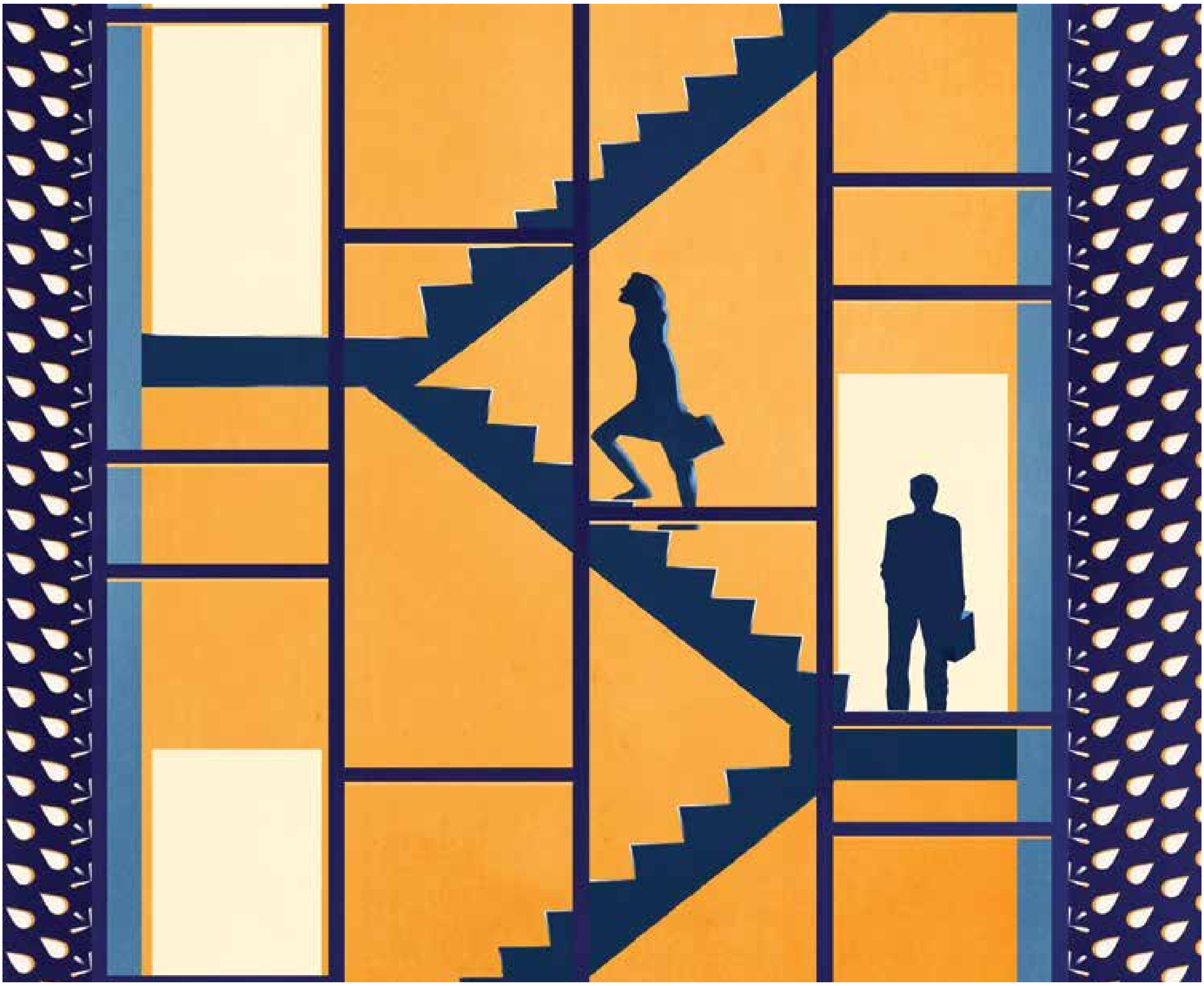
Cristal Advocates

Corporate Reorganizations in Uganda
An Overview of the tax consequences



Cristal Knowledge Series
March 2023

1 Introduction

Companies sometimes overhaul their corporate structures through merger, acquisition and division transactions keen to reposition their business. Such changes that involve the transfer of assets and liabilities from one entity to another typically trigger tax liabilities unless there are special rules that apply.

In this article, we give a highlight of Uganda's tax regime on corporate reorganizations. While the law in some instances defers the taxation of any arising gains, there are related capital raising dealings such as farm outs in the oil and gas industry not covered and continue to stoke disagreements.

2 Corporate reorganizations

Corporate reorganizations involve the rearrangement of a company's legal and operational structure and take several forms including acquisitions, divestures, mergers, consolidations, divisions, change in domiciliation, recapitalization and bankruptcy reorganizations.

In merger transactions, the assets and liabilities of one or more companies are moved into a single transferee company with the transferor companies ceasing to exist. Under consolidations, there is a combination of two or more companies into one through the transfer of their assets and liabilities into a newly established company. Acquisitions are by way of share or asset purchase/transfer. An entity can acquire the assets of another company without buying its share stock or may acquire a stake in another company through buying its shares.

Corporate divisions result into separate entities or subsidiaries being established within a larger company through spin offs, split offs and split ups. Recapitalization adjusts the capital structure of company so as to improve its financial position while bankruptcy reorganizations see businesses restructuring their operations and debt to be able to repay creditors instead of closing shop.

3 General tax consequences

Under corporate merger, consolidation and division transactions, one of the parties may resultantly disappear though it is not necessarily the case that the transferor ceases to exist under share and asset acquisition transactions unless it chooses to liquidate. These all influence the attendant general tax consequences as set out below.

a) *Capital gains*

Gains arising on the transfer of assets and liabilities are generally taxed in the hands of the seller/transferor under the income tax regime. In Uganda, companies are taxed at the corporate income tax rate of 30% while individual income tax rates are on a graduated scale up to a maximum of 40%. There are elaborate rules under Uganda's Income Tax Act ("ITA") by which capital gains and losses are determined taking into account the consideration and cost base of the assets transferred.

b) *Deemed disposal*

Enterprises that undergo a change in their direct or underlying ownership by 50% or more, within a period of 3 years, are deemed to have disposed of their assets and liabilities. Immediately after the change, the enterprise is also treated as having re-acquired the same assets and liabilities at market value. To the extent that the asset re-acquisition value exceeds the market asset value at deemed disposal, there are capital gains taxable as business income of the enterprise.

c) *Transferability of tax losses*

A company may not deduct any tax losses brought forward if there has been a change of 50% or more in its direct or underlying ownership unless it continues to carry on the same business after the change in ownership and does not engage in any new business or investment after the change where the primary purpose of the company or beneficial owners of the company is to utilise the assessed tax losses as to reduce the tax payable on the income arising from the business or investment.Tax losses aren't transferable across entities.

d) *Stamp duty*

Asset transfers are typically subject to stamp duty at the rates set out in the Stamps Duty Act. The transfer of property and shares attracts stamp duty at the rate of 1.5% of the value of the asset sold. The expense of the stamp duty is on the person drawing, making or executing the instrument. Alternatively, the parties can agree on who should bear the cost.

e) *Value Added Tax*

VAT is not chargeable on share transfers but asset sales are at the standard rate of 18% unless certain conditions are satisfied in which case they may exempted from VAT as set out further under section 4.

f) *Withholding tax*

Payments for business asset purchases attract withholding tax at the rate of 6% or 10% for resident and non-resident taxpayers which is creditable against the year-end tax year income tax liability for resident taxpayers.

4 Uganda's specific tax regime on corporate reorganizations

Uganda has a special tax regime applicable to corporate reorganizations. Given that such reorganizations are principally aimed at business optimization rather than profit extraction, it is the recommendation under international best practice to exclude such transactions from onerous tax impositions and deferring taxation to such time when any arising gains are actually realized through disposal to third parties.

a) *Rollover relief*

The ITA provides for the rollover relief enabling asset exchange and transfers between Uganda tax resident group companies without triggering capital gains. The transfer is not treated as a disposal of the asset by the seller/transferor but is treated as an acquisition by the buyer/transferee of a business asset.

Uganda's tax body can similarly permit any resident company involved in a reorganisation transaction to treat the reorganisation as not giving rise to the disposal of any business asset or the realisation of any business debt where a resident company or a group of resident companies is reorganised without any significant change in the underlying ownership or control of the company or group.

b) *Other no loss no gain transactions*

Gains and losses arising on the disposal or transfer of assets are not taken into account for income tax purposes if they relate to an involuntary disposal of an asset to the extent to which the proceeds are reinvested in an asset of like kind within one year of the disposal.

There are other no loss no gain transactions under the law but are not relevant for this corporate reorganizations.

c) *Stamp duty*

Share transfers effected pursuant to company reorganisations are relieved from stamp duty subject to the following conditions being satisfied: the effect of the instrument is to convey or transfer a beneficial interest in property from one company with limited liability (transferor) to another company (transferee); either one of the companies is beneficial owner of not less than 90% of the issued share capital of the other company; or not less than 90% of the issued share capital of each of the companies is in the beneficial ownership of a third company with limited liability.

d) *Transfer of business as a going concern*

Asset sales/transfers are chargeable to VAT at the rate of 18% unless the sale qualifies as transfer of business as a going concern in which case it is exempted.

5 Scope for policy reform

Though Uganda presently provides for the capital gains reinvestment ('rollover over') relief, its scope is narrow and does not extend to upstream oil and gas interest ("PSA") transfers to third parties unless it is an involuntary disposal or involve a corporate acquisition of related entities which often is not the case with farm outs. Taxing unrealized gains on PSA transfers re-invested into the country's petroleum sector is inconsistent with the aspiration of attracting foreign direct investment.

It is also inconceivable taxing consideration on a PSA transfer in the form of work obligations. This arises when the transferee earns a right in the transferor's PSA interest by incurring some of the costs the transferor is under duty to spend under the PSA work commitments. Taxing notional gains accruing from the assumption of the work obligations of the transferor under a PSA by the transferee reduces the investment available for core petroleum operations.

6 Conclusion

Corporate reorganizations are principally aimed at positioning the company for long term growth and success, improving a company's financial and operational performance and increasing shareholder value In the absence of a special tax regime, reorganization transactions would be subject to onerous taxation even though such transactions do not immediately crystallize realized gains that would be absurd. It is for this reason that Uganda has a special tax regime to cover corporate reorganisations.

Contacts for this Publication

Denis Yekoyasi Kakembo

dkakembo@cristaladvocates.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@cristaladvocates.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@cristaladvocates.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 Asiimwe Katta

dasiimwe@cristaladvocates.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@cristaladvocates.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. ■

CRISTAL
'total solutions'

- Energy & Infrastructure
- Business support
- Employment
- Banking & Finance
- School of Professional Excellence
- Tax
- Company Secretarial & Trustee Services
- Public Law & Policy Advocacy
- Dispute Resolution
- Corporate and Commercial

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