

**IN THE TAX REVENUE APPEALS TRIBUNAL
AT DAR ES SALAAM**

INCOME TAX APPEAL NO. 7 OF 2011

COMMISSIONER GENERAL APPELLANT

VERSUS

NATIONAL MICROFINANCE BANK LTD..... RESPONDENT

PROCEEDINGS

10/5/2011

QUORUM:

Hon. Judge Dr. F. Twaib	Chairman
Prof. J. Doriye	Member
Mr. J.B. Kalolo	Member
For the Appellant	Absent
For the Respondent	Absent
Mrs. Halima Said	RMA

Order:

Hearing on 26th May, 2011 at 14.00 hrs. Notify parties.

Hon. Judge Dr. F. Twaib Chairman, Sgd

10/05/2011

15/6/2011

QUORAM:

Hon. Judge Dr. F. Twaib	Chairman
Prof. J. Doriye	Member
Mr. J.B. Kalolo	Member
For the Appellant	Mr. Felix Haule , assisted by Joyce Sojo, Advocates.
For the Respondent	Dr. O. Kibuta, Advocate assisted by Mr. Allan Kileo
Mrs. Halima Said	RMA

Mr. Haule:

My Lord, first of all, I notice that my first prayer attest that the appeal should be dismissed. That is an error. I pray that the same be amended to say that this appeal be allowed.

Dr. O. Kibuta:

I think he needs to pray for an order that the Tribunal allows him to amend the memorandum of appeal. Also, technically, we need to be served with the new, amended memorandum of appeal, unless the Tribunal directs otherwise. Otherwise, I have no objection to the prayer to amend, and I am prepared to waive my right to be served with the amended memorandum of appeal and he may, with leave of the Tribunal, proceed to argue the appeal.

Order:

Mr. Haule prayer's granted. Memorandum of appeal is hereby amended to state, as the first prayer thereof, that "this appeal be allowed".

Upon Dr. Kibuta having waived his client's right to be served with the amended memorandum of appeal, counsel for the Appellant is hereby allowed to proceed to argue in support of the appeal.

Mr. Haule:

Hon. Chairman and Members of Tribunal, this appeal emanates from the decision of the Tax Revenue Appeal Board dated 17/2/2011. The Appellant having been aggrieved by the said decision, has preferred this appeal.

I have divided my submission into four major sections. The first one is the Background, then the Dispute or Bone of Contention between the Parties; thirdly, the Hearing and Determination of the Board; and fourth, the Appeal to this Tribunal.

TRIBUNAL:

We were of the view that the appeal is essentially on points of law. Couldn't it be more convenient if the same is argued by way of written submissions?

Mr. Haule:

That's true my lord.

Mr. Kibuta:

I also agree, My Lord.

Order:

1. The appeal shall be argued by way of written submissions.
2. Submissions to be filed in accordance with the following schedule:
 - a) By the Appellant, on or before 28/6/2011
 - b) By the Respondent, or before 6/7/2011
 - c) Rejoinder, if any, on or before 13/7/2011
 - d) Hearing (for clarifications) on 14/7/2011 at 14.00 hrs.

Hon. Judge Dr. F. Twaib

Prof. J. Doriye

Mr. J.B. Kalolo

Chairman, Sgd

Member, Sgd

Member

14/6/2011

APPELLANT'S MAIN SUBMISSIONS IN SUPPORT OF THE APPEAL

Honourable Chairman and members of the Tribunal, this appeal emanates from the decision of the Tax Revenue Appeals Board dated 17th February, 2011. The appellant has been aggrieved by the said decision hence, this appeal.

A: BACKGROUND:

Honourable Chairman and members of the Tribunal, sometime in 2003, the Respondent bank (NBM) entered into an Agreement with Neptune Software PLC of UK whereby the Respondent (hereinafter called the **Licensee**) agreed to buy from Neptune Software PLC (hereinafter called the **Licensor**) **the right to use the software** under the terms and conditions contained in that Agreement.

Honourable Chairman and members of the Tribunal, let it be known here that what was bought in that Agreement was not the **software** itself but a mere **right to use the licensor's software**. That Agreement was accompanied by a number of terms and conditions which were contained under Para 3.1 to 3.9 of the contract.

- (a) Agreement grants the licensee the right to use the software and make backup copies - **3.1**

- (b) Where new release of the provided software is supported by the licensor with or on such upgrade, then the licensor shall extend the licence accordingly - **3.2.**

- (c) The Licensee shall not to sublicense, deploy or distribute to any third party – **3.3.**
- (d) Software documentation shall be used by the licensee only – no reproduction to the other parties – **3.4.**
- (e) Software licensed not to include licences for the operating systems or third party -run time of development licensees – **3.5**
- (f) Licensee may copy the object code of the software – **3.6.**
- (g) Licensee not to temper with the software – **3.7**
- (h) Licensor not to be liable for damage or loss arising from misuse or modification of the software by the licensee – **3.8.**
- (i) Implementation to be performed at locations to be specified by the licensee **3.9.**

Honourable Chairman and members of the Tribunal, not only these terms and conditions, to prove that the parties never intended to have a permanent deal, the Agreement also contained other major conditionalities as can be seen in the following paragraphs:

- (i) Support service – **paragraph 9**
- (ii) Modifications – **paragraph 10**
- (iii) Safe Preservation – **paragraph 11**
- (iv) Copyright – to be owned by licensor - **paragraph 13**
- (v) Maintenances of Confidentiality – **paragraph 14**
- (vi) Unauthorized use – **paragraph 16**
- (vii) Limitation of liability – **paragraph – 17**
- (viii) Force Majeure – **paragraph 18**
- (ix) Termination – **Paragraph 19**
- (x) Consequences of Termination – **Paragraph 20**
- (xi) Dispute Settlement – **paragraph 22**

Payments Terms (Contract renewed on 13th April, 2006)

Honourable Chairman and members of the Tribunal, going through all the above mentioned paragraphs, it goes without saying that the parties when they were entering into that agreement they never intended it to be of permanent nature. Any breach of the contract terms particularly by the licensee, gave right for the licensor to revoke or terminate the contract.

B: DISPUTE BETWEEN THE PARTIES:

Honourable Chairman and members of the Tribunal, having seen the nature of the contract between the Respondent and the supplier of the software and payment terms, it became evident to the Appellant in this appeal that the Lumpsum Annual Licence Fees which was agreed to be paid by the licensee to the licensor was a royalty.

Honourable Chairman and members of the Tribunal, the bone of contention between the parties in this appeal and in the Tax Revenue Appeals Board is based on the interpretation of the two terms above mentioned – i.e. **royalty** and **lease** and the issue of services. While the appellant contends that the payments made by the Respondent (NMB) to the Licensor of the software in UK amounted to royalty which royalty is subject to withholding tax under section.83 (1) (b) Income Tax Act, 2004 - Cap. 332, the Respondent (Licensee) disputes that contention by stating that such payments do not constitute a royalty simply because the said payments were not made from a lease agreement between the licensor and licensee but mere license agreement for the purchase of the software.

Regarding the service fee paid by the licensee to the licensor, it is the Appellants contention that some of those services were performed in the United Republic of Tanzania by the foreign supplier of the software, hence chargeable to withholding tax under S.69(i) while the Respondent disputes the whole thing and states that all of the

services were performed by the supplier while sitting in his own country Refer to paragraph 2 of page 7 of the Proceedinds)..

C: CHEARING AND BOARD DECISION:

Honourable Chairman and members of the Tribunal, when this matter came for hearing before the Board, three issues were framed:

- (a) Whether lumpsum payments for software are subject to withholding tax.
- (b) Whether service fees, relating to software are subject to withholding tax.
- (c) To what reliefs are the parties entitled to?.

Honourable Chairman and members of the Tribunal, in resolving the three issues above, the Tax Revenue App[peals Board held that:-

1. The Lumpsum payments made by the appellants (Respondents) to the Licensor is not a royalty under S.82 (1) (a) – Income Tax Act , 2004 – Cap. 332.the .
2. The service fees relating to software are not subject to withholding tax because the services were not to performed in Tanzania..
3. The appeal is found to have merit and is consequently allowed.

D: APPEAL TO THE TRIBUNAL

Honourable Chairman and members of the Tribunal, the Appellant has brought this appeal before this Hon. Tribunal based on two major grounds.

- (a) That, the Tax Revenue Appeals Board erred in law and in fact by holding that the Lumpsum payments made by the Respondent (Licensee) to the licensor is not a royalty under section 82 (1) (a) of the Income Tax Act, 2004 and is therefore not subject to withholding tax.***

Honourable Chairman and members of the Tribunal, in order to support this ground, let me go to the definition of the term **royalty** as defined under Sect.3 of Income Tax Act, 2004.

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

(b) The use of or the right to use, a copyright, patent, design model, plan, secret formula or process or trade mark.

In the contract between the Respondent and the supplier of the software there were three types of payments involved.

- (i) Investment costs
- (ii) Lumpsum Annual Licence Fees, and
- (iii) Service fees.

The appellant has no objection with the first type. It is obvious that Investment costs normally do not attract any kind of tax. The appellant is vigorously contending that the **Lumpsum Annual License Fees** which falls under the above definition and **"service fees"** which is also defined in the same section 3 to mean "a payment to the extent to which, based on market values, it is reasonably attributable to services rendered by a person through a business of that person or a business of any other person....."

The Respondent stance is that the Lumpsum payments for Annual Licence fee made by it to the supplier of the software was not a royalty simply because the same was not made out of a lease Agreement but a software Licence Agreement.

Honourable Chairman and members of the Tribunal, in order to tackle this issue let us look to the definition of the term **lease** as defined under the same 8.3 of ITA.

“Lease” means an arrangement providing a person with a temporary right in respect of an asset of another person, other than money, and includes a **license.....”**

The Respondent disputes the Appellant’s contention that the software Licence Agreements gave the Respondent a temporarily right to use the software, by saying the software was bought and three License Agreement gave it unrestricted rights to use it. It is the Appellant’s submission that had the software been bought by the Respondent, it couldn’t be in a form of a license which according to the definition above is a **lease**. Before the Board, counsel for the Respondent (then appellant) contended that intellectual properties as software in this case are not sold and bought in the same way like tomatoes or potatoes. We do agree with him and it is now surprising to hear him saying that the software was bought with unrestricted rights to use it. This is what disputed by the Appellant. In the first place what was bought was not that software itself but a mere right to use it. The software remained to be the sole property of the supplier.

Honourable Chairman and members of the Tribunal, It was from that premise that, the Licence Agreement was attached with stringent terms and conditionalities regarding that right to use the said software. Having so submitted it is now evident that since lease include a license, it can now be concluded that the software Licence Agreement entered between the Respondent and Neptune Software PLC was a lease Agreement and that under that Agreement and that under that Agreement the Respondent (Licensee) became a **lessee**. That being the case therefore, the payments made by the Respondent (Lessee) to the software suppliers as Annual Licence Fee was a **royalty** subject to withholding tax under section 82(1)(a) of the Income Tax Act, 2004.

Honourable Chairman and Members of the Tribunal, The Board at therefore erred in law and fact when it held page 7 that the appellant (now Respondents) through the Software Licence Agreement acquired unrestricted right to use the software and further

that the Lumpsum Annual Licence Fee payments made by the appellants (Respondents) to the Licensor is not a royalty under S.82 (1) (a) ITA which provides:-

S. 82 (1) Subject to subsection (2), where the resident person:

(a) pays a dividend, interest, natural resource payment, rent, royalty and

(b) the payment has a source in the United Republic of Tanzania and is not subject to withholding under section.81

the person shall withhold income tax from the payment at the rate provided for in paragraph 4(b) of the First Schedule.

(b) The Tax Revenue Appeals Board erred in law and in fact by holding that the service fees paid by the Respondent (then appellant) relating to the installation, testing and maintenance of the supplied software are not subject of withholding tax.

Honourable Chairman and members of the Tribunal Clause .9 of the Software Licence Agreement provided for a support Technical Services to be provided by the Licensor through its qualified consultant staff throughout the existence of the Agreement.

Hon. Members of the Tribunal, much as it is appreciated that those services to a large extent were being provided directly from the licensor's home country, still there were other services which could not be so provided without stationing staff in the licensee's home country i.e the Tanzania. In the Appellant's (then Respondent) Written Statement of Defence filed before the Board, under paragraph 2 had enumerated 2 types of services which were not entirely rendered outside the United Republic of Tanzania and not paid for by the Government as provided under section .69(i). Those services are subjected to withholding tax under section 83 (1) (b) of the Income Tax Act, 2004. Under this category the following services were rendered in the United Republic of Tanzania namely:

(a) Support and maintenance of the Base Support System, and

(b) Sybase SA (PTY) – 54,880.020 .

Honourable Chairman and members, the Board in its Judgment never touched on the types of services which were rendered direct from outside vis-a-vis those which were being rendered from within. It just ruled out and I quoted:- (page 8 para 2).

“Thus, it is our unanimous finding that, the said services were not performed in Tanzania be it wholly or partly and as such, the said fees cannot attract withholding tax”

Honopurable Chairman and members of the Tribunal, it is this omnibus holding of the Board which has aggrieved the Appellant to reach the extent of appealing to this Honourable Tribunal. Software installation being a new technology in our country once installed the software cannot be left to be maintained by itself without being supported by staff from the supplying country.

In the submission before the Board counsel for the then Respondent one Sojo categorically stated that services falling under clause 9.7 of the Software Licence Agreement were rendered in Tanzania. The Board never said anything to counter this fact instead, it addressed itself to cause 9.3, 9.4 and 9.5 as being services which Neptune was being paid for without showing any evidence to prove that these were the kind of services which it was agreed that Neptune would be paid for. It was from this Board’s holding that the Appellant is of the humble opinion that the Board erred in law and fact when it held that the said services were not performed in Tanzania and hence are not subject to withholding tax.

E: CONCLUSION

Honourable Members of the Tribunal, in view of what I have submitted herein above, the Appellants humbly prays for Judgment and Decree as follows:

- a) This appeal be allowed;

- b) Judgment and all orders of the Tax Revenue Appeals Board be set aside;
- c) Costs of this appeal be provided for,
- d) Any relief that this Hon. Tribunal may think fit to grant.

We humbly submit

RESPONDENT'S REPLY TO THE APPELLANT'S MAIN SUBMISSION IN SUPPORT OF THE APPEAL

Honourable Chairman and honourable members of the Tribunal, this is the Respondent's Reply to the Written Submissions of the Appellant as served on us to support the Appeal by the Tanzania Revenue Authority against the decision made by the Tax Revenue Appeals Board in favour of the Respondent National Microfinance Bank PLC.

I have had great difficulty with the Appellant's written submissions. Ordinarily, an Appellant outlines what was decided by the judicial forum below and why the he thinks the decision contested is wrong. He should state what was decided, on what page, and then explain why it is wrong. The error in the decision is what forms the basis of the appeal and is buttressed with legal/evidential argument to convince the upper body to overturn the decision below. Strangely, in the Appellant's written submissions there is virtually no references to the judgment of the Board save for two peripheral references.

The first reference is at the third paragraph on page 6 of the submissions, and the second on page 7 towards the end of the submissions. I say these are peripheral because the first time the Appellant makes reference to the judgment he is appealing against is when he is concluding his written submissions on the first ground of appeal. What the Appellant has done in these submissions is to argue his case afresh, rather

than demonstrate how the Board where and how the Board erred in its decision. This causes difficulty for both the Respondent and the Tribunal because this is not a fresh trial it is an appeal. It ought to be limited only to the evaluating the correctness of the Board decision. As this matter is for judicial consideration, I will leave it in the hands of the Tribunal to deal with appropriately.

Background

In its judgment dated 17th February 2011, the Tax Revenue Appeals Board ruled that lump-sum software payments made by NMB Plc to Neptune Software Plc were not royalty payments liable to withholding tax under section 83(1)(b). Similarly, the Board ruled that technical support services provided by Neptune Software Plc in connection with the software acquired by NMB Plc were not performed in Tanzania and payment made in relation to such services are not liable to withholding tax under the terms of section 823(1). The TRA challenges both findings of the Board.

1. The uncontroverted evidence before the Board consisted of the Software Licence Agreement dated 30th April 2003 together with the Extension Agreement dated 13th April 2006 (both shown as "**Appendix 7**"). Having examined the contract(s), the Board at page 5 of the judgment observed that "***we wholly agree with Mr. Kibuta that, the parties meant what they said in the contract and that, as outsiders we can not speculate about their intentions. We can interpret what they are saying by looking at the contract deed.***" On page 6 the Board arrived at the following conclusion "***In our humble opinion, in the first place, it was wrong for the respondent to interpolate the otherwise clearly worded agreement apparently with a sole purpose of laying a wider trap against the appellants. Secondly it is rather erroneous to say that, the appellants had acquired the right to use the software until the same becomes obsolete or is superseded by a better software from other suppliers and the appellants in their own discretion opt to discontinue using it. Properly***

interpreted, such an arrangement can not be said to be a temporary right. And if it is not granting a temporary right as we have said hereinabove, it is not a lease but a purchase of the software the payment for which is not a royalty.” The written submissions of the Appellant have not referred to this critical part of the judgment nor have they showed why from point of evidence or law this conclusion is erroneous.

2. Honourable Chairman and honourable members of the Tribunal, contrary to counsel for the appellant’s submission, what was acquired by the respondent under a contract between the respondent and Neptune Software Plc is **software** namely, **Integrated Banking Software**. At page 5 of the proceedings counsel for NMB referred to the Agreement at Appendix 7 and said that ***“it seems to me that the purpose of the agreement and the nature of the agreement is determined by the parties in the words they have used in the agreement. So in the agreement they have said NMB desires to acquire and NMB has agreed to buy*** (see page 1 of the Agreement in recitals one, two and three)”. The agreement did not say NMB agrees to lease the software. It said NMB agrees to buy and indeed they bought the software with the lump-sum payments they made.

3. At page 5 of the written submissions, the respondent counsel has repeated in his written submissions the argument that the lump-sum payments were a royalty or a payment for the software licence. In his view, since the word “lease” is defined in section 3 of the Income Tax Act as including a licence, then the payment for the licence is a royalty liable to withholding tax. It is our respectful submission that the appellant misses the essential ingredient in both the word “royalty” and the word “lease” as defined in the Act. It is a critical requirement that the payment which is a royalty must be made under a lease. The payment in this case was not made under lease. Counsel for Appellant contends that according to the Act lease includes license. With that line of argument counsel has to surmount two obstacles which he

has not done and had previously failed to do at the Board hearing. He has to demonstrate that the payment is for **a temporary right to use an asset**. Temporary by any stretch of imagination can only mean for a determined period, usually a brief period. Counsel did not provide evidence that this transaction involved a term arrangement nor did he say the length of that term. He only jumps to the fact that lease includes licence but forgets the critical requirement that even in relation to licence the payment has to relate to temporary use for a term determinate.

4. Honourable Chairman and members of the Tribunal, the Income Tax Act, 2004 defines royalty as a ***payment made by the lessee under a lease of an intangible asset***. The underlying requirement is that the payment must arise out of a lease arrangement for an intangible asset. While software is certainly an intangible asset, the issue that requires determination by this Tribunal is whether the lump sum payment was made out of a lease agreement. To answer this question one needs to look no further than the contract between NMB and Neptune Software Plc.
5. We have referred you to the recitals in the agreement which clearly state the intention of the parties being to **purchase/acquire** the software from Neptune Software Plc. These words leave nothing to speculation as the transaction is one of purchase not lease or otherwise. By purchasing the software, the respondent bears both the risk and the rewards associated with the software. The software is used for generation of income for the bank (rewards) and the degradation expenses - obsolescence (risks) are born by the bank as well.
6. The last paragraph of page 5 of the appellant's written submission contains a statement that the respondent did not purchase the software but only paid for the right to use. This statement intentionally misrepresents the parties' intention as

stands manifestly clear in words they have used in the agreement, which is to purchase the software. The appellant's argument is clearly untenable.

7. Honourable Chairman and members of the Tribunal, the definition of the term **lease** as provided for under the Income Tax Act, 2004 is clear. It is "*an arrangement providing a person with a **temporary right** in respect of **an asset of another person**, other than money and includes a **licence***". A lease envisage a scenario where a person uses an asset belonging to another person or (as the counsel for the appellant seems to suggest but failing to appreciate properly) a licence to use an asset belonging to another person temporarily. The word temporary means lacking continuity or not lasting. That is why the Income Tax Act, 2004 defines a lease as an arrangement giving a person a temporary right. This temporary right can be in form of a licence. Therefore the licence under a lease arrangement has to be temporary.
8. Honourable Chairman and members of the Tribunal you need to look at Clause 29 of the Software Licence Agreement at appendix 7. The wording is very clear in relation to length of use of the agreement. It provides that the agreement shall continue until terminated in accordance with the provisions of the agreement. This indicates that there is continuity and permanence. There is no lease which is open ended or with indeterminate term.
9. Honourable Chairman and members of the Tribunal, if the parties had intended this to be a lease, they would have said so in their contract. As a matter of law no one (including the tax man) has the right to impose on the parties intentions which were not contemplated by them. The only reason the Counsel for the respondent seeks to impose these intentions which are otherwise not evident is to collect tax where tax is not due. This is not the spirit of the Income Tax Act, 2004.

10. Honourable Chairman and members of the Tribunal, Counsel for the respondent seems not to appreciate the nature of the asset in question. This is an intangible asset (know how), arising out of inventions and intended to be used to by many people while protecting the interest of the inventor. The interests of the inventor are protected by making sure that the underlying ownership (through a copyright) remains with the inventor. Otherwise the value of owning the invention would be degraded.

11. In order to hold that the lump sum payment is a royalty and therefore subject to withholding tax under Section 82(1)(a) of the Income Tax Act, 2004, this Tribunal must be satisfied that the payment was a result of temporary arrangement whereby the respondent acquired a temporary right to use an intangible asset belonging to Neptune Software Plc. To arrive at such a decision you have to ascertain that from the contract between the respondent and Neptune Software Plc was a lease agreement having a fixed term.

12. As a second ground of appeal, the Appellant contends that the Tax Revenue Appeal Board erred in law and in fact in holding that the service fees paid by the bank in connection with the installation, testing and maintenance of the software are not subject to withholding tax. The appellant further contends that the service fees paid by the respondent to Neptune Software Plc for support services provided by Neptune Software Plc are liable to withholding tax.

13. We argued before the Board that the Income Tax Act restricts withholding tax only to payments which have a source in Tanzania. Section 69(i) declares that a payment for services has a source in Tanzania if the services are performed in Tanzania. Although the payment was made from Tanzania, the services for which Neptune Software Plc were paid for were not performed in Tanzania therefore they

do not have a source in Tanzania and therefore according to the Income Tax Act 2004 are not liable to withholding tax. Having examined the evidence, the Board agreed. In arriving at its decision, the Board correctly appreciated that software support of the kind provided by Neptune were not performed in Tanzania. Things like software development, software maintenance, uploading of updates, debugging existing software, which together constitute support services were performed either in the UK or from South Africa. They cannot be subjected to withholding tax without contravening section 69.

14. Honourable Chairman and members of the Tribunal, paragraph two of page 7 of the appellant's written submission attempts to break up the software support services into what he calls (a) Support and maintenance of the Base Support System and (b) Sybase SA (PTY) which services he argues were performed in Tanzania therefore have a source in Tanzania and accordingly subject to withholding tax. In reply we ought to say three things. This breakdown argument was not made in the Board below and is being made for the first time which is irregular and not allowed on appeal. Secondly no evidence was presented at the Board (because the argument was not made) and no evidence is produced now as none can be produced on appeal. Thirdly, the reference to Sybase SA (PTY) a service is bizarre because what is alleged by the Counsel to be a type of service is actually the name of the company which performed the support service from South Africa

15. Hon. Chairman and members of the Tribunal, withholding tax in Tanzania is applicable to payments for service which have a source in Tanzania as provided in sections 83(1)(b) and 69 (i) of the Income Tax Act, 2004. These sections provide that withholding tax is applicable to services fees that are paid for services that are performed by non resident person in Tanzania and payment made by a resident person.

16. Honourable Chairman and members of the Tribunal, the Counsel for the respondent has submitted that the Board failed to take in to account the services provided for under clause 9.7 (testing and installation of new releases issued by the licensor) of the agreement between the respondent and Neptune Software Plc. Our position is that these types of services do not have to be performed in Tanzania. In any event, Counsel for the respondent fails to appreciate that payment for such services are made when the services are performed. We argued in the Board and wish to reiterate our position that the respondents did not pay for these services because they were not performed in the relevant years of income. Counsel for the respondent assumes and indeed provides no evidence that the respondent paid for these services. Although this type of service is included in the agreement, it is only rendered when there is a new release. If there is no release, there is no testing or instalment. Accordingly there cannot be a payment.

17. Finally, let us say one more thing. There are many of us who purchase software packages such as Microsoft office from Microsoft, architectural and photographic software from Apple, GPS and other positioning software from Google, etc. These software packages are constantly updated and maintained for users by the software companies. It would be absurd to suggest that the support/maintenance services provided by these companies are subject to withholding tax in Tanzania

Honourable Chairman and Members of the Tribunal it our respectful submission that for the above reasons this appeal must fail and the judgement of Board be confirmed. We pray for the costs here and below.

We humbly submit.

14/7/2011

QUORAM:

Hon. Judge Dr. F. Twaib	Chairman
Prof. J. Doriye	Member
Mr. J.B. Kalolo	Member
For the Appellant	Mr. Maliseli Busegano, Legal counsel
For the Respondent	Dr. Kibuta, Advocate
Mrs. Halima Said	RMA

Tribunal:

One member of the panel Mr. Kalolo Bundala is not present. We cannot continue with the hearing.

Order:

Hearing adjourned to tomorrow 15th July, 2011 at 1.00 pm.

Hon. Judge Dr. F. Twaib	Chairman, Sgd
Prof. J. Doriye	Member, Sgd

14/7/2011

15/7/2011

QUORAM:

Hon. Judge Dr. F. Twaib	Chairman
Prof. J. Doriye	Member
Mr. J.B. Kalolo	Member
For the Appellant	Mr. Haule, Advocate
For the Respondent	Dr. Kibuta, Advocate.
Ms. G. Ntamuturano	PS

Mr. Haule:

Hon. Chairman and members of the Tribunal, your directives required us to file rejoinder submissions by 13/7/2011.

Unfortunately, on 4/7/2011, I had to travel to Kigoma, via Mwanza. I returned on 10/7/2011. On 11/7/2011, I had a matter before the Court of Appeal. I met Mr. Kibuta at the Court of Appeal. I was told by Mr. Kibuta's assistant Mr. Ndangi, that they had filed their Reply. I could not get the submissions on that day, though it had been received by one of our officers. I managed to get a copy thereof on 12/7/2011. I was supposed to file my rejoinder submission by 13/7/2011.

I began preparing the submissions, but could not do finish. I had to send my assistant, one Marcel, to appear before the Tribunal and pray for extension of time. I have documentary proof to support my assertion that I was in Kigoma. Mr. Marcel told me upon his return to the office that we are supposed to appear today. I thus pray for extension of time of two days.

I thought that making the prayer by chamber summons would require time. That's why I am making this prayer orally. I humbly submit.

Dr. Kibuta:

My Lord Chairman and Members of the Board, I am afraid that I am forced to object to this application. And, I do so with a heavy heart. I am always courteous to my colleagues in the TRA, as they indeed are to me. The matter raises a significant point for this Tribunal and the time and commitment that we all make.

I don't question that the trip was made. But for a diligent counsel, there is always time to fulfill the obligations that we undertake to discharge. I feel it is ridiculous that a document filed in the Respondent's department somehow could not be found for two

days. I find it incredible that sometime counsel had to obtain confirmation from us that we had filed submissions. Counsel should have made arrangements to have the document placed on his desk.

The Court of Appeal appearance that we made on 11/7/2011 did not cost more than 10 minutes. All we were doing was to notify the court that the Application before it had collapsed and that, therefore, there was nothing to hear.

Even in that appearance, my colleague was categorizing when we were rising after Honourable Nsekela had finished. There was still sufficient time for him acting with diligence to start working on the rejoinder submissions and finish it. But I would expect, my Lord, that a diligent Counsel, understanding the commitment that all others have made and realizing that he is running out of time, would have preferred the submission and have the submissions in hand while making an application such as this one. To ask for three days is not a practice to which we all must subscribe.

I am thus obligated to oppose the application. I am very much obliged, and thank you.

Mr. Haule:

My Lord, I wish to reply as follows:

First of all, I would like to express the difficulty of a legal counsel working in-house in a large organization like the TRA as opposed to a counsel working for a firm of 3 or 4 lawyers.

We are a total of about 17 advocates, and are accommodated in 3 different buildings. In this case, the submissions were received by an intern. Such a person would not be so responsible. The document was received on 6/7/2011. But it was only on 12/7/2011 (in the afternoon) when it landed on my desk. I could not have started working on the rejoinder after leaving the Court of Appeal.

Regarding my Commitment to do the work, I do have a draft already, which I cannot file because it is incomplete. I will be able to file it on the day if given a chance.

If Dr. Kibuta has a good case, we cannot be worried about extension of time, unless he thinks that by my filing the rejoinder, it would prejudice his client's case. I have already started working on the rejoinder.

Order:

1. Ruling on 19/9/2011 at 14 HRS.
2. Deliberations to be conducted today. Opinions today.

Hon. Judge Dr. F. Twaib

Chairman, Sgd

Prof. J. Doriye

Member, Sgd

B. Kalolo

Member, Sgd

15/7/2011

Tribunal:

Deliberations conducted.

Member's opinions:

Prof. Doriye:

My opinion is that the filing of the submissions would not prejudice the Respondent. It is clear, however, that the Appellant's Counsel was negligent. And his reasons for the prayer for extension of time are not convincing. In the interests of justice, however, let the prayer be granted.

Prof. J. Doriye

Member, Sgd

15/7/2011

Mr. Kalolo:

I do not think that there is good ground for granting extension. In the ordinary course of things, we should not have granted the prayer. But, in order to do substantial justice, I feel that the application should be granted. The Applicant/Appellant should, however, pay the cost of the two adjournments whatever the results of the appeal.

B. Kalolo

Member, Sgd

15/7/2011

19/5/2011

QUORAM:

Hon. Judge Dr. F. Twaib

Chairman

Prof. J. Doriye

Member

Mr. J.B. Kalolo

Member

For the Appellant

Mr. Felix Haule, Advocates.

For the Respondent

Dr. O. Kibuta, Advocate

Ms. Sabiha Nassib

SA

RULING

We begin by stating that the Tribunal has, after careful consideration of the rival submissions by Counsel for the parties herein, decided to grant the Applicant the extension of time for filing rejoinder submissions. We are doing this not because we are convinced by the reasons advanced by learned Counsel Haule for the Appellant on his failure to file his rejoinder submissions within time, but rather because we are of the view that the dictates of substantive justice so require.

Usually, submissions are, as in the present case, not evidence but mere explanations by parties or their advocates or representatives of the grounds in support of their causes. We feel that submissions actually assist the Court or Tribunal in reaching a fair decision.

Hence, we all agree with Dr. Kibuta, learned counsel for the Respondent, that the reasons given by Mr. Haule are entirely without merit, with, perhaps, the possible exception of the fact that the application for extension has been made without undue delay.

We are also alive to the inconvenience caused to Dr. Kibuta (as indeed the Tribunal) by the Appellant's failure to comply with the earlier orders of the Tribunal. For that reason, while we grant the prayer for extension time, we order that the Appellant should in any event, pay the Respondent's costs for the proceedings on 14/7/2011, 15/7/2011 and today 19/7/2011.

It is so ordered.

Hon. Judge Dr. F. Twaib	Chairman, Sgd
Prof. J. Doriye	Member, Sgd
B. Kalolo	Member, Sgd

19/7/2011

Tribunal:

Ruling delivered in the presence of Counsel as appears above this 19th day of July, 2011.

Hon. Judge Dr. F. Twaib	Chairman, Sgd
Prof. J. Doriye	Member, Sgd
B. Kalolo	Member, Sgd

19/7/2011

Order:

1. Rejoinder submissions on 20/7/2011
2. Hearing (for clarifications) on 26/7/2011

Hon. Judge Dr. F. Twaib

Prof. J. Doriye

B. Kalolo

Chairman, Sgd

Member, Sgd

Member, Sgd

19/7/2011

APPELLANT'S REJOINDER TO THE RESPONDENT'S REPLY SUBMISSIONS

A. GENERAL OBSERVATION:

Honourable Chairman and Members of the Tribunal, counsel for the Respondent has said that he has failed to understand the Appellant's submission simply because it doesn't give reference in terms of pages and paragraphs and how the Board erred in its decision and therefore makes the submission to be a fresh case while it is an appeal.

Honourable Chairman and Members of the Tribunal, the Appellant could not go on arguing the errors committed by the Board in its decision without first giving an introduction to the whole transaction which gave rise to the dispute at hand. The terms of the contract between the supplier of the software (the **licensor**) and the Respondent (the **licensee**) is what makes the bone of contention between the Appellant and the Respondent in this appeal. Hence, that introductory part was very much crucial for this Honourable Tribunal to be enlightened with.

B. Background:

Honourable Chairman and Members of the Tribunal, in paragraph 1 of the Respondent's Reply Submission, the Respondent has quoted verbatim the words of the Board in holding that the lumpsum payments made by the Respondent to the software supplier was not a Royalty and hence not subjected to withholding tax. **Honourable Members of Tribunal**, it was this holding of the Board which has aggrieved the Appellant to the extent of coming to this Honourable Tribunal by way of an appeal. In our main submission at page 4 to 6 we have clearly analysed how the Licence Agreement between the Respondent and the software supplier can be a *lease* agreement and the payment made out of that agreement can be a royalty chargeable to withholding tax.

The Appellant categorically has disputed the Respondent's contention that the agreement was an agreement for the purchase of the software with unrestricted rights to use it. The Appellant has vividly shown restrictions contained in the Agreement from clauses 3:1 to 3: 9 and clauses 9 to 22 which contained terms and conditions, the contravention of which would lead to revocation of the whole Agreement. All these terms show that, the Agreement was not for the purchase but lease, after all intangible assets like the software cannot be wholly purchased like potatoes or tomatoes.

Honourable Chairman and Members of the Tribunal, in paragraph 2 of the Reply Submission, the Respondent relies on the proceedings and recitals of the Agreement in support of its defence submission. The Appellant wishes to submit here that what is being appealed against is not the contents of the proceedings but the Board's decision. That being the case therefore, the contents of the proceedings are much irrelevant here and need not be relied upon.

With regard to the recitals to the main contract, those have nothing to do with the terms and conditions of the main contract. Normally recital only shows the intention of the parties and in the Agreement it is clearly being stated that, the Licensee has agreed to buy from the Licensor ***the right to use the software under the terms and conditions contained therein.*** In the presence of the licensor and licensee nothing is bought but mere licensed or leased and further that, normally an outright purchase is not accompanied by any term or condition. It is from this premise we submit that the software was leased or licensed, and that any payment made thereof is a loyalty under the provisions of section 82 (1) (a) of the Income Tax Act 2004 hence, chargeable to withholding tax.

Honourable Chairman and Members of the Tribunal, the Respondent in paragraph **3** of his submission insists that the arrangement between itself and the software supplier (the licensor) was not a lease simply because it was not temporary with a determined period. That notwithstanding, the fact that the Respondent was obliged to pay a lumpsum annual licence fee every year is a clear indication that the arrangement was a temporary one based on annual length of time, for failure to pay the fee would result into revocation of the whole contract, hence a lease.

Honourable Chairman and Members of the Tribunal, coming to paragraph **4** of the Respondent's Reply Submission, the Appellant sticks to his guns that, since it is not disputed that the contract was in respect of **the right to use an intangible asset**, that arrangement was a lease because an intangible asset cannot be bought like tomatoes or potatoes.

Regarding paragraph **5** of the Respondent's Reply Submission, the Appellant reiterates his stance that software cannot be acquired through a total

purchase but can only be leased to be followed by periodic licence fees as was the case here. It was from this kind of arrangement that the word "*royalty*" came in and defined by the Income Tax Act, 2004 to mean ***payment made by a lessee under a lease of an intangible and includes payment for:-***

(a) ***The use, or the right to use a copyright, potent, design, model, plan secret formula or process or trademark.***

In our case, the Annual lumpsum payments made by the Respondent were the payments for the right to use the secret formula contained in the software, hence a ***royalty*** chargeable to withholding tax under section 82 (1) (a) of the Income Tax Act, 2004 .

Honourable Chairman and Members of the Tribunal, paragraph 6 of the Respondents submission is totally disputed. The Appellant repeats his position stated in page 5 of his main submission that, the Respondent never purchased the software but only leased it for the right to use it. This is manifested in the terms and conditions of the Agreement where it is restricted from copying or transferring it to third parties (Clause 3.3 of the Agreement).

Honourable Chairman and Members of the Tribunal, much as it is appreciated that a **lease** connotes ***a temporary use***, (paragraph 7 of the Respondent's Reply Submission), in the Agreement between the Respondent and the software supplier, parties knew that such an arrangement was not to last long, that is why under clause 19 of their Agreement there were provisions relating to **Termination** of the Agreement followed by **Consequences of Termination** in clause 20. All these clauses prove that the arrangement was not to last forever, but mere temporary subject to the licensee complying with all the terms and conditions of the Agreement.

Going to paragraph **8** of the Respondent's Submission, the fact that the continuity to use the software was subject to termination in accordance with the provisions of the Agreement is a clear evidence that the Agreement was not infinitive, but a temporary one.

Honourable Chairman and Members of the Tribunal, regarding paragraph **9**, "**lease**" and "**licence**" are words which can be used interchangeably to mean the same thing. It is like using the words "**filing**" or "**lodging**" a document. The two words have the same meaning. In our case one has to look on the substance of the contract. Software being an intangible asset cannot be bought but only leased under a special licence agreement. That being the case therefore, the allegation that the Appellant forces the use of the said words to collect taxes has no meaning at all.

Paragraph **10** of the Respondents Reply Submission helps to strengthen the Appellant's case that, in order to encourage inventions software as an intangible asset cannot be bought but only leased.

Honourable Chairman and Members of the Tribunal, in paragraph 11 of the Respondents Reply Submission, going by definitions of the terms "**royalty**" and "**lease**" as defined under section 3 of the Income. Tax Act, 2004 and taking the fact that the lumpsum payments were being made annually (not once and for all) it goes without saying that, such an arrangement was not intended to go to infinity but to be of periodic basis (i.e. annually) depending on the licensee complying with the terms of the contract.

Honourable Chairman and Members of the Tribunal paragraphs 12, 13 and 14 of the Respondent's Reply Submission can be replied as follows:-

- (a) After having installed the software there was a need to support it and that the support was through the provision of technical services. The Respondent states

that there was no tax to be collected taking into account the fact that all the support services were being done from outside Tanzania. The Appellant denies this contention by stating that, if the services were wholly being performed from outside Tanzania, the Respondent wouldn't be obliged to remit monies from Tanzania to pay the supporters of the software who were sitting outside the country.

(b) Regarding the breakdown argument, this had already been averred in the Written Statement of Defence as a pleading. With regard to services like software development, software maintenance, uploading of updates and debugging existing software, these were not mentioned before the Board and that even the Board in its judgment never categorized those services and clearly state which services were performed where. This is evidenced by the counsel for the Respondent when he says that the support services were performed either in the UK or from South Africa – meaning that even the counsel himself is not sure of what kind service and where from it was performed.

(c) Before the Board at page 7 (paragraph 2) of the proceedings the same counsel with all the confidence told the Board that the said services were provided by the seller of the software while sitting in his own country. This sentence is misleading in that software as an intangible property cannot be sold and secondly South Africa was not the home country of the supplier of the said software hence the whole argument by the Respondent should not be relied upon.

Honourable Chairman and Members of the Tribunal, regarding paragraphs 15 and 16 respectively of the Respondent's Reply Submission, the Appellant replies that the payments for technical support of the software had a source in Tanzania because by providing the support of the software which by the time was in Tanzania though the

person who was rendering the service was sitting outside Tanzania, the monies that the foreign supporter was being paid automatically had a source in Tanzania as provided under section 83(1)(b) of the Income Tax Act, 2004, hence liable to withholding tax. The Tax Revenue Appeals Board failed to appreciate this fact, hence decided in favour of the Respondent (then appellant).

Honourable Chairman and members of the Tribunal, regarding paragraph 17 of the Respondents Reply Submission, we wish to reiterate our earlier position that, software packages can not be purchased but mere leased in the form of licence agreements. Further, what is subjected to withholding tax is not the support/maintenance services but payments arising from those services if they have a source in Tanzania. We pray your Honourable Tribunal not to be misled by the Respondent on this point.

Honourable Chairman and Members of the Tribunal, in view of what has been stated in our main submission and in this rejoinder submission, the Appellant prays for Judgment and Decree as follows:-

- (i) This appeal be allowed.
- (ii) All orders of the Tax Revenue Appeals Board be set aside.
- (iii) Costs be provided for.
- (iv) Any other or further order that this Honourable Tribunal may think fit and just to grant.

We humbly submit.

26/7/2011
QUORAM:

Hon. Judge Dr. F. Twaib	Chairman
Prof. J. Doriye	Member
Mr. J.B. Kalolo	Member
For the Appellant	Mr. Beleko, Advocates.
For the Respondent	Dr. O. Kibuta, Advocate
Ms. Sabiha Nassib	SA

Tribunal:

The Tribunal has gone through the submissions you have both filed. We only have one question for both of you:

Apart from the "Investment Costs" which is provided for under clause of the original Software Licence Agreement, what was the other considerations?

Dr. Kibuta:

We have gone through the record and do not seem to be able to find out the information requested. We endeavour to supply it to the Tribunal tomorrow once we find it.

Mr. Beleko:

We are in the same position.

Order:

1. Deliberations on 10/8/2011
2. Opinion on 18/8/2011
3. Judgment on 26/8/2011 at 1400 hrs.

Hon. Judge Dr. F. Twaib

Chairman, Sgd

Prof. J. Doriye
B. Kalolo

Member, Sgd
Member, Sgd

26/7/2011

17/8/2011

QUORAM:

Hon. Judge Dr. F. Twaib **Chairman**

Prof. J. Doriye **Member**

Mr. J.B. Kalolo **Member**

For the Appellant **} Absent**
For the Respondent **}**

Tribunal:

Deliberations done today after being adjourned on 10/8/2011 due to the absence of Mr. Bundala Kalolo, Member.

Hon. Judge Dr. F. Twaib

Chairman, Sgd

17/8/2011

Order

- a) Opinions on 29/8/2011
- b) Judgment 14/9/2011

Hon. Judge Dr. F. Twaib

Chairman, Sgd

17/8/2011

25/10/2011

QUORAM:

Hon. Judge Dr. F. Twaib **Chairman**

Prof. J. Doriye **Member**

Mr. J.B. Kalolo **Member**

For the Appellant **} Absent**
For the Respondent **}**
Mrs. H. Said **RMA**

Order:

- a) Opinions by 3/11/2011
- b) Judgment on 21/11/2011

Hon. Judge Dr. F. Twaib Chairman, Sgd
25/10/2011

16/01/2012

QUORAM:

Hon. Judge Dr. F. Twaib		Chairman
Prof. J. Doriye		Member
Mr. J.B. Kalolo		Member
For the Appellant	}	Absent
For the Respondent		
Mrs. H. Said		

Tribunal:

- i. Opinions 16/2/2012.
- ii. Judgment on 6/02/2012 at 14.00 hours.

Hon. Judge Dr. F. Twaib Chairman, Sgd
16/01/2012

OPINION BY PROF. J. DORIYE:

This is an appeal against the judgment of the Tax Revenue Appeals Board in Income Tax Appeal no. 32 of 2010 delivered on 17th February, 2011 with Hon. P. M. Kente, Chairman, presiding. The parties agreed to three framed issues from the outset of the deliberations as follows:

- 1. Whether payment for software are subject to withholding tax;
- 2. Whether service fees relating to software are subject to withholding tax; and
- 3. To what relief the parties are entitled.

In the course of its judgment the Board endeavoured to answer the above framed issues. With regard to the first issue the Board took the view that for the annual lamp sum payments to qualify for withholding tax charge it has to constitute a royalty payment defined as "any payment made by the lease of intangible asset and includes payments for the use of or the right to use a copyright, patent, design model plan, secret formula or process or trademark ...". Accordingly, for there to be a royalty payment there has to be a lease agreement, the chief characteristic of which is that it has to have a revocability clause. Hence according to the Board "we see nowhere in the contract deed where it has stated that the right given to the appellant to use the software would be revocable..." by this reasoning, since the right granted is not revocable it is not a lease but a purchase which entitles the Appellant to unrestricted right to use the software; as such "the lampsum payment made by the Appellant is not royalty under S.82(1) (a) of the Income Tax Act, 2004, R.E. 2006 and as such was not subject to withholding tax."

With regard to whether service fees relating to software are subject to withholding tax, the Board posed the question "whether or not the said fee has a source in the United Republic of Tanzania as required by S.83 (1)(b) of the Income Tax Act 2004," and the Board's answer to that question was in the negative.

It was on that basis that the Board allowed the Appeal by the Respondent in this case but ordered each party to bear own costs; hence this appeal before the Tribunal.

The hearing before the Tribunal was by way of written submissions. In his written submission before the Tribunal the Counsel for the Appellant adduced two grounds of Appeal, namely that

- a) The Tax Revenue Appeals Board erred in law and in fact by holding that the lampsum payment made by the Respondent (licencee) to the licensor is not a royalty under S.83(1) (a) 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.

Submitting on the first ground the Appellant counsel argued that what was bought by the Respondent under the Agreement was not a software itself but a right to use the licensor's software as the agreement contained number of terms and conditions; the infringement of which would render the agreement revocable. Consequently, the "right" was temporary, the agreement was a lease and the lumpsum payments were a royalty; hence were subject to withholding tax. In this context a lease is defined as "an arrangement providing a person with a temporary right in respect of an asset of another person other than money and includes a license...".

With regard to the Board's holding that the service fees paid by the Respondent relating to installation testing and maintenance of the supplied software are not subject to withholding tax the counsel for the Appellant makes a distinction between those services that were being provided directly from the leensor's home country and those that must have been provided by station staff in the licensees home country. It is this latter category of services whose payments are subject to withholding tax. Indeed in this category are those services categorically stated under clause 9.7 of the Software License Agreement

In his reply submission by the Appellant's counsel the Respondent contended that the evidence available for this case is the software license agreement between the parties namely, NMB and Neptune Software PLC. The agreement clearly indicates that what was acquired by the Respondent is Integrated Banking Software and that nowhere did the Agreement refer to lease of software and the lampsum payment was for purchase of software. The Appellant's argument that the lumpsum payment was a royalty is untenable since a royalty payment must be made under a lease agreement and for there to be a lease agreement payment has to be for a license which must be temporary with a determinate time frame giving a specifically stated length of time. While it is true that software is an intangible asset, it is not true that the lumpsum

payment was made out of a lease agreement for the parties had made it unambiguously clear in the recitals to the Agreement that the intention was to purchase/acquire the software. In this regard by purchasing the software, the Respondent bears both the risk and rewards associated with the software and that the agreement will continue until terminated in accordance with the relevant provisions indicating that there is continuity and permanence.

With regard to second ground of Appeal the counsel for the Respondent argued that Income Tax Act restricts withholding tax only to payment with a source in Tanzania and that S. 69(1) states that services have a source in Tanzania if they are performed in Tanzania and since the services were not performed in Tanzania their payments being made from Tanzania notwithstanding, they are not subject to withholding tax. On service listed under clause 9.7 of the Agreement, the Counsel for the Respondent argues that "the Respondent did not pay for these services because they were not performed in the relevant years of income" as these are rendered only when there is a new release of the software, which was not the case in the instant situation.

In this appeal the parties are in agreement that the evidence available is the software agreement and all the arguments and counter arguments draw support from the agreement between Neptune Software PLC and the National Microfinance Bank which agreement is stated to be software Licence Agreement and not a Software Purchase Agreement. If it is true that parties meant what they said in the contract, then the starting point is not the recitals as the Board wants one to believe but the title of the Agreement itself.

According to the Board, the Agreement is a purchase agreement because "the right given to the Appellant to use the software" was not revocable. With due respect to the Board a purchase agreement must clearly state a purchase price which may only vary according to the terms of payment, that is to say cash or credit terms. Under normal conditions cash and credit terms will differ in that cash terms may contain an element

of discount in recognition of time value of money. In the instant case there is no indication as to what the purchase price of the software is and what the terms of payment are. In his submission the Respondent's counsel has conveniently avoided this issue and the Board conveniently sidestepped it by no saying what the annual lumpsum payments were other than that they were "not a royalty" This, however, cannot suffice, for a purchase price must be known in advance along with its payment terms:- whether cash or credit and whether in it's a lumsum or installments with a clearly spelt out time frame and limit. That is to say there has to be a date on which a purchase price is fully paid. Both the Board and the Respondent have failed to demonstrate this. Turning to whether or not the right given to the Respondent was temporary and hence revocable the only evidence available is the agreement itself. A right is only irrevocable if there are no conditions attached to its use. As long as there are conditions attached to it it is revocable to the extent the use did not comply to those conditions.

In the instant case "the Licencee" agreed "to buy from the Licensor the right to use the software under terms and conditions" stipulated under clauses 3.1 to 3.9 of the Agreement and particularly clauses 19.3(1) – 19.3(4)j clause 19.3.1 is particularly definitive in this regard; -

"19.3 The Licensor may also terminate this Agreement by serving the Licensee a not less than thirty (30) days written notice intimating its intention to terminate the Agreement where the Licensee is in breach of any fundamental term, condition or warranty contained in this Agreement and upon being informed of the breach, the Licensee has failed to remedy the breach within thirty days of being notified of such breach... or the Licencee has failed or refused to offer adequate compensation thereof. A breach of any provision relating to payment shall entitle the Licensor to terminate the Agreement at the expiry of thirty (30) days from the due date of payment or the date of receipt of a notice of the breach, ..."

The provisions relating to payment are spelt out in the software license Agreement extension of 7th April 2006 which spells out payments to be made by the licensee

namely investment costs, project expenses, consulting services and "a lumpsum annual license fee". In the latter case

"The licensee agrees to pay a lumpsum annual license fee ... commencing on the date of the agreement and on subsequent anniversaries".

The provisions are definitive in that they clearly spell out the critical condition for revocability of the license and the time frame within which that critical condition must be fulfilled, namely, a year. The Board is clearly wrong when it held that

"we see nowhere in the contract deed where it is stated be it expressly or impliedly that the right given to the Appellants (sic,) to use the software would be revocable as alleged....."

From the evidence available in the Agreement it is clear that the Board did not look hard enough to locate the revocability clause. It is our considered view that not only was there a time frame for the license but also revocable implying that this agreement is a lease Agreement and temporary. In this respect the conditions laid down by the Respondent counsel in his submission for payment to be a royalty, namely that "for the payment to be for a license, it has to be for temporary right to use an asset" (i.e. a determinate period) and with a term arrangement with a stated term, have been met.

Turning to the second issue framed by the Board namely, whether service fees relating to software are subject to withholding tax the Board's response was that while the payment was made from Tanzania the services were not performed in Tanzania, therefore they do not have a source in Tanzania, hence not liable to withholding tax. This position of the Board is clearly at variance with provisions of the law which it claims to have guided its judgment.

The law-Income Tax Act, 2004 R.E 2006 provides for when a payment is considered to have a source in Tanzania under section 67, 68 and 69. For our present purpose S. 68(1) (b) of the Income Tax Act 2004, R.E. 2006 provides that "Amounts directly included in calculating income have a source in the United Republic where they consist

of:- payments that have a source in the United Republic” in addition S.69(h) provides that “the following payments have a source in the United Republic: “(h) payment received by a person who conducts a business of transmitting messages by cable radio optical fibre or satellite or electronic communication in respect of messages **by apparatus established in the United Republic**

The above provisions evidently support the Appellant counsel’s submission that “the monies that the foreign supporter was being paid automatically had a source in Tanzania as provided for under Section 83(1) (b) of the Income Tax Act, 2004, hence liable to with holding tax”

In this regard I take the view that the Agreement between NMB and Neptune software PLC was a lease agreement both in form and and essence and the payment thereon is a royalty and that the services rendered to the Respondent by the suppliers irrespective of their location were performed on an asset in Tanzania and the payments have a source in Tanzania and therefore subject to withholding tax.

It is my considered view that this appeal be upheld and the Respondent should bear the cost of his appeal at all levels.

Prof. J. Doriye Member, Sgd

OPINION BY MR J. KALOLO-BUNDALA

It is my considered opinion that the Agreements in totality, and the various provisions in the said Agreements between National Microfinance Bank PLC and the supplier of the softwares, Neptune Software PLC was that of the Licencee and Licensor, as the arrangement was not intended to transfer the software permanently to the Bank. The supplier remained with, and had the right to withdraw the software, replace it or

change it, without approval or consent of the Bank, hence the Agreement was limited to a right of use of the software.

In addition, the fact that the Bank was making annual payments to the supplier for use of the software defeats the argument that there was a sale, as there was no permanency of ownership by the Bank

It would have been different if the annual payments were being made towards settlement of the purchase price.

In the light of the foregoing observation, I am inclined to opine that the appeal has merit and it ought to be allowed.

J. Kalolo-Bundala Member, SGD

16/2/2012

QUORAM:

Hon. Judge Dr. F. Twaib	Chairman
Prof. J. Doriye	Member
Mr. J.B. Kalolo	Member
For the Appellant	}
For the Respondent	
Ms. G. Ntamuturano	Absent PS

Tribunal:

Members opinions submitted.

ORDER:

Judgment on 20/2/2012 at 12.00 noon.

Hon. Judge Dr. F. Twaib Chairman, Sgd

16/2/2012

20/2/2012

QUORAM:

Hon. Judge Dr. F. Twaib	Chairman
Prof. J. Doriye	Member
Mr. J.B. Kalolo	Member
For the Appellant	Mr. Amandus Ndayeza, Legal Counsel
For the Respondent	Mr. Allan, Kileo, Adv. Assisted by Macktrida Boniface
Ms. G. Ntamuturano	PS

Tribunal:

Judgment delivered this 20th day of February 2012 in the presence of counsel/parties as above.

Hon. Judge Dr. F. Twaib	Chairman, Sgd
Prof. J. Doriye	Member, Sgd
Mr. J.B. Kalolo	Member

20/2/2012

**IN THE TAX REVENUE APPEALS TRIBUNAL
AT DAR ES SALAAM**

INCOME TAX APPEAL NO. 7 OF 2011

**(Appeal from the judgment and decree of the Tax Revenue Appeals Board in
Income Tax Appeal No. 32 of 2010 (P.M. Kente, Chairman)
dated 178th February 2011)**

THE COMMISSIONER GENERAL APPELLANT

VERSUS

NATIONAL MICROFINANCE BANK LTD. RESPONDENT

JUDGMENT

F. Twaib, J, Chairman

The material facts giving rise to the dispute that led to this appeal can be briefly stated as follows:

By a deed dated 30th April 2003, the Respondent NATIONAL MICROFINANCE BANK LTD., entered into an Agreement with NEPTUNE SOFTWARE PLC., entitled "Software Licence Agreement".

Certain payments were made pursuant to the said Agreement. In 2009, the Appellant's Large Taxpayers Department conducted an audit of the Respondent covering corporate tax, VAT, employment tax and stamp duty for the period from 2004 to 2007. The Appellant issued a preliminary audit report on 12th October 2009. The Report said, *inter alia*, that the Bank made several payments to non-resident persons for licence fees for software and related IT support services from which the Respondent "had an obligation to deduct tax at appropriate non-resident withholding tax rate as required by sections 34 (1) and 83 (1) (b) of the Income Tax Act 1973 and 2004 respectively".

The Respondent disputed these findings, but the Appellant stood his ground. On 31st May 2010, the Appellant issued Withholding Tax Certificate/Interest No. WHT/NR/14/5/2010 for the period 2004 to 2007. The Certificate showed a total withholding tax payable of TZS 680,042,401. It comprised a principal tax of TZS 411,876,562 and interest thereon of TZS 268,165,839. The Respondent was aggrieved by the position taken by the Appellant and appealed to the Tax Revenue Appeals Board in Income Tax Appeal No. 32 of 2010. Three issues were framed for the determination of the Board, namely:

4. Whether payments for software are subject to withholding tax;
5. Whether service fees relating to software are subject to withholding tax;
and
6. To what reliefs are the parties entitled?

In a judgment delivered on 17th February 2011, the Tax Revenue Appeals Board allowed the Respondent's appeal in its entirety.

In determining the first two issues, the Board held that the annual lump sum payments for software under the contract were not subject to withholding tax because the agreement was a purchase agreement and not a lease and, secondly, that the service fees paid by the Appellant (now Respondent) relating to software were not subject to withholding tax because the services were not performed in Tanzania. Consequently, the Board allowed the appeal.

The Respondent (now Appellant) was aggrieved and preferred the present appeal. The Statement of Appeal contains two grounds of appeal, which are:

- c) The Tax Revenue Appeals Board erred in law and in fact by holding that the lump sum payment made by the Respondent (licencee) to the licensor is not a royalty under s 83 (1) (a) of the *Income Tax Act*, 2004 and is therefore not subject to withholding tax; and
- d) 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.

The hearing before the Tribunal was by way of written submissions. Submitting on the first ground, the Appellant's counsel began with the statement that there were three types of payment involved in the contract: Investment costs, Lumpsum Annual Licence Fees and Service Fees. The Appellant does not dispute that the first type of payment normally does not attract any kind of tax. However, Counsel strongly argued that the second type of payment (i.e., Lumpsum Annual Licence Fees) was a royalty and thus withholding tax is payable thereunder. For that reason, counsel opines that the Board erred in holding that the said payments were not a royalty simply because the same was not made pursuant to a lease agreement but rather a Software Licence Agreement.

It is clear from the foregoing that in order to resolve both grounds of appeal, it is necessary to determine whether the second category of fees were a royalty or not. A negative answer would mean that the same are subject to withholding tax while an affirmative answer would result in a determination that they are. The Respondent's position, which was accepted by the Board, is that the payments were not royalties and thus not taxable. The Appellant thinks they are.

Arguing in support of the appeal, counsel Haule for the Appellant submitted that what was bought by the Respondent under the Agreement was not a software itself but a right to use the licensor's software. One of the reasons advanced for this assertion was that the agreement contained a number of terms and conditions, the infringement of which would entitle the Licensor to terminate the Agreement. Consequently, it is the view of the Appellant that the "right" was temporary, it would thus amount to a lease, and that the lump sum payments were a royalty. Hence, they were subject to withholding tax.

In his reply submissions, counsel for the Respondent contended that the evidence available is the Software License Agreement between the Respondent and Neptune Software PLC. He argued that the agreement clearly indicates that what was acquired by the Respondent is "Integrated Banking Software" and that

nowhere did the Agreement refer to lease of software and that the lump sum payment was for purchase of software.

Counsel countered Appellant's argument that the lump sum payment was a royalty as untenable since a royalty payment must be made under a lease agreement and for there to be a lease agreement payment has to be for a license, which must be temporary with a determinate time frame giving a specifically stated length of time. While it is true that software is an intangible asset, it is not true that the lumpsum payment was made out of a lease agreement because the parties had made it unambiguously clear in the recitals to the Agreement that the intention was to purchase or acquire the software.

In this regard, argues counsel, by purchasing the software, the Respondent bore both the risk and rewards associated with the software and that the agreement will continue until terminated in accordance with the relevant provisions, indicating that there is continuity and permanence.

It is important at this point to consider what a lease is. A lease is defined under s 3 of the Income Tax Act as:

“...an arrangement providing a person with a temporary right in respect of an asset of another person other than money and includes a license...”.

We think that in order to determine whether the rights acquired by the Respondent under the Agreement was a lease, certain incidentals must exist: The right, once acquired, must be permanent and irrevocable, unconditional and, perhaps more importantly, it must have the effect of transferring ownership rights from the seller to the buyer. In other words, a licence is, in law, a lease, which is a temporary right to use another person's asset. Was the arrangement in the Agreement under reference a licence?

The Agreement at the centre of this controversy is entitled “Software Licence Agreement”. The supplier (Neptune Software PLC) is called “the Licensor” and the recipient (the Respondent herein) is called “the Licensee”. It is provided in the recitals that the Licensee is “desirous of acquiring and be licensed to use an Integrated Banking Software” and the Licensor is said to be able “to supply, install and license the use of” such software. “Software” is defined under clause

1.1 as "the software programs in object code form identified by title and reference number in the Schedule including any new releases of the same as modified and varied from time to time, in machine readable form, being licensed by the Licensor to the Licensee."

It cannot be denied that there is a Licensor/Licensee relationship created by the Agreement. That much is clear from the wording used. And, since a license is a lease in terms of the *Income Tax Act*, then the arrangement created by the Agreement can rightly be referred to as an agreement for the lease of software. As for the question as to the ownership of the software, incidences of the Licensor's continued ownership are evident in the nature of the Agreement and in some provisions it is expressly so provided. Perhaps more significantly, is the definition of the word "owner", as referring to "the Licensor or any other disclosed owner": See clause 1.1 of the Agreement. At no point can it even be inferred from the Agreement that the Licensee would have acquired ownership of the software. That title may shift to third parties (for instance, under clause 9.9) but never to the Respondent. The picture one gets from the use of the word "Owner" is that it is a right that may belong to the Licensor or some other owner with whom the Licensor would have acquired the right to supply to the Respondent. This is further strengthened by clause 13.1, under which the Respondent:

"...acknowledges that the Licensor (either in its own right or under licence) owns and will continue to own all rights in the software and documentation...and...the copyright and other industrial, intellectual property and marketing rights in such software and documentation are, shall be and shall remain the property of the Licensor as aforesaid."

(emphasis ours)

The wording of the above clause clearly renders whatever right the Respondent acquired through what elsewhere in the Agreement is termed a "purchase" of the software was temporary in nature and certainly did not transfer ownership or title of the said software to the so-called purchaser. Counsel for the Respondent has argued that the purchase of a software as a "right to use" is "an intentional

misrepresentation" of the parties' intention, which is to purchase the software. However, it is clear from the clauses I have mentioned that the parties' intention was to grant to the Respondent a temporary right to use the software, with no proprietary right whatsoever. It is actually the use of the words "purchase" and "purchaser" which may be an "intentional misrepresentation" of the parties' intentions, to use counsel's phraseology.

In this appeal, the parties are in agreement that the evidence available is the software agreement. All the arguments and counter arguments claim to have support from the agreement between Neptune Software PLC and the National Microfinance Bank. It is to be recalled, that the Agreement is titled "Software License Agreement" and not "Software Purchase Agreement". That should be the starting point.

The Board took the view that the Agreement is a purchase agreement because "the right given to the Appellant to use the software" was not revocable. With due respect to the Board, a purchase agreement must clearly state a purchase price. This price may only vary according to the terms of payment, whether they are on cash or credit terms. The purchase price of the software is not stated anywhere in the Agreement, let alone the terms of payment. As Prof. Doriye, one of the members of the Tribunal stated in his Opinion:

"In his submission, the Respondent's counsel has conveniently avoided this issue and the Board conveniently sidestepped it by not saying what the annual lump sum payments were, other than that they were "not a royalty". This, however, cannot suffice, for a purchase price must be known in advance along with its payment terms: whether cash or credit and whether it is in a lumpsum or installments with a clearly spelt out time frame and limit. That is to say, there has to be a date on which a purchase price is fully paid."

We are, with respect, of the settled view that the Respondent failed to demonstrate that the Agreement has the above elements of a purchase, neither to us nor to the Board before us. On the other hand, the Board, failed to see the

necessity for their existence in a purchase Agreement and thereby erred in its conclusions.

Before we wind up on the first ground, let us return to the question as to whether the right given to the Respondent under the Agreement was temporary and hence revocable. Again, the Agreement provides a ready answer, which the Board failed to see. Under it, the Licensee agreed "to buy from the Licensor the right to use the software under terms and conditions" stipulated under clauses 3.1 to 3.9 thereof. Clauses 19.3 (1) to 19.3 (4) and clause 19.3.1 of the Agreement give the Licensor the right to terminate the contract where the Licensee is in breach of one or more of its fundamental terms, conditions or warranties. Clause 19.3 (1) to 19.3 (4) and clause 19.3.1 of the Agreement are relevant. Clause 19.3.1 stipulates:

"19.3 The Licensor may also terminate this Agreement by serving the Licensee a not less than thirty (30) days written notice intimating its intention to terminate the Agreement where the Licensee is in breach of any fundamental term, condition or warranty contained in this Agreement and upon being informed of the breach, the Licensee has failed to remedy the breach within thirty days of being notified of such breach... or the Licensee has failed or refused to offer adequate compensation thereof. A breach of any provision relating to payment shall entitle the Licensor to terminate the Agreement at the expiry of thirty (30) days from the due date of payment or the date of receipt of a notice of the breach...." (emphasis ours).

The provisions relating to payment are spelt out in the Software License Agreement Extension of 7th April 2006 which provides the payments to be made by the licensee. These are investment costs, project expenses, consultation services and "a lump sum annual license fee". In the latter case:

"The licensee agrees to pay a lump sum annual license fee ... commencing on the date of the agreement and on subsequent anniversaries".

These provisions are definitive in that they clearly spell out the critical condition for revocability of the license and the time frame within which that critical condition must be fulfilled, namely, a year. Also, the fact that payment is to be

made periodically (annually) as long as the License subsists is an aspect of a lease which is temporary in that it will terminate the moment the License ceases to exist. In other words, the duty to pay survives as long as the Lease survives. That is a feature that does not exist in a purchase agreement, where the amount to be paid is fixed and does not depend on time—except, of course, where the time value of money is taken into account in the price or interest, which is something quite different from payment for use of goods or services, as is the case in a Lease. The latter is what constituted the arrangement the subject matter of this appeal. Hence, the Board was clearly wrong in finding nothing in the Agreement stating, “expressly or impliedly”, that the right given to the Appellants to use the software would be revocable.

From the evidence available in the Agreement as we have endeavoured to show above, it is clear that the Board did not look hard enough to locate the revocability clause. For, not only was there a time frame for the license, which was obviously from year to year, it was also revocable. Hence, the agreement was a lease Agreement and temporary. In this respect, the conditions laid down by the Respondent’s counsel in his submission for payment to be a royalty, namely that “for the payment to be for a license, it has to be for temporary right to use an asset” (i.e. a determinate period) and an arrangement with a stated term, have been fully met.

In the premises, we are unable to agree with the Board that the Agreement was for purchase of the software and not a lease and that the lumpsum Annual Licence Fee payments made by the Respondent to the Licensor are not royalties under section 82 (1) (a) of the Income Tax Act. As such, we hold that the said payments are subject to withholding tax.

With regard to the Board’s finding that the service fees paid by the Respondent relating to installation, testing and maintenance of the supplied software are not subject to withholding tax, counsel for the Appellant makes a distinction between services that were being provided directly from the licensor’s home country and those that must have been provided by station staff in the licensee’s home country. In counsel’s view, payment for this latter category of services whose are

subject to withholding tax. In it are those services specifically mentioned under clause 9.7 of the Software License Agreement. Appellant's counsel argued that the latter types of services are subjected to withholding tax under sections 83 (1) (b) of the Income Tax Act, 2004. The two services were, one, Support and Maintenance of the Base Support System; and two, Sybase SA (PTY)–54,880.020.

Without drawing the necessary distinction between the various types of services, the Board simply concluded that the said services were not performed in Tanzania be it wholly or partly and that, as such, they cannot attract withholding tax.

In response to submissions in support of this second ground of appeal, counsel for the Respondent argued that the *Income Tax Act* restricts withholding tax only to payment with a source in Tanzania and that s 69 (1) states that services have a source in Tanzania if they are performed in Tanzania and since the services were not performed in Tanzania their payments being made from Tanzania notwithstanding, they are not subject to withholding tax. On services listed under clause 9.7 of the Agreement, it is Counsel's argument that "the Respondent did not pay for these services because they were not performed in the relevant years of income" as these are rendered only when there is a new release of the software, which was not the case in the instant situation.

The Board's finding was that while the payment was made from Tanzania the services were not performed in Tanzania and, therefore, they do not have a source in Tanzania. For those reasons, they are not liable to withholding tax. With due respect, this position of the Board is clearly at variance with provisions of the law which it claims to have guided its judgment.

The relevant law in this regard is in ss 67, 68 and 69 of the *Income Tax Act*. It provides for when a payment is considered to have a source in Tanzania. S 68 (1) (b) of the *Income Tax Act* provides for "*amounts directly included in calculating income have a source in the United Republic where they consist of payments that have a source in the United Republic*". S. 83 (1) (b) recognizes as payment that has a source in Tanzania payment that is:

"...received by a person who conducts a business of transmitting messages by cable, radio, optical fibre or satellite or electronic communication in respect of messages by apparatus established in the United Republic.

The above provisions evidently support the Appellant counsel's submission that the monies that the foreign supporter was being paid automatically had a source in Tanzania as provided for under Section 83 (1) (b) of the Income Tax Act, 2004, hence liable to withholding tax.

In view of the above, 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 payments have a source in Tanzania.

Consequently, our answers to the first and second issues as framed by the Board are in the positive: In both instances, the payments are subject to withholding tax.

In finely, we would allow this appeal in its entirety. Given the rather novel issues that have arisen in this case, we would not make any order as to costs.

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

Judgment Delivered this 20th day of February, 2012, in the presence of Mr. Amandus Ndayega, for the Appellant and Mr. Allan Kileo, Advocate assisted by Macktida Boniface for the Respondent.

20th February, 2012