

THE REPUBLIC OF UGANDA
IN THE TAX APPEALS TRIBUNAL AT KAMPALA
TAT APPLICATION NO. 12 OF 2024

SAI OFFICE SUPPLIES LIMITED.....APPLICANT

VERSUS

UGANDA REVENUE AUTHORITY.....RESPONDENT

**BEFORE: MS. CRYSTAL KABAJWARA, MRS. KABAKUMBA MASIKO,
MS. ROSEMARY NAJJEMBA**

RULING

This ruling is in respect of an application challenging the Respondent's tax assessment of Shs.291,603,729 arising from interest restrictions under section 25 of the Income Tax Act ("ITA"). Specifically, the taxpayer disputes the treatment of carry forward losses as allowable deductions for purposes of computing Tax EBITDA.

1. Background Facts

The Applicant trades in office supplies, computers and stationery. In their final income tax return for the year 2019, the Applicant claimed an interest deduction / expense amounting to Shs.1,099,803,000. In determining their Tax EBITDA under section 25 of the ITA, the Applicant did not deduct carry forward losses on the understanding that they are not an allowable deduction in respect to the computation of Tax EBITDA.

Upon review, the Respondent found that the Applicants interest deduction was overstated as a result of having not included carry forward losses in the allowable deductions that are offset against gross income. This resulted in liability of Shs.291,603,729 which the Respondent assessed.

The Applicant objected to the Respondent's assessment and the Respondent issued an objection decision disallowing the Applicant's objection and maintaining the assessment.

2. Issues for determination

The issue to be determined is whether the applicant is liable to pay the tax assessed, specifically, whether carry forward losses form part of allowable deductions for purposes of section 25 of the ITA.

3. Representation

The Applicant was represented by Mr. Bruno Kalibala and Mr. Bruno Edwin Amanya while the Respondent was represented by Mr Barnabas Nuwaha.

Mr. Ankit Jangla, a Tax Consultant of the Applicant was the Applicant's sole witness. He stated in his witness statement that the Applicant trades in office supplies, computers and stationery. On 30 October 2023, the Respondent wrote to the Applicant stating that the Applicant overstated their interest expense. The Respondent reduced the net loss of the Applicant for the year 2019/2020 and issued with additional income tax assessments amounting to Shs.291,603,729 for the period 2020/2021 and 2021/2022

The witness further stated that the Respondent while computing tax EBITDA considered carry forward losses as a deduction, which was an erroneous application of section 25 of the ITA.

Mr. Solomon Musoke an Officer with the International Tax Division of the Respondent was the Respondent's sole witness. He stated in his witness statement stated that he reviewed the tax returns and declarations of the Applicant for period 2019 to 2022 which revealed that the Applicant over claimed an interest expense for the period 2019 to 2022. In computing the deductible interest expense, the Applicant did not deduct carry forward assessed losses in determining its Tax EBITDA as required by Section 25(3) of the Income Tax Act.

4. Submissions of the Applicant

The Applicant submitted that the gist of this Application is whether carry forward losses should be included in the computation of the current year's Tax EBITDA for purposes of determining the amount of allowable interest expenses for the current year under Section 25 (3) of the ITA.

The Applicant submitted that the losses should not be included in the computation of the current year's Tax EBITDA for purposes of determining the amount of allowable interest expenses for the current year.

The Applicant further submitted that the basis of its 's submission is threefold:

- a) Section 25 does not provide for the inclusion of losses carried forward from and relating to, the previous year as a deduction in calculating the current year's Tax EBITDA.
- b) Tax EBITDA is a derivation of a business's operating income less operating expenses for a particular year, thus rendering the inclusion of losses carried forward from and relating to the previous year in its computation erroneous.
- c) Treating losses carried forward from and relating to the previous year as an expense in determining the current year's Tax EBITDA results into an absurd application of the law.

The Applicant submitted that on the Legislative history and rationale for Section 25(3).

They stated that in 2018, Uganda phased out the thin capitalization rules and adopted the EBITDA based fixed ratio rules as recommended in the Organization for Economic Co-operation and Development ("OECD") Final Report on Action Point Four – Base Erosion and Profit Shifting issued in 2015 (the "**Report**").

Before the enactment of the current Section 25 (3) of the ITA in 2018, the ITA limited deductible interest under the framework of thin capitalization rules. The rules denied foreign-controlled companies (as defined in the ITA at the time) with a debt-to-equity ratio of more than 1.5 to 1 **at any time during a year of income**, a deduction for interest expenses on the part of the debt that exceeded the 1.5 to 1 ratio. However, this limitation did not apply if the company's amount of debt during the year did not exceed the arm's length debt amount, as defined within the ITA at the time.

The Report discouraged the use of the thin capitalization rules and recommended best practices in the design of rules to address base erosion and profit shifting using interest and payments equivalent to interest, by aligning interest deductions with taxable economic activity.

The Report recommended a fixed ratio rule as a substitute to, among others, the thin capitalization rules. The recommended fixed ratio rule limits an entity's net interest deductions to a fixed percentage of its EBITDA. The OECD observed, among others, that the fixed ratio rule is a straightforward rule to apply and ensures that an entity's interest deductions are directly linked to its economic activity and further, that it directly links the deductions to an entity's taxable income, which makes the rule reasonably robust against planning

The Applicant submitted that, the common thread cutting across both the thin capitalization rules and the EBITDA based fixed ratio rule is that factors affecting the amount of deductible interest in relation to a particular period are those occurring or pertaining to that particular period. In particular, whereas the thin capitalization rules focused on the level of debt above the fixed ratio for a particular period, the OECD's rationale for the EBITDA-based fixed ratio is to align interest deductions (for a particular period) with the corresponding taxable economic activity (occurring during that particular period).

In addition, the Applicant submitted that Section 25 does not provide for the inclusion of losses carried forward from and relating to the previous year as a deduction in calculating the current year's Tax EBITDA.

The Applicant quoted Section 25 (5) of the ITA which defines Tax EBITDA as the sum of:

- (a) gross income less allowable deductions, except a deduction under subsection (1);
- (b) depreciation; and
- (c) amortization

The Applicant submitted that the term "allowable deductions" as used the definition of Tax EBITDA above does NOT include losses carried forward from and relating to, the previous year.

The Applicant also submitted concerning Section 17(1) of the ITA which defines gross income of a person to mean income derived by the taxpayer during the year of income. Similarly, under section 22 (1) (a) of the ITA, allowable deductions are limited to such expenses and losses incurred by the person during the year of

income to the extent to which the expenditure or losses were incurred in the production of income included in gross income.

The Applicant relied on ***Uganda Revenue Authority v COWI A/S Civil Appeal 34 of 2020***, where the High Court while discussing the harmonious rule of statutory interpretation stated that;

“...The rule requires that a legislative instrument must be construed on the prima facie basis that its provisions are intended to give effect to harmonious goals.... The provisions of one statute should be interpreted in harmony with the tenor of the statutory provisions or the overall statutory purpose...”

The Applicant submitted that in view of Sections 17(1) and 22 (1) (a), for an expenditure or loss qualifies as an allowable deduction if it is incurred in the production of gross income for that particular period. For an expenditure or loss not incurred in the production of income (such ***losses carried forward from and relating to, the previous year***) to qualify as a deduction or expense for any particular purpose or determination under the ITA, whether in determining Tax EBITDA, chargeable income, or otherwise, the ITA must specifically provide that such expenditure or loss shall be treated as a deduction or expense for that particular purpose.

The Applicant contended that in this particular case, the ITA, particularly Section 25 (5) does not provide for the inclusion of previous year losses as deduction while determining Tax EBITDA. Had the legislature intended for *the losses carried forward from and relating to, the previous year(s)* to be included in the computation of Tax EBITDA, it would have stated so.

The Applicant submitted that losses carried forward from and relating to, the previous year(s) are a historical fact and are neither expenditures nor losses incurred by the person in the production of gross income for the current year.

As such, the Applicant submitted that losses carried forward from and relating to the previous year can only be considered as a deduction for purposes specifically mentioned in the ITA. In this particular case, for purposes of gross income in relation to Tax EBITDA under Section 25 (5), the ITA does not require that losses carried forward from and relating to the previous year be considered as a deduction against the gross income for purposes of Tax EBITDA.

The Applicant further submitted that Tax EBITDA is a derivation of a business's operating income less operating expenses for a particular year, thus rendering the inclusion losses carried forward from and relating to the previous year in its computation erroneous.

The Applicant further that Section 36 of the ITA which provides for carry forward losses to be deducted in the computation of chargeable income not Tax EBITDA. The purpose of allowing taxpayers to offset losses carried forward from and relating to the previous year(s) against the current year's taxable profits is to ensure that businesses are taxed on their net economic income over time, allowing them to recover initial investments or absorb cyclical downturns.

The Applicant submitted that using these same losses to limit the deductibility of genuinely incurred interest expenses as suggested by the Respondent results into manifest absurdity and incongruity, whereby, a taxpayer's loss position is used to further restrict the deductibility of genuinely incurred interest expense. This approach unfairly affects businesses that suffered genuine losses due to investment, economic downturns, or start-up challenges. The result is double jeopardy – disallowance of current interest based on prior losses already accounted for.

In conclusion the Applicant prayed that this Honourable Tribunal:

- a) Determines that carried forward losses are not allowable deductions in the computation of Tax EBITDA for purposes of Section 25 (3), (4) and (5).
- b) Consequently, it vacates the tax assessment of Shs.291,603,729.

5. Submissions of the Respondent

The Respondent submitted that the Applicant is liable to pay tax premised on the reading of Section 25 (5) of the Income Tax Act, which provision allows for the inclusion of carry forward losses in computing EBITDA under the provision as recomputed

Section 25 reads:

'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.'

In this Section (a) "tax earnings before interest, tax, depreciation and amortisation" means the sum of gross income less allowable deductions, except a deduction under subsection (1);

The Respondent invited the tribunal to consider the dictum of Justice Cornelia in ***Nile Breweries Ltd v URA Civil Appeal 0113 of 2023***, citing ***Cape Brandy Syndicate v IRC (1921) KB 64***. The aforementioned authorities are to the effect that there is no presumption regarding tax and that tax legislation must be strictly construed according to its precise language with nothing to be added or implied.

The Respondent relied on Section 25 (5) of the Income Tax Act which provides:

"In this section- (a) "tax earnings before interest, tax, depreciation and amortisation" means the sum of gross income less allowable deductions, except a deduction under subsection (1); depreciation; and amortisation."

The Respondent further submitted that section 15 of the Income Tax Act provides as follows with regard to chargeable income:

"Subject to Section 16, the chargeable income of a person for a year of income is the gross income of the person for the year less total deductions allowed under this Act for the year."

Further, Section 22 of the Income Tax Act which deals with allowable deductions provides:

*"Subject to this Act, for the purposes of ascertaining the chargeable income of a person for a year of income, there shall be allowed as a deduction (a) all expenditures and **losses** incurred by the person during the year of income."*

The Respondent also submitted that Section 38 of the Income Tax Act on carry forward provides:

*(1) Subject to this Section and Section 74, where, for any year of income, the total amount of income included in the gross income of a taxpayer is exceeded by the total amount of deductions allowed to the taxpayer, the amount of the excess, in this Act referred to as an assessed loss, **shall be carried forward and allowed as a deduction in determining the taxpayer's chargeable income in the following year of income***

Legislative rationale

The Respondent submitted that the legislative intent can be inferred from the long title of the Income Tax (Amendment) Act, 2018 which states:

"An Act to amend the Income Tax Act, Cap. 340 to provide for exception of expenditure incurred during a year of income in acquiring returnable containers as a deductible expense, to provide for taxation of income arising from change of ownership of a business; to redefine immovable property, to provide for restrictions on deductible interest..."

The Respondent submitted that the Report on the Income Tax (Amendment) Bill, 2018 under paragraph 5 reads: "To provide for restrictions on deductible interest;" The rationale from the aforementioned report and long title to the Act is crystal clear, the legislators intended to limit the amount of interest claimed as a deduction.

The Respondent further submitted that construing the Applicants tax affairs and interpretation of Section 25 to exclude carry forward losses would not only be in disregard of the aforementioned provisions governing allowable deductions but also allow for more interest claimable by the Applicant, which would defeat the intention of the legislators.

In ***Registered Trustees of Kampala Institute Vs Departed Asians Property Custodian Board SCCA No.21 of 1993*** Platt JSC observed at page 13:

"It is against the usual canons of construction to add words which are not there, unless there is a necessity to do so....." "The words of a statute never should in interpretation be added or subtracted from without almost a necessity."

The Respondent relied on Sections 15,22,25, 38 of the Income Tax Act which is to the effect that carry forward losses are allowable deductions in the computation of chargeable income when computing the chargeable income under Section 25 of the Income Tax Act.

In the circumstances the Respondent prayed that this Honourable Tribunal be pleased to find that the carry forward losses are allowable deductions in the computation of interest deductions under Section 25 of the Income Tax Act and the Respondent be awarded costs of the suit as against the Applicant.

6. Submissions of the Applicant in Rejoinder

The Applicant reiterates their earlier submissions regarding the issues raised and submitted that there was need for a holistic interpretation of sections 22, 25 and 36 of the ITA.

Indeed, in **Platinum Credit v URA TAT No 28 of 2018 (9 December 2020)**, this Honourable Tribunal held that;

"When interpreting a provision in an Act, it is necessary to read the other provisions of it. A taxing Act has to be considered as a whole..."

The Applicant reiterated its submission that upon a holistic interpretation of the applicable provisions of the ITA, it is clear that losses carried forward from, and relating to previous years should not be considered as deductions in the determination of Tax EBITDA.

In particular, Section 36 of the ITA provides for the deduction of carried forward losses from the chargeable income of a particular year. This however does not ipso facto mean that such losses are or should be treated as an allowable deduction for purposes of determining Tax EBITDA.

The Applicant submitted that Section 36 of the ITA limits the capacity in which losses carried forward from and relating to previous years can be allowed as deductions in the current year of income. These losses are only allowed as a deduction in the final determination of chargeable income for the current year. There is nothing either in section 36 or elsewhere in the ITA that permits the deduction of losses carried forward from and relating to previous years for the purposes of determining Tax EBITDA.

7. The determination of the Tribunal

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

The dispute concerns the interpretation of section 25 of the ITA which restricts the amount of interest that taxpayers who are members of a group may claim as deductions for income tax purposes. The claimable interest is limited to 30% of Tax EBITDA.

At the heart of this dispute is the definition of Tax EBITDA. Specifically, whether carried forward losses ought to be included in the definition of "allowable deductions" which are offset against gross income for purposes of computing Tax EBITDA.

For purposes of our analysis, we have reproduced the key relevant provisions of section 25 of the ITA below.

Section 25

“(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, 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 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 -

“Tax Earnings Before Interest, tax, depreciation and amortisation means that the sum of-

- (a) Gross income less allowable deductions, except a deduction under subsection (1)*
- (b) Depreciation; and*
- (c) Amortisation.”*

Purpose and context of section 25

The purpose of section 25 is to restrict interest deductions claimed by taxpayers who are members of a group. This is aimed at preventing such taxpayers from using interest payments to suppress their chargeable income. It has been recognised by tax authorities and affirmed by the OECD Report on Base Erosion and Profit Shifting that the use of third party and related party interest is one of the most used techniques of profit shifting in international tax planning.

With that in mind, in 2018, Uganda revised its interest limitation provisions from a balance sheet approach as was the case with the previous thin capitalisation rules that specified the maximum debt to equity ratio beyond which interest was non-deductible on a prorata basis. This was the position prior to 2018 before Uganda introduced the free cash flow / profitability approach as is currently expressed in section 25 of the Income Tax Act.

That said, it should be borne in mind that the overarching objective of section 25 is to limit / restrict interest deductions and reduce the opportunity for profit shifting via interest payments.

It is worth noting at this point that any excess interest can be carried forward for not more than three years. We shall return to this point later.

According to **Action 4 of the OECD BEPS Report on Limiting Base Erosion Involving Interest Deductions and Other Financial Payments:**

“... a fixed ratio rule which limits an entity's net interest deductions to a fixed percentage of its profit, measured using earnings before interest, taxes, depreciation and amortisation (EBITDA) based on tax numbers. This is a straightforward rule to apply and ensures that an entity's interest deductions are directly linked to its economic activity. It also directly links these deductions to an entity's taxable income, which makes the rule reasonably robust against planning. ... the best practice allows a country the flexibility to introduce rules based on earnings before interest and taxes (EBIT).”

The above statement is instructive. For one, it tells us that:

- (i) The fixed ratio rule aligns interest deductions to economic activity
- (ii) It links deductions to taxable income (which in Uganda's case is termed chargeable income as per section 15 of the ITA.
- (iii) It allows countries the flexibility to introduce rules based on EBIT. In other words, no one size fits all and countries are free to modify the rule as they deem fit.

Bearing the above in mind, we now turn to the determination of Tax EBITDA and whether carry forward losses should or should not be included in “allowable deductions” which are offset against gross income when determining Tax EBITDA.

We have already seen that the BEPS Action 4 states that the fixed ratio rule links interest deduction to both economic activity and taxable income.

Let's begin with taxable income. What is taxable income?

Any tax student will tell you by heart that taxable income is gross income less allowable deductions. This formula derived from section 15 of the ITA which provides:

“Subject to Section 16, the chargeable income of a person for a year of income is the gross income of the person for the year, less total deductions allowed under this Act for the year.”

What does this mean for our Tax EBITDA formular? It effectively covers section 5 (1) (a):

Tax Earnings Before Interest, tax, depreciation and amortisation means that the sum of-

(a) Gross income less allowable deductions...

Effectively, (a) deals with chargeable income as provided for by section 15 of the ITA. This is the same thing as “taxable income” as used by the OECD.

Allowable deductions

The next question then is, what are allowable deductions?

Allowable deductions are provided for by section 22 of the ITA which states as follows:

“(1) Subject to this Act, for the purposes of ascertaining the chargeable income of a person for a year of income, there shall be allowed as a deduction –

(a) all expenditures and losses incurred by the person during the year of income to the extent to which the expenditures or losses were incurred in the production of income included in gross income...”

The general rule of thumb is that all expenditures and losses incurred by a taxpayer during a year of income are allowable deductions save for those specifically mentioned under section 22 (2) as non-allowable.

It should also be noted that the purpose of section 22 is to determine the chargeable income of a person for a year of income.

In effect, section 22 (1) set down the general principle for allowable deductions. For this reason, section 22 (1) does not enumerate the different types of allowable deductions. However, sections 23 – 36 contains provisions which contain special considerations for certain types of allowable deductions. These provisions lay down the rules for the treatment of the specified allowable deductions. For example, while the general rule is that all expenditures and losses are allowable deductions, section 25 of the ITA caps interest deductions.

Another such provision is section 36 which deals with carry forward losses.

Carry forward losses

Section 36 of the ITA treats carry forward losses as an allowable deduction for

purposes of ascertaining chargeable / taxable income for a year of income. It provides:

“(1) Subject to this section and section 74, where, for any year of income, the total amount of income included in the gross income of a taxpayer is exceeded by the total amount of deductions allowed to the taxpayer, the amount of the excess, in this Act referred to as an assessed loss, shall be carried forward and allowed as a deduction in determining the taxpayer's chargeable income in the following year of income.

In effect, an assessed loss arises when the total deductions exceed the gross income. The resulting loss, is then treated as a carry forward loss, that is an allowable deduction in determining the taxpayer's future chargeable income.

Therefore, the determination of chargeable / taxable income for any year of income whether present or future requires that carry forward losses are treated as allowable deductions.

Having laid out the provisions of the law concerning the determination of taxable / chargeable income which is a key factor in the computation of Tax EBITDA, we now turn to the parties' arguments.

The Applicant has argued that carried forward losses should not form part of the allowable deductions for various reasons including:

- (i) Section 25 does not provide for inclusion of losses carried forward and relating to the previous year.
- (ii) Allowable deductions are limited to expenses incurred by the person during the year of income to the extent to which the expenditure was incurred in the production of income included in gross income (i.e. losses are a historical fact).
- (iii) Use of EBITDA is derived from a typical income statement

We do not agree with the Applicant for the following reasons.

- (i) On point (i) above, there was no need for the section 25 to specify carried forward losses since for they are treated as allowable deductions for income tax purposes.

In this regard, the cardinal principle pertaining to the interpretation of tax statutes laid out in the various precedents which authoritatively cite ***Cape Brandy Syndicate v IRC***

(1921) KB 64 is instructive - tax legislation must be strictly construed according to its precise language with nothing to be added or implied.

If the Legislature intended for carried forward losses to be excluded, the provision would have been worded to that effect as section 36 has historically existed in the ITA and carry forward losses have always been treated as allowable deductions.

- (ii) Regarding the second point, it is not correct that allowable deductions are only limited to expenses incurred during the year of income. A holistic and harmonious interpretation of the Act indicates that the section 22 (1) which contains the general rule that in respect of expenditures and losses incurred in the year of income is subject to other provisions of the Act such as section 36 which treats other items, such as carry forward losses, which may not have been incurred in the current year of income, as allowable deductions. The same principle would apply to section 25 of the ITA which allows the excess interest to be carried forward for not more than three years.

Therefore, the Applicant's argument that section 25 only applies to current year deductions does not hold since excess interest can be carried forward to future years of income.

It should also be noted that the primary purpose of deducting allowable deductions from gross income is to ascertain the chargeable income of a person for a year of income. The ascertainment of chargeable income for a year of income requires that all allowable deductions, whether from the current year or otherwise are deducted from gross income.

- (iii) On the third point regarding the typical income statement, we agree with the Applicant that EBITDA is derived from a typical income statement, which means that is derived from accounting EBITDA. However, it should be pointed out that the language used in section 25 of the ITA is "Tax EBITDA" which we believe differs from accounting EBITDA.

For example, this Tribunal dealt with section 25 in ***Rwenzori Bottling Co. Ltd v URA, TAT 21 of 2021*** where it agreed with the taxpayer that the Tax EBITDA formular includes tax depreciation as computed in accordance with sections 26, 27 and 29 of the ITA (as it then was). Tax depreciation differs from accounting depreciation.

In the same vein, deductions cannot be limited to current year expenses as is the practice in accounting. In effect, if the intention of the Legislature was for the provision to mimic the typical income statement, then the provision would have provided for EBITDA, which is an accounting concept and not Tax EBITDA.

On the point of economic activity can generate with taxable profits or tax losses. Where taxable profits are generated by a taxpayer, the interest restrictions under section 25 would most likely not come into play. However, if the taxpayer is loss making, it invariably follows that section 25 will serve its purpose to restrict interest deductions for loss making entities.

Therefore, the inclusion of carry forward losses in "allowable deductions" in the Tax EBITDA formula is in line with the treatment of such losses as allowable deductions income tax purposes.

In sum, we find the wording of section 25 clear and unambiguous without the need to add or subtract from them.

In view of the above, this application fails and is hereby dismissed with costs to the Respondent.

Dated at Kampala this 20th day of August 2025.



MS. CRYSTAL KABAJWARA
CHAIRPERSON



MRS. KABAKUMBA MASIKO
MEMBER



MS. ROSEMARY NAJJEMBA
MEMBER