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Share purchase or asset deal?

The key Ugandan tax considerations at business acquisition

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1. Introduction

This publication discusses the key tax issues that may arise on a business acquisition in Uganda. The principal means of acquiring business are asset deals and share purchases. Both are implemented via legal steps that can be simple or complicated depending on the structuring of the transaction. The payment for the acquisition can include cash, asset exchanges and share swaps. The decision on the option to take is not only informed by legal, tax and accounting considerations but also the commercial objectives and bargaining power of the parties to the transaction. Buyers often prefer an asset acquisition but sellers are generally inclined towards business divesture via share sales.

a) Asset deal

An asset deal involves the sale and purchase of ascertained business assets. The buyer may also take up any defined liabilities but will wish to reduce the risk of unknown burdens being passed at transaction completion (e.g. environmental liabilities in relation to business premises). Asset sales with large number of properties can be complex since the individual assets and liabilities to be transferred must be delineated. Third party consents may also be required to effect some of the asset transfers. The due diligence on asset deals is limited in scope to the properties and liabilities being acquired.

b) Share transaction

This comprises the purchase of shares from shareholders with the ownership of the company passing to the buyer along with all its assets and liabilities. Due diligence on share acquisition deals is usually full scope given the risk of unknown liabilities transferring to the buyer at transaction completion. Typically, tax would be a key area of focus as any historic underpayments which are not provided for in the balance sheet would remain with the company reducing its value to the buyer. As such, sellers normally give representations and warranties to the buyer to provide protection against undisclosed past liabilities at transaction closure. A warranty is a type of guarantee that the seller makes regarding the state of the company being sold. It also refers to the terms and situations in which compensation will be made to the buyer in the event that more liabilities than disclosed in respect of past dealings arise after transaction closure.

2. Value Added Tax

VAT is not chargeable on share transfers as they are out scope. Asset sales on the other hand attract VAT at the standard rate of 18% unless certain conditions are satisfied. Uganda's VAT Act (VATA) exempts from VAT the supply of property as part of the transfer of a business as a going concern. The VATA defines transfer of business as a going concern to include the disposal of any part of the business which is capable of separate operation.

The Uganda Revenue Authority (URA) provides additional guidance on what amounts to a transfer of business as a going concern for VAT purposes via a Practice Note issued on 2nd June 2008. Mere disposal of an asset used for business is not a supply of a going concern and the Note states that all the requirements set out below must be satisfied for the disposal of a business asset to be exempt from VAT.

- If part of the business is disposed of, it must be capable of separate operation (for example a branch of a business);
- Both the seller and the buyer must be registered as a taxable person for VAT;
- The sales agreement should make it absolutely clear that the property is a whole or part of the seller's business which is being sold as a going concern;
- Activities of the business must continue after the business is transferred to the purchaser for at least two years;
- The seller delivers to the buyer all the facilities that are necessary for the continued operation of the business (or part of a business) being sold. This may include premises, plant and equipment, stock in trade, intangible assets such as goodwill, contacts and licenses and all the operating structure and process of the enterprise;
- The seller carries on, or will carry on the business until the day of the supply and that the nature of the business will not change after the transaction; and

- The buyer and seller shall within 21 days of the transfer, notify the Commissioner General in writing of the details of the transfer in accordance with the VAT legislation.

We would like to note that Practice Notes issued by the URA do not override primary legislation unless explicit delegated power has been given to the tax authorities to enact such secondary legislation. Some of the conditions in the foregoing Note that narrow the scope of the VAT exemption for the transfer of business as a going concern as set out in the VATA may therefore be subject to challenge.

3. Income tax

Several Ugandan tax implications arise at business acquisition and divesture as set out below.

a) *Capital gains*

Capital gains on share and asset disposals are taxed in the hands of the seller under the income tax regime. Companies and equivalent are taxed at the corporate income tax rate of 30% while individual income tax rates are on a graduated scale up to a maximum of 40%.

Capital gains not included in business income are exempt from income tax unless they relate to the sale of shares in a private limited liability company or on the sale of a commercial building. There are elaborate rules in the Income Tax Act (ITA) that set out the parameters for determining capital gains and losses taking into account the consideration and cost base of the asset being disposed.

Gains and losses arising on the disposal or transfer of assets are not taken into account for income tax purposes if they relate to:

- transfers of assets between spouses;
- transfers of assets between former spouses as part of a divorce settlement or bona fide separation agreement;
- an involuntary disposal of an asset to the extent to which the proceeds are reinvested in an asset of like kind within one year of the disposal; or
- the transmission of an asset to a trustee or beneficiary on the death of a taxpayer.

b) *Restriction on the deductibility of tax losses*

In the case of a share acquisition, a company may not deduct any tax losses brought forward for a period of 2 years if there has been a change of 50% or more in its direct or underlying ownership unless:

- it continues to carry on the same business after the change in ownership; and
- does not engage in any new business or investment after the change where the primary purpose of the company or beneficial owners of the company is to utilise the assessed tax losses as to reduce the tax payable on the income arising from the business or investment.

c) *Deemed disposal*

This too applies where there has been a change in the shareholding of a company. Enterprises other than individuals, a government, a political subdivision of a government and listed institutions, that are subject to a change in their direct or underlying ownership by 50% or more, within a period of 3 years, are deemed to dispose of their assets and liabilities on the date of change of control. Listed institutions are organisations set out in the First Schedule to the ITA that are exempted from income tax. Immediately after the change, the enterprise is also treated as having re-acquired the same assets and liabilities at market value. To the extent that the asset re-acquisition value exceeds the market asset value at deemed disposal, there are capital gains taxable as business income of the company.

d) *Rollover relief*

The rollover relief enables asset exchange and transfers between group companies without triggering capital gains. When a resident person transfers a business asset to another resident person in exchange for a 50% or more shareholding in the transferee after the transfer:

- The transfer is not treated as a disposal of the asset by the seller but is treated as an acquisition by the buyer of a business asset;
- The buyer's cost base for the asset is equal to the seller's cost base for the asset at the time of the transfer;
- The cost base of a share received by the seller in exchange for the asset is equal to cost base of the asset transferred less any liability assumed by the seller in respect of the asset.

e) *Company reorganisations*

Capital gains may not arise on group company reorganisations. Where a resident company or a group of resident company is reorganised without any significant change in the underlying ownership or control of the company or group, the Commissioner may;

- permit any resident company involved in the reorganisation to treat the reorganisation as not giving rise to the disposal of a business asset or the realisation of any business debt as the case may be; and
- determine the cost base of any business asset held or business debt undertaken, by the resident company after the reorganisation in order to reflect the fact that no disposal or realised is treated as having occurred.

4. Stamp duty

Unless explicitly exempted, the documentation used to effect a business acquisition either by way of share deal or asset purchase is an instrument chargeable to stamp duty.

a) *Transfer of assets*

Asset transfers attract stamp duty at the rates set out in the Stamps Duty Act. The transfer of commercial property and shares attract stamp duty at the rate of 1.5% of the value of the asset sold. The expense of the stamp duty is on the person drawing, making or executing the instrument. Alternatively, the parties can agree who should bear the cost.

b) *Relief from stamp*

Share transfers effected pursuant to company reorganisations are relieved from stamp duty subject to the conditions below among others being satisfied:

- the effect of the instrument is to convey or transfer a beneficial interest in property from one company with limited liability (transferor) to another company (transferee);
- either one of the companies is beneficial owner of not less than 90% of the issued share capital of the other company; or
- not less than 90% of the issued share capital of each of the companies is in the beneficial ownership of a third company with limited liability.

5. Valuation of shares at transfer

Prior to effecting share transfers, the Companies Act sets out a requirement for a Certified Public Accountant (CPA) to confirm the value of the shares being transferred. Different methods can be used by the CPA to determine the valuation of shares of non-listed companies.

- ***Net Asset Valuation (NAV) Approach***

This approach values the shares of a company based on the book value of its assets at a specific point in time. Though a fairly simplistic approach, it can provide a reasonable benchmark value. Its limitation is that the valuation is based on accounting numbers, which are historic in nature. Furthermore, this approach cannot put a value on the intangible assets, management skills, and infrastructure and, therefore, does not take into consideration any value of 'goodwill'. Some investors, however, use the net assets value as a base and add a premium for goodwill.

This premium can be based on the business and company performance e.g. the estimated value of key contracts with clients, etc.

The Net Assets Method may be more appropriate for a company that is facing financial constraints for closure and cannot, therefore, be classified as a going concern.

- ***Market Multiples Method***

The market multiples approach can also be used to determine the market value for shares of unquoted companies. In doing so, an analyst examines commonly used multiples of similar actively traded public companies to extrapolate the market value of the company being valued from measures of the profits or cash flows that it generates.

One of the appropriate multiples that may be applied is Enterprise Value to Earnings before Interest, Tax, Depreciation and Amortisation (EV/EBITDA). The earnings should be adjusted, if necessary, for any extraordinary items, which are of a non-recurring nature to arrive at an estimated maintainable level of earnings. The applicable ratio is determined by identifying and applying the ratio of similar companies quoted on stock exchanges around the world. Working out the value of the company using this approach involves the following:

- Obtaining current multiples for similar actively traded businesses in other markets;
- Adjusting these multiples for the regional risk;
- Working out maintainable earnings for the company. In working out the maintainable earnings, we will adjust the earnings, if necessary, for any extraordinary items, which are of a non-recurring nature; and
- Computing the value of the company by applying the computed multiples.

It should be noted that the multiples approach assumes the equity market to be efficient and that the share prices reflect their "true" values.

- ***Discounted Cash Flow (DCF) Approach***

This method is based on the premise that the value of a company is a function of the future cash flows generated by the business and all its assets (including goodwill) discounted at a risk-adjusted cost of capital to attain a net present value. The method involves an in-depth analysis of the company's historical operating and financial performance, its current market position, future plans and the economic environment in which it operates.

In the case of loans under this method, usually the effect that the principal and interest payments will have on the projected cash flows of a company is examined. Additionally, under the DCF approach the equity value is the business value less the loans where the business value in this case is the discounted value of the future (projected) cash flows. Brand value or goodwill, if it exists, can be captured in this valuation methodology.

Therefore, greater reliance on DCF method may be more prudent in assessing business value ranges for the companies as a 'going concern'.

6. Conclusion

Several factors some of which are complex and deal specific influence the determination of the optimal structure of a business acquisition. A decision on the structure needs to be made as early as possible since this impacts virtually all of the transaction documents. International tax issues are beyond the scope of this article and should also be considered if the sellers or buyers are not Uganda tax resident. If considering business acquisition or divesture, it is important you consult early in the process with legal counsel, accounting and tax advisors to avoid potential delays and unnecessary expense.

Contacts for this Publication

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Bill is a Senior Advisor with Cristal Advocates. He has concentrated on working with energy companies with a particular focus on cross border transactions and M&A since 1989 and is a leading global energy and tax practitioner with wide international experience. Between 1986 and 1998, he worked in London with the UK tax authorities and Big Four accounting firms. From 1998 to 2004, he was based in Kazakhstan working across the Caspian region with Deloitte. He was in the region at the time it was developing its infrastructure for crude oil production with international investment following the collapse of the Soviet Union.

From 2004 to 2008, he worked in Russia where he led Deloitte's oil and gas industry group and established Deloitte's office in Sakhalin. He moved to East Africa in 2009 leading Deloitte's energy and resources industry group in Uganda, Kenya, Tanzania, Rwanda, Ethiopia and Mozambique. He was initially based in Kampala, Uganda later relocating to Dar es Salaam, Tanzania. Bill returned to the UK in 2014 supporting Deloitte UK teams working on outbound projects investing in Africa and was a key member of Deloitte UK's energy and resource practice until his retirement from the firm in September, 2018.

Bill is a graduate of Oxford University and completed his inspectors' training with the UK Inland Revenue in 1989. ■

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Denis is the Managing Partner at Cristal Advocates where he also leads the energy and tax practice. He is qualified both as a Lawyer and Chartered Accountant with vast experience serving various industries in Sub Saharan Africa. Before joining Cristal Advocates. He had worked for close to 10 years with Deloitte and Touche where he started his career and rose to senior managerial positions.

At Deloitte, he lived and worked in Uganda, Kenya, Tanzania and the United Kingdom for over 6 years and subsequently became the firm's chief of staff for the Energy and Resources Industry Group seeing him play a lead advisory role in Uganda, Kenya, Tanzania, Mozambique, South Sudan, Somalia and Ethiopia.

Denis is widely published and a regular commentator in the local, regional and international media and speaker at various forums regarding the taxation and financing of energy projects as well as the protection of large capital projects within the framework of international investment law.

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John leads the public policy and advocacy practice at the firm and combines unique public and private sector experience.

Prior to joining Cristal Advocates, he had worked as a Private Secretary to the President of the Republic of Uganda. During this time, he participated in several public and private sector engagements that included advising and coordinating activities relating to oil and gas as well as infrastructural projects of national significance. John had earlier worked with the Post Bank Uganda Limited and Shonubi Musoke and Co. Advocates.

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Dickens leads the oil and gas practice at Cristal Advocates. He has an in depth appreciation of Uganda's oil and gas sector having served as the maiden Company Secretary of the Uganda National Oil Company (UNOC) and the Uganda Refinery Holding Company Limited (URHC). UNOC represents the Government of Uganda commercial interests in the oil and gas sector while URHC represents government interests in the refinery project as well as managing the petrol based industrial park.

Dickens was instrumental in UNOC's formation and initial period of operation and also served as its head of Contracts, Negotiations and Advisory until May 2018. Prior to joining UNOC, Dickens was Legal Counsel at the Petroleum Directorate of the Ministry of Energy playing key legal advisory roles on the negotiation and implementation of PSAs, Joint venture and other oil and gas agreements. He was also part of the team that shepherded the process of enacting the current Ugandan oil and gas Legislations and Regulations including the local content requirements.

He is a certified project control specialist (IFP) and holds a Master of Laws Degree in Petroleum Law and Policy from the University of Dundee in the United Kingdom, a Post Graduate Diploma in Legal Practice and a Bachelor of Laws degree from Makerere University. ■

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