

THE REPUBLIC OF UGANDA
IN THE TAX APPEALS TRIBUNAL AT KAMPALA
APPLICATION NO. 265 OF 2022

KALANGALA INFRASTRUCTURE SERVICES LIMITED..... APPLICANT

VERSUS

UGANDA REVENUE AUTHORITY.....RESPONDENT

BEFORE: MS. CRYSTAL KABAJWARA, MR. SIRAJ ALI, MRS. CHRISTINE KATWE

RULING

This ruling is in respect of a withholding tax assessment of Shs. 1,284,961,527 arising from interest paid in by the Applicant on a loan from Emerging Africa Infrastructure Fund (EAIF), an entity that is based in Mauritius.

1. Background Facts

The Applicant deals in the business of developing public infrastructure with maiden projects in Kalangala. The Applicant obtained loans in the form of debentures from Nedbank Limited and Emerging Africa Infrastructure Fund (EAIF) in the amount of USD 5,000,000 and USD 7,000,000 respectively and paid interest on the loans of Shs. 9,350,898,000 and declared the said interest in the tax returns as exempt.

On 31 May 2022, the Respondent issued an additional withholding tax (WHT) assessment of Shs. 1,872,938,802 on the grounds that the Applicant failed to withhold in accordance with the law. The Applicant objected on grounds that the interest paid to EAIF was exempt from tax under Section 83 (5) of (currently 82 (5)) the Income Tax Act (ITA). The Respondent issued an objection decision partially allowing the objection in the amount of Shs. 588,013,276 for the period when the Applicant was not registered for WHT and maintained tax of Shs. 1,284,961,527.

2. Issues for determination

The main issue for determination by the Tribunal is whether interest payments made by the Applicant to EAIF are exempt from withholding tax.

3. Representation

The Applicant was represented by Ms. Jackie Aturinda and Ms. Linda Mugisha while the Respondent was represented by Ms. Gloria Twinomugisha and Mr. Rodney Amanyamba Mushambi.

The Applicant's sole witness was Mr. Ken Mwesigwa Rwomushana, the Finance and Administrative Manager of the Applicant. He stated in his witness statement that the Applicant entered into a Public Private Partnership with the Government of Uganda to undertake infrastructure improvements on Bugala Island which included the construction and expansion of the main island road, construction of a power generation plant and distribution lines, expansion of water supply and provision of ferry transport services between the main land and the island.

For purposes of undertaking the projects, the Applicant issued a loan note to Nedbank Limited in the amount of USD 12,000,000. Nedbank Limited was only able to raise USD 5,000,000 and engaged Emerging Africa Infrastructure Fund (EAIF) to finance the balance of the Facility. Between 2015-2020, the Applicant paid interest for both noteholders to Nedbank Limited in the amount of USD 4,216,861.72.

The witness testified that the Respondent issued an additional WHT of Shs. 1,872,938,802 on the grounds that the Applicant failed to withhold tax in accordance with section 82 (5) of the ITA.

The witness further testified that the assessment was raised from interest paid by the Applicant to Emerging Africa Infrastructure Fund (EAIF), a company resident in Mauritius that provides long-term commercial debt to deliver inclusive and impactful infrastructure projects in Africa. The Applicant objected to the assessment on the ground that the interest paid to EAIF is exempt from WHT under Section 83 (5) of the ITA as the loan was obtained from EAIF, a financial institution registered outside Uganda.

The Respondent's first witness was Mr. Brian Mugasa, an Officer in the Business policy, Ruling and Interpretation department. He testified that EAIF does not meet the public offer test in paragraph 4 of Income Tax practice Note of 24 July 2006. According to the test, the loan ought to have been issued to a reasonable number of people operating in

a capital market, to several investors with a history of previous acquisition of debt instruments or debentures, as a result of negotiations of the loan in a public forum used by financial markets dealing in debt instruments or to a dealer, manager or underwriter for the purpose of placement of the debt instrument. For an institution to be of a public character, it should render services to the public and there is no beneficial interest in it vested in any private person.

He further stated that there is no evidence of public placement of the debt to meet the public offer test and therefore, the interest payment in question is not exempt from WHT.

4. Submissions of the Applicant

The Applicant submitted that it is not liable for the withholding tax assessed because the interest paid to EAIF is exempt under Section 82 (5), of the ITA. The section provides as follows:

"Interest paid by a resident company in respect of debentures is exempt from tax under this Act where the following conditions are satisfied -

- a) debentures were issued by the Company outside Uganda for the purpose of raising a loan outside Uganda;*
- b) the debentures were widely issued for the purpose of raising funds for use by the Company in a business carried on in Uganda or the interest is paid to a bank or a financial institution of a public character; and*
- c) the interest is paid outside Uganda."*

The Applicant submitted that it is not in dispute that EAIF is a non-resident company, incorporated and resident in Mauritius and the debenture was issued outside Uganda. The debentures from which the interest arises meet the requirement under Section 82(5)(a) hence the interest paid is exempt.

Further, Section 82(5) (b) of the Income Tax Act provides:

"The debentures were widely issued for the purpose of raising funds for use by the Company in a business carried on in Uganda or the interest is paid to a bank or a financial institution of a public character".

The Applicant submitted that the interest in question qualifies for the exemption because it was paid to the Emerging Africa Infrastructure Fund (EAIF), a financial institution of public character. The Applicant submitted that a financial institution is defined under Section 2(dd) of the Income Tax Act as:

"Any person carrying on the business of receiving funds from the public or from members through the acceptance of money deposits repayable upon demand, after a fixed period, or after notice, or any similar operation through the sale or placement of bonds, certificates, notes or other securities, and the use of such funds either in whole or part for loans, investments or any other operation authorized either by law or by customary banking practices for the account and at the risk of the person doing such business".

The Applicant submitted that EAIF provides long-term commercial debt to deliver inclusive and impactful infrastructure projects in Africa. It is regulated by the Mauritius financial services regulator and holds a category one Global Business License: AGBC1 licensed by the Financial Services Commission of Mauritius as a closed end fund.

The Applicant submitted that EAIF receives funds from the public and private sources, namely UK Aid, Sweden, Ministry of Foreign Affairs of Netherlands, FMO Entrepreneurial Development Bank, KFW, African Development Bank, Allianz Global Investors and standard chartered bank. EAIF pays back the money received from its subscribers after a specific agreed time. It also raises funds investment, securities, bonds, certificates and notes. The funds are used to provide long-term commercial debt to deliver inclusive and impactful infrastructure projects in Africa. The debt issued is paid back by the Applicant at an agreed time at an agreed interest rate. According to the registration status, nature of business and operations of EAIF, as demonstrated above, the company is a financial institution.

Public Character

The Applicant submitted that 'an institution of public character' is defined under Paragraph 3(b) of the Practice Note issued on 24 July 2006 as:

"An institution of public character - The benefit provided must be to the public at large or at least to a sufficient section of the Community."

The Applicant submitted that EAIIF funds infrastructure projects for different governments in Africa, including social infrastructure, power, digital communications, water sewerage and transportation. The benefit provided by EAIIF funding is open to any country looking for debt financing for infrastructure projects in Africa; the infrastructure developed by the recipients benefits the citizens in the respective countries and is available for use by all members of the public.

The Applicant submitted that the loan issued was used to provide a benefit to a sufficient section of the public being citizens of Uganda and was also available to any member of the public that met the set criteria of the fund. The Applicant submitted that the interest in question was paid to EAIIF through Nedbank, both of which are companies that are residents outside Uganda and therefore qualifies for exemption and therefore meets the criteria under Section 82 (5) (b).

Double Taxation Agreement between Uganda & Mauritius

The Applicant submitted that without prejudice to the above, there is a Double Taxation Agreement (DTA) between Uganda and Mauritius, Article 11 provides:

1. *"Interest arising in a Contracting State and paid to a resident of the other Contracting State may be taxed in that other State.*
2. *However, subject to the provisions of paragraph 3, such interest may also be taxed in the Contracting State in which it arises and according to the laws of that State, but if the recipient is the beneficial owner of the interest the tax so charged shall not exceed 10 per cent of the gross amount of the interest".*

The Applicant submitted that according to Article 11, the state where the person receiving the interest resides in Mauritius must tax the interest earned in the other Contracting State. However it allows Uganda to tax the interest, but the tax rate cannot exceed 10% of the gross interest amount if the recipient is the beneficial owner. The Applicant cited Section 88 (2) of the Income Tax Act which provides:

"The terms of the international agreement to which Uganda is a party prevails over the provisions of the ITA in case the terms of the international agreement are inconsistent with the provisions of the Act."

The Applicant submitted that it was Respondent's testimony during cross-examination that the DTA was reviewed during the audit, but a rate of 15% was applied in arriving at the assessment, which is incorrect. The Applicant prayed that the Tribunal declares that the Applicant is not liable to pay the tax assessed of Shs. 1,284,961,527 and that the Respondent refunds 30% amounting to Shs. 440,723,213 with interest from the date it was deposited.

5. Submissions of the Respondent

The Respondent submitted that the Applicant is liable to pay withholding tax on interest payments. **Section 82 (1)** of the Income Tax Act states:

"Subject to this Act, a tax is imposed on every non-resident person who derives any dividend, interest, royalty, rent, natural resource payment agency fee in the case of Islamic financial business, or management charge from sources in Uganda".

Whereas the Applicant contends that the interest payments are exempt from withholding tax premised on the provision of **Section 82 (5) of the ITA**, the Respondent submitted that the debenture issued does not fulfil the mandatory conditions stipulated in the above provision.

Does interest on the debenture satisfy the exemption condition?

The Respondent submitted that the debenture issued by the Applicant to Nedbank Limited was not widely issued and does not satisfy the conditions of exemption envisaged under the Income Tax Act. Section 82 (5) (b) of the ITA states:

"Interest paid by a resident company in respect of debentures is exempt from tax under this Act where the following submissions are satisfied;

b) The debentures were widely issued for the purpose of raising funds for use by the company in a business carried on in Uganda or the interest is paid to a bank or financial institution of a public character and"

The Respondent cited **Black's Law dictionary 8th** edition which defines issue as:

"To send out or distribute officially".

The Respondent cited **AFGRI Uganda Limited V URA** where it was held:

"Therefore, that portion of Section 83(5) that requires a debenture to be widely issued, meant that it has to be issued to different individuals, that is to the public as opposed to a loan that is between two parties. The debenture between the Applicant and Afgri Mauritius cannot be considered to be one issued widely. It is between two parties, actually one debenture holder. Therefore, the loan or debenture between the Applicant and Afgri Mauritius fail to meet the condition in Section 83(5)(b) of the Income Tax Act".

The Respondent submitted that the Applicant issued a loan note to Nedbank Limited for the amount of USD 12,000,000. Therefore, the debenture was issued to Nedbank Limited and not the public in general or to multiple lenders. The debenture issued did not satisfy the condition of **Section 82 (5) (b) of the Income Tax Act.**

Whether the lenders are financial institutions of public character?

The Respondent submitted that EAIF is neither a bank nor a financial institution of public character within the meaning of the Income Tax Act, and the interest payments thereto are not exempt. The interest payments to Nedbank Limited, which is a bank within the meaning of the Income Tax Act, are not in issue and objection was allowed to that extent. The Respondent cited **Section 2 of the Income Tax Act** which defines a financial institution as:

"any person carrying on the business of receiving funds from the public or from members through the acceptance of money deposits repayable upon demand, after a fixed period, or after notice, or any similar operation through the sale or placement of bonds, certificates, notes or other securities, and the use of such funds either in whole or part for loans, investments or any other operation authorized either by law or by customary banking practices, for the account and at the risk of the person doing such business".

The Respondent submitted that by the definition in the ITA, financial institutions are of a public character, given the fact that the services are accessible to the general public. The Respondent submitted that there are three qualifying factors of financial institutions, that is, source of funds, usage of the sourced funds and lending to the general public. There is no dispute about the first two qualifiers, that is; sourcing funds from members and usage of the funds solely for lending for profit. What is in contention is whether EAIF meets the public character test.

Public character test

The Respondent submitted that financial institutions are not engaged in activities that provide public benefits. The public character test in the context of financial institutions requires that financial services offered by the institution are accessible to the general public without any sectoral and or other preferential limitations to access the products/ services offered by such financial institution.

The Applicant's witness, AW1 in cross examination confirmed that EAIF is a lender for borrowers engaged in the public infrastructure development space. This is further affirmed by EAIF's profile that was tendered into evidence. The profile states that "EAIF mainly supports private sector infrastructure projects to create or expand existing facilities. The profile further affirms limitations in the sectors eligible to access financing including bulk storage, logistics & warehousing, transportation, renewable energy, digital communication infrastructure. This constitutes an admission that EAIF does not satisfy the public character test.

The Respondent submitted that from the above, it is evident that EAIF is limited in scope in terms of sectors and persons eligible to receive project financing. Therefore, EAIF is a specialized financial institution and not a financial institution of public character. Therefore, the interest payments do not qualify for exemption under Section 82(5)(b) of the Income Tax Act.

6. The Applicant's Submissions in Rejoinder

In rejoinder, the Applicant submitted that Practice Notes are the Commissioner's interpretation of the law and are binding on the Commissioner not the taxpayer. The Applicant submitted with regard to the condition for "widely issued", the law requires the taxpayer to satisfy only one of the conditions; either that the debentures were widely issued or that the payments were made to a financial institution of public character and not both. The Applicant submitted that EAIF is a financial institution of public character

7. The Determination by the Tribunal

Having read the submissions of both parties, this is the ruling of the Tribunal.

The Applicant entered into a Public Private Partnership with the Government of Uganda to undertake infrastructure improvements on Bugala Island which included the construction and expansion of the main island road, construction of a power generation plant and distribution lines, the expansion of water supply and the provision of ferry transport services between the main land and the island.

In furtherance of the above projects, the Applicant issued a loan note to Nedbank Limited in the amount of USD 12,000,000. Nedbank Limited was only able raise USD 5,000,000. It then engaged other financiers including Emerging Africa Infrastructure Fund (EAIF) to finance the remainder, being USD 7,000,000.

This kind of arrangement is called syndicating, wherein a lead bank, in this case, Nedbank Limited arranges financing from other banks. Syndication is undertaken when a loan is too large or risky for a single lender. This allows the lender, in this case, Nedbank to spread risk and take part in financial opportunities that may be too large for their individual capital base.

Between 2015-2020, the Applicant paid interest to Nedbank Limited in the amount of USD 4,216,861.72. This amount was made up of both Nedbank and EAIF's share of the interest.

The Applicant treated the interest payment as exempt from withholding tax in accordance with Section 82 (5) of the ITA. However, the Respondent issued a WHT assessment in respect of the portion of interest that was attributable to EAIF. The Respondent's position is that EAIF does not qualify for the WHT exemption available under Section 82 (5) of the ITA.

Section 82 (5) of the ITA

Section 82 (5) of the Income Tax Act provides:

"Interest paid by a resident company in respect of debentures is exempt from tax under this Act where the following conditions are satisfied –

- a) *debentures were issued by the Company outside Uganda for the purpose of raising a loan outside Uganda;*
- b) *the debentures were widely issued for the purpose of raising funds for use by the Company in a business carried on in Uganda or the interest is paid to a bank or a financial institution of a public character; (it should be noted that part b offers two options namely “widely issued” or “public character.” The Applicant’s arguments are based on the latter.)*
- c) *the interest is paid outside Uganda.”*

What is the significance of section 82(5)?

Uganda is a net importer of capital. This means that the total amount of capital flowing into the country from foreign sources is greater than the amount of capital flowing out. This is because the country’s domestic investment needs exceed its national savings. Therefore, the country must attract foreign funds to finance its development.

The capital that we import comes at a cost. Therefore, as far as is possible, it is important to reduce the cost of capital. Taxation is a tool through which this can be achieved. Section 82 (5) is one of such provisions. It is aimed at facilitating the raising of capital outside Uganda from foreign lenders. By exempting interest income paid to qualifying financial institutions who meet the criteria in the provision, the government aims to incentivize such foreign lenders to lend to Ugandan projects.

Such external financing is often used to fund infrastructure projects, which are too risky for ordinary banks to finance. Currently, infrastructure development in areas such as roads, integrated transport, hospitals, ICT and digital technology is a government priority.

It is worth mentioning that the word “infrastructure” appears 355 times in the National Development Plan III.

Analysis of the conditions under section 82 (5)

We shall now analyse each of the conditions under Section 82 (5) to determine whether EAIF meets them.

- a) **Debentures were issued by the company outside Uganda for the purpose of raising a loan outside Uganda**

Section 1 of the ITA defines a debenture to include:

"Any debenture stock, mortgage stock, loan, loan stock or any similar instrument acknowledging indebtedness, whether secured or unsecured."

Black's Law dictionary 8th edition at page 430 which defines a debenture as;

"A debt secured only by the debtors earning power, not by a lien on a specific asset. An instrument acknowledging such a debt".

The Applicant raised a loan outside Uganda by issuing loan notes to EAIF, an entity that is based in Mauritius. Therefore, the Applicant satisfied this condition.

- b) **The interest is paid to a bank or a financial institution of a public character**

This is the main point of disagreement. The Respondent argues that EAIF is not a financial institution of a public character because it only offers infrastructure related loans. The Applicant disagrees. Therefore, we must determine whether EAIF is a financial institution.

Section 2 of the Income Tax Act which defines a financial institution as:

"any person carrying on the business of receiving funds from the public or from members through the acceptance of money deposits repayable upon demand, after a fixed period, or after notice, or any similar operation through the sale or placement of bonds, certificates, notes or other securities, and the use of such funds either in whole or part for loans, investments or any other operation authorized either by law or by customary banking practices, for the account and at the risk of the person doing such business".

The Applicant submitted that EAIF is a financial institution that is licensed by the Financial Services Commission of Mauritius. It collects funds from public and private sources and provides long term debt. The Respondent did not dispute this fact. Therefore, based on the evidence adduced, we can conclude that EAIF is a financial institution.

Public character

The dispute primarily revolves around the public character attributes of EAIF. The phrase “public character” is not defined in the ITA. However, it has been defined by the Respondent in their Practice Note of 24 July 2006. It is worth stating at this point that Practice Notes set out that Respondent’s interpretation or guidance regarding a certain provision of the tax law. While they are binding on the Respondent, they are not binding on the taxpayer. Nonetheless, we find it necessary to consider the Practice Note.

The Note defines the phrase “financial institution of a public character” as follows:

“An institution of public character - The benefit provided must be to the public at large or at least to a sufficient section of the Community.”

Therefore, to qualify, the following conditions must be met:

- (i) The institution must provide a benefit; and
- (ii) The benefit must be to the public at large; or to a sufficient section of the community.

The word “benefit” is defined by the Black’s Law Dictionary, 9th Edition at page 188 to mean:

“The advantage or privilege something gives; the helpful or useful effect of something.”

Further, the adjective “public” is defined at page 1422 to mean:

“Of relating to, or involving an entire community, state or country; open or available for all to use, share or enjoy.”

When all this is brought together, the question that we must now ask, is whether the financing that EAIF extends gives an advantage or privilege or is helpful or useful to an entire community, state or country.

What does EAIF do?

The Applicant submitted that EAIF funds infrastructure projects for different governments in Africa, including social infrastructure, power, digital communications, water sewerage and transportation.

We have looked at the EAIF website and have indeed confirmed that it does all the above in Africa.

In this particular case, the financing that was extended by EAIF to the Applicant was for purposes of funding infrastructure projects in Uganda, particularly for the benefit of the people of Kalangala, a community in Uganda.

Therefore, we are satisfied that EAIF does indeed provide a benefit to the public at large or at the very minimum, a sufficient section of the public.

It is important to note that the wording used in the Practice Note is “*sufficient section of the community*”.

The Respondent has argued that restricting financing to infrastructure projects negates the public character of a lender. However, they do not tell us what they consider to be “sufficient section of the community” for this purpose. What is the threshold? Is it 100 people? 1000? 100,000? 1,000,000?

The Respondent interprets the phrase “financial institution of a public character” to mean that the lender should be accessible to the entire public either in terms of deposits or borrowings. However, this is a thin argument. The public is not one homogeneous body. It comprises of various persons e.g. individuals, body corporates, limited liability partnerships. These persons come in different shapes and sizes in terms of demographics, income levels etc. In addition, they have different aspirations. Some aspire to be small traders, while others, like the Applicant aspire to build social infrastructure in hard-to- reach places like Kalangala.

The fact that EAIF caters to a section of the public such as the Applicant’s does not make EAIF less of an institution of public character than say an ordinary bank that only lends to small scale farmers.

Therefore, the restrictions on the purpose for which the borrowed funds are to be used to deny EAIF its public character nature. Besides, all financial institutions have similar restrictions.

The Respondent drew comparison with the case of *Afgri Uganda Limited v URA TAT Application 18 of 2019* where a debenture arrangement between two related entities, Afgri Uganda and Afgri Mauritius failed to meet the conditions in section 82 (5). There are differences between the Afgri case above and the present case. These are:

- (i) Afgri Mauritius was not a financial institution:
- (ii) It only lent to its related parties, i.e., only members of the Afgri family who included, Afgri Uganda;
- (iii) It did not open up its lending to third parties, namely persons not part of the Afgri group;
- (iv) Therefore, any benefit from its lending activities would have accrued only to Afgri Uganda and sister companies.
- (v) It is also worth pointing out that the Afgri case concerned the concept of “widely issued” rather than an “institution of public character”.

In the present case however, EAIF lends to any member of the public who intends to utilize the funds towards developing infrastructure projects in Africa.

c) The interest is paid outside Uganda

This is the last condition. In the present case, the interest was paid to Nedbank, a bank that is based in South Africa. Nedbank then passed on the interest to EAIF, in Mauritius, in line with the syndicated arrangement.

Therefore, the interest was paid outside Uganda.

Conclusion

In view of the above analysis, we are satisfied that EAIF met all the conditions stipulated in Section 82 (5) of the ITA. Therefore, it was not liable to withholding tax on the interest income earned from funding extended to the Applicant.

Therefore, it follows that the Applicant is not liable to pay the withholding tax which arose from the purported failure to withhold.

The Uganda Mauritius Double tax agreement (DTA)


We have taken note of the Applicant's submissions concerning the Uganda – Mauritius DTA. It is correct that Article 11 allows Uganda to tax such income at a rate that does not exceed 10%. The treaty rate prevails over the domestic withhold tax rate of 15%. This is as per the provisions of Section 88 (2) of the ITA which provides that the terms of an international agreement prevail over the provisions of the ITA.

However, it should be noted that a tax treaty does not impose tax. It merely allocates taxing rights. Since in the present case, we have found that EAIF meets the criteria in section 82 (5) and is therefore exempt from withholding tax, it follows that the provisions of the DTA do not apply to the current circumstances.

Therefore, the application is hereby allowed and we make the following orders:

- (i) The applicant is not liable to pay the assessed tax;
- (ii) The Respondent should refund the 30% of the tax in dispute; and
- (iii) Costs are awarded to the Applicant.

Dated at Kampala this 12th day of March 2025.



CRYSTAL KABAJWARA
CHAIRPERSON



SIRAJ ALI
MEMBER



CHRISTINE KATWE
MEMBER

