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CASES THAT HAVE CHANGED THE TAX LANDSCAPE

MAY 18-2020
11 AM - 12:30 PM
PLATFORM: ZOOM

TOPICS:

1. Tax Treatment of Rent and Premium
2. Tax Treatment of Education Materials
3. Enforcement by URA
4. Application of Tax Treaties

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Tax Treatment of Education Materials

- **S.24 (4) VAT Act** - the rate of tax imposed on taxable supplies specified in the Third Schedule is zero.
- **3rd Schedule Paragraph 1(d)** zero- rated, **Paragraph 4 (a)** defines educational materials.
- **2nd Schedule Paragraph 2(a)** – defines education services.
- **S.20 VAT Act** exempts VAT on imports.
- **S.114 (2)** EACCMA

  5th Schedule Part B, Item 17 - exemption
- Florence Agreement (Article 1 & 2)

Gustro Limited V URA; TAT 17/2017

Facts

- Gustro imports, distributes, wholesales and sales on retail educational textbooks, educational charts, catalogues, dictionaries and reference books.

- URA carried out a post clearance audit and alleged that the imported goods were not exclusively educational materials.

Issues

- Whether the importation and or supply of the disputed books and other materials is zero rated or exempt under the VAT Act?

Appellant's arguments

- Sec 114(2) and Item 17 of the 5th Schedule to the EACCMA exempt the importation of educational materials specified in the Florence Agreement from duty.

- Article 1 of the Florence Agreement exempts books and educational materials intended to stimulate study.

- The books imported by Gustro were educational materials sold only to educational institutions and therefore not taxable.

- The assessment arose out of a customs post clearance audit and therefore the EACCMA was applicable not the VAT Act.

Gustro Limited V URA Cont..

Respondent's arguments

- The Applicant misused CPC 472
- VAT is solely provided for under the VAT Act not EACCMA.
- The Florence Agreement was not applicable
- The books were for a dual purpose which disqualified them from being used only in public libraries and specialised educational establishments.
- No evidence that the Applicant sold the books to public libraries and educational institutions.

Gustro Limited V URA Cont..

Tribunal's Ruling

Taxable Supply in Uganda

- **Sec 24(4) & Par 4(a) 3rd Schedule** – tax rate is zero
- Only requirement under **Paragraph 4(a)** is that the books should be "suitable for use only in public libraries and educational establishments"
- The word 'only' limits the application of the books to public libraries and educational establishments but **not** the functionality of the books.
- The fact that the books may be for dual purposes does not stop them from being suitable for use only in a public library or educational establishments.
- Books in a public library are not limited to textbooks and educational ones.

Importation of Goods

- **Section 20 VAT Act** - exemption of goods by virtue of importation under the 5th Schedule of the EACCMA.
- Item 17 B of the 5th Schedule to the EACCMA exempts educational articles and materials as specified in the Florence Agreement (Agreement on the importation of Educational, Scientific and Cultural Materials).
- The books imported by the Applicant fell within the ambit of the EACCMA and Florence agreement.
- The books and other educational items were exempt from VAT at the time of importation.

❖ A nation that taxes books that are critical in the improvement of its citizen's reading skills aims at promoting illiteracy. In a country like Uganda that has illiteracy problems it would be difficult to comprehend a law that discourages the supply of books aimed at improving the reading skills of its citizens

Significance of the Case

- Paragraph 4 (a) of the Third Schedule amended in 2018.
  - Educational Materials <u>restricted to **locally**</u> produced materials suitable for use in public libraries or for educational services.
  - Word 'only' deleted.
  - Imported materials are no-longer zero-rated when sold locally. *(5th Schedule EACCMA)*
  - Tax payers can charge VAT at 18% even when sold to educational institutions.
- Books or other material related to education are exempt from VAT at Import i.e charts, leisure books (Florence Agreement)
- Books must be fit for purpose - educational or public libraries.

Picfare Industries Ltd V URA; TAT 35/2017

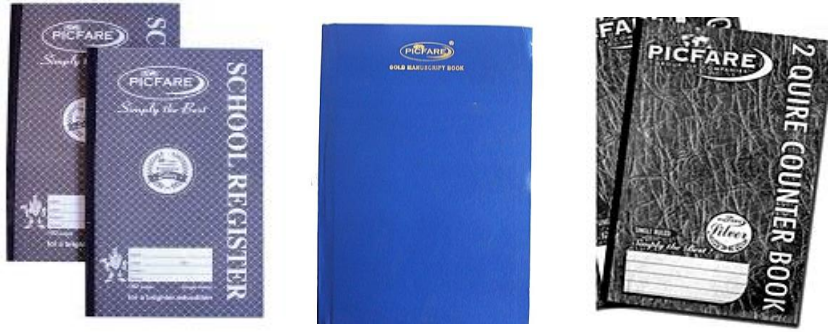
Facts

- The Applicant is a producer and supplier of stationery for education purposes including A4 hard cover books. The Applicant applied for a VAT refund but was rejected by URA and an assessment was issued on the basis that the Applicant had misclassified some items as zero rated.

- URA reclassified the books as standard rated on the basis that they were used for both educational and non-educational purposes and issued an assessment.

Issues

Whether the supply of A4 hard cover books was zero rated?



Applicant's arguments

- Educational materials are zero rated - **(S.24(4) and Par 1(d) of the 3rd Schedule).**
- The books were customised to work as exercise books and sold to schools and students.
- The practice notice issued by URA that excluded counter books could not be applied retrospectively.
- The Applicant should not be held responsible for customers who misapply the books.

Respondent's arguments

- The use of the word 'only' in the definition of educational materials under Paragraph 4 of the 3rd schedule indicates that for a material to be educational, it must be exclusively or solely for use in public libraries and educational establishments.
- The books were used for other purposes such as entry books at entrances of some offices. They should only be used in educational establishments.

Picfare Industries Ltd V URA; TAT 35 of 2017

Tribunal's Ruling

❖ *Would books if used for other purposes cease to be educational materials?*

- The only requirement under Section 24 is 'suitable for use'. If the legislature wanted the books only for educational purposes then the Law should not have added the word "suitable".

- When one uses a book customized for educational purposes for other purposes, it is not the appropriate use but they are still appropriate for educational purposes.

- The Practice notices are not law. They only bind the Commissioner General not taxpayers.

Implication of the cases

- The fact that books can be used for both education and non-education purposes does not disqualify them from the definition of education materials.
- A product only needs to be fit for the purpose it was created even if it is used for some other purpose.
- A4 counter books are zero rated supplies.
- VAT (Zero Rated Educational Materials) Regulations S.I 38/2018; educational materials include counter books.
- With the amendment, locally produced educational materials, books are still zero-rated.
- Taxpayers should declare the goods as zero-rated and can claim input tax.
- A Practice Notice is not Law and is only binding on the Commissioner General.
- The Law cannot be applied retrospectively.

TAX ENFORCEMENT MEASURES

Measures

- Collection of tax from persons leaving Uganda permanently
- Distress proceedings
- Temporary closure of business
- Charge over immovable property
- Seizure of goods
- Agency notices **(Section 31 – 35 TPCA)**

Requirements

- A person is, or will become liable to pay tax.
- The tax is unpaid.
- Commissioner has reasonable grounds to believe that the taxpayer will not pay the tax by the due date for payment.
- Notice should be in writing.
- Amount not to exceed the amount of tax unpaid.
- Provide a payment date (not before the due date).
- The notice must be served on the taxpayer

URA V Paramount Insurance Ltd; CACA 97/2015

Background

- URA suspended the Respondent's operations on the basis of unaccounted customs bond security executed by Cargo Stars Limited and issued an agency notice.
- The security was paid but URA demanded for taxes on bonds executed by other companies, suspended the Respondent's operations and issued an agency notice.
- Respondent filed a suit in the High Court - issues were whether URA was justified to suspend her operations, issue agency notices and demand for taxes. Judgment was entered in favor of the Plaintiff (Respondent).

Ground of Appeal

- The Learned Trial judge erred when he held that the Appellants were not justified to suspend the operations of the Respondent.

URA V Paramount Insurance Ltd Cont..

Appellant's arguments

- **Sec 133(1) EACCMA** – Obligation incurred deemed to be an obligation to pay duties payable or recoverable.
- **Section 109 (1) EACMA** – Failure to comply, Commissioner may require a person who issued security to pay the tax due.
- Suspension and issuance of agency was justified since the Respondent failed to account for securities executed.

Respondent's arguments

- Appellant not justified to suspend the Respondent's operations and issue agency notices.
- Respondent informed the Appellant that 3 Companies had furnished their accountability and the 4th was in the process but the suspension was effected indefinitely.
- If there was tax due, why was the agency notice lifted?

Court's Judgment

Section 109 (1) EACCMA.

- The process of reconciliation was still on going and there was no justification for enforcement.
- The suspension ought to have been made after 14 days' notice from the date the actual amount due was determined.
- Issuing of 3rd party agency notices was contrary to the law, irregular and therefore unjustified.

❖ Applicant awarded general damages of and exemplary damages.

Housing Finance Bank Ltd V URA HCCS 259/2014

Facts

- An agency notice was issued against the taxpayer's account held with the Housing Finance Bank.
- The agency notice was not honoured by the bank.
- The taxpayer withdrew the money from the account over the weekend and URA demanded that the sums be paid personally by the bank.

Issues

- Whether the Defendant lawfully issued the Agency notices?
- Whether the Plaintiff had a legal obligation to honour the third-party Agency Notices?
- Whether the Plaintiff was liable to pay the tax due to the tax payer?

Plaintiff's case

* **Section 106 ITA**

- Tax payer not served with the agency notice
- The agency notice was served on a different branch and by the time it was transferred, it was a weekend and the office was closed.
- Tax was not yet due as per assessment.

Defendant's case

- The notice was served on the taxpayer's agent at the tax payer's premises.
-
- Bank was personally liable since the agency notice had been served before the money was withdrawn.

Housing Finance Bank Ltd V URA Cont..

Court's Judgment

- **Section 99 ITA** - party dissatisfied with an assessment may lodge an objection within 45 days.
  - Agency Notice could only be issued after the 45 days.
- Issuing an assessment notice simultaneously with the agency notice deprives the taxpayer the chance to object to the assessment.
- Once a third party agency notice was brought to the attention of the third party, it was their duty to execute.
- Where the 3rd party knows that there is an illegality, it will be unlawful and against public policy to implement a thing that they knew to be invalid.
- Plaintiff Not liable to pay the tax due.
- Agency notice was illegal.

Implications

Sec 106 ITA (Repealed)

(1) Where a taxpayer fails to pay income tax on the due date on which it becomes due and payable, and the tax payable **is not the subject of a dispute**, the commissioner may, by notice in writing, require any person

- owing or who may owe money to the tax pager;
- holding or who may subsequently hold money for, or on account of, the tax payer or …

(3) **At the same time** that notice is served under subsection (1), the commissioner shall serve a. copy of the notice on the taxpayer."

Section 31 TPCA

(1) This section applies where a person is, **or will become liable** to pay tax and—

- the tax is unpaid; or
- **the Commissioner has reasonable grounds to believe that the taxpayer will not pay the tax by the due date for payment.**

(2) The Commissioner may, by notice in writing, require a person who—

- owes or may subsequently owe money to the taxpayer;
- holds or may subsequently hold money, for or on account of, the taxpayer or....

(8) A copy of a notice served on a person under this section shall **also be served** on the taxpayer.

Challenges

- Service on the taxpayer through the e-portal.
- Can be issued where the Commissioner has reasonable ground to believe that the tax will not be paid – URA can collect anytime.
- Issued before due date stated in the assessment.
- Notices state that the should be paid immediately. ***CADER V URA.***
- Issued even when an injunction has been obtained and 30% requirement met.
- Issued against overdraft facilities.
- Issued before an assessment.

  Sande Pande V URA; *URA transferred liability from a company to a shareholder/director of the Company and issued agency notices.*

  Held; *Right to a fair hearing infringed; taxpayer not given adequate notice to object to the assessment; agency notices issued illegal.*

DOUBLE TAXATION AGREEMENTS

Definition

- An international Agreement entered into between the Government of Uganda and the government of a foreign country(s) shall have effect as if the agreement was contained in the Act. **(Sec 88(1) ITA**

- Where there is a conflict between the DTA and domestic law , the treaty takes precedence. **(Sec 88(2) ITA**

An International agreement means;

- An agreement with a foreign government providing for the relief of international double taxation and the prevention of fiscal evasion; or
- A bilateral or multilateral agreement with foreign government(s) or foreign organization providing for administrative assistance in tax matters. **Section 88(6) ITA**

Purpose

- eliminate juridical double taxation of residents
- prevent fiscal evasion of tax.

– Executed to facilitate foreign direct investment (FDI) and as a result source countries forego taxes in exchange for FDI

Target Well Control (U) Ltd v URA;CS 751/2015

Facts

- The Plaintiff incorporated under the laws of Uganda, was leased a directional drilling equipment by Target Well Control UK.
- Lease payments were made but no withholding tax was charged.

Issue

- Whether the plaintiff is liable to pay tax on the intercompany lease payments?

Plaintiff's Argument

- Target Well Control (UK) was exempted from pay tax on the basis of Art. 7 of the DTA between Uganda and UK. Hence no duty to withhold.

Defendant's Argument

- Target Well (UK) was liable for tax under section 83 of the ITA. Hence the duty to withhold.

Target Well Control (U) Ltd v URA Cont..

Court's Decision

- Based on section 88 (2) of the ITA, the DTA took precedence over the ITA.

- Target Well Control (UK) was exempted from tax by virtue of Article 7 since Target Well Control (UK) was not a permanent establishment.

Implication

- DTA takes precedence save for circumstances envisaged under section 88 (2)

- A subsidiary can constitute a permanent establishment where the parent company trades through the subsidiary as opposed to trading with the subsidiary i.e. principal agent relationship.

White Sapphire & Crane Bank V URA; CS No.465/15

Facts

- The 1st Plaintiff is incorporated under the laws of Mauritius and a shareholder in Crane Bank. The 1st Plaintiff was owned (100%) by a Kenyan Resident.
- 2nd Plaintiff paid dividends to the 1st Plaintiff and withheld tax at 10% pursuant to the DTA between Uganda and Mauritius. The defendant raised an additional tax assessment on the basis that tax ought to have been withheld at a rate of 15%.

Issues

- Whether the Plaintiffs are entitled to a reduction under the provisions of Article 10 of the DTA.
- Whether the Plaintiff are not entitled to a reduction by virtue of section 88(5) of the ITA and on account of residence of the first Plaintiff.

Plaintiffs' Arguments

- Article 10 of the Treaty is applicable and as such the Plaintiff is entitled to taxed a lower rate of 10%
- Section 88(5) was being applied retrospectively

Defendant's arguments

- The 1st Plaintiff was owned by a Kenyan resident as such its place of effective management was not Mauritius.
- The Plaintiff is a holding company formed for the purpose of treaty profit shifting through treaty shopping.
- Section 88(5) limits the benefit to circumstances where the underlying owner is resident in the contracting state.

White Sapphire & Crane Bank V URA Cont..

Court's Decision

- The 1st Plaintiff was resident in Mauritius and entitled to benefit from Article 10 (2) of the DTA. Section 88(5) was not being applied retrospectively
- The case should be resolved by mutual agreement with competent authorities of Mauritius. The Plaintiff cannot file an action in the High Court.
- The duty is on the Defendant to resolve the matter with the competent authority of Mauritius.

Implications of the Case

- Amendment of section 88(5) to include economic substance
- Duty of URA to pursue Mutual Agreement Procedure

Article 25 OECD MTC - MAP

- Competent authorities from contracting states resolve International tax disputes

Tax Treatment of Leases and Premium

- **Sec 22(1) (a) ITA**

  A deduction is allowed on all expenditures and losses incurred during the year of income in the production of income included in the gross income.

- **S.22(2)(b) ITA**

  No deduction is allowed for any expenditure or loss of a capital nature or any amount included in the cost base of an asset.

Mukwano Enterprises V URA; TAT 06/2018

Facts

- Mukwano Enterprises, a company engaged in property development and real estate business acquires leases and rents out the property. The rent and premium expenses incurred were amortized over the lease period, and deducted when ascertaining chargeable income.

- URA carried out an audit, disallowed the expenses on the basis that they were capital not revenue expenditures and raised an assessment of Ushs. 3,250,011,968.

Issue

- Whether the assessment by the Respondent was lawful?

Mukwano Enterprises V URA; TAT 06/2018

Applicant's arguments

- The expenses incurred were in the production of income as they related to buying the right to use the land for business and therefore a revenue expense which is an allowable deduction.

- These were operating leases. Since the ITA is silent on operating leases, relied on Paragraph 4 of the IAS 17 as a basis of its amortization.

Respondent's arguments

- The expenses incurred were of a capital nature and form the cost base of the Applicant's assets.

- A leasehold tenure is a recognized form of land ownership which became an asset for the Applicant on acquisition and any expenditure incurred in the acquisition of such an asset is of a capital nature.

Mukwano Enterprises V URA Cont..

Tribunal's Ruling

- An expenditure is of a capital nature if paid for the acquisition of a capital asset and not stock in trade.
- The land transactions were the modus operandi, the land or leases were its stock in trade.
- Any expenses incurred in acquiring the said leases are revenue in nature and therefore allowable deductions.
- IAS not applicable. Where the Act is clear, accounting standards cannot override it.
- The expenses should not be amortized.

❖Matter referred back to the URA for reconsideration.

VIVO Energy (U) Ltd V URA; TAT 29/2017

Facts

- Vivo Energy obtains leases for purposes of setting up service stations, pays rent and sometimes premium for the lease period. The expenses are amortized and deducted for tax purposes.

- URA carried out an audit and concluded that the land held was a tangible asset and the expenses incurred were of a capital nature and not allowable.

Issues

- Whether the premium and rent paid by VIVO were deductible expenses under the ITA?

VIVO Energy (U) Ltd V URA Cont..

Applicant's arguments

- The leases do not grant ownership to the lessee as the land reverts back to the landlord at the expiry of the lease.
- The expenses incurred are not capital expenditures. A lease is not an acquisition of land but rather a right to use the land.

Respondent's argument

- Leaseholds are assets to Applicant, the rent and premium should be considered as capital expense and should form part of the cost base of the taxpayer's assets under Section 52(2) of the ITA.

VIVO Energy (U) Ltd V URA Cont..

Tribunal's Ruling

- Revenue expenditures incurred to maintain the business and benefit the current expenditure while capital expenditures are incurred to benefit future periods and create a benefit of an enduring nature.
- For an expenditure to be one of capital nature, it must be one paid for the acquisition of a capital asset and not stock in trade.
- Unlike a rent agreement, the premium and rent paid for leases grants the taxpayer the rights of ownership of the fixed asset (land).
- The land leased was for a long term and the leases conferred interest on the applicant in land which was capital in nature.
- Acquisition of a lease interest grants exclusive possession and ownership of a capital asset. The costs incurred are capital expenditures and there for not deductible.

VIVO Energy (U) Ltd V URA; HCCA No. 1 of 2019

Facts

- An appeal against the decision of the Tribunal in TAT 29/17.

Ground of Appeal

- The Tribunal erred in law in holding that rent and premium paid in respect of the Appellant's leases are not deductible expenses.

* Appellant conceded to the fact that premium were capital expenditures and not deductible.

Question for determination - **whether rent is a capital or revenue expenditure and therefore an allowable deduction.**

VIVO Energy (U) Ltd V URA; HCCA No. 1 of 2019

Court's Ruling

- Rent is a recurrent expenditure that is paid to maintain occupancy of leased facilities or premises. It is paid to maintain the revenue generating capacity derived from possession of the lease.

- The Act defines rent as consideration for use or occupation, or right to use or occupy land or buildings. The definition does not confer title on the lessee beyond granting a license to use or to occupy the land or buildings. It does not connote acquisition of the property, which would if it did, qualify the payment made to be categorized as capital expenditure incurred to acquire property.

- Decision of the Tribunal reversed

Implications of the Decisions

- Rent and Premium expenses incurred by a person dealing in real estate are revenue in nature and therefore allowable deductions but cannot be amortized.

- Where a taxpayer's stock in trade is not property or land, the premiums paid are part of the cost base to acquire an asset and not allowable deductions.

- Rental expenses incurred on the lease of property are allowable deductions.

Q & A