Cristal Advocates

Limitation on Benefit Clause in Uganda's Income Tax Act
Does It Override Existing Double Tax Agreements?

Cristal Knowledge Series
February 2025

1. Introduction

A recurrent question tax practitioners in Uganda face is whether the Limitation on Benefit (LOB) clause within the Income Tax Act (ITA) can override the benefits under the country's Double Tax Agreements (DTAs).

While LOB clauses are typically included in DTAs, Uganda has also integrated them directly into its ITA, a move which has in recent years been a subject of heightened debate and judicial scrutiny, particularly in the context of treaty interpretation and the hierarchy of norms in tax law.

This possibly explains why the LOB provision in the ITA has over the last decade or so been frequently amended, reflecting a sustained effort to streamline its application in line with international tax obligations. These revisions notwithstanding, the question remains whether they have struck the right balance between protecting Uganda's tax base and honoring its international commitments, a debate that continues to engage tax professionals and policymakers alike and which this article explores.

2. LOB clauses

Whereas DTAs are intended to alleviate double taxation and curb fiscal evasion, their objectives have often been undermined by treaty shopping, where entities structure their operations to access treaty benefits despite lacking substantive economic presence in the contracting states, thereby eroding the tax base of source countries.

To guard against such outcomes, LOB clauses have been incorporated into tax treaties, establishing definitive eligibility thresholds ranging from residency and ownership requirements to active business operations ensuring that only entities with genuine economic substance in the treaty jurisdictions qualify for the tax treatment therein, thereby fortifying the integrity of the international tax regime and precluding abusive tax planning.

3. LOB clause in Uganda

While Uganda's DTAs incorporate provisions limiting entitlement to tax reliefs or reduced rates to recipients who qualify as beneficial owners, they generally do not contain explicit LOB clauses. Instead, Uganda has embedded the same within its ITA, adopting a domestic legislative approach to curbing treaty abuse rather than relying solely on treaty-based safeguards.

From its enactment in 1997, the ITA included an LOB clause stipulating that a resident of the other contracting state would be ineligible for treaty-based tax exemptions or rate reductions if 50% or more of its underlying ownership was held by individuals who were not treaty residents of that state. However, this provision remained largely overlooked until a 2011 amendment reinforced its scope and unequivocally signaled the intent of the Uganda Revenue Authority (URA) to enforce it. This development sparked intense debate, eventually leading to judicial challenges questioning whether the LOB clause within Uganda's ITA could override DTA benefits.

Despite the complexity of this discourse, a prevailing view among tax practitioners in Uganda is that domestic law must yield to international obligations to the extent stipulated in the relevant treaties. This view is supported by Article 26 of the Vienna Convention on the Law of Treaties (VCLT), which asserts that every treaty in force is binding upon the parties to it and must be performed by them in good faith. Furthermore, Article 27 of the VCLT provides that a party may not invoke the provisions of its internal law as justification for its failure to perform a treaty, reinforcing the primacy of international agreements over domestic law in treaty implementation.

4. White sapphire versus URA

The first judicial challenge to the LOB clause within Uganda's ITA arose in the 2014 filed matter of White Sapphire Limited (WSL) & Crane Bank versus URA, where the URA contested the application of a reduced 10% withholding tax on dividends paid by Crane Bank Limited to its Mauritian shareholder, White Sapphire Limited, under the Uganda-Mauritius DTA, on the grounds that the company did not meet the eligibility criteria in the LOB clause in the ITA asserting that the underlying ownership of WSL was held 50% or more by individuals resident outside Mauritius.

Though this case presented the High Court with an opportunity to determine whether the LOB provision in Uganda's domestic tax framework could supersede the benefits granted under the Uganda-Mauritius DTA, the Court refrained from making a definitive pronouncement on the matter. Rather than addressing the substantive issue, it opted to refer the dispute to the mutual agreement procedure outlined in the Mauritius-Uganda DTA, thereby sidestepping the question that was in issue of how domestic LOB clauses interact with treaty-based entitlements.

5. 2016 LOB amendment

Responding to the concerns raised by various stakeholders, the government amended the LOB clause in section 88(5) of the ITA in 2016, providing that, except for publicly listed companies, where a DTA grants tax exemptions or reduced tax rates to a resident of the other contracting state, such benefits shall not apply unless the recipient qualifies as the beneficial owner of the income within the meaning provided by the relevant DTA, exercises full control over the income's use, and possesses genuine economic substance in their country of residence.

This amendment largely aligned with international tax jurisprudence, seeking to address the concerns of treaty abuse, without a revival of the debate of whether domestic law could override international law. Instead, the amendment complemented the framework of international tax obligations, ensuring that Uganda's domestic provisions reinforced, rather than conflicted with, the principles established by its DTAs, thereby providing greater clarity and consistency in the application of tax treaty benefits.

6. 2019 and 2021 LOB amendments

Concerned by the expansive interpretation of "beneficial ownership" under international tax jurisprudence departing from the narrower scope envisioned in the earlier ITA amendments, the government commenced a gradual retreat from its 2016 position. This shift was first seen in the 2019 amendment to the ITA, which revised the definition of "beneficial ownership" by removing the reference to its interpretation under the relevant DTA. In doing so, the government aimed to regain control over the definition of the concept of beneficial ownership within the domestic legal framework.

The 2021 amendment gave its own definition of the term beneficial ownership to generally mean natural persons who ultimately own or control an entity or act on its behalf. While this approach aligns with the traditional view of beneficial ownership, it raises questions given that international tax jurisprudence does not necessarily limit beneficial ownership to natural persons. This divergence casts doubt on the legal resilience of Uganda's approach, raising critical questions about whether its restrictive definition of beneficial ownership can withstand legal scrutiny while effectively curbing treaty abuse.

7. Conclusion

Ultimately, Uganda may need to reassess its existing DTAs to incorporate explicit LOB clauses, ensuring coherence with international treaty standards. While the legislative approach provides an immediate and overarching mechanism to mitigate treaty abuse, it may not fully resolve the persisting debate on the primacy of domestic tax provisions over DTA commitments especially where there is a divergence and conflict in the interpretation of domestic law and treaties.

Contacts for this Publication

Denis Yekoyasi Kakembo

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
c) Diploma in Law (First Class) - Law Development Centre, Uganda
d) Basic Philosophy of Public Service Administrative Communication - Uganda Management Institute, Uganda

---

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.

IFLR 1000 RECOMMENDED FIRM 2021

IFLR 1000 RECOMMENDED FIRM 2022

IFLR 1000 RECOMMENDED FIRM 2023

IFLR 1000 RECOMMENDED FIRM 2024

- **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
+256 (414) 971274
admin@cristaladvocates.com
www.cristal advocates.com