Challenges and Opportunities of Implementing Digital Economy Tax Policies in Zanzibar Compared to Other East African Nations

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Abstract

This paper focuses on the proposed Digital Service Taxation and examines the challenges aimed at boosting income tax and value-added tax (VAT) compliance. It applies the qualitative method through documentary analysis and compares the approach to digital taxation in Zanzibar with initiatives undertaken by other East African countries. The analysis includes literature reviews and articles to gain insights into the regional tax landscape. The paper seeks to uncover the differences in tax rates and business registration thresholds among the countries' digital tax policies. It also extends the analysis to explore the potential economic impacts of the Digital Economy Taxation Act on Zanzibar, considering both the opportunities and complexities posed by its enforcement if it is adopted. The paper emphasizes the dominant nature of digital taxation in an era increasingly reliant on digital transactions and highlights the challenges associated with tax collection from non-resident digital service providers. This paper aims to provide a comprehensive understanding of the African digital taxation framework and suggests insights into establishing clear rules that ensure effective tax collection without hindering the growth of the flourishing digital economy.

Keywords: *digital tax economy, challenges, opportunities, East Africa countries.*

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1. Introduction

1.1 Overview of the Digital service taxation in East Africa

Digital service taxation in East Africa is an emerging topic as governments in the region are looking to introduce taxes on digital services provided by foreign companies.[1] The member states of the East African Community have recently agreed to develop strategies for taxing digital services revenue. [2] These taxes aim to ensure that multinational tech companies pay their fair share of taxes in the countries where they operate. Kenya, Uganda, and Tanzania are among the countries in East Africa that have already implemented or are considering implementing digital service taxes. This motion comes as East African countries contest to tax digital services revenues in the determination to boost revenue collections, narrow fiscal deficits, curb excessive borrowing, and level the playing field for local businesses.[3] Additionally, regional tax authorities have proposed a uniform percent DST across the economies of the East Africa Community bloc, which could waves digital service providers including US tech giants like Google, Netflix, Meta, Twitter, and Microsoft.[4]

Digital economy is the use of ICT/Digital tools to ensure everyone participates in the economic activity of the country."[5] In the last two decades the world has been transformed by digitalization processes and it has had a precedent impact on society.

On top of that, Zanzibar is a semi-autonomous part of the United Republic of Tanzania, it has a complete government with a President, Cabinet, Legislature, and Judicial system. Zanzibar is given a great deal of autonomy to determine its laws and legal institutions, including its constitution. Digitalization of the economy has ushered in many benefits for companies and citizens alike, however, this new business model is increasingly becoming a challenge for legacy taxation systems and their legal and regulatory framework. All sectors inclusive digital economies have to play an important role in the payment of taxes and contribute to the

[1] https://www.bing.com/search?q=eastafrican+with+digital+service+taxation, accessed on 8/07/2024
[2] F Sebele, & Moloi, Direct Digital Services Taxes in Africa and the Canons of Taxation, 2022
[3] https://www.bing.com/search?q=eastafrican+with+digital+service+taxation, accessed on 8/07/2024
[4] East African Communications Organization. (2017). *EAC Model Policy On Electronic Transactions.* Arusha: East African Communications Organization.
[5] TCRA. (2024). *ABOUT DIGITAL ECONOMY*. Retrieved from TCRA: https://www.tcra.go.tz/services/about-digital-economy

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development of societies.[6] The design of the current tax structures was based on a system that has a physical presence in a specific country which has brought about tax evasion and reduced tax collection. Makulilo[7] further argues that in the modern era, the Act lacks important attributes of digital evidence such as electronic signatures among others. These shortcomings highlighted by the above strengthen the argument that a digitalized economy needs a comprehensive policy same as legal and regulatory framework overhaul to address the challenges currently being experienced by many nations all over the world in this digital era.

2. Body

2.1 Literature Review

The review of the literature will discuss multilateral, unilateral initiatives and any other relevant material in taxing the digital economy as discussed below,

Werner Haslehner and others[8] in the book "Tax and the Digital Economy Challenges and Proposals for Reform" that the digital economy is challenging traditional tax systems due to the absence of physical presence. Potential solutions include modified permanent establishment concepts, withholding taxes for digital transactions, and equalization levies. The EU Commission has proposed interim solutions, but international consensus is missing. Concerns about the impact on businesses, consumers, and international obligations remain. Some EU member states are considering unilateral methods due to the shortage of agreement at the EU level. Among the issue raised by the author is among the challenges faced by developing countries like Zanzibar which wish to adopt new policies, laws, and regulations on the digital taxation economy, while their legacy law still exists without any reform.

Also a recent study conducted by PwC[9] has unveiled that a total of twenty-one African nations have applied regulations requiring non-resident suppliers to comply with value-added tax, goods, and sales tax regulations for electronically provided services. The report highlights the

[6] European Council, Council of the European Union. (2021, October 8). *Digital Taxation*. Retrieved from Digital Taxation-Consillium: https://www.consilium.europa.eu/en/policies/digital-taxation/

[7] Ibid pg. 57

[8] Werner. H, and other, Tax and the Digital Economy Challenges and Proposals for Reform, Kluwer law international, Netherland, 2019.

[9] Abimbola, O. *21 African countries enact tax laws on digital economy – PwC*. London: Price Water House. 2024.

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growing trend of taxing Africa's digital economy, as numerous countries across the continent have either introduced or modified their VAT, goods, and sales tax and other indirect tax legislations to encompass the digital sector.

Job Kabochi, the Indirect Tax Leader for PwC Africa, expressed his concern about the lack of a consistent approach to taxing the digital economy across Africa. He highlighted the significant differences and complexities in tax policies among countries, including variations in definitions of taxable services, value thresholds, tax rates, and requirements for registration, compliance, and enforcement.[10]

Raymond and Alison's[11] book "Digital Taxation: Can It Contribute to More Just Resource Mobilization in Post-Pandemic Reconstruction" discusses the essential to update tax policies due to the rapid enlargement of global digital services and e-commerce. Africa faces challenges with the African Continental Free Trade Area (ACFTA) and diminishing traditional trade tariffs. Harmonizing digital taxation policies is vital for the success of the single digital market in Africa. The paper recommends evaluating tax regulations, aligning them with international standards, and implementing revenue thresholds based on customer payments to non-resident service providers. Additionally, it proposes addressing concerns of developing countries in the WTO's e-commerce negotiations to promote a more equitable international trade regime promoting e-commerce. Raymond continue to urge that the Internet environment has brought the situation. Despite the changes and regulatory reforms made by the country since independence, most of the laws enacted since British colonial rule before the 1960s are still in force, the situation is resembling to Zanzibar, hence the book carries on by providing the benefits obtained in accommodating and updates tax policies on digital service specifically in African countries. The gap exists in the book is a formulation on how contribution occur, reform the law without systematic technology procedure existence will still be the challenges for the economy of the country.

Elma Hadzovic, in the thesis on the topic of Taxing the Digital Economy in Developing Countries,[12] suggest that the digital economy's taxation has been a significant issue in international taxation in modern years. The digitalization of business models has put pressure

[10] Ibid

[11] Raymond. O and Alison. G, Digital Taxation: can it contribute to more just resource mobilisation in post-pandemic reconstruction? cape town South Africa, 2022.

[12] Elma Hadzovic, Taxing the Digital Economy in Developing Countries, faculty of law lund university, 2021.

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on the international tax system, prompting the necessity for reform. The OECD/G20 and the UN have proposed solutions to address tax challenges arising from the digital economy. The purpose of his thesis is to examine and compare the OECD's Pillar One and the UN's Article 12B to identify similarities and differences, and to determine which proposal favors developing countries. The thesis concludes that Article 12B is in favor of developing countries, offering a less complex solution that may lead to more tax revenues being reallocated to these nations. The discussion in this book relates to the thesis as the research also assesses the developing country which is Zanzibar, hence among its recommendations is that laws should be enacted associated with each country's strength in the implementation.

Correspondingly, Ellis Rootsma, in "Adapting Taxation of Business Profits to the Digital Economy Assessment of the Pillar One and Pillar Two Proposal" [13] thesis discuss that, Digitalization has significantly changed how businesses operate and create value, impacting international corporate taxation. Current tax rules based on physical presence are outdated, allowing digitalized companies to shift profits to low-tax jurisdictions, leading to tax base erosion. Many countries are considering digital services taxes, while the OECD is working on a global solution to address tax challenges arising from digitalization, to reach an agreement by mid-2021. therefore, particularly relevant to Zanzibar and acknowledge the operation of e-commerce and traditional commerce. The author's trenchant analysis of current and future challenges regarding e-commerce and the law situation, furthermore the thesis gives out similarities and differences between the two approaches and comes out with the best approach to be taken by Zanzibar which is among the developing countries and needs reforms of the law in digital taxation. Similarly, to Raymond's thesis on their argument, Ellis has not clearly explained how to charge, and through what kind of procedure to be used on imposition of those taxes that can contribute to more revenue and reduce loss of revenue.

The initial drafts of e-commerce policy in Africa are rooted in national strategies aimed at advancing the digital economy. For instance, Côte d'Ivoire expressed its intention to foster the growth of the digital economy and e-commerce within its 2016–2020 National Development Plan. Kenya's Digital Economy Blueprint[14] emphasizes the significance of expanding e-commerce across borders and suggests that uniting Africa into a single digital market will

[13] Ellis, R. Adapting Taxation of Business Profits to the Digital Economy Assessment of the Pillar One and Pillar Two Proposal by the OECD/G20 Inclusive Framework on BEPS, Department of Law Spring Term ,2021.
[14] Ibid

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lead to economies of scale and opportunities for economic growth at local and regional levels. Additionally, Kenya's National ICT Policy includes a proposal to bolster the development of local e-commerce platforms with international reach.

Sean Eric and others, [15] in their research of Pixel to Taxes, a comparative study of digital economy tax policies in the Philippines to selected ASEAN member states, argue that where the research focuses on the Philippine Digital Economy Taxation Act, analyzing its impact on income tax and value-added tax compliance. It compares the Philippine approach to digital taxation with other ASEAN countries and examines the potential economic impacts of the Act on the Philippines. The research aims to understand and provide insights into establishing clear rules for effective tax collection in the digital economy. The research is helpful as it compares and gives best practices that have been done by other ASEAN states jurisdictions on the part of the unilateral approach taken as shall be among the objectives discussed in this research by the researcher, however, it has not shown clearly the complexity of the database analysis or assessments of the data internationally in the implementation and adaptation of the system of digital service taxation.

Pamela, S.'s [16]research analyses the proposed changes to treaty rules concerning the direct taxation of business profits in the context of e-commerce. The study explores the interpretation challenges of the permanent establishment definition due to the diverse characteristics of e-commerce transactions. The challenges discussed in the book are the main challenge that occurs in tax laws of Zanzibar as each law for registration requires a condition of permanent establishment of the supplier of goods which is not necessary to the rapid expansion of the digital taxation economy transactions.

2.2 Digital Taxation Economy in Kenya

In 2020, Kenya introduced two new types of taxes aimed at the digital economy: The Digital Service Tax and the Value Added Tax on Digital Marketplace Supply. The Digital Service Tax (DST) is set at 1.5% of the gross transaction value and is charged along with VAT. The Income Tax (Digital Service Tax) Regulations, 2020 and the Value Added Tax (Digital Market Supply)

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[15] Sean, E and others, Pixel to taxes, a comparative study of digital economy tax policies in the Philippines to selected ASEAN member states. Philippines, 2024.

[16] Schembri, P. An analysis of the proposed changes to treaty rules with respect to direct taxation of business profits in the context of e-commerce (Bachelor's thesis, University of Malta). 2005.

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Regulations, 2020 have been enacted, simplifying the tax registration process for non-residents and expanding the scope of digital services subject to VAT.[17] These regulations also outline the necessities and process for VAT registration for non-residents, the appointment of local tax representatives, and the rules for accounting and payment of VAT. Furthermore, registered individuals are prerequisite to declare and pay tax on digital marketplace supplies at a specified rate of 14 percent.[18]

The major developments conveyed by the Value Added Tax (Digital Market Supply) Regulations, 2020 include the identification of a wider scope of taxable supplies which fascinate VAT on international digital supply of services, the concept of digital market supply, Simplified Tax Registration Framework done online under Regulation 7, special registration criteria for foreign suppliers to be registered under Regulation 5, and the criteria for determination of the place of supply where services are rendered through the digital market supply system as provided in Regulation 8.[19]

2.3 Digital Taxation Economy in Uganda

Stirring to Uganda, the Uganda Revenue Authority (URA)[20] started accumulating Value Added Tax (VAT) from non-resident electronic services provider companies functioning in the Ugandan economy starting July 1, 2022. Uganda also implemented a 5% income tax on all non-resident individuals earning income by providing digital services within the country. URA allotted a public notice on January 27, 2022,[21] informing all non-resident suppliers of electronic services to collect, file, and pay this tax. The services subject to this tax include online advertising, online music streaming, movie streaming services, websites, web-hosting or remote maintenance of programs and equipment, supply of software and software updates, supply of images, text and information, access to databases, self-education packages, and

[17] The Value Added Tax (Digital Market Supply) Regulations, 2020
[18] Ibid
[19] Ibid
[20] The Value added Tax of Uganda CAP 349
[21] https://thetaxman.ura.go.ug Uganda Set to Collect Taxes from Digital Economy – The Taxman (ura.go.ug) visited on 29/06/2024

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music, films, games of chance, political, cultural, artistic, sporting, scientific and other broadcasts and events including television., etc.[22]

According to Section 16 (2) (d) [23]of the VAT Act, URA is authorized to charge VAT on electronic services supplied to a recipient in Uganda. The Act states that a non-resident person (NR) is considered to have made a taxable supply in Uganda when electronic services are supplied to a non-taxable person in Uganda. In this case, a non-taxable person refers to an individual or entity not registered for VAT. This provision applies to non-taxable persons as taxable persons already pay this VAT under the reverse charge mechanism. Although this legal provision was first enacted in 2011, URA could not collect this VAT at that time due to undefined provisions on how non-residents would account for the VAT once charged. Consequently, section 31A[24] was introduced in July 2020, requiring non-residents to account for this tax on a quarterly basis, with payments due on the 15th day of the first month following the end of a quarter.[25]

To register or file a VAT return, a non-resident needs to visit the URA web portal http://ura.go.ug. Under e-Services, they should steer to Payments and select Quarterly VAT Return for Non-Resident Service Providers. First-time users must fill in the online registration form, after which a Tax Identification Number will be issued instantly. Following this, the non-resident can clear out the online return form, submit it, and pay the tax within the stipulated time. A non-resident person may appoint a tax agent or a tax representative for purposes of fulfilling their tax obligations.[26]

While many countries around the world have practical this measure, Uganda is the fourth African country to do so, following South Africa, Nigeria, and Kenya. URA has been in contact with many non-resident service providers, such as Google, Microsoft, Netflix, Meta, Spotify, Zoom, Amazon, Apple, Bolt, Uber, etc., and some of these entities have registered and paid the tax due. URA is supposed to collect at least UGX 5 billion in taxes from this measure. This

[22] Ibid
[23] Ibid
[24] S. 31A. Ibid
[25] Ibid
[26] Ibid

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development is part of Uganda's determinations to collect taxes from the e-commerce economy. Similar to other countries internationally, Uganda is considering levying income tax on non-resident entities aiming the income they derive from Uganda, a substance that is still under dialogue on the global stage and is organized by the Organization for Economic Co-operation and Development (OECD).[27]

2.4 Digital Taxation Economy in Tanzania

The independent states of Tanganyika and the People's Republic of Zanzibar compound to form the United Republic of Tanzania. After the Zanzibar revolution of January 1964, the two regions formalized their union in the Articles of the Union, outlining areas of cooperation such as constitution, foreign relations, defense, and more.[28] However, taxation system of Tanzania mainland (Tanganyika) is administered by the Tanzania Revenue Authority (TRA)[29] and the Zanzibar taxation system is administered by the Zanzibar Revenue Authority (ZRA).[30]

In Tanzania mainland, Digital Services Tax is charged at 2% of gross payment to a non-resident person who receives payment from a source in the United Republic of Tanzania from an individual. Digital Services Tax is operative from 1 July 2022. As per the Minister of Finance and Planning, the objective is to preserve bonds with rapid growth in the digital economy, increase government revenue, and safeguard equity.[31] Digital Services Tax applies to non-resident persons who accept a payment that has a source in the United Republic of Tanzania from an individual, other than a payment made in the course of conducting business, in respect of services rendered through a digital marketplace.

Nevertheless, in each year, Zanzibar has made significant legal reforms, amending existing laws and enacting new ones. For instance, the Zanzibar Revenue Authority Act (ZRA Act) was passed into law by the Revolutionary Government of Zanzibar on 13 January 2023 and is

[27] Ibid
[28] Tanganyika and Zanzibar: Tanzania's 60-year-old union may need a restructure (theconversation.com) accessed on 1/07/2024Tanzania Revenue Authority Act No.11of 1995.
[28] The Zanzibar Revenue Authority Act, no 11 of 2022.
[28] Tanzania Introduces Digital Services Tax | Auditax International visted on 1/07/2024
[28] Ibid
[29] Tanzania Revenue Authority Act No.11of 1995.
[30] The Zanzibar Revenue Authority Act, no 11 of 2022.
[31] Tanzania Introduces Digital Services Tax | Auditax International visited on 1/07/2024

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now in effect. A related case found that the demand for digital goods in Zanzibar has increased due to the absence of taxation or specific tax provisions. The current tax laws for revenue collection still require the physical presence or permanent establishment of the business supplier for registration, as stipulated in the Tax Administration and Procedural Act, no. 7 of 2009 R.E 2017 (TAPA). This non-tax environment directly benefits business-to-business (B2B) ICT services, such as telecommunications, web design, and development, while also leading to disadvantages like income loss from digital goods.[32] Nevertheless, the legal and regulatory framework for digital taxation in Zanzibar is similar to the mainland in terms of income tax, which can create jurisdictional obstacles for imposing revenue on multinational enterprises. However, there may be differences in the implementation and enforcement of tax laws due to the semi-autonomous nature of Zanzibar. Due to the observed inherent shortcomings, ZRA Tax's laws do not adequately address the challenges that occur in the model business of the Digital economy and as a result, Zanzibar is unable to tax most income received by MNEs from businesses conducted virtually in Zanzibar[33]. Therefore, there is a need of introducing a new legislation which will be dedicated in addressing these challenges. Several key aspects to consider within the legal and regulatory framework for digital taxation in Zanzibar may include; Taxation Policies, permanent establishment, transfer pricing, Data Protection and Privacy Laws, and international agreements.

Furthermore, the new legislation shall address issues of digital PE, user participation, value creation, assessment, return process, information gathering, enforcement, and other taxation mechanisms.

2.5 Advantages of Digital Service Taxation

Fairness and Equity: It creates a more stable and equitable tax system by guaranteeing that digital corporations recompense their fair share of taxes in countries where their services are used and profits are complete.

Increased Revenue:[34] It provides an extra revenue stream for governments, which can be used to fund public services and infrastructure.

[32] Ibid
[33] The Zanzibar Revenue Authority Act, no 11 of 2022.
[34] Ibid

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Level Playing Field:[35] It helps level the playing field between digital companies and traditional businesses, which are often subject to more significant local taxes. It encourages digital companies to submit with local tax laws and regulations, fostering enhanced accountability.

2.6 Shortcomings of Digital Service Taxation

Digital service taxation (DST) in East Africa presents multiple challenges, including implementation, compliance, and international cooperation. Here are some solutions and recommendations to mitigate these challenges:

Lack of Standardization: Different countries in East Africa may have altered digital tax laws, creating difficulty for businesses operating across borders, East African Community (EAC) member states should work towards harmonizing digital taxation policies to create a standardized framework, and Co Establish regional forums where policymakers can discuss and support on DST regulation.

Compliance and Administration: Implementing and complying with DST can be complex and burdensome,[36] both for tax authorities and businesses. The digital economy is fast-moving and in global, complicating tax administration. It can be overcome by Simplified Tax Regulations Implementing clear and straightforward tax guidelines that are relaxed to follow for both local and international businesses, and on the part of Digital Infrastructure Investment, they have to Advance robust IT systems to streamline tax collection and administration, ensuring efficient monitoring and enforcement.

Economic Impact on Local Businesses: Increased tax burdens on large digital companies can be passed down to consumers, leading to higher prices Excessive or poorly designed taxation could stifle innovation within the digital economy, discouraging investments in new technologies and platforms. Small businesses using digital platforms could also tolerate increased costs, the clarification for this can be by Defining revenue thresholds for tax

[35] Ibid

[36] The Zanzibar Revenue Authority Act, no 11 of 2022.

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applicability to exempt small businesses, and Introducing the tax gradually to allow businesses time to adapt.

International Cooperation and Double Taxation[37]: Lack of international agreements may lead to double taxation issues, where digital companies are taxed both in East African countries and their home countries. This can also lead to international trade disputes, as countries with large digital companies may view these taxes as unfair and retaliate with their tariffs or restrictions The way out of this challenge is to institute Bilateral Agreements with major digital service provider countries to prevent double taxation, together with Adherence to Global Standards by supporting regional policies with international best practices and the OECD's guidelines on taxation in the digital economy.

Tax Evasion and Fraud. The hardship in following and taxing digital transactions leads to expected evasion and fraud. Hence Employ advanced data analytics and artificial intelligence (AI)

Monitoring digital transactions effectively can be the cure for the problem.[38] Working with global digital platforms to ensure transparency and accuracy in tax reporting is important. Lack of awareness and technical expertise can be a challenge for businesses trying to comply with DST regulations. Tax administrators should provide education programs and resources for businesses to understand and comply with tax obligations. They should also establish advisory services to help businesses navigate the complexities of digital taxation.

Political resistance and legislative hurdles can delay the implementation of DST. Engaging stakeholders, including businesses, consumers, and legislators from the planning stages, can help ensure buy-in and smooth implementation. Additionally, joining collaborations between governments and private sector companies to create mutually beneficial digital tax frameworks, constantly reviewing and updating DST policies, and transparent

[37] Ibid
[38] The Zanzibar Revenue Authority Act, no 11 of 2022.

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communication about the purpose and benefits of DST can help overcome challenges associated with digital service taxation.[39]

These solutions and recommendations can help East African countries overcome the challenges associated with digital service taxation, ensuring a fair and efficient tax system for the digital economy.

3. Conclusion

3.1 Lessons to be learned by Zanzibar on the DST proposal of East African countries' approach

In conclusion, East African countries including Kenya, Uganda, and Tanzania mainland are the best examples to learn about the imposition of Digital Service Taxes (DST) with reasonable rates. The common thread among these countries is the implementation of VAT on non-resident online sellers. The tax rates and registration thresholds differ by government, with simplified registration systems established to stimulate compliance among cross-border businesses. This ensures fairness and equity for both modern and traditional businesses and contributes to the economic development of Zanzibar through revenue collection.

Moreover, it's essential to moderate the potential challenges that occur from adapting and introducing a digital taxation economy. This can be simplified by regularly reviewing policies enacted and ensuring effective and efficient administration. Therefore, Zanzibar have an opportunity to borrow from ATAF recommendations, which is the approach taken by East African countries, by introducing DST that will enable effective taxation of the digital economy.

[39] Ibid

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