

Withholding Tax on Rent and Service Charges

Author: Hanif Fattehalı Habib

MSc, UK ; BSc (Hons), UK ; FCCA, UK ; CIA®,
USA ; CPA, T ; CPA, CGA (Canada), UAECA ;
GTP (SA)™ ; Commissioner of Oaths (RSA)
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In most scenarios, landlords bill their tenants separately for rent and service charges. Service charges mainly include provision of water, and other utilities.

In some cases, landlords prepare two separate invoices for rent and service charges, and in other cases they prepare 1 invoice and itemise the bill.

It has been observed in most cases that tenants withhold 10% from rent value and 5% from service charge value and remit the netto plus VAT (where applicable) to the landlord.

The main purpose of this article is to evaluate whether this approach of Withholding Tax is correct or not.

Let us begin by exploring what the law says.

Section 82 of the Income Tax Act (R.E. 2019) states the following:

82.-(1) Where a resident person-
(a) pays a dividend, interest, natural resource payment, rent or royalty; and
(b) the payment has a source in the United Republic and is not subject to withholding under section 81, the person shall withhold income tax from the payment at the rate provided for in paragraph 4(b) of the First Schedule.

The rate provided for in paragraph 4(b) of the First Schedule to the Income Tax Act (R.E. 2019) is 10%.

Hence it is fairly simple and straight forward to assume that the Withholding Tax rate applicable on rent payments is 10% and not otherwise. This is crystal clear and very straight forwardly stipulated in the Act.

However, the trick lies with service charges.

Lets begin by looking at what the Income Tax Act says about Withholding Tax rate on service fees:

83.-(1) Subject to subsection (2), a resident person who-
(a) is conducting business of extractive industry in mining, oil or gas pays a service fee to another resident person in respect of management or technical services provided wholly and exclusively for the business;
(b) pays to a non-resident an insurance premium with a source in the United Republic;
(c) pays to-
(i) a non-resident a service fee with a source in United Republic; or
(ii) a resident person a service fee for provision of professional services.
(d) pays money transfer commission to a money transfer agent,

shall withhold income tax from the payment at the rate provided for in paragraph 4(c) of the First Schedule.

83.-(2) (a) payments made by individuals unless made in conducting a business; or
(b) payments that are exempt amounts.

The rate defined in paragraph 4(c) of the First Schedule is 5%. Hence it is clear that Withholding Tax on service fees is chargeable at the rate of 5% and not otherwise.

But a more relevant question is: what is a service fee? What does a service fee encompass in the Income Tax Act?

Interestingly, the word “Service Fee” is defined in the Income Tax Act (R.E. 2019) as follows:

"service fee" means a payment to the extent to which, based on market values, it is reasonably attributable to services rendered by a person through a business of that person or a business of any other person and includes a payment for any theatrical or musical performance, sports or acrobatic exhibition or any other entertainment performed, conducted, held or given;

Unfortunately, the above definition doesn't cover the type of service fees one pays to his/her landlord for utilities and other charges.

Income Tax Act (R.E. 2019) also defines the word “Professional Services” under Section 83 (3) as follows:

(3) For purposes of subsection (1)(c)(ii), “professional service” means services rendered by a person licensed as a practitioner by any recognised professional body and shall include other services or activities of an independent business

character including consultancy, legal, architectural, engineering, supervisory, accounting, auditing, medical, artistic, survey, theatrical performance, sports, exhibition, private security services, private investigation and consultancies in various disciplines or any entertainment held or given other than those for remuneration under contract of employment: Provided that, where the service referred in subsection (1)(c)(ii) involves construction works, the payment which is subject to withholding shall be based on the ratio of 3:2 for materials and services respectively.

Again, above definition doesn't encompass the service charges one pays to his/her landlord.

Hence there is no direct/precise requirement within the Income Tax Act that states that all service charges payable to landlords shall attract Withholding Tax at the rate of 5%.

But this doesn't mean that our Income Tax Act has limitations. Instead, let us look at the definition of the word “Rent” in the Income Tax Act (R.E. 2019):

"rent" means any payment made by the lessee under a lease of a tangible asset including any premium and any other payment for the granting of the lease but excludes a natural resource payment and a royalty;

The phrase “and any other payment for the granting of the lease” ideally takes care of the service charges. Because when we rent, we cannot segregate the service charge. It is part and parcel of the same deal. One cannot be renting and exercise the option of not having to pay service charges. If you don't agree

to service charges, you cannot rent a premise. This is very obvious.

With this analysis, it is prudent to conclude that both rent and service charges payable by a tenant to his/her landlord should be subjected to 10% Withholding Tax. It would be wrong to withhold 5% tax from service charges payable to landlord.

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About the author:

Hanif Fattahali 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.