

THE REPUBLIC OF UGANDA
IN THE HIGH COURT OF UGANDA AT KAMPALA
(COMMERCIAL DIVISION)
CIVIL APPEAL NO. 26 OF 2016

GOLDSTAR INSURANCE LTD :::APPELLANT
VERSUS
UGANDA REVENUE AUTHORITY:::RESPONDENT

BEFORE: THE HON. JUSTICE DAVID WANGUTUSI

J U D G M E N T:

This is an Appeal against the finding of the Tax Appeals Tribunal between Goldstar Insurance Limited the Appellant and Uganda Revenue Authority the Respondent.

The Appellant seeks the following;

- a) That the Honourable members of the Tax Appeals Tribunal erred in law when they misconstrued the issue of contingency reserves as provided for in the Insurance Act and the Income Tax Act.
- b) That the Tribunal erred in law when it stated that contingency reserves are not allowable deductions under paragraph 3(c) of the 4th Schedule of the Income Tax.
- c) That the Tribunal erred in law and fact to rule that reserves are post profits items and therefore not deductible under the Income Tax Act.
- d) That the Tribunal erred in law and fact when it stated that the Applicant claimed that there is no relationship between contingency reserves and unexpired risks.
- e) That the Tribunal erred in law when they held that there was no evidence adduced by the Applicant to prove that the assessment for the year 2008 was time barred.

The Appellant then prayed that the decision and orders of the Tribunal be set aside with costs.

The Respondent conducted a Corporation Tax Compliance Audit on the Appellant covering the period 2008 to 2012 in relation to the treatment of contingency reserves. On 2nd October 2013 the Respondent served the Applicant its findings **RE1**. She wrote;

“We verified financial statements for the period 2008 to 2012 with special emphasis on the treatment of contingency Reserves. In determining the chargeable income of an insurance business, paragraph 3(d) of the 4th Schedule of the ITA Cap 340 allows for the deduction the amount of a reserve for unexpired risks.

Contingency reserves which are provided to cover fluctuations in securities and variations in statistical estimates are not allowable deductions because they do not fall under the category of reserves for unexpired risks referred to in paragraph 3(d) of the 4th Schedule of the ITA Cap 340.

Contingency reserves amounting to UGX. 1,815,897,000/= for the period 2008 to 2012 were claimed as deductions for corporation tax which resulted in the understatement of taxable profits/chargeable income.”

The Appellant rejected this assessment. In a letter dated 11th October 2013 **A6** Destiny Consultants Limited on behalf of her client the Appellant wrote to the Assistant Commissioner Compliance Management Domestic Tax Department;

“Reference is made to your letter of 2nd October 2013 addressed to our client Goldstar Insurance Co. Limited in respect to the tax treatment of contributions it makes to contingency reserves.

In your letter you propose to disallow for corporation tax purposes contributions made by our client to contingency reserves on grounds that the deductions are not covered by paragraph 3(d) of the 4th Schedule of Income Tax Act Cap 340.”

The objection was grounded on the following;

“On behalf of our client we object to your position and respond as follows.

Goldstar Insurance Company Limited hereinafter referred to Goldstar; makes transfers to the contingency reserves. The

contributions, which are a statutory requirement, are made in accordance with section 47(2) of the Insurance Act and have previously been claimed as a deduction for corporation tax purposes.

Section 47(2) (c) of the Insurance Act requires an annual transfer to contingency reserves equal to 2% of the gross premium income, or 15 % of the net profits, whichever is the greater, until the reserves accumulates to an amount stipulated by the Act.”

On 17th October 2013 the Respondent wrote to the Insurance Regulatory Authority of Uganda, **RE7** requesting for advise on the purpose of Contingency Reserves and how they are computed to enable them give the appropriate tax treatment to insurance firms.

In a response dated 22nd October 2012 **RE8** the Insurance Regulatory Authority of Uganda referred to Contingency reserves as per section 47 of the Insurance Act Cap 213. She wrote;

“This is one of the reserves an insurer must maintain in respect of each class of insurance business. The purpose of these reserves is to cover fluctuations in securities and variations in statistical estimates.”

As regards treatment in the financial statements the Insurance Regulatory Authority Uganda had this to say;

“The movement in the reserve for the year is charged in the statement of changes in equity and not the income statement because it does not meet the recognition criteria of the International Accounting Standard No.37(provisions contingent liabilities and contingent assets) to be accounted for in the income statement. As you are aware the IAS No. 37 requires that a provision shall be recognized where there is a present obligation arising out of a past event and it’s probable that an outflow of resourcing embodying economic benefit will occur. This is not the case with contingent reserves.”

Maintaining her prior findings as of 2nd October 2013 the Respondent replied by issuing a Corporation Tax Compliance issue audit dated 24th October 2013 **RE4** to the Appellant for the period 2008-2012 indicating a tax liability of UGX 699,319,467/= inclusive of penal tax. By the same audit the Appellant was advised to pay the UGX. 699,319,467/= immediately to avoid accumulation of interest on the outstanding stated sum. On 28th October 2013 the Respondent addressed the Appellant's objection to the tax assessment **RE3**. The Respondent wrote to the Appellant in these words;

“The movement in the reserve for the year is charged in the statement of changes in equity and not the income statement because it does not meet the recognition criteria of International Accounting Standard No. 37 (provisions, contingent liabilities and contingent assets) to be accounted for in the income statement. IAS No. 37 also requires that a provision shall be recognized where there is a present obligation arising out of a past event and it's probable that an outflow of resources embodying economic benefit will occur. This is not the case with contingency reserves.

In light of the above, we still maintain that contingency reserves which are provided to cover, fluctuations in securities and variations in statistical estimates are not allowable deductions because they do not fall under the category of reserves for unexpired risks referred to in paragraph 3(d) of the 4th Schedule of the ITA Cap 340...”

Aggrieved by the findings and decision of the Respondent the Appellant appealed to the Tax Appeals Tribunal. At the Tax Appeals Tribunal two issues were raised by the parties;

- 1) Whether the Applicant is liable to pay the tax assessed and;
- 2) What remedies and costs are available to the Parties?

The Appellant contended that the contingency reserves were allowable deductions under the Income Tax Act and that they were a statutory requirement under the insurance laws in Uganda.

The Appellant also argued that the assessment was done after the period of five years and therefore time barred. The Respondent in response contended that the Appellant's claims were

erroneous in as much as the Contingency reserves was not a deductible expense. It further contended that the assessment was not time barred.

During the hearing of the matter before the Tribunal the Respondent conceded that the International Accounting Standard No. 37 is not applicable to insurance business. According to the Respondent the rejection of the Applicant's claim was premised on the fact the 4th Schedule to the Income Tax Act does not provide for contingency reserves.

The Tax Appeals Tribunal convinced by the Respondent's arguments, dismissed the Appeal. The Appellant being aggrieved by the decision of the Tribunal filed this Appeal.

During the hearing of this Appeal the Appellant argued grounds 1 and 4 together and then proceeded to grounds 2, 3, and 5. The Respondent on the other hand narrowed the grounds to two. The first being; *whether the Tax Appeals Tribunal erred in law in holding that contingency reserves are not allowable deductions for income tax purpose. Secondly whether the tribunal erred in law in holding that the corporation tax assessment against the Respondent was not time barred.*

I have decided to deal with the first and second and fourth grounds of Appeal together. The first ground of appeal is that the Tribunal erred in law when it misconstrued the issue of contingency reserves as provided for in the Income Tax Act. The second ground of appeal is that the Tribunal erred in law when it stated that Contingency reserves are not allowable deductions under Paragraph 3(c) of the 4th Schedule of the Income tax Act.

The fourth ground of Appeal is that the Tribunal erred in law and fact when it stated that there is no relation between contingency reserves and unexpired risks.

The second ground of appeal as to the Tribunal having erred in law when it stated that Contingency reserves are not allowable deductions under paragraph 3(c) of the 4th Schedule of the Income Tax Act it was the Appellant's contention that any expenditure or loss incurred in the production of income is an allowable deduction in insurance business law as provided for under paragraph 3(c) of the 4th Schedule of the Income Tax Act.

An allowable deduction in this case would be a deduction on any item or expenditure subtracted from gross income to reduce the amount of income subject to income tax. The Respondent

contended that since Section 22 of the Income Tax Act which provided for allowable deductions on expenses of derived income was silent on contingency reserves, the Act did not bring contingency reserves under the purview of allowable deductions.

Section 22 of the Income Tax Act provides;

“22. Expenses of deriving Income

Subject to this Act, for the purposes of ascertaining the chargeable income of a person for a year of income there shall be allowed as a deduction;

(a) all 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;

(b) the amount of any loss as determined under Part VI, which deals with gains and losses on the disposal of a business asset during the year of income, whether or not the asset was on revenue or capital account; and

(c) in the case of rental income , 20 percent of the rental income as expenditures and losses incurred by the individual in the production of such income.”

The above section does not provide for contingency reserves as an allowable deduction in form of expenditure or losses. The Appellant however contended that since section 47 of the Insurance Act compels them to set aside sums of money as contingency reserves, the amount can be equated to expenditure and therefore be deducted from their gross income in computing tax payable.

In this case the Court was required to determine whether the Tribunal was right in holding that the Contingency reserves of the Appellant resulting from the compulsion of section 47 (1) (c) of the Insurance Act were not allowable deductions under Paragraph 3(c) of the 4th Schedule of the Income Tax Act.

Paragraph 3(c) of the 4th Schedule of Income Tax Act dealing with Chargeable Income arising from Short term insurance Business provides;

“ The total deduction allowed for a year of income in the production of income from carrying on a short-term insurance business is the sum of –

(c) the amount of expenditures and losses incurred by the person during the year of income in carrying on that business which are allowable as deduction under this Act other than expenditure or losses referred to in paragraph (a) and (b).”

Contingency reserves are provided for in section 47 (1) (c) of the Insurance Act which refers to insurance reserves as follows;

“An insurer shall establish and maintain in respect of each class of insurance the following reserves;

(a) Reserves for unexpired risks.

(b) Reserves for outstanding claims

(c) Contingency reserves to cover fluctuations in securities and variations in statistical estimates.”

The Appellant contended that the contingency reserves under the Insurance Act were a legal requirement for a specific purpose namely to fill in the gap in event of need like compensation or other monetary needs. That in that case it was not an earning or profit as would attract tax. That that being the case it was deductible in arriving at the taxable profits of the Appellant, which was an Insurance Company governed by the provisions of the Insurance Act, Cap 213.

To deal with the matter, one has to consider what happens with the Contingency reserve at the end of the year. Can one say that because of the legal requirement of section 47 of the Insurance Act, the money so reserved had been lost by the Appellant? In my view the amount standing to the credit of the Contingency Reserve could not be said to have gone out of the hands or control of the Appellant and therefore become subject of ownership by someone else. It is true the Act did impose certain restrictions of the money by the Appellant but that did not mean that the amounts had ceased to belong to the Appellant.

The money did not only remain that of the Appellant, but he could even invest it for profit. This is borne out by the evidence of the Managing Director of the Appellant Mr. Azim Fahrani who

when asked by the Tribunal at what stage the contingent reserves were converted to income replied in these words;

“Until such a time when the insurance Company goes out of business. Otherwise, it may not happen. We use contingent reserves to invest.”

Investment in this case was directly connected with the Appellant’s business. It was utilized and enjoyed by her. The fact that the Appellant was required by the Act under section 48 of the Insurance Act to invest, did not in any way affect this position.

The Appellant continued to be the owner of the investment and even where the benefit derived by the Appellant from the investment was limited; it was still the Appellant’s investment. The mere fact that the Act required the Appellant to make an appropriation out of her revenues for particular purposes and also that it was a compulsory appropriation which the Appellant had to make, did not mean that for the purpose of income tax such appropriation would necessarily be deducted to arrive at the profits and gains of the Appellant’s business.

It still remained that the amount appropriated towards the Contingency reserves was collected and received by the Appellant as Premium for insurance cover of her clients. The amount remained at the disposal of the Insurer in this case the Appellant and for her benefit. The purpose for which the Contingency reserve could be used was all for the Appellant’s business payment for compensation and other liabilities envisaged in insurance was all normal business of an Insurance Company like that of the Appellant.

In the case of ***Associated Power Co. Ltd vs Commissioner of Income Tax [1996] 218 TIR 185/ 1996 AIR 894,1996 SCC(7) 221*** court disallowed the argument that contingency reserves were expenditures wholly and conclusively laid out for the assessee’s business and should be allowed as a deduction. The court held that the money had been set apart for meeting unknown future liabilities. It was not a provision but a reserve. There had been no expenditure in the real sense of the term. Furthermore, that though the amount of reserves could be utilized for certain purposes, the nature of the purposes as indicated within the law were not general. They were specific. For those reasons, the appropriation to the contingency reserve account was not an allowable deduction.

From the foregoing it is clear that setting aside contingency reserves was not diversion of income before it reached the Appellant, but rather a case of setting aside a portion of the Appellant's income under force of law for the use and benefit of the Appellant. In other words, the amount appropriated into contingency reserves still formed part of the real income of the Appellant.

Furthermore, much of this money remained un-utilized and would as in the words of the Managing Director of the Appellant, be *invested*. Once it becomes an investment it is put out of the ambit of expenditures and as such cannot be an allowable deduction.

I want to conclude that what is deducted must be sums of money that were used in the production of income. In this case contingency reserves were not used in the production of income but were the income themselves.

In conclusion Contingency reserves for Insurance Company are not allowable deductions for purposes of tax.

The foregoing in my view disposes off grounds one, two and four of the Appeal.

On the third ground of appeal that the Tribunal erred in law and fact to rule that reserves are post profits items and therefore not deductible under the Income Tax the Appellant contended that this was an error because contingency reserves were allowable deductions and therefore could not have been subjected to tax. Counsel for the Appellant submitted that the Contingency reserves were put aside before profit is calculated.

She further submitted that contingency reserves were expenses and profit could only be obtained after their removal. She referred court to the Income Statement of the Appellant of the year ending 31st December 2008. She submitted that both the 2% of the gross premium income and the 15% of the Net profits were all profits before tax.

I have studied the evidence on record and I am of the considered opinion that the 2% referred to under section 47 (2) (c) of the Insurance Act is a sum of money that is appropriated in reserves before tax because it is from gross premium income. As for the 15%, it is an appropriation after tax.

The majority of reserves unless specifically provided for by legislation are items that come after tax because these are retained earnings which arise out of the profitable operations. And this is so because if a company makes losses, no reserves are made so therefore no reserves are recorded. These reserves which are portions of profit are earned through a company's normal operation and then set aside for any particular purpose or strengthening of the company. That is why a reserve account is an asset and forms the most liquid asset in a business.

For those reasons, the Tribunal was correct when it held that monies that are put aside for a Contingency Reserve Fund are done after profits have been taxed.

Turning to the last ground of Appeal the Appellant asked court to find that the Tribunal erred in law when they held that there was no evidence adduced by the Applicant to prove that the assessment for the year 2008 was time barred.

Matters of time are in section 95 and 97 of the Income Tax Act.

Section 95 on the assessment reads;

“95. Assessments

(1) Subject to Section 96, the Commissioner shall, based on the taxpayer's return of income and any other information available, make an assessment of the chargeable income of a tax payer and the tax payable on it for a year of income within five years from the date the returns were furnished.”

Section 97 of the same Act provides as follows;

“(1) Subject to subsections (2) and (3), the Commissioner may, within three years after service of a notice of assessment, make an additional assessment amending an assessment previously made.

(2) Where the need to make an additional assessment arises by reason of fraud or any gross or willful neglect by, or on behalf of the tax payer, or the discovery of new information in relation to the tax payable for any year of income, the Commissioner may make an assessment for that year at any time.

(3) *The Commissioner shall not make an additional assessment amending an assessment in respect of an amount, if any previous assessment for the year of income in question has in respect of that amount, been amended or reduced pursuant to an order of the High Court of the Court of Appeal unless such order was obtained by fraud or any gross or willful neglect.”*

While the assessment must be made five years from the date the returns were furnished, an additional assessment can be made amending the previous one within three years from the time the first one was made. The issue before this court would then be whether the original assessment was made within five years and if there was an additional assessment, within three years from the first one.

There are issues of time and therefore called for hearing through evidence to establish the time the Appellant submitted her returns.

It therefore had to be an issue before the Tribunal so as to enable both parties to present through evidence what they wanted the Tribunal to believe on limitation of time.

To answer this one has to look at the issues that were before the Tribunal. These were three issues namely;

- a) Whether amounts transferred by the Applicant to the Contingency reserves as per the Insurance Act fall within paragraph 3 (d) of the 4th Schedule of the Income Tax Act and qualify as allowable deductions under the Income Tax Act?
- b) Whether assessments issued by the Respondent are justified?
- c) What are the costs and remedies available to the Applicant?

The foregoing issues were the ones that the Tribunal was asked to look into by the Appellant. Those being the issues the evidence that was drawn out of the witnesses must have been geared towards the issues that were under investigation. I have gone through the evidence. The only time AW1 Ronald Akankwasa talked of time that would otherwise be relevant to limitation was when he stated the month that an audit was done. He said;

“ The audit was carried out in October 2013 by the Respondent.”

The second witness was Azim Fahrani. He did not give any evidence that concerned time limitation.

For this matter to be resolved properly the Appellant had to adduce evidence on the dates that they submitted their returns that led to the assessment. When this court asked Counsel when they had made their submissions she replied;

“My Lord unfortunately I do not have the documetation.”

In the absence of those dates, the Tribunal could not have been able to calculate and come up with an answer based on the evidence that the assessment had been done out of time.

Furthermore, the issue of time was not one of those included in the statement disputing the assessment. That being the case, even the Respondent was denied the chance to adduce evidence in support of their position. There was therefore no evidence adduced by the Appellant.

I accordingly find that the Appellant by pursuing the claim of limitation of time when she did not make any pleadings as to that effect and also failed to adduce evidence as to the entitlements of that defence, has no justification to fault the Tax Appeals Tribunal for its finding that there was no evidence to prove time bar; ***Uganda Revenue Authority vs Wanume David Kitamirike Civil Appeal No. 43 of 2010.***

The ground of Appeal fails.

The sum total is that after subjecting the evidence as a whole to that fresh and exhaustive scrutiny, it is my finding that the Appellant’s criticism of the Tax Appeals Tribunal that it did not properly scrutinize and evaluate the evidence adduced at hearing and by implication that, if it had done so would have rejected the Respondent’s pleas and accepted the Appellant’s instead unjustified.

This Appeal therefore lacks merit and is dismissed with costs.

Dated at Kampala this 20th day of February 2019

**HON. JUSTICE DAVID WANGUTUSI
JUDGE**