LEGAL UPDATE

FB ATTORNEYS

13 March 2020

Court of Appeal Rules on Legality of Grossing up in Tanzania

- **Court rules that grossing up provides taxable benefits**
- **Declares grossing up as prohibited under the law**
- **Court relies on the TRA's Employer's Guide to Pay as You Earn issued in 2017**
- **Blow to investors with net of tax contracts**

On 6 March 2020, the Court of Appeal of Tanzania (the Court) pronounced its decision in Civil Appeal No. 81 of 2019 by ruling that for purposes of calculating Pay As You Earn (PAYE), grossing up confers a taxable benefit to an employee and the same is prohibited under the laws of Tanzania. This is despite the PAYE being calculated on the grossed up value as opposed to the net value.

Brief Background

By way of background, the Appellant in Civil Appeal No. 81 of 2019 had entered into net of tax contracts with its employees, most of them being expatriates. For the Appellant to withhold and remit the correct amount of PAYE, the net amount was grossed up and subsequently subjected to tax.. The Respondent Tanzania Revenue Authority (TRA) conducted a tax audit in 2013 on the tax affairs of the Appellant and subsequently issued a Demand Notice claiming additional PAYE and interest thereof for the years 2008 - 2010. TRA allegedly observed that grossing up provided benefits to employees, hence taxable under the Income Tax Act, 2004 (ITA 2004).

Having been aggrieved by the said Demand, the Appellant unsuccessfully preferred appeals to the Tax Revenue Appeals Board (the Board) and the Tax Revenue Appeals Tribunal (the Tribunal) respectively. Both the Board and the Tribunal retained only the principal tax as payable, and waived the assessed interest on the ground that there was no willful neglect to pay tax by the Appellant.

Subsequent to the above, the Appellant preferred an appeal to the Court challenging the decision of the Tribunal to treat net of tax payments as taxable benefit for PAYE purposes. The grounds of appeal advanced by the Appellant were two, namely: (i) the Tribunal grossly erred in law by holding that grossing up method is not justifiable in law; and (ii) the Tribunal grossly erred in law by holding that grossing up method provided taxable benefits to the employees of the Appellant.

Arguments by Parties

In prosecuting its appeal, the arguments advanced by the Appellant were: (i) that it was a misconception by the Tribunal to conclude that grossing up method invoked by the Appellant provided taxable benefits to employees; (ii) through grossing up, the Appellant computed, withheld and remitted the correct amounts of PAYE by basing the same on the highest grossed up amounts, hence neither the Appellant and its employees enjoyed any benefit, nor the Respondent (TRA) suffered any loss of revenue; (iii) there is no law in Tanzania which prohibits grossing up provided that the method results into the correct amounts of PAYE payable (which was the case with the Appellant); (iv) the grossing up approach adopted by the Appellant is a common practice in other Commonwealth countries including Kenya, South Africa, Ireland and the United Kingdom; (v) additional imposition of PAYE on the already grossed up amounts is tax on tax, hence making the

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tax rate applicable to be 35.7% contrary to the maximum rate of 30% provided by the ITA, 2004; (vi) grossing up is not a new method as the same was adjudicated upon and confirmed by the Tribunal in the cases of TRA vs. Kilombero and Resolute vs. TRA that it is legally applicable in Tanzania; and (vii) the Appellant religiously honoured its withholding obligation of PAYE in line with sections 7 and 81 of the ITA, 2004.

On the side of the Respondent, the arguments were that: (i) it was improper for the Appellant not to withhold on what accrued as benefits to employees as required by ITA, 2004; and (ii) grossing up shifted the employee's obligation to pay tax from chargeable income which is against the law; (iii) net of tax contracts of employment was against the law.

Decision of the Court

Based on the above, the issue for determination by the Court was on the propriety of the grossing up method as applied by the Appellant in the computation of PAYE. The Court held that by grossing up the Appellant did not honour its statutory obligations, and the same was not justified in law. Further, the Court in arriving at its decision relied on sections 7, 81 and 84 of ITA, 2004 and the TRA's Employer's Guide to Pay as You Earn of 2017 (which was not in place during the assessed years) to conclude that grossing up is prohibited in Tanzania. The Court therefore upheld the decision of the Tribunal by stating that it was justifiable to hold that grossing up provided taxable benefits in the hands of employees. However, the Court retained the decision of the Board and the Tribunal of waiving the interest.

This decision will be a disappointment to employers/investors in Tanzania who have net of tax contracts with expatriates and non-resident entities providing outsourced services to investments.

To read the entire judgment click here.

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