THE REPUBLIC OF UGANDA

IN THE TAX APPEALS TRIBUNAL AT KAMPALA REGISTRY

APPLICATION NO. 9 OF 2014

POLYPACK LIMITED ==========APPLICANT

VERSUS

UGANDA REVENUE AUTHORITY

MULTIPLE ICD LIMITED ========== RESPONDENTS

RULING

This ruling is in respect of an application challenging a Value Added Tax (VAT) assessment arising from rental income. Consent judgment was entered in respect of the principal tax of Shs. 260,977,334/= and interest of Shs. 5,394,923/=. The penalty of Shs. 603,793,001 under S. 65(3) of the VAT Act assessed by the 1st respondent was left to the Tribunal to determine. The claim of penalty of Shs. 226,635,254/- under S. 65(6) of the VAT Act was abandoned by the 1st respondent

The agreed facts giving rise to this application are as follows; The applicant owns premises located at Plot M 613, Ntinda, Industrial Area from where it operates and rents out part of the premises to Multiple ICD Limited, the 2nd respondent. The applicant and the 2nd respondent entered into a three-year tenancy agreement with effect from 1st August 2000 to 31st August 2003. It was renewed from 1st September 2003 to 31st August 2006. The 2nd respondent is still in occupation of the applicant's premises and has not paid rent since 1st September 2009 to 31st July 2014. One of the shareholders of the applicant Mr. Rajinder Singh is a shareholder in both the applicant and 2nd respondent.

At the scheduling conference the following issues were set down for resolution by the tribunal:

1. Whether the applicant is liable to pay VAT as assessed?

2. Whether the relationship between the applicant and Multiple ICD Limited is a scheme to obtain an undue tax benefit?

The applicant was represented by Ms. Jackie Aturinda and Ms. Belinda Nakiganda, while the respondent, by Ms. Nakku Mwajuma and later Mr. George Okello. Counsel for the 2nd respondent is Ms. Lorna Karungi.

When this matter came up for scheduling the Tribunal noticed that the 2nd respondent was a tenant of the applicant who claimed that the former had refused to pay rent and VAT. The 1st respondent contended that the applicant and the 2nd respondent were in a scheme to avoid paying taxes. The Tribunal noted that the applicant was a collecting agent of VAT. The Tribunal ordered the 2nd respondent be added as a party in order to effectively dispose of this matter. The 2nd respondent was added as a party. Eventually the parties reached a partial settlement whereby the 1st respondent and the 2nd respondent acknowledged that VAT was due on the rental services provided to the second respondent. The 2nd respondent agreed to pay tax of Shs, 217,466,481/= for the years 2006 to 2010 in response to the applicant issuing tax invoices. The dispute as to penalty was left to the Tribunal to determine. The parties agreed to call evidence on the remaining issue.

The applicant's first witness, Mr. Nirmal Shyam was its General Manager. He testified that the three shareholders of the applicant are directors of the 2nd respondent. He further testified that the 2nd respondent was the applicant's tenant from September 2000 to August 2006. The applicant sent an eviction notice to the 2nd respondent on the 14th March 2007. The 2nd respondent has been in occupation of the premises since 2006 to date. The 2nd respondent has not remitted rent. No invoices were raised. The applicant received a notice of assessment for VAT from the 1st respondent in August 2014. The witness stated that the 2nd respondent has not been the tenant of the applicant since 1st September 2006. The applicant did not take any court action against the 2nd respondent. It did not distress for rent. The witness admitted that one of its directors Mr. Rajinder Singh is the majority shareholder of the 2nd respondent so they

could not take action against it. The applicant raised tax invoices against the 2nd respondent after this application was filed. The 2nd respondent made the VAT payment directly to the 1st respondent.

The 2nd respondent's witness was Ms. Sunil Malhotna, its General Manager. She testified that Mr. Rajinder Singh Biranga was one of its directors. She admitted that 2nd respondent was a tenant of the applicant. The 2nd respondent received a letter from the 1st respondent in respect of rent the latter claimed it was paying rent to the applicant in its returns. However, the applicant was not paying rent as stated in the returns. The witness stated that the 2nd respondent was accounting on accrual basis and not cash. The witness claimed that the 2nd respondent did not receive a notice of eviction from the applicant. The 2nd respondent has never paid any rent to the applicant since 2007. The 2nd respondent is still occupying the premises to date. On cross examination the witness testified she was not in the employment of the 2nd respondent at the time the notice of eviction was purportedly delivered.

The 1st respondent's witness Ms. Kelemensio Busingye is its Manager Compliance. She testified that the 2nd respondent in its return claimed that it was paying rent to the applicant. From the returns of the applicant the said income was not declared. The applicant had made no VAT payments since September 2009. The 2nd respondent is still occupying the premises.

The applicant submitted that under S. 4 of the VAT Act a tax known as Value Added Tax is charged for the supply of goods and services. Under S. 11 of the VAT Act a supply of services includes the making available of any facility or advantage and the toleration of any situation or the refraining from doing any activity. Under S. 14 of the VAT Act provision for time of supply is made. It states that where goods are supplied under a rental agreement or law which provides for periodic payments, the goods or services are treated as successively supplied for successive parts of the period of the agreement and each successive supply occurs on the earlier date on which the payment is due or received. S. 18 provides that a supply of the provision of services is

made by a taxable person for consideration as part of his business activities. Under S. 18(4) of the VAT Act a supply is made for consideration if the supplier directly or indirectly receives payment for the supply. S. 18 of the VAT Act defines consideration as the total amount in money or kind payable for the supply by any person. From the above provisions the applicant contended that it made a supply of services up to 2006. Upon the expiry of the tenancy agreement the applicant ceased to make a supply as there was no rental agreement, no payment and income received. The applicant issued an eviction notice which the 2nd respondent did not acknowledge receipt thereof. The applicant submitted that it could not be said to have made a supply when there is no legal relationship between it and the 2nd respondent.

The applicant cited S. 65(3) of the VAT Act which provides for penal tax. It reads that a person who fails to pay tax on or before the due date is liable to pay a penal tax on the unpaid tax. For one to penalized under S. 65(3) of the Act one must have failed to pay tax on or before the due date. The applicant after August 2006 did not renew the tenancy agreement.

The applicant also cited S. 65(6)(a) of the VAT Act which provides for penal tax where one makes a statement to Uganda Revenue Authority that is false or misleading. The applicant contended that it did not make a false declaration to the 1st respondent as there was no rental agreement and the nil return was correct. The applicant is therefore not liable to the tax assessed, penalty and interest.

The applicant in the alternative, argued that in the event there was a tax liability, interest or penalty it should be borne by the 2nd respondent. The applicant submitted that the 2nd respondent made a false and misleading declaration to the 1st respondent with an intention to obtain an undue tax benefit by claiming it was paying rent so that it may be considered as an expense when there is no valid contract or invoices.

The 1st respondent submitted that a consent was filed which had the effect of altering the assessments and changing the state of affairs. The VAT was readjusted. The

consent confirmed that the only subsisting issue was that of penalty under Sections 65(3) and (6) of the VAT Act. The 1st respondent indicated that it had vacated the penal tax imposed under S. 65(6) of the VAT Act for the applicant never made any declarations that were false to the respondent. This left the issue of penal tax under S. 65(3) as the only outstanding issue.

The 1st respondent contended that since the principal tax had been agreed in the consent judgement therefore penal tax was due. Since the principal tax had not been disturbed there is no way the penal tax can be challenged. The applicant cited the case of *Hassanali v City Motor Accessories and another* [1972] EA 423 where the Court of Appeal held that a court cannot interfere with a consent judgment except in circumstances which would afford good ground for varying or rescinding a contact between parties.

The 1st respondent submitted that a taxable supply was made to the applicant by the 2nd respondent. The applicant made available a facility by means of a rental premise to the respondent. This arrangement was a commercial one for consideration. It did not matter that consideration was paid later. S. 1(d) of the VAT Act recognizes money payable for the supply as consideration.

The 1st respondent requested the tribunal to scrutinize the relationship between the applicant and the 2nd respondent. The two companies shared a majority shareholder. The 1st respondent would not have known about the rent paid as expenses if the 2nd respondent had not indicated it as expenses in its annual returns.

The 1st respondent also argued that a tenancy agreement should not be a condition precedent for a taxable person to make available a facility to another person. What is important is that a person makes available a facility.

The 1st respondent argued that the applicant neglected to perform its statutory duty of issuing invoices to the 2nd respondent. S. 29(1) of the VAT Act provides that at the time

of supply a taxable person should provide the other person with an original tax invoice. The 1st respondent contended that under S. 14 of the VAT Act the applicant ought to have issued an invoice for the entire period the premises were made available to the 2nd respondent. The 1st respondent cited the case of *Uganda Posts and Telecommunications Corporation v East African General Insurance Company Ltd* [1983] HCB 36 where the court held that where a tenant refuses to quit the premises after receiving a notice terminating the tenancy, the land lord has no option except to bring a suit to recover possession from the tenant. The 1st respondent contended that there was no evidence that service of notice to quit was served on the tenant.

The 1st respondent submitted that in the alternative that the applicant by conceding that the 2nd respondent should pay the penalty was an admission that it was due and payable. The 1st respondent contended that the applicant was assessed under S. 5 of the VAT Act. Since the 2nd respondent has paid the principle it only just and fair that the penalty is paid.

The 1st respondent contended that the penalty ought to have been paid monthly from September 2006 for the period the 2nd respondent was in occupation of the applicant's premises. Thus penal tax accrued with each month until the principal was paid upon the partial consent judgment.

The 1st respondent also contended that S. 75 of the VAT Act is applicable to the present case. That is the relationship between the applicant and the 2nd respondent fitted within the description of a scheme to obtain a tax benefit. The 2nd respondent should not be charged VAT while it continues to occupy the applicant's premises.

The 2nd respondent submitted that the applicant never indicated in it returns to the 1st respondent that it had not paid rent for the period in issue. The applicant never served any tax invoice to the 2nd respondent which was in violation of S. 29 of the VAT Act. The applicant attached two debit notes. However, the Tribunal notes that the said debit notes were not tendered in as exhibits during the hearings.

The 2nd respondent further contended that the applicant did not take any steps to evict it from the premises. It instead allowed the 2nd respondent to have quiet possession of the premises. Therefore, the applicant should pay the VAT, interest and penalties.

The 2nd respondent contended that the 1st respondent's submission that since the former accepted to pay taxes in the consent it should pay penalties as inconceivable. The 2nd respondent contended that the issue for determination before the Tribunal should be restricted to liability to pay penalties.

The applicant in reply to the 1st respondent's submission contended that the principal tax giving rise to the penal tax was paid by a consent judgement therefore the penal tax flowing from it cannot be challenged or disturbed. The applicant cited *Fosroc Chemicals (India) Pvt ltd v The state of Karnataka (Commissioner of Commercial Taxes)* where it was held that the imposition of penalty under S. 72(2) is not automatic. A discretion is conferred on the assessing authority to impose penalty. In CIR v Da Costa 1985 (3) SA 768 SATC where it was held that the Commissioner must be satisfied that any act or omission in the relevant subsection must be done with intent to evade taxation. The said principle was affirmed and extenuating circumstances should also be considered.

The applicant argued that it issued an eviction notice and the 2nd respondent refused to vacate. The 2nd respondent continued in occupation. These are special circumstances and are not covered by the normal interpretation of the VAT Act.

The applicant also contended that there was no scheme to obtain undue tax benefits under S. 75 of the VAT Act. The 2nd respondent made a false and misleading declaration with an intention to obtain an undue tax benefit by claiming an expense in the absence of a valid contract, invoices and payment of rent. The applicant contended any assessment against it is therefore wrong. It should be the 2nd respondent to bear the penal liability.

In reply to the 2nd respondent's submission the applicant contended that though there was an option to renew the agreement neither parties renewed it. The 2nd respondent occupied the premises despite protests by the applicant. Despite the 2nd respondent having paid VAT it has not paid rent. Mr. Rajinder Singh Biranga took advantage of his majority shareholding in both companies to oppress the minority shareholders.

In respect of S. 65 of the VAT Act the applicant made no statement or omission that was knowingly or reckless to warrant the application of the section. The applicant could not have received rent when there was no tenancy agreement and no income received.

In respect of taxable supply, the applicant contended there was no VAT output return there was no agreement and no basis for raising an invoices. The applicant argued that though tax was paid does not mean that there was a contract with the applicant.

The Tribunal taking into consideration the terms of the consent order, having listened to the testimony of witnesses, perused the record of evidence and read the submissions wishes to rule as hereunder.

The dispute between the parties arose from a tenancy on premises located on Plot M613 Ntinda, Industrial Area. The applicant and the 2nd respondent entered a tenancy agreement effective 1st August 2000 for 3 years. It was renewed on the 1st September 2003 for another 3 years which expired on the 31st August 2006 and was not renewed thereafter. The 2nd respondent continued occupying the said premises but was not paying rent.

However, the tax dispute arose when the 2nd respondent claimed that it was paying rent in its return. The 1st respondent issued a VAT assessment on the applicant who objected to it, hence this application. During the course of the trial the 2nd respondent was added as a party. The 1st respondent and 2nd respondent entered into a consent order where the latter agreed to pay VAT and interest. However, the issue of penalty was left hanging.

The Tribunal will not delve into the legality of the consent order. When parties enter into a consent, it resolves that issue in dispute. As long as it is entered without any duress, fraud or coercion or other grounds for rescinding a contract the Tribunal like any other court will not query it. However, the Tribunal notes that in the consent order the 1st respondent and the 2nd respondent were agreeable to the latter paying the principal VAT and interest thereon. The 2nd respondent is the actual consumer of services allegedly provided by the applicant. The applicant who is a VAT collecting agent is the actual tax payer was not found to be liable to pay the taxes and interest. Therefore, it becomes difficult to discuss the issue of penalty without looking at whether the applicant was liable to pay VAT. Whatever the decision of the Tribunal, the terms of the consent will not be varied or rescinded. They will remain intact.

The dispute on the VAT payment and hence the penalty hinges on the tenancy agreement between the applicant and the 2nd respondent. The applicant and the 2nd respondent renewed the first agreement by an agreement of 15th August 2003. The tenancy was renewed for a further term which expired on the 31st August 2006. Under Clause 2 of the Agreement the tenant was liable to pay VAT on the monthly rent. When the tenancy agreement expired there was no renewal but the tenant continued to occupy the premises.

It is without doubt that when a tenancy agreement expires after the period in the agreement, there is no contract. A contract can be renewed by the conduct of the parties. For instance, where the tenant continues to pay rent and the landlord accepts it. For a contract to exist the minds of the parties should be in agreement. Where the parties do not seem to be in agreement and a tenant continues to occupy the premises it does so as a tenant at sufferance. *Black's Law Dictionary* 8th Edition p. 1507 defines a tenant at sufferance as:

> "A tenant who has been in lawful possession of property and wrongfully remains as a holdover after the tenant's interest has expired."

It is good to note that Black's law Dictionary states that the tenant "wrongfully remains" on the property. If there is no interest or it has expired what is there to tax?

The 1st respondent contended that the applicant as landlord should have evicted the tenant at the expiry of the contract or served them with an eviction order. There is no legal requirement, whether by statue or equity, that compels a landlord to evict a tenant on the expiry of a tenancy. For a landlord to serve a tenant with an eviction notice to mark an end of tenancy though may be done is uncalled for and superfluous because the tenant is already in the wrong. The tenant should be aware that its tenancy has expired and has no interest any longer on the premises.

There is no fast and firm rule on how a tenant can be treated when a tenancy expires. There are many options that are available when a tenancy expires and the tenant continues to occupy the premises. The landlord can treat the tenant as a permissive tenant or tenant at will. *N Bweya Steel Works Limited v National Insurance Corporation (1985) HCB 58 the court held inter alia*

> A tenant at will is implied when a person is in possession by the consent of the owner. A tenant who with the consent of the landlord remains in possession after his lease has expired is a tenant at will until some other interest is created. In the present case the plaintiff remained in occupation after the expiration of three years' tenancy with the consent of the landlord, the defendant. Prima facie the plaintiff was a tenant at will unless some other interest was created.

Alternatively, the landlord may treat the tenant as a trespasser. Where a contract comes to an end and a tenancy continues to occupy the premises illegally or without the consent of the landlord it becomes a matter of trespass which is tortuous in nature. As to whether the landlord should file a suit against the tenant, that is at the former's discretion. A court and a Revenue Collecting Authority cannot compel the landlord to file a suit against a tenant who has refused to leave as it has financial and legal implications.

The matter of the applicant and the respondent was complicated by the fact that one of the shareholder of the landlord was a shareholder of the tenant. From the evidence adduced such as the omission of make a further renewal agreement, the failure to issue a VAT tax invoice and from the animosity between the applicant and the 2nd respondent it cannot be denied that the latter was occupying the premises without the consent of the former. The 2nd respondent took advantage of the majority shareholding to refuse to pay further rent.

S. 65 of the VAT Act provides that "a person who fails to pay the tax imposed under this Act on or before the due date is liable to pay a penal tax on the unpaid tax at a rate specified in the Fifth Schedule for the tax which is outstanding" The Fifth Schedule provides the rate of interest chargeable as penalty shall be 2% per month compounded. Therefore, a question arises as to whether the taxpayer failed to pay VAT on or before the due date.

Despite the fact that there was no renewal of the tenancy agreement the 1st respondent contends that the applicant made a VAT chargeable supply to the 2nd respondent. S. 4 of the VAT Tax Act provides that a tax known as Value Added Tax shall be charged on every taxable supply in Uganda made by a taxable person. It is not in doubt that the applicant was a taxable person and VAT registered. S. 10 of the VAT Act provides that a supply of goods means any arrangement under which the owner of goods parts with or will part with the possession of goods, including a lease. It is also not in issue that the applicant parted with possession of his premises which is deemed to be a supply of goods.

However, it is not all supplies that are liable to VAT. S. 18 of the VAT Act deals with taxable supplies. The applicant cited S. 18(4) of the VAT Act which provides that "A supply is made for consideration if the supplier directly or indirectly receives payment for the supply from the person supplied or any other person, including any payment wholly or partly in money or kind." S.1(d) of the VAT Act defines consideration to mean the total amount in money in kind or payable for the supply. The 2nd respondent did not

make any rental payments to the applicant. When the consent order was made the 2nd respondent paid the 1st respondent the VAT but there is no evidence to show that it paid rent to the applicant. There is no evidence to show that the applicant received consideration for any taxable supply to the 2nd respondent. There can be no supply under the VAT Act if there is a failure of consideration.

In order for the applicant to be liable for VAT, the liability must be clear. In this case the tenancy agreement had expired. The parties never agreed on any rent. VAT is imposed on rent agreed. When a tenancy expires, there is no law that states that the parties ought to continue charging the old rent. The landlord is free to review his rent. In short there is no consideration for the supply as the tenant wrongfully occupied the premises. The Tribunal does not think that the 1st respondent can benefit from a wrongful act or one which is tortuous in nature unless a court has made a finding thereon and passed judgement. Where a party is aggrieved by the actions of a tenant the former is free to file for an action for mesne rent/profits in trespass and general damages. Until a court has made a decision thereon it would be difficult to ascertain the rent payable and therefore VAT chargeable. If the 2nd respondent was a tenant at will the story would have been different.

S. 14(2)(a) of the VAT Act provides that where goods are supplied under a rental agreement the goods or services are treated as successively supplied for successive parts of the period of the agreement or as determined by law, and each successive supply occurs on the earlier of the date on which payment is due. The Tribunal has already noted that the rental agreement in this case expired. In the absence of a rental agreement the period when the goods are supplied becomes disputable where the tenant is not a tenant at will. S. 14(1) may be applicable where a tenant is a tenant at will and the agreement has been renewed by the conduct of the parties. However, one cannot talk of payment being due under S. 14(2)(a) where a tenant is a trespasser.

The Tribunal notes that the 2nd respondent in its returns claimed that it had paid rent. The 2nd respondent claimed that its accounts are done on an accrual basis. A tax payer

whose accounting is on an accrual basis incurs expenditure when it becomes payable, and not on cash payment. An amount is payable when all the events that determine liability occur for instance, as in this case, when the property is rented. Though the accounts of the 2nd respondent were on an accrual basis there is no evidence the it had attempted or paid rent even when after furnishing the returns. The 1st respondent contended that the applicant and the 2nd respondent had entered into a scheme to obtain a tax benefit. S. 75 of the VAT Act reads

(1) Notwithstanding anything in this Act, If the Commissioner General is satisfied that a scheme has been entered into or carried out where –

(a) a person has obtained a tax benefit in connection with the scheme; and

(b) having regard to the substance of the scheme, it would be concluded that the person, or one of the persons, who entered into or carried out the scheme did so for the sole or dominant purpose of enabling the person to obtain a tax benefit.

The Commissioner General may determine the liability of the person who has obtained the tax benefit as if the scheme has not been entered into or carried out, or in a manner as in the circumstances the Commissioner General considers appropriate for the prevention or reduction of the tax benefit.

(2) In this Section –

(a) "Scheme" includes any agreement, arrangement, promise or undertaking whether express or implied and whether or not enforceable, by legal proceedings, and any plan, proposal, course of action, or course of conduct;

(b) "tax benefits" includes –

(i) a reduction in the liability to pay taxes;

(ii) an increase in the entitlement of a person to a credit or refund; or

(iii) any other avoidance or postponement of liability of the payment of tax.

It is not difficult to discern that the 2nd respondent adopted a course of conduct in which it attempted to reduce its liability to pay taxes. However, there is no evidence to show that the applicant was part of any arrangement, agreement or any undertaking where it

wanted to obtained a tax benefit. Under S. 5 of the VAT Act a person liable to pay the tax in the case of a taxable supply is to be paid by the person making the supply. As already stated in the absence of consideration the tribunal cannot say that the applicant made a taxable supply to the 2nd respondent. In the circumstance we cannot say that S. 75 is not applicable to the applicant.

Likewise, if there is any party that is supposed to be penalized, it should be the 2nd respondent. However as in this case, the VAT Act deals with the person making the taxable supply. It is not concerned with the final consumer. While the Tax Appeals Tribunal Act is silent on adding parties to its proceedings, the Tribunal through judicial activism used the Civil Procedure Rules to add the 2nd respondent as a party to effectively determine issues before it. However, the VAT Act does not allow the Tribunal to impose taxes on a person who is not liable to pay taxes under S. 5 of the VAT Act. The Tribunal cannot plug the loopholes in the Act and make a party liable when the Act does not impose such liability. That is the work of the legislature. Parliament has the duty to impose taxes. The Tribunal can only recommend that the VAT Act may be amended to handle situations like this where a consumer of a taxable supply refuses to pay VAT within a specified time. In short, the Tribunal recommends that the Act should be amended to empower a tax collecting authority to proceed against a non-complying consumer where consideration fails on a taxable supply and penalty maybe imposed.

Taking the above into consideration, the Tribunal hereby orders that the assessment of the penal tax be vacated. The 2nd respondent will shall bear the costs of the application.

Dated at Kampala this day of 2016

DR. ASA MUGENYI	**MS. CHRISTINE KATWE**	**MR. ALI SIRAJ**

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