FK House
23 Barack Obama Drive | Sea View | Upanga
P.O Box 20787
Dar es Salaam, Tanzania

Tel :+255 (0) 22 212 2029/31/32
Fax :+255 (0) 22 212 2027
Email:info@fklawchambers.net
Web :www.fklawchambers.co.tz

Legal Brief

17th July 2018

The Court of Appeal of Tanzania Disregards "the Source of Payment Rule" as Interpreted in *Civil Appeal No. 146 of 2015 between Commissioner General and Pan African Energy Tanzania Limited* in Dismissing *Civil Appeal No. 24 of 2018 between Tullow Tanzania BV and Commissioner General, TRA*

- *Holds that a purpose approach may be appropriate in interpreting tax legislations contrary to the established principle that tax statutes must be interpreted strictly.*
- *The word 'rendered' as used in section 69(i)(i) of the Income Tax Act, 2004 is synonymous to 'supplied' or 'delivered'.*
- *Rules for determination of the 'source of income' are different from those used to determine 'source of payment'; that is, while 'income is earned', 'payments are made'.*
- *That Pan African Energy case was wrongly decided in so far as it was much influenced by the interpretation accorded to section 9(1)(vii)(c) of the Indian Income Tax Act, 1961.*
- *Notes that sections 68 and 69 of the Income Tax Act, 2004 are anti-avoidance provisions as far as cross-border transactions are concerned, as such purposive approach is the correct approach in interpretation of anti-avoidance provisions.*

Brief Facts of the Dispute

The Respondent had, between 18th November, 2010 and 1st February, 2011 carried out an audit in order to satisfy itself of the Appellant's compliance with various tax laws administered by the former. The outcome of the audit led to the Respondent to conclude, *inter alia*, that the Appellant had not withheld TZS 792,394,929.18 on payment in respect of services provided by non-resident service providers. The Appellant objected to the assessment on the basis that it had no obligation to withhold as the services were performed outside the United Republic of Tanzania and consequently did have a source in the United Republic.

Aggrieved by the Respondent's decision the Appellant preferred an appeal to the Tax Revenue Appeals Board (the Board) and subsequently to the Tax Revenue Appeals Tribunal (the Tribunal). The Appellant's attempts were unsuccessful both at the Board and the Tribunal. Being further aggrieved, the Appellant preferred an appeal to the Court of Appeal of Tanzania.

The Appellant's Case

The Appellant in this case supported its appeal by advancing the following arguments:

- That the Court should interpret tax statutes according to the clear words of the statute, regard being consideration of the content and scheme of the relevant Act as whole and its purpose in order to give the true perspective of the law by avoiding creating a situation which was not contemplated by the legislature.

- That the Court should be guided by its own decision in *Civil Appeal No. 146 of 2015 between Commissioner General, TRA and Pan African Energy Tanzania Limited*. In this regard, as services in the instant case were performed in Dublin, Northern Ireland and South Africa, then a withholding obligation did not arise in respect of the payments.

- That in construing section 69(i)(i) of the Income Tax Act, 2004 (the ITA, 2004), due consideration should be placed on where utilization of that economic activity occurs and not otherwise.

- Section 83(1)(b) of the ITA, 2004 imposes an obligation for withholding tax on payments to non-residents where the source of payment is in the United Republic but only if the services are performed in Tanzania which was not the case with the present case. In this regard, the Appellant urged the Court to find that Pan African Energy as a good law and consequently follow it in arriving at its decision.

- That the scenario in *Civil Appeal No. 125 of 2015 between BP Tanzania and Commissioner General, TRA,* is quite distinct from the instant case as in the former, the Court was interpreting section 69(e) of the ITA, 2004 on royalties for using the assets in Tanzania which is quite different from service fees.

The Respondent's Arguments

The Respondent, TRA, on its part had advanced the following arguments:

- The essence of charging the Appellant a tax was due to the latter's default in paying tax liable to be paid by a non-resident person. That in terms of section 83(1)(b) of the ITA, 2004, any person who effects payments to a non-resident shall withhold income tax and that the payment of tax has to go with the source principle in section 69(i)(i) of the ITA, 2004.

- That the Court should not rely on Pan African case as that case was erroneously decided. He urged the Court to depart from the decision in Pan African case.

- That the purposive approach to interpretation of tax statutes is the best approach as applied in *Civil Appeal No. 125 of 2015 between BP Tanzania and Commissioner General, TRA.*

The Court's Decision

In dismissing the appeal with costs, the Court reasoned as follows:

- That sections 6(1)(b), 69(i)(i) and 83(1)(b) of the ITA, 2004, read together, give two conditions for payment to a non-resident to be subjected to withholding tax. These are; first, the service of which the payment is made must be rendered in the United Republic of Tanzania; and second, the payment should have a source in the United Republic of Tanzania.
- That the Court's strong view, is that the word 'rendered' as used under section 69(i)(i) of the ITA, 2004 is synonymous to words 'supplied' or 'delivered'. In this regard, a non-resident person who provides services to a resident, has delivered/supplied services to a resident of the United Republic of Tanzania.
- As the recipient of the service is actually the payer for such services, 'source of payment' cannot be any other place except where the payer resides. Such services were consumed or utilized by the Appellant in the United Republic of Tanzania for purposes of earning income in the United Republic, as such payments made for such service had a source in the United Republic of Tanzania.
- As opposed to the Indian Income Tax Act, 1961, as amended, where its section 9 provides for 'income deemed to have a source in India', section 69 of the ITA, 2004, deals with 'source of payment'. The Court stated as follows:

  > *"As opposed to the Indian Income Tax 1961 (as amended in 2010), where its section 9 provides for* ***"income deemed to have a source in India"*** *section 69 of the Tanzania Income Tax Act deals with* ***"source of payments."*** *These are two distinct concepts and it is our considered view that one cannot rely on an interpretation of section 9 of the Indian Income Tax Act 1961 (as amended) in interpreting section 69 of the Tanzania Income Tax Act, 2004. While* ***"income is earned," "payments are made,"*** *in which case the rules for determination of where a particular income is earned cannot be the same as the rules in determining where a particular payment originates. Payment ordinarily originates from where the payer is, regardless of where such payments are effected."*

- The Act imposes a withholding obligation on a service fee based on the source of payment of such fees, that being the case, the Court sees that there is no ambiguity in section 69(i)(i). The key issue was not looking at the nature of payment, but rather, the source where the payment originated.
- That the Court's finding in respect of the case of Pan African Energy, was much influenced by the findings of the Tribunal that section 9(1)(vii)(c) of the Indian Income Tax Act is in *pari materia* with section 69 of the Tanzania Income Tax Act, whereas the two provisions are substantially different, as such Pan African's case is distinguishable.
- The Court notes that sections 68 and 69 of the ITA, 2004 are anti-avoidance provisions so far as cross-border transactions are concerned and the modern approach to interpretation of anti-avoidance provisions is the purposive approach.

The purposive approach drives the Court into holding that the Tribunal's decision, that irrespective of the place of rendering services, as payments was made by a person resident in Tanzania, for services utilized in the United Republic, then payments made are subject to withholding tax under the provisions of section 6(1)(b), 69(i)(i) and 83(1)(b) of the ITA, 2004.

Our Assessment of the Judgment

FK Law Chambers views the decision as making some pronouncements which are contrary to the cardinal principles on interpretation of a taxing statute. In particular the Court's general pronouncement that a purposive approach in interpreting a tax statute as appropriate, appears to go contrary to the well-established principle that taxing statutes must be construed strictly leaving no room to intendments or inferences. The Court ought to have been very specific that, the purposive approach to interpretation of taxing statutes is only relevant where the Court is faced with an anti-avoidance provision. Such general pronouncement seems to suggest all taxing provisions are fit for a purposive approach, which we find it incorrect.

Notwithstanding the above, FK thinks that the central issue that the Court and the parties had to labour much, was on the meaning of the word 'rendered' and how income is determined under the source rules in section 69 of the ITA, 2004. While section 6(1)(b) of the ITA, 2004 subjects income of a non-resident to tax in the United Republic of Tanzania to the extent that the source of such income is in the United Republic of Tanzania, section 69 of the ITA, 2004 provides for the test for determining whether certain payments should be treated as having a source in the United Republic of Tanzania. The interpretation of section 69(i)(i) of the ITA, 2004 should be guided by the principle that, one should not interpret one provision of a taxing statute in order to defeat the other.

Further, FK views that the Appellant had missed an important opportunity to advance arguments in respect of the applicability of Double Taxation Agreements (DTA) that would have reduced the taxpayer's tax exposure. FK understands that the United Republic of Tanzania has a DTA with the Republic of South Africa, which is in force. It was upon the Appellant to advance arguments basing on the DTA so that withholding obligation would not arise in respect of the payments made to South African service providers. This would, notwithstanding the Court's position on source of payment, have reduced the Appellant's tax exposure.

What Impact does the Decision have to Taxpayers?

FK reckons that the decision in Tullow Tanzania BV will impact a number of tax appeals pending before various tax adjudicating bodies which have similar facts to this case. Taxpayers had found great relief when the decision in Pan African Energy case was made, which the Court states that it was decided based on the wrong footing. It is important to note that subsequent to Pan African Energy's decision, the Parliament amended the ITA, 2004 by introducing a definition as to what 'service rendered' means. The amendment made clear that withholding obligation would arise whether services are performed in the United Republic of Tanzania or outside the United Republic of Tanzania. This means that after 2016, the position of the law was made very clear which would not necessitate undertaking ingenious linguistic interpretation of the words.

FK however, reminds taxpayers to explore sound legal arguments on whether withholding obligation arises or not even after the 2016 amendments taking into account the existence of DTAs and other Tax Agreements, whose existence may operate in their favour.

For further information or advice on any tax or other legal issue, feel free to contact the following:

Dr. Erasmo Nyika
Associate Partner
FK Law Chambers
Lecturer – University of Dar es Salaam School of Law
PhD (Aberdeen); LL.M. (Dar); PGDLP (LST); LL.B. (Hons)(Dar)
FK House|23 Barack Obama Drive|Sea View|
Upanga PO Box 20787|
Dar es Salaam|Tanzania
Tel: +255 22 2 122 029|031|032
Fax: +255 22 2 122 027
Mobile:+255 759 247 118
+255 689 551 298
www.fklawchambers.co.tz

Hadija Kinyaka
Associate Partner
FK Law Chambers
Registered Arbitrator - TIA
LL.M. (Taxation) (Dar); PGDLP (LST); LL.B. (Hons) (Dar)
FK House|23 Barack Obama Drive|
Sea View|Upanga PO Box 20787|
Dar es Salaam|Tanzania
Tel: +255 22 2 122 029|031|032
Fax: +255 22 2 122 027
Mobile:+255 682 497 475
www.fklawchambers.co.tz

Mr. Martin O. Nasson
Specialist Tax Consultant
FK Law Chambers
Former Commissioner for Large Taxpayers - TRA
BA (Finance) (Charles University, Czechoslovakia);
FK House|23 Barack Obama Drive|
Sea View|Upanga PO Box 20787|
Dar es Salaam|Tanzania
Tel: +255 22 2 122 029|031|032
Fax: +255 22 2 122 027
Mobile:+255 (0) 784 783 660 /
+255 (0) 777 775 190
www.fklawchambers.co.tz

Prof. A. M. Mapunda
Managing Partner
FK Law Chambers
Senior Lecturer – School of Law, UDSM
PhD (Warwick); LL.M. (Dar); LL.B. (Dar)
FK House|23 Barack Obama Drive|
Sea View|Upanga PO Box 20787|
Dar es Salaam|Tanzania
Tel: +255 22 2 122 029|031|032
Fax: +255 22 2 122 027
Mobile:+255 +255 (0) 754 276 526
www.fklawchambers.co.tz