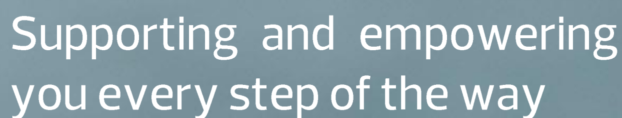


TANZANIA – NAVIGATING TAX AUDITS AND MITIGATING TAX ASSESSMENTS THROUGH TIMELY RECONCILIATIONS

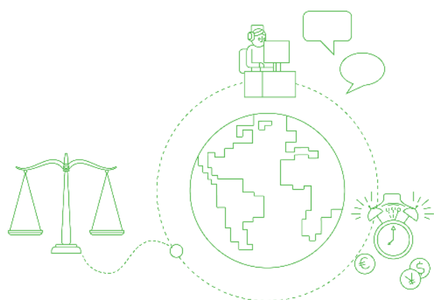
Background on tax audits / investigation

The Commissioner General (CG) of the Tanzania Revenue Authority (TRA) is conferred with powers under S.45 of the Tax Administration Act (TAA), 2015 to conduct an audit or investigation of a person's tax affairs.

In practice, an audit or investigation of the person's tax affairs will commence with an entry meeting between the taxman and the taxpayer. Issuance of audit findings will follow with the taxpayer being accorded a right to respond to such findings within 14 days. The adjusted assessment is then issued in accordance with the provisions of section 48 of the TAA,2015.

It is imperative to note that the purpose of any audit or investigation is ascertaining whether such person remits and lodges the requisite tax returns timely and complies with the relevant provisions of the tax laws.

In the process of the audit, it is a practice by the taxman to carry out several tests/reconciliations to ascertain the assertions mentioned above. We shall cover below the key reconciliations carried out during such audits which can be prepared in advance to navigate tax audits and mitigate potential tax exposures and disputes:



1. Value Added Tax (VAT)

a) Turnover as per monthly VAT returns submitted Vs Turnover as per the audited financial statements submitted with the Return of Income (ROI)

To ascertain the accuracy of the turnover declared by the taxpayer, comparison is usually carried out between the turnover declared in the VAT returns and the turnover reported in the audited financial statements.

The variance observed is then subject to either additional corporate tax or VAT. Key reconciling items for such variance include but not limited to:

a) Work in progress / Deferred Income movement – the revenue recognition approach differs between the FS and the VAT whereby the revenue is recognised in the FS in line with the accruals principle and revenue is recognised in the VAT returns based on S.15 of the VAT Act.

b) Difference in tax base – for example, on disposal of assets, the gain on such disposal is reported in the FS as revenue/other income whereby in the VAT returns, the proceeds from disposal are recorded.

c) Imported services – these are required to be reported for in the VAT returns, however, do not have any impact on the financial statements.

It is therefore prudent to ensure that the reconciliation is well documented and any variance is explained in both, the VAT and income tax files for reference in case the query arises during the tax audit.

b) Turnover as per Electronic Fiscal Devices (EFDs') Vs Turnover as per submitted VAT returns and Audited Financial Statements

In addition to the above, a comparison is also carried out between the turnover as per the EFD machine and the amount reported in the VAT returns / FS to assess compliance with the EFDMS and review the accuracy/reasonability of the turnover recognised by the taxpayer.

Where the turnover as per the EFDMS is lower than that reported in the FS or declared in the VAT returns, a penalty of up to TZS 4,500,000 is imposed for improper use of EFD.

Key reconciling items for such variances include but not limited to:

a) Credit notes issued – while the credit notes are usually adjusted for in the respective VAT returns and the audited financial statements, the EFD machine does not have an option to capture the same. It is also imperative to note that credit notes should be supported with the respective adjustment notes.

b) Work in progress / Deferred Income movement – the WIP/ Deferred income accounting entries are not captured in the turnover as per the EFD.

On that basis, it is of paramount importance for the taxpayer to ensure timely reconciliation between turnover as per EFDs' and turnover as per submitted VAT returns and monthly management accounts/audited financials is prepared, with variance thereon explained by relevant reconciling items.

2. City Service Levy (CSL)

Following from the above, it has also been a practice to peruse the CSL remitted by the company to establish whether the turnover declared by the company for the purposes of VAT and corporate tax ties up with the one declared for the CSL computation. Where the turnover as per the CSL is higher than that reported on the FS/VAT returns, additional corporate tax and VAT could be assessed.

Key reconciling item for such variance include but not limited to:

- Estimations in City Service Levy return – it is imperative to note that CSL remittance quarterly before the end of the quarter. Hence, it is likely that companies have to file the return and make the payment based on the estimated turnover. This could result in potential over / underestimation, whereby the same is then adjusted in the subsequent quarter. It is therefore recommended that where the company estimates sales for the purposes of the CSL (especially in the last quarter), any overpayment of CSL is notified to the Municipal Council and a copy of the correspondence is retained.

Therefore, timely reconciliation between reported turnover in the audited financial statements/management accounts and turnover declared for the purposes of CSL remittance will mitigate potential exposures.

3. Payroll taxes (PT)

In order to assess the accuracy of the employment-related taxes i.e. PAYE & SDL, it is likely that the Authority will review the following:

- Comparison between payroll costs reported in the audited financials/management accounts and payroll costs as reflected in the relevant monthly payroll computation. Any unreconciled variance will attract additional PAYE & SDL liability with interest for late payment compounded monthly at statutory interest rate thereon.
- Comparison between payroll costs declared in the half-yearly returns i.e. P9 & P10 and payroll costs as reflected in the relevant payroll computation schedules. Any unreconciled variance is then subject to either additional tax or a penalty for incorrect filing of the return is imposed.

Key reconciling items for such variances may include but not limited to:

a) Expense items not susceptible to employment taxes - payroll costs reported in the audited financial statement may include expense items such as statutory social contributions by the employer, SDL remittances and WCF contributions to name a few, which are not susceptible to employment taxes.

b) Omission – this occurs mainly where the company omits to declare the in-kind benefits in the half-yearly return. It is also important to note that while the in-kind benefits are included in the half-yearly returns, the same may not reflect as part of salary costs in the financial statements/management accounts.

4. Withholding tax (WHT)

In terms of assessing the reasonability of the withholding tax payable by the company (on professional fees, interest, rent, imported services, etc), it has been a practice to perform a global test to derive the expected withholding tax due which is then compared to the payments made by the company.

How is the global test carried out?

For example, on professional services, expense accounts which are susceptible to withholding tax, are extracted from the trial balance and withholding tax rate of 5% is applied on the expenses to derive the expected withholding tax, which is compared to the actual withholding tax payments made by the company.

Any unreconciled variance is deemed as WHT underpayment. This test does not consider a number of factors that are treated as reconciling items.

Key reconciling items for such variance may include but not limited to:

a) Expense items not susceptible to WHT – While WHT is re-computed on the full expense ledger, the ledger may likely include entries/transactions of such nature which are not subject to WHT per relevant provisions of the tax laws. Therefore, it would be advisable to bifurcate the expense ledgers that can clearly differentiate expenses that are subject to withholding tax and those expenses on which withholding tax does not apply.

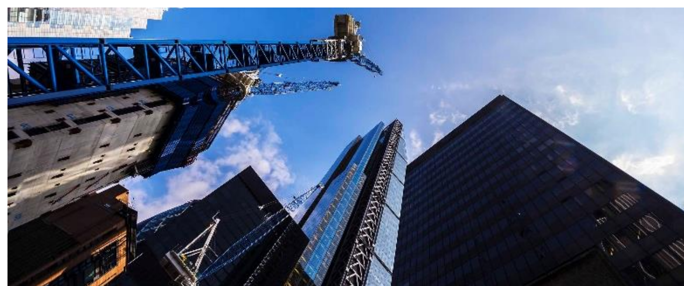
b) Accruals and prepayments - For instance, on rent, a company may likely be amortising prepaid rent from the previous year (recognising an expense in the current year as per the accruals concept). In such cases, withholding tax would have been paid in the previous year when the invoice was received. Therefore, it is important to factor the impact of the accruals and prepayments in such reconciliations.

Conclusion

Based on relevant TAA provisions read together with respective TAA Regulations, a taxpayer is accorded fourteen days (14) to respond to the audit findings raised by TRA with additional fourteen (14) days upon lodging extension application to the CG. In a nutshell, the taxpayer only has twenty-eight (28) days to respond to such audit findings.

Further, the TAA provisions obligate the taxpayers to provide all relevant information and documents to the taxman during the audit and objection stage. Failure to adhere to the requirement will revoke the taxpayer's right to provide such information and documents during the Appeal stage, should the taxpayer require to take the matter forward at a dispute resolution stage.

In conclusion, having the key reconciliations prepared in advance and integrating compliance as a company practice will assist in mitigating potential tax exposures and disputes with the taxman.



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