**Adapting Digital Economy Taxation in Zanzibar**

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**Abstract**

Taxation of e-commerce is a broad topic of tax policy with different thoughts on how e-commerce relates with traditional principles of taxation specifically to regional countries like Zanzibar. Taxation of e-Commerce is characterized by the transaction of goods and services through the Internet. As the e-commerce market for providing services over the Internet continues to grow, several online companies have emerged to serve the growing needs of Internet users. They include Dell, Amazon, Aliexpress, Alibaba Yahoo, Baidu, WhatsApp Sina, and Ebay amongst others. The issue of collecting tax concerning electronic commercial transactions in Zanzibar is facing various challenges simply because the whole operation needs high achievement of advancement of science and technology and new form of administer. Tax administration is a very detailed and increasingly complex area of expertise, particularly as far as international issues related to MNCs are concerned. Consequently, the adoption of DST is necessary to assist in the collection of tax from those types of businesses in Zanzibar, which poses the greatest challenges to the current international tax framework.

***Keywords****:* Adaptation, Taxation of digital service tax, tax administration of Zanzibar.

1. **Introduction**

E-Commerce is one of the frequent aspects of this technology that has several influences on both, non-commercial and commercial organizations. The use of electronic devices, systems and infrastructures to conduct business operations such as transactions and advertising has significantly developed how most organizations operate[[1]](#footnote-1). E-commerce is rapidly growing at a global level, and it has affected all industries and changed how organizations conduct business. The impact of E-Commerce has been felt in all approaches, from Large Enterprises to Small and Medium Scale Enterprises (SMEs). Most SMEs have also appreciated the advantages of E-Commerce. They are making efforts to create use of this technology, but for many reasons, most have been unsuccessful in accomplishing this due to various hindrances that they have come across[[2]](#footnote-2).

Zanzibar, also known as the semi-autonomous region of Tanzania, has its tax system and institutions for administering taxes. The main tax laws in Zanzibar are the Zanzibar Revenue Board Act[[3]](#footnote-3), the Income Tax Act[[4]](#footnote-4) administered by the Tanzania Revenue Authority (TRA), and the Value Added Tax (VAT) Act[[5]](#footnote-5). The Zanzibar Revenue Authority (ZRA) is the main institution responsible for administering taxes in Zanzibar.

Zanzibar Revenue Authority Act, enacted in 2022, is the primary legislation governing taxation in Zanzibar. This act established the Zanzibar Revenue Board as the autonomous body responsible for collecting and administering taxes in Zanzibar. The board is headed by a Commissioner General who is appointed by the Zanzibar’s President. Under the Zanzibar Revenue Board Act, no 7 of 1996, the ZRB has the power to administer, assess, and collect all taxes, duties, and other revenues in Zanzibar. The board is also responsible for conducting tax audits, enforcing tax laws, and providing guidance to taxpayers on tax compliance.[[6]](#footnote-6) And depends much on the revenue collection for its economic development. On the other hand, the advent of the digital economy has had profound implications for taxation. Jurisdictions have been forced to adapt their tax systems as they become increasingly unsuited to the realities of modern commerce.

Furthermore, Zanzibar is a low-taxed country in an export-oriented ICT industry,[[7]](#footnote-7) and it’s the loophole that interests foreign MNCs' investment intentions to be encouraged with this approach, increasing flow to the country. The related case found that Zanzibar's demand for digital goods is stimulated with no taxed environment due to the lack of digital tax provisions enacted.[[8]](#footnote-8) B2B in ICT services like telecommunication to web design and development directly benefited from the non–tax environment of the country. And face Disadvantages like loss of income through digital goods. Several key aspects hinder the legal and regulatory framework for digital taxation in Zanzibar including; Taxation Policies, permanent establishment, transfer pricing, Data Protection and Privacy Laws, and international agreements.

However, the legal and regulatory framework for digital taxation of Zanzibar is similar to the mainland on the part of income tax, which somehow creates jurisdictional obstacle on imposing revenue multinational enterprises, but there may be some differences in the implementation and enforcement of tax laws due to the semi-autonomous nature of Zanzibar.

The digital economy is constantly evolving, and tax authorities in Zanzibar have to update their regulations to adapt to changes in technology and business practices.

1. **International digital Tax law initiatives development**

In recent years, digital commerce has posed challenges for traditional taxation systems. To discourse this, international organizations such as the OECD and ATAF have established treaties, aiming for fair and efficient taxation of digital companies and avoiding double taxation.[[9]](#footnote-9)

The OECD's BEPS project motivations on preventing tax avoidance in the digital economy, while ATAF has established a related framework for African countries. The OECD proposes a "digital nexus" to determine when a company should be subject to taxation, supported by a "two-pillar" solution and a simplified approach for smaller businesses.[[10]](#footnote-10)

ATAF's approach reflects the unique challenges faced by African countries and proposes a "sales-based approach" to determine taxable profits of digital companies. These approaches may have challenges, such as the complexity in accurately determining a company’s economic presence, dispute resolution between countries, and potential impact on developing countries, particularly in Africa.[[11]](#footnote-11)

The Organization of Economic Cooperation and Development (OECD) has been working on guidelines towards the creation of harmonized digital taxes (OECD 2019, 2020, 2021) and the African Tax Administration Forum (ATAF) has been working towards issuing guidelines and donation guidance to African countries in designing their digital tax structure and frameworks[[12]](#footnote-12). Considering these have been taking time before being free for use, some countries including African countries passed their digital taxes to collect tax revenue while waiting for the completion of the international and continental guidelines.[[13]](#footnote-13)

New tax policies have also emerged and these include digital services taxes and equalization levies to supplement the traditional taxes and regulations such as transfer pricing legislation aimed at taxing digital transactions. In some cases, political expediency might have overtaken consistent tax policy construction that follows the canons of taxation. Even though various African Nations (South Africa, Zimbabwe, Uganda, Kenya, and Nigeria among others) have included digital transactions in their taxation scope through indirect taxes such as Value Added Tax (VAT) direct digital services taxation or tax provisions remain scarcely implemented. Currently, direct digital tax legislation is found in four African countries (Zimbabwe, Nigeria, Tunisia, and Kenya). These taxes are in their nascent stages of implementation as effective implementation dates range between the years 2019 and 2021.[[14]](#footnote-14)

ATAF developed a draft Digital Services Tax (DST) Legislation that member countries may consider whenever want to introduce new tax rules to tax highly digitalized businesses[[15]](#footnote-15).

The key feature of digital Service Tax is that, the tax is functional to specific e-services, with a set rate based on the payment for those services, and it cannot be claimed as a credit or relief against income tax, although it can be considered a business expense and deducted according to the country's regular income tax deduction rules.

Several African countries have applied different types of digital service taxes (DSTs). For example, as of January 2021, Kenya has imposed a 1.5% DST on income earned or accrued within the country from services provided through a digital marketplace[[16]](#footnote-16). Nigeria, on the other hand, orders that companies offering digital services in the country (whether resident or non-resident) pay a tax equivalent to 6% of their annual turnover in Nigeria[[17]](#footnote-17). In 2020, Tunisia announced a 3% tax on the revenue generated by non-residents from the sale of computer applications and the provision of digital services[[18]](#footnote-18). Ghana, beginning from 2022, has implemented a 1.5% levy on electronic transactions, with a particular focus on mobile money transfers.[[19]](#footnote-19)

1. **Overview of Tax Laws related to Revenue in Zanzibar.**

One of the main challenges faced by semi-autonomous countries like Zanzibar in the digital taxation of multinational enterprises (MNEs) is the difficulty in effectively implementing and enforcing tax laws and regulations. This is because MNEs often have complex and sophisticated tax planning strategies, making it difficult for governments to accurately assess and collect taxes from them and the design of the current tax structures was based on a system that has a physical presence in Zanzibar. The tax system under the current set up in Zanzibar consists of three administrative organs namely Zanzibar Revenue Authority ZRA (collects Direct taxes), the Tanzania Revenue Authority TRA (collects indirect taxes), and the Municipal and District Councils/ local Government’s Tax Administration.[[20]](#footnote-20)

Zanzibar Revenue Authority (ZRA) is the main Agent of the Revolutionary Government of Zanzibar responsible for Revenue Administration in Zanzibar established under Act number 11 of year 2022. Zanzibar tax laws have not yet included the provisions for digital transaction tax

***3.1 The Digital Tax Position in The Zanzibar Revenue Authority Act No. 11 Of 2022***

The Zanzibar Revenue Authority is governed by the Zanzibar Revenue Board Act No. 7 of 1996 Revised Edition of 2018 The Zanzibar Revenue Authority Act No. 11 of 2022, the act composed of 5 parts (part 1 –preliminary provisions, part 11- establishment of the Authority, part 111- administration and management of the Authority, part IV – Financial provisions and part v – miscellaneous provisions) and two schedule (schedule I – laws relating to revenues of Zanzibar, schedule two – proceedings of the Board).

The authority shall be the agency of the government and has a board under the general which the president shall appoint[[21]](#footnote-21), the authority shall consist of departments, divisions, and units that shall be concerned with the collection of revenue, and the functions of the authority are to ensure fair, transparent[[22]](#footnote-22), efficient and effectiveness administration and enforcement of the laws and regulations concerning revenue collection in Zanzibar as set out in the Schedule to this Act, to promote voluntary tax compliance and maximize revenue collection, to take such measures as may be necessary to improve the standard of service given to taxpayers by the authority, to improve the effectiveness, to advise the Minister and other relevant organs of the Government on matters of fiscal policy and tax administration and to advise the Minister and other relevant organs of the Government on matters of government revenue through its Board.[[23]](#footnote-23)

In the course of its duties, the authority must combat tax evasion, tax avoidance, and government revenue loss. It needs to establish identification systems for all taxable individuals to enforce revenue laws in Zanzibar. With the increasing use of the internet via mobile phones and significant advancements in ICT not adequately contributing to the growth of revenue from the digital economy, new policies are needed to create a legal and institutional framework for the effective administration of the digital economy in the country. This means that the board is mandated to advise the minister on implementing and improving tax policies and the new Act, which includes imposing a reasonable tax rate on the digital economy, also known as Digital Service Taxation (DST).

Taxation of the digital economy does not require a permanent establishment of the taxpayer. Revenue, as defined in this act, encompasses "taxes, duties, fees, fines, penalties, or other charges imposed or payable under the laws and regulations related to inland Revenue of Zanzibar."[[24]](#footnote-24) The revenue authority cannot impose charges on goods or services for which no provisions have been enacted, or rules governing service Permanent Establishment (PE) codified. This means that no charges shall be remitted for digital transactions without proper provisions of the law. This has even been emphasized by Vanistendael[[25]](#footnote-25), who stated that the legal framework for tax law entails that taxation must be implemented according to the rule of law. The fundamentals of the framework require that taxes can only be levied if a statute is lawfully enacted, taxes must be impartially applied, and the revenue collected by taxes must be used for public purposes. Independent courts play an important role in the implementation of the rule of law.

However, digital taxation has many potential implications and does not require traditional principles for basing digital taxable. In most cases, digital service providers are outside the country where their services are consumed and can process payments directly or through intermediaries, such as Alibaba or Aliexpress. Furthermore, the digital economy enables business to be conducted virtually without physical presence, which diverges from section 26 aiming to eliminate fraud of fiscal form.In The matter of dispute settlement, ZRA has only recognize the Zanzibar Tax Appeal Board, in all its tax laws mentioned in schedule two (made under sec 5 (a) which state that;[[26]](#footnote-26)

*“Any person who is aggrieved by the decision of the Commissioner in relation to any act or omission in the course of the discharge of any function conferred upon him under the law set out in the First Schedule to this Act, may appeal to the Zanzibar Tax Appeals Board.”*

The entity used by the World Trade Organization Dispute Settlement Board to resolve sub-national, national, and international levels disputes. The Appellate Body of the World Trade Organization (WTOAB)[[27]](#footnote-27) is a standing body of seven persons that hears appeals from reports issued by panels in disputes brought on by WTO members. Therefore, in proposing digital taxation, the ZRA also has to consider dispute settlement in case any issues arise and determine the policies and actions to address them in their laws.

ZRA Act is a recent act enacted which replaced ZRB which was monitored by The Zanzibar Revenue Board Act, No.7 of 1996, it’s the act that gives an outface of the institution, power, and its function. Hence although recently enacted it does not the digital taxation in the systematic collection of taxes in the model business trend of the absence of the permanent establishment of suppliers and consumers of goods as the tax laws on which it operates are still the same as shall be explained below.

***3.2 Tax position in Tax Administration and Procedures Act. No. 7 of 2009. R.E 2017 (TAPA)*** Section 3[[28]](#footnote-28) define a taxable person which means “ a person registered or required to be registered under the provision of this act, also Section 5(4)[[29]](#footnote-29) makes it mandatory for Businesses operating in multiple locations to be required to register in each location, ensuring that the supplier or enterprise has a physical presence. The sections mandates that only registered taxable payers are subject to revenue collection, creating a loophole in the digital service system that allows suppliers to avoid paying taxes on their transactions. And Section 6[[30]](#footnote-30) provides the things to comply in application for registration which state as follow;

*“6.(1) An application for registration shall be made to the Commissioner in accordance with the Regulations made under this Act.*

*(2) Any application for registration shall comply with the following requirements: -*

*(a) Proof of identity: -*

*(i) in the case of a sole proprietor, a certificate of business name including a valid identity issued by the applicant’s national or state identity authority;*

*(ii) in the case of a partnership, a partnership deed including valid identity issued by the applicants’ national or state identity authority;*

*(iii) in the case of a company, certificate of incorporation or certificate of compliance;*

*(i) in the case of a cooperative, certificate of registration.*

*(b) approval from a competent regulatory or licensing authority;*

*(c) proof of residence and permanent place of business in Zanzibar;*

*(d) list and full address of all storage, manufacturing, processing, packing and repacking facilities; and*

*(e) any other requirement as may be determined by the Commissioner”.[[31]](#footnote-31)*

Both above sections in this paragraph support the notion of only suppliers of the good on physical presence to be taxed, while the growth of the digital economy presents new opportunities and the widespread availability of broadband internet that can benefit important sectors such as information technology, wholesale trade, and healthcare, as demonstrated during the COVID-19 pandemic. This is a major existing gap that need to be cure in this act as it hinders collection of revenue and produce unfairness to business.

However, Section 22[[32]](#footnote-32) compose of records and accounts where it said that, “the taxable person shall maintain his principal place of business in Zanzibar” and all accounting records including receipts and invoices. In the current law, physical presence in Zanzibar is considered a crucial factor for taxation. It is suggested that Zanzibar adjust its policies and legal framework to incorporate advanced technology to address challenges in tracking and taxing digital transactions. The recommendation includes appointing banks or other paying agents as withholding agents for digital economy transactions to improve tax collection effectiveness and prevent potential tax evasion. Additionally, it is recommended to enhance the knowledge and skills of ZRA staff for effective monitoring of their duties. However, it is noted that the current tax appeal board does not have the authority to handle disputes related to digital transactions, highlighting a gap in the existing tax administration and procedures.

Nevertheless, similar to the first schedule[[33]](#footnote-33) of the Zanzibar Revenue Authority discussed above, the Tax Administration and Procedures Act No. 7 of 2009 provides a schedule of the tax laws that the administration (ZRA) oversees, which are: 1) The Value Added Tax Act No. 4 of 1998, (2) the Stamp Duty No. 6 of 1996, (3) The Hotel Levy Act No. 1 of 1995, (4) The Port Service Charge Act No. 2 of 1999, (5) The Petroleum Levy Act No. 7 of 2001 and the Trades Licensing Act, No. 3 of 1983. The tax laws still seem to be the legacy traditional enactment revenue laws and maintain hindrance to digital taxation economy as shall be argued more below together. All the tax laws overseen by The Tax Administration and Procedure Act have the mandate to comply with registration requirements as stipulated in this act, recording, and accounting on tax returns as well as assessment, monitoring, and compliance together with the rule of dispute settlement. These conditions cause the chief major hindrance to tax electronic commercial transactions, like part of registration, monitoring, and dispute settlement procedure has more lacuna as discussed above.

1. **Several key aspects and gaps exist within the legal and regulatory framework for digital taxation in Zanzibar, including:**

**Taxation Policies:** Zanzibar may have specific tax policies and laws that address digital taxation, such as VAT on digital services, corporate income tax on digital companies, or specific regulations governing e-commerce transactions. However, none of the tax laws have specified digital service policies or digital service rates to impose revenue.

**Permanent Establishment Rules:** Determining when a digital company has a taxable presence in Zanzibar, known as a permanent establishment, is crucial for establishing tax liabilities. Nonetheless, all tax laws have acknowledged the physical footprint of taxable goods or services supplied in Zanzibar as a requirement for establishing a permanent establishment, which may not be necessary for multinational enterprises.

**Transfer Pricing:** Transfer pricing regulations are essential for transactions between digital entities within the same multinational company group to ensure arm's length pricing and prevent profit shifting.

**Data Protection and Privacy Laws:** Regulations around data protection and privacy may impact how digital transactions are conducted and may have tax implications.

**International Agreements:** Zanzibar may have international agreements or treaties in place to address issues such as double taxation on digital transactions conducted across borders.

In the context of Zanzibar, the legal framework for digital taxation typically involves regulations that govern the taxation of digital services and transactions. This may include aspects related to value-added tax (VAT) on digital services, corporate income tax on earnings from digital activities, and any specific rules regarding cross-border digital transactions[[34]](#footnote-34). However, The Zanzibar Revenue Authority (ZRA) is responsible for collecting and administering taxes from inland revenue sources in Zanzibar, excluding customs, excise, and income taxes managed by the Tanzania Revenue Authority (TRA). The challenge which causes jurisdictional conflicts and presents a significant obstacle for semi-autonomous countries in the digital taxation of multinational enterprises (MNEs). As MNEs[[35]](#footnote-35) conduct operations on a global scale, it becomes difficult to ascertain which country holds the authority to tax their activities and collect taxes. This complexity can result in double taxation or the exploitation of tax loopholes by MNEs, leading to revenue loss for the semi-autonomous country.[[36]](#footnote-36)

However, The Income Tax of 2004 (ITA) still has some lacuna in Digital economy operation in the virtual world as such the requirement of physical presence in Tanzania is not compulsory.

In the absence of a special provision within the ITA, 2004 which will expand the current definition of PE, the taxability of the digital economy on business operations within the country will continue to be a challenge; The Digital economy has intensified challenges in taxation of non-residents based on source rule;

Section 83(2) excludes individuals from the obligation to withhold tax when making payments to resident and non-resident service providers unless the individual is conducting business, which results in the exclusion of B2C and C2C transactions from the tax net;

And Information on income generated from such digital transaction is still the major challenge in enforcement and compliance monitoring, as most online transactions go undetected even if transactions involve physical goods by communication and payment is done through electronic means.

**Moreover, several measures have been implemented to tax the digital economy:** In July 2022, the Finance Act introduced both VAT and Income tax on digital (electronic) services provided by non-residents to resident individuals at the rate of 18% and 2%, respectively. And several efforts have been made in Tanzania to bring digital economy transactions into the tax net, addressing the previous weakness in the tax laws[[37]](#footnote-37) which are;

**First,** Taxation of Mobile Money Transfer: The Income Tax Act no 332 of 2004 requires a resident person who pays a money transfer commission to a money transfer agent to withhold income tax at a rate of 10 percent.[[38]](#footnote-38) **Second** is the taxation through Representative Assesse: The Finance Act of 2020 has introduced new definitions and imposes income tax on representative assesses who cause non-residents to earn income[[39]](#footnote-39) in Tanzania. **Third** is the VAT[[40]](#footnote-40) on the Supply of Internet Services: Internet services, including digital goods such as software and e-books,[[41]](#footnote-41) are subjected to VAT. Non-resident suppliers without a place of business must appoint a representative for VAT purposes in Tanzania.

The Finance Act of 2020 introduces Section 69(A) to tax the profits of non-resident entities with associated entities or business connections in Tanzania.

The Commissioner General has the authority to disregard tax arrangements between parties and tax such arrangements using transfer pricing and anti-avoidance rules.

To effectively tax the digital economy in Tanzania, measures have been introduced. However, challenges exist in enforcing taxation on tech giants and international aggregators, such as VISA. More determination is needed to fully regulate this evolving economy.

1. **Recommendations**

Zanzibar, as a developing economy country, faces significant challenges in generating revenue for its development projects. As the digital economy develops, Zanzibar must deliberate in incorporating provisions for digital taxation into its laws. The current taxation laws do not have specific provisions for digital taxation services, especially for international transactions online business. This gap needs to be addressed to capture possible tax revenue that the government may be missing out on.

To counter this, Zanzibar should consider implementing a digital tax system that captures revenue from the digital economy while guaranteeing a level playing field for all businesses. This could be achieved by adapting and introducing digital services within the country. One way to implement digital taxation is by introducing a tax on revenues generated by digital companies from users within specific jurisdictions, regardless of their physical presence in the country. In addition, Zanzibar could consider implementing a withholding tax on digital transactions and a tax on digital advertising services.

Furthermore, Zanzibar could also modify the solution for the jurisdictional challenge of double taxation within Tanzania mainland and Zanzibar by involving exemptions or setting benchmarks to eliminate tax havens in jurisdictions.[[42]](#footnote-42) Together with staying informed about international developments in digital taxation, such as those by the OECD, may also influence local regulations in this area.

Additionally, **ZRA should be enhancing efficiency and effectiveness in administration by;**

**Sealing and Authentication:** Documents issued by ZRA must bear the ZRA seal and be authenticated by the Commissioner General or an authorized Commissioner. Without these requirements, a document lacks legal force.

**Enhanced Functions:** ZRA ensures fair, effective, and efficient administration and enforcement of revenue laws. It also focuses on improving services to taxpayers and capacity building for its officers. ZRA has to establish a special division that will be accountable for administering the digital economy.

**Countering Tax Evasion:** ZRA has new powers to counter tax evasion, tax avoidance, and revenue loss by cooperating with the Ministry of Finance (MOF), bot, and the Tanzania Communication Regulatory Authority (TCRA) to identify digital economy transactions and associated payments for taxation purposes.

**Promoting Understanding:** ZRA stimulates a better understanding of taxation among taxpayers, crucial for voluntary compliance.

**Systems for Identification:** ZRA establishes and maintains simplified systems for identifying taxpayers and revenue collection.[[43]](#footnote-43)

1. **Conclusion**

The OECD Inclusive Framework on taxation of the digital economy poses a significant risk for African countries including Zanzibar if they simply wait for an international solution. There are opportunities to improve Zanzibar's tax reforms by implementing Digital Service Taxes (DST) with reasonable rates, drawing from examples in the UK, Austria, Malaysia, Singapore, and Kenya. Additionally, implementing VAT on digital goods and services, as observed in Mexico, Colombia, Malaysia, South Africa, and Nigeria, presents another workable option. Zanzibar can also consider implementing VAT on non-resident online sellers and adopting DST in line with ATAF recommendations to effectively tax the digital economy.

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36. Yige zu, Developing VAT treaties: international tax cooperation in times of global recovery Published online by Cambridge University Press:  02 July 2021 [↑](#footnote-ref-36)
37. [www.rsm.global/tanzania/insights/tax-insights/taxation-digital-services](http://www.rsm.global/tanzania/insights/tax-insights/taxation-digital-services) visited on 7/10/2024 [↑](#footnote-ref-37)
38. S. 83 (1) (d) of the Income Tax Act, Cap 332 R.E 2019 [↑](#footnote-ref-38)
39. S. 4 ibid [↑](#footnote-ref-39)
40. The Value Added Tax Act, Cap 148 R.E 2019 [↑](#footnote-ref-40)
41. S. 51 of the Value Added Tax Act, cap 148 R.E 2019 [↑](#footnote-ref-41)
42. ibid [↑](#footnote-ref-42)
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