LEGAL UPDATE

FB ATTORNEYS

16 May 2016

Court of Appeal rules in favour of taxpayer in withholding tax case

- Issue of withholding tax on services not rendered in Tanzania now settled
- Big relief to the private sector
- Court issues an unbiased opinion against TRA
- Recommends the law be changed

In what has been a controversial interpretation and application of the Income Tax Act 2004 (Income Tax Act) by the Tanzania Revenue Authority (TRA) on the issue of whether or not withholding tax applies to services rendered to a Tanzanian entity by a non-resident service provider from outside Tanzania, the Court of Appeal has today dismissed TRA's appeal and ruled in favour of the taxpayer.

The parties to Civil Appeal No 146 of 2015 were TRA as the Appellant and PanAfrican Energy Tanzania Limited (PanAfrican Energy or the Company) as the Respondent, where PanAfrican Energy was represented by FB Attorneys as one of the counsels.

Background

PanAfrican Energy is a limited liability Company registered in Tanzania with activities in the oil and gas sector including exploration, production, distribution and marketing of natural gas at Songosongo in Tanzania. The Company, as is the case with other companies in Tanzania and elsewhere, uses various technical service providers both resident and non-resident in undertaking its operations. The services procured fall into three categories: (i) services performed in Tanzania by service providers based in Tanzania; (ii) services performed abroad by technical service providers who do not come to Tanzania; and (iii) technical services performed partly in Tanzania and partly outside Tanzania.

A dispute arose between the TRA and the Company on whether or not technical services that were performed outside Tanzania by the Company's non-resident consultants attracted withholding tax under the ambit of section 69(i)(i) of the Income Tax Act. TRA's position all along has been that so long as the Company who is a resident of Tanzania paid service fees to a non-resident and the source of the money was in Tanzania, the Company should have withheld tax irrespective of whether the service was rendered in or outside of Tanzania.

The dispute was heard by the Tax Revenue Appeals Board (Board) and although the Board was divided in its discussions leading to the decision, it ultimately ruled in favour of the TRA in that withholding tax should have been deducted by the Company since the money had a source in Tanzania irrespective of whether or not

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the services by the non-resident consultants were performed in or outside of Tanzania. The Company was thus held liable for the withholding tax.

Aggrieved by the decision of the Board, the Company appealed to the Tax Revenue Appeals Tribunal (Tribunal) and asserted that withholding tax was not applicable as the payment had no source in Tanzania since the services were performed by the consultants outside of Tanzania. The Tribunal ruled in favour of the Company and hence reversed the decision of the Board. The Tribunal was satisfied that since the consultants who were paid the service fees were residents in the United Kingdom and the work was done outside of Tanzania, the Company was not liable to pay withholding tax on the service fees paid to the consultants.

Grounds of appeal

TRA then appealed to the Court of Appeal and filed three grounds of appeal namely:

(1) That the Tax Revenue Appeals Tribunal erred in law by wrongly construing provisions of section 83(1)(c) of the Income Tax Act

(2) That the Tax Revenue Appeals Tribunal erred in law by wrongly construing provisions of section 69(i)(i) of the Income Tax Act

(3) That the Tax Revenue Appeals Tribunal erred in law by holding that the Respondent was not liable to pay the assessed withholding tax.

Two main issues were framed at the Court of Appeal:

(i) Whether or not the payments made by the Respondent to non-resident persons are liable to withholding tax

(ii) Whether or not the Respondent is liable to pay withholding tax not with held.

Arguments by counsels

Both counsels for the TRA and the Company agreed that the dispute could be resolved by a proper interpretation of sections 69(i)(i) and 83(1)(c) of the Income Tax Act.

TRA submitted to the Court of Appeal that the correct interpretation of section 69(i)(i) justifies the TRA to demand payment of the withholding tax when the Company paid its consultants abroad so long as the payments were made from Tanzania and hence had a source in Tanzania. TRA submitted that what was important for consideration by the Court was that the services were delivered to a recipient in the United Republic and payments were made in consideration of such services, and therefore under section 83(1)(c) such payments attracted withholding tax. TRA faulted the Tribunal for being inconsistent with the principle of territorial nexus where tax liability is fastened on the income sourced within the geographical borders of the taxing territory. Finally, TRA submitted that if the Court of Appeal did not rule in favour of TRA, it would encourage tax evaders and evasion, create discrimination among taxpayers, and deprive Government revenue.

On its part, the Company countered the TRA's submission that the obligation to withhold tax only arose where the services were rendered/performed in Tanzania, further stating that subjecting income of non-resident service providers to withholding tax in Tanzania is contrary to tax laws and internationally accepted tax norms. Counsels for the Company cited persuasive Indian cases of *Ishikawajima-Harima Heavy Industries Limited vs Director of Income Tax and Ashapura Minichem Ltd vs ADIT* where the same point was litigated and ruled in favour of the taxpayer.

Counsels for the Company also submitted that India then changed its tax laws to bring such transactions under its tax net, which is not the case in Tanzania and hence the law should be interpreted as it is read unless it is amended going forward. Counsels also submitted that the TRA's arguments on tax evasion, discrimination and deprivation of Government revenue is not relevant and the Court should give proper effect to what the Government has intended by enacting such law and to avoid putting into the provision of the law what the Government had thought of.

The Judgment

In a unanimous decision boldly and fairly authored by Madam Justice N.P. Kimaro, with the bench comprising also of Madam Justice K.K. Oriyo, and His Lordship A.G. Mwarija, the Court of Appeal dismissed TRA's appeal and ruled in favour of the Company.

The Justices had this to say:

"That is actually what took place but with respect to the learned advocates for the Appellant, we do not think they have grasped the real meaning of section 69(i)(i) of the Income Tax Act. The section is clear that income tax is chargeable for service fee received for services rendered in Tanzania. What is stressed in the section is that the services must be rendered in Tanzania. This could be a leeway for tax evasion for unfaithful businessmen or unlawful transactions. All the same the Court is bound to interpret the law in its true perspective.... We cannot create a situation in the statute that was not intended by the legislature"

The Court added:

"Section 69(i)(i) makes a distinction between payments made by an individual person and that made by the Government under section 69(i)(ii). Where the Government is the Payer, income tax is chargeable regardless of the place where the service is rendered. It is chargeable even when it is rendered ouside the United Republic. This is not the case with section 69(i)(i). A private Company like the Respondent has no obligation to withhold tax where the services paid were for services rendered outside the country. We think the best way to remedy the situation of allowing loss of income to the Government is to amend the law to cater for such situations as it happened in this case. Other jurisdictions, like the Government of India changed the law and is now in a position to charge income even for services rendered outside India but payment made in India. See the case of Ashapura Minishem Ltd (supra)."

The Court concluded:

"Section 69(i)(i) does not impose a liability on an individual Company to withhold tax where service fee is paid in relation to services rendered out of the United Republic regardless of the fact that payment is made by a Company registered in and is doing business in Tanzania. The situation would have been different if the Respondent was Government. This also answers the issues that were raised by the parties that the payments that were made by the Respondent to non resident consultants were not liable for withholding tax. Since the payments were not liable for withholding tax the Respondents are not liable for payment of the tax that was withheld. We recommend to the Attorney General as the Advisor of the Government to look into the possibility of amendment of the law to remove leeway for loss on income to the Government as it will be found appropriate. We dismiss the appeal but we make no order as to costs."

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The judgment will be widely welcomed by oil and gas and mining players in Tanzania and demonstrates the impartiality and strictness with which the apex court will interpret statutes even if they do not favour the Government. This is a big victory for both private companies and Dr. Magufuli's Government in that the rule of law in as far as tax law prevailed and respected.

FAyaz Bhojani, Managing Partner of FB Attorneys, was one of the counsels who represented PanAfrican Energy in this appeal.

Snapshot

Facts

The Company did not withhold tax on payments made to non-resident service providers as the services were not rendered in Tanzania.

Issue

Whether or not such payments made to non-resident suppliers of services rendered outside Tanzania attracted withholding tax in Tanzania under the purview of section 69(i)(i) read together with section section 83(1)(c) of the Income Tax Act.

Holding and ruling

The Court of Appeal held that:

1. Construction of the section is tied to the place where the services are rendered.
2. Section 69(i)(i) does not impose liability on an individual Company to withhold tax where service fee is paid in relation to services rendered out of Tanzania regardless of the fact that payment is made by a Company registered in Tanzania.
3. Since the services were not rendered in Tanzania, such payments had no source in Tanzania and hence withholding tax does not apply.
4. The Court is bound to interpret the law in its true perspective and cannot create a situation in the statute that was not intended by the legislature.
5. Best way for the Government to remedy the situation so as not to allow loss of income to the Government is to amend the law as was the case in India.

Judgment delivered by the Court of Appeal on Monday 16 May 2016.

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