THE REPUBLIC OF UGANDA
IN THE HIGH COURT OF UGANDA AT KAMPALA
(COMMERCIAL DIVISION)

CIVIL APPEAL NO. 007 OF 2021
ARISING FROM TAX APPEALS TRIBUNAL APPLICATION NO. 23 OF 2019

M-KOPA UGANDA LIMITED :: APPELLANT

VERSUS

UGANDA REVENUE AUTHORITY :: RESPONDENT

(Before: Hon. Justice Patricia Mutesi)

JUDGMENT

Background

1. This is an appeal from the ruling and orders of the Tax Appeals Tribunal (hereinafter "the Tribunal") in Application No. 23 of 2019 which challenged 2 tax assessments issued by the respondent on the appellant on 3rd December 2018. The assessments were in respect of the periods 1/1/2016 – 31/12/2016 and 1/1/2017 – 31/12/2017. The 1st assessment was for tax of UGX 402,435,515 which the appellant ought to have withheld on interest paid to M-KOPA LLC in the 2 periods. The 2nd assessment was for interest on the tax not withheld.

2. The brief background of the appeal, as can be gathered from the record of the Tribunal, is that the appellant is a limited liability company carrying on the business of supplying solar lighting devices in Uganda. The appellant started its operations in Uganda sometime 2013 after borrowing start-up capital from M-KOPA LLC and M-KOPA Funding Ltd which were both non-resident tax payers. Between 2013 and 2015, the 2 companies did not charge interest on the loan. However, in 2016, the 2 companies merged and started charging interest on the loan balance at the time at the rate of 13% per annum from 2016 until full repayment.

3. Sometime in 2018, the respondent conducted a comprehensive review of the appellant's tax compliance for the period from January 2013 to December 2017. During that review, the respondent established that the

appellant is controlled by M-KOPA LLC incorporated in the United States of America which owns 99.9% of the appellant's shares. The respondent also discovered that although interest was charged on the loan balance from 2016 onwards, the appellant had neither declared nor paid any withholding tax on that interest. Accordingly, on 3rd December 2018, the respondent issued 2 assessments on the appellant in respect of withholding tax arrears and interest thereon.

4. The appellant objected to the assessments arguing that the accrued interest on the loan balance had not yet been paid, yet withholding tax on interest accruing to a non-resident only becomes payable at the time when that interest is actually paid. The respondent disallowed the objection. The appellant was dissatisfied and appealed the objection decision to the Tribunal. After hearing evidence from both parties, the Tribunal ruled that the appellant had paid interest on the loan balance and that, as such, ought to have withheld tax on those payments. The Tribunal, therefore, upheld the assessments.

The Appeal

5. The appellant was aggrieved by the ruling and orders of the Tribunal and appealed to this Court on the following 3 grounds:

> ***"1. The Honourable Members of the Tribunal erred in law when they held that interest was paid to MKOPA LLC and that the appellant ought to have withheld tax on that interest.***
>
> ***2. The Honourable Members of the Tribunal erred in law when they relied on the contra proferentum rule to interpret the statement of cash flow against the appellant.***
>
> ***3. The Honourable Members of the Tribunal erred in law when they failed to evaluate the evidence thereby reaching a wrong conclusion that the appellant was liable to pay the tax assessed."***

Duty of the High Court in tax matters

6. Section 27(2) of the Tax Appeals Tribunal Act Cap 345 provides that an appeal may be made to the High Court from a decision of the Tribunal on questions of law only. In **Uganda Revenue Authority V Tembo Steels Ltd,**

High Court Civil Appeal No. 9 of 2006, this Court explained that the intention of the legislature in enacting that provision was to leave questions of fact, such as the accuracy of tax assessments, to tax professionals at the appellant and at the Tribunal, and to reserve to this Court only points of law for determination.

7. Therefore, in appeals from the Tribunal, this Court entertains and decides questions of law only. Nevertheless, since the failure to exhaustively and objectively appraise evidence constitutes an error of law, this Court may, after finding that the Tribunal is guilty of such an error, reappraise the evidence adduced in the Tribunal and draw its own inferences of fact (see **SWT Tanners Ltd & 14 Ors V Commissioner General, URA, Court of Appeal Civil Appeal No. 172 of 2019**).

Representation

8. At the hearing of the appeal, the appellant was represented by Mr. Oscar Kamusiime from M/S Birungyi, Barata and Associates while the respondent was represented by Ms. Diana Mulira and Mr. Alex Ssali Aliddeki from the respondent's Legal Services and Board Affairs Department.

Determination of the appeal

9. The central question in this appeal is whether the appellant actually paid interest on the loan to M-KOPA LLC for the period 1/1/2016 – 31/12/2017 and, consequently, whether the appellant ought to have withheld tax on that interest. I have fully considered the materials on record, the submissions of the parties and the laws and authorities cited. Since all the 3 grounds are related, I will resolve them concurrently.

10. On ground 1, counsel for the appellant submitted that the Tribunal misconstrued Sections 47 and 83(1) of the Income Tax Act Cap 340. Counsel stated that Section 83(1) imposes income tax on every non-resident person who derives interest from sources in Uganda while Section 47(2) provides that where interest is subject to withholding tax, the interest is taken to be derived or incurred when paid. Counsel faulted the Tribunal for upholding the impugned assessments yet there was no

evidence adduced to prove that the appellant had actually paid any interest to M-KOPA LLC.

11. On ground 2, counsel for the appellant criticised the Tribunal's reliance on the contra proferentum rule in the interpretation of a cash flow statement. Counsel emphasised that the said rule is only applicable to the interpretation of ambiguities in contracts and that it is irrelevant in the construction of financial statements. On ground 3, counsel pointed out that the Tribunal ignored the fact that the respondent did not challenge the testimony of AW1 (Monica Kasirye Kavuma – the appellant's Head of Finance) which confirmed that the appellant had not paid interest for 2016 and 2017. Further, counsel clarified that the appellant's bank statements did not show any single interest payment to M-KOPA LLC as confirmed by RW1 (Azarius Asasira – a Tax Officer in the Tax Inspection Unit of the respondent's Large Taxpayers' Office). Counsel also stressed that the respondent failed to adduce independent evidence proving that the interest had been paid.

12. In reply to the appellant's submissions on ground 1, counsel for the respondent pointed out that the during the comprehensive review of the appellant's tax compliance, the respondent received and analysed the appellant's financial statements and tax returns, among other records, for the period between January 2013 and December 2017. The appellant's financial statements indicated that the appellant had incurred interest on the loan balance during 2016 and 2017. The appellant's income tax returns also indicated that the appellant had deducted the interest from its income before tax for the respective years. Counsel submitted that these financial records proved that the interest had actually been paid.

13. On ground 2, counsel for the respondent submitted that the Tribunal's decision was largely based on the doctrine of estoppel and not on the contra proferentum rule, but that, in any case, there is nothing that stops the Tribunal or this Court from applying the contra proferentum rule to tax matters such that the words in financial documents submitted to the respondent are taken strongly against the tax payers who seek to rely on them. Finally, on ground 3, counsel for the respondent submitted that the appellant failed to discharge its burden of proof to show that it is not liable

to pay the taxes assessed. Counsel supported the analysis and findings of the Tribunal on the evidence adduced.

14. Section 25(1) of the Income Tax Act provides that:

> ***"Subject to this Act, a person is allowed <u>a deduction for interest incurred</u> during the year of income in respect of a debt obligation to the extent that the debt obligation has been incurred by that person in the production of income included in gross income."*** (Underlining mine for emphasis).

The purpose of this provision is to allow people to deduct the interest they incur on business loans taken to produce gross income. The provision insulates businesses from such interest by classifying it as an allowable deduction in the tabulation of chargeable income for tax purposes.

15. In the instant case, it is not disputed that interest for the loan balance was expensed in both the appellant's financial statements and its income tax returns for 2016 and 2017. This had the effect of reducing the chargeable income, enabling the appellant to lessen its income tax liability for the two years. It is inconceivable that a business would lawfully expense a sum of money which is yet to be paid or incurred (See **High Court Civil Appeal No. 35 of 2020; Afgri Uganda Limited V Uganda Revenue Authority**). It is also implausible that a tax payer who has been requested to submit his or her financial records to the respondent for tax review would knowingly submit records which he or she is aware are false or inaccurate.

16. Counsel for the appellant suggested that the Tribunal ignored some of the appellant's critical evidence which had proved that interest payments had not been made to M-KOPA LLC during 2016 and 2017. The appellant had adduced its bank statement, which allegedly reflected all the appellant's transactions during the relevant period, reflecting no interest payment to M-KOPA LLC. The appellant had also adduced the testimony of AW1 who stated that the interest remains outstanding. In my considered view, the Tribunal considered all this evidence and correctly weighed it against the appellant's financials in which the appellant unequivocally stated that the interest had already been paid and expensed for tax purposes.

17. The admission in the appellant's financials and tax returns of 2016 and 2017 that the impugned interest had already been expensed constitutes a major contradiction in the appellant's evidence. Apart from fraud, there is no other logical or plausible explanation as to why a tax payer would tell the respondent that he or she has incurred an allowable expense during a year of income, thereby reducing that tax payer's tax burden, yet he or she has not actually incurred that expense.

18. There are numerous authorities laying down the principles upon which Courts should approach contradictions in evidence. Courts will readily ignore minor contradictions which do not go to the root of a party's case and which have been satisfactorily explained away. However, major contradictions which go to the root of a party's case and which have not been satisfactorily explained away often indicate untruthfulness and, almost invariably, lead to the rejection of that evidence. (See **Serapio Tinkamalirwe v Uganda Supreme Court Criminal Appeal No. 27 of 1998**.)

19. In the instant case, the said major contradiction in the appellant's evidence points to deliberate untruthfulness on the appellant's part. On the one hand, the appellant submitted income tax returns for 2016 and 2017 telling the respondent that it had incurred and paid interest on the loan balance amounting to UGX 1,720,474,000 and UGX 2,813,931,000 in 2016 and 2017, respectively. The appellant benefitted from this information since it was able to reduce its chargeable income during the 2 years. On the other hand, when the respondent discovered in 2018 that the appellant had neither declared nor paid withholding tax on the said interest, the appellant then turned around and claimed that it had not yet actually incurred and paid that interest. This, in my view, is the textbook definition of tax evasion and it is unacceptable.

20. To this day, the appellant remains a beneficiary of the 2016 and 2017 tax returns in which it expensed the impugned interest thereby reducing its tax liability. It is inconceivable that the same appellant, who is yet to amend those said tax returns and pay the would-be right amount of tax, now wants this Court to believe that the interest has never been paid.

21. A great deal of debate was presented in the Tribunal and in this Court regarding the weight of the appellant's adjusted financials which were

aimed at correcting what the appellant called accounting mistakes in the financials initially submitted to the respondent. In my view, such adjustments in the said financials remain unhelpful and inconsequential if they were never followed up with amended tax returns and additional tax payment after deletion of the interest earlier captured as an allowable deduction. The only evidence which would have compelled the Tribunal and this Court to find that the appellant indeed never paid the interest would have been amended tax returns and proof of payment of the respective additional tax. Accordingly, the omissions to file amended tax returns and to pay the respective additional tax significantly prejudice and undercut the genuineness and accuracy of the adjusted financials.

22. Furthermore, I agree with the respondent that accepting the appellant's arguments in this case could open the door for tax payers to take unfair advantage of the privileges afforded by Sections 25(1) and 47(2) of the Income Tax Act. Even by the time this appeal was heard, the appellant still claimed that it had not yet paid the impugned interest to M-KOPA LLC. The appellant seems to suggest that a resident tax payer can get a business loan from a non-resident tax payer and deliberately omit/refuse to pay the interest accruing thereon in perpetuity, even when his or her financials are strong enough to support that interest payment, thereby avoiding or evading the associated withholding tax altogether.

23. It is highly unlikely that this was the legislative intention behind Sections 25(1), 47(2) and 83(1) of the Income Tax Act. In my considered view, the insistence of the legislature on withholding tax becoming payable only when interest is paid was intended to protect tax payers who are financially struggling and who cannot pay the interest in time. By binding the date for withholding of tax to the date of the actual payment of interest, the law ensures that a tax payer will not be required to pay any withholding tax on interest which he or she is still struggling to come up with. Therefore, it seems to me that the appellant, who provided no evidence of its inability to pay the interest to M-KOPA LLC, is simply trying to take unfair advantage of the liberty provided by Sections 25(1), 47(2) and 83(1) of the Income Tax Act, and thereby circumventing and frustrating the legislative intention in those provisions.

24. With specific regard to ground 2 of the appeal, the Tribunal acknowledged that the contra proferentum rule is primarily a rule of contractual interpretation usually applied to standard-form contracts. I agree with the Tribunal's position that, strictly speaking, there is no bar to the application of the contra proferentum rule in the interpretation of ambiguities in non-contractual documents. Plainly speaking, the rule is rooted in the need to hold authors of documents accountable for any ambiguities therein. In the instant facts, the appellant was best suited to avoid the ambiguities in its financial statements and logically, any ambiguities therein ought to be interpreted against it. In any case, the appellant did not point out any particular prejudice that arose from the Tribunal's reference to that rule.

25. Nevertheless, even if this Court was to entertain the appellant's strict view that the contra proferentum rule is inapplicable to financial statements, I would still be hesitant to find that reference to the rule had any significant influence on the Tribunal's decision so as to irreparably taint it. I am satisfied that even if there had been no reference to the said rule, the doctrine of estoppel would still have naturally justified the Tribunal's findings on the cash flow statement.

26. The true ratio decidendi of the Tribunal's decision to this extent, was that a tax payer who has been asked by the tax collector to submit his or her financial statements and tax returns for review and who has submitted those records, cannot turn around later and claim that what he submitted should not be relied upon. Without a reasonable explanation as to how and why false, contradictory or unclear records were submitted, the tax collector is justified in relying on the records initially submitted. For this reason, even if the Tribunal's reference to the contra proferentum rule in its analysis of the cash flow statement had been erroneous, that error would be inconsequential.

27. Since the appellant's financials and tax returns showed that the interest had already been paid, the appellant ought to have withheld tax on that interest. The Tribunal was, therefore, right to uphold the assessments.

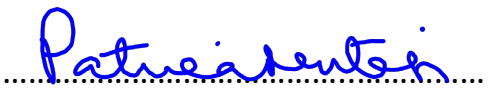
Reliefs

28. Consequently, the appeal fails and I make the following orders:

i. The appeal is hereby dismissed.

ii. The appellant is liable to pay the withholding tax plus interest thereon as assessed by the respondent.

iii. Costs of the appeal are awarded to the respondent.



Patricia Mutesi

JUDGE

(29/12/2023)