

11 July 2018



TRA wins case against Banks at Court of Appeal

- **The Income Tax Act must be read as a whole**
- **Holds that evidential burden not met by the Bank**
- **Poses major exposure for all Banks that have written off debts**
- **With proper evidence, such debts may be allowed subject to TRA's assessment**

In what was a critical case affecting a majority of Tanzania's Bank's profits and balance sheets, the Court of Appeal on Monday 9 July 2018 dismissed NBC's ('taxpayer' or 'the Bank') appeal which was premised on how to treat bad debts in the Bank's books of accounts.

The parties to Civil Appeal No. 52 of 2018 were National Bank of Commerce (NBC) as the Appellant and Tanzania Revenue Authority (TRA) as the Respondent, which was heard in Dodoma on 27 June 2018 under His Lordship the Chief Justice Ibrahim Juma, Justice A.G. Mwarija and Justice R.E.S Mziray.

Background

The crux of the matter was around deductibility of provisions by Banks for impairment of bad debts and doubtful debts under the Income Tax Act (Act) vis the Banking and Financial Institutions Act 2006 & the Banking and Financial Institutions (Management of Risk Assets) Regulations 2008 (BOT Regulations).

At the Tax Revenue Appeals Board (Board), the Bank submitted that it had written off bad debts in line with the BOT Regulations and that it had complied with the applicable accounting principles where any doubtful or impaired debts were first established and impairment charged to the appropriate account accordingly.

TRA's position at the Board was that for Income Tax purposes, a person can only enjoy a deduction on losses arising from debt claims, when the debt has been actualized and for financial institution, that debt must have been both realized in terms of section 39 of the Act and also written off after all recovery mechanisms have failed. The TRA argued that the deduction that the Bank was seeking had not been realized in accordance with section 39 and those doubtful debts 'are mere estimates or probable loss' which may be recovered if proper measures are put in place for their recovery. The TRA further submitted that the Appellant had neither provided the list of accounts which were written off nor evidence to prove that they were uncollectible.

The Board dismissed the Bank's appeal and ruled in favour of TRA holding that the provisions for impairment of bad debts and doubtful debts is permissible under law, but only when the debts have been actualized and all debt have been realized as well as written off from the books of accounts after all recovery mechanisms have failed.

Aggrieved, the Bank appealed to the Tax Revenue Appeals Tribunal (Tribunal) which also dismissed the appeal stating that the Bank had not shown that its debt had been written off from its books of accounts being one of the two conditions before the Bank could rely on section 25(5) of the Act. The upshot of the Tribunal's decision was that the Bank could not rely on the deductions.

Aggrieved by the Tribunal's decision the Bank appealed to the Court of Appeal.

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Arguments by counsels

At the Court of Appeal, the Bank's counsels argued that the debt must have become a debt in accordance with standards set by the BOT and that the financial institution must have written off the debt as bad, specially referring to Regulation 15(5) of the BOT Regulations that governed the Bank. The Bank's counsels submitted that according to the BOT Regulations, which the Bank was bound to follow, once a loan is classified as a loss, it has to be taken out in the period in which it appears as uncollectible, adding that section 25 of the Act itself reflected the BOT Regulations and that the Act and BOT Regulations must be harmoniously constructed.

In their reply submissions, TRA counsels submitted that section 18 of the Act provides guidance in calculating a taxpayers income, and also guides the calculation for the deduction of loss incurred during a year of income from business. Counsels added that it was section 39(d) of the Act that provides the ultimate guide for deduction of bad debts, and sets the condition precedent before deductions of bad debts can be accepted by the TRA. TRA submitted that banks should not be allowed deduction of debts which can still be pursued and realized by selling of collaterals and that with such specific conditions provided for under the Act, there was no room for the Bank to peg its deduction of bad debts under the BOT Regulations. Such BOT Regulations, TRA counsels stated, 'are not income tax provisions and in any case the Act overrides and takes precedence over any other laws.'

The Judgment

In a unanimous decision by the Court in dismissing the Appeal by the Bank, the Court had this to say:

- According to the Court, the main area of contention between the Bank and the TRA was premised on which provision of the Act are applicable to the deductibility of the Bank's impairment provisions; that is between section 25(5) on one hand, and sections 18(b) and 39(d) on the other hand.
- The Court held that in interpretation of statutes it is bound to apply the plain language of a Statute to give effect to the intention of the legislature adding that every section, sub section, paragraph of the Act must be given effect to.
- The Court stated that section 25(5) of the Act, on one hand, and section 18(b) and 39(d) on the other hand, are all part of the same Statute, and each intended for distinct purposes and as such, these provisions require harmonious construction to give effect to every word used.
- The Court stated that section 25(5) of the Act relied upon by the Bank was intended by the legislature for purposes of providing guidance in preparation of tax returns before the same are filed for assessment to the TRA. Hence this gives the Bank an opportunity to indicate therein what debt claim has become ripe for deduction with relevant proof to the TRA.
- The Court added that *"We reckon that section 25(4), (5) of the Act, and sections 18 and 39(d) of the Act are not in conflicting positions. They are harmonious in so far as they provide for distinct matters. While sections 25(4), (5) provide for the preparation of accounts, returns and proposal for deductions, sections 18 and 39(d) of the Act gives the TRA the leverage to receive returns and accounts from taxpayers and enjoys finality in the assessment, allowing or disallowing deductions."*

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LEGAL UPDATE

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- In dismissing the Appeal, the Court held that *“Much as the Appellant has sought refuge under section 25(5)(a) of the Act, we must point out here that the Appellant did not discharge its evidential burden to prove that it complied with any of the two options the Appellant claimed to have complied with under section 25(5)(a) of the Act. The Appellant has not shown which option it had complied with. There is no evidence to show whether the Appellant exercised the option of disclaiming any entitlement to receive the amount (which it described as charge off).”*
- In conclusion the Court added that *“There is similarly no evidence to justify the Appellant’s claim that the BOT had approved any loan loss of the Appellant to be written off.”*

Analysis

- It must be stated that the Court has not totally closed the doors for Banks to claim such deductions, but subject to relevant evidence being adduced before the TRA. The Court did not specifically ponder over whether the BOT Regulations override the Act, but rather that the Act must be harmoniously constructed.
- This judgment will, however, affect most of the Banks who may not have taken the necessary steps to discharge the evidential burden that the Court has stressed.
- The judgment will result in the further ‘weakening’ of a number of the Bank’s balance sheets and further stressing their financials in what is already seen as one of the most challenging years for banks profitability and liquidity.
- It is to be seen how the Tanzania Bankers Association (TBA) and the BOT will come into the picture to rescue the situation, as consequences of the judgment could have a multiplier effect in the economy.
- A welcome judgment for the TRA for tax purposes in the short term, but may have dire consequences for banks in the medium and long term in terms of performance and stability.

[Click here](#) to read the full judgment.

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