THE REPUBLIC OF UGANDA

IN THE HIGH COURT OF UGANDA

COMMERCIAL DIVISION

HCT – 00 – CC - CS - 434 - 2011

BABIBAASA FRANK ..... PLAINTIFF

Versus

THE COMMISSIONER GENERAL URA ..... DEFENDANT

Before: The Hon Justice Geoffrey Kiryabwire

J u d g m e n t

The Plaintiff filed this suit against the defendant the for a declaration that the tax assessment of Ushs 60,909,264/= against him was without justification was wrongfully assessed, not due and therefore the tax collection enforcement measures made against him in respect of the said tax assessment was illegal.

The case for the plaintiff is that he as a tax informer/whistle blower supplied to the defendant information of companies which had evaded taxes in accordance with Section 21 of the Finance Act (No. 1) of 1999 and earned rewards totalling Ushs 212,330,838/= from the defendant during 2006 to 2008 for the information supplied.

The plaintiff further avers that on 24th August 2011, the defendant assessed tax of Ushs 60,909,264/= on the said rewards. Furthermore, that on the same day 24th August 2011, the defendant further issued an agency notice to collect the said tax, before the expiry of the statutory period allowed for him to objection and appeal the said assessment. The plaintiff avers that by letter dated 26th August 2011, he nonetheless objected to the assessment and agency notice, but the objection was rejected by the defendant on 12th October 2011.

In their defence, the defendant admitted that the plaintiff supplied information of companies which had evaded taxes in accordance with S. 21 of the Finance Act of 1999, received the rewards and was assessed for tax. The defendant however contended that the plaintiff earned taxable income between the period of 2006 to 2008 but never filed any returns, prompting the defendant to issue an estimated assessment in lieu of filing a return within the law, and hence the agency notice.

At the hearing of the case, the plaintiff was represented by Mr. C. Birungyi while the defendant was represented by Mr. M Mugabi. The parties agreed that since the issues for trial were points of law,

there was no need to call evidence and on this basis, the parties proceeded to file written submissions.

The issues agreed to by the parties in the joint scheduling memorandum were as follows;

1. Whether monies paid to the plaintiff as informers reward under S. 21 (1) of the Finance Act No. 1 of 1999 is taxable income under the Income Tax Act Cap 340.
2. Whether the agency notice against the plaintiff was lawfully issued.
3. Remedies.

Issue one: Whether monies paid to the plaintiff as informers reward under S. 21 (1) of the Finance Act No. 1 of 1999 is taxable income under the Income Tax Act Cap 340.

Counsel for the plaintiff submitted that for receipts to be chargeable, they must arise from a source and fall within the words of the charging section. Counsel for the plaintiff submitted that provision of information by the plaintiff to the defendant was provided for under the Finance Act (No. 1) of 1999 and is therefore a creature of statute. Counsel for the plaintiff further submitted that the provision of such information is not a business (as the defendant had asserted), and therefore a reward earned given there under is not business income for purposes of Section 18(1) of the Income Tax Act (hereinafter referred to as ITA). Counsel for the plaintiff further submitted that the plaintiff did not earn business income because he did not provide goods or services in return for a payment. Furthermore, that the bulk of the work involved as a result of the information the plaintiff supplied such as the audits, assessment and collection or enforcement was actually done by the defendant's own staff and that there was never a guarantee that the provision of this information would entitle the plaintiff to the reward under the Finance Act, because such a reward can only be obtained after the information has led to the recovery of tax. Counsel for the plaintiff relied on the cases of **JOSEPH MUSISI (Alias JOSEPH MUSIITWA KABUUSU) V COMMISSIONER URA & AG** (HCCS 72 of 2005) and **AHAMYA SAM V URA** (HCCS 487 of 2007) for the proposition that an informer cannot demand a reward on the basis of the information he has given unless and until that information has resulted into the recovery of taxes.

Counsel for the plaintiff further submitted that the defendant had classified the plaintiff's reward money "property income" under Section 20 of the ITA because the section makes provision for *'any other income'*. He however submitted that the reward money was not property income and that the words "any other income" in the section should be read ejusdem generis to arise out of exploitation of property by the plaintiff.

Counsel for the plaintiff further submitted that if the plaintiff had earned income as the defendant asserts then URA while paying the plaintiff the reward money should have applied the provisions of Section 119 of the ITA for withholding tax but did not do so, this shows that the defendant knew therefore that the plaintiff was not supplying any services or goods to it by providing tax evasion information.

On the other hand, Counsel for the defendant submitted that the monies paid to the Plaintiff as informers rewards are taxable income under the ITA, because income derived from all geographical sources is taxable unless it is exempted by the taxing Act. In this regard Counsel referred to Sections 4(1), 15 and 17 of the ITA, and submitted that the informers' rewards are taxable in accordance with these sections but not the exemptions under the provisions of Sections 21 of the ITA. Counsel for the defendant further submitted that the plaintiff in his objection dated 26th August 2011 acknowledged that the rewards were income to him and that the plaintiff can not rely on the provisions of Section 21(r) of the ITA to exempt the rewards because this section applies only to income of the Government of Uganda, but not to income which accrued to the plaintiff as an individual.

Counsel for the defendant further submitted that in interpreting tax statutes, one has to look at the words of the statute and construe them fairly and reasonably. Counsel cited the authorities of **CAPE BRANDY SYNDICATE V IRC** (1921) 1 KB 64, **LORD REID** in **IRC V HINCHEY** (1960) AC 748, and **ATTORNEY GENERAL V ASSOCIATED NEWSPAPERS LIMITED** (1994) 1 ALL ER 556, among others for this submission. Furthermore, that the monies received by the plaintiff are categorized as business income under Sections 18 (1) (d) and 2 (g) of the ITA, as income earned in an 'adventure in the nature of trade', because the supply of information by the plaintiff, leading to the recovery of tax was done with a legitimate expectation of a reward of 10% of whatever taxes had been recovered by the defendant. Counsel for the defendant relied on the case of **RUTLEDGE V THE COMMISSIONERS OF INLAND REVENUE** (1929) 14 TC 490 for the proposition that an adventure in the nature of trade was subject to tax.

Counsel for the defendant further submitted that the plaintiff is a taxpayer within the meaning of the term under Section 2(ttt) of the ITA, and that as a taxpayer, the plaintiff was obligated to file returns for the years 2006 to 2008 which he failed to do, hence the assessments by the defendant.

I have carefully considered the submissions of both counsels and the authorities referred to for which I am grateful.

It is an agreed fact in this case that the plaintiff earned rewards by supplying information. In this regard both parties referred to the provisions of Section 21 of the Finance Act (No. 1) of 1999. However, I have found that the said section is non existent. The relevant law is Section 9 of the Finance Act (no. 1) of 1999 which provides as follows,

> ***"Reward to person or officer relating to tax or duty.***
>
> ***The Commissioner General shall reward any person who provides information leading to the recovery of tax or who seizes any goods or by whose aid goods are sized under any law relating to tax or duty, with a reward of 10 per cent of the tax recovered."***

There has been some debate as to whether the plaintiff's rewards are taxable under the categories of 'business income' or 'property income' or in the further alternative as income earned under 'an adventure in the nature of trade'.

To my mind the starting point for the assessment of income tax has to be section 15 of the ITA which provides for "Chargeable income" as follows

> ***"..Subject to section 16 (not applicable here) the chargeable income of a person for the year of income is gross income of the person for the year less total deductions allowed under the Act for the year…"***

Section 17 (1) of the ITA then divides the gross income of a person for the year into three broad categories as follows

> *"…**the gross income of a person for a year of income is the total amount of—***
>
> ***(a) business income;***
> ***(b) employment income; and***
> ***(c) property income,***
> ***derived during the year by the person, other than income exempt from** tax…"*

Section 17 (2) then provides that for purposes of determining gross income different sources of income will apply to resident and non resident persons. The applicable subsection for resident persons (which applies to the plaintiff) is Section 17 (2) (a) which provides

> "… **the gross income of a resident person includes income derived from all geographical sources** ;"(Emphasis mine).

In the Objection Decision of the defendant from the URA to the plaintiff dated 12th October 2011 signed by Ms Irene Mbabazi Irumba (Ag Manager Kampala Central) it is stated that the plaintiff's reward money was property income within the meaning of Section 20 (1) (d) of the ITA as *"any other income derived by a person"*. Ms Irumba writes

> ***"…from the above provisions of the law and in the absence of any statutory exemption of rewards in the Finance Act that provided for the rewards to informers and section 21 of the Income Tax Act or any other provisions of the Act, the income accruing or accrued to Mr. Babibaasa Frank is part of his gross income and therefore chargeable to income tax…"***

A close look at Section 20 of the ITA in sub section (1) (a) to (c) while referring to property income gives the examples of dividends, interest, natural resource payments, royalties, the value of any gifts and contributions made to a retirement fund or the provision, use or exploitation of this property. Counsel for the plaintiff submitted that sub section (d) that refers to any other business should be

read ejusdem generis with the rest of that section. I am inclined to agree with Counsel for the plaintiff and find that reward money would not fall within the same bracket of property income as the rest of the same section which appears as income from various types of investments. I find that the position taken by the defendant in the objection decision was therefore erroneous.

Conversely the objection by the plaintiff dated 26th August 2011 that the said reward money was income of the government of Uganda and therefore exempt from tax under Section 21 (r) of the ITA is equally untenable. The reward money would accrue to the plaintiff personally while the tax proceeds would go to the Government and the two are distinctly different.

Counsel for the defendant took another position from the objection position that reward money was a business within the meaning of Section 2 (g) of the ITA namely being an "adventure in the nature of trade". The term 'adventure in the nature of trade' has not been defined in the ITA however in case of RUTLEDGE V. IRC [1929] 14 TC 490, where the tax payer, while on business in Berlin for a cinema company in which he was interested, accepted an offer of toilet paper which he sold at a profit of over 10,000 pounds. This was found to be an adventure in the nature of trade. Lord Clyde held that,

> *"…It* ***seems quite plain that the appellant in buying the large stock of toilet paper entered upon a commercial adventure or speculation. This adventure or speculation was carried through in exactly the same way as any regular trader or dealer would carry through any of the adventure or speculation in which it was his regular business to engage, and therefore, the purchase and resale of the toilet paper was an adventure in the nature of trade within the meaning of the Income Tax Act 1918"(Emphasis mine)***

It follows therefore that an adventure in the nature of trade incorporates an aspect of trading. The provision of information leading to the recovery of tax can not be an adventure in the nature of trade.

Clearly whether or not reward money is chargeable income has interpretational challenges as both parties have had difficulties establishing the position of the law on rewards of this nature. I have found no direct Ugandan case on the subject. In the case of **AHAMYA SAM V URA** (HCCS 487 of 2007)**,** for example the court dealt only with the issue of when a person becomes entitled to the reward. However it is necessary for me to establish the correct position of the law on this point.

Authorities from other jurisdictions however have held that the rewards earned by a whistle blower (*qui tam payments*) are taxable. This question was considered in the case of **ALBERT D. CAMPBELL V COMMISSIONER OF INTERNAL REVENUE** (134 T.C. No. 3 UNITED STATES TAX COURT filed January 21, 2010). In that case the petitioner omitted $5.25 million net proceeds of the qui tam payment from the calculation of taxable income and contended that the qui tam payments were not taxable but failed to identify any authority for excluding from his taxable

income the $5.25 million net proceeds of the qui tam payment. The respondent contended that the qui tam payment is a taxable reward and should be included in petitioner's gross income. The trial Judge Wells held that,

> ***"Gross income is "all income from whatever source derived". Courts have given a broad construction to the definition of gross income. Commissioner v. Glenshaw Glass Co., 348 U.S. 426, 430 (1955). The effect of such a broad view of gross income is that exclusions from gross income are narrowly construed. Commissioner v. Schleier, 515 U.S. 323, 328 (1995)...this Court has considered the issue of whether a qui tam payment is taxable income. In Roco v. Commissioner, 121 T.C. 160 (2003), the taxpayer received a qui tam payment from the United States for his role as relator in an action pursuant to the FCA. The Court ruled that rewards are included in gross income pursuant to section 1.61-2(a), Income Tax Regs., and that the qui tam payment was the equivalent of a reward and, therefore, includable in the taxpayer's gross income. Roco v. Commissioner, supra at 164."***

The position from these US authorities is that rewards should be part of a taxpayer's gross income. This is because rewards was seen an income falling under the category of "income from whatever source derived". Furthermore US Courts tend to interpret exclusions from taxation rather narrowly. This in my finding will tally very well with our own Section 17 (2) (a) of the ITA which covers income from all geographical sources. In this regard I find the position in the US as stated in the above cases to be very persuasive.

Before I leave this issue it can be said that reward money is a benefit given to an informer for providing information leading to a collection in tax in which case it is also chargeable income under Section 58 (a) of the ITA which provides

"Indirect payments and benefits.

The income of a person includes—

(a) ***…a payment that directly benefits the person****…"* (Emphasis mine)

I find that the rewards earned by the plaintiff are payments directly benefitting him for the valuable information that he gave the Uganda Revenue Authority and is therefore chargeable income under Section 58 (a) of the ITA.

I further find that notwithstanding the wrong basis of the tax assessment by the defendant in the objection decision as a matter of law reward money is a chargeable income for the reasons given above under the ITA. I therefore answer the first issue in the affirmative.

Issue two: Whether the agency notice against the plaintiff was lawfully issued.

Counsel for the plaintiff submitted that for an agency notice to be issued under Section 106 of the ITA, two conditions must be fulfilled; first, the tax payer must have failed to pay the tax on the due date and secondly, the tax payable should not be the subject of a dispute in this regard Counsel relied on the case of **CADER V URA & STANDARD CHARTERED (U) LTD** (HCMA 734 of 2006).

Counsel for the plaintiff submitted that these two conditions were not present for the defendant to validly issue the agency notice. Counsel for the plaintiff further submitted that the ITA under Section 99 (1) allows a tax payer 45 days within which to object to an assessment, and in this case, the agency notice was issued within the time allowed for the plaintiff to object to the assessment, and therefore, it could not have been concluded that the tax payable by the plaintiff was not in dispute. Furthermore, that the agency notice was not in conformity with the ITA because it in effect denied the plaintiff his right to object to the assessment having been issued on the very same day the assessment was made. Counsel for the plaintiff submitted that this defect could not be cured by Section 98 of the ITA, because there was no legal basis for the issuance of the agency notice.

In reply, counsel for the defendant submitted that the plaintiff had adopted a restrictive approach in his interpretation of the Section 106 as Sub section (2) provides that the date specified in the notice under subsection (1) must not be a date before the money becomes due to the taxpayer, or is held on behalf of the taxpayer. Counsel for the defendant submitted that this provision means that an agency notice cannot be issued for tax a tax before it becomes due. Counsel for the defendant submitted that in this case each of the three assessments made by the defendant in respect of the plaintiff; the tax had become due before the date specified in the agency notice.

Counsel for the defendant further submitted that under Section 98 (3) (b) of the ITA, the only way an agency notice can be invalidated is;

(i) If it is not in substance and effect in conformity with the Income Tax Act and

(ii) If the person assessed or intended to be assessed or affected by the document is not designated in it according to common intent and understanding.

Counsel for the defendant submitted that following the tests above, the plaintiff was clearly designated in the agency notice according to common intent and understanding, and that the agency notice was in substance and effect in conformity with the Act because as stated in the objection decision of 12th October 2011, the intention of the notice was to recover tax from a non-compliant taxpayer who had not filed returns for three years of income and who was unlikely to file returns had the Commissioner not estimated his tax.

Counsel for the defendant further submitted in the alternative that, should Court be inclined to disagree with the defendant, all the actions of the defendant were within the confines of the ITA and the court in this regard be guided by the principles laid out by **Justice J.G Nyamu** in the Kenyan

case of **REPUBLIC V COMMISSIONER GENERAL OF KRA, COMMISSIONER OF CUSTOMS & EXCISE & KRA EX-PARTE: ARROW HI-FI LTD**, where he held that,

> ***"in the face of clear violation of the Act as indicated the harshness of the closure of business cannot in the circumstances be said to be unlawful or unfair. Where the taxman is within the four corners of the enabling law, the Court must uphold the provisions and it cannot substitute its sense of fairness or decision and would have no right to do so. Whether it is warrants of seizure or any other action of the Respondents they are all based on clear provisions of the law."***

I have considered the submissions of both counsels and read the authorities referred to therein.

Section 106 (1) and (2) of the ITA, provides for the recovery of tax and reads

> ***"Recovery of tax from person owing money to the taxpayer.***
>
> ***(1) Where a taxpayer fails to pay income tax on the date on which it becomes due and payable, and the tax payable is not the subject of a dispute, the commissioner may, by notice in writing, require any person—***
>
> ***(a) owing or who may owe money to the taxpayer;***
>
> ***(b) holding or who may subsequently hold money for, or on account of, the taxpayer;***
>
> ***(c) holding or who may subsequently hold money on account of some other person for payment to the taxpayer; or***
>
> ***(d) having authority from some other person to pay money to the taxpayer,***
>
> ***to pay the money to the commissioner on the date set out in the notice, up to the amount of tax due.***
>
> ***(2) The date specified in the notice under subsection (1) must not be a date before the money becomes due to the taxpayer or is held on behalf of the taxpayer."***

The requirements for issuing an agency notice are laid down by **Hon. Justice Remmy Kasule** in the case of **CADER V URA & STANDARD CHARTERED BANK** (HCMA 734 of 2006), as follows;

> "*...**court notes that the section can only be resorted to when:***

i. ***There is failure by a tax payer to pay income on a date the said tax is due and payable.***
ii. ***The tax payable is not the subject of a dispute.***
iii. ***There must be notice in writing.***
iv. ***The addressee of the notice must be owing or holding or has the authority to pay money belonging to the tax payer.***
v. ***The notice must be issued by the Commissioner.***
vi. ***The notice must have in it the date when money is to be paid to the Commissioner****."*

It is the case for the plaintiff that the agency notice was illegally issued against him. On the other hand the defendant asserts that the tax had become due but was not paid hence the issue of the said notice against him.

In resolving this question, it is necessary for the court to determine when tax is said to be due and owing. Section 103 of the ITA, provides for when tax is payable and reads

*"**Due date for payment of tax.***

(1) Subject to this Act, tax charged in any assessment shall be payable—
(a) in the case of a taxpayer subject to section 96, on the due date for furnishing of the return of income to which the assessment relates; or
(b) in any other case, within forty-five days from the date of service of the notice of assessment." (Emphasis mine)

In this case, the plaintiff did not make a self assessment and therefore, the provisions of Section 103(1)(b) of the ITA are applicable. The Commissioner issued assessment notice no. 89849/201, on 24th August 2011, and an agency notice dated 24th August 2011. Reading Sections 106 and 103 (1) (b) of the ITA, it would appear to me that the tax only became due and payable after 45 days of service of the notice of assessment. It therefore follows that the agency notice having been issued on the same day as the assessment notice it was issued before the tax payable became due and owing. Furthermore, it could not be said that the tax was not in dispute before the lapse of the 45 days. It is apparent that the defendant for some reason was in hurry to collect this tax from the plaintiff. The agency notice was therefore issued in violation of Sections 103 (1) (b) and 106 (1) of the ITA and is therefore defective.

Having found that the agency notice is unlawful, the next question to be considered by the court is whether this defect can be cured by Section 98 (3) of the ITA as submitted by the defendant. According to Section 98(3) of the ITA,

> *"**No notice of assessment, warrant or other document purporting to be made, issued or executed under this Act—***
>
> ***(a) shall be quashed or deemed to be void or voidable for want of form; or***

(b) shall be affected by reason of mistake, defect or omission therein, if it is, in substance and effect, in conformity with this Act and the person assessed or intended to be assessed or affected by the document is designated in it according to common intent and understanding."(Emphasis mine)

To my mind this provision above only validates a defect in the notice or other document where the irregularity therein is one of form, but the said document can none the less still be said to be issued in accordance with the Act. In this case however, I have already found that the agency notice is not in conformity with the ITA and therefore, it can not be cured by Section 98(3) of the said Act. It therefore follows that the agency notice was unlawfully issued.

Issue three: Remedies.

Having found that the rewards earned by the plaintiff are taxable, the plaintiff is not entitled as he prayed for to the declaration sought in respect of the assessment by the defendant. These declarations are accordingly rejected.

With respect to the agency notice, having found that the agency notice was unlawfully issued, it is declared that the third party agency Notice dated 24th August 2011, issued by the defendant is unlawful and is hereby quashed.

The plaintiff prayed in the plaint prayed for damages but did not submit to Court on this prayer nor provide Court with an assessment for the damages. Court shall therefore not make a finding on this prayer.

The plaintiff having been partially successful in this matter I award him half of the taxed costs of this suit.

…….……

Geoffrey Kiryabwire

JUDGE

Date: 21/01/13

21/01/13

10:24 a.m.

Judgment read and signed in open court in the presence of;

- Faruk Kitaaka for Defendant
- P. Katutsi h/b for E. Barata for Plaintiff

In Court

- Plaintiff
- Rose Emeru – Court Clerk

……

Geoffrey Kiryabwire

JUDGE

Date: 21/01/2013