calls, sending money and receiving money through mobile phones, internet banking and as well as transacting through Automatic Teller Machines (ATM) that need no physical contact with bank officers. Such arrangements did not exist before, and it is quite different from how it used to be previously where movement of papers was an essential requirement for a transaction to be completed likewise exchange of papers was essential for a legally enforceable contract to be concluded.

In terms of banking services and one was forced to visit his or her bank physically for services which now one perform her banking just from his or her personal computer at home. With the internet contracts and other agreements are electronically concluded, hence calls in the demand for corresponding changes to address such situation, first and foremost the need for changes in legislative framework as a fundamental foundation of all changes associated with the technological development.

1.2 Scope of E-commerce

E-Commerce generally speaking has been assigned a diversity of definition by different authors depending on one's perspective. The business process for instance view point sees it as a facilitation of purchase and sales of goods or services; the communication view point sees it as a delivery of data, goods or services, computer network payments through telephone lines and other communication modes; and

from the service perspective, it is providing quality services and products to satisfy customers, both business and consumers while reducing service cost.⁶

Parties involved in the e-commerce include manufacturers, wholesalers, and retailers also sellers of internet commerce products like oracle, Microsoft, and Netscape; Financial institutions, including banks and insurance companies; standard setting organisations as well as industry associations.⁷ On the basis of such arrangements the term e-commerce may be defined to mean the use of computer networks to facilitate transactions involving the production, distribution, and sale and delivery of goods and services in the marketplace.⁸ Further Electronic commerce refers to the delivery of information, products, services or payments by telephone, computer or other automated media.

It includes many kinds of business activities that are being conducted electronically much more just than the purchase of goods and services electronically. For instance; Electronic banking; Electronic monies; Electronic purchasing and inventory systems; Electronic payment systems; All commercial transactions conducted by the internet, telephone and fax; and all forms of trade in digitized goods and services. Electronic commerce has been extremely effective in strengthening businesses and stimulating growth in new areas.⁹

⁶J.K. Shim et al The International Hand Book of Electronic Commerce, Glenlake Publishing Company, LTD, New Delhi, at pg 2

⁷Ibid pg.3

⁸See Charles E. McLure, Rethinking Straight about the Taxation of Electronic Commerce: Tax principles, compliance problems, and nexus. Hoover Institution, Stanford University.

⁹ See the UNITED NATIONS PAPER on Ad Hoc Expert Group Meeting on Strategies for Improving Resource Mobilization in Developing Countries and Countries with Economies in Transition Montreal, 2 - 6 October 2000 at pp.12

The United Nations Commission on International Trade Law (UNCITRAL) has defined electronic commerce as commercial activities conducted through an exchange of information generated, stored, or communicated by electronic, optical, or analogous means.¹⁰ More specifically, electronic commerce has become an umbrella term for telecommunications activities conducted over open computer networks, such as the Internet. Such activities may include electronic data interchange (EDI), on line retailing, and electronic financial services (such as home banking, electronic funds transfer (EFT), payment processing, and business process reengineering).¹¹ Generally speaking e-commerce is reflected in two transaction systems, that is offline business and online business.

1.2.1 Offline-Business

In offline business transactions, also known as indirect electronic commerce, the Internet is only used to conclude the contract. The marketing, advertising and certain information is provided through the Internet. However, the delivery of the goods is not done through the Internet; it is done offline by using traditional ways such as the post or other delivery services or other forms of transportation. The crucial criterion for offline business is that the Internet is used as a communication tool.¹²

The Internet is used instead of telephone, fax or letter. With regard to tax implications offline businesses are not considered to be a new form of business with

¹⁰ See a paper by *Clayton W. Chan* on Taxation of Global E-Commerce on the Internet: The Underlying Issues and Proposed Plans at pp.3

¹¹ *Ibid*

¹² See VAT Taxation of E-Commerce -under special consideration of the 6th EU VAT Directive-, a dissertation by *Andreas Krensel* in partial fulfillment of the requirements for the degree of Masters of Law at the University of Cape Town.

new tax implications. From a tax point of view the offline business is just a new form of ordering system.¹³

1.2.2 Online-Business

Online-business, sometimes referred to as direct electronic commerce, has an important feature that the Internet is used to fulfill the contractual obligation, for instance to deliver ordered software, music or videos. The Internet provides the infrastructure for fulfilling the contract and not just concludes it. The contractual obligation is delivered electronically. Not all services or goods can be delivered electronically. However, there are already several applications in place on the Internet. For instance downloading of e-books, magazines, newspapers, music, standard-software, individualized software and using online information services.¹⁴

1.3 E-commerce and Changes in the Economy

The nature of e-commerce suggests profound changes to normal economic structure in the society. For instance as a result of digitization the electronic market place requires no physical stores or market institutions. The electronic market places allow sellers to innovate the entire business process from manufacturing to customer service. Seller and buyers meet to trade products using digital processes. The arrangement of doing things in the economy has been fatally affected, goods and services to suit the circumstances has been introduced. Computer software which can be downloaded to the consumer, video, cable television, music albums, electronic books, newspapers and magazines, information databases, education and job

¹³Ibid pg. 6

¹⁴Ibid pg. 7

training, home banking bulletin boards and chatrooms have now become famous products commonly transacted under electronic commerce. However, applicability of such new goods and services under electronic commerce arrangement can be experienced in different levels depending on the level of technological development in a particular national or state. In Tanzania for instance electronic books, home banking, and bulletin boards are still uncommon, but with the fast moving wind of technological changes it is just a matter of time all these will be knocking at the doors.

1.4 Principles of Taxation and E-commerce

The OECD countries at Ottawa meeting¹⁵ managed to set out principles to be applied among member countries in relation to issues such as domicile for personal and corporate taxation, electronic tax records and filing and e-commerce. Such principles which include neutrality; efficiency; certainty & simplicity, effective & fairness; as well as flexibility should not be differently applied under e-commerce circumstance as they operate under conversional commerce.

1.4.1 Income Characterization

Tax rules under domestic laws as well as treaties impose different tax treatment on different types of cross-border income. For example, business profits are generally sourced to the country where the income-producing business is based and taxed on a net basis. Royalty income, on the other hand, is generally sourced to the country where the intellectual property was used (e.g., the country where the consumer of the

¹⁵ See <http://www.oecd.org/dataoecd/46/3/1923256.pdf> , OECD Taxation and electronic commerce.

intellectual property is resident) and may be subject to gross withholding taxes.¹⁶

The digital world raises a number of problems with respect to income characterization issues. Cross-border transactions involving the transmission of digital goods or services often make it difficult to determine whether a transfer of a product has occurred, whether services have been performed, or whether an intangible product has been licensed. The problem is that transactions involving digital goods and services often blur the lines among different categories of income.¹⁷

1.4.2 Server/Permanent Establishments

Due to the advent of the Internet, cross-border commercial transactions can be enabled by computer servers (i.e., a computer that has been networked to the Internet) instead of traditional business intermediaries such as retail stores. For example, a consumer can now download digital music from a commercial web site whereas these consumers would normally have purchased this music in the form of a CD at a retail outlet prior to the rise of the Internet and digital goods. This development led to the view that the tax treaty definition of permanent establishment, which is typically defined as a “fixed place of business through which business is conducted”, should be extended to computer servers.¹⁸

¹⁶ See the paper by Arthur J. Cockfield on the Rise of the OECD as Informal ‘world tax organization’ through the Shaping of National Responses to E-commerce Tax Challenges, Yale Journal of Law and Technology (forthcoming, 2006) pg. 8

¹⁷Ibid

¹⁸Ibid pg.9

1.4.3 Place of Effective Management

In the context of taxing e-commerce earnings, a residence-based system raises a number of concerns. Under the 'place-of incorporation' test, a corporation is considered a resident in the country where it has been incorporated while corporations incorporated outside of the country are considered to be non-residents. Moreover, the place-of-incorporation test does not require a business to maintain an economic presence within the country, the simple act of filing articles of incorporation will suffice to fulfill the residency requirement. As such, residency can change by simply changing the country of incorporation. Following the rise in the number of ecommerce businesses or internet business in recent years, such business has chosen to incorporate their companies in tax haven jurisdictions. The decision of incorporating an online company in a tax haven may be motivated by tax reasons, but may also be influenced by permissive laws with respect to commercial activities such as gambling or pornography.¹⁹

Countries also employ a *place of central management and control* test to determine whether or not a company is a resident. This test generally involves looking to where a company's head office is located or where the board of directors meets on regular basis. Traditionally, directors had to hold face-to-face meetings to make business decisions. Internet technologies that promote video conferencing and email exchanges may pose a challenge to the place of central management and control test. The need for a physical head office may be eliminated as senior managers and directors can attend meetings without leaving their desks. These managers and

¹⁹Ibid pg.11

directors could maintain residences in different jurisdictions (including tax havens), making it harder for high tax countries to assert that corporations are residents of their jurisdictions.²⁰

1.4.4 Services and Permanent Establishments

As part of its review of e-commerce tax reform issues, the OECD Business Profits TAG proposed in a draft discussion that rules governing the taxation of cross-border service income be altered within the OECD model tax treaty. Under the proposed changes, source countries would be able to tax income from services if a non-resident firm or its representatives is present in the source country for a period of time. The proposal was aimed at replacing the permanent establishment requirement with a physical presence test that is similar to the one in the United Nations model tax treaty. The rationale for the proposal is, in part, that service providers are very mobile and can generate significant income in foreign countries without the need to set up a physical facility or use a fixed base of operations.²¹

1.5 Statement of the Problem

The objective of this research is to examine the effect or rather influence of electronic transactions on the tax laws as a result of technological advancement, particularly the Income Tax Act and the Value Added Tax, as some of the laws administering domestic collected taxes in Tanzania. The research seeks to explore whether there has been any measures undertaken to address the contemporary situation in the two selected tax legislations, what so far has been done by the

²⁰Ibid pg.11

²¹Ibid pg. 13

Government and the concerned tax authority in that relation. Moreover the research will examine the effect of e-commerce on the two selected tax legislations in relation to the principles of taxation regarding neutrality; efficiency; certainty & simplicity, effective & fairness; as well as flexibility of taxation.

1.6 The Underlying Assumption of the Study

The research is based on the underlying assumption that, taxation principles that govern the governments in relation to conversional commerce are still useful to govern collection of taxes in Tanzania under the domestic tax laws of income tax and value added tax in the electronic commerce environment.

1.7 Objective of the Study

Basing on the research problem, the following are the objectives of this study:-

- a. To examine the background of the electronic commerce in Tanzania.
- b. To identify whether the taxation legal frame work in Tanzania addresses e-commerce, particularly on the income tax and Value Added Tax being domestic collected taxes.
- c. To analyze and critically examine the law relating to e-commerce in Tanzania and its practice by the Tanzania Revenue Authority.
- d. To assess the prevailing legal environment in Tanzania whether it satisfy the contemporary technological advancement in the country particularly on e-commerce.
- e. To provide possible recommendations for the smooth taxation of e-commerce in Tanzania.

1.8 Significance of the Study

The significance of this study articulates on the following:-

1. The study seeks to cultivate and impart knowledge and awareness on the law governing taxation of e-commerce in Tanzania.
2. The ultimate findings of the study is expected to be of great use and importance to tax officers, tax authorities, policy makers in the government especially on fiscal policy, taxpayers, tax consultants, lawyers, researchers as well as tax adjudicating machineries. The influx of e-commerce has profound influence to the daily activities conducted by the mentioned groups, as new commercial relations have been created other than the ones existed under conversional commerce, hence the mentioned groups are the primary expected beneficiaries of the results of the study as they are actively involved in daily transaction leading to taxation of e-commerce.
3. There exist highest demands to ensure that taxation legislations are regulated in conformity with the changes in the technology, where nothing can be done unless thorough research is conducted to identify loopholes and weakness in the current taxation laws, especially the Income Tax Act, and the Value Added Act which were drafted under conversional commerce environment. Hence this research becomes of most significance to address and arrest this situation. Under ecommerce environment the World has become a small village making the boundaries created under conversional commerce ineffective, as most of the transactions are currently done through the boundless internet facility. This pose challenges in the applicability of territorial tax legislations in the e- commerce transaction environment

between taxpayers located in different tax jurisdictions.

4. It is expected that the outcome of this study will be of much use to the stakeholders in the industry of taxation i.e. The Government through the revenue authority, taxpayers through their organized forum and tax consultants, as it will enable them see the importance of revisiting and proposing possible amendments or re-enactment of the tax legislations in line with the results of the study.

1.9 Research Methodology

As will be seen in the literature review there is a little writings on taxation of electronic commerce in Tanzania that can be cited in demonstrating the position in the country in this field. This fact has rendered the exercise of literature based research uneasy task hence the most used methodology was the internet research for purpose of accessing electronic document on the subject. However, most of the internet obtained literature has a reflection that much has been written from other foreign jurisdictions on taxation of ecommerce and a little has been explored that relate to the Tanzania circumstance.

1.9.1 Detail of Research Sources

The research methods used by the researcher included documentary research including various books, journals magazines by different authors, case laws reports and Internet search for various articles. On the field research the researcher used questioners and interview with officers of different ranks who are involved in collection of taxes from the Tanzania Revenue Authority.

1.9.2 Internet Based Research

Much effort was directed by the author on internet search from various online websites and resources. Through this means much was gathered on the approach to taxation of electronic commerce by various jurisdictions and International organisations such as the UN, OECD and UNICINTRAL. A variety of literature was discovered particularly on how countries have tried to tackle the challenges posed by e-commerce taxation to conversional commerce, including its legal framework. About three writers at least have written something that has drawn attention to the Tanzania legal frame work as far as taxation of electronic commerce is concerned.

1.9.3 Law Reports

Various Law Reports were used in the course of establishing whether there are any decided cases on the area of e-commerce taxation. The Law Reports explored include the Tanzania Law Reports, Tax Law Reports of Tanzania and other law reports visited through internet search. However, in all Tanzania Law Reports no case law was found directly addressing the taxation of e-commerce taxation except the case of *Trust Bank Tanzania LTD*²² which addressed the issue of admissibility of electronic evidence.

This of course can as well be applicable to e-commerce taxation in the event admissibility of electronic evidence is an issue. Another case related to taxation was the case which addressed issues of interconnection charges between

²²See TLR, 2000 pg.

telecommunication companies and roaming service charges found in the Tanzania Tax Law Report²³.

1.9.4 Legislations

A number of Tax legislations and other statutes of general and specific applications were canvassed. These legislations include the Income tax Act²⁴, the VAT Act²⁵, the Evidence Act, RE: 2002, The Electronic and Postal Communications Act, 2010, Communications Act of 1993 and the Tanzania Communications Regulatory Authority (TCRA) Act of 2003; the Universal Communications Services Access Act, 2006, the Broadcasting Services Act, 2003.

Some relevant regulations to the communications industries were as well visited. These include the Tanzania Communications(Licensing) Regulations,2005, the Tanzania Communications(Importation and Distribution) Regulations,2005, the Tanzania Communications(Radio Communications and Frequency Spectrum) Regulations,2005; the Tanzania Communications(Tariffs) Regulations,2005, the Tanzania Communications(Access and Facilities) Regulations,2005, the Tanzania Postal Regulations,2005, the Tanzania Communications (Interconnection) Regulations,2005, the Tanzania Communications (Consumer Protection) Regulations,2005, the Tanzania Communications (Quality of Services) Regulations,2005, the Tanzania communications(Broadband services) Regulations,2005, the Tanzania Communications (contents) Regulations,2005, and

²³See the case of Celtel Tanzania Limited v. Commissioner General, TTLR 2005, Vol.1 at pg. 86

²⁴CAP 332 of the laws of Tanzania.

the Tanzania Communications (Telecommunications Numbering the Electronic Address) Regulations,2005.

1.10 Research Questions

This research study was built on the following research questions:-

1. Are you aware of any provision in the tax legislations that provide for electronic commerce taxation?
2. Are you aware of any changes in tax legislations that seek to address the issue of e-commerce taxation in Tanzania?
3. Have you ever tackled any e- commerce related issues in tax operation?
4. Is the current legal environment regarding electronic commerce taxation in the country sufficient?
5. Do you know any changes made in the Income tax and Value Added tax laws that addressed e-commerce taxation?
6. Do you know any other measures taken by the Government and the tax authority to cope with the wind of technological changes, especially on taxation of e-commerce?
7. Do you think there is a need to revisit, re-write or re-interpreted the current Income Tax and Value Added tax laws to suit the current technological development and market situation?
8. Have you ever received any training in taxation of ecommerce?
9. What is your comment on taxation of ecommerce in Tanzania?

1.11 Interview Conducted with Tax Officers

Interviews were conducted with various tax officers who are involved in the audit of tax cases and responsible for issuing assessment for any under paid taxes either as a result of deliberate evasion or avoidance. The researcher managed to interview a total of 8 people who in one way or another are engaged in tax matters. Out of the interviewed people four of them are tax officers involved in tax audits and in issuing tax assessments, two of whom are Legal counsels involved in litigation of cases emanating from revenue laws administered by the Tanzania Revenue Authority. The remaining two out of the eight people were advocates engaged in defending tax payers aggrieved by decisions of tax officers in the implementations of tax laws.

In the course of an interview with tax officers engaged in tax audits and issuing assessments as well as Legal counsels involved in litigation of cases the following was revealed; the Question that was posed to each of the six tax officers engaged in tax audits and assessment as well as litigation legal counsels was whether they were aware of any provision in the tax legislations that provide for electronic commerce taxation.

Each of them answered to this question that, they are not aware of any specific provision; however they indicated that what they know is that, the general provisions under the Income Tax Act 2004 apply as well to taxation circumstances of e-commerce. Another Question imposed to the officers was whether they were aware of any changes in tax legislations that seek to address the issue of e-commerce

taxation in Tanzania. Four of the six tax officers answered no to this question. Two officers who are also legal counsels engaged in pursuing cases emanating from tax laws in tax adjudicating machineries, both of them principally answered that there is a recent effort made under the Income Tax Act, 2004 intended to address e-taxation. They identified that provision as s.69 (h) of the Act which states that:-

*“s.69.The following payments have a source in the United Republic:-
(h)payments received by a person who conducts a business of transmitting messages by cable, radio, optical fibre or satellite or electronic communication in respect of the transmission of messages by apparatus established in the United, whether or not such messages originate in the United Republic.*

According to the interviewed officer, the sought amendment if will sail through is intended to provide a solution to the words “apparatus established in the United Republic” as such words deny the government the ability to tax this area, especially where transmission of messages is through apparatus established ease where such as through satellite established in space or in any other jurisdiction. This is purely common under the current situation where ecommerce transactions need no established apparatus in Tanzania, as they are carried out through the internet which is borderless and not easy to establish where the apparatus are established, hence such e-commerce transactions can always escape from taxation in Tanzania. He further pointed out that efforts to amend this provision have been made, where currently a proposal for amendment has been forwarded to the Ministry for Finance for onward presentation to the parliament for the final decision.

In addition to the above provision the two legal counsels also pointed out that recently the government through TRA managed to introduce provisions in the Income Tax Act and the VAT Act as well as regulations that seeks to introduce and regulate e-filing of returns something which did not exist before. This has been prompted by the increased usage of computer and the internet that facilitate communication, hence signifying as one of the impact on e-commerce taxation. The law on Electronic Fiscal Device(EFD) was also one of the mentioned piece of legislation that recognize the link between every sale made by the taxpayers and TRA computers reflecting all such transactions made by the taxpayer for purposes of ascertaining correct tax payable by the taxpayer at the end of the accounting period.

Another question imposed on the tax officers and Legal counsels was on whether they had ever tackled any e- commerce related issues in their tax operations and litigated cases. All of the six interviewed tax officers answered no to this question, adding that they had not experienced any e-commerce case. However, the two legal counsels among the six tax officers added that even where any difficult could have been encountered they would have applied similar principles of taxation applicable under conversional commerce in the existing tax legislations.

Another question put to each of the six tax officers and legal counsels was whether the current legal environment regarding electronic commerce taxation in the country is sufficient. One tax officer out of the six interviewed indicated that he is not conversant as to whether the current legal framework regarding e-commerce taxation is sufficient. The remaining five other officers indicated that the legal frame work regarding electronic commerce taxation suffice as it is regulated by the existing

domestic tax laws. They further indicated that in case of any difficulties experienced in implementing the domestic laws in relation to e-commerce taxation they have always been proposing for possible amendments to the laws to accommodate the desired circumstance under e-commerce environment, a good example is the above stated proposal for amending s 69(h) of the Income tax Act in an effort to eliminate the difficult imposed by the words ‘by apparatus established in the United Republic of Tanzania’.

Another question put to the officers was whether they know any changes made in the Income tax and Value Added tax laws that addressed e-commerce taxation. They all answered no, adding that except for the recent proposed amendment on s.69 (h) of the Income Tax Act, 2004. The six officers were further asked whether they knew any other measures taken by the Government and the tax authority to cope with the wind of technological changes, especially on taxation of e-commerce. Some of them said they knew nothing but some said that they knew that the government through the Law reform commission was doing something on ensuring that the changes in technology generally are regulated by specific legislations.

Such efforts by the government include the enactment of the Electronic and Postal communication Act in the year 2010. However, no specific effort had been shown on the aspect of e-commerce taxation apart from the various proposals for amendment of the laws that is made by the Tanzania Revenue Authority in the course of discharging its duties and implementation of the tax laws. The six officers were asked similar questions as to whether in their opinion there was a need to revisit, re-write or re-interpreted the current Income Tax and Value Added tax laws to suit the

current technological development and market situation. They all answered generally yes, they provided their differed views but all aimed towards the fact that the changes in technology has substantially affected relations in the society hence corresponding changes to the laws that regulate relations in the society including tax laws need to be revisited to arrest the situation. In the circumstance they were of the views that consented efforts need to be made by the government to ensure that there is no leakage of revenue through the loophole in our laws created by challenging changes in technology through which some taxpayers might take or are currently taking advantage of.

Another question asked was whether all such officers ever received any training regarding taxation of ecommerce, the answer given by all of them was no. However, some of them indicated that they have attended seminars organised by different organisations other than on tax matters which were providing general knowledge on how e-commerce operates but was not specifically geared at addressing aspects of e-commerce taxation.

The question regarding their comments on taxation of ecommerce in Tanzania asked to all officers was generally responded to the effect that they were sensing a danger in future, as they currently know almost nothing about e-commerce taxation given the fact that electronic transactions now are becoming predominant in the World economy, hence there is a greater threat to the economies of developing countries, Tanzania being one of them, as there is a likely hood of the conventional principles of taxation becoming inapplicable under the complexity brought about by

ecommerce transactions. In that regard there is a lot to be research and provide possible solution, especially with respect to the tax legislations so as to be capable of bringing into taxation all e-commerce transactions and prevent tax avoidance and evasion.

An interview with two advocates of the High court who are engage in the litigation of tax cases revealed the following:-

Similar Question that was posed to each of the six tax officers engaged in tax audits and assessment and litigation legal counsels was also put on the two Advocates of the High court who demanded anonymity to their names. The first question was whether they were aware of any provision in the tax legislations that provide for electronic commerce taxation. Both of the Advocates said no to the question adding that in their practice in tax matters they have never seen any provision in the tax laws of Tanzania that address specifically on e-commerce taxation. Most of the provisions can however be generally applied to cover as well e-commerce taxation.

The answer to the question on whether the two advocates were aware of any changes in tax legislations that seek to address the issue of e-commerce taxation in Tanzania was no and no further comments was given to the effect.

The question as to whether they had ever tackled any e-commerce related issues in tax operation or tax disputes handled for their clients against the Tax Authority the answer was also no. Whether the current legal environment regarding electronic commerce taxation in the country is sufficient, the answer was that it is not

sufficient. They added that their answer is substantiated by the fact that they had never come across a single provision in the Tanzania Tax laws that specifically tries to address the issue of e-commerce, leave apart the fact that in their more than fifteen years of tax litigation practice in the country they had never come across any tax dispute concerning e-commerce in their litigation life.

Do you know any changes made in the Income tax and Value Added tax laws that addressed e-commerce taxation?. The answer to this question by both Advocates was no.

Do you know any other measures taken by the Government and the tax authority to cope with the wind of technological changes, especially on taxation of e-commerce?. To this question one of the advocates said no and the other said yes. The one said yes added that he knew of the efforts made by the Government through the Ministry of communications in corroboration with the Tanzania Communication Regulatory Authority, Tanzania Commission for Science and Technology and other stake holders in their efforts to enact laws regulating communication related legislations electronic communication Act being one of the target . However, despite of such efforts the frame work for enactment of such act is yet to be accomplished, hopefully will be accomplished in the near future.

Do you think there is a need to revisit, re-write or re-interpreted the current Income Tax and Value Added tax laws to suit the current technological development and market situation?. Both of the two advocates interviewed responded positively to the question, each advancing his own observation towards the question, but basically

they were focusing on the same argument that the wind of technological changes has swept the world at large, Tanzania is not an exception though much effect of such changes has not been seen in the country, precaution has to be taken to pave a way for the influx of technology. Hence, immediate efforts to revisit re-write or re-interpreted the current Income Tax and Value Added tax laws to suit the current and future technological development and market situation is desirable.

Whether the two advocates ever received any training in taxation of ecommerce was another question put to them and both of them said that, they generally received trainings regarding e-commerce done as part of their continuing legal education (CLE) trainings through the Tanganyika Law Society (TLS). But such trainings could not specifically address issues of taxation of e-commerce but rather focused on electronic evidence and signature as some of the components that constitutes e-commerce transactions.

Regarding their comments on taxation of ecommerce in Tanzania, generally both advocates posed that much research is needed as taxation of e-commerce in Tanzania is almost not known, neither the tax officers nor tax consultants/ practitioners have sufficient knowledge on e-commerce taxation. The concept is so far-fetched in the tax legislations, if at all it is there. Therefore for the taxation of e-commerce in Tanzania to be developed efforts need to be devoted to clear the way for a conducive environment for e-commerce taxation and e-commerce generally to operate. All stake holders in the area of e-commerce taxation, such as tax officers, tax consultants, tax practitioners, litigation lawyers, policy makers, legislators,

researchers, tax adjudicating bodies as well as taxpayers need to be involved in preparing the favourable legal environment that can tackle the technicalities that e-commerce taxation is likely to import into the country.

CHAPTER TWO

2.0 LITERATURE REVIEW

There is no much written on the area of taxation of electronic commerce in Tanzania as compared to other jurisdictions. This entails that e-commerce taxation is quite a new area in the country and demands much work to be done to enrich this field in terms of legislations and literature, as a result of the unavoidable influence of globalisation brought about by fast moving wind of technological changes. However, there are few writers who have endeavoured to address ICT situation generally in the country, in so doing they have touched the element of e-commerce taxation in the course of their discussion.

Adam A. Mambi in his book entitled *ICT Law Book, a source book for information and communication*,²⁶ he writes that e-commerce has been seen as the potential and one of the greatest economic developments of the 21st century, whereby the revenue authorities have the role to realise this potential. He further points out that the impact of digital technology on e-commerce has posed a greater challenge on taxation systems at global level. Most countries like Tanzania apply some principles of taxation where under the current offline laws situation the traditional and general principles of source, residence and jurisdiction for purposes of income tax might be affected by the global nature of e-commerce. The no boundary nature of the internet entails that business or income can be accrued electronically anywhere in the world.

The author further states that the challenges behind taxation systems is that it is always difficult to tax information products between one country and another and it

²⁶pg 149

is extremely difficult to use existing offline laws in Tanzania and other countries to the cyberspace analogues of physical world business. He emphasize that unlike indirect taxation such as PAYE, more difficult issues will arise in respect of indirect taxation imposed upon businesses and individuals who generate income in respect of operations undertaken in two or more countries. Here the author finds two issues that arise, the first being the division between taxes based on source of income and upon the residence of the taxpayer, and the second concerns the issue where a business may be considered to be established.²⁷

The author further writes on legal analysis of cyber taxation in Tanzania and points out that under e-transaction it might be difficult to apply the principle of permanent establishment for purposes of taxing income.²⁸ He mentions that under digital technology, digitised goods can be ordered, paid and delivered electronically the fact that poses a challenge on taxation systems. He recommends that there is a need to reform the laws governing income tax in Tanzania to reflect e-taxation and accommodating digital technology and electronic taxation. He argues that the cross border nature of internet transactions pose a challenge, the multiplicity of overlapping applicable laws and jurisdictions can lead to situations where an activity is subject to multiple and contradictory regulation or to no regulation at all.

The author gives out some findings on difficult legal questions to answer given, the nature of the current laws that are tuned to the impact of e-commerce which has resulted from the rapid development of computer technology. Assuming that two

²⁷Ibid

²⁸Ibid

parties are transacting electronically the questions that are expected to arise include; where is a business regarded to be established for fiscal purposes? Where do cyberspace transactions take place,? Where Income is earned in one country by an individual resident or undertaking established in another country where is tax paid?, How can we avoid double taxation and prevent fiscal tax evasion?, How can we reform our tax laws to cope with e-development? How can we assist tax collectors where the transaction is done electronically?, Where and when can taxes be collected?, Assuming that the goods or services are ordered, paid delivered online within the country or even between two countries, is tax to be collected?.²⁹

The author concludes that most governing business transactions provides that, the contract must be in writing and duly signed or authenticated before a witness, requirement which are no longer applicable in cyberspace world hence affecting these offline laws which have to be changed and reformed to accommodate e-commerce principles.³⁰ Another writer, John Ubena³¹ in his article entitled *why Tanzania needs electronic communication legislation? law keeping up with technology*, he states the fact that Information Communication Technology (ICT) or in other name electronic communication as an industry, in a strict sense is unregulated in Tanzania, the fact that makes the country run at risk of being a cyber-criminals' haven. He went on identifying some legislative efforts that took shape in the year 2000 following a decision in the case of *Trust Bank Ltd v. Le-Marsh Enterprises Ltd and others*³² which opened doors for the admissibility of electronic

²⁹Ibid pg.150

³⁰Ibid pg. 272

³¹See the Law Reformer Journal, Volume 2, Number 1, 2009, at pg. 17

³²Commercial Case no. 4 of 2000, High Court Commercial Division at Dar es Salaam (Unreported).

evidence, as a result of which an amendment³³ was effected to the Tanzania Evidence Act 1967 to accommodate the admissibility of such evidence, hence as of now electronic evidence is admissible in the Tanzanian courts of law. However, the author remarks that with such effort reached in amending the Tanzania Evidence Act, more legislation need be devised in this area to regulate among other things electronic commerce, electronic signature and electronic communication generally.

The author points out that the traces back to the 1960s and 1970s there were pieces of legislations that sought to regulate ICT in the country.³⁴ These were later amended, repealed and replaced with new legislation such as the Tanzania Posts and Telecommunication Act of 1993; the Broadcasting Services Act of 1993 and the Tanzania Communications Act of 1993. Further efforts were made to enact the Tanzania Communications Regulatory Authority Act (TCRA)³⁵ for the purpose among others, to establish a communication regulatory body.

The author went on arguing that neither the Communications Act 1993 nor the TCRA Act of 2003 addresses issues of cyber-crimes or IT crimes generally, hence matters of convergence of technologies or even development of ICT have not been mentioned in the said legislations, the fact that lead him to conclude that with lapse of time these pieces of legislation will be redundant.

³³ Amended by Section 33 of the Written Laws (Miscellaneous Amendments) Act, No. 15 of 2007. Which had an effect of making admissible in evidence all information obtained from computer systems, networks, servers, facsimile machines, electronic transmission, audio or video records and other Communication facilities are admissible as evidence.

³⁴ Such legislations include the Broadcast Receiving Apparatus (Licensing) Act, No. 6 of 1964; the Tanganyika Broadcasting Corporation (Dissolution) Act, no. 11 of 1965; The Tanzania Posts and Telecommunications Corporation Act of 1977.

³⁵ An Act no. of 2003

The author comments on the availability of scattered pieces of legislations found in the country and question the fact as to whether such scattered pieces of legislation so far enacted sufficiently address the changes and convergence of ICT and whether they are really adequately regulating electronic communications.³⁶ He went on saying that the impact of these changes and the convergence of ICT is that of legislation becoming obsolete, while in other instances, there are lacunae found in the law.

This brings in problems not only in legal interpretation of ICT legislation but also in the administration and enforcement of the law since there is a multiplicity of several pieces of legislation that are scattered in different statute books which are difficult to be comprehended by lay persons.³⁷ The author proposes that the solution to the problems experienced in Tanzania is to enact a comprehensive electronic communications legislation to cover all the technologies. Such legislation must be drafted to take cognizance of the pace of technology and the convergence of technologies.

To allow technological neutrality, the legislation should thus have open ended phrases to cover many technologies than having restricted itself to a particular technology like TV or radio broadcasting or telecommunication, instead of enacting an electronic communication law, etc. The legislation designated as electronic communications Act will serve all the purpose and do away with the piece meal approach of enacting a new law for every new technology or change of technology

³⁶PP. 18

³⁷Ibid

or convergence of technology.³⁸

In his conclusion the author expresses that if one considers the pace of development of ICT and the convergence of various ICT technologies, he or she would obviously have no doubt that, Tanzania needs electronic communications legislation. The basic factors for such conclusion are in three limbs; one being the pace of ICT development and the convergence of ICT technologies and second, the need for a technological neutral legislation; and likewise, the need for sustainability of the law. He further identifies other problems not mentioned in his article to include areas such as the failure to tax e-commerce, the fact that create loophole for any Tanzanians and foreigners to take advantage and conduct e-commerce which is afforded by the lack of electronic communications legislation that could have defined what e-commerce is and ascertain possibly what is to be taxed under the same legislation.

Furthermore another problem is how the privacy of Tanzanians is to be guaranteed when they go to the cyberspace; this ought to have been stated in the electronic communications legislation. All these matters deserve a separate piece of writing to be expounded in explicating perspectives.³⁹ Dr. Sandler C. Hadler in the paper entitled *Improving Tax Administration in Sub-Saharan Africa: The Potential of Revenue Agencies and Electronic Service Delivery*⁴⁰ states that, while electronic

³⁸Ibid

³⁹Ibid pp.26

⁴⁰A paper prepared in the document (ST/SG/2000/L.3) for Ad Hoc Expert Group Meeting on Strategies for Improving Resource Mobilization in Developing Countries and Countries with Economies in Transition

commerce can help increase the effectiveness of tax administrations, it also raises major new issues and challenges on established tax systems and laws. The potential with electronic commerce for avoidance and evasion is major and necessitates that countries review their tax policies and administration to ensure that tax laws are applied appropriately.⁴¹ For instance, it is difficult to determine where a commercial activity occurs; since there is no paper trail, problems arise similar to that raised by an underground economy. She poses the same argument, in similar way posed by Adam Mambi⁴² by emphasizing that it becomes difficult to determine which jurisdiction has the authority to tax incomes and transactions in the case of electronic commerce.⁴³

The writer points out that, since 1995, most developed countries have established Advisory Committees on Electronic Commerce under the Minister of Finance to determine the implications of electronic commerce on tax administration. Consistent with the OECD approaches and recognizing that the private sector should lead the way.⁴⁴ The Committees' recommendations have tended to focus on:-

1. Developing a strategy for electronic commerce
2. Developing and adopting guiding principles for electronic commerce
3. Facilitating universal access
4. Building trust in the electronic marketplace
5. Defining a legal framework for electronic commerce

Montreal, 2 - 6 October 2000, Organized by the United Nations in cooperation with Association de Planification Fiscale et Financière (APFF).

⁴¹Ibid pp.16

⁴² See the ICT Law Book, a source book for information and communication, *supra*

⁴³Ibid

⁴⁴ Ibid

6. Playing an active role in international forum on electronic commerce, in particular, to promote consistency in national policies around the world.⁴⁵

With respect to the tax and regulatory environment, the committees recommend that:

1. Governments should create a favorable policy and legal environment for electronic commerce and ensure that the network and physical infrastructure for electronic commerce figure prominently in their policies and programs.
2. Governments should ensure a tax neutral position with regard to electronic commerce transactions so as to avoid new or additional taxes driving business elsewhere. Any new taxes should be based on detailed impact studies,
3. All levels of Government and key private sector players should work cooperatively towards building trust in the electronic market place, and in particular, work together to establish clear policies in a number of technical areas (for instance, digital signatures, encryption, privacy and protection of consumer rights).⁴⁶

Clayton W. Chan⁴⁷ discusses the principle of tax neutrality that requires any equitable tax system to treat economically similar income equally. He went on saying that for electronic commerce to flourish, the principle of tax neutrality, as applied to e-commerce, would require that income earned through electronic means be taxed similarly to income earned through more conventional channels of commerce.⁴⁸ To do otherwise would be to place e-commerce at a competitive disadvantage relative to

⁴⁵Ibid

⁴⁶Ibid 17

⁴⁷See a paper on Taxation of Global E-Commerce on the Internet: The Underlying Issues and Proposed Plans, *Supra* at pp.11

⁴⁸Ibid

other modes of commerce, defeating one of the purposes of an equitable tax system. The practical application of tax neutrality, then, would be a position that no new taxes should be placed on e-commerce transactions.⁴⁹

He further point out that the concept of permanent establishment as found defined under article 5 of the OECD Model Tax Convention⁵⁰ is a key tax concept because, under most tax treaties, a business must be determined to have a permanent establishment presence in that country before the country can attempt to tax the profits of the business. The author further retaliates that the income flows occurring over the Internet are a new and potent source of potential government tax revenue. However, if the potential tax revenue from this new form of income is not captured, the overall tax base will be eroded by a double whammy the total loss of tax revenue not collected, plus the loss of tax revenue from the income of workers displaced by new information technologies.⁵¹

The author adds on that, form of tax base erosion may occur due to the ephemeral nature of global e-commerce transactions as they are exceedingly difficult to verify, since they leave no physical record and may be conducted with electronic cash.⁵² Deriving from the OECD perspective the author states that electronic cash is floating around the Internet, the lack of a paper trail would prevent tax authorities from conducting accurate audits. He points out that this problem would be especially

⁴⁹Ibid pg.

⁵⁰ Article 5 of the OECD Model Tax Convention 2012, defines a permanent establishment to mean a fixed place of business through which the business of an enterprise is wholly or partly carried on.

⁵¹ A paper on Taxation of Global E-Commerce on the Internet: The Underlying Issues and Proposed Plans, *Supra* at pp. 13

⁵²Ibid

acute for countries which rely on consumption taxes for tax revenue, such as the VAT. Since consumption taxes are a tax on sales, any lost taxes on undetected consumption of products conducted over the Internet would mean a proportional loss to the country's tax base.⁵³

Paulo Bastos Tigre and David O'Connor⁵⁴ write and state that most developing countries have not yet faced major concerns about how the growth of e-commerce might affect tax revenue collection, but eventually they will need to confront this issue. They add more that while the biggest question surrounds the treatment of goods and services that can be delivered digitally via the Internet, there may also be tax implications of online payment for traditional goods and services.⁵⁵

These authors identify three broad sets of taxation issues raised by e-commerce which are:⁵⁶

1. Consumption Tax Issues: defining the place of consumption (for cross-border transactions) and the collection mechanisms best suited to ensuring effective collection.
2. International direct Tax Issues: monitoring application of the current rules for taxing business profits; characterizing payments from different e-commerce transactions for taxation purposes; clarifying the concept of permanent establishment.

⁵³Ibid

⁵⁴ See the OECD development Centre, Working Paper No. 189 (Formerly Technical Paper No. 189) policies and institutions for e-commerce readiness: what can developing countries learn from OECD experience at pp.28

⁵⁵Ibid

⁵⁶Ibid

3. Tax Administration Issues: examination of the opportunities internet technology provides for improving taxpayer services as well as assisting and promoting compliance.

The authors went on saying that there remains the question of the tax treatment of income from the sale of a digital product. If it is treated as a goods sale, then the tax implications are likely to be different than if it is considered a transfer of copyright. In the latter case, a royalty income tax would be appropriate. A further complication arises when different international jurisdictions assign different tax treatment to the same revenue flow from the purchase of a digital product, giving rise to the possibility of double taxation.

They adds on that another tax jurisdiction issue is the definition of “place of permanent establishment” for e-commerce enterprises, which in turn has income tax implications. Normally, the business will have a website hosted by an Internet service provider on one of its servers. Does the location of that server then constitute the place of business, or permanent establishment, of the website owner, even if that owner maintains no physical presence in the jurisdiction. They maintain that within the OECD, a near consensus (with dissenting opinions expressed by Portugal and Spain) has been reached to the effect that a web hosting arrangement typically does not result in a permanent establishment for the enterprise that carries on business through that website and that an ISP will not, except in very unusual circumstances, constitute a dependent agent of another enterprise so as to constitute a permanent establishment of that enterprise.

This matters to whether local tax authorities in the jurisdiction where the server resides can levy taxes on income generated by the websites hosted on that server. They mention that in 1992, the US Supreme Court ruled that mail-order firms are not required to collect sales tax from customers located in states where they do not maintain a physical presence. This ruling has been interpreted as applying to e-commerce as well.⁵⁷

Mr. Julius K. Magile writing on the Challenges to Income Taxation on e-Commerce and e-Business⁵⁸ he puts it that the determination of whether the site constitutes a “fixed place of business” has to consider in view of various possible scenarios. He gives an example of a server that could be located in building situated in a country where the company has no physical presence. It could be located on a portable computer used in different locations or countries. He points out that the technology today is such that it is possible to mirror the web sites and server from the Service Provider, lease both the web site and the Server from the ISP or lease the web site and server and share various functions with the ISP. He adds on that other questions to consider are whether the activities carried out satisfy the law. Digitized information poses the problem of definition of services income as distinguished from sales of goods income or royalties.⁵⁹

⁵⁷Ibid

⁵⁸See a paper presented to stake holders forum on 6th July 2006 by the Tanzania Revenue Authority on the *impact of e-commerce on Taxation*, pp. 8

⁵⁹Ibid

Andrew Murray⁶⁰ writing on *Electronic Payments and taxation* he says that there is a risk of an extensive amount of taxation revenue being lost following a high degree of cross border transactions with a number of virtual goods such as MP3 Music files, on demand movies and games, and online business services such as continuing professional education and market research being deliverable at a touch of button and in a form distinguishable from non- commercial services such as home movies or personal web pages. He further says that in many ways the easiest taxation problem to solve is the gathering of tax on goods sold online and delivered overseas.⁶¹

He went on saying that individuals buy goods online from a variety of sources ranging from legitimate ecommerce sites such as Amazon, iTunes, and eBay or even downright illegal offshore sites offering tobacco, alcohol, or jewelry tax free. The author analyses techniques for obtaining the correct taxation revenue on the above mentioned goods, he says that there are international agreements that regulates cross border transactions, although the exact provisions of the agreements vary, the general provision is that a consumer who buys goods overseas is not liable for local sales tax but will potentially be liable for local sales taxes, as well as import duties upon their importation.⁶²

⁶⁰A. Murray, *Information Technology Law the law and society* Oxford University Press, New York 2009 at pp.436

⁶¹Ibid pp. 353

⁶²Ibid

Ian Tunstall⁶³ writing on the implication of e-commerce, he says that the fact that trading occurs through technological means should not make a difference to the way in which profits and other income are taxed and expenses allowed for deductions. However the market place for e-commerce transactions is not a physical place or permanent establishment which would allow the tax laws to identify the residency of the Taxpayer. ⁶⁴ He adds on that the fact that e-commerce may have a presence anywhere in the World can present problems when interpreting the tax laws to determine assessable income and expenses that can be deductions for purposes.

J.K. Shim and others⁶⁵ expressing their view on taxation of e-commerce state that, the area of taxation of e-commerce is characterised by ambiguity, confusion and presence of unset rules. When taxation of ecommerce varies by state, ascertaining what is taxable and who is responsible for paying those taxes become complex. Confusing and overlapping tax laws may cause double taxation as well as multiple reporting and compliance problem.

Marcus Stelloh and Lilla Stack⁶⁶ they write that, following the increase in conducting business using the Internet, electronic commerce is becoming one of the largest industries in the world hence demand for appropriate tax legislation that clearly establishes the tax principles to be applied in taxing electronic commerce transactions. Electronic commerce, referred to as “e-commerce” takes place in a

⁶³I. Tunstall , Taxation and the Internet, Law book co. 2003, Sydney

⁶⁴Ibid pp.3

⁶⁵J.K. Shim et al, The International Handbook of Electronic Commerce, Glen lake Publishing Company, LTD,London,pp.235

⁶⁶ See“Taxation and Electronic Commerce”, a Paper presented at the Southern African Accounting Association Conference held on 25 – 28 June 2008 at Emperor’s Palace, Johannesburg , PAPER - SAAA 09

global environment, while each country imposes taxes based on national legislation.

⁶⁷ They argue that most countries enter into a network of Double Tax Agreements (DTA) with their main trading partners which aim at preventing or mitigating the effect of taxing transactions in both of the signatory countries and providing mutual assistance in administering the collection of taxes. However many of the agreements are based on the OECD Model Tax Treaty, which does not specifically address the problem of e-commerce.⁶⁸

These writers try to explain by giving an example which illustrates how difficult it can be to apply the concepts of permanent establishment, residence or source in order to tax the transaction. They point out that the main problems arise with companies that trade online and sell goods in another country, if the place where their permanent establishment is situated differs from their online establishment. For example, a company may be incorporated in South Africa (a South African resident by definition) and decides to establish its online business through a server in America. If a product is sold to a customer in Germany who bought the product via the new website, which country or countries may tax the South African company's business profit on the sale to the German customer? Is it America where the website is hosted, or Germany because that is where the purchase was made, or South Africa because that is where the product was produced and therefore where its permanent establishment is situated.⁶⁹

⁶⁷Ibid pp.3

⁶⁸Ibid

⁶⁹Ibid

The authors went on saying and proposing that, because e-commerce transactions cross international borders they are very likely to conflict with the legislation and regulations of different countries and therefore a new tax system for e-commerce needs to be adopted. They went on stating that the main aim of the system must be to be fair and tax neutral so as to ensure that no hidden costs will occur in an electronic transaction. Companies may not be willing to enter into e-commerce transactions if the risk of paying more taxes is greater than bargained for. Specifically, two problems arise with the taxing of e-commerce. It is very complex and in most situations it is not clear what tax jurisdictions are involved in transactions. The authors provide the scenario of South African legislation and regulations which do not provide specifically for business transactions in the technological age, which means that jurisprudential interpretation is non-existent or underdeveloped. They put on another complicating issue, that of different countries applying different tax systems. From such findings they see the importance of a new system needed which taxes electronic transactions fairly, quickly and inexpensively in order to maintain the advantages of e-commerce.

Arthur J. Cockfield⁷⁰ writing on the Rise of the OECD as Informal 'world tax organization' he states that Tax observers scrutinized whether traditional tax laws and principles would need to be reformed to take into account the new commercial environment under e-commerce. He surveys steps taken by governments to address e-commerce challenges and shows that, as of December 2005, many governments

⁷⁰See Arthur J. Cockfield research paper on the Rise of the OECD as Informal 'world tax organization' through the Shaping of National Responses to E-commerce Tax Challenges. Yale Journal of Law and Technology (forthcoming, 2006)

had not yet passed any significant laws or administrative guidance with respect to the taxation of international e-commerce. He states that the lack of action at the national level was influenced by the lead role undertaken by the Organization for Economic Cooperation and Development (OECD) in establishing the guiding principles and tax rules to govern the tax treatment of international e-commerce transactions.⁷¹ He further discusses the e-commerce reform efforts undertaken by the OECD that resulted in changes or proposed changes to the OECD model tax treaty, including steps to amend provisions concerning: (a) the characterization of income; (b) permanent establishments; (c) corporate residence; (d) 'group' permanent establishments; and (e) cross-border service income.⁷² He further discusses lessons provided by the OECD's e-commerce tax reform process and outcome.

First, he identifies that this process provided an unprecedented level of tax cooperation among OECD member states, non-member countries and industry representatives: the enhanced cooperation likely encouraged 'buy in' and broad acceptance of principles and rules, encouraging tax certainty and reducing the likelihood that e-commerce transactions will lead to disputes among national tax authorities or international double taxation. Second, he explains that the OECD's success with e-commerce tax reform shows that calls for a formal (upper case) World Tax Organization, which could impose binding tax rules on participating nations, may be misplaced. In particular, the OECD e-commerce reform process overcame hurdles presented by theoretical uncertainty surrounding appropriate

⁷¹Ibid pg.3

⁷²Ibid pg. 4

principles to guide international tax policy as well as the desire by governments to maintain as much tax sovereignty as possible.⁷³

The author also dwells on the efforts adopted by the OECD to arrest the e-commerce challenges. He states that in October 1998, an OECD ministerial meeting on global e-commerce was held in Ottawa, Canada, where the members reached agreement on two important documents relating to the taxation of international e-commerce. First, the Committee on Fiscal Affairs endorsed a set of principles that would guide the OECD in its reform efforts with respect to the taxation of international e-commerce. Importantly, the so called Ottawa Taxation Framework noted that traditional international tax principles should be applied to the new commercial environment promoted by the Internet and the increased sale of digital goods and services.⁷⁴

Moreover, the approach does not preclude new administrative or legislative measures, or changes to existing measures, relating to electronic commerce, provided that those measures are intended to assist with the application of the existing taxation principles. Any adaptation of existing international taxation principles should be restructured to maintain the fiscal sovereignty of countries, to achieve a fair sharing of the tax base and to avoid double taxation and unintentional non taxation.⁷⁵

⁷³Ibid pg.5

⁷⁴See OECD Committee on Fiscal affairs, Electronic Commerce: Taxation Framework Conditions (1998)[“Ottawa Taxation Framework”].

⁷⁵Ibid pg.3

Other guiding principles included the need for maintaining neutral tax treatment between-commerce and traditional commerce, low compliance costs for taxpayers and low administrative costs for tax authorities, clear and simple tax rules to promote business certainty, reducing the risk of tax evasion and tax avoidance, and flexibility to keep pace with technological and commercial developments.⁷⁶

Second, the OECD members and industry representatives signed onto a lesser known document that similarly advocated the use of traditional international tax principles in the formulation of any new rules for the taxation of e-commerce. These two documents were an important step toward developing consensus on international tax principles and could prove to be useful beyond e-commerce purposes as the principles could be reformulated for guidance with respect to future international tax challenges.⁷⁷

⁷⁶See paper by Arthur J. Cockfield, *supra*, at pg 6

⁷⁷*Ibid*

CHAPTER THREE

3.0 E-COMMERCE AND THE COLLECTION OF INCOME TAX

3.1 Background to Income Tax in Tanzania

Tanzania was declared a trust territory of the League of Nations after the defeat of the German in the First World War in 1919 and subsequently handed over to British as trustees on behalf of the League of Nations. Following that event the British became the first colonizers to establish institutions that shaped Tanzania's legal and tax structure, where in 1940 income taxation was first introduced.⁷⁸ The East Africa High Commission created by the British in 1948 which administered in Kenya Uganda and Tanzania, in 1952 synchronized all the tax legislation in the territories and passed the East African Income Tax (Management) Act⁷⁹, which remained in force until 1958 when the East African Income Tax Management Act, 1958 was enacted. The later Act levied on resident of East Africa on their income sourced within East Africa⁸⁰. After Tanzania gained its independence in 1961 from the British, the first Income tax Act was enacted in 1973⁸¹.

⁷⁸Makinyika L.F.D.A, A source book of Income tax Law in Tanzania(DUP(1996)LTD, pp. 3

⁷⁹Act No. 8 OF 1952

⁸⁰Makinyika L.F.D.A, supra pp.4

⁸¹Income Tax ACT No. 33 of 1973 revised in 2002

The current income tax law⁸² in Tanzania was enacted in the year 2004, and it repealed the former Income tax Act⁸³. The major aim behind re-enactment of the Income tax law was to accommodate changes brought in by modern taxation requirement as compared to the trend in other jurisdictions which has direct and indirect influences to the domestic taxation and the country economy generally. Issues which were not addressed or canvassed in the former legislation were addressed under the new Act. The Act has an effect of expanding the tax base by capturing revenue items which under the former law escaped taxation due to narrow scope of taxable payments in that Act, such as types of payments made in –kind, payments of a person’s agreement to any condition of employment, business or investment carried on or amounts delivered as condition for ascertaining a restriction on the capacity to conduct business or investment⁸⁴.

The Act introduced some anti-avoidance rules such as transfer pricing adjustments for transactions between associate persons to comply with the arm’s length principle⁸⁵. It further counters the adverse effects of globalized economy on direct tax by providing clear rules on quantification, characterization and allocation of income from intra-group and cross border transactions, it provides rules distinguishing between domestic and foreign sourced income payment and expenses, and as well it clarifies the concept of residence with respect to a resident of the

⁸²The Income Tax Act, CAP 332

⁸³Act no. 33 of 1973 supra

⁸⁴See The Tanzania Revenue Authority Hand Book on the Application of the Income Tax Act, 2004, 1st ed 2009 pp. iii

⁸⁵See s.33 of CAP 332, supra

United Republic as applicable to individuals and entities and scope of liability to Tanzania income tax⁸⁶.

Quite unfortunate the Act being a latest enacted piece of legislation in tax matters does not specifically address the issues of e-commerce in the global economy. This is a challenge that requires special attention as will be discussed in our current study.

3.2 The Law Governing Income Tax

As pointed out under 2.1 above, the law governing income taxation in Tanzania is the Income Tax Act CAP 332. The Act makes provisions for the charge, assessment and collection of Income Tax, for the ascertainment of the income to be charged and for matters incidental thereto.⁸⁷ Mainly the provisions of the Act are based on conventional commerce as opposed to electronic commerce as pointed out above. This act since its enactment in 2004 has been in operation for almost nine years now, and in all those years it has undergone several amendments that make the Act take care changing environment to suit its enactment purposes. The Act imposes tax on income of a person chargeable in a year of income from employment, business and investment less allowable deductions under the Act for the year of income.⁸⁸

Under the Act a resident person is chargeable to income from any employment, business or investment for the year of income irrespective of the source of income,⁸⁹ and a non-resident is chargeable to income from employment, business or

⁸⁶See the TRA Hand Book, *supra*

⁸⁷See the Preamble to the Act

⁸⁸See S. 5(1) OF cap 332, *supra*

⁸⁹*Ibid*, s. 6(1)

investment for a year of income, but only to the extent that the income has a source in the United Republic.⁹⁰ In other words the Act imposes tax on a resident person on his or her worldwide sourced income from employment, business or investment, but a non-resident is chargeable only from that portion of income that has a source in the United Republic of Tanzania. Generally speaking the Income Tax Act imposes tax over a person based on source and residence.

3.3 Collection of Income Tax under E-commerce Environment

We have seen from the preceding part that income tax is chargeable and collectable basing on source and residence principles, where a resident person is chargeable on his or her worldwide income, while a non-resident is chargeable only on his portion of income that has a source in the United Republic of Tanzania. Business profits are generally sourced to the country where the income-producing business is based and taxed on a net basis. Royalty income, on the other hand, is generally sourced to the country where the intellectual property was used (e.g., the country where the consumer of the intellectual property is resident) and may be subject to gross withholding taxes.

The digital world raises a number of problems with respect to income characterization issues. Cross-border transactions involving the transmission of digital goods or services often make it difficult to determine whether a transfer of a product has occurred, whether services have been performed, or whether an intangible product has been licensed. The problem is that transactions involving

⁹⁰Ibid, s. 6(2)

digital goods and services often blur the lines among different categories of income.

The OECD for instance, for e-commerce transactions involving software, amended its Commentary to the OECD model tax treaty to distinguish between the underlying copyright in the program and software which incorporates a copy of the copyrighted program. The Commentary now makes it clear that e-commerce transfers of all digital products should attract the same treatment as software payments, and that the technological method of transfer (whether a purchase of a program on a disk or an e-commerce online transfer) is not relevant.⁹¹

3.4 E-commerce and Residence Taxation

Under the Income Tax Act an individual is taxed on the bases of his or her residence⁹² in Tanzania for a particular year of income if such an individual has a permanent home in the country and is present in the country during any part of the year of income; is present in the country during the year of income for a period or periods amounting in aggregate to 183 days or more; is present during the year of income for period averaging more than 122 days in each such year of income; or is an employee or official of the government of Tanzania posted abroad during the year of income.

Under e-commerce environment the aforesaid chargeability of tax on income is likely to face some challenges, especially on the issue of residence of a person.

⁹¹See paper by Arthur J. Cockfield, *supra*, at pg 8

⁹² Ibid s.66(1)

Taking the reality seen surrounding the e-commerce environment which is characterised by the advancement in technology leading to increased use of internet hence increased electronic transactions, some difficulties might be experienced in identifying income sourced in Tanzania especially where the issue of permanent establishment, in case of a company and permanent home in case of an individual is of essence and paramount importance in establishing residence and source for purposes of taxation in Tanzania. Through the use of internet for instance, a taxpayer can effectively reside and conduct business in different tax jurisdictions in so doing he can reside in any country as an e-resident who crosses international boundaries many times every day and effectively resides in a number of jurisdictions.⁹³

3.4.1 Residence of an Individual and E-commerce Taxation

The residency concept under the Income tax Act which is based on physical residence of an individual and the 183 days rule as elaborated above suffers a greater challenge under a situation where an individual telecommunicate using the internet and become able to reside in a multiple of tax jurisdictions, with no clear records of crossing the borders. Under such instance, such a person might be taxed in the country of physical domicile than in the actual country he resides electronically, something which is contrary to what the law provides under conventional commerce. There is a weak link between the physical location of a person and the jurisdiction in which he or she is electronically resident, it is difficult to provide a clear demarcation and establish as to which jurisdiction has the right to tax the income of

⁹³See A.Lymer and J. Hasseldine, *The International Taxation System*, Kluwer Academic Publishers London

such a person, this is a typical difficult under the Tanzania Income Tax Act which basically centres on conversional principles of taxing an individual.

This area of taxation of income suffers challenges under the e-commerce environment, where it becomes difficult to identify the source of income given the boundless nature of the transactions transacted through internet. Under such a situation a danger of some income tax going untaxed at all or being erroneously taxed in a wrong territorial tax jurisdiction is created resulting from the confusion as to which jurisdiction has the right to tax. Furthermore there is a danger of existence of unequal tax treatment on the same tax, hence creating favourable environment for prevalence of tax evasion, avoidance as well as double taxation over the same income.

3.4.2 Residence of a Company and E-commerce Taxation

Under the Tanzania Income Tax Act, residency of companies is determined by the place of incorporation or place of central Management. The place of central Management has been variously determined as being where the business exists, or where the directors exercise their Management and control. In most cases the location of directors has been seen to be the determining factor to conclude as to the residency of a company. However, under e-commerce environment it becomes difficult to apply that test especially where all the directors resides in different countries and their communication are conducted through internet based technology

via emails, chat rooms, video and audio conferencing under such situation the central Management control test becomes useless.⁹⁴

3.4.3PE and E-commerce Taxation

The income Tax Act ⁹⁵provides for what constitute a permanent establishment as a place where a person carries on business and include 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 such as a place where a person has used or installed, or is using or installing substantial machinery; and a place where a person is engaged in construction, assembly or installation project for six month or more, including a place where a person is conducting supervisory activities in relation to such a project.

With the influx of internet, global business now operates through websites and without the physical presence of a branch office in countries around the world. For government in technology importing countries where this physical presence is removed there is a potential loss of revenue from locally sourced income.⁹⁶Typical examples of this kind of transaction can be depicted from how goods are sold under e-bay or books sold by Amazon book sellers who are based in different jurisdictions from where their products are sold online, in all such situations there is no physical presence neither there is no physical store or agent in the country where the goods

⁹⁴Ibid

⁹⁵Cap 322 under sec. 3 supra

⁹⁶See , Andrew Lymer and John Hasseldine, Supra pg. 68

or books are sold, in other words there is no physical nexus to the place where the income is sourced.

3.4.4 PE Under E-commerce and the OECD

The OECD Committee on Fiscal Affairs has come up with consensus on the issue of application of the current definition of permanent establishment in the context of e-commerce. Such consensus was reached on various issues, although with two dissenting views from member countries.⁹⁷ This consensus includes the important views that a web site cannot, in it, constitute a permanent establishment, that a web site hosting arrangement typically does not result in a permanent establishment for the enterprise that carries on business through that web site and that an ISP will not, except in very unusual circumstances, constitute a dependent agent of another enterprise so as to constitute a permanent establishment of that enterprise.⁹⁸ However, two members i.e. Spain and Portugal do not consider that physical presence is a requirement for a permanent establishment to exist in the context of e-commerce, and therefore, they also consider that, in some circumstances, an enterprise carrying on business in a State through a web site could be treated as having a permanent establishment in that State.⁹⁹

There has been some changes in the OECD model convention in the commentaries to Article 5 in that it is stated that a location where automated equipment is operated

⁹⁷See the paper by OECD Committee on Fiscal Affairs (22 December 2000) on Clarification on the application of the permanent establishment definition in e-commerce: changes to the commentary on the model tax convention on Article 5 at pg 2

⁹⁸Ibid

⁹⁹ Ibid

by an enterprise may constitute a permanent establishment in the country where it is situated, however a distinction have to be made between computer equipment, which may be set up at a location so as to constitute a permanent establishment under certain circumstances, and the data and software which is used by, or stored on, that equipment. For instance, an Internet web site, which is a combination of software and electronic data, does not in itself constitute tangible property.

It therefore does not have a location that can constitute a place of business as there is no facility such as premises or, in certain instances, machinery or equipment as far as the software and data constituting that web site is concerned¹⁰⁰. On the other hand, the server on which the web site is stored and through which it is accessible is a piece of equipment having a physical location and such location may thus constitute a fixed place of business of the enterprise that operates that server.¹⁰¹

3.5 Server and Website

The distinction between a web site and the server on which the web site is stored and used is important since the enterprise that operates the server may be different from the enterprise that carries on business through the web site. For example, it is common for the web site through which an enterprise carries on its business to be hosted on the server of an Internet Service Provider (ISP). Although the fees paid to the ISP under such arrangements may be based on the amount of disk space used to store the software and data required by the web site, these contracts typically do not

¹⁰⁰Ibid at pg. 5

¹⁰¹Ibid

result in the server and its location being at the disposal of the enterprise, even if the enterprise has been able to determine that its web site should be hosted on a particular server at a particular location. In such a case, the enterprise does not even have a physical presence at that location since the web site is not tangible.¹⁰²

In these cases, the enterprise cannot be considered to have acquired a place of business by virtue of that hosting arrangement. However, if the enterprise carrying on business through a web site has the server at its own disposal, for example it owns (or leases) and operates the server on which the web site is stored and used, the place where that server is located could constitute a permanent establishment of the enterprise if the other requirements of the Article are met.¹⁰³

3.6 Computer Equipment

It is stated further in the commentary that computer equipment at a given location may only constitute a permanent establishment if it meets the requirement of being fixed.¹⁰⁴ In the case of a server, what is relevant is not the possibility of the server being moved, but whether it is in fact moved. In order to constitute affixed place of business, a server will need to be located at a certain place for a sufficient period of time so as to become fixed within the meaning under the article which of course attains similar position in the law under the Tanzania circumstances.

The commentary put it clear that the issue whether the business of an enterprise is wholly or partly carried on through equipment such as a server at its disposal needs

¹⁰²Ibid

¹⁰³Ibid

¹⁰⁴Ibid

to be examined on a case-by-case basis, having regard to whether it can be said that, because of such equipment, the enterprise has facilities at its disposal where business functions of the enterprise are performed.¹⁰⁵ Where an enterprise operates computer equipment at a particular location, a permanent establishment may exist even though no personnel of that enterprise are required at that location for the operation of the equipment. The presence of personnel is not necessary to consider that an enterprise wholly or partly carries on its business at a location when no personnel are in fact required to carry on business activities at that location. This conclusion applies to electronic commerce to the same extent that it applies with respect to other activities in which equipment operates automatically, e.g. automatic pumping equipment used in the exploitation of natural resources.

Under the commentary no permanent establishment may be considered to exist where the electronic commerce operations carried on through computer equipment at given location in a country are restricted to the preparatory or auxiliary activities covered by paragraph 4. The question of whether particular activities performed at such a location fall within paragraph 4 needs to be examined on a case-by-case basis having regard to the various functions performed by the enterprise through that equipment. Examples of activities which would generally be regarded as preparatory or auxiliary include: providing a communications link – much like a telephone line – between suppliers and customers; advertising of goods or services; relaying information through a mirror server for security and efficiency purposes; gathering market data for the enterprise; supplying information.¹⁰⁶

¹⁰⁵Ibid pg.6

¹⁰⁶Ibid

Where, however, such functions form in themselves an essential and significant part of the business activity of the enterprise as a whole, or where other core functions of the enterprise are carried on through the computer equipment, these would go beyond the activities covered by paragraph 4 and if the equipment constituted a fixed place of business of the enterprise there would be a permanent establishment.¹⁰⁷

What constitutes core functions for a particular enterprise clearly depends on the nature of the business carried on by that enterprise. For instance, some ISPs are in the business of operating their own servers for the purpose of hosting web sites or other applications for other enterprises. For these ISPs, the operation of their servers in order to provide services to customers is an essential part of their commercial activity and cannot be considered preparatory or auxiliary. A different example is that of an enterprise (sometimes referred to as an "e-toiler") that carries on the business of selling products through the Internet. In that case, the enterprise is not in the business of operating servers and the mere fact that it may do so at a given location is not enough to conclude that activities performed at that location are more than preparatory and auxiliary. What needs to be done in such a case is to examine the nature of the activities performed at that location in light of the business carried on by the enterprise.

If these activities are merely preparatory or auxiliary to the business of selling products on the Internet (for example, the location is used to operate a server that hosts a web site which, as is often the case, is used exclusively for advertising,

¹⁰⁷Ibid

displaying a catalogue of products or providing information to potential customers), paragraph 4 will apply and the location will not constitute a permanent establishment. If, however, the typical functions related to a sale are performed at that location, for example, the conclusion of the contract with the customer, the processing of the payment and the delivery of the products are performed automatically through the equipment located there, these activities cannot be considered to be merely preparatory or auxiliary.¹⁰⁸

3.7 ISP and Permanent Establishment

The commentary further deal with the issue whether paragraph 5 of the OECD Model convention may apply to deem an ISP to constitute a permanent establishment. As already noted above, it is common for ISPs to provide the service of hosting the web sites of other enterprises on their own servers. The issue may then arise as to whether paragraph 5 may apply to deem such ISPs to constitute permanent establishments of the enterprises that carry on electronic commerce through web sites operated through the servers owned and operated by these ISP.

While this could be the case in very unusual circumstances, paragraph 5 will generally not be applicable because the ISPs will not constitute an agent of the enterprises to which the web sites belong, because they will not have authority to conclude contracts in the name of these enterprises and will not regularly conclude such contracts or because they will constitute independent agents acting in the ordinary course of their business, as evidenced by the fact that they host the web

¹⁰⁸Ibid

sites of many different enterprises. It is also clear that since the web site through which an enterprise carries on its business is not itself a “person” as defined in Article 3 of the OECD Model, paragraph 5 cannot apply to deem a permanent establishment to exist by virtue of the web site being an agent of the enterprise for purposes of that paragraph.”¹⁰⁹

3.8 E-commerce Challenges on Taxable Income

As pointed out under the preceding chapters, taxable income under e-commerce environment is prone to challenges given the current structure of the governing taxation statutes in Tanzania. The residence and source principle is subject to technical challenges under e-commerce environment that demand a presence of well-structured stable legislation that address specifically such issues so as to minimize or curb tax evasion and avoidance. In the word of Adam Mambi¹¹⁰ where he recommends that there is a need to reform the laws governing Income Tax in Tanzania to reflect e-taxation and accommodating digital technology and electronic taxation.

3.9 E-commerce and Income Tax Dispute Settlement

Although research and records has shown that there is no disputes experienced in the tax adjudicating machineries in Tanzania, i.e. the Tax Revenue Appeals Board and tribunal as well as the Court of Appeal of Tanzania as the apex court, there is however a greater likelihood of emerging complicated disputes that may stem out of

¹⁰⁹ Ibid pg 7

¹¹⁰ ICT law book, a source book for information and communication *supra*

electronic commerce taxation. In the absence of provisions specifically providing for such relations in the industry determination of such disputes will also be a challenge to all stake holders in the industry including tax adjudicating bodies, tax officers and taxpayers involved.

CHAPTER FOUR

4.0 E-COMMERCE AND COLLECTION OF VALUE ADDED TAX

4.1 Meaning of VAT

VAT is a consumption tax that is designed to be borne by the ultimate consumer, and it is collected at every stage from the point of the production manufacturing, distribution chain, whole sale, sub whole sale and retailers, it is therefore imposed on business-to-business transactions as well as business-to-consumer transactions. The essence of a VAT is that it is charged on a wide range of transactions, with a mechanism for offsetting tax paid on inputs against tax paid on outputs.¹¹¹

¹¹¹See a Paper on The Value Added Tax Experience and Issues by International Tax Dialogue at www.itdweb.org/vatconference/Document... Pg.8

4.2 Back ground to Value Added Tax in Tanzania

Value Added Tax in Tanzania was introduced in the year 1998 by an act of the parliament,¹¹²this tax replaced the existed sales tax that was only collected on one stage of manufacturing as opposed to the VAT which has multiple stage of collection at different level of the transaction.

4.3 The Law Governing Value Added Tax

In Tanzania, Value Added Tax is regulated by the Value-Added Tax Act no.20 of 1997¹¹³. This Act imposes a tax on value added on supplies of goods and services and for related matters. The tax is charged on any supply of goods or services in Mainland Tanzania where it is a taxable supply made by a taxable person in the course of or in furtherance of any business carried on by him¹¹⁴. However, the Act provides that, VAT on the importation of taxable goods or services from any place outside Mainland Tanzania shall be governed and payable in accordance with the Act and the procedures applicable under Customs Laws for imported goods shall apply in respect of VAT imports.¹¹⁵

4.4 Taxable Supplies Under the VAT Act

Taxable supplies under the Act constitutes 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

¹¹²Cap 148 of the laws of Tanzania, and commenced with effect from July 1998.

¹¹³ Ibid

¹¹⁴See s.4(1) of the Act

¹¹⁵Ibid s. 4(3)

VAT and includes the making of gifts or loans of goods¹¹⁶; the leasing or letting of goods on hire¹¹⁷; the appropriation of goods for personal use or consumption by the taxable person or by any other person¹¹⁸; barter trade and exchange of goods¹¹⁹; goods produced by processing or treating the goods of another person the supply is regarded as a supply of goods¹²⁰; the supply of any form of power, heat, or ventilation also is regarded as a supply of goods¹²¹.

The Act does not provides scenarios where goods or services are supplied electronically, however it may be argued that the same provisions of the law under conversational commerce may as well be applicable under e-commerce circumstance but yet the new relations established by electronically transacted goods remain a challenge that needs immediate actions to tackle the situation. Imagine a situation where goods or services are advertised through website and such goods or services transacted may be ordered online without any notice to the tax administration and sometimes services rendered in form of software may escape taxation as may be supplied without notice to the concerned authority and leaving no traces of such transaction, hence escape from taxation.

4.5 Administration of VAT

VAT is administered in all three revenue departments of the Tanzania Revenue Authority, i.e. The Domestic Revenue Department that administer domestic taxes for

¹¹⁶S. 5 (1)(a)

¹¹⁷S.5 (1)(b)

¹¹⁸S.5 (1)(c)

¹¹⁹S.5 (1)(d)

¹²⁰S.5(2)

¹²¹S.5(3)

small and medium taxpayers under the Commissioner for domestic revenue; the Large Taxpayers Department that administer domestic taxes for large taxpayers under the Commissioner for Large Taxpayers and the Customs and excise department that administer import taxes including VAT on imports under the Commissioner for Customs and Excise.

4.6 Nature of VAT in Tanzania

Like in other jurisdictions VAT in Tanzania is a destination based tax, meaning that the tax is collected in the country where the goods are consumed. According to international trade, the standard and recommended approach is to levy VAT on domestic consumption through the destination principle¹²². The implementation of this principle has been done through zero-rating of exports and taxing imports, with the result that total tax paid in relation to a commodity is determined by the rate levied in, and revenue accruing to, the jurisdiction of its final sale.¹²³ The alternative to destination based taxation is “origin” based taxation in which the tax is paid at the rate of, and to, the country or countries in which the item is produced.

Implementing the destination principle by zero-rating exports requires some mechanism for identifying the movements of goods and services across borders. However this has recently attained a complicated arrangement following the technological development and influx of ecommerce transactions and the Internet being the major vehicle. Regional integration such as the EU that has eliminated

¹²² See International Tax Dialogue, The Value Added Tax Experience and Issues at pg. 19 www.itdweb.org

¹²³ Ibid

existed border among countries in the region has resulted in a long-running debate on how best to deal with VAT on intra-union trade.

Particular problems arise in the VAT treatment of international services. In this case, border controls cannot be used to monitor international flows, and it can be far from clear in which country consumption is properly deemed to occur. A recent report from the OECD²⁰ suggests that there are some significant issues for cross-border supplies of services and intangibles, and notes the absence of internationally accepted principles in this area. As trade-in services continue to grow, these problems are set to become more important in the coming years.¹²⁴

4.7 The Rate of VAT in Tanzania

Tanzania has two VAT rates upon which tax is calculated, which include the standard rate of 18% and zero-rate, both computed on taxable supplies¹²⁵. There are also exemptions under the Act where some standard rated supplies are not taxable at all and some organization enjoys special relief under the law. In Tanzania Value Added Tax is also payable upon importation of goods irrespective of whether the importer is a VAT registered taxpayer or not. However, registered importers are entitled to claim credit for VAT paid on imports in their monthly VAT returns. All exports originating from Tanzania are charged at a zero rate meaning that if not exported they are subject to the rate of 18%, this is for the purposes of encouraging exports and ensuring that products originating from the country attain a fair competition in the world market by reducing the cost of their exportation hence more

¹²⁴Ibid

¹²⁵See S. 8 of cap 148

foreign currency in return. This is also in line with the destination principle outlined above.

4.8 Collection of VAT under E-commerce Environment

The Committee on Fiscal Affairs' (CFA) current Programme of Work addressing the taxation aspects of electronic commerce basing on the Ottawa Taxation Framework Conditions, it developed core elements of the taxation frame work in the field of consumption taxes as follows:¹²⁶ First taxation of cross border transactions in the rules of consumption taxation should be designed to end up into their taxation in the jurisdiction where consumption takes place and an international consensus should be sought on the circumstances under which supplies are held to be consumed in a jurisdiction.¹²⁷ Second with regard to digitized goods, for purposes of consumption taxes, the supply of digitized products should not be treated as a supply of goods. Third where business and other organizations within a country acquire services and intangible property from suppliers outside the country, countries should examine the use of reverse charge, self-assessment or other equivalent mechanisms where this would give immediate protection of their revenue base and of the competitiveness of domestic suppliers.

Countries should ensure that appropriate systems are developed in co-operation with the World Customs Organization (WCO) and in consultation with carriers and other interested parties to collect tax on the importation of physical goods, and that such

¹²⁶ see tax and *e* - commerce @ OECD, Consumption tax aspects of electronic commerce a report from working party no. 9 on consumption taxes to the Committee on Fiscal Affairs February 2001 at pg. 5

¹²⁷ Ibid

systems do not unduly impede revenue collection and the efficient delivery of products to consumers.

4.9 VAT and Cross Border E-commerce Transactions

In a VAT regime, with transactions whose chain of delivery crosses boundaries, a very complicated set of issues is raised as to who collects the tax, who has to remit tax funds, and how the tax should be designed such that the country where the ultimate consumer lives will collect all of the tax and not just the tax on the finals. Under e-commerce environment goods are sold via internet communication or other means of telecommunication, such goods include retailing and wholesaling of physical goods. Retailers and wholesalers may use the Internet to supplement or replace paper catalogues and advertisements. However, this category of electronic commerce is most akin to traditional business methods.¹²⁸

Other goods include computer software and online database information, in such goods customers may access web sites to purchase downloadable software or access electronic research databases. Digitized information is another form of goods under e-commerce where customers may access web sites and rent or purchase images in digital form that are transmitted over the Internet.

¹²⁸ See Clayton W. Chan, Taxation of Global E-Commerce on the Internet at pg 4

Financial services is another category of e-commerce goods where clients may use the Internet to trade stocks and purchase securities or to access a cyber-bank and do remote on-line banking.¹²⁹

¹²⁹Ibid

CHAPTER FIVE

5.0 CONCLUSION AND RECOMMENDATION

5.1 A General Observation

E-commerce has been seen by literature that it presents vast challenges to the international tax system, which usually has concentrations on territorial and personal bases of tax jurisdiction. The challenges crop up from the very basic character of e-commerce as global, borderless, virtual, and anonymous, whereas the international tax system is based on state jurisdiction, focused on territorial borders and physical presence. These challenges can be divided into three categories. First, feasibility challenges question whether the current regime can be applied to e-commerce. Second, normative challenges question whether the current regime should be applied to e-commerce. Third, acceptability challenges question whether countries will accept the application of the current regime to e-commerce.¹³⁰

Generally there have been several policy proposals by tax literature that aim at coping up with e-commerce challenges in the area of taxation.¹³¹ For example, as pointed out under chapter two, the OECD proposed to give tax jurisdiction to the country of the server, if the server is an essential part of the business activity¹³². Professor Reuven Avi-Yonah proposed to give tax jurisdiction to the country of the

¹³⁰See Azam Rifat, E-Commerce Taxation and Cyberspace Law: The Integrative Adaptation Model; Virginia Journal Of Law & Technology, Volume 12 no.5 at pg.3

¹³¹ Ibid

¹³²See also Organization for Economic and Co-Operation Development [Oecd], Taxation And Electronic Commerce: Implementing The Ottawa Taxation Framework Conditions (2001); Oecd, Implementation Of The Ottawa Taxation Framework Conditions: The 2003report (2003); Oecd, Tax And Electronic Commerce, http://www.oecd.org/findDocument/0,2350,en_2649_33741_1_119666_1_1_1,00. *Supra*

consumers (demand jurisdiction).¹³³ Professor Jinyan Li proposed to apply formula taxation to e-commerce.¹³⁴ The U.S. Department of the Treasury proposed to tax e-commerce exclusively according to personal jurisdiction.¹³⁵

However, in other literatures it has been argued that a very basic point is missing from the tax debate as it ignores the cyberspace law literature that deals with similar challenges of applying the current territorial law to the Internet. The literatures therefore have paid no attention to anything beyond the limits of tax law. However, the tax challenges are not unique to the application of the international tax regime to e-commerce. Instead, the tax challenges are only one aspect of the difficulties in regulating the Internet and gaining jurisdiction to set the rules, to judge, and to enforce the law. In this way, the tax challenges are similar to other challenges of applying current legal doctrines to cyberspace. Therefore, we must not overlook cyberspace law in the debate on e-commerce taxation.¹³⁶

5.2 Recommendations

As pointed out both under the Income Tax Act and the VAT Act, in Tanzania there are no provisions that accommodate e-commerce taxation, neither much efforts has been deployed by the legislative bodies in the country to legislate laws to address e-taxation, except for the individual effort by TRA to amend some provisions in its endeavour to smoothen its daily taxation operations.

¹³³See Reuven S. Avi-Yonah, *International Taxation of Electronic Commerce*, 52 TAX L. REV. 502 (1997).

¹³⁴See, Jinyan Li, *International Taxation In The Age Of Electronic Commerce: A Comparative Study* (2003).

¹³⁵ See Office Of Tax Policy, U.S. Dep't Of The Treasury, *Selected Tax Policy Implications Of Global Electronic Commerce 22*, at <http://www.treas.gov/offices/taxpolicy/library/internet.pdf>.

¹³⁶See AzamRifat*Supra*

There is a high demand for legislative changes and consented efforts to revisit and rewrite both the Income Tax Act and the Value Added Tax Act so as to be able to address and cope with technological changes, especially the prevalence of e-taxation transactions. Although it has been argued by some of the officers engaged in the business of tax administration that the tax laws applicable in conventional commerce yet are applicable in the electronic commerce environment, the reality does not suggest in the same way. This is because with the complex of the electronic transactions, there exist typical new issues that demands corresponding complex solution approach. For instance, the current business transactions is characterized by digitized information as another form of goods under e-commerce, where customers may access web sites and rent or purchase images in digital form that are transmitted over the Internet. This is a complex situation which requires corresponding efforts in arresting the situation.

In their nature such transactions are characterized by anonymity, hence difficult for the tax authority to trace and track such information. Similarly, another category as addressed in the preceding chapters involves financial services which are another category of e-commerce goods where clients may use the Internet to trade stocks and purchase securities or to access a cyber-bank and do remote on-line banking. In such situations a greater part of the electronic tax transactions is likely go out under taxed or un- taxed at all, given the anonymity nature of electronic transactions, sometimes may not be detected at all.

Gathering from what has been contented by various literatures and out of what has been observed from the field survey that involved various stakeholders in the

taxation industry; it is in our recommendations that much is need to be done in the existing tax statutes in Tanzania.

As observed, currently there is a lacuna in the tax statutes in relation to taxation of electronic commerce in the country. The existing tax statutes enacted in the era of conversional commerce needs extra efforts aimed at their re-enactment to suit the current and future challenging e-commerce circumstances. We subscribe to the ideas of various authors as canvassed under chapter two of this study, especially the proposal by John Ubena for enactment of comprehensive electronic communication legislation to cover all technologies and which recognise the pace of technology. As pointed out above, it is high time to reform the Income Tax and the Value Added Tax Acts to reflect e-taxation sufficiently to accommodate digital technology.

This brings us to the findings and conclusion that the current tax laws in Tanzania that reflect conversional commerce cannot survive the challenges brought in by new technology development hence are not sufficient to address the e-commerce taxation circumstances. They need to be improved at equal pace with the fast moving technology innovations. Although it may be argued that Tanzania has made endeavours to cope with the heat of technological changes, yet such efforts are not sufficient. One of the efforts witnessed is the formulation in place of the Tanzania Information Technology Policy¹³⁷ whose broad objective is to provide a national framework that will enable ICT to contribute towards achieving national

¹³⁷See the Tanzania Information Technology Policy, 2002 whose vision statement states that “By exploiting its unique geographical position, Tanzania becomes a regional hub of ICT infrastructure providing ICT -based solutions that enhance sustainable socio-economic development, which addresses national and regional poverty Reduction concerns.”

development goals; and to transform Tanzania into a knowledgeable society through the application of ICT. The ICT Policy has good and well-focused aspects aimed at facilitating ICT services to all sectors of the economy, taxation being one of such sectors. However, the implementation side of it is highly needed to make the policy a reality. In so doing the country should adopt enabling legal and regulatory environments that support e-development. Such enabling environment requires legal, market and social considerations that interact both at domestic and global levels to create fertile conditions for ICT-led growth.¹³⁸

The importance of such enabling environment was recognized in the Declaration and Action Plan of the first phase of the World Summit on the Information Society (WSIS), which emphasized on a trustworthy, transparent and non-discriminatory environment, as essential for the use and growth of ICTs in the developing world. Efforts by Tanzania in ensuring the availability of legal framework and infrastructure for the prevalence of e-commerce have been seen also on the enactment of the Electronic and Postal Communications Act¹³⁹. However, such efforts do not address the central problem of e-taxation which is the core subject of this paper.¹⁴⁰

In other jurisdictions such as the EU there have been a number of measures adopted or proposed such as the Distance Selling Directive¹⁴¹, the substantive law elements of the Electronic Commerce Directive¹⁴². The Electronic Commerce Directive in the EU

¹³⁸ See Creating the “right” enabling environment for ICT, by Boutheina Guerhazi and David Satola Chapter 2

¹³⁹ Act no. 3 of 2010

¹⁴⁰ See the preamble to the Act

¹⁴¹ Directive 97/7/EC.

¹⁴² Directive 2000/31/EC.

contains provisions relating to the legal recognition of electronic contracts in cases where national laws require that contracts be concluded in a particular form. Such matters are covered in the Directive on ‘A Community Framework for Electronic Signatures’.¹⁴³ These are very important aspect of e-commerce which as well has basic role in e-commerce taxation which need be established. These need to be done together with e- commerce taxation in the circumstance of Tanzania like in other jurisdictions. In reforming the existing tax laws, it is important to ensure the principles of taxation which include neutrality; efficiency; certainty &simplicity, effective &fairness; as well as flexibility are adhered to, so as to avoid distortion in the economy.

5.2.1 Neutrality

Neutrality means that taxation should seek to be neutral and equitable between forms of electronic commerce and between conversional and economic forms of commerce. Business decisions should be motivated by economic rather than considerations. Taxpayers in similar transactions should be subjected to similar levels of taxation.¹⁴⁴

5.2.2 Efficiency

Efficiency connotes that compliance costs for taxpayers and administrative costs for the tax authorities should be minimized as far as possible.

¹⁴³Directive 99/93/EC, OJ 2000 L 13/12.

¹⁴⁴ See A. Murray, Information Technology and Law, the law and society, Oxford University Press- New York, 2009, at pg. 454

5.2.3 Certainty & Simplicity

Certainty & simplicity focus on the fact that the rules should be clear and simple to understand so that taxpayers can anticipate the tax consequences in advance of transaction, including knowing when, where, and how the tax is to be accounted.¹⁴⁵

5.2.4 Effective & Fairness

Effective & Fairness, demands that tax should produce the right amount of tax at the right time. The potential for tax evasion and avoidance should be minimized while keeping counteracting measures proportionate to the risk involved.

5.2.5 Flexibility

Flexibility demands that the system for the taxation should be flexible and dynamic to ensure that they keep pace with technological and commercial development.¹⁴⁶

¹⁴⁵ Ibid

¹⁴⁶ Ibid

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