Important update for Tanzanian entities doing business with South African suppliers

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Background:

The Court of Appeal of Tanzania has passed a landmark judgment on the interpretation of the **Double Taxation Avoidance Agreement (DTAA) between Tanzania and South Africa**. In this tax update, we would like to throw some light on the important aspects of this famous decision in the case of **Mlimani Holdings Limited (referred to as 'MHL' or 'Appellant') Vs. Commissioner General** Civil Appeal no. 265 of 2021. The main issue highlighted here was related to the applicability of **Article 7** of DTAA on service fees paid by the MHL to the South African Company.

Here, the court has passed the decision saying that the said service fees cannot be considered as part of Article 7 as Business profits, but rather, it should be considered as payment made to the non-resident service provider that is subject to withholding tax.

The Court of Appeal relied on its previous judgment passed under similar circumstances in the case of **Kilombero Sugar Company Limited v. Commissioner General, Tanzania Revenue Authority,** Civil Appeal No. 218 of 2019**.**

We would be analyzing the impact of this decision on Tanzanian Taxpayers in this tax update, stay tuned:

How does this decision affect Tanzanian Taxpayers?

The Court of Appeal is the highest ruling authority in Tanzania and the decision taken by them would be considered binding law. Therefore, all the Tanzanian taxpayers who make the service fees payment to South African companies under the shelter of Article 7 of DTAA signed between the two countries, would not be allowed to do so. Because Article 7 does not apply to service fees payment made by Tanzanian taxpayers and instead, they must deduct **withholding tax at the rate of 15%** on such payments as per provisions of section 83 of the Tanzanian Income Tax Act.

For businessmen, it is important to understand that the service fees agreed in the contract with the supplier should be renegotiated to accommodate the withholding tax component. Otherwise, in case the withholding tax burden is not borne by the supplier, it will increase the operational cost of the entity. The amount could be grossed up with a withholding tax element to keep the total cost intact.

In the case of signing new agreements with South African suppliers, the taxpayers should take into consideration the element of withholding tax for negotiating terms of the service fees with the supplier on the grounds of the landmark decision.

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How does this decision affect South African Suppliers?

We understand that the DTAA is signed between both countries on a certain agreement. When the Tanzanian companies would deduct withholding tax from the payments made to South African suppliers, it may have opposing effects and challenges on South African entities' end. Primarily because the South African Revenue Service (SARS) maintains its stand that the service fee payment made under DTAA is considered as part of business profit under Article 7 of the tax treaty. Therefore, in case Tanzanian entities deduct withholding tax from their payments, the South African counterpart may not be able to claim the withholding tax credit of such payment. Furthermore, income earned from Tanzanian companies would be subjected to income tax in South Africa and this would lead to double taxation for the South African suppliers.

We must follow the judgment passed by the Court of Appeal on these grounds. This may affect business understanding between Tanzania and South African companies. Therefore, while making new commercial agreements, it is important to understand the business and tax impact of this decision to have a win-win situation for both ends.

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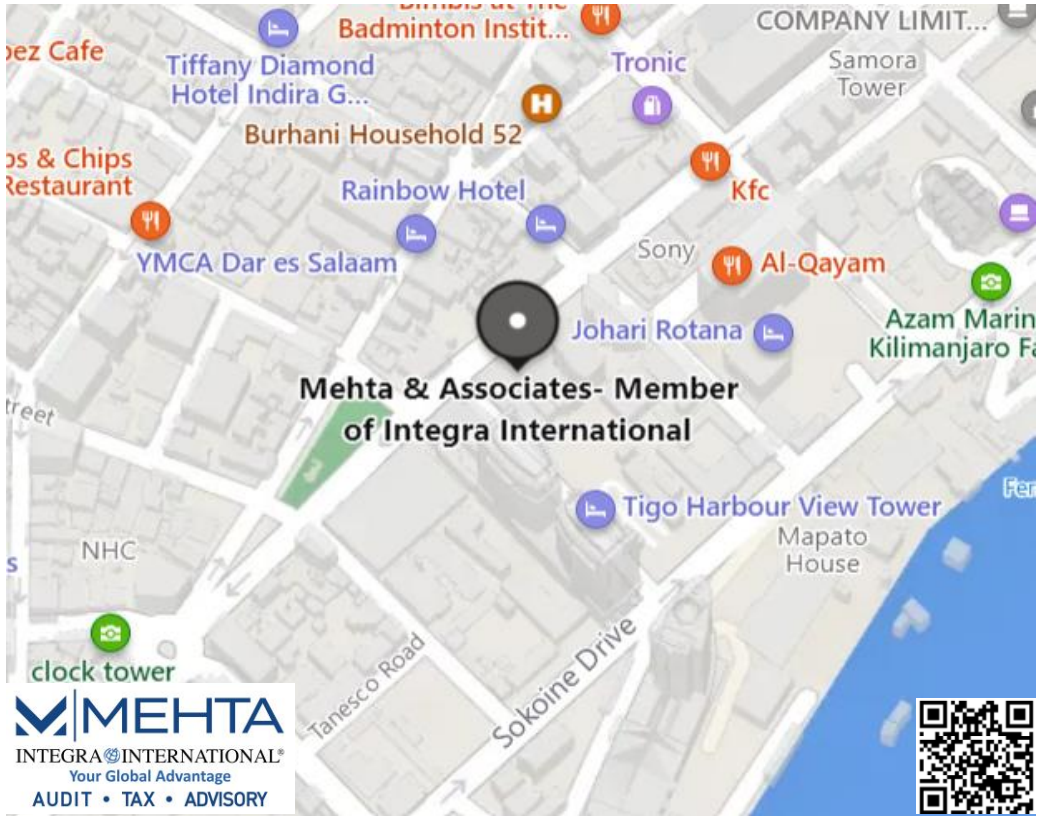

Disclaimer:

This tax update is based on the Court of Appeal decision in the case of Mlimani Holdings Limited Vs. Commissioner General Civil Appeal no. 265 of 2021. Any opinions or estimates contained in this publication represent our understanding at this time and are subject to change without notice. While all reasonable care has been taken in the preparation of this highlight, we accept no responsibility for any errors it may contain or for any omissions or otherwise or for any loss, howsoever caused or sustained, by the person who relies on it.