IN THE COURT OF APPEAL OF TANZANIA

AT DAR ES SALAAM

(CORAM: LILA, J.A., MASHAKA, J.A. And KIHWELO, J.A.)

CIVIL APPEAL NO. 456 OF 2021

AGGREKO INTERNATIONAL PROJECTS 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)

(Kamuzora, Vice Chairperson)

dated the 28th day of September, 2021
in
Tax Appeal No. 35 of 2020

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JUDGMENT OF THE COURT

31st May & 7th September, 2023

KIHWELO, J.A.:

This appeal arose from the decision of the Tax Revenue Appeals Tribunal (the Tribunal) dated 28.09.2021 in Tax Appeal No. 35 of 2020 which upheld the decision of the Tax Revenue Appeals Board (the Board) that found the Commissioner General (the respondent) was justified in imposing the assessed taxes. Disgruntled by the impugned decision the appellant has approached this Court by way of an appeal.

The abridged background facts which led to this appeal may be appropriately described as follows; The appellant is a limited liability company incorporated under the laws of Tanzania as a branch of Aggreko International Projects Limited (AIPL), a company registered in and resident in the United Kingdom with a regional hub in Jebel Ali, Dubai. Its principal business is generation of emergence power (electricity) and its main customer in Tanzania is Tanzania National Electricity Supply Company (TANESCO).

Central to the appeal before us is the dispute whose genesis is the comprehensive tax audit exercise into the tax affairs of the appellant for the years of income 2011-2012 which covered various taxes including corporate tax. Essentially, the respondent found out that, the appellant disallowed management costs attributed to the appellant's regional hub in Dubai and also the appellant claimed full year wear and tear allowance on assets which were used for less than twelve months.

Conversely, the appellant responded by indicating how head office costs are allocated to the appellant relying on head office allocation of transfer pricing, while indicating that depreciation costs are claimed in relation to the number of days in one's year of income, according to the Income Tax Act, Cap. 332 (the Act). On 30.06.2015 the respondent issued a notice of adjusted assessment of corporate income tax for the years of income 2011-2012 which was subsequently objected to by the appellant on 29.07.2015 in terms of section 12 (1) and (4) of the Tax Revenue Appeals Act, Cap. 408 R.E. 2002 (the TRAA).

An attempt was made to settle the matter amicably whereby there were several exchange of correspondences between the appellant and the respondent as well as series of meetings which however, did not bear any fruits and finally, the respondent made final determination.

The appellant, unamused by the respondent's decision, knocked the door of the Tax Revenue Appeals Board (the Board) challenging it. Upon full determination, the Board in its findings unanimously found the appellant's appeal to be devoid of merit and therefore dismissed it. The Board further ordered the appellant to pay the assessed taxes in accordance with the law.

Aggrieved, the appellant lodged the appeal before the Tribunal seeking to reverse the decision of the Board. Upon hearing the parties, the Tribunal dismissed the appeal in its entirety which triggered the instant appeal before the Court.

The appellant presently seeks to impugn the decision of the Tribunal upon a Memorandum of Appeal which goes thus;

1. *The Tax Revenue Appeals Tribunal erred in law in holding that the Board correctly applied section 11 (2) of the Income Tax Act, 2004 in determining the correctness of allocation of head office costs to the Appellant;*
2. *The Tax Revenue Appeals Tribunal erred In law in failing to consider section 33 (1) of the Income Tax Act, 2004 and the OECD Transfer Pricing Guidelines 2010 in determining the correctness of the Respondent's decision to disallow head office costs;*
3. *The Tax Revenue Appeals Tribunal erred in law in misdirecting itself on the evidence on records and hold that the appellant failed to prove that the costs were actually incurred by the appellant;*
4. *The Tax Revenue Appeals Tribunal erred in law by wrongly interpreting section 17 (1) of the Income Tax Act, 2004 and paragraph 3 of the third schedule to the Income Tax Act, 2004 and hold that the respondent correctly computed capital allowance on depreciation; and*
5. *The Tax Revenue Appeals Tribunal erred in iaw in holding that the imposition of penalty and interest by the respondent was correct in law.*

When the matter was placed before us for hearing on 31.05.2023 the appellant enjoyed the services of Mr. Alan Nlawi Kileo who teamed up with Mr. Norbert Mwaifwani, both learned counsel whereas Ms.

Consolata Andrew, Principal State Attorney assisted by Mr. Hospis Maswanyia, Senior State Attorney stood for the respondent. Both parties lodged written submissions in compliance with rule 106 (1) and sub-rule (8) of the Tanzania Court of Appeal Rules, 2009, (the Rules) which they, respectively, fully adopted during the hearing, either in support or in opposition to the appeal.

Mr. Kileo prefaced his submission by arguing grounds 1, 2 and 3 conjointly then grounds 4 and 5 separately. We propose to consider the arguments later on in that order.

Arguing in support of the first set of grounds of appeal Mr. Kileo contended that, the Tribunal erred when it failed to consider section 33 (1) of the Act as well as the Organization for Economic Cooperation and Development (OECD) Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations, 2010 (the OECD Transfer Pricing Guidelines) in determining the correctness of the respondent's decision to disallow head office costs. The learned counsel further argued that, the Tribunal erred in holding that the Board correctly applied section 11 (2) of the Act. He further argued that the main challenge in this appeal is the findings of both the Board and the Tribunal that the dispute was on disallowance of head office costs incurred by AIPL in terms of section

11 (2) of the Act and not on transfer pricing under section 33 (1) of the Act. He also challenged the Tribunal for agreeing with the respondent that the allocation of costs by AIPL to the appellant was not at arm's length which was contradictory because the requirements of arm's length allocation of costs is applicable under section 33 (1) of the Act and not section 11 (2) of the Act and further to that, the cost plus method which the Tribunal applied as a basis of disallowance instead of the turnover method applied by the appellant is not indicated under section 11 (2) of the Act but rather is one of the transfer pricing method used to test arm's length pricing of transaction between associates in terms of paragraph 2.45 of the OECD Transfer Pricing Guidelines.

Mr. Kileo further argued at considerable length that, it was a misconception to consider that the allocation of costs did not meet the criteria under section 11 (2) of the Act while allocation of costs in a transaction between associates is specifically governed by section 33 (1) of the Act which has specific criteria to determine compliance with arm's length and that in an effort to prove compliance with section 33 (1) of the Act the appellant produced two studies exhibit A-3 which were conducted under the OECD Transfer Pricing Guidelines and came up with the findings that the head office costs charged to the appellant was at arm's length. Thus, in his view the appellant discharged its burden of proof while the respondent did not discharge its burden of proof and bearing in mind that the respondent did not conduct any transfer pricing study to show that services were not rendered. Reliance was placed in our earlier unreported decision in **Insignia Limited v. Commissioner General**, Civil Appeal No. 14 of 2007 for the proposition that a tax payer need only give an explanation which appears reasonable in all the circumstances to discharge the onus and the burden of proof at that point shifts to the tax authority which must satisfy the Court or Tribunal the justification for maintaining the assessment.

Advancing further his support for the appeal, the learned counsel contended that, the respondent did not dispute the fact that the appellant received services from AIPL and that is why the respondent imposed withholding tax on management fees and that the only challenge was how to identify or allocate services to a particular entity amongst the group shared services and in his view the respondent had a problem with transfer pricing methodology which was the basis of its decision and therefore, in his view, it was erroneous for the Tribunal to hold that the Board was right in upholding the respondent's decision on the ground that the appellant failed to provide evidence to prove that services were actually rendered while the basis for issuing the assessments by the respondent was not lack of evidence that AIPL actually provided services to the appellant.

He faulted the Tribunal for agreeing with the respondent that the basis of disallowance of the costs is that costs allocated to the appellant should have been charged on the cost-plus method and not the turnover method because there is no transfer pricing study or a benchmark study by the respondent to justify that claim and also because the direct method is not viable but rather a direct charging method such as the cost-plus method is the most viable according to the OECD Transfer Pricing Guidelines. He contended further that, even if it is to be assumed that the appropriate method to be used to allocate costs was the cost-plus method, still it does not justify total disallowance of costs as the respondent ought to have established the amount that it considers at arm's length using the cost-plus method as required under section 33 (1) of the Act. He thus, implored us to uphold the first set of grounds of appeal.

The appellant's counsel submitted in support of the fourth ground of appeal that, the appellant correctly calculated the capital allowance based on section 17 of the Act as well as paragraph 3 of the Third

Schedule to the Act. Elaborating, Mr. Kileo argued that according to the provisions above, capital allowance is calculated based on the number of days in a person's year of income and that in 2011 the appellant's year of income began in May and therefore, the assets were put to use from May to December, 2011 and throughout 2012 wholly and exclusively in the production of its income. He was of the view that, it was erroneous to calculate capital allowance based on calendar year whilst the law specifically requires the computation to be based on the number of days in the year of income.

In further submitting in support of the fifth ground of appeal, Mr. Kileo argued that, the Tribunal was wrong to find and hold that the respondent was correct to impose interest and penalty to the appellant since the appellant ably demonstrated that the allocation of head office costs was at arm's length and the respondent's computation of capital allowance was incorrect, therefore, the imposition of penalty and interest was erroneous. He rounded of by inviting us to decide grounds four and five in favour of the appellant and finally, he urged that the appeal be allowed with costs.

In response, Ms. Andrew strongly disagreed with the counsel for the appellant and argued in response to the appeal in a pattern adopted by the appellant. Essentially, she opposed the appeal by contending that, the Tribunal did not fail to consider the provisions of section 33 (1) of the Act and the OECD Transfer Pricing Guidelines but in the contrary the Tribunal correctly considered section 33 (1) of the Act and the OECD Transfer Pricing Guidelines in determining the correctness of the respondent's decision to disallow head office costs. The learned Principal State Attorney went further to submit that, although the appellant submitted at considerable length the applicability of section 33 (1) of the Act, it is quite unfortunate that the appellant is misleading the Court since the dispute before the Tribunal was not on transfer pricing but rather the respondent's decision to disallow head office costs. She contended that, the Tribunal even sought to revisit the evidence on record and the law specifically sections 33 (1) and 11 (2) of the Act and came to the conclusion that the dispute was not on transfer pricing in terms of section 33 (1) of the Act but rather on disallowance of head office costs allocated to the appellant for the years of income 2011 and 2012.

In her view, the appellant's submission on transfer pricing studies and other documents as evidence justifying deduction of head office costs amounted to forcing the dispute to change from disallowance of head office costs to transfer pricing just because the Tribunal did not rule in favour of the appellant. She further strongly disputed the argument that the appellant submitted studies which were conducted by an independent third party indicating that the transaction was at arm's length and contended that the respondent clearly informed the appellant that the amount claimed to have been incurred by the regional hub in Dubai and allocated to the relevant entities is not verified by an independent auditor a fact which was not disputed by the appellant before both the Board and the Tribunal.

In further opposing the appeal, the learned Principal State Attorney, argued that, the Tribunal correctly held that, for head office costs to be deducted as expenses there has to be compliance with the requirements under section 11 (2) of the Act and that the respondent requested for evidence from the appellant showing payments made to AIPL as management fee for the years of income 2011 and 2012. She contended that, the respondent further requested for documentary proof to support services rendered to the branch and the corresponding actual cost paid so as to prove the incurrence of such costs to warrant deduction but unfortunately such proof was never availed by the appellant to the respondent and the appellant admittedly and expressly explained to the respondent during the audit and the objection that, due to the nature of the services provided it was not possible to identify or allocate services to a particular entity.

Illustrating further, the learned Principal State Attorney, expressed her dismay at the appellant's conduct of raising a new dispute that was not even in its grounds of objection and unfairly condemning the Tribunal that it did not consider section 33 (1) of the Act and the OECD Transfer Pricing Guidelines while deciding that the dispute is on disallowance of head office costs allocated to the appellant for the years of income 2011 and 2012 which were incurred by AIPL in UK with the regional hub in Dubai. In her considered opinion transfer pricing was not an issue even before the Board while deliberating on deductibility of the costs, it addressed the issue on cost allocation not to be at arm's length for lack of transparence for the appellant employed the wrong calculation methods of deductible expenses.

The learned Principal State Attorney went further to submit that, the appellant disagreed with the respondent's bases of disallowance of the costs in that the appellant should have been charged on the basis of cost-plus method and not on the turnover method applied by the appellant. She further argued that, the amount claimed to be incurred by the regional hub and allocated to relevant entities is not verified by independent auditor and therefore the audited financial statement of the regional hub was necessary in terms of section 11 (2) of the Act in order to determine the amounts which were duly incurred by the regional hub. She thus argued that, the Tribunal correctly applied section 11 (2) of the Act in determining the correctness of the allocation of head office costs to the appellant.

Thus, in her view, the appellant did not discharge the burden of proof and therefore, the appellant was justified under section 18 (2) (b) of the TRAA to disallow head office costs allocated to the appellant and distinguished the case of **Insignia Limited** (supra) which was cited by the appellant and cited our previous unreported case in **Shana General Store Limited v. Commissioner General, TRA**, Civil Appeal No. 392 of 2020.

In reply to the fourth ground of appeal, the learned Principal State Attorney contended that, it was erroneous to argue that the appellant correctly calculated capital allowance on the depreciated assets in terms of section 17 of the Act. Illustrating further, the learned Principal State Attorney submitted that, capital allowance on depreciated assets claimed by the appellant was computed in accordance with the requirements of the Third Schedule to the Act by applying the formula AxBxC/365 in which the term number of days refers to number of days in which the asset was put into use. She argued further that, the appellant's reasoning that the respondent was wrong in re-apportioning capital allowance in 2011 year of income based on twelve months instead of eight months was unfounded. She firmly argued that, the Tribunal clearly and rightly explained the conditions for deduction of depreciation allowance for depreciated assets in terms of section 17 and paragraph 3 to the Third Schedule to the Act. In her considered opinion 8/12 factor in apportioning the allowance as indicated in exhibit A-8 refers to a number of months in a year and not number of days in a year as argued by the appellant and therefore, the interpretation under paragraph 3 to the Third Schedule does not give the number of days the asset was put to use but rather number of days in the year of income to which depreciable asset was employed in the production of income, she stressed.

In her further submission, the learned Principal State Attorney contended that, the Tribunal rightly held that the year of income in terms of section 20 of the Act means the calendar year or the period approved by the Commissioner General hence, the appellant incorrectly employed 8/12 factor in calculating capital allowance while the respondent rightly applied the formula AxBxC/365 as provided for in the Third Schedule. She rounded off by submitting that the Tribunal was correct in law to hold that the respondent was correct in its computation of the capital allowance on depreciable assets as the capital allowance on depreciated assets is calculated based on the number of days the depreciable assets was employed by the person wholly and exclusively in production of the person's year of income.

Arguing in response to the fifth ground of appeal on the issue of interest and penalty, the learned Principal State Attorney was fairly brief and direct to the point, she contended that, interest and penalty were correctly imposed by the respondent based on the established principles of tax since the appellant could not substantiate the deductibility of the head office direct expenses as required under section 11 (2) of the Act and the respondent's computation of depreciation allowance was correct in terms of section 17 and paragraph 3 of the Third Schedule to the Act. In all, she urged the Court to disallow the appeal.

In a brief rejoinder, Mr. Kileo reiterated his earlier submission by arguing that section 33 of the Act comes into play because the appellant is a branch office of AIPL and that auditors confirmed that through exhibit A-3. He went further to submit that the law does not determine the type of audit but rather the transactions determine the type of audit. On our prompting, Mr. Kileo submitted that, when the dispute arose in 2011-2012 the OECD Transfer Pricing Guidelines were not applicable by then in Tanzania but there was nothing wrong to follow best practices. He implored us to hold that it was wrong to disallow the whole amount and direct the respondent to re-calculate the amount allowable.

After a careful consideration of the entire record and the rival submissions by the parties there remains only one contentious aspect that needs to be resolved and that is whether or not the Tribunal erroneously decided the appeal before it and therefore came to the wrong conclusion warranting this Court to interfere.

Starting with the first limb of the three grounds of grievance, which were ably argued by the learned trained minds conjointly, we think the central issue for our determination is whether or not the dispute before the Tribunal was not on transfer pricing but rather on disallowance of head office costs allocated to the appellant. While the appellant has sturdily argued that the Tribunal failed to consider section 33 (1) of the Act and the OECD Guidelines on Transfer Pricing, the respondent gallantly submitted that the dispute before the Board was not on transfer pricing and therefore the Board was right in not considering section 33 (1) of the Act.

Our careful reading of the record quite obviously contradicts the appellant's submission that the Tribunal erred when it failed to consider section 33 (1) of the Act as well as the OECD Transfer Pricing Guidelines in determining the correctness of the respondent's decision to disallow head office costs.

While we agree that section 33 (1) of the Act relates to transfer pricing and that the OECD Transfer Pricing Guidelines were relevant despite the fact that the Income Tax (Transfer Pricing) Regulations, 2014 which were later repealed and replaced by the Income Tax (Transfer Pricing) Regulations, 2018 were not yet in place, we find considerable merit in the submission by the learned Principal State Attorney that the dispute before the Tribunal was not on transfer pricing in terms of section 33 (1) of the Act but rather on disallowance of head office costs allocated to the appellant for the years of income 2011 and 2012. The record bears out clearly that none of the five grounds of grievance against the decision of the respondent as found at page 11 of the record of appeal specifically faulted the respondent for failure to consider section 33 (1) of the Act. The five grounds of appeal focused on the applicability of sections 11, paragraph 3 of the Third Schedule and section 98 of the Act.

It seems to us that, the Tribunal justifiably found out that the appellant failed to prove the total amount claimed to have been incurred by the regional hub in Dubai and allocated to the relevant entities owing to the absence of verification by independent auditors but also bearing in mind that the appellant admittedly stated that since costs are made up of numerous expenses it would have been cumbersome for the branch to provide individual invoices for each item.

We find merit in the learned Principal State Attorney's submission that, for head office costs to be deducted as expenses there has to be compliance with the requirements under section 11 (2) of the Act. It is convenient at this stage to excerpt section 11 (2) of the Act so far as it governs calculation of income tax:

> *"11-(2) Subject to this Act, for purposes of calculating a person's income for a year of income from any business or investment, there shall be deducted all expenditure incurred during the year of income, by the person wholly and exclusively in the production of income from the business or investment."*

We have excerpted the above provision which clearly demonstrate the conditions to be met in determining the correctness of the amount to be deducted as expenditure incurred during the year of income as long as the expenditure were incurred by that person wholly and exclusively in the production of income from the business or investment. In our view, however, the appellant for an obscure cause did not prove this and therefore, the Board and the Tribunal rightly found out that the evidence was wanting.

In these circumstances, we are decidedly of the view that, the appellant did not discharge its burden of proof as required under section 18 (2) (b) of the TRAA. For, the better understanding of section 18 (2) (b) of the TRAA, we think, it is desirable to reproduce the relevant provisions. It reads:

> "18-(2) *In every proceeding before the Board and before the Tribunal-*
>
> *(a) N/A*
>
> *(b) the onus of proving that the assessment or decision in respect of which an appeal is preferred is excessive or erroneous shall be on the appellant."*

Adverting next to the fourth ground of appeal, in our considered view, the narrow, but important issue at the core of this ground, and on which its outcome depends, principally turns on a proper construction of section 17 and para 3 of the third schedule to the Act. We think in an attempt to answer this question, we should start by reflection of the provisions of section 17 and para 3 of the third schedule to the Act, which reads:

Section 17 of the Act

> *"17- For the purposes of calculating a person's income for a year of income from any business, there shall be deducted in respect of depreciation of depreciable assets owned and employed by the person during the year of income wholly and exclusively in the production of the person's income from the business the allowances granted under the Third Schedule."*

Paragraph 3 of the third schedule

> *"3-(1) Subject to this paragraph, an allowance shall be granted to a person for a year of income for each of the person's pools of depreciable assets equal to the depreciation for the year of income of each pool calculated in accordance with subparagraphs (2). (7) or (8) of this paragraph.*

(2) Depreciation for a year of income for each of a person's pools of the depreciable assets shall be calculated-

(a) in the case of Class 1, 2 and 3 pools, according to the diminishing value method; and

(b) in the case of Class 5, 6 and 7 pools, according to the straight using the following formula:

A x B x C/365

Where-

A is the depreciation basis of the pool at the end of the year income;

B is the depreciation rate applicable to the pool; and

C is the number of days in the person's year of income."

Section 20 of the Act provides:

"20.-(1) Subject to the provisions of this section, the year of income for every person shall be the calendar year.

(2) Subject to the provisions of subsections (6), (7) and (8), an entity may apply, in writing to the Commissioner to change the entity's year of income from-

(a) the calendar year; or

(b) a twelve-month period previously approved by the Commissioner under subsection (3), to another twelve-month period."

On a close and combined reading of the above provisions on the available fact, with respect, it would appear to us that the Tribunal was right to find and hold that in apportioning capital allowance on depreciated assets the factor to be considered is the number of days the depreciable assets was employed by the person wholly and exclusively in production of the person's year of income. To conclude the fourth ground of appeal must fail.

We will next move to the fifth ground of appeal on the complaint that the Tribunal was wrong to find and hold that the respondent was correct to impose penalty to the appellant. Parties locked horns on the propriety or otherwise of subjecting the appellant to pay penalty. It bears reaffirming that the Income Tax Act, 2004 particularly section 98 which has since been repealed by Act No. 10 of 2015, imposed interest and penalty for failure to maintain documents or file statement or return of income. In the case at hand, as observed by both the Board and the Tribunal the appellant could not substantiate the deductibility of the head office direct expenses and the respondent's computation of depreciation allowance was correct in terms of the law therefore imposing penalty was inevitable. We therefore, find no good cause to interfere with the findings of the Tribunal in as far as imposition of penalty is concerned. That said, this ground of appeal too has no merit and therefore it stands dismissed.

In view of the foregoing position, we find no reasons for us to interfere with the decision of the Tribunal which is hereby affirmed. Consequently, we dismiss the appeal in its entirety with costs.

DATED at **DAR ES SALAAM** this 6th day of September, 2023.

S. A. LILA
JUSTICE OF APPEAL

L. L. MASHAKA
JUSTICE OF APPEAL

P. F. KIHWELO
JUSTICE OF APPEAL

The judgment delivered this 7th day of September, 2023 in the presence of Mr. Norbert Mwaifwani, learned counsel for the Appellant and Mr. Erasto Ntondokoso, learned State Attorney for the Respondent, is hereby certified as a true copy of the original.

THE COURT OF APPEAL OF TANZANIA

A. L. KALEGEYA
DEPUTY REGISTRAR
COURT OF APPEAL