KAA TAX ALERT

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in association with 大成 DENTONS

Uganda Electricity Transmission Company Limited V Uganda Revenue Authority TAT No. 34 of 2017

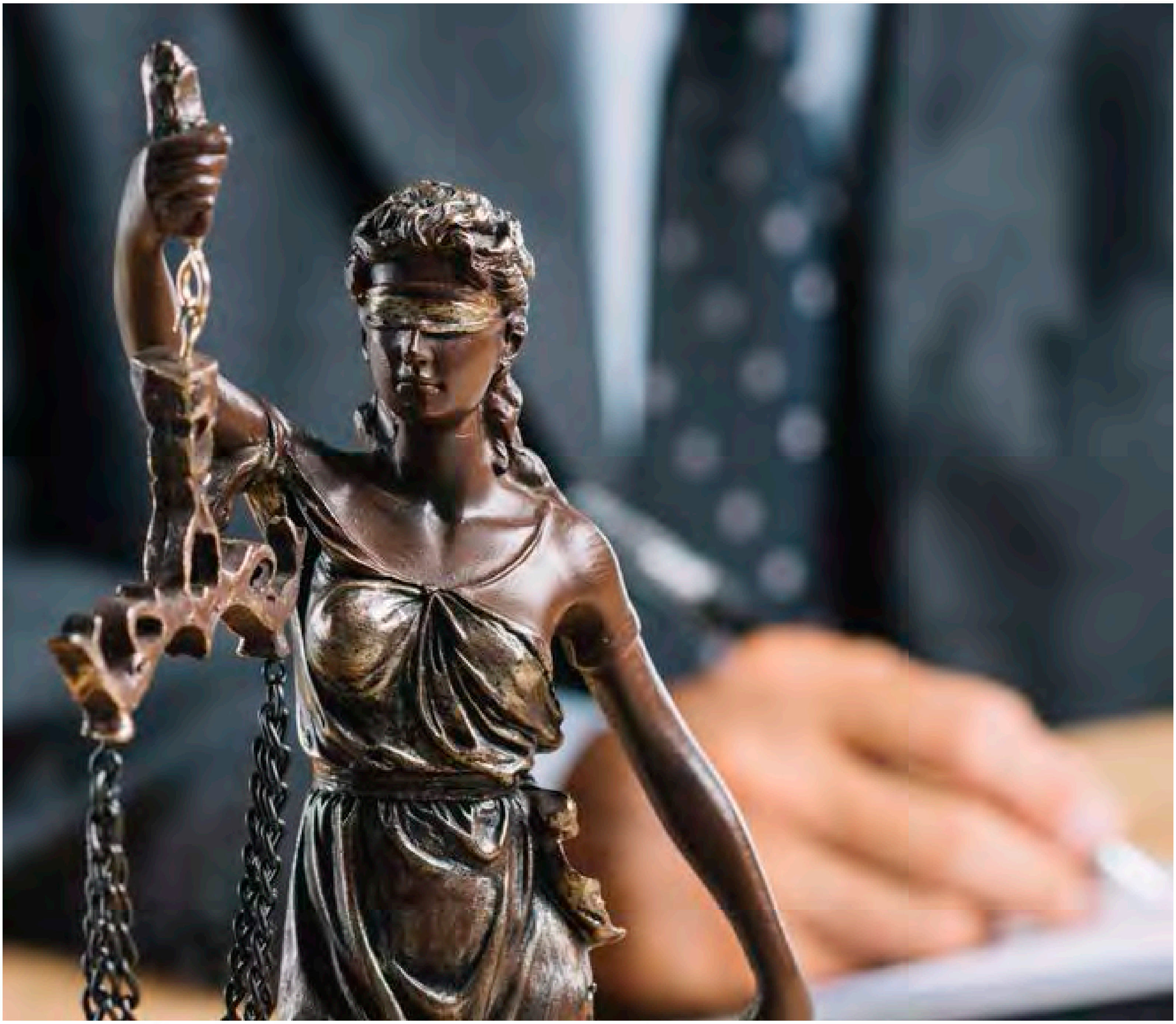
Between 2006 to 2009, UETCL imported electricity from Kenya and Rwanda to which it earned an import VAT/tax credit. In 2011, the URA issued against it an assessment worth UGX 14,933,056,019. The URA issued agency notices in 2014, 2016 and 2017 to claim the aforementioned taxed amounts. In 2015, UETCL applied to claim its credit. URA admitted that UETCL was entitled to the tax credit, however URA claimed that UETCL was time barred since UETCL had not followed the procedure under Section 23(3) of the Tax Procedure Code Act, 2014 (TPC).

During the hearing, UETCL argued that the claim was not time barred. UETCL specifically argued that a claim for a refund under Section 28 of the VAT Act was not one that came with any time limitations. UETCL also argued that since URA had issued an agency notice and collected the tax, it was now entitled to recover the input tax.

The courts and tribunals in East Africa have made significant decisions regarding income tax, Value Added Tax and Customs issues. Below is a tax alert regarding the recent decisions:

Regarding the TPC, UETCL argued that it did not apply since it came into force on the 1st July, 2016, after the claim for the input credit arose.

URA maintained that the claim for the input credit was time barred. URA argued that the input credit arose when the supply was made, in this case, around 2006-2009. URA also claimed that UETCL should have filed an additional assessment under Section 23(1) of the TPC, and this ought to have been done in 12 months in order to claim the credit.



Ruling

Regarding the issue of whether there is a time limit within which one can claim an input credit, the Tribunal held that:

> *A perusal of the VAT Act does not show any time limit in which one should claim input tax credit. S.28 of the VAT Act does not place any time limit on when a taxable person can make a claim for an input tax credit. Therefore the applicant was free to claim any input tax paid at any time. The issue of input tax paid did not arise till the respondent issued third party agency notice to collect the output tax from the applicant.*

On the issue of the applicability of Section 23 of the TPC, the Tribunal held that:

> *A close reading of the said Section clearly shows that it is concerned with filing of additional assessments. There is no evidence that the applicant made a self-assessment return and it contained an error which it discovered. While S.23(1) allows a Commissioner General to make an additional assessment in respect of an excess input tax credit S.23(3) deals with the time limit in which a taxpayer may apply to file an additional assessment. The respondent's argument that the applicant's claim for input tax credit is barred under S.23(3) of the Tax Procedure Tax Code Act is misconceived as the said Section is not applicable to time limits on claims of input tax credit. It only deals with extension of time to make an additional assessment where there is an error discovered by the taxpayer.*

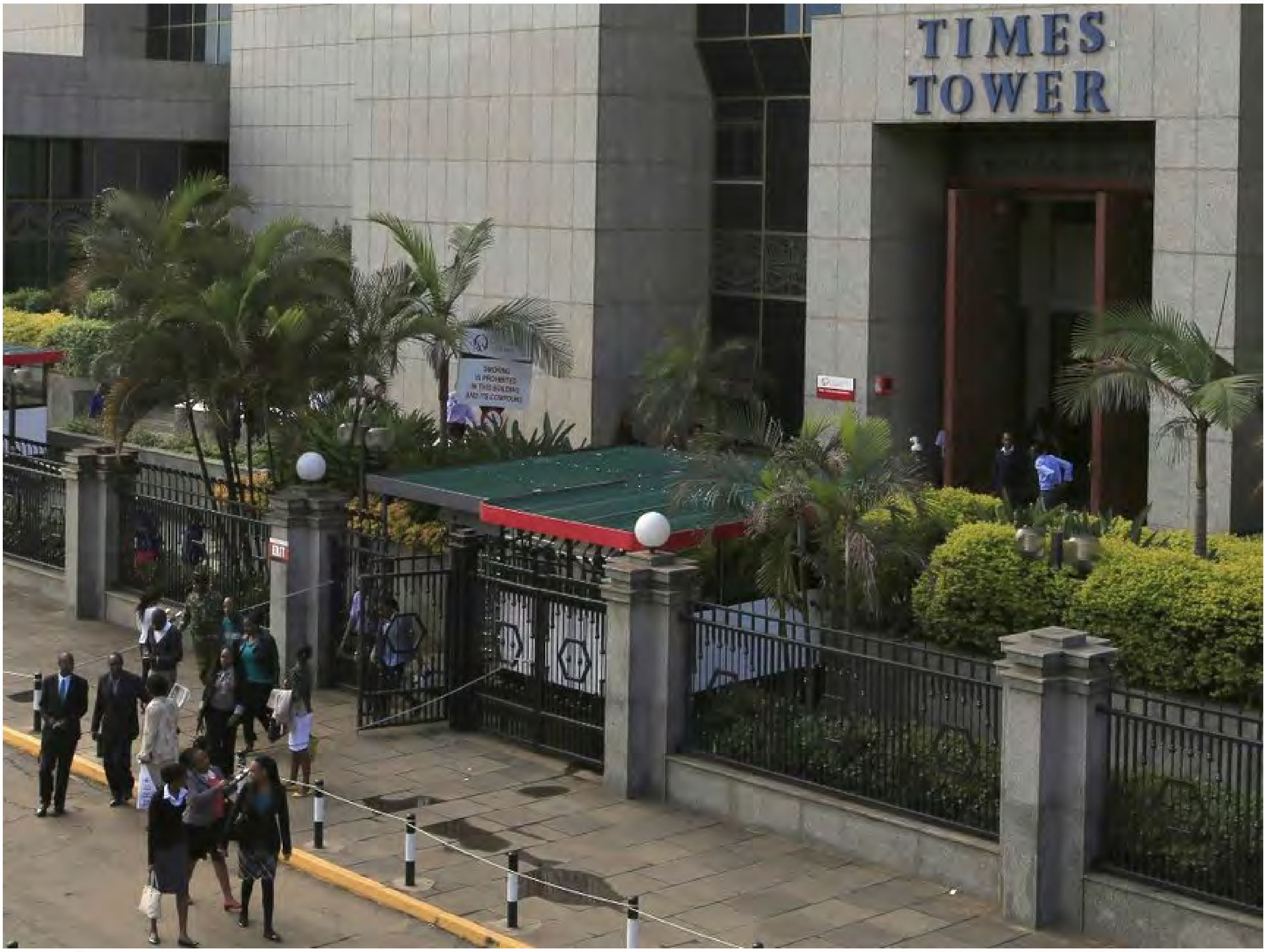
On whether the failure to file an additional assessment would be a bar to a claim for a tax credit, the Tribunal held that:

> *The failure to file an additional return cannot bar a taxpayer from claiming an input tax credit where the respondent carried out an audit and verified the amount due. If the legislature had intended to provide time limits for claiming input tax credit it would have clearly stated so or expressly provided for it, taking into consideration the constitutional provisions in respect of a citizen's right to property. Once money becomes due it becomes property. A party is entitled to it.*

In addition to the above findings, the Tribunal found that Section 42 of the VAT Act did not state a time bar for a taxpayer to claim a credit. Rather the said Section was meant to compel the commissioner to refund the excess within a stipulated period of time.
The Tribunal concluded that UETCL was entitled to the Refund.
Please refer to the link below to view the Ruling of the Tax Appeals Tribunal
https://drive.google.com/file/d/1_PkSccbWzTqABhRKbfVAB4r9j96j2Wsa/view?usp=sharing

Customs

Total Kenya Limited V Kenya Revenue Authority Civil Appeal No. 148 of 2013



Facts

Kenya Revenue Authority (KRA) assessed Total Kenya Limited (Total) taxes for a consignment of 21 cases of prime burners. The assessment was made under the provisions of Section 183 and 225A (1) of the Customs and Excise Act (Cap 42). Total produced evidence to show that duty had been paid. Total stated that it had relied on an agent that was appointed by KRA, and it was the duty of the agent to pay the taxes and issue invoices to it thereafter. Total stated that the agent had raised an invoice for a tax that it duly paid.

KRA asked Total to avail a copy of the duty entries. Total availed the copies of the duty entries it had. However KRA responded and said they were forgeries. The Respondent claimed that the entries related to a different company not Total and grain milling, dairy machinery as well as cultivators and not prime burners. KRA maintained that under Section 166 of the Act, Total was liable for the acts of the agents.

The lower court agreed with KRA and stated that the agent was for Total and all his acts were binding on Total. Total being dissatisfied with the decision appealed to the ourt of Appeal. On appeal, Total claimed that it could not be assessed taxes after the five-year period and acts of fraud were not committed by its agent and therefore not binding on it. Total maintained that KRA would only exceed the five year limit if fraud was attributable to it and not the agent. Total submitted that it paid the duty through the agents appointed by KRA. Total further argued that it was not required to pay duty arising from the fraud of the agent.

KRA argued that the consignment was to be warehoused in a bonded warehouse but it was not. That it demanded evidence showing proof of payment of duty and discovered that they were forgeries.

The Court of Appeal ruled and found that the person who should have paid the duty was Total, though it contracted an agent. The Court of Appeal also held that Total never countered the fact that the import entries were forgeries and that the goods never reached the warehouse. As result, the Court found that the aforementioned evidence showed that Total had not paid the duty.

The Court of Appeal specifically found that:

> ***"…..once a principal pays the duty to its agent, it has no way of knowing if such duty ends up with the respondent."***

Interestingly the appellant did not bother to enjoin in the proceedings its agent who was in a better position to counter, it at all, the allegations of fraud attributed to it as the appellant by the respondent. It was not enough for the appellant to merely proclaim that "…..once a principal pays the duty to its agent, it has no way of knowing if such duty ends up with the respondent". Accordingly the appellants interpretation of Section 158(1) of the Act that the duty could not be levied in the event that the person liable to pay (the appellant) was personally found to have been fraudulent is clearly erroneous and a misinterpretation of the provision. The judge in our view properly held that the person liable to pay the duty was the appellant as the principal, since fraud had been established which then allowed the respondent to levy duty beyond the five year stipulated period.

Of course the appellant maintained throughout the proceedings that in the event that fraud was established, then such fraud should be apportioned to the agent. What we are saying, however, is that we're not persuaded that the words "…….. the person who should have paid the amount short levied" in the proviso do not refer to the principal, the appellant in the circumstances of this case. We doubt that, that could have been the intention of parliament. If anything, sections 165 and 166 of the Act seem to buttress the position that even in a scenario where fraud was perpetrated by the duly authorized agent, the owner of the goods of the principal still remains liable.

The Court of Appeal concluded by holding that Total was vicariously liable for the fraud of its agent.

Please refer to the link below to view the complete ruling of the Court of Appeal of Nairobi https://drive.google.com/file/d/1ctOKZecn_3y92mU7EqniDUME3puXql54/view?usp=sharing

Vivo Energy Uganda Limited V Uganda Revenue Authority

Vivo Energy rents and leases various service stations more commonly referred to as petrol stations from various landlords including the Uganda Land Commission, District Land Boards, Kingdom Land Boards, Church Land Boards and Ugandan Individuals. Accordingly Vivo energy pays rent for some of the stations on a monthly basis or six months or annually and others premiums on a once off basis for the period of the lease. Vivo claimed that the rent and premium payments were deductible for income tax purposes.

However, the URA stated that the rent and premium are not deductible because they are a capital expenditure. The issue for determination before the Tribunal was whether the said rent and premiums paid by Vivo are tax deductible.

Vivo claimed that the rent and premium are deductible under the matching principle embedded in Section 43 of the Income Tax Act ("ITA"). It also claimed that under S.22 of the ITA, it was entitled to a deduction for expenditure incurred during the year of income. Vivo submitted that rent and premium are a recurrent expenditure and therefore deductible under Section 22. Vivo averred that a lease is not an acquisition of land but rather a temporary acquisition of land and therefore not a capital expenditure.

Regarding the penalty, Vivo stated that it filed its provisional returns in 2003 but later filed an amended provisional estimate on which it paid full provisional returns for the year 2003.

The URA claimed that the leases are assets of the applicant and are declared as such in their returns and financial statements. The URA stated that the premium and rent should be considered as a capital expenditure and should form the cost base of Vivo's assets. The URA further averred that the payments are not deductible. URA maintained that the lease is an ownership of land and not an acquisition of a right to use land.

Concerning the penalty, the URA claimed that a person that understates their provisional tax is liable to a penalty. The URA contended that Vivo understated its charge and was liable to a penalty. The URA further contended that the revision of the provisional tax must occur within the year of income in which the provisional return should have been filed. In the facts before the Tribunal, the URA contended that the provisional tax return was received on 30th June, 2003, and the revision was received on the 1st March, 2004 and therefore that the filing of the return was out of time.

Tribunal Ruling

The Tribunal held that under Section 22, assessable income is deductible to the extent that it is incurred in gaining or producing assessable income. Other income that is incurred in the business which do not have the purpose of producing income are not deductible.

On the issue of whether rent or premium for acquiring leases is an expenditure of a capital nature or are they amounts included in the cost base of an asset, the tribunal found that the ITA does not define what an expenditure of a capital nature is. The Tribunal further held that:

> *"Revenue expenditure are those incurred in the daily operation of the company or the day to day running of the company."*

> *In order to understand what an expenditure of capital nature is one has to know that there are two types of expenditures. These are expenditures of a revenue nature in contrast to those of a capital nature. Revenue expenditures are put in the income statement or the profit and loss account while capital expenditures go in the balance sheet.*

On the definition of revenue expenditure the Tribunal held that:

> *Revenue expenditure are those incurred in the daily operation of the company or the day to day running of the company. These are expenses incurred to maintain the business and benefit the current expenditure. These expenses are incurred in the normal course of business. They are expenditures incurred for the purposes of keeping a profit earning asset in condition to earn profits. They are expenditures incurred in the production of income. If the expenditure is incurred with the purpose of earning profit it would be an expenditure of a revenue nature.*

For a capital expenditure, the Tribunal held that:

> *Capital expenditure, on the other hand, is expenditure incurred to benefit future periods. Capital expenditure creates a benefit of an enduring nature. They increase the earning capacity of a company. It can also be considered as money aspect for the purchase of long term assets and includes assets such as buildings and machines or that has the effect of increasing the capacity, efficiency, lifespan of a fixed asset. The character of the expenditure is ordinarily determined by reference to the nature of the asset acquired or the liability being discharged by the company. The character of the advantage sought in acquiring the asset is in most cases the most critical and determining factor in deciding the nature of the expenditure.*
>
> *An expenditure of a capital nature is incurred with the purpose of bringing in existence an asset or an advantage for the enduring benefit of a trade.*

The Tribunal further held that for one to be a capital expenditure it should be one paid for the acquisition of a capital asset and not a stock in trade. Further that before determining that expenditure is capital in nature it must first be determined whether it was expensed for a fixed asset or stock in trade.

The Tribunal held that under the ITA premium is considered as rent. The Tribunal found that both rent and premium are costs incurred in acquiring an interest in land. The Tribunal held that how they are worded does not change the effect in acquiring the said interest. The nature of the advantage is what matters. The Tribunal also held that the mode of payment by Vivo could not be an absolute final or determinative in deciding whether they amounted to revenue expenditure.

As a result, the Tribunal held that it would consider the character of the advantage sought where the recurrence of payments plays their part in determining if the payments were capital in nature. The Tribunal also held that it would have to consider whether the payments were for future benefits.

The Tribunal held that the land leased to Vivo was for long term. As a result, the leases conferred interests on the application in land which was capital in nature. The Tribunal also held that it did not matter whether the lease was for 5 years or 99 years, as long as there is ownership.

The Tribunal also made a distinction between rent and leases. It stated with a lease there is exclusivity to use and occupy the property unlike with a tenancy agreement. The lease allows one to modify a premise without consent unlike the tenancy agreement. The Tribunal thus concluded and stated that:

> ***Rent paid for such premises is considered as a revenue expenditure as it is incurred for the operation of the business. While rent and premium paid for leases is incurred to acquire a fixed asset.***
>
> On the lease, the Tribunal held:
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> ***The above decision confirms the Tribunal's finding that when one acquires a lease interest in land it obtains exclusive possession of the land for the period specified in the lease. That acquisition is one of ownership of a capital asset.***
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> The Tribunal thus concluded that the payments were capital in nature and held that:
> ***The Tribunal notes that the applicant deals in fuel and lubricants which are its stock in trade and not land. The applicant leased land from various land boards to enable it operates its petrol stations, the said leases conferred ownership on the applicant on the land for the period specified in the leases. The said leases were an acquisition of a capital asset by the applicant. Hence the costs incurred by the applicant were capital in nature. Therefore the Tribunal finds that the payments of rent and premium by the applicant to the landlords were for the acquisition of a capital asset and therefore not deductible allowance under S.22 of the Income Tax Act. The said payments are to be considered in the cost base of an asset under section 52(2) of the ITA.***

On the penalty, the Tribunal reiterated the facts as being that Vivo estimated and paid provisional taxes amounting to UGX 19,666,666,667 for the year 2003. Vivo's financial year of income run from January to December. Vivo revisited and paid the amount over and above the estimated tax on 30th December, 2003. Vivo filed the revised tax assessment in March, 2004, hence creating the issue. The URA claimed that the revised assessment should have been filed by December, 2003. Vivo stated that it filed the revised return on the 30th December, 2003. The Tribunal held that the amount paid on the 30th December, 2003 corresponds with the amount indicated in the provisional return. The Tribunal observed that there is doubt as to how Vivo would have paid taxes without filling the revised tax estimates. As a result, the Tribunal agreed with Vivo and set aside the assessment for the penalty.

Please refer to the link below to view the Ruling of the Tribunal
https://drive.google.com/file/d/1JZPz82m1rIH-gKoJ_DC25Sd4ZEAtFIWd/view?usp=sharing

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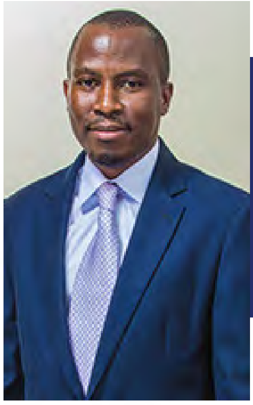
5. Some of the decision are the subject of appeal, and we do not hold responsibility for any changes that would happen as a result of the appeal.

THE TEAM



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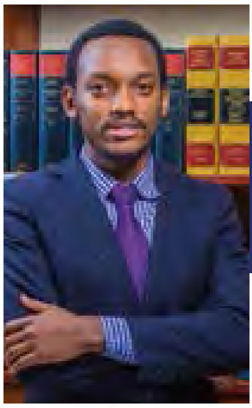

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