THE REPUBLIC OF UGANDA

IN THE TAX APPEALS TRIBUNAL AT KAMPALA

TAT APLICATION NO. 201 OF 2022

LOCAL WORKS LIMITED.. APPLICANT

VERSUS

UGANDA REVENUE AUTHORITY..RESPONDENT

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

RULING

This ruling is in respect of an application disputing an additional income tax assessment of Shs. 233,805,988, arising from a variance of Shs.779,353,296 between revenue declared for income tax purposes and sales declared for VAT purposes for the financial year 2019/2020.

1. Background

The Applicant, a construction company in Uganda, entered into a long-term turnkey contract in September 2019 with Friends of Mustard Seed (the Employer) to construct a school. The contract provided for payments based on achieved milestones.

In the 2019/2020 financial year, a variance of Shs. 779,353,296 was identified between the Applicant's VAT sales and its declared income tax sales. This led the Respondent to issue an additional income tax assessment of Shs. 233,805,988, which the Applicant objected to. The Applicant claimed that the variance stemmed from deferred income related to the Mustard Seed Junior School construction project.

The Applicant's financial statements for the year ending 30 June 2020 reported Shs. 1,754,463,884 in sales revenue, including Shs. 762,620,536 in deferred income arising from the contract with Friends of Mustard Seed.

On 24 March 2022, the Respondent issued an income tax assessment based on the variance of Shs. 779,353,296. The Applicant objected in April 2022, asserting that the variance was due to advances received under the construction project in 2019-2020, which were earned in 2020-2021 and treated as deferred income.

The Respondent requested the Applicant's bank statements and sales ledgers, which were provided. However, on 4 July 2022, the Respondent issued an objection decision, disallowing the objection, stating that "the undeclared invoices related to the period in which they were assessed," without specifying the invoices involved.

Dissatisfied with the Respondent's decision, the Applicant appealed to the Tribunal for review of the decision.

2. Issues for Determination

The issue for determination by this Tribunal is whether the Applicant is liable to pay the tax liability as assessed by the Respondent.

3. Representation

The Applicant was represented by Mr. Cephas Birungyi, Mr. Ian Mutibwa, Ms. Belinda Cheptoek and Ms. Racheal Kembabazi, while the Respondent was represented by Mr. Barnabas Nuwaha.

The Applicant's first witness was Mr. Wilson John Sendikwanawa (AW1), its director as well as the Project Manager for the construction of Mustard Seed Junior School. AW1 testified that the Applicant entered into a turnkey contract with Friends of Mustard Seed, under which payments were milestone-based.

AW1 submitted that the Applicant issued invoices for milestone payments, but these included advance payments meant for future work.

The witness further testified that the Audited Financial Statements and revenue recognition documents from Mazars BRJ, the Applicant's auditors justified the deferred income of Shs. 762,620,536.

The witness also testified that all deferred income was declared in the following financial year, which the Respondent failed to consider. Additionally, he presented bank statements showing that funds were held in the Applicant's account and had not been used for completed milestones during the assessment period. He concluded that the tax assessment was erroneous and should set aside.

The Applicant's second witness was Major James Mutabazi, its tax advisor (AW2). He testified that VAT and income tax follow different recognition principles, with VAT being payable upon invoicing while income tax is assessed when revenue is earned. He maintained that the variance between VAT and income tax sales was expected due to the timing differences in revenue recognition. AW2 further testified that the deferred income of Shs. 762,620,536 was documented in the financial statements and that the Applicant had provided sales ledgers to URA upon request. He concluded that the Respondent's assessment was based on incorrect assumptions and should be set aside.

The Respondent's witness was Mr. Patrick Echasa, a supervisor in the Respondent's Domestic Taxes Department. The witness testified that the Respondent's audit established that the Applicant had declared VAT on payments received in 2019/2020 but had failed to include the same figures in its income tax returns. He stated that under Section 42 of the Income Tax Act, a taxpayer using the accrual basis must recognize income when it is earned, and since VAT had already been declared on these transactions, the corresponding income should have been taxed in the same period. He referenced the audit report highlighting the undeclared invoices.

The witness testified that the Applicant had issued invoices amounting to $804,817.04, but bank statements showed receipts of $804,592.04. He further stated that the Applicant did not account for $310,184 of the contract sum despite the same having been earned in the financial year 2019/2020.

4. The submissions of the Applicant

The Applicant's Counsel submitted that the additional income tax assessment was unlawful and should be set aside on the following grounds:

The Applicant contended that under Section 43 of the Income Tax Act, revenue from long-term construction contracts should be recognized based on the percentage-of-completion method. The Applicant's financial statements (Exh. A-15, Joint Trial

Bundle, p. 583) and invoices (Exh. A-10, Joint Trial Bundle, p. 380-440) supported its claim that income was properly accounted for.

The Applicant further contended that the funds in dispute were classified as deferred income and were recognized in the subsequent financial year. This was evidenced by the Applicant's audited accounts (Exh. A-16, Joint Trial Bundle, p. 590) and revenue reconciliation documents (Exh. A-21, Joint Trial Bundle).

The Applicant submitted that VAT is payable upon invoicing (Section 14 of the VAT Act), while income tax is based on actual revenue earned. Consequently, a variance was expected between VAT returns and income tax returns.

The Applicant also submitted that the Respondent did not identify which invoices were undeclared, nor did it use the documents submitted in its assessment (Exh. A-19, Joint Trial Bundle, p. 616). Under Section 19 of the Tax Procedures Code Appeals Tribunal Act, the burden of proving the correctness of an assessment lies on the Respondent.

The Applicant submitted that it had provided sufficient documentary evidence, including its bank statements (Exh. A-15, Joint Trial Bundle, p. 474) and contract documents (Exh. A-1, Joint Trial Bundle, p. 29), to demonstrate that the assessment was erroneous.

The Applicant further stated that enforcing the assessment would result in double taxation, as the same income would be taxed twice in different financial years.

5. Submissions of the Respondent

The Respondent's argued that under section 28 of the Tax Procedures Code Act, the burden of proof lies with the taxpayer to demonstrate that an assessment is incorrect. This position was affirmed in ***Williamson Diamonds Ltd v. Commissioner General [2008] 4 TLR 197*** **and** ***Uganda vs. Gurindwa and 5 Others (HCT-00-AC-0070 OF 2012),*** where it was held that the taxpayer must prove they do not owe the assessed taxes.

Further, the Respondent cited ***Kampala Nissan vs. URA (High Court Civil Appeal No. 07 of 2009)***, where the court ruled that statutory tax obligations must be fulfilled unless the taxpayer can prove otherwise. The Respondent submitted that the

Applicant failed to provide sufficient evidence to refute the assessment of Shs. 233,805,988.

The Respondent relied on section 43 of the Income Tax Act, which mandates accrual-basis taxpayers to recognize income based on the percentage of contract completion. In confirmation of this position, the Respondent cited ***Bank of England v. Vagliano Bros 1891 AC 107*** and ***Uganda Revenue Authority vs. Balondemu David HCCA No. 2 of 2023***, where it was ruled that statutory provisions must be applied based on their plain meaning.

In support of progressive revenue recognition, the Respondent referred to ***Commissioner of Income Tax vs. Bilahari Investment P Ltd (2008) 299 ITR 1 (SC)*** and ***Arthur Murray (NSW) Pty Ltd v. FCT 114 CLR 314***, which held that income must be recognized when all obligations under a contract are fulfilled. The Respondent contended that the Applicant had issued invoices and received payments in 2019/2020 and should have recognized this income in that financial year rather than deferring it.

The Respondent also presented evidence from Patrick Echasa, Supervisor, Domestic Taxes Department, who testified that the Applicant had declared VAT on payments received but failed to report corresponding income for tax purposes. He referred to Exhibit A-13, Joint Trial Bundle, p. 474, which listed undeclared invoices, and Exhibit RE7, Respondent's Supplementary Exhibits, p. 672, containing an invoice omitted from income tax declarations.

Basing on the above analysis, the Respondent maintained that the Applicant's failure to declare this income led to the variance between VAT and income tax returns, thereby justifying the additional assessment.

The Respondent further made reference to RW1's testimony where he testified that while the Applicant provided invoices for VAT declarations, it did not furnish corresponding income tax declarations. The Tribunal was referred to Exhibit A-10, Joint Trial Bundle, p. 380-440, showing seven invoices issued and paid for in 2019/2020 but not declared for income tax purposes. The Respondent argued that allowing the Applicant's deferral method would lead to tax distortions and revenue loss.

Further, the Applicant had a contractual obligation to invoice and receive payments only upon milestone completion, which meant that the amounts were fully earned and should have been recognized for tax purposes in 2019/2020.

The Tribunal was urged to uphold the assessment as lawful and justified. The Respondent also referenced ***Maritime Electronic Company Ltd vs. General Dairies Ltd [1937] 1 All ER 748*** and ***Arthur Murray (NSW) Pty Ltd v. FCT 114 CLR 314***, which emphasized that income is taxable once earned, regardless of internal accounting treatment. Given the Applicant's failure to justify its tax position, the Respondent submitted that the assessment should stand, and the Applicant should be held liable for the tax due.

6. Submissions of the Applicant in Rejoinder

In rejoinder, the Applicant contended that the key issue in dispute was not whether tax must be paid but rather when it should be accounted for. It argued that sections 4 and 15 of the Income Tax Act are general charging provisions, whereas section 43 specifically governs long-term contracts and should take precedence.

The Applicant submitted that the Respondent misapplied section 43 by basing the assessment on the percentage of payment rather than the percentage of completion, citing ***Uganda Revenue Authority vs. Balondemu David HCCA No. 2 of 2023***, where the High Court underscored that tax statutes must be interpreted in accordance with their actual provisions. The Applicant further referred to ***Arthur Murray (NSW) Pty Ltd v. FCT (114 CLR 314)***, where the court ruled that income must be recognized only when contractual obligations have been fulfilled, supporting its argument that revenue should be deferred until work is completed.

The Applicant's Counsel emphasized that its revenue recognition was consistent with Generally Accepted Accounting Principles (GAAP), IFRS 15, and section 40 of the Income Tax Act, which governs accrual accounting. It reiterated that advance payments received were properly treated as deferred income and only recognized upon milestone completion.

The Applicant cited ***Commissioner of Income Tax vs. Bilahari Investment P Ltd. (2008) 299 ITR 1 (SC)***, which affirmed that revenue recognition in long-term contracts must align with actual project progress. The Applicant also relied on ***Steel Corporation of East Africa v. URA HCT CA of 2010*** **and** ***J.K Patel v. Spear Motors***

Ltd SCCA No. 4/1991, both of which reaffirmed the principle that the burden of proof rests with the taxpayer, but once a taxpayer presents evidence supporting their position, the tax authority must justify its assessment with substantive proof.

The Applicant argued that the Respondent's failure to apply the prescribed formula under section 43(2) of the Income Tax Act, which determines taxable income based on contract completion rather than cash receipts, rendered the assessment flawed.

Regarding the variance between VAT and Income Tax returns, the Applicant argued that VAT is accounted for upon invoicing, while income tax is based on work performed.

Counsel pointed out that section 4 of the VAT Act mandates VAT payment upon issuance of an invoice, whereas section 43 of the Income Tax Act ties income tax to project completion. The Applicant refuted the Respondent's claim that it failed to provide supporting documentation, citing Exhibits 474-564, 574-598, and 614 of the Joint Trial Bundle, which contained financial statements, sales ledgers, and invoices. The Applicant submitted that the Tribunal should dismiss the assessment as erroneous and uphold the principle that long-term contracts should be taxed in accordance with section 43 of the Income Tax Act.

7. Determination by the Tribunal

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

The matter concerns the recognition of income by the Applicant, that is, whether the income was recognised in the correct year of income.

The Applicant is a provider of construction services and was awarded a contract to construct a school. According to the contract, the Applicant was paid an advance for purposes of mobilisation. The Applicant was also paid agreed upon sums based on the completion of specified milestones.

The Respondent carried out an audit and established variances between the Applicant's income tax declarations and VAT refunds. Specifically, for the 2019/2020 year of income, the Respondent established that the Applicant's revenue for income tax purposes was understated by Shs. 779,353,296, which gave rise to a tax liability of Shs. 233,805,988.

The Applicant argued that the variance arose from deferred income which was earned in the subsequent year, FY 2020/2021 and income tax was paid accordingly. According to the Applicant, the deferred income arose primarily from the initial advance payment, which although received by the Applicant, was not the income of the Applicant until the specified milestones had been completed. The Applicant stated that the unutilised advance payment was therefore unearned income, which was not subject to tax in the current year, FY 2019 / 2021.

The Respondent argued that the income ought to have been recognised in FY 2019/2020 as all milestones had been met and the work completed. Therefore, the income was earned in 2019/2020 and should not have been deferred to the subsequent year.

Both parties relied on Section 43 of the Income Tax Act, which provides as follows:

"(1) In the case of an accrual basis taxpayer, income and deductions relating to a long-term contract are taken into account on the basis of percentage of the contract completed during the year of income."

A long-term contract is defined to mean:

"a contract for manufacture, installation or construction or, in relation to each, the performance of related work which under the contract commenced, other than a contract estimated to be completed within six months of the date on which work under the contract commenced."

It is not in contention that the Applicant entered into a long-term contract. What is in contention is whether the works under the contract were completed within the 2019/2020 year of income to warrant the corresponding income to be taxable in that period.

We have looked at the contract and the payment schedules thereunder as well as the invoices that were issued by the Applicant. These are summarised below.

Item	Milestone	Amount excl. VAT	Invoice date	Completion date
1.	Advance payment (mobilisation)	$245,762	16 September 2019	-
2.	Milestone 1	$114,406.78	15 November 2019	16 November 2019
3.	Milestone 2	$114,406.78	15 January 2020	31 December 2019
4.	Milestone 3	$59,322	1 February 2020	31 January 2020
5.	Milestone 4	$64,775	24 March 2020	24 March 2020
6.	Milestone 5			30 May 2020
7.	Milestone 6	$72,033	8 June 2020	6 June 2020

The Applicant's year of income runs from 1 July – 30 June. Based on the above schedule of milestones, completion of works and invoicing, all works were completed in the period 1 July 2019 – 30 June 2020.

The dispute however centres on the treatment of two things - the advance payment and milestone six.

Advance payment

In construction contracts, advance payments are repaid through proportional deductions in interim payments (milestones). Deductions are normally made at the amortisation rate stipulated in the particular conditions which are applied to the amount otherwise due until such time as the advance payment has been repaid. If the contract does not state the amortisation rate, it is calculated by dividing the total amount of advance payment by the contract price, which is then applied to the amount otherwise due ***(Understanding Clauses in FIDIC 'Conditions of Contract for EPC / Turnkey Projects', first edition, 1999)***

The Applicant submitted as follows:

"It was agreed that from the monies remitted to the Applicant...part of it would be treated as advance payments for the commencement of works of the next milestone / level of construction while some of the money would be allocated to expenses and income earned by the Applicant...accordingly, the balance would be carried forward as a cumulative advance amount to be used for completion of the remaining milestones of the project."

We do not agree with the Applicant.

We have perused the contract and nowhere in the contract is the above agreement documented.

According to Clause 19 of the construction contract, an advance payment was to be made to enable the Applicant mobilise and commence the works. No where is it stated that the advance payment would be carried forward cumulatively and utilised against due milestone amounts.

This is further corroborated by the invoices for the respective milestones. If the intention was to utilise the advance payment towards subsequent milestones, the invoices for the respective milestones would indicate deductions against the outstanding amounts for the respective milestones. Instead, each completed milestone was invoiced for fully, demonstrating that the advance was not to be utilised against future invoices.

Further, the practice in the industry is for contractors to issue Employers with interim payment certificates which show the allocation of the advance payments against the various milestones. None of this was presented in evidence. The Applicant exhibited (AExh3) excel workings showing the advance payments. This is an internal computation that appears to have been prepared as an after thought rather than as part of the Applicant's invoicing arrangements with the Employer.

Therefore, the only inference that can be drawn is that the advance payment was a one-off payment for mobilisation and commencement of works. The amount was invoiced for on 16 September 2019 and as mobilisation and commencement of works occurred before the first milestone, it follows that mobilisation was completed within the 2019/2020 year of income. Therefore, the advance payment was fully earned.

Milestone six – USD 85,000 (incl. VAT)

The Applicant's position is that milestone six, which was invoiced from on 6 June 2020 was correctly accounted for in the subsequent year of income 2020/2021.

We do not agree with the Applicant. This is because delivery of milestone six was duly completed on 6 June 2020 and this fell within the 2019/2020 year of income.

We have taken note of the case of **Arthur Murray (NSW) Pty Ltd v FCT (114 CLR 314)** which the Applicant cited as follows:

"Advance payments were not immediately assessable as income. Instead, they were considered unearned income until the services were provided.... income must be recognised when it has come home to the taxpayer, meaning all obligations must be met before the revenue is deemed earned."

In the present case, the Applicant met all the obligations concerning the respective milestones and went ahead to invoice for each successfully completed milestone. Therefore, all income earned in respect of completed milestones and obligations was earned income. The position would be different, if, for example, invoices were issued in advance of completion, in which case, the amounts invoiced would be apportioned between the completed works and the incomplete works.

In the present case, since completion preceded invoicing, the Respondent was correct in treating all the income in 2019/2020 as having been earned in the year in which the respective milestones were completed, that is 2019/2020.

Therefore, we find that the Respondent was justified in treating the income as having been earned and taxable in 2019/2020.

Remedies

It is not disputed that the Applicant eventually recognised the deferred income of Shs. 762,620,536 in the subsequent year of income 2020/2021. At the hearing of the case, AW1 testified as such and this has not been controverted by the Respondent.

Consequently, there was a timing difference between when the income ought to have been declared and taxed and when it was actually declared and taxed.

We therefore agree with the Applicant that it would amount to double taxation if the same income were to be subjected to tax for the 2019/2020 year of income, when it has already been taxed in respect of the 2020/2021 year of income.

In the circumstances, the remedy that is available to the Respondent is to charge interest and penalties for late payment of the income tax in accordance with Section 148 of the Income Tax Act and section 60 of the Tax Procedure Code Act.

In the circumstances, the Application is dismissed and the Tribunal makes the following orders:

(i) The Respondent was justified in treating the income as having been earned in 2019/2020 year of income.
(ii) The assessment of Shs. 233,805,988 is hereby set aside as the corresponding income was subsequently taxed in 2020/2021.
(iii) The Respondent should compute the interest and penalties arising from non-payment of tax in accordance with sections 148 of the Income tax Act and Section 60 of the Tax Procedure Code Act, where applicable.
(iv) The Applicant shall pay the interest and penalties so computed by the Respondent.
(v) Costs are hereby awarded to the Respondent.

Dated at Kampala this 11th day of April 2025

CRYSTAL KABAJWARA	**SIRAJ ALI**	**CHRISTINE KATWE**
CHAIRPERSON	**MEMBER**	**MEMBER**