Do banks trade off 70% of impairment just to save 30% tax?

"The key question arising from this regulation is whether banks are perceived to be negligently incurring losses from impairment just to save the 30% tax? "

For a very long time, the banking industry faced challenging circumstances when it comes to impairment of bad debts. As part of their core activities, banks are engaged in issuance of loans hence they are prone to impairments. In very simple terms, impairments in banks arise once conditions exist that portray some weakness on the assets - in this case a loan - hence posing a risk of non-recovery of the loan amount. These conditions are derived from both International Financial Reporting Standards (IFRS) and BOT regulations.

However, for over a span of two decades, banks have been clear losers in the struggle to get impairments allowed as deductible items for tax purposes by the The Tanzania Revenue Authority (TRA). Even upon appeal filing at different stages, most cases have historically been decided in favor of TRA. Particularly, banks bear a heavier tax burden when the loans they cannot recover are not properly recognized as impairments for tax purposes thus attracting an additional tax at 30%.

It is often claimed by the taxman that, such impairments do not amount to losses because they are covered by securities. However, BOT regulations allow banks to issue both secured and unsecured loans to extents as guided under Regulation 6 of the Banking and Financial Institutions Regulations, 2014. Given the role banks play in the economy, it is important to allow access to loan facilities to individuals without security.

Even so with secured loans, circumstances upon issuance of loans might significantly change and affect the value of the security from which banks expect to recover loans they have issued. Under the circumstances described, impairments could be considered an inherent risk factor in the business of issuing loans.

AUTHOR

Evelyn Manu

Director
TP&Tax Advisors Ltd

Contacts
+255 717 381 538
emanu@tpandtax.co.tz

One of the key issues at hand relates to the seeming goal post change in the interpretation of relevant income tax laws every other time a case is decided. Prior to the amendment of the Finance Act in July 2014, relevant provisions of income tax laws did not require banks to demonstrate any reasonable steps prior to deducting impairments for tax purposes.

Furthermore, the introduction of reasonable steps to banks in 2014 did not define what "reasonable steps" are and instead left it at the Commissioner's discretion to determine whether any steps taken were reasonable enough.

As a result, there are several cases where banks believe they took reasonable steps, but the taxman would reject their propositions on the basis that protective steps such as insurance, pension funds and public decommissioning could be utilized to recover the loans.

Another major issue relates to glaring inconsistencies in application of laws guiding the treatment of impairments. While the specialist sections on loans in the Income Tax Act, including Section 18, 25 and 39 have mostly been used to make judgements regarding the treatment of impairments on loans, the very definition of loans remains ambiguous. In particular, Section 13 of the Income Tax Act recognizes loans as "trading stock", which would then require them be treated quite differently from the practices set in Sections 18, 25 and 39.

Currently with the existing ambiguity, the fate of impairment treatment for income tax purposes is unknown to the banking industry with most cases continuously being ruled against banks, sadly with no clear learning points highlighted.

As businesses need to operate in a friendly and transparent environment, the key question arising from this regulation is whether banks are perceived to be negligently incurring losses from impairment just to save the 30% tax. In reality, banks lose a whole other 70% under such circumstances, hence convincingly refuting the possible assumption of negligence considering that impairment costs are established following consideration of BOT and financial reporting standards.

Amidst all this confusion, lawmakers should quickly act to amend the applicable laws for clarity and to avoid the current turbulence in order to improve the business environment for banks and their many clients.

A congregation should be set up bringing together banks, TRA, BOT and lawmakers to discuss and agree on the practicability of impairment treatment. This will ensure that taxpayers are taxed fairly, and businesses can plan better, all in the interest of national economic gains.