

The Court of Appeal of Tanzania Rules that Payment for Acquiring Computer Software is Royalty subject to Withholding Tax

The growth in technology has changed how business are operated by firms throughout the world. One of the key contributing factor is the use of computer software to perform and provide services.

Amongst sectors which depend much on software applications is the banking industry. This sector is also followed closely by the telecommunication industry which uses various applications to provide telecommunication services.

Banks and other companies have been purchasing computer software from software manufacturing companies. The underlying thinking by these companies when purchasing computer and other related software is that the software is being purchased in the form of goods rather than an intangible asset. Purchase of a copyrighted material rather than a copyright for the reproduction of the computer software. The simple example is the purchase of an audio music/video CD from a musician. The CD is a material/good but the music is copyrighted by the musician and it remains his/ hers.

In case of software, there is a periodic need to update the software by the manufacturer. And the manufacturer is always tasked with periodic maintenance and system updates. In that regard, the purchase agreements are styled in a manner which confers the purchaser a licence to utilize the software rather than the right to acquire/purchase the software. This being the case, most of software purchase agreements are entitled 'Software Licence Agreements' rather than 'Software Purchase Agreements'.

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The thinking for most companies as stated before is that the software is purchased as a copyrighted material instead of a copyright. Payments made therefore are business profits on the part of the manufacturer rather than rental/lease payments for temporary use.

However, the Tanzania Revenue Authority (TRA) had taken a different view. TRA's view is that payments made for acquisition of computer software is payment for a lease therefore a royalty. TRA has, as a result subjected software purchase payments to withholding tax on the ground that the payment is a royalty.

The question therefore is whether payments made by banks/other companies for purchasing computer software is a royalty.

This question has recently been dealt with by the Court of Appeal of Tanzania in appeals involving both a bank and a telecom company.

In the case involving **Celtel Tanzania Limited versus Commissioner General (Civil Appeal No 56 of 2018 Unreported)**, the Court of Appeal took a view that payments for the licence to use a computer software is a royalty hence subject to withholding tax. In arriving at that conclusion the court relied on the definition of the terms 'lease' and 'royalty' as provided in the Income Tax Act, 2004 9ITA).

In terms of the ITA, the term 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 licence, option agreement, rental agreement, royalty agreement and tenancy.

The term royalty on the other hand is defined to mean a payment made by a lessee under a lease of an 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 trademarks.

The Court having looked at the definition of the two words above and the title of the software purchase agreement concluded therefore that since the agreement explicitly states that it confers Celtel a licence to use the software then payments made were for temporary use of the software. Since licence is a lease and royalty is a payment for temporary use including a lease, then the payments made by Celtel were royalty payments subject to withholding tax.

That position was again confirmed by the same Court in another recent case between **National Microfinance Bank Limited versus Commissioner General (TRA) (Civil Appeal No 68 of 2018 Unreported)**.

In the National Microfinance Bank Tanzania Limited (NMB), the Court examined the software purchase agreement and found that one of the clauses in the agreement provided NMB with licences and authority to use the computer software, a right which was non-exclusive and non-transferrable. It therefore held that payments made by NMB were royalty subject to withholding tax.

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Implication of Court of Appeal decision

The ruling sets a position for the TRA to impose withholding tax on all software agreement containing similar clauses. It is important to note that most software purchase agreements are in standard format and seldom do internal legal departments take time to change the wording of the agreements. This position can as well be caused by the manufacturing companies in trying to retain the ownership of the software and impose liability on purchasing companies on the restriction to transfer the purchased software or use for other purposes other than the one stipulated in the agreements. The position taken by the Court aligns with the position in Kenya.

However, it is different in India and other developed countries in which courts have ruled that purchase of a computer software amounts to a purchase of a copyrighted material hence not a royalty.

In that regard, withholding tax does not attach to payments made for the purchase of the computer software.

Way forward

Banks, telecom and other companies using computer software to do business should take note of the position reached by the Court until declared otherwise. Secondly, companies should be alive of the above position when entering into similar agreements in future.

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