

**THE REPUBLIC OF UGANDA**  
**IN THE HIGH COURT OF UGANDA AT KAMPALA.**  
**COMMERCIAL COURT DIVISION**  
**HCT - 00 - CC - CS - 63 - 2011**

- |   |   |                      |            |
|---|---|----------------------|------------|
| <b>1. STANDARD CHARTERED BANK (U) LTD.</b>      | } | <b>... Plaintiff</b> | <b>(U)</b> |
| <b>2. CENTERARY RURAL DEVELOPMENT BANK LTD.</b> |   |                      |            |
| <b>3. BANK OF BARODA (U) LTD.</b>               |   |                      |            |
| <b>4. BANK OF AFRICA LTD .</b>                  |   |                      |            |
| <b>5. DIAMOND TRUST BANK (U) LTD.</b>           |   |                      |            |
| <b>6. NATIONAL BANK OF COMMERCE (U) LTD.</b>    |   |                      |            |
| <b>7. ORIENT BANK LTD.</b>                      |   |                      |            |

**VERSUS**

**THE COMMISSIONER GENERAL**  
**UGANDA REVENUE AUTHORITY . . . . .**  
**Defendant**

**BEFORE: THE HON. JUSTICE GEOFFREY KIRYABWIRE**

**J U D G M E N T**

The plaintiffs are all Commercial Banks (hereinafter referred to as “the banks”) operating in Uganda and have filed this suit jointly as members of the Uganda Bankers Association.

The banks have brought this suit against the Commissioner General Uganda Revenue Authority (hereinafter referred to as “The Commissioner General”) for declarations that the issuance of bonus shares does not in substance amount to a distribution of accumulated profits of the company within the meaning of Section 2(W) (V) of The

Income Tax Act for such a transaction to attract withholding tax under Section 118 of the same law. The banks also seek a permanent injunction prohibiting the Defendant Commissioner-General from taking steps to enforce the said payment of withholding tax.

For the Commissioner-General it is averred that the said issue of bonus shares is liable to withholding tax within the meaning of Sections 83(1) and 118 of The Income Tax Act. It is also the case for the Commissioner-General that the suit is an attempt to fetter the Defendant's Statutory Mandate and in any event is premature as no assessment has been issued to banks on the matter.

As this case involved a determination on the law, the parties agreed to file written submissions regarding the dispute. From the submissions the court under Order 15 rule 1(5) shall frame the following issues;

- 1- Whether bonus shares are deemed dividends?
- 2- Whether the issue of bonus shares is in substance a distribution of profits by the banks to its shareholders?
- 3- Whether the issue of bonus shares is the subject of withholding tax?
- 4- Remedies

Mr. Oscar Kambona appeared for the Plaintiff while Mr. Ali Ssekatawa appeared for the Defendant.

### **The Facts**

The facts which are not disputed by either party are as follows. On the 5<sup>th</sup> November, 2010, the Minister of Finance Planning and Economic Development issued a new Statutory Instrument known as The Financial Institutions (Revision of Minimum Capital Requirements) 2010 (S.I. 43 of 2010 herein after referred to “The Statutory Instrument”).

The Statutory Instrument required Commercial Banks to build up their minimum paid up share capital unimpaired by losses to Ug.Shs.10,000,000,000/= (Uganda Shillings Ten Billion) by 1<sup>st</sup> March, 2011 and Ug.Shs.25,000,000,000/= (Uganda Shillings Twenty Five Billion) by 1<sup>st</sup> March, 2013.

Thereafter the Governor of the Bank of Uganda wrote to all Commercial Banks in Uganda notifying of this new requirement. The Governor required that all Banks that did not meet this requirement do present a credible capital restoration plan to the Central Bank by the 31<sup>st</sup> December, 2010. The banks then considered that as part of their capital restoration plan, the capitalization of their retained reserves through the issuance of bonus shares to their existing shareholders. This capital restoration plan would enable these banks to increase their paid up capital to at least Ug.Shs.10,000,000,000/= (Uganda Shillings Ten Billion).

On the 20<sup>th</sup> December, 2010, the Uganda Banks Association (hereinafter referred to as “UBA”) wrote to the Commissioner-General and requested for a private ruling on the tax treatment for the bonus shares. In the said letter the UBA took the position that the issuance of bonus shares does not result in the bank’s (as companies) giving away any of its assets to its shareholders,

therefore such a transaction is not in substance a distribution of profits by the banks to their shareholders within the meaning of Sections 2(W) (V) of the Income Tax Act.

This distribution would thus not attract withholding tax within the meaning of Sections 83 and 118 of The Income Tax Act. In her reply, the Commissioner-General disagreed and took the view that the issuance of bonus shares was distribution of dividends from reserves. This is because in her view the bonus shares issued are assets with an ascertained value in the company's books, giving the shareholder an enduring entitlement to dividends and the fact that the assets of a company do not change again has no bearing of the tax liability of the transaction.

### **Issue No. 1: Whether bonus shares are deemed dividends**

Both parties addressed court on whether bonus shares should be regarded as dividends.

### **The Legal Arguments**

#### **For the Banks**

For the Banks it was submitted that, distribution of bonus shares from reserves of the bank was not to be deemed a dividend to its shareholders. Counsel for Banks submitted that the issue of bonus shares by a company to its shareholders by converting part of the companies retained reserved into share capital does not result in the company transferring or providing any of its assets to its shareholders. Furthermore, the transaction does not also involve the distribution of the company's profits to its shareholders. Counsel for banks submitted that the issue of bonus shares would only give rise

to a dividend, if, the value of the bonus shares issued by the company to its shareholders is deemed as an asset provided by the company to its shareholders and the value of bonus shares issued by the company to its shareholders is in a transaction which is in substance was a distribution of profits. Since the company has not given away any of its assets to its shareholders, the issue of bonus shares is not in substance a distribution of profits. Counsel for the banks submitted that following the issue of bonus shares to shareholders, their proportional interest in company remains the same.

Counsel illustrated the effect of issuing bonus shares using a hypothetical case. Assuming ABC Ltd has a share capital of Ug.Shs.100 represented by 100 shares held by 100 different shareholders and had an accumulated reserve of Ug.Shs.900.= then the balance sheet would look like this:-

ABC LIMITED'S			
BALANCE SHEET AS AT 31 <sup>ST</sup> DECEMBER, 2011			
Cash		Issued share capital	
100	1,000		
		Retained earnings	900
Total assets		Total shareholder's	
equity	<u>1,000</u>		

If ABC Ltd was to issue bonus shares of nine shares to every one share held (bonus issue of 9:1) that means each shareholder would be issued with nine free shares as bonus. This would increase the company's issued share capital to 1,000 (i.e. the original 100 shares

plus the 900 bonus shares) but reduce the reserves to zero. The balance sheet would then look like this:-

ABC LIMITED'S			
BALANCE SHEET AS AT 1 <sup>ST</sup> JANUARY, 2011			
Cash		1,000	Issued share capital
100			
			Retained earnings
			0
Total assets		<u>1,000</u>	Total shareholder's
equity	<u>1,000</u>		

This illustration show that whereas it is true that the issuance of bonus shares results in an increase of shares owned by a shareholder in the company, the value of the shareholders total shareholdings in the company does not change.

Counsel for the banks also relied on the holding of Lord Viscount Cave in **Inland Revenue Commissioners V Fisher's Executors** [1926] AC 395 at 401 - 2; where he quoted Lord Finlay in the case of **Inland Revenue Commissioners V Bloth** [1921] 2 AC 171, 184, 192 and 195

for the proposition that the issue of banks shares from undistributed accumulated profit was not income so as to found a claim for super tax.

**For the Commissioner-General**

Counsel for the Commissioner-General submitted bonus shares when issued are an asset provided to the shareholder in the form of additional shares, as a result of which the shareholder's asset base is enhanced. He submitted that in such a situation, the shareholder obtained property which is income in the shape of dividends or capital gains - rational or realized which may be derived in the future.

Counsel for the Commissioner-General submitted that by the banks issuing bonus shares to its shareholders, it was actually conferring on them a benefit which was not cash but still was an asset moving from the company to the shareholder.

He further submitted that the yardstick for determining whether a particular shareholder has received a benefit is not dependant on their participating rights in the company but on the increase in their shareholding from one point to another.

In this regard, he relied on the definition of dividend in Section 2(W) (V) of The Income Tax Act (Cap 340) which provides

*“...The amount of any loan, the amount of any payment for an asset or service, the value of any asset or service provided, or the amount of any debt obligation released, by a company to, or in favour of, a shareholder of the company or an associate of a shareholder to the extent to which the transaction is, in substance, a distribution of profits...” (emphasis as in submissions)*

Counsel also relied on the definition of payment in Section 2(xx) of the Income Tax Act which provides that payment

*“...Includes any amount paid or payable in cash or kind, and any other means of conferring value or benefit on a person ...”*

Counsel for the Commissioner-General submitted that these Sections read together were wide enough and actually did cover the issue of bonus shares as a dividend.

Counsel for the Commissioner-General also relied on the case of

**Swan Brewery V Rex** [1914] AC 231

In that case the company had not distributed all its profits in the past. It therefore accumulated a vast reserve fund. The company increased its capital from the reserve fund and issued shares pro rata. It was held by Lord Summer that the distribution of those shares was a dividend.

He submitted that what happened in **Swan Brewery** was exactly what the banks wanted to do in this case. Counsel submitted that once a dividend had been established, then, it was subject to tax under Section 83(1) of the Income Act for which withholding tax is to be paid under Sections 118(1) of the same Act.

Findings of the Court



I have addressed my mind to pleadings and the submissions of both counsels for which I am grateful. It would appear to me that with respect to the tax implications both parties agreed that a dividend once established is subject under Sections 83(1) and 118(1) of The Income Tax Act to taxation and the payment of withholding tax respectively. That indeed I find is the correction position of the law relating to the taxation of dividends of a company.

The question however, is whether the issue of bonus share is or should be deemed to be a dividend. What is or is not taxable is the subject of the written law. In the case of

**Stanbic Bank (U) Ltd & 7 Others V The Uganda Revenue Authority** HCCS 792 of 2006 and 170 of 2007 (consolidated)

I referred with approval to the speech of **Lord Simonds** in the case of

**Russell V Scott** [1948] 2 ALLER 1 at p2 where he held

*“... My Lords, there is a maxim of income tax law which, though it may sometimes be over stressed, yet not be forgotten. It is that the subject is not to be taxed unless the words of the taxing statute unambiguously impose a tax on him. It is necessary that this maxim should on occasion be reasserted and this is such an occasion ...”*

I find this applicable to this case as well in that the law should provide that the issue of bonus shares is taxable as income.

## What is a bonus share?

The Income Tax Act does not define or refer to bonus shares, so we shall have to look elsewhere for that definition. The author L.C.B Gower in his book Gower's Principles of Modern Company Law Fourth Edition has this to say about bonus shares

*"... the company does not require new money, but very reasonably wishes to bring the nominal amount of its issued share capital more into line with the true excess of assets over liabilities... This operation can be undertaken by means of a 'bonus' or 'scrip' issue, that is by issuing more shares to the existing holders and using the funds available for dividend but retained by the company to pay for them. By this means the reserves or share premium account, or some part of them are capitalized and converted into share capital ..."*

The learned author goes on to write

*"...from the point of view of the company, the capitalization of free, i.e. voluntary reserves merely means that undistributed profits have been permanently "ploughed back" and converted into share capital which as we shall see, cannot be returned to the members by way of dividend. Essentially a bonus share is nothing more sinister or subtle than a formal means of restoring share capital and net book value ..." (emphasis mine)*

To my mind the learned author makes a distinction between bonus shares and dividend in that once reserves have been ploughed back into bonus shares they cannot be returned to shareholders as dividends.

### **What is a dividend?**

The Gower (supra) explanation of what a dividend is, notwithstanding is still subject to the definition and tests to be found in Section 2 of the Income Tax Act. It is interesting to note that in the definition of dividend, Section 2 of the Income Tax Act does specifically in (W) (i) refer to preference shares though there is no direct reference to a bonus share, yet both of them are special classes of shares.

Counsel for the Commissioner-General prefer to take inference from Section 2(W) (V) that a bonus share is an asset for purposes of that subsection and hence falls within the meaning of a dividend.

### **Is a bonus share a dividend?**

An analogy was also made with the Swan Brewery case (supra) where funds had been transferred from the company's reserve funds and distributed to shareholders as new shares. In the said case (which was an appeal to the Privy Council from the Court of Appeal of Western Australia), the dispute rested the interpretation of The Dividends Duties Act of 1902 of Western Australia. Section 2 of that Act defined dividend as

*“... every profit, advantage or gain intended to be paid or credited to or distributed among the members ...”*

It is interesting to note the observation of **Lord Sumner** in that case when he stated (Swan Brewery supra P.234)

*“... in ordinary language the new shares would not be called a dividend nor would the allotment of them be a distribution of a dividend ...”*

However, because of the specific definition in The Dividends Duties Act of 1902, the Court did find the new shares to be an advantage and hence a dividend.

This to me appears to be authority for the proposition that in the absence of clear legislation in ordinary language and understanding bonus shares cannot be deemed to be dividends.

Perhaps the most detailed discussion on the issue on the authorities supplied to court can be found in the case of

**Commissioner of Income Tax, Bihar V Dalmia Investments** [1964] AIR 1464

The issue in that case, very much akin to the issue here, was whether the definition dividend in the Indian Income Tax Act extended to the issue of bonus shares.

In the Dalmia Investments case (supra), the Indian Court of Appeal disapproved of the Swan Brewery case (supra) because the unique definition of dividend in the Western Australian law.

In the judgment of Hidayatullah, J. he held at p. 221 that

*“... it is obvious that it was impossible to hold that the bonus shares were outside the extended definition ...”*

That to me is the same test to apply with respect to the Income Tax Act of Uganda; that is whether bonus shares would be included the extended definition of dividend in particular Section 2(W) (V).

The learned Judge continues at p. 222 to discuss the capitalization of bonus shares as follows

*“... it follows that though profits are profits in the hands of the company but when they are disposed of by converting them into capital instead of paying them over to shareholders, no income can be said to accrue to the shareholder because the new shares confer a title to a larger proportion of the surplus assets at a general distribution. The floating capital used in the company which formerly consisted of subscribed capital and the reserves now becomes the subscribed capital. The amount said to be payable to the shareholders as income goes merely to increase the capital of the company and in the hands of the shareholders the certificates are property from which income will be derived ...”*

In that case, the Indian Income Tax Act definition of dividend was said to extend in some directions but not so as to make the issue of bonus shares a release of reserves as profits so that they could be included in the term.

I am persuaded by the Dalmia Investment case (supra) and I find it is applicable to this case.

With the greatest of respect, I cannot agree that a bonus share is an asset which in substance is a distribution of profits, for purposes of Section 2(W) (V) of the Income Tax Act. If it is an asset then it is property from which future income could be derived through a declaration of a dividend which then would be taxable. I also do not agree that a reading of Section 2(W) (V) and (xx) extends or is wide enough to deem an issue of bonus shares to be a dividend. I find that bonus shares to be deemed a dividend should have unambiguously provided for in the same manner that preference shares were under Section 2(W) (i) of the same Act.

In light of my findings above, I answer the first issue in the negative.

**Issue No. 2: Whether the issue of bonus shares is in substance a distribution of profits by the banks to its shareholders.**

The bulk of this issue has been addressed in the resolution of issue one above and I shall not repeat the arguments here. However, there is an additional alternative submission that Counsel for the Commissioner-General made that I need to address.

Whether on close scrutiny the whole issue of bonus shares from retained/undistributed profits as opposed to other methods of capitalization will reveal a carefully crafted tax avoidance scheme?

### **The arguments**

#### **For the Commissioner-General**

It is the alternative submission by Counsel for the Commissioner-General that the recapitalization scheme by the banks is a tax avoidance scheme and that courts should not only concern themselves with the genuineness of the transaction but also with the intended effect of it on fiscal purposes. Counsel for this proposition relied on the case of

**WT Ramsay Ltd V IRC** [1981] 1 ALL ER 865

Counsel for the Commissioner-General wondered why the Banks were so keen to avoid an obligation of a tax incidence not on them but on their shareholders. Counsel for the Commissioner-General submitted that the banks still had open to them an option to

- a) Increase share capital and issue new shares
- b) Create a rights issue for existing shareholders to take an additional shares
- c) Issue preference shares

However, the option of bonus shares was to avoid the tax man and should not be allowed.

#### **For the banks**

Counsel for the banks submitted that the argument of tax avoidance was disrespectful as the banks consider themselves law abiding tax payers. Counsel submitted that the banks simply considered the issuance of bonus shares as the best method to raise additional capital. That this decision was taken after professional advice and that there was nothing wrong with the banks seeking a private ruling of the Defendant in this regard.

### **Findings of the Court**

As found earlier, the issuance bonus shares is not and cannot be deemed to be dividends within the meaning of the Income Tax Act.

I am persuaded to agree with the submissions of Counsel for the banks that this was simply a move to raise capital to meet the new statutory requirements. To my mind this was simply a “balance sheet restructuring” that is allowed under the law and is frequently done anyway in other jurisdictions. To my mind I would think that would be unfortunate if this type of balance sheet restructuring would be subject to income tax after all the overall balance sheet does not change and even dividends on the adjust shares cannot be guaranteed until the banks makes profits and declares dividends.

On the strength of this and my earlier findings, I also answer this issue in the negative.

**Issue No. 3: Whether the issue of banks shares is subject to withholding tax?**



In light of my earlier finding that the issue of bonus shares is not and cannot be deemed to be a dividend, it follows that such issue is not subject to income tax and therefore not subject to withholding tax.

## **Remedies**

Order 2 rule 9 of the Civil Procedure Rules provides

*“... No suit shall be open to objection on the ground that a merely declaratory judgment or order is sought by the suit and the court may make binding declarations of right whether any consequential relief is or could be claimed or not ...”*

The Plaintiff banks sought two remedies namely; a declaration and a permanent injunction.

As to the declaration, I hereby declare that the issuance of bonus shares does not in substance amount to a distribution of accumulated profits of the company in terms of Section 2(W) (V) of the Income Tax Act or at all for such a transaction to impose a withholding tax obligation on the banks under Sections 118 of the same law.

As to a permanent injunction in light of the clear declaration that I have made above, I find that there is no need to grant a permanent injunction; in any case no assessment for tax has been raised at this point in time. The prayer for a permanent injunction is accordingly declined.

As to costs given the nature of this declaration and its importance to both the banking sector and tax administration in Uganda which, provides clarity on the law I order that each party bears its own costs.

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**Justice Geoffrey Kiryabwire**

**JUDGE**

**Dated: 21/11/2011**

21/11/2011

09:50

Judgment read and signed in open Court in the presence of:

- Oscar Kambona for Plaintiff
- Angela Mugisha for Defendants

In Court

- No parties
- Rose Emeru - Court Clerk

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Geoffrey Kiryabwire

**JUDGE**

**Date: 21/11/2011**