IN THE COURT OF APPEAL OF TANZANIA
AT DAR ES SALAAM

(CORAM: MUSSA, J. A., MWAMBEGELE, J. A. And LEVIRA, J. A.)

CIVIL APPEAL NO. 168 OF 2018

NATIONAL MICROFINANCE BANK LIMITED ..... APPELLANT

VERSUS

COMMISSIONER GENERAL,
TANZANIA REVENUE AUTHORITY .....RESPONDENT

(Appeal from the Judgment and Decree of the Tax Revenue Appeals Tribunal at Dar es Salaam.)

(Twaib, J.)

dated the 20th day of February, 2012
in
Tax Appeal No. 7 of 2011
.....

JUDGMENT OF THE COURT

3rd June & 1st July, 2019

MUSSA, J.A.:

The appellant is a licensed Bank with a wide network operating through 133 branches in the country. Of recent, the Bank has gone through major restructuring programmes including the automation of its banking systems which entailed the purchase of various items of computer software as well as technical support services. To facilitate the undertakings, on the 30th April, 2003 the appellant entered into an

agreement with a foreign company, namely, Neptune Software PLC of Carolyin House, 22 – 26 Dingwall Road, Croydon, surrey, United Kingdom. In the agreement which was titled "**Software Licence Agreement**" (the SLA), the Foreign Company (the licensor) and the appellant (the licensee), respectively, agreed to supply and obtain the use of a modern banking software under the agreed terms and conditions contained in the SLA. The provisions relating to payments were spelt out in the SLA – extension agreement which was dated the 13th day of April, 2006. According to it, the licensee agreed to pay the licensor investment costs amounting to USD 165,117.00 on signing of the extension agreement. Thereafter, the licensee agreed to pay the licensor a lumpsum annual licence fee equal to USD 29,716.20. There is little doubt that the prescribed payments were made by the licensee to the licensor in consideration of the SLA.

In the year 2009, through its large taxpayer's department, the respondent conducted an audit of the appellant's affairs covering corporate tax withholding tax, VAT, employment taxes and stamp duty for the period from 2004 to 2007. Consequently, on the 12th October, 2009 the respondent issued a preliminary audit findings report which stated, *inter alia,* that the appellant made several payments to non-resident persons for

licence fees in respect of software and related IT services for which she (appellant) was obliged to deduct the appropriate non-resident withholding tax rate as required by section 83 (1) (b) of the Income Tax Act, 2004 (the ITA, 2004).

Upon receipt of the preliminary audit report, on the 13th October, 2009 the appellant wrote the respondent disputing the claim that payments for the acquired software and related services were subject to withholding tax. On the 22nd December, 2009 a meeting was held between the representatives of both parties in which the disputed audit report was featured. In the final event, on the 1st June, 2010 the respondent issued to the appellant a withholding tax certificate showing that the appellant's tax liability was to the tune of Tshs. 680,042,401/= which was comprised of Tshs. 411,876,562/= being the principal tax and Tshs. 268,165,839/= being interest on the principal tax.

Dissatisfied, the appellant lodged a statement of appeal in the Tax Revenue Appeals Board (the Board) which instituted the Income Tax Appeal case No. 32 of 2010. At the hearing before the Board, the thrust of the appellant's argument was that the payments she made in relation to the software do not represent a royalty and, thus, the same were not

subject to withholding tax. A further argument was taken to the effect that the appellant's payments in relation to IT services were not a service fee subject to withholding tax, the more so as the services were performed outside Tanzania.

On the other hand, it was the contention of the respondent that the right granted by the licensor to the appellant for the use of the software was a temporary one and, thereby, the payments made to acquire it constituted a royalty within the meaning of the term as defined by section 3 of the ITA, 2004. As regards the IT support and maintenance services, the respondent countered that the same were not entirely rendered outside Tanzania and, hence, they were subject to withholding tax.

Upon its deliberations, the Board made a unanimous finding that the lumpsum payment made by the appellants to the licensor did not constitute a royalty and, as such, the same was not subject to withholding tax. On the issue as to whether or not the payment in relation to IT services were subject to withholding tax, the Board, again, unanimously found that the services were not performed in Tanzania be it wholly or partly and, as such, the payment could not attract withholding tax. In the upshot, in a judgment that was handed down on the 17th February, 2011 the appellants

appeal was allowed with an order that each party should bear her own costs.

The respondent was discontented, whereupon she instituted an Income Tax Appeal No. 7 of 2011 in the Tax Revenue Appeals Tribunal (the Tribunal). At the Tribunal, the respondent herein (the appellant there) lodged two grounds of appeal, namely that:-

> *"(a) the Tax Revenue Appeals Board erred in law and in fact by holding that the lumpsum payment made by the Respondent (licensee) to the licensor is not a royalty under section 83 (1) of the Income Tax Act, 2004 and is, therefore, not subject to withholding tax; and*
>
> *(b) the Tax Revenue Appeals Board erred in law and in fact by holding that the service fees paid by the Respondent relating to the installation, testing and maintenance of the supplied software are not subject to withholding tax."*

At the height of its deliberations, the Tribunal took the following position:-

> *"...it is the Tribunal's respectful view that the Agreement between the Respondent and Neptune Software PLC was a lease agreement; that the payment made pursuant thereto was a royalty; that the services rendered to the Respondent by the suppliers irrespective of their location were performed on an asset in Tanzania and that the said payment have a source in Tanzania."*

Consequently, the tribunal allowed the respondent's appeal and, in fine, the decision of the Board was overturned.

Dissatisfied, the appellant presently seeks to impugn the decision of the Tribunal upon a memorandum of appeal which is comprised of four points of grievance, namely:-

> *"(i) That the Tax Revenue Appeals Tribunal erred in law when it held that the Agreement between the*

Appellant and Neptune Software PLC was a lease agreement;

(ii) That the Tax Revenue Appeals Tribunal erred in law and fact when it held that payment made pursuant to the Agreement between the Appellant and Neptune Software PLC was a royalty;

(iii) That the Tax Revenue Appeals Tribunal erred in law in holding that payments for services performed outside Tanzania in relation to the software agreement between the Appellant and Neptune Software PLC are payments which are sourced from Tanzania irrespective of the place where the services were performed; and

(iv) That the Tax Appeals Tribunal erred in upholding the respondent's appeal and setting aside the judgment of the Tax Revenue Appeals Board."

When the appeal was placed before us for hearing, the appellant was represented by Dr. Kibuta Ong'wamuhana and Mr. Wilson Mukebezi, both

learned Advocates, whereas the respondent had the services of Mrs. Joyce Sojo, also learned Advocate.

Dr. Kibuta who took the floor to argue the appeal, fully adopted the appellant's written submissions as well as the memorandum of appeal which he highlighted in his oral submissions. From the memorandum of appeal, Dr. Kibuta formulated three issues for our determination; **first**, whether or not the Tribunal correctly held that the agreement between Neptune and the appellant was a lease; **second**, whether or not the payment in consideration of the agreement was a royalty subject to withholding tax; and **third**, whether or not the service fees paid by the appellant are subject to withholding tax.

To begin with, Dr. Kibuta submitted that the first two issues are intertwined and he, thus, proposed to advance a single argument in their support. In that regard, it was his respectful contention that the agreement between the appellant and Neptune did not constitute a lease. The terms of the agreement, he said, are categorically clear in that the same was a purchase agreement. The learned counsel for the appellant contended that the recitals in the agreement clearly state the intention of the parties being to **purchase/acquire** the software from Neptune which

words leave no speculation that the transaction was not a lease. In her written submissions, the appellant contended that a lease evisages a cenario where a person uses an asset belonging to another person or a licence to use it temporarily. On the contrary, she further submitted, clause 29 of the SLA makes provision to the effect that *"the agreement shall continue until terminated in accordance with the provisions of the agreement"*. To that extent, she concluded, there was continuity and permanence in the terms of the agreement. The appellant's payments, she added, represented the purchase price of the software which is a copyrighted article and, for that matter, such payments did not constitute a royalty.

To bolster her submissions, in this regard, the appellant referred the Court to several Indian decision which are apparently unreported – viz – Civil Appeal No. 2582 of 1998 – **Tata Consultancy Services vs The State of Andra Pradesh**; **Motorola Inc. Ersson Radio vs Deputy C. I. T**; **Velankani Mauritius Ltd vs Assessee**; and **M/s Infrasoft Limited India Branch vs Assistant Director of Income Tax.**

As regards the third issue, Dr. Kibuta submitted that the services fee paid by the appellant to non-residents for services performed outside

Tanzania has no source in Tanzania hence not subject to withholding tax. The dispute in point, he said, is not new. In the unreported Civil Appeal No. 146 of 2015 – **Commissioner General (TRA) vs Pan African Energy (T) Ltd** the Court made the following observation:-

> *"The appellant (TRA) agrees that he services were not rendered in Tanzania but says the services were rendered in connection to samples drilled from Tanzania and payment made in Tanzania. That is actually what took place but, with respect to the learned advocates for the appellant, we do not think that they have grasped the real meaning of section 69 (i) (i) of the Income Tax Act. The section is clear that income tax is chargeable for service fee received for services rendered in Tanzania. What is stressed in the section is that the services must be rendered in Tanzania."*

In the upshot, the Court concluded that the payment for the services were not chargeable to withholding tax. Dr. Kibuta was of the firm view

that the decision in the **Pan African Energy** case (supra) was a correct exposition of the law. He was aware, however, that the Court decided differently in the unreported Civil Appeal No. 24 of 2018 – **Tullow Tanzania BV vs The Commissioner General (TRA)**. In her written submissions, the appellant firmly contends that the **Tullow** case (supra) was erroneously decided and, accordingly, she invited us to depart from it and, in lieu thereof, we should uphold the **Pan African Energy** (supra) decision. In sum, Dr. Kibuta urged us to allow the appeal with costs.

In reply, Mrs. Sojo, similarly, fully adopted the respondent's written submission which were, incidentally, of her own making. To resist the appeal, the learned counsel for the respondent commenced her submissions with the contention that the appellant did not purchase the software from Neptune but, rather, she made payments to secure the use of the same. To that extent, Mrs. Sojo reaffirmed the Tribunal's finding to the effect that the transaction between the appellant and Neptune constituted a lease agreement and that the payments made in consideration thereof was a royalty to which withholding tax is chargeable.

To buttress her contention, the learned counsel for the respondent sought to cull from the preamble of the SLA itself. It is provided therein, she said, that *"the licensee is desirous of acquiring and being licensed to use an integrated software..."* and that the *"licensee has agreed to buy from the licensor the right to use the software..."* Additionally, she further submitted, the agreement is titled "**SOFTWARE LICENCE AGREEMENT**" to depict its true nature as a mere licence to use the licensor's software as distinguished from a purchase agreement. To that end, the learned counsel for the respondent reiterated her contention that the transaction between the appellant and Neptune was a lease just as her payments in consideration thereof constituted a royalty.

As regards the service fee, Mrs. Sojo painstakingly faulted the appellant for repeatedly insisting that they did not withhold tax because the services at issue were "*performed*" outside the United Republic. The learned counsel for the respondent took strong exception to the appellant's use of the word *"performed"* since performance, as such, is not a determinant factor. She referred to section 69 (i) (i) of the ITA 2004 which provides:-

(i) Payment including service fee of any type not mentioned in paragraph (g) or (h) or attributable to employment exercised, service rendered or forbearance from exercising employment or rendering services-

(ii) In the United Republic regardless of place of payment; or ..."

Mrs. Sojo then submitted that the catch words are: "*Services rendered*" as distinguished from "*services performed*". Drawing from the foregoing, in her written submissions the learned counsel for the respondent concluded thus:-

> *"We strongly reiterate and insist that the question of whether the services were performed inside or outside Tanzania is completely immaterial when in consideration (sic) of its taxability through withholding tax, and the only criteria to look into, is to see if the said services were rendered meaning if were delivered or transmitted in Tanzania and that was precisely the intention of the legislature."*

In sum, the learned counsel for the respondent urged us to dismiss the appeal with costs.

Having heard the learned rival submissions, we agree with Dr. Kibuta that this appeal involves three issues worth our consideration and determination. The learned counsel for the appellant consolidated the first two issues and, in our determination, we propose to do the same. In determining the first two issues we deem it instructive, as a starting point, to be clear of the terms "lease" and "royalty" as used in the ITA, 2004. Under section 3 of the ITA, 2004 the term lease is defined to mean:-

> *"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 – prendre, option, rental agreement, royalty agreement and tenancy."*

Under the same provision the term royalty is defined to mean:-

"Royalty" means any payment made by the lessee under a lease of an intangible asset and includes payments for –

a) the use of, or the right to use, a copyright, patent, design, mode, plan, secret formula or process or trademark;

b) the supply of know-how including information concerning industrial, commercial or scientific equipment or experience;

c) the use of, or right to use, a cinematography film, videotape, sound recording or any other like medium;

d) the use of, or right to use, industrial, commercial or scientific equipment;

e) the supply of assistance ancillary to a matter referred to in paragraphs (a) to (d); or

f) *a total or partial forbearance with respect to a matter referred to in paragraphs (a) to (e)."*

We think it is also pertinent for us to just as well reproduce sections 6 (1) (b), 69 (i) (i) and 83 (1) (b) of the ITA 2004. For a start, section 6 (1) (b) stipulates:-

> *"6 (1) Subject to the provisions of subsection (2), the chargeable income of a person for a year of income from any employment, business or investment shall be:-*

(a) .....N/A

(b) In the case of a non-resident person, the persons income from the employment' business or investment for the year of the income, but only to the extent that the income has a source in the United Republic."

For its part, section 69 (i) (i) goes as follows:-

"69. The following payments have a source in the United Republic:-

(a) .....N/A

(b) .....N/A

(c) .....N/A

(d) .....N/A

(e) .....N/A

(f) .....N/A

(g) .....N/A

(h) .....N/A

(i) Payments, including service fees, of a type not mentioned in paragraphs (g) or (h) or attributable to employment

exercised, services rendered or for bearance from exercising employment or rendering service-

(i) in the United Republic, regardless of the place of payment; or..."

And, section 83 (1) (b) provides thus:-

"83 (1) Subject to subsection (2) a resident person who-

(a) .....N/A

(b) Pays a service fee or an insurance premium with a source in the United Republic to a non-resident person shall withhold income tax from the payment at the rate provided for in paragraph 4 (c) of the First Schedule."

In our consideration and determination of the issues involved in this appeal, we shall throughout have in mind the foregoing extracted provisions.

As we have already intimated, the first two issues seek to fault the Tribunal for holding that the agreement between Neptune and the appellant was a lease and that the same constituted a royalty. In our

endeavour to resolve the issue of contention, we take the position that, of all the terms of the SLA, the most telling is the one comprised in article 2.0 which went thus:-

> *"2.0* ***License***
>
> *2.1 The licensor hereby licenses, grants and authorizes the licensee at all times during the continuance of this licence and so long as the software continues to exist and function to the satisfaction of the licensee and, subject to the terms and conditions hereinafter appearing, a non-exclusive and non-transferrable right to use the following software for its internal use only:-*
>
> ***Description of software: Those elements of the Equinox solution as defined in Schedule One hereto."***

For her part the appellant (licensee) acknowledged as follows in article 2.2:-

"2.2 The licensee hereby accepts to be licensed under the terms and conditions set forth herein the right to use on a non-exclusive and non-transferrable basis the software for its own internal use only."

To us, it is clearly discernible from the foregoing article of the SLA that what was transferred to the appellants is only a licence to use the software which was to be supplied by Neptune under certain terms and conditions. To that extent, on a proper construction, we do not entertain a flicker of doubt that the SLA constituted a lease within the definition of the term under section 3 of the ITA, 2004. Likewise, we are just as well fully satisfied that the payment of the licence fees was a consideration for the right to use software which is within the definition of a "royalty" under clause (a) of its definition under section 3 of the ITA, 2004.

Thus, all said, with respect to the first two issues, we find ourselves unable to accede to the appellant's contention that the SLA constituted a purchase agreement and not a lease just as we do not accept her further contention that the payments in consideration thereof did not constitute a

royalty. We, accordingly, uphold the decision of the Tribunal with respect to the nature of the SLA.

Coming to the third issue, the point of contention is, whether or not the service fees paid by the appellant to Neptune were subject to withholding tax. As we have already intimated, the appellant thinks not, her argument being that since the service were not performed in Tanzania as required by section 69 (i) (i), then the payment had no source in Tanzania and, therefore, withholding tax is not chargeable. As we have, again, also intimated, from the adversary's end, the respondent faulted the appellant for using the word "performed" with respect to the services rendered and, in the upshot, she submitted that he question whether the services were rendered inside or outside Tanzania is completely immaterial.

On our part, we entirely subscribed to what the Court set as conditionalities of subjecting payments to withholding tax in the case of **Tullow** (supra) wherein the Court observed:-

> *"Reading sections 6 (1), 69 (i) (i) and 83 (1) (b), all together gives two conditions a payment to a non-resident to be subjected to withholding tax. These*

are: (1) the services of which the payment is made must be rendered in the United Republic of Tanzania, and (2) the payment should have a source in the United Republic of Tanzania."

Further down in its judgment, the Court also observed:-

"It is our strong view that the word rendered used under section 69 (i) (i) is synonymous to words "supplied" or "devivered". In this regard a non-resident who provides services to a resident, has delivered/supplied services to a resident of the United Republic of Tanzania. The recipient of the service is actually the payer for such services, in which case, "source of payment" cannot be any other place except where the payer resides. In other words, as the services of which the payments were made, were consumed or utilized by the appellant in the United Republic of Tanzania for the purposes of earning income in the United Republic,

then payments made for such services had a source in the United Republic of Tanzania and the respondent had to withhold tax under section 83 (1) (c) of the Act."

In arriving at the foregoing conclusion, their lordships were well aware of the **Pan African Energy case** (supra) but distinguished it in the following words:-

"While the indian Act talks of the source of income, on the other hand section 69 (i) (ı) talks of source of payment. The case of Pan African Energy (supra) is therefore distinguishable as it relied on the interpretation of section 9 (1) (vii) (c) of the Indian Income Tax Act to arrive at its finding that the said provision, as it was, was in parimateria with section 69 (i) (i) of the Act."

We just as well subscribe to the reasoning of the Court in distinguishing from it the case of **Pan African Energy** (supra). That being the position, we find no cause to embrace the appellants invitation to

us to depart from the decision in **Tullow**. We note that, of recent, a corresponding stance was adopted by the Court in the unreported Civil Appeal No. 123 of 2018 – **Shell Deep Water Tanzania BV. V. Commissioner General (TRA).**

In view of the aforesaid, we similarly uphold the decision of the Tribunal with respect to the service fees and, in the final event, we find the appeal to be bereft of merits and we, accordingly, dismiss it with costs.

DATED at **DAR ES SALAAM** this 25th day of June, 2019.

K. M. MUSSA
JUSTICE OF APPEAL

J. C. M. MWAMBEGELE
JUSTICE OF APPEAL

M. C. LEVIRA
JUSTICE OF APPEAL

I certify that this is a true copy of the original.

S. J. KAINDA
DEPUTY REGISTRAR
COURT OF APPEAL