

Finance Act 2008 update

Introduction

This newsletter is an update on the information set out in June in our Budget newsletter. The Budget newsletter, which was based on the speech of the Minister for Finance, can be accessed at: www.pwc.com/tz. We now summarise some additional points arising out of our review of the Finance Act 2008, which was assented to on 3rd October 2008, and has recently been published by the Government Printer.

Issues covered in this newsletter include the following:

- Detailed review of the new legislative provisions on Alternative Minimum Tax (in relation to income tax) and Export of Services (in relation to VAT)
- Changes in the Income Tax Act 2004 in relation to agency notices as well as to the power to compound offences
- Certain other minor changes in relation to VAT and excise duty

The issues we raise in relation to the drafting of the legislation on Alternative Minimum Tax and on Export of Services reinforce our view that there is a need for a more inclusive / consultative approach to the actual drafting of

legislation so as to incorporate input from stakeholders such as tax professionals.

1 Income Tax

1.1 Alternative Minimum Tax ("AMT")

The Finance Act 2008 provides for the following amendments:

- In section 4(1)(a), the addition (after the words *"who has total income for the year of income"*) of the words *"or is a corporation which has a perpetual unrelieved loss determined under section 19 for the year of income and the previous two consecutive years of income attributable to tax incentives"*.
- An amendment to section 4(3) to make reference to the new paragraph 3(3) in the First Schedule and to make reference to *"turnover"* in addition to *"total income"*.
- A new subsection (8) to Section 4 that reads as follows: *"(8) The income tax payable by a corporation with perpetual unrelieved loss for three consecutive years of income under paragraph (a) of subsection (1) shall not apply to a corporation conducting agricultural business or*

engaged in the provision of health or education”.

- A new subparagraph (3) to paragraph 3 in the First Schedule as follows: *“(3) Income of a corporation with perpetual unrelieved loss for three consecutive years attributable to tax incentives shall be taxed at the rate of 0.3 per centum of the turnover of the third year of perpetual unrelieved loss”.*

A number of questions arise as to the interpretation of the new provision and in particular as to the meaning of the words *“tax incentives”* and *“third year of the perpetual unrelieved loss”*.

What is meant by “tax incentives”?

AMT only applies where tax losses arise *“as a result of tax incentives”*, however the term *“tax incentives”* is not defined – its scope is therefore unclear.

What is meant by “third year of the perpetual unrelieved loss”?

A TRA notice in the Daily News of 31 July 2008 in a paragraph titled *“introduction of income tax to perpetual loss making corporations”* stated the following in relation to AMT: *“The Bill has introduced the new income tax rate of 0.3% on annual turnover to corporations with perpetual loss status for three consecutive years of income as a result of tax incentives. The annual turnover for the purpose of computation of tax is the third year’s turnover in the period in which the corporation is in loss. Therefore, basing on the effective date of the provision, the 1st accounts (by perpetual loss making corporations) that will be considered under this taxation are final accounts for the period ending 31st July 2008. However, the*

status for such accounts and accounts for the previous two years should all indicate losses. Take note that the first return that will be affected by this new provision is the one that is due for submission on or before 31st January 2009.”

However, the reference in the legislation to a relevant corporation being *“taxed at the rate of 0.3 per centum of the turnover of the third year of the perpetual unrelieved loss”* does beg the question as to whether you start to count the three years not from before 1 July 2008 (as suggested in the 31 July notice) but from 1 July 2008 on the basis that prior to this there was no concept of *“perpetual unrelieved loss”* – in other words, the first accounting period that could be affected is the year ending 31 July 2010.

In addition there is a question as to what happens in years following the third year of perpetual unrelieved losses, being the year in which the AMT becomes due. Although the intention would appear to be that AMT will continue to apply so long as the company continues to make tax losses, a literal reading of the legislation could arguably suggest a more limited effect such that either (a) no further AMT is due in later years as the AMT is only due in the third year of such losses, or (b) that the clock is reset following the third year and if losses continue for a further three years, then the last of these three years attracts the AMT.

Is there any opportunity to defer a claim to “tax incentives”?

Given that AMT is only triggered where the loss is generated by *“tax incentives”* (not defined), we would assume that a taxpayer would have the right to defer to a later year the claim (or part of the claim)

to the relevant incentive – for example, if such an incentive related to the basis for claiming capital deductions. Such a deferral would be to his benefit if such disclaimer could result in his taxable result being a no gain no loss position and therefore not being liable to AMT. Currently, the legislation does not appear to explicitly provide for such deferral.

Tax Policy considerations

We have a number of concerns with AMT from a policy perspective as follows:

- We believe that the introduction of AMT works against the objective of simplicity and believe that this cost will outweigh the benefit of any revenue impact
- If the AMT is non-creditable against normal tax in future years, it has the impact of increasing the effective tax rate on an entity
- It is unclear why the reference point should be tax losses rather than accounting losses bearing in mind that tax losses are a product of the Government's own decisions as to tax structure. If the concern is the understatement of income or overstatement of expenditure, surely the reference point should be accounting losses not tax losses. If the concern is overgenerous provisions in the Income Tax Act, then surely the objective should be to amend those provisions - rather than give with one hand and take back with the other?
- It is unclear why Tanzania needs such a provision when the rest of East Africa manages without

- Given that the Income Tax Act 2004 was only promulgated a few years ago, we believe that the most prudent approach would be to be very circumspect in making changes to what was already a very well considered and thought through piece of legislation. The risk of too many ad hoc amendments to it will be that the document will revert to the previous “patchwork” legislation previously repealed.

For the future, if it is considered absolutely necessary to keep an AMT within our Income Tax Act, then we would suggest that consideration be given during the 2009 pre-Budget discussions to one of the following options:

- No trigger of AMT until such time that dividends are declared and can be seen to be derived out of profits that have not yet suffered the full rate of tax
- Alternatively, AMT to be triggered / calculated by reference to a certain percentage of the accounting profit not tax profit, and in addition any AMT to be carried forward as a credit.

The TRA pre-Budget submission in support of the AMT amendment made particular reference to the 0.5% alternative minimum tax applicable in Pakistan as a good reference point. Interestingly, in the same month (June 2008) that our Budget introduced the 0.3% tax, the Pakistan 2008 Budget abolished it – so we hope, that in our 2009 Budget we can follow Pakistan's lead and abolish AMT!

1.2 Agency Notices

An amendment is made to section 117 “*Recovery of tax from person owing money to tax debtor*” to provide that a tax liability that has

been the subject of a notice under section 117 can be recovered directly from the person served with such notice where all the following conditions are satisfied:

- a) The person served with the notice fails to pay the amount of tax specified in the appointment notice within thirty days of the later of (i) the date of service of such notice on him and (ii) the date on which any money came into his hands or became due by him to his tax debtor, and
- b) The person served with the notice has either (i) not given a notification to the Commissioner of the reasons for his inability to comply or (ii) has given such notification but the notification has been rejected by the Commissioner.

This change reinstates the position that previously applied under section 103(7) of the Income Tax Act 1973.

1.3 Delegation by the Commissioner – Power to Compound Offences

Section 127 as originally drafted provided that

*“The Commissioner may, subject to such restrictions and limitations as he may specify, authorise an officer to exercise any of his powers and duties under this Act other than the power to -
(a) compound an offence under section 119; or
(b) remit interest and penalties under section 125(2).”*

The Finance Act 2008 now limits the exception in section 127 to the power to remit interest and penalties – in other words, the power to compound offences can now also be delegated.

2 Value Added Tax

2.1 Export of Services

In recent years the business community have expressed significant concern that a consequence of an amendment made to the VAT Act in 2003 was that it was normally no longer possible for services supplied to an overseas customer to be treated as an export. As a result, such supplies became standard rated instead of zero-rated, thereby making Tanzanian suppliers of services uncompetitive internationally by loading VAT as an additional cost (as the overseas business is unable to claim credit for such VAT). One of the announcements welcomed in the 2008 Budget was that a change would be effected in relation to the zero-rating of export of services with effect from 1 January 2009, by which time regulations would be published.

Consistent with this the Finance Act 2008 confirms the implementation of amendments to the First Schedule of the VAT Act, which it states are to come into operation on 1 January 2009. We attach at the end of this newsletter, a copy of the relevant amendments. We understand that the regulations are currently being drafted and should be made available in January 2009.

Notwithstanding the new provisions in the Act and Regulations, a number of concerns remain as follows:

- The legislation lists the services that can qualify to be exported rather than listing the services that can not qualify. The problem with this approach is that it is likely to result in the

unintended omission of certain services that should qualify. For example, the new legislation does not refer to management services – and therefore any management services provided from Tanzania to an overseas entity are in principle excluded.

- The exclusion of certain services (that would otherwise qualify as exported services, for example data processing services and the provision of information) where such services are supplied to a related person. Such a provision will in effect mean that the new legislation will not make Tanzania any more attractive to regional businesses who are looking to locate their data processing or information services in one location for the region. Again Tanzania will remain unattractive as it will be loaded with an irrecoverable 20% VAT cost.
- Further clarity as to what is meant in relation to exportable telecommunication services, which are stated to be limited to those where “*effective enjoyment of such services takes place outside “Tanzania”*”.
- Incorrect assumption in the legislative drafting that the place of supply of services determines whether such a supply is an export or not. It does not – the purpose of the place of supply rules is to determine whether a supply is taxable or not, it is then a separate question as to whether it is taxable at the standard rate or (if an export) at the zero rate.

Overall, whilst the new provisions are a step forward from the position that has applied since the Finance Act 2003, they do not go far enough as a significant number

of transactions with businesses with no presence in Tanzania will still be subjected to VAT, which they will then be unable to recover.

2.2 Other

New exemption

Certain supplies by the sugarcane growers association to its members have been added to the list of items that are exempt from VAT.

Special Relief

Previously, item 13 of the Third Schedule to the VAT Act granted special relief to entities that held special agreements with the Government so long as that agreement provided for relief from taxation. This item has been amended and no longer covers such entities.

3 Excise Duty

Excise Duty on small vehicles

In the budget speech the Minister had proposed the introduction of excise duty of 5% for small vehicles with engine capacities between 1,000cc and 2,000cc with vehicles above 2,000cc continuing to be subject to a 10% excise duty.

However the Finance Act 2008 amendments are not clear in that they appear to imply that the 5% rate will apply to vehicles over 1,500cc (instead of 1,000cc) and that the higher 10% rate will apply to vehicles over 2,500cc (instead of 2,000cc). Notwithstanding this we understand from discussion with the Tanzania Revenue Authority that the intention is that the position is as announced in the Budget.

Finance Act 2008

Amendments to item 2(b) of the First Schedule to the VAT Act

- (b) *all supplies of services are treated as being supplied in the place where the supplier belongs as defined in subsection (4) of section 7 except supplies of services which may be treated as exported, subject to documentary proof acceptable to the Commissioner as follows-*
- (i) *The supply of services and ancillary services relating to cultural artistic, sporting, scientific, educational, entertainment fairs and exhibitions, including the supply of services of organizers of such activities shall be treated as being exported only when such services are physically carried out outside the United Republic of Tanzania;*
 - (ii) *The supply of services of valuation of, and work on movable tangible property shall be treated as being exported only when such services are physically carried out outside the United Republic of Tanzania;*
 - (iii) *The supply of ancillary transport activities such as loading and unloading handling and similar activities shall be treated as being exported only when such services are physically carried out outside the United Republic of Tanzania;*
 - (iv) *The supply of services connected with immovable property, including:*
 - (a) *The services of experts and estate agents;*
 - (b) *The provision of accommodation in the hotel sector or in sectors with a similar function such as holiday camps or sites developed for use camping sites;*
 - (c) *The granting of rights to use immovable property and services for the preparation and coordination of construction of firms providing on site supervision,*

shall be treated as being exported only when the immovable property is located outside the United Republic of Tanzania;
 - (v) *The supply of services rendered by an intermediary acting in the name and on behalf of another person shall be treated as being exported only when the underlying transaction is supplied outside the United Republic of Tanzania;*
 - (vi) *The supply of services of consultants, engineers, lawyers, accountants and other similar services, as well as data processing and the provision of information, shall be treated as being exported only when such services are supplied to a person other than a related person who is established to or has his permanent address or usually resides outside the United Republic of Tanzania, provided that such services are not related to business established or to be established in the United Republic of Tanzania;*
 - (vii) *The supply of telecommunications services, radio and television broadcasting services shall be treated as being exported only if effective enjoyment of such services takes place outside the United Republic of Tanzania.*