The Inward Investment and International Taxation Review

Third Edition

Editor
Tim Sanders

Law Business Research

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Third Edition

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EDITOR'S PREFACE

The downturn in economic activity has led to increased competition in the global market as jurisdictions compete to encourage inward investment. Businesses are increasingly receptive to moving to more business-friendly jurisdictions, and are more mobile than ever. One significant factor for any business considering where to locate its headquarters, offices and production facilities is the impact that choosing a particular location has on its effective tax rate. This requires not only a detailed evaluation and comparison of the tax benefits and incentives available in competing jurisdictions, but also consideration of the tax consequences of moving capital and income flows across international borders, and increasingly widespread and complex rules intended to penalise domestic businesses for moving jobs and economic activity elsewhere. Consideration of such cross-border tax opportunities, issues and conflicts between tax systems requires business tax advisers to be more aware than ever before of tax laws beyond the geographical boundaries of the country where they practice.

The aim of this book is to provide a starting point for readers, and to assist businesses and advisers by providing topical and current insights from leading experts on the tax issues and opportunities in their respective jurisdictions (or, in one case, in the European Union). While specific tax advice is always essential, it is also necessary to have a broad understanding of the nature of the potential issues and advantages that lie ahead; this book provides a guide to these.

I would like to thank the contributors to this book for their time and effort, and above all for their expertise. I would also like to thank the publisher and the team for their support and patience. I hope that you find the work useful, and any comments or suggestions for improvement that can be incorporated into any future editions will be gratefully received.

The views expressed in this book are those of the authors and not those of their firms, the editor or publishers. Every endeavour has been made to ensure that what you read is the latest intelligence.

Tim Sanders
Skadden, Arps, Slate, Meagher & Flom LLP
London
January 2013

Chapter 38

TANZANIA

Nimrod E Mkono and Ofotsu A Tetteh-Kujorjie[1]

I INTRODUCTION

Tanzania's improving business climate has seen the country jump 19 places in the World Bank Doing Business Rankings since 2006. Due partly to an economic liberalisation programme initiated in the early 1990s, the economy has enjoyed steady growth, averaging 6 to 7 per cent a year since 2000, making it one of the 20 fastest-growing economies in the world and an investment destination of interest to many foreign investors. The Tanzanian Investment Centre ('the TIC'), voted the world's best investment promotion agency in 2007, administers a regime of investment guarantees and incentives, such as the guaranteed transferability of capital, profits and dividends, protection against nationalisation and a number of tax incentives. The TIC also promotes targeted investment in certain sectors, among which the mining, construction, financial services, manufacturing, transport, communications and agriculture sectors appear to have enjoyed the fastest growth in recent years. Investing in Tanzania offers access to regional markets of over 300 million people and remarkable political stability. Nonetheless, challenges remain, among them poor infrastructure (especially related to power generation), a shortage of highly skilled personnel and limited access to capital.

II COMMON FORMS OF BUSINESS ORGANISATION AND THEIR TAX TREATMENT

i Corporate

There are three types of incorporated companies in Tanzania: the unlimited company, the company limited by shares and the company limited by guarantee. The most

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common corporate form, however, is the limited company. Two main types of limited companies exist: private limited companies and public limited companies, of which the former is the most common vehicle for foreign direct investment in Tanzania. A private limited company must have a minimum of two and a maximum of 50 shareholders, must restrict the right to transfer its shares and cannot offer shares to the public. A public limited company, on the other hand, may raise funds through public share issue. A corporation (including branches of non-resident companies) is liable to tax separately from its shareholders.

ii Non-corporate

Companies generally use the traditional corporate form to limit liability and not expose the assets of the parent to obligations of the subsidiary. Nonetheless, apart from the corporate form, sole proprietorships, partnerships and cooperative societies are also relatively common in Tanzania. While sole proprietorships are subject to personal income tax, partnerships are not taxed as an entity; rather, tax is levied on its constituent partners' share of income. Trusts are taxed separately from their beneficiaries, and separate returns must be made for trusts even with the same trustees. Insurance businesses, retirement funds, charitable organisations, clubs and trade associations are taxed under special rules.

III DIRECT TAXATION OF BUSINESSES

i Tax on profits

Determination of taxable profit

Both resident (i.e., locally incorporated) and non-resident companies are subject to corporate income tax ('CIT') under the Income Tax Act 2004. While residents are taxed on worldwide income, non-residents are taxed only on income sourced in Tanzania. Tanzania uses both the place-of-incorporation test and the place-of-effective-management test. As such, a company is resident in Tanzania if it is incorporated or formed under the laws of Tanzania, or if the management and control of its affairs are exercised in Tanzania during any period in the year of income.

Income tax accounting is based on generally accepted accounting principles. Corporation profits are taxed on an accruals basis, and taxable income is determined based on audited financial statements as gross revenue less tax-deductible expenses. Generally, allowable deductions include expenses incurred wholly and exclusively in the production of income. Donations to charities and education institutions are deductible up to a prescribed limit. Expenditure of a capital nature is not tax-deductible, but a depreciation allowance is available for seven classified pools of depreciable assets owned and employed during the year of income, wholly and exclusively in the production of income. Depreciation for certain asset classes – 1 to 3 – are based on the diminishing value method, while that for the rest – classes 4 to 7 – are based on the straight-line method.

Other deductions allowable under the Income Tax Act include interest incurred under a debt obligation, an allowance for the cost of trading stock of the business, expenditure incurred in respect of repair or maintenance of depreciable assets, agricultural research development and environmental expenditure to the extent incurred, losses on realisation of business assets and liabilities, and losses from business or investment.

Capital and income

There is no distinction between the taxation of income and capital profit. Capital gain (or loss) is included in business or investment income for companies and taxed at the regular CIT rate, currently 30 per cent; however, the sale of interests in land or buildings and financial assets (shares) attracts capital gains tax, although shares of companies quoted on the Dar es Salaam Stock Exchange ('the DSE') are exempt. For land and buildings, a single instalment is payable at 10 per cent for residents and 20 per cent for non-residents at the time of transfer, but goes against the final tax liability.

Losses

While losses may be carried forward indefinitely, subject to continuity-of-ownership and same business tests, the carry-back of losses is not permitted. With regard to the determination of corporate tax liability, profits from one project may be offset against losses from another project held by the same tax entity. Furthermore, losses incurred in connection with the realisation of business assets employed wholly and exclusively in the production of income from the business is includable in business or investment income.

Rates

The corporation tax rate for both resident and non-resident corporations is 30 per cent. Additionally, a non-resident corporation with a domestic permanent establishment ('PE') is liable to a withholding tax of 10 per cent on repatriated profits, which includes any profits remaining unappropriated in the accounts of the company. Furthermore, newly listed companies on the DSE that have issued at least 30 per cent of their share capital to the public enjoy a concessionary rate of 25 per cent for the first three years of listing. Both resident and non-resident companies with tax losses for three consecutive years must pay an alternative minimum tax of 0.3 per cent on turnover.

Administration

Tanzania has a three-tiered tax administration structure encompassing the central government tax administration, tax administration in Zanzibar and local government tax administration. The Tanzania Revenue Authority ('the TRA') is an autonomous body charged with the assessment, collection and accounting of central government taxes. The Zanzibar Revenue Board is responsible for consumption taxes in Zanzibar, while local government taxes are collected by local authorities.

With the goal of creating a modern taxpayer and investor-friendly environment, the TRA seeks to provide high-quality and responsive customer service and to promote tax compliance through a fair, equitable and transparent application of the tax law. The TRA has established a stakeholders' forum with the aim of facilitating dialogue between itself and its major stakeholders, and aims to deliver prompt service for the least cost possible, with minimal inconvenience to the taxpayer. Departments are organised on a functional basis rather than by tax type (as was previously the case).

The TRA administers central government taxes, which comprise direct and indirect taxes. Direct taxes include corporate income taxes, personal income taxes and withholding taxes on capital income. Indirect taxes include a value added tax ('VAT'), which is levied on international trade transactions, and on domestically produced goods and services at the current rate of 18 per cent, and import duty at rates ranging from zero to 25 per cent.

The year of income is the calendar year, although a different 12-month period may be granted by the Commissioner upon written request by the taxpayer. Under Tanzania's self-assessment regime, an estimated tax return is filed three months after the start of the tax year and the estimated tax burden is payable in four instalments. A final tax return must, however, be filed within six months of the end of the tax year.

The return must specify (among other things) the person's chargeable income for the year of income from any employment, business and investment, and the source of that income; the person's total income for the year of income and the income tax payable with respect to that income; and any income tax paid by that person for the year of income by withholding, instalment or assessment for which a tax credit is available under applicable sections of the tax code. Penalties apply for late filing of returns as well as for late payment.

Furthermore, taxpayers may request a private ruling setting out the Commissioner's position with regard to the application of the tax code on a proposed or actual arrangement. Such rulings are binding on the Commissioner, so long as full and true disclosure of all aspects of the arrangement relevant to the ruling was made prior to its issuance and the arrangement proceeds in all material respects as described in the application for the ruling. Taxpayers aggrieved by an assessment issued by the Commissioner or by related matters may also seek redress before the Tax Appeals Board. Further appeal to the Tax Appeals Tribunal is also available. However the highest forum for tax disputes is the High Court of Tanzania.

Tax grouping

Tanzania does not provide for the filing of consolidated returns, and each company within a group of companies is taxable in its own right. As a result, losses cannot be transferred from one member of a group to another. Rather, the losses must be carried forward and charged against the future profits of the company that actually incurred them. It is however possible to discuss ways of mitigating group losses with the Comptroller of Income Tax.

ii Other relevant taxes

In addition to income taxes, Tanzanian companies are subject to other taxes, including VAT, payroll tax (the skills and development levy ('the SDL')), real property tax, social security tax, stamp duty and transfer tax.

Under the VAT Act 1997, all goods and services supplied or imported into Tanzania are taxed at a standard VAT rate of 18 per cent unless they are zero-rated, exempted or acquired by persons who are entitled to special relief. VAT is charged and collected by registered persons carrying on business (output tax), and must be remitted to the Commissioner for Domestic Revenue on or before the end of the last working day of the month following the month to which such return relates. The registration threshold is 40 million Tanzania shillings *per annum* or a taxable turnover exceeding 10 million Tanzania shillings attained over three consecutive months.

The SDL payable by the company is calculated at 6 per cent of cash emoluments to employees. In Dar es Salaam, property tax is charged on residential and commercial properties at 0.15 per cent and 0.2 per cent, respectively, of the property value. Real property in other regions is, however, taxed at the applicable municipal rate. With respect to social security, the employer and employee are each expected to contribute 10 per cent, with the employer deducting the employee's contribution from wages. Stamp duty may be levied either as a specific amount or at progressive rates up to a maximum of 1 per cent of the value of the consideration. A transfer tax of 50,000 Tanzania shillings applies to motor vehicles and a city service levy imposed at 0.3 per cent of turnover.

IV TAX RESIDENCE AND FISCAL DOMICILE

i Corporate residence

A corporation is a resident corporation for a year of income if it is incorporated or formed under the laws of Tanzania, or if at any time during the year of income, management and control of its affairs is exercised in Tanzania. The extent to which an offshore corporation's activities can be carried on in Tanzania without resulting in the company becoming a Tanzanian resident for tax purposes is not entirely clear; however, as Tanzania continues to liberalise its economy and cross-border transactions increase, the risk of an offshore company being treated as resident in Tanzania for tax purposes is only likely to grow. Concerns may arise, for example, where the directors or shareholders are resident in Tanzania.

Indeed, under the domestic tax legislation, if management and control of the company is exercised in Tanzania, clearly, the company itself will be deemed a Tanzania resident. Nonetheless, what constitutes 'management and control' of a company has neither been defined in the domestic tax legislation, nor been tested in the courts. One may, however, speculate that 'management and control' would likely encompass the highest decision-making function and possibly need not even involve the directors *per se*, particularly where the directors can be shown to follow the directives of other persons, or where their decisions are reviewable in some manner that curbs their freedom to act.

In any case, there is a distinction to be drawn between a company's administration and its management. Importantly, a company could be managed in one place and administered in another. The essential criterion would be where the fundamental decisions concerning the company are made, as long as the decision-making act itself constitutes the free exercise of discretion on the part of the directors and no usurpation of the directors' function by other persons has occurred. Ostensibly, a mere rubber-stamping exercise by the relevant decision-makers should not rise to the level of management and control.

ii Branch or permanent establishment

A non-resident company may do business in Tanzania by registering as a branch. A Tanzanian branch of such a company is usually referred to as a domestic PE under the

Income Tax Act. Under this Act, a PE is defined as a place where a person carries on business and includes a place where a person:

a carries on business through an agent, other than a general agent of independent status acting in the ordinary course of business as such;

b has used or installed, or is using or installing, substantial equipment or substantial machinery; and

c is engaged in a construction, assembly or installation project for six months or more, including a place where a person is conducting supervisory activities in relation to such a project.

A domestic PE is liable to 30 per cent corporate income tax as well as 10 per cent withholding tax on repatriated profits.

The income of a PE is calculated separately from its owner's, by attributing certain amounts derived and expenditure incurred to the PE. These include amounts derived and payments received in respect of assets held by, liabilities owed by or the business of the PE, and expenditure incurred and payments made for the purposes of assets held by, liabilities owed by or the business of the PE, but only to the extent the expenditure is recorded in the accounts of the PE.

The assets and liabilities of the PE include:

a tangible assets situated in the country of the PE;

b intangible assets created by or through the PE;

c intangible assets, to the extent that they may be exploited in the market of the country of the PE;

d debt obligations incurred in borrowing money, to the extent that the money is employed in or used to acquire an asset that is employed in the business of the PE; and

e other liabilities arising directly out of the business of the PE.

V TAX INCENTIVES, SPECIAL REGIMES AND RELIEF THAT MAY ENCOURAGE INWARD INVESTMENT

Foreign income tax paid by a Tanzanian resident may be credited against the income tax payable in Tanzania, calculated on worldwide income, if there is no existing double taxation agreement between Tanzania and that foreign country; however, foreign tax relief is limited to the Tanzanian income tax payable. Excess credits may be carried forward.

i Holding company regimes

Tanzania has no holding company regime in place.

ii IP regimes

No IP schemes exist.

iii State aid

Agriculture continues to be the mainstay of the Tanzanian economy and is of central importance to the welfare of the vast majority of the population. The government therefore gives very high priority to stimulating a rapid supply response to deal with high food prices. In this regard, the government returned to subsidising fertiliser in 2003, and since 2008 has employed a voucher-based scheme known as the National Agricultural Input Voucher Scheme, which is a short-term strategy to intensify food production by giving farmers better access to necessary agricultural inputs.

VI WITHHOLDING AND TAXATION OF NON-LOCAL SOURCE INCOME STREAMS

i Withholding outward-bound payments (domestic law)

Dividends paid to a resident company controlling 25 per cent or more of the distributing company's shares are exempt. Dividends paid by a company listed on the DSE are taxed at 5 per cent, otherwise the rate is 10 per cent irrespective of whether the dividends are paid to residents or non-residents. In the case of interest, the rate is 10 per cent whether paid to a resident or non-resident. However, there are exemptions for interest earned by non-residents on deposits in banks registered by the Bank of Tanzania and on interest paid to resident financial institutions. Royalties attract a withholding tax of 15 per cent for residents and non-residents alike.

ii Domestic law exclusions or exemptions from withholding on outward-bound payments

Interest earned by a non-resident on deposits in banks registered by the Bank of Tanzania is exempt from withholding tax. A branch profit tax is imposed at the rate of 10 per cent. Dividends received by a non-resident person, provided that non-resident person is registered on the DSE, are subject to a withholding tax rate of 5 per cent.

iii Double taxation treaties

Tanzania has signed double taxation treaties with Canada, Denmark, Finland, India, Italy, Kenya, Norway, Sweden, Uganda, the United Kingdom and Zambia. Among the countries with which negotiations are continuing are Belgium, Burundi, Egypt, Iran, Lebanon, Malaysia, Mauritius, Oman, Pakistan, the Republic of Korea, Russia, Rwanda, South Africa, the Seychelles, the United Arab Emirates, Yugoslavia and Zimbabwe. None of the treaties entered into by Tanzania with other territories, however, reduce the rate of withholding tax on payments of dividends, interest or royalties to non-residents below the domestic rates.

iv Taxation on receipt

Dividends paid to a company that holds 25 per cent of shares or more are subject to a withholding tax rate of zero per cent for a resident company and 10 per cent for a non-resident company. If a company is listed on the DSE, the dividend received by this company is taxed at the rate of 5 per cent. This rate applies to both resident and non-resident persons.

VII TAXATION OF FUNDING STRUCTURES

Since the debt capital markets in Tanzania are not very well developed, entities, by default, are most commonly funded by equity.

i Thin capitalisation

In Tanzania, interest expense incurred during a year of income under a debt obligation incurred wholly and exclusively in the production of income from a business or investment is tax deductible. Nonetheless, effective from 1 July 2012, the interest deduction is limited to the interest portion in respect of debt that does not exceed a 7:3 debt-equity ratio. These rules limit the ability of a taxpayer to deduct interest in computing its taxable profits, where the ratio of debt finance to equity finance exceeds the prescribed level, the result being that interest would effectively be converted to a deemed dividend or income distribution for tax purposes.

Where the thin capitalisation rules apply, the applicable test is whether the interest would have been paid if the parties had been parties between whom there was no relationship, arrangement or other connection. If and to the extent the interest is viewed as having been paid by virtue of the relationship, that interest is treated as a non-deductible income distribution. Moreover, interest paid to a foreign shareholder, which is treated as 'excess' under the thin capitalisation rules, may also be excluded from exemption from withholding tax under relevant double taxation treaties.

ii Deduction of finance costs

Generally, there are no restrictions on the deductibility of finance costs, so long as they are related to the production of income.

iii Restrictions on payments

A company may pay a dividend either out of its realised profits less its realised losses, or out of its realised revenue profits less its revenue losses (whether realised or unrealised), provided the directors reasonably believe that immediately after the dividend has been paid, the company will be able to discharge its liabilities as they fall due and the realisable value of the company's assets will not be less than the amount of its liabilities.

iv Return of capital

A company limited by shares or a company limited by guarantee and having a share capital may, if so authorised by its articles, by special resolution, reduce its share capital in any way, and may, if and so far as is necessary, alter its memorandum by reducing the amount of its share capital and of its shares accordingly. The company can return paid-up capital to the shareholder as capital rather than as income, and this return of capital is tax-free. Amounts returned in excess of paid-up capital are considered dividend income (taxable) to the shareholder.

Notably, the notice given of the intention to propose the special resolution to reduce the company's share capital must be accompanied by a directors' certificate of solvency given in accordance with the Companies Act, 2002, and where appropriate, the auditors' report thereon prepared in accordance with the Act. However, a special resolution passed reducing the share capital of a company will not take effect until after the resolution has been filed with the Registrar, and the resolution shall not, in any event, be filed with the Registrar until 35 days from the date that it was passed.

Furthermore, a special resolution reducing the share capital of a company must be advertised in the Gazette, and in the case of a public company a national newspaper, in each case within five working days of the resolution having been passed. If the company fails to comply with the advertising requirement, the directors shall be liable to a fine.

VIII ACQUISITION STRUCTURES, RESTRUCTURING AND EXIT CHARGES

i Acquisition

Non-local companies acquiring local businesses use both local and non-local entities to effect the transaction, and the law is silent on whether withholding or tax can be avoided by the timing or type of consideration paid.

Mergers, however, are generally differentiated from acquisitions partly by the way in which they are financed and partly by the relative size of the companies. A company acquiring another will frequently pay for the other company with cash. Such transactions are usually termed acquisitions rather than mergers, because the shareholders of the target company are removed from the picture and the target comes solely under the control of the buyer's shareholders. An acquisition can involve a cash and debt combination, or a combination of cash and stock of the purchasing entity, or just stock.

A merger, or on the other hand, is often financed by a stock swap. Such deals are considered mergers rather than acquisitions, because neither company pays cash and the shareholders of each company end up as the combined shareholders of the merged company. There are two methods of merging companies in this way: one company takes ownership of the other, issuing new shares in itself to the shareholders of the company being acquired as payment, or a third company is created, which takes ownership of the target company (or its assets) in exchange for shares in itself issued to the shareholders of the target.

If cash is paid, it can be raised in a number of ways. The company may have sufficient cash available in its account, but this is unlikely. More often the cash will be borrowed from a bank, or raised by an issue of bonds or of equity. Acquisitions financed through debt are known as leveraged buyouts, and the debt will typically be moved onto the balance sheet of the acquired company. Many leveraged acquisitions include a component of mezzanine debt, which falls between senior secured bank debt and equity.

ii Reorganisation

Whenever the underlying ownership of an entity changes by more than 50 per cent, compared with its ownership at any time during the three preceding years, a taxable acquisition is deemed to have occurred. The Finance Act 2012 eliminated the prior two-year continuity-of-business tax-free exception, such that currently, where there is a relevant change in control, the deemed realisation is automatic, regardless of whether there is a continuity of the business in the same manner or otherwise.

iii Exit

There are no tax penalties, but the TRA will try to recover any taxes outstanding and any tax liability accrued up to the time of cessation of business in Tanzania.

IX ANTI-AVOIDANCE AND OTHER RELEVANT LEGISLATION

i General anti-avoidance

Taxpayers are subject to general anti-avoidance rules when the main purpose of the arrangement is the avoidance or reduction of tax liability. The income splitting strategy is negated by specific rules.

ii Controlled foreign corporations

A controlling person must include in its income the attributable income less distributions from any controlled foreign trust or company

iii Transfer pricing

Transfer pricing refers to the pricing arrangements set by multinational related entities in respect of transactions between them such as the sale of goods, provision of services, transfer of intangible assets, lending or borrowing of money, and any other transactions that may affect the profit or loss of the entities. Tanzania's transfer pricing rules are lodged in Section 33 of the Income Tax Act, and apply to transactions involving both resident and non-resident entities. Under these rules, a controlled foreign company may trigger the transfer pricing rules if it is determined to be an associate of a local entity.

Under the Act, arrangements between associates are required to be at arm's length, and where in the opinion of the Commissioner a person has flouted the arm's-length requirement, the Commissioner is authorised to make adjustments by way of recharacterising the source and type of any income, loss amount or payment. Such adjustments are often made in two circumstances: when the economic substance of a transaction differs from its form; and where the arrangements made in relation to the transaction, viewed in its totality, differ from those that would have been adopted by independent enterprises behaving in a commercially rational manner, and the actual structure practically impedes the tax administration from determining an appropriate transfer price. Additionally, the Commissioner may apportion and allocate expenditure between associates based on their comparative turnovers.

Although the Act does not expressly require transfer pricing documentation, under the self-assessment regime, the burden of proof is on the taxpayer to ensure that transactions are carried out at arm's length. Section 33 requires persons engaged in controlled transactions to quantify, apportion and allocate amounts to be included or deducted in calculating income between persons as is necessary to reflect the total income or tax payable that would have arisen for them if the arrangement had been conducted at arm's length.

Significantly, the code does not provide any methodologies for assessing what constitutes an arm's-length price; however, Regulation 33 of the Income Tax Regulations 2004 makes provision for the Commissioner to enter into binding agreements as to the manner in which an arm's-length price is to be determined. Nonetheless, in practice, the TRA has been reluctant to issue binding rulings, and no known advance pricing agreements have been issued to date. Moreover, according to Regulation 6 of the Income Tax Regulations, Section 33 is to be construed in such manner as best secures consistency with the transfer pricing guidelines in the Practice Notes issued by the Commissioner. Notably, no Practice Notes have been issued by the TRA in this regard to date.

No specific procedures exist in relation to transfer pricing audits; however, the TRA has raised transfer pricing audit queries in connection with multinationals operating locally during the normal audit process.

iv Tax clearances and rulings

Taxpayers may request a private ruling setting out the Commissioner's position with regard to the application of the tax code on a proposed or actual arrangement; however, such rulings are binding on the Commissioner where, before its issuance, full and true disclosures of all aspects of the arrangement relevant to the ruling were made.

X YEAR IN REVIEW

The tax structure of Tanzania is centred on direct and indirect tax. The structure has undergone significant reforms for fairness, simplicity and equity, as well as efficient and taxpayer friendliness characterised by the abolition of a number of nuisance taxes. Most tax rates in Tanzania today are consistent with internationally accepted best practice.

The corporate income tax regime is significantly challenged due to the tax–base substantially narrowing, mainly through tax exemptions and the provision of tax holidays in the investment code and free zones. The current trend, however, is to limit some generous tax incentives in order to broaden the tax base.

Incidentally, the Finance Act, 2012, which came into force on 1 July 2012, amended the 'Change of Control' provision in Section 56 of the Income Tax Act, 2004, to deem a capital gains tax charge on gains accruing from transactions in shares of foreign non-resident companies having an underlying interest in Tanzanian entities. The trigger for the application of Section 56 is the moment the underlying ownership of an entity changes by more than 50 per cent as compared with that ownership at any time during the previous three years.

There are three possible outcomes where this situation occurs, namely: the accounting period of the local Tanzanian entity is split at the point of the change, such that the segments of the year of income before and after the change are treated as distinct years of income; the local entity is deemed to be realising any assets owned and any liabilities owed by it immediately before the change, and to reacquiring these assets and liabilities immediately after the change, the realisation and reacquisition being determined at market value; and the local entity forfeits the ability to carry forward certain reliefs from the earlier period, including unutilised tax losses and tax credits.

This amendment will significantly impact on resident entities that are directly or indirectly held by foreign (parent) entities, insofar as a disposal of shares by the parent will give rise to a taxable event in Tanzania even though no change in local shareholding occurs. Significantly, this amendment, primarily targeted at Tanzania's emerging oil and gas, mining and telecommunications sectors, is aimed at allowing the government to benefit from the share appreciation of a foreign parent company, where the share appreciation is attributable to a core asset in Tanzania. Prior to the Finance Act, 2012, no local taxes applied to overseas share disposals, since no change in local shareholding actually occurred. Similar amendments have been implemented in China, India and Peru.

XI OUTLOOK AND CONCLUSIONS

As previously indicated, Tanzania's transfer pricing regime remains vague and largely untested, and the TRA is yet to issue detailed guidelines on how the rules will, in fact, be applied. Nonetheless, the TRA has indicated that it will follow the OECD Transfer Pricing Guidelines.

Of particular importance is the standard by which the arm's-length principle governing transactions between related parties will be applied. Importantly, Tanzania tends to follow Kenya's lead in situations involving new approaches to tax enforcement. In this regard, the TRA has indicated that it will follow the approach taken by the Kenyan High Court in the landmark case of *Unilever Kenya Limited v. The Commissioner for Income Tax*.[2]

In the *Unilever* case, the High Court of Kenya acknowledged that the OECD Guidelines represented internationally accepted principles that could not be disregarded in applying transfer pricing legislation and that are to be applied in the absence of specific guidelines in the legislation. The detailed methodology to be applied under the transfer pricing rules therefore is that provided in the OECD Guidelines. Incidentally, the judgment of the High Court in the *Unilever* case led to the introduction of transfer pricing rules, which came into effect in Kenya in July 2006.

Assuming Tanzania follows its usual practice of following Kenya's lead, Tanzania's transfer pricing regime will, likely, allow persons to choose from a list of specified approaches to determining the arm's-length price. These approaches would probably include the comparable uncontrolled price method, the resale price method, the cost plus method, the profit split method and the transactional net margin method. Other features that might be reasonably anticipated could be a well-defined set of the types of transaction that might come within the ambit of the transfer pricing rules, and sweeping powers accorded to the Commissioner to request information, including books of accounts and other documents relating to relevant transactions.

The transfer pricing rules would place the burden of proving that prices are at arm's length on the taxpayer, so that a taxpayer that fails to provide transfer pricing documentation to support the arm's-length nature of its prices would be at risk that the TRA would conduct a transfer pricing audit and examine its transfer pricing policies in detail. In the event that the TRA, as a result of the examination, adjusts the transfer price adopted by the taxpayer, the lack of adequate documentation would make it difficult for the taxpayer to rebut the adjustment.

2 Income Tax Appeal No. 753 of 2003.

Appendix 1

ABOUT THE AUTHORS

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Nimrod E Mkono is a member of parliament, and the founder and managing partner of Mkono & Co Advocates, Tanzania's largest law firm. He has headed the practice since 1977, and is recognised as one of the country's top corporate and finance lawyers. He has represented the government of Tanzania in a number of international commercial arbitrations and has acted for clients in numerous transactional matters, including mergers and acquisitions as well as production sharing agreements in the energy sector. Mr Mkono has also been instrumental in the drafting of several Tanzanian laws and regulations. He regularly writes for the *International Finance Review* and is a practising advocate in Tanzania and Zanzibar. He also holds an LLB from the University of East Africa, University College, Dar es Salaam, and a master of arts in business law from the Council for National Academic Awards of the United Kingdom. He is also a fellow of the Institute of Chartered Secretaries and Administrators in London.

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Ofotsu A Tetteh-Kujorjie is cross-border counsel at Mkono & Co. He is an Ivy League-educated lawyer, with corporate finance and private equity transactional experience. Ofotsu holds bachelor's (BS) and master's (MEng) degrees in engineering from Cornell University, a JD from the University of Pennsylvania Law School, a certificate in business and public policy from the Wharton School of the University of Pennsylvania and an LLM in taxation from the Georgetown University Law Center. Mr Tetteh-Kujorjie's career interests span the universe of cross-border transactions. In his current position at Mkono, he focuses on special projects, as well as on a broad range of banking, taxation, energy, mining and corporate advisory matters.

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