

Issuing Bonus Shares in Uganda

An overview of the tax implications

***BONUS
SHARES!!!***

1. What are bonus shares?

Sometimes, companies opt to give out bonus shares instead of declaring dividends. Bonus shares are free additional shares given to the existing shareholders in proportion of their current holding. A number of companies listed on Uganda's Securities Exchange have over the years issued bonus shares to their shareholders.

As a company makes profits, its retained earnings increase building up substantial surpluses over the years. As such, the company is in position if it so wishes to distribute some of these accumulated profits as free shares to the current shareholders. The issue of bonus shares is merely a reclassification of the reserves causing an increase in the issued share capital of a company and a proportionate decrease in retained earnings but keeping the net worth of the company intact.

In this publication, we discuss the income tax consequences when bonus shares are issued by a company

2. Pre 1st July 2013

The question whether the bonus issue of shares to shareholders amounted to a distribution of dividends under section 2(w) of the Income Tax Act ("ITA") and therefore subject to withholding tax ("WHT") was a contested one until 11th November 2011 when the High Court of Uganda pronounced itself on the matter. Prior to the High Court determination, the Uganda Revenue Authority ("URA") took the position that the issue of bonus shares to shareholders was a distribution of dividends subject to WHT under the ITA.

In the case of Standard Chartered Bank (U) Limited and 6 others versus the URA, Justice Geoffrey Kiryabwire held that the issue of bonus shares was not a distribution of dividends. The genesis of this legal duel was that on 20th December 2010, the Uganda Bankers Association ("UBA") wrote to the URA seeking for a private ruling on the tax treatment of the bonus issue of shares. It was UBA's position that by issuing bonus shares, the banks did not give away any of their assets to their shareholders. As such, the banks argued that the issue of bonus shares was not a distribution of profits to qualify as dividends under the ITA.

In its response, the URA contended that the issue of bonus shares was a distribution of dividends from reserves. URA premised its view point on the argument that the bonus shares issued are assets with an ascertained value in the company's books giving the shareholder the right to an enduring entitlement to dividends. It is against this background that the foregoing suit was instituted. The key issue was whether bonus shares were dividends and therefore subject to WHT.

The High Court found that the ITA was silent on whether bonus shares were dividends. As such, the issue of bonus shares did not amount to a distribution of profits to shareholders. Consequently, there was no applicable WHT as was demanded by the URA.

3. Post 1st July 2013

Intent on clearly placing the issue of bonus shares within the taxable bracket, the government introduced the Income Tax (Amendment) Bill of 2013 ("Bill") for deliberation by Parliament.

The initial text of the Bill extended the definition of a dividend to include the issuance of bonus shares to shareholders. The implication of this was that issued bonus shares would be taxable as dividends and thus subject to WHT. The Report of the Parliamentary Committee on Finance, Planning and Economic Development on the Bill stated the following on the proposed amendment to include the issuance of bonus shares as dividends:

Clause 2 extends the definition of dividends to include the issue of bonus shares. Bonus shares issued to a shareholder will fall within the realm of dividends and thus be taxable.

However, when the Bill was presented before Parliament on 18th September 2013 for the final reading, the discussion amongst Members of Parliament was whether there was policy justification to subject the issue of bonus shares to WHT. The majority view was that taxing the issue of bonus shares would discourage capital creation via the option of capitalizing profits. The minority view was that the issuance of bonus shares was some form of tax avoidance scheme by companies that needed to be sealed with the proposed WHT imposition.

The recommendation of Parliament that went on to form the final text of the law was that the issue of bonus shares would only be taxable upon disposal. The definition of dividends in section 2 (w) (vi) of the ITA was thus expanded

in 2013 to include the issuance of bonus shares to shareholders. However, the same section further guided that the issue of bonus shares would only be taxable upon disposal.

4. Contradictions

The amendment of the law notwithstanding, there are practical challenges regarding how taxpayers can comply with the arising tax obligations. The obligation to withhold tax would lie on the party that declares and pays out the dividends. At the time the bonus shares are being disposed which is the point at which the obligation to withhold tax would arise, the issuer of the bonus shares no longer has any control over those shares because the same were ceded to the shareholder at the time of allotment of the bonus shares. It is therefore unclear who would withhold the tax for the dividend pay-out that the law deems to arise at the time the bonus shares are being disposed.

It is therefore prudent to deduce that the URA is only likely to collect capital gains tax of which the obligation to account would lie on the selling shareholder.

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Contacts for this Publication



Denis Yekoyasi Kakembo

dkakembo@crystaladvocates.com
+256 751 834 168

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. ■



Bill Page

bpage@crystaladvocates.com

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. ■



John Teira

jteira@crystaladvocates.com
+256 704 493 997

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.

He holds a Bachelor of Laws degree from Makerere University and a Post Graduate Diploma in Legal Practice from the Law Development Centre and various other qualifications. ■



Dickens Asiiwwe Katta

dasiimwe@crystaladvocates.com
+256 772 370 021

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. ■



Francis Tumwesige Ateenyi

ftumwesige@crystaladvocates.com
+256 702 540 936

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.

He holds a Master of Laws degree in Petroleum Law and Policy from the University of Dundee in the United Kingdom and various other qualifications. ■



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Contact us

Cristal Advocates
32 Lumumba Avenue
4th Floor, Padre Pio House
Lumumba Avenue

P.O. Box 1769 Kampala, Uganda
Tel: +256 (414) 671 274
Email; admin@cristaladvocates.com
www.cristaladvocates.com