THE REPUBLIC OF UGANDA

IN THE TAX APPEALS TRIBUNAL OF UGANDA AT KAMPALA

APPLICATION N0. 75 OF 2019

SMEC INTERNATIONAL LIMITTED.....APPLICANT

VERSUS

UGANDA REVENUE AUTHORITY..... RESPONDENT

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

RULING

This ruling is in respect to an additional income tax assessment for the period 2011-2016 of Shs. 2,015,322,525.30 arising from the disallowance by the Respondent of certain related party expenses incurred by the Applicant.

1. Background facts

The Applicant is a branch of a non-resident company based in Australia. The Applicant engages in the provision of engineering consulting services such as planning studies, feasibility studies, detailed engineering designs, project management, construction supervision, asset management and maintenance, environmental and social impact assessment.

The Respondent carried out a comprehensive audit for the period July 2011 to December 2016 and disallowed expenses related to head office cost allocation, head office support, overhead reallocation and regional office cost allocation.

The Respondent assessed the Applicant income tax of Shs. 2,575,670,684 and penalties of Shs. 2,006,884,435 for the period July 2011 to December 2016 on the basis that the Applicant had not furnished proof that the expenses relating to head office cost allocation and as a result, the Respondent was unable to establish whether the costs were actually incurred.

On 25 march 2019, the Applicant objected to the disallowed expenses relating to head office cost allocation, head office support, overhead allocation and regional office cost allocation. The grounds were:

(i) The costs were incurred and the amounts expensed represent the economic value that the branch received from the services rendered

(ii) The Applicant was already audited for transfer pricing purposes for the period 2009 – 2012 by the Respondent and it was unfair for that period to be audited again. Further, that some of the issues arising from the audit were settled before the High Court

(iii) Some assessments for June 2011 and 2016 were time barred as they should have been issued three years from the filing date.

The Respondent issued an objection decision disallowing the Applicant's objection because they could not establish whether the costs were incurred.

2. Issues for determination

The issue for determination by the Tribunal is whether the Respondent was correct in disallowing the head office costs allocated to the Applicant.

3. Representation

The Applicant was represented by Mr. Cephas Birungi and Ms. Belinda Nakiganda while the Respondent by Ms. Gloria Twinomugisha and Mr. Tony Kalungi.

Mr. Eric Misiani, the Applicant's Regional Manager, Africa Division, in his witness statement stated that the head office and regional office cost allocations were legitimate expenses incurred by the Applicant's head and regional offices to support the Uganda branch's operations.

He stated that these expenses included services from executives, finance, legal, and administrative staff that were allocated based on the level of activity and time spent on Ugandan projects, as documented in the timesheets and supporting records. The

Applicant argued that these costs were essential to the branch's functioning and met the criteria for allowable deductions.

Mr. Eric Lihuluku, the Applicant's second witness stated that the Ugandan branch receives support services from its head office and regional offices across Africa. He stated that for the period of July 2011 to December 2016, the Respondent conducted an audit and disallowed certain deductions related to expenses on head office cost allocation, head office support, regional office cost allocation, and other overloads. According to the Applicant, these costs reflect the economic value received by the branch and should be allowable deductions in determining its taxable income.

Mr. Solomon Musoke, the Respondent's witness, stated that the Applicant failed to provide sufficient evidence that these expenses were incurred specifically for generating income in Uganda, as a requirement under section 22 of the Income Tax Act.

During Cross examination, Mr. Eric Misiani confirmed that it is currently the regional office in Kenya that supports the Ugandan branch. At the time of the dispute, the regional office was based in Tanzania. He also confirmed that the head office issues invoices for the support rendered to Uganda.

Mr. Eric Misiani further confirmed that the Applicant is Registered in Uganda as a branch and the head office in Australia. During re-examination he stated that the overhead costs allocation comprises of salaries of the team working at head office and regional office who allocates costs to the Applicant.

Mr. Eric Misiani explained that the overhead costs are the costs not directly attributable to the project. Individuals incur these costs to support these projects in Uganda. For example, Legal reviews legal processes of the contract clause while the Tax Team review tax clauses and the Commercial team reviews the viability of the proposed projects.

He further explained that the Applicant operates as an engineering construction firm designing information projects, supervising and implementing of projects. The firm certifies works done on behalf of the client and other works.

Mr. Eric Lihuluku explained that the corporate overhead costs amounting to 34,000 Australian dollars represent costs which are coming from Australia. The divisional management costs of Shs. 277,683 represent costs which are from South Africa and Kenya. However, the Tribunal noted that the issues of cost allocation are not in dispute, what it needed was proof of payment which the witness indicated to be on page 695.

3. The Submissions of the Applicant

The Applicant broke down their submissions along three lines, namely:

(i) Whether the assessment for the period 2011 – 2016 issued on 7 February 2019 were time barred;
(ii) Whether the Applicant is entitled to deductions of head office cost allocation, head office support, overhead reallocation and regional office cost allocation; and
(iii) Whether the re-auditing of the period 2009 – 2012 was lawful

(i) Assessments are time barred

The Applicant submitted that section 23 (1) of the Tax Procedure Code Act ("TPCA") grants the Commissioner powers to issue additional assessments. However, section 23 (2) (b) limits the time to issue the assessments to three years.

In the present case, the assessments were issued on 7 February 2019 for the period 2011 – 2016. Therefore, the additional assessments were issued beyond the three year time limit and should thus be vacated.

The Applicant relied on the case of Kasese Cobalt Company Limited v URA, CA no. 4 / 2020 wherein it was observed that:

"...the additional assessments if any, should have been made within three years from 12 / 02/ 2018, the date of service of the notice of the additional assessment therefore, the year 2015, which is three years from 12/02/2018 was out of time, and or tax period for such an additional assessment to be valid on grounds of either fraud, willful neglect or discovery of new information."

The Applicant further submitted that the Respondent never claimed that the Applicant was fraudulent or that the Respondent discovered new information. Further, that the Respondent had carried out an earlier transfer pricing audit for part of the period 2009 – 2011, and all the issues, if any, were resolved.

In addition, the Applicant submitted that the Respondent's information requests exceeded the five year statutory limit for documentation retention prescribed by section 15 (1) (c) of the TPCA.

(ii) Whether the Applicant is entitled to the deductions for head office and regional cost allocation / support costs (head office and regional recharges).

The Applicant submitted that the head office and regional recharges were expenditures incurred in the production of income included in gross income as per section 22 of the Income Tax Act (ITA).

The Applicant further submitted that to carry on its business effectively, the Uganda branch incurs shared costs at the head office, expenses on services and goods from the regional office and some overhead costs attributable to it.

In addition, the Applicant stated that the costs related to specialised technical and engineering support services on specific client projects. Further, the Applicant's staffing gaps necessitates reliance on foreign resources, who are identified at proposal stage. The resources have standard hourly charge out rates depending on expertise and seniority. The Applicant adduced timesheets in AEX 3 at page 11, Ex. 21 at page 400-403.

The Applicant expounded on each cost item as follows:

(a) Overhead reallocation costs – this relates to time spent by foreign resources on the Applicant's projects in Uganda. The resources are paid by their primary employers abroad and the costs regarding work done for the Uganda branch are reallocated to the branch.

(b) Head office costs – These are costs of central management resources at the head office in Australia such as the CEO, Commercial and Legal, Corporate Governance,

Group Finance, Tax and Treasury who provide input to the Uganda branch. Their costs are charged based on level of activity that each person contributes to the branch. The Applicant provided copies of the cost allocation.

(c) Regional costs – these are costs incurred at the Africa Division with personnel located in Kenya, Tanzania and South Africa. The Group operates a matrix structure that combines divisional and functional leadership responsibilities. The leaders are responsible for business operations across the specified regions. The management support expenses incurred at the regional offices attributable to the Uganda branch are charged to the branch per level of activity.

(iii) The lawfulness of the re-audit

The Applicant submitted that they had been previously audited for the period 2009 – 2012 by the Respondent. Therefore, having already audited the Applicant for the same tax period and issued additional assessments, the Respondent acted in a manner that was procedurally unfair and unjust. Further, the additional tax established and demanded by the Respondent's tax decision of 20 June 2019 was fully settled by consent judgement dated 21 May 2019. This created a legitimate expectation on the part of the Applicant that the matters were fully audited and settled.

The Applicant submitted that the amount in contention is Shs. 2,575,670,684 as principal tax and Shs. 2,006,884,435 as penalty.

In addition to the above submissions, the Applicant also submitted on the following:

a) Withholding tax credit – the Applicant had a withholding tax credit of Shs. 8,265,762,900 which was verified by the Respondent following an audit. This was used to offset certain assessed taxes and reduced to Shs. 1,361,517,152. However, the credit has never been refunded and the Applicant prayed that the same be refunded by the Respondent.

b) Penalty waiver – The Applicant submitted that Shs. 2,006,884,435 relating to a penalty should be waived in accordance with section 46 and 47 (1) of the TPCA

which provides for waiver of interest and penalty outstanding as at 30 June 2020 and at 30 June 2023 respectively.

c) The Tribunal should remit the matter back to the Respondent as the Respondent did not exhaustively review all the documents submitted by the Applicant at the objections stage of the dispute.

d) The Applicant prayed for general damages of Shs. 300,000,000 to compensate for the loss suffered by not being able to utilize its withholding tax credit which affected its cashflows for five years. The Applicant also prayed for costs of the suit as well as interest at a rate of 2% per month on the unrefunded WHT tax credit payable from the date that the application for the refund was made.

4. The Submissions of the Respondent

The Respondent submitted on the following:

Whether the assessment is time barred

The Respondent submitted that they issued assessments on 7 February 2019 for the period July 2011 to December 2016.

The Respondent stated that section 25 of the TPCA grants the commissioner powers to issue additional assessments at any time if fraud or gross willful neglect has been committed by or on behalf of the taxpayer or new information has been discovered in relation to the tax payable by the taxpayer for a tax period.

The Respondent submitted that they carried out an audit of the period 2011 – 2016 and discovered new information. The Respondent cited the case of Uganda Electricity Transmission Company Ltd v URA HCCS no. 423 of 2010 where Justice Madrama (as he then was) held:

"...any information that shows that the returns of the Applicant to the defendant for any year of income is false or misleading can be termed a "discovery of new information" ...where there is discovery of new information in relation to tax payable for any year of income, then the five year limitation period does not apply and an additional assessment may be made at any time."

The Applicant submitted that the new information was communicated to the Applicant and adduced in evidence in AEX 1, 2 and 3 on pages 1 -15 of the joint trial bundle.

Deductibility of the head office and regional charges

The Respondent submitted that Section 19 of the TPCA provides that the burden of proof is on the taxpayer to prove that the assessment is incorrect or that a decision should not have been made or should have been made differently. Therefore, where a taxpayer is challenging the validity of an assessment, the burden of proof squarely rests upon them.

The Respondent further submitted that on 18 February 2019, following the audit, they communicated to the Applicant informing them that deductions relating to head office and regional charges had been rejected by the Respondent on the basis that the Applicant had not furnished proof that the said expenses had been incurred in the process of deriving income under section 22 of the ITA.

The Respondent requested the Applicant to provide documents to substantiate the expenses but the same were not provided by the Applicant. Therefore, the Applicant did not discharge its statutory burden of proof.

Re-auditing of the period 2009 – 2012

The Respondent submitted that the Applicant's contention that they had already been audited for the period 2009 – 2012 and a consent judgement entered dated 21 May 2019 is misleading. The Respondent submitted that the consent judgement was specific to the issues in contention. In the consent, the Respondent vacated an assessment of Shs. 896,780,812 which had been taxed as management fees by the Respondent.

The Respondent submitted that the consent was based on different facts, issue assessments and assessment periods which should not be relied upon for this application.

The Respondent prayed that the Tribunal finds that the Respondent is not entitled to the remedies and reliefs sought by the Applicant as the Applicant did not discharge its burden of proof.

5. The Submissions of the Applicant in Rejoinder

In rejoinder, the Applicant submitted that it has at all times during the audit and the objection stated that the assessment was out of time. The Respondent cannot assess without justifiable reasons. The assessments must be based on new information which should be communicated to the taxpayer. The Respondent should have audited the Applicant within three years. The Respondent has the evidential burden to prove the new information which they did not mention at all in the audit and objection process.

The Applicant further noted that the Respondent had already carried out an audit on the Applicant and issued additional assessments for the period 2009-2012 which were settled by consent at the High Court. (AEX.9, AEX10 AND AEX 80 JTB)

The Applicant submitted that in the assessments of 2009-2012 the Respondent had charged the Applicant 15% WHT on management fees, the Applicant explained that these are not management fees, but expenses incurred in the course of business. The Applicant prayed that this preliminary objection is upheld as the assessment was raised out of time.

Whether the Applicant is liable to pay the tax assessed?

The Applicant submitted that they discharged their burden of proof through documentary evidence, financial statements among others that showed that the Applicant had projects in Uganda and incurred expenses in production of the projects in Uganda entitled to the deduction under Section 22 of the ITA. The Applicant contended that the Respondent never or gave reasons to justify why the documents submitted by the Applicant were not enough to prove the costs incurred.

Re-auditing of the Period 2009-2012

The Applicant submitted that it used to name cost allocation as management fees until the Respondent advised them to change to costs allocation (head office, regional and overhead).

The Applicant contended that the consent in May 2019 was in regard to the Respondent subjecting the cost allocation termed as management fees to withholding tax. When it

was proved and explained to the Respondent, a consent was entered into by the parties as WHT could not apply to expenses. The period 2009-2012 covers the period in question 2011-2016. Once the audit (2009-2012) was concluded and the tax liability settled, it was considered closed.

The Applicant prayed that having discharged its burden of proof, the Tribunal finds that they are not liable to pay the tax assessed and allow this application with costs.

6. The Determination of the Tribunal

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

The Applicant is a branch of a foreign company SMEC International Pty Limited that is resident in Australia. The Applicant provides engineering consultancy services and some of its customers in Uganda include UETCL, UNRA and KCCA.

On 14 May 2018, the Respondent informed the Applicant of its intentions to carry out a comprehensive audit of the Applicant. This followed a returns examination for the period July 2011 to December 2016. The Respondent identified several issues during the returns examination which warranted a comprehensive audit. The Respondent provided the Applicant with an extensive list of the issues identified.

On 18 February 2019, the Respondent communicated the findings from the comprehensive audit. Key among the findings that is at the heart of this dispute is head office and regional support costs that are allocated to the Applicant from its Australian head office and other regional divisions.

The Respondent subsequently issued assessments for income tax, arising from among others, disallowed deductions of the head office and regional recharges. The Respondent claimed that the Applicant did not substantiate the recharges and consequently, the Respondent found that the costs had not been incurred in the production of income included in gross income as per section 22 of the ITA.

The Applicant objected to the assessments and the Respondent maintained its earlier position on the basis that the Applicant had failed to provide supporting information.

Earlier audit

It should be noted that prior to this dispute, the Respondent had in 2014 carried out a transfer pricing audit of the Applicant covering the period July 2009 – June 2012 (See A80 of Applicant's supplementary bundle). The audit established that the Applicant paid management fees to the head office and other related parties. The Respondent sought to collect withholding tax in respect of the management fees. The matter was eventually resolved on 21 May 2019 by consent judgement before the High Court wherein the Respondent vacated the withholding tax assessment.

Withholding tax credit

The Applicant also brought to the attention of the Tribunal a withholding tax credit for the period 2011 to 2016 that has not been refunded by the Respondent following verification of the same. The credit, which was initially Shs. 8,265,762,900 reduced to Shs. 1,361,517,152 following certain offsets. The Applicant seeks a refund of the said credit with interest.

Three main issues have been raised in this application and the Tribunal will address them sequentially as follows:

(i) Whether the re-auditing of the period 2009 – 2012 was lawful
(ii) Whether the assessment of 7 February 2019 for the period July 2011 to December 2016 was time barred
(iii) Whether the Applicant is entitled to deductions for head office cost allocation, head office support, overhead reallocation and regional office cost allocation.

Resolution of the issues

1. Whether the re-auditing of the period 2009 – 2012 was lawful

The Applicant stated that the Respondent previously carried out an audit for the period 2009 – 2012 where they established that the Applicant paid management fees to its head office and other non-resident related parties. Consequently, the Applicant submitted that the audit of 2018 for the period 2011 – 2016 was duplicative of the previous audit and amounted to a re-audit.

The Applicant argued that when the earlier audit of 2009 – 2012 was settled by consent judgement, this created a legitimate expectation which the Applicant relied on in establishing that any tax issues relating to the tax period 2009 – 2012 were fully audited and settled.

With disagree with the Applicant's submission for the following reasons:

(i) According to the correspondence from the Respondent to the Applicant dated 4 September 2014, the Respondent communicated its findings from a transfer pricing for July 2009 – June 2012. This focused on withholding tax on alleged management fee payments to the head office. This appears to have been an issue audit / review which focused on withholding tax. According to an OECD Report dated 16 October 2006 titled ***"Strengthening Tax Audit Capabilities: General Principles and Approaches"***, single issue audits are –

> *"...confined to one item of potential non-compliance that may be apparent from examination of a taxpayer's return. Given their narrow scope, single issue audits typically take less time to perform and can be used to review large numbers of taxpayers involved in similar schemes to conceal non-compliance."*

In 2018, the Respondent carried out a returns examination of the Applicant's tax returns. According to their letter to the Applicant dated 14 May 2018, the Respondent informed the Applicant that they had identified a number of issues which necessitated the initiation of an audit to address all the issues. Consequently, the Respondent carried out a comprehensive audit of the Applicant (refer to letter dated 18 February 2019).

Therefore, whilst the 2014 audit was an issue audit, the subsequent audit of 2018 was a comprehensive audit which was brought about by anomalies identified in the returns examination.

According to the ***OECD Report (supra)***, a comprehensive audit, also known as a full audit is –

> *"... all-encompassing. It typically entails a comprehensive examination of all information relevant to the calculation of a taxpayer's tax liability for a given period. The objective is to determine the correct tax liability for a tax return as a whole."*

Indeed, the scope of the 2018 audit is evidenced by the extent of the issues that were identified which included undeclared sales, imported services, head office support costs, capital allowances, meals while travelling etc. In comparison, the 2014 audit only dealt with withholding tax.

Therefore, going by the nature of audits carried out, it would not be accurate for the Applicant to state that there was a re-audit. We are also not persuaded that a single issue audit could have created a legitimate expectation on the part of the Applicant that it had been given a completely clean bill of health. A malaria test does not equate to a full body check.

It should also be noted that the 2018 audit was as a result of a returns examination. In view of the kind of issues identified from the returns examination, it would have been imprudent for the Respondent to turn a blind eye to the issues identified, high risk issues moreover, involving expenses of significant amounts to non-resident related parties.

(ii) The period of the audit differs. The 2014 audit covered 2009 – 2012 while the 2018 audit covered 2011 – 2016. While there was an overlap regarding two of the years in the two periods, namely 2011 and 2012, it is not entirely accurate that the audit covered the same period. Section 15 (1) of the Tax Procedures Code Act (TPCA) requires taxpayers to maintain records as may be required to determine the

taxpayers' liability under tax law. Further, section 15 (c) provides that such records should be retained for a period of five years after the end of the tax period to which it relates. In tax terms, this five year period is typically referred to as the "open period". This is the period that is open to investigation by virtue of the documentation retention requirement. Therefore, part of the period 2011 – 2016 was still open for investigation.

It can be argued, rightly so, that the years 2011 and 2012 should not have been reviewed / assessed as they were technically outside the five year statutory limit for document retention. However, we shall address this issue under issue two concerning whether the assessments were time barred.

On the whole, we are not persuaded that there was a re-audit and that the earlier issue audit created a legitimate expectation on the Applicant's part that all tax liabilities were settled.

2. Whether the assessment of 7 February 2019 for the period July 2011 to December 2016 was time barred

The Applicant argued that the assessment of 7 February 2019 was time barred because it was issued outside the 3 year statutory timeline imposed by section 25 (2) (b) of the TPCA for making additional assessments.

The Respondent on the other hand cited section 25 (2) (a) which allows the Commissioner to raise an assessment at any time if fraud or any gross or willful neglect has been committed by or on behalf of the taxpayer, or new information has been discovered in relation to the tax payable by a taxpayer for a tax period. The Applicant submitted that none of these exceptions were ever cited by the Respondent or brought to the attention of the Applicant.

On 14 May 2018, the Respondent wrote to the Applicant informing them of the outcome of a returns examination (See AEX 1 on page 1). The Respondent informed the Applicant as follows:

"Given a number of issues identified during our meeting held on Tuesday 26th September 2017 at your premises….an audit has been initiated…. On further analysis of your returns, a number of issues have been identified which require your immediate response…".

The Respondent went ahead to catalogue 21 issues that had been identified from the returns examination.

It is evident from the above that the Respondent did discover new information, which they brought to the attention of the Applicant. In ***UETCL v Uganda Revenue Authority HCCS no. 423***, Justice Madrama (as he was then) cited with authority the case of Rex v Kensington Income Tax Commissioners where it was held regarding discovery of new information:

"…the expression does not mean…it ascertains by legal evidence…it means "if he comes to the conclusion on the information before him…if he has reason to believe that such a person is not entitled to an exemption, he thereby discovers that he is chargeable, the commissioners are thereupon authorized and directed to make an assessment."

In the present case, upon analysis of the Applicant's returns, the Respondent discovered certain issues that had a bearing on the tax payable by the Applicant for the period 2011 – 2019. The Respondent had a duty to make an assessment upon being satisfied that there was tax chargeable.

Therefore, we are satisfied that the Respondent was within their rights to raise the additional information on the basis of this new information.

3. Whether the Applicant is entitled to deductions for head office cost allocation, head office support, overhead reallocation and regional office cost allocation.

The Applicant contends that they were entitled to the deductions for the head office and regional recharges as the costs were incurred in the generation of income included in gross income. The Respondent alleged that the Applicant did not provide information needed to substantiate the costs incurred and thereby failed to discharge the burden of proof.

The costs that are at the heart of this dispute relate to recharges from the head office of the Applicant and regional divisions of the group to which the Applicant belongs.

We have summarized in the table below the recharges for the relevant period.

	Period	June 2013	June 2014	June 2015	June 2016	Dec 2016
1.	Head office support cost allocation	-	225,427,836	80,552,236		
2.	Regional Office cost allocation	-	1,220,329,988	995,218,474	1,087,122,991	736,189,782
3.	Overhead reallocation costs	97,181,996			45,871,821	24,773,991
4.	Foreign taxes		112,272,866	368,100,466	1,695,057,143	
5.	Meals while travelling and allowances				2,204,772,635	
	Total	**97,181,996**	**1,558,030,690**	**1,444,171,176**	**5,032,824,590**	**760,963,773**

The Applicant conceded to items 4 and 5. However, it is important to examine the amounts involved in the context of the Applicant's business. For example, for the period ended June 2016, the Applicant as per its financial statements (page 381 of the Joint Trial Bundle) earned revenue of Shs. 18.9 billion and operating profit of Shs. 3 billion. The related party expenses claimed in the same period of Shs. 5 billion accounted for 28% of revenue and 167% of operating profit.

In December 2016, the Applicant as per its financial statements at page 40-57 of the joint trial bundle earned revenue of Shs, 843 million. It had an operating loss of Shs. 677 million. The head office and regional expenses claimed in the 6 month period ended December 2016 accounted for 90% of the Applicant's revenue. This means that for each $100 of revenue that was generated in Uganda, $90 was paid to the head office or other related parties in the form of head office or regional allocations.

This context is critical for understanding why transactions between taxpayers and their non-resident associates warrant additional scrutiny.

The transfer pricing legal framework

Transactions such as this, between a Ugandan taxpayer and a non-resident related party are governed by the transfer pricing legal framework set out in Section 116 of the Income Tax Act, read together with the Income Tax (Transfer Pricing) Regulations, 2011. The spirit of the legal framework is to ensure that expenses incurred in or income earned from transactions with associates / related parties, particularly non-resident persons, reflect an arm's length outcome. In other words, the outcome of the transactions must be the same as that which would have occurred had the same transaction taken place between unrelated and unaffiliated parties, acting independently and in their self-interest.

This is in accordance with Regulation 9 of the Transfer pricing Regulations which requires incomes and expenditures between associates to be determined in a manner that is consistent with the arm's length principle.

Therefore, in the present case, the Respondent has to satisfy themselves that the cost allocations by the head office and regional offices to the Applicant were fair, justified and result in an arm's length outcome.

Application of transfer pricing rules to activities of branches and head offices.

With specific regard to activities between branches, the Transfer Pricing Regulations provide in Regulation 5 to the effect that:

(i) A branch is treated as a separate and distinct person from its head quarters
(ii) A branch and its headquarters are treated as associated (related)
(iii) A branch and headquarters are located where their activities are located.

Therefore, activities between branches and their head offices must meet arm's length requirement. Where it is established that the costs allocated to a branch were excessive, such costs will not be deductible for tax purposes under section 22 of the ITA.

This is in accordance with section 116 of the ITA which empowers the commissioner to distribute, apportion or allocate income, deductions, or credits between the associates to reflect the chargeable income realized by the taxpayer in an arm's length transaction.

In the present case, the Respondent's disallowance of the expenses incurred by the Applicant in respect of payments to its head office and other regional offices for services rendered is an attempt to allocate or apportion deductions to reflect what ought to have been the applicant's chargeable income.

The relationship between section 22 and 116 of the ITA

The Applicant contends that the recharges from its head office and the regional divisions were costs incurred in the production of income included in gross income. The Respondent challenged this and contended that the Applicant did not provide sufficient evidence to substantiate the expenses.

Section 22 (1) deals with the deductibility of expenses for income tax purposes. The section provides that 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".

On the face of it, it appears that section 22 (1) allows all expenses incurred by a person in the production of income included in gross income. However, section 22 (2) lists certain expenses, which though incurred by a person, are not allowable, even where they were incurred in the production of income. Examples include any expenditure above five million shillings in one transaction on goods and services from a supplier who does not have a taxpayer identification number.

Section 116 is another exception to the general deductibility principle in section 22. This exception is specific to expenses incurred between associated parties that are found not to be arm's length. As explained above, the Commissioner may apportion or allocate the deductions to reflect the chargeable income realized by the taxpayer in an arm's length transaction.

The question for determination therefore is whether the Respondent was justified in disallowing the expenses incurred.

Whether the Respondent was justified in disallowing the expenses

Two tests must be satisfied in demonstrating whether a charge for services between associates is arm's length. These tests are set out in Chapter 7 of the OECD Guidelines which explains the transfer pricing considerations for intragroup services:

(i) That a service was in fact been rendered - this is a question of fact. A service is rendered if it provides/(d) a benefit to the recipient – a service is deemed to provide a benefit if it enhances the commercial position of the recipient. It should be noted that services that are duplicative in nature or relate to the group's shareholder activities do not benefit the recipient.

(ii) Whether the charge for the services is appropriate.

To establish whether a taxpayer meets the tests above, tax authorities require information from taxpayers. This information often includes transfer pricing documentation and any additional information needed to verify the appropriateness of the income or expense.

The Respondent contends that the Applicant did not provide sufficient information to enable them establish whether the expenses in issue had been incurred in support of activities rendered to the Uganda branch. The Applicant disagrees.

Therefore, we must examine the information that the Applicant provided and determine whether it was sufficient for the Respondent's purposes.

a) Overhead reallocation costs

The Applicant provided the following information:

i) A list of projects that the Applicant undertook in the period June 2013 – June 2016 *(AEX 17, pg 220 -224)*

ii) Timesheets showing the time spent by the head office staff supposedly on the Applicant's projects in Uganda *(AEX 18, pg 225 – 352)*

iii) Tax invoices to the Applicant for salary costs incurred *(AEX 19)*.

Our observations of the above documents are that they do not establish whether the services were in fact rendered to the Applicant. For example, a list of the Applicant's projects does not indicate the staff who worked on the respective projects. The time sheets merely indicate a person's name and the hours posted. They do not include a narration of the work done and the corresponding project or the location of the project. The work could have been done for a project in Mongolia. It was not possible for the Respondent to establish these facts from the timesheets.

The tax invoices for salary costs are generic. They merely state *"general office overheads salary costs"*. Whose salary costs are they? What work was done and for whom? The answers to these questions are not on the invoices.

b) Head office costs

The Applicant provided the following information:

i) Uganda service allocation charge – this breaks down the costs charges to Uganda by the various departments at the head office and divisions. AEX 14 - 16 shows an indirect allocation of central costs to subsidiaries based on estimated time spent on the respective subsidiaries in the years 2015 June 2016 and December 2016

ii) Cost center print outs for various functions such as corporate service, Africa Division Office, Africa Regional Office etc.

The above information shows that there are costs that are incurred at the head office which are allocated out to the subsidiaries / branches of the SMEC group. However, there is no clear indication of what the costs related to, whether the underlying services were rendered to the Uganda branch and the benefit derived from the services rendered.

c) Regional costs

The Applicant provided the following information:

i) Cost details of various SMEC staff per function based on hours spent

ii) Sample invoices for travel, accommodation and expenses *(367 -380 of the joint trial bundle)*. These include air tickets to Entebbe, accommodation costs in Nairobi among others.

While it is indeed true that the Applicant provided various kinds of information, the information was lacking in the following ways:

a) It does not explain the services that were rendered by the head offices/regional offices etc. to the Applicant;
b) It does not indicate the Applicant's projects that were the beneficiaries of this support from the head office / regional offices
c) It does not state when the services were rendered
d) It does not state who rendered the services.

A lot of the information provided was generic in nature and was not sufficient to substantiate the extent of services rendered to the Applicant.

It is also worth pointing out that there are multiple services supposedly rendered to the Applicant – from the head office and the regions. This presents a risk of duplication which made it more pertinent for the Respondent to carry out due diligence to substantiate the nature of services.

Transfer pricing documentation

Regulation 8 of the Transfer Pricing Regulations requires a person (the Applicant) to –

"record, in writing, sufficient information and analysis to verify that the controlled transactions are consistent with the arm's length principle."

We have noted that the Applicant provided the Respondent with transfer pricing documentation for 2019 that was prepared for Surbana Jurong Holdings (Australia) Pty Limited (SJH). The documentation covers activities of SMEC International Pty Ltd, which is a subsidiary of SJH

It should be noted that the period audited by the Respondent was 2011 – 2016. Therefore, 2019 documentation was not relevant to the audit period

Further, the documentation was prepared for the benefit of the SJH Group, which has over 120 offices globally. Nothing in this documentation is specific to the Applicant's operations and neither has it been prepared for purposes of satisfying Uganda's transfer pricing documentation requirements contained in Regulation 8 of the Transfer Pricing Regulations.

Transfer pricing documentation is a mandatory compliance obligation for taxpayers dealing with associates. It must be relevant to the activities and transactions between the Ugandan taxpayer and its associates. Documentation that has been prepared for affiliates in the group is not sufficient for Ugandan purposes as it does not address the specifics of the dealings between the Ugandan taxpayer and its associates.

Therefore, the transfer pricing documentation that was provided to the Respondent was not sufficient to establish whether the costs incurred by the Applicant were incurred in the production of income included in gross income.

Information that was requested for by the Respondent

Having reviewed the information that was provided by the Applicant and found it insufficient, the Respondent asked the Applicant to provide certain information. This is as per the testimony of the Respondent's witness, Solomon Musoke, a Supervisor in the Respondent's International tax Unit. The information includes:

i) Copies of the invoices / debit notes raised by the Head Office and Regional office for all costs allocated to Uganda for the year ended June 2016
ii) Spreadsheet showing the recharge cost base file and costs allocated to Uganda by the Regional and head office
iii) Functional structure of SMEC International PTY in respect of the support rendered to the Uganda branch projects. This should have indicated the names of department, personnel and their job roles
iv) Copies of job descriptions and appraisals of key personnel supporting the Ugandan branch and head office
v) Authentication of foreign tax paid and recharged to the Uganda branch

vi) Evidence of system or mode of interaction between the Uganda branch, Regional Office, and head office and examples of such evidence including emails, reports, physical visits, among others.

vii) The Respondent asked the Applicant to sample any two projects executed during the year ended June 2016 for purposes of the above evidence.

The Respondent's witness testified that the above information was not provided.

It can be deduced from the information requested that the Respondent sought to establish a nexus / connection between the activities of the head office / regional offices and the Applicant's projects in Uganda. For example, evidence of mode of interaction would have shed light on the personnel at the head office / regional offices that the Applicant was dealing with regularly to warrant the cost allocations. Evidence of emails, visits and reports would have established the nature of interaction and the deliverables /benefits to the Applicant arising from the support rendered to them.

Indeed, in his testimony, Solomon Musoke, the Respondent's witness testified that as the Applicant's nature of work is supervisory, requiring physical presence at the project being supervised personnel had to be physically present in Uganda and not remotely in Australia.

Transfer pricing is a significant risk to Uganda's economy as it potentially erodes the tax base of the country through the shifting of profits from Uganda to other countries through expenses and income. The Respondent's duty is to protect the country's tax base while the Applicant has a duty to demonstrate that its expenses incurred where necessary, relevant, justified and at arm's length.

As observed, the Applicant did not have the requisite transfer pricing documentation for the period under review. Para.5.5 and 5.6 of the OECD Transfer Pricing Guidelines (which are recognized by the Uganda's Transfer Pricing Regulations) state:

"5.5 Three objectives of transfer pricing documentation are:

1. to ensure that taxpayers give appropriate consideration to transfer pricing requirements in establishing prices and other conditions for transactions between associated enterprises and in reporting the income derived from such transactions in their tax returns;

2. to provide tax administrations with the information necessary to conduct an informed transfer pricing risk assessment; and

3. to provide tax administrations with useful information to employ in conducting an appropriately thorough audit of the transfer pricing practices of entities subject to tax in their jurisdiction, although it may be necessary to supplement the documentation with additional information as the audit progresses.

5.6. Each of these objectives should be considered in designing appropriate domestic transfer pricing documentation requirements..... it is important that tax administrations be able to access or demand, on a timely basis, all additional information necessary to conduct a comprehensive audit once the decision to conduct such an audit is made."

By failing to provide the information requested for by the Respondent, we find that the Applicant did not discharge the burden of proof. Therefore, the Respondent was justified in disallowing the expenses relating to the head office and regional office costs.

4. The remedies for the parties

Having established that there were gaps in the Applicant's information and the Respondent has been unable to substantiate the expenses incurred by the Applicant, the Tribunal hereby remits this matter back to the Respondent. The parties are directed to do the following:

(i) The Applicant should provide the Respondent with the information requested for and any other information that is necessary to enable the Respondent comprehensively examine and assess the arm's length nature of the head office and regional recharges.

(ii) Confirm the withholding tax refund due to the Applicant and interest thereon. Where following the exercise in (i) above, it is established that the Applicant has a tax liability, the withholding tax credit should be utilized towards the liability.

(iii) Assess whether the Applicant is entitled to benefit from the waiver of interest and penalties under sections 46 and 47 of the TPCA where the principal tax has already been paid.

The costs of this cause are hereby awarded to the Respondent.

Dated at Kampala this.....15th.....day of.....November.....2024.

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