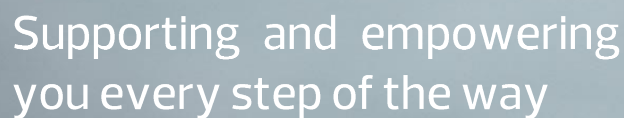


TANZANIA – TAXATION OF BRANCH/PERMANENT ESTABLISHMENT

Introduction

In every tax jurisdiction, residential status is one of the crucial benchmarks for determining the tax obligations of a person during the year of income.

In Tanzania, the tax obligation of a resident person is extended to the worldwide income of such person. That is to say, a resident person in Tanzania is obliged to account and pay income tax on the worldwide income whereas, for a non-resident person the tax obligations in Tanzania are determined to the extent of the income generated in Tanzania.

Challenges facing multinational companies

In a bid to grow and expand operations globally, multi-national entities usually establish a subsidiary, a branch, division or partner with local companies in Tanzania.

The most common practice opted by multinational companies has been operating in Tanzania through a branch and the main reason for doing so is on account of entering into contracts with government institutions and other entities specifically for large capital-intensive projects where the government institutions prefer engaging directly with the Parent company rather than working with a new established limited liability company (subsidiary). In addition, most of the large contracts stipulate the Parent company to set up a branch in Tanzania to provide services.

As far as Tanzania tax is concerned, the choice to operate through a subsidiary or a branch should not only be made on the basis of the easiest approach to penetrate into the market but the tax implications associated with such approach should also be considered.

Taxation of branch and subsidiaries in Tanzania

The tax obligation of an entity in Tanzania is determined by its residential status and according to the income tax laws of Tanzania. A company is resident in Tanzania during a year of income if it is either incorporated in Tanzania or its management and control are exercised (physically or electronically, FA 2022) in Tanzania.

When a foreign company intends to operate in Tanzania through a branch, it is issued with a certificate of compliance. Hence, unlike a company incorporated in Tanzania, which makes it a resident entity in Tanzania, the Head Office of the Branch operating in Tanzania shall not be construed as a resident in Tanzania.

In simple term, the Branch of a foreign company shall be resident in Tanzania and taxation of a permanent establishment/branch is provided for under S.71 of the Income Tax Act.

According to Section 3 of the Income Tax Act, a non-resident entity/person is construed to have a permanent establishment where such person is engaged in a construction, assembly or installation project for six months or more, including a place where a person is conducting supervisory activities in relation to such a project.

A Branch and its Head office shall be treated independently for tax purposes but considered as associated persons. This means that the Branch shall account for its income and expenses separately from that of its Head office for income tax purposes in Tanzania. Any transaction or arrangement between the Branch and its Head office are treated as if the Branch and the Head office were independent persons. Further, the transactions carried out by the Head office in Tanzania without involving the Branch shall not be attributed to the Branch.

However, according to S. 71 (5), the following activities shall be considered as conducted by a permanent establishment or a branch:

- Where the Head Office employs a resident individual in Tanzania, such employment shall be deemed to have been carried out by the Branch;
- Where the Head Office sells goods (trading stock) of the same or a similar kind as those sold through the Branch such sales shall be attributed to the Branch; and
- Where the Head Office carries out other business activities of the same or a similar kind as those effected through the Branch such activities shall be attributed to the Branch for income tax purposes.

The above provision in the Income Tax Act has been one of the most contentious issues in the taxation of a Branch and its Head Offices in Tanzania.

In a recent tax case, a company incorporated in Germany signed a long-term contract with one of the Government institutions in Tanzania for the supply of equipment. Based on the contract, the project was a turnkey project where the contractor was responsible for designing, manufacturing, installing and commissioning the project.

The contract was for supply of materials and provision of civil work with the condition that the materials are supplied directly by the Head Office from Germany. As part of the government requirements, the company was required to maintain a Branch in Tanzania solely for the supervision of the installation of the equipment. Accordingly, the income related to the civil work (onshore income) was recognised in the books of the Branch and the Branch paid the relevant taxes on such income in Tanzania. However, the revenue relating to supply of equipment (offshore income) was recognised in the books of the Head Office in Germany and no taxes were paid in Tanzania.

When the contract was reviewed by the Revenue Authority, it was of the view that since the contract was a turnkey project, all contractual revenue should be attributed to the Branch and taxed in Tanzania. The conclusion was drawn based on the Force of Attraction Rule, which links the income earned by the Head Office to the income earned by the Branch in Tanzania as highlighted in this article, that where the owner (Head Office) of a permanent establishment (Branch) carries on activities of the same or similar nature as those carried on in Tanzania through a Branch, such income shall be treated as derived by the Branch and taxed in Tanzania.

The Revenue Authority backed its decision based on the following grounds:

- That since the Head Office obtained a certificate of Compliance, the Head Office was a resident in Tanzania;
- That since the project was a Turn Key project there is no way one can separate the activities performed by the Head Office from those performed by the Branch.

To understand whether the Revenue Authority was correct in its decision, it is imperative to note the following key criteria which results to the above conclusion:

- for the Head Office to be taxed in Tanzania, apart from the business carried on through a permanent establishment, it should be resident in Tanzania during the year of income;
- the direct income of the Head Office should be attributed to the Branch if the activities that gave rise to such income are the same or similar to that activities carried on through the Branch.

In the referred case, we do not find any ambiguity resulting to taxation of the revenue related to the supply of equipment in Tanzania, since the contract was clear in terms of what is the contract value for supply of equipment and installation of the same. The supply of equipment is the supply of trading stock, which is not subject to income tax in Tanzania when supplied from outside Tanzania (importation done by the customer). According to the Income Tax Act, supply of trading stock shall be attributed to the income derived in Tanzania if such sale is as a result of any asset or liability owned by the seller in Tanzania.

The supply of equipment and installation are two different activities as far as tax is concerned. In fact, the Branch did not play any role on the supply of equipment to the customer since the same was done from outside Tanzania (no domestic asset or liability involved), and the customer had cleared the goods themselves at the customs area. The Branch was only responsible for supervision of the installation of the equipment. Hence, we believe it was not correct, both in law and fact to state that the activities performed by the Head Office from outside Tanzania are of the same or similar nature to those performed by the Branch. The Head Office supplied the goods and the Branch was only involved in installation (service) of the same. These are different and unrelated activities.

We appreciate the fact that as far as turnkey project is concerned, it may be difficult to differentiate the activities performed by the Head Office from that performed by its Branch due to the fact that there is a

single contract. However, in case the contract clearly indicates the contractual value for each activity to be performed, there should be no question of whether the supply of equipment can be equated to the installation of the same. These are two different activities, where one is the sale of a trading stock and the other is the provision of service.

Had the installation part been outsourced to a subsidiary, sister company or third party, similar issue would not arise since the Head Office is not resident in Tanzania and it would have only supplied the goods from Germany. The company dealing with the installation of such equipment would be assessed with the relevant taxes in Tanzania only to the extent of the income related to the installation and not supply of equipment.

Conclusion

One may appreciate the differing views between the taxpayers and the revenue authority when it comes to interpretation of the tax statutes. This is because of the ambiguities and technicality engulfing the tax laws.
Hence, it is essential to mitigate the tax risks and exposures by selecting the best tax alternative operation method with minimal complications.

For instance, in this case study, the route cause of the problem is the type of contract (turn-key) and the manner of execution of the contract.

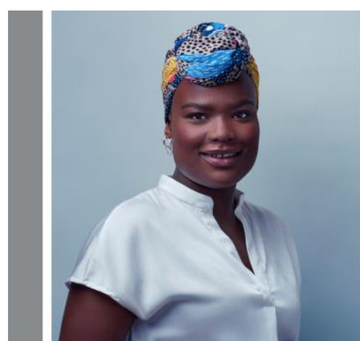
In terms of the type of the contract, it is important to seek inputs from tax consultants and law firm in Tanzania upfront to mitigate any tax or legal exposures arising from such contracts.

In the above case study, to mitigate the uncertainty and exposure, one may consider, subject to legal advice, having two separate contracts for supply of equipment and installation. This would set a clear demarcation of the different activities performed offshore and onshore. Hence, removing the contradiction on the activities performed by the Branch and that of the Head Office.

Alternatively, the company could outsource the execution of the onshore part to another company and not through the use of the Branch or a permanent establishment. In case the onshore part is executed through another independent company, the provision of Section 71 (5) of the Income Tax Act (Force of Attraction Rule) would not apply.

On the other hand, we appreciate the challenges involved in signing different contracts or performing activities through other companies, particularly on government projects. However, one should not only look into the profit aspect only but also consider the tax impact on the type of contract entered into. In case the Force of Attraction Rule is not adequately addressed, the company will end up paying taxes in two different tax jurisdictions. With Tanzania having limited number of double taxation agreements, the income may be subject to tax in both jurisdictions.

With the changes in tax laws, it is imperative to obtain tax opinion on any intended projects/incorporation before execution of the agreements. This will enable you to anticipate the tax exposures, plan for the same and enhance the compliance level. Should you have any questions or require further clarification please reach out to us on *lratansi@tz.rsm-ea.co.tz/msinai@tz.rsm-ea.co.tz/jboke@tz.rsm-ea.co.tz* or our office premises at *1st Floor, Plot 1040, Haile Selassie Road, Masaki.*



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