

IN THE REPUBLIC OF UGANDA
IN THE TAX APPEALS TRIBUNAL AT KAMPALA
TAT APPLICATION NO. 219 OF 2023

AMBITIOUS CONSTRUCTION COMPANY LIMITED.....APPLICANT

VERSUS

UGANDA REVENUE AUTHORITY.....RESPONDENT

BEFORE: MS.CRYSTAL KABAJWARA, MRS.STELLA NYAPENDI CHOMBO,
MS. GRACE SAFI

RULING

This ruling is in respect of an application challenging the Respondent's capping of the Applicant's interest expense to 30% of EBITDA as provided under section 25 of the Income Tax Act. The Applicant contends that the Respondent should have applied net interest and not gross interest.

1. Background Facts

The Applicant deals in construction, civil engineering, and warehouse rental. The Respondent conducted a review of the Applicant's tax returns for the period 2019, 2020 and 2021 and established overclaimed interest expense contrary to sections 25 of the Income Tax Act. The Respondent established that the Applicant overstated their interest expense by Shs. 433,236,952, Shs. 875,538,300, and Shs. 1,115,940,530 in 2019, 2020 and 2021 respectively. Consequently, the Respondent issued additional income tax assessments totaling Shs. 727,414,734, citing the overstatement of the interest expense.

On 3 November 2023, the Applicant objected on grounds that net interest should be considered when computing the earnings before interest, tax depreciation and amortization (EBITDA) and not the gross interest expense. The Applicant premised their

position on Action Plan 4 of the OECD Base Erosion and Profit Shifting Report (BEPS Report), which recommends the net interest rule to be the best practice to reduce the risk of double taxation.

On 29 November 2023, the Respondent disallowed the objection on the grounds that interest expenses were correctly considered in the computation of EDITDA.

2. Representation

The Applicant was represented by Mr. Kyambadde Andrew and Mr. Ntege Trevor Mark while the Respondent was represented by Mrs. Doreen Amutuhaire and Mr. Amanya Mishambi.

Mr. Ankit Jangla, the Director of the Applicant, was the Applicant's sole witness. He stated in his witness statement that the Applicant is in the business of construction, civil engineering, and warehouse rental.

He also stated that the Respondent reviewed the Applicant's tax returns for the period 2019-2021 and issued a tax compliance advisory letter followed by additional assessments. The Applicant objected to the assessments on the grounds that net interest should be used in EBITDA computation, particularly where the taxpayer has earned and paid tax on interest income. Therefore, the Respondent committed tax computation errors by using gross interest instead of net interest in chargeable income determination.

He further testified that the Respondent misinterpreted and misapplied Section 25(3) of the ITA, by ignoring OECD BEPS Action Plan 4, which advocates for net interest methodology to avoid double taxation.

Mr. Bwambale Herbert, an Officer in the Respondent's Legal Services & Board Affairs Department, was the Respondent's sole witness. He stated in his witness statement that the Respondent conducted a review of the Applicant's tax returns for the periods 2019 – 2021 and established overclaimed interest expenses contrary to Section 25 of the Income Tax Act.

He testified that the Applicant objected on grounds that the net interest should be considered when computing the earnings before interest, tax, depreciation and amortization and not gross interest expense based on Action Plan 4 of the BEPS report which recommends net interest as the best practice to reduce the risk of double taxation. He testified that the Respondent correctly considered the computation of the EBITDA.

3. Issues for determination

The issue for determination is whether the Applicant is liable to pay the tax assessed.

4. Submissions of the Applicant

The Applicant submitted that the Respondent misinterpreted and misapplied Section 25(3) of the Income Tax Act by failing to consider International best practices, specifically the OECD's BEPS report which recommends the use of net interest where a taxpayer has earned interest income and also incurred interest expenses.

OECD BEPS Action Plan 4

The Applicant contended that Section 25(3) must be interpreted in light of International Accounting and tax standards, including OECD and BEPS Action Plan 4, which recommend that net interest expense (interest paid minus interest received) should be considered during the EBITDA computation.

Paragraph 62, of Action Plan 4 on "**Limiting Base Erosion Involving Interest Deductions and Other Financial Payments**", at Page 38 recommends:

"A net interest rule would reduce the risk of double taxation, as an entity's interest income would be set against its interest expense before the interest limitation is applied. It would also allow an entity to raise third party debt and on-lend borrowed funds within its group, without the entity incurring a disallowance of part of its gross interest expense. Taking into account these considerations, the general interest limitation rules contained in this report apply to an entity's net interest expense paid to third parties, related parties and intragroup, after offsetting interest income. Rules should apply to all of an entity's net interest expense, as discussed in Chapter 2,

to ensure that a broad range of base erosion and profit shifting risks are addressed, including where excessive third party interest expense is incurred in a high tax country....."

The Applicant submitted that the OECD BEPS Action Plan 4 aims to limit excessive interest deductions that erode a country's tax base. It recommends that in applying a fixed ratio rule to restrict net interest deductions to 30% of EBITDA to prevent profit shifting, focusing on net interest expense (interest paid minus interest received) to reflect the true cost of external financing and avoiding double counting of interest by ensuring businesses deduct only the actual net financing costs.

The Applicant contended that the Respondent's approach contravenes basic accounting principles as well as international tax obligations and best practices for which Uganda is not an island.

The Applicant cited the case of ***Unilever Kenya Ltd V The Commissioner of Income Tax, Income Tax Appeal No. 753 of 2003***, where Hon. Justice Alnashir Visram emphasized:

"...Therefore, I cannot ignore the time-tested experiences and best practices of others.....The ways of doing modern business have changed very substantially in the last 20 years or so and it would be fool-hardy for any court to disregard Internationally accepted principles of business as long as these do not conflict with our own laws. To do otherwise would be highly short- sighted".

The Applicant submitted that the narrow interpretation of Section 25(3) of the ITA leads to double taxation as interest income is taxed and the excess of 30% interest is disallowed by the Respondent during the year of income.

The Applicant prayed that the Tribunal finds that net interest expense is should form part of the EBITDA computation in conformity with the International best practices of the OECD principles and to ensure and promote fair tax treatment. The Applicant further prayed that the assessment should be set aside.

Section 25 of the ITA

The Applicant quoted Section 25(3) of the ITA which provides:

"The amount of deductible interest in respect of all debts owed by the taxpayer who is a member of the group, other than a financial institution, microfinance deposit-taking institution, Tier 4 microfinance institution, or person carrying on insurance business, shall not exceed thirty percent of the tax earnings before interest, tax, depreciation, and amortization (EBITDA)."

Further, section 25(4) states:

"A taxpayer whose interest exceeds thirty percent of the tax earnings before interest, tax, depreciation, and amortization may carry forward the excess interest for not more than three years, and the excess interest shall be treated as incurred during the next year of income."

The Applicant submitted that in the case of ***Attorney General v Bugishu Coffee Marketing Association Limited [1963] EA 39***, Justice Slade confirmed:

"In a taxing Act, one has to look merely at what is clearly said...."

The Applicant submitted that the provision is concerned with interest incurred and there is no mention of the word gross interest. Where the Applicant has earned interest income and also incurred interest expenses, the difference is the interest expenditure which would be recognized as the interest expenses forming part of the EBITDA tax computation.

The Applicant submitted that Section 38 of the Income Tax Act, enjoins taxpayers to apply accounting methods that conform to the Generally Accepted Accounting Principles (GAAP). Where a taxpayer has earned interest income, such income is recorded as revenue in the statement of comprehensive income (profit and loss account).

The Applicant argued that the interest income is taxed as part of the taxpayers net profits, and when a taxpayer borrows and incurs interest expenses, such expenses are recorded as a deduction in the statement of comprehensive income (profit and loss account). The

difference between the interest income and the interest expense would be the interest incurred by the taxpayer during the year of income as per the International Accounting Standard one (1) IAS 1- Presentation of Financial Statements and the respective rules of accounting double entry.

5. Submissions of the Respondent

The Respondent submitted that the dispute in this application revolves around interpretation of Section 25 (1) and (5) of the Income Tax Act. The scope of dispute is whether in the computation of EBITDA, the interest component to be applied is gross interest or net interest.

The Respondent submitted that only interest expenses incurred by a taxpayer in the production of income each year constitute an allowable deduction. Section 25(3) of the Income Tax Act states:

"The amount of deductible interest in respect of all debts owed by a taxpayer who is a member of a group, other than a financial institution, micro-finance deposit taking institution, tier 4 micro-finance institution or person carrying on insurance business, shall not exceed thirty percent of the tax earnings before interest, tax, depreciation and amortization".

The Respondent submitted that the import of Section 25(3) of the Income Tax Act is to cap the deductible interest for enterprises in a group. There is no dispute that the Applicant is a member of a group as per the definition therein.

The Respondent relied on the case of ***New Vision Printing & Publishing Corporation V URA HC Civil Appeal 78 of 1999***, where it was held:

"It is the view of this court that for a deduction to be allowed it must either be so allowed by statute and or that it is not prohibited by a statute. At the same time for an expenditure to qualify for a deduction some evidence of its character must be adduced. Thus, to a certain extent it is a question of fact and law. The evidence demonstrates that the expenditure was "wholly and

exclusively" incurred by the appellant in the production of the income. If part of such expenditure relates to a capital acquisition, wasting asset or could be deemed to be the capitalized value for an asset then a doubt arises as to whether it was wholly and exclusively incurred in the production of income (and not an asset).

The Respondent submitted that Section 22 (1)(a) of the Income Tax Act and ***New Vision Printing & Publishing Corporation V URA (supra)***, support the Respondent's submission that gross interest constitutes the only allowable deduction envisaged in computation of EBITDA.

Regarding the application of the OECD BEPS Action Point 4, the Respondent argued that the OECD BEPS action plans have no force of law as the same are merely a proposed tax policy framework. Whereas the Applicant hinges its submission on the BEPS action point 4, the same has no force of law in Uganda and cannot supersede provisions of the Income Tax Act. Had the Legislature intended that the net interest as prescribed by the BEPS Action plan 4 be applied, it would have expressly stated so.

The Respondent submitted that they correctly disallowed the Applicant's objections on the premise that interest expenses were correctly considered in the computation of EBITDA and that the Applicant overstated its interest expense contrary to the provisions of Section 25(3) of the Income Tax Act.

In rejoinder, the Applicant reiterated their earlier arguments.

6. The determination of the issues

Having listened to the evidence and read the submissions of the parties, this is the decision of the Tribunal.

The Applicant contends that the Respondent misapplied Section 25(3) of the ITA by using gross interest rather than net interest in arriving at the EBITDA computations. The Applicant contended that Section 25(3) ITA did not specify that 'gross interest' must be used, hence the Respondent's interpretation was erroneous and unlawful. The Applicant

submitted that the Respondent's assessment goes against generally accepted accounting principles as required by section 38 of the ITA and Action Plan 4 of the BEPS Report, which recommends net interest as the best practice to reduce the risk of double taxation. However, the Respondent contended that it correctly considered the computation of the EBITDA hence gross interest.

Section 38 (1) of the ITA

Regarding the Applicant's reference to generally accepted accounting principles under Section 38 (1) of the ITA, this is merely a requirement for taxpayers to follow these principles when preparing their books of account.

The provision states:

"A taxpayer's method of accounting shall conform to generally accepted accounting principles."

It should be noted that accounting and taxation serve different purposes.

The purpose of accounting is to provide interested parties information relevant to stewardship, control, and decision-making. On the other hand, the main purpose of taxation is to raise revenue for the government's economic and social policy. Therefore, taxation does not always follow accounting as tax is determined by the provisions of the applicable tax legislation and not the taxpayers' accounting.

We now turn to section 25 of the ITA that is the heart of this dispute as to whether the Respondent correctly applied gross interest expense in capping the Applicant's deduction.

Section 25 of the ITA

Section 25 of the Income Tax Act provides as follows:

"(1) Subject to this Act, a person is allowed a deduction for interest incurred during the year of income in respect of a debt obligation to the extent that the debt obligation has been incurred by the person in the production of income included in gross income.

(3) The amount of deductible interest in respect of all debts owed by a taxpayer who is a member of a group, other than a financial institution, microfinance deposit taking institution, tier 4 microfinance institution or person carrying on insurance business, shall not exceed thirty percent of the tax earnings before interest, depreciation and amortisation.

(4) A taxpayer whose interest exceeds thirty percent of the tax earnings before interest, tax, depreciation and amortisation may carry forward the excess interest for not more than three years, and the excess interest shall be treated as incurred during the next year of income.

(5) In this section—

“group” means persons other than individuals, with common underlying ownership; “tax earnings before interest, tax, depreciation and amortisation” means the sum of—

(a) gross income less allowable deductions, except a deduction under subsection (1);”

Subject to certain exceptions, section 25(3) of the Income Tax Act provides that the deductible interest for a member of a group shall not exceed 30% of the taxpayer's tax EBITDA.

A plain reading of the above provision indicates that the capping applies to interest incurred, which would ordinarily be tax deductible. This interest is incurred in respect of a debt obligation, which refers to a person's borrowings.

The Applicant has argued that the capping should apply to net interest.

Net interest is not “interest incurred”, neither does it arise from a debt obligation, nor is it tax deductible. Net interest refers to the interest income after deducting all interest expenses, such as interest paid on deposits or borrowed funds. Therefore, a plain reading of the provision reveals that the provision is concerned with the interest expense, that was incurred by the taxpayer, which, in the absence of the capping provision, would have been fully deductible. It does not apply to net interest income or net interest expense, which ever way the Applicant would like to frame it.

We've considered the Applicant's arguments around BEPS Action Point 4 as well as Accounting Standards and how these are international best practice that are applicable in Uganda. While we agree with the Applicant that international best practice should be

adhered to, where there is a clear and unequivocal statutory provision, it takes precedence over the international best practice.

We've taken note of the Applicant's reliance on the Unilever case (supra) wherein the OECD Transfer Pricing Guidelines were found to be applicable in Kenya. The facts that distinguish the Unilever case from the present case is that in Unilever, the Kenyan Government had not yet introduced transfer pricing legislation. In the absence of such legislation, the court found the OECD Transfer Pricing Guidelines applicable.

In fact, the main issue for determination in the Unilever case was:

“Whether in the absence of specific guidelines from the Kenya Revenue Authority on this issue, the OECD (The Organization for Economic Co operation and Development) guidelines and the methods prescribed thereunder for the calculation of an ‘arm’s length price’ are a proper, reasonable and objectively acceptable basis for the determination of an arm’s length price as required under section 18(3)”.

In the present case however, section 25 is as clear as broad day light.

Further, it is also worth noting that the OECD BEPS Action Plan came into force in 2015. This includes Action Point 4 which sets out a best practice approach for countries to prevent erosion of the tax base through the use of interest expense. Section 25 in its current form was introduced by the Income Tax (Amendment) Act, 2018, 3 years after the BEPS Project. If there was any intention of the government, through the Ministry of Finance, which shapes the country's tax policy, to align section 25 with the BEPS Action Plan 4, the BEPS recommendations would have been fully adopted in the Income Tax (Amendment) Bill that was tabled before the Legislature and eventually passed in the form of the Income Tax (Amendment) Act, 2018. However, this was not the case.

In the case of ***Rwenzori Bottling Company Ltd v Uganda Revenue Authority TAT 21 of 2021***, the Tribunal held:

“When interpreting a statute words should be given their ordinary meaning...The Tribunal cannot subtract, or read out from the Act what is already in. The work of the Tribunal is to interpret statutes as clearly stated and not to legislate.”

In the circumstances, we find that the Respondent rightly the assessed and taxed the Applicant. The Tribunal therefore makes the following orders:

- (i) This application is dismissed.
- (ii) The Applicant is liable to pay the tax assessed.
- (iii) Costs are hereby awarded to the Respondent.

Dated at Kampala this 12th day of June 2025.



MS.CRYSTAL KABAJWARA
CHAIRPERSON



MS. STELLA NYAPENDI CHOMBO
MEMBER



MS. GRACE SAFI
MEMBER

