

6 July 2018



Court of Appeal rules against Taxpayers in two latest decisions

- Apex Court heard tax cases in Dodoma beginning 25 June 2018
- Both decisions in favour of TRA and against oil and gas companies
- Rules that withholding tax applies notwithstanding where service is rendered from, despite its own previous decision of 2016 and subsequent change of law
- States that for depreciation to apply in any particular year, both ownership and usage conditions must apply
- Decisions big setback for oil and gas companies

The Court of Appeal (Court) has continued its efficient spree to clear case backlogs, especially in tax matters. Two key cases, amongst many others filed in the Court registry in Dar es Salaam involving international oil and gas companies in Tanzania, were heard during the week of 25 June 2018 in Dodoma.

Civil Appeal No. 24 of 2018- Tullow Tanzania BV v TRA

Background

Tullow lost its appeal at both the Tax Revenue Appeals Board (Board) in 2011 and the Tax Revenue Appeals Tribunal (Tribunal) in 2013 against the decision of TRA to impose withholding tax on amounts remitted to non-resident companies for services that were rendered outside Tanzania. The Tribunal upheld the decision of the Board that such payments made by Tullow to non-resident companies for services rendered from outside Tanzania had a source in Tanzania, for that reason, liable to withholding tax. Tullow decided to appeal to the Court of Appeal against such decision on the primary basis that the services must be rendered in Tanzania for withholding tax to apply.

The Judgment

In dismissing Tullow's appeal in favour of TRA, the Justices of Appeal held that reading section 6(1)(b), 69(i)(i) and 83(1)(b) of the Income Tax Act, all together gives two conditions for a payment to a non-resident to be subjected to withholding tax. These are: (1) the service which the payment is made for must be rendered in the United Republic of Tanzania, and (2) the payment should have a source in the United Republic of Tanzania.

Furthermore the judgment reads that the *"recipient of the service is actually the payer for such services, in which case, "source of payment" cannot be any other place except where the payer resides. In other words as the services of which the payments were made were consumed or utilized by the appellant in the United Republic of Tanzania for purposes of earning income in the United Republic, then payments made for such services had a source in the United Republic of Tanzania, and the respondent had to withhold tax under section 83(1)(c) of the Act."*

The judgment is concluded by stating that *"...the respondent's learned counsel (TRA's counsel) is right in inviting the Court to opt for a purposive approach which would derive this Court into holding the decision of the Tribunal in the case at hand, that irrespective of the place of rendering services, as the payment was made by a person resident in Tanzania, for services utilized in the United Republic, then the payments made are subject to withholding tax under the provisions of sections 6(1)(b), 69(i)(i) and 83(1)(b) of the Income Tax Act, 2004."*

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Our Analysis

In 2016, PanAfrican Energy Tanzania on an identical matter in Civil Appeal No 146 of 2015 (see [link](#) to the FB Attorneys legal update issued at the time) successfully defended its position at the Court of Appeal. This new judgment of the Court of Appeal effectively means that the Court now has two decisions, one stating that withholding tax only applies on payment to non-resident suppliers if the service is rendered in Tanzania (Pan African decision), and this latest decision (Tullow decision) that states irrespective of the place of such rendering of service, withholding tax applies.

In the Tullow decision, the Court has not explicitly stated that it is departing from the PanAfrican decision but has simply stated that *“the case of PanAfrican Energy (supra) is therefore distinguishable as it relied on the interpretation of section 9(1)(vii)(c) of the Indian Income Tax Act to arrive at a finding that the said provision, as it was, was in parimateria with section 69(i)(i) of the Act.”*

In the PanAfrican decision, the justices, who addressed themselves in detail to what it meant to render a service in Tanzania, 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 of Appeal in the PanAfrican decision had this to add in supporting its decision that withholding tax should not apply to services by non-resident companies that are not rendered in Tanzania:

“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 outside 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 in the PanAfrican decision concluded when dismissing the appeal against TRA:

“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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It must be stated that the Government did, indeed, take advice from the PanAfrican judgment (*supra*) and vide the Finance Act 2016 amended the Income Tax Act to imply that payments for services by non-resident persons irrespective of place of rendering of the service would, beginning 1 July 2016, attract withholding tax.

With respect, this latest Tullow decision comes as a surprise considering that the law was especially amended post the PanAfrican decision to impose withholding tax on payments to non-residents beginning 1 July 2016, and did not have retrospective effect. This was not taken into account in the Tullow judgment where the notion of where the service was consumed or utilized has been introduced (under the 'purposive statute interpretation'), which is not provided for in the Income Tax Act to prove source.

To read a full copy of the Tullow judgment, [click here](#).

Civil Appeal No. 192 of 2018- PanAfrican Energy Tanzania v TRA

Background

PanAfrican Energy Tanzania (PAET) was denied depreciation expense by TRA for the year 2009 in respect of a well it had drilled, on the basis that for that year, PAET had not used the well. TRA disallowed depreciation stating that section 17 of the Income Tax Act required any taxable person to show that (a) the depreciable asset was owned by such person, and (b) such asset must have been employed in the relevant year of income.

PAET's position was that section 17 of the Income Tax Act could not be read in isolation of the Third Schedule of the Act especially paragraph 1(1) (class 4) and paragraph 1(3), since the Act had a separate approach for depreciation for assets of companies in the natural resource industry, considering the high risk and capital nature of the industry. PAET's appeals to both the Board and Tribunal were dismissed, hence the appeal to the Court of Appeal.

The Judgment

In dismissing PAET's Appeal, the Court of Appeal, stuck to the position adopted by the Board and the Tribunal in that section 17 required both twin conditions of ownership and employment of asset to be satisfied before depreciation could be claimed.

The Court commenting on paragraph 1(3) of the third schedule held that *"It is true that paragraph 1(3) of the Schedule provides that expenditure incurred by a person in the production of income from business of natural resource prospecting, exploration and development shall be treated as if it were incurred in securing the acquisition of an asset. The provision goes on to state however, that such an asset must be "an asset that is used by the person in that production."*

The Court rejected the approach that for depreciation to be allowed, employment of an asset specifically in the natural resource industry does not need to wait for usage of such an asset, considering the wording in paragraph 1(1) and 1(3) of the Third Schedule read together with section 17.

In its judgment, the Court stated that *"In our view therefore, although the expenditure incurred in the production of the income from the business of natural resource prospecting, exploration and development shall be treated as if it were incurred in securing the acquisition of an asset hence entitling the person to depreciation allowance on that asset, such an asset must have been used in the production of the income. In our view, that is the import of paragraph 1(3) of the Schedule."*

In rejecting inspiration from other jurisdictions where such depreciation is allowed, the Court of Appeal stated that the method of depreciation in Tanzania is *"clearly provided by law."*

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Our analysis

This is a big setback for oil and gas companies who will now not be able to rely on section 17 read together with the Third Schedule to enable them depreciate after such an expense is incurred, as is the case in other jurisdictions. The fact that there is a provision in the Income Tax Act for companies in this sector was rejected by the Court despite there being a special paragraph to the Third Schedule dealing with how assets are employed in the natural resource industry. How an asset is employed in the natural resource industry, in as far as depreciation is concerned, was not fully appreciated and a general approach to depreciation in other normal industries seems to have been adopted. Further, the fact that the third schedule provision for oil and gas assets to promote such assets development was introduced in the Income Tax Act 2004, and did not appear in the Income Tax Act 1973, was also not fully addressed.

Whilst the impact on the Appellant is not significant considering the well has been subsequently producing, the impact on the nascent oil and gas industry as a whole will be massive.

To read a full copy of the PanAfrican judgment, [click here](#).

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