Finance Bill 2017 Update

PwC insight and analysis

Summary of points additional to those highlighted in our Budget Newsletter

We hope that you will find this update helpful and look forward to your comments

Finance Bill 2017 Update

Highlights

This newsletter summarises details of changes proposed in the Finance Bill 2017, which were not referred to in the Budget speech and therefore not included in our Budget Speech newsletter. Changes proposed include the following:

Income Tax

- Changes that seem to have the objective of charging income tax on non-profit organisations by way of a wider definition of "business" and increased conditions for entities to qualify as "charitable".
- Disallowance of withholding tax paid by a withholder as a deductible expense .
- Extension of the scope of non-resident withholding tax on insurance premiums to (i) explicitly cover reinsurance payments and (ii) also cover insurance of risks outside Tanzania.
- Increased share listing threshold requirement (35% instead of 30%) to qualify for reduced 25% corporate income tax rate for newly listed entities.
- Explicit requirement for income tax returns to be accompanied by certified financial statements.
- Ring fencing of speculative transactions such as hedging.

VAT

- Narrow definition of ancillary services that qualify for zero-rating for VAT purposes

Tax Administration

- Removal of Ministerial involvement in interest or penalty waiver decisions, but Commissioner General's power to waive is capped at 50% of the relevant amount.
- Interest on late payment to (i) be compounded monthly, and (ii) continue to run during time the tax dispute resolution period.
- Power to restrain assets extended to (i) any failure to use an electronic fiscal device and (ii) cases where "a provision of any tax law has been breached"

Timetable for consultation on the Finance Bill

The concern remains that with the Finance Bill only available half a month before the Act comes into force, and with taxpayers only given a few days to respond with inputs to the Bill, the process of consultation on the detail of the legislation is likely to be rushed and therefore flawed. Given the potentially far reaching implications of some of the changes proposed, this compressed time frame is a concern; in an ideal world, draft legislation might be available at the beginning of April rather than mid June.

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Income tax

- **Definition of "business"**: Deletion from the definition of the phrase *"and any that, having regard to its nature and the principal occupation of its owners or underlying owners, is not carried on with a view to derived profits*". Comment: The object of this change appears to be capture activities of not for profit organisations within the income tax net unless such organisations have been issued with a ruling confirming acceptance as a charitable organisation. The need for this amendment is however unclear. In particular, income tax seeks to tax profits and if such organisations operate activities with a view to generate profit, then such profit would be taxable subject to the special rules related to qualifying charitable organisations. Prior to the amendment if there was no profit motive, then there would be no liability to income tax.

  The practical challenge of this amendment is that income received by these organisations (including grants) would now be deemed to be business income and (unless qualifying as a charitable organisation) the money spent by such organisations to pursue the objectives of the organisation would not be deductible (as it is not spent to produce the income but instead is a use of income received). The practical effect would appear to subject income such as grant to income to tax at 30% for all non profit organisations not registered as charities. Whilst this may not be the intention of the amendment, it does appear to be the practical impact.

- **Charitable organisations:** In order to qualify as a charitable organisation, the requirement to date has included the precondition that an entity is a resident entity of a public character established and functioning solely as an organisation for either of the following three purposes: (i) the relief of poverty or distress of the public; (ii) the advancement of education; or (iii) the provision of general public health, education, water or road construction or maintenance. The Finance Bill imposes new additional conditionalities as follows:
  - A requirement to provide the services referred to under the three categories above *" free of charge or at a reasonably affordable fee to the general public"* and in this regard the Bill states that where *"fees exceed fifty per cent of a fair market value, the entity shall be treated as conducting a business other than charitable business"*;
  - A requirement that on winding up or liquidation any net assets remaining will transfer to another charitable organisation in Tanzania;
  - A requirement that the charitable business disburses annually more than eighty per cent of contributions received towards the charitable activities.

  A new definition is also introduced of the term *"an entity of a public character"*, with a number of conditions including a requirement for membership to be *"open to the general public or an identifiable group of a community with common interests"*, and that *"it does not allow any distribution or deemed distribution of profit generated out of its charitable business"*.

- *Definition of "business" amended to remove exclusion for not for profit activities.*
- *Further restrictions for entities to qualify as charitable organisations*

Comment: The additional requirements to qualify as a charitable organisation, as well as the amendment to the definition of "business" raise several concerns including the following:

- A number of genuine non-profit organisation may be required to pay income tax despite not having a profit making motive, and as worded the risk is that such income tax would be payable on gross grants received.
- The terms "reasonably affordable fee" and "fair market value" are subjective particularly in the context of activities such as education provision.
- The requirement to spend 80 per cent of contributions received contradicts a separate part of the same section that already refers to a requirement of 75 per cent.
- Though unintended, as drafted, the three purposes listed above no longer seem to be alternatives, though logically this should be the case.

Income tax (Cont'd)

- *Non deductibility of withholding tax paid by withholder – understood be aimed at "net of tax" contracts*

- **Disallowance of withholding tax (net of tax contracts):** A new category of disallowable expenditure is introduced by amending the definition of *"excluded expenditure"* to include *"withholding tax paid by withholder"*.

  Comment: Although the legislative provision does not explicitly state this, it appears that the objective of the amendment is in relation to the treatment of "net of tax" contracts which has been an area of contention between taxpayers and the TRA.

  In order to simplify cross-border trading, it is a standard and acceptable international commercial practice for international contracts to be entered into on a net of tax basis given that the overseas party will have limited knowledge on taxation rules outside its home jurisdiction and will want some certainty as to the net amount that will be remitted to the home jurisdiction. In addition, these commercial arrangements do not result in a loss of tax for the revenue authority, as withholding tax is accounted for as required by calculating the withholding tax on a gross up basis.

  By way of example, and assuming a withholding tax rate of 15%, there is no reason why the tax treatment should be different between a contract entered into for (i) $100 gross consideration, from which $15 withholding tax is deducted from by applying a factor of 15/100 to the $100, and (ii) $85 consideration " net of taxes", to which a factor of 15/85 is applied to arrive at the withholding tax of $15.

In both cases, the commercial cost to the company is $100 and the withholding tax accounted for is $15 - equally in both cases the tax deduction should be $100. However, the objective of the amendment would appear to limit the deduction in example (ii) to $85 rather than $100 by way of disallowance of the $15 grossed up.

However, where a contract is on a gross basis and the payer has overlooked the need to withhold, and subsequently accounts for the withholding tax later and therefore incurs an additional cost, then the case for disallowance is understood as the cost incurred is in effect in excess of the contractual amount required. In particular using the numbers cited above, if there is a gross consideration of $100 and the payer omitted to deduct the $15 and so paid the supplier $100 instead of $85, and subsequently paid an additional $15 as withholding tax then this $15 would not be deductible - in other words, the deduction would be $100 (the gross consideration) and not $115. This position is understood and does not need a legislative amendment.

As stated above, a net of tax contract is a common mechanism to simplify contracting arrangements with non-residents by stating the consideration in after tax terms so that the provider has certainty as to the payment it will receive back in his home jurisdiction. This certainty is particularly important as in most cases it is unlikely that the provider will receive tax credit relief, or full tax credit relief, in his home country for the following reasons:

- the home jurisdiction may deny the credit on the basis the tax is not charged on profit but rather on gross income, or
- the home jurisdiction may deny the credit if services are performed in that same home jurisdiction on the basis that the income is domestic source income in that jurisdiction (as the services are performed there) and therefore not eligible for a foreign tax credit, or
- even in a case that the home jurisdiction does provide a withholding tax credit, full credit for the withholding tax is unlikely to be granted given that the high (15%) withholding tax on gross income is likely to exceed the relevant attributable tax on profits.

Given the analysis set out above, it is to be hoped that there can be a last minute rethink on this proposed amendment, which appears to have been proposed on the misunderstanding that net of tax contracts result in tax avoidance. As explained above, they do not; and indeed this concept is understood and accepted in many other jurisdictions.

The wording as drafted also leaves open the scope for ambiguity in interpretation as it could also potentially be misconstrued as even applying to contracts contracted on a gross basis such that it is only the net amount after deduction of withholding tax that would be the deductible amount.

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Income tax (Cont'd)

- **5% withholding tax on minerals - "specified minerals" and "licensed dealer"**: The Bill sets the scope of the 5% withholding tax on payments of minerals as payments for specified minerals that a "licensed dealer" (as defined in the Mining Act 2010) is authorised to deal with (being gold, metallic minerals, coloured gemstones, diamonds, coal and industrial minerals).

- **Insurance premium and proceeds**: The source rules for insurance premiums and proceeds are amended so as to refer to (i) not only in relation to general insurance but also re-insurance and (ii) not only risks in Tanzania but also risks outside Tanzania.

  Comment: The objective of this amendment is to make clear that re-insurance is also within scope for withholding tax. In addition, the source rules are effectively made extra territorial by extending their scope to risks insured in locations outside Tanzania. This amendment is a continuance of recent trends (as seen with the rules for services and communication services) to de-construct the logic of nexus as originally set out in the ITA 2004 and essentially move to a framework that treats anything paid out of Tanzania as having a source in Tanzania irrespective of the location of other factors previously treated as significant in determining source. These changes simply increase the cost of doing business for Tanzanian businesses as overseas businesses will simply gross up their charges for these additional costs which generally will not be creditable in their home jurisdiction.

- **Increased 35% share listing threshold for reduced Corporate Income Tax ("CIT") rate for newly listed entities:** Previously a relief was granted to newly listed companies on the Dar es Salaam Stock Exchange (DSE) by way of a reduced CIT rate of 25% for three years provided at least 30% of shares were listed. The Bill proposes to increase this threshold to a minimum of 35% of shares publicly issued.

  Comment: In practice the previous relief did not have any real impact in encouraging entities to list. Against this background, and given the recent drive to encourage companies to list, it is surprising that the threshold has been increased. If anything one might have expected a reduction of the requirement to say 25%, so as to encourage listing.

- **Income tax returns:** "Certified financial statements" will now be required to accompany income tax returns.

  Comment: The term "certified financial statements" has not been defined, but it is understood that it refers to financial statements that have been certified by a person licensed by the National Board of Accountants and Auditors (NBAA) as the preparer of such financial statements. Although the ITA 2004 did not previously include an explicit requirement for signed accounts, corporate entities would still need to have such accounts to satisfy the Companies Act requirements, and the TRA would in practice expect signed accounts to accompany the income tax return of a company.

- *Source rules for insurance to include risks outside the United Republic*
- *Increased listing threshold to qualify for reduced CIT rate for newly listed companies*
- *Income tax returns to be accompanied by certified financial statements*

Whilst the predecessor Income Tax Act (ITA) 1973 did include a requirement for provision of accounts, it only applied where *"accounts of [the] business for any accounting period relating to such year of income have been prepared or examined by an auditor or accountant in a professional capacity"*. In this case there is no express limitation stated as to who should file signed accounts - for example, there is no express limitation to corporate entities and / or business income, and so as drafted the requirement would in principle apply to personal tax returns even without business income.

The need for the amendment is unclear given the existing practice as well as the power already in the legislation for the attachment to a tax return of *"any other information that the Commissioner may prescribe"*. Otherwise, if an amendment is to be made, the scope of application should be more clearly defined - and ideally linked to requirements in the Companies Act.

Income tax (Cont'd)

- **Single instalment tax - exclusion of carriage of horticulture products:** The carriage of horticulture products by a foreign aircraft will now be excluded from single instalment tax (as is already the case in relation to carriage of fish). (Ordinarily, single instalment tax is applicable on payments received by a non-resident person in conducting a business of land, sea or air transport operator or charterer, other than through a permanent establishment in Tanzania.)

- **Ring fencing of speculative transactions:** The Finance Bill proposes to ring fence losses arising from "speculative transactions", which are defined to include hedging and other similar financial arrangements. Specifically "speculative transaction" is defined to mean:

  "(a) a transaction which is a contract for sale or purchase of a commodity including stocks and shares settled otherwise than actual delivery or transfer of the commodity or scrip; or
  (b) any agreement for repurchase or resale, forward sale or purchase, futures contracts option or wap contracts".

  Comment: As drafted the impact of the law is quite all encompassing, and the question arises as to the justification for segregating the results of derivative instruments entered into for genuine financial reasons.

For example, if an airline sought to hedge its future fuel costs, and losses were derived from the hedge then there does not appear to be a good reason to deny the deduction for this cost. Indeed, if hedge gains accrue in one year and hedge losses in a subsequent year, there would appear to be a risk that you end up taxing hedge gains but giving no relief for hedge losses. In addition, it is unclear how this law would be applied to the financial services industry whose core business by definition involves transactions that by definition are speculative in terms of the future direction of interest and currency movements.

The question arises as to the intention of this change. If the intention is more specific to a sector - for example, the extractive sector - then it would be better to ensure that the amendment specifically targets whatever the perceived nuisance is, and so avoid other unintended "collateral damage".

- *Exclusion of 5% single instalment tax from carriage of horticultural products by non-resident transporters*
- *New provisions to ring fence "speculative transactions" including hedging and other similar financial transactions*

Value Added Tax Act

- **Zero-rating of VAT on ancillary transport services on transit goods:** Although the Budget announced the re-introduction of VAT at the zero rate (0%) on the supply of ancillary transport services in relation to goods in transit, the Finance Bill states that any such service will only qualify for zero rating if it is:
  - An integral part of supply of international transport service; and
  - Rendered by the same supplier providing international transport service; and
  - In respect of goods stored at the port, airport, or a declared customs area, is stored for not more than seven days while awaiting onwards transport.

  Comments: The second condition listed would in practice make the relief purely theoretical. In particular, it would be unusual for these services be provided by the same supplier as the supplier of international transport. This is because the supplier of the international service is usually a non-resident who has entered into a contract with a non-resident customer to transport the goods to the customer's destination country albeit through Tanzania, but who does not have any operations in Tanzania.

  The seven day time limit appears to be unrealistic. Our experience indicates that some cargo (e.g. fuel) stays longer than seven days not least due to customs control pending clearance. A review would appear to be required of the proposed seven day time limit.

- **VAT return and payment - due date on non-working day:** An amendment is made to clarify that where the due date for filing a VAT return falls on Saturday , Sunday or public holiday, then the VAT return shall be lodged on the first working day following that day. In this case, the respective payment will also be due on the same day. To some extent this mirrors provisions already in the Interpretation of Laws and General Clauses Act.

  Previously VAT relief for bad debts could be claimed if unpaid after twelve months and the debt had been written off, or otherwise after eighteen months. The law is now amended so that the earliest that bad debt relief can be claimed in respect of unpaid VAT is after eighteen months.

- **New exemptions:** In addition to the exemptions highlighted in our Budget speech newsletter, we note that the Finance Bill also exempts motor vehicle specifically designed for use by persons with disability.

  The Finance Bill also provides HS code details in respect of exempted capital goods.

- **Amendment of existing exemption:** The term "unprocessed tobacco" has been substituted with "tobacco not stemmed/stripped".

- *Zero rating of ancillary transport services on transit goods to only apply in very restricted circumstances*
- *Earliest date to claim relief for bad debts is now a period of 18 months (whereas previously bad debt relief could be claimed after 12 months if debt had been written off)*

Tax Administration Act

- **Determination of objection**: An amendment is made to make clear that the Commissioner General is required to issue a notice of final determination of objection once the objection has been determined. In addition, the provisions dealing with the appeal procedure now include the words *"aggrieved by a final determination of objection by the Commissioner General"* to replace *"aggrieved by an objection decision or other decision or omission of the Commissioner General"*.

  Comment: This amendment, which amongst other things deletes reference to "omission", creates uncertainty as to how taxpayers can appeal against an omission by the Commissioner General to take a particular action. (On the other hand, the Tax Revenue Appeals Act (as amended in earlier years) already no longer includes reference to omission but simply to objection decision.)

- **Dispute resolution procedures on tax decisions:** Commissioner General's decisions on assessments to be extended to include similar procedure for other "tax decisions".

  Comment: This proposal is meant to take away the uncertainties on dispute resolution procedures pertaining to tax decisions other than "assessments", e.g. demand notices.

- **Reinstatement of the time limit for application of tax refunds:** A three year deadline is set for application for tax refunds. The three years runs from the date of payment of the excess tax.

  Comment: Although the ITA 2004 had a similar deadline, the three year time limit applied from the later of the following two dates:
  - the end of the year of income during which the events occurred that gave rise to the payment of the excess; or
  - the date on which the excess was paid.

  The amendment proposed only refers to the second date, which begs the question as to what happens where the tax position has not been settled three years after the relevant payment has been made.

- **Interest and penalties:**

  - ***Remission*:** Amendments are made to the powers of remission of interest or penalty as follows:
    - Whereas previously remission was only capped for interest - at a maximum 50% remission - a similar cap now applies to penalties (namely 50%)
    - Removal of the requirement for Ministerial involvement in remission of interest (that had been introduced by the Finance Act 2016.)

> - *Removal of Ministerial involvement in remission of interest or penalty, but remission limited to a maximum of 50%.*
> - *Late payment interest compounded monthly*
> - *Tax refund application to be made in three years*
> - *Non-compliance with EFD requirements or any other breach of tax law may lead to asset restraint.*

  - ***Interest on late payment of tax:*** Changes to the calculation of late payment interest include the following:
    - Calculation on a compounded basis
    - Interest will continue to run during the dispute resolution process (including court proceedings)

  - ***Extended powers to restrain assets**:* The power to restrain taxpayers' assets is extended to (i) any failure by a taxpayer to use an electronic fiscal device (EFD) and (ii) cases where *"a provision of any tax law has been breached"*

Finance Bill 2017 Update

Local Government Finances Act

- **TRA to collect advertisement fees:** TRA's mandate to collect is extended from property tax to now also include *"advertisement fees for billboards, posters and hoarding"*. In addition, the power is granted to the Minister for Finance (on behalf of the local authorities) to set fees for such advertisements.

- **Removal of establishment fees on pharmacies and drug shops:** The Bill exempts pharmacies and drug shops from paying establishment fees to Local Government Authorities.

- **Permit fee on transportation of livestock:** Although the Budget speech had proposed to remove fees for transportation of livestock, and on livestock when in market for auction, these changes have not been reflected in the Finance Bill.

Urban Authorities (Rating) Act

- **Flat rate of Property Tax for un-valued properties:** As regards to the proposed amounts of TZS 10,000 and TZS 50,000 property tax on un-valued buildings, the Finance Bill proposes that a fraction of a building belonging to one or several co-owners in accordance with the Unit Titles Act be treated as a separate building.

  Comment: This amendment appears to require each co-owner to treat his/her fraction of the building as a separate building on which property tax will be payable.

- *TRA to collect advertisement fees*
- *Removal of establishment fees on pharmacies and drug shops*
- *Property tax payable on each fraction of a building belonging to co-owners as a separate building*

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