Growing tomorrow's economy

National Budget 2012/2013

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Finance Bill 2012 Update

Introduction

Our Budget newsletter of 14 June was based on the speech of the Minister for Finance. We now summarise some additional points arising out of our review of the Finance Bill 2012. Please note that the Bill may be subject to further change before it is enacted as the Finance Act 2012.

Income Tax

Change in control

The Budget speech included a proposal to deem a tax charge in relation to gains arising on transactions in shares of companies with an underlying interest in Tanzanian entities. We have set out in the attached "International Tax Update" a summary of how the Finance Bill will effect this change.

Thin Capitalisation

The Finance Bill 2012 introduces definitions of "debt" or "equity" for the purpose of thin capitalisation calculations. Further detail is given in the attached "International Tax Update".

Alternative Minimum Tax

The Finance Act 2008 introduced an Alternative Minimum Tax (AMT) applying at a rate of 0.3% to the turnover of companies with unrelieved tax losses for the current and prior two income years – but excluding application to agriculture, health or education. However, AMT was stated to only apply where such losses were "attributable to tax incentives". The Finance Bill deletes the words "attributable to tax incentives".

Foreign exchange differences

One of the features of the Income Tax Act 2004 was a move towards greater alignment of taxable and accounting profits. One example of this was the recognition of exchange gains and losses on an accruals basis.

The Finance Bill 2012 removes the clauses providing for recognition on an accruals basis. This change is most unwelcome as the use of a realisation basis will add additional complexity to the process of completing tax calculations.

Significant shareholdings by resident corporate shareholders

Previously, where a resident company held 25% or more of the shares of another resident company, and controlled 25% or more of the voting power, no tax was applicable to:

1. Dividends paid by the subsidiary to the resident parent. (The effect being that dividend withholding tax was only paid once the top Tanzanian parent company paid

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out a dividend – thereby ensuring that dividend withholding tax was only borne once.)

2. The disposal by the resident parent company of shares in the subsidiary where held as an investment asset. The ultimate distribution of such proceeds by the top Tanzanian parent company would however result in tax by way of dividend withholding tax.

The Finance Bill 2012 removes the exemptions so that:

1. Dividends paid to a resident corporate shareholder (assuming that satisfying the 25% shareholding and voting power requirement) will be subject to a 5% withholding tax
2. Income tax will be payable at the normal corporate rate on any gain arising on a relevant share disposal by a resident parent company.

The change on dividend withholding tax will make it tax inefficient to have structures involving a local holding company with a subsidiary below.

Previously the use of a local holding company could enable investors to reinvest gains from share investments without suffering tax (i.e. if such gains were not distributed by the parent by way of dividend but instead were reinvested). The changes made remove this flexibility.

Single instalment tax – disposal of shares

On a disposal of a building, there is a requirement to pay instalment tax (10% for residents, 20% for non-residents) on any gain realised. The transfer of title cannot be effected without the production of a certificate from the Tanzania Revenue Authority (TRA) certifying that the instalment has been paid or that no instalment is payable.

The requirement to account for single instalment tax is now extended to investment assets (rather than just land or buildings) and therefore now covers shares. Where there is a share transfer, the Registrar of Companies can now not register such a transfer unless there is a certificate from the TRA certifying that the instalment tax has been paid or is not applicable.

Electronic Fiscal Device

The Finance Act 2010 introduced a requirement for VAT registered taxpayers to issue fiscal receipts using an Electronic Fiscal Device ("EFD").

The Finance Bill proposes to:

- Extend this requirement to all taxpayers subject to a power for the TRA to exempt certain persons from this requirement.
- Enable taxpayers who are not VAT registered to claim a 100% capital deduction for the cost of EFDs.
- Introduce an offence under the Income Tax Act 2004 where a person fails to "*acquire or use electronic devices or issue fiscal receipt or fiscal invoices*". The penalty for committing such an offence upon conviction is three million shillings or imprisonment for not more than three years.

Statutory Rate

Interest for late payment is calculated by reference to the *"statutory rate"*. Previously, the relevant definition stated that the *"statutory rate in relation to a calendar year means the Bank of Tanzania discount rate at the start of the year"*. The words *"the Bank of Tanzania discount rate at the start of the year"* are now replaced by *"the prevailing discount rate determined by the Bank of Tanzania"*. This implies a move to the use of different rates for each month rather than one rate for the year.

Personal Income Tax - Zanzibar

An amendment is made to enable the Zanzibar Government to determine personal income tax rates applicable in Zanzibar.

Excise Duty

Adjustment of specific excise duty rates no longer based on inflation rate.

Previously the specific excise duty rates under the Excise (Management and Tariff) Act, Cap 147 were required to be adjusted by the annual inflation rate. The Finance Bill removes this requirement (by amending the relevant provision to state *"may be annually adjusted as may be required depending on prevailing circumstances".*)

This change is made against a background of above inflationary increases in specific excise duty rates in this year's Budget.

Change in rates for juice and increase of rate on water (including mineral water)

In the budget speech, the Minister had proposed an introduction of Excise duty on juices. However, the rates in the Finance Bill differ from those in the Budget speech as follows:

- TZS 7 per litre (and not TZS 8) on locally produced juice; and
- TZS 77 per litre (rather that TZS 83 per litre) on imported juice.

The Bill also proposes to increase the excise duty rate on bottled and mineral water from TZS 69 to TZS 83 per litre.

Service Levy

Changes are proposed to the Local Government Finances Act, Cap 290 to deal with the place where corporate entities should be paying their service levy. The change requires branches of corporate entities to pay their service levy (at the rate not exceeding 0.3% of their turnover net of VAT and excise duty) to the district councils in whose areas of jurisdiction they are located.

We foresee this change as resulting in significant technical, practical and administrative difficulties – not least the question of what is a "branch" in this context and how one determines its revenue, and the prospect of multiple payment requirements for entities with countrywide operations.

Value Added Tax

Fiscal receipt to replace tax invoice

Following the Finance Act 2010 change in relation to EFDs, the law was amended so as to make reference to fiscal receipts – following which the law required the taxpayer to issue a tax invoice or fiscal receipt. The legislation is now amended to remove the reference to tax invoice, so that the requirement simply refers to the issuance of a fiscal receipt.

The Finance Act 2010 had also amended the legislation in relation to input tax claims so as to add the words *"or fiscal receipts"* after the words *"tax invoice"*. The Finance Bill 2012 deletes the words *"tax invoice or"*. The effect of this is that an input tax claim can no longer be supported by a traditional tax invoice - instead all claims for input tax can now only be supported by a fiscal receipt issued by an EFD.

Place of Supply: Amendment of taxing rights of Mainland Tanzania and Zanzibar in relation to telecommunication services

The VAT place of supply rules have been amended to provide that *"the place of supply for telecommunication services within the United Republic of Tanzania shall be a place where the effective use and enjoyment takes place irrespective of contract, payment or beneficial interest"*.

Unlike the other provisions dealing with place of supply, this refers to *"the United Republic of Tanzania"* instead of *"Mainland Tanzania"*.

The primary objective of this change is to deal with an existing impasse in relation to the VAT treatment of supplies by way of interconnection charges by telecommunications operators on the Mainland to telecommunications operators in Zanzibar. In particular, whilst the law has previously required VAT output tax to be accounted for in the Mainland on such supplies, the Zanzibar Revenue Board refused to allow corresponding input tax credits claimed in Zanzibar for such output tax. The new amendment will effectively remove the requirement to account for VAT output tax on such supplies between the Mainland and Zanzibar.

Taxable Value: Removal of the word "premium" as it relates to valuation of telecommunications services

The Finance Act 2009 amended the VAT Act so as to provide that *"the taxable value for prepaid airtime mobile phone voucher shall be the face value of the voucher plus any premium thereon"*. The Finance Bill now removes the words *"plus any premium thereon"*.

Restriction of Special Relief

The Third Schedule to the VAT Act has been restructured so as to distinguish supplies:

- Eligible for full (100%) VAT relief, and
- Eligible for partial relief (45%), resulting in a requirement to now pay VAT (but at a lower rate of 10%).

We have set out in a separate summary "Special Relief Update", details of the supplies eligible for 100% relief and those eligible for only 45% relief (i.e. 10% VAT rate).
We assume that the special relief administrative process will continue to apply to the supplies subject to partial relief.

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Finance Bill 2012 - International Tax Update

Overseas disposals - Change in control

The Budget speech included a proposal to deem a tax charge in relation to gains arising on transactions in shares of companies with an underlying interest in Tanzanian entities. The Finance Bill seeks to effect this by an amendment to the "Change in Control" provision (section 56 ITA 2004).

The trigger for the potential application of Section 56 is the moment the underlying ownership of an entity changes by more than 50% as compared with that ownership at any time during the previous three years. Where this happens the potential consequences are as follows:

1. The accounting period of the local Tanzanian entity is split at the point of such a change, so that the parts of the year of income before and after the change are treated as separate years of income.
2. The local entity is deemed to be realising any assets owned and any liabilities owed by it immediately before the change, and to reacquiring these assets and liabilities immediately after the change. Such realisation and reacquisition being at market value.
3. The local entity forfeits the ability to carry forward certain reliefs from the earlier period including unutilised tax losses, tax credits.

However, to date these consequences could not apply provided that for a period of two years after the change in control there was:

1. A continuity of business(es) and conduct of such business(es) in the same manner as in the twelve month period before the change, and
2. No conduct of any business or investment other than those conducted at anytime during the twelve month period before the change.

The Finance Bill now limits the relevance of this exception to the question of forfeiture of unutilised reliefs. In other words, where there is a relevant change in control, the deemed realisation (and reacquisition) is automatic, irrespective of whether there is a continuity of the business in the same manner or not.

This change follows significant public debate and disquiet and consequent political pressure in relation to the

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perceived inequity of Tanzania not receiving tax proceeds in the case of high profile transactions (particularly related to oil and gas, mining, telecoms and tourism), where shares have been sold in overseas companies and where the companies sold have an underlying economic interest in Tanzanian subsidiaries.

In the context of Tanzania the change will be particularly significant for the emerging oil and gas and mining sectors, being industries frequently characterised by "junior" companies carrying out initial exploration activity with subsequent divestments to "majors". It is to be hoped that there will be adequate time given for consultation before finalisation of the Finance Act so as to ensure that the final legislation is sufficiently considered so as to produce an outcome that is workable and practical from both an administrative and economic perspective.

Thin Capitalisation - Clarification

The Finance Act 2010 introduced a new thin capitalisation restriction that provided for a 70:30 debt to equity ratio. (This balance sheet determined ratio replaced the predecessor "interest cover" restriction, which limited relief for interest costs to a set percentage (70%) of earnings before net financing costs.)

The Finance Bill 2012 has amended debt to equity ratio to 7:3.

The Finance Act 2010 amendments did not however incorporate a definition of "debt" or "equity" for the purpose of thin capitalisation calculations. The Finance Bill 2012 now includes the following definitions:

"debt" means "*any debt obligation excluding:*

- *(i) a non-interest bearing debt obligation;*
- *(ii) a debt obligation owed to a resident financial institution;*
- *(iii) a debt obligation owed to a non-resident bank or financial institution on whose interest tax is withheld in the United Republic;"*

"equity" means "

- *(i) paid up share capital*
- *(ii) paid up share premium; and*
- *(iii) retained earnings on an unconsolidated basis determined in accordance with generally accepted accounting principles"*

In addition, an amendment is made to the effect that "*where there is a change of the amount of debt or equity, the amount of equity or debt shall be the average of [the] balances of [the] amount of debt or equity at the end of each period". "Period"* is then defined as *"a month or a part of [a] month"*. This monthly averaging requirement introduces additional unwarranted complexity to the calculations.

We maintain the view that the predecessor interest cover restriction (repealed in 2010) was preferable as being (i) simpler (ii) more effective in combating abuse (iii) less likely to result in inequity. We note that internationally an increasing number of countries are focussing on interest cover ratios rather than the traditional thin capitalisation approach.

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Finance Bill 2012 – VAT Special Relief Update

Proposed amendments to the Third Schedule of the VAT Act

The Third Schedule to the VAT Act has been restructured so as to distinguish supplies:

- Eligible for full (100%) VAT relief, and
- Eligible for partial relief (45%) resulting in a requirement to now charge/pay VAT (but at a lower rate of 10%).

1. Persons/organisations eligible for 100% relief

- Supplies to or importation of goods or services by diplomats or a diplomatic mission that is accredited by the United Republic of Tanzania for the official purposes of that mission, where the foreign country provides reciprocal treatment to diplomats and the diplomatic mission of Tanzania in that country.
- Supplies or importation of goods or services under a technical aid or donor funded agreement as far as that agreement provides for relief from taxation in the United Republic of Tanzania.
- Importation or supply of goods or services to project funded by the Government relating to infrastructure and utilities development.
- Travellers' or deceased's personal effects - Imported goods in respect of which relief of duty is available under Customs Laws.
- Supply of specified goods to the Armed Forces.
- The importation by or supply to a registered and licensed explorer or prospector of goods or services to be used exclusively for exploration or prospecting activities.
- The importation by or supply of goods or services to a registered and licensed mining company which has a mining development agreement with the Government executed before 1st July, 2009.
- The importation by or supply to a registered licensed exploration or prospecting company, of goods which if imported or supplied would be eligible for relief from duty

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under the customs Jaws and services for exclusive use in exploration or prospecting of petroleum or gas.

- The importation or local purchase of goods or services, by or on behalf of registered religious organisations or institutions, which are intended to be used solely by the organisation or institution for, (i) the advancement of religion; (ii) relieving persons from the effects of natural calamities, hazards or disaster; and (iii) the development, maintenance or renovation of projects relating to health, education, training, water supply, infrastructure or any other projects relating to advancement of the community.

- The importation or local purchase by charitable community based or other non profit driven organisations of household consumables for subsequent supply to orphanage, day care centers and schools.

- The importation by or supply to the Red Cross Society of Tanganyika of goods or services which are solely to be used in the performance of its statutory functions.

- The importation by or supply of goods or services to any institution or organization established under an Agreement to which the Government of the United Republic of Tanzania is a party so long as that Agreement provides for relief from taxation.

- The supply of destination inspection services to the Tanzania Revenue Authority.

2. Persons/organisations eligible for 45% relief

- The supply to a registered medical practitioner, optician, dentist, hospital or clinic, or to a patient, of equipment designed solely for medical or prosthetic use including ambulance and mobile health clinics.

- The supply to a registered veterinary practitioner of equipment designed solely for veterinary use.

- Supply of specified goods for sale in the Armed Forces duty free shops.

- The importation by or supply of goods and services for water and sewerage infrastructure development to water and sewerage authorities and institutions or scheme or agent or concessionaire thereof contracted for purpose of providing water and sewerage services to public in the urban and rural areas.

- The supply of raw and packaging materials to a registered manufacturer of spectacles lenses.

- The supply to the investor licensed under the Export Processing Zones Act, 2002 of goods and services for use as raw materials, equipment and machinery including all goods and services directly related to manufacturing in the Export Processing Zones, but shall not include non utility motor vehicles, spare parts and consumables.

- The supply of building materials and construction services by the developer licensed under the Export Processing Zones Act.

- The importation or supply' to an investor licensed under the Special Economic Zones Act, of raw materials and goods of capital nature directly related to manufacturing in the Special Economic Zones including ambulances, fire fighting vehicles and fire fighting equipment.

- The importation by or supply to a registered water drilling company of goods to be used solely for water drilling.

- The importation by or supply to a registered pharmaceutical manufacturing company, of goods to be used solely in the manufacturing of human medicines.

- The supply of goods by domestic manufacturers for sale in a duly licensed duty free shop.

- The importation or local purchase of a generator or water pump for use by a farmer in irrigation, a Charcot "malambo or fishpond on condition that such farmer submits to the Tanzania Revenue Authority a confirmation from a Director of a Local Government Authority that such generator or water pump shall be used for the purpose of irrigation, fishing or keeping livestock".

- The importation by or supply of capital goods to any person.

- The importation by or supply of railway locomotives, rolling stocks, parts and accessories to a registered railways, company, corporation or authority.

- The importation by or supply of fire fighting vehicles to the Government or Government Agencies.

- The importation by or supply to the Bank of Tanzania of goods or services which are solely to be used in the performance of its statutory functions.

- The importation of ethanol, dyestuff and thickening agent by a local manufacturer of burning jelly.

- The importation or supply of greenhouse to horticulture grower.

- Supply of goods and services to the organized fanning for the purposes of building irrigation canals, construction of road networks, godowns and similar storages in the farms.

- The supply of spare parts for combined harvesters, threshers, rice dryers, mills, planters, trailers, power tillers, tractors, grain conveyors, sprayers and harrows to a farmer.

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