

To gross up or not to gross up?

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After the Court of Appeal's decision in ***PanAfrican Energy Tanzania Ltd v. Commissioner General, Tanzania Revenue Authority***, Civil Appeal No. 81 of 2019 (unreported) in March 2020, there emerged the argument that grossing-up for tax purposes is illegal in Tanzania. Soon after, a good number of people, with this understanding in mind, prepared different synopses arguing that grossing up for tax had been declared illegal in Tanzania. Given commercial reality and the changes in law that took place in 2018, could it be in their enthusiasm to be first-off-the-press that they misconstrued the Court's decision? Or could it be that their choice of words paints a misleading picture?

Grossing-up

Grossing up arises where someone opts to shoulder someone else's tax burden, which is common in a withholding tax scenario. For example, in an employment scenario where an employee is to be remunerated a certain gross amount (for instance, TShs 10 million), the employer is required to compute and determine all the deductions that are due from this amount and afterwards remit the amounts to the appropriate statutory bodies – pension to NSSF, the tax element to the Commissioner etc. After factoring in all these deductions, the employee will end up with about TShs 6 million in his bank account as his net salary.

However, if the TShs 10 million is a net amount, it means that the employee expects TShs 10 million in his bank account after all the deductions. This, therefore, requires the employer to gross up the TShs 10 million in order to determine the gross salary amount so that, after he has computed and accounted for the

different statutory deductions, the employee ends up with TShs 10 million in his bank account. Such an arrangement means that, instead of taxing the employee, the employer has instead acquiesced to paying the employee's tax burden and as a result increased his expenses by the gross-up amount that he need not have incurred in the first place. This is exactly what happened in the ***PanAfrican Energy grossing up case***, where the Commissioner raised an assessment alleging that the company had failed in its role as a withholding tax agent for the payroll taxes arising from its employees' employment income. The Commissioner argued that, in an employment scenario, the tax due should be borne by the employee and not the employer; the role of the employer is to deduct and account for the same to the Commissioner. The dispute found its way to the Court of Appeal which after considering the issue agreed with the position that had been advanced by the Commissioner – that just because someone acquiesced to shoulder your tax burden in a gross up scenario, it does not mean that your tax burden has been discharged.

Legislative changes

The decision to gross up is purely a commercial one and tax courts around the world have restrained themselves from interfering with how those in business conduct their affairs. The changes that were introduced in July 2017 to the income tax legislation in relation to grossing up support this position. In a nutshell, the law acknowledges that there can be grossing up but, where this happens, the law imposes tax on those acquiescing to shoulder others' tax burden.

After the change in 2017, since the employer is paying the employee's income tax in our net contract employment scenario above, then the employee is construed to have received a taxable benefit that is equal to 330% of the tax paid. At the same time, the employer will not be allowed a deduction of the tax paid on behalf of the employee. The same applies in a typical withholding tax on services arrangement, where the withholding tax agent who agrees to shoulder the tax burden of a withholder is not allowed a deduction in the tax that he paid on behalf of his service provider to whom he was making the payment. Therefore, given that the legislation does recognise grossing up and provides for how it should be treated for tax purposes, it would be somewhat misleading to argue that grossing up is not allowed in Tanzania.

I suspect that the confusion as to whether grossing up is allowed in Tanzania arose where the Court of Appeal in the **PanAfrican Energy grossing up case** pointed out that, though the practice is carried out and accepted in other countries whereby someone shoulders another person's tax burden and thereby extinguishes that other person's income tax liability, the same was not provided for in Tanzania. From the 2017 changes, the law accepts that grossing-up is driven by a business's needs and those acquiescing to such an arrangement ought to be aware of the consequences that follow.

Review of contracts

In addition to ensuring that gross or net contracts are reviewed from a tax perspective, it is important to also toss in numbers from the envisaged transaction, to consider the documentation that will be used to evidence the transaction, and to consider the consequences that would then follow for tax purposes. The consequences of grossing up means that entities ought to review their existing contracts to gauge where they stand. If they have gross contracts, then they are potentially home and dry, and need not worry. However, if they have net contracts, then they need to be aware that, for employment-type contracts, the employee has an additional benefit which needs to be taxed for personal income tax purposes. If in the context of a withholding tax on services arrangement, the person acquiescing to shoulder another's tax burden needs to be aware that they will be required to pay 30% income tax on that amount.

If you have any questions regarding this or if you would like to get in touch, please contact **Joseph Thogo** or your usual contact person at Dentons EALC.



Joseph Thogo
Dar es Salaam
joseph.thogo@dentons.co.tz