

# Withholding Tax on the Disposal of Mortgaged Property Uganda's Tax Appeals Tribunal Decision



## 1. Introduction

In a decision that has divided opinion amongst tax practitioners but also unnerved the banking fraternity, Uganda's Tax Appeals Tribunal ("Tribunal") has ruled that sales proceeds on the disposal of mortgaged property to recover outstanding loans from borrowers are subject to withholding tax ("WHT") at the rate of 6%.

As a result of the Tribunal's decision in the matter of Luwaluwa Investments Limited versus Uganda Revenue Authority ("URA") Application No.39 of 2021, we see the URA going forward seeking to test more provisions of the law that have for long been perceived as ambiguous to facilitate tax collection. URA has in the recent past pulled off unlikely victories in the Tribunal on principles of law considered as vague by tax practitioners where the odds appeared overwhelmingly stacked against it.

## 2. The contention

Equity Bank sold property to the Applicant in the foregoing case to recover sums owed to it by a customer. This property had previously been mortgaged to the Bank by a customer who subsequently defaulted on the debt repayment.

URA faulted the Applicant for not withholding tax at the rate of 6% on remitting payment to the Bank for the purchase of the mortgaged property and upon which a tax assessment was issued. URA premised its assessment on the provisions of section 118(B) 2 of the Income Tax Act ("ITA") that set out the obligation on the buyer to withhold tax on payments to a seller on the purchase of a business or business asset.

The Applicant objected to URA's assessment contending that section 118(B)2 of the ITA conflicted with section 117(2) b of the same. Section 118 B (2) of the ITA deals with WHT on the purchase of a business or business asset while section 117(2) b deals with WHT on interest paid by a resident person to another person. It exempts WHT on the interest paid to Banks.

It was the Applicant's argument that Equity Bank sold the mortgaged property to recover its outstanding loan balances inclusive of interest

income. Therefore, the sale of property was for the recovery of interest. A resident person is exempted from withholding tax on interest that is paid to a Bank. The Applicant affirmed that the foregoing provision of the law implied that WHT ought not to have applied on the disposal of the mortgaged property as the Bank was recovering its interest income.

## 3. Decision of the court

The majority members of the Tribunal were not persuaded that there was any ambiguity in the law. They did not find merit in the submission of the Applicant that sections 118(B)2 and 117(2)b of the ITA conflicted.

The Tribunal ruled that in accordance with the tenor of section 118(B)(2) of the ITA, the Applicant ought to have withheld tax on the payment for the purchase of property. It had been demonstrated as the law set out that the Applicant was a resident person who purchased a business asset for which the obligation to withhold tax arose.

## 4. Commentary

The minority dissenting decision in this matter sustained the Applicant's argument that there were indeed two conflicting provisions in the ITA regarding whether withholding tax should have been applied on the payment for the purchase of this property. Siraj Ali took the view that where there is a conflict between two statutory provisions of the law and the other specific, the Court would apply the specific provision of the law in this case the provisions of the law under section 117(2)b that deal with the taxation of Bank's interest income.

The decision of the majority members of the Tribunal, notwithstanding, we find the dissenting one more persuasive. Section 62 of the ITA provides that where a previously deducted expenditure, loss or bad debt is recovered by a taxpayer, such amount takes on the character of the income to which the deduction is related.

According to the Financial Institutions (Credit Classification and Provisioning) Regulations,

2005, Banks are required to maintain specific provisions for all non-performing credit facilities which even for tax purposes are deductible. By the time a mortgage is foreclosed, the underlying credit facilities have been underperforming for a while with specific provisions already taken into account by the Banks hitting their profitability.

The proceeds from the foreclosure are merely a recoupment of interest income that ought to have been paid in the first place. Under section 117(2) of the ITA, interest income paid to Banks should not be subject to withholding tax.

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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.

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.

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