WITHHOLDING TAX ON LOAN INTEREST

13 April 2025

''Withholding tax on loan interest must be accounted for when the interest becomes due under the loan agreement, NOT when it is actually paid''

*The statement means that **withholding tax** (WHT) on **loan interest** must be **calculated and reported at the time the interest becomes payable**, according to the terms of the loan agreement — **not when the borrower physically pays the money** to the lender.*

🧾 *Simple Example:*

Let's say:

- *A company borrows TZS 100 million from a lender.*
- *The loan agreement says **interest of TZS 10 million is payable on 31st December 2024**, even if the company doesn't pay it immediately.*
- *The company delays the payment and pays the interest in **March 2025**.*

💡 *How Withholding Tax Applies:*

*Even though the actual cash payment happens in March 2025, the **withholding tax must be calculated and reported in December 2024**, because **that's when the interest became due** under the loan agreement.*

*This aligns with the **accrual basis of accounting** — recognizing income and expenses when they are earned or incurred, not when cash is exchanged.*

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LANDMARK CASE FROM THE COURT OF APPEAL- TANZANIA

On 8th April 2025, the Court of Appeal of Tanzania delivered a landmark judgment in Civil Appeal No. 485 of 2023, between the Commissioner General of the Tanzania Revenue Authority (TRA) and Vodacom Tanzania Public Limited Company. The central issue was whether withholding tax (WHT) on interest from loans should be charged when the interest becomes payable (accrual basis) or only when it is actually paid (cash basis). This decision carries significant implications for tax compliance and financial planning across sectors, emphasizing the supremacy of economic substance in taxation.

Summary of Key Findings

- Withholding tax on loan interest must be accounted for when the interest becomes due under the loan agreement, **NOT** when it is actually paid.
- The Court broadly interpreted the term 'payment' to include any form of entitlement to a benefit, not just the physical exchange of money.
- Statutory interpretation must uphold legislative intent, especially where the language is clear and unambiguous.
- Recognizing tax liability upon accrual prevents avoidance strategies based on deferring payment timelines.

Material Facts

Vodacom received inter-company loans in 2004, 2007, and 2009, with agreed interest payments deferred until 2015. Following an audit for the 2011–2012 tax years, TRA issued an assessment of TZS 7.78 billion for unpaid WHT, arguing that tax was due as interest accrued. Vodacom maintained that WHT only became payable upon actual payment. The Tax Revenue Appeals Board and Tribunal initially sided with Vodacom. TRA appealed to the Court of Appeal, asserting that liability crystallizes upon accrual, not payment.

Arguments of the Parties

Appellant (TRA)

- Cited accrual-based accounting principles requiring recognition of tax liabilities when they arise, regardless of payment timing.
- Interpreted 'payment' under Section 3 of the Income Tax Act (ITA) to include the creation of a legal obligation to pay.
- Asserted that interpreting WHT as payable only upon cash transfer allows deferral and undermines fiscal discipline.

Respondent (Vodacom)

- Argued WHT becomes due only upon actual payment.
- Highlighted the financial strain imposed by taxing unpaid amounts.
- Urged a literal reading of Section 82(1) of the ITA, which refers to payment as a tangible cash transfer.

The Court's Decision

The Court harmonized Sections 3, 21(3), and 82(1) of the ITA to affirm that 'payment' includes legal entitlement, not just physical disbursement. Accordingly, WHT is triggered upon accrual of interest. The Court emphasized legislative intent and relied on persuasive precedents, including Kenya Revenue Authority v. Republic (Ex parte: Fintel Ltd), Civil Appeal No. 311 of 2013 and Engineers Board of Kenya v. Jesse Waweru & Others, Civil Appeal No. 240 of 2013. Both cases underscore that clear statutory language must be upheld and not distorted by equitable concerns. As a result, the Court overturned earlier decisions and upheld TRA's assessment.

Analysis of the Judgment

The judgment affirms the importance of the accrual basis in Tanzania's tax framework. It reinforces the idea that tax law is anchored in economic substance. By recognizing tax obligations upon accrual, the Court curbs deferral-based tax avoidance and aligns tax collection with economic activity. While this ruling promotes fiscal integrity, it may challenge companies with long-term or staggered payment structures.

Sectors such as telecommunications, infrastructure, and insurance—where deferred payment structures are common—may be particularly impacted. For instance, insurance accounting involves recognizing obligations and entitlements irrespective of cash flow. Applying strict accrual-based tax rules could cause mismatches and liquidity stress for such sectors.

Policy Recommendations

To harmonize the accrual principle with practical realities, legislative adjustments may be warranted. Possible reforms include:

- Allowing phased remittance options for businesses under genuine liquidity constraints.
- Sector-specific carve-outs or transitional provisions for industries with unique accounting standards.

Advice to Businesses

Business owners are advised to reassess financing agreements and clearly define the timing of liabilities in line with tax obligations. Where liquidity issues exist, renegotiating terms or restructuring contracts can reduce exposure to unexpected tax liabilities. Proactive contract design and tax planning are crucial for compliance and operational continuity.

Disclaimer

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