

Withholding Tax on Non-Executive Directors - Decoding the Jumble

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Objectives of this article are:

- (a) *To ascertain with certainty as to what does a non-executive director mean;*
- (b) *To deduce whether withholding tax suffered at source by a non-executive director is final tax or non-final tax; and*
- (c) *Are there any differences in tax treatment for Tanzanian and non-Tanzanian non-executive directors?*

To begin with, the terms “non-executive director” or “non-full-time director” remains undefined within the Income Tax Act CAP 332 (R.E. 2019).

The Income Tax Act defines the term “full-time service director” as a person at a managerial position and is in full time service in a corporation.

Hence, by way of common sense, then a non-full-time director or non-executive director implies to be any person who is not employed or working in full time service at a managerial position in a corporation.

We now move to Section 7 of the same Act which deals with “income from employment”. This section of the law deals with all income of an individual that needs to be brought into and excluded from the tax net as employment income.

Section 7(2)(h) clearly states that director fees paid to a director other than a full-time service director should be brought into the tax net as employment income of that individual/director. This precisely means that director fees paid to non-executive directors must be reported as employment income by these non-executive directors in their personal capacity.

Let us now look at First Schedule of the Income Tax Act CAP 332 (R.E. 2019) – Paragraph 4(a)(iii):

Income tax to be withheld from payments under Division II of Part VII shall be withheld at the following rates -

in the case of director fees referred to in Section 7(2)(h) – fifteen percent.

Division II of Part VII of the Income Tax Act deals with Tax Payment Procedures. Section 81 of this Act falls within the domain of Division II of Part VII. It reads as follows:

81-(1) A resident employer who makes a payment that is to be included in calculating the chargeable income of an employee from the employment shall withhold income tax from the payment at the rate provided for in paragraphs 1 and 4(a) of the First Schedule.

Hence to sum up, payment of director fees to non-executive directors firstly requires the payer (termed as an employer under the Act) to withhold 15% from the gross amount and remit 85% of the director fees to the non-executive director.

Thereafter, the non-executive director must report this income on gross basis (full 100%) as his employment income when filing personal tax returns with Tanzania Revenue Authority. This gross income will be taxed at the full PAYE tax rate. During this time, 15% Withholding Tax suffered at source shall be deductible as advance tax paid.

The above explanation cements the fact that 15% Withholding Tax suffered at source by non-executive directors is not a final tax, and that they (in their personal capacities) are mandated under the law to disclose this income as employment income in their respective personal income tax returns and pay balance tax on the same income to Tanzania Revenue Authority. This is surely the case for all non-executive directors who are tax residents in

Tanzania (Tanzanian citizens and non-Tanzania citizens having taxpayer identification number (TIN) issued by Tanzania Revenue Authority).

For those who are not tax residents and therefore do not possess TIN numbers, they may end up only suffering the first 15% Withholding Tax at source. Since, by virtue of their tax residency status in Tanzania, they are not obliged to file any personal income tax returns in the United Republic of Tanzania they will not be paying the second half of the tax on this income stream.

Therefore, indirectly the 15% Withholding Tax suffered at source becomes final tax for foreign non-executive directors in Tanzania who are not tax resident in Tanzania.

We have seen scenarios where directors hold non-investor work permit and residency permit in Tanzania and earn non-executive director fees and tax themselves at 15% Withholding Tax only. This practice is very wrong and not advisable. The fact that a person holds a non-investor work permit and residency permit automatically renders him or her as a person in full time service of a corporation regardless of the time spent for the corporation.

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Hanif Fattehali Habib has an extensive auditing, tax and accounting career with experience in various roles spanning over 18 years. Prior to establishing his audit and tax consultancy firm M/S Hanif Habib & Cco., he served in leading audit firms in Tanzania. Hanif's solid experience, across various functions, is a testament to his diverse background within Audit, Tax and Finance.