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Uganda's High Court Tax Decisions

Hot news

Input VAT | Equipment rental payments | Insurance Brokers | Practice Notes

We are pleased to share with you our analysis of two recent Uganda High Court decisions found in favor of taxpayers. Unless appealed to the Court of Appeal by the Uganda Revenue Authority ("URA"), the judgements in the cases of *Target Well Control Uganda Limited versus Uganda Revenue Authority ("The Target Well Case") and APA Insurance and 22 others versus Uganda Revenue Authority ("The Insurers case")* will remain binding judicial precedents.

1. The Target Well Case

Target Well Control (Uganda) Limited ("Target Well Uganda") is a company incorporated under the Laws of Uganda. It sought the intervention of the High Court to annul positions taken by the URA following an audit of its tax affairs.

URA had denied Target Well Uganda a credit for input Value Added Tax (VAT) in respect of VATable goods that it had procured. It also demanded withholding tax (WHT) from Target Well Uganda on equipment rental payments to Target Well Control (UK) Limited ("Target Well UK") which is a UK incorporated and tax resident company.

a) The contention

URA denied Target Well Uganda input VAT credit in respect of VATable goods it purchased. URA contended that the vendor in question was neither registered for VAT nor remitted the VAT they collected on the tax invoice issued to Target Well Uganda. URA was categorical that it could not refund to Target Well Uganda the VAT in dispute because it was not remitted by the vendor.

Target Well Uganda disputed URA's position arguing that in accordance with the provisions of the VAT legislation, entitlement to input VAT credit and refund was not predicated on the vendors remitting to URA the VAT that was collected on the invoices they issued. Target Well Uganda further argued that it did not bear any responsibility under the VAT legislation to follow up vendors to remit to the URA the VAT they collected.

URA also demanded WHT from the Target Well Uganda in respect of payments to Target Well UK for the lease of drilling equipment. This equipment was used to conduct its business in Uganda. URA argued that these lease payments were royalties under the provisions of the Income Tax Act ("ITA") and were therefore subject to WHT.The ITA definition of royalties includes any payment, including a premium or like amount made as consideration for the use of, or the right to use, any tangible movable property.

Target Well Uganda disagreed with URA's demand for WHT arguing that equipment rental payments to Target Well UK did not attract WHT in Uganda under the provisions of the UK-Uganda Double Tax Agreement ("the DTA")

b) Decision of the Court

The Court upheld the taxpayer's arguments and ruled in their favour. Justice David Wangutusi held that Target Well Uganda was entitled to claim the input VAT credit in contention. The Court was not convinced by URA's argument that Target Well Uganda ought to have followed up to ensure that the VAT it incurred had been paid to the URA by the vendor.

Justice Wangutusi ruled that this would be an onerous requirement as Target Well Uganda did not have access to the vendor's tax returns and books of account which the URA is by law empowered to obtain. Justice Wangutusi concluded that collection of tax is the sole responsibility of URA. Where a taxable person charged VAT, it was URA's duty to ensure it was collected and remitted.

The Court further ruled that payments for equipment rental to Target Well UK neither attracted WHT nor income tax under the provisions of the Uganda-UK DTA on the basis that Target Well UK had not created a Permanent Establishment ("PE") in Uganda. While we agree with this position, the Court's rationale for this position is not well articulated as we set out below.

c) Commentary

- We are in agreement with the Court's decision that taxpayers are entitled to a credit for input VAT to the extent they incurred the VAT on their purchases and this is supported by a proper tax invoice or other satisfactory evidence. URA's demand for prior remittance of VAT by the billing vendor for taxpayer's entitlement to input VAT credit is not supported by the provisions of the VAT law.

  The VAT law provides for both cash and invoice basis accounting for VAT. Under the cash basis, vendors remit VAT to the URA when collected from their customers and so the corresponding input VAT credit crystallizes when the underlying VAT is paid to the vendor. With invoice basis accounting, VAT is due to the URA at the tax point namely the earliest of the time of sale or supply, making of payment, time of performance of service or the issuance of an invoice.

  While we appreciate that there is leakage if the URA allows input VAT credit to taxpayers where the underlying output VAT was not remitted by vendors, URA's attempt to deny taxpayers input VAT credit as discussed above is not supported by the law. We encourage the URA to consider the use of risk mitigation measures to combat vendors who collect VAT from their customers but do not remit it to the URA.The use of Electronic Fiscal Devices that report real time sales made by vendors could potentially be helpful. Though this has been under consideration for the past 2 years, URA is yet to implement the scheme.

- We also agree with the Court's decision that in accordance with the provisions of the UK-Uganda DTA, WHT would not apply to equipment rental payments. The provisions of DTAs generally take precedence over the ITA. Under the provisions of the ITA, the definition of royalties includes any payment, including a premium or like amount made as consideration for the use of, or the right to use, any tangible movable property.

  We however note that the definition of the royalties under the DTA is more restricted and does not cover the lease of tangible movable property. Article 12(3) of the DTA defines royalties to mean payments of any kind received as consideration for the use of, or the right to use, any copyright of literary, artistic or scientific work including cinematograph films, any patent, trade mark, design or model, plan, secret formula or process, or for information concerning industrial, commercial or scientific experience. Lease of equipment is clearly not included.

  Given that payments for rent or lease of equipment are not expressly addressed by the DTA, we should also consider the provisions of Article 22 which deal with the taxation of any other types of income that the DTA does not explicitly address. Article 22 provides that items of income of a resident of a Contracting State, wherever arising, other than income paid out of trusts, which are not dealt with in the other articles of the DTA shall be taxable only in that State. Unless Target Well UK has a PE in Uganda, the exclusive right to tax payments for the lease of tangible movable property is given to the country of residency of the recipient of these payments, being the UK in this case.

2. The Insurers case

This matter was heard by the High Court on appeal following a decision by Uganda's Tax Appeals Tribunal ("the Tribunal") that dismissed an application by Ugandan licensed insurance companies challenging the position of the URA that classified insurance brokers as employees for income tax purposes.

a) The contention

Three issues were framed for determination at appeal by the High Court. These were whether the Tribunal erred in law:

- when it found that URA was not bound by its Practice Note addressing (amongst other matters) the treatment of insurance brokers?
- when it ruled that insurance agents are employees for ITA purposes ; and
- when it decided that agreements entered into between the insurance companies and agents rendered the agents employees by virtue of exclusivity.

b) Decision of the Court

Justice Richard Wejuli Wabwire held that the Court could not overlook the purpose of Practice Notes issued by the URA. According to Section 44 of the Tax Procedures Code Act ("the TPC"), the Commissioner General of the URA may issue Practice Notes setting out the Commissioner's interpretation of the application of the law. (This provision replicates the repealed section 160 of the ITA which was in place before the enactment of the TPC)

Section 44(3) of the TPC further provided that a Practice Note is binding on the Commissioner of the URA until revoked. There had been a Practice Note issued in 2007 subjecting insurance brokers to WHT at 6%. Given there was no evidence of revocation of this Practice Note, the High Court ruled that the URA was bound by it.

The Court further held that the provisions of the Insurance Act No. 6 of 2017 unambiguously prohibited employees of insurers and reinsurers from acting as agents. Since an Act of Parliament excludes employees from being agents, the court held that it is not open to the URA or the Tribunal to characterize agents as employees for income tax purposes.

Justice Wabwire observed that there was no doubt that by excluding agents from being employees, the law intended for them to be considered as independent contractors. Where the Act of Parliament is clear, there was no need to look at the contracts between the Insurers and their agents. By ignoring the provisions of the Act of Parliament and considering the agreements between the insurers and their agents, the Tribunal was looking into the business sense of the relationship as opposed to the law.

c) Our commentary

- Quite often, courts rely on the common law distinction between a contract of service and contract for services to determine the existence of an employment or independent contract relationship. This takes into account factors such as control exercised, skill, tools required, duration of the relationship, location of the work, discretion over hours, method of payment, establishment as a business, tax treatment, as well as whether or not there is an express agreement between the parties. This would have been a plausible test for the URA to consider if there had not been explicit provisions in the Insurance Act excluding employees from being agents and vice versa.
- Though URA is bound by its Practice Notes, it is possible to argue that it cannot be bound by positions of the same to the extent that they contradict with the provisions of the law. We don't however consider that the Practice Note in question conflicts with any provisions of the Law.

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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.

He holds a Master of Laws degree in Petroleum Taxation and Finance 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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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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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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He joined Cristal Advocates from Kizza, Tumwesige, and Ssemambo Advocates. He previously worked with the Advocates Coalition for Development and Environment (ACODE). He also undertook a traineeship with the oil and gas division of Webber Wetzel in Johannesburg, South Africa.

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