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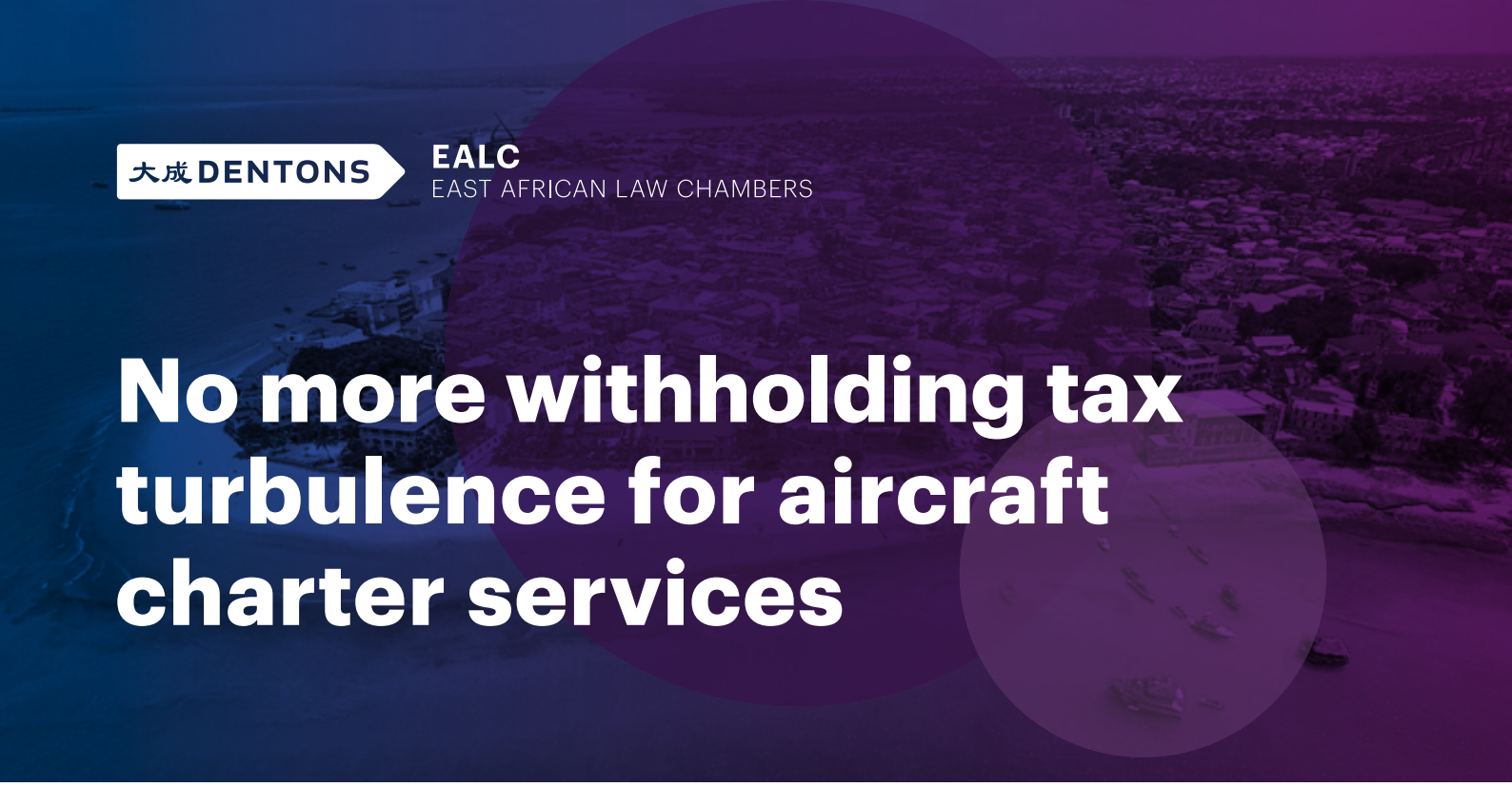


# No more withholding tax turbulence for aircraft charter services

For the withholding tax mechanism to apply in Tanzania, following boxes have to be ticked: there must be income derived from a source that is subject to income tax as provided for in the income tax legislation (i.e. income from royalty, rental, lease, service fees, interest, dividend etc); the income must be sourced from Tanzania; and, there must be payment being made to recipient of that income from a resident person who become an involuntary tax agent for the Commissioner under the withholding tax mechanism. The resident person is required to withholding the appropriate amount of the tax from the payment that he is making in relation to royalty, rental, lease, service fees, interest, dividend etc. and account for that tax to the Commissioner.

The tax that is withheld and accounted for to the Commissioner under the withholding tax regime is not the tax of the tax agent who is required to operate the withholding mechanism; the tax that is withheld is part the recipient of tax which is accounted for at source by the tax agent. Under section 87 of the income tax legislation, that recipient |is allowed to treat that tax which has been accounted for the Commissioner as his tax credit and can offset it against his future income tax liability. It therefore means that if the withholding tax agent does not operate the withholding tax mechanism, the recipient has to account for tax on his income without the benefit of a tax credit.

In law, it is often argued that as long as words and phares are used to communicate intention, there will always be varied interpretation; different people reading a set of words will probably interpret these differently and probably arrive at different meanings. Perhaps no where is this more evident than when it comes to tax statutes where on the one hand you have the tax authority seeking to interpret a set of words in a manner that suits revenue collection and taxpayers on the other hand who have a different interpretation. We should point out that this does not happen all the time, it often occurs for example where words used by the draftsman in a statute lend themselves to varied interpretation, where a certain word or phrase that has been used has acquired generic meaning or is unique to a certain industry or in most instances where the law has yet to catch up with the commercial reality. All these, and perhaps many more instances, often result in polar opposite interpretations depending on one's intentions.

Under the withholding tax regime at the moment, the contentious issues that have arisen between the Commissioner and taxpayers have revolved around the four elements described above; (i) where something falls within what is subject to withholding tax under the as provided for in the income tax legislation; (ii) whether the income in relation to what is being paid for is sourced from Tanzania (where there is a plethora of case law and emerging jurisprudence discussing this); (iii) whether there payment has been effected; and, (iv) what punish should befall a statutory agent who has not operated the mechanism.

## Relevant legislation provisions

Section 82(1) and 82(2)(d) of the Income Tax Act Cap 332 requires a person who rents an aircraft to withhold 10% from the payments that they make to the person from whom they are renting the aircraft and remit the amount withheld to the Commissioner through the withholding tax mechanism. The Act define the word '**rent**' as

"...any payment made by the lessee under a lease of a tangible asset including any premium and any other payment for the granting of the lease but excludes a natural resource payment and a royalty" which brings the word 'rent' into the context of a lease. The Act then defines a 'lease' as "... an arrangement providing a person with a temporary right in respect of an asset of another person, other than money, and includes a licence, profit-a-pendre, option, rental agreement, royalty agreement and tenancy".

When considered together therefore, it means that for section 82(1) and 82(2)(d) to apply, there must be a rental/lease arrangement in place. The nature of the rental/lease arrangement that is envisaged based on the definition above entails the transfer of an aircraft without transferring its title and by its nature grants the lessee control of the aircraft. The aircraft owner (the lessor) retains the legal tittle but the possession and control transfers to the lessee (often a licensed operator) for a determined period of time. The transaction between the aircraft owner and the person taking possession of the aircraft is a leasing arrangement whereby that lessee (i.e. the licensed operator) is able to make use of the entire aircraft for commercial purposes and makes periodic lease payments to the lessor.

Once the lessee has possession of the aircraft, he may use it for commercial purposes e.g. transportation of passengers or goods. The onward commercial transactions between the lessee (the person in possession of the aircraft) and paying passengers does not amount to renting/leasing; such transactions are in the form of either scheduled flights (commonly known as commercial flights) and non-scheduled flights (commonly known as chartered flights). The difference between commercial flights and the chartered flights is the flexibility in determining the departure time of the aircraft and the destination at in certain cases.

## *Safari Plus Ltd* versus *Commissionner General*[1]

Safari Plus Ltd, a licensed operator found itself facing a withholding tax assessment from the Tanzania Revenue Authority. The company owned and operated different capacity aircraft which it uses to transport passengers to different locations within Tanzania, mostly within game parks. The passengers that use the Safari Plus Ltd's air transportation services would often pay for the services as part of an all-inclusive end-to-end safari or vacation package that often includes air transportation, hotel accommodation, game drives etc. Where the number of passengers seeking air transportation services exceeds the Safari Plus Ltd's aircraft capacity or where the Safari Plus Ltd's aircraft are grounded (while being serviced or being repaired), Safari Plus Ltd would reserve and pay for seats for the excess passengers from other air transportation operators flying to the destination where the Safari Plus Ltd would ordinarily fly. The seats reserved and paid for depend on the number of passengers who have exceeded the Safari Plus Ltd's aircraft capacity at the given time, if Safari Plus Ltd does not have excess passengers it does not reserve any seats. The number of seats reserved could range from a single seat for one passenger or he could reserve and pay for the entire capacity of the available aircraft; it depends on the number of excess passengers at the time.

## Arguments by the parties

At the Tax Board, the Commissioner argued that charter services fell within the scope of section 82(1) and 82(2)(d) since Safari Plus Ltd was renting/leasing aircraft and therefore should have withheld and accounted for 10% withhold tax from the payments that it made in relation to these. The Commissioner argued that the reservation of seats amounted to rental or leasing of an aircraft.

On the other hand, Safari Plus Ltd argued that at all material times the chartered aircraft remained under the possession and control of the third-party licensed

1 Tax Revenue Appeals Board at Dar es Salaam, Consolidated Income Tax Appeals No. 321 and 322 of 2019 (unreported)

air transportation services provider from whom Safari Plus Ltd had reserved the seats for his vacationing passengers. At time of boarding and during the flight, the excess passengers were treated just like any passengers on their aircraft by that service provider. However, these service providers would invoice Safari Plus Ltd for seats reserved and refer to these as 'charter services', a term used in the airline industry for such services, on their invoices. The company argued that 'charter services' were not a rental or lease and therefore used the ambit of section 82(1) and 82(2)(d) which meant that the company was obliged to withholding any tax on the payments that it made to the third-party licensed operators for the charter services.

## The Tax Board's decision

In its judgement, the Tax Board held that section 82(2)(d) seeks to capture the rental of aircraft for withholding tax purposes. The rights that would accrue to a lessee under a lease arrangement – i.e. possession and control of the leased aircraft – did not accrue to Safari Plus Ltd in this instance since the company was only paying for available seats on a-need-basis. The Tax Board in deciding in favour of Safari Plus Ltd stated that:

"...in this Appeal neither party submitted any lease agreement for the renting of aircraft, at no stage the [Commissioner] provided evidence that an agreement for leasing or renting of aircraft existed between [Safari Plus Ltd] and the resident owner of the aircraft which carried the passengers of [Safari Plus Ltd], nor did [Safari Plus Ltd] anywhere admit that [he] was hiring or renting or leasing aircraft from another resident entity. We noted that the determination of the 'rentals' by the [Commissioner] was on the basis of the use of the words "charter" on the invoices issued by the air transportation company which facilitated transportation of the excess passengers of [Safari Plus Ltd] from time to time. Nowhere has the [Commissioner] stated that the invoices clearly referred to payment of rentals or leasing charges or any other periodic payments for use of aircraft".

From this statement one can infer that had the Commissioner adduce a lease agreement perhaps the Tax Board would have arrived a different decision.

In addition, in what perhaps can be construed as obiter dictum, the Tax Board seemed to suggest the Commissioner should have established if there indeed is a tax liability in the context of withholding tax where two resident persons are involved before raising the assessments. In indicating that alleged tax liability was not due, the Tax Board said that:

"We are of the opinion that the tax auditors could have easily determined if there was any tax evasion by reference to the gross income earned and tax returns filed by the aircraft owners which carried passengers of [Safari Plus Ltd]. Did the [Commissioner] lose any tax revenue by the aircraft owners reporting full (untaxed) gross income on their tax returns? As per the submissions of the [Commissioner], there were only two suppliers to [Safari Plus Ltd]....both resident entities. So, if the other resident entities paid full tax due on their invoices, is the [Commissioner] trying to tax the same base again? In the circumstances we are of a settled view that the first and second issues are answered in the negative."

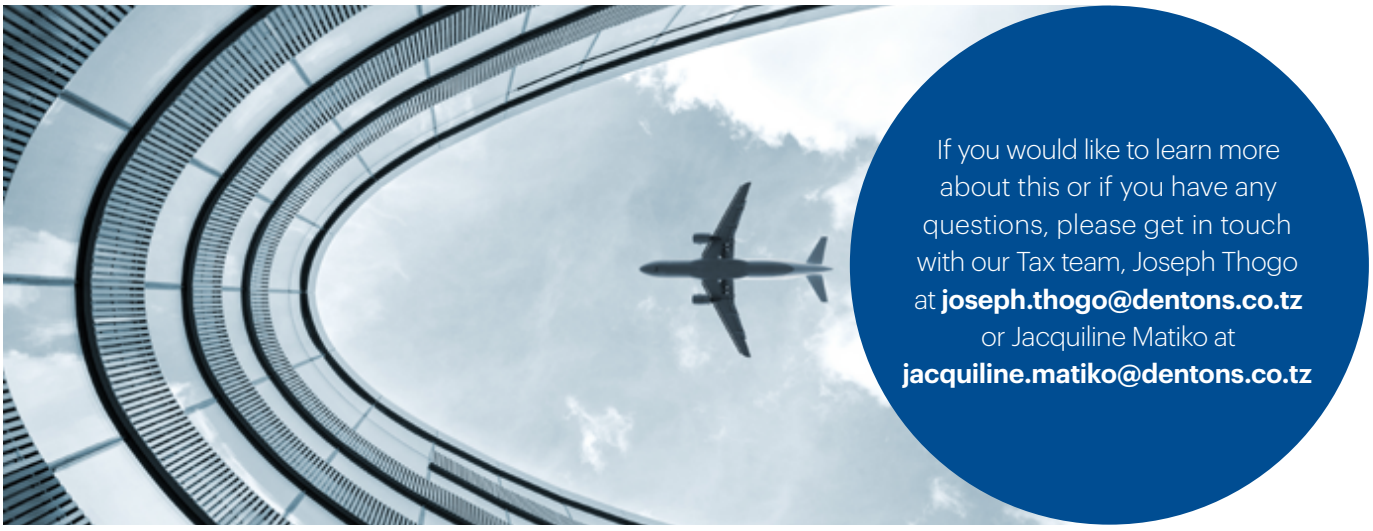
This position by the Tax Board stems from the essence of the withholding tax mechanism – a form of collecting income tax through a person who is deemed a statutory tax agent on behalf of the Commissioner due to the nature of services that he is has procured, and which he is paying for. The tax that is withheld and accounted for to the Commissioner by the statutory tax agent becomes a tax credit in the hands of the person who is receiving the payment and he allowed to offset the credit against his income tax liability. Therefore, if the statutory agent did not withhold the tax, his punishment should be limited to an administrative failure to operate the withholding tax mechanism since the tax that he should have withheld was accounted for by the recipient of the income at the point in time when he accounts for his income and tax thereon to the Commissioner. Collecting the tax from the recipient of the income (who in this case will not have a tax credit) and at the same time issuing an assessment for the same tax against the statutory agent who failed to follow the withholding tax mechanism amount to double taxation of the same income especially where it relates to resident persons.

Lastly, the Tax Board went to say that for there to be a rental/lease and therefore withholding tax, there needs to be an agreement which gives the person making the rental/lease payments rights and control over the possession and physical control of the actual aircraft. The Board held that charter services arrangement did not give Safari Plus Ltd possession and control that would have accrued under a typical lease agreement; having control over the departure time in the case of a charter flight does not amount to possession and control.

## Our view

The decision of the Tax Board in this case is commendable especially since the Board was able to draw a line between business-to-business transactions (assuming Safari Plus Ltd, as a lessee, had leased aircraft from lessor in order to operate the same under a lease agreement) and business-to-customer transactions which can adopt various forms depending on the customers' needs. Therefore, those who charter aircraft should breathe a sigh of relief.

What is perhaps interesting is the Board's foray into question of double taxation which arises where a tax agent has failed to operate the withholding tax mechanism. Since the recipient of the income would have accounted for tax on his income, the question that often arises is whether the tax agent should be penalised for his failure to operate the mechanism and perhaps be required to pay interest for the period of time during which Caesar was denied what is due to him through the failure to remit the tax to him? This would be the period between which the tax agent was meant to have withheld tax and point in time when the recipient of the income accounted for tax on the same income. Or whether, the tax agent should also be penalised for the tax which the recipient of the income would have accounted for thereby resulted in double taxation. To be fair, we should point out that despite the obvious double taxation the current income tax legislation does allow a tax agent who has been assessed to claim the tax assessed as a result of the failure to account for withholding tax from the recipient of the income.



If you would like to learn more about this or if you have any questions, please get in touch with our Tax team, Joseph Thogo at **joseph.thogo@dentons.co.tz** or Jacquiline Matiko at **jacquiline.matiko@dentons.co.tz**

 CSBrochure-57938-Tax & Legal article for Tanzania - No more withholding tax turbulence for aircraft charter services-02 — 13/05/2021