

Legal Brief

Lawhill & Co. Advocates – Premier Tax & Corporate Attorneys

*Issue No. 3, May 30th 2020.
From our Tax Desk*

Incidence of Withholding Tax is on Actual Payment – the Tax Appeals Tribunal of Uganda Decides

The Tax Appeals Tribunal of Uganda (the TAT) has ruled that:

- *Withholding tax on interest on loan should be due on interest when it is paid and not when it accrues;*
- *It is a cardinal principle in statutory interpretation that a specific provision overrides a general provision;*
- *Section 2 of the Income Tax Act (Uganda) defining payment is an interpretation section, however, it is subject to the context of section 47 (2);*
- *The decision of the Court of Appeal of Kenya in Kenya Revenue Authority vs Republic (ex parte Fintel Ltd), Civil Appeal No. 311 of 2013 disregarded;*
- *Conversion of interest and adding it to the principal loan amounts to payment and withholding tax arises on conversion.*

Brief facts of the Dispute

ATC Uganda Limited (the Applicant) received a loan of \$ 124,500,000 from Uganda Tower Interco. B.V (UTI), a non-resident company incorporated in Netherland and owning 99% shares in the Applicant. Under the Shareholder Loan Agreement between the two parties’ (“affiliates”), the loan was for the period of 7 years with an interest rate of 6.56 per annum. In an initial period of 30 months, interest accrued was to be added to the principal amount and payable at a future time. While in subsequent years interest was to be paid annually, unless the Applicant faces financial hard ships, a case in which interest will accrue and will be payable at a future time.

In 2018, the Uganda Revenue Authority (the Respondent) audited the Applicant and assessed the Applicant for Withholding Tax on interest arising out of a foreign loan received from UTI that had accrued for the years 2012 to 2017 to the tune of Uganda Shillings 24,232,558,369. The basis of the Respondent’s assessment was that, withholding tax on such accrued interest was due to be paid on accrual basis, annually. Further, after examining the audited financial statements of UTI (the lender), it transpired that UTI had reported such interest as income to it and already paid by the Applicant. The Applicant contended that, it had never made payments to UTI on interest and further that, withholding tax is payable when the interest is paid or remitted and not when accrued. Aggrieved with the Respondent’s decision to assess her, she applied to the Tax Appeals Tribunal for redress.

Issues for determination

The TAT recorded the following issues as agreed by parties:

1. Whether Withholding Tax is payable on purported accrued interest which was added to the principal loan; and
2. What remedies are available to the parties

The Applicant's Case

The Applicant's key arguments were that;

- That the obligation to pay tax in respect of interest arises at the point of remittance of the interest and not when it accrued;
- That the Respondent's reliance of section 2 (xxx) of the Income Tax Act disregarded section 47 of the Income Tax Act. The opening statement in section 2 reads: "unless the context otherwise requires...", the context of section 47 of the Income Tax Act is that withholding obligation arises on actual remittances.
- That it is a rule of statutory interpretation that a specific provision in a statute takes precedence over a general provision.
- That courts should interpret any provision in any way that would render another part of statute inoperative or redundant.
- Application of Ugandan tax law does not depend on what a taxpayer does with its books of accounts but from the language of the law.

The Respondent's Case

The Respondent, URA, on its part, in attempt to defend its position argued as follows;

- That interest paid or payable to UTI was subject to withholding tax under section 47 (1) that provides that interest in the form of discount, premium or deferred payment shall be taken into account as it accrues, but section 47 (2) provides that interest shall be taken to be derived or incurred when paid;
- Section 2 (xxx) defines "payment in" to include any amount "paid or payable" in cash or in kind and any other means conferring value or benefit on a person; and
- Relying on the decision of the Court of Appeal of Kenya in *Kenya Revenue Authority vs Republic (ex parte Fintel Ltd)*, *Civil Appeal No. 311 of 2013*, the Respondent argued that "when paid" should not be given an ordinary meaning but rather a contextual meaning with the Act.

The TAT Decision and its Reasoning

The TAT was of the view that the Respondent's contention that withholding tax becomes due when interest accrues was founded on convenience. The TAT agreed with the Applicant that the opening statement in section 2 of the Income Tax Act is: "In this Act, unless the context otherwise requires..." The context in section 47 (2) requires withholding tax to be charged when interest is paid. A specific provision, in this case section 47 (2), in a statute overrides general provisions, these are section 2 and section 47 (1). In holding that withholding tax should be due on interest when it is paid and not when it accrues, the TAT cited with approval the decision of the Tribunal in *Cooper Motors v Uganda Revenue Authority*, *TAT 67 of 2018*, where the Tribunal stated:

"The Tribunal notes that S. 2 of the Income Tax Act that defines payment is an interpretation section. The word payment is defined to include payment of any amount paid or payable in cash. In essence where interest accrues WHT becomes payable. On the other hand, S. 47(2) states that interest subject to withholding tax shall be taken to be derived or incurred when paid. In other words WHT tax on interest accrues when the interest is paid. If S. 2 of the Income Tax Act had been read as a whole one would have noted that S. 2 begins with "In this Act, unless the context otherwise requires..." S. 2 of the Act applies until the context so requires. The context in S. 47(2) requires that WHT on interest be withheld when it is paid. S. 2 is in consonance with S. 47(2). It does not conflict with S. 47(2) of the Act. It gives room for S. 47(2) to apply. It is just a question of reading the whole Section without limiting oneself to only the definition of the term "payment".

The TAT however held further that when interest is converted into capital and added to the principal loan, the Applicant is paying interest. That it should not confuse the issue of ‘paid’ or ‘accrued’ with the ‘mode of payment’. Reading clauses 3.3 and 3.4 of the Shareholder Loan Agreement, the Applicant fully discharged its obligation to UTI as the interest was paid at the end of each interest period when it was converted into the loan.

What the TAT’s Decision means and why is it Important to Taxpayers in Tanzania?

Lawhill & Co. Advocates notes this is a decision of a century that does justice to canons of statutory interpretation and applicability of the withholding obligation. The decision, though persuasive, is very crucial besides restating the cardinal rule that a specific provision overrides a general provision, it elucidates on the how tax bodies should approach similar issue. There are numerous tax disputes that are either pending before the Tanzania Revenue Authority (TRA) or tax adjudication bodies where the issue regarding the incidence of withholding obligation is central to the dispute. It been TRA’s position that withholding obligation arises on actual payment as well as accrual basis. TRA basis its position on the definition of the word “payment” under section 3 of the Income Tax Act, 2004 (the ITA 2004). On the other hand, taxpayers maintain that, section 83 imposes a withholding obligation when a person ‘pays’ the qualifying payments with a source in the United Republic.

One would note the wordings of the ITA 2004 are not substantially different from the Ugandan Income Tax Act. More importantly, the cardinal principle of statutory interpretation which states that a specific provision overrides a general provision, is part of the law in the United Republic. It is interesting to note that section 3 of the ITA 2004 starts with the words: “In this Act, unless the context requires otherwise”. This means that whereas, the definition of ‘payment’ under section 3 of the ITA 2004, includes the creation of an asset into another person, which TRA has always used to form the basis of their position, is subject to the context required under section 83 of the ITA 2004. The context in that section, requires withholding tax to be withheld when it is paid and not otherwise. Section 3, being an interpretation section, cannot take precedence over section 83 of the ITA 2004, which is a specific provision. TRA also relies on section 23 (1) of the ITA 2004, which requires a corporation to account for income tax purposes on accrual basis. However, such reliance is incorrect on two basis: first, it is cardinal principal of taxation, that an accounting entry cannot create an income, unless it has actually resulted. Income tax is a tax on income, and a hypothetical income is not income for the purpose of levy of tax. Second, section 23 of the ITA 2004, just like section 3, being general provisions cannot override section 83 of the ITA 2004, being a specific provision.

Based on our analysis, the Ugandan decision will assist tax adjudication bodies in Tanzania to appreciate the correct and pragmatic approach as to the correct incidence of taxation when it comes to withholding taxes. Lawhill & Co. Advocates commends the approach taken by the Tax Appeals Tribunal of Uganda in developing tax jurisprudence based on the established and long-tested principles of income taxation. This timing obligation to withhold taxes is not limited to interest on loan, but it covers all withholding obligations such as rent, premium, and service fees. Taxpayers are encouraged to rely on the Ugandan jurisprudence and the general principle of statutory interpretation in defending assessment regarding withholding taxes that are issued on payments which have not been paid and their associated interest for late payment.

Disclaimer! This brief is issued for general information purposes and does not in any way constitute a legal opinion by Lawhill & Co. Advocates. Lawhill & Co. Advocates shall not be liable for any injury and/or loss arising from relying on this brief. Should you have issue relating to the brief or any other issue, kindly contact our office for an opinion that suits your particular needs.

For inquiries on this or any other legal issue contact us through our below contact details or visit www.lawhill.co.tz