AN ANALYSIS ON THE INCOME TAX ACT 2015

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A brief Overview of the Income Tax Regime

Uganda has a residence based system of taxation, i.e. tax is charged on residents on all their worldwide income. Non-residents are taxed only on income they have sourced in Uganda. Income tax is charged on business income, employment income and property income. The Act provides for various rates of tax on the chargeable income and also sets rules for determining chargeable income. It also sets out what deductions are allowed under the law and what income is considered exempt from tax.

The Income Tax Act also provides for different persons who are assessable for tax purposes, e.g. Individuals, Partners, Trusts, companies and also provides for rules on international taxation. There are special provisions on taxation of petroleum and mining operations. Under the Act, tax may be withheld at source or paid by the recipient of the income through self-assessments.

There are mechanisms provided within the Act on how the tax should be administered and what the taxpayer can do in the event of a disagreement with the revenue collecting body.

Gaps in the old law and contentious issues in the legal framework

It should be noted that since the Income Tax Act was passed in 1997, it has been amended every financial year to reflect the revenue issues addressed by the Country's budget. The norm has been that at the time of reading the budget, the amendments are still in form of a Bill. The Bills are debated and passed after the month of July. However, starting with the financial year 2015 – 2016, the relevant amendments will have been passed as Acts at the time of reading the budget.

In spite of the annual amendments, the Income Tax Act still has a few gaps that have been a source of concern for the taxpayer and these need to be addressed. This paper is not intended to cover all the gaps but rather provide a brief discussion on some of the areas that have consistently raised concern in practice.

1. Anti- Tax avoidance measures

In Section 91 of the Income Tax Act, the Commissioner General is given powers to re-characterize a transaction which does not reflect the substance, or which was entered into as a tax avoidance scheme or which does not have substantial economic effect. Whereas this is a good safeguard to have, the law did not provide guidance on how the Commissioner General should apply his or her discretion in this case. The exercise of this discretion has given rise to a number of court matters which basically have raised the issue of how far can the Commissioner influence or interpret the affairs of a taxpayer.

2. International taxation rules

i) This part is covered under IX of the Income Tax Act and basically deals with payments made to non-residents from sources in Uganda.

These same sections are usually covered in the Double Taxation Agreements (DTAs) which may be in place. Where there are DTAs in place there is need to harmonise the meaning of terms used in the Income Tax Act. For example use of the term “Branch” in the Act as opposed to “Permanent Establishment” in the DTA. In the DTA, permanent establishment is wider and includes a branch. The problem usually arises where the Revenue Authority seeks to apply to the concept of a permanent establishment domestically (i.e. within the Income Tax Act) to ascertain a taxpayer’s status.[i] The use of the term “underlying ownership” in the Act as opposed to “beneficial owner” in the DTA could also be re-visited for purposes of ensuring harmonization.

ii) The concept of a “Ugandan-source services contract” is also still a challenging one. Whereas the Act provides a definition of what amounts to a Uganda-source services contract there is always a danger of stretching the nexus between Uganda and the non – resident who is being paid. For example, there is need to clarify the status of payments made to non-residents for services wholly performed outside Uganda. The Revenue Authority has many times deemed this kind of payment subject to withholding tax on the grounds that it is sourced in Uganda merely because the resident who is making the payment has a separate contract with the Government. However, it should be clarified that there needs to be a nexus between the service being performed by the resident for the Government of Uganda and the service provided by the non-resident to the resident person.

3. **Tax advice obtained from the URA**

The law envisages situations where a taxpayer wishes to know in advance how a particular transaction he or she wishes to enter into will be treated for tax purposes. The Act has provided for private rulings where the taxpayer initiates the process and for Practice notes where the process is initiated by the Commissioner. The problem however arises where no practice note has been issued and a taxpayer has not exactly sought a private ruling but rather has simply made an inquiry and obtained tax advice from the Revenue Authority. A taxpayer who is not aware of the difference between this kind of arrangement and a private ruling will most likely find themselves in a situation where the Revenue Authority has come up with a different position. The Revenue Authority has in such instances imposed penalties on a taxpayer for non-compliance even where the taxpayer acted on the advice of the officers of the Revenue Authority.

The tax procedure Code Act which is yet to take effect makes this position worse. A taxpayer may apply for a private ruling and the URA can decide not to consider it because in the Commissioner General’s opinion it is frivolous or vexatious. This kind of loophole may be abused by the Revenue body and it denies a taxpayer the advantage of certainty of tax obligations.

4. **Transfer Pricing Regulations 2011.**

These are relatively new having come into force in the 2011 Income Tax amendments. They deal with controlled transactions that take place between associated companies and are relevant for determining whether associated companies have dealt with each on at arm's length. The regulations require companies to provide certain documents as proof that payment for goods and services was made at arm's length. I.e. it is the same price that would have been paid if the companies were not related or associated. These regulations are a major anti – tax avoidance check because companies may misuse the transfer prices to lower profits of a branch or subsidiary situated in a country that charges high taxes while raising profits of the branch situated in a country that charges low taxes. The gap here is in the information requirements for the taxpayer. There is need to sensitize the public of these regulations.

5. **The Tax Procedure Code Act**

   In 2014 -2015 financial year, the Tax Procedure Code Act was passed into law. This Act is to commence on a date to be appointed by the minister and when it does, it will repeal sections 92, 94 -110, 129, 131-135, 137 to 162 of the Income Tax Act which deal with administration of the Income Tax Act. Some of the provisions are contentious as some may be interpreted as contravening provisions of the Constitution. For example, the requirement to pay tax disputed (including penalties and interest) before an objection can be considered by URA. If this provision is maintained in the Tax Procedure Code Act, it is likely to make it burdensome, if not impossible, for the taxpayer to object to assessments raised; the provisions making a tax representative personally liable for his client's tax obligations ignores the law governing the principal –agent relationship. The changes in the Code are too many to properly address in this brief.

Changes in the new law and their effects on the taxpayer

The Income Tax (Amendment) Act 2015 came into force on 1st July 2015. It made the following changes to principal Act.

1. **The increased threshold for small business taxpayers**

   The threshold for small business taxpayers was increased from Ushs 50m to Ushs 150m. This means that whilst taxpayers in this category are not required to prepare audited accounts, they are still required to file returns for their gross turn over. The increment is meant to be commensurate with the threshold in the VAT Act. The tax rate for this category of taxpayers has also been reduced from 3% to 1.5 %. A taxpayer with a gross turnover of Ushs 50m pays a flat tax, as set out in part 1 of the 2nd schedule of the Act. This is a final tax and the taxpayer is not allowed any credits or deductions for expenditures or losses incurred in the production of income.

2. **Disallowing deductions relating to suppliers who have no TIN**

Under S. 22 (2), a new subsection (m) has been added. It excludes from allowable deductions, any expenses over Ushs 5M in one transaction on goods and services from a supplier who does not have a taxpayer identification number. The aim is to widen the tax base by bringing the informal sector under the Act.

The implementation of this section is bound to be problematic for the revenue authority. For example, there is no provision that prevents the taxpayer from splitting the transactions with one supplier so that each supply is below Ushs. 5m. In this case the taxpayer can rightfully claim the deduction.

It is also a requirement now that every local authority, Government institution or regulatory body must require a taxpayer identification number from any person applying for a licence or any form of authorization for purposes of conducting any business in Uganda.[ii] It is clear that the burden of ensuring tax registration has been shifted to these bodies and is aimed at getting as many people as possible into the tax bracket.

3. **Definition for roll over relief for re-organization of companies**

The Act as it was in 2014 did not have a definition for roll over relief nor did it specify what re-organization would qualify for roll over relief. In brief, rollover relief is a way for a business to postpone capital gains tax where a business has disposed of its business assets and used all or part of the proceeds to buy new assets. The tax is postponed to the time the new asset is being disposed of.

The 2015 Amendment specifies 5 transactions that would qualify for roll over relief[iii] and clarifies that a sale of a share from one person to another does not constitute re-organization. This will provide clarity on the application of this provision especially in instances where there are mergers and acquisitions.

4. **Definition of a branch and immovable property**

The definition of "branch" has been broadened to include,

> *"the furnishing of services, including consultancy services, by a person through employees or other personnel engaged by the person for such purpose, but only if activities of that nature continue for the same or a connected project for a period or periods aggregating more than ninety days in any twelve month period."*

The 90 day rule has been previously applied only in respect of use or installation of substantial equipment or machinery or construction, assembly or installation projects. It has now been extended to provision of services.

The definition of Immovable property has been introduced. It includes a mining right, petroleum right, mining information or petroleum information.

The previous law did not have this definition. The question is whether information per-se (whether on mining or petroleum) really ought to form immovable property. The amendment is meant to bring the activities of the mining and exploration sector within the ambit of S. 79 (on income sourced in Uganda). The administration of this provision is yet to be seen. For example, how will the Revenue Authority know what information the taxpayer has? What exactly constitutes mining information? Should the information first contain a benefit to the holder of that information or does merely possessing the information bring one within the ambit of this law?

5. Provisions on income sourced in Uganda.[iv]

Previously S. 79(a) of the Income Tax Act was limited to income derived from the sale of goods. The amendment[v] has substituted the old paragraph (a) with a new paragraph that covers business of a resident person in Uganda as a whole. Only that income that is attributable to a business carried on by a person through a branch outside Uganda is excluded. In other words under the new section, income is sourced in Uganda to the extent that it is derived by a resident person carrying on business in Uganda. The section however covers all business of a non-resident that is carried on through a branch in Uganda.

S. 79(c) was also substituted with a clearer section that covers;

a) employment income for services exercised or rendered in Uganda;
b) employment income or fees for the provision of services paid by a resident person (other than fees paid as expenses of a business carried on through a branch outside Uganda); and
c) Employment income or fees for the provision of services paid by a non-resident person as an expenditure of a business carried on by a person through a branch in Uganda.

The previous s.79(c) was restricted to income derived from employment exercised or services rendered in Uganda. The amendment clarifies on the status of payments made by resident persons in respect of their activities outside Uganda and the status of payments made by non-residents to their branches in Uganda.

6. Change in allowable ratios for debt to equity with respect to thin capitalization

In brief, thin capitalization refers to instances where a company has its capital comprising of more debt than equity. The concern for Uganda Revenue Authority is that such a company would be in position to claim excessive interest deductions and thereby reduce its taxable income. The previous Act allowed for foreign controlled resident companies (except financial institutions) an interest deductions of up to 50%:50% foreign debt to foreign equity ratio.

The amendment[vi] has limited the allowable deduction. Under the amended law, a foreign controlled company that has a debt to equity ratio of 1.5 : 1 (i.e. 60%: 40%) at any time during its year of income cannot claim interest deduction on that part of the debt that exceeds the 1.5:1 ration for the period in the year of income in which that ratio as exceeded.

Where the debt to equity ratio exceeds 1.5:1 for the year of income, the restriction or limitation will not apply if the Company can show that at all times during the year of income, the amount of debt was at arm's length.

7. **Repeal of WHT tax exemption on the supply of certain goods and services**

The Act[vii] previously granted a withholding tax exemption on supplies or importation of petroleum and petroleum products, the supply or importation of plant and machinery, the supply or importation of human and animal drugs, the supply or importation of scholastic materials and the supply or importation of raw materials.

The 2015 amendment[viii] has removed this exemption. Therefore these supplies will attract WHT at the rate of 6%.

8. **Requirement for advance tax for Transport operators.**

Taxpayers who provide passenger transport services or taxpayers providing freight transport services using vehicles having a load capacity of more than 2 tonnes are not only required to have tax clearance certificates but also required to pay advance tax under the 2015 Amendments.

The rates for advance tax are set out in a new part III of the 2nd schedule of the Act, i.e. Goods vehicles pay Ushs 50, 000 per tonner per year while passenger service vehicles pay Ushs 20, 000 per passenger per year.

The administration of this provision is yet to be seen but it is likely that there will be some difficulty, e.g. URA will likely estimate the number of passengers transported by the taxpayer in a year because there is no way these can be ascertained. A dissatisfied taxpayer might want to object but for them to do that, they will need records to disprove URA's position because URA is empowered under the law to raise administrative assessments using available information. In effect, this section is encouraging record keeping for the taxpayer.

The advance tax has to be paid before the operational licence is renewed. If at the end of the year of income, a taxpayer by his records can prove that he has paid more than he should have paid in tax, then he can claim a refund under the Act.

9. **WHT tax on re-insurance premiums**

The rate of withholding tax on re-insurance premiums has been reduced from 15% to 10%

10. **Amendments relating to the mining and petroleum industry**

The law on taxation of petroleum operations has been amended to cover the mining sector. Previously the Income Tax Act only specifically provided for Petroleum sector. The amendments are too many to adequately analyze in a short paper like this one. However in brief, the following are some of the changes that have been made;

a) The year of income ending December 31st for the sector has been repealed. This does not prevent the taxpayer from applying for a substituted year of income which may end on 31st December.
b) There are number of definitions provided in S. 89A to cater for the mining sector. Mining and petroleum operations have been defined separately.
c) Provisions of this part of the Income Tax Act prevail over other parts of the Income Tax Act in case of inconsistencies – See S. 89B as amended
d) Under S. 89C & 89GA as amended, deductions are allowed in the year of income against gross income in the licensed area. Accounting is done per licence area. If deductions exceed gross income for the year of income, then they are carried forward to the following year until the excess is fully recovered or operations cease. If deductions are carried forward for more than one year of income, the loss of the earliest year is treated as the first deduction.
e) Under S. 89D & 89GB as amended, the licensee is allowed a deduction for expenditure during the exploration phase of business at 100% during the year of income.
f) Under S. 89E & 89GC as amended, the licensee is allowed to amortize the asset in less than 6 years or expected life whichever is lesser and to account for deductions on a straight line basis. Amortization is allowed for depreciable assets acquired before commencement of production.
g) Under S. 89GF, if there is a change in the underlying ownership of a licensee, the Commissioner General must be notified in writing immediately. If the interest is disposed to a non-resident person, the licensee is responsible for tax payment from the non-resident. This is meant to avoid disputes on who is liable for tax in the event of change of ownership.
h) Under S. 89E for mining extraction expenses, a licensee is allowed to reduce on gain from disposal (in cases of disposal of intangible assets) any unclaimed deductions that have not been applied. This does not apply to petroleum operations.
i) Under S. 89GG, a non-resident contractor who derives a fee for provision of a service is liable to 10% WHT on gross service fee. This fee will not be applicable if the non-resident subcontractor is a branch in Uganda. The tax is withheld at the point of crediting the account of the non-resident contractor or at the time the fee is actually paid, whichever is earlier. An associate of the licensee who provides services and derives a service fee is taxable. The definition of a service fee is not comprehensive. S. 10 of the Income Tax (amendment) Act 2015 defines service fees to "include an amount treated as royalty in section 2 (mmm)(i)(E)". Section 2 (mmm)(i)(E) defines "royalty" to mean the use of, or the right to use, any tangible movable property. This in my view does not define service fee.

Areas needing reform so as to harmonise the law with practical realities.

The advantage with the tax laws is that there is an opportunity for review every year. The 2015 amendments have provided a level of clarity for some areas but have also introduced some gaps especially with regard to administration. The following are some of the observations;

1. The administrative implications of some of the changes in the law (2015 amendments) that have been highlighted need to be revised. For example the requirement for advance tax by passenger transport services and freight services. There is need to clarify what kind of information the taxpayer ought to keep to ensure that they can prove their tax liability to the Revenue Authority.

2. The law needs to have some parameters within which the commissioner exercises his or her discretion under the anti-avoidance provisions. This will avoid the overlap with functions of other statutory bodies. There have been disputes that have gone to the courts of law on this issue. E.g. where a taxpayer (usually a corporate taxpayer) has paid out bonuses to its directors and deducted withholding tax and the Commissioner General instead re-characterizes this payment as payment of dividends and subjects it to corporation tax and Withholding tax. The dispute is usually about whether the Commissioner can decide when a company should pay out dividends. The process of paying dividends is governed by the Companies Act. Where the procedure set out in the Companies Act has not been undertaken by the Company, can the URA's Commissioner General exercise her discretion to re-characterize income and force the operation of this procedure where the Company's administration has not? In which instances can the Commissioner General disregard statutory documents properly approved and filed on record with the Registrar or companies? This is an area still under litigation[ix]. The gap is on absence of guidance on when the Commissioner can invoke S. 91 of the Act and whether this section can be used to determine what amounts to acceptable or unacceptable corporate practice and whether this is an area within the jurisdiction of the Uganda Revenue Authority and not the Registrar of Companies.

3. The courts have rightly interpreted as illegal, any agreements between the Revenue Authority and the taxpayer where the effect is to allow the taxpayer pay less tax than he or she is required to pay under the law.[x] The point of concern arises where there is no such intention to limit tax liability but the Revenue Authority has made an error, say in computing taxes and interest, and a taxpayer has acted on the advice of the Authority. It is unfair for the authority to later penalize the taxpayer for acting on the advice it provided. It would be helpful to have this kind of scenario clarified in the law, i.e. where a taxpayer who makes full disclosure of his transaction, seeks advice (which is not in form of a private ruling) from the Revenue Authority and acts upon it, if it later turns out that the Revenue Authority's interpretation of the law on the transaction was wrong, the taxpayer should not have to bear the penalties that come with late payment of tax. It could also be clarified whether the taxpayer can indeed receive tax advice from the Revenue Authority and whether the law would recognize such advice as binding on the authority especially when it is not a private ruling.

End Notes

[i] See SMEC International PTY Ltd Vs Uganda Revenue Authority Vide HCCS No. 9 of 2015 – Still under litigation.
[ii] See S. 24 of the Income Tax Amendment Act 2015
[iii] See S. 6 of the Income Tax (Amendment) Act 2015
[iv] See S. 79 ITA
[v] See 8 of the Tax (Amendment) Act 2015
[vi] See S.9 of the Income Tax (Amendment) Act 2015
[vii] See S. 119 (5) before the amendment
[viii] See S.9 of the Income Tax (Amendment) Act 2015
[ix] See Skenya Motors (U) Ltd vs Uganda Revenue Authority TAT Application No 7 of 2012
[x] KM Enterprises Ltd and 2 others Vs Uganda Revenue Authority, HCT-00-CC-CS-0599-2001

References:

1) The Constitution of the Republic of Uganda, 1995
2) The Income Tax (Amendment) Act 2015
3) The Income Tax Act (as amended by the Income Tax Amendment Act 2014)
4) The Tax Procedures Code Act No. 14 of 2014
5) Skenya Motors (U) Vs Uganda Revenue Authority TAT Application No 7 of 2012
6) Down Town Forex Bureau and 2 others Vs Uganda Revenue Authority TAT Application No 4 of 2012
7) KM Enterprises Ltd and 2 others Vs Uganda Revenue Authority HCCS No. 599 of 2001