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International taxation

What is it and why is it important?

1. Introduction

The three decades since the ending of the Cold War and the birth of the internet have seen widespread deregulation and the emergence of a more deeply connected global economy. Though globalisation has critics as well as supporters, it is a fact of life for businesses and governments, impacting taxation amongst other matters. These days many businesses, even quite small ones, are international in the sense that they have investors, employees, subsidiaries or customers outside the jurisdiction where they reside.

Tax is largely a matter for sovereign national governments and tax laws are, for the most part, national rather than international in scope. What does the expression 'international taxation' mean then? Tax practitioners use it as a short-hand expression to cover the impact of the domestic tax system on international transactions and the interaction of the tax regimes of different countries which result from the activities of international businesses. We'll look at some of the key aspects of international taxation in the remainder of this article, with an emphasis on those issues likely to be encountered in a Ugandan context.

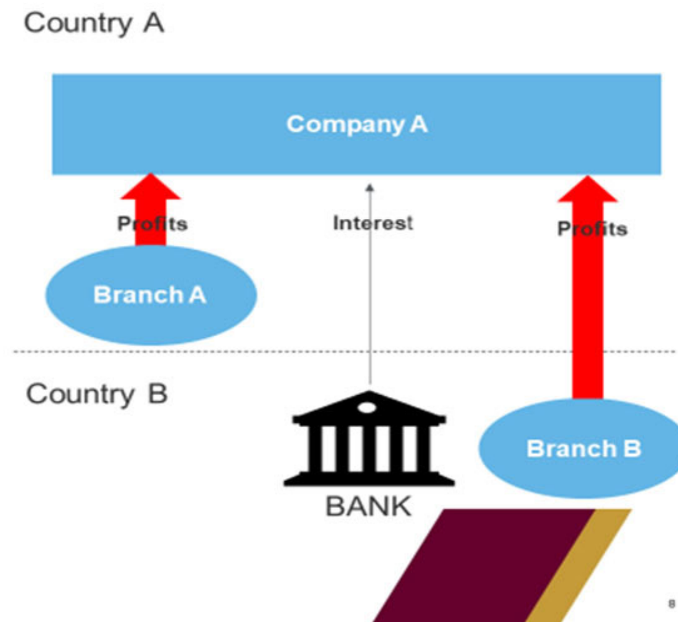
2. Residence and source

One of the most important issues in international tax can be summarised in a straightforward question: if an individual who resides in Country A has income from a source in Country B, how should this be taxed? As the source jurisdiction, Country B will usually assert its right to tax income and gains arising in its territory. In the case of 'passive income' such as interest or dividends, this tax may be applied via withholding at source. If the source is an active business, Country B may require the individual to determine his/her net profit for tax purpose and pay tax on that. Country A may also consider it has a right to tax the income as the individual is a resident in Country A. As a result, one income stream is potentially subject to taxation in two jurisdictions.

More complex situations can arise in practice, of course.

Residence and source-based taxation

- Country B taxes income and gains arising in Country B regardless of the residence of the recipient.
- Country A taxes the worldwide income and gains of residents
- Bank interest and profits of Branch B may therefore be taxable in both Country A and Country B



Governments keen to promote economic activity consider such double taxation to be undesirable as it imposes a significant additional burden on business. Fortunately, there are remedies. Country A may provide a credit against domestic tax for any tax paid in Country B (a 'foreign tax credit'), or it may provide a blanket exemption for foreign income and gains (often referred to as a 'participation exemption'). These methods can be applied unilaterally or may be covered by a treaty between countries A and B, referred to as a double tax treaty or double tax agreement.

3. Transfer pricing

A significant proportion of the transactions in our globalised economy arise within multinational groups. For example, a motor manufacturer may design cars in Japan, manufacture parts in Malaysia and Thailand, assemble the vehicles in China and sell them throughout the World. Typically each activity is carried on by a local subsidiary in the relevant jurisdiction. The transactions between these subsidiaries require transfer prices to be determined for the goods and services contributed to the manufacturing process and this will impact the tax liabilities of the individual companies within the group. There is an obvious opportunity to manipulate these transfer prices to reduce the overall tax burden of the group by maximising profits in the jurisdictions where the effective rate of tax is lowest.

Almost every jurisdiction now has transfer pricing rules which require the prices set for such intra-group transactions to be in accordance with the arm's length standard, that is to say, the price that would be set between independent parties where the price is agreed by means of an arm's length bargain, the terms of which are unaffected by extraneous factors. Uganda has detailed transfer pricing rules, introduced in 2011 which enable the Uganda Revenue Authority to adjust the tax liabilities of a business in Uganda which it considers not to have applied arm's length prices to intra-group transactions.

Transfer pricing has become one of the most critical and complex areas of international taxation. It is particularly important to remember that transfer pricing adjustments have an impact in at least two jurisdictions: where the seller of goods or services is deemed to have understated its prices on sales to a related party in a different jurisdiction, by the same token the buyer may have overstated its tax liabilities by deducting less than the arm's length price in determining its taxable profits. If not adjusted by agreement between the relevant taxing authorities, the result will amount to economic double taxation. Not surprisingly such agreement can be hard to achieve in practice as this is a zero sum game.

4. Indirect taxation

So far, we have focused on the taxation of income and gains, referred to as 'direct taxation'. The term 'indirect taxation' refers to taxes on goods and services such as VAT and customs duties. These apply to domestic transactions but also on importation, so have an international aspect. Most goods are subject to both VAT and customs duty when they are imported into Uganda. Customs duties only apply to physical goods, but VAT may apply not only to goods but also to the provision of services to a Ugandan taxpayer by a foreign business. In such cases the Ugandan taxpayer itself is required to account for any VAT which is due on the importation. Globally importers of goods can usually offset the VAT paid on import against VAT that must be accounted for on their own sales ('output VAT'). The Ugandan VAT system is unusual in prohibiting such an offset in the case of VAT on imported services, apart from a few specific cases.

Ugandan VAT law has its own transfer pricing rules which are similar to those applicable for direct tax purposes.

5. Imports of goods

When importing goods into Uganda the following taxes may need to be considered:

- Customs duty;
- Import VAT; and
- Import withholding tax (effectively a pre-payment of income tax)

These are applied as a percentage of the customs value. Customs legislation provides specific rules for determining the value of goods on import for the purposes of calculating the duty payable. Where the cost of the imported goods is deductible or depreciable in computing income tax, transfer pricing will also need to be considered if the goods are purchased from a related party.

6. Imports of services

Whilst customs duty will not apply to imports of services, VAT and withholding tax should be considered. As noted above, VAT which must be charged in respect of imported services will be a cost for most taxpayers as it cannot be offset against output VAT on sales to customers.

Where services are provided to a Ugandan business by a foreign person or company, payment will be subject to withholding tax at a rate of 15% unless a double tax agreement between Uganda and the country of residence of the service provider provides for an exemption or reduction in the rate. As noted above, the payee may be able to obtain relief by way of an exemption from domestic tax on the income, or a credit for the withholding tax against its domestic tax liability.

Where the service-provider is present in Uganda whilst performing the service, there may be a requirement to register a branch for tax purposes and account for VAT, and income tax on net profits. In international tax jargon the term 'permanent establishment' is used to describe such a presence. The jurisdiction where the service provider is resident may provide relief for the income tax paid by the branch either by credit or exemption.

7. Exports

In the case of exports of goods or services, customs duties do not generally apply, but VAT and income tax withholding are important issues. As noted above imports are generally subject to VAT payable by the importer. If the exporting jurisdiction also charged VAT, there would be double taxation. For this reason, jurisdictions with a VAT regime permit the exporter of goods or services to apply a zero rate of VAT subject to the provision of evidence of export. This is more difficult in the case of services than goods. It will also be important to consider whether the customer has an obligation in its home jurisdiction to apply tax withholding and whether the seller has any right to relief or exemption in respect of the foreign tax.

8. Employees

The physical presence of a foreign company's employees in Uganda may also give rise to liabilities to income tax and social security contributions (NSSF). If the employer registers a branch, then the branch will be required to deduct income tax under the Pay-As-You-Earn system and account for NSSF. Where employees are seconded to a local business to act under its control, the obligation to account for these taxes will also be transferred. The employees themselves will potentially be liable to income tax in their home jurisdiction on the same income and this may be reduced by a credit for the Ugandan tax deducted at source, or by exemption. This will not apply in the case of NSSF however.

9. Income and gains from investment

Similar issues arise in respect of 'passive' income and gains such as interest on loans or deposits, dividends on shares and capital gains arising on the disposal of investment assets. Most jurisdictions, including Uganda, require the payer of interest or dividends to deduct tax at source. Where there is a double tax treaty between the source jurisdiction and the payee's home jurisdiction, the rate of tax withholding may be reduced or an exemption provided.

The position with respect to capital gains may be complex. Where there is a direct disposal of an asset by a non-resident, most jurisdictions will tax any gain on the disposal. If the assets sold by the non-resident are shares in a company, some jurisdictions will apply tax, but many do not. The taxability of the transaction may also be affected by a tax treaty. The jurisdiction of residence of the seller may provide credit for foreign tax or exemption.

10. Final comments

International tax is a complex area and this short article is intended to provide only a brief overview of some of the key issues that arise. For readers wishing to learn more, Cristal Advocates is holding an international tax training seminar at its offices on 13th February 2020. For more information please visit our website (http://cristaladvocates.com/) or get in touch with your usual Cristal contact.

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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.

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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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.

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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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