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THE REPUBLIC OF UGANDA

IN THE TAX APPEALS TRIBUNAL AT KAMPALA

APPLICATION NO. 63 OF 2018

SMILE COMMUNICATIONS (UGANDA) LIMITED :::::::::::::::::::::: APPLICANT

VERSUS

UGANDA REVENUE AUTHORITY :::::::::::::::::::::::::::::: RESPONDENT

DR. ASA MUGENYI, MR. GEORGE MUGERWA. MS. CHRISTINE KATWE

RULING

This ruling is in respect of an application challenging the respondent's decision disallowing the applicant's Value Added Tax (VAT) refund claims and imposing Withholding tax on interest paid on loans abroad.

The agreed facts between the parties are: The applicant applied for a VAT cash refund of Shs. 7,799,583,046 for the period from October 2011 to December 2016. Due to a tax credit of Shs. 127,479,612, the respondent increased the amount to Shs. 7,927,062,648. The respondent allowed a VAT refund of Shs. 5,870,940,939. The applicant had VAT liabilities which the respondent deducted from the VAT refund. The respondent paid the applicant a sum of Shs. 1,189,022,475. The applicant filed an application in the Tribunal seeking to recover VAT refund of Shs. 2,718,296,153 which it alleged that the respondent had wrongly deducted.

From the joint scheduling memorandum filed the parties had reconciliation meetings. Following a reconciliation meeting on 14th December 2020, it was resolved that the applicant is entitled to a tax credit of Shs. 231,228,389 which has not been paid. The applicant is entitled to input VAT of Shs. 258,801,054. The applicant is entitled to 281,823,435 that was wrongly charged by the respondent as VAT on shared services. The total agreed refund was Shs. 771,852,878, subject to reconciliation of the applicant's tax ledger. The applicant was not entitled to input VAT of Shs. 437,883,299. The applicant conceded that it erroneously contested Shs. 917,690,843 instead of Shs. 777,704,105. The applicant conceded to only a tax liability of Shs. 495,880,670. The applicant also conceded to having erroneously contested Shs. 113,755,199 instead of Shs. 96,402,711 as VAT levied for financial services. The applicant

conceded to Shs. 96,402,711. The parties agreed to adjust the Withholding tax claim from Shs. 648,752,061 to 589,774,601

The following issues were agreed by the parties in the memorandum for determination.

1. Whether the applicant is entitled to a refund of Withholding tax of Shs. 589,774,601 levied by the respondent on interest paid by the applicant on foreign loans.
2. Whether the applicant is entitled to a refund of interest that was levied on the outstanding Withholding tax by the respondent?
3. What remedies are available to the parties?

The applicant was represented by Mr. Tom Magezi and Ms. Aretha Uwera, while the respondent by Mr. Ronald Baluku, Mr. George Ssenyomo and Mr. Alex Ssali Alidekki.

The remaining dispute between the parties revolves around Withholding tax imposed on the applicant for interest paid on loans from abroad. The applicant contends that the said interest is exempt and was wrongfully offset against the VAT refund payable.

The applicant's witness Mr. Silvernus Okoth, its Head of Finance and Administration and Acting Country Manager, testified that the applicant applied for a VAT refund for Shs. 7,799,583,036 for the period from October 2011 to December 2016. Owing to a tax credit of Shs. 127,479,612 the VAT refund to be paid increased to Shs. 7,927,062,648. The respondent allowed a VAT refund of Shs. 5,870,940,939. The respondent deducted a VAT liability of Shs. 1,505,172,638 leaving a tax credit of Shs. 4,365,768,301 as due to the applicant. The said amount was subject to other tax liabilities and the respondent paid Shs 1,189,022,475 leaving a balance of Shs. 231,228,389. Thereafter the applicant filed this application seeking to recover Shs. 2,718,296,159.3 from the respondent on grounds that it was wrongly deducted. After reconciliation meetings the respondent agreed to refund Shs. 771,852,878.

In respect of the outstanding dispute, the witness testified that the applicant together with Smile Telecoms Holdings Ltd, Smile Communications Tanzania Ltd and Smile Communications Nigeria Ltd executed loan agreements with a) Export Credit Agency of Sweden and Belgian Office National Du Ducrioe for US$ 195,000,000. The applicant had a borrowing limit of US$ 24,000,000. b) Development Bank of South

Africa (DBSA) for US$ 50,000,000. The applicant had a borrowing limit of US$ 7,875,000 c) Industrial Development Corporation for US$ 20,000,000 with the applicant having a borrowing limit of US$ 3,000,000 d) Government Employees Pension Fund (PIC) US$ 50,000,000 with the applicant having a borrowing limit of US$ 8,250,000. The witness testified that in 2016 and 2017 the applicant paid interest of Shs. 6,487,520,616.28 on the said loans. The respondent levied withholding tax of 10% and deducted Shs. 648,752,061. In a reconciliation meeting it was mutually agreed to adjust the tax to Shs. 589,774,601.

The witness contended that the loans are debentures under S. 2(r) of the Income Tax Act. Under the loan agreements the applicant created fixed and floating debentures outside Uganda through African Export – Import Bank. He believed that the debentures were issued to a public security agent African Export – Import Bank for the purpose of raising capital. Therefore, interest paid was exempt from Withholding tax.

The applicant submitted that S. 83 of the Income Tax Act provides that interest paid by a resident company is exempt from tax. It was erroneous for the respondent to levy penal interest when a debenture is issued by a company outside Uganda for the purposes of raising a loan to the public. The applicant contended that S. 2 of the Income Tax Act defines debentures to include loans. The applicant cited **Afgri Uganda Ltd. v Uganda Revenue Authority** TAT 18 of 2019 where the Tribunal said that debentures include loans. The Tribunal interpreted "widely issued" to mean a lot of people. The applicant contended that the debentures were distributed to it by many diverse financial institutions. These included numerous entities as stated above.

In reply, the respondent submitted that S. 83 of the Income Tax Act provides that debentures should be widely issued. The respondent cited Practice Note of 2006 which provides guidance on "widely issued". It requires that the debenture must have been issued to a reasonable number of people, to several investors, as a result of negotiations for the loan in a public forum. The respondent contended that the issue of debentures should therefore be non-exclusive and preferably in a capital market arrangement that caters for public involvement. The respondent also cited **Afgri Uganda Ltd. v Uganda Revenue Authority** (supra) where the Tribunal stated that the debenture has to be issued to different individuals, the public. The respondent contended that five individuals do not amount to public.

As regards interest on withholding tax, the respondent cited S. 39(2) of the Tax Procedure Code Act which provides that interest shall be refunded to a person to the extent that the principal amount to which the interest relates is found not to have been payable. The respondent contended that the applicant is not entitled to a refund on the interest levied on the outstanding withholding tax.

In rejoinder, the applicant contended that the Practice Note's interpretation of the term "widely issued" and the conditions stipulated thereunder are not provided under the Income Tax Act. The applicant cited **Afgri Uganda Ltd. v Uganda Revenue Authority** (supra) where the Tribunal stated the Commissioner General does not have powers to legislate. It agreed with the applicant that the Practice Note does not bind the taxpayer. The applicant contended that the respondent wrongfully deducted a penalty of Shs. 935,615,504 attributed to interest paid by the applicant on foreign loans as the interest it paid was exempted from withholding tax.

Having read the submissions of the parties and perused their exhibits, this is the ruling of the Tribunal.

The applicant filed this application where the subject matter was Shs. 3,949,880,121. The amounts in dispute between the parties has kept on changing. After filing the matter, the parties had reconciliation meetings. They agreed on the issue of the VAT refunds while that of Withholding tax on interest paid abroad remained unresolved. These were addressed in the Joint Scheduling memo. Some of the tax disputes were settled subject to reconciliation of the applicant's tax ledger. No evidence was adduced on the taxes that were left for reconciliation. The Tribunal will consider the agreed issues in the Joint Scheduling Memo.

The first dispute on VAT refundable was in respect of VAT paid by the applicant on importation of goods. This was not among the issues agreed by the parties for trial. The VAT refund in dispute was Shs. 446,937,250. The second dispute is in respect of a VAT refund of Shs. 249,747,105 which the respondent rejected on the ground that the suppliers did declare and pay output VAT. The third dispute is in respect of a VAT amount the applicant wrote of Shs. 917,690,843 for services which were not rendered. The respondent disallowed the write-off. The Tribunal already noted that in the Joint

Scheduling Memo the parties agreed on what input VAT the applicant was entitled to. It was also agreed that the applicant was not entitled to VAT of Shs. 437,883,299. The applicant does not seem to be interested in pursuing them. Therefore, the tribunal will not dwell on the VAT refunds claimable but address the issues which constitute the fourth dispute.

The fourth dispute is in respect to the applicant's claim for a refund of Shs. 648,752,061 which it alleges were wrongly deducted by the respondent as Withholding tax on interest on loans paid by the applicant for financial services to foreign lenders. In the joint Scheduling Memo it was agreed that the applicant adjusts the Withholding tax claim from Shs. 648,752,061 to Shs. 589,774,601.

The applicant contended that income from the interest is exempt under S. 83 of the Income Tax Act. S. 83(1) of the Income Tax Act provides:

> "Subject to this Act a tax is imposed on every nonresident person who derives any dividend, interest, royalty, rent, natural resource payment, or management charge from sources in Uganda"

Income is derived from sources in Uganda under S. 79(k) of the Income Tax Act which reads:

> "interest where –
> (i) the debt obligation giving rise to the interest is secured by immovable property located, or movable property used, in Uganda;
> (ii) the taxpayer is a resident person; or
> (iii) the borrowing relates to business carried on in Uganda."

It is not in dispute that the applicant is a resident person. The loans were to provide capital for the applicant which carried on business in Uganda. Therefore, any interest payable or paid would be or is sourced from Uganda.

The applicant contended that the interest payable or paid to the financiers abroad is exempt under S. 83(5) of the Income Tax Act, which reads:

> "Interest paid by a resident company in respect of debentures is exempt from tax under this Act where the following conditions are satisfied –
> (a) the debentures were issued by the company outside Uganda for the purpose of raising a loan outside Uganda;

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

(c) the interest is paid outside Uganda."

The applicant argued that the interest paid was widely issued for the purpose of raising funds for use by the applicant. The respondent cited its Practice Note. In **Afgri Uganda Ltd. v Uganda Revenue Authority** TAT 18 of 2019, the Tribunal held that the Practice Note did not bind taxpayers. We do not see any reason to deviate from that ruling.

In **Afgri Uganda Ltd. v Uganda Revenue Authority** (supra) the Tribunal stated that:

> S. 83(5)(b) of the Income Tax Act, which is in contention, requires a debenture to be 'widely issued'. The Income Tax Act does not define the term "widely issued." The Tribunal agrees with the applicant's definition of "widely" to mean "a lot of different people". However the applicant omitted to define "issue." *Black's Law Dictionary* 10th Edition defines the term "issue" to mean "to send out or distribute officially". Companies are known to issue debentures to the public as a means of raising working capital. Unlike shares which are issued to a limited number of people by private companies debentures are issued to the public widely. Unlike shares where a shareholders gets a dividend, a debenture holder gets interest until the loan is paid off. A share is a unit of investment while a debenture is a unit of loan. Therefore that portion of S. 83(5)(b) that requires a debenture to be issued widely, meant that it has to be issued to different individuals, that is the public as opposed to a loan that is between two parties.

Black's Law Dictionary 10th Edition p.1422 defines public as "1. The people of a country or community as a whole". The Tribunal notes the loan agreements between the applicant and its financiers involved about five parties, Export Credit Agency of Sweden and Belgian Office National Du Ducrioe, Development Bank of South Africa (DBSA), Industrial Development Corporation and the Government Employees Pension Fund (PIC) and the applicant and its related companies. Our plain understanding of the word "public" is that four or five financiers, the applicant and its related companies cannot constitute a community. The loan agreements between the said parties cannot be considered as debentures widely issued. Therefore, the interest that the applicant paid was not exempt and it should have withheld tax.

The Tribunal having found that the applicant was liable to pay Withholding tax then the penal interest which the respondent levied was due. The quantum was not challenged. S. 39 of the Tax Procedure Code Act provides:

> "1. Interest payable on unpaid tax under a tax law shall be collected by the Commissioner in accordance with this Act as if it were unpaid tax,
> 2. Interest paid by a person under subsection 1 shall be refunded to the person to the extent that the principal amount to which the interest relates is found not to have been payable."

The applicant did not pay the principal tax at the due time attracting penal interest. The respondent was justified to offset the penal interest due against any input VAT claim.

The Tribunal therefore holds that

1) The applicant was rightfully assessed Withholding tax of Shs. 589,774,601 for interest paid abroad.
2) The penal interest levied on the applicant was due
3) The respondent is awarded costs of the application.

Dated at Kampala this.....24th..... day of .....February..... 2021.

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DR. ASA MUGENYI	**MR. GEORGE MUGERWA**	**MS. CHRISTINE KATWE**
CHAIRMAN	**MEMBER**	**MEMBER**

Kim Staff. SIMON KANYESIGHA
U.R.A.