

THE REPUBLIC OF UGANDA
IN THE TAX APPEALS TRIBUNAL OF UGANDA AT KAMPALA
APPLICATION NO. 34 OF 2021

CAPITAL SHOPPERS LIMITED ===== APPLICANT
VERSUS
UGANDA REVENUE AUTHORITY ===== RESPONDENT

BEFORE: DR. ASA MUGENYI, DR. STEPHEN AKABWAY, MR. SIRAJ ALI

RULING

This ruling is in respect of an application challenging an assessment of Pay As You Earn (PAYE) of Shs. 140,403,000 on transport allowance and income tax assessment of Shs. 600,000,000 and VAT of Shs. 360,000,000 arising from re-characterization of loan as income.

The applicant operates a supermarket. In March 2020, the respondent conducted an audit on the applicant's tax affairs for March 2012 to December 2019. It assessed the applicant tax of Shs. 6,984,601,254. The respondent recharacterized loans from a director and Iffley Ventures Limited. The respondent also alleged that the applicant paid transport allowances to its employees at an average of Shs. 7,500 per day. It also alleged that the applicant availed its directors motor vehicles for their private use. Upon reconciliation the PAYE assessment was reduced to Shs. 140,403,000 and VAT to Shs. 360,000,000.

Issues .

1. Whether the applicant is liable to pay the tax assessed?
2. What remedies are available to the parties?

The applicant was represented by Mr. Cephass Birungyi, Ms. Belinda Nakiganda and Mr. Oscar Kamusiime while the respondent by Ms. Diana Mulira Kagonyera and Ms. Patricia Ndagire.

The applicant's first witness, Mr. Ponsiano Ngabirano, is managing director, testified that the applicant was audited by the respondent for 2016 to 2019 and assessed tax of Shs. 11,393,453,318 for PAYE, corporation tax and VAT. He stated that the applicant objected. The respondent issued an objection decision maintaining assessments of PAYE of Shs. 140,403,000, corporation tax of Shs. 600,000,000 and VAT of Shs. 360,000,000. He stated that the applicant agreed to pay the corporation tax without prejudice because it could not show how a director's loan of Shs. 2,000,000,000 was transferred from Rwanda to Uganda. The witness stated that the applicant objected to the VAT assessment of Shs. 360,000,000 following re-characterization of the director's loan to sales. The applicant objected to the PAYE in its letters of 12th May and 15th June 2020. He stated the applicant paid its employees a monthly lump for transport, depending on where they stayed between Shs. 5,000 to Shs. 7,000. He did not say that he was paying them an extra allowance for transport.

The applicant's second witness, Mr. Jacob Ngobi, an associate at Abet & Company, an accounting firm, testified that he reviewed the applicant's management accounts for the period ending 30th April 2015 to establish the completeness, accuracy and correct classification of transactions and balances. He testified that during the audit he noticed borrowings classified under bank overdraft, bank loans, director's loans and shareholders' funds. He testified that the managing director availed documentation for the bank overdraft and the loan but did not provide any documents for the director's loan because the money was received in cash. He stated that he analyzed the cash flow statement and was able to confirm through the audit that the director's loan was injected into the business.

The respondent's witness, Ms. Vivian Adong, a supervisor in its international tax unit testified that in March 2018 the respondent conducted a review of the applicant's tax affairs for March 2012 to December 2019. As part of the review the applicant was requested to complete an Associated Party Disclosure Form (Disclosure form). The applicant declared directors' loans of Shs. 2,000,000,000 for 2015 out of which Shs. 1,000,000,000 was from Ponsiano Ngabirano, Shs. 600,000,000 of Eva Ngabirano and

Shs. 400,000,000 of Maburisi Kedresi. The applicant's income tax return for 2015 revealed a net increase in long-term unsecured liabilities due to related party loans of Shs. 2,000,000,000 which was consistent with the applicant's said disclosure. The parties held a meeting on 19th April 2018 where the applicant's managing director was requested to submit additional information concerning the director's loan from Iffley Ventures and from Rwanda. The respondent sought further information in respect of the Iffley loan from the United Arab Emirates and the British Virgin Islands through the exchange of information mechanism. The information received was shared with the applicant. The respondent also requested the applicant to provide documentary proof to support the loan of Shs. 2,000,000,000. The applicant's officials failed to provide a bank statement to show how the loan was disbursed because the loan was received in cash. The applicant's officials were not aware of the legal requirement to fill in customs disclosure forms when receiving monies from a foreign country. The applicant stated that the funds were a share of the inheritance of one its directors realized through a sale of property in Rwanda. The applicant failed to provide information relating to the estate, the will and the general probate process. As a result of the applicant's failure to provide the said information the said loan was re-characterized by the respondent as undeclared income on which VAT and corporation tax was accordingly assessed.

The witness testified further that the respondent also established that the daily transport allowances paid to employees were not being declared by the applicant in the PAYE returns. The PAYE assessment arose from a confirmation by the managing director in a meeting of 19th April 2018 that the employees were paid transport allowances between Shs. 5000 to Shs. 10,000 per day. The respondent used an average of Shs. 7500 for 20 working days which formed a basis of the PAYE assessment. The respondent assessed the applicant tax of Shs. 11,393,453,318 comprised of corporation tax for 2015 of Shs. 7,077,103,077, VAT for April 2015 of Shs. 3,899,204,238 and PAYE for January 2016 to December 2018 of Shs. 417,146,003. The applicant objected to the said assessments. On 12th April 2021, the respondent issued an objection decision partially allowing the objection with PAYE of Shs. 140,403,000, corporation tax of Shs. 600,000,000 and VAT

of Shs. 360,000,000. The witness stated that the applicant only disputes the PAYE and VAT assessments.

The respondent's second witness, Mr. Abert Muhwezi, an officer in its objections and appeals unit testified that the applicant was assessed PAYE, VAT and Corporation tax for March 2012 to December 2019. He stated that an additional PAYE was imposed on the applicant because it was paying transport allowances to its employees. The applicant's director during audit stated that all its staff received a daily transport allowance of between Shs. 5,000 and Shs. 10,000 depending on the distance travelled by each employee. The VAT and corporation tax was imposed due to the failure by the applicant to support a purported loan from its director which was re-characterized as sales. During the objection process the respondent requested for documents in respect of the transport expenses but none were provided. The witness testified that the objection team disallowed the objection on the ground that transport allowance is taxable. He stated further that the applicant's officials informed the objection team that the director's loan of Shs. 2,000,000,000 was brought in cash from Rwanda. There was no documentary evidence of the transfer of the money. The loan was from a sale of property inherited by one of the applicant's directors. The objection was partially allowed and assessments for PAYE of Shs. 140,403,000, corporation tax of Shs. 600,000,000 and VAT of Shs. 360,000,000 were issued.

The applicant submitted that transport allowances incurred by its employees is an allowable deduction under the Income Tax Act and therefore not liable to tax. It cited S. 19(2)(d)(i) of the Income Tax Act which states that employment income of an employee does not include any allowance given for, and which does not exceed the cost actually or likely to be incurred, or a reimbursement or discharge of expenditure incurred by the employee on accommodation and travel expenses while undertaking travel in the course of performing duties in employment. The applicant submitted that it provides transport allowances to its employees for each working day.

The applicant submitted further that the respondent was wrong to re-characterize its directors' loans into income. It submitted a query was raised in respect of an increase in directors' loans from Shs. 5,805,711,000 in 2014 to Shs. 6,805,711,000 in 2015. It submitted that the loan was a share of a director's inheritance from Rwanda which he injected into business. No receipts or paperwork were given to the director in respect of the inheritance hence it could not provide documentary proof. However, the financial statements indicated the director's loan. The cash flow statement in the audited financial statement confirms that the loan was injected into the business as cash. The applicant submitted that under Ugandan law payments can be made in cash. It is not illegal to receive business financing in cash. It submitted that the increase in the director's loan which amounted to Shs. 1,000,000,000 was reflected in the balance sheet while tax items which are reflected in the profit and loss account show an increase in sales from the previous year of Shs. 9,905,032,000. The applicant submitted that the respondent's act of re-characterizing the loan amounts to the taxation of capital and creates distortion in the balance sheet. The applicant submitted that the Income Tax Act imposes tax on specific income of the business and a director's loan is not an income of the business.

The applicant submitted that for the respondent to re-characterize a transaction under S. 91(1)(a) and (c) of the Income Tax Act, it must be shown that the transaction was entered into as part of a tax avoidance scheme or a transaction that does not reflect its substance. It submitted that it should be shown that the transaction either led to the understating of sales or overstated expenses. The applicant stated that the respondent had failed to prove that the transaction in question had led to a reduction in the tax to be paid by the applicant. It submitted that it acted transparently by duly declaring the said director's loan in its income tax returns and financial statements. The applicant cited *John Livingstone Okello v. The Commissioner General Uganda Revenue Authority* to support the argument that by filing and paying its declared taxes a tax payer is deemed to have discharged the burden of producing documents for the purpose of showing the source of income. It submitted that its returns were not rejected by the respondent for being inadequate or challenged for being incorrect or incomplete. The applicant submitted that the

assessment of Shs. 600,000,000 on a disputed figure of Shs. 1,000,000,000 was not founded on any tax rates in the Income Tax Act.

The applicant submitted that VAT is not due on the loan even if it was re-characterized. It submitted that the respondent in a management letter dated 16th August 2020 imposed VAT on director's loan which was considered as undeclared sales. The respondent failed to address how undeclared sales could generate VAT. The applicant submitted further that the VAT Act does not provide for re-characterization of any transaction. The VAT assessment arose from an income assessment which is untenable as the two taxes are governed by different principles. The applicant submitted that under S. 4 of the VAT Act, VAT is charged on either a taxable supply, an import of goods or services. The applicant stated that the nature of good which the applicant is claimed to have supplied has not been specified by the respondent thereby creating uncertainty as the VAT regime provides for exempt, standard rated and zero-rated goods. It cited *Mukwano Enterprises v URA* in support of the argument that once the VAT Act does not specifically provide for re-characterization then the respondent cannot re-characterize under the VAT Act.

The applicant also cited *Kyotera Victoria Fishnets Ltd v The Commissioner URA & Another* HCCS 224 of 2014 to contend that the burden of proof shifts to the respondent to prove the nature of goods supplied and that the supply actually took place. The applicant submitted that there is no evidence by the respondent on the nature of goods the applicant is deemed to have supplied. The respondent had failed to prove any variances in the applicant's sales which suggests that the applicant had duly declared all its taxes. The applicant submitted therefore that it is not liable to pay the VAT of Shs. 360,000,000 as there was no supply.

The applicant prayed for a declaration that it is not liable to pay PAYE of Shs. 140,403,000 and that the applicant received a director's loan which was unlawfully re-characterized as income by the respondent. The applicant also prayed for a refund of Shs. 600,000,000 with interest at 2% per month from the date of payment until payment in full. A further declaration that the respondent unlawfully re-characterized the loan under the VAT Act

and that no VAT is payable on the said loan. General damages of Shs. 200,000,000 for unlawfully re-characterizing the loan and losses arising.

The respondent submitted that the applicant is liable to pay PAYE of Shs. 140,403,000. It submitted that it established from the applicant's Associated Party Disclosure form that the latter provides transport allowance of between Shs. 5,000 to 10,000 per day to its employees. The respondent conducted a further review which revealed that the said transport allowances were not declared by the applicant in its PAYE returns. It accordingly issued an additional assessment on the PAYE. The respondent submitted that the applicant objected to the said additional assessment but failed to provide documentation to support the amount of transport allowance paid. The respondent calculated an average transport allowance for all the employees on the payroll. It arrived at the said sum by using the best information available to it. The respondent relied on S. 42(1)(a) of the Tax Procedures Code Act and *Tembo Steel Uganda Ltd v URA* Civil Appeal. 77 of 2011. The respondent submitted that the applicant's submission that the transport allowances were incurred when travelling thus an allowable deduction is attempted by it to depart from its pleadings. The respondent cited *Interfreight Forwarders (U) Ltd v East African Development Bank* Civil Appeal 33 of 1992. The applicant did not clearly state the actual figure that the employees were given and that the said allowances were not declared in the PAYE returns. The applicant did not provide information requested by the respondent to support its claim thereby leaving the respondent to use an average of Shs. 7,500 as the amount paid to the applicant's employees.

The respondent submitted that the applicant is liable to pay income tax of Shs. 600,000,000 that was imposed following the re-characterization of its director's loan. The respondent submitted that the income tax of Shs. 600,000,000 did not form part of the objection decision neither was it raised by the applicant in its application for review nor during scheduling. The respondent submitted further that there was no mention of the said tax during the hearing and no evidence was adduced in respect of it. It submitted further that the issue of corporation tax came up in the witness statement of AW1 Ponsiano Ngabirano where he stated that the applicant agreed to pay the corporation tax

without prejudice because it could not show how the money was transferred from Rwanda to Uganda. The respondent argued that under S. 16(4) of the Tax Appeals Tribunal Act the tribunal is bound to conduct a review of the actual objection unless it adds new issues. It cited *Interfreight Forwarders (U) Ltd v East African Development Bank (supra)* to argue that parties ought not to depart from their pleadings.

The respondent submitted that under S. 91 of the Income Tax Act where a taxable person has a transaction the form of which doesn't reflect the substance the Commissioner has the authority to re-characterize the transaction. It cited *Akinsete Syndicate G.M v Senior Inspector of Taxes Akure, Supreme Court of Nigeria, F.S.C. 164/63; All Nigerian Tax Cases page 161, Downtown Forex Bureau Ltd & Others v URA Application 4 of 2012* and *URA v Downtown Forex Bureau Ltd and 2 others*. It submitted that the re-characterization of the transaction was based on contradictory statements of the applicant as to the source of the funds and failure to show any documentary proof. The contradictory statements were that: The funds were carried in cash from Rwanda, the applicant was not aware of the requirement to declare funds in Custom Form D. The applicant did not have any details regarding the estate of the managing director's father-in-law, the funds loaned to the applicant was sourced through the sale of property in Rwanda which had been inherited by the managing director's wife, from her grandfather. Documentary evidence in support of the estate and the sale of the property could not be obtained because of the poor relations between Uganda and Rwanda during the time in question. The correspondence by the applicant dated 12th May 2020, stated that the funds were brought into Uganda by the managing director's father-in-law and not by the directors. AW1 testified that the sum of Shs. 2,000,000,000 was brought by bus and given to him. The respondent submitted that taking into consideration the discrepancies relating to the source of the funds the loan was re-characterized as income.

The respondent submitted that once the loan was re-characterized as income, it was deemed to be from a sale of goods which attracted VAT. The respondent conceded that the VAT Act does not provide for re-characterization but stated that the re-characterization was not done under the VAT Act but under the Income Tax Act. The

respondent cited Sections 4 (a), 5(1)(a), 6, 10(1), 18, 21 and 24(1) of the VAT Act to argue that VAT is a tax payable by any person fully registered who makes a taxable supply. The respondent submitted that the applicant owns a supermarket whose sole business is the sale and supply of goods which include exempt, standard rated and zero-rated goods. It submitted that the inclusion of a loan in a financial statement did not by itself turn it into a loan. The respondent submitted further that the assertion by the applicant that there was no variance in the sales and income tax ledger to warrant an assessment of income tax is irrelevant since the assessment was as a result of a re-characterization. The respondent submitted therefore that the need to specify the goods in respect of which VAT was imposed does not arise considering that the VAT also arose from a re-characterization of the loan into income. The respondent submitted that the applicant failed to provide proof of the loan, how and when it was disbursed.

In rejoinder, the applicant submitted that it objected to the re-characterization of its director's loan by letter dated 12th May 2020 and through an online objection. It submitted that it applied to the tribunal for review of the income tax assessment of Shs. 600,000,000 and that during the trial both the applicant's and respondent's witnesses testified on the issue. The applicant paid Shs. 600,000,000 as part of the 30% of the tax in dispute without which it could not have been heard by the tribunal. The applicant submitted that it objected to assessments which were for income tax, PAYE and VAT.

The applicant submitted that the issue relating to the PAYE assessment is a point of law which can be raised at any time. It denied that it submitted an Associated Party Disclosure form stating that it provides transport allowance to its employees. It did not make any disclosures in the said form. It stated that the respondent sent minutes to the applicant's managing director who unknowingly signed them without realizing that they included a statement that the applicant provides transport allowance to its employees.

Having listened to the evidence and read the submissions of the parties, the following is the ruling of the tribunal.

“deemed” creates a fiction which makes something exist which did not and could not exist before...” In *Anyang` Nyongo and others v Attorney-General and Others 2007 2 EA 5* (EACJ) the East African Court of Justice stated that “We agree that the word `deemed` is commonly used both in principal and subsidiary legislation to create what is referred to as legal or statutory fiction. The legislature `uses the word for the purpose of assuming the existence of a fact that in reality does not exist.” As can be seen above, the power to `deem` rests with the legislature. Thus under S. 24(5) of the VAT Act, VAT charged by a contractor to a licensee is deemed paid and therefore the contractor is not required to pay the VAT it would otherwise have paid, in the absence of the deeming provision. In this case the respondent had no authority to deem, that the applicant’s director’s loan which had been re-characterized as sales, gave rise to VAT. Such an assessment could only have been made by the respondent on the basis of a deeming provision clearly set out in an Act of Parliament. As is apparent no such deeming provision exists in the VAT Act.

One of the canons of taxation is certainty. The taxpayer should know how much tax, what tax and why it is paying the tax. The problem with recharacterization of income for VAT purpose arises from the nature of supplies. Under the VAT Act, VAT is charged on standard rated and zero rate supplies while exempt supplies attract no VAT. If the respondent was to recharacterize income, in order to charge VAT, there has to be evidence on the nature of supplies, the applicant made. Suppose the applicant made zero rated and exempt supplies only, would VAT be due.? In this case, there is no evidence that the applicant was only making standard rated supplies. In the absence of such evidence the Tribunal cannot say that the VAT of Shs. 360,000,000 is due

In respect of the PAYE assessment of Shs. 140,403,000, the applicant submitted that the transport allowance of Shs. 5000 to its employees per working day is provided in the course of its business and is an allowable deduction and is accordingly not taxable. This contradicts the testimony of the Mr. Ponsiano Ngabirano, the applicant’s managing director that the admission that the applicant paid transport allowance was as a result of miscommunication between him and the respondent. The applicant denied that it made a disclosure in its Associated Party Disclosure form stating that it provides transport

allowance to its employees. It further submitted that the respondent sent minutes to its managing director who unknowingly signed them without realizing that they included a statement that it provides transport allowance to its employees. An extract of the minutes of minutes of the reconciliation meeting between the respondent's and applicant's officials on 7th September 2020, exhibit REX4, states

"The taxpayers tax agent explained that the company used to pay transport allowance between 5000 Uganda Shillings and 10,000 Uganda Shillings. At a later date the company decided to include it as part of gross salary. Therefore, the salary paid to staff is a consolidated pay."

While citing S. 19(2)(d)(i) of the Income Tax Act, the witness stated that the transport allowance was a re-imbusement of the cost of transport depending on where each staff came from or lived. The applicant tendered in a board resolution, Exhibit A1 which showed that the board on 1st May 2017 resolved that staff shall be paid transport allowance of Shs. 5,000 per working day. To be more precise, the board resolution reads.

"It was resolved that

1. The staff shall be paid a transport allowance of 5000 (Five Thousand) Uganda Shillings per working day."

The evidence of the applicant is full of contradictions. Therefore, if there was any miscommunication, it was ironed out by the board resolution. There is no doubt that the applicant was paying its staff transport allowance.

The outstanding issue is whether the transport allowance should be considered as employment income of the employees and PAYE is payable. S. 19 of the Income Tax Act reads

"(1) Subject to this section, employment income means any income derived by an employee from any employment and includes the following amounts, whether of a revenue or capital nature—

- (a) any wages, salary, leave pay, payment in lieu of leave, overtime pay, fees, commission, gratuity, bonus or the amount of any travelling, entertainment, utilities, cost of living, housing, medical or other allowance;
- (b) the value of any benefit granted;

A reading of the said Section shows that the amount of any travelling is considered as employment income. However, S. 19(2)(d) of the Act provides exceptions. It states as follows:

- (2) Notwithstanding subsection (1), the employment income of an employee does not include-

Under S. 19(2)(d) it states

“(d) any allowance given for, and which does not exceed the cost actually or likely to be incurred, or a reimbursement or discharge of expenditure incurred by the employee on-

- (i) accommodation and travel expenses; or
- (ii) meals and refreshment,

While undertaking travel in the course of performing duties of employment.”

The said Sections are clear. Emphasis should be on the underlined. Transport allowances paid while one is undertaking travel in the course of performing his or duty of employment is not considered as employment income.

A perusal of the resolution and the minutes do not show that the transport allowance paid to the applicant's employees was for travel in the course of performing duties of employment. There is no evidence that the applicant's employee was traveling upcountry or elsewhere to perform tasks or duties. The fact that transport allowances being deductible does not bar a taxpayer from withholding PAYE on the allowance. In *Goal Relief Development Organization v Uganda Revenue Authority* Application 77 of 2021 the Tribunal emphasized that “What is important to note is that if an expense is an allowable deduction, it does not make it exempt from PAYE.” While the resolution put the transport allowance at Shs. 5,000 per working day, the minutes had put it somewhere between Shs. 5,000 and Shs. 10,000. The respondent used an average of Shs. 7,500 per working day. The applicant is not challenging the quantum but the principle that it should not pay PAYE. The tribunal has stated that the applicant has to pay PAYE on the transport allowance which was not for performing duties in the course of employment. Therefore, the applicant is obliged to pay PAYE of Shs. 140,403,000

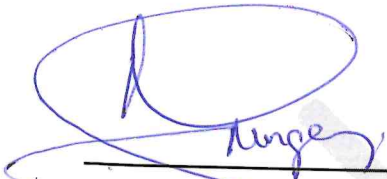
The respondent already submitted that the question relating to the re-characterization by the respondent of the applicant's director's loan of Shs. 2,000,000,000 to sales on Shs.

600,000,000 did not form part of the applicant's pleadings nor the objection decision. For purposes of emphasis that the applicant did not dispute it, the Tribunal shall make orders in respect thereof.


Taking the above into consideration, this application is partially allowed with the following orders;

1. The applicant is liable to pay the corporate tax assessment of Shs. 600,000,000.
2. The applicant is liable to pay the PAYE assessment of Shs. 140,403,000.
3. The applicant is not liable to pay VAT of Shs. 360,000,000 on the re-characterization of its director's loan.
4. The respondent is awarded three quarters ($\frac{3}{4}$) of the costs of this application.

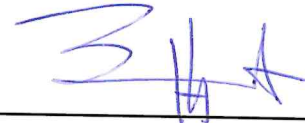
Dated at Kampala this 28th day of August 2023.



DR. ASA MUGENYI
CHAIRMAN



DR. STEPHEN AKABWAY
MEMBER



MR. SIRAJ ALI,
MEMBER