THE REPUBLIC OF UGANDA

IN THE HIGH COURT OF UGANDA AT KAMPALA

(COMMERCIAL DIVISION)

HCCS NO. 751 OF 2015

TARGET WELL CONTROL UGANDA LIMITED:::::::::::::::: PLAINTIFF

VERSUS

COMMISSIONER GENERAL,

UGANDA REVENUE AUTHORITY :::::::::::::::::::::::::::::: DEFENDANT

BEFORE: THE HON. JUSTICE DAVID WANGUTUSI

J U D G M E N T:

Target Well Control Uganda Limited herein called the Plaintiff sued the Defendant Commissioner General Uganda Revenue Authority seeking the following;

1) A declaration that equipment lease payments do not attract withholding tax deductions under Double Taxation Agreement between Uganda and the United Kingdom
2) A declaration that the Plaintiff is entitled to input tax credit of UGX. 23,191,098.47/= on invoices issued by Neptune Petroleum Uganda Limited.
3) An injunction against the Defendant restraining collection measures against the Plaintiff in respect of tax the subject of this suit.

The Plaintiff also seeks general damages and costs.

The Plaintiff a limited liability company incorporated under the laws of Uganda with its head office at Plot No. 8A/8B, M189 Kabalega Close, Luzira was leased Directional Drilling Equipment by Target Well Control (UK) a limited Liability Company, incorporated in the United Kingdom. The purpose of this equipment was to enable her carry on business of oil field operations.

In their relationship the Plaintiff would pay Target Well Control (UK) Limited money for the lease of equipment. It is the Defendant's contention to which the Plaintiff objects that that

money should have been subjected to Withholding tax under section 83(1) of the Income Tax Act which the Plaintiff would remit to the Defendant.

According to the Plaintiff the Defendant carried out comprehensive tax audits on the Plaintiff Company for the period January 2011 to May 2014. On 5th June 2015 the Defendant assessed tax of UGX 1,957,185,593/= **ExhP2**, in the following terms;

a) Corporation tax credit of UGX 200,176,619/=
b) Withholding Tax of UGX 1,230,855,735/=
c) Pay As You Earn of UGX 545,427,194/=
d) Value Added Tax of UGX 180,902,664/=.

The Plaintiff through its agent Deloitte (Uganda) Limited objected to the findings of the Defendant. In a letter dated 24th July 2015, **ExhP3** the Plaintiff contended that they were entitled to claim input tax for reverse charge Value Added Tax (VAT) incurred in the period starting 1st June 2011 to 30th June 2012. That the repeal of Regulation 13 of the Value Added Tax Act did not affect the rights of taxpayers to credit for VAT on imported goods.

One of the grievances of the Plaintiff was that the Defendant disallowed input tax of UGX. 99,670,264/= on grounds that they were not tenable. In its assessment the Defendant had disallowed VAT refunds on goods supplied by Neptune Petroleum Uganda Limited more specifically claims based on invoices dated 16th August 2012 and 21st September 2012.

The reasons given by the Defendant for refusal were that the supplier Neptune Petroleum Uganda Limited was not a registered collector of VAT. Secondly, that Neptune did not in any case remit the VAT that was collected in respect of the supplies of the two invoices mentioned above.

It is the Plaintiff's contention that the VAT Act is silent about such remittances being a prerequisite for claiming an input tax credit. That in any case, it is not the responsibility of the tax payer to ensure that their suppliers have remitted VAT to Uganda Revenue Authority before claiming credit.

The other grievance was that the Defendant demanded withholding tax on proceeds which arose from the intercompany equipment lease payments by the Plaintiff to Target Well Control (UK) Limited.

Aggrieved by the decision of the Defendant, the Plaintiff filed this suit seeking a declaration that; equipment lease payments do not attract withholding tax deductions under the Double Tax Agreement between Uganda and the United Kingdom. Furthermore, that the Plaintiff Company was entitled to recover VAT in respect of invoices issued by Neptune Petroleum Uganda Limited, an injunction restraining the Defendant's collection measures against the Plaintiff, general damages and costs of the suit.

The issues before trial were;

1. **Whether the Plaintiff is liable to pay withholding tax on the intercompany lease payments?**
2. **Whether the Plaintiff is entitled to input tax credit in respect of invoices issued by Neptune?**
3. **What remedies are available to the parties?**

On the issue of whether the Plaintiff is liable to pay withholding tax on the intercompany lease payments, Section 4 of the Income Tax provides for charge of income tax. Section 4 provides that;

> *"Subject to, and in accordance with this Act, a tax to be known as income tax shall be charged for each year of income and is imposed on every person who has chargeable income for the year of income."*

Except as exempted or deducted by way of credit, every person with an income shall be liable to pay income tax. Following Section 4 of the Act non-resident persons like Target Well Control (UK) Limited are provided for under Section 83 of the Income Tax Act on international payments. It reads;

> "*Subject to this Act, a tax is imposed on every non-resident person who derived any dividend, interest, royalty, rent, natural resource payment, or management charge from sources in Uganda."*

The Defendant based its demand for the tax from the Plaintiff under Section 83 of the Income Tax Act.

The relationship between the Plaintiff and the Defendant is however heavily influenced by the International Agreements executed between Uganda and the United Kingdom.

International Agreements are provided for under Section 88 of the Income Tax Act. It provides;

> *"(1)An international agreement entered into between the Government of Uganda and the Government of a foreign country or foreign countries shall have effect as if the agreement was contained in this Act."*

By Section 88, the international agreement is sort of fused with the Act only that where there are conflicting provisions Section 88 (2) provides;

> "*To the extent that the terms of an international agreement to which Uganda is a party are inconsistent with the provisions of this Act, apart from subsection (5) of this Section and Part X which deals with tax avoidance, any other law of Uganda dealing with matters covered by this agreement, the terms of the international agreement prevail over the provisions of this Act and any other law of Uganda dealing with matters covered by this agreement."*

In my view therefore the solution to the matter in issue will generally be solved by the International agreement between Uganda and the United Kingdom.

Since the matter in this instant case involves issues of double taxation the provisions to be applied will be that in the United Kingdom/Uganda Double Taxation Convention.

On 23rd December 1992 Uganda and the United Kingdom signed what was called UK/Uganda Double Taxation Convention. The Convention came into force a year later on 21st December 1993 and effective in Uganda 1st January 1994.

The Convention was for "*avoidance of double taxation and the prevention of fiscal evasion with respect to taxes and capital gains*."

The taxes which formed the subject of the Convention were in the United Kingdom as follows;

i. The income tax
ii. The corporation tax

iii. The capital gains tax

As for Uganda it encompassed Income tax including income tax charged on corporations. It also provided for taxes that would come into being in future as long as it was identical or substantially similar to the existing taxes of the state.

The Application of the Convention is provided for in section 88(1) of the Income Tax Act which provides;

> *"An international agreement entered into between the Government of Uganda and the Government of a foreign country or foreign countries shall have effect as if the agreement was contained in the Act."*

The tax intended to be collected by the Defendant streams from the relationship between Target Well Control Uganda Limited and Target Well Control (UK) Limited.

That being the case, the Convention will be applicable as well as the Income Tax Act and where they conflict, the Convention will prevail; ***Section 88(2) of the Income Tax Act***.

For taxation to take place there must be an income from a source in Uganda. In this case it is not in dispute that the Plaintiff leased Directional Drilling Equipment from Target Well Control (UK) Limited. It is also not in dispute that the Plaintiff paid for the use of equipment.

This is clear from the testimony of George Soden PW1 who appeared and testified on behalf of the Plaintiff.

It is however the Plaintiff's contention that they are not liable to pay tax because it would amount to double taxation since the United Kingdom and Uganda signed a Double Tax Convention.

Article 7 provides that the profits of an enterprise of a contracting state shall be taxable only in that state unless the enterprise carries on business in the other contracting state through a permanent establishment situated therein.

It is an acceptable principle of Double Taxation Convention that an enterprise of one state shall not be taxed in the other state unless its business in the other state is carried out through a permanent establishment.

This means that unless an enterprise sets up a permanent establishment in another state, it should not be taxed.

The rationale is that an enterprise resident in State A should not be liable to tax on profits it earns in State B where it is not resident unless it has a permanent establishment.

So for the Defendant to collect withholding tax from the Plaintiff, it has to prove that the Plaintiff is a permanent establishment of Target Well Control (UK) Ltd.

Article 5(2) lists what constitutes a permanent establishment. It reads;

> "The *term permanent establishment includes especially;*
>
> *(a) A place of management*
> *(b) A branch*
> *(c) An office*
> *(d) A factory*
> *(e) A workshop*
> *(f) Premises used as a sales outlet for receiving or soliciting orders*
> *(g) A warehouse in relation to a person providing storage facilities for others*
> *(h) A mine, an oil or gas well, a quarry or any other place of extraction of natural resources*
> *(i) An installation or structure used for the exploration or exploitation of natural resources."*

According to Article 5(3) the foregoing would not constitute a permanent establishment unless the infrastructure lasted more than 183 days.

The Plaintiff gave herself a description as a limited liability company incorporated under the laws of Uganda with its head office at Plot 8A/8B M189 Kabalega Close Luzira where it carried on business of oil field operations.

In the course of her business as an Upstream Oil Field Service Company, the Plaintiff sought and hired Directional Drilling equipment from Target Well Control (UK) Limited. The Plaintiff provides equipment and personnel to oil companies in the drilling business.

Soden George PW1 stated that they leased and paid for the equipment. It is this payment that the Defendant wanted to tax under section 83(1) of the Income Tax Act mentioned earlier in this judgment.

The Plaintiff however contends that she is not liable to pay tax because it is forbidden by the Double Taxation Agreement between Uganda and United Kingdom.

The issue here for resolution is whether the Plaintiff was a permanent establishment of Target (UK). The other question is whether the two Targets simply traded ***with*** each other or Target Well Control (UK) Limited traded ***in*** or ***through*** Target Well Control Uganda Limited. If they simply traded ***with*** each other, the Defendant could not collect tax. If Target Well Control (UK) Limited trade ***in*** the Plaintiff, then the Defendant would be justified in collecting tax because then it would be Target Well Control (UK) Limited doing business here.

The relationship in this case was that Target Well Control (UK) Limited owned Directional Drilling Equipment which it leased to the Plaintiff. PW1 for the Plaintiff testified that Target Well Control (UK) Limited charged the Plaintiff for the use of the equipment in Uganda. This evidence remained unchallenged.

That being the case Target Well Control (UK) Limited simply traded ***with*** Target Well Control Uganda Limited and not ***in*** or ***through*** the Plaintiff. Coming back to permanent establishment, it should be noted that the basic considerations are that there should a country of residence in this case Target Well Control UK Limited and a source country which in this case is Uganda.

There are therefore two jurisdictions. In one is found the legal entity (country of residence) United Kingdom and the other no legal entity (source country) Uganda.

For a permanent establishment to exist, the party in the source country must be dependent on the other. The question that arises here, was Target Uganda dependent on Target Well Control (UK) *Limited?* In the absence of permanent establishment in the taxing country, no tax would be collected. The Permanent establishment must have a fixed place of business like an office or warehouse where business for the external party is conducted.

Note that merely conducting research or administration is not enough. It is a facility that is fixed with some degree of permanency and business, that generates revenue at that site. The said site must be identified with Target Well Control (UK) Limited.

If the party in the taxing country is an agent, then its activities may be attributed to the other party as the principal.

This however only happens when the following three principles are satisfied. Firstly, the agent must be dependent on the principal. Secondly, the interaction in business must be regular or habitual and thirdly, the agent must act in the name of the principal. Also note that all the three principles must exist.

An example here is that, the agents office must also be the principal's office or at the disposal of the foreign party for a substantial period. It must be one through which the business is carried. The facility must be at the disposal of the foreign company at the disposal of the foreign company without doubt.

The dependence of the source country must be of ''*real significant and substantial economic connection.*''

In the present case, there is no evidence that shows that the offices of the Plaintiff which by all intents were a separate entity to Target Well Control (UK) Limited, were at the disposal of the foreign enterprise. There is also no evidence to show that the Plaintiff economically depended on the Target Well Control (UK) enterprise. On the other hand all the evidence shows that the Plaintiff was a business entity that hired from Target Well Control (UK) Limited or bought equipment from Neptune to do its work. This work is in no way connected to that of Target Well Control (UK) Limited which simply leased out the equipment.

The need for proof of what amounts to a permanent establishment is well stated in ***Nokia Networks vs JCIT June a Commentary Article 5(7) of the Model Convention***. This was a case of a company with a subsidiary relationship but which I feel lays the emphasis on the permanent establishment subject. It held;

> ''*It is generally accepted that the existence of a subsidiary company does not, of itself constitute that subsidiary company a permanent establishment of its parent company.*''

I agree with the above finding because it is a well established principle of corporate tax that a subsidiary has separate legal existence from that of its parent and should be treated as a separate entity even for tax purposes.

The Court went on to say;

''It could only be a permanent establishment if it met the physical or representative presence.''

They proceeded to hold that merely providing administrative support services (such as telephone or fax or conveyance services) did not make it a permanent establishment. They further held that if a subsidiary was to be a permanent establishment by default, Article 5 would have specifically stated so. It has been authoritatively held that for a representative presence to exist, the dependent agent must routinely conclude contracts on behalf of the foreign enterprise.

In the present case there is no proof that the Plaintiff did or had authority to conclude contracts on behalf of Target Well Control (UK) Limited.

The Plaintiff was an independent legal entity which entered into independent drilling agreements. It used equipment it hired from Target Well Control (UK) Limited and paid for them. Moreover it was taxed on the profits it made from its activities.

Furthermore, it had its own personnel and there is no evidence to show that the human resource was supplied by Target Well Control (UK) Limited under its control and direction. Even if the Plaintiff supplied administrative support, that would not constitute her into a permanent establishment; ***Formula One World Championship Ltd vs Commissioner Tax International, 3 Dehli & Anor. Civil Appeal No. 38491/ 2017, 3850/ 2017, 3851/2017.***

There is also no evidence to show that the Plaintiff was an agent of Target Well Control (UK) Limited and that she was dependent, had regular and habitual dealings in the name of Target Well Control (UK) Limited . The absence of one of the foregoing principles perforated the relationship of Agent and Principal in as far as permanent establishment is concerned.

What seems to have come out of the proceedings is that the business premises of the Plaintiff was not at the disposal of Target Well Control (UK) Limited as her fixed place of business through which she ran her affairs wholly or even partially. There is no evidence to show that Target Well Control (UK) Limited had dominant control over the business that occurred at the Plaintiff's premises.

Taking a wholesome view of the relationship between the two, the Plaintiff had complete control of the premises and what occurred there. Target Well Control (UK) Limited did not even have any control over the drilling.

The sum total is that having failed to meet the physical or representative presence, the Plaintiff was never a permanent establishment.

Since under the Convention, Target Well Control (UK) Limited would only pay tax if it was shown to trade or act through a permanent establishment, and this has not been established, it is my finding that it is not liable to pay the tax as its collection was barred by the double taxation covenant between Uganda and UK.

As to whether the Plaintiff is entitled to input tax credit in respect of invoices issued by Neptune, the Plaintiff contended that in the course of its operations more specifically on 16th August 2012 and 21st September 2012 it bought supplies from Neptune Petroleum Uganda Limited with VAT inclusive. Its claim for refund of VAT was however rejected by the Defendant on the ground that Neptune was not registered.

Secondly, that in any case it had not remitted the taxes allegedly collected by it. The Defendant insisted that it could only refund what she had received.

The Plaintiff contended that it paid VAT on the stabilizers and other equipment that were supplied by Neptune. It relied on **ExhP9**, an invoice issued by Neptune Petroleum Uganda Limited to show that Neptune was a tax collector and therefore an agent of the Defendant.

The Plaintiff further contended that Neptune was registered and that it was not until February 2013 that it was deregistered. That its supply was made on 16th August 2012 and 21st September 2012 when Neptune Petroleum Uganda Limited was still registered. That since Neptune was a registered tax payer at that time; it had to charge VAT which made it an agent of the Defendant to whom it was obliged to remit the tax.

Furthermore, since Neptune was registered as a tax payer, the public was justified to consider it so unless notified of its deregistration. The Plaintiff argued that it was not its duty to find out who was registered and who was not registered. That on the contrary it was the Defendant's duty to track down businessmen and demand for payment from those who had not paid. Their argument was that in a situation such as this one, the Plaintiff as a taxable person had a right to claim a credit for input tax as long as he/she was supported by tax invoices.

One of the arguments of the Defendant was that the Plaintiff should have exercised due diligence to find out whether Neptune was VAT registered and also followed up to ascertain whether she had remitted to the Defendant the tax that was collected.

With due respect I do not agree with that argument for the simple reason that it does not make sense to require a taxable person to follow up a payment and find out whether the agent has remitted the tax so collected from him or her.

This would be asking the Plaintiff to do a very difficult task because first of all he has no access to the agent's returns and books of accounts. Secondly, it is the Defendant who has access to the books of businessmen in the country. They are the ones who find out returns that are recklessly made or made intentionally to deceive.

It is clear under section 65(3) of the Value Added Tax Act that as an agent, the collector in this case Neptune was obliged to remit the money. The failure to declare or remit the money is punishable under section 65(6) (a) and (b). It provides;

> *"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 official 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."*

From this section is seen a relationship between the agent and the Defendant. It is this section which enables the Defendant to follow up and cause penalty using section 65(6) (a) and (b) as a sanction.

The tax laws make it clear that collection of tax is the sole responsibility of the Defendant. Where a taxable person claimed for VAT, it was the Defendant's duty to take on the party that received the money from the person. It as I said before could never be the duty of the payer to ensure that the money was remitted. Even where the Plaintiff did not do due

diligence, the Defendant was obliged to demand it from Neptune and the latter was obliged to hand over the tax to Uganda Revenue Authority.

Moreover it is not in dispute that the Plaintiff did purchase goods from Neptune Petroleum Uganda Limited. It is undisputed that the Plaintiff bought equipment from Neptune Petroleum Uganda Limited whose Tax Identification Number 1000027886 issued a Tax Invoice No 26 dated 16th August 2012 clearly showing that VAT of 18% was charged.

The invoice does not only show that Neptune received VAT of 18%, but also shows that as late as 16th August 2012 Neptune was still in existence doing business at their address located on Yusuf Lule Road formerly Plot 5 Kitante Road, Nakasero.

Considering the above, firstly that Neptune Petroleum Uganda Limited was a registered business in Uganda, with the full knowledge of the Defendant collecting VAT from its customers secondly, that it supplied goods to the Plaintiff. Thirdly, that the Defendant did not produce anything to show its deregistration. It is this Court's finding that the VAT collected by Neptune Petroleum Uganda limited from the Plaintiff during the period in question is recoverable by the Plaintiff.

As for the remedies, the Plaintiff also prayed for general damages. These are awarded at the discretion of the Court and are presumed to be the natural and probable consequence of the Defendant's act or omission; ***James Fredrick Nsubuga and Another vs Attorney General HCCS No. 13 of 1992.***

It follows that a Plaintiff who has suffered damage due to a wrongful act of the Defendant must be put in a position as near as he/she should have been in had he/she not suffered the wrong. In assessing these damages, Courts are guided by the value of the subject matter and the economic inconvenience that a party may have been put through; ***Kibimba Rice Limited vs Umar Salim SCCA No. 17 of 1992***

In the instant case, the Defendant unjustifiably withheld the Plaintiff's VAT refunds of UGX. 23,191,098.47/=. The Defendant therefore deprived the Plaintiff of the use of this money which as a business entity would have re-ploughed into its business. The Plaintiff has been deprived the use of this money since 5th June 2015. She therefore ought to be restored to the position she would have been in if the Defendant had not deprived her of the use of the money.

The Plaintiff did not however justify a big award as general damages.

Taking all the circumstances into consideration and the interest that would probably have accrued on this sum of money I find an award of UGX. 30,000,000/= appropriate.

In conclusion judgment is entered in favour of the Plaintiff against the Defendant in the following terms;

a) The equipment lease payments made to Target Well Control UK is not subject to withholding tax under the Income Tax Act as its collection was barred by the double tax covenant between Uganda and UK.
b) The Defendant is restrained from collecting any tax in respect of the tax the subject of this suit.
c) The Defendant refund UGX. 23,191,098.47/= as tax input credit.
d) Defendant to pay general damages of UGX. 30,000,000/=
e) Costs of the suit.

Dated at Kampala this 19th day of June 2019

HON. JUSTICE DAVID WANGUTUSI

JUDGE.