

## TAX ALERT

21 June 2020

### **Court of Appeal of Tanzania reaffirms its previous decisions on deductibility of bad debts and impairment of loan losses for financial institutions**

On 16<sup>th</sup> June 2020, the Court of Appeal of Tanzania, in the case of *National Bank of Commerce ("NBC") versus Commissioner General, Tanzania Revenue Authority ("TRA")*, Civil Appeal No. 251 of 2018, reaffirmed its previous decisions on the deductibility of bad debts and allowances for impairment of loan losses by banks and financial institutions. This tax alert gives a bird-eye view analysis of this decision.

#### **Facts of the Case**

The Appellant, NBC, is a financial institution engaged in the provision of banking, financial services and related services. NBC was aggrieved by the decision of the Tax Revenue Appeals Tribunal ("TRAT") holding that TRA was correct in law to disallow impairment on loan losses for the years of income under dispute. In its decision, TRAT insisted that NBC ought to have followed the laid down legal requirements which include taking recovery measures and seeking its Board's approval before writing the debts off as bad. In that regard, the mere approval of impaired loan losses by the Bank of Tanzania ("BOT") does not qualify the same to be allowable deductions.

Before CAT, NBC raised four grounds of appeal as follows:

- i. The TRAT erred in law by failing to correctly interpret the provisions of section 39(d) of Income Tax Act, 2004 ("ITA, 2004") and held that an approval of impaired loan losses by the Bank of Tanzania does not qualify the same for deduction.
- ii. The TRAT erred in law in holding that the Tax Revenue Appeals Board ("TRAB") was right to rely on the decision of TRAT, in Appeal No. 3 of 2011, *Barclays Bank Tanzania vs Commissioner General* which correctly used purposive approach in interpreting the Income Tax Act, 2004.
- iii. The TRAT erred in law in endorsing the decision of the TRAB that a financial institution could not qualify for deduction on impaired loan losses unless it proves that it has taken recovery measures and written off the debt and that this requirement was introduced by the Finance Act, 2014.
- iv. The TRAT erred in law in holding that the TRA's decision to impose interest is correct in law.

#### **Arguments by Counsel for NBC**

The counsel for NBC argued that the impaired loan losses which have been calculated and approved according to the standards established by the BOT, qualify for deduction. In that regard, both TRAB and the TRAT failed to correctly interpret the provisions of section 39(d) of the ITA, 2004. It was further submitted that TRAT wrongly imposed a requirement that, prior to the bad debt claim being written off, the tax payer must embark on recovery measure and demonstrate that such measures have failed was introduced by the Finance Act of 2014 which was not applicable at the time of filing returns in 2005 and 2006 as the law was not in existence.

The counsel for NBC also invited the Court to depart from its previous decision in *NATIONAL BANK OF COMMERCE VS THE COMMISSIONER GENERAL, TANZANIA REVENUE AUTHORITY*, Civil Appeals No. 52 of 2018 and *ACCESS BANK (TANZANIA) VS THE COMMISSIONER GENERAL, TANZANIA REVENUE AUTHORITY*, Civil Appeals No. 137 of 2017 (all unreported) on ground that the Court in these decisions dealt with factual matters contrary to Section 25(2) of the Tax Revenue Appeals Act ("TRAA") which mandates the Court, in tax disputes, to determine only questions of law.

### **Arguments by Counsel for TRA**

The Counsel for TRA submitted that a person can enjoy deduction on losses arising from bad debts claims only when the debt has been actualized and in respect of a financial institution, the debt must be realized in terms of section 39(d) of ITA, 2004 and written off after all recovery measures have failed. It was further submitted that the provisions of bad debts claims which NBC had sought to be deducted, had not been realized in accordance with sections 39 and 18 of ITA, 2004 and as such did not qualify for deduction. It was further submitted that TRA was justified in imposing interest on tax uncollected.

### **Decision of the Court**

- The **NBC** and **ACCESS BANK** cases (referred above) are still good law having interpreted the ITA, 2004 on conditions warranting allowable deductions on loan impairment losses or what constitutes bad debt claims.
- It is a settled position that a financial institution seeking deduction on impaired loans must comply with the requirements prescribed under sections 18(b), 25(5) and 39(d) of the ITA, 2004.
- The BOT's approval of bad debts and impairment of loan losses by financial institutions is not a stand-alone requirement because such claims must as well qualify for deduction in terms of section 39(d) of the ITA, 2004 which requires such financial institution to provide proof that recovery measures were taken but the debt claim is absolutely uncollectible and has been written off from the books of accounts.
- Given that the Management of Risk Assets Regulations of 2001 and its successor the Financial Institutions (The Management of Risk Assets) Regulations of 2008 have provisions characterizing loss as doubtful or classifying them as absolutely uncollectible, it follows therefore that the requirement of taking reasonable steps in pursuing the payment until it is reasonably believed that the debt claim will not be satisfied was in existence even prior to the enactment of the Finance Act 2014.
- Since the NBC did not adduce evidence on having taken the required measures as stipulated under ITA 2004, it is estopped from complaining that the Tribunal was wrong to disallow the deductions.
- Appeal dismissed with costs.

### **Significant takeaways**

This is yet another decision that obfuscates the proper tax treatment of bad debts and provisions for impairment of bad and doubtful debts for banks and financial institutions. For example, in its decision, the Court does not make a distinction between *bad debts* and *provisions for impairment* of bad and doubtful debts. The lack of this distinction sometimes creates a misleading impression that bad debts and provisions for impairment of bad and doubtful debts are one and the same

thing, which is not correct. Luckily, in the case of **ACCESS BANK** (referred above), the Court held that *bad debts* are deductible under sections 18, 25, 25(4), 25(5)(a) &(b) and 39(d), of ITA 2004, while the *provisions for impairment* are deductible under sections 3 and 13 of ITA, 2004 as trading stock allowances. This distinction is very crucial in determining the deductibility of bad debts and provisions for impairment of bad and doubtful debts.

The Court has also reinforced its earlier position that the BOT's approval of bad debts and impairment of loan losses by financial institutions is not a stand-alone requirement. Therefore, once the approval has been obtained from BOT, a bank or financial institution is required to present to TRA proof that recovery measures were taken but the debt claim is absolutely uncollectible and that such debt has been written off from the books of accounts.

***Disclaimer;** this tax alert has been posted for information purpose only. The information and /or observations contained in this alert do not constitute legal advice and should not be acted upon in any specific situation without appropriate legal advice. Should you need further details please contact:*

Dr. Boniphace Luhende  
Managing Partner  
[bluhende@lunolaw.co.tz](mailto:bluhende@lunolaw.co.tz)

Makanja Manono  
Partner  
[mmanono@lunolaw.co.tz](mailto:mmanono@lunolaw.co.tz)