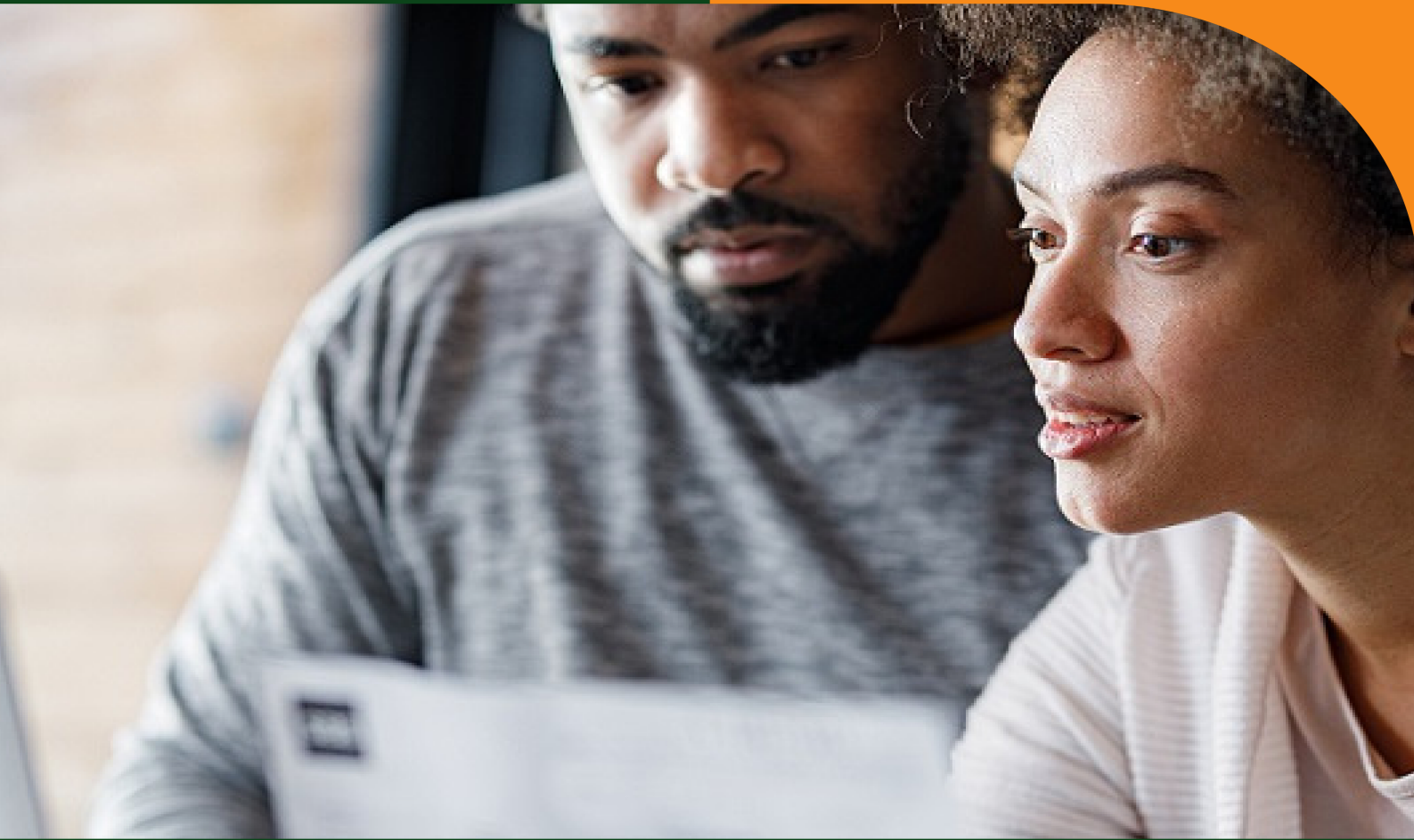




2024

EDITION



Taxation

STUDY TEXTBOOK

CPA (U)

PAPER 6

TAXATION

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This study text has been published in close consultation with lecturers and tutors with vast experience in teaching CPA(U) papers in particular Taxation (Paper 6) and has been updated to capture the new changes in the CPA(U) Syllabus that took effect in June 2016 examination sitting. Therefore, this study text contains all the information that you need to pass your exam.

The study text therefore;

- Highlights the most important elements in the CPA(U) Syllabus and the key skills you need
- Emphasizes how each chapter links to the CPA(U) Syllabus and the study guide
- Provide a lot of exam focus points demonstrating what is expected of you in the exam

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Taxation Principles and Theories



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1.0

INTRODUCTION TO TAXATION

UNIT 1 OVERVIEW

- Basic Concepts and purpose of taxation
 - Activities of Government
 - Public Revenue
 - The Purpose of Tax
 - Tax Burden
 - Tax Incidence
 - Principles of Optional Tax System
 - Tax Evasion and Tax Avoidance
-

1.1 BASIC CONCEPTS AND PURPOSE OF TAXATION

This first chapter brings out the general theory of taxation. From our general knowledge, we are aware that the government (central or local government) provides goods and services to the public. The goods and services provided to the public cost money, which means that the government must incur expenditure in providing them. This is referred to as the government expenditure.

On the other hand, the government cannot incur any expenditure unless it obtains money in form of government revenue or income. Government therefore has got to create the various sources of revenue from which it will generate money. Taxation forms one of the major and important sources of Government revenue. As a result, therefore Taxation becomes part of public finance. Public finance in this context refers to the study of the spending and revenue raising activities of the government.

In order for one to understand why government requires money or funds, it is vital at this level to explore the activities carried out by Government.

1.2 ACTIVITIES OF THE GOVERNMENT

The major government activities include the following;

1. To maintain internal security and external defense as well as carrying out general administration. In this respect government will incur expenditure relating to the following:
 - The cost of police and judiciary for maintenance of law and order.
 - The cost of the armed forces such as the army, navy and air force for defense against external aggression. e.g. UPDF, Local Defense Units (LDUs)



- Cost of provincial administration and general administration of law and order. Examples include the Chief Administrative Officers (CAOs), District Security Officers (DISOs) etc
2. To provide infrastructure and communication such as:
 - Cost of constructing roads, railways, airports and harbors
 - Cost of constructing electricity and telephone networks, television and radio systems, etc.
 3. To provide basic social services. Examples include:
 - Medical services and medicine in hospitals
 - Education in schools, colleges and universities
 - Water supply and sewerage
 - Sports and cultural activities
 - Entertainment and information on radio and television.
 4. To participate in the production and marketing of commercial goods and services.
 - Cost of establishing public enterprises such as parastatals. (Examples would include parastatals like Posta Uganda which provides services to the population that cannot be provided by any other private service provider.
 - Combining with private business through purchase of shares in commercial enterprises. There is pressure all over the world for government to divest or privatise business enterprises. The Uganda government has already privatized a number of formerly government parastatals. E.g. Coffee Marketing Board, Uganda Commercial Bank now Stanbic, Nytil, Tororo Cement and Kibimba Rice Scheme now called Tilda, Uganda Telecom UTL is now partially owned by Government.
 - Providing in form of easy loans not obtainable in financial institutions, and providing cheap business premises e.g. the activities of Micro Finance Institutions like Uganda Micro Finance Support Center which is providing loans to the population at very low interest rates through the Cooperative Savings and Credit Organizations (SACCOs).
 - Guaranteeing markets through protection from competition and preferential purchases.
 5. Influencing and guiding the level and direction of economic activities through various regulations:
 - Monetary policy (relating to interest and money supply)
 - Fiscal policy (deliberate manipulation of government income and expenditure so as to achieve desired economic and social goals).
 6. Redistributing income and wealth through taxation and public spending:
 - Taxing the rich and those able to afford tax
 - Cost of providing basic needs to the poor such as free education, medical care and housing.
 - Cost of relief of famine and poverty which may arise from unemployment, sickness, old age, crop failure, drought, floods, earthquakes, etc.

To perform the above functions effectively and adequately, the government needs funds. Taxation is one of the major sources of government revenue and is a very important source of government income.

The income of the government from taxes and other sources is known as public revenue.

1.3 PUBLIC REVENUE

Public revenue therefore is all the amounts, which are received by the government from different sources. The different sources of revenue to Government are classified below with taxes being the major source of revenue to government.

1. Taxes

Taxes are the most important source of public revenue. A tax can be defined as an involuntary payment by a person referred to as a taxpayer without involving a direct repayment of goods and services (as a “quid pro quo”) in return. In other words, there are no direct goods or services given to a taxpayer in return for the tax paid. The taxpayers can, however enjoy goods or services provided by the government like any other citizen without any preference or discrimination.

A common tax system will usually comprise of the following features.

(i) Taxing authority

This is the authority with the power to impose taxes, e.g. the central government or a local authority. The taxes are received as public revenue. The taxing authority has power to enforce payment of tax. Example is the Uganda Revenue authority. It has the power to enforce the payment of taxes.

(ii) Taxpayer

This is the person or entity that pays the tax. Examples will include; individuals, companies, business and other organizations that pays taxes. The amount of tax is compulsory whose failure to remit will result in fines and penalties.

(iii) Tax

The amount paid to the taxing authority as direct cash payment or paid indirectly through purchase of goods or services. The tax is not paid for any specific service rendered by the tax authority to the taxpayer. The tax paid becomes revenue and is used to provide public goods and services to all citizens.

In addition to the above common features often, the definitions of tax by some tax experts as list below are important:

- (i) Tax is a compulsory contribution to a public authority, irrespective of the exact amount of service rendered to the taxpayer in return.
- (ii) Tax is a compulsory contribution from a person to the government to defray the expenses incurred in the common interest of all.
- (iii) Tax is a compulsory contribution of wealth by a person or body of persons for the service of the public.

There are different kinds of taxes classified in different ways as will be elaborated later in this book. However, in summary, the different kinds include; Income Taxes, Value added Tax, Sales Tax, Excise Duty, Customs Duty, stamp Duty and Land Rents and Rates.

2. Fees

Fees is an amount which is received for any direct services rendered by the central or local authority e.g. television and radio fees, national park fees, air[port departure fee, airport landing and parking fee, port fee by ships, university fee, etc.

3. Prices



Prices are those amounts which are received by the central authority for commercial services, e.g. railway fare, postage and revenue stamps, telephone charges, radio and television advertisement, etc..

4. Specific Assessments

Specific assessments are those amounts, which are charged for specific purposes. The government may charge a specific assessment from the residents of a particular area for the purpose of establishing a secondary school in that area and that would be a specific assessment. An urban council/municipality whenever it constructs a road will allocate the cost of the road to the owners of plots served by the road, and that would also be specific assessment.

5. Fines and Penalties

If individuals and firms do not obey the laws of the country, fines and penalties are imposed on them. Such fines and penalties are also the income of the government. Examples are Traffic fines, Court Fines and Penalties, penalties for failure to file tax returns etc...

6. State Property

Some land, forest, mines, national parks, etc. are government property. The income that arises from such property is also another source of public revenue. The income will arise from payment of rents, royalties, or sale of produce.

In conclusion, public revenue is comprised of both tax and non-tax revenue. Tax revenue is that revenue which accrues basically from taxation. Non tax revenue is any other revenue raised by government and not accruing from taxation.

1.4 THE PURPOSES OF TAX

The raising of the revenue is not the only purpose for which taxes are levied. The taxes are levied for various purposes which are in line with the activities of Government as outlined in section 1.2.

a) Raising Revenue

The main purpose of imposing taxes is to raise government income or revenue. Taxes are the major sources of government revenue. The government needs such revenue to maintain the peace and security in a country, to increase social welfare, to complete development projects like roads, schools, hospitals, power stations, etc.

b) Economic Stability

Taxes are also imposed to maintain economic stability in a country. In theory, during inflation, the government imposes more taxes in order to discourage the unnecessary expenditure of the individuals. On the other hand, during deflation, the taxes are reduced in order to encourage individuals to spend more money on goods and services. The increase and decrease in taxes helps to check the big fluctuations in the prices of goods and services and thus maintain the economic stability.

c) Protection Policy

Where a government has a policy of protecting some industries or commodities produced in a country, taxes may be imposed to implement such a policy. Heavy taxes are therefore imposed on commodities imported from other countries, which compete with local commodities thus making them expensive. The consumers are therefore encouraged to buy the locally produced and low-priced goods and services.

d) Social Welfare

Some commodities such as wine, alcoholic drinks, tobacco, cigarettes, etc., are harmful to human health. To discourage wide consumption of these harmful commodities, taxes are imposed to make the commodities more expensive and therefore out of reach of as many people as possible.

e) Fair Distribution of Income

In Uganda, any country some people will be rich and others will be poor due to limited opportunities and numerous hindrances to becoming wealthy. Taxes can be imposed which aim to achieve equality in the distribution of national income. The rich are taxed at a higher rate and the amounts obtained are spent on increasing the welfare of the poor. That way, the taxes help to achieve a fair distribution of income in a country.

f) Allocation of Resources

Taxes can be used to achieve reasonable allocation of resources in a country for optimum utilization of those resources. The amounts collected from taxes are used to subsidize or finance more productive projects ignored by private investors. The government may also remove taxes on some industries or impose low rates of taxes to encourage allocation of resources in that direction.

g) Increase in Employment

Funds collected from taxes can be used on public works programmes like roads, drainage, and other public buildings. If manual labour is used to complete these programmes, more employment opportunities are created.

1.5 CLASSIFICATION OF TAXES

Taxes can be classified in accordance to the following:

- (i) The incidence or final resting place of the tax
- (ii) According to how the marginal rates of tax vary with one's level of income
- (iii) Can also be classified in accordance with the object of taxation. i.e. the tax base.

1.5.1 CLASSIFICATION ACCORDING TO FINAL RESTING PLACE (TAX INCIDENCE)

(a) DIRECT TAXES

These are taxes where the final burden cannot be shifted by the taxpayer to another taxpayer(s). Both the impact and Incidence fall on the same person. A direct tax is legally assessed on one person and paid by the same person. Direct taxes include personal income tax, corporation tax, Capital gains tax, Inheritance tax, etc. Direct taxes are unavoidable, which means that they must be paid by everyone who has taxable income. A direct tax is paid directly by a taxpayer to the Revenue Authority.

Advantages of Direct Taxes:

Direct taxes are fair and equitable because they are usually progressive or proportional taxes.

- (a) They are levied according to ability to pay



- (b) They are less inflationary than indirect taxes.
- (c) They are unavoidable i.e. one who earns is the one who pays.
- (d) The tax payers know what their tax liability is

Disadvantages of Direct Taxes:

Taxes on incomes are often criticized for causing harmful distributions especially on incentive to work.

(i) Disincentive to investment:

A direct tax on profits is likely to get as a disincentive to risk taking. The tax reduces the net return from an investment.

(ii) Reduces ability to Invest:

A tax on profits will reduce the ability to invest. A considerable part of new investment comes from retained profits. So any tax on corporation profits reduces ability of firms to save, therefore limit the sources of funds for investment.

(iii) Immigration of Labor:

High taxation might also cause immigration of highly skilled and highly paid workers to countries with more favorable tax regimes.

(iv) Discourages mobility of labour.

When income tax is levied at high rate, it might discourage both the geographical and occupational mobility of labour.

(b) INDIRECT TAXES:

Refers to taxes where there is a possibility of the final burden being shifted by the tax-payer onto other person(s) depending on the elasticity of demand. With an indirect tax, the burden and incidence do not fall on the same person. This implies that tax is legally assessed on one person and paid by another. Example is Value Added Tax (VAT). The Impact and Incidence of an indirect tax does not fall on the same person.

Characteristics of indirect taxes:

- They can be shifted by the tax payer to other person(s)
- They are collected by business people on behalf of government.
- They are not compulsory i.e. they can be avoided by not consuming commodities on which they are imposed.
- They are regressive in nature.
- They are imposed on commodities not income or properties.

Types (forms) of Indirect taxes:

- (i) Sales tax
- (ii) Excise duty
- (iii) Export duty
- (iv) Import duty



- (v) Sumptuary tax
- (vi) Value added tax (VAT)

(i) Sales tax

Sales Tax is a tax imposed on sale of commodities. The burden falls either on the seller or buyer or both depending on elasticity of demand of the commodity.

When the demand for a commodity is perfectly inelastic, the tax burden falls squarely on the buyer. Sales tax and Commercial Transaction Levy (CTL) was abolished in Uganda with effect from 30th June 1996 to be replaced with Value Added Tax (VAT) which came into effect on the 1st of July 1996.

(ii) Excise duty:

This is a tax charged on goods which are produced locally in a country. It is a kind of license permitting the local producer to carry out business. Example is tax on locally manufactured soap by Mukwano Industries or Locally manufactured biscuits by Riham Industries.

(iii) Export duty:

This is a tax charged on exports to raise government revenue. Other reasons may be to discourage exports and raise revenue for government development and social programs.

(iv) Import duty:

Is a tax charged on imported goods with an aim of;

- Raising revenue for government.
- Protecting young Industries from cheap highly subsidized imported goods.
- To conserve foreign exchange that would be drained by imports.
- To protect citizens of a Country from harmful goods from abroad.

(v) Sumptuary tax:

Sumptuary shares the same root as the word "sumptuous," which means rich and luxurious. Thus, a sumptuary tax is a levy on items of luxury, frequently the object of an addiction. Because sumptuary taxes have focused on products considered vices, such as alcohol and tobacco, the more colloquial term "sin tax" has evolved for these taxes, while the term "luxury tax" is used for those high-end items characterized by an increase in demand as their price rises.

This tax is therefore charged on commodities to discourage their consumption.

Sumptuary Tax can further be clarified using the following stages or steps:

➤ **Identification**

Any tax on a socially undesirable class of products can be described as a sumptuary tax. Alcohol and tobacco are the most common, though many are unaware that the single most expensive ingredient in a glass of beer is the beer tax, levied per barrel on the producer and passed on to the consumer. Though beer could be considered a luxury in the traditional sense of it not being a strict necessity, it is hardly what most people would consider luxurious.

➤ **Function**

Sumptuary taxes are often political and funding expedients. When funds are needed for a particular project, or for a general budget shortfall, a raise in sumptuary taxes is usually the least objectionable to the majority of voters. After

all, they can avoid the tax by not buying or using the products. A classic use of the sumptuary tax as fundraiser is the case of municipal sports stadiums. Rather than raise property taxes in the area, a highly unpopular proposition for a politician, an increase in the tax on beer purchased is more likely to target the users of the stadium and be more acceptable. Similarly, taxes on tobacco are used to fund anti-tobacco public service initiatives.

➤ **Significance**

While taxes on real luxuries, like expensive jewelry and yachts, are truly progressive, meaning they have a higher impact on the wealthy than the poor, sumptuary taxes are regressive, meaning they are felt more severely by lower and middle income individuals. Furthermore, the sumptuary tax is not levied in relation to the final cost of the product, with the result being that tax on high-end alcohol and tobacco products is a smaller overall percentage of the consumer's cost.

➤ **Effects**

The commonly stated justifications of sumptuary taxes are that they discourage the use of dangerous products and they offset the cost burden that the users of alcohol and tobacco put on the healthcare system. In fact, however, there is little evidence that taxes alone cause people to reduce their use of "vice" products, and many claim that the personal use of such products should not be regulated by government in any case. Furthermore, a study published by the Public Library of Science finds that smokers and drinkers do not create a financial burden or strain on healthcare systems because the costs of living longer offset any benefits. In fact, the increased mortality of heavy alcohol and tobacco users creates as much as a 30 percent savings in lifetime healthcare costs.

➤ **Potential**

In the wake of the recession created by the 2007-08 credit crisis, the state of New York proposed taxes on sugary beverages and junk food snacks as a "fat tax" designed to help the state recover lost tax revenues. As with most sumptuary taxes, this measure was generally supported by the voting public. Others, however, noting its endorsement by the World Health Organization, and the concurrent plans to tax carbon emissions nationally, described a frightening future where consumers are taxed according to a strict code of socially proscribed allowances. The same electronic cashless payment systems that already provide advertisers with information about consumer preferences could also be used to track purchases and assign taxes to (or create other consequences for) buyers of vice products

(vi) Value Added Tax (VAT)

Is a tax levied on the production and consumption of goods and services. It is administered by the tax Authorities, but most of the work of collecting the tax falls on the VAT registered business persons, who then will hand the tax they collect over to the tax authorities. We shall be covering this in detail while covering Value Added Tax as a topic.

Advantages:-

- It is easy to collect since registered businesses are the ones, which collect the taxes on behalf of the government.
- It is self-policing i.e. It's very difficult for business to falsify documents involved in a business transaction.
- VAT is neutral to the forms of production i.e. at each stage in the production and distribution chain a tax is charged.
- VAT taxes all factors of production.
- There is less tax evasion
- VAT encourages exports through refund of taxes paid on exportable goods.
- VAT promotes efficiency i.e. it tries to improve on performance and reduces the costs of production.

Disadvantages of VAT:

- VAT is not easy as a system to adopt especially in developing countries. It requires honest and efficient government machinery to do the cross-checking.
- VAT system depends upon the cooperation of the taxpayers since each firm calculates its tax liability to begin with and also finds out taxes paid by the earlier firms.
- Taxpayers are required to maintain elaborate and costly accounts, this becomes highly un economical especially for smaller firms.
- Difficulties of maintaining accounts, cross-checking and preventing tax evasion.

Advantages of Indirect Taxes:

- Indirect taxes are “hidden” in the sense that the tax payer is largely unaware of the amount of tax that they are paying,
- Difficult to evade, Indirect taxes are generally more difficult to evade than direct taxes.
- Non-Compulsory:
- It is argued that indirect taxes are more preferable to direct taxes in that they leave the tax payer with a choice of not paying the tax by not consuming the taxed commodity.
- Indirect taxes can be used to encourage or discourage the production or consumption of particular goods and services.
- Easy to collect:
- Indirect taxes are easy to collect i.e. most taxes are collected by businessmen and manufacturers. This reduces the cost of tax administration.
- Controlling Inflation:
- Indirect taxes can be used to control inflation.
- Instrument of economic policy:
- Indirect taxation is a flexible instrument of economic policy i.e. the rates of indirect taxes can be charged quickly and easily and can take effect immediately.
- High revenues:
- Indirect taxes results into high revenues for the government since they are embedded in the prices of commodities.

1.5.2 CLASSIFICATION ACCORDING TO HOW THE MARGINAL RATES OF TAX VARY WITH ONE’S LEVEL OF INCOME

1. Progressive Taxes

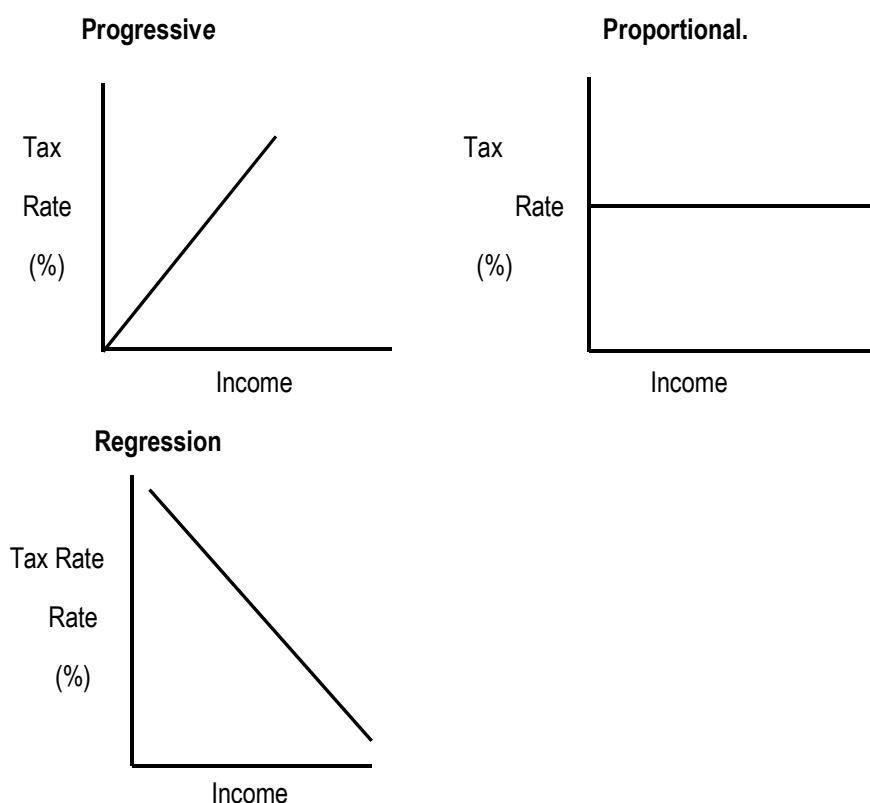
A tax is progressive when the marginal rate of tax rises with income. A good example of a progressive tax in Uganda is the income tax.

2. Proportional Taxes

A tax is proportional when the same rate of tax is applied to all taxpayers, for example the corporation tax.

3. Regressive Taxes

A regressive tax is one where the rate of tax falls as income rises. Here, the poor are called upon to make a greater sacrifice than the rich.



1.5.3 CLASSIFICATION ACCORDING TO THE OBJECT OF TAXATION (TAX BASE)

For example:	Income tax	-	Tax based on income
	Sales tax	-	Tax based on expenditure
	Wealth tax	-	Tax based on wealth

Progressive taxes are favored for their redistribution of income. Progressive taxes take a larger proportion of an individual's gross income, the larger his income is, the higher the taxes paid.

CONCLUSION

In conclusion, the advantages and disadvantages of direct taxes as opposed to indirect taxes can be summarized below:

- They are economical in collection for example, with income tax the collection is done through employers who are unpaid "tax collectors".
- Direct taxes, if progressive, can be made to fall equitably on all taxpayers having regard to their relative abilities to pay. Indirect taxes tend to be regressive, i.e. they take more from the poor and relatively less from the rich.
- Direct taxes are relatively more certain in quantity as opposed to indirect taxes e.g. a sales tax whose yield would depend on the elasticity of demand for the goods taxed.

- They are usually less inflationary than indirect taxes. Usually indirect taxes are imposed on goods thus raising the price of goods (through forward shifting). The cost of living rises and which may trigger off serious confrontations between workers and employers, as the workers seek salary increases. If the employers grant such increases, it will lead to higher costs of production and prices. Higher prices will affect workers leading to a damaging wage-price spiral.

As compared to indirect taxes, direct taxes have the following disadvantages:

- They are costly to administer; for example, every individual liable to income tax would have to be assessed independently depending on his taxable capacity. Indirect taxes have fewer collection points leading to administrative efficiency.
- They are not flexible hence not adaptable to differing circumstances. They cannot be varied so quickly as indirect taxes and therefore, it takes longer for changes to take effect in the economy.
- Indirect taxes as opposed to direct taxes lack announcement effect i.e. people are often unaware that they are paying tax or even how much they are paying. Direct taxes have direct effect on income and therefore may act as a deterrent to effort and enterprise. On the other hand, indirect taxes, although resulting in higher prices, encourage enterprise as people are induced to work harder so as to afford articles desired.
- Higher levels of income tax reduce the incentive to save. On the other hand, high levels of indirect taxes, may encourage saving when goods become unaffordable, and purchasing of goods is delayed in the hope that tax will be reduced later.
- Some forms of direct taxes are paid annually as a lump sum. It may be difficult for the taxpayer to find a lump sum and it gives opportunities for evasion by the submission of fraudulent returns of income.

1.6 TAX BURDEN

There are four aspects of tax burden, namely:

- a) *The direct burden*
 - b) *The indirect burden*
 - c) *The money burden*
 - d) *The real burden*
1. The total direct money burden of a tax is its yield to the government; for every shilling of tax received by the treasury there corresponds a shilling of direct money burden upon someone. Someone has actually paid this Shilling out.
 2. The payment of tax constitutes a sacrifice of economic welfare or utility to the taxpayer. The sacrifice is relatively greater, for example, to a poor man who parts with a shilling than to a rich man paying the same amount. This is referred to as the direct real burden of tax. E.g. both the poor man and the rich man will buy a kilo of Sugar at the same amount and pay the same tax regardless of the economic status. The poor man who pays Shs 50 as tax on a kilo of Sugar will sacrifice more than a rich man paying the same tax on a kilo of Sugar.
 3. A tax on commodity, which is shifted forward to the consumers, has the effect of raising its price. This may force the consumers to partake less of that commodity. The reduced consumption is the indirect real burden of the tax. If Mwalimu reduces his beer consumption from 5 bottles per day to 3 as a result of the increase in excise duty on Beer, then the reduction of the two bottles is the indirect real burden.



4. In the illustration above, the dealer would pay the tax to the government even before the commodity is sold and the tax recovered from the customers. Some time will elapse; occasioning an opportunity cost to the dealer equivalent to the interest he could have earned on the money paid to the tax authorities. This constitutes the indirect money burden of the tax. Other examples of indirect money burden of tax would include tax consultancy fees, and the cost of remitting tax.

Example is where a trader pays for Value Added Tax at the point of importation; this VAT may take time before it is recovered from the consumers. If the trader had put this money in the bank, he would earn an interest of say 3% per month. The would-be lost interest on this money is what is referred to as indirect money burden of the tax.

1.7 TAX INCIDENCE

The incidence of a tax is the direct burden of the tax. It deals with who ultimately pays the tax. Incidence of tax is the final resting place of the tax.

From the illustration given above, the incidence of the tax collected from the dealer is:

- Wholly on the consumer if, as a direct result of the tax, the price of the commodity rises by at least the full amount of the tax.
- wholly on the dealer if the price does not rise at all
- Partly on the dealer if the price rises by an amount less than the full amount of the tax.

1.7.1 The importance of tax incidence

There are numerous objectives of taxation. An efficient and good tax system must be designed having regard to the possible incidence of the taxation. For example if a tax is imposed on cigarette sales in order to discourage smoking and hence cut expenditure on health, it must be ascertained whether the smokers would be affected “adversely” by the tax.

1.8 PRINCIPLES OF AN OPTIMAL TAX SYSTEM

The principles of an optimal tax system which are also referred to as “Canons of Taxation” were laid down by Adam Smith. Every tax system must be in position to fulfill the principals of an optimal tax system. The students should be able to relate each of the principles to the tax system in place. Example could be how the PAYE system fits the canons of taxation. These have been explained below:

1. Taxable Capacity

This refers to the maximum tax, which may be collected from a taxpayer without producing undesirable effects on him. A good tax system ensures that people pay taxes to the extent they can afford it. There are two aspects of taxable capacity.

- a) *Absolute taxable capacity.*
- b) *Relative taxable capacity*

(a) **Absolute taxable capacity** is measured in relation to the general economic conditions and individual position, e.g. the region, or industry to which the taxpayer belongs. If an individual, having regard to his circumstances and the prevailing economic conditions pays more tax than he should, his taxable capacity would have been exceeded in the absolute sense.

(b) **Relative taxable capacity** is measured by comparing the absolute taxable capacity of different individuals or communities.



2. Administrative Efficiency

A good tax system should be capable of being administered efficiently. The system should produce the highest possible yield at the lowest possible cost both to the tax authorities and the taxpayer.

The tax system should ensure that the greatest possible proportions of taxes collected accrue to the government as revenue.

Example is the situation where Uganda Revenue Authority has offices located in all areas and regions within the Country. This is to ensure administrative efficiency. URA has offices being manned by the caliber of staff that is commensurate to the revenue being collected. We cannot have an assistant commissioner based in Vurra or Lia since the revenue being collected from there may not even be in position to meet all the operational expenses of the station. This is to ensure that taxes are collected at a very low cost.

3. Simplicity

A tax system should be simple enough to enable a taxpayer to understand it and be able to compute his/her tax liability. A complex and difficult to understand tax system may produce a low yield as it may discourage the taxpayer's willingness to declare income. It may also create administrative difficulties leading to inefficiency. The simplest tax system is where there is a single tax. However, this may not be equitable, as some people will not pay tax.

Example 1.1: P.A.Y.E

In reference to the current P.A.Y.E system in Uganda, *how does this fit into the principle of simplicity?*

Answer

The method of computing the tax payable is simple enough in that the rates are provided and easily computed by following the relevant tax brackets.

Monthly Tax rates for PAYE in Uganda;

- Below 130,000 no tax is paid
- Between 130,000 to 235,000 Per month, tax of 10% is payable
- Between 235,000 to 410,000 Per month, tax of 20% + 10,500 is payable
- Above 410,000 Pm, Tax of 30% + 45,500 is payable.

This makes the PAYE tax system simple enough and therefore fulfilling the canon of Simplicity. If the system required that PAYE will be computed by obtaining ones age multiplied by number of years worked and then divided by the square root of the result, this would be very complicated and will not



4. Neutrality

Neutrality is the measure of the extent to which a tax avoids distorting the workings of the market mechanism. It should produce the minimum substitution effects. The allocation of goods and services in a free market economy is achieved through the price mechanism. A neutral tax system should not affect the taxpayer's choice of goods or services to be consumed.

Example: If a person's consumption of sugar is affected because of levying a tax on Sugar and one starts looking for alternative replacement of sugar e.g. pounding sugarcane as a substitute, then such a tax is not neutral. A tax should not distort the workings of the market mechanism. Therefore, all countries will ensure that the tax system in place does not distort the market mechanism.

5. Certainty

The tax should be formulated so that taxpayers are certain of how much they have to pay and when. The tax should not be arbitrary. The government should have reasonable certainty about their attainment of the objective(s) of the tax, the yield and the extent to which it can be evaded. There should be readily available information if taxpayers need it.

Certainty is essential in tax planning. This involves appraising different business or investment opportunities on the basis of the possible tax implications. It is also important in designing remuneration packages. Employers seek to offer the most tax efficient remuneration packages, which would not be possible, if uncertainty exists.

Example of certainty within the Uganda Tax system is reflected by the Due dates for payment of taxes. E.g. PAYE, VAT and any taxes withheld should be remitted not later than 15 days after the month in which the taxes were deducted. This enables the taxpayer know and understand when taxes should be remitted. It is a means of certainty to the tax payer.

6. Convenience

The method and frequency of payment should be convenient to the taxpayer, e.g. PAYE where the taxes are deducted at source by the employer. This may discourage tax evasion. Another example is the payment of provisional taxes for both individuals and companies. For example it may be difficult for many taxpayers to make a lump-sum payment of tax at the year-end. For such taxes the evasion ratio is quite high.

7. Equity

A good tax system should be based on the ability to pay. Equity is about how the burden of taxation is distributed. The tax system should be arranged so as to result in the minimum possible sacrifice. Through progressive taxation, those with high incomes pay a large amount of tax as well as a regular proportion of their income as tax.

Equity means people in similar circumstances should be given similar treatment (horizontal equity) and dissimilar treatment for people in dissimilar circumstances (vertical equity).

There are three alternative principles that may be applied in the equitable distribution of the tax burden.

- a) *The benefit principle*
- b) *The ability to pay principle*
- c) *The cost of service principle*

a) The Benefit Principle

This dictates that tax is apportioned to individuals according to the benefit they derive from government activity and spending. The state is regarded as a market and taxes are treated as a payment for the goods and services provided by the state.

According to the principle, the provision of government goods and services will, like the provision of private goods and services be dictated by market demand. This provision is inadmissible as it goes against the aims of taxation, which are also the duties of the government in a market economy, namely the redistribution of income and the clearing of market imperfections. In addition, the principle may have application in limited areas where a close relationship between government expenditure and benefit to the taxpayer can be identified. For example the owners of vehicles who are the road users pay road licenses and toll charges. However, even in such instances, the road users may not obtain benefit from such payment if the revenue so raised is not applied for the benefit of road users.

b) The Ability to Pay Principle

This is concerned with the equitable distribution of taxes according to the stated taxable capacity of an individual or to some criterion of ability to pay. This is in keeping with one of the principal aims of taxation, namely the distribution and stabilization objective. The difficulty in the application of this theory is in determining the criterion of the ability to pay. Three propositions have been advanced income, wealth and expenditure. Should individuals be taxed according to their income, wealth or expenditure?

A wealth-based tax may be useful in the redistribution of income and wealth but may not provide sufficient revenue by itself. An expenditure tax ensures that income and wealth are taxed, when they are spent. Most tax regimes would, therefore, be partly income-based and partly expenditure based.

c) The Cost of Service Principle

This is the cost to the authority of the services rendered to individual taxpayers. Tax is a payment for which there is no "quid pro quo" between the tax authority and the taxpayer; the taxpayer does not necessarily have to receive goods and services equivalent to the tax paid.

For this reason, the principle cannot be applied in relation to services rendered out of the proceeds of taxes e.g. police, judiciary and defense. Rather it may be applied for such services as postal, electricity, or water supply where the price of these services are fixed according to this principle, i.e. the price paid for postal services is the cost incurred in providing the service. It can therefore be stated that this principle may have limited application areas.

1.9 TAX EVASION AND TAX AVOIDANCE

1. Tax Evasion

Tax evasion is the defrauding of revenue through illegal acts by the taxpayer. It entitles deliberate exception and under-declaration of one's income and other fraudulent actions rendering a tax to non-payment or under payment of tax. In other words, tax evasion is a deliberate attempt or refusal to pay taxes.

Tax evasion is a criminal activity!

2. Tax Avoidance

This is where a taxpayer arranges his tax affairs in such a way that he/she pays the lowest taxes at the lowest cost without breaking any law. A tax payer escapes paying tax or pays less tax by taking advantage of the loopholes in the tax laws. It entitles meticulous experts study of the strict laws and taking fullest advantage of what the tax permits. That is to say, portfolios are arranged in such a way so as to meet the least tax possible within the framework of the law. It's regarded as an entirely proper and lawful activity that is socially regrettable.

CHAPTER REVIEW QUESTIONS

1. What factors should a country take into account in designing its tax policy? Is it possible to accommodate all the factors?
 2. Explain how taxes may be different from other sources of revenue.
 3. Explain why people in Uganda should pay taxes to the Government.
 4. Give sources of revenue to the government of Uganda, giving examples of each.
 5. Briefly explain five Cannons of Taxation as laid down by Adam Smith.
 6. Why is taxation necessary? Give examples to illustrate your answer.
 7. Explain six principles of a good tax system citing relevant examples in Uganda.
 8. Distinguish between tax evasion and avoidance.
 9. Explain the nature and implication of Uganda's tax structure on the overall revenue, economic growth and development.
 10. Suggest measures that can be used to achieve the desired tax revenue as ratio of the Gross Domestic Product (GDP).
 11. Which of the following is a direct tax?
 - i. VAT
 - ii. Import Duty
 - iii. Corporation Tax
 - iv. Excise Duty
 12. Argue the case for and against the principle of progression in a system of direct taxation.
 13. Discuss the advantages and disadvantages of direct taxation as opposed to indirect taxation, explaining and illustrating the various terms used in your answer.
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Income Tax in Uganda

2.0

INCOME TAX IN UGANDA

UNIT 2 OVERVIEW

- Imposition of income tax
- Key terms

1.1 IMPOSITION OF INCOME TAX

Income tax is tax on Income of a person for each year in accordance with section 4 of the income tax Act. According to this section, a tax known as income tax shall be imposed on every person having chargeable income for that year. The tax to be calculated on such income shall be calculated in accordance with the relevant rates under the income Tax Act.

1.2 KEY TERMINOLOGIES IN INCOME TAX COMPUTATION

Before tax is imposed on any person, it is important to establish some key terms that will be important in determining whether one is subject to tax or not.

The following terminologies are very important for tax purposes.

(a) Resident and non-resident persons

Residence status of a person is very important for tax purposes. A person's taxable income will be determined by the residence status. A resident person is taxed on all his worldwide income and nonresidents are taxed only on income accruing from sources within Uganda. The resident person who has been taxed on all worldwide sources of income will however be given a relief from Double taxation as we shall be gathering later in this book.

Note that residence status of a person is determined in relation to a year of Income. A person may therefore be a resident in one year and non-resident in another. Residence status of a person can be categorized according to the nature of the person for tax purposes as follows:

(b) Resident individual (sec 9)

According to the Income Tax Act, A resident individual is that individual who fulfills the following:

- (a) Has permanent home in Uganda and was present in Uganda during the year of income under consideration.
- (b) Has no permanent home in Uganda but was present in Uganda:
 - (i) For a period or periods amounting in total to 183 days or more during the year under consideration.
 - (ii) Has no permanent home in Uganda but was present in Uganda for any period during the year of income under consideration and in the two preceding years of income for period averaging more than 122 days for the three years.

Please note that an individual is a natural human being. This is different from an incorporated body of persons.



Activity 1: Resident Individual

Wazalen and Ndebele are citizens of South Africa; they visited Uganda in 2017 and 2019 as follows:

	Wazalen	Ndebele
2017	365	182
2018	4	180
2019	<u>0</u>	<u>5</u>
	<u>369</u>	<u>367</u>

Required:

Establish the residence status of each individual for each of the years and give reasons for your answer.

For 2017 Mr. Wazalen was a resident person in Uganda because he stayed in Uganda for an average of 183 days as compared to Ndebele who stayed for only 182 days.

For 2019, Wazalen is not considered a resident although his average days in the three years amount to 122 days; he was not present in Uganda during 2019. For Ndebele, he was present in Uganda during 2019 and the two preceding years at least for an average of more than 122 days in each of the years. This therefore makes him a resident in 2019 by virtue of staying for an average of more than 122 days in the three years including the current year.

- (c) Is an employee or official of the government of Uganda posted abroad during the year of Income. Examples here include the ambassadors and other government representatives who are posted to carry out their duties outside Uganda for years. Such people are still considered residents of Uganda for tax purposes.

Note:

- Uganda includes the air space, which is a distance up in the sky considered to be part of Uganda. It also includes the territorial waters which is a distance in the sea considered to be part of Uganda.
- An individual must be physically present in Uganda to be considered a resident for that year of Income
- If an individual has a permanent home in Uganda and physically appears in Uganda even for a single day, he is deemed to be a resident for that year.

The Act does not give the definition for a permanent home, but this will be regarded to mean one's dwelling place not necessarily meaning a house.



In Commissioner General of Income Tax Vs Nuruddin Hassanali Noorani.

The case was concerned with whether the individual had a home in the partner states.

Guidelines to interpretation of a home were given as follows:

- An individual could have more than one home and one could be outside the partner states
- A home does not necessarily mean a house, bungalow or flat but could even be a hotel room or a cave.
- The home may be rented or owned
- The home must be available for at least part of the year
- The individual must have full control of the home
- In the home, one would expect to find the family and personal belongings
- The home is to a substantial degree occupied by the individual or his family

Other issues that may be considered are, Place of birth, Citizenship, business interest etc.

Sec 9(2) An individual who is a resident person in the current year of income but was not a resident person for the preceding year of income is treated as a resident individual in the current year of income only for the period commencing on the day that individual was first present in Uganda.

Section 21(1) gives exemption from income tax to short term residents of Uganda. Short term resident refers to a resident individual other than a citizen of Uganda who was present in Uganda for a period or periods not exceeding two years.

(d) Resident Company. (Sec 10)

A Company is resident for year of income if it is:

- (i) Incorporated or formed under the laws of Uganda.
- (ii) Its management and control is exercised in Uganda at any time during the year of income.
- (iii) Undertakes the majority of its operations in Uganda during the year of income

Note:

The place of control and management will only be considered as a question of fact. This may be considered to be where the Board of Directors meetings are held since the management and control of the company is entrusted to the Board of directors by the share holders.

(e) Resident Trust. (Sec 11)

A Trust is resident for year of income if it is:

- (i) Trust was established in Uganda
- (ii) At any time during the year of income trust was a resident person.
- (iii) Management and control of the trust is exercised in Uganda at any time during the year of income.

(f) Resident partnership. (Sec 12)

A partnership is resident if the partners or at least one of the partners was resident person for the year of income.

(g) Resident Retirement Fund. (sec 13)

A retirement fund is a resident retirement fund for a year of income if it-

- (a) is organized under the laws of Uganda;
- (b) is operated for the principal purpose of providing retirement benefits to resident individuals; or
- (c) Has its management and control exercised in Uganda at any time during the year of income.

(h) Non-Resident Person

Subject to subsection (2), a person is a non-resident person for a year of income if the person is not a resident person for that year.

Where section 9(2) or (3) applies, an individual is a non-resident person for that part of the year of income in which the individual is not a resident individual

(i) Taxable persons

This refers to an individual i.e. a natural person or legal entity e.g. company, a trust, cooperative society, estate, club, trade associations, etc.. For income tax purposes, much as a partnership is defined as a person, the definition of taxable persons excludes a partnership. A Partnership therefore is not a taxable person. The individual partners are taxed in their individual capacity.

(j) Year of Income:

Year of income is a period of 12 months commencing 1st July and ending on 30th June as defined by the Income Tax Act section 39(9). Income tax is charged for each year of income. A tax payer may however apply to the Commissioner General to use any other period of 12 months other than the normal year of income. This period other than the normal year of income is referred to as a substituted year of income. The normal year of income is also referred to as the fiscal year of income.

(k) Substituted year of income

As defined in section 39(1), a substituted year of income is a period of twelve months other than the normal year of income which runs from 1st July to 30th June.

(l) Calendar year of Income

A calendar year of income is a period of 12 months running from 1st January to 30th December of any year. Some of the tax payers use the calendar year while others use the normal year of income.

(m) Transitional year of Income:

Where the tax payer changes his year of income either from the normal year of income to a substituted year of income or from a substituted year of income to a normal year of income, the period between the last full year of income prior to the change and the date on which the changed year of income commences is treated as a separate year of income, to be known as the "transitional year of income".

Activity 2

Mr Katula's year of income runs from January to December. In 2019, he would like to change his year of income to run as the normal year of income which runs from July to June. The period between December 2018 when his year that runs from January 2018 to December 2018, and June 2019 will be referred to as transitional year of income. i.e 1st January 2019 to 30th June 2019 is the transitional year and is regarded as a full year of income.



Employment Income Tax



3.0

EMPLOYMENT INCOME TAX

UNIT 3 OVERVIEW

- Key terms
- Composition of employment income
- Taxable employee payments and allowances
- Taxable benefits in Kind
- Other considerations
- Tax exempt employment income
- PAYE System

1.1 INTRODUCTION

Section 4 of the Income Tax Act, Cap 340 of the laws of Uganda, imposes a charge to income tax on every person, for each year of income, who has chargeable income. Chargeable income is defined in Section 15 to be gross income of a person for the year less deductions allowed under the Act.

Section 17(1) defines Gross Income to include three sources of income:-

- (a) Business Income (**Section 18**)
- (b) Employment Income (**Section 19**) and
- (c) Property Income (**Section 20**)

As observed from section 15, employment income is part of a taxable person's chargeable income against which income tax is payable for the year of income.

1.2 EMPLOYMENT INCOME

In order to establish whether income derived by a person is employment income, it is necessary to determine whether a person's activities amount to employment. Employment presupposes the existence of two parties – employer and employee – and these are defined in Section 2 of the Act.

“Employer” is defined to mean a person who employs or remunerates an employee. The definition of a ‘person’ in the act includes an individual, a partnership, a trust, a company, a retirement fund, a government, a political sub-division of a government and a listed institution. This is broad enough to cover an individual or any entity which employs, remunerates an individual engaged in employment.

“Employee” is defined to mean an individual engaged in employment i.e. any holder of an appointment of office for which a remuneration is payable.

The term **“Employment”** is also defined in Section 2 of the Act to mean –

- ✦ The position of an individual in the employment of another person.
- ✦ A directorship of a company;
- ✦ A position entitling the holder to a fixed or ascertainable remuneration;
- ✦ The holding or acting in any public office.



Employment is ordinarily regarded to exist where there is a legal relationship of master and servant. An employee will be under a contract of service, whether written, verbal or implied.

It should be noted that the employment relationship does not exist where the individual is engaged on his/her own account as an independent contractor. The statutory definition of "Employment" is intended to widen the scope of the term beyond the ordinary meaning of the word and would include the rendering of services by one person to another other than in the course of (ordinary) employment or as part of the operations of a business.

1.3 COMPOSITION OF EMPLOYMENT INCOME

According to section 2 part Z (aa), employment income has its meaning in section 19, and according to section 19 subsection 1 of the income tax act cap 340, employment income means any income derived by an employee from any employment and includes the following amounts, whether of a revenue or capital nature;

- (a) any wages, salary, leave pay, payment in lieu of leave, overtime pay, fees, commission, gratuity, bonus, or the amount of any travelling, entertainment, utilities, cost of living, housing, medical, or other allowance;
- (b) the value of any **benefit granted**;
- (c) the amount of any **discharge or reimbursement by an employer of expenditure incurred by an employee**, other than expenditure incurred by an employee on behalf of the employer which serves the proper business purposes of the employer;
- (d) any amount derived as **compensation for the termination of any contract of employment**, whether or not provision is made in the contract for the payment of such compensation, or any amount derived which is in commutation of amounts due under any contract of employment;
- (e) any **amount paid by a tax-exempt employer as a premium for insurance on the life of the employee** and which insurance is for the benefit of the employee or any of his or her dependants.
- (f) any **amount derived as consideration for the employee's agreement to any conditions of employment or to any changes in his or her conditions of employment**. The following circumstances may amount to a change in the employee's conditions of employment;
 - An employee is paid to leave a job for inefficiency then the amount paid is employment income.
 - An employee is paid to due transfer from head office branch to an upcountry branch,
 - An employee is paid a token as an appreciation to taking on multi-tasks in a given,
 - An employee's salary has been increased as a result of merging two or more roles,
 - An employee is paid an additional salary to helping a colleague on sick leave.
- (i) the amount by which the **value of shares issued to an employee under an employee share acquisition scheme at the date of issue exceeds the consideration**, if any, given by the employee for the shares including any amount given as consideration for the grant of a right or option to acquire the shares;
- (ii) the amount of any **gain derived by an employee on disposal of a right or option to acquire shares under an employee share acquisition scheme**.

1.4 TAXABLE PAYMENTS AND ALLOWANCES DERIVED

Section 19(1) (a) lists essentially two categories of payments to be included in employment income for a year of income, and these are:-

Payments which represent the ordinary income for employment and are enumerated to include any wages, salary, leave pay, payment in lieu of leave, overtime pay, fees, commission, gratuity and bonus.

Allowances and these are detailed to include any traveling, entertainment, utilities, costs of living, housing, medical or other allowance.

An “allowance” is an amount paid to an employee by his/her employer for meeting particular expenses but the employer does not carry out a detailed check to establish if the amount given has been used for that specific expense.

This usually comes on a periodical basis. Examples could be a monthly housing allowance, transport, lunch or medical allowance. The employer will not be bothered whether the employer has used this money for the specified expense.

Note that if any part of the allowance other than allowances for private expenditure, is expended in performing duties of employment, then such part may be excluded from employment income. Example here would include subsistence allowance while on official duty, out of station allowance while on official duty out of one's station etc.

1.5 TAXABLE BENEFITS IN KIND

Section 19 (1) (b) widens the scope of chargeability beyond monetary payments by including the **value of any benefit**, advantage or facility granted to the employee during the year of income. The determination of the value of benefits follows the rules as stipulated in the fifth schedule of the Act. This therefore implies that an employee will be taxed on the benefits in kind highlighted below. The Income Tax Act goes ahead to outline how such benefits will be computed for tax purposes.

1. Private Use of a Motor Vehicle

This benefit arises if the employer provides the employee with the use or availability to use a motor vehicle wholly or partly for the private purposes of the employee. It should be noted that private use of the car is all that time that one is out of official working time. Example could be coming from home to the place of work and also going back. This will also include periods like weekends and public holidays where by the employee enjoys the benefit of the car outside working time. This may also include usage on affairs not directly related to one's employment e.g. picking of school children etc.

The formula for determining the value of the benefit derived from use of motor vehicles is:-

Formula to learn

$$\text{Motor Vehicle Benefit} = \left[20\% \times A \times \frac{B}{C} \right] - D$$

Where;

A: is the cost or market value of the motor vehicle at the time it was first provided for the private use of the employee.

B: is the number of days in the year of income during which the motor vehicle was used or available for use for private purposes by the employee for all or part of the day.

C: is the number of days in the year of income.

D: is any payment or contribution made by the employee for the benefit.

The vehicle will not be considered to be available for private use if:-

- ☞ It is used or available for use by employee of the employer in general for duty purposes (assuming the employee is a driver, he is a marketer etc.)



- ✎ The nature of the employee's duties are such that he / she is regularly required to use vehicle for duty outside his / her normal working hours but otherwise is not allowed to use it for private purposes.

Activity 1: Motor vehicle Benefit

Jua Kaali is employed by Uganda Telecom. He is availed a vehicle for use for both employment duty and private purposes. The vehicle was purchased on 01/01/2019 at a cost of Ushs.40 million. He used the vehicle for 300 days (excluding 45 days of annual leave) in the year. He was also charged a nominal monthly figure of Ushs.15, 000/= for the benefit by the employer.

Required:

(i) Compute the car benefit to Jua Kaali for the year ended 31st December 2019, assuming the car was given to him on 1/01/2019

(ii) Compute the car benefit to Jua Kaali for the year ended 31st December 2019 assuming the car was bought in 2017 at a cost of 40 million and given to him on 1st January 2019 when its market value was Shs 37 million.

2. Provision of Domestic Assistant / Servants

These would ordinarily include housekeepers, chauffeurs or drivers, gardeners, etc. the value of the benefit is the total remuneration paid by the employer to the domestic assistant in respect of services rendered to the employee less any payment made for the benefit by the employee. **(Note that security guards are no longer regarded as a benefit to the employee and so are not taxable any more).**

3. Meals, Refreshments or Entertainment

Where an employer provides meals, refreshments or entertainment, the taxable value is the cost of benefit to the employer less any contribution or payment made by the employee for the benefit. We shall later on highlight circumstances when this benefit may be tax exempt.

4. Utilities

This includes facilities like water, sanitation, telephone, e-mail and internet facilities, facsimile, electricity etc. The value of the benefit is the cost of providing the utility to the employer less any payment made by the employee for the utility.

5. Low Interest Loans

An employee will derive a taxable benefit known as "loan benefit in kind" if he / she is provided by the employer with a loan or loans whose (total) amount exceeds one million shillings and with no interest or at an interest rate below the statutory rate. The statutory rate is defined in relation to a year of income to mean the Bank of Uganda discount rate at the commencement of the year of income. The statutory rate will be that rate of interest that will be given by BOU at the beginning of the financial year.

The value of the benefit is the difference between the statutory rate of interest given by BOU and the interest actually paid on the loan if any.

The statutory rate to be used will be the statutory rate given for the year in which the employee obtained the loan. This rate should not be confused with the market rate of interest.



Formula to learn

$$\text{Loan Benefit} = [R_{st} - R] \times L \times \frac{M}{I_y}$$

Where;

R_{st} : Statutory rate of interest (Bank of Uganda's rate of interest)

R: Rate as provided by the employer

L: Loan

M: Months in the year of income

I_y: Number of months in the year (12 months)

Activity 2: Loan Benefit

Mr. Okumu Patrick is an employee of ABC Uganda Limited. During the year ended 30th June 2019, he received a housing loan amounting to Shs.10 million at a nominal rate of interest of 5% per annum.

Required:

Compute the low interest loan benefit assuming the statutory rate of interest by BOU was 13%, for the year.

Please note:-

A short-term loan that is fully repaid within three months of being provided, and is not rolled over or replaced by another advance does not constitute a taxable benefit.

It is however, important to note that, the short-term loan referred to above will be taken into account in determining whether the threshold of one million shillings (referred to above) is satisfied in relation to any other loans provided to employee.

6. Waiver of Debt Obligation

Where an employer decides to waive a debt wholly or partly, the actual relief granted is the value of taxable benefit. Example, if Mr Magombe was owing money to his employer and the employer decides to forgive him of the debt, then the equivalent will be taken as a taxable benefit to Mr Magombe.

7. Transfer or Use of Property or Provision of Service

Where an employer transfers a property to the ownership of an employee or avails such property to the employee's use or provides any service, the value of the benefit in the market value of the property or services reduced by payment made by the employee for the property or service.



Activity 3: Transfer or Use of Property or Provision of Service

If National Housing Construction gave a benefit to all senior staff whereby if a senior staff had land and materials, the company would provide labour for construction as a benefit. The equivalent amount that the senior staff would have paid for the construction will be regarded as a taxable benefit to the employee.

Activity 4: Transfer or Use of Property or Provision of Service

Mr Kisumali worked with Majimoto Limited for 12 years. At the end of the 12th year, he was advised to leave and company and was paid a compensation fee of Shs 300 Million and advised not to set up any such companies for the next 10 years.

Required;

Advise Mr Kisumali on the tax implications of the payment

8. Housing or Residential Accommodation (Quarters)

An employer can provide housing to the employee in three main forms:-

- i. Houses directly owned by the employer.
- ii. Houses let by the employer on behalf of the employees.
- iii. Housing allowance or re-imbursement of rental expenses.

In case of (iii), the benefit is the amount of the re-imbursed rental expenses or the housing allowance being given by the employer while in case of (i) and (ii), the value of the benefit will be the lesser of:-

- a) The market rental value of accommodation or housing reduced by any payment made by the employee for the benefit, or,
- b) 15% of the employment income (paid by the employer to the employee), including the market value of accommodation or housing (determined in (a) above).

Activity 5: Housing Benefit

Mr Makondere has a total employment income of Shs 45 Million excluding the housing. His employer gave him a house in Lungugya where he stays with his family. The market rental value for such a house in Lungugya is Shs 3,000,000 per month. He makes a monthly contribution to his employer of Shs.150,000 per month towards the maintenance of the house.

Required:

- i. *Compute the employees housing benefit for the year.*
- ii. *Compute the housing benefit if the employer was paying for Mr Makondere Shs 2,500,000 per month in form of rent.*
- iii. *What would be the taxable benefit if Mr Makondere was getting a housing allowance of Shs 3,000,000 per month?*



9. Any Other Benefit

There is a general provision for the quantification of any other benefit not covered in the fifth schedule or other provisions of the Act, and it is the market value of the benefits reduced by any payment made by the employee for the benefit.

Section 19(1) includes in employment income the amount of discharged or re-imbursement by an employer of the private or personal expenditure incurred by an employee. A re-imbursement differs from an 'allowance' in that, a re-imbursement will be vouched by the employer to establish if it was used for the specific purpose.

10. Gifts by employer to Employee:

Generally gifts are not treated as income in the hands of the recipient. This rule applies to personal gifts e.g. gifts by a person to his friend. However if gifts are received by virtue of employment services rendered, then it is a gain from employment and it is taxable. Example is tips to a waiter or a taxi driver. This also includes gifts made to employees as Christmas gifts or long time service awards.

In Weston V Hearn An employee received a sum of money on completion of twenty five years of service. It was held that this was not a personal gift. He received this as a result of having been employed by his employer. If he was not employed, then he would not have received the gift. This amount was therefore assessable for tax purposes.

In Calvert V Wainwright; It was held that a taxi driver was assessable in respect of his tips. "Tips received by a man as a reward for services rendered, voluntary gifts made by people other than the employer are assessable to tax as part of the profits arising out of employment and if given in the ordinary way as a reward for services, but on the other hand, personal gifts which mean gifts to a man on personal grounds, irrespective of and without regard to the question of whether services have been rendered or not are not assessable.

The important principle is that for a gain to be assessable, the motive of the payment must be to reward past and present services rendered.

In Ball V Johnson A bank had a scheme of giving cash awards for to its employees who past the institute of bankers Examination.

It was held that the reason for giving the payment was not services rendered but personal success of employee in passing the examinations and not remuneration of services. ***The payment was therefore not taxable.***

1.6 LIFE INSURANCE PREMIUM

Section 19(1)(e) brings to charge any payment made by a tax-exempt employer as a premium for insurance on the life of an employee where the insurance is for the benefit of the employee or any of his or her dependants.

Note that, in case of taxpaying employers such premiums are not tax deductible and are therefore effectively charged to tax on the employer.

1.7 OTHER CONSIDERATIONS

Residence status again is a key factor in assessing ones taxable employment income.

✎ Employees who are resident persons are assessed to tax on their worldwide employment income i.e. from all geographical sources within and outside Uganda. They would however, be given a credit for tax paid on income earned from sources outside Uganda provided tax was paid on such income in that country.

✎ Employees who are non-resident persons are assessed to tax on only their employment income derived from sources in Uganda.

Note: Resident individual is defined in Section 9 of the Act and has already been defined in our earlier topics.

This unit considers the receipts and benefits (earnings) of employment that are to be included in employment income. This should, however, be preceded by defining circumstances under which an amount or value of a benefit received by an employee will be considered to be income derived in respect of employment for the employee.

The amount or value of benefits to be included in employment income has been expanded by the Act to include those given to an “associate” of the employee.

An “associate” is defined in Section 3(1) to generally mean that “Where any person acts or is likely to act in accordance with the directions, requests, suggestions or wishes of another person, whether or not they are communicated to the first-mentioned person, then both persons are treated as associates of each other. The commonest example of an associate is a “relative”. An item given to an associate of the employee say a spouse or child will be included in the employee’s income.

Naturally, the amount or value of benefit provided by the employer to the employee for specified services rendered is income derived in respect of employment. However, Section 19(6) details rules of general application that expand the scope further by providing that an amount of or value of benefit is included in employment income if it:-

- ✎ Is provided to the employee by an associate of the employer or by a third party (i.e non-associate person) under an arrangement with the employer or an associate of the employer. The fact that no services have been provided to the person paying the amount or providing the benefit is immaterial.
- ✎ Is provided to an associate of the employee by an employer of the employee or an associate of the employer or a third party under an arrangement with the employer or associate of the employer. Though someone else receives the amount or benefit, the employee is deemed to have received it.
- ✎ Is provided to an employee in respect of a past, present or future employment. The receipt should have a sufficient bond to the employment irrespective of whether the employment is completed or is yet to commence.

1.8 TAX EXEMPT EMPLOYMENT INCOME

Section 19 subsection 2 details employment income that is exempt from tax and therefore not deemed employment income. Such income will be exempt from tax in the hands of the employee.

Such exemptions will however apply to full time employees and not directors who are not whole time service directors. A whole time service director is defined to mean; a director who qualifies to be a full time employee of the company, and such a director is defined to be:

- Is required to devote substantially the whole of his or her time to the services of the company in a managerial or technical capacity, and
- Does not have an interest of more than 5% in the underlying ownership of the company.

Employment income does not include the following:

- The cost incurred by the employer of any of passage to and from Uganda incurred by the employer in respect of the employees appointment and termination of employment where the employee meets the following conditions;

- i. Was recruited or engaged outside Uganda.
- ii. Is in Uganda solely for the purpose of serving the employer and
- iii. Is not a citizen of Uganda



- The re-imbursement or discharge of an employee's medical expenses. Note that, medical expenses are defined to include 'a premium or other amounts paid for medical insurance'.
- Life insurance premiums paid by a taxable employer for the benefit of an employee or his or her dependants. (Please note that this will change if the employer is an exempt organization that does not pay income tax.
- An allowance, or re-imbursement or discharge of expenditure incurred by an employee on accommodation and travel expenses and on meals and refreshments while traveling in the course of performing duties of employment.
- The value of any meal or refreshment provided by an employer to an employee in say a canteen, cafeteria or dining room operated by or on behalf of the employer solely for the benefit of employees on equal terms i.e. without any discrimination.
- Any benefit granted by the employer to the employee during a month, where the total value of the benefits provided by the employer to the employee for the month is less than ten thousand shillings; or
- A (taxable) employer's contribution for the benefit of the employee or any of his or her dependants made to a retirement fund. The contribution scheme must be established by the Act of Parliament e.g. NSSF, UCEPS.
- *The value of a right or option to acquire shares granted to an employee under an employee share acquisition scheme.*
- If an employee has been in the employment of the employer making the payment for at least ten years, then only 75% of the amount paid is included in employment income and the remaining 25% is actually tax exempt income. The taxable amount will be computed as follows:

$$A \times 75\%$$

Where A, is the total amount derived by the employee from either termination of service or as a lump sum payment after working for 10 years or more of continuous service with an organization.

Section 21 of the income Tax Act gives the following income arising from employment as exempt from tax. This therefore implies that such income will be not be subject to tax in the hands of the employee.

- Employment income of a person working in a public service of the government of a foreign country i.e. in foreign mission based in Uganda, and the income will be tax exempt if the following circumstances are satisfied:-
 - ☞ The person is either a non-resident or a resident individual solely by reason of performing such service.
 - ☞ The income is payable from the public funds of the foreign government.
 - ☞ The income is taxed in the concerned foreign country.

Note that this provision does not cover Ugandans employed by foreign mission in Uganda.

- Allowances payable outside Uganda to persons working in Uganda foreign mission.
- Employment income derived under a technical assistance agreement. The exemption is applicable if the employee is non-resident solely for the purpose of performing duties under the agreement and the Minister (of finance) has concurred in writing with the tax provisions of the agreement.

A technical service agreement is defined in the Act as a "grant agreement between the Government or listed institutions for the provision of technical assistance to Uganda"

- A Pension which is paid from a registered contributory pension scheme.

- Official employment income of persons employed in Uganda's Armed Forces, Police and Prisons, other than a person employed in these organizations in a Civil Capacity.
- Foreign sources employment income derived by a resident individual on which he / she has paid foreign income tax.
- Income of any person entitled to privileges under the Diplomatic Privileges Act to the extent provided in the regulations and order made under that Act e.g. Diplomats accredited to Uganda.
- A lump sum payment made by a resident retirement fund to a member of the fund or a dependant of such a member.
- Any educational grant which the Commissioner-General of URA is satisfied has been made bona fide to enable or assist the recipient (an employee) to study at a recognized educational or research institution.

1.9 DEDUCTIONS ALLOWED AGAINST EMPLOYMENT INCOME

While computing employment income for tax purposes, this income will be taxed at the individual tax rates given by the income tax Act.

The Income Tax Act under section 22 allows a taxable person to deduct all expenses incurred in the production of income that is included in the gross income of that person. However deductions against employment income are given in line with the PAYE system. This brings in force a uniform method of computing the tax on employment income for all the people earning employment income. The Act sets out in Section 22 the general principal of deductibility of expenses which are highlighted below:

a) The three conditions of deductibility are:-

- ✎ There must be an expenditure or loss
- ✎ The expenditure or loss must be incurred by a person during the year of income
- ✎ The expenditure or loss must be incurred wholly and exclusively in the production of income included in gross income of that person.

Therefore, in order for expenditure to be allowed against employment income, it should be relating to that employment and should not be of a domestic nature. With the various forms of expenditures being incurred by employees who may be earning same income it is difficult to categorize between domestic and business expenditure with regard to employment income.

Therefore, with this background, it was impossible to have or to let each employee determine the expenses that are wholly and exclusively incurred in the production of their employment income allowed.

The Income Tax Act therefore came up with the Pay As You Earn system that would tax each employee equally. This system will group the different employees who earn similar income into one category. This will be in compliance to the canons of taxation.

1.10 P.A.Y.E SYSTEM

- i) Section 116 of the Act provides for the withholding of tax from payments of employment income under the Pay As You Earn (P.A.Y.E) regulations to be made under Section 164. Tax is to be withheld by the employer from a payment of employment income to an employee.
- ii) The obligations to withhold tax from employment income has priority over any other amount that is to be deducted or withheld from a payment of employment income by an employer. The obligation to withhold tax under the Act overrides any law in force in Uganda that forbids the reduction or attachment of employment income.
- iii) PAYE withholding for a year of income is effectively a final tax on the employee's income for that year of Income provided the employee does not have any other forms of income.

1.7.1 Returns for P.A.Y.E

- i) Each employer is required to file both monthly and annual PAYE returns. Monthly returns of PAYE are submitted upon making remittance of the tax deducted.
- ii) Previously, URA had two ways of submitting PAYE returns. However currently, there are many reforms within URA that have brought electronic tax system in filing of returns. The tax payer can use the system for filing returns on the system.
- iii) If an employee has one employment, and his or her employer has duly submitted the PAYE returns and remitted the correct tax, then he or she is not obliged to submit a return of income.

Where an employee has multiple employment sources or other sources of income from business or property, then the employee is required to file an annual return of income. Where a person has multiple employment or other sources of income, the tax deducted under the PAYE scheme will be credited against the total liability to get the net tax due.

1.11 RATES OF TAX

In computing monthly PAYE tax, the following monthly rate of tax are used –

Total Monthly Employment Income	Monthly Income Tax
Where total income does not Exceed Shs.235,000= per month.	- NIL
Where total income exceeds Shs.235,000= but does not exceed 335,000= per month.	10% of the amount by which total monthly income exceeds Shs.235,000=
Where total income exceeds Shs.335,000= but does not exceed Shs.410,000= per month.	Shs.10,000 plus 20% of the amount by which income exceeds Shs.335,000=
Where total income exceeds Shs.410,000= per month.	<p>(a) Shs.25,000= plus 30% of the amount by which total monthly income exceeds Shs.410,000= and</p> <p>(b) Where the chargeable income of an individual exceeds shs. 10,000,000 per month an additional 10% is charged on the amount by which chargeable income exceeds shs. 10,000,000.</p>

Residents:

If one had to compute employment income, for the year or from multiple sources (if employment income), he or she would normally use the following annual resident income tax rate.

Annual Rates

Chargeable Income	Rate of Tax
Not exceeding Shs.2,820,000=	NIL
Exceeding Shs.2,820,000= but not exceeding Shs.4,020,000=	10% of the amount by which chargeable income exceeds Shs.2,820,000=
Exceeding 4,020,000= but not exceeding Shs.4,920,000=	Shs.120,000= plus 20% of the amount by which chargeable income exceeds Shs.4,020,000=
Exceeding Shs.4,920,000=	(a) Shs.300,000= plus 30% of the amount by which chargeable income exceeds Shs.4,920,000= (b) Where the chargeable income of an individual exceeds Shs. 120,000,000 an additional 10% is charged on the amount by which chargeable income exceeds Shs. 120,000,000.

Non Resident PAYE Rates: (Annual Rates)

Chargeable Income	Rate of Tax
Not exceeding Shs.4,020,000=	10%
Exceeding Shs.4,020,000= but not exceeding Shs.4,920,000=	Shs.402,000= plus 20% of the amount by which chargeable income exceeds Shs.4,020,000=
Exceeding Shs.4,920,000=	(1) Shs.582,000= plus 30% of the amount by which chargeable income exceeds Shs.4,920,000=, (2) Where the chargeable income of an individual exceeds Shs. 120,000,000 an additional 10% is charged on the amount by which chargeable income exceeds Shs. 120,000,000.

Conclusion

We have made a relatively detailed consideration of employment income as provided for in the Income Tax Act 1997. The following issues should be re-emphasized.

- That all amounts or benefits included in employment income are to be chargeable to tax irrespective of whether they are revenue or capital in nature.
- That so long as an amount is connected to employment, it will be chargeable to tax irrespective of whether it is received by the employee or his or her associate and the fact that the employment services have been, or are yet to be done are inconsequential.
- Where benefits in kind are chargeable to tax either the market value or the cost of such benefit to the employer will be the primary basis of determining the value to be included in

Property Income Tax



4.0

PROPERTY INCOME TAX

UNIT 4 OVERVIEW

- Definition of Property income
- General rules of taxing property income
- Dividend Income
- Interest Income
- Annuities
- Royalty Income
- Natural Resource Payments

1.1 DEFINITION OF PROPERTY INCOME

Property is not defined by Income Tax Act Cap340 and VAT Act Cap 349 of the laws of Uganda.

Property has been defined by some scholars to mean any physical or intangible entity that is owned by a person or jointly by a group of people. Depending on the nature of the property, an owner of property has the right to consume, sell, rent, mortgage, transfer, exchange or destroy it, or to exclude others from doing these things.

Important widely recognized types of property include real property (the combination of land and any improvements to or on the land), personal property (physical possessions belonging to a person), private property (property owned by legal persons or business entities), public property (state owned or publicly owned and available possessions) and intellectual property (exclusive rights over artistic creations, inventions, etc.), although the latter is not always as widely recognized or enforced. A title, or a right of ownership, establishes the relation between the property and other persons, assuring the owner the right to dispose of the property as the owner sees fit. Some philosophers assert that property rights arise from social convention. Others find origins for them in morality or natural law.

1.2 PROPERTY INCOME

Property Income has meaning in Section 20(1) of the Income Tax Act (Cap 340). It is defined as;

- a) Any dividends, Interest, Natural resource payments, rents, royalties and any other payments derived by a person from the provision, use or exploitation of property.
- b) The value of any gifts derived by a person in connection with the provision, use or exploitation of property.
- c) The total amount of any contribution made to a retirement fund during a year of income by a tax-exempt employer.
- d) Any other income derived by a person but does not include amount which is business, employment, or exempt income.

Any amount included in property under sub section (1) (a) retains its character as dividends, interest, annuity, natural resource payments, rent or royalties for the purposes of any section of the Act referring to such income.



1.3 TAXATION OF PROPERTY INCOME (General Rules)

Property income can either be earned by an individual or an incorporated body like companies, trusts, partnerships etc. We shall consider how property income is taxed for each of the categories mentioned.

5.3.1 Property Income earned by an Individual

Property income earned by an individual from a resident person with the exception of rental income will in most cases attract a withholding tax at the specified rate of 15% or 10% depending on the source of this income. This tax at source is the final tax on such income of an individual. The I.T.A clearly states that any income which attracts withholding Tax as a final tax cannot be included in the gross income of that person for tax purposes again. This therefore implies that property income of an individual which attracts W.H.T as a final tax cannot be included in the gross income of the Individual for tax purposes again as the W.H.T at source is deemed to be the final tax on such income.

Note: This provision is only applicable to property income earned from a resident person by an individual. It does not apply to property income earned from a nonresident person even if tax was held at source by the nonresident person.

5.3.2 Property Income earned by companies

Although property income earned by companies will equally attract withholding tax at the same rates like the individual, such W.H.T will not be the final tax on such income. This implies therefore that this income will be grossed up with other sources of income of that that person and subject to tax at the corporation tax rate of 30%. The W.H.T deducted at source will then be given as a relief from double taxation or as a tax credit.

Property income includes the following:

- Any dividends
- Interest
- Natural resource payments,
- rents
- royalties
- And any other payments derived by a person from the provision, use or exploitation of property.

Withholding Tax under sections 117 and 118 is the final tax on such income. Any Income which is earned by an individual and it is subject to withholding Tax at source which is a final tax, such income will not be included in the gross income of that person for tax purposes again. The provision also excludes rental income earned by a resident individual from a resident person as this will be taxed at the relevant individual tax rates for rental income.

However, if such income is not earned from a resident person, it will be treated like any other business income, it will be aggregated together with the other sources of income and taxed at the individual tax rates. The WHT tax paid in advance in any other country will be regarded as tax paid in advance and will be reduced from the tax payable by the individual.



1.4 DIVIDEND INCOME

Dividend income is defined in the ordinary meaning of the term dividend as “the share of profits payable to the shareholders of a company”.

As per the Income Tax Act 1997, the term dividend includes;

Where a company issues debentures or redeemable preference shares to a shareholder;

- In respect of which the shareholder gave no consideration an amount equal to the greater of the nominal or redeemable value of the debentures or shares.

Dividend income can be earned by both an individual and an incorporated body like companies. The tax implications and treatment will vary depending on who has received the dividend income and its source.

Activity 1: Dividend Income

If a shareholder received a free issue of 100 redeemable preference shares in May 2020 at a nominal value of Ug Shs. 4,000/= per share but redeemable in 2021 at Ug Shs. 12,500/=.

The value treated as the amount of dividend paid will be;

$$= \text{Shs. } 12,500/= \times 100$$

$$= \text{Shs. } 1,250,000/=$$

Thus; $X = 12,500/=$ where $X > 4,000/=$ (nominal value)

If the debenture is redeemable at a price less than the nominal value, say 3,500/= “No dividend is taxable”

- In the respect of which the shareholder gave a consideration less than the greater of the nominal or redeemable value, an amount equal to the excess, i.e. the shareholder gave consideration, but less than the redeemable value but greater than the nominal value;

Activity 2: Dividend Income

If the shareholder in illustration 1 above had actually paid Ug. Shs. 9,300/= per share, the amount treated as dividend will be:-

$$= \text{Shs. } 12,500 - 9,300$$

$$= \text{Shs. } 3,200/= \text{ per share}$$

- Any distribution upon redemption or cancellation of a share, or made in the course of liquidation in excess of the nominal value of the share redeemed, cancelled or subject to liquidation. This applies where a distribution is made by a company or redemption or cancellation of a share, or is made in the course of liquidation and the amount of the distribution exceeds the nominal value of the share redeemed, cancelled or subject to liquidation. The distribution is treated as a dividend of an amount equal to the difference between the amount of the payment and the amount by which the nominal value of the shares was reduced.



- In the case of partial return of capital, any payment made in excess of the amount by which the nominal value of the shares was reduced.
- In the case of reconstruction of a company, any payment made in the respect of the shares in the company in excess of the nominal value of the shares before the reconstruction.
The definition above is relevant to a situation where a company undergoes corporate reconstruction. It applies where a payment made in the course of a corporate reconstruction in respect of shares in a company exceeds the nominal value of the share before the reconstruction.
The payment is deemed a dividend of an amount equal to the difference between the amount of the payment and the amount of nominal value of the shares to which the payment relates.
- The amount of any loan, the amount of any payment of an asset or services, or the amount of any debt obligation released, by a company to, or in favor of a shareholder to the extent to which the transaction is in substance a distribution of profits, but does not include a distribution made by a building society.

Paragraph (e) of the definition is referred to as the disguised dividend rule in that it treats certain transactions between a company and a shareholder or an associate of the shareholder as a payment of a dividend, to the extent that the transaction is a distribution of profits.

1.4.1 Treatment of Dividend Income

A dividend paid by a resident company to an affiliate resident company is **exempt** from tax if the company that is receiving the dividend controls directly or indirectly 25% or more of the voting power in the company paying the dividend.

This provision is intended to prevent the 'cascading' of tax at the corporate level between related companies. Cascading of tax implies that there is a tax on tax.

A dividend paid by a resident company to any other resident shareholders (this includes individuals and resident companies that control directly or indirectly less than 25% of the control of the company paying the dividend) is subject to 15% withholding tax on the gross amount.

However, note should be taken that the 15% Final Tax clause only applies to Dividend income received by a resident individual from a resident company where the individual has a control of less than 25%. To a company, the 15% Withholding Tax is not a final tax. The dividend received will be regarded as property income for the company but aggregated together with the other sources of income and taxed at the corporation tax rate of 30%. The tax withheld will however be reduced from the tax payable by the tax payer.

The Income tax amendment bill reduced the rate of Withholding Tax on dividend income received by an individual from the companies listed on the Ugandan stock exchange from 15% to 10%. This was to encourage individuals participate in the stock exchange market within Uganda.



Activity 3 (Example 4.1) - ALEX

During the year ended 30th June 2015, Alex received a dividend income from the following companies:

Avis (U) Limited	Shs 50,000,000
Uganda Clays	Shs 70,000,000
Nike in the Uk	Shs 60,000,000 net

Additional Information

Alex paid with-holding tax in UK of shs. 12,000,000

Required:

Compute the tax payable by Alex under the following Circumstances:

- a) As an individual
- b) As a resident company under Alex (U) Limited

1.5 INTEREST INCOME

Interest is the amount paid for the use of money. In accounting terms, interest as taxable income, is said to be the interest received in respect of any loan, deposit, claim or other right.

Section 2 of the Income Tax Act defines Interest to include;

- Any payment including a discount or premium, made under a debt obligation which is not a return on capital.
- Any swap or other payments functionally equivalent to interest.
- Any commitment, guarantee, or service fee paid in respect of debt obligation or swap agreement.
- A distribution by building society (dividend paid by a building society).

1.5.1 Tax Treatment of Interest Income

Interest income just like Dividend income can be earned by both an individual and an incorporated body other than an individual. The treatment of interest income will basically depend on the person earning it and whether the income is from a resident or non-resident person.

Interest paid by a resident financial institution to a resident individual. (defined in Section 9) or resident retirement fund (defined in Section 13) or an exempt organization (defined in Section 2) is subject to a 15% withholding tax on the gross amount of the interest under Section 117, and the tax so withheld is deemed a final tax under Section 122 of the Income Tax Act.

Interest derived by a resident person in circumstances other than those specified in the paragraph above including interest derived from foreign sources, is included in the gross income either as business income under Section 18(1)(f) or as property income under Section 20(1)(a) and is fully taxable. The tax withheld is allowed as a credit (Section 128) or a credit for foreign tax paid in respect of the interest (Section 81).



Subject to the operation of double tax agreement, interest derived from sources in Uganda by a non-resident person is subject to 15% tax on the gross amount of the interest as a final tax (Sections 83 and 87). The tax is collected by withholding under Section 120.

Interest derived from sources in Uganda by a non-resident person in respect of widely issued debentures by a resident person outside Uganda is exempt from tax where conditions under Section 83(5) are satisfied.

The conditions are:

- (a) The debentures were widely issued by the company to a non-resident person 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;
- (c) or the interest is paid to a bank or a financial institution of a public character; and
- (d) The interest is paid outside Uganda.

Activity 4 - JANE

Jane is a very successful Woman in Kampala. During the year ended 30th June 2009, she earned the following interest income from the various sources:

Interest income from Bank of Africa Shs. 30,000,000

Interest Income from Grind lays Bank Denmark Shs. 50,000,000. Withholding Tax in Denmark was at a rate of 20%

Required:

Advise Jane on the Tax implications of her Income in Uganda as an individual and as a company.

1.6 ANNUITY

The term "Annuity" has not been defined under the income tax Act. As per the oxford dictionary, it means the investment yielding a fixed annual sum i.e. yearly grant or allowance. Any annuity derived by a person from the provision, use or exploitation of property is taxable under the property income.

1.6.1 Tax Treatment of Annuities

Annuities derived by a resident person from any source is property income and should be included in gross income of the person.

Where the annuity derived by a resident person is from a nonresident person, the resident person will be allowed a credit of the foreign tax paid or what he/she would have paid on such income if it had accrued from Uganda, whichever is low.

Annuities derived by a non-resident person from sources in Uganda are subject to Withholding tax of 15% on gross amount of the payment.



1.7 ROYALTY INCOME

Section 2 defines royalty to include any payment as consideration for the use or right to use a range of rights and properties. Such properties should either be tangible or intangible. Other forms of payments included in the definition are expenditure incurred on importing scientific technical industrial or commercial knowledge or information. The definition is even wide to include forbearance payments and grants from dealing in the rights or property.

1.7.1 Tax Treatment of Royalty Income

Royalties derived by a resident person from any source are property income included in the gross income of the person [Section 17 and 20(1)(a).] and where royalties are a foreign source income, the resident person is allowed a credit for any foreign tax paid in respect of this income (Section 81)

Royalties derived from sources in Uganda by a non-resident person are subject to a 15% tax, on gross amount of the payment as a final tax. The tax is collected by withholding under Section 120.

1.8 NATURAL RESOURCE PAYMENTS

A Natural resource payment is defined under Section 2 to mean a payment including a premium or like payment, made as consideration for the right to take minerals, living or non-living resource from the land or payment calculated in whole or in part by reference to the quantity or value of minerals or living resource taken from land.

1.8.1 Tax Treatment

A natural resource payment derived by a resident person from any source is property income and should be included in gross income of the person.

A natural resource payment derived by a non-resident person from sources in Uganda is subject to a 15% W.H.T on the gross amount of the payment as a final tax. The tax is collected by withholding under Section 120.

Note: All Withholding tax collected above is a final tax if it is earned by a resident individual from a resident person. If the income is not earned by a resident individual but a resident company or any other incorporated entity, the Withholding tax will be reduced from the total tax computed on that person's income for that year.



Rental Income Tax



5.0

RENTAL INCOME TAX

UNIT 4 OVERVIEW

- Meaning and Scope of Rental Income
- Challenges of taxing property income
- With-holding property income at source

1.1 RENTAL INCOME

Rental tax can either be direct tax or indirect tax (Consumption tax). It is a direct tax when the taxable person cannot shift the tax burden to a final consumer and it is an indirect tax, when the taxable person can shift the tax burden to the final consumer. Some properties attract both direct tax and indirect tax.

5.9.1 Direct rental tax (Income Tax).

This is levied on a person earning income from rental properties, both for residential and commercial purposes. In case of a resident individual, rental tax is levied on a person earning rental income exceeding 2,820,000 per annum (235,000/= per month). A person who falls under this category is required open up an Income Tax file with the nearest URA Domestic Taxes office. Authority to levy tax is given by Section 5 of the Income Tax Act (Cap 340).

The rate of tax applicable is determined by the status of the taxable person. If the taxable person is a company, a trust, and a retirement fund, the rate applicable is 30% (Section 7 & 8 of the Act).

The rental income of a resident individual earned from a resident person for the year of income is charged to rental tax at the rate prescribed in Part VI of the third schedule of the Act. It is 30% of the chargeable income in excess of Shs. 2,820,000 per annum (235,000/= per month).

A resident individual is given a maximum of 20% of the gross rental income as expenses and a nontaxable amount of Shs 2,820,000 per annum.

A company however will be allowed all expenses wholly and exclusively incurred for the production of income that is included in the gross income of that person. The income will then be taxed at the corporation tax rate of 30%.

Note: Chargeable income of a person for the year of income is the gross income of the person for the year less total deductions allowed under the Act (Section 15 of ITA Cap 340).

But the deductions allowed for an individual for purposes of rental income is 20% of the rental income whether they incurred more or less.

The rental income of an individual is assessed separately from other sources of income.



1.9.2 Indirect Rental Tax (VAT).

Authority to charge VAT on rental is given by VAT Act Cap 349 of the laws of Uganda. It is charged on a person making taxable rental supplies.

The definition of a taxable supply is implied by a supply qualifying as neither a zero-rated supply nor an exempt supply.

As regards property, the following supplies are specified as exempt supplies;

- The supply of un-improved land.
- The supply by way of lease or letting of immovable property other than;
- Lease or letting of commercial premises.
- The lease or letting of hotel or holiday accommodation in Kampala and Entebbe.
- Lease or letting for periods not exceeding three months.
- Lease or letting for parking or storing cars or other vehicles.
- Lease or letting of service apartments.

A person, who makes or expects to make annual taxable supplies in excess of 50 million shillings, should apply to the Commissioner General for VAT registration (Section 7 of VAT Act (Cap 349)).

Note: Unlike direct individual rental tax, income from rent for VAT purposes is combined with other taxable supplies made during the period.

1.2 CHALLENGES OF TAXING PROPERTY INCOME

Due to the nature of how property income is generated, the Inland Revenue Authority (e.g. the U.R.A) usually encounters the following challenges when taxing individuals that generate such income;

- (i) Non-disclosure of classes of shares to enable determination of voting powers.
- (ii) Non-declaration of dividends
- (iii) Non-compliance
- (iv) Deliberate concealment,
- (v) Limited accessibility to information on international transactions.

1.3 WITHHOLDING TAX AT SOURCE

Withholding tax is tax withheld by a person making paying another. This could arise from payment of salaries i.e. PAYE payment of interest dividends and any other payments for supplies made.

It is tax paid in advance. Withholding of tax at source is in line with the provisions of an optimal tax system. It is in line with the canon of simplicity and efficiency.

Who is liable to W.H.T?

The following persons are subject to withholding tax at the prescribed rates:

Section 116 all employees earning above the prescribed thresh hold at the individual PAYE rates.

Resident persons receiving interest from any other resident person (Section 117). Thus rule excludes the following:

- Interest paid by natural person, for example if Mr. Kabale paid interest to Mrs. Kagolo for money lent to him.



- Interest paid to a financial institution.
- Interest paid by a company to an associate company, i.e. A Company which controls 50% or more of the voting powers directly or indirectly in the paying company.
- All resident shareholders receiving dividends.
- The rates applicable to section 117 and 118 are 15% of the gross amount.
- Withholding tax from an individual and non-residents will be deemed final tax.

CHAPTER REVIEW QUESTIONS

1. (a) Explain briefly the major sources of royalty income in Uganda.
(b) How is Royalty income earned by non-residents from sources in Uganda taxed?
2. (i) What is meant by "Rental Income"?
(ii) Explain briefly the procedure for taxation of individual rental income in Uganda
3. (i) Distinguish between Dividend income and Annuities.
(ii) How is dividend income treated for tax purposes?
4. The following information relates to Ms. Kadilo for the year ended 30th June 2019.

PLACE	RENT PER MONTH PER UNIT	NO. OF HOUSING UNITS
Nabbingo	1,000,000	6
Nateete	300,000	12
Makerere	268,000	14
London City UK	750,000	10

Additional information

- i. All the housing units are fully occupied throughout the year except the 2 units in Nabbingo which were not occupied for 3 months.
- ii. Ms. Kadilo made a donation of Shs. 500,000 to Uganda Balokole Women federation.
- iii. She paid Shs. 2,300,000 for security during the year.
- iv. She paid staff salaries of Shs. 4,000,000 during the year.

Required

- (a) Determine Ms. Kadilo's taxable income and tax liability for the year ended 30th December 2019.
- (b) Supposing Ms. Kadilo was operating as Kadilo Ltd would her tax liability be any different?



6.0

WITHHOLDING TAX

UNIT 6 OVERVIEW

- Introduction
 - Withholding Modules
 - Accountability for Withholding Tax
 - Failure to withhold and /or remit tax
 - Other considerations
 - Return filing and submission
-

1.1 INTRODUCTION

The Income Tax Act Cap 340 specifies the persons who are required to withhold tax as well as those upon whom the tax should be imposed, depending on the nature of the transaction. This tax is deducted at source by a withholding agent upon making payment to another person.

A withholding agent is the person making payment and obliged to withhold tax; and the recipient of the payment is the payee.

1.2 WITHHOLDING MODULES

The major withholding modules of income tax in Uganda include

- (a) **Employment income:** Tax is deducted by the employer from the employment income of every liable employee on a monthly basis under the PAYE system.
- (b) **Payments on professional fees:** A resident person who pays management or professional fees to a resident professional is required to withhold tax at 6% of the gross amount of payment. Excluded from this provision are professionals whom the Commissioner is satisfied have regularly complied with the obligations imposed by the Income Tax Act.
- (c) **Withholding tax on payments to foreign entertainers and sports persons:** Tax is charged at a rate of 15% on payments to nonresident entertainers, sports persons or theatrical, musical or other group of nonresident entertainers or sports persons who derive income from any performance in Uganda. The obligation to withhold the tax is placed with the person making the payment e.g., promoter, agent, or such similar person.
- (d) **Withholding tax on Interest:** A resident person who pays interest to another resident person is required to withhold tax at 15% of the gross amount of the interest paid. Withholding tax is, however, not applicable where interest is paid by a natural person (individual), paid to a financial institution, paid by a company to an associated company or exempt from tax in the hands of the recipient. Where tax is withheld on payment of interest by a financial institution to an individual, the tax withheld is a final tax on the income.



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- (e) **Payments to non-resident contractors or professionals:** Tax is imposed on every non-resident person deriving income under a Ugandan source service contract. The tax is charged at 15% of the gross amount of payment and the person making the payment should withhold the relevant tax before effecting the payment.

Note:

A Ugandan source service contract is a contract under which the principle purpose is the performance of services which gives rise to income sourced in Uganda, and any goods supplied under the contract are only incidental to the purpose. A Ugandan-sourced service contract excludes an employment contract.

- (f) **Payments on dividends:** A resident company which pays a dividend to a resident shareholder is required to withhold tax at 15% of the gross amount of the dividend paid, except where the dividend income is exempt from tax in the hands of the shareholder. However, where the dividend is paid by a company listed on the stock exchange to a resident shareholder, the rate is 10% on the gross amount.
- (g) **Payment for Goods and services:** Any payment of amounts in total exceeding **Shs 1,000,000** to any person in Uganda for the supply of goods, materials of any kind or services, is required to withhold 6% of the gross amount. The threshold of Shs 1,000,000 is in respect of the total contract value, implying that separate supplies which constitute one contract are subject to the 6% withholding tax regardless of the fact that the amount paid per a single supply or transaction is less than the threshold value.
- (h) **International payments:** Tax is imposed on every non-resident person who derives any dividend, interest, royalty, natural resource payment or management charge from sources in Uganda. The tax is withheld by the payer at the rate of 15% on the gross amount before payment.
- (i) **Payment on imports:** Every person who imports goods into Uganda is liable to pay withholding tax at 6% based on Customs Value in Uganda, at the time of importation. This provision, however, does not apply to a supplier or importer who is exempted from withholding tax and exempt organisations.
- (j) **Withholding tax on commissions to insurance agents:** A person paying commission to an insurance agent or advertising agent shall withhold tax at a rate of 10%.
- (k) **Gaming and pool betting:** A person who makes payment for winnings of betting or gaming shall withhold tax on the gross amount of the payment at a rate of 15 %.
- (l) **Commission paid to telecom service providers on airtime distribution and mobile money:** A telecommunication service provider who makes a payment of commission for airtime distribution or provision of mobile money services shall withhold on the gross amount of the payment at a rate of 10%.

1.3 ACCOUNTABILITY FOR WITHHOLDING TAX

- The withholding agent is required by the Income Tax Act to pay to URA the tax withheld (or that should have been withheld), within 15 days after the end of the month in which the payment was made. In the case of a person about to leave Uganda, the tax should be withheld and paid before the payee leaves.
- The agent is further required to maintain and avail for inspection by URA, records of all payments to the payee(s) and the corresponding tax withheld for five years after the end of the year of income to which such records relate. Except where it is a final tax, tax withheld is a credit against the tax assessed on the payee for the year of income in which the payment is made.



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- Upon withholding the tax, the withholding agent is required to issue a withholding tax credit certificate to the payee; and then pay the tax to URA.

1.4 FAILURE TO WITHHOLD AND/OR REMIT THE TAX

A withholding agent who fails to withhold tax is personally liable to pay to URA the tax which has not been withheld and/or remitted. The agent, however, is entitled to recover the amount from the payee thereafter. URA is mandated to recover the tax from the agent as though it were tax due from such agent together with the accrued interest.

Note that the amount withheld on any payment is part of the taxpayer's annual Tax payment and thus reduces on the taxpayer's annual tax liability.

1.5 RETURN FILING AND SUBMISSION

A withholding tax agent who makes payment, is required to furnish a return of withholding tax no later than 15 days after the end of every month to which the tax relates. This is not only for PAYE but also all other Withholding taxes.



7.0

PRESUMPTIVE TAX

UNIT 7 OVERVIEW

- Meaning and Scope
- Fines and Penalties
- Tax Rates
- Return Submission

1.1 Who is a small Taxpayer?

- A Small Business Taxpayer for income tax purposes is a resident taxpayer whose gross turnover from all businesses owned by such a person in a year is above TEN MILLION SHILLINGS but is less than ONE HUNDRED AND FIFTY MILLION SHILLINGS.
- The term TURNOVER refers to one's total sales in a year.
- A taxpayer whose gross turnover does not exceed 10 million shillings a year does not pay tax on their income.

1.2 Scope of Presumptive Tax

- A taxpayer for this purpose may be an individual, trustee or a company.
- However, this section excludes a resident taxpayer who is in the business of providing;
 - (a) *medical,*
 - (b) *dental,*
 - (c) *architectural,*
 - (d) *engineering,*
 - (e) *legal, or*
 - (f) *other professional services,*
 - (g) *public entertainment services,*
 - (h) *public utility services, or*
 - (i) *construction services.*

1.3 Registration for Presumptive Tax

- To register as a taxpayer under presumptive tax, one might need the following requirements;

1. Individuals

Passport, National ID, Village ID, Employment ID, Driver's Permit, Bank Statement



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2. Sole Proprietor

- Certificate of registration,
- Statement of particulars

3. Company

- TINs of directors, Certificate of Registration or Certificate of Incorporation, Company form 7
- The company must already be registered by Uganda Registration Services Bureau (URSB).

1.4 Change of Basis of Taxation

- Presumptive taxpayer can seek to be assessed on profits instead of total sales.
- For this to happen the taxpayer must apply in writing to the Commissioner Domestic taxes with specific reasons.
- However, this will require the taxpayer to prepare financial statements.

1.5 Tax Credits and offsets

- A presumptive tax is a final tax and no tax credit is allowed to offset another tax liability in Uganda Revenue Authority.
- For this to happen the taxpayer must apply in writing to the Commissioner Domestic taxes with specific reasons.
 - (a) *Where a tax was withheld on the sales made.*
 - (b) *Where an amount was paid as provisional tax during the year of income.*

1.6 Expenditures and losses

No deductions are allowed in respect of any expenditure or losses incurred during the year of income.

1.7 Fines and Penalties

- A person who fails to file a return by the due date is penalized.
- A return is said to be late if it is filed after the due date.
- The penal tax is computed as; the greater of 2% of tax assessed or ten currency points (Shs. 200,000) per month for the period the return has been outstanding.

Activity 1

Ms. Kweyu a Kenya citizen is a former employee of Kampala Coaches. Following the closure of Kampala coaches, she remained stranded in Uganda until she opened up a shop in Balikudembe Market. Her business grew by 20% during the year ending 30 June 2021 compared to the previous year and she registered gross turnover of shs. 76,460,000.

Required:

Compute Ms. Kweyu's tax payable for the year ending 30th June 2021 if the business operated for the whole year.

1.8 Return Submission

For periods after 01st July 2015, small taxpayers are advised to simply register a payment for income tax-small businesses and the payment details captured will be considered to be the return.



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Business Income Tax



8.0

BUSINESS INCOME

1.1 COMPOSITION OF GROSS INCOME

Gross Income of a person is deemed to include the following:

- (a) *Business income*
- (b) *Employment income*
- (c) *Property income*

Derived by a person during the year of income other than income exempt from tax. The gross income of a resident person includes income derived from all geographical sources while that of a non-resident person includes only income from sources within Uganda.

We shall now examine how each of the components of the Gross Income of a person is assessed to tax. We shall explain each item individually.

1.2 DEFINITION OF BUSINESS INCOME (Sec 18)

Business is defined to include any trade, profession or vocation, and every manufacture, adventure and concern in the nature of trade, but does not include employment. These terms are further defined below:

(a) Trade

Trade refers to the traditional buying and selling of goods or services for a gain.

Example 3.1: Trading

If Mr Wamondo deals in the buying and selling of 2nd hand clothes in St. Balikuddembe Market, then he is trading

(b) Profession

Profession refers to professional practice such as by a doctor, lawyer, accountant etc. It requires a qualifying exam to be passed before becoming a professional in that area. Example is Cam & Co. Certified Public Accountants, KKI Doctors, Muguwa & Co Advocates etc. These are earning income from the profession.

(c) Vocation

Vocation refers to a calling or career. It also involves passing one's life in earning one's living on a talent which may be inborn or acquired. Examples could be the footballers. Athletes if they are being paid on a periodical basis. Note that this does not include one off payments for having won a race; as this may be regarded as a windfall gain. The athlete did not expect to win by the time he/she went to perform.

(d) Adventure



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Non organized business- could be legal or illegal e.g. smuggling or drug trafficking and prostitution.

(e) Concern

Commercial undertaking or enterprises e.g. transport business etc. Example could be Gateway Bus Service in Uganda.

1.3 BADGES OF TRADE:

In order to ascertain whether income is from business, it is very important to establish whether business is being carried on or not.

We could do this establishing if there is any trade taking place. The following factors which are also referred to as the badges of trade are very important in establishing whether business in the nature of trade is being carried on.

(i) Profit Motive:

In order to establish whether business is being carried on for trade, there must be a profit motive. This was outlined in the case of *Grace Vs YMCA* 1903, and *(Royal agricultural Society of England Vs Wilson)*, 1924 *CIR Vs Eccentric Club* 1927.

Example 3.2: Profit Motive

Mr. Magala went to London to see his daughter. On his return he bought 2 suites for his personal use. On realizing that the suites were not fitting him, he sold them and earned a profit of shs 100,000. The profit of Shs 100,000 earned by Mr. Magala is not subject to tax since Mr. Magala's Motive was not to make a profit on the sale. The suites had been purchased for own use. This income cannot be regarded as business income since he did not have any profit motive for this.

(ii) Number of transactions involved.

A transaction which is one of a series usually is an indication that it constitutes trade. E.g. if one purchases timber repetitively for sale, this would imply that there is timber trading. But if this was a one off transaction, this may not indicate that one is trading.

(iii) Quantities involved.

Big quantities may indicate trade.

(iv) Method of Financing

This would imply that proceeds from the sale are re invested in the same. i.e. sales are used to purchase other goods. This is an indicator of trading. If Mr. Mulooki harvests sugarcane from his garden in Mukono and sells them in Sseeta, the proceeds are used to buy milk and food at home. This kind of income from the sugarcane cannot be regarded as taxable business income. There is no trading taking place here. However, if he has intention of farming and proceeds from the sales of sugarcane are re invested into the same, then this has indications of trading and can be regarded as business income.



(v) Method used to generate sales

Nature of assets acquired to aid the sale, and Advertising and marketing, display of items. Any marketing technique used may indicate trade.

(vi) Mode of acquisition of an asset

This is basically how an asset is acquired and the motive. If an asset is acquired for private use and then re sold, this does not constitute trade, like wise if a gift or inherited assets are sold this does not constitute trade. If Mr Walusimbi buys his car for personal use and later sells the car at a profit, this profit cannot be regarded as business income and will not be subject to tax.

(vii) Length of time an asset is held and how it is used.

The length of time an asset is held and used will also be a determinant as to whether the income from the asset is business income or not.

(viii) Supplementary work

In case there is repair, modification or improvement made to the asset, it may indicate trade - to make it more easily saleable or saleable at a greater profit.

1.4 DETAILED ANALYSIS OF BUSINESS INCOME

Business Income under section 18 therefore means any income derived by a person in carrying on business and includes the following amounts whether of **revenue or capital nature**:

1. The amount of any gain, as determined under Part VI of the Income Tax Act. This part deals with gains and losses on disposal of business assets derived by a person on the disposal of a business asset, or on the satisfaction or cancellation of a business debt, whether or not the asset or debt was on revenue or capital account;

Points to note

- (i) *In this Case, the Asset must be a business asset and not trading stock or a depreciable asset.*
- (ii) *A business Asset is an asset that is used in the business or held ready for use in the business to generate income that is included in the gross income of that person.*
- (iii) *A depreciable asset is that asset which is subject to any loss in value which is given as a capital deduction. Note that a non-commercial vehicle acquired at an amount more than sixty million Shillings will be treated differently. Analysis will be done later.*

Example 3.3 Gain or loss on the disposal of a business asset

If Mr. Kabiito disposed off a non depreciable asset at an amount above the cost base of that asset, such gain would be regarded as taxable income and included in the gross income of Mr Kabiito. If the transaction resulted into a loss, then such loss would be a deductible expense.

(Further analysis of the cost base of an asset for capital gains tax purposes will be done while reviewing Capital Gains as a topic later)



Example 3.4 Cancellation of business debt

If Mr. Kabiito owed Mr. Mulokole some money and Mr. Mulokole forgives Mr. Kabiito of that debt, such debts forgiven will be regarded as income arising from trade as cancellation of the debt.

2. Any amount derived by a person as consideration for accepting a restriction on the person's capacity to carry on business;

Example 3.5: Restriction on the person's capacity to carry on business

If XYZ Ltd a training Institution was approached by one of the competitors and advised to stop the business of training professional accountants for the next five or so years at a sum of 500 million Shillings. The consideration of the 500 million shillings will be considered as taxable income to XYZ Ltd.

3. The gross proceeds derived by a person from the disposal of trading stock;
4. Any amount included in the business income of the person under any other section of the Income Tax Act
5. The value of any gifts derived by a person in the course of, or by virtue of, a past, present, or prospective business relationship;
6. Interest derived by a person in respect of trade receivables or by a person engaged in the business of banking or money lending; and
7. An amount included in business income under subsection (1)(f) or (g) retains its character as interest or rent for the purposes of any section of the Income Tax Act.
8. Where, as a result of any concession granted by, or a compromise made with, a taxpayer's creditors in the course of an insolvency, the taxpayer derives a gain on the cancellation of a business debt, section 38(3) applies in lieu of including the gain in the business income of the taxpayer under subsection (1).

Therefore if a person realized any income from the above mentioned sources, such income will be subject to tax. Business can be carried out by either an individual, or a corporate entity.

Business income of a person for a year of income is therefore the income derived by that person in carrying on business during the year.

3.4.1 Other forms of business income include the following

- Any gain on disposal of business asset is included with in the taxable income of a person regardless of whether the asset is of revenue or capital nature.
- Disposal of business asset for tax purposes implies the disposal of all those assets that do not lose value in the form of depreciation/wear and tear or industrial building allowance. Examples are land and those buildings other than industrial buildings.
- For commercial vehicles whose cost exceeds shs. 60 million, the excess cost above the 60 Million shillings will be regarded as the cost of a business asset on whose disposal, a gain or loss will be computed and either taxed or allowed as a deduction. Where a resident person carries on business partly within and partly outside Uganda, the gains or profits are deemed to be derived from Uganda. A good example of this is a transporter who transports goods from Kampala to Kigali (trading in Uganda) and then transports goods from Kigali to Nairobi and to Kampala (trading outside Uganda).



- An amount of insurance claim received for loss of profit or for damage or compensation for loss of trading stock.
- An amount of trade debt recovered which was previously written off as a bad debt.
- **An amount of balancing charge.** A balancing charge arises when a taxable person sells or disposes all items in a given class of wear and tear at an amount which is over and above the written down value in that class. The balancing charge will only occur if the sell takes place when the business is ceasing/closing/winding up or liquidation.

Example 3.6: Balancing Charge

Kawakawa Ltd at the beginning of the year had total assets in Class III with a net book value of 30,000,000. During the year, they sold off all the assets in Class III at Shs 35,000,000 because the business was closing down. *The balancing charge will be computed as follows:*

Wear and tear computation

	Class III
	Shs.
Written down value	30,000
Sale proceeds (business ceased)	<u>35,000</u>
Balancing Charge (taxable income)	<u>(5,000)</u>

- **An amount of trading receipts.** This arises where business is continuing and all the assets in a given class are disposed off at an amount that is more than the written down value in that class. However the difference between a balancing charge and a trading receipt is that for a trading receipt or loss to occur, the assets must be disposed off when the business is still going on. For example, the same figures as in the example above can be used.

Example 3.7: Trading Receipts

Assuming all assets in class 3 were sold off for Shs 35,000,000 and the business is still a going concern, the gain on the disposal will be referred to as a trading receipt and will be computed as follows:

Wear and tear computation

	Class III
	Shs.
Written down value	30,000
Sale proceeds (business continuing)	<u>35,000</u>
Trading receipts (taxable income)	<u>(5,000)</u>

NOTE: *The trading receipt is regarded as taxable business income.*



➤ **An amount of realized foreign exchange gain.** An exchange gain or loss arises as a result of foreign currency translation. i.e. translating of foreign currencies into the local currency. The exchange gains are categorized into realized and unrealized gains or losses.

A realized exchange gain or loss will occur after a transaction has occurred in foreign currency and payment is made in the local currency resulting into a gain after translating the foreign currency into the local currency. For a gain or loss to be realized, payment must have taken place.

Example 3.8: Realized foreign exchange gain

Mulembeki borrowed USD \$ 2,000 from Wambazo money lenders at the beginning of the year when the exchange rate was 1 USD : 1,000. By closure of the year, he had not made any payments to Wambazo. The exchange rate had now gone to 1 USD : 1,200. In Mulembeki's books, at the time of borrowing, he reflected UGS 1,000 x 2,000 = 2,000,000. However by the closure of the year, he had a debt of UGS 1,200 x 2,000 = 2,400,000. The difference of Shs 400,000 has come up as a result of currency translation at the end of the year. To Mulembeki, this is an un realized foreign exchange loss and to Wambazo, it is an un realized foreign exchange gain. It is unrealized because no payment has been effected. No actual cash has been paid. So the Loss has been brought up as a result of currency translations

Taking the example above, if Mr. Mulembeki had actually paid off the \$ 2,000 at the exchange rate of 1,200 for a dollar, then he would have parted with Shs 2,400,000 instead of the Shs 2,000,000 that he actually borrowed when the exchange rate was 1 USD to 2,000. The difference of Shs 400,000 will be regarded as a realized foreign exchange gain to Wambazo and a realized foreign exchange loss to Mulembeki. Wambazo will therefore recognize this as income subject to tax and Mulembeki would recognize this as an expense which will be allowed for tax purposes.

3.4.2 Exempt Income

There are items, which are commonly referred to as income but are not included in the above list of taxable income. A number of such untaxed incomes come to mind such as dowry, sweepstake winning, gifts, horse and goat race winning in Munyonyo, donations received, foreign employment income of an individual provided it was taxed in the country of origin, betting winning, inheritance, and profit on sale of isolated assets unless dealing in them as a business. This kind of income cannot be categorized under any specific source of income and so the taxability of such income is difficult and in most cases this income is exempt from tax.

The Income Tax Act under section 21 clearly specifies the following incomes as exempt from tax.

1. The income of a **listed institution**. Listed institutions have been classified by the Income Tax Act and are appended to the income tax Act.
2. The income of any **organization or person entitled to privileges under the Diplomatic Privileges Act** to the extent provided in the regulations and orders made under that Act;
3. The official employment income derived by a person in the public service of the government of a foreign country if that person meets the following conditions;
 - (i) *The person is either a non-resident person or is a resident individual solely by reason of performing such service;*
 - (ii) *The income is payable from the public funds of that country; and the income is subject to tax in that country;*

Examples of such people will include ambassadors, or other foreign government representatives.



4. Any **allowance payable outside Uganda** to a person working in a Ugandan foreign mission;
5. The income of any local authority, examples include Local Governments, Municipal Councils and Sub counties.
6. The **income of an exempt organization**, other than-
 - (i) *Property income, except rent received by an exempt organization in respect of immovable property and the rent is used by the lessor exclusively for the activities of the organization which is an exempt organization specified as an amateur sporting association, or a religious, charitable or educational institution of a public character.*
 - (ii) *Business income that is not related to the function constituting the basis for the organization's existence.*
7. An **education grant** which the Commissioner is satisfied has been made bona fide to enable or assist the recipient to study at a recognized educational or research institution;
8. Any **amount derived by way of alimony or allowance** under any **judicial order or written agreement of separation**;
9. The **value of any property acquired by gift, bequest, devise, or inheritance** that is not included in business employment, or property income.
10. Any **capital gain that is not included in business income**, other than gains on the sale of shares in a private limited liability company;
11. **Employment income derived** by an individual to the extent provided for in a **technical assistance agreement** where;
 - (i) *The individual is a nonresident or a resident solely for the purpose of performing duties under the agreement; and*
 - (ii) *The Minister has concurred in writing with the tax provisions in the agreement;*
12. **Foreign source income** derived by;
 - (i) *A short-term resident of Uganda; (A short-term resident is an individual who stays in Uganda for a period or periods not exceeding two years).*
 - (ii) *A person in the employment of the public service of the government of a foreign country*
 - (iii) *A member of the immediate family of a person referred in bullet (i) and (ii) above*
13. **A pension**, please note that pension is only paid by an approved pension scheme. This case will not be permitted where the employer try to classify some payments to their employees as pension.
14. A **lump sum payment made by a resident retirement fund to a member of the fund** or **a dependent** of a member of the fund. Example here are the lump sum payments made by NSSF to members.
15. The **proceeds of a life insurance policy** paid by a person carrying on a life insurance business;
16. The official **employment income** of a person employed in the **Uganda People's Defense Forces**, the Uganda Police Force, or the Uganda Prisons Service, other than a person employed in a civil capacity;
17. The **employment income** of a person employed as **a member of Parliament**, except salary;
18. The **income of the Government of the Republic of Uganda** and the Government of any other country
19. The **income of an investor compensation fund** established under section 81 of the Capital Markets Act.
20. The **income of the Bank of Uganda**.



21. The **income of a collective investment scheme** to the extent of which the income is distributed to participants in the collective investment scheme. Example here would include income distributed to members of SACCOs or Cooperative Unions.
22. **Emoluments payable to employees of the East African Development Bank** with effect from 1st July, 1997.
23. The **income of a person derived from operation of aircraft in domestic and international traffic or the leasing of aircraft,**
24. The **income of a person derived from exportation of finished consumer** and **capital goods** for a period of 10 (Ten) years where he person:
 - (i) In case of a new investment, the person applies to the commissioner in writing to be issued with a certificate of exemption at the beginning of his or her investment

Or;

 - (ii) In the case of an existing investment, applies for a certificate from the commissioner which is effective from 1st July 2007 and the person does the following:
 1. Exports at least 80% of his or her production of goods
 2. Has fulfilled such conditions as may be prescribed by the minister of Finance
 3. Has been issued with a certificate of exemption prescribed by the commissioner
- The **income of a person for a year of income derived from agro processing** where by:
 - (i) The person or the associate of the person has not previously carried on agro processing of similar or related agricultural product in Uganda;
 - (ii) Upon commencement of agro processing in Uganda, the person writes to the commissioner General a certificate of exemption which the commissioner may issue within sixty days of receiving the application.
 - (iii) The person invests in plant and machinery that has not been used in agro processing to process agricultural products for final consumption;
 - (iv) The person processes agricultural products grown or produced in Uganda,
 - (v) The person regularly files tax returns,
 - (vi) The person fulfills all obligations under this act relating to that person's investment
 - (vii) The person has been issued with a certificate of exemption for that year of income by the commissioner

Please note that for this exemption to take place, the listed conditions above should be observed by the tax payer. The certificate of exemption will be issued for a period of year and can be renewed on application to the commissioner by the tax payer.

For purposes of clarity, the income Tax Act defines the following terms as follows:

- (a) **"short-term resident"** means a resident individual, other than a citizen of Uganda, present in Uganda for a period or periods not exceeding two years;
- (b) **"technical assistance agreement"** means an agreement between the Government of Uganda and a foreign government or a listed institution for the provision of technical assistance to Uganda.
- (c) **"Agro processing"** in relation to agricultural products of pastoral, agricultural or other pastoral farming operations, means an industrial or manufacturing process that substantially transforms or converts raw agricultural produce in order to convert the produce into a different chemical or physical states and includes activities that take place between slaughter or harvest of the raw product in order to change it or preserve it.

1.5 DEDUCTIONS ALLOWED AGAINST TAXABLE INCOME OF A PERSON

(a) Expenses in production of income (Sec 22)

In computing the chargeable or taxable income of a person, there are expenses that are incurred in the production of such income. The Income Tax Act section 22 therefore allows a taxable person to deduct such expenses that are wholly and exclusively incurred in the generation of income that is included in the gross income of that person from the gross income of that person.

The Act recognizes these as a necessity in order to earn the taxable income. In a decided case in the United Kingdom of Great Britain, the judge said:

“Where a deduction is proper and necessary to be made in order to ascertain the balance of profits and gains that ought to be allowed...provided there is no prohibition against such an allowance.” Examples of prohibited expenses would include items like financing terrorism or costs related to drug trafficking.

The URA's acid test is that the *expenditures or losses must have been incurred in the production of income included in gross income*.

In summary an expense will be deducted in arriving at the profit for tax purposes, provided:

- (i) *The expense is specifically authorized by the Act; or*
- (ii) *It is, in the circumstances of the particular trade a proper commercial deduction according to accounting practice and it is neither:*
 - Capital expenditure; nor
 - Prohibited by any provision of the Act

Section 22 (1) gives the following guide on which expenses will be allowed against ones income for tax purposes. In ascertaining the chargeable income of a person, for a year of income, the following expenses will be deductible.

- All the 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; This implies that such expenses must be incurred wholly and exclusively for the generation of income and such income must be included in the gross income of that person. By person, here we refer to a person for tax purposes e.g. an individual, a company, a trust etc.
- The amount of any loss as determined under Part VI, which deals with gains and losses on the disposal of assets, incurred by the person on the disposal of a business asset during the year of income, whether or not the asset was of revenue or capital nature. **Part VI is concerned with the gains and losses on the disposal of business assets (Capital gains Tax).**
- In the case of rental income earned by a resident individual from a resident person, twenty per cent (20%) of the rental income as expenditures and losses incurred by the individual in the production of such income
- *Local Service Tax paid by an individual.*
- **Interest on a mortgage from a financial institution as expenditure incurred by an individual to acquire or contract premises that generate rental income.**
- 2% of the income tax payable by private employers who prove to Uganda Revenue Authority that 5% of their employees on fulltime basis are persons with disabilities.



Example 3.9: Persons with disabilities

Panyako and co. Ltd had a taxable income of Shs. 300 Million for the year ended 30th June 2011 before considering the percentages of disabled employees in the company. The company had 200 employees of which 10 were disabled in one way or the other.

Required:

Advise panyako co. ltd on the deduction that he may get arising from employing staff with disabilities:

Solution to Example 3.9 above:

We need to establish the percentage of disabled employees, and then the tax payable.

Tax payable on income = 30% X 300,000,000 = **Shs. 90,000,000**

The percentage of disabled employees will be:

Number of disabled employees = 10

Total employees = 200

$$\text{Percentage} = \frac{10}{200} \times 100 = 5\%$$

Since the company has at least 5% of the employees on permanent basis as disabled, the company will get a tax allowance of 2% of the tax payable.

Tax payable is 90,000,000

$$\text{Hence 2\% of this will be: } \frac{2}{100} \times 90,000,000 = \text{Shs. 1,800,000}$$

Therefore, the tax to be paid by Panyako will be computed as follows:

	Shs
Taxable profits	300,000,000
Less allowable due to disabled employees	(1,800,000)
New Taxable income	<u>298,200,000</u>
Tax on income at 30%	<u>89,460,000</u>

In conclusion, the company saves Shs 540,000 which is 30% of the 1,800,000.

Though all expenses incurred wholly and exclusively for the generation of income are allowed for tax purposes, there are some expenses which though may be incurred wholly and exclusively for the generation of such income that is included in the gross income of a person, they will not be allowed by the Income Tax Act as deductible. Such expenses are itemized in section 22 subsection 2 of the Income tax Act as below:



(b) Nondeductible Expenses (s. 22 (2))

Section 22 subsection 2 of the Income Tax Act states as follows:

“Except as otherwise provided in this Tax Act, no deduction is allowed for the following”:

This therefore implies that the expenses listed this section will not be deductible for tax purposes, however should there be any other provision in any other section of the Income Tax Act after this, then the section after this will supersede. The contentious example for this is in section 33 under training expenditure as related to the expenses of a domestic nature in awarding a degree.

The under listed expenditures will therefore not be allowed for tax purposes under section 22 subsection 2 of the Income Tax Act.

➤ **Any expenditure or loss incurred by a person to the extent to which it is of a domestic or private nature;**

In this regard, expenditure of a domestic or private nature incurred by a person includes -

- The cost incurred in the maintenance of the person and the person's family or residence. Example is food for own consumption.
- The cost of commuting between the person's residence and place of work;
- The cost of clothing worn to work, except clothing which is not suitable for wearing outside of work; and the cost of education of the person not directly relevant to the person's employment or business, and the cost of education leading to a degree, whether or not it is directly relevant to the person's employment or business.

Should a tax payer incur such expenditure in furtherance of his/her business, such expenses will be termed as expenditures of a domestic nature and therefore not allowed for tax purposes as expenses. They can however only be allowed if they have been taxed in the hands of the recipient if the recipient is an employee. This implies that they will have been included as employment income of the employee.

Review of section 33 in comparison to section 22 subsection 2:

The section states as follows:

An employer is allowed a deduction for expenditure incurred during the year of income for the training or tertiary education, not exceeding in the aggregate five years, of a citizen or permanent resident of Uganda, other than an associate of the employer, who is employed by the employer in a business, the income from which is included in gross income.

In this section, “permanent resident” means a resident individual who has been present in Uganda for a period or periods in total of five years or more.

This therefore contravenes section 22 and the definition of domestic expenditure. The Act however states that “except as otherwise provided in this Act”. This therefore in my own interpretation, implies that section 33 supersedes the provisions of section 22 under domestic expenditure.

This therefore means that under certain circumstances, the cost of education leading to a degree, which is relevant to the person's employment or business, may be allowed by the Commissioner General. The onus is therefore on the tax payer to prove that the degree was relevant to the person's business and that it did not exceed 5 years, and the beneficiary was a citizen of Uganda. However one may take the assumption that the Act eliminates the degree from all other certificates that may be provided by tertiary institutions.



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With such scenarios, it is very important that the student clearly makes their assumptions during examination conditions. Assumptions should only be made where the question has a possibility of two alternative treatments. However under section 21 of the income Tax Act where exempt income is defined to include any educational grant which the commissioner is satisfied it has been made bona fide to enable or assist the recipient to study at recognized educational or research institute.

Subject to subsection (1), any expenditure or loss of a capital nature, or any amount included in the cost base of an asset; This therefore implies that such cost will be aggregated with the capital expenditure of that asset and given the necessary capital deductions.

- Any expenditure or loss which is recoverable under any insurance, contract, or indemnity;

Example 3.10: Loss recoverable

If Mr Mukasa lost stocks due to theft worth Shs 200,000. These losses are genuine and will be allowed for tax purposes if there is proof of theft. However if the stocks were insured and Mr Mukasa recovers Shs 150,000 from the insurance company, then the expense to be allowed will only be Shs 50,000 since the Shs 150,000 is to be recovered from the insurance Company.

- Income tax payable in Uganda or a foreign country; The argument here is that much as tax payable or paid is a normal expense, as per the normal accounting treatment, for tax purposes this cannot be regarded as a deduction simply because by carrying out all these computations and adjustments, we are basically looking for the tax element.
- Any income carried to a reserve fund or capitalized in any way;
- The cost of a gift made directly or indirectly to an individual where the gift is not included in the individual's gross income;
- Any fine or similar penalty paid to any government or a political subdivision of a government for breach of any law or subsidiary legislation. Penalties and fines are expenses that can be avoided. It will be unfair to other tax payers if such expenses are allowed to others who have been careless in their actions.
- A premium or similar payment made to a person carrying on a life insurance business on the life of the person making the premium or on the life of some other person.
- The amount of a pension paid to any person; or (Note: A number of employers will make payments to their staff in form of gratuity and call this pension, however, it should be understood that pension is only paid by a recognized pension fund e.g. National Social Security Fund (NSSF) and the Uganda Communication's Employees Contributory Scheme (UCECPS). These two were put in place by the Acts of Parliament. The other pension Scheme is that of the government employees.
- Any alimony or allowance paid under any judicial order or written agreement of separation. Alimony means any payment made under any judicial order or written agreement of separation. It is not an allowable expense.

• **Meals and refreshments**

A tax payer will be allowed a deduction for expenditure incurred in providing meals, refreshment, or entertainment in the production of income included in gross income. However, the expenditure will only be allowed under the following circumstances

- (a) The value of the meals, refreshment, or entertainment is included in the employment income of an employee under Section 19(1)(b). or is excluded from employment income by Section 19(2)(d). Section 19(2)(d) states that any allowance



given for, and which does not exceed the cost actually or likely to be incurred, or a reimbursement or discharge of expenditure incurred by the employee on –

- (i) Accommodation and travel expenses; or
- (ii) Meals and refreshment; while undertaking travel in the course of performing duties of employment.

Such allowances for meals and refreshments will be allowed as a deduction for tax purposes.

Part (e) of section 19(2) states that the value of any meal or refreshment provided by the employer to the employee in premises operated by, or on behalf of the employer solely for the benefit of employees and which is available to all fulltime employees on equal terms will be allowed as a deduction;

(b) The person's business includes the provision of meals, refreshment, or entertainment and the persons to whom the meals, refreshment, or entertainment have been provided have paid an arm's length consideration for them.

This therefore implies that if GPX Solutions which is in the business of training for professional courses incurs an expenditure on meals, entertainment for the would be parents and students, such an expenditure will not be allowed even if the recipient paid an arm's length for it. However, the situation will be different with Coca Cola, Serena Hotel or Club Silk that may give sodas, food or complimentary tickets respectively. These are in the business of provision of meals and entertainment

• **Bad debts (s.24)**

A bad debt deduction is allowed only:

- (i) *If the amount was included in the person's income in any year of income; or*
- (ii) *If it is in respect of money that was lent in the ordinary course of business by a financial institution of the production of income.*
- (iii) *If the amount of the debt was in respect to a loan granted to any person by a financial institution for the purpose of farming, fish farming, bee keeping and animal poultry or similar operations.*

To qualify as a bad debt reasonable steps to collect the debt must have been taken. In the case of a financial institution a loss reserve, in respect of identified losses or potential losses, must have been made solely for those losses. For non-financial institutions or taxpayers, only bad debts written off (not provisions) are allowed as deductible expenses. It is very common for tax payers to reflect provisions for bad debts as actual bad debts incurred.

Further analysis of Bad Debts and provisions:

Bad debts will only be allowed as an expense if they were incurred in the normal process of business of which such bad debt was recognized as income at the time of the transaction. (Section 24) The tax payer must prove that he/she has taken all possible steps to pursue the payment and failed. E.g. A debtor goes bankrupt, dies or simply disappears. It may not be easy to convince Uganda Revenue Authority that such a debtor simply disappeared.

Staff debts written off are not allowed for tax purposes where the tax payer is not in the business of lending money and such loans were not given in the normal business process.

Bad Debts Provision

As earlier explained, provisions are not allowed for tax purposes. We have two types of provisions: **Specific and General Provisions**.



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General Provisions:

These occur where by the entity from experience makes a percentage of the total debtors as anticipated not to pay. Example: If Harvest College had an intake of students amounting to Shs 500 Million as tuition fees and by close of the year, only 200 Million was paid and the balance of Shs 300 million remained outstanding. From experience, at least 10% do not usually pay up. Harvest College will make a general provision of 10% totaling to 30M. However if Harvest College has some students whose conditions suggest that they will most likely not to pay totaling to say 5 Million, then Harvest College will make a specific provision to those particular customers. Conditions that would qualify one to be among the specific provision would include; nearing liquidation i.e. a company may be in receivership, the client may be sick and conditions of recovery very minimal, a person may have ceased to operate after giving them goods on credit. Under such circumstances, the tax payer may make a specific provision.

However, the case is different for financial institutions where specific provisions are allowed for tax purposes. These are provided for by the bank of Uganda given the nature of the business.

- **Interest (s.25)**

Interest incurred during the year of income is allowed as a deduction to a person only to the extent that it is in relation to a debt obligation.

There is a restriction to the interest allowed in the case of a foreign-controlled resident company (not being a financial institution) with a foreign debt to foreign equity ratio exceeding 2:1 in the year of income (s.89). Interest on the debt in excess of the 2:1 ratio is disallowed.

Analysis of Section 89:

Where a foreign-controlled resident company which is not a financial institution has a foreign debt-to-foreign equity ratio in excess of 2 : 1 at any time during a year of income, a deduction is disallowed for the interest paid by the company during that year on that part of the debt which exceeds the 2 : 1 ratio.

- “Foreign-controlled resident company” means a resident company in which fifty per cent or more of the underlying ownership or control of the company is held by a non-resident person, in this Section referred to as the “foreign controller”, either alone or together with an associate or associates;
- “foreign debt”, in relation to a foreign-controlled resident company means the greatest amount, at any time during a year of income, of the sum of:–

The balance outstanding at that time on any debt obligation owed by the foreign controlled resident company to a foreign controller or non-resident associate of the foreign controller on which interest is payable which interest is deductible to the foreign-controlled resident company and is not included in the gross income of the foreign controller or associate; and

The balance outstanding at that time on any debt obligation owed by the foreign-controlled resident company to a person other than the foreign controller or an associate of the foreign controller where that person has a balance outstanding of a similar amount on a debt obligation owed by the person to the foreign controller or a non-resident associate of the foreign controller; and

- **“Foreign equity”, in relation to a foreign-controlled resident company and for a year of income, means the sum of the following amounts –**

(i) The paid-up value of all shares in the company owned by the foreign controller or a non-resident associate of the foreign controller at the beginning of the year of income;



(ii) so much of the amount standing to the credit of the share premium account of the company at the beginning of the year of income as the foreign controller or a non-resident associate would be entitled if the company were wound up at that time; and

(iii) so much of the accumulated profits and asset revaluation reserves of the company at the beginning of the year of income as the foreign controller or a non-resident associate of the foreign controller would be entitled if the company were wound up at that time; reduced by the sum of –

(iv) The balance outstanding at the beginning of the year of income on any debt obligation owed to the foreign-controlled resident company by the foreign controller or a non-resident associate of the foreign controller; and

(v) Where the foreign-controlled resident company has accumulated losses at the beginning of the year of income, the amount by which the return of capital to the foreign controller or nonresident associate of the foreign controller would be reduced by virtue of the losses if the company were wound up at that time.

Further and detailed analysis of this will be made while discussing anti avoidance provisions under thin capitalization:

➤ **Repairs and Minor Capital Equipment (S.26)**

Repair of property occupied or used in the production of income is an allowable deduction. Where that amount of expenditure is significant, Uganda Revenue Authority will seek detailed and further clarity of such expenditure. The accountancy concept is that expenditure incurred in repairing an asset is capital if it enhances the value of the asset and/or prolongs its life. In other words, the expenditure is of the nature of improvement rather than mere repairs. This sometimes is not so convincing to the authority.

What should be used, as a fair judgment is the objective of the expenditure. Even then the distinction between capital and revenue can be a fine one.

The principle established in the above case was softened by a more recent case. *Odeon Associated Theatres Ltd. vs Jones* that appears to allow expenditure necessitated by the normal wear and tear of the previous owners.

Example 3.11: Repairs and Minor Capital Equipment

Assuming Uganda Housing Corporation incurred the cost of refurbishing their building located in Kampala and completely gave it a new look both externally and internally. As a result of the improved facilities in the building, the rent was revised from \$ 8 dollars per square meter to \$14 Dollars per square meter. Because this refurbishment caused an increase in the rental fees, this was not a repair but a capital expenditure to be capitalized and given capital deductions as appropriate.

Gemtel Ltd owns a building; the external part of the building was given a new painting to make it look magnificent as compared to the buildings around it. After the painting was done, there was no revision of rental fees. In other words this was a normal repair expense that can be incurred either annually or otherwise. This cost will be expensed in the books of Gemtel Ltd. It cannot be capitalized as for the case of Uganda Housing and their building.



➤ **Start-up costs (sec.30)**

Expenditure incurred in starting up a business is allowed as a deduction over a period of four years. In other words, 25% of such expenditure is allowed in each of the years starting with the year in which the expenditure was incurred.

These would include what is normally referred to as preliminary or formation expenses unless they are specifically excluded by the Act. Capital expenditure is not included under start-up costs since it is allowed as depreciation under s.27 of the Act.

➤ **Intangible assets (sec.31)**

Intangible assets are not classified among the assets in respect of which depreciation is allowed. However, section 31 of the Income Tax Act allows expenditure on intangible assets having an ascertainable useful life to be deducted in each year of the asset's useful life. The amount allowed in each year is a fraction of the cost determined by dividing the expenditure by the number of the ascertained useful life. Intangible assets are assets that cannot be seen or touched.

The Income Tax Act does not define intangible assets. It is assumed that they include purchased trademarks and patents, goodwill and such like expenditure.

Food For Thought

If a witch doctor incurred an expense to purchase ghosts which are later used in his/her business to generate income, would this cost be allowed as an expense of intangible assets over the useful life of the ghosts?

The onus will therefore be on the witchdoctors to substantiate the useful life of their so called ghosts, and that they are used to generate income which should be included in the taxable income of the witch doctor. If this is proved, the deduction should be granted.

➤ **Scientific Research Expenditure (sec.32)**

A deduction is allowed in the year in which the expenditure is incurred in respect of scientific research. The Income Tax Act defines scientific research as "any activities in the fields of natural or applied science for the development of human knowledge".

Scientific research expenditure is also defined to mean the cost of scientific research undertaken for the purposes of developing the persons business including any contributions to the scientific research institution which is used by the institution in undertaking research for the purpose of developing the persons business but does not include the following:

- (i) expenditure incurred for the acquisition of a depreciable or intangible asset;
- (ii) expenditure incurred for the acquisition of land or buildings; or
- (iii) expenditure incurred for the purpose of ascertaining the existence location, extent, or quality of a natural deposit; and

Scientific research institution" means an association, institute, college, or University which undertakes scientific research.

➤ **Training expenditure (Sec. 33)**

Expenditure on training or tertiary education not exceeding total of five years, of a citizen or permanent resident of Uganda is allowed in the year in which it is incurred. The employee must not be an associate of the employer.

Tertiary education, also referred to as third stage, third level, and post-secondary education, is the educational level following the completion of a school providing a secondary education, such as a high school, secondary school, university-preparatory school. Higher education is taken to include undergraduate and postgraduate education. Colleges,



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universities, institutes of technology and polytechnics are the main institutions that provide tertiary education. Tertiary education generally culminates in the receipt of certificates, diplomas, or academic degrees.

Tertiary education is not defined by the Act, however from the above definition; it shows that education leading to a degree is regarded as tertiary education. This then implies or indicates that there is a clear contradiction between the provisions of section 22 sub-sections 3 (d) and Section 33. In Section 22 the cost of education leading to a degree (whether or not it is directly relevant to the person's employment or business) is regarded as domestic or private, and therefore not an allowable deduction. It should however be noted that the **Act specifies that "except otherwise stated in another section of the Act"**, the following are not deductible. This therefore implies that the cost of education leading to the award of a degree can be allowed as long as it conforms to the requirement of section 33 of the ITA. The tax payer should be in position to prove that:

- (i) The degree was relevant to the person's business.
- (ii) It did not exceed 5 years,
- (iii) And the beneficiary was a citizen of Uganda.

However one may take the assumption that the Act eliminates the degree from all other certificates that may be provided by tertiary institutions. Under such circumstance, students are at liberty to give their assumptions.

➤ Charitable donations

A person is allowed a deduction for a gift made during a year of income to an organization which an exempt organization that fulfills the following two conditions. There are many exempt organizations under the definition of an exempt organization, but the donation will only be allowed if it is given to the following:

An exempt organization which is a company, institution or irrevocable trust which is;

- (i) An amateur sporting association;
- (ii) A religious, charitable, or educational institution of a public character

The amount of a deduction allowed under this section for a year of income shall not exceed 5 percent of the person's chargeable income, calculated before taking into account the deduction for this particular donation.



Example 3.12: Charitable donations

Mr Magandaazi gave a donation of Shs 50 Million to each of the following entities:

Mama Ingia Pole Womens' association fully recognized by URA as an exempt organization and registered. It helps women to carry on business in the market.

Uganda Womens' Association UWESO which is a religious body and looking after orphans in Uganda

Postingo Company trade union.

Magandazi's gross income was Shs 500 Million for the year.

Required:

Advise Magandazi on the donation figure that will be recognized by URA:

Solution to Example 3.12 above

✚ The deduction that will be allowed as a donation should be to an exempt organization which is either an amateur sporting association or to a religious, charitable, or educational institution of a public character. Even though all the organizations that were given a donation are exempt, they all do not suit the definition of the exempt organization that for which the donation will be allowed as an expense. It is only the donation to UWESO that will be allowed as an expense.

✚ Furthermore the donation should not exceed 5% of Magandaazi's chargeable income before removing the donation.

For this case, assume Magandazi's allowable expenses were Shs 10 million, his chargeable income would be;

Gross Income	500 Million
Less Expenses	<u>10 Million</u>
Chargeable income before donation	<u>490 Million</u>

The donation should not exceed 5% of the chargeable income of Mr. Magandaazi, hence the donation should not therefore exceed Shs. 23 Million.

➤ **Farming**

Expenditure incurred by a person in acquiring farm works is included in the person's pool for class 4 assets under section 27 in the year of income in which the expenditure is incurred and is depreciated accordingly.

(2) Subject to subsection (3), a person carrying on a business of horticulture in Uganda **to produce income included in gross income** who has incurred expenditure of a capital nature on the following items shall be allowed a deduction of an amount equal to 20 percent of the amount of the expenditure in the year of income in which the expenditure was incurred and in the following four years of income in which the plant or greenhouse is used in the business of horticulture carried on by the person. The items to be considered are:

- (i) The acquisition or establishment of a horticultural plant; or
- (ii) The construction of a greenhouse,



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Expenditure of a capital nature incurred on the establishment of a horticultural plant shall include expenditure incurred in draining or clearing land. For clarity the Income Tax Act gives the following definitions:

“farm works” means any labour quarters and other immovable buildings necessary for the proper operation of a farm, fences, daps, drains, water and electricity supply works, windbreaks, and other works necessary for farming operations **carried on to produce income included in gross income**, but does not include-

- (i) Farm houses; or
- (ii) Depreciable assets

“Horticulture” includes-

- (i) Propagation or cultivation of seeds, bulbs, spores or similar things;
- (ii) Propagation or cultivation of fungi; or
- (iii) Propagation or cultivation in environments other than soil whether natural or artificial.

➤ **Carry forward losses**

Section 35 of the Income Tax Act allows a tax payer who has a loss in a given year of income to take this as a deduction for the following year of income. This carry forward of the loss shall however apply separately to income from sources within Uganda and that from sources outside Uganda or foreign source income.

The Act further states that where a tax payer who is an individual makes a loss from farming income, this loss shall not be deductible against any other source of income but from farming income.

The amount of an assessed loss carried forward under this section for a taxpayer shall be reduced by the amount or value of any benefit to the taxpayer from a concession granted by, or a compromise made with, the taxpayer's creditors **in the course of an insolvency** whereby the taxpayer's liabilities to those creditors have been extinguished or reduced, provided such liabilities were incurred in the production of income included in gross income.

Where a taxpayer has more than one class of loss, the reduction of the loss as an allowable deduction in the paragraph above shall be applied ratably to each class of loss

➤ **Trading Stock**

A tax payer will be allowed the cost of trading stock disposed off during the year of income as a deduction. This cost will be obtained as follows:

Opening Stock	xxxx
Add Purchases during the year	xxxx
Less Closing stock at the end of the year	(xxxx)

Cost of stocks disposed off during the year xxxxx

The cost of stock will be allowed as a deduction for that year of income

➤ **Foreign Currency Debt Gains or losses**

Section 48 of the income Tax Act will allow a tax payer a deduction incurred as a result of a foreign currency loss and also a gain resulting from a foreign currency debt will be included in the taxable income of the tax payer for that year of income.

In order for the deduction to occur, or to be allowed, the tax payer must have informed in writing of the existence of the foreign debt which gave rise to the loss by the due date for furnishing of the taxpayers return.



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In order for gain or loss arising from foreign debt currency exchange to be recognized or allowed, it should not arise out of mere currency translation but when the debt is actually satisfied or realized. This therefore implies that unrealized gains or losses arising from foreign currency translation will not be considered for tax purposes.

Example on Realized and unrealized Gains and Losses

An unrealized exchange gain arises as a result of currency translations. Under the generally accepted accounting principles, an unrealized foreign exchange gain will be recognized as income and an unrealized exchange loss will be recognized as an expense. However, under the provisions of the Income tax Act, an unrealized exchange gain or loss cannot be recognized as income or expenditure.

Example 3.13: Realized and unrealized Gains and Losses

Muna borrowed USD \$ 2,000 from Wamba money lenders at the beginning of the year when the exchange rate was 1 USd : 1,000. By closure of the year, he had not yet paid and the exchange rate had now gone to 1 USd : 1,200. In Muna's books, at the time of borrowing, he reflected UGX 1,000 x 2,000 = 2,000,000. However by the closure of the year, he had a debt of UGX 1,200 x 2,000 = 2,400,000. The difference of Shs 400,000 has come up as a result of currency translation at the end of the year. To Muna, this is an unrealized foreign exchange loss and to Wamba, it is an unrealized foreign exchange gain. It is unrealized because no payment has been effected. No actual cash has been paid. So the Loss has been brought up as a result of currency translations.

This loss or gain is not allowed or recognized under the provisions of the ITA.

Learning Outcomes from the example

1. A Realized exchange gain or Loss

A realized exchange gain or loss will occur after a transaction has occurred and payment or exchange of money has taken place. Taking the example above, if Mr Muna had actually paid off the \$ 2,000 at the exchange rate of 1,200 for a dollar, then he would have parted with Shs 2,400,000 instead of the Shs 2,000,000 that he actually borrowed when the exchange rate was 1 USd to 2,000. The difference of Shs 400,000 will be regarded as a realized foreign exchange gain to Wamba and a realized foreign exchange loss to Muna. Wamba will therefore recognise this as income and Muna would recognize this as an expense.

1.6 CAPITAL DEDUCTIONS:

Section 22 of the ITA allows a tax payer a deduction for all expenses wholly and exclusively incurred in the production of income that is included in the gross income of that person for tax purposes provided:

- The expense is specifically authorized by the Act; or
- It is, in the circumstances of the particular trade a proper commercial deduction according to accounting practice and it is neither:
 - (a) Capital expenditure; nor
 - (b) Prohibited by any provision of the Act



Since expenditure of Capital Nature will not be allowed for tax purposes, it will therefore be unfair for a tax payer who incurred a capital expenditure not to be given any deductions. The ITA however came up with a deduction to be allowed or given to a tax payer who incurs a capital expenditure to be known as a capital deduction. Capital Deductions are categorized as follows:

3.6.3 Depreciation (s.27)

Depreciation is the loss in value of an asset. A tax payer may acquire assets for use in business and such assets will lose value. This loss in value is termed as depreciation. While computing an entities' profit using the Generally Accepted Accounting Principles, it is noted that each entity will have its own method of computing depreciation. The ITA 1997 however came up with uniform method of computing depreciation for purposes of income Tax and to have uniformity for all entities.

A person is allowed a deduction for the depreciation of the person's depreciable assets, other than an asset the cost base of which does not exceed UShs. 1,000,000 or 50 currency points during the year of income as calculated in accordance with the provisions of the Act. For assets whose cost base is below Fifty (50) Currency points, i.e. 1,000,000 such assets will be expensed within the Income and expenditure account within the year in which such assets were acquired.

For this provision to apply such an asset should be able to function independently on their own and not various parts of the same asset. These are referred to as Small investments in Section 27 subsection 2 of the ITA

3.6.4 Small investment expenditure (s.27 (2))

Expenditure on depreciable capital assets whose cost base is less than fifty currency points (UShs. 1,000,000) is allowed in total as a deduction from gross income in the year of income in which it is incurred. Note that one currency point is the equivalent of UGX 20,000.

- **Analysis of Depreciation and how it is computed for Tax purposes**

Depreciable assets are classified into four classes as set out in Part I of the Sixth Schedule to the ITA and depreciation rates applicable for each class as specified in the ITA as follows:

Class 1	40%
Class 2	35%
Class 3	30%
Class 4	20%

The Act requires that in that a person's depreciable assets shall be placed into separate pools for each class of assets mentioned above and the depreciation deduction for each pool is calculated according to the following formula;

Formula to learn

$$\text{Depreciation Deduction} = [A \times B]$$

Where;

A: is the written down value of the pool at the end of the year of Income

B: is the depreciation rate applicable to the pool.



Depreciable assets are classified into four classes:

The rates and items included in each class have been highlighted below:

CLASS	ASSETS INCLUDED	RATE
1	Computers and data handling equipment	40%
2	Automobiles; buses and mini-buses with a seating capacity of less than 30 passengers; goods vehicles with a load capacity of less than 7 tones; construction and earth moving equipment.	35%
3	Buses with a seating capacity of 30 or more passengers; goods vehicles designed to carry or pull loads of 7 tones or more; specialized trucks; tractors; trailers and trailer mounted, containers; plant and machinery used in farming, manufacturing or mining operations.	30%
4	Railroad cars, locomotives and equipment; vessels, barges, tugs and similar water transportation equipment; aircraft; specialized public utility plant, equipment and machinery; office furniture, fixtures and equipment; any depreciable Asset not included in another class.	20%

Note that Depreciation is computed on reducing balance method.

To enable depreciation to be computed for a group of depreciable assets with the same rate of depreciation the assets are placed in the same pool. Each of the 4 classes is a pool. *The depreciation for each pool is then calculated as follows:*

- Take the written down value of the pool at the end of the preceding year of income.
- Add the cost base of assets added to the pool during the year of income.
- Deduct the consideration received from the disposal of assets in the pool during the year of income.

The result of the above is taken as “**A**” (Section 27 (3)). Apply the formula $A \times B$ where A is as explained above and B is the depreciation rate applicable to the pool. The amount computed as **A** when negative (where the total of sales proceeds exceeds the total of written down value of the pool at the end of previous year and the cost base of additions during the year of income) is treated as income for the year and subject to tax.

Example 3.14: Capital Deductions

Malokweza Construction Company had the following transactions during the year ended 30th December 2010. Balances as at 1st January 2010 were as follows:

	Shs
Class 1	45,000,000
Class 2	35,000,000
Class 3	1,500,000
Class 4	Nil

During the year, the company had the following transactions:

- Acquired 2 Trucks with load capacity of 14 tones at Shs 20,000,000 each,
- A concrete mixer truck for Shs 30,000,000
- A Mercedes Benz for the Managing Director Shs 90,000,000



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- iv. 25 Computers for 50,000,000 and software for Shs 3,000,000
- v. Furniture for the reception at Shs 3,000,000
- vi. Bought a specialized plant for Shs 999,990

The company also disposed of the following items during the year:

- vii. 4 Computers which were purchased at Ushs 1,500,000 each two years ago at Shs 7,000,000 for all
- viii. One truck of less than 7 tonnes at Shs 7,000,000
- ix. Furniture for Shs 2,000,000.

Required

Compute the Capital Deductions due to Malokweza Assuming Malokweza is located in Namanve.

Using the above example, we shall now go through the practical computation of depreciation.

The following should be clearly noted while computing depreciation for tax purposes:

- Depreciation is computed on the reducing balance method
- All additions are to be recorded in the depreciation schedule at the cost. I.e the amount that was incurred to acquire that asset
- The proceeds from the disposals are to be recorded under the disposals.

	Class I	Class II	Class III	Class IV	Total
	'Shs'	'Shs'	'Shs'	'Shs'	'Shs'
Rate	40%	35%	30%	20%	
Balance b/f (1.01.10)	45,000,000	35,000,000	1,500,000	-	81,500,000
Additions					
2trucks(14 tonnes)			40,000,000		40,000,000
Concrete mixer			30,000,000		30,000,000
Mercedese Benz		60,000,000			60,000,000
Computers	50,000,000				50,000,000
Software	3,000,000				3,000,000
Furniture				3,000,000	3,000,000
Disposals					
2 Computers	7,000,000				7,000,000
One Truck		7,000,000			7,000,000
Furniture				2,000,000	2,000,000
WDV	91,000,000	88,000,000	71,500,000	1,000,000	251,500,000
Depreciation	36,400,000	30,800,000	21,450,000	200,000	88,850,000
NBV at 31.12. 2009	54,600,000	57,200,000	50,050,000	800,000	162,650,000



Answer to Question 3.14**COMPUTATION OF CAPITAL DEDUCTIONS FOR MALOKWEZA LTD FOR THE YEAR ENDED 31st DECEMBER 2010**

The following issues are vital while computing Depreciation for Tax purposes:

- If the WDV of any class is below fifty currency points i.e. 1,000,000 Million shillings, then there is no need to compute Depreciation as that value should all be written off under the expenses.
- If a tax payer sales off all assets in a class or an asset at an amount which is over and above the written down value in that class, the difference will be a gain which is subject to tax. This gain will be referred to as a trading receipt if the business is ongoing and a balancing charge if the business is ceasing.
- The tax payer may also dispose of all assets in a class at an amount below the written down value in that class. The resultant will be a loss. Such loss is referred to as a trading loss if the business is continuing and will be reduced from the taxable income. It will also be referred to as a balancing deduction if the business is ceasing or winding up. It is allowed against the taxable income of the tax payer.
- Depreciation unlike other capital allowances will only be given for the time that the asset has been used in business. There is therefore need to apportion the depreciation charge if the asset has only been used for part of the year.

3.6.5 Non-commercial vehicles (s.27 (11))

The cost base of a non-commercial road vehicle is restricted to shs 60 (Sixty) million for purposes of depreciation deduction. This means that where the vehicle costs more than shs 60 (Sixty) million the excess is ignored when computing the depreciation deduction if the asset is not sold off. If the asset is sold off, the taxpayer will be deemed to have acquired two assets; a depreciable asset of 60 million and a business asset whose cost base is the excess over the shs 60 million. For the case above, the depreciable asset is 60 million and the business asset deemed to be 30 million shillings. For the case above, if Malokweza does not sell the vehicle, then simply include the addition and ignore the rest. If Malokweza sells off the car, then there is need to establish the gain or loss on the disposal of the business asset side of the Vehicle.

Assuming Malokweza sold of the vehicle at Shs 80 Million after using it for one year only.

The following steps will be followed while computing the capital gain or loss on the disposal of the car:

- Apportion the proceeds using the proportions of the cost base between the would be depreciable asset and the business asset.
- For the case of Malokweza it will be $(80 \text{ Million} \times 60/90) = 53 \text{ Million}$. This implies that the proceeds to be included under disposals in the depreciation schedule will be 53 Million and for the business Asset will be 27 Million. This gives the total of Shs 80 Million.
- A capital Gain or Loss will be computed on the disposal of the business asset by getting the proceeds less the net book value of the asset. Net book value will be obtained by getting the cost of the asset and reduce it by the accumulated depreciation for the period the asset has been used. The depreciation rates to be used will be for class 2 in the depreciation Schedule.

Solution:

	Shs	Shs
Sales Proceeds (as appropriately apportioned)		27
Less: Cost base	30	
Reduced by deemed depreciation (One Year at 35%)	(10.5)	19.5
Gain or loss on disposal of business asset		7.5

The assumed depreciation is the sum of depreciation deductions which would have been allowed to the person if the asset:

- Had been a depreciable asset being a road vehicle; and
- The asset was the only asset in the pool.

The gain of Shs 7.5 Million will be included in the taxable income of Malokweza for the Year. If the result was a loss, then such loss would be allowed as an expense against the taxable income of Malokweza.

A commercial vehicle is defined as:

- A road vehicle designed to carry loads of more than half a tonne or more than 13 passengers; or
- A vehicle used in transportation or rental business.
-

3.6.6 Industrial Building Allowance (Section .29)

A tax Payer, who acquires or constructs an industrial building and uses it in his business to generate income that is included in the gross income of the tax payer, he/she will be given a capital deduction known as Industrial Building Allowance.

An Industrial Building is defined in Section 2 of the Act to mean the following:

Any building which is wholly or partly used, or held ready for use, by a person in:

- Manufacturing operation;*
- Research and development into improved or new methods of manufacture;*
- Mining operations;*
- An approved hotel business; or*
- An approved hospital*

These are further defined to mean the following:

1. Approved Hotel

An approved hotel is an industrial building licensed by the appropriate authorities for use, at a price, for boarding and lodging with at least

- Ten bedrooms with minimum facilities of bed and bedding, toilet and bath or shower room; and



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- (b) Restaurant or dining room for provision of food and beverages.

2. Approved Hospital

An approved hospital is a specialized institutional industrial building manned by a fully registered specialist and general practitioner for the purpose of treating general patients as outpatients or inpatients, or both, for medical, pediatrics, surgical and obstetric or gynecological conditions, providing treatment and nursing care and equipped with equipment and facilities for specialized establishment.

3. Approved Commercial Building:

An approved commercial building is an industrial building which is: primarily used by the owner or let out for rent

- For the purpose of carrying on a business, trade or profession;
- As an office;
- As a warehouse or commercial storage facility; or
- As a workshop.

For the avoidance of doubt, an approved commercial building does not include a building let out or used for residential accommodation.

Subject to section 29 where a person has incurred capital expenditure in any year of income on the construction of an industrial building and the building is used by the person during the year of income in production of income included in gross income, the person is allowed a deduction for the depreciation of the building during the year of income as calculated according to the following formula:

Formula to learn

$$\text{Depreciable Deduction} = A \times B \times \frac{C}{D}$$

Where:-

A: Is the depreciation rate applicable to the building as determined under part III of the 6th schedule i.e. 5%.

B: Is the capital expenditure incurred in the construction of the building.

C: Is the number of days in the year of income during which the asset was used or was available for use in the production of income included in gross income and

D: Is the number of days in the year of income.

- ↪ Where an extension is added to an existing industrial building that extension is treated as a separate building.
- ↪ If the person who has constructed the building for use as an industrial building sells it to another person, the purchaser is deemed to have incurred the same capital expenditure on the construction and is entitled to the industrial building allowance.
- ↪ Expenditure incurred in making a capital improvement to an industrial building, in a year of income, is treated as capital expenditure incurred in that year in the construction of a separate industrial building.
- ↪ Where an industrial building is used for more than one use and the capital expenditure incurred in the construction of that part of the building used for a prescribed use is 90% or more of the total cost of the whole industrial building, the building is treated as wholly used for the significant prescribed use.



Example 3.15: Capital deductions- Industrial Building

During the year ended 31st December 2010, Mr. Mwanawasa constructed a factory building at a cost of 240,000,000. 12% of this factory building was used for office and canteen space.

Required

How much capital deductions should Mr. Mwanawasa claim for the year ended 31st December 2010?

Solution:

Capital Deductions to be claimed will be in form of the following:

(a) Industrial Building allowance will be computed as follows:

Item	Cost	Qualifying Expenditure	IBA at a rate of 5% on the qualifying expenditure
Factory Building	211,200,000	211,200,000	10,560,000

The industrial building allowance for a given industrial building cannot exceed the total capital cost of the building where there have been several owners of the building.

As mentioned under before, the industrial building allowance is charged at 5%. The qualifying expenditure is claimable as industrial building allowance over a minimum of 20 years. It should be noted that the seller of industrial building cannot pass on to the buyer a cost base, for, purposes of industrial building allowance, greater than the original total capital cost less the total of all the industrial building allowances that have been granted in respect of the industrial building.

Accordingly, where an industrial building is bought and sold together with land, the value of the land is taken as the difference between the total consideration and the value of the industrial building (which is the residual cost base as explained above).

“Capital expenditure” does not include:

- Expenditure incurred in the acquisition of a depreciable asset installed in an industrial building; or
- Expenditure incurred in the acquisition of, or of any rights in or over, any land;

“Prescribed uses” means the uses specified in the definition of “industrial building” in section 2; and Residue of expenditure” means the capital expenditure incurred on the construction of an industrial building less any deductions allowed under this section to any person and any amounts which would have been allowed as deductions if the building was solely used for prescribed uses at all times since construction was completed.”



Example 3.16: Capital deductions- Industrial Building

Byansi & Sons Uganda Limited is in the business of manufacturing soft drinks in the Ugandan Market. During the year ended 31st December 2009, he incurred the following expenditure in his business.

- (a) He constructed a building that was being used for manufacture at a cost of 300 Million shillings. The building is located in Buwenge Kamuli District.
- (b) He installed plant and machinery worth 150 Million in the same building
- (c) During the year, he constructed a boundary wall on the old factory which had cost him 500 Million shillings to construct in the year 2001. The cost of the boundary wall in 2010 was Shs 100 Million.

Required:

Advise Byansi & Sons Uganda Limited on the Capital deductions to claim in respect to his capital investments.

Solution to Example 3.16

Byansi & Sons Limited will be required to claim the following Capital Deductions:

1. Industrial Building Allowance

Item	Qualifying Expenditure	Industrial Building Allowance Rate of 5%	Net Book Value	Remarks
New Industrial Building	300,000,000	15,000,000	285,000,000	Industrial Building is claimed on the cost base at the rate of 5%
Plant and Machinery	37,500,000	NIL	NIL	This is not an Industrial Building. It will however qualify for Depreciation (Wear and Tear)
Boundary Wall	100,000,000	5,000,000	95,000,000	Industrial Building is claimed on the cost base. IBA Claim cannot exceed the cost of the building. i.e. 100 million shillings. IBA will be claimed within a period of 20 years. At a rate of 5% p.a
Old Building	500,000,000	25,000,000	250,000,000	Assumption is that the Building was constructed on or after 1 st of July 2000 and has been getting IBA since 2001 for the last 10 years. This explains the Net Book Value,

Computation of industrial building allowance will be done as follows:



Where a person has incurred expenditure in making a capital improvement to an industrial building in a year of income, this Section applies as if the expenditure was capital expenditure incurred in that year in the construction of a separate industrial building.

Reference is made here to the Boundary wall that was constructed by Byansi as an additional industrial building. This cost is not part of the original Shs 500 Million

(5) Where an industrial building is purchased by a person, the person is deemed to have incurred the capital expenditure incurred by the person who constructed the building.

Example 3.17

Assuming that Wazalendo and company Ltd purchased the factory building from Byansi & Sons Limited in 2010 at a price of Ushs 900 Million Shillings. For purposes of Industrial, it is deemed that Wazalendo incurred the cost of construction that Byansi & Sons incurred. Thus the Shs 300 Million. Wazalendo will therefore claim industrial building allowance based on the Shs 300 Million incurred by Byansi & Sons. Wazalendo will also claim industrial building only for the remaining years. If the tax payer buys an industrial building after the expiry of 20 years, then that tax payer claims nothing in form of Industrial Building Allowance.

Where an industrial building is bought and sold together with land, the value of the land shall be the difference between the total consideration and the value of the industrial building.

Where subsection (4) applies, the consideration received on disposal of an industrial building shall be reasonably apportioned among the separate Industrial buildings identified under that subsection.



Example 3.12: Exam Type Question

Rusuku Ltd is a foreign controlled company registered in Uganda, which deals in general merchandise and exports in Kampala's Central Business District. In the year ended 30 June 2010, the company's merchandise profit was Shs 400,000,000. The company has a new accountant and upon review by the Chief Accountant, it was established that operating profit included the following items.

The	Amount "000"
Profit from disposal of land at Namanve & Company truck	130,000
Unrealized exchange gains	20,000
Additions to revaluation reserve	25,000
Legal costs on land disposal	5,000
Boundary wall around company warehouse	15,000
Insurance costs	12,000
Staff costs	300,000
Contribution to a staff retirement fund	90,000
Bad debts	25,000
Depreciation	40,000
Interest cost	50,000

company's 100% owned branch in Rwanda made a profit of Ushs 100,000,000 on which Rwandese tax of Ushs 40,000,000 was charged. This had not been captured by the new accountant in the books.

Notes:

- The company sold land at its revalued amount of Ushs 120 million. It had acquired the land in 2004 for Ushs 10,000,000.
- The unrealized exchange gain related to a loan from a related entity which has now made foreign debt to equity ratio of 3: 1.
- Staff costs include the following:

Ushs '000'

Director's' PAYE	20,000
Staff Education assistance (Masters Degrees)	40,000
Penalties on PAYE for Expatriates	30,000
Staff feeding (Company Canteen)	6,000
Staff bonus provision	10,000
Compensation to terminated staff	22,000

- The bad debts include a staff bad debt written off of Ushs 1,000,000 and a bad Debt provision of Ushs 5,000,000.
- Included in depreciation was lease hold amortization for ten years' on a straight Line basis on a property that cost Ushs 100,000,000 in 2002. The, lease period for this property is 50 years.
- The company had an agreed prior year tax loss of Ushs 70,000,000 as at 1st July 2009.
- The company's additions and disposals of plant and machinery for the year were as follows:

Purchases:	'000'
i. Office Furniture	45,000
ii. Computer	25,000
iii. Computer software	15,000
iv. Motor vehicles -1 Pajero	75,000



Disposal proceeds: One 10-ton Toyota Truck at Shs 7,500,000

viii. The tax written down value of the company's depreciable assets as at 1 July 2009 were as follows:

Class I Shs"000"	Class II Shs "000"	Class III Shs"000"	Class IV Shs "000"
45,000	100,000	110,000	200,000

Required:

- (a) Calculate the corporation tax payable by Rusuku Ltd for the year ended 30 June 2010.
- (b) Advise the company on the VAT implications of the following transactions on the basis that the company did not consider the transactions for VAT Purposes;
 - i. Trade bad debts written off of Ushs 20 million for the last 3 years.
 - ii. Provision for technical fees. This was unsupported but based on management estimates.
 - iii. Lease rental invoice received of Ushs 100 million and VAT of Ushs 18 million.
 - iv. VAT charged on the purchase of a private passenger motor vehicle and the related repairs.
 - v. Disallowed input VAT of Ushs 270 million following a Uganda Revenue Authority Tax Audit that has just been completed. The Company is yet to analyze the URA working.

Question 3.12 above requires the student to have thorough knowledge of the basic principles in taxation. The question combines International taxation, Corporation tax and Value Added tax. In other cases, such questions will involve customs taxes as well. This question requires an understanding of all these aspects of taxation. Please note that we have not yet covered the other aspects of VAT and customs. At this moment therefore, you may not need much emphasis.

Approach to the question:

The following steps should therefore be considered while carrying out any tax computation:

- Financial statements are prepared in accordance to the Generally Accepted Accounting Principles
- Expenses are recognized using the generally accepted accounting principles. Income of the entity is recognized in the same way.
- The Income Tax Act gives provisions under which expenses will be considered as deductible for tax purposes and how incomes will be recognized.
- Not all expenses and incomes that are recognized by the Generally Accepted Accounting Principles will be recognized by the provisions of the Income Tax Act and Vice Versa

This therefore calls for reconciliation between the financial statements that have been prepared in accordance to the Generally Accepted Accounting Principles to the provisions of the Income Tax Act. The following steps will now be taken as we prepare the taxable income of an entity that has prepared its financial statements in Accordance to the Generally Accepted Accounting Principles.



Format or procedure for computing taxable income of an entity

Profits as per Generally Accepted Accounting Principles(As Per Accounts)		APP (1)
Add: Add all those expenses that were deducted in arriving at the above profits(APP) but such expenses are not regarded as deductible by the Provisions of the Income Tax Act e.g. Depreciation, un realized foreign exchange loss etc. Add such incomes that were not recognized in arriving at the profits above(APP) e.g. Capital Gain on disposal of a business asset	NPP YPP	 <u>(NPP+YPP) (2)</u>
Less (Deduct) All incomes that were recognized in arriving at the profit above (APP) but are not recognized by the provisions of the Income Tax Act. E.g. Accounting profit on the sale of a depreciable asset Deduct such expenses that were not recognized in arriving at the profits above. E.g. Depreciation(Wear and Tear) Capital Deductions etc.	EPP EP	 <u>(EPP+EP) (3)</u>
Taxable Income		(1+2+3)
Apply the tax rate of 30% on (1+2+3)		

Solution to Question 3.12

With this background, we can now review the question:

In this solution, we have assumed current rates and provisions of the Income Tax Act as of 1st July 2009 onwards.

Computation of Corporation tax Payable by Rusuku Limited for the Year ended 30th June 2006

	Shs	Shs
	'000	'000
Profits as per Financial Accounts		400,000
<u>Add expenses deducted but not allowed</u>	1	
Un realised exchange Gain	3	20,000
Staff Education Assistance (Masters Degrees)	5	40,600
Penalties on PAYE for expatriates	4	30,000
Staff Bonus provision	7	10,000
Bad Debts:		



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Staff Bad debt written off	9	1,000	
Bad debts Provision	10	5,000	
Depreciation	11	40,000	
			253,400

Less Items that are not recognized as income/Not allowed:

Profits on disposal of company trucks	2	20,000	
Wear & Tear	13	161,750	
Amortization	12	2,000	
			(203,750)
Profit before tax			449,650
Net loss b/f			
Tax at 30%			134,895

Wear and Tear Schedule

Item	Class 1	Class 2	Class 3	Class 4	Total
	40%	35%	30%	20%	
	Shs "000"	Shs "000"	Shs "000"	Shs "000"	Shs "000"
Bal B/f	45,000	100,000	110,000	200,000	455,000
Additions					-
Office furniture				45,000	45,000
Computer	25,000				25,000
Computer soft ware	15,000				15,000
Motor vehicle 1 Pajero		60,000			30,000
Disposals					
One 10 Tone Toyota truck			(7,500)		(7,500)
					-
Written Down Value	65,000	160,000	102,500	245,000	572,500
Wear & Tear	26,000	56,000	30,750	49,000	161,750
Net Book Value	39,000	104,000	71,750	196,000	410,750



Notes

Notes have been given for each item that has been dealt with in the tax computation basically for the sake of the students' understanding. The notes are not necessarily required when answering an examination question. However a student may give assumptions especially where there is alternative treatment of items. No assumption is required where an item does not have alternative treatment.

It will be ambiguous if the student made such an assumptions like"

- ***I have assumed that staff costs are allowable expenses,***
- ***that computers are included in class 1"***

The notes below have been given to enable students understand the workings:

Note 1.

Add back Items. All items that were allowed or deducted as per generally accepted accounting principles but are not allowed as per the provisions of the income Tax Act will be added back to the profits before computation of taxable income. Also to be added back will be incomes that are not recognized as per the Generally Accepted Accounting principles but are recognized by the provisions of the Income Tax act. Examples of these are the trading receipts and balancing charge.

Note 2: Profits from Disposal of Land and Truck

Rusuku included a profit of Shs 130,000,000 in the accounting profits. Note that if the land was a business asset, then the gain on the disposal of land will be subject to tax under capital Gains. However, the gain on the disposal of a depreciable asset will not be subject to tax under the provisions of the Income Tax act. This implies that out of the income of Shs 130,000,000, only Shs 110,000,000 will be subject to tax since it is the capital gain arising from the disposal of Land. Gain on the disposal of land (Shs 120,000,000 Less 10,000,000) i.e. the proceeds less the cost base. The balance of Shs 20,000,000 is regarded as profits from the disposal of the company trucks which are depreciable assets. The gain on the disposal of trucks is not subject to tax since it will be dealt with under the wear and tear schedule. This is the very reason why it is deducted from the taxable income.

However if all assets or an asset in a class are or is disposed off at a price above the written down value of that class, then the difference will be taxable income and referred to as a trading receipt if the company is still trading. It will be referred to as a balancing charge if the company is winding up.

Note 3: Unrealized exchange gains:

An un-realized exchange gain arises as a result of currency translations. Under the generally accepted accounting principles, an un-realized foreign exchange gain will be recognized as income and an unrealized exchange loss will be recognized as an expense. However, under the provisions of the Income tax Act, an un-realized exchange gain or loss cannot be recognized as income or expenditure.

Furthermore, the examiner has hinted on the issue of the loan coming from a related entity which has made a foreign debt to equity ratio of 3:1. Under the provisions of the ITA, interest on funds borrowed for use in business will be allowed as an expense for tax purposes. Under Tax planning however, this could be used by nonresident companies to reduce on their taxes. We shall explain this in detail.

The issue of foreign debt to foreign equity in this case would not apply. The examiner has already told you that this was an unrealized exchange gain and not an expense. As long as it is an unrealized gain, no need to go to the details of the foreign debt foreign equity ratio will not apply.



Note 4: Directors PAYE

The treatment of this expense is subject to what the taxpayer included in his expenses for salaries to the directors. Generally salaries to the directors are allowed as expenses so long as they are taxed in the hands of the recipient.

PAYE as an expense will only be allowed if the taxpayer included the figure for salaries in his/her expenditure as net of PAYE. If the figure was included as the gross amount before deduction of PAYE, then such PAYE is not allowed since it is already included in the gross salary amount. For such items which have two alternative treatments, there is need to have an assumption.

My assumption here is that the figure included in the financial statement for salaries to the directors was Net of PAYE. Therefore I have allowed it as an expense

Note 5: Staff Education assistance to masters' degree.

According to section 22 of the Income tax Act, subsection 2 states as follows: "Except as otherwise provided in this Act no deduction is allowed for expenditure of domestic or private nature.

The Act in sub section 3 (d) defines domestic nature expenditure to include: The cost of education of the person not directly relevant to the person's employment or business and the cost of education leading to a degree whether or not is directly relevant to the person's employment or business.

Section 33 states as follows:

An employer is allowed a deduction for expenditure incurred during the year of income for the training or tertiary education, not exceeding in the aggregate five years, of a citizen or permanent resident of Uganda, other than an associate of the employer, who is employed by the employer in a business, the income from which is included in gross income.

In this section, "permanent resident" means a resident individual who has been present in Uganda for a period or periods in total of five years or more.

This therefore contravenes section 22 and the definition of domestic expenditure. The Act however states that "except as otherwise provided in this Act... "This therefore implies that section 33 supersedes the provisions of section 22 under domestic expenditure. The onus is therefore on the tax payer to prove that the masters' degree was relevant to the taxpayers business and that it did not exceed 5 years and that the beneficiary was a citizen of Uganda. However one may take the assumption that the Act eliminates the degree from all other certificates that may be provided by tertiary institutions.

With such scenarios, it is very important that the student clearly makes their assumptions. Assumptions should only be made where the question has a possibility of two alternative treatments.

My assumption here is that the Masters' degree was not relevant to the employees work or business. It was more to benefit the individual.

Note 6: Penalties on PAYE expatriates.

The Act does not allow any expenditure incurred as a penalty. Penalties, fines etc. as assumed to be expenses that can be avoided and are voluntary. Take the case of a traffic offender. If you drive carefully, then no traffic offence. In conclusion, all fines, penalties etc. are not allowed as expenses for tax purposes.



Note 7: Staff Feeding Company Canteen:

This is regarded as meals, refreshment or entertainment. Such expenditure will only be allowed if it is included in the employee's income or if the meals are provided to all employees at equal terms in a general place e.g. a canteen. The examiner has been very clear and told us that the meals were at a company canteen. This expenditure is therefore allowable.

Note 8: Staff Bonus provision:

No provisions are allowed as expenses for tax purposes. A provision is a sum of money kept aside for an intending issue whose occurrence is not certain. For accounting purposes, it is a requirement that provisions are set. For tax purposes, provisions are not allowed as expenses.

Please note that if this bonus had actually been paid to staff it would be allowed as an expense. Also note that this bonus would be taxable income in the hands of the recipient.

Note 9: Compensation to terminated staff

Compensation to terminated staff is an expense which is wholly and exclusively incurred for the generation of income which is included in the gross income of the business. It is within the normal business. This is therefore allowed as an expense for tax purposes. The employee will however be taxed on the compensation depending on the number of years he/she has been in continuous employment with the employer. (**See taxation of employment Income**)

Note 10: Staff Bad debts written off

Bad debts will only be allowed as an expense if they were incurred in the normal process of business of which such bad debt was recognized as income at the time of the transaction. (Section 24) The tax payer must prove that he/she has taken all possible steps to pursue the payment and failed. E.g. If a debtor goes bankrupt, dies or simply disappears. It may not be easy to convince URA that a debtor simply disappeared.

Staff debts written off are not allowed for tax purposes. The company is not in the business of giving loans to staff members. (***Lending money is not the main line of business for Rusuku Ltd.***) If it was a financial institution and gave out loans to staff in the normal business, this would be allowed as an expense. Since the case is different, ***the expense is therefore not allowed.***

Note 11: Bad Debts Provision:

As earlier explained, provisions are not allowed for tax purposes. We have two types of provisions: ***Specific and General Provisions.***

General Provisions:

These occur where by the entity from experience makes a percentage or proportion of the total debtors as anticipated not to pay. Example: If XYZ college had an intake of students amounting to Shs 500 Million as tuition fees and by close of year, only 200 Million was paid and the balance of Shs 300 million remained outstanding. From experience, at least 10% do not usually pay up. XYZ College will make a general provision of 10% totaling to 30M. However if XYZ has some students whose conditions suggest that they will most likely not pay totaling to say 5 Million, then XYZ will make a specific provision to those particular customers. Conditions that would qualify one to be among the specific provision would include; nearing liquidation i.e. a company may be in receivership, the client may be sick and conditions of recovery very minimal, a person may have ceased to operate after giving them goods on credit. Under such circumstances, the tax payer may make a specific provision.



Note:

For CPA Kenya, specific provisions are allowed as compared to C.P.A Uganda where no provision whether specific or general are allowed.

However, the case is different for financial institutions where specific provisions are allowed for tax purposes. These are provided for by the bank of Uganda given the nature of the business that financial institutions are dealing in.

In conclusion, both expenses presented by the examiner are not allowed for tax purposes and so are added back.

Note 12: Depreciation expense;

Depreciation as provided for by the Generally Accepted Accounting Principles will not be allowed as an expense. Note that each and every company or business entity has their own policy of computing depreciation. The Income Tax Act however provides for uniformity in charging depreciation under section 27 of the ITA which is under the wear and tear Computation. Therefore, depreciation computed as per accounting principles will not be allowed as an expense for tax purposes. It is only depreciation computed under section 27 on depreciable assets that will be allowed for tax purposes as an expense. All 40M should be added back and then see note 12 for further explanation.

Note 13: Leases hold amortization:

Leased properties should be amortized over their useful life but in any case not exceeding 20 years. In this case, the amount included is an apportionment for only 10 years. The actual expense should be an annual amortization of the cost for the leased property over its useful life or lease period of 50 years. I.e the Shs 100m should be divided by the 50 years and an annual expenditure of shs 2 million will be written off per annum. The amortized amount for ten 10 years i.e Shs $100M / 10 = 10M$ Pa should be added back and only deduct shs 2 Million per annum.

Note 14: Computation of Depreciation Charge:

Please note that effective 1st July 2009, the maximum limit for a noncommercial vehicle was increased from the 30 Million shillings to 60 Million shillings. After dealing with all the notes, the student should go back to the body of the question and establish whether all items there have been treated correctly:

Note 15: Boundary Wall Around Company ware house

Boundary wall around the company ware house is a capital expenditure and has been added back.

A ware house is defined as a commercial building a commercial building for purposes of industrial building allowance. Please note that a commercial building is defined to exclude such buildings that are used for residential purposes. However this wall qualifies for industrial building allowance.

Note 16: Profits from Rwanda

The company is a foreign controlled but registered in Uganda. The issue of contention here is whether it is a resident company or not. A company is resident if it is incorporated under the laws of Uganda; Its major operations are carried out in Uganda. A branch of a foreign controlled company will be a nonresident since it was not incorporated in Uganda. However whether a company is resident or nonresident, it will have to be registered for income tax purposes in Uganda with Uganda Revenue authority. The examiner should have been clearer on the issue of registration, does it mean incorporation or being registered for tax purposes.

My assumption in this case is that this is a foreign controlled company and incorporated outside Uganda. It is therefore a nonresident person for tax purposes. Non-resident persons will be taxed only on income accruing from sources within Uganda only. The Shs 100 Million obtained from Rwanda is therefore regarded as income from sources outside Uganda and not subject to tax in Uganda.

It should therefore not be included in the taxable income for Rusuku.



B: What is the Value Added Tax Implications for the following transactions on the basis that the company did not consider the transactions for VAT purposes?

B.1 Trade bad debts written off of U.shs 20 million for the last 3 years

Refund of Tax for Bad Debts

Section 43 of the Value Added Tax act states as follows:

(1) Where a taxable person has supplied goods or services for a consideration in money, and has -
paid the full tax on the supply to the Commissioner General, but has not within two years after the supply received payment, in whole or in part from the person to whom the goods or services are supplied; and
Taken all reasonable steps to the satisfaction of the Commissioner General, to pursue payment and he or she reasonably believes that he or she will not be paid,

B.2 That person may seek a refund of that portion of the tax paid for which he or she has not received payment.

If a refund is taken under subsection (1) and the taxable person later receives payment in whole or in part, in respect of the debt, he or she shall remit to the Commissioner General, with his or her next tax return, a sum equal to the portion of the payment that represents the tax refunded.

Rusuku Ltd therefore can claim the output tax that was remitted on the transactions for the 20 million shillings. With the assumption that the 20 million is exclusive of VAT, then Rusuku Ltd should claim the VAT remitted of Shs 3,600,000. It is also assumed that all reasonable steps were taken to recover the money and failed.

B.3 Provision for technical fees. This was unsupported but based on management estimates.

Provision for technical fees will have no VAT effect. For input tax only invoice values are considered and not estimates. Since there is no out flow of money, Rusuku Ltd will have no claim on input tax as regards to this provision.

B.4 Lease rental invoice received of Ushs 100 million and VAT of Ushs 18 million.

Rusuku Ltd will have to include the VAT of Shs 18 million as input tax within the monthly VAT returns. This will be offset from the output tax and the difference if any be paid to URA.

B.5 VAT charged on the purchase of a private passenger motor vehicle and the related repairs.

VAT charged on the purchase of the private passenger motor vehicle will not be claimed as input tax for tax purposes. Input tax is claimed only on expenses that are wholly incurred for the production of income included in gross income of the trader. Much as VAT incurred on the purchase of private passenger motor vehicle will not be deductible for tax purposes.

B.6 Disallowed input VAT of U.shs 270 million following a Uganda Revenue Authority Tax Audit that has just been completed. The Company is yet to analyze the URA working.

Input tax is not regarded as an expense for income tax purposes since this tax is to be offset from the output tax. If the input tax is disallowed by URA, it should then be regarded as an expense for tax purposes. Rusuku Ltd should regard the disallowed input tax as an expense for income tax purposes.

Rusuku also has the right to object to the commissioner if they believe that the input tax being claimed is genuine. Section 33 allows a person who is dissatisfied with an assessment to object to the Commissioner General within a period of 30 days after the assessment.

The objection referred to shall be in writing and shall specify in detail the grounds upon which it is made.

CHAPTER REVIEW QUESTIONS

1. Critically analyse the principles governing taxation of company income in Uganda.
 2. What expenses are referred to as "Non-deductible" according to the Income Tax Act 1997?
 3. Explain the sources of business income for tax purposes as per Section 19 of the Income Tax Act.
 4. Define a non-commercial vehicle.
 5. Briefly explain how you would account for depreciation of a non-commercial vehicle with a cost base of 75 million.
 6. (i) What is meant by Presumptive tax?
(ii) What are the advantages and disadvantages of this tax System?
 7. Write short notes on Industrial building allowance. In your answer, relate the allowance to wear and tear allowances.
 8. What are the different types of business income exempt from tax according to the Income Tax Act 1997?
 9. Explain how the following items would be treated under 1997 income tax.
 - (i) Entertainment allowance of an employee
 - (ii) Meals and refreshments to employees
 - (iii) Shares issued to an employee under the employee share acquisition scheme
-



VALUE ADDED TAX (VAT)



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9.0

VALUE ADDED TAX

UNIT 9 VERTVIEW

- Meaning and Scope of VAT
- VAT Registration
- Supply of goods
- Supply of Services
- Taxable Supplies
- Exempt Supplies
- Mixed Supplies
- Output and Input Tax
- Accounting for VAT
- Other considerations

8.1 INTRODUCTION

Value Added Tax is a tax levied on the production and consumption of goods and services. It is administered by the tax Authorities, but most of the work of collecting the tax falls on the VAT registered business, which hand the tax they collect over to the tax authorities.

Value added tax was introduced in Uganda with effect from 1st July 1996 to replace sales tax and Commercial Transaction Levy (CTL). It was believed that VAT was to close the loopholes within the sales tax system which included the following among others:

- Sales tax had a very high level of evasion since it was a single stage collection system
- Sales tax had a cascading effect which would cause distortions within the economy
- Tax base for sales tax was narrow as compared to VAT.

Value Added Tax is governed by the Value Added Tax Act.

8.1.1 General Principles:

Value Added Tax is an indirect tax and essentially a tax on expenditure in the domestic economy rather than tax on output of the domestic economy. Value Added Tax will be calculated at each stage of output within the supply chain.

It is a tax levied on the production and consumption of goods and services. It is administered by the tax Authorities, but most of the work of collecting the tax falls on the VAT registered business entities, which hand the tax they collect over to the tax authorities. The registered traders will however deduct the V.A.T they pay as input tax. The final consumer of the goods or services will however not be allowed to deduct the Value Added Tax. He/She suffers the burden of the tax and that is where the incidence of the tax falls.



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8.1.2 Advantages:-

- It is easy to collect since registered businesses are the ones, who collect the taxes on behalf of the government.
- It is self-policing i.e. It's very difficult for business to falsify documents involved in a business transactions
- VAT is neutral to the forms of production i.e. at each stage in the production and distribution chain a tax is charged.
- VAT taxes all factors of production.
- There is less tax evasion
- VAT encourages exports through refund of taxes paid on exportable goods.
- VAT promotes efficiency i.e. it tries to improve on performance and reduces the costs of production.

8.1.3 Disadvantages of VAT:

- VAT is not easy as a system to adopt especially in developing countries. It requires honest and efficient government machinery to do the cross-checking.
- VAT system depends upon the cooperation of the taxpayers since each firm calculates its tax liability to begin with and also finds out taxes paid by the earlier firms.
- Taxpayers are required to maintain elaborate and costly accounts; this becomes highly un economical especially for smaller firms.
- Difficulties of maintaining accounts, cross-checking and preventing tax evasion.
- Even when no business is done for a particular period, a VAT registered person is required to file a monthly return. This becomes tiresome and costly.

8.1.4 Sales tax and CTL had the following deficiencies.

- The sales system was a single tax system
- Where inputs for manufacturing were subject to sales tax, then the imposition of sales tax on the finished product would result in the imposition of tax on tax.
- Sales tax was levied on certain specific manufactured goods.
- Sales tax therefore had a narrow tax base as compared to Value Added Tax and the revenue yield was comparatively low.

8.1.5 Administration of VAT

VAT is under the care and management of the commissioner of Domestic Taxes subject to the direction and control of the Commissioner General and the minister of finance planning and Economic development

VAT is an indirect tax. It is essentially a tax on the domestic consumption in the economy. Under VAT, it is generally the end user that bears the tax. The tax is charged on each transaction in the production and distribution chain.

The system of VAT employed in Uganda is both the cash and invoice basis. The invoice basis implies that VAT will be computed on supplies whether they have been paid for or not. Cash basis implies that VAT will be computed only on cash supplies made. Only for those items that cash has been paid out.

Under the invoice from invoice system, VAT is calculated on the basis of invoices issued at the point of sale. The application of the invoice method together with the system of tax credits means that it is necessary to calculate the value added by each transaction in the economic sense.

8.2 SCOPE OF VALUE ADDED TAX

VAT will only be charged on such transactions that have occurred within the geographical location of Uganda and are taxable according to the Value Added Tax Act. In order for VAT to be within the scope of Uganda, the following conditions must be fulfilled;



8.2.1 A supply takes place

A supply can be made of goods or services. These are clearly defined in section 10 and 11 of the VAT Act.

(a) Supply of Goods (Section 10)

- Supply of goods means any arrangement under which the owner of the goods parts or will part with possession of the goods, including a lease or an agreement of sale and purchase.
- A supply of goods will have taken place where a trader or business entity gives the goods to the buyer with or without payment being made.
- The application of goods to own use is a supply of the goods.

Example 8.1:

Mr Newumbe a trader in Kikuubo picked two dresses valued at Shs 90,000 for his two daughters and did not pay because he is the owner of the shop.

Required:

Was Mr Newumbe required to account for VAT on this transaction?

Solution:

This is regarded as a supply of goods by Mr. Newumbe. The goods have been taken and applied to own use.

(b) Supply of Services (Section 11)

A supply of services means any supply which is not a supply of goods or money, including –

- The performance of services for another person;
- The making available of any facility or advantage; or
- The toleration of any situation or the refraining from the doing of any activity.
- The provision of thermal and electrical energy, heating gas, refrigeration, air conditioning and water.

Note:

A supply of services made by an employee to an employer by reason of employment is not a supply made by the employee and therefore does not fall in the scope of V.A.T.

8.2.2 A supply that has been made is a taxable supply.

We shall later see the definition of a taxable supply. A taxable supply is that supply on which Value Added Tax is charged at the standard rate of 18% or the Zero rate. The VAT Act outlines supplies that are zero rated and those that are exempt. Any supplies that do not fall in either category are referred to as standard rated and charged VAT at a rate of 18%.

8.2.3 That the taxable supply has been made by a taxable person.

A taxable person is a person who is registered or liable to register for VAT.

13.2.4 That the supply takes place within Uganda.

Uganda includes the air space, which is a distance up in the sky considered to be part of Uganda. It also includes the territorial waters which is a distance in the sea considered to be part of Uganda.

13.2.5 That the supply is made within the furtherance of business. This means that the supply is made in the normal course of business.

Therefore for a transaction to qualify for VAT, all the five conditions listed above from 1 to 5 must occur.

8.3 TAXABLE PERSON. (Section 6)

This means any person liable to apply for registration. Generally any person who makes or intends to make taxable supplies will be treated as a taxable person while he or she is required to be registered.

A taxable person is further defined by section 6 of the VAT Act as

- A person registered under section 7 from the time when the registration took effect.
- A person who is not registered but who is required to be registered or to pay VAT under the Act. This person will be a taxable person from the beginning of the tax period immediately following the period in which the duty to apply for registration or to pay tax arose.

Example 13.2: Taxable Person

Bowaz and sons limited started trading in January 2011 when his turnover was 10 Million shillings per annum. However in April 2011, his turnover and prospects changed to Shs 20 Million per month. *When will Bowaz and Sons be regarded as a taxable person?*

Solution:

Bowaz and sons will be regarded as a taxable person at the beginning of the tax period immediately following the time that he should have registered for VAT.

(This will clearly be understood after knowing the time given to a trader to register for VAT after establishing that he/she qualifies for registration)

8.4 REGISTRATION

In order for one to charge VAT or claim any input tax as we shall consider later in the chapter, there are processes that they have to go through. The very first process is being registered for VAT.

Section 8 of the Value Added Tax Act provides for registration of a taxpayer for VAT purposes after fulfilling the requirements for registration. In order for someone to register for VAT, he/she must be dealing in taxable supplies.

The persons listed below will be required or are permitted to register for VAT in accordance with the Value Added Tax Act section 7

- (1) A person who is not already a registered person shall apply to be registered in Accordance with Section 8 -



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(a) within twenty days of the end of any period of three calendar months if during that period the person made taxable supplies, the value of which exclusive of any tax exceeded one-quarter of the annual registration threshold of Shs 50 Million per annum.

Or

(b) At the beginning of any period of three calendar months where there are reasonable grounds to expect that the total value exclusive of any tax of taxable supplies to be made by the person during that period will exceed one-quarter of the annual registration threshold which is Shs 50 Million per annum.

(2) The annual registration threshold is fifty million shillings.

(3) In determining whether the registration threshold is exceeded for the Period specified in (1) above, it is to be assumed that the person is a taxable person during that period.

(4) A person supplying goods or services for consideration as part of his or her business activities, but who is not required by subsection (1) or (5) to apply for registration, may apply to the Commissioner General to be registered in accordance with Section 8.

(5) Notwithstanding subsection (1) above, a person being a national, regional, local or public authority or body which carries on business activities shall apply for registration at the date of commencement of those activities.

13.4.1 Methods of Registration for VAT

There are two methods or types of registration for VAT;

(a) Compulsory registration

Compulsory registration is where by someone is required to register for VAT by law.

If a taxpayer fulfills the following conditions, then he/she will be required to register for VAT by law:

- One is dealing in taxable supplies. i.e. Standard rated and Zero rated supplies.
- The value of taxable supplies within one year will be 50 Million shillings and above
- If within twenty days after the end of three months one's taxable supplies were 12.5 Million shillings and above
- If at the beginning of a period of three calendar months one expects the turnover to be more than 12.5 Million shillings during that period of three months or 50 Million during the one year
- A person being a national, regional, local or public authority or body which carries on business activities shall apply for registration at the date of commencement of those activities. This implies that once an entity deals in taxable supplies, they don't have to wait for the end of twenty days after the three months to apply for registration. They have to apply as and when they commence business.

If the entity fulfills all the above, then that entity is supposed to register for VAT by law. This is referred to as compulsory registration for VAT.

(b) Voluntary registration

This is the second type of type of registration. One can register voluntarily after making a written application to the Commissioner who must give a written approval. Before applying you should consider whether registration will really be of benefit to you as the taxpayer. Voluntary registration is at the discretion of the commissioner general. The Commissioner General may however refuse to grant the application if the taxpayer falls in the category mentioned below:

- Has no fixed place of abode (i.e. has no fixed address)
- Has no proper accounting records

- Has no bank account
- Is not a fit and proper person to be registered for Value Added Tax purposes
- He has previously been registered for VAT and purposes but failed to perform his duties under the VAT law.

Note that, once one has voluntarily registered for VAT, he/she cannot apply for de-registration not until after a period of at least 2 years once approved.

Section 8 (5) of the VAT Act empowers the Commissioner General to register a person if there are reasonable grounds for believing that the person is required to apply for registration under Section 7 but has failed to do so, and that registration shall take effect from the date specified in the certificate of registration.

13.4.2 Effective date of Registration.

The application for VAT registration form should be filled and taken to the nearest VAT offices by the 20th day of the month following the month you exceed the turn over limit requiring registration. With the advancement into e tax, registration for VAT can now be done online under the e-tax system introduced by URA.

Once the application for registration has been made, URA will advise you of your registration number which will be in addition to your TIN (Tax identification Number). A certificate of registration will be issued to the taxpayer which will be displayed at the main business premises. If registration is disallowed, one will be notified and the reasons for the refusal explained.

Note:

Under the e-Tax system, no VAT number is given. The TIN is a single identifier – the person registering just has to indicate the different tax types that he is liable to at the time of first registration or make an amendment to either deactivate or include another tax type, thereafter.

The tax payer will then start keeping VAT records and charging VAT to their customers from the date shown on the certificate of registration and will have to account for VAT from the date on which one was registered which will be noted on the certificate of registration.

13.4.3 Advantages of VAT registration (Merits of VAT)

- This system helps the business firm to recover the input tax in the form of deduction from the output tax hence the chance of tax evasion is minimized.
- This system encourages exports because VAT is refunded on exportable goods.
- This system puts the firm in a better position in the market. This is true because some organizations and individuals will trade with only V.A.T registered firms so that they can be able to claim the input tax that they incurred on their purchases.
- This system helps the firm to improve its efficiency. A firm is liable to tax even if it is making losses because the tax is paid on the value added not on the profits. In this way, the firm will make efforts to improve the performance by reducing the cost of production.
- This system has a wide tax base which will help government to collect more taxes from VAT.
- VAT registration puts the firm in a more strategic position of winning tenders. Though there is no requirement for a firm to be VAT registered before it is prequalified for supplies with government, it is in the best interest of government

that firms are compliant with all the tax regimes. Therefore, VAT registered firms may be preferable to those that are not registered.

13.4.4 Disadvantages of VAT registration (Demerits of VAT)

- The administration of this system is very complicated. It requires proper records and financial structure. This may make it difficult to be applicable in developing countries like Uganda where many business entities do not maintain proper records. However, with the introduction of e-tax system, it may make matters a little bit easy.
- The costs of collecting this to the tax administrators may be high due to the complexity of the system. It may require following up on business entities that do collect output tax but do not remit to the authority.
- This system requires a lot of co-operation from tax payers which is difficult to get in most cases.

13.4.5 Obligations of a registered taxpayer

The tax payer who is registered for VAT will be under obligation to do the following:

- Keep records as required by the law.
- Submit monthly returns and pay tax due on time.
- Charge VAT on all taxable supplies
- Display the registration certificate
- Submit a schedule of the input tax alongside the return.
- Taxpayers who apply for a tax refund are required to submit invoices for verification.

8.5 DE-REGISTRATION

As per section 9 of the Value Added Tax Act, A registered tax payer may either cancel his registration by applying to the Commissioner General or may be de-registered by the Commissioner General if he/she fails to fulfill the requirement of the law.

One may apply for de-registration if;

- Under voluntary registration, a trader may only apply for deregistration after two years from the date of registration.
- Where the taxable supplies of the trader are below the thresholds for registration
- A person has ceased to make taxable supplies
- The taxable turnover of goods or services in the most recent 3 months does not exceed 12.5 million and if taxable supplies for the previous 12 months does not exceed 75% of the annual threshold.

Note:

Under e-Tax, the taxpayer has an option to apply for de-activation of a tax type (temporary) even before applying for de-registration

NOTE:

Annual Threshold = 50m, therefore 75% of the threshold = [75% of 50m] = 37.5m

The Commissioner General shall serve a notice in writing on a taxable person of a decision to cancel or refuse to cancel the registration of a person within 14 days of making the decision. The cancellation of registration takes effect from the end of the tax period in which registration is cancelled. (i.e. if you register in April, you will receive notice from the Commissioner General in May)

De registration may also occur as a result of change in legal status of the entity for example;

- A sole proprietor forms a partnership
- A partnership is dissolved and one runs the business as a sole proprietor
- Your sole proprietorship or partnership is replaced by an incorporated company.
- The company is wound up and replaced by a partnership or sole proprietorship.
- The trader was allowed registration as an investment trader because he/she intend to make taxable supplies and no longer does so.

Or

- The trader has been registered for 4 years and not made any taxable supplies. In this case, you will have to repay any refunds you have received to the URA.
- The trader stops making taxable supplies for any other reason e.g. if a registered sole proprietor dies, his executors have the responsibility of cancelling his registration.
- In any of the above cases the trader must inform the commissioner General in writing within 14 days of the change.

Failure to apply for deregistration at a proper time may render the trader liable to a penalty. The trader can ask for cancellation if he/she can satisfy the commissioner general that for the most recent period of 3 calendar months, the value of his/her taxable supplies exclusive of VAT did not exceed 12.5m and the value of the taxable supplies as exclusive of VAT did not exceed 50million shilling for the previous 12 calendar months. One may only apply for cancellation under these provisions after 2 years from the date of registration if one registered voluntarily.

13.5.1 Disadvantages of De registration

The trader will no longer be able to claim the VAT paid on the standard rated purchases. Your customers may choose to trade with other VAT registered suppliers thus you will lose business since you cannot issue tax invoices on which your registered customer can claim a credit for the tax you may have been charged.

If you have stock and assets at hand on which you have received a credit for VAT you will have to account for this VAT to the URA before your registration is cancelled.

- VAT is calculated at the fair market value of stocks and assets.
- The trader ceases to be a taxable person and cannot charge and claim VAT.

13.5.2 VAT Paid before registration

VAT paid before registration on stock and capital assets in stock and acquired not more than 6 months prior to the date of registration can be claimed.

13.5.3 Transfer of business entity as a going concern

Any person who disposes a registered business as a going concern to another registered person may make the transfer without charging VAT or in these circumstances the supply of these goods is exempt.

In order for a transaction to qualify for transfer of going concern, the following conditions must be fulfilled.

- a) Both businesses must be registered for VAT.
- b) The transferor must make a written application to the commissioner stating the following;
 - i) Details of the transaction

- ii) Arrangements made to pay outstanding tax
- iii) Quantities and values of assets and stock of taxable goods on hand at the date of disposal,
- iv) Details of the arrangements made for transferring the responsibility for keeping the records and producing books of the business for the period prior to disposal.

13.5.4 Change of registration circumstances.

The application for registration for VAT contains details, which are put in a register of tax payer. Such details include;

- a) The name, postal and physical address.
- b) The nature of supplies made
- c) The ownership of the business
- d) The value of supplies made or expected to be made.

This information is used to ascertain if a business is eligible for registration. Consequently, whenever there is a change in the registration details, the law requires the taxable person to notify the commissioner General within 14 days. A registered person must notify the commissioner General when;

- e) The address of the place of business changes.
- f) Business premises cease to be used.
- g) The person who is authorized to sign returns is changed.
- h) The partners in a partnership are changed.
- i) There is a change in the trade classifications of the goods and services supplied.
- j) More than 30% of the share capital of a limited company is transferred to another person or group of persons,

From the date deregistration, one must not charge VAT or issue tax invoices for any supplies made and you must not show your cancelled registration number on invoices you issue. Remember that it is fraudulent to issue tax invoice after your cancellation of registration and you will be rendering yourself liable to a financial penalty.

A person who has de-registered must keep all the records related to his VAT registration for a period of at least 6 years. The Value Added Tax office will notify you if the application is acceptable and the date from which your registration is to be cancelled. If it is not accepted, the taxpayer will have to continue to account for Value Added Tax in the normal way. If it is accepted, the tax payer will be issued with a final Value Added Tax return for the period up to the date of cancellation of the tax payer's registration.

The taxpayer must complete the return in the normal way and include any tax due on stock and assets, The VAT registration certificate must be surrendered to the VAT office with the final return within 15 days of the date of cancellation. The taxpayer must pay any tax due on the return within the same 15 days period.

The VAT office will confirm a final cancellation of the registration when they are satisfied with the final return.

If the tax payer starts up a new business whose taxable turnover exceeds the registration threshold of the existing business exceeds the limits, one may need to apply for registration again,

13.5.5 Conditions where the Commissioner General may de- register a taxpayer:

Section 9 (5) of the VAT Act empowers the Commissioner General to cancel the registration of the person who has not applied for cancellation of registration but in respect of whom the Commissioner General is satisfied that he or she is neither required nor entitled under Section 7 to apply for registration.

This section also empowers the Commissioner General to de register a tax payer who does not have the following:

- Has no fixed place of abode or business;
- Has not kept proper accounting records relating to any business activity carried on by him or her;
- Has not submitted regular and reliable tax returns as required by law
- Is not, in the opinion of the Commissioner General, a fit and proper person to be registered.

The following must be followed and communicated after the de registration has taken place:

- The Commissioner General shall serve a notice in writing on a taxable person of a decision to cancel or refuse to cancel the registration within fourteen days of making the decision.
- The cancellation of registration shall take effect from the end of the tax period in which the registration is cancelled.
- Where the registration of a person is cancelled, the Commissioner General shall remove the person's name and the details described in Section 8 from the register.
- A taxable person whose registration has been cancelled under this Section shall be regarded as having made a taxable supply of all goods on hand (including capital goods) and shall be liable for output tax, at the time the registration is cancelled, on all goods in respect of which he or she received input tax credit, the output tax payable being based on the fair market value of the goods at the time his or her registration was cancelled.
- The obligations and liabilities of a person under this Act, including the lodging of returns required by Section 31, in respect of anything done or omitted to be done by that person while a taxable person shall not be affected by cancellation of the person's registration.

13.6 SUPPLY OF GOODS AND SERVICES

13.6.1 Taxable Supply (S.18)

A taxable supply is a supply of taxable goods and services other than an exempt supply made in Uganda by a taxable person for consideration as part of his or her business activities.

For the supply to qualify as a taxable supply, the supply must be made in Uganda and not anywhere else.

VAT is chargeable on the supply of taxable supplies in Uganda by a taxable person. A supply of goods therefore would have the ordinary meaning if any of the under listed conditions takes place as defined in section 10 of the VAT Act:

- Any arrangement under which the owner of goods parts or will part with possession of goods including an agreement of sale and purchase.
- The supply of electrical, thermal energy, heating, gas, refrigeration, air conditioning or water.
- Application of goods to own use.

Other considerations for a supply of goods would include the following:

- The supply of goods for no consideration other than trade samples.
- The sale, supply or delivery of taxable goods to another person.
- Goods taken for personal use by a registered person. These are deemed to be supplied by the taxable person in the course of carrying on the business.
- The hire of goods, the letting of goods on hire leasing or other transfer.
- The sale or provision of taxable services to another person.
- The making of a gift.
- The provision of taxable services by a contractor to him or herself in putting up a building for sale, use or renting.
- The receipt of a sum of money by a registered person for loss of goods and services.
- The appropriation of taxable goods for own use in a business where if supplied by another person VAT charged would not be deductible as input tax.

13.6.2 What is a supply of services?

A supply of services could also be referred to as:

Anything done for a consideration that is not a supply of goods or money is a supply of services as defined in section 11 of the VAT Act. This includes the grant, assignment or surrender of any right. The hire, lease and rental of goods amount to a supply of services.

Point to note

- (i) *An employee contract is not considered to be a contract of supply of services*
- (ii) *A supply of services incidental to the supply of goods is part of the supply of goods.*

13.7 PLACE OF SUPPLY

13.25.1 Supply of goods

A supply of goods shall take place in Uganda if the goods are delivered or made available in Uganda by the supplier or if the delivery or making available involves transportation, the goods are in Uganda when transportation commences.

Example 13.2:

If Mr Male bought a car from Dubai, paid for it and later shipped it to Uganda. While in Dubai, he was given his car and allocated the car. The place of supply therefore is in Dubai. This implies that the VAT that was paid while in Dubai relates to a situation outside Uganda and will therefore be outside the scope of VAT.

Example 13.3:

If Mr. Wangara a resident of Tunisia came to offer services of installation of computer points for the Ministry of Finance in Uganda or to Sekanyolya Limited in Uganda, the supply shall have been made in Uganda because both the Ministry of Finance and Sekanyolya are in Uganda.

13.8 TAX POINT

Tax point refers to the time when a supply is deemed to have taken place. Tax becomes due and payable at the time when;

- a) The goods are supplied or services have been rendered to the purchaser or;
- b) An invoice is issued in respect of the supply;
- c) Payment is received for all or part of the supply, whichever time shall be the earliest.



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Example 13.4

Mr. Wangolo obtained the services of a consultant for the year ended 30th June 2010. The consultant was paid a total amount of Shs 235 Million during the month of May 2011. The services were carried out in the month of January 2011. The invoice was however received in June 2011.

Required:

When should Mr. Wangolo account for VAT?

Solution:

Tax point is the earliest of the three, i.e. when goods/services are supplied, or when an invoice is issued or when payment is received. For this case, the service was consumed in January 2011. VAT should therefore be accounted for during the month of January 2011 when the services were rendered.

13.8.1 Importance of the time of supply or tax point

- a) The Value Added Tax Act requires every registered person to issue a tax invoice for every person to which a supply has been made within a period not exceeding 30 days after the supply has been made. It is therefore very vital to understand the time when the tax point actually occurred.
- b) The Accounting period for Value Added Tax in Uganda is the calendar month. A registered trader will therefore be required to account for VAT after every calendar month and not merely a period of 30 days. The determination of a tax point is necessary for accounting period in which a transaction is to be recorded. VAT must be accounted for during the period that the transaction has taken place or occurred
- c) In cases where the law changes with regard to the rates to be applied, the rates to be applied will be at the ruling rate during a particular tax point.
- d) If a tax point occurs before a person is registered for VAT then no VAT is chargeable. However there is the provision in the Act allowing a registered person to claim input tax for a period not exceeding six months prior to registration
- e) Registration for VAT is determined by the value of taxable supplies made over a specified period.

In determining such a value only transactions with tax point within the specified period will be taken into account.

13.9 VALUE OF THE SUPPLY

This is the value on which VAT is due or will be charged. VAT is calculated by applying the appropriate percentage rate on the value of the supply made, the amount of the tax is the value for tax multiplied by the tax rate. Generally the value for tax depends on the consideration given in exchange whether in cash or in kind, including any payment received to cover costs incurred in making the supply.

13.9.1 Supplies made for consideration in money.

If the consideration for a supply is wholly an amount of money, the value for tax is based on the amount. However note that the amount of money paid by the purchaser in consideration includes the tax element. The value of the supply therefore may be said to be such an amount which in addition to (the tax chargeable is equal to the consideration, The VAT fraction therefore is calculated using the following formula;

$$\frac{R}{R + 100} \quad \text{Where } R \text{ is the rate of Tax}$$

$$\text{e.g. with a VAT rate of 18\% the VAT fraction will be } \frac{18}{18 + 100}$$

The application of the VAT fraction to one's gross sales figure will enable the trader to determine his/her output tax. Please note that the application of the VAT fraction is on the premise that the sales figure is inclusive of the VAT amount.

If the sales figure is net of the VAT amount, then the percentage to apply in order to obtain the output tax is simply the VAT rate of 18% on the amount of sales or purchase.

13.9.2 Consideration is not wholly in money

If a supply is made and the consideration is not money (e.g. in barter trade) or is partly in money, and partly in something else the value for tax is the open market value i.e. the price which a customer would have to pay for the supply if money was the only consideration.

13.9.3 Time of supply.

A supply of goods or services occurs;

- a) Where the goods are applied to own use on the date on which the goods or services are first applied to own use.
- b) Where the goods or services are supplied by way of gift on the date on which ownership in the goods passes or the performance of the services is complete.
- c) In any other case on the earliest of the date on which:
 - i) The goods are delivered or made available or the performance of the service is completed.
 - ii) Payment for the goods or services is made or
 - iii) A tax invoice is issued

Time of supply of the goods is very important in establishing when the VAT should be accounted for.

13.9.4 Imported Service

Is a service rendered by a person normally resident outside Uganda who is not required to register for tax in Uganda. The time of supply for imported services is when the services are rendered or payment is made in respect of the service, whichever is earlier. VAT paid on imported services can be claimed as input tax by registered persons.



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Example 13.5:

Wyne Limited a US company performed a computer installation for Uganda Clays in January 2011. They were however paid for the service in March 2011. The time of supply for this service is January 2011 when the imported service was rendered.

13.10 INPUT AND OUTPUT TAX**13.10.1 Input tax means;**

- a) Tax on the supply to a registered person of any goods or services for the purpose of a business carried on by him or her.
- b) Tax paid or payable by a registered person on the importation of any goods or services for the purpose of a business carried on by him or her.

A person carrying on business may suffer VAT on goods or services supplied to him or her or imported by him or her if no relief could be obtained for VAT suffered, a most substantial liability would be incurred. This possibility is removed in appropriate cases by provisions which enable input tax to be compared with the output tax and the difference is paid to the government.

13.10.2 Output Tax

Output tax is tax, which is due on taxable supplies. A registered person may make taxable supplies and therefore charge VAT on invoice cost to his or her customers (output) he or she may also receive taxable supplies and be charged VAT by his or her suppliers (input tax).

The input tax suffered or paid by a taxable person may at the end of a prescribed accounting period be deducted from the output tax chargeable on supplies made by the person in that period if the input tax is greater than the output tax. The difference is carried forward and charged against future output tax. Not all input tax would qualify for deduction. The input tax which may qualify, as deductible will be governed by the nature of supplies made.

13.10.3 Types of supplies for VAT

There are basically two types of supplies for VAT purposes. Taxable and exempt supplies.

(a) Taxable Supplies

Taxable supplies are supplies of goods which are not exempt as part of a business of a person. Taxable supplies are further divided into two categories:

Standard and Zero rated supplies

(b) Standard rated Supplies

Standard rated supplies are those supplies that are charged VAT at the standard rate of 18%

The Value Added Tax Act categorizes both exempt and Zero rated supplies. Any items that are not categorized in this schedule will be treated as standard supplies.

(c) Zero Rated supplies

Zero rated supplies are those supplies on which VAT is charged at 0%. Zero rated supplies are taxable supplies on which VAT is at Zero percent. In effect, no VAT will be charged on zero rate supplies.

This means

- No tax will be charged on the supply but
- The supply will in all other respects be treated as a taxable supply.

Zero rated supplies are taxable supplies where value forms part of one's taxable turnover for registration purposes. The person dealing in zero rated supplies will therefore be required to register for VAT if the turnover fulfills the require registration thresh hold.

A registered trader dealing in zero rated supplies can claim full input tax (tax paid on purchase) credit related to his/her supplies. If one makes only zero rated supplies, he she should be able to claim refunds from URA.

A Registered person making zero rated supplies will not charge VAT on their supplies, but will obtain a refund of VAT paid by them on their goods and services.

(d) Exempt supplies include;

Section 19 and schedule two of the VAT Act gives the following items as exempt supplies. This implies that a trader dealing in these supplies need not register for VAT and charges no VAT on these supplies. Note that these are bound to change every year as the commissioner may deem necessary. If they are to change, then amendments will be made to the Act.

EXAM FOCUS POINT:

The value added tax Act was amended in July 2014 to have the following items that have been exempt from VAT taxed. Therefore effective 1st July 2014, the following supplies will be subject to VAT at 18%;

- (i) Supply of new computers, desk top printers, computer parts and accessories
- (ii) Supply of computer software and software licenses
- (iii) The supply of accommodation in tourist lodges and hotels outside Kampala District;
- (iv) The supply of Liquefied Petroleum Gas.
- (v) The supply of feeds for poultry and livestock;
- (vi) The supply of machinery used for the processing of agricultural or dairy products;
- (vii) the supply of salt;
- (viii) The supply of packing materials exclusively used by the milling industry for packing milled products;
- (ix) The supply of insurance services except medical and life;
- (x) The supply of specialized vehicles, plant and machinery, feasibility studies, engineering designs, consultancy services and civil works related to hydro-electric power, roads and bridges' construction public water works, agriculture, education and health sectors.

above 2014 Amendments;

- (a) The supply of unprocessed foodstuffs, unprocessed agricultural products and livestock;
- (b) The supply of postage stamps;



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- (c) The supply of financial services;
- (d) The supply of unimproved land;
- (f) A supply by way of leasing or letting of immovable property, other Than
- (i) A lease or letting of commercial premises;
- (ii) A lease or letting for parking or storing cars or other vehicles
- (iii) A lease or letting of hotel or holiday accommodation;
- (iv) A lease or letting for periods not exceeding three months; or
- (v) A lease or letting of service apartments;
- (g) The supply of education services;
- (h) The supply of veterinary, medical, dental, and nursing services;
- (i) The supply of social welfare services;
- (j) The supply of betting, lotteries, and games of chance;
- (k) The supply of goods as part of the transfer of a business as a going concern by one taxable person to another taxable person;
- (l) The supply of burial and cremation services;
- (m) The supply of precious metals and other valuables to the Bank of Uganda for the State Treasury;
- (n) The supply of passenger transportation services (other than Tour and Travel operators);
- (o) The supply of petroleum fuels subject to excise duty, (motor spirit, kerosene and gas oil), spirit type jet fuel kerosene type jet fuel and residual oils for use in thermal power generation to the national grid;
- (q) The supply of dental, medical and veterinary equipment;
- (r) The supply of photosensitive semiconductor devices, including photovoltaic devices, whether or not assembled in modules or made into panels; light emitting diodes; solar water heaters, solar refrigerators and solar cookers.
- (u) The supply of lifejackets, lifesaving gear, headgear and speed governors;
- (y) The supply of mosquito nets, insecticides and acaricides;
- (aa) The supply of contraceptive sheaths and examination gloves;
- (cc) The supply of any goods and services to the contractor and subcontractor of hydro-electric power projects;
- (ee) the supply of diapers.
- (ff) The supply of packing materials exclusively used by the dairy industry for packing milk.

In this Schedule –

➤ **"Education services" means education provided by –**

- (i) A pre-primary, primary, or secondary school;
- (ii) A technical college or university;
- (iii) An institution established for the promotion of adult education, vocational training, technical education, or the education or training of physically or mentally handicapped persons;

➤ **"Financial services" means -**

- (i) Granting, negotiating, and dealing with loans, credit, credit guarantees, and any security for money, including management of loans, credit, or credit guarantees by the grantor;
- (ii) Transactions concerning deposit and current accounts, payments, transfers, debts, foreign currency sales and purchases, cheques, and negotiable instruments, other than debt collection and factoring;
- (iii) Transactions relating to shares, stocks, bonds, and other securities, other than custody services;
- (iv) Management of investment funds; but does not include provision of credit facilities under a hire-purchase or finance lease agreement;
- (c) "Passenger transportation services" means the transportation of fare paying passengers, and their personal effects by road, rail, water, or air, but does not include passenger transport services provided by a registered tour operator; and

➤ **"Social welfare services" means -**

- (i) Care for the elderly, sick, and disabled, including care in a hospital, aged person's home, and similar establishments; or
- (ii) Care and welfare services provided for the benefit of minors.
- (e) "Transfer of a going concern" includes the disposal of any part of a business which is capable of separate operation;

➤ **Insurance services include brokerage.**

The term "unprocessed" includes low value added activity such as sorting, drying, salting, filleting, deboning, freezing, chilling, or bulk packaging, where, except in the case of packaging, the value added does not exceed 5% of the total value of the supply.



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(e) Zero rated supplies include;

The Second Schedule of the VAT Act gives the following items as Zero rated. This is as per the Value Added Tax Act for the Financial Year 2009/2010.

EXAM FOCUS POINT:

The Value Added Tax Act was amended in July 2014 to have the following items where VAT was charged at the 0% rate to be taxed at the standard rate. Therefore effective 1st July 2014, the following supplies will be subject to VAT at 18%;

- (i) The supply of printing services for educational materials,
- (ii) The supply of cereals, where the cereals are grown, milled or produced in Uganda;
- (iii) The supply of milk, including milk treated in any way to preserve it and milk products,
- (iv) The supply of machinery, tools and implements suitable for use only in agriculture
- (v) The supply of seeds, fertilizers, pesticides, and hoes;

The following supplies are specified as Zero rated supplies for the purposes of Sec.19 – (After incorporating the above 2014 Amendments;

- (a) A supply of goods or services where the goods or services are exported from Uganda as part of the supply;
- (b) The supply of international transport of goods or passengers and tickets for their transport;
- (c) The supply of drugs and medicines;
- (d) The supply of educational materials;
- (h) The supply and installation of Mobile Toilets, Ekoloo Toilets, and components made from polythene with effect from 1st July 2004; and
- (j) The supply of sanitary towels and tampons and inputs for their manufacture.
- (k) The supply of leased aircraft, aircraft engines, spare engines, spare parts for aircraft and aircraft maintenance equipment.

Goods or services are treated as exported from Uganda if –

- (a) in case of goods, the goods are delivered to, or made available at, an address outside Uganda as evidenced by documentary proof acceptable to the Commissioner General; or



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(b) In the case of services, the services were supplied by a person engaged exclusively in handling of goods for export at a port of exit or were supplied for use or consumption outside Uganda as evidenced by documentary proof acceptable to the Commissioner General.

International transport occurs where goods or passengers are transported by road, rail, water, or air –

(a) From a place outside Uganda to another place outside Uganda where the transport or part of the transport is across the territory of Uganda;

(b) From a place outside Uganda to a place in Uganda; or

(c) From a place in Uganda to a place outside Uganda

“Educational materials” means

Materials suitable for use only in public libraries and educational establishments specified in paragraph 2 of the second Schedule to the VAT Act;

(b) “Pesticides” means insecticides, rodenticides, fungicides and herbicides but does not include pesticides packaged for personal or domestic use.

13.11 CALCULATION OF TAX PAYABLE

Tax payable is calculated by applying the rate of tax to the taxable value of the transaction

For Uganda the rate for standard rated supplies is 18%, 0% for zero rated supplies and NIL for exempt supplies.

13.11.1 Cash Basis Accounting

The recommended basis of accounting in the invoice basis However section 26 of the Value Added Tax Act allows a taxable person whose taxable supplies do not exceed 200 million shillings per annum to Account for VAT on cash basis.

This election shall be made in writing to the CG. by the due date for the first return in which the taxable person intends to use the method.

Where election is made, the person must account for both input and output tax credited on cash basis.

An election to account on cash basis should stay until such a time when

- a) When withdrawn by the tax payer in writing to the Commissioner General.
- b) By the CG in writing to the tax payer.
- This election if made by the taxable person may not be withdrawn until after 2 years.
- Any taxable person changing the accounting basis is liable to tax of any as determined in the tax period in which the change occurred.
- Where one changes from invoice basis to cash basis, the tax payable is determined as follows:

M - N

M Total amount of input tax credited in relation to amounts due by the taxable person at the time of change in accounting basis.

N Total amount of output tax accounted for in relation to the taxable person at the time of change in accounting basis.

If the amount determined is negotiable, then thus shall be refunded to the tax payer

Advantages of using the Cash basis of accounting:

- i. One accounts for VAT only on transactions where cash or payment has been made
- ii. One does not take the risk of accounting for VAT on bad debts since he only accounts for cash transactions only.

Disadvantages:

One cannot claim input tax on items that have not been paid for

3.11.2 Accrual Basis of Accounting for VAT

This is the system where the taxpayer accounts for VAT on all transactions regardless of whether they have been paid for or not. The trader will therefore be required to account for VAT even on transactions that have not been paid for.

13.12 INPUT TAX

Input tax can be defined as that tax charged to a trader or business person on all his purchases and expenditure. These are referred to as inputs. It can also be defined as tax on the supply to a registered person of any goods or services for the purpose of a business carried on by him or her.

Input tax can also be defined in relation to imports as tax paid or payable by a registered person on the importation of any goods or services for the purpose of a business carried on by him or her.

Examples of input tax (VAT) on expenses include VAT charged on overheads like office equipment, rent, electricity, telephone charges for business use, commercial vehicles. Please note that VAT paid on passenger car related expenses cannot be offset or claimed.

When one spends money on taxable business activities, he/she can claim a credit for VAT paid which is his/her input tax.

13.12.1 Conditions for one to claim input Tax

In order for a business person to claim input tax paid on his purchases and expenses, one must possess an original tax invoice or customs import entry to claim a credit for input tax. For imports.

No Business entity can claim input tax on passenger automobiles except where the business is dealing in hiring automobiles

No input tax will be claimed in respect of the following expenses;

- i) The repair and maintenance of passenger automobiles.
- ii) Entertainment
- iii) Where taxable supply is partly for business and private use, only that portion for business shall be taken for VAT.
- iv) 10% of the input tax on telephone services. This means that telephone services are reduced by 10% i.e. claim up to 90% in the calculation.

Passenger automobiles are defined as road vehicles designed solely for the transport of sitting persons.

Entertainment is defined as the provision of food, beverages, tobacco, accommodation, amusement, recreation or hospitality of any kind.

13.13 MIXED SUPPLIES

It is not uncommon to come across traders who are dealing in mixed supplies. The trader may be dealing in Taxable supplies and exempt supplies. This therefore implies that the trader is dealing in mixed supplies.

If a trader makes or deals in **exempt supplies**, together with **taxable supplies**, he/she may not be able to claim a credit for all the **input tax**. However, where the value of **taxable supplies** exclusive of the VAT exceeds **95%** of the total value of all supplies, in any tax period, one will be deemed to be dealing in taxable supplies and can claim all the input tax.

If the value of exempt sales exceeds 95% of the total sales exclusive of VAT in any tax period, then one cannot claim a credit for any input tax because he/she will be deemed to be making exempt supplies.

Where the percentage of exempt supplies is more than 5% but less than 95%, the trader cannot claim all the input tax on his inputs. This will imply that the input tax to be offset will have to be apportioned using any of the apportionment methods. i.e. There are two methods of apportionment for input tax to be offset where the trader is dealing in mixed supplies and he/she is registered for VAT.

- a) General Apportionment Method
- b) The Alternative apportionment method.

(a) Using the General Apportionment Method,

$$\text{Input tax to be offset} = A \times \frac{B}{C}$$

Where

- A** is the total amount of input tax for the tax period.
- B** is the total value of taxable supplies for the tax period, including zero rated supplies,
- C** is the total value of all supplies made during the tax period including all exempt supplies (except any exempt supplies resulting from the transfer of a taxable business but excluding any VAT.)

The result of this calculation is the amount of input tax to be offset by the taxpayer.

If a trader imports goods, he/she must apply the above calculation separately to the VAT paid on both local purchases and imports.

The following documents must form some of the proof for the input tax being claimed.

- a) Original tax invoice or simplified tax invoice
- b) Certified customs bills of entry for imports

(b) The Alternative apportionment method

A tax payer who wishes to use the alternative apportionment method will have to seek for permission from the Commissioner General to use this method. When this method is used, it either increases on one's VAT Claimable from URA or reduces the VAT payable by the taxpayer.

While using the alternative method of apportionment, the trader will claim VAT on all taxable supplies including the expenses, he/she will have. Please note that taxable supplies include Standard rated and Zero rated supplies. No claim will however be made for VAT that was incurred on the exempt related expenses.

The tax payer must obtain approval of the Commissioner General before using this method. This method requires that three separate purchasing records are to be kept:

1. A record of purchases of taxable goods and services specifically related to taxable supplies. Input tax attributed to taxable supplies is claimed in full, subject of legal restrictions if any.
2. A record of purchases of taxable goods and services specifically related to exempt supplies where no credit for tax is claimed.
3. A record of purchases of taxable goods and services which relate to both taxable and exempt supplies. Credit for input tax is calculated using the Partial Exemption Method.

13.14 OUTPUT TAX

Output tax is tax, which is due on taxable supplies. A registered person may make taxable supplies and therefore charge VAT on invoice cost to his or her customers (output) he or she may also receive taxable supplies and be charged VAT by his or her suppliers (input tax).

The input tax suffered or paid by a taxable person may at the end of a prescribed accounting period be deducted from the output tax chargeable on supplies made by the person in that period if the input tax is greater than the output tax. The difference is carried forward and charged against future output tax. Not all input tax would qualify for deduction. The input tax which may qualify, as deductible will be governed by the nature of supplies made.

Example 13.6: Supply of Telephone Services

UNI Ltd paid a telephone bill of Ug. Shs 236,000 (VAT inclusive) for May 2010. What is the input VAT claimable by the company?

Answer

$$\begin{aligned}
 \text{Input VAT claimable} &= 90\% [236,000 \times 18 / 118] \\
 &= 0.9 \times 36,000 \\
 &= \text{Shs. 32,400/=}
 \end{aligned}$$



Example 13.7: Mixed Supplies:

Abbey who registered for VAT has the following transactions in the month of March 2010. All amounts are exclusive of VAT.

Payments Made;	U.Shs
Duplicating paper	218,000
Fuel	970,000
Water bills	204,000
Telephone	312,000
Electricity	447,000
Receipts received for the months of march:	
Sales	1,700,000
Exports	680,000
Sales of Matooke from the Farm	650,000

Required

- (a) Calculate the VAT payable by Abbey for the month of March 2010.
 (b) Advice Abbey on the date when his tax return should be filed with U.R.A

Solution:

Receipts:	Rate	Excluding VAT	VAT
Sales	Standard (18%)	1,700,000	306,000
Exports	Zero rated (0%)	680,000	<u>0</u>
Exempt Sales	Nil	650,000	<u>Nil</u>
Total Supplies		3,030,000	306,000
Payments:			
Duplicating paper	Standard (18%)	218,000	39,240
Water	Standard (18%)	204,000	36,720
Telephone	Standard (18%) 90%	312,000	50,544
Electricity	Standard (18%)	447,000	80,460
Fuel	Exempt	970,000	<u>NIL</u>
			<u>206,964</u>

Before computation of the input tax to be offset for the month of March, it is required that we establish the percentage components of the supplies.

i.e. Total Supplies = Shs. 3,030,000 and Exempt Supplies = Shs. 650,000
 Percentage of the Exempt supplies as compared to taxable supplies;

$$= \frac{650,000}{3,030,000} \times 100 = \text{Shs. 21.4\%}$$



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This implies therefore that the tax payer can't claim all the input tax as an offset. There is need to apportion the input tax claimable using the apportionment method given above. (A X B/C)

A=	206,964
B=	2,380,000
C=	3,030,000

$$\text{Input tax to be offset} = 206,000 \times \frac{2,380,000}{3,030,000} = \text{Shs. } 162,565$$

Therefore:

Input Tax	306,000
Output Tax	<u>(162,565)</u>
VAT Payable	<u>143,434</u>

- Abbey must pay VAT of Shs. 143,434 to the U.R.A
- The above value of VAT is payable by 15th April 2010

13.15 VALUE ADDED TAX RECORDS AND ACCOUNTS

13.15.1 Tax invoice

Taxable persons supplying goods or services to other taxable persons are required to provide them with invoices referred to as tax invoices. These provide documentary evidence of goods and services supplied and will be indispensable to the persons acquiring goods or services when claiming relief for input tax suffered.

The tax invoice must be issued at the time of supply or within 30 days of the completion of that supply. No tax invoice should be issued for any supply if;

- a) The supply is not a supply of taxable goods or services
- b) The supplier is not a registered person.

13.15.2 Particulars to be stated on a full tax invoice

- a) The name, address, VAT registration number, Tax Identification Number (TIN) the word tax invoice written in a prominent place,
- b) The serial number of the invoice.
- c) The date of the invoice.
- d) The date of the supply if different from the date of the invoice.
- e) The name, addresses and VAT registration number of any person to whom the supply was made
- f) The description, quantity and price of goods or services being supplied.
- g) The taxable value of the goods and services if different from (the price charged).
- h) The rate and amount of tax charged on each of these goods and services.
- i) Details of whether the supply is a cash or credit sale and details of cash or other discounts if any.
- j) The total value of the supply and (the total amount of VAT charged). A tax invoice must be serially numbered and issued in serial numbers.

13.15.3 Simplified Tax Invoice

Where the tax payer accounts for VAT on cash basis, he may issue a simplified tax invoice.

Just like any other tax invoice, a simplified tax invoice shall contain details as those on the other tax invoice other than a simplified tax invoice. However, the following exceptions must be complied with;

- The total amount on the invoice should not exceed shs 100,000
- No single item on the invoice should exceed 50,000

Other details that may appear on the simplified tax invoice include the following:

- The name, address, VAT registration number and TIN of the person making the supply.
- The serial number of the invoice
- A brief description of the goods or services being supplied,
- The total amount charged to the customer VAT included,
- The explicit statement that the price includes VAT.

13.15.3 Other Records to be maintained for VAT purposes

VAT registered persons are required to keep the following;

1 Value Added Tax Account.

The VAT account is posted with monthly totals. The total input tax for the month is debited to the account and the total output tax credited. A credit balance will represent the tax payable to the commissioner General while a debit balance will represent excess in put tax, which is carried, forward and offset against output tax of the following month.

This is the information, which is entered on the VAT return. This will indicate both input and output tax on a monthly basis as well as the amount of tax to be paid to URA or to be claimed and offset.

1. Purchases record

- Local purchases and the VAT there on.
- Imports and the VAT thereon
- All other purchases from suppliers who are not registered for VAT where you will not have been charged any VAT.
- Original tax invoices including simplified invoices received from your local suppliers
- Certified copies of customs Bills of entry
- Purchase invoices received for all other purchases.

2. Sales Record

- Taxable sales at the standard rate and the VAT thereon or VAT charged there from.
- Taxable sales at the zero rate
- Exempt sales

The following must also be retained separately;

- Copies of tax invoices, including simplified invoices related to taxable sales and copies of any debt or credit notes issued to customers. If you use cash accounting or a small trader scheme, you must keep a daily record of your gross takings at the standard rate.
- Copies of invoice of goods sold at the zero rate.
- Copies of invoices of exempt goods sold.

13.15.4 Debit notes and credit notes.

Issued should be separately filed from debit and credit notes received. They should be filed in order of date.

Exports, the following must be retained.

- i) A certified copy of the customs export entry
- ii) A purchase order form or contract with the foreign customer
- iii) Evidence of transportation from Uganda in the form of copies of transit documents such as airway bills, shipping bills, road or rail transit documents

13.15.5 Cash Records.

The following must be retained:

Cash books, petty cash vouchers and account books records of daily taking including till rolls, copy of receipts or daily taking records. Computer records should tally with manual records.

The Value Added Tax regulations require a V.A.T registered person to display his V.A.T registration certificate at his principal place of business.

VAT registered persons whose taxable turnover exceeds 200 million shillings per annum must retain the following in addition.

- Orders and delivery notes All business correspondence
- Appointment and job books.
- Annual accounts including trading accounts, profit and loss account and balance sheet.
- Bank statement and paying in records.

The law requires that all the specified accounts and records must be retained for at least 6 years and made available to authorized officers of the URA on official duty.

13.16 VAT RETURNS

Every registered trader is required to submit and file a return at the end of the VAT accounting period. In this case the period being discussed is a close friendly

Registered persons are required to submit a VAT return, not later than the 15th day of the month following the month for which the return has been completed. With the introduction of the e tax in Uganda Revenue Authority, it is now a requirement that all Offices that are already linked to the system do file electronic returns.

The electronic returns will also follow the normal period of filing. The major advantage is that the system is accessible to the tax payers for 24 hours and seven days a week as compared to the manual system where one needed to wait for the offices of URA to open.

After submitting the electronic return, the tax payer is given 10 days in which to file the printed hard copy of the VAT return to the office where the tax payer belongs.

The return should have the following particulars:

- Particulars of the total value of supplies
- The rate of tax to which the supplies are liable
- The amount of tax payable
- The total value of taxable supplies received
- The rate at which tax was paid
- The amount of tax paid in respect of which deductible input tax is claimed.

If no transactions are carried on in any month a Nil return indicating no transactions carried out should be submitted. The taxpayers should keep a copy of returns made for record purposes. Failure to submit a return by the due date will attract penalties as prescribed by the Value Added Tax Act.

Point to Note for Exam Purposes:

Example 13.8 below is an illustration that shows you how the examiner may bring up a question. The examiner will not give you a list of exempt nor will you get a list of zero rated supplies. It is therefore upon the student to identify these items. At this moment it will be very important to get accustomed to both zero rated and exempt items.

Example 13.8: Exam type Question

Nekemiya Nsi' Yaletta is a business man in Kampala. During the month of April 2010, he made the following transactions:

- a) Made sales of General Merchandise amounting to Shs 35,000,000
- b) Sold Samaki from his stall in Kiseka Market worth Shs 40,000,000
- c) From his Farm in Kalagi he sold 50 cows at Shs 1,000,000 each
- d) Sold general merchandise to Muko Investments worth shs 150,000,000
- e) Exported Samaki to Rwanda worth Shs 300,000,000 during the month.

Other transactions for the period were;

- f) Imported goods from Japan with CIF Value of Shs 55,000,000, paid import duty at 25% and Excise duty at 10%
- g) Transportation of goods from Mombasa to Kampala cost him Shs 10,000,000
- h) Local Purchases amounted to shs 70,000,000
- i) Paid Salaries and wages of Shs 15,000,000 for the month
- j) Repairs and maintenance for the saloon cars cost him Shs 5,000,000
- k) Telephone bills cost him Shs 1,250,000
- l) Medical bills for staff cost him shs 2,550,000
- m) Office stationery cost him shs 1,300,000
- n) He returned to his suppliers local purchases amounting to shs 7,550,000

During the previous two years, he had accounted for input tax on a sale of Shs 25,000,000 but the debt has since gone bad and there is no hope of recovery. This figure is VAT inclusive

Paid for water and electricity charges for the month of March amounting to Shs 450,000, for the month of April amounting to shs 550,000 and also paid in advance for power to be consumed in May 2010 amounting to shs 650,000.

Other over heads 60,000,000

Note: All Sales are VAT exclusive. Purchases and expenses are VAT inclusive where applicable.



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Required:**Advise Nekemiya on the following issues:**

- (i) Is there any need for him to register for VAT with URA?
- (ii) Advise him on the VAT implications of his transactions for the month of April 2010, clearly explaining to him why you have used some of the information and left out some.
- (iii) Advise him on the VAT payable or claimable by him.

Solution:

Is there need for Nekemiya to register for VAT

The VAT Act section 8 requires all taxable persons dealing in taxable supplies to register for VAT if they fulfill the following conditions:

- Where the person is dealing in taxable supplies
- within twenty days of the end of any period of three calendar months if during that period the person made taxable supplies, the value of which exclusive of any tax exceeded 12.5 Million shillings
- At the beginning of any period of three calendar months where there are reasonable grounds to expect that the total value exclusive of any tax of taxable supplies to be made by the person during that period will exceed 12.5 Million shillings
- Annual Turnover is 50 million shillings and above

From the question, Nekemiya is dealing in mixed supplies which are taxable and exempt.

Let us establish whether Nekemiya is required to register for VAT

By reviewing the % of the exempt supplies as compared to the total supplies;

Item	Amount	Remarks
General Merchandise	35,000,000	Taxable
Sale of Samaki	40,000,000	Exempt
Sale of Cows	50,000,000	Exempt
Sale of Goods to Muko	150,000,000	Taxable
Export of Samaki	300,000,000	Taxable
Total Sales/Supplies	575,000,000	
% of Exempt supplies	16%	

This therefore implies that Nekemiya should register for VAT if not already registered for VAT because the percentage of exempt supplies is more than 5% and less than 95%. If the percentage of exempt supplies was more than 95%, then he will be deemed as dealing in exempt supplies.

In conclusion, he needs to register for VAT if at all he is not registered.

VAT Implications for the Transactions for the month of May 2010

This requires the student to compute the VAT payable or claimable by the trader. We shall use a table where by we shall obtain the output tax from which we shall deduct the input tax.

VAT Payable/ Claimable is obtained by **OUTPUT TAX Less INPUT TAX**

It is therefore vital that we obtain both output and input Tax.

Item	Amount	VAT	Remarks
OUTPUT TAX			
General Merchandise	35,000,000	6,300,000.00	Standard rated
Sale of Samaki	40,000,000	Nil	Exempt
Sale of Cows	50,000,000	Nil	Exempt
Sale of Goods to Muko	150,000,000	27,000,000.00	Standard rated.
Export of Samaki	300,000,000	0	Exports are Zero rated
Total Sales/Supplies	575,000,000	33,300,000	

Total output tax for the month is Shs 33,300,000

INPUT TAX	Amount	VAT	Remarks
Imported goods from Japan CIF	75,625,000	13,612,500	See analysis
Transportation of goods Mombasa to K'la	10,000,000	0	Zero rated
Local Purchases	70,000,000	10,677,966	Standard rated
Salaries	15,000,000		Outside the scope of VAT
Repairs and Maintenance Saloon Cars	5,000,000		Can't claim for the input tax on these repairs though it was paid by the trader
Telephone Bills	1,250,000	171,610	Only 90% of the input tax to be offset
Medical Bills	2,550,000		Exempt from VAT
Office Stationery	1,300,000	198,305	Taxable supply



Returned goods to suppliers	7,550,000	(1,151,694)	Input tax that had been claimed earlier has to be reversed through a credit note
Bad debts from previous years	25,000,000	3,813,559	The Act allows to claim the output tax that had been accounted for earlier on the bad debt
Water and electricity bills for March	450,000		Input tax was accounted for in March when the invoice was issued or when services were consumed. Tax Point was in March 2010
Water and electricity Bills for April	550,000	83,898	Input tax can be accounted for in April
Water and Electricity Bills for May	650,000	99,152	Input can be accounted for in April as it is the tax point. I.e. the earliest of supply of service, receipt of invoice, or when payment is made. Payment in this case was the earlier of all.
Other Overheads	60,000,000	9,152,542	Taxable
Total		36,657,838	

Imports	
C.I.F Value	55,000,000
Import duty (25% of the CIF)	13,750,000
Total	68,750,000 (A)
Excise Duty (10% of CIF + Import duty)	6,875,000 (B)
Value for VAT Purpose A +B	75,625,000
VAT 18% of (A+B)	13,612,500



Input tax

Before computing the VAT payable or claimable, it is required that we test for the 95% rule. Since the % of exempt supplies is 16%, then Nekemiya cannot offset all the input tax. The input tax to be offset has to be apportioned using the formula given earlier on when one is dealing in mixed supplies.

Input tax to be offset will be as follows; $A \times \frac{B}{C}$

Please note that the input tax to be apportioned will be the input tax accruing from that period. The net figure of 36,657,838 is inclusive of the claim of the output tax that was accounted for on the bad debt. This will therefore be reduced from the 38,657,838 before apportionment is done.

A= Computed in put tax = (36,657,838-3,813,559) = **Shs. 32,844,279**

B= Total Taxable supplies = 485,000,000

C= Total Supplies = 575,000,000

Substituting into the formula:

$$= 32,844,279 \times \frac{485,000,000}{575,000,000}$$

$$= \text{Shs. 27,703,435}$$

Therefore VAT Payable;

INPUT TAX	Amount	VAT	Remarks
Imported goods from Japan CIF	75,625,000	13,612,500	Claim all
Transportation of goods Mombasa to	10,000,000	0	
Local Purchases	70,000,000	10,677,966	Claim All
Salaries	15,000,000		Outside the scope of VAT
Repairs and Maintenance Saloon Cars.	5,000,000		Can't claim for the input tax on these repairs though it was paid by the trader
Telephone Bills	1,250,000	171,610	Apportion as can't be attributed to a particular supply
Medical Bills	2,550,000		Exempt from VAT
Office Stationery	1,300,000	198,305	Apportion Can't be attributed to a particular supply
Returned goods to suppliers	7,550,000	(1,151,694)	Offset all since was accounted for in the purchases
Bad debts from previous years	25,000,000	3,813,559	This will be reduced from the VAT Payable



Water and electricity bills for March	450,000		Apportion
Water and electricity Bills for April	550,000	83,898	Apportion
Water and Electricity Bills for May	650,000	99,152	Apportion.
Other Overheads	60,000,000	9,152,542	Apportion
Total		36,657,838	

Output – Input

$$33,300,000 - (27,703,435 + 3,813,559)$$

$$1,783,005$$

This method of apportionment is referred to as the General apportionment Method.

Using the Alternative apportionment Method:

The trader can apply to the commissioner General to be allowed to use the alternative apportionment method. When using this method, the taxpayer will claim all the input tax paid on the taxable supplies including expenses incurred on inputs related to taxable supplies. No claim will be made on expenses incurred on inputs that are related to exempt supplies. An apportionment will be made for input tax that can't be attributed to any particular type of supply. This will usually fall under overheads.

Using the alternative method of apportionment, establish the VAT payable or Claimable by Nekemiya.

Therefore, the figures for apportionment are:

$$(171,610 + 198,305 + 83,898 + 99,152 + 9,152,542) = 9,705,507$$

Apportioning using the formula $A \times \frac{B}{C}$

$$= 9,705,507 \times \frac{485,000,000}{575,000,000} = \text{Shs. 8,186,384}$$

Therefore, VAT Payable = Out Put – Input

$$= 33,300,000 - (8,186,384 + 13,612,500 + 10,677,966 + 3,813,559)$$

$$= 33,300,000 - 36,290,409$$

Claimable of Shs (2,990,409)

Conclusion: The alternative method of apportionment reduces on the tax payable and that is the reason why one must apply to the Commissioner General before using that method.



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13.17 OFFENCES and PENALTIES

Offences and penalties are put in place to deter tax payers failing to observe the provisions of the law. A tax payer who does not abide by the provisions of the Act will have committed an offence and will be liable to a fine or penalty. The Value added Tax Act outlines the various offences that may be committed by a tax payer and the penalties and fines that such a tax payer will be liable to.

13.17.1 Offences Related to registration

A tax payer who fails to fulfill the following with regard to registration will have committed an offence under section 51 of the VAT Act. A person who fails to do the following:

- To apply for registration
- To notify the commissioner-general of a change in circumstances.
- To apply for cancellation of registration commits an offence and is liable on conviction.

Such a person will be liable to;

- Where the failure is deliberate or reckless to a fine not exceeding 500,000 or imprisonment for a term not exceeding 2 years or both.
- In any other case to a fine not exceeding 300,000 or imprisonment for a term not exceeding 6 months or both.

13.17.2 Offences Related To Tax Invoices, Credit Notes And Debit Notes.

A taxable person who fails to provide a tax invoice or a credit note commits an offence under section 52 and is liable on conviction to a fine not exceeding 500,000 or to imprisonment for a term not exceeding two years or both.

A person who provides a tax invoice otherwise than is provided under subsection (1) or (6) of section 29 (Sub section 1 of section 29 requires a tax payer to provide an original tax invoice to the other party at the time of supply of the goods or services. This implies therefore that the tax payer will be liable to the fine and penalty if he/she does not provide the other party with the original tax invoice at the time of supply. Sub section 6 of the Act provides that where a person requests for a tax Invoice where upon he was supplied goods prior to being registered, the other party must provide him/her with a n original tax invoice with in a period of thirty days.)

or a credit or debit note otherwise than is provided for in Sec 30 commits an offence and is liable on conviction to, Where the act is deliberate or reckless a fine not exceeding 500,000 or to imprisonment for a term not exceeding two years or both or in any other case a fine not exceeding 300,000 or to imprisonment for a term not exceeding two years or both.

Section 30 of the VAT Act states as follows:

Where a tax invoice has been issued in the circumstances specified in section 22(1)(e) and the amount shown as tax charged in that tax invoice exceeds the tax properly chargeable in respect of the supply, the taxable person making the supply shall provide the recipient of the supply with a credit note containing the particulars specified in section 3 of the Fourth Schedule.

Where a tax invoice has been issued in the circumstances specified in section 22(1)(e) and the tax properly chargeable in respect of the supply exceeds the amount shown as tax charged in that tax invoice, the taxable person making the supply shall provide the recipient of the supply with a debit note containing the particulars specified in Section 4 of the Fourth Schedule.



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13.17.3 Failure to Lodge a Return

Section 53 of the VAT Act imposes a penalty on a person who fails to lodge a return or any other document under this Act within fifteen days of being so required commits an offence and is liable on conviction of a fine not exceeding three hundred thousand shillings (300.000=) or to imprisonment for a term not exceeding 6 months or both.

If a person convicted of an offence under subsection (1) fails to lodge the return or document within the period specified by the commissioner- General that person commits an offence and is liable on conviction to a fine of 50.000= for each day during which the failure continues and to imprisonment for 3 months without the option of a fine in lieu of imprisonment.

5.54 (1) A person who fails to comply with;

A notice under Sec 40 (recovery of tax from third parties)

The requirement of Sec 41 (duties of receivers) commits an offence and is liable on conviction to a fine not exceeding two years or both. Where a person is convicted of an offence under paragraph (a) Subsection (1) the court in addition to imposing a penalty may order that person to pay to the Commissioner General an amount not exceeding that amount that person failed to pay as required by Section 40.

S.55 Failure to maintain proper records is an offence and is liable on conviction to

- a) Where the failure was deliberate or reckless a fine not exceeding 500.000= or to imprisonment for a term not exceeding 2 years or both or
- b) In any other case, a fine not exceeding 300.000= or to imprisonment for a term not exceeding 6 months.

S.56 Failure to provide reasonable assistance to the commissioner general or authorized officer with all reasonable facilities and assistance is required under Subsection 3 of Sec 52 commits an offence and is liable on conviction to a fine not exceeding 300.000= or to imprisonment for a term not exceeding 6 months.

S.57 Failure to comply with S.48 (notice to obtain information or evidence or S.49 (books and records not in English language) commits an offence and is liable on conviction to a fine not exceeding Shs. 300,000/= or to imprisonment for a term not exceeding 6 months or both.

S.58 Improper use of taxpayer identification number.

A person who knowingly uses a false tax identification number (TIN) of another person on a return or document prescribed or used for the purpose of this statute commits an offence and is liable on conviction to a fine not exceeding 500.000= or to imprisonment for a term not exceeding two years or both.

S.59 False or misleading statements.

- 1- A person who;
 - a) Makes a statement to an officer of URA that is false or misleading in a material particular or
 - b) Omits from a statement made to an officer of URA any matter or thing without which the statement is misleading in a material particular, commits an offence and is liable on conviction to-

Where the statement or omission was made knowingly or recklessly, a fine not exceeding 500.000= or to imprisonment for a term not exceeding 5 years or both or In any other case a fine not exceeding 300.000= or to imprisonment for a term not exceeding 6 months.

S.60 Obstructing an officer of the authority in the performance of his duties under the VAT Act commits an offence and is liable on conviction to a fine not exceeding 500.000 or to imprisonment for a term not exceeding 2 years or both.

S.61 Offences by officers and other persons

- 1) Any officer or any other person employed in carrying out the provisions of this statute who;
 - Directly or indirectly asks for or takes in connection with any of the officials' duties any payment or reward whatsoever whether pecuniary or otherwise or any promise of security for any such payment or reward not being a payment or reward which the officer was lawfully entitled to receive or,
 - Enters into acquiesces in any agreement to do abstain from doing permit, conceal or connive at any act or thing whereby the tax revenue is or may be defrauded or which is contrary to the provisions of this statute or to the proper execution of the officers' duty.

Commits an offence and is liable on conviction for a term not exceeding 5 years or both.

2) **Any person who;**

- a) Directly or indirectly offers or gives to any officer payment or reward whether pecuniary or otherwise or any promise or security for such payment or reward.
- b) Proposes or enters into any agreement with any officer in order to induce him to do or to abstain from doing, permits, conceal, connive at any act or thing where by tax revenue is or may be defrauded or do any act or thing which is contrary to the provisions of this statute or the proper execution of the duty of that officer commits an offence and is liable to a fine not exceeding 500.000= or to imprisonment for a term not exceeding five years or to both the fine and imprisonment.

S.62 Offences by companies.

- 1) Where an offence is committed by a company every person who at the time of the commission of the offence;
 - a) Was a nominated officer, director, general manager, secretary or other similar officer of the company or
 - b) Was acting or purporting to act in that capacity is deemed to have committed the offence.

13.17.4 Penal Tax (S. 65)

Penal Tax is a penalty which arises as a result of the tax payer not performing or following the laid down rules and procedures after registration. His will result into the prescribed penalties for the offences. These will include the following:

- (1) A person who fails to apply for registration as required by Section 7(1) or (5) is liable for a penal tax equal to double the amount of tax payable during the period commencing on the last day of the application period in Section 7(1) until either the person files an application for registration with the

Commissioner General or the Commissioner General registers the person under Section 8(6).

- (2) A person who fails to lodge a return within the required time under this Act is liable to pay a penal tax amounting to whichever is the greater of the following:

- (a) two hundred thousand shillings; or an interest charge for the period the return is outstanding calculated according to the formula specified in the Fifth Schedule.

(3) A person who fails to pay tax imposed under this Act on or before the due date is liable for a penal tax on the unpaid tax at a rate specified in the Fifth Schedule for the tax which is outstanding.

(4) If a person pays a penal tax under subsection (3) and the tax to which it relates is found not to have been due and payable by the person and is refunded, then the penal tax, or so much of the penal tax as relates to the amount of the refund, shall also be refunded to that person.

(5) A person who fails to maintain proper records in a tax period in accordance with the requirements of this Act is liable for a penal tax equal to double the amount of tax payable by the person for the tax period.

(6) Where a person knowingly or recklessly –

(a) Makes a statement or declaration to an official of the Uganda Revenue Authority that is false or misleading in a material particular;

or

(b) Omits from a statement made to an officer of the Uganda Revenue Authority any matter or thing without which the statement is misleading in a material particular, and

(i) The tax properly payable by the person exceeds the tax that was assessed as payable based on the false or misleading information;

(ii) The amount of the refund claimed was false; or

(iii) The person submitted a return with an incorrect offset claim, that person is liable to pay penal tax equal to double the amount of the excess tax, refund or claim.

(7) Section 59(4) applies in determining whether a person has made a statement to an officer of the Uganda Revenue Authority.

13.18 SMALL VAT TAX PAYERS

A number of measures have been introduced to simplify VAT accounting for taxpayers with a turnover of less than 200 million Shs per year. These include;

- a) Accounting for VAT on cash basis
- b) Issuing simplified tax invoices to VAT registered customers
- c) Special scheme to help a person account for VAT.

13.18.1 Investment Trader

Is a trader who has been approved or certified by the Uganda Investment Authority as an investor in Uganda. The investor has to fulfill the conditions prescribed by the authority in order to receive certain tax advantages.

When an investor is starting business in Uganda, he may incur significant business expenses before he starts trading. These expenses will generally be liable to VAT, which he has to pay. So he has to register for VAT.

The VAT regulations have a provision for applying for registration prior to making taxable supplies so that the investor can claim a refund of the VAT he has been charged. This ensures that VAT is not a burden to an investor setting up business in Uganda.

13.18.2 Conditions for VAT Registration as an Investment Trader

- a) Evidence from Uganda investment Authority in the form of a license, certificate or letter of approval.
- b) Satisfy the CG that your investment business will eventually make taxable supplies and that significant VAT expenses will be incurred, e.g. business plans, feasibility study, proposed contracts or patent application.
- c) Under take to keep the prescribed books and records required in the VAT statute and file VAT returns by the due date.
- d) The investment trader can remain registered as one for a maximum period of four years and give an under taking to repay all refunds of VAT received within.
- e) The CG of URA may require the investment trader to provide security for repayment of the tax refunded should the investor fail to make taxable supplies within that period.

The investor can only provisionally reclaim input tax that is wholly attributable to his intended taxable supplies. As soon as the investor makes taxable supplies and declares them on his VAT return he will cease to be an investment trader. The VAT office will notify the investor that that he has now met the conditions of investment trader registration and that he is now registered as a normal VAT tax payer.

13.18.3 Domestic VAT

Domestic VAT is VAT charged on goods whose value is 4 million shillings and above imported by non-VAT registered persons. Domestic VAT came into effect on 1st March 2001. Domestic VAT was introduced in Uganda as a means of widening the tax base. It is paid by non-registered traders who are importing taxable supplies of CIF value of Shs. 4,000,000 and above.

Domestic VAT will be paid by importers who meet the following criteria:

- The importer who is not VAT registered
- The CIF value as determined by customs of the goods is 4 million shillings and above.
- The goods must be standard rated
- The goods are not personal effects or motor vehicles.

Domestic VAT is paid at import stage together with the other customs taxes at designated banks. The domestic VAT payable on importation is value computed by adding a 15% mark; up as the customs VAT value. The mark up is the expected value added between the stage of imports and sale.

The customs VAT value is the value on which VAT at customs is computed. The customs VAT value is the sum total of CIF (Cost, Insurance and Freight) import duty and excise duty.



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Example 13.9:

Mr Banda who is a business man in Kikubo bought goods in Dubai at an invoice value of Shs 9 Million after conversion to Uganda Shillings. He paid insurance of 500,000 and freight of Shs 400,000.

He is not registered for VAT.

Assume import duty at a rate of 15% and Excise duty of 10%

Required:

- Advise Mr Banda as to whether he will be required to pay any VAT at Entebbe Airport.
- Advise Mr Banda on the likely amount of VAT to pay while at the Airport.

Solution:

Mr Banda will be required to pay domestic VAT while at Entebbe Airport because the CIF value of his imports is over and above 4 Million Shillings.

Mr Banda is importing taxable supplies.

The Domestic VAT to be paid will be computed as follows:

Obtain the CIF Value:

Cost of the Goods in Dubai	9,000,000
Insurance	500,000
Freight	400,000
CIF Value	9,900,000
Import Duty 15% of CIF	1,485,000
Value on which to compute excise duty	11,385,000
Excise duty 10% of 11,385,000	1,138,500
Value for VAT (11,385,000 + 1,138,500)	12,523,500
Add 15% Mark up	1,878,480
Value to Charge Domestic VAT at 18%	14,401,980
Domestic VAT Payable by Mr Banda at 18%	2,592,356



13.19 VAT ON IMPORTS.

All goods imported into Uganda are liable to VAT except exempt supplies and zero rated supplies.

The import regardless of whether the goods are private or for business purposes and whether or not the importer is registered for VAT has to pay VAT on imported goods.

The import regardless of whether the goods are private or for business purposes and whether or not the importer is registered for VAT has to pay as imported goods. VAT on imports is paid at the point of clearing the goods through the customs department.

If a person has registered for VAT he must pay the VAT that is due, however he must provide his TIN and VAT registration numbers on his customs bill of entry and declare if the goods incorporated are for his business. If they are imported for taxable business purposes he will be able to claim a credit for the tax he has paid on his VAT tax return.

The value on which the importer will have to pay VAT is defined in the VAT law as the CIF (Cost Insurance and Freight) value for customs duty plus the customs duty plus any excise duty. The customs department will advise the importer on the correct basis of value for VAT purposes. Importers are offered a deferred VAT facility.

No VAT is paid on goods in transit in Uganda to another foreign country, but the importer will have to provide security to the customs department for the value on the goods together with other duty or taxes. An importer can claim a VAT credit paid on imports if;

- a) He is a registered **VAT** taxpayer.
- b) The imports must be for business and not for private use. The importer must obtain a copy of the customs bill of entry certified by the customs department as to the amount of **VAT** he has paid.
- c) Customs receipt for taxes paid (original copies).
- d) Customs amendment forms if the figure on the receipt differs from the figure on the customs bill of entry.

NB Failure to produce a customs certified bill of entry will lead to the rejection of the **VAT** credit claim.

VAT is chargeable on services imported from abroad if the supplier of the service conducts business in Uganda and is registered for VAT then VAT will have to be paid.

If the service is supplied by a foreigner who is not registered for VAT in Uganda, then the importer must account for VAT himself if he is registered for VAT in Uganda.

You account for VAT on services at the time the service is completed or when the payments for the service is made or when the payments for the service is made or when invoice is received from the foreign supplier whichever is earlier.

An importer of services who is not registered for VAT in Uganda has to account for VAT as services supplied by a foreign supplier not registered for VAT in Uganda if the value of the supplies he receives exceeds 12.5 millions in any 3 months period, the commissioner general may require the importer of the service to register for VAT.

An importer can claim a VAT credit for VAT he has paid on supplies of services if he is registered for VAT in Uganda and the services received must be for his taxable business activities. If the services are supplied by a VAT registered person he must hold an original tax invoice issued by that supplier.

If the importer is accounting for the tax from a foreign based supplier he must bill himself on his own tax invoice and retain this in his records as evidence of tax due.

10.0

CAPITAL GAINS AND LOSSES

1.1 CAPITAL GAINS AND LOSSES ON DISPOSAL OF ASSETS

Capital Gains tax was introduced in Uganda with effect from 1st April 1998. It applies to all capital assets disposed on or after the 1st of April 1998.

The Income tax Act exempts a gain on the disposal of a depreciable asset from tax. It should be noted in the part that the Gain on the disposal of a business asset excludes gains on the disposal of all assets that do qualify for capital deductions arising from the loss in value.

This section applies for the purposes of determining the amount of any gain or loss arising on the disposal of an asset where the gain is included in gross income or the loss is allowed as a deduction under the provisions of the income tax Act.

1.2 HOW GAINS AND LOSSES ON DISPOSAL OF ASSETS ARISE

A gain on the disposal of a business asset is the excess of the consideration received for the disposal over the cost base of the asset at the time of the disposal. The cost base of an asset will be discussed later.

A loss on the disposal of a business asset is the excess of the cost base of the asset at the time of the disposal over the consideration received for the disposal.

1.3 CONDITIONS UNDER WHICH AN ASSET CONSIDERED AS A DISPOSAL

A taxpayer is treated as having disposed of an asset when the asset under the following conditions:

- (a) Where the asset has been Sold, exchanged, redeemed, or distributed by the taxpayer;
- (b) Transferred by the taxpayer by way of gift; or
- (c) Destroyed or lost.

Therefore if any of the highlighted conditions occurred, then it will be deemed that the asset has been disposed by the tax payer.

A disposal of an asset includes a disposal of a part of the asset. Example will be where one buys an entire acre of land on which he constructs a factory building. If he sold off part of the land, we shall consider the partial sale for tax purposes.

An asset is deemed to have been disposed by the taxpayer Where the Commissioner is satisfied that a taxpayer;

- (a) Has converted an asset from a taxable use to non-taxable use; or
Example: Where the asset was being used by a taxable entity and it converts from being a taxable entity to an exempt organization. The asset has been converted from a taxable use to a nontaxable use and therefore there is need to establish the gain or loss on the conversion which is deemed to be a sale of the asset.
- (b) Has converted an asset from a non-taxable use to a taxable use,

Example: Where the asset was being used by an exempt organization and it converts from being an exempt organization to a taxable entity. The asset has been converted from a nontaxable use to a taxable use and therefore there is need to establish the gain or loss on the conversion which is deemed to be a sale of the asset.

The taxpayer is deemed to have disposed of the asset at the time of the conversion for an amount equal to the market value of the asset at that time and to have immediately reacquired the asset for a cost base equal to that same value.

Assuming the UWESO which is an exempt organization had business assets that were being used or held ready for use by the entity worth 5,000,000 at the end of June 2010. At the beginning of July 2010, UWESO converted to being a vibrant commercial entity subject to tax.

At the time of conversion, it is assumed that UWESO sold off its business assets at an amount equal to the Market Value and the new entity acquired them at the same value.

Where a non-resident person becomes a resident person, it is deemed that he/she has acquired all assets, other than taxable assets, owned by the person at the time of becoming a resident for their market value at that time. However, a resident person who becomes a non-resident person is deemed to have disposed of all assets, other than taxable assets, owned by the person at the time of becoming a non-resident for their market value at that time.

If the person who has changed from a resident status to a nonresident status intends in future to reacquire his/her resident status and provides the commissioner with sufficient security to satisfy any tax liability which would otherwise arise under the deemed disposal of the business asset, the commissioner may by notice in writing exempt the person from the application of this section.

1.4 DETERMINATION OF THE COST BASE

We have established that capital gain is the difference between the proceeds received and the cost base of the asset being sold.

The cost base of the asset will therefore be determined in accordance with the provisions of the income tax act with states as follows:

The cost base of an asset purchased, produced, or constructed by the taxpayer is the amount paid or incurred by the taxpayer in respect of the asset, including incidental expenditures of a capital nature incurred in acquiring the asset, and includes the market value *at the date of acquisition* of any consideration in kind given for the asset.

The cost base of an asset acquired in a non-arm's length transaction is the market value of the asset at the date of acquisition. Where a part of an asset is disposed of, the cost base of the asset shall be apportioned between the part of the asset retained and the part disposed of in accordance with their respective market values at the time of acquisition of the asset.

Unless otherwise provided in the Income Tax Act, expenditures incurred to alter or improve an asset which have not been allowed as a deduction are added to the cost base of the asset.

Where the acquisition of an asset by a taxpayer represents the derivation of an amount included in gross income, the cost base of the asset is the amount included in gross income plus any amount paid by the taxpayer for the asset.

Where the receipt of an asset represents the derivation of an amount which is exempt from tax, the cost base of the asset is the amount exempt from tax plus any amount paid by the taxpayer for the asset.

1.5 TRANSITIONAL PROVISIONS UNDER THE CAPITAL GAINS

The Income Tax Act section 166 gives transitional provisions that will apply before the Income Tax Act came into force on 1st July 1997. One of the provisions is the determination of the cost base of the assets that were acquired before the enforcing the capital gains tax law which came into effect on 1st April 1998.

Capital gains tax does not apply to business assets disposed before 1st of April 1998

1.5.1 Determination of the cost base for assets acquired before the 1st of April 1998

Where the taxpayer is able to substantiate the market value of an asset on 31st March 1998, the taxpayer may substitute that value for the cost base of the asset. Otherwise the following can be used

Where the asset being determined above is an immovable property, the market value as at 31st March 1998 will be determined by the Chief Government Valuer.

In any other case, the cost base of the asset will be determined using the following formula.

The cost base of assets that were acquired before 1st April 1998 will be determined using the following formula;

$$\text{Cost Base} = \text{CB} \times \frac{\text{CPID}}{\text{CPIA}}$$

Where:

CB = Is the amount of an item of cost or expense incurred on or before 31st March 1998 included in the cost base of the asset;

CPI D = Is the Consumer Price Index number published for the month ending on 31st March 1998; and

CPI A = is the Consumer Price Index number published for the month immediately prior to the date on which the relevant item of cost or expense was incurred.

1.5.2 Special Rules for Consideration Received

➤ The consideration received on disposal of an asset includes the market value *at the date of the disposal* of any consideration received in kind.

➤ Where an asset is disposed of to an associate or in a non-arm's length transaction other than by way of transmission of the asset to a trustee or beneficiary on the death of a taxpayer, the person disposing of the asset, referred to as the "disposer", is treated as having received consideration equal to the greater of –

- (a) The cost base of the asset to the disposer at the time of disposal; or
- (b) The fair market value of the asset at the date of disposal.

➤ Where two or more assets are disposed of in a single transaction and the consideration paid for each asset is not specified, the total consideration received is apportioned among the assets disposed of in proportion to their respective market values at the time of the transaction..

1.5.3 Non-Recognition of Gain or Loss

No gain or loss is taken into account in determining chargeable income in relation to –

- (a) a transfer of an asset between spouses;
- (b) a transfer of an asset between former spouses as part of a divorce settlement or bona fide separation agreement;
- (a) an involuntary disposal of an asset to the extent to which the proceeds are reinvested in an asset of a like kind within one year of the disposal; or
- (b) the transmission of an asset to a trustee or beneficiary on the death of a taxpayer.

Where no gain or loss is taken into account as a result of subsection (1)(a), (b), or (d), the transferred or transmitted asset is deemed to have been acquired by the transferee, or trustee or beneficiary as an asset of the same character for a consideration equal to the cost base of the asset to the transferor or deceased taxpayer at the time of the disposal.

The cost base of a replacement asset described in sub-section (1)(c) is the cost base of the replaced asset plus the amount by which any consideration given by the taxpayer for the replaced asset exceeds the amount of proceeds received on the involuntary disposal.

Example 1

Mr Mplogoma acquired land in January 1979 around Namanve at a cost of Shs 125 Million Shillings. He constructed a factory building in January 1980 which cost him 340 Million shillings.

In 2008, M Mplogoma sold off the factory inclusive of the land at Shs 1.2 Billion shillings.

Consumer price indices were given as follows:

December	1978	15%
January	1979	20%
March	1998	30%
July	1997	25%
December	1979	17%

The following should be noted:

- Capital Gain is = Proceeds from the Asset Less the cost base of the asset
- If Mplogoma can establish the market value of the asset by 31st March 1998, then that will be regarded as the cost base of the asset.
- The Market value of the asset can also be given by the Chief Government Value.
- In any other case, we shall use the indices.

Determination of the cost base will be as follows:

The cost base of assets that were acquired before 1st April 1998 will be determined using the following formula;

$$\text{Cost Base} = \text{CB} \times \frac{\text{CPID}}{\text{CPIA}}$$

We shall have to establish the cost base of both the Land and the factory building.

Cost base of Land:

CB = Is the amount of an item of cost or expense incurred on or before 31st March 1998 included in the cost base of the asset in this case Shs 125M

CPI D = Is the Consumer Price Index number published for the month ending on 31st March 1998; in this case 30%

CPI A = is the Consumer Price Index number published for the month immediately prior to the date on which the relevant item of cost or expense was incurred. In this case 15%

Therefore Cost Base of land

$$= 125,000,000 \times \frac{0.3}{0.15}$$

$$= \text{Shs. } 150,000,000$$

Cost Base for the Factory Building

$$= 340,000,000 \times \frac{0.3}{0.17}$$

$$= \text{Shs. } 600,000,000$$

Therefore, total cost base is Shs 750,000,000

The proceeds from the disposal will be equally apportioned between the Land and the factory building. The factory building being an asset that loses value, the gain on its disposal will not be taxable.

$$\text{Proceeds from sale of land will be } 1,200,000,000 \times \frac{150,000,000}{600,000,000} = \text{Shs. } 300,000,000$$

Therefore the Capital Gain will be $300,000,000 - 150,000,000 = \text{Shs. } 150,000,000$

As the gain from the disposal of the land on which the factory building. We did not consider the factory building because it is an asset that loses value in form of Industrial Building Allowance.

“Depreciable asset” means any plant or machinery, or any implement, utensil, or similar article, which is wholly or partly used, or held ready for use, by a person in the production of income included in gross income and which is likely to lose value because of wear and tear, or obsolescence;

“Business asset” means an asset which is used or held ready for use in a business, and includes any asset held for sale in a business and any asset of a partnership or company;

CUSTOMS MANAGEMENT & PROCEDURES

11(i)

CUSTOMS TAX

1.1 INTRODUCTION

This section will basically cover the following elements within the customs tax.

- *Laws applicable to customs, International conventions.* Types of goods subject to customs control. Rules of origin – EAC and COMESA.
- *Importation procedures:* Re-exports, Goods in transit, Unloading and removal of goods, Entry, examination and delivery,
- *Customs warehouses:* Definition, receipt, delivery and disposal of Goods, bonded warehouses: entry, control, receipt, treatment and delivery of goods, Importation by post. Prohibited goods.
- *Exportation:* Definition and forms, Prohibition and restrictions, Procedures for exports and re-exportation, Export of bonded goods, Arrival and reporting and Tariffs.
- *Smuggling of goods:* Definition, Methods of smuggling, Penalties, Effects of smuggling on the economy, Prevention of smuggling and treatment of offenders
- *Prohibitions and restrictions* – Definition, powers to prohibit, prohibited and restricted goods, exemptions of goods in transit.
- *Customs offences* – types, seizures and forfeitures, procedures, penalties and settlement, Objections and appeals.

1.1.1 Definition of Customs

Customs is defined as duties and or taxes imposed on goods and less commonly on exported goods. Customs can also be defined as the governmental agency authorized to collect taxes and customs duties. It can further be defined as the process used to clear goods/people involved in international trade.

1.1.2 Role of Customs:

Customs play a very big role in good governance, protection and prosperity of society and the country at large. It manages the physical movement of goods, people and conveyance across borders. Other roles played by customs include the following among others:

- Collection of Government Revenue e.g. collection of import and customs duties at all entry ports in a given country.
- Facilitation of legal trade.
- Trade compliance and legal enforcement e.g. not allowing certain products to be imported in the country and curbing smuggling.
- Collection of data used for planning purposes by government departments e.g. Data regarding the number of vehicles imported in a country in any given year, the number of vehicles carrying imported goods using the roads can also be obtained from customs.
- Protection of society, environment and domestic industries. Customs plays a role in enforcing some compliance on behalf of government of some laws that protect society and the environment. Example is where the government bans importation of certain items like second hand tyres, and old refrigerators. This will be enforced by customs.
- Heritage and cultural preservation. E.g. No one is allowed to export certain products that are to preserve the heritage of the country e.g. elephant tusks, and birds like Kasuku (Parrots). Since all exports have to through customs, such items will not be allowed to go through the customs check points.

1.1.3 Customs in the International Context

There are two main organizations involved in international trade. The World Trade Organization (WTO) and World Customs Organisation, (WCO)

The World Trade Organisation is the Umbrella organization responsible for overseeing the implementation of all multilateral and plurilateral agreements that have been negotiated in the Uruguay rounds and those to be negotiated in future. WTO was established on 1st January 1995 and has a membership of 153 countries.

1.2 CUSTOMS UNION

1.2.1 Introduction

As a common practice, countries within the same region (i.e. sharing the same geographical boundaries) will always come to table to create an economic integration due to the vast number of benefits that come with it.

A Customs union is a stage of economic integration that comes after the establishment of a preferential and a free trade area amongst the intending partner states. A customs Union therefore is the third stage in the process of economic integration.

Customs Union can therefore be defined as “ *a trade agreement between nations intending to create a common economic and political relationship between them.*” It is a trade agreement by which a group of countries charges Customs Union is regarded as partial form of economic integration intermediate between free-trade zones which allow mutual free trade but lack a common tariff system , and common markets , which both utilize common tariffs and allow free movement of resources including capital and labour between members.

A customs union, unlike a free trade area, requires its members to adopt a common external tariff of customs duties. The objective, seldom in fact achieved, is to enable goods (but not labour or capital) to move freely throughout the union.

1.2.2 Main Features of a Customs Union

The main features of a Customs Union include the following:

- i. A common set of import duty rates known as Common External Tariffs (CETs) charged on goods from countries outside the union.
- ii. Duty-free and quota-free movement of tradable goods within countries in the Union.
- iii. Common safety measures for regulating the importation of goods from third parties such as sanitary requirements and food standards.
- iv. A common set of customs rules and procedures including documentation.
- v. A common coding and description of tradable goods (common tariff nomenclature, CTN);
- vi. A common valuation method for tradable goods for tax (duty) purposes (common valuation system);
- vii. A structure for collective administration of the Customs Union.
- viii. A common trade policy that guides the trading relationships with third parties or countries/trading blocs outside the Customs Union i.e. guidelines for entering into preferential trading arrangements such as Free Trade Area's etc with third parties.

1.2.3 Main Objectives of a Customs Union

The main objective of most (if not all) Customs Unions is the desire to create a Common External Tariff (CET); which involves charging uniform tariff rates for third countries, same treatment to all products originating outside the Union, in addition to removing trade barriers amongst countries within the Union.

Other objectives of a Customs Union include;

- (i) Facilitation of free movement of goods by having Common customs procedures and regulations for all member Countries.
- (ii) Elimination of trade barriers between the member states.
- (iii) The need to strengthen and develop industries in the region through acquisition of bigger markets, wider resource base and allocation, and free or flexible transfer of investments between member states.

1.3 THE EAST AFRICAN COMMUNITY CUSTOMS UNION (EACCU)

1.3.1 Back ground

The East African Community is an intergovernmental organization comprising of the five East African Countries of Burundi, Kenya, Rwanda, Tanzania and Uganda.

While other members were in favour of the East African Federation, informal polls indicated that most Tanzanians were not in favour of the East African Federation with the major fear that their land may be grabbed with the increasing scarcity of land especially in Kenya.

The East African Countries have had a long history of cooperation since 1917. The East African community established in 1967 did collapse in 1977 when Kenya demanded to have more seats than Uganda and Tanzania under the leader ship of Idi Amin in Uganda, Socialism in Tanzania and Capitalism in Kenya. The three countries lost so many years of economic cooperation and economies of scale.

Later a treaty for East African Cooperation was signed in Arusha between President Moi of Kenya, Mwinyi of Tanzania and Museveni of Uganda on 30th November 1993 establishing a tri-partite commission for cooperation.

The East African community was finally revived on the 30th of November 1999.

The East African Community Customs Union (EACCU) came into force on the 1st January 2005, after the signing of a treaty between Uganda, Kenya and Tanzania (as the founder members) that established the East African Community on the 30th November 1999.

The EACCU kicked off with transitional activities such as training of the Customs staff, sensitization of the general public, configuration of the Customs database, and reviewing of the regulations in the partner states

1.3.2 Objectives of the EACCU

The specific objectives of the EACCU included the following:

- Creation of a common External Tariff (CET) regime for goods originating from outside East Africa.
- Establishment of common Customs laws and regulations which will apply uniformly in the partner states that is Uganda, Kenya and Tanzania.
- Harmonizing and simplifying Customs procedures in Uganda, Kenya and Tanzania and documentation of these procedures.

Note that at the time of formation, Rwanda and Burundi had not yet been admitted to the union. As of today, Rwanda and Burundi are members of the East African Community Customs Union.

1.3.3 Tariffs

A tariff is a tax placed on imported goods. Each country has separate tariff regulations. The five main types of tariffs include revenue, ad valorem, specific, prohibitive and protective.

(i) **A revenue tariff** increases government funds. For example, countries that do not grow bananas may create a tariff on importing bananas. The government would then make money from businesses that import bananas.

(ii) **An ad valorem tariff** means that the tariff applies to a percentage of the import's value such as a set number of cents on every dollar of value. A specific tariff, on the other hand, means that the tariff is not concerned with the estimated value of the imported goods, but rather is based on specific amount of the goods. A specific tariff may apply to the number of goods imported or to the weight, volume or other measurement of the goods.

(iii) **A prohibitive tariff** is one that is such as high cost that it keeps the item from being imported. A protective tariff is used to raise the price of imported goods as a protective measure against the competition from foreign markets. A higher tariff allows a local company to compete with foreign competitors.

(iv) **Protective tariffs** can be advantageous as they can help foster the local economy, but sometimes they can also make the price of the item so expensive that companies must charge more. For example, when gas prices become too high, industries such as the trucking industry may have to charge retailers more for delivering products. The retail industry then has to mark up their items to allow for their increased transportation costs in order to make the same profit they once did. The end result is that consumers pay more for the goods.

When no tariff or other restrictions are placed on imported goods, it is called free trade. Some people consider free trade to allow increased economic growth potential. Others counter that the removal of tariffs to permit free trade only makes the economy have to depend on global markets rather than increase the stability of domestic markets.

1.3.4 Tariffs under the EACCU

There are three classes of tariffs under the Customs Union and these include;

- (a) *Internal Tariffs*
- (b) *Common External Tariff (CET)*
- (c) *Zero Tariffs*

(a) Internal Tariffs

An internal tariff is defined as the tax charge in form of import duty charged by an individual country on all commodities entering it across its borders.

According to the EACCU provisions, the member countries (i.e. Uganda, Kenya and Tanzania, Rwanda and Burundi) are to remove all internal tariffs on goods imported from within the member countries and establish a Common External Tariff, introduce rules of origin, and a variety of administrative arrangements, including a harmonized customs administration, a customs valuation system and a customs procedures and documentation. This would mean that certain imports the four East African Community Countries of Kenya, Burundi, Rwanda and Tanzania will enter Uganda free of Tariffs.

Apparently, customs duties have been removed of all other tariff lines with an exception of 433 lines for goods originating from Kenya to Uganda and 880 tariff lines for goods originating from Kenya to Tanzania. Goods originating from Tanzania to Uganda and vice versa currently enjoy free import duty.

However internal tariffs still apply on a phase out method to Category B Commodities originating from Kenya to Uganda and Tanzania, over five years. The programme for phase out tariffs reduction was for a period of 5 Five years for all products but was different for Uganda and Tanzania. This started in 2005 and to end by 2010.

However, to qualify for free entry without tariffs, an importer must prove that the goods actually originate from Kenya or Tanzania, and failure of which, the goods will be subject to the EAC Common External Tariff.

Point to note:

Category B Commodities have been prepared by respective member countries and are contained in Annex II of the Protocol.

A common external tariff (CET) is an identical rate of tariff imposed on all products coming from countries outside the Customs Union. The member countries of the EACCU have an aim to apply in the same way, a common tariff on such products.

A common external tariff tax structure is deemed to have the following hierarchical rates;

Rate Hierarchy	Rate Applicable	Class of goods
Minimum rates	0%	Raw materials and Capital items.(Raw materials defined as items that have not undergone any processing as per world customs organization. As an exception, agricultural input like fertilizers enjoy 0% rate.
Middle rates	10%	Semi-processed or intermediate products and spare parts. These products are semi processed and are meant to be used for manufacturing and processing other products.
Maximum rates	25%	Finished goods

EAC member states came up with items which were categorized as “Sensitive items” on which it was agreed that these would attract rates of more than 25% and in some instances a mixture of specific duty and ad volorem rates.

These included;

- Subsidized exports, mainly agricultural products, from industrial countries; and
- Second hand items.

Accordingly, the sensitive items included cigarettes, dry cells, fabrics, garments, matches, milk, cement, packing materials of plastic, palm oil, sugar, tyres, used clothes, vehicles (reconditioned cars), vehicle chassis, rice, Jute Bags, Khanga, Kikoyi & Kitenge, wheat and wheat flour.

These items are equivalent to 361 tariff lines and are estimated at about 20 percent of total imports.

(c) Zero Tariffs

Zero tariffs means that the commodities in this category are not subject to import duty.

According to the EACCU provisions, Category A commodities qualify for zero tariff throughout the member countries as long as they originate from any of the member countries.

However, it should be noted that there is no list of category A commodities and therefore in effect, all commodities not appearing in Category B are treated as Category A commodities.

Point to note

Where members of the EACCU belong to other Customs Union like Uganda which belongs to the COMESA; allowance is given towards application of tariffs provided under such treaties for two years from the date of implementation of the protocol.

Valuation and Coding of commodities under Customs

The member countries in the EACCU have decided to use the World Trade Organisation Agreement on Customs Valuation (ACV) for valuing goods for import duty purposes.

For easy classification of commodities as regards tariffs, the member countries have adopted the Harmonized commodity description and coding system.

1.4 THE EAC-RULES OF ORIGIN

The EAC Rules of origin refer to a set of criteria that is used to distinguish between goods that are produced within the EAC customs territory and are eligible to community tariff treatment against those produced outside the EAC customs territory that attract import duties specified in the common external tariff.

1.4.1 Criteria for determining the Origin

There are three criteria used to determine goods which qualify as originating from the East African Community;

(a) Goods wholly produced or obtained in a partner state and its clear that no material from outside the EAC have been used in the production/manufacture of the product,

- For Live animals, they should be born and raised in that country
- Minerals should be mined from the ground or sea bed of the partner state
- Fish should be got from the waters of that country

(b) Substantial transformation:

Under this criterion, value must be added on goods produced in partner state from materials imported from outside the partner state.

❖ Goods produced in the Partner state and the CIF value of any foreign or non-EAC materials used does not exceed 60% of the total cost of all materials used in their production, Goods produced in partner states whose value added resulting from the process of production accounts for at least 35% of ex-factory cost of the goods,

(c) Change in Tariffs.

Goods produced in partner states and are classified or become classified under a tariff heading under which they were imported, always provided that the change to the character and nature of the goods is such that it demands a change in the first four digits of the classification under the harmonized system Tariff. In other words, the product and the raw materials should not fall under the same heading. Eg after processing, a raw material and it falls under another tariff line, then this could be considered as substantial transformation.

Point to note

It's not a must that an exporter should comply with all the above four criteria for any good to qualify for the EAC tariff treatment. Only one of them must be complied with for any good to qualify for the EAC tariff treatment.

14.4.2 Exception to the Criteria

Simple processes such as the ones listed below, are not allowed under the criteria above;

- (i) Assembly of spare parts where the component parts where they were imported from outside the partner state and their composition to the final product exceeds 60%.
- (ii) Simple Packaging processes, bottling, placing in flasks, bags, cases and boxes, fixing on cards or boards.
- (iii) Slaughter of animals born and raised from outside the partner states.
- (iv) Marking, labeling, or affixing other like-distinguishing signs on products or their packages.
- (v) Removal of dust, sifting, screening, sorting, classifying and matching including making up of sets of goods, washing, painting and cutting up.

Point to note

Electrical power, fuel, plant, Machinery and tools used in the production of goods shall always be regarded as wholly produced within the partner states when determining the origin of the goods.

1.4.2 Certificate of origin

An exporter intending to export goods to another Partner state and desiring to have such goods granted EAC tariff treatment in the importing Partner State must obtain a certificate of origin from the designated authority in his state. The certificate, when presented by the importer to the Customs authorities in the importing Partner State will serve as evidence to enable the goods to be accorded the EAC tariff treatment that is being sought.

In order to obtain an EAC certificate of origin, the exporter must present to the designated certifying authority evidence that the goods have been produced in conformity with the conditions of the EAC Rules of Origin.

1.5 GOODS SUBJECT TO CUSTOMS CONTROL

According to the EAC-customs management Act the following goods shall be subject to Customs control;

- (a) All imported goods, including goods imported through the Post Office, from the time of importation until delivery for home consumption or until exportation, whichever first happens;
- (b) All goods under drawback from the time of the claim for drawback until exportation;
- (c) All goods subject to any export duty from the time when the goods are brought to any port or place for exportation until exportation;

- (d) All goods subject to any restriction on exportation from the time the goods are brought to any port or place for exportation until exportation;
- (e) All goods which are with the permission of the proper officer stored in a Customs area pending exportation;
- (f) All goods on board, any aircraft or vessel whilst within any part or place in Uganda.

The following regulations shall be observed for goods under customs control;

- Where any goods are subject to Customs control, then any officer may at any time examine such goods;
- No person shall interfere in any way with goods under customs control except by authority or in accordance to the EACCMA.
- Where any goods are subject to Customs control, then the Commissioner-General may permit the owner of such goods to abandon them to the Customs; and on such abandonment such goods may, at the expense of the owner thereof, be destroyed or otherwise disposed of in such manner as the Commissioner-General may direct and the duty thereon shall be remitted or refunded, as the case may be.
- Any person who contravenes the above subsection, shall be guilty of an offence and any goods in respect of which such offence has been committed shall be liable to forfeiture.
- Where any loss or damage is occasioned to any goods subject to Customs control through the willful or negligent act of an officer, then an action shall lie against the Commissioner-General or such officer in respect thereof.

1.6 BENEFITS OF CUSTOMS UNION

a) By moving towards the creation of one economic region through the Customs Union, EAC will create a single market of over 90 million people (2002) and a combined GDP of around US\$30 billion. This large economic region can only be meaningful if it is more than a simple aggregation of neighboring countries.

On the average, the size of EAC countries is around 30 million people in population with a GDP of around US \$10 billion. With the exception of Rwanda and Burundi. Inclusion of these countries increases on the number of people in the community. Such economies on their own are too small to attract any major meaningful investment in today's globalised economy, where mass production is vital to reduce unit costs.

In 2000, with their total GDP of US\$25.553bn (Kenya-\$10.357bn; Tanzania-\$9.027bn; and Uganda-\$6.17bn) and a combined population of around 86 million people, the 3 countries combined compared unfavorably with Vietnam with a total GDP of \$31.344bn and a population of 79 million people. Vietnam would have been more attractive to investors since it is one customs territory.

b) Currently, trade in the region is carried out under different external tariffs; customs regulations, procedures and documentation. The EAC Customs Union will assist to level the playing field for the region's producers by imposing uniform competition policy and law, customs procedures and external tariffs on goods imported from third countries, which should assist the region to advance its economic development and poverty reduction agenda.

c) Further to this, the customs union will promote cross-border investment and serve to attract investment into the region, as the enlarged market with minimal customs clearance formalities, shall be more attractive to investors than the previously small individual national markets. In addition, the Customs Union will offer a more predictable economic environment for both investors and traders across the region, as regionally administered CET and trade policy will tend to be more stable.

d) Private sector operators based in the region with cross-border business operations will be able to exploit the comparative and competitive advantages offered by regional business locations, without having to factor in the differences in tariff protection rates, and added business transaction costs arising from customs clearance formalities. The regionally based enterprises will also get better protection, as enforcement of the CET will be at a regional level.

- e) Adjustment of the national external tariffs to the common external tariff will result into major welfare gains for consumers, since the CET on finished goods will be lowered as a result of such adjustment.

1.7 CHALLENGES OF THE CUSTOMS UNION

While the Customs union will generate major benefits, it will also bring about greater competition among domestic firms. In the short run, the firms that stand to gain most are those that are already competitive. This causes economic disparity between the different countries within the East African Community with Kenya taking the lead while the other four countries are trailing. It is with this consideration that the principle of asymmetry was adopted in the phasing out of internal tariffs, in order to provide firms located in Uganda and Tanzania with an adjustment period of five years. Nevertheless, such firms may in the medium term overcome lack of competitiveness, through:

- 1) There is a challenge of the magnitude of political will and commitment the leaders and people of the partner states have towards the customs union. The fact that the customs union creates a leveled playing ground, in some cases has been viewed negatively as reducing of national sovereignty. Eg Individual partner states have been stripped off the powers to grant exemptions.
- 2) Low level of understanding the entire concept of the customs union and its benefits within all the East African Community. More effort is needed to educate the public on this concept.
- 3) The challenge whether the business community is prepared to play a leveled ground by adopting the best trade practices that will ensure that the objective of the customs union are achieved.
- 4) Proper documentation of business transactions and declaration to customs is one area which still needs enormous cooperation from the business community in order to achieve the objectives of the customs union.
- 5) Consistency adherence and uniformity in application of the EAC customs laws, regulation and procedures by the partner states, customs administration and other agencies.
- 6) Legal complexities where related national legislations are non-existent or have not been approximated or harmonized e.g.
 - ❖ Tax Appeals legislation
 - ❖ Intellectual property laws
 - ❖ Other laws outside the customs union framework but applicable on international trade e.g. VAT, Excise and Income Tax Legislation.
 - ❖ Additional investment in newer production technologies;
 - ❖ specialization in activities where they have a competitive advantage
 - ❖ Re-training of human resources; and
 - ❖ Forming strategic alliances with their competitors

Another implication of the customs union is that it will minimize discretionary powers earlier enjoyed by partner states, and which sometimes had created uneven playing ground for firms. Such powers, in particular, relate to granting of exemptions from customs duties. The partner states have undertaken harmonization of their exemption regimes which shall be administered regionally. In some cases, this has been viewed negatively as reduction of national sovereignty.

11(ii)

IMPORTATION OF GOODS

1.1 DEFINITION

According to the East African Community Customs Management Act (2004), Importation is defined as the activity involving the bringing or the cause to bring into the member country goods or services from a foreign country.

1.2 IMPORTATION MEANS AND FORMALITIES

Generally, imported goods arrive by Sea on vessels, by airfreight on aircrafts and by land.

(a) Arrival by vessel and aircrafts

On arrival, the following procedures must be followed by the importer as prescribed in the Act;

- (i) The proper customs officer allows the aircraft or vessel to land.
- (ii) The allowed vessel or aircraft comes directly to the place of mooring or unloading as directed by the proper officer.
- (iii) The master must park where he is directed to park.
- (iv) The master may not move the vessel or aircraft to any other part without permission.
- (v) After departure on the voyage, the master may not land on any other part in the EAC without permission of the previous proper officer of the departing port.
- (vi) No one is allowed to enter a vessel or aircraft without proper permission of the proper officer.

(b) Arrival by overland

Arrivals overland are of four types;

- (i) By vehicles
- (ii) By international train
- (iii) By any other overland means
- (iv) By pipeline (for goods such as petroleum and gas)

The Formalities followed on all the above mentioned arrivals by land take the same form which include;

- Reporting at customs area,
- Filling in forms (about the vehicle, cargo or consignment),
- Declaring and answering of relevant questions put forward by the proper Customs officer,
- Customs officer assesses the duty,
- On payment of the required duty and taxes, the delivery of goods is effected.

1.3 GOODS IN TRANSIT

According to the East African Community Customs Management Act provisions, goods in transit are deemed as if they are still in the vessel or aircraft until they are delivered from such a shed.

The shed, or customs area owners, or agents are responsible for the goods as if still in the vessel or aircraft.

This means that the owners' means of carriage and their agents, shed owners or their agents have the following responsibilities;

- (i) A transit shed owner who receives goods in transit is responsible and accountable for the goods.
- (ii) The owner or agent of a vessel or aircraft or the owner of the transit shed is responsible and liable for the payment of customs duty if the goods are not delivered or cause consequently short landed or demanded in transit as the proper officer may determine.
- (iii) The owner of vessel or aircraft or his agent, or the transit owner fails to account for the reshipment or for destruction of the goods condemned.
- (iv) The owner or agent of an aircraft or vessel or owner of a transit ship who fails to meet the costs or reshipment or destruction of any condemned goods commits an offence.

1.4 UNLOADING AND REMOVAL OF GOODS / CARGO

1.4.1 Unloading

In respect to the customs rules, as regards unloading of goods;

- (a) No goods shall be unloaded from any aircraft or vessel arriving from a foreign port unless such goods have first been duly entered;
- (b) No goods shall be unloaded or removed from any aircraft or vessel arriving from a foreign port on Sundays or public holidays at any time whatsoever, or on any other day except between the hours of six o'clock in the morning and six o'clock in the afternoon;
- (c) No goods shall be unloaded from any aircraft or vessel arriving from a foreign port except at an approved place of unloading or at a sufferance wharf:

Provided that-

- Goods may be unloaded from any such aircraft or vessel into another vessel in order to be landed; and in any such case such goods shall be taken directly to and landed without delay at an approved place of unloading or at a sufferance wharf;
- With the permission of the proper officer and subject to such conditions as he may impose, goods reported for re-exportation by another aircraft or vessel may be unloaded into any other aircraft or vessel pending re-exportation;

(d) all goods which have been unloaded or landed shall be conveyed to a Customs area and, if the proper officer so requires, shall be deposited in a transit shed or in a Customs warehouse provided that such goods as the proper officer may consider to be unsuited for storage in a transit shed or a Customs warehouse shall be deposited in such other place as the proper officer may direct, and there upon such other place shall, for the purpose of such deposit, be deemed to be a transit shed;

1.4.2 Removal

(e) No goods shall be removed from any part of a Customs area or from a transit shed or a Customs warehouse unless such goods have first been duly reported and entered and authority for their removal or delivery has been given by the proper officer; Provided that the proper officer may, if he considers it necessary, direct the agent of any aircraft or vessel from which goods have been landed into any transit shed or Customs warehouse to remove such goods to some other place (which other place shall, for such purpose, be deemed to be a transit shed) selected by such proper officer and, if the agent fails to remove the goods when called upon, the proper officer may have them removed at the risk and expense of such agent;

(f) all goods entered for warehousing shall be removed by the importer by such routes, in such manner, and within such time, as the proper officer may direct to the warehouse for which they were entered and shall be delivered into the custody of the person in charge of the warehouse: Provided that, if the proper officer so requires, the owner shall first enter into a bond for the due warehousing of the goods.

Point to note

Any person who contravenes this section, or any of the conditions which may have been imposed by, or any of the directions which may have been given by, the proper officer shall be guilty of an offence and any goods in respect of which such offence has been committed shall be liable to forfeiture.

1. Except otherwise provided in the Customs laws, the whole of the cargo of any aircraft or vessel which is unloaded or is to be unloaded shall be entered by the owners within a period of twenty one days after the commencement of discharge either for;
 - (a) Home consumption
 - (b) Warehousing;
 - (c) Transshipment;
 - (d) Export ex-warehouse;
 - (e) Removal to another warehouse;
 - (f) Use as stores for aircraft or vessels; or
 - (g) Re-warehousing
2. Where any entry is delivered to the proper officer, the owner shall furnish with the entry full particulars supported by documentary evidence of the goods referred to in the entry.
3. Entries for goods to be unloaded may be delivered to the proper officer for checking before the arrival at the port of discharge of the aircraft or vessel in which such goods are imported; and in any such case the Commissioner-General may in his or her discretion permit any goods to be entered before the arrival of such aircraft or vessel.
4. Where any goods remain un entered at the expiration of the prescribed period or of such further period as may have been prescribed period, or of such further period as may have been allowed by the proper officer, then such goods shall, if the proper officer so requires, be removed by, or at the expense of, the agent of the aircraft or vessel in which such goods were imported to a Customs warehouse
5. Where goods are entered for home consumption and are liable to taxes, payment of taxes should be effected within a period of forty-five days, and any person who contravenes with this subsection is liable to payment a fine of 1% of the taxes assessed to be paid.

1.5.2 Entry of transfer goods

1. Unless otherwise provided in the Customs laws, any goods liable to transfer tax which are unloaded or to be unloaded from any aircraft, vessel or vehicle, shall be entered by the owners in the manner and within the period prescribed, or within such further period as may be instructed by the proper officer.
2. Where any goods liable to transfer tax remain un-entered at the expiration of the period prescribed or such further period as may have been allowed by the proper officer, then such goods shall, if the proper officer so required, be removed to a Customs warehouse by, or at the expense of, the owner of the aircraft, vessel or vehicle in which such goods were transferred.

1.5.3 Surplus stores Entry

The surplus stores of any aircraft or vessel may, with the permission of the proper officer, be entered for home consumption or for warehousing.

1.5.4 Mail, personal baggage and others

The provisions relating to mail, personal baggage, etc are as follows;

(a) Mail bags and postal articles in the course of transmission by post may be unloaded and delivered to an officer of the Post Office without entry;

(b) goods which are the bona fide personal baggage of the passengers, or members of the crew, of any aircraft or vessel may, subject to the provisions of any regulations, be unloaded and delivered to such persons without entry;

(c) the proper officer may permit the unloading and delivery to the owner of any bullion, currency notes, coin, or perishable goods, without entry subject to an undertaking being given by such owner to furnish the necessary entry within forty-eight hours of the time of delivery, and an owner who contravenes any undertaking given under this subsection shall be guilty of an offence and liable to a fine not exceeding **fifty thousand shillings**.

1.5.5 Entry in absence of documents

(1) If the owner of any goods is, by reason of the absence of any, or of any sufficient, documents or information concerning them, unable to furnish full particulars of such goods, he shall make and subscribe a declaration on the prescribed form to that effect, and thereupon the proper officer may permit the owner to examine such goods in his presence.

(2) Upon such examination having been made the proper officer may, subject to section 33, permit the owner to enter such goods for home consumption, or for warehousing, if he is satisfied that the description of the goods for tariff and statistical purposes is correctly made in such entry, and also-

- a. in the case of goods liable to duty *ad valorem*, that the value declared on the entry is approximately correct; and
- b. in the case of goods liable to duty according to weight, quantity, number, measurement, or strength, that the weight, quantity, number, measurement or strength declared on the entry is correct.

(3) Where the proper officer has permitted entry to be made under subsection (2), the delivery of such goods may accordingly be made, but the proper officer may, in the case of goods liable to duty *ad valorem*, retain such samples of the goods for such period up to the passing of perfect entry as he may think fit.

(4) Where the owner of any goods referred to in the declaration does not make, or is not permitted to make, entry thereof in accordance with this section, then the proper officer shall cause the goods referred to in such declaration to be deposited in a Customs warehouse.

1.5.6 Provisions relating to goods liable to ad -valorem duty

1. Where any goods entered in accordance with Section 32 are goods liable to duty *ad valorem*, then such entry shall be deemed to be a provisional entry.

2. Where any such goods are provisionally entered for home consumption, then the proper officer may require the owner to deposit, in addition to the amount estimated as the duty for the purpose of making such provisional entry, such further sum as the proper officer may think fit; and such estimated duty and further sum shall be held on deposit and shall be

forfeited unless the owner within three months, or such further period as may be allowed by the proper officer, of the provisional entry produces to the proper officer satisfactory evidence of the value of such goods and makes perfect entry thereof.

3. Where the owner makes perfect entry in accordance with subsection (2), then-

(a) If the amount of the deposit is more than the full amount of the duty, either the difference shall be refunded to the owner and the balance brought to account as duty or the owner shall pay to the proper officer the full amount of the duty and be refunded the amount of the deposit;

(b) If the amount of the deposit is equal to or less than the full amount of the duty, the deposit shall be brought to account as duty, and the difference, if any shall thereupon be paid by the owner to the proper officer.

1.5.7 Delivery from customs in special circumstances

(1) The proper officer may subject to such conditions as he may impose and to the giving of such security as he may think appropriate for the due return thereof or the payment of the duties thereon, permit any goods to be removed from any transit shed or Customs area without payment of the duty for such purpose, for such period, and in such quantities, as he may think fit.

(2). Any person who contravenes any conditions imposed under subsection (1) shall be guilty of an offence and any goods in respect of which such offence has been committed shall be liable to forfeiture.

1.5.8 Repackaging, etc in customs areas

The proper office may permit any goods to be re-packed, skipped, bulked, sorted, lotted, or packed, on any approved place of unloading, or on a sufferance wharf, or in a transit shed, or in a Customs area.

1.6 CUSTOMS WAREHOUSES

1.6.1 Definition

A customs warehouse can be defined as Place approved by the Commissioner for deposit of un-entered, unexamined, detained and seized goods for the security of duties thereon.

Unclaimed, abandoned and goods transferred from bonded warehouse are also stored in Customs warehouses.

The following are the provisions relating to a Customs Warehouse

1.6.2 Goods deposited in customs warehouse may be sold, etc where;

(a) any goods which have been deposited in a Customs warehouse are not lawfully removed within two months after deposit, then such goods may be sold by public auction after one month's notice of such sale has been given by the proper officer by publication in such manner as the Commissioner-General may see fit:

Provided that any such goods which are of a perishable nature, or are animals, may be sold by the proper officer without notice, either by public auction or by private treaty, at any time after deposit in the Customs warehouse.

(b) any goods have been deposited in a Customs warehouse then they shall be subject to such rent and other charges as may be prescribed.

Any goods are sold under this section, then the proceeds thereof shall be applied in the order set out below in the discharge of-

- (a) The duties, if any;
- (b) The expenses of removal and sale;
- (c) The rent and charges due to the Customs;
- (d) The port charges; and
- (e) The freight and any other charges.

Where, after the proceeds of any such sale have been applied in accordance to the above and there is any balance, then such balance shall-

- (a) if the goods were prohibited goods, or restricted goods in relation to which there had been any contravention or if no application for such balance is made as provided in paragraph (b) hereof, be paid into the Customs revenue;
- (b) In any other case be paid to the owner of the goods if he makes application therefore within one year from the date of the sale.

Where any goods are offered for sale in accordance with this section and cannot be sold for a sum to pay all duties, expenses, rent, freight, and other charges, they may be destroyed or disposed of in such manner as the Commissioner-General may direct.

Any officer having the custody of any goods in a Customs warehouse, or place of deposit deemed to be a Customs warehouse, may refuse delivery there from until he is satisfied all duties, expenses, rent, freight and other charges due in respect of such goods have been paid.

1.6.3 Goods deemed to be in customs warehouse

- 1 Where under this Act any goods are required to be deposited in a Customs warehouse, the proper officer may, in his discretion, decide that it is undesirable or inconvenient to deposit such goods in a Customs warehouse and direct that such goods shall be deposited in some other place; and thereupon such goods shall for all purposes be deemed to have been deposited in a Customs warehouse as from the time that they are required to be so deposited.
- 2 Where any goods are deemed to have been deposited in a Customs warehouse then such goods shall, in addition to the rent and other charges to which they are liable under section 36, be chargeable with such expenses incurred in the securing, guarding, and removing, of them as the proper officer may consider reasonable; and neither the Commissioner-General nor any officer shall be liable for the loss of or damage to such goods which may be occasioned by reason of their being so deposited and dealt with.

1.7 BONDED WAREHOUSES

1.7.1 Definition

A bond ware house can be defined as any warehouse licensed by the commissioner for customs and Excise for the deposit of dutiable goods on which duty has not been paid, and which have been entered to be warehoused.

1.7.2 Types of bonded warehouse

There are 2 types of bonded warehouses;

(i) General bonded warehouse

These are used for warehousing of general goods and operate on commercial basis.

(ii) Private bonded Warehouse

These are bonded warehouses owned by a company for the storage of own goods e.g. raw materials, motor vehicles, petroleum etc.

1.7.3 Warehousing of goods

The following are the General Provisions as regards warehousing of goods.

1.7.4 Dutiable goods

(1) Subject to any regulations, goods liable to import duty may on first importation be warehoused without payment of duty in a Government warehouse or a bonded warehouse.

(2). On, or as soon as practicable after, the landing of any goods to be warehoused, the proper officer shall take a particular account of such goods and shall enter such account in a book; and such account shall, subject to sections 43 and 49, be that upon which the duties in respect of such goods shall be ascertained and paid.

1.7.5 Procedure on warehousing

(1) Where any goods entered to be warehoused are delivered into the custody of the person in charge of a warehouse, the proper officer shall, save where the Commissioner-General otherwise directs, take a particular account of such goods, whether or not any account thereof has been previously taken.

(2). The proper officer shall, in taking such account, enter in the book for that purpose the name of the aircraft or vessel or the registered number of the vehicle, as the case may be in which the goods were imported or, in the case of postal articles, the parcel post reference, the name of the owner such goods, the number of packages, the mark and number of each package, and the value and particulars of the goods.

(3). After such account has been taken and the goods deposited in the warehouse in accordance with the direction of the proper officer, such officer shall certify at the foot of the account that the entry and warehousing of the goods is complete; and such goods shall from that time be considered goods duly warehoused.

(4). Subject to section 41, all goods entered to be warehoused, shall forthwith be removed to the warehouse for which they are entered and deposited therein in the package in which they were imported:

Provided that where any goods are permitted to be repacked, skipped, bulked, sorted, lotted, or packed, in accordance with section 35, then such goods shall be deposited in the packages in which they were contained when that account thereof was taken.

(5). Any person who contravenes subsection (4) shall be guilty of an offence and any goods in respect of which such offence has been committed shall be liable to forfeiture.

1.7.6 Removal to warehouse of goods entered therefore

(1) Where any goods entered to be warehoused and not duly warehoused by the owner, the proper officer may cause them to be removed to the warehouse for which they were entered.

(2). Where any goods are so removed to a bonded warehouse the warehouse keeper shall pay the cost of the removal of such goods and shall have a lien on such goods for such cost.

1.7.7 Entry of warehoused goods

Goods which have been warehoused may be entered either for-

(a) Home consumption;

- (b) Exportation;
- (c) Removal to another warehouse;
- (d) Use as stores for aircraft or vessels; or
- (e) Re-warehousing.

(3). Where any goods have been entered for warehousing, they may, before they are actually warehoused, be entered for home consumption, for exportation, for removal to another warehouse, or for use as stores for aircraft or vessels, and in any such case such goods shall be deemed to have been so warehoused and may be delivered for home consumption, for exportation, for removal to another warehouse, or for use as stores for aircraft or vessel, as the case may be as if they had been actually so warehoused.

1.7.8 Operations in a warehouse

(1) Where any goods are warehoused, the Commissioner-General may, subject to such conditions as he may impose-

- (a) permit such goods to be repacked, skipped, bulked, sorted, lotted, or packed, therein;
- (b) permit samples of such goods to be taken by the owner;
- (c) permit the name of the owner of such goods in the account taken under section 38 to be changed if application therefore is made on the prescribed form and signed by both the owner and the intended owner,
- (d) permit the assembly or manufacture in the warehouse of any article consisting wholly or partly of such goods; and for such purpose the Commissioner-General may permit the receipt in a warehouse of duty free or locally produced,
- (e) articles required as components of the article to be so assembled or manufactured therein:

Provided that where the finished article is entered for home consumption, duty shall be paid on the goods forming part thereof according to the first account thereof taken upon the warehousing of the goods except in the case of oils which are warehoused in a refinery in which case duty shall be paid on the goods which are entered for home consumption.

(2). Any person who contravenes any conditions which may be imposed by the Commissioner-General under this section shall be guilty of an offence and any goods in respect of which such offence has been committed shall be liable to forfeiture.

1.7.9 Re-gauging and re-valuation

(1) The proper officer may, either on the direction of the Commissioner-General or on the application and at the expense of the owner-

- (a) re-gauge, re-measure, re-weigh, examine, or take stock of, any warehoused goods;
- (b) re-value any warehoused goods liable to duty *ad valorem* which have deteriorated in quality and in either such case the duty on any such goods shall be payable according to the result, unless the proper officer considers that any loss or deterioration is excessive or has been willfully or negligently caused, in either of which events the duty shall, subject to such reduction, if any, as the Commissioner-General may allow, be payable according to the original account.

1.7.10 Delivery from warehouses in special circumstances

(1) The proper officer may, subject to such conditions as he may impose and to the giving of such security as he may think appropriate for the due return thereof or the payment of duties thereon, permit any goods to be removed from any warehouse without payment of the duty for such purpose, for such period, and in such quantities, as he may think fit.

(2). Any person who contravenes any conditions imposed under subsection (1) shall be guilty of an offence and any goods in respect of which such offence has been committed shall be liable to forfeiture.

1.7.11 Removal to another warehouse

(1) Where any warehoused goods are to be removed to another warehouse, then the proper officer-

(a) Shall require the owner of such goods to deliver an entry thereof in such form and manner as the proper officer may direct;

(b) shall require such owner to give security in such amount, not being less than the duty chargeable on such goods, as the proper officer may think fit for the due arrival and re-warehousing of such goods within such time as the proper officer may consider appropriate; and

(c) Shall transmit to the proper officer of the place where such goods are to be re-warehoused in such other warehouse an account containing the particulars of such goods.

(2). Any security given under this section shall not be discharged unless-

(a) the conditions attaching thereto have been satisfied; or

(b) the full duty payable on such goods has been paid in accordance with this Act; or

(c) such goods are otherwise accounted for to the satisfaction of the proper officer, and any duties due in respect of any deficiency in such goods not so accounted for has been paid.

(3). On the arrival of such goods at such other warehouse they shall be re-warehoused in the same manner as if they were being warehoused on the first importation thereof.

1.7.12 Situations where warehoused goods are delivered as stores

(1) Where any warehoused goods have been entered for use as stores for an aircraft or vessel, they may be delivered for that purpose to any vessel or aircraft proceeding to a foreign port:

Provided that warehoused goods shall not be entered for use as stores for a vessel of less than ten tons register or be delivered for that purpose.

(2). Where any warehoused goods are delivered for the purpose of being used as stores for an aircraft or vessel, they shall forthwith be put on board the aircraft or vessel for which they are entered.

(3). Where any warehoused goods are dealt with contrary to this section, then the owner of such goods shall be guilty of an offence and any goods in respect of which such offence has been committed shall be liable to forfeiture.

1.7.13 Abandonment of warehoused goods

(1) The Commissioner-General may, subject to such conditions as he may impose-

(a) permit the owner of any warehoused goods to abandon such goods to the Customs;

(b) permit the owner of any warehoused goods which, in the opinion of the proper officer, are not worth the duty payable thereon or have become damaged, or are surplus, by reason of any operations in connection therewith carried out under section 42 to destroy such goods; and in either such case the duty on such goods shall be remitted.

(2). Where under subsection (1) any warehoused goods are-

(a) abandoned to the Customs, then such goods may be destroyed or otherwise disposed of in such manner as the Commissioner-General may direct and at the expense of the owner thereof;

(b) permitted to be destroyed and such goods were warehoused in a Government warehouse, then the owner of such goods shall nevertheless be liable to pay to the proper officer the rent and other charges due to such goods.

1.7.14 Period of warehouse and sale of goods

(1) All warehoused goods which have not been removed from a warehouse in accordance with this Act within three months from the date on which they were warehoused may, with the written permission of the commissioner General, be re-entered for a further period of three months. Provided that in the case of motor vehicles and raw materials, the periods will be six months.

(2) Where any goods required to be re-warehoused under subsection (1) are not so re-warehoused, then they shall be sold by public auction after one month's notice of such sale has been given by the proper officer by publication in such manner as the Commissioner-

General may see fit:

Provided that any such goods which are of a perishable nature may be sold by the proper officer without notice, either by public auction or private treaty, at any time after the expiry of such period of one year.

(3). Where any goods are sold under the provisions of this section, then the proceeds thereof shall be applied in the order set out below in the discharge of-

The duties;

(a) the expenses of the sale;

(b) any rent and charges due to the Customs or to the warehouse keeper;

(c) the port charges; and

(d) the freight and any other charges.

(4). Where, after proceeds of any such sale have been applied in accordance with subsection (3), there is any balance, then such balance shall, if the owner of the goods makes application therefore within one year from the date of the sale, be paid to such owner, or, in any other case, be paid into the Customs revenue.

(5). Where any goods are offered for sale in accordance with this section and cannot be sold for a sum to pay all duties, expenses, rent, freight, and other charges, they may be destroyed or disposed of in such manner as the Commissioner-General may direct.

1.7.15 Examination of warehoused goods on delivery (sec 49)

(1) Where any warehoused goods are delivered for home consumption, for exportation, for removal to another warehouse, or for use as stores for aircraft or vessels, or are to be re-warehoused or sold under section 48, then the proper officer may examine and take stock of such goods.

(2). Where there is any deficiency between the quantity shown by the warehouse account and that ascertained on such examination, then, if the proper officer considers-

(a) that the deficiency is not excessive or that it was not willfully or negligently caused, he may allow the deficiency and direct that the duties on such goods shall be payable, or that the re-warehousing entry shall be made, as the case may be, on the result of such examination;

(b) that the deficiency is excessive or that it was willfully or negligently caused, he shall require the duties on such goods to be paid by the owner, according to the warehouse account;

Provided that-

(i) where the goods are to be re-warehoused, the duty on such deficiency shall be forthwith paid by the owner of such goods and the re-warehousing entry shall be made according to the result of such examination;

(ii) where the goods are to be sold under section 48, the duty on such deficiency shall be forthwith paid by the warehouse keeper in any case where the goods were warehoused in a bonded warehouse.

1.7.16 Access to warehouse (sec 50)

(1) The proper officer shall at all times have the right of access to any part of any warehouse and may examine any goods therein; and for the purpose of obtaining such access the proper officer may break open the warehouse or any part thereof, or any adjacent premises.

(2). No person, other than the proper officer or, in the case of a bonded warehouse, the warehouse keeper or any duly authorized employee, shall open any warehouse or gain access to any goods therein save with the approval of the proper officer; and any person who contravenes this subsection shall be guilty of an offence and liable on conviction to a fine not exceeding **five hundred thousand shillings**.

(3). No person shall enter any warehouse, or part thereof, contrary to the orders of the proper officer or shall refuse to leave any warehouse, or part thereof, when directed to do so by the proper officer; and any person who contravenes this subsection shall be guilty of an offence and liable on conviction to a fine not exceeding **five hundred thousand shillings** or to imprisonment not exceeding five years.

1.7.17 Removal of goods after entry for home consumption (sec 51)

Where any goods remain in any warehouse for a period of more than fourteen days after they have been entered for home consumption or after they have been sold in accordance with this Act, then such goods shall, unless the Commissioner-General in any special case otherwise directs, be forfeited and may be destroyed or otherwise disposed of in such manner as the Commissioner-General may direct.

1.7.18 Penalty for unlawfully taking warehoused goods

(1) Any person who,

(a) Takes, or causes or permits to be taken, any goods from any warehouse otherwise than in accordance with this Act;

(b) Fails to carry into and deposit in the warehouse, any goods entered for warehousing; or

(c) Willfully destroys or damages any warehoused goods otherwise than in circumstances specifically provided for in this Act, shall be guilty of an offence and liable on conviction to imprisonment for a term not exceeding two years or a fine equal to ten percent of the C.I.F. value of the goods.

1.7.19 License to warehouses

(1) The Commissioner-General may, on application, license any building as a warehouse for the deposit of goods liable to import duty; and the Commissioner-General may, without assigning reason, refuse to issue any such license and may, subject to a refund of the proportionate part of the license fee, at any time revoke any license which has been issued.

(2) The Commissioner-General may license any building as either-

(a) a general warehouse, that is to say, for the warehousing of goods generally; or

(b) a private warehouse, that is to say, only for the warehousing of goods which are the property of the warehouse keeper.

(3) Every license shall be in the prescribed form and shall be subject to the payment of the prescribed annual fee and shall expire on the 31st December in each year.

(4) The Commissioner-General may require the person applying for a license to furnish such security as the Commissioner-General may think appropriate as a condition to the grant of the license and the Commissioner-General may, at any time, require a warehouse keeper to furnish new security in a different amount or on different terms.

(5) The Commissioner-General may, at any time, require a warehouse keeper to make such alterations or additions to his bonded warehouse as the Commissioner-General may consider necessary to ensure the proper security or warehousing of any goods.

(6) No building shall be used as a bonded warehouse unless there is in force in relation thereto a valid license.

(7) Any warehouse keeper who uses, or permits to be used, his warehouse in contravention of any of the terms of his license shall be guilty of an offence.

(8) Any owner or occupier of a building who uses, or permits to be used, such building as a bonded warehouse without being the holder of a valid license in respect thereof, shall be guilty of an offence and liable on conviction to a fine not exceeding **five hundred thousand shillings** for any day, or part of a day during which the building was so used.

1.7.20 Procedure on revocation or expiry of license

(1) Where the Commissioner-General revokes any license under section 53, then he shall cause to be served on the warehouse keeper notice of such revocation by leaving such notice with the person in charge of the bonded warehouse; and thereupon such service shall be deemed to be notice of such revocation to the owners of all goods warehoused therein.

(2) Where any warehouse keeper proposes not to renew his license in relation to any bonded warehouse, then he shall cause notice of such intention to be given to the owners of all goods warehoused therein.

(3) Where the license in relation to any bonded warehouse has been revoked or has expired, then, within such time as the Commissioner-General may direct, all goods warehoused therein shall be entered and delivered for home consumption, for exportation, for removal to another warehouse, or for use as stores for aircraft or vessels.

(4) Where any goods have not been so entered and delivered in accordance with subsection 3 above, then the proper officer may cause such goods to be taken to a Customs warehouse and thereupon such goods shall be dealt with in accordance with section 36.

1.7.21 Roles of the store keeper

(1) Every warehouse keeper shall-

(a) provide such office accommodation and just weights, scales, measures, and other facilities, for examining and taking account of goods and for securing them as the proper officer may require;

(b) keep a record of all goods warehoused therein and shall keep such record at all times available for examination by the proper officer;

(c) stack and arrange the goods in the bonded warehouse so as to permit reasonable access to and examination of every package at all times;

(d) provide all necessary labour and materials for the storing, examining, packing, marking cooping, weighing, and taking stock, of the warehoused goods whenever the proper officer so requires;

(e) maintain such records and accounts relating to the operations of a refinery, in such form and manner, as the proper officer shall require, and shall keep such records and accounts at all times available for examination by the proper officer.

(2) Where any warehouse keeper contravenes this section the Commissioner-General may direct that no other goods shall be warehoused by such warehouse keeper until such warehouse keeper has, in the opinion of the Commissioner-General, complied with such provisions.

(3) Any warehouse keeper who contravenes any of the provisions of this section or of any direction given by the Commissioner-General under this section shall be guilty of an offence and liable on conviction to a fine not exceeding four thousand shillings.

(4) Any warehouse keeper who takes, substitutes, causes or permits any goods to be substituted shall be guilty of an offence and shall be liable to a fine of ten percent of the C.I.F. value of the goods substituted or taken.

1.7.22 Storage of goods in bonded warehouse (sec 56)

(1) The proper officer may direct in what parts or divisions of any bonded warehouse and in what manner any goods shall be deposited therein.

(2) Subject to section 42, where any goods have been warehoused in a bonded warehouse, then, except with the approval of the proper officer, such goods shall not be moved or interfered with in any way, nor shall any alteration be made in the marks or numbers of any package.

(3) Any warehouse keeper who contravenes, or who causes or permits a contravention of, this section shall be guilty of an offence and shall be liable to a fine equal to ten percent of the C.I.F. value of the goods, and any goods in respect of which any offence under subsection (2) has been committed shall be liable on conviction to forfeiture.

1.7.23 Removal of goods from private to general warehouses.

(1) Where the warehouse keeper of a private bonded warehouse contravenes any of the provisions of this Act, the proper officer may require him within such time as the proper officer may direct, to remove all or any of the goods warehoused in such private warehouse to a general bonded warehouse or to enter and deliver them for home consumption, for exportation, or for use as stores for aircraft or vessels.

(2) Where any warehouse keeper contravenes any requirement given under subsection (1), the proper officer may cause such goods to be taken to a Customs warehouse and thereupon such goods shall be dealt with in accordance with section 36.

1.7.24 Government Warehouses (sec 59)

(A) Rent

Where any goods are deposited in a Government warehouse, then they shall be subject to such rent and other charges as may be prescribed or as may be provided for in this Act, and, if such rent and other charges are not paid to the proper officer when lawfully demanded, the goods in respect of which such rent and other charges are due may be sold, and the proceeds thereof applied, in accordance with section 36.

(B) Removal of goods

(1) Where any goods are deposited in a Government warehouse, then the proper officer may-

- (a) Remove, at the expense of the Customs, such goods from that warehouse to another Government warehouse;
- (b) perform, in relation to such goods and at the expense of the owner thereof, all such acts as he may consider reasonably necessary for the proper custody and preservation of such goods:

Provided that the proper officer shall not, save where he considers immediate action necessary, perform any such act until twenty-four hours after the owner of such goods has been notified that any such act is necessary;

- (c) by notice inform the owners of such goods that it is proposed to close such warehouse at the end of such period, not being less than three months from the date of such notice, as may be specified in such notice; and in any such case regulations shall be made providing for the manner in which any such goods shall be dealt with on such warehouse being closed.

(C) Importation by post

As regards importation by post, the post office is responsible for unpacking, sorting, piling and preparing of post parcel for examination by a customs officer on behalf of the owner.

1.8 PROHIBITED AND RESTRICTED IMPORTS

(a) Prohibited Goods

The following are the prohibited goods as per the second schedule of the CMA,

- a. All goods the importation of which is prohibited under the Customs Management Act or of any law for the time being in force in Uganda.
- b. False money and counterfeit sterling or coin, and any money not being of the established standard in weight or fineness.
- c. Indecent or obscene prints, paintings, books, cards, lithographs, or other engravings, and any indecent or obscene articles.
- d. Manufactured articles bearing the name, address, or trade mark, of any manufacturer or dealer, or the name of any place, in the United Kingdom, or in any member country of the Common wealth, calculated to impart to such articles a special character of British manufacture and which are not of such manufacture.
- e. Matches in the manufacture of which white phosphorus has been employed.
- f. Any article marked, without proper authority, with the Armorial Ensigns or Coat of Arms of State, or having such Ensigns or Arms so closely resembling them as to be calculated to deceive.
- g. Shaving brushes manufactured in or exported from Japan.
- h. Any advertisement or statement intended to promote the sale of any medicine, appliance, or article, for the alleviation or cure of tuberculosis, or of cancer, or of any venereal disease affecting the generative organs or functions or of sexual impotence, or of any complaint or infirmity arising from or relating to sexual intercourse in or of humans.

Provided that nothing herein shall apply to any book, document, or paper, published for the advancement of medical science and intended for the use of any Government department, or registered medical practitioner. Any medicine, appliance, or article, to which is affixed any such advertisement or statement as is referred to in paragraph (1) of this item or to which such advertisement or statement relates.

- i. Distilled beverages containing essential oils or chemical products which are injurious to health, including thujone, star anise, benzoic aldehyde, salicylic esters, hyssop and absinthe: Provided that nothing herein contained shall apply to "Anise" and "Anisette" liqueurs Containing not more than 0.1 per centum of oil of anise and distilled from either *Pimpinella anisum* or the star anise *Allicium verum*.

(b) Restricted Goods

1. All goods the importation of which is for the time being regulated under the Customs Management Act or of any law for the time being in force in Uganda.

2. Publications, that is to say, any writing, picture, or photograph, dealing with sex or the psychological or medical aspects of sex or birth control, except under and in accordance with the terms of a written permit granted by the Commissioner-General on the advice of the Chief Medical Officer of Uganda.

3. Tear gas and any other similar lachrymatory substance (whether in liquid or gaseous form) whatsoever, and any device or instrument specifically designed to expel tear gas or any such other similar lachrymatory substance (whether in liquid or gaseous form), except under and in accordance with the terms of a written permit granted by the Minister of Internal Affairs.

4. Potable spirits, unless in respect of each consignment of any such spirits there is produced a certificate of age, issued in the country of production or shipment by such official authority as may be acceptable to the Commissioner-General, showing that such spirits have been stored in wood for a period of not less than three years:

Provided that-

(a) the Commissioner-General may, in his discretion, accept in place of such certificate of age a sworn declaration to the like effect from the blender or exporter of any such spirits in respect of all shipments made within a period of twelve months from the date of such declaration;

(b) no such certificate of age or declaration shall be necessary in respect of any potable spirits which the Commissioner-General is satisfied are-

(i) alcoholic bitters, liqueurs, cordials and similar alcoholic mixtures;

(ii) gin, geneva, hollands, schnapps or any other similar potable spirits;

(iii) spirits imported for medical, industrial or scientific purposes.

5. Postal franking machines, except under and in accordance with the terms of a written permit granted by the Authority of the Uganda Posts and Telecommunications Corporation.

6. Traps capable of killing or capturing any game animal, except under and in accordance with the terms of a written permit granted by the Chief Game Warden of Uganda for which any such trap is destined.

7. Articles bearing Boy Scout or Girl Guide badges, tokens or emblems, except under and in accordance with the terms of written permit granted by the territorial Boy Scout or Girl Guide Commissioner.

8. Unwrought precious metals, and precious stones which are not manufactured or made up into any article of commerce, from Zaire, Rwanda or Burundi whether to be imported in transit or for transshipment or otherwise except under and in accordance with a written permit granted by the Minister of Finance.

11(iii)

EXPORTATION OF GOODS

1.1 DEFINITION

Exportation can be defined as a commercial activity of selling and shipping of goods to a foreign country.

Exportation also refers to the act of goods leaving the country to other destinations across the borders.

Usually, domestic commodities leave home countries for final sale on the international market or for input as raw-materials in foreign industries.

Since certain goods are prohibited from exportation, customs measures are needed to control the exit of commodities on top of proper collection of taxes.

1.2 TYPES OF EXPORTATION PROCEDURES

There are three types of exportation and these are:

(a) **Outright exportation;**

This is the type of exportation involving goods leaving the country with an intention of remaining permanently or for consumption in the foreign country e.g. Ugandan coffee leaving for international markets.

(b) **Temporary exportation**

This is the type of exportation that involves goods that are exported outside the country for special purposes and are brought back after exportation from foreign land e.g. construction equipment taken for building in foreign countries.

(c) **Re-exportation**

This is the type of exportation that involves goods which were imported for temporary use or purpose only and are to be exported at the end of the activities intended. Such goods are exempt from import duties hence the owner of such goods has to impact them under bond or cash deposit of the amount equal or greater than the assessed import duties.

Examples of goods for re-exportation include touring equipments, commercial travelers sample and goods imported for renovation.

1.2.1 **A Goods to be exported are grouped into three (3) categories; i.e.**

- i. Exports of domestic goods free of duty
- ii. Exports of domestic goods liable to export duty
- iii. Re-exportation of goods not under duty drawback

1.2.2 **Export customs procedures**

Goods to be exported are required to be entered on the export bill of entry in quadruplet copies and the owner is required to furnish full particulars, supported by documentary evidence.

1.2.3 **Export processing zone**

An Export processing zone means a designated part of the customs territory where any goods introduced are regarded, for the purpose of import duties and taxes are being outside the customs territory but are restricted by controlled access.

Goods in an export processing zone are either of foreign or domestic nature and include goods such as plants, machinery equipment, works in progress, raw-materials, finished goods and processing wastes. Such goods are exempt from duty.

1.2.4 Duty drawback

This is a scheme set to allow exporters to claim import duty on importation of goods or other input used for production of the products exported or performance of such conditions as may be prescribed or on performance of such conditions as may be prescribed.

Goods that may qualify for drawback include examples such as;

- (i) Caddy sacks on Tea,
- (ii) Solid board cartons, corrugated cartons and labels in fish exportation,
- (iii) Packages for horticulture such as sleeves, craft paper, carton boxes and coca peat in which flowers are grown.

1.3 PROHIBITED AND RESTRICTED EXPORTS

Prohibited and restricted as per the third schedule of the CMA include;

(a) Prohibited Goods

1. All goods the exportation of which is prohibited under the Customs Management Act or of any law for the time being in force in Uganda.

2. All goods for conveyance to Zaire, Rwanda or Burundi which are set out in the Schedule hereto and which-

- (i) Are subject to drawback; or
- (ii) Have been entered for warehousing but the duty thereon has not been paid, except where such goods are-

(a) The property of diplomatic or consular missions or of members of such missions in Zaire, Rwanda or Burundi or of the United Nations Organisation (of which the United Nations Children's Emergency Fund and the United Nations Special Fund are integral parts) or of the United Nations Technical Assistance Board or the International Labour Organisation or the Food and Agriculture Organisation of the United Nations or the United Nations Educational Scientific and Cultural Organisation or the International Civil Aviation Organisation or the World Meteorological Organisation or the World Health Organisation or the Universal Postal Union or the International Telecommunications Union or the International Atomic Agency or of members of such bodies in Zaire, Rwanda or Burundi; or

(b) Personal and household effects.

(c) Restricted Goods

1. All goods the exportation of which is regulated under this Act or of any law for the time being in force in Uganda.

2. The following goods shall not be exported in vessels of less than ten tons register-

- (a) warehoused goods;
- (b) goods under drawback;
- (c) transshipped goods.

Why countries impose prohibitions and restriction to certain goods

There are two major reasons:

1. Protection of the economy; such as local industries, local markets and primary production.
2. Protection of society against health and environmental hazards.

11(iv)

SMUGGLING AND ITS EFFECTS

1.1 DEFINITION

Smuggling is an activity which involves the importation or exportation of goods by wrong or unlawful means with the objective of evading taxes and any other measures prohibiting or restricting the importation or exportation of such goods.

Smuggling is an ILLEGAL method of conducting business.

The principle causes of smuggling are greed for wealth, ignorance and lack of nationalism.

1.2 FORMS IN WHICH SMUGGLING OCCURS

a) **Outright avoidance of official customs controls across the borders** e.g. on Lake Victoria, overland on road, rail and often through the bush ways. This form of smuggling is generally associated with highly marketable goods, goods of high tax value, and prohibited or restricted goods.

b) **Under declaration Of Goods**

This is a circumstance where the importer declares less quantity on importation documents than the actual goods being imported. This form of smuggling occurs through customs controls usually deliberately, on the side of the importer.

c) **Undervaluation of goods**

This is a situation whereby goods are given a lower value than they actually have. Undervaluation often happens out of ignorance, negligence or connivance at the customs control. It aids smuggling indirectly.

d) **Misclassification of goods**

This means that goods are declared under a different class of imports particularly to attract lower rates of tax with intent to reduce the tax liability. This again may happen out of ignorance, negligence or deliberately. This problem also aids smuggling.

e) **Falsification of documents**

Sometimes documents pertaining to certain goods are tampered with in their particulars with intent to benefit the taxpayer by a reduction in tax.

f) **Mis-declaration of Country of Origin.**

This is a circumstance whereby a different country is declared as the source of goods instead of the correct country of origin. It is very common with COMESA and NON COMESA states because of the lower tariff rates for goods originating from COMESA member states.

g) **Short-landing transit and or re-export goods.**

Transit goods are those goods which are destined to other countries through Uganda, e.g. from abroad through Uganda to Rwanda, DRC, ETC.

Re-exports are goods which come into the country but subsequently exited. In both cases, smuggling occurs when the goods finally end up on the Uganda market, leading to total evasion of taxes and other controls.

1.3 PROBLEMS ASSOCIATED WITH SMUGGLING

i. Loss of revenue

Smuggling is an act of tax evasion which deprives government of revenue for public expenditure.

ii. Distortion of market prices

Goods which are smuggled into the country are often sold a lot cheaper than goods brought onto market through the right procedures. Smuggling therefore deprives traders of free competition.

iii. Collapse of local industries

A country achieves better economic growth by developing its own industrial base. Smuggling under-cuts prices of the locally manufactured goods thus destroying the market for local products. This leads to collapse of local industries.

iv. Unemployment

When there is unfair competition in the market, compounded by the collapsing of industries, the labour market (employment base) is eroded. Many professionals, skilled and unskilled personnel remain jobless.

REVIEW EXERCISE

1. What are the specific objectives of the East African Community Customs Union?
2. What is the common External Tariff (CET)?
3. When did the East African Community Customs Union come into force?
4. What is a tariff line as defined under the EACCMA-2004?
5. (i) What are the East African Community (EAC) Rules of Origin?
(ii) How is the origin of goods determined?
6. What should an exporter do to obtain a certificate of origin?
7. What are some of the features of a customs Union?
8. What benefits and challenges do you think will come with the implementation of the East African Community Customs union?
9. Outline five commodities that fall in a category of 'sensitive goods'

12.0

OFFENCES AND PENALTIES

1.1 INTEREST

1.1.1 Interest on unpaid tax (Sec 136)

- (1) A person who fails to pay any tax (including provisional tax), any penal tax, or tax withheld/required to be withheld by the person from a payment to another person on or before the due date for payment is liable for interest at a rate equal to 2% per month on the amount unpaid calculated from the date on which the payment was due until the date on which payment is made.
- (2) Interest paid by a person under subsection 1 above shall be refunded to the person to the extent that the tax to which the interest relates is found not to have been due and payable.
- (3) Where good cause is shown, in writing, by the person liable for payment of interest, the minister may, on the advice of the Commissioner, remit, in whole or in part, any interest charged under this section.
- (4) Interest charged in respect of failure to comply with Section 123 of the Income Tax Act is borne personally by the withholding agent and no part of it is recoverable from the person who received the payment from which tax was or should have been withheld.
- (5) Interest charged under this section 136 of the Income Tax act shall be simple interest.
- (6) The provisions under the Income Tax Act relating to the collection and recovery of tax apply to any interest charged under section 136 as if it were tax due.

1.1.2 Failure to furnish a return (Sec 137)

- (1) A person who fails to furnish a return or any other document within 15 days commits an offence and is liable on conviction to a fine not exceeding 15 currency points.
- (2) If a person convicted of an offence under subsection (1) above fails to furnish the return or document to which the offence relates within the period specified by the court, that person commits an offence and is liable on conviction to a fine not exceeding 20 currency points.

1.1.3 Failure to maintain proper records (Sec 139)

A person who fails to maintain proper records commits an offence and is liable on conviction to;

- (a) where the failure was deliberate, a fine of not less than 15 currency points or to imprisonment for a term not exceeding one year; or
- (b) in any other case, a fine not exceeding 20 currency points.

1.1.4 Improper use of Taxpayer Identification Number (Sec 141)

A person who knowingly or recklessly uses a false taxpayer identification number, including the taxpayer identification number of another person, on a return or document prescribed or used for tax purposes, commits an offence and is liable on conviction to a fine of not less than 25 currency points or to imprisonment for a term not exceeding 1 year, or to both.

1.1.5 Making false or Misleading statements (Sec 142)

- (1) A person who makes a statement to an officer of the Authority (URA) that is false or misleading in a material particular; or omits from a statement made to an officer of the Authority (URA) any matter or thing without the statement is misleading in a material particular; commits an offence and is liable on conviction to;
 - Where the statement or omission was made knowingly or recklessly, a fine of not less than 20 currency points or to imprisonment for a term not exceeding one year, or to both; or
 - In any other case, a fine not exceeding 20 currency points.
- (2) It is a defence for the accused person to prove that he or she did not know could not reasonably be expected to have known that the statement to which the prosecution relates was false or misleading.
- (3) A reference in this section to a statement made to an officer of the Uganda Revenue Authority is a reference to a statement made in writing to that officer acting in the performance of his or her duties, and includes a statement made;
 - (a) In an application, certificate, declaration, notification, return, objection, or other document made, prepared, given, filed or furnished.
 - (b) In information required to be furnished under the Income Tax Act;
 - (c) In a document furnished to an officer of the Uganda Revenue Authority otherwise than pursuant to the Income Tax Act;
 - (d) In an answer to a question asked of a person by an officer of the Uganda Revenue Authority; or
 - (e) To another person with the knowledge or reasonable expectation that the statement would be conveyed to an officer of the Uganda Revenue Authority.

1.1.6 Obstructing an officer of the Authority (Sec 143)

A person who obstructs an officer of the Uganda Revenue Authority in the performance of duties commits an offence and is liable on conviction to a fine not exceeding 20 currency points.

1.1.7 Aiding and Abetting (sec 144)

Any person who aids and abets another person to commit an offence, or counsels or induces another person to commit such an offence, commits an offence and is liable on conviction to a fine not exceeding 20 currency points or to imprisonment for a term not exceeding 1 year, or to both.

1.1.8 Offences by and relating to officers and Person employed to carry out the Act; Penalties

- (1) *Any officer of the Uganda Revenue Authority or any person employed in carrying out the provisions of the Income Tax Act of Uganda who;*

- (a) Directly or indirectly asks for, or takes in connection with any of the officer's duties, any payment or reward whatsoever, whether pecuniary or otherwise, or promise or security for any such payment or reward, not being a payment or reward which the officer was lawfully entitled to receive; or
- (b) Enters into or acquiesces in any agreement to do or to abstain from doing, permit, conceal, or connive at any act or thing whereby the tax revenue is or may be defrauded or which is contrary to the provisions of the Income Tax Act or to do the proper execution of the officer's duty,

Commits an offence and is liable on conviction to a fine not less than 25 currency points or to imprisonment for a term of not less than 3 months.

(2) Any person who;

- (a) Directly or indirectly offers or gives to any officer payment or reward whatsoever, whether pecuniary or otherwise, or any promise or security for any such payment or reward, not being a payment or reward which the officer was lawfully entitled to receive; or
- (b) Proposes or enters into any agreement with any officer in order to induce the officer to do or to abstain from doing, permit, conceal, or connive at any act or thing whereby tax revenue is or may be defrauded or which is contrary to the provisions of the Income Tax Act or to the proper execution of the officer's duty,

Commits an offence and is liable on conviction to a fine not less than 25 currency points or to imprisonment for a term of not less than 3 months.

- (3) Notwithstanding subsection (1), an officer or person employed in carrying out the provisions of the Income Tax Act of Uganda who commits an act specified in subsection (1)(a) or (b), and who volunteers information to the Commissioner relating to that act shall;

- (a) be exonerated from prosecution; and
- (b) receive 20% of the fine that would be imposed on a person convicted of an offence under subsection (1).

- (4) Notwithstanding subsection (2), a person who commits an act specified in subsection (2) (a) or (b), and who volunteers information to the Commissioner relating to that act shall;

- (a) be exonerated from prosecution; and
- (b) be liable to tax only to the extent agreed upon with the officer to whom the offence relates.

- (5) An officer convicted of an offence under subsection (1) is, in addition to any penalty imposed under that section, liable to pay the difference in tax between the tax due and the tax payable by a person under subsection (4)(b); and the amount due under this section shall be deemed to be tax from the officer under section 104.

1.2 OFFENCES BY COMPANIES (Sec 146)

- (1) Where an offence is committed by a company, every person who, at the time the offence was committed;

- (a) was a nominated officer, director, general manager, secretary, or other similar officer of the company; or
- (b) was acting or purporting to act in that capacity,

is, without prejudice to the liability of the company, deemed to have committed the offence.

- (2) Subsection (1) does not apply where;

- (a) the offence was committed without that person's consent or knowledge; and
- (b) the person has exercised all diligence to prevent the commission of the offence as ought to have been exercised having regard to the nature of the person's functions and all the circumstances.

1.2.1 Officer may appear on Behalf of the Commissioner (Sec 147)

Notwithstanding anything contained in any written law, any officer duly authorized in writing by the Commissioner may appear in any court on behalf of the Commissioner in any proceedings in which the Commissioner is a party and, subject to the directions of the Attorney-General, that officer may conduct any prosecution for an offence under this Act and, for that purpose, shall have the powers of a public prosecutor appointed under the Magistrates Courts Act.

1.3 COMPOUNDING OFFENCES (Sec 148)

- (1) Where any person commits an offence under the Income Tax Act of Uganda other than an offence under section 145, the commissioner may, at any time prior to the commencement of court proceedings, compound the offence and order the person to pay a sum of money specified by the commissioner, not exceeding the amount of the fine prescribed for the offence.
- (2) The commissioner shall only compound an offence under this Section if the person concerned admits in writing that the person has committed the offence.
- (3) Where the Commissioner compounds an offence under this Section, the order referred to in subsection (1);
 - (1) Shall be in writing and specify the offence committed, the sum of money to be paid, and the due date for payment, and shall have attached to it the written admission referred to in subsection (2);
 - (2) Shall be served on the person who committed the offence;
 - (3) Shall be final and not subject to any appeal; and
 - (4) May be enforced in the same manner as a decree of any court for the payment of the amount stated in the order.
- (4) Where the Commissioner compounds an offence under this section, the person concerned shall not be liable for prosecution in respect of that offence or for penal tax.

1.4 PENAL TAX

1.4.1 Penal tax for failure to furnish a return of Income (Sec 151)

A person who fails to furnish a return of Income for a year of income within the time required under this Act is liable to pay a penal tax equal to 2% of the tax payable for that year before subtracting any credit allowed to the tax payer on his or her chargeable income or ten currency points per month, whichever is the greater, for the period the return is outstanding.

1.4.2 Penal tax in relation to records (Sec 152)

A person who deliberately fails to maintain proper records for a year in accordance with the requirements of the Income tax Act is liable to pay a penal tax equal to double the amount of tax payable by the person for the year.

1.4.3 Penal tax to false or misleading statements (Sec 153)

- (1) Where a person knowingly or recklessly;

- (a) Makes a statement to an officer of the Uganda Revenue Authority that is false or misleading in a material particular; or
 - (b) Omits from a statement made to an officer of the Uganda Revenue Authority any matter or thing without which the statement is misleading in a material particular,
And the tax properly payable by the person exceeds the tax that was assessed as payable based on the false or misleading statement or omission, that person is liable to pay a penal tax equal to double the amount of the excess.
- (2) Section 142(3) applies in determining whether a person has made a statement to an officer of the Uganda Revenue Authority.

1.4.4 Penal tax for Under-stating provisional tax estimates (Sec 154)

- (1) A provisional taxpayer whose estimates or revised estimates of chargeable income for a year of income under Section 112 is less than 20% of the taxpayer's actual chargeable income assessed for that year, is liable for penal tax equal to 20% of the difference between the tax calculated in respect of the taxpayer's estimate, as revised, of chargeable income and the tax calculated in respect of 90% of the taxpayer's actual chargeable income for the year of income.
- (2) A provisional taxpayer whose estimate or revised estimate of gross turnover for a year of income under section 112 is less than 90% of the taxpayer's actual gross turnover for that year is liable for penal tax equal to 20% of the difference between the tax calculated in respect of the taxpayer's estimate, as revised, of gross turnover and the tax calculated in respect of 90% of the taxpayer's actual gross turnover for the year of income.
- (3) This section does not apply to a taxpayer who is in the business of agricultural, plantation or horticultural farming.

1.4.5 Recovery of Penal Tax (Sec 155)

- (1) Liability for penal tax is calculated separately with respect to each section dealing with penal tax,
- (2) Subject to subsection (3), the imposition of penal tax is in addition to any interest imposed under Section 136 and any penalty imposed as a result of conviction of an offence.
- (3) No penal tax is imposed on a person under Section 152 or 153 where the person has been convicted of an offence under Section 139 or 142 respectively for the same act or omission.
- (4) If penal tax under section 152 or 153 has been paid and the Commissioner institutes a prosecution proceeding under section 139 or 142 respectively in respect of the same act or omission, the Commissioner shall refund the amount of penal tax paid; and that penal tax is not payable unless the prosecution is withdrawn.
- (5) Penal tax as assessed by the Commissioner under Sections 151, 152, 153 and 154 shall be treated for all purposes as an assessment under the Income tax Act.
- (6) Where good cause is shown, in writing, by the person liable to pay penal tax, the minister may, on the advice of the Commissioner, remit, in whole or in part, any penal tax payable.

ETHICAL ISSUES

Presentation Outline

Importance of acting with integrity and the consequences of tax avoidance

Dealing with tax issues ethically

Importance of acting with integrity

Integrity is the quality of being honest and having strong moral principles, or moral uprightness. It is a personal choice to hold one's self to consistent standards.

In ethics, integrity is regarded as the honesty and truthfulness or accuracy of one's actions. Integrity can stand in opposition to hypocrisy, in that judging with the standards of integrity involves regarding internal consistency as a virtue, and suggests that parties holding within themselves apparently conflicting values should account for the discrepancy or alter their beliefs. The word integrity evolved from the Latin adjective integer, meaning whole or complete. In this context, integrity is the inner sense of "wholeness" deriving from qualities such as honesty and consistency of character. As such, one may judge that others "have integrity" to the extent that they act according to the values, beliefs and principles they claim to hold.

Importance of acting with Integrity

1. It increases the reputation of the entity

The higher the reputation, the more business it draws and the more successful the entity becomes.

2. Enhances integrity thus, trust

At the most basic level, all business relationships are built on trust. Strong customer and employee relationships increases the company's productivity and profitability due to constructed Public Confidence.

3. Helps at minimizing non-allowable deductions and tax offences

The entity will avoid penalties, fines, investigations and even imprisonment of its directors or owners

4. Helps to get more business

Tax compliant businesses can easily win business from entities that require their suppliers to tax compliant

5. Easy to get tax benefits and / or reliefs

It makes it easy to get tax benefits from URA like WHT exemption and tax clearance certificates

6. Cost of doing business reduced

Helps at reducing costs like tax litigation costs and saves on related legal fees

The consequences of tax avoidance

Tax Avoidance: The arrangement of one's financial affairs to minimize tax liability within the law **OR**

Exploiting the legal scope for discretion of the tax system running counter to the purpose of the tax law

Consequences:

You should be aware that URA has sophisticated analytical tools to detect and tackle taxpayers using tax avoidance schemes. Revenue will always investigate and challenge tax avoidance schemes and will litigate cases up to the High Court, Court of Appeal and, or the Supreme Court, *if necessary. Here below are the consequences*

1. If you enter into a tax avoidance scheme you are potentially **exposing yourself to significant costs often greater than the potential tax advantage.**
2. Significant business disruption caused by the inevitable URA enquiries
3. Potential litigation and prolonged uncertainty about the outcome.
4. Organisation reputation risk since company name stand a chance to be published on the list of tax defaulters
5. The Company stands a big chance of not transacting with government agencies and organisations yet it's the bigger funder.
6. Possible loss of public trust into the company products due to image damage

Dealing with tax issues ethically

Avoiding tax may be legal, but can it ever be ethical?

Rather than hiding behind the business case for tax avoidance, companies need to be transparent about their tax planning.

As part of good governance, companies will seek to minimize their tax liability through "tax planning", making the most of the tools and mechanisms which the government makes available to them specifically for this purpose: allowances, deductions, rebates, exemptions, and so on. Tax planning is tax compliant behavior but there is a grey area between this and "tax avoidance".

Tax avoidance, while legitimate, can be seen as aggressive when it involves using financial instruments and arrangements not intended as, or anticipated by, governments as a vehicle for tax advantage. For example, the use of overseas tax havens. Avoiding tax and bending the rules of the tax system is not illegal unlike tax evasion; it is operating within the letter, but perhaps not the spirit, of the law.

Businesses may therefore be complying with the law – but is it ethical?

The Integrity Journey in Uganda Revenue Authority while managing tax issues over years.

In the last 13 years the public perception of URA has changed and most people speak highly of its services. *What has been done to change the perception from what it used to be?*

Prior to 2005, the public perceived URA as a corrupt organization. URA had a number of manual tedious processes which made it difficult for clients to comply. URA had numerous challenges within the tax body which enabled corruption to thrive.

After restructuring in 2005, URA embarked on a total transformation drive to address the following vices but not limited to: fraud and corruption tendencies, lengthy bureaucratic procedures, a long chain of command, absenteeism, incompetency, late coming, lack of professionalism, and other inefficiencies that were bringing disrepute to the organization. Clearly something had to be done.

Among the key aspects undertaken to achieve total transformation was the Integrity Enhancement Project. URA launched this project in September 2006 and it committed staff to developing a Strong Integrity Culture in URA by **focusing on the following tenets of an integrity culture;**

- i. Building corruption resistance mechanisms within all URA operations.
- ii. Publicly declaring zero tolerance to corruption in URA.
- iii. Promoting transparency, staff empowerment and fairness.
- iv. Developing and continuously upgrading the Risk Management Policy.
- v. Initiating open communication platforms both internally and externally.
- vi. Reviewing the code of ethics that govern URA staff discipline.
- vii. Reviewing the regulatory frame work in which URA and client operations take place and,
- viii. Initiating client partnerships.

Ethical strategies instituted by URA

- a) Developed policies to guide the ethical behaviors of staff, namely:
 - i. The Code of Conduct.
 - ii. Reviewed the Risk Management Policy.
 - iii. Whistle blowing Policy.
 - iv. The Rewards and Recognition Policy.
- b) Carried out sensitization training for all URA staff on integrity, compliance and fraud risk awareness. Staff were sensitized on the benefits of integrity and compliance with all URA Policies, Procedures and Guidelines.
- c) Developed an integrity, compliance and fraud risk awareness module which was incorporated in our induction curriculum for all new staff to the organization.

- d) Staff were given an opportunity to nominate and elect Integrity Focal Persons from URA business areas all over the country. These were appointed and commissioned to help light the Integrity “Candle” in URA.
- e) Also carried out engagements with external stakeholders such as clearing agents, suppliers, service providers, and tax consultants. In these fora, URA shared information on the integrity initiatives we had put in place and also heard from them on the areas where we needed to improve.
- f) Initiated a whistle blowing or hot line that anyone can use to report any tendencies of corruption; non-compliance or misconduct among our staff while providing services.
- g) Re-engineered processes and systems and educated clients about them. In Domestic Taxes Department, introduced e-tax and in Customs Department ASYCUDA World. Staff’s skills have been developed and aligned with these new business procedures and performance standards.

2. Benefits URA has reaped from this Integrity Drive (Benefits of imploring integrity while managing tax issues)

The benefits that have reaped from the transformation drive include but are not limited to:

- a. All staff are trained to provide excellent professional services to URA clients.
- b. There is also a marked increase in levels of compliance among tax payers. They are now more willing to voluntarily pay taxes and negotiate payment terms if they cannot pay immediately.
- c. The re-engineered processes have improved URA service delivery to tax payers. The e-tax system is a reliable accurate database of taxpayers; and provides simple and easy to understand procedures for tax payers. The ASYCUDA System in Customs likewise has reduced clearance times for importers tremendously.