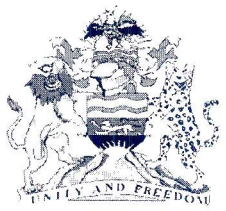
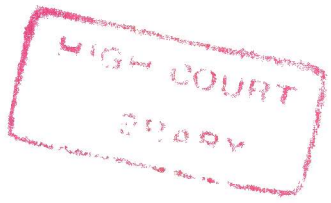




IN THE CHIEF RESIDENT MAGISTATE'S COURT SITTING AT BLANTYRE AS A SPECIAL ARBITRATOR UNDER THE TAXATION ACT

ARBITRATION APPEAL NO 1 OF 2013

CHIBUKU PRODUCTS LIMITED ..... **APPELLANT**

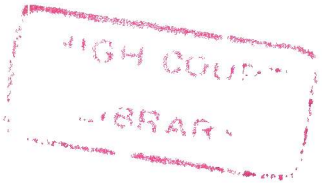
AND

MALAWI REVENUE AUTHORITY ..... **RESPONDENT**

CORAM:	Ligowe	: Special Arbitrator/ Chief Resident Magistrate
	Sauti Phiri	: Counsel for Appellant
	Chungu	: Counsel for Respondent
	Magwira	: Court Clerk

DETERMINATION

1. In a letter dated 30th September 2009, Malawi Revenue Authority (MRA) wrote to Chibuku Products Ltd. that following an audit MRA carried at Chibuku Products Ltd. around 7th September 2009, they discovered that for the tax period between April 2005 and August 2009 Chibuku Products Ltd had not deducted and remitted non-resident tax on management fees amounting to K351 014 880 paid to SABMiller Management BV of Netherlands through the Accounts Department of UK based SABMiller Plc. MRA found this contrary to S. 76A of the Taxation Act, as the Double Taxation Agreement between Malawi and the Kingdom of the Netherlands does not exempt management fees from taxation by Malawi. Consequently MRA found that non-resident tax amounting to K52 652 232 was due and payable, plus a penalty of K15 795 670 being 30% of the total tax due.



2. Chibuku Products Ltd appealed against this assessment to the Commissioner General under S. 97 of the Taxation Act. The grounds of appeal were as follows:-

(a) MRA misconstrued Article II(f) of the Double Taxation Agreement defining "industrial or commercial profits." (sic)

(b) MRA ignored established principles for interpreting law.

(c) MRA interpreted Article II(f) of the Double Taxation Agreement in a manner clearly contravening the intentions of Double Taxation Agreements.

(d) MRA ignored the definition of "industrial or commercial profits." For management fees not to be covered by the term "industrial or commercial profits" they must be specifically excluded by the Double Taxation Agreement. If there is any doubt about the definition of industrial or commercial profits, the *contra fiscum* principle must be applied.

(e) There was no requirement to deduct non-resident tax from the transactions, therefore penalties do not apply.

(f) MRA has no legal basis for calculating penalties at the rate of 30%. Penalties for non-deduction of non-resident tax have to be in accordance with S. 112(g) of the Taxation Act.

3. The Commissioner General dismissed the appeal in part in his letter to Chibuku Products Ltd, dated 7th September 2010, holding that the Malawi-United Kingdom Double Taxation Agreement is the proper instrument to use in this case since the recipient of the management fees is a resident of the United Kingdom. Management fees are specifically excluded from the definition of "industrial or commercial profits" in Article 2(j) of the Convention. The Commissioner General found that the appropriate amount of penalties chargeable is K30 000.

4. Before me now is an appeal against the decision of the Commissioner General. The procedure according to Rules 5, 6 and 7 of the Rules of Procedure for Appeals under the Eighth Schedule to the Taxation Act required the appellant to give written notice to the Commissioner General of the intention to appeal to the Special Arbitrator within 21 days of the Commissioner General's notice of his

decision dismissing the appeal. Then within 42 days of the notice of intention to appeal, lodge with the Commissioner a duplicate statement containing grounds of appeal which must not, without leave of the Special Arbitrator include any grounds not included in the statement delivered upon appeal to the Commissioner General. Thereafter, the Commissioner General has to lodge with the Special Arbitrator within 42 days, the appellant's grounds of appeal and his/her own reply stating which of the appellant's arguments in law and contentions of fact are admitted, and which are denied, and setting out all such other facts and arguments as the Commissioner General considers relevant and material to the determination of the appeal. Then the Special Arbitrator can give the date of hearing.

5. It appears though that this procedure was not followed in this case. Instead, the parties engaged in negotiations which delayed the whole process. I allowed the appeal out of time.

6. The grounds of appeal are as follows:-

(a) MRA erred in finding that the recipient of the management fees paid by the tax payer was a UK holding company.

(b) MRA's decision that the applicable instrument is the Malawi and UK Double Taxation Agreement is arbitrary and contrary to law.

(c) MRA misapplied the residence requirements of the Malawi/Netherlands Double Taxation Agreement.

(d) In the alternative, MRA erred by deliberately opting to apply the Malawi/UK Double Taxation Agreement in order to circumvent the definition of "industrial or commercial profits" contained in the Malawi/Netherlands Double Taxation Agreement, which is the proper instrument to apply in a transaction between Chibuku Products Ltd. and SABMiller Management BV.

(e) MRA erred in law in imposing a penalty of 42%.

7. These grounds of appeal are essentially the same as what was in the appeal made to the Commissioner General, so there is no need for leave of the Special Arbitrator.

8. The Commissioner General raised an issue in the course of the hearing that Chibuku Products Ltd. is not the right party to appeal in this case as it would not be the one to suffer double taxation and therefore has no sufficient interest, but SABMiller Management BV. In my view S. 76A(2) of the Taxation Act settles this question. It provides that tax on income of a non resident of Malawi from a source within Malawi and not attributable to a permanent establishment of that person in Malawi must be deducted by the person from whom the money is due and remitted to the Commissioner General. In the present case Chibuku Products Ltd is the person from whom the management fees were due and the one responsible for deducting and remitting the tax. This is sufficient authority for Chibuku Products Ltd to dispute the tax deductible with the Commissioner General and therefore to lodge the present appeal.

9. Chibuku Products Ltd did not deduct nonresident tax from the management fees paid to SABMiller Management BV claiming the latter is a resident of Netherlands and under the Malawi/Netherlands Double Taxation Agreement industrial or commercial profits which are exempt from Malawi tax include management fees.

10. Reading and listening to the contentions of both parties to this case, according to them, the issue is the residence of SABMiller Management BV. If it is resident in Netherlands, the Malawi/Netherlands Double Taxation Agreement applies and if United Kingdom then the Malawi/UK Double Taxation Agreement applies. So they each brought evidence and made lengthy written submissions in support of their positions to which I am most indebted. While this holds, there is yet one question that may help us determine this matter before we get to the issue of residence. Whether at all either of the double taxation agreements exempts

management fees from tax in Malawi. To unravel this, it is important that we look at the law involved, starting with S. 76A of the Taxation Act.

11. S.76A provides:-

> "(1) Subject to subsection (3), any income payable to a person, not being a person resident in Malawi, arising from a source within Malawi and not attributable to a permanent establishment of that person in Malawi shall be liable to a final tax at the rate of 15 per cent of the gross amount of such income.
>
> (2) The tax payable under subsection (1) shall be deducted from the amount referred to therein upon—
>
> (a) accrual of the amount to such person; or
>
> (b) payment of the amount to such person whether directly to him or to his account in or outside Malawi; or
>
> (c) remittance of the amount to such person; or
>
> (d) crediting of the amount or of the value thereof in favour of such person,
>
> and it shall be the responsibility of the person from whom the amount is due to deduct the tax and to remit it forthwith to the Commissioner.
>
> (3) The tax payable under subsection (1) is not payable in respect of—
>
> (a) income and other amounts exempt from tax under the provisions of the First Schedule; and
>
> (b) any pension or annuity payment."

12. Under this provision therefore, Chibuku Products Ltd should have deducted 15% of the management fees it paid to SABMiller Management BV to be remitted to Malawi Revenue Authority as non-resident tax unless it were exempt under the First Schedule to the Taxation Act. Reading the First Schedule we find it does not provide for any exemption in this regard. Take note, this is tax on any income payable to a non-resident arising from a source not attributable to a permanent establishment of that person in Malawi.

13. This notwithstanding, S122 of the Taxation Act provides that the Act is subject to arrangements declared by order of the Minister to have been made with the Government of any country with a view to preventing, mitigating or discontinuing double taxation. For this reason, believing that SABMiller Management BV is resident in Netherlands, the appellant cited Articles III(2) and II(1)(j) of the Second Schedule to the Relief from Double Taxation (Kingdom of Netherlands) Order 1970 (Malawi/Netherlands Double Taxation Agreement), contending that the management fees are thus exempted from taxation in Malawi. For the same reason, the respondent believing SABMiller Management BV is rather resident in UK, cited Articles III(1) and II(1)(j) of the Annexure to the Schedule to the Relief from Double Taxation (United Kingdom) Order 1964 (Malawi/UK Double Taxation Agreement), contending that the management fees are thus not exempted from taxation in Malawi.

14. On the one part, Article III(2) of the Malawi/Netherlands Double Taxation Agreement states:-

> "The industrial or commercial profits of a Netherlands enterprise shall not be subject to United Kingdom tax unless the enterprise carries on a trade or business in the United Kingdom through a permanent establishment situated therein. If it carries on a trade or business as aforesaid, tax may be imposed on those profits by the United Kingdom, but only on so much of them as is attributable to that permanent establishment"

By the way, Malawi and Netherlands adopted the double taxation agreement between United Kingdom and the Kingdom of the Netherlands entered on 15th October 1948, so in the provision above, "United Kingdom" has to read "Malawi."

15. Article II(1)(j) of the same provides:-

> "In the present Convention, unless the context otherwise requires-
> (j) The term 'industrial or commercial profits' includes rents or royalties in respect of cinematograph films."

Further, under Article II(1)(i) a "Netherlands enterprise" means an industrial or commercial enterprise carried on by a resident of the Netherlands.

16. On the other part, Article III(1) of the Malawi/UK Double Taxation Agreement states:-

> "The industrial or commercial profits of a United Kingdom enterprise shall not be subject to Federal Tax unless the enterprise is engaged in trade or business in the Federation through a permanent establishment situated therein. If it is so engaged, tax may be imposed on those profits by the Federation, but only on so much of them as is attributable to that permanent establishment."

Article II(1)(j) of the same provides:-

> "In the present Agreement, unless the context otherwise requires-
> (j) The term 'industrial or commercial enterprise or undertaking' includes an enterprise engaged in mining, agricultural or pastoral activities, or in the business of banking, insurance, life insurance or dealing in investments, and the term 'industrial or commercial profits' includes profits from such activities or business and also includes rents or royalties in respect of cinematograph films but does not include income in the form of dividends, interest, rents, royalties (other than rents or royalties in respect of cinematograph films), management charges or remuneration for personal services."

17. So far, according to S. 76A(1) of the Taxation Act, **any income** payable to a non-resident arising from a source not attributable to a permanent establishment of that person in Malawi is liable to tax to the extent provided in that section. However, under the Malawi/Netherlands and the Malawi/UK Double Taxation Agreements, industrial or commercial profits of enterprises not attributable to permanent establishments in Malawi of residents of the respective countries are exempted from Malawi tax.

18. What then are "industrial or commercial profits?" In the book "Simon's Taxes, Income Tax, Corporation Tax, Capital Gains Tax, Revised Third Edition, Volume F, Double Tax Relief Agreements," Division F1.2 is entitled "Consideration of Usual Articles in Agreements. Paragraph F1.212 is on Business Profits. In this paragraph the authors write:-

> "The industrial and commercial profits of an enterprise of one country are exempt from tax in the other, except to the extent that they arise from a permanent establishment in the latter. When industrial and commercial profits are defined for this purpose, they normally mean income from a trade or business, including the business of providing the services of personnel, but excluding-
>
> (a) dividends, interests, royalties and rents, unless these are connected with the business of the permanent establishment; and
>
> (b) remuneration for personal (including professional) services."

19. It is probably for this reason that under both the Malawi/Netherlands and the Malawi/UK Double Taxation Agreements, rents or royalties in respect of cinematograph films are specifically included as 'industrial or commercial profits.' And it is probably for the avoidance of doubt that under the Malawi/UK Double Taxation Agreement, dividends, interest, rents, royalties (other than rents or royalties in respect of cinematograph films), management charges or remuneration for personal services are specifically excluded from "industrial or commercial profits.' The short of it all is that ordinarily management charges are not industrial or commercial profits and in a double taxation agreement which provides for exemption of industrial or commercial profits of an enterprise of one country from tax in the other, this does not include management fees. So unless management charges or fees are specifically included as industrial commercial profits in a double taxation agreement between Malawi and any other country, the same cannot be exempt from Malawi Tax. Neither the Malawi/Netherlands nor the Malawi/UK Double Taxation Agreement makes that provision. Therefore, the management fees Chibuku Products Ltd paid to SABMiller Management BV

were subject to non-resident tax under S. 76A of the Taxation Act and the same should have been deducted from the payment.

20. In accordance with S. 105(2) of the Taxation Act, notwithstanding this appeal the tax should have been paid when it was due unless the Commissioner had directed otherwise.

21. This far it is no longer necessary to delve into issues of whether SABMiller Management BV is resident in the UK or Netherlands as neither of the double taxation agreements with these countries exempts management fees from tax in Malawi.

22. Under S. 105(5) of the Taxation Act, if tax is not paid when it is due, it attracts interest at the rate provided in subsection (6). Subsection (6) provides:-

> "where the tax unpaid exceeds K22, the rate of interest referred to in subsection (5) shall be three-quarters per cent per month in respect of the first month or part thereof, with the addition of one-quarter per cent per month for each additional month or part thereof and the final rate of interest shall apply for the whole period during which any tax has remained unpaid, so however that in no case shall the total interest payable be less than K5.50"

23. The parties before me appeared to differ on how to calculate the interest in accordance to this provision as they argued their case. Counsel for Malawi Revenue Authority argued that the provision provides for an arithmetic progression of the rate of the interest, so that the final rate can be solved by the formulae ¾ + (n-1)¼. Counsel for Chibuku Products Ltd argued that the provision does not so provide specifically. If the drafters intended it to be an arithmetic progression they would have so provided. So the appellants calculated the final rate of interest adding a ¼% for every additional month the tax remained unpaid. In effect these are two approaches to the same thing. Only that in

making the calculations Malawi Revenue Authority erred and got the wrong answer.

24. In the book "Business Mathematics and Statistics" 6th Edition by Andre Francis page 286, it is stated:-

> "An arithmetic progression is a sequence of numbers, called *terms*, in which any term after the first can be obtained from its immediate predecessor by adding a fixed number, called the common difference."

This is exactly what S. 105(6) of the Taxation Act provides for. So if the first term i.e. the initial rate of interest is "*a*" and the common difference i.e. the additional rate of interest for every additional month the tax remains unpaid is "*d*", the final rate of interest, which is the *n*-th term can be calculated by the formulae below.

$$Tn = a + (n-1)d$$

In terms of S. 105(6) and the 64 months the non-resident tax remained unpaid, this means:-

$$\text{Final rate of interest} = \tfrac{3}{4} + (64 - 1)\tfrac{1}{4}$$

$$\tfrac{3}{4} + (63 \times \tfrac{1}{4})$$

$$\tfrac{3}{4} + 15\tfrac{3}{4}$$

$$\underline{16\tfrac{1}{2}}$$

This is the same rate Chibuku Products Ltd found following their approach and has to be applied for the whole period the tax remained unpaid.

25. For avoidance of doubt, interest at the rate of 16½% for the unpaid tax of K52 652 232 is K8 687 618.28.

26. Since the tax has remained unpaid up to now despite the provisions of S. 105(2) of the Taxation Act, the final rate of interest should ordinarily be calculated for the whole period the tax has remained unpaid. However, S. 105(6) gives the Commissioner General of Malawi Revenue Authority discretion, on good cause shown, to make such arrangements as he thinks fit with any taxpayer for payment of tax or whether the taxpayer should remit the whole or any part of interest due under subsections (5) and (6) or even decide that no interest should

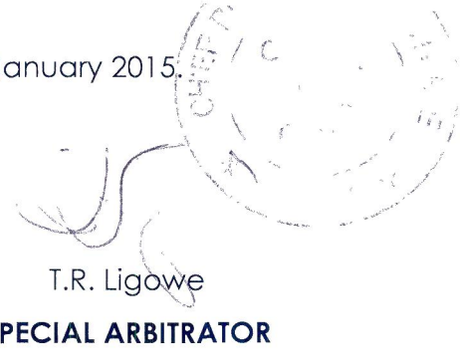
be charged. I leave the issue of whether the interest should be paid in this case and the rate thereof in view of the period the tax has remained unpaid to the discretion of the Commissioner General.

27. Finally on the grounds before the Special Arbitrator, it has not been necessary to inquire into whether the recipient of the management fees in this case was SABMiller Management BV or SABMiller Plc and the residence thereof for purposes of determining which of the double taxation agreements between the Malawi and Netherlands and Malawi and United Kingdom would be applicable. Both of them apparently do not exempt management fees paid to a non resident in Malawi from Malawi tax. The appeal fails in this regard.

28. The non-resident tax is due and payable with interest having remained unpaid since it became due. The tax and interest should have been paid when they fell due despite this appeal unless the Commissioner General had directed otherwise in accordance with the discretion given to him under the proviso to S. 105(6) of the Taxation Act. I am not taking this discretion away.

29. The parties agreed on the penalty applicable under S. 112(g) of the Taxation Act for failure to deduct and remit non-resident tax under S. 76A as being K30 000 which was rightly put by the Commissioner General in his letter of 7th September 2010.

30. Made in chambers this 14th January 2015.



T.R. Ligowe

SPECIAL ARBITRATOR

CHIEF RESIDENT MAGISTRATE