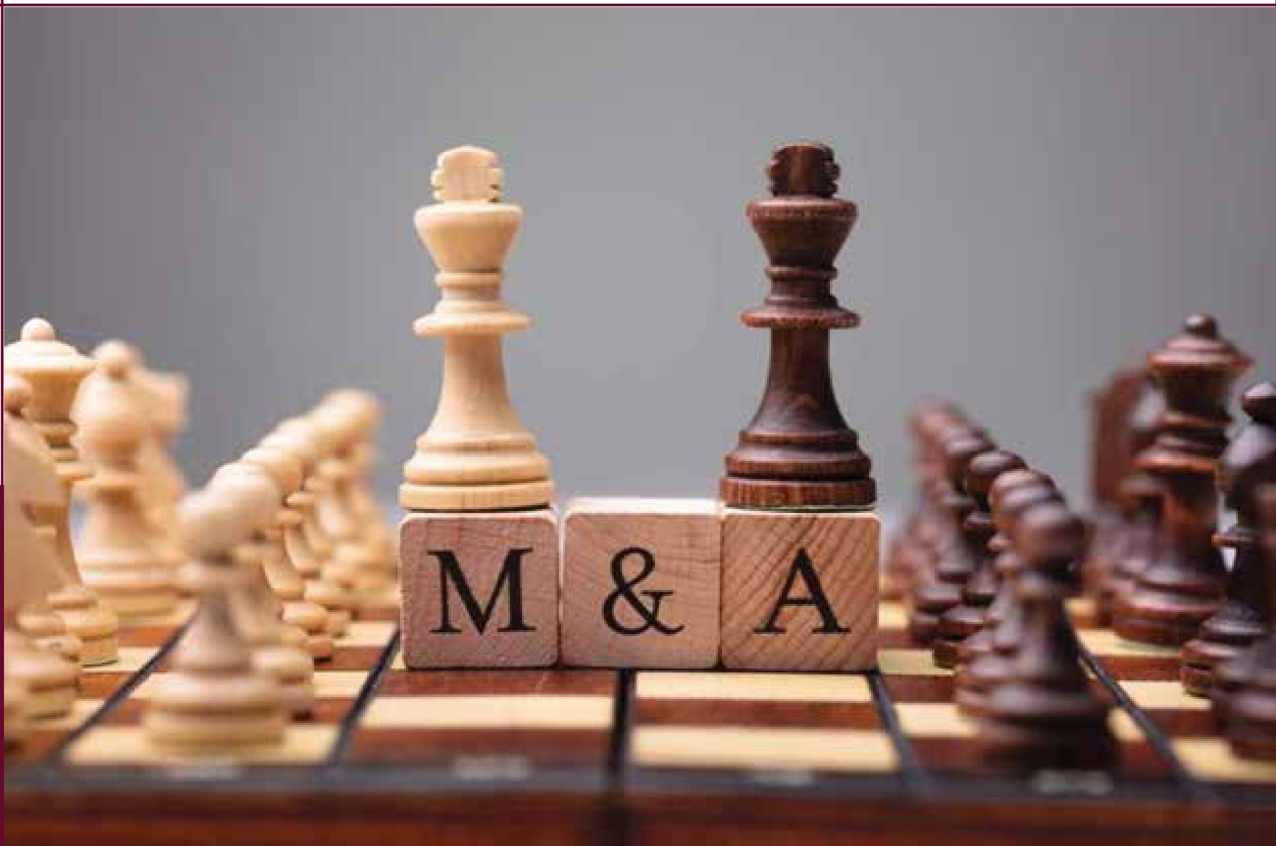
Cristal Advocates

The Taxation of Deemed Disposal Transactions

A Robust Uganda Legal Regime?



Cristal Knowledge Series
June 2024

1. Introduction

Whereas Uganda, like other developing nations, has previously encountered challenges in taxing offshore share disposal transactions that derive value from assets and businesses within its jurisdiction, uncertainty remains whether the law enacted to address this anomaly precisely targets the issue. With the tax authority increasingly focusing on merger and acquisition transactions, there is growing apprehension that the 2018 amendment to sections 75 and 79 of the Income Tax Act (ITA) may inadvertently lead to double taxation more so for local companies where shareholders disposing off shares have already been subjected to capital gains tax.

2. Motivation for the amendment

Following in the example of other developing countries such as Nepal, Ghana, and Tanzania, Uganda amended section 75 of the ITA together with section 79 (ga), to decisively deal with the taxation of offshore share disposal transactions deriving value from locally owned assets or businesses.

This move was pressed by the prevailing international tax position, that considers offshore share sales as "extraterritorial," with ownership of assets in developing countries considered incidental. It has been common for entities within multinational groups to be sold off at the group or parent level. A change at this level equally implies a change in ownership at the subsidiary level but ordinarily would escape taxation at local level.

Drawing on the concept of separate legal entities, it is contended that jurisdictions where assets are situated lack the legal authority to tax such extraterritorial events involving non-resident taxpayers unless such income is deemed sourced from their jurisdictions. Consequently, gains from offshore share sales often escape taxation in those jurisdictions. This raises concerns about tax fairness, as it allows significant economic activity to occur without contributing to the tax revenue of the countries hosting the assets from which offshore share sale value derives.

3. The amendment to section 75

To bring the foregoing transactions within the source rules and subject them to taxation under Uganda's taxation regime, amendments were made to section 75(2) and 79 (ga) of the ITA in 2018. However, as we delve into this article, it becomes evident that a plain interpretation of the text of that amendment may inadvertently broaden its scope, potentially leading to unintended consequences especially double taxation.

Under section 75(2) of the ITA, when an entity changes its ownership by 50% or more within a period of 3 years, it is treated as realizing all its assets and liabilities immediately before the change. It is considered to have parted with ownership of each asset and deriving an amount in respect of the realization equal to the market value of the asset at the time of the realization. In addition, the entity is deemed to have realized each liability and is deemed to have spent the amount equal to the market value of that liability at the time of the realization.

4. Two sides of the same coin

A key issue is whether the amendment to section 75 of the ITA was intended to apply to share disposals at the immediate shareholding level in Uganda. If so, such transactions would activate section 75 of the ITA for direct and indirect share-sale transactions at the Uganda level involving a 50% or more change in ownership. This would potentially result into double taxation on a single transaction.

For a local share sale visible to the Ugandan tax authorities, a plain interpretation of section 75 implies that selling shareholders would be subject to capital gains tax, just as the entity would be deemed to have realized its assets and liabilities due to the change in its ownership by more than 50%.

Though not documented in the law, it is plausible to consider that sections 75(2) and 79(ga) of the ITA were intended to capture offshore share sales involving non-resident shareholders on one side and local Ugandan entities on the other. In such instances, selling shareholders would typically be subject to taxation in their respective jurisdictions on share-sale transactions but escape taxation at local level in Uganda.

The amendment to section 75 in 2018 acknowledged the jurisdictional limitations to tax offshore share-sale transactions involving non-resident persons, despite their connection to Uganda and aimed to bring the realization event into Uganda, assess the transaction's value related to Uganda, and treat the transaction as a local asset sale, thereby collecting tax from the local entity. Any interpretation to the contrary would risk double taxation of a similar economic event.

5. Valuation

Where a change in ownership pursuant to section 75 of the ITA occurs, the entity is deemed to realize all its assets and liabilities at book value but also dispose of the same at their market value. If we strictly interprete the law, would other approaches to valuation such as those based on asset and income methods suffice? The market value of individual items of assets and liabilities is determined by reference to the prevailing market conditions and transactions reflecting what an investor or buyer would be willing to pay for the assets or assume the liabilities in an open and competitive market. In practice, this particular issue about valuation is easier to read than implement.

6. Conclusion

To reassure markets and bolster confidence that is vital for merger and acquisition transactions avenues through which foreign direct investment can flow, it's crucial for the government to align legal provisions with its policy stance. Past incidents have highlighted instances where the Uganda Revenue Authority (URA) has interpreted the law literally, despite government's differing tax policy stance. A case in point was the recent contentious issue over whether inbound international transport was taxable or not where both URA and the government read different scripts. Such disparities breed uncertainty, eroding investor trust. Clear, consistent tax regulations are essential for fostering a favorable business climate.

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Contacts for this Publication

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Denis is the Managing Partner of the Firm. He is qualified both as a Lawyer and Chartered Accountant with UK training and vast experience serving local, regional and international companies in Sub Saharan Africa. He is recognized as a notable corporate and commercial law practitioner in Uganda.

Before joining Cristal Advocates, Denis spent nearly 10 years at Deloitte, an international professional services firm, where he started his career and rose to senior roles. While with Deloitte, he worked and lived in Uganda, Kenya, Tanzania and the United Kingdom.

Education

a) Master of Laws in Petroleum Taxation and Finance with distinction - University of Dundee, UK
b) Certified Public Accountant (Uganda) - ICPAU
c) Certified Chartered Accountant (“ACCA”) – ACCA
d) Post Graduate Diploma in Legal Practice - Law Development Center, Uganda
e) Bachelor of Laws degree - Makerere University, Uganda

John Teira

John is a Partner with the firm but presently on sabbatical leave. Before joining Cristal, he worked as a Private Secretary to the President of Uganda. Prior to this role, he had worked with Shonubi Musoke & Company Advocates and Post Bank Uganda Limited.

John is presently a Member of Parliament representing Bugabula County North in Kamuli District in Uganda National Assembly.

Education

a) Post Graduate Diploma in Legal Practice - Law Development Centre, Uganda
b) Bachelor of Laws (Honours) - Makerere University, Uganda
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d) Basic Philosophy of Public Service Administrative Communication - Uganda Management Institute, Uganda

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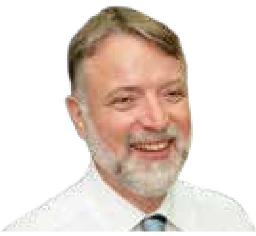
Dickens Asiimwe Katta

Dickens is a Partner at Firm where he also leads the oil and gas practice. Before joining Cristal Advocates, Dicken had served as Company Secretary of the Uganda Refinery Holding Company Limited (URHC) and the Uganda National Oil Company (UNOC) where he played key role in its formation.

Prior to joining the UNOC, Dickens had spent five years as Legal Counsel at the Petroleum Directorate of the Ministry of Energy and Mineral Development, where he evaluated several oil and gas transactions, negotiated contracts, and participated in the preparation of Uganda’s oil laws and regulations.

Education

a) Master of Laws in Petroleum Law and Policy with merit - University of Dundee, UK
b) Post Graduate Diploma in Legal Practice - Law Development Center, Uganda
e) Bachelor of Laws degree - Makerere University, Uganda



Bill Page

Bill is a Senior Advisor at the Firm and is a leading global energy and tax practitioner with extensive international experience.

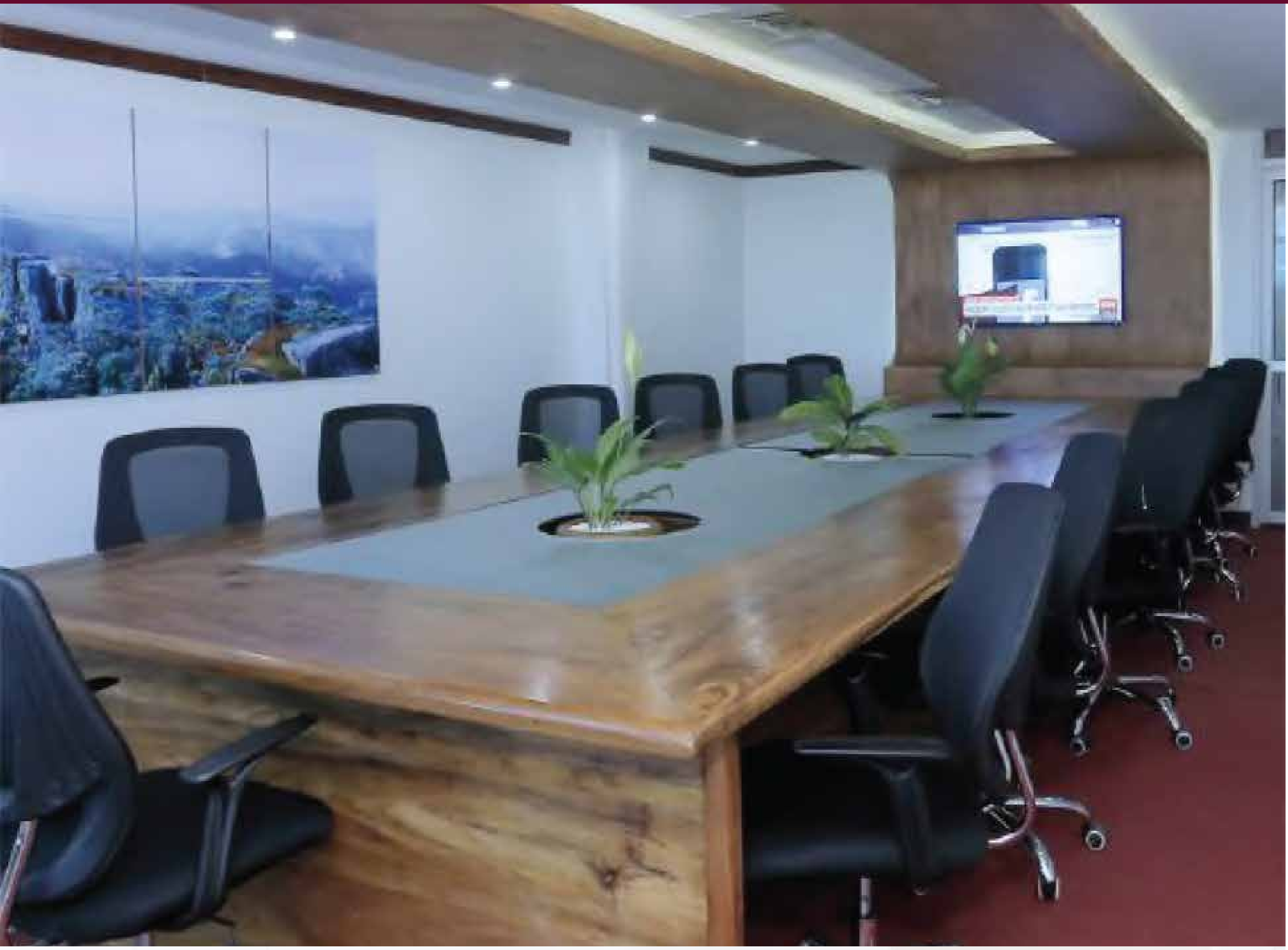
From 1986 to 1998, Bill worked in London with the UK tax authorities and Big Four accounting firms. From 1998 to 2004, he was based in Kazakhstan, working across the Caspian region with Deloitte during a period of major infrastructure development for crude oil production.

From 2004 to 2008, Bill worked in Russia, leading Deloitte's oil and gas industry group and establishing the firm's Sakhalin office. In 2009, he moved to East Africa, where he led Deloitte’s energy and resources industry group in Uganda, Kenya, Tanzania, Rwanda, Ethiopia, and Mozambique. Initially based in Kampala, Uganda, he later relocated to Dar es Salaam, Tanzania.

In 2014, Bill returned to the UK to support Deloitte UK teams on projects investing in Africa and remained a key member of Deloitte UK's energy and resource practice until his retirement in September 2018.

Education

Bill is a graduate of Oxford University and completed his inspectors’ training with the UK Inland Revenue in 1989.



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