Cristal Advocates

International Business Structures

Taxation of Branches in Uganda

1. What is a branch?

A branch is a corporate law concept that implies the presence in a jurisdiction of a legal entity incorporated in another jurisdiction (a foreign legal entity – 'FLE'). A branch in Uganda is created by formal registration under the Companies Act 2012.

A branch does not have a separate legal personality from the FLE which created it and any acts and liabilities of the branch are attributable in law to the FLE itself. In contrast, a subsidiary of a FLE is a separate legal person and as a result of limited liability rules the FLE cannot usually be held liable for acts and liabilities of the subsidiary beyond the cost of the shares that it holds unless it has provided a specific contractual undertaking such as a parental guarantee.

Uganda's Income Tax Act includes in section 78 a broader definition of a branch which does not depend on the formal registration of a FLE under corporate legislation, though the existence of a branch for tax purposes may also imply the requirement to register under the Companies Act. For tax purposes a branch is 'a place where a person carries on business[1]'. This includes, *but is not limited to*, four specifically identified situations:

a) A place where business is carried on by an agent other than one who carries out such activities independently in the ordinary course of its business, i.e. a *dependent agent*[2].

b) A place where a person has, is using or installing substantial equipment or machinery for a period of 90 days or more.

c) A place where a person is engaged in a construction, assembly or installation project for 90 days or more, including supervisory activities in relation to such a project.

d) Provision of services by a FLE via employees or others engaged for the purpose where the activities relate to a single or connected projects and last for more than 90 days in any 12-month period. It should be noted that this situation doesn't require there to be a specific place where the services are carried out.

Uganda is party to a number of double tax agreements ('DTAs')[3]. DTAs do not refer to 'branches' but use the term 'permanent establishment' ('PE') instead, a term which is widely used by international tax practitioners and in the legislation of many countries[4].

The concept of a PE is identical to that of a branch as used in Ugandan legislation, though DTAs generally have a narrower list of criteria resulting in the creation of a PE than those which create a branch under Uganda's domestic law. For example, under the DTA with the UK, a UK resident company would create a PE in Uganda if engaged in a construction, assembly or installation project but only if it lasts more than 183 days, compared to the 90-day limit in domestic law.

2. In what circumstances might a branch structure be used?

When a multinational group of companies ('MNC') decides to undertake activities in a new country, the most common approach is to establish a local subsidiary. This may be a legal/regulatory requirement in specific fields of activity, for example jurisdictions may prohibit foreign companies from owning real property, mining or telecoms licences.

There may also be an intention to involve local shareholders either via direct investment or a listing on a local stock exchange, both of which would usually require the creation of a locally incorporated company. The establishment of a local subsidiary may also imply to local stakeholders (e.g., customers, suppliers, employees, regulators) that the investor has a long-term commitment to the market which may have advantages from the perspective of public and government relations.

These kinds of considerations do not always apply, though. Establishing a separate entity will require the establishment of a separate management and capital structure, and the entity will need to acquire its own personnel and equipment to execute the project. This may not be necessary for a limited duration project: if the MNC is engaged in such a project, using equipment and personnel that will be subsequently transferred to projects in other countries, it may be inconvenient and time-consuming to go through the process of setting up a separate local entity, capitalising it and transferring in any required assets.

Additionally in some industries, customers may see a local subsidiary established for such a project as a 'man of straw' and prefer to contract with a substantial entity which has the resources to execute the project or which can be sued effectively in the case of inadequate performance. Examples of activities where branches are preferred in practice include major construction projects, drilling and other technical work associated with mining, oil and gas development and production or other kinds of limited duration service contracts. The hallmarks of such projects are a defined work scope, timeframe and a specific customer or customer base. In the case of Uganda such an approach may be taken by companies involved in oil development or construction of the East African Crude Oil Pipeline.

3. International approaches to taxing branches

As a legal entity, a branch or PE is subject to income tax on profits and gains just like locally incorporated legal entities, individuals, partnerships, etc. We might call this a 'net profit' approach and many countries tax branches in precisely this way.

Fiscal policy makers in some jurisdictions however have taken the view that the net profit approach is difficult to apply in practice as a branch or PE will often be carrying out activities in several different countries. This can make it challenging to determine the revenues, costs and therefore the profits attributable to activities in a specific jurisdiction. Therefore, in some countries, legislation has been developed to address this difficulty using two other approaches:

a) Requiring a customer to apply a final withholding tax on payments to a FLE related to the branch. This is treated as fully discharging the branch's liability to tax on profits and gains so that a detailed tax return and computation is not required; or

b) Requiring branches to pay income tax on a deemed profit margin so that there is no need to determine the costs attributable to activities in the jurisdiction, though in this case the branch still needs to self-assess the revenues attributable to activities in that jurisdiction, rather than relying on customers' judgement.

Another complexity arises from the fact that most jurisdictions require a company to apply withholding tax on distributions of profits to shareholders, which is a final tax in the case of non-resident shareholders. Branches don't have share capital and can't pay dividends, so an additional layer of taxation has been introduced in many (but not all[5]) jurisdictions to ensure that the total tax burden on profits of a branch is equivalent to that on a company. This can be achieved by simply increasing the rate of income tax applicable to profits of branches[6], or by introducing a formula to determine the profits repatriated to the head office in a period and applying an additional tax to that amount[7].

The question also arises of how activities of a FLE with foreign branches will be taxed in its home jurisdiction. Broadly there are two approaches:

c) All revenue costs related to the branch will be included in the FLE's tax return in its home jurisdiction and included in calculating the global profit or loss for tax purposes. Under this approach a credit will usually be given against home country tax for any income tax paid by the branch in the jurisdiction where it operates, up to the amount of home jurisdiction tax on those profits, with any excess being relieved as an expense.

d) Many countries have now adopted an exemption approach (often referred to as a 'participation exemption') which excludes the results of the branch from the FLE's home country tax return.

4. Uganda's income tax rules for branches

Uganda has adopted a formula approach to determine the additional tax to be applied to branches of FLEs. The tax base is determined by calculating the result of the following:

$$\textit{Tax base} = A + (B - C) - D$$

Where

- A is the cost base of assets at the start of the relevant year of income, less liabilities;
- B is the accounting profit of the branch for the year of income;
- C is the income tax payable for the year of income (not the accounting tax charge, which would include deferred tax); and
- D is the cost base of assets at the end of the relevant year of income, less liabilities.

In effect the formula deems any net profit generated in a year which is not reflected in the closing net assets of a branch as having been repatriated.

The term 'cost base' is defined in section 52 of the Income Tax Act and comprises the capital cost of an asset including the market value of any consideration in kind, the market value of assets acquired other than at arm's length and any capital costs of improvements. The definition does not require the value to be reduced by tax or book depreciation, though the latter would be included in B.

The rate of tax applicable to the tax base is currently 15% which is the same as the rate of withholding tax applied to dividends[8]. This equates to an effective tax rate of 40.5% on branch profits repatriated, as illustrated below:

Item	**Amount**
Profits	**100**
Income tax at 30%	(30)
Net profit (all treated as repatriated)	**70**
Branch profits tax at 15%	(10.50)
Profits after tax	59.50
Total tax	**40,50**

5. Calculation of profits

The Income Tax Act prescribes (in section 17) that the income of a non-resident person, such as a FLE with a Ugandan branch, comprises only income derived from sources in Uganda. The definition of Ugandan source income is in section 79 and includes income derived by a non-resident through a branch in Uganda. This vague and circular definition of branch income is clarified a little by the remainder of section 79, in particular section 79(s) refers to any activity *in Uganda*, including activity conducted through a branch.

There may still be questions however about projects which include significant elements which need to be executed elsewhere, for example engineering design and manufacturing work related to large infrastructure projects. In such cases there may be arguments that the work scope executed outside Uganda is so closely connected to the project here that revenues should be included in the branch books for tax purposes, though they will also be taxable in the jurisdiction where they take place. For this reason, where commercially practical, contracts in such cases may be split between work scope which is executed in

Uganda via a branch of a FLE, and work which is to be carried out elsewhere which may be carried out by a different FLE with no Ugandan branch or other nexus.

The Income Tax Act provides in section 22 that a taxpayer may deduct expenses which have been incurred in the production of income which is included in gross (i.e. taxable) income. This provides the basis for a branch to claim a deduction for a reasonable allocation of costs incurred at the level of the head office as well as costs incurred directly by the branch itself.

Charges from the head office to the branch which are internally generated and do not relate to underlying third party costs are not 'incurred' therefore not deductible. In the case of costs incurred by the head office, it is important branches maintain evidence to satisfy the Uganda Revenue Authority that the underlying costs were actually incurred, that they related to the business of the branch and that the method of apportioning the total costs between the branch and other parts of the FLE's business is reasonable.Costs recharged to the branch in this way may also give rise to withholding tax and reverse charge VAT issues. DTAs often provide more specific guidance on cost allocation[9].

In the case of capital expenditure, a branch is entitled to claim deductions for depreciable assets under sections 27, 27A and the Sixth Schedule of the Income Tax Act like any other Ugandan business. Relief is available for other types of capital expenditure under the relevant sections.

6. Miscellaneous issues

a) Transfer pricing

For the purposes of the 2011 Transfer Pricing Regulations, a branch and its head office are treated as separate associated persons (regulation 5). This means that the income tax liabilities of a Ugandan branch of a FLE should be calculated as if transfers of goods, services, etc between the head office and the branch were on arm's length terms. This will need to be reflected in the transfer pricing documentation which the branch is required to maintain.

On this basis, assets transferred into the branch from other parts of the FLE to execute the project should be treated as acquired at market value for purposes of tax depreciation. Any transfers of assets from the branch to other parts of the FLE will also be treated as carried out at market value for purposes of computing adjustments to tax depreciation pools.

b) Value Added Tax ('VAT')

Transferring goods owned by a FLE to its Ugandan branch will trigger the usual payments on importation, including import VAT. VAT also applies to imports of services, of course, and the 1996 VAT Regulations provide specific rules for services provided to a branch by other parts of the same FLE. The approach is similar to that prescribed in the Transfer Pricing Regulations with the branch and the rest of the FLE being treated as separate entities for tax purposes, so that the import of taxable services by the branch is subject to reverse charge VAT[10] and the tax base calculated by reference to the market value.

c) Residence considerations for branches

Branches are taxable on their Ugandan source income and gains, but resident companies are taxable on their worldwide income and gains and must also account for withholding tax on any distributions they make to shareholders. It is therefore important to consider whether the existence of a Uganda branch may imply that a FLE is tax resident in Uganda so it must include non-Ugandan income in its tax return and account for withholding tax on dividends to shareholders.

The Income Tax Act determines where a legal entity is resident for tax purposes based on three criteria. The most commonly applied criterion is the place of incorporation: companies which are incorporated in Uganda are automatically tax resident here under the Act. However, FLEs may also be deemed resident in two cases:

- If management and control is exercised in Uganda at any time in the year of income. Management and control of companies is usually regarded as being exercised by the board of directors, so holding a board meeting in Uganda would render the company tax resident for the whole of the relevant year of income.
- A company which undertakes the majority of its operations in Uganda in a year of income is also deemed to be resident here. This might apply in the case where a special purpose entity is established to hold the Ugandan branch and the FLE does not carry out any material activities in other jurisdictions.

In all cases any relevant DTA should also be considered to determine whether the FLE is resident in Uganda.

7. Conclusions

The taxation of branches and PEs is a complex area of international taxation and should be approached with care. It is likely to become more important for Ugandan practitioners when oil development moves forward, given the likelihood that many elements of the field development, oil refinery and pipeline construction will require input from specialist global engineering and oil field service companies that habitually use branch structures in project execution. Cristal Advocates has extensive experience of working on the tax and legal implications of such structures in Uganda and many other jurisdictions. If you need assistance, please get in touch with Denis Kakembo (dkakembo@cristaladvocates.com), Bill Page (bpage@cristaladvocates.com) or your usual Cristal contact.

(Endnotes)

1 *Under section 2 of the Income Tax Act a 'business' includes a trade, profession, vocation or 'adventure in the nature of trade'*

2 *An independent agent would usually carry out these activities for several unrelated principals and have no economic relationship with them beyond the agency agreement. A dependent agent would usually have only one principal and be a subsidiary of that principal or have some other common ownership.*

3 *DTAs are in force between Uganda and Denmark, India, Italy, Mauritius, Netherlands, Norway, South Africa, the UK and Zambia.*

4 *Kenya and Tanzania for example use the term PE in their income tax laws. The UK on the other hand, uses the term branch.*

5 *Mozambique does not impose any additional tax on PEs/branches. Companies pay tax at a rate of 32% and resident companies must also withhold tax at a rate of 20% on dividends to foreign shareholders (subject to any reduction under a DTA).*

6 *Kenya has adopted this approach: the income tax rate for branches is 37.5%.*

7 *This approaches is adopted by Uganda and Tanzania, for example.*

8 *Some DTAs (eg that with Denmark) provide for a reduction in the rate of additional tax on branches in line with the reduced rate of withholding tax on dividends. Even if this is not explicitly provided there may be an argument that a reduction is required under the non-discrimination article of the DTA.*

9 *For example, see article 7(3) of the Uganda-Norway DTA.*

10 *Reverse charge VAT is not creditable as input VAT for most Ugandan VAT-payers.*

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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.

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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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Francis leads the litigation and dispute resolution practice at the firm. He is an Advocate of the High Court of Uganda with expertise in oil and gas, infrastructure and dispute resolution. He has been part of teams advising on projects in Uganda, Tanzania, Mozambique and South Africa. He specializes in regulatory compliance, national content, health and safety and dispute resolution.

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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