THE REPUBLIC OF UGANDA

IN THE HIGH COURT OF UGANDA AT KAMPALA

(COMMERCIAL COURT)

APPEAL NO. 5 OF 2002

(Arising from Tax Appeals Tribunal Application No. 9 of 2001)

INTERTEK TESTING SERVICES
INTERNATIONAL LIMITED ……..……APPELLANT

VERSUS

UGANDA REVENUE AUTHORITY ……RESPONDENT

BEFORE: THE HONOURABLE MR JUSTICE JAMES OGOOLA

**JUDGMENT**

**1.** This is an appeal from a decision of the Tax Appeals Tribunal ("Tax Tribunal") regarding a disputed amount of income tax that was assessed and collected by the Uganda Revenue Authority ("URA") in 1998 as withholding tax on certain pre-shipment inspection services performed by or through certain inspection entities affiliated with a London based Pre-shipment Company.

The real issue of law in this appeal turns on a firm grasp of a complex matrix of facts underlying this case. I will therefore delve into a recitation of those facts at some length.

**2.** The Appellant is INTERTEK TESTING SERVICES INTERNATIONAL LTD (herein referred to as "INTERTEK"). It is an inspection company incorporated under the laws of the United Kingdom. It is also registered as a foreign company under the laws of Uganda. INTERTEK entered into a pre-shipment inspection services contract ("PSI Contract") with the Government of Uganda. As required by the PSI Contract, INTERTEK registered a place of business in Uganda ("ITS Uganda Office") for the purpose of carrying out the pre-shipment inspections under that contract. The function of the ITS Office was to remit money to

INTERTEK's Head office in the United Kingdom; and to withhold, by way of tax, 10% from all such remittances.

**3.** In addition to its ITS Office in Uganda, INTERTEK also had a network of inspecting entities as separate legal entities incorporated as limited liability companies in the jurisdictions in which they operated. These entities were sub-contracted by INTERTEK to carry out, on behalf of INTERTEK, the pre-shipment inspection services required of INTERTEK under its contract with the Government of Uganda. The inspection services were performed by these entities in their respective countries of domicile — notably in United Arab Emirates, Hong Kong, Italy, Japan and Kenya. The payments for these services, however, would appear to have been made by the importers in Uganda, and then remitted by the ITS office to the INTERTEK Head office in the United Kingdom. At any rate, the Respondent (URA) assessed and collected withholding taxes amounting to Shs.273,884,187/- on the payments made on account of the pre-shipment inspection services provided by the above network of non-UK entities. It is in respect of this withholding tax that the present dispute arises.

**4.** INTERTEK contends that the URA's assessment and collection of this withholding tax was improper and contrary to sections 80 and 86 of the Income Tax Act (Cap. 340, 2000 Edition of the Laws of Uganda), in as much as the non-UK inspecting entities were not sourcing their income from Uganda. INTERTEK also averred that the moneys constituting the withholding tax were costs of inspections incurred by INTERTEK in paying the various inspecting entities; and that the Tax Tribunal was wrong to hold that the non-UK inspecting entities were the beneficial owners of income under the PSI Contract with the Government of Uganda. In this respect, INTERTEK's London office was not a conduit for income destined to the non-UK inspecting entities. En view of all these challenges, INTERTEK prayed the Court to order a refund of the amount of tax that the URA withheld.

**5.** For its part, the URA dismissed INTERTEK's contentions. It averred that the withholding tax in question was properly and lawfully assessed and collected under sections 79 and 121 of the Income Tax Act on income sourced from Uganda. The separate inspection entities, being non-UK residents, could not benefit from Article 7 nor Article 13 of the Double Taxation Agreement concluded between the UK and Uganda. Additionally, the URA averred that

internationally accepted accounting principles on recognition and treatment of income apply to the circumstances of this case. In particular, the URA contended that while the ITS Uganda office was a branch of INTERTEK (and therefore dependent on INTERTEK), the other inspecting entities were subsidiaries (i.e. independent from their parent: INTERTEK). These differences gave rise to different implications on their tax liability in Uganda.

**6.** The force of the respective arguments of each counsel to this appeal was formidable. To each argument, I gave considerable attention and thought. In particular, a primary contention of INTERTEK's was that under section 79 of the Income Tax Act,

*'79. Income is derived from sources in Uganda to the extent to which it is —*

*(d) derived in respect of any services rendered under a contract with the Government of Uganda, whenever the…… services are rendered;"*

**7.** It was argued, that the above-quoted statutory language of section 79 of the Income Tax Act excludes the Ugandan income of the separate entities in as much as those entities were not themselves privy to the **PSI** Contract with the Government of Uganda. **First,** I find that construction of the statute to be too narrow and too literal. Sections 79 and 85 are in part IX of the Act which deals with **International Taxation.** Section 79 deals with sources of income *derived from Uganda.* The tax falling in that category is payable by non-residents on income derived from Ugandan sources. Conversely, sections 80-86 deal with foreign source incomes (notably income from foreign employment, foreign tax credits, branch profits, international payments, non-resident public entertainers, shipping, and telecommunications). Of particular importance to the instant case is Section 85 of the Income Tax Act — which deals with the taxation of payments to non-resident contractors and professionals. This is the one provision in the entire Act which directly addresses the specific issue of the taxation of non-resident providers of services (such as the pre-shipment inspections services that were rendered by INTERTEK's network of independent entities). That section provides as follows:

*"85 (1) subject to this Act, a tax is imposed on every nonresident person deriving income under a Ugandan source services contract.*

*(4) In this section, Ugandan source services contract' means a contract, other than an employment contract, under which—*

*(a) the principal purpose of the contract is the performance of services which gives rise to income sourced in Uganda; and*

*(b) any goods supplied are only in incidental to that purpose".*

**8.** The above-quoted section provides for two elements which are extremely important for the issue now under consideration. The first is that section 85(1) — unlike section 79(a) — does not confine itself to a services contract to which the Government of Uganda is a party. Instead, the requisite contract under section 85 is articulated more broadly. The section does not require the service provider himself to be a party to the service contract. To read into section 85 a requirement of any such privity of contract, is to do violence to the simple, ordinary and clear language of the statute. Privity of contract on the part of the non-resident service provider is not a necessary precondition for the imposition or collection of the tax. Thus, any service contract qualifies for this tax — as long as the income involved is derived under the aegis of a services contract, and as long as the principal purpose of that contract is the performance of services which give rise to income sourced in Uganda.

In the instant case, it is quite evident that the services rendered by the inspection entities were performed under and derived their authority from the underlying PSI Contract. Equally evident, the income accruing to those entities on account of the inspection services performed by them was sourced from Uganda.

**9.** **Secondly,** the narrow and literal construction of section 79 that was canvassed by INTERTEK in this instant case goes against the principle of agent and principal. True, the entities carried out their inspection services <u>on behalf</u> of INTERTEK. That fact is expressly conceded at p.1 of the written submissions of the learned counsel for INTERTEK, thus:

*"The appellant has a network of inspecting entities that are separate legal entities incorporated as limited liability companies in the jurisdictions in which they operate, which*

*carry out pre-shipment inspect/on services and* *were contracted by the Appellant to carry out pre-shipment inspection on its behalf'* [emphasis added]

To that extent, it is evident that the entities carried out their duties and functions as agents of INTERTEK. Moreover, they did so for benefit of the Ugandan importers of the goods inspected. The importers then made payments for these services. For logistical and similar purposes, the payments were not made directly to the entities, but circuitously to the ITS Office in Uganda, for transmission to the entities, via INTERTEK London. There is thus a very real and substantive umbilical cord between the ultimate recipients of these remittances (i.e. the inspection entities) and the source of these funds (i.e. the Ugandan importers).

**10. Third,** INTERTEK's contention that the entities' income was not sourced from Uganda is inimical to the doctrine of substance over form. That doctrine is clearly understood and readily applied, especially in matters of taxation. In this regard, two cases of the Canadian Supreme Court are immensely instructive. **In Dominion Taxi Cab Association v MNR [1954] SCR 82,** the Court held that:

"It *is well settled that in considering whether a particular transaction brings a party within the terms of the Income Tax Act, its substance rather than its form is to be regarded"*

**In** similar vein, in the recent case of **Placer Dome Inc v Canada [1992] 2 CTC 98 at 109,** the Canadian Supreme Court held that:

*"It is the substance of a transact/on that must be looked at in order to determine the true legal rights and obligations of the parties. Similarly, It Is the commercial and practical nature of the transaction, the true legal rights and obligations flowing from it that must be looked at to determine its tax implications"*

**11.** From the above doctrine of substance over form, it is quite evident that the tax consequences of a transaction — such as the payment remittances for the pre-shipment inspections effected by the independent entities in this case — are to be determined by having regard to the larger economic substance of that transaction, rather than narrowly restricting one's focus on the

transaction's legal form only. Looked at from that standpoint, there can be no doubt at all but that the payments made by the Ugandan importers to the ITS Uganda Office for transmittal to the non-UK inspection entities were indeed income "sourced from Uganda."

**12.** In light of the above doctrine, this Court must reject INTERTEK's contention concerning non-privity of contract between the independent inspection entities and the PSI Contract with the Government of Uganda. True, there was indeed no direct contractual linkage between these entities and the Government's PSI Contract with INTERTEK. However, this is to put form over substance — rather than the other way around. The better view is to compare this transaction to the following two analogies of:

A. the construction or building sub-contractor (e.g. for electrical, mechanical, or plumbing works). Such a sub contractor is an independent contractor in his own right, but he nonetheless works under the overall umbrella of the main Contractor and of the Employer. Yes, the sub contractor is "independent", but only to the extent of the professional performance of his duties. The main Contractor does not instruct him as to how to perform his duties under the sub-contract. Moreover, strictly (i.e. formally) speaking, the sub-contractor is not privy to the main Contract. But in the larger (i.e. substantive) sense of the overall economic picture, the sub-contractor is really working on behalf of the main Contractor. All of them are performing their respective tasks under the aegis of the main Contract and for the good of the Employer.

B. the shipment of goods whether by sea, land or air. The transaction involves a veritable array of independent subcontractors — some of these deal with the shipping of the goods; others with the transportation of those goods from the port of unloading to the bonded warehouse; others with the clearance of the goods through customs; and yet others with the final delivery of the goods to the ultimate consignee of those goods. All these subcontractors work independently — in the sense that each one is professional and performs his duties without instructions from above. Yet in the overall economic scheme of things (as opposed to the formal legalism of the transactions) as viewed by the consignee, they are all agents performing their several tasks for the collective benefit of the initial Shipper/Consignor of the goods.

C. The third appropriate analogy is the principle of lifting a company's veil. The officers and agents of the company carry out their functions and duties clothed in the veil of corporate personality. But when (in fitting cases) the veil is lifted, you find real human beings performing those duties and functions. In the instant case too, the separate inspection entities (being agents of INTERTEK) do indeed exude their own independent corporate personalities and do carry out seemingly independent duties and functions. But if (in pursuit of substance over form) you lift the veil, you find behind it all the real person: INTERTEK.

All the above three analogies, which are real in our legal system, give credence to the doctrine of **substance** over **form.** I am unreservedly prepared to embrace that doctrine in the instant case.

**13.** There were other issues canvassed in this appeal. But these were largely subsidiary to the main issue dissected and analysed above. For the sake of completeness, however, I will consider just two of these subsidiary issues:

**First,** is the effect of the Double Taxation Agreement concluded between Uganda and the United Kingdom. Articles 7 and 13 of that Agreement confer certain benefits on UK residents (and Ugandan residents). In the instant case, however, suffice to say that the separate entities were not UK residents. To that extent, they obviously could not then and cannot now benefit from that Agreement.

**Second,** there are internationally accepted principles on the recognition and treatment of income. This Court is satisfied that those accounting principles do indeed apply in this case. In particular, the Court is convinced that for purposes of accounting for the remittances effected by the Ugandan ITS Office to the respective entities abroad, the Ugandan Office was a branch of INERTEK London (i.e. dependent on INTERTEK), while the separate inspection entities were subsidiaries (i.e. independent of INTERTEK). These differences in classification have divergent implications for the recognition and treatment of the Ugandan tax liability of these entities.

**14.** In light of all the above reasons, this appeal must fail, with costs awarded to the Respondent.

**Ordered accordingly.**

James Ogoola

JUDGE

04/12/03

DELIVERED IN OPEN COURT, BEFORE:

Mubiru Kalenge, Esq — Counsel for the Appellant

Ms. Dorris Akol — Counsel for the Respondent

J.M. Egetu — Court Clerk

James Ogoola

JUDGE

04/12/03