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Double Tax Treaties and their Application in Uganda

A deeper level of detail

Cristal Tax Series

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1. What is a double tax treaty?

Double tax treaties were developed in the early part of the twentieth century in response to concerns that multinational groups were subject to multiple claims to tax their income and gains from international activities, eg an overseas branch would be subject to tax on its profits whilst these would also be subject to tax in the location of the head office. The League of Nations (predecessor of the United Nations) issued the first model double tax treaty in 1928 and this included a mechanism which is still found in most double tax treaties: the investee country limits its right to tax income and gains of the investor whist the investor country provides a credit for any investee country taxes against the tax that it levies.

Countries were encouraged to enter into such treaties in order to promote trade and investment. Today there are over 2,000 double tax treaties in force worldwide. Uganda has 9 treaties currently in effect. The treaty partners are Denmark, India, Italy, Mauritius, Netherlands, Norway, South Africa, United Kingdom and Zambia. It is understood that treaties have also been negotiated with Belgium and China, but these have not yet been finalised.

2. What issues does a double tax treaty normally cover?

The most helpful way to understand what's covered by a typical double tax treaty is to take a specific example: the treaty between Uganda and the United Kingdom which was signed in 1992 and came into force in 1993. Whilst each treaty is unique, there are significant similarities in terms of the issues addressed and the overall structure.

The preamble to the UK treaty states that it is entered into, 'for the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income and capital gains', though most of the articles deal with the former rather than the latter. It should be noted that the treaty, like most other bilateral tax treaties, deals only with direct taxes and does not impact the application of indirect taxes such as VAT and customs duties.

(Please note that the following is only a selective summary of key provisions and in specific cases the terms of the treaty and related domestic law should be carefully reviewed).

Article	Overview
Article 1 **(Personal scope)**	The treaty applies to residents of one (or both) of the signatories. This includes individuals and legal entities.
Article 2 **(Taxes covered)**	As already mentioned in the preamble, the treaty applies to taxes on income and gains. In the UK, these comprise income tax and capital gains tax (which apply to individuals) and corporation tax (which applies to both income and capital gains of companies). In Uganda income and gains for individuals and corporates are subject to income tax.
Article 3 **(General definitions)**	Some terms are specifically defined. Importantly, the UK for these purposes excludes Crown dependencies (eg the Channel Islands and Isle of Man). Where definitions are not specified terms have the meanings ascribed under the relevant domestic law. This article introduces the concept of 'an enterprise' which is not defined but may be understood as embracing commercial activities carried on via a company, individual, partnership or other legal form.
Article 4 **(Fiscal domicile)**	As the treaty applies to residents, it is important that this concept is clearly explained. Domestic tax law is to be applied initially but it is possible that individuals and companies may be resident in both jurisdictions under domestic law therefore the treaty provides a tie-break to determine where they are resident for the purposes of applying the treaty. For example a company may be incorporated and hence tax resident in the UK but if management and control is exercised in Uganda the Income Tax Act would treat it as Uganda resident also. In this case the article provides that for the purposes of the treaty it will be resident in the location where effective management is located.

Article	Overview
Article 5 (Permanent establishment – 'PE')	This addresses the situation where a resident of one of the countries (usually a company) carries out business activities in the other. It sets out detailed rules for determining whether such activities are sufficient to create a PE, which becomes important when considering Article 7 (see below). Key criteria include the existence of a fixed base which may include not only obvious facilities like offices or factories, but also mines, oil wells and a construction site (but only if it lasts more than 183 days). It excludes various activities of a 'preparatory or auxiliary character', subsidiaries and independent agents.
Article 6 (Income from immovable property)	This gives the jurisdiction where immovable property is located the right to tax income arising even where that income is derived by a resident of the other jurisdiction. The term 'immovable property' is to be construed in accordance with domestic legislation in the jurisdiction where it is located. The treaty explicitly allocates certain payments arising from natural resources to the jurisdiction where that resource is located.
Article 7 (Business profits)	Where business is carried by a resident of one of the jurisdiction, via a PE in the other, the other jurisdiction has the right to tax profits attributable to the PE. Further details are provided on how the profits of the PE should be calculated, including the application of transfer pricing principles.
Article 8 (Shipping and air transport)	Profits arising to a resident of one of the jurisdictions from the operation of ships or aircraft are only taxable in the jurisdiction where effective management is located.
Article 9 (Associated enterprises)	This provides a basis for the transfer pricing rules provided in domestic tax law of the two jurisdictions to be applied in the case of transactions between enterprises under common control.
Article 10 (Dividends)	This applies where a resident of one of the countries derives a dividend from shares of a company resident in the other jurisdiction. The dividend can be taxed both in the jurisdiction where the recipient is resident and at source in the paying jurisdiction (though at a rate not exceeding 15%). In the case of a dividend paid by a Ugandan resident company to a UK resident the normal rate of domestic withholding tax is 15% so the treaty does not provide any reduction. Other treaties provide a reduced, or even zero rate of withholding tax. (It should be noted that the UK does not apply withholding tax on dividends.)
Article 11 (Interest)	This article is very similar to that applicable for dividends, providing a 15% withholding tax on interest payments. Treaties which provide a reduced rate of withholding tax generally restrict application of relief to an arm's length amount of interest, so a borrower that is thinly capitalised will have to apply the normal domestic rate to any 'excess' interest.
Article 12 (Royalties)	This is also very similar to the article dealing with dividends, providing a 15% limit on the withholding tax rate Uganda and the UK can impose on royalties payable to a resident of the other jurisdiction. The definition of royalties covers payments for the use of various categories of intellectual property and for the use of equipment of various sorts (so it could also cover equipment leases).

Article	Overview
Article 13 (Technical fees)	Where a resident of one jurisdiction provides technical, consultancy or management services to a resident of the other jurisdiction, payments may be subject to 15% withholding tax. This does not apply to payments in respect of employment (covered in article 16). Similar articles are frequently found in treaties between developing and developed economies and broaden Uganda's right to tax a broad range of service activities even when the provider does not create a PE in Uganda. The UK does not apply withholding tax under its domestic law in such cases. Treaties which do not have such an article (such as the Uganda-Netherlands treaty) only permit Uganda to tax active business income from such services where the provider creates a PE, as defined in article 5 or under the article covering independent personal services in the case of individuals (see article 15 below).
Article 14 **(Capital gains)**	A resident of one jurisdiction may be taxed on a gain arising on the disposal of immovable property located in the other jurisdiction. This does not provide the right for Uganda to tax disposals of shares which derive value from immovable property located in Uganda but it is increasingly common for treaties to extend taxing rights to these situations. Recent changes to Uganda's domestic tax law have given Uganda an alternative means of taxing such transactions: by deeming a Uganda resident company to sell (and reacquire) assets at market value on a change in underlying control (see sections 75 and 79 of the Income Tax Act) thus crystallising any gains.
Article 15 (Independent personal services)	An individual resident of one jurisdiction providing professional or similar services in the other may be taxed in that other jurisdiction if (s)he has a fixed base available or spends more than 183 days in the jurisdiction in any 12-month period. The effect of this is similar to articles 5 and 7 in the case of companies.
Article 16 (Dependent personal services)	This article deals with the taxation of employees' remuneration which may be taxed only in the jurisdiction where the employee is resident unless (s)he carries out duties in the other jurisdiction. In such circumstances the location where the duties are performed also has the right to tax the income unless the employer is non-resident, the cost is not charged to a PE or the employer <u>and</u> the employee does not spend more than 183 days in the jurisdiction during any 12-month period.
Article 17 (Directors' fees)	All fees and similar remuneration of directors of a resident company are taxable in that jurisdiction.
Article 18 **(Artistes and athletes)**	Payments to artistes, athletes, sportsmen and sportswomen (usually in respect of performances, etc) are taxable in the jurisdiction where they perform. This includes payments via an intermediary.
Article 19 (Pensions)	Pensions and similar payments are taxable only in the jurisdiction of residence of the recipient.
Article 20 (Government service)	In most circumstances, payments to individuals in government service are only taxable in the jurisdiction on behalf of which the relevant duties are performed.
Article 21 (Students)	Payments to students (eg grants, bursaries, etc.) who are resident of one state and present in the other only for purposes of their education, will not be taxable in the latter jurisdiction provided paid from a source outside that jurisdiction.
Article 22 (Income not expressly mentioned)	This is a catch-all provision to ensure that any type of income not covered in the other articles is taxed in the jurisdiction where it arises.

Article	Overview
Article 23 (Elimination of double taxation)	This provides rules to ensure that credit is provided for tax payable in accordance with domestic law and the treaty in one jurisdiction on income and gains of a resident of the other jurisdiction. (Credit relief works by reducing the tax charge in the country of residence by the amount of tax paid in the other jurisdiction.) The provision also provides that the UK will give a credit for tax that would have been paid but for specific exemptions provided under Uganda's 1974 tax legislation or a replacement thereof. This is largely of historic interest as the UK has moved to a territorial tax system since the treaty came into force, meaning that the UK generally does not tax foreign business income and gains of UK resident companies.
Article 24 (Non-discrimination)	This provides that residents of one jurisdiction shall not be subject to tax by the other jurisdiction which is more burdensome than that which it imposes on its own residents.
Article 25 **(Mutual agreement procedure)**	This provides a mechanism for a resident of one jurisdiction to appeal to its home tax authorities to intervene on its behalf if it considers that the other jurisdiction has not taxed it in accordance with the provisions of the treaty. The respective tax authorities may attempt to resolve the issue by negotiation, but no mechanism is provided to settle any difference of view between them.
Article 26 (Exchange of information)	This is the only article which deals directly with evasion. It provides a mechanism for tax authorities in the UK and Uganda to exchange confidential information regarding taxpayers for the purposes of applying the treaty or domestic law. This may only be publicly disclosed as part of legal proceedings (eg prosecution for tax evasion). Other Ugandan tax treaties (eg those with South Africa and Norway) include an additional article requiring that the parties should also provide mutual assistance in the collection of tax. For example, if a South African resident was found not to have paid Ugandan taxes which were due, the URA could request the South African Revenue Service to assist it in enforcing its claim for tax.
Article 27 (Diplomatic agents and consular officials)	These individuals are generally taxable only in their jurisdiction that they represent.
Article 28 **(Entry into force)**	This describes the timeline for the treaty coming into force.
Article 29 (Termination)	This provides a process for terminating the treaty. At least six months' notice is required.

3. Some provisions of Uganda's current treaties

As noted above, Uganda currently has 9 treaties in force. These provide relief from withholding tax, which generally applies at the rate of 15% under domestic tax law to all the categories of payment listed when made to non-residents.

Treaty	Dividends	Interest	Royalties	Technical Fees
Denmark	10% or 15%	10%	10%	10%
India	10%	10%	10%	10%
Italy	15%	15%	10%	10%
Mauritius	10%	10%	10%	10%

Treaty	Dividends	Interest	Royalties	Technical Fees
Netherlands	0%, 5% or 15%	10%	10%	0%
Norway	10% or 15%	10%	10%	10%
South Africa	10% or 15%	10%	10%	10%
United Kingdom	15%	15%	15%	15%
Zambia	0%	0%	0%	0%
No treaty	15%	15%	15%	15%

Note: certain treaties specify a lower (or zero) rate for dividends where the shareholder owns more than a certain proportion of the shares.

4. Criticisms

Recent years have seen a growing focus on the tax planning techniques used by multinational groups in developing countries, particularly the utilisation of double tax treaties. Some commentators suggest that double tax treaties have actually done little to encourage trade and investment but have given rise to significant losses of tax revenue in developing countries because treaties have been negotiated poorly.

In the case of Uganda, critics have focused particularly (but not exclusively) on the Netherlands treaty and pointed to the absence of an article permitting the imposition of withholding tax on technical fees (see the commentary above on article 13 of the UK treaty); the ability to reduce or even eliminate withholding tax on dividends (see the commentary on article 10 of the UK treaty); and the limitation on Uganda's right to tax gains arising from indirect disposals of property and rights located in Uganda (see the commentary on article 14 of the UK treaty).

It has been suggested that a significant amount of investment in Uganda has been routed via the Netherlands specifically to exploit the weaknesses in the treaty. It has also been pointed out that Australian companies have made significant investments in Uganda without the benefit of a double tax treaty and that countries like Angola have been successful in attracting major foreign investment without any tax treaties.

In response to these criticisms Uganda announced a review of its approach to double tax treaties in June 2014 and no new treaties have come into force since the Netherlands treaty (in force since 2006). It should also be noted that the Netherlands has acknowledged that some of the treaties it has concluded with developing countries may be amended to provide a more equitable treatment for the counter-parties.

5. Recent changes

An initiative to combat aggressive tax planning using Base Erosion and Profit Shifting ('BEPS') techniques was launched by the G20 in 2012. One of the key issues identified was the misuse of double tax treaties, particularly in financing structures and the action plan to combat BEPS includes measures to limit the ability to use of double tax treaties. Uganda has not been as active in the BEPS discussions as some other developing countries, but recent changes to Ugandan law relating to international taxation make it clear that fiscal policy makers have been paying close attention.

Up to 2018, the Income Tax Act restricted the application of double tax treaties where the country of residence of the company claiming a treaty benefit was not the same as that of 50% or more of the underlying owners. This treaty override was of questionable validity and the 2018 Finance Act included an amendment to bring this into line with international best practice. The relevant section now restricts the application of treaties where the claimant is not the beneficial owner of the income in question and lacks economic substance. This is aimed at the use of intermediate companies in jurisdictions with favourable treaties which, in reality, are no more than a brass name plate.

In response to aggressive tax planning using loans from related parties, Uganda has broadly followed the recommendations of the BEPS programme by restricting interest deductions to 30% of EBITDA (earnings before deducting interest, tax, depreciation and amortization).

A third change introduced in 2018 targets the use of holding structures to use treaties to avoid taxation of capital gains. As noted above, where valuable assets located in Uganda are held via an offshore structure it could be possible to argue exemption from Ugandan tax on gains if a sale was made at the level of an intermediate holding entity in a jurisdiction with a suitable treaty. This was the point at issue in the recent Zain Telecom case. The law change now enables Uganda to tax such a transaction by deeming the local entity, which directly owns the valuable assets, to sell and reacquire all of its assets and liabilities at market value in the event of a change in its underlying ownership. This approach has also been adopted by Ghana and Tanzania.

6. A continuing role for double tax treaties?

In the past, double tax treaties were seen as having an important role in attracting foreign investment to Uganda. In the future they may be less important in this respect, and it is worth noting that the key investors in Uganda's oil sector, Total and CNOOC, are headquartered in jurisdictions which do not currently have double tax treaties with Uganda. It is, however, important to consider not only the substance, but also the optics when considering the future of Uganda's existing treaties. Amendments to existing treaties are possible, but a wholesale revocation of treaties is likely to create an adverse response amongst investors in general. It will also be interesting to see whether Uganda moves forward with the Belgium and China double tax treaties and whether these ultimately include provisions which are more favourable than current treaties to Uganda as an investee jurisdiction.

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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.

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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.

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