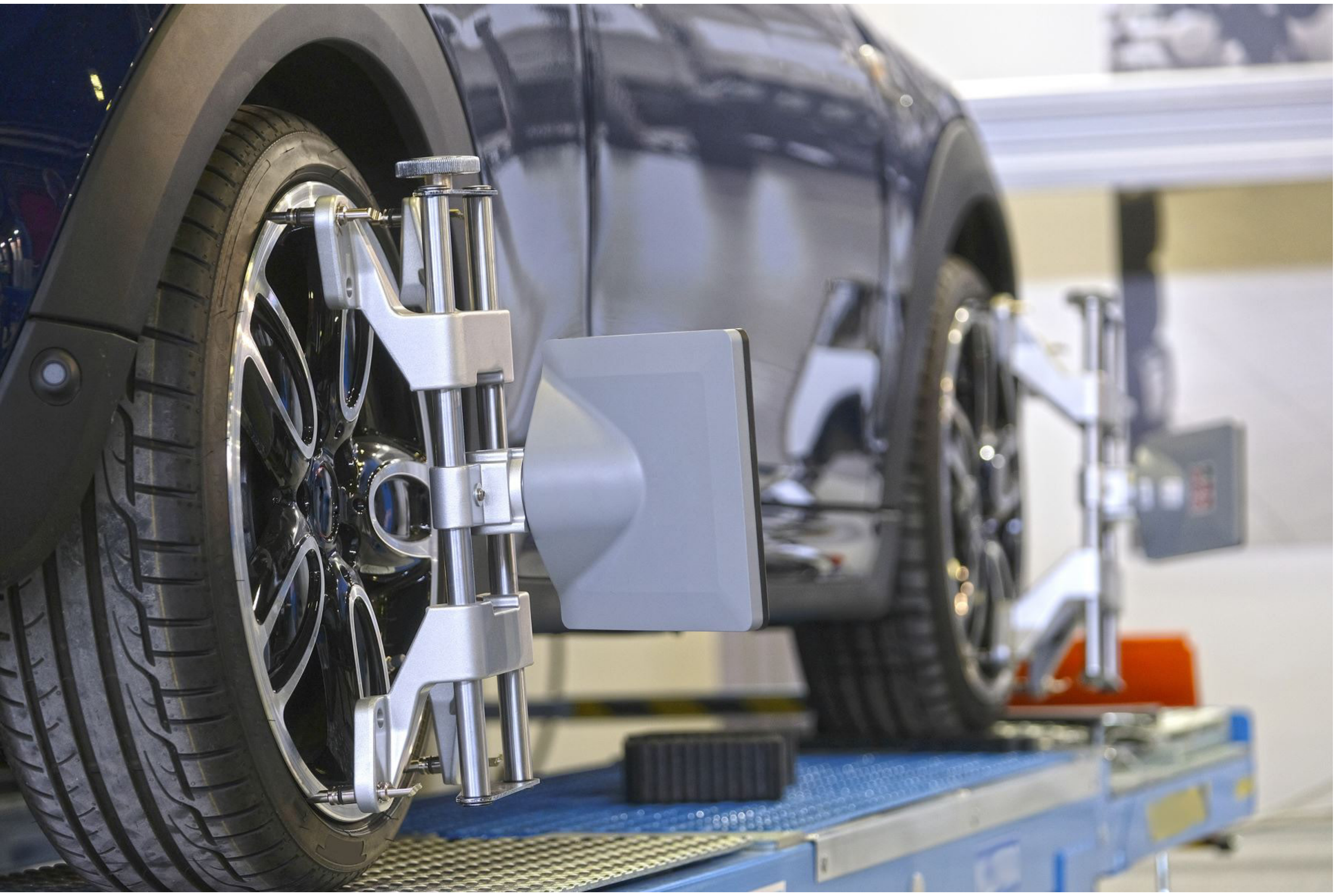
Cristal Advocates

Uganda's Proposed Tax Changes for the Financial Year 2020/2021

Aligned with the Times?



Cristal Knowledge Series

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1. Introduction

Uganda's Minister of Finance, Planning and Economic Development will formally read the national budget for the financial year 2020/2021 by the 15th June 2020. Activities to comply with the budget preparation, approval and management requirements set out in the Public Finance Management Act 2015 ("PFMA 2015") aimed at having a transparent, credible and predictable annual budget began way back in the second half of 2019.

Given that it is a requirement under the PFMA 2015 for the government to present the proposed annual budget to Parliament by 1st April of each year, the draft budget for 2020/2021 was finalized before the degeneration of the coronavirus pandemic. As such, the draft budget lacks specific interventions to deal with the adverse economic impact of the pandemic and it remains to be seen whether the budget approved by Parliament will be aligned to the current economic times.

Draft bills with tax proposals for 2020/2021 are now in public domain. These are the:

- The Value Added Tax (Amendment) Bill, 2020.
- The Income Tax (Amendment) Bill, 2020;
- The Excise Duty (Amendment) Bill, 2020;
- The Stamp Duty (Amendment) Bill, 2020; and
- The Tobacco Control (Amendment) Bill 2020.

These bills will go through 3 stages of parliamentary deliberation before they are assented to by the President to have the force of law. The commencement date for the proposed tax changes is 1st July 2020. Following the enactment of the PFMA 2015, amendments to the tax laws as part of the budget cycle are passed timely. In the past, the Uganda Revenue Authority (URA) would rely on an interim Collection Order issued every year on 1st July as stipulated in the Tax and Duties Act, 1963 to embark on the temporary collection of taxes introduced in the tax bills yet to be passed by Parliament.

Over 70 countries globally including Uganda's neighbour Kenya have introduced interim fiscal measures to alleviate the expected business hardships during this coronavirus period. The themes in these measures include but are not limited to extending financial support to affected business, settling government arrears of domestic suppliers and fast tracking tax refunds to ease cash flow constraints, reducing VAT rates to make goods and services more affordable to final consumers, reducing employment taxes to protect the disposable incomes of employees reinforcing their effective purchase power thus keeping manufacturers producing. Uganda has performed commendably well in establishing measures to contain the spread of the coronavirus but can be more proactive on the economic front.

The proposed tax amendments tabled before Parliament are oblivious of the current economic realities and if passed in their current form will not provide the expected interventions to ease the envisaged business hardships.

2. Overview of the proposed tax changes

In this snapshot, we provide an outline of the proposed tax changes for the financial year 2020/21. More detail is provided in the rest of this publication.

Tax issue	Amendment
a) Value Added Tax (VAT)	
Input VAT – manufacturers	• Manufacturers can claim input VAT incurred prior to VAT registration in respect of imports and local purchase of capital goods on hand at the time of registration provided that the import or local purchase occurred not more than 12 months prior to registration
Input VAT – supporting documentation	• To qualify as a credit for input tax, supplies procured from taxpayers subject to e-invoicing must be supported by an e-invoice or e-receipt
Input VAT – commercial buildings	• VAT accounting must be prepared separately for each building. Input VAT on construction of one building may not be offset against output VAT on a different building
Repayment of excess input VAT	• Excess input VAT may be carried forwards for 3 months only. After that a formal claim for repayment must be made

Tax issue	Amendment
Public International Organisations	• The Islamic Development Bank is added to the list in the First Schedule and will therefore enjoy certain VAT benefits
List of exempt supplies	• The Second Schedule is amended to include various categories of goods and services, particularly in relation to the agricultural sector • Requirements to qualify in relation to industrial parks and free zones are relaxed; certain specific manufacturing activities are added
b) Income Tax	
Alternative basis of calculation	• A minimum income tax equal to 0.5% of turnover will apply to taxpayers which have a tax liability of less than 0.5% of turnover on average over 5 years
Deductions – supporting documentation	• To qualify as deductible, supplies procured from taxpayers subject to e-invoicing must be supported by an e-invoice or e-receipt
Income from rental property	• The tax rate on rental income for individuals to increase from 20% to 30% • Tax to be calculated on each building separately • Where property is owned by a partnership, partners are to be taxed separately • Deductions for individuals, partnerships and companies limited to 50% of rental income • Mortgage interest relief for individuals abolished
Withholding tax ("WHT")	• 10% WHT to apply to commissions to insurance agents and advertising agents • 0.5% WHT to apply to transactions in land which is not a business asset between residents • Revised reporting obligations
Vehicles – advance income tax	• Tax clearance certificate required before renewal of operating licences for certain goods and passenger vehicles
Exemption from income tax	• Islamic Development Bank and Deposit Protection Fund to be exempt • Modification of rules for operations in industrial parks and free zones
Presumptive tax – rate changes	• Modified formula resulting in higher tax • Lower rates for taxpayers without records
c) Excise Duty	
Rate changes	• The government proposes increases in duties on a wide range of goods
d) Stamp Duty	
New category of instrument subject to duty	• Professional licences and certificates will be subject to UGX 100,000 duty
Exemptions	• Requirements are relaxed for instruments in respect of strategic investment projects to be eligible for exemption
Tobacco Control	
Export levy	• A levy of USD 0.80 per kilogram is proposed on the export of processed and unprocessed tobacco leaf

3. Value Added Tax (Amendment) Bill 2020

The Value Added Tax (Amendment) Bill, 2020 proposes changes to the VAT Act Cap 348 as set out below.

(a) *Input VAT – supporting documentation*

A miscellaneous bundle of VAT changes are proposed, the most important of which is probably a proposal to prevent a credit being given for input VAT which is not supported by an e-invoice or e-receipt in the case of supplies rendered by a supplier are subject to the e-invoicing system. Though delayed, it has been the intention of the URA to roll out electronic fiscal devices similar to its neighbours Kenya and Tanzania to electronically monitor sales as a means of mitigating VAT leakages.

(b) *Input VAT- manufacturers*

Manufacturers are now able to claim input VAT incurred prior to VAT registration in respect of imports and local purchase of capital goods on hand at the time of registration provided that the import or supply occurred not more than 12 months prior to registration. The time limit to claim VAT incurred prior to registration for other persons is 6 months.

(c) *Input VAT – commercial buildings*

There is a proposal requiring owners of commercial buildings to account for VAT on each building separately and prevent the offset of input VAT on construction costs against output VAT in respect of completed buildings. This revenue raising measure mirrors the approach proposed to income tax on rental properties (see below) though it is difficult to see how the restriction would be applied in the case of a business which operates through multiple commercial premises which it owns, as the output VAT would arise from the sales of goods and/or services by the business as a whole rather than rental income attributable to individual buildings. Otherwise, it will create burdensome reporting challenges if taxpayers are to fully comply with this amendment.

(d) *Repayment of excess input VAT*

Section 42 deals with excess input VAT and the Bill proposes an amendment to prevent the carry forward of excess input VAT for more than three months. Once this period is exceeded a taxpayer is obliged to claim a refund. It is not very clear what the intention of this amendment is but in practice, a tax refund normally triggers a tax audit.

(e) *Public International Organisations*

The Islamic Development Bank is to be added to the list of *Public International Organisations* in the First Schedule. It will thus be able to seek refunds in the case of locally procured goods and services (subject to detailed rules).

(f) *List of exempt supplies*

Several amendments are proposed to the Second Schedule which specifies exempt supplies of goods and services:

- Agricultural trailers, combine harvesters, cotton seed cake, liquified gas and processed milk are added to the list.
- The criteria to qualify for VAT exemption for specified activities related to industrial parks or free zones is to be further relaxed. The requirement for locally sourced raw materials is reduced from 70% to 50% and the requirement to employ Ugandans is amended from 60% of the total employees to a minimum of 100 individuals. The list of activities is expanded to include the manufacture of tyres, footwear, mattresses and toothpaste.
- Exemption is also introduced 'for the supply of digital stamps for the purpose of implementing tax verification, quality and safety system', and the supply of hotel accommodation in respect of hotels and lodges located 'up-country'.
- Certain imported services are to be exempted from VAT. This is important because for most VAT payers reverse charge VAT on imported services cannot be credited as input VAT and is a cost. The specified services are :
    - software and equipment installation services provided to manufacturers;
    - services incidental to tele-medical services (ie medical services provided remotely using information technology); and
    - royalties in respect of agricultural technologies.

4. Income Tax (Amendment) Bill 2020

A number of changes to the income tax regime are proposed. These seem to be mostly aimed at increasing tax revenue.

(a) *Alternative basis of calculation*

A minimum income tax equal to 0.5% of gross turnover is proposed. Taxpayers that are subject to this will therefore pay the higher of their income tax liability calculated on their taxable profit at 30% and the 0.5%. *Gross turnover* is defined in section 2 as the gross proceeds recognised in the financial statements without deductions, plus gains (less losses) on disposals of business assets (apart from trading stock). This alternative calculation will apply to any taxpayer whose declared tax liability over a period of 5 consecutive years is an arithmetic average of less than 0.5% of *gross income*.

The alternative calculation will apply 'after the sixth year' which seems to imply that it does not apply to the sixth year itself. The term gross income differs from gross turnover and is defined in section 17 to include all business, employment and property income of a taxpayer. Once the alternative method applies, there seems no means for it to be disapplied in any subsequent year.

This proposal is similar to the income tax charge for loss making companies which was included in the 2019 proposals but dropped before final passage into law. The essential difference is that the 2020 package does not require the taxpayer in question to have losses, only low profitability. It would penalise companies with have low profit margins or tax losses and would potentially impact many taxpayers in the global recession which coronavirus has triggered. If policy makers are concerned that a pattern of losses or low profitability is the result of tax avoidance or the application of non-arm's length pricing, the existing rules combatting tax avoidance and transfer pricing regulations would seem a more appropriate tool.

(b) *Deductions - supporting documentation*

Consistent with the rules proposed for VAT (see above), expenses will only be deductible if supported by e-invoices or e-receipts, where the goods and services are acquired from a person who is designated to use the e-invoicing system.

(c) *Income from rental property*

Changes have been proposed to the taxation of income from property. In 2019, a proposal to ring fence rental income on a property by property basis was dropped before the budget proposals became law. A more extensive set of proposals are included in the 2020 Bill:

- The tax rate for individuals earning rental income is to be increased from 20% to 30%
- Tax will be calculated on each property separately, so it will not be possible to offset tax losses arising from one property (e.g. related to construction costs) against profits arising on other properties owned by the same person. This is the same as the 2019 proposal.
- Where property is owned by a partnership, tax on rental income applies to the partners individually.
- Currently relief for expenditure and losses arising from the rental business is restricted to 20% of rental income in the case of individuals and partnerships. No restriction applies to companies. The Bill proposes to increase the limitation to 50% but it will now apply to individuals, partnerships <u>and</u> companies. Companies previously enjoyed full relief of qualifying costs.
- A provision introduced in 2018 to provide tax relief for interest incurred by individuals on mortgages to acquire or construct premises for rental is to be abolished.

(d) *Withholding tax*

Various new categories of withholding tax are proposed:

- Commissions paid to an insurance agent will be subject to 10%.
- Commissions paid to an advertising agent will be subject to 10%
- Purchase of land which is not a business asset by a resident from another resident will be subject to 0.5% though it is questionable whether this withholding tax would apply on land sales exempt from capital gains tax under section 21 of the Income Tax Act.

Reporting requirements are extended to cover these obligations. It is also proposed to withdraw an exemption from withholding tax in respect of payments for agricultural supplies by designated withholding agents which was introduced in 2019.

(e) *Vehicles – advance income tax*

In a measure apparently intended to combat tax evasion by transport operators, taxpayers who transport freight or passengers using vehicles with a capacity of more than two tonnes are required to make an advance payment of income tax linked to the relevant vehicle's capacity. It is proposed to require a tax clearance certificate (confirming the relevant payments) prior to renewal of the relevant operational licences.

(f) *Exemption from income tax*

The Islamic Development Bank is added to the list of organisations in the First Schedule which are exempt from income tax. This is consistent with the related amendment to the VAT legislation discussed above. Income of the Deposit Protection Fund established under the 2016 Financial Institutions Act is also to be exempted.

The 2019 income tax amendments included extensive modifications to expand the scope of income tax exemptions available in respect of industrial parks and free zones. Some further changes are proposed and, if enacted, these will be effective from 1 July 2019, ie fully retroactive. The definition of qualifying activities is refined and now includes manufacture of tyres, footwear, mattresses and toothpaste (see also the related VAT changes discussed above). Additional provisions are proposed to apportion income and expenditure between qualifying and non-qualifying activities.

(g) *Presumptive tax – rate changes*

Taxpayers with a turnover of UGX 150 million (approximately USD 40,000) or less may opt to be taxed based on turnover rather than profits. For taxpayers who keep tax records this is likely to mean higher tax payments, though those who do not seem to be more favourably treated!

- <u>Current basis</u>

Gross turnover per annum	Tax payable
Not exceeding UGX 50 million	NIL
Not exceeding UGX 75 million	Lower of UGX 937,500 and 1.5% of turnover
Not exceeding UGX 100 million	Lower of UGX 1,312,500 and 1.5% of turnover
Not exceeding UGX 125 million	Lower of UGX 1,687,500 and 1.5% of turnover
Not exceeding UGX 150 million	Lower of 2,062,500 and 1.5% of turnover

- <u>Proposed basis</u>

Gross turnover per annum	Tax assuming no records	Tax where records maintained
Not exceeding UGX 10 million	NIL	NIL
Not exceeding UGX 30 million	UGX 80,000	0.4% of turnover exceeding UGX 10 million
Not exceeding UGX 50 million	UGX 200,000	UGX 8,000 plus 0.5% of turnover exceeding UGX 30 million
Not exceeding UGX 80 million	UGX 400,000	UGX 180,000 plus 0.6% of turnover exceeding UGX 50 million
Not exceeding UGX 150 million	UGX 900,000	UGX 360, 000 plus 0.7% of turnover exceeding UGX 80 million

5. Excise Duty (Amendment) Bill 2020

The 2019 Finance Act made no changes to rates of excise duty, so it is not surprising that the government has focused on this area in its endeavours to increase revenue this year. Where it is prudent to increase excise tax rates in an economy ravaged by the coronavirus is another matter.

The changes proposed are as follows.

Product	Duty 2019/2020	Duty 2020/2021
Cigarettes – soft cap, locally manufactured	UGX 55,000 per 1,000	UGX 75,000 per 1,000
Cigarettes – soft cap, imported	UGX 75,000 per 1,000	UGX 75,000 per 1,000
Cigarettes – hinge lid, locally manufactured	UGX 80,000 per 1,000	UGX 120,000 per 1,000
Cigarettes – hinge lid, imported	UGX 100,000 per 1,000	UGX 120,000 per 1,000
Malt beer	Higher of 60% or UGX 1,860 per litre	Higher of 60% or UGX 2,050 per litre
Beer – local raw material content at least 75% by weight (excluding water)	Higher of 30% or UGX 650 per litre	Higher of 30% or UGX 790 per litre
Beer – produced from barley grown and malted in Uganda	Higher of 30% or UGX 950 per litre	Higher of 30% or UGX 1,115 per litre
Ready to drink spirits	Higher of 80% or UGX 1,500 per litre	Higher of 80% or UGX 1,700 per litre
Wine from local raw materials	Higher of 20% or UGX 2,000 per litre	Higher of 20% or UGX 2,300 per litre
Undenatured spirits from local raw materials	Higher of 60% or UGX 2,000 per litre	Higher of 60% or UGX 1,500 per litre
Non-alcoholic beverages excluding fruit and vegetable juices	Higher of 12% or UGX 200 per litre	Higher of 12% or UGX 250 per litre
Fruit and vegetable juices (unless at least 30% of pulp from locally grown source)	Higher of 13% or UGX 300 per litre	Higher of 12% or UGX 250 per litre
Gasoline/motor spirit	UGX 1,200 per litre	UGX 1,350 per litre
Gas oil (automotive)	UGX 880 per litre	UGX 1,030 per litre
Gas oil for power generation to national grid	NIL	NIL
Illuminating kerosene	UGX 200 per litre	UGX 300 per litre
Specified plastic sacks and bags, except vacuum bags for food, juices, tea and coffee. *Sacks and bags used in manufacture of sanitary pads**	120%	Higher of 120% or UGX 10,000 per kilogram of plastic bags or sacks
Motor vehicle *and other** lubricants (excluding those for aircraft)	10%	15%
Motorcycles at first registration	UGX 200,000	UGX 300,000
*Other fermented beverages including cider, perry, mead, spears, near beer**	n/a	Higher of 60% or UGX 950 per litre

*denotes new categories included in the list of excisable goods.

In addition, certain minor changes are made to the exemption for construction materials available for certain activities in industrial parks, etc, mirroring VAT and income tax changes mentioned above. 'Light industry' ceases to be a qualifying activity but manufacture of tyres, footwear, mattresses and toothpaste is included. The minimum level of local raw materials required is reduced from 70% to 50%.

6. Stamp Duty (Amendment) Bill 2020

The proposed changes to the Stamps Duty Act are:

(a) *New category of instrument subject to duty*

The bill proposes the introduction of a completely new category of instrument subject to stamp duty: professional licences or certificates. The applicable duty is UGX 100,000 per document, which will raise a relatively modest amount of additional revenue from Uganda's professional class.

(b) *Exemptions*

The bill also proposes two modifications to the criteria used to identify strategic investment projects for the purposes of item 60A of Schedule 2 to the Stamp Duty Act 2014. Though not clear from the text of the bill made available to us, the amendments seem to apply to item 60A (b) which deals with operators in or adjacent to, industrial parks.

- The requirement for at least 70% of raw materials to be locally sourced will be reduced to the capacity to use at least 50% locally sourced raw materials, in both cases subject to availability.

- The requirement to employ at least 100 Ugandan citizens will be amended to refer to the capacity to employ at least 100 Ugandan citizens.

The exemption applies to any instrument executed by, or on behalf of a company or the government of Uganda for the sole purpose of a qualifying project. It is not clear how a taxpayer should demonstrate that the capacity requirements are met. Similar changes are proposed for excise tax and VAT as noted above.

7. Tobacco Control (Amendment) Bill 2020

The Tobacco Control Act of 2015 was introduced to bring Uganda into line with World Health Organisation recommendations on controlling the harmful effects of tobacco and is not tax legislation per se. It is proposed to amend the Act to introduce a levy on exports of both processed and unprocessed tobacco leaf at the rate of 80 US cents per kilogram.

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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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