

**THE REPUBLIC OF UGANDA**  
**IN THE TAX APPEALS TRIBUNAL AT KAMPALA**  
**APPLICATION NO. 65 OF 2018**

**BONDO TEA ESTATES LTD =====APPLICANT**

**VERSUS**

**UGANDA REVENUE AUTHORITY =====RESPONDENT**

**BEFORE: DR. ASA MUGENYI    MR. GEORGE MUGERWA    MR. SIRAJ ALI**

**RULING**

This ruling is in respect of an application challenging an adjustment made by the respondent to the price at which green leaf was supplied by the applicant to Kijura Tea Company Limited, a related party. The application also seeks to challenge the disallowance by the respondent of an assessed loss of Shs. 220,985,115.

The applicant is an out grower of tea which it supplies to an associated company, Kijura Tea Company Limited. In 2018, the respondent conducted a review of the applicant's income tax returns for the year ending 31<sup>st</sup> March 2017 which purportedly revealed that the applicant had under declared its sales and that it had unreconciled retained earnings and current liabilities. The respondent adjusted the price of the tea which affected the sales. The applicant was not contended with the adjusted price. The applicant declared a loss brought forward from the previous year of income which the respondent did not consider. The respondent issued the applicant with an assessment of Shs. 544,409,110 of which Shs. 174,409,650 was principal income tax, Shs. 348,819,302 penalty and Shs. 20,929,158 interest.

The following issues were set down for determination.

1. Whether there was under-declaration of sales by the applicant to the respondent for the financial year ending 31<sup>st</sup> March 2017?

2. Whether the average price adjustment by the respondent is in conformity with the law?
3. Whether there was loss incurred by the applicant for the year ending 31<sup>st</sup> March, 2017 which was not recognized by the respondent?
4. What remedies are available to the parties?

The applicant was represented by Mr. Tayebwa Elisha while the respondent by Mr. Donald Bakashaba.

The applicant's witness, Mr. Arawal Pradip, its director testified that it properly declared its sales for the financial year ending 31<sup>st</sup> March 2017. The applicant sold tea to Kijura Tea Company limited, which is a related company. The price given to Kijura Tea was arrived at an arm's length and is comparable to the prices charged by other non-related third parties within the same locality in the same period. The respondent adjusted the price. The witness testified further that the respondent's use of the concept of a "fair market value" to the value of its sale did not apply as it only arises where the price of a commodity is not known, or a payment was made in kind or where goods are given free of charge. None of the circumstances arose in this case. He testified that the price charged by the applicant is comparable to that charged by other unrelated parties. He stated that that the green leaf purchased by Kijura Tea Company in the field was cheaper than that at its factory. Out growers who sold their tea at the factory incurred additional expense of transporting the green leaf to the factory which those in the field did not incur. He contended that the respondent's conclusion was wrong as it did not take into account the cost of transporting green leaf to Kijura Tea Company.

The witness also testified that the adjustment by the respondent to the applicant's taxable income by reducing the assessed losses carried forward made the latter liable to pay taxes when it had no liability. He contended that assessed losses are allowed as a deduction in determining chargeable income. The applicant's self-assessment for the year ending March 2017 disclosed an assessed loss. The respondent had no basis for challenging the assessed loss carried forward because it did not carry out an audit to

confirm the actual amount. He admitted that the applicant did not have a transfer price policy.

The respondent's witness, Mr. Gabriel Muwonge Musenero, a tax officer testified that he was involved in making the objection decision. He testified that in reviewing the applicant's objection he verified the documents provided by it. He established that for the period in question the applicant's average selling price for a kilogram of green leaf was Shs. 320 while other out growers sold their green leaf between Shs. 500 to Shs. 700. The applicant sold green leaf to Kijura Tea Company limited, its parent company, at a price lower than the market price. The applicant contended that Kijura Tea Company limited provided it with additional services like financial support and farm inputs on credit and free of interest. The witness also established that Kijura Tea Company limited has no transfer pricing policy. He determined the average sale price using a lower limit of Shs. 320 per kg of green leaf and the upper limit of Shs. 700 and obtained an average sale price of Shs. 510, which he used to arrive at a figure of undeclared sales of Shs. 223,257,400 for the year of income ending 31<sup>st</sup> March 2017.

The witness testified that he did not consider the applicant's loss of Shs. 220,785,115 as at 1<sup>st</sup> April 2016 in determining the taxable income for the year of income ending 31<sup>st</sup> March 2017, because it failed to provide information to support it. The witness stated that the said loss was later verified and reduced to Shs. 135,628,522.

The applicant submitted that the sales declared in its financial statements and tax returns for the year of income 2017 were the actual income received from its sale of green leaf to Kijura Tea Company. It submitted that the price at which green leaf was sold to Kijura Tea Company during the period in review was the same as that sold to it by other out growers in the region. The applicant contended that the respondent's use of a fair market value was not supported by the law. It argued that a fair market value is applied for income tax purposes in circumstances where the value of a transaction between parties is unknown, or where a payment for a supply is made in kind, or where goods are transferred for no consideration. The applicant contended that none of the above instances were

present in its transactions with Kijura Tea Company so as to justify the use of the 'fair market value' method.

The applicant submitted that income tax law requires that transactions between related parties ought to be at an "arm's length". Under the arm's length principle transactions between related parties are compared to those between unrelated parties to determine the price. It concluded that the arm's length principle and not the market price was the benchmark for verifying the transfer prices for intra-group transactions for tax purposes. It cited the Indian court decision of **UE Development India Pvt Ltd vs. DCIT in IT (TP)** No. 1104/Bang/2011 to support its argument. The applicant submitted that the price paid by Kijura Tea Company limited for the applicant's green leaf was the same price it paid to other out growers. This price which should have been considered by the respondent and not a 'fair market value'. The applicant contended that the price of green leaf sold to Kijura Tea Company Limited in the tea field is different from the price of green leaf sold to the company at their factory. The difference arose from the cost of transport and other incidental costs incurred by the out grower to transport their green leaf from their fields to Kijura Tea Company's factory.

The applicant submitted that the price at which green leaf is sold to Kijura Tea Company limited at their factory varies between out growers due to the distance between the out grower's field and the company's tea factory. Out growers in close proximity to the Kijura Tea Company limited factory incurred lower transport costs to the factory than those whose fields are at a considerable distance from the factory sold. The applicant contended that the price that the respondent ought to have considered was the field price and not the factory one as the latter can be distorted by transport costs. The applicant argued that the respondent did not confirm whether the price range of Shs. 500 to Shs. 700 per kg of green leaf it relied on to arrive at an average price was a field price or a factory price.

In respect of the second issue, the applicant contended that the adjustment to the average market price to goods between the applicant and its parent by the respondent was not

lawful. The applicant submitted that Sections 51 to 69 of the Income Tax Act provide for the application of a “fair market value” while Sections 23(4), 52(3), 53(2), 90(1) provide for the application of an “arm’s length value”. The applicant submitted that while the Income Tax Act provides for the application of both a “fair market value” and an “arm’s length value” for the purpose of determining the price between independent parties under the concept of “a willing buyer-willing seller” considerable differences existed between these two methods. The “arm’s length principle called for a subjective valuation by establishing comparing uncontrolled transactions the fair market value principle requires an objective, market based valuation.

The applicant submitted that S. 90(1) of the Income Tax Act provides that the Commissioner may allocate income between the related parties so as to reflect the income realized in an arm’ length transaction. The applicant argued that Regulation 3 of the Income Tax (Transfer Pricing) Regulations, 2011 provides that an arms’ length transaction refers to a transaction between related parties, the results of which are consistent with results that would have been realized in a transaction between independent persons dealing under the same conditions. The applicant argued that the arm’s length principle does not envisage the allocation of income on the basis of an “average market price” but rather whether the price charged between related parties is a price that would be charged to an independent person. The applicant argued that the concept of “average market price” only applies to transactions involving the transfer of assets or transactions for consideration paid or received in kind. The applicant argued that the respondent ought to have looked at the arm’s length price of the green leaf and not the fair market value because the applicant was not exchanging the leaves in kind with its related party, Kijura Tea Company but was selling them at a price. The applicant submitted that there was therefore no transfer pricing or manipulation of prices with its related party as the green leaf was sold at an arm’s length price.

In respect of the third issue of assessed loss, the applicant argued that S. 38 of the Income Tax Act provides that assessed losses are to be carried forward and allowed as deductions in determining the tax payer’s chargeable income in the following year of

income. The applicant submitted further that under S. 20 of the Tax Procedures Code Act, where a tax payer has submitted a self –assessment return and the tax payer has an assessed loss for the year in question the tax payer is treated as having made an assessment of the amount of the loss set out in the return. The applicant submitted that a tax payer has an assessed loss for a year of income if the total amount of deductions allowed to the tax payer for the year exceeds the gross income of the tax payer for the year. The applicant submitted that the excess amount became the tax payer’s assessed loss for the year of income and that such assessed loss can be carried forward indefinitely and deducted from taxable income provided that the tax payer satisfies either the continuity of ownership test or the business continuity test. The applicant submitted that under S. 23(1) of the Tax Procedures Code Act, the respondent ought to have reviewed the applicant’s disclosures by verifying the applicant’s self-assessment and making adjustments to either the gross income declared and /or the allowable deductions claimed through an audit exercise. The applicant submitted that the respondent failed to review the applicant’s assessed loss for the previous year of income. The applicant concluded that the respondent’s refusal to consider the assessed loss of Shs. 220,785,115 for the reason that it had not been verified as unlawful and irregular.

In reply, the respondent argued that there was under declaration of sales by the applicant According to the testimony Gabriel, Muwonge Musenero, information from third parties and Revenue Information officers showed that that the price at which the applicant sold its green leaf to Kijura Tea Company was below the market average. The respondent contended that it used the best information available to adjust the price under powers granted to it by S. 23 of the Tax Procedure Code Act. The respondent relied on Oxford Advanced Dictionary to define the term “best information” as knowledge gained through study, communication, research or instruction. From the findings of the inquiries made by Gabriel Muwonge Musenero, the average sale price of Shs. 510 was determined by using the average of Shs. 320 and Shs. 700 per kg of green leaf which it used to arrive at the undeclared sales of Shs. 223,257,400.

The respondent submitted that S. 23 of the Tax Procedure Code Act provides that the Commissioner may make an additional assessment to ensure that a tax payer is liable for the correct amount of tax payable in respect of a stated period. The respondent also cited S. 23(2) which provides that an additional assessment may be made at any time if fraud or any gross or willful neglect has been committed by or on behalf of a tax payer or new information has been discovered in relation to tax payable. It cited **Tembo Steels (U) Ltd v Uganda Revenue Authority** Civil Appeal No. 77 of 2011 to support the argument that S. 23 of the Tax Procedures Code Act grants the Commissioner General powers to make a tax assessment on the basis of the best information available. The respondent cited also **Lanyero v Okene & another** Civil Appeal No. 0029 of 2018 to support its argument that the Commissioner General is entitled to make adjustments to ensure that the income and expenditures resulting from transactions involving related parties are consistent with the arm's length principle.

The respondent submitted that the assessed loss had been verified during mediation and reduced from Shs. 220,785,115 to Shs. 135,628,522.

Having listened to the evidence and read the submissions of the parties, this is the ruling of the Tribunal.

The applicant is a related company to Kijura Tea Company Limited, a parent company. The applicant sells tea leaves to the said company. The respondent contends that the applicant undeclared its sales for the financial 2016/2017. This was based on a field inspection report compiled by Muwonge Musenero Gabriel and Mpumu Vincent Muhoozi, the respondent's employees.

The field inspection conducted on 12<sup>th</sup> September 2018 was to verify the correct price charged by the applicant for the sales of its green leaf to Kijura Tea Company limited. According to the field inspection report five out growers were interviewed. They sold their green leaf to tea companies like Rusekere Growers Tea Company, McLeod Russell Uganda Limited and Mabale Growers Tea Factory Limited and charged prices ranging

from Shs. 500 to Shs. 700 per kilogram. On the basis of the interview the respondent concluded that the price for a kilogram of green leaf for the period 2016/2017 ranged from Shs. 500 to Shs. 700 and that the applicant whose sales price to Kijura Tea Company was Shs. 320 per kilogram had under-declared its sales. The respondent accordingly recomputed the applicant's sales from April 2016 to March 2017.

The Income Tax Act gives powers to the Commissioner to recompute transactions in order to reflect the chargeable income received by a taxpayer. S. 90 of the Income Tax Act provides that:

“In any transaction between associates or persons who are in an employment relationship, the Commissioner may distribute, apportion, or allocate income, deductions, or credits between the associates or persons who are in an employment relationship, as the case may be, as is necessary to reflect the chargeable income realised by the taxpayer in an arm's length transaction.”

S. 3 of the Income Tax Act defines an associate. S.3(2)(3) states that an associate includes:

“a company in which the person, either alone or together with an associate or associates under another application controls fifty per cent or more of the voting power in the company either directly or through one or more interposed companies, partnerships, or trusts.”

It is not in dispute that Kijura Tea Company limited, the parent company of the applicant was its associate. What is in dispute is whether the transactions between them were at “arm's length”.

The term “arm's length transaction” is not defined in the Income Tax Act. Black's Law Dictionary 10<sup>th</sup> Edition p. 1726 defines it as “1. A transaction between two unrelated and unaffiliated parties. 2. A transaction between two parties, however closely related they may be, conducted as if the parties were stranger, so that no conflict of interest arises.”

The question the Tribunal has to ask itself, was the price set by the applicant and its associate, Kijura Tea Company limited, one that could be considered as one between unrelated parties?



In order to understand whether the applicant's price to Kijura Tea Company was at arm's length one has to ask how was the price set? The minutes of a tea stakeholders meeting of 7<sup>th</sup> January 2015 at Toro Club, Fort Portal, exhibit A5 show that it was attended by representatives of all the major green leaf buyers, namely; Mpanga Growers Tea Factory, Kijura Tea Company, Mabale Growers Tea Factory, Rusekere Growers Tea Factory and others. The meeting agreed to reduce the price of green leaf from the current Shs. 350 per kg to Shs, 280 per kg with effect from 16<sup>th</sup> January 2016 due to the fall in prices at the auction market. The meeting also reduced transport cost from Shs. 100 to Shs. 80 per kg of green leaf. The meeting resolved that stakeholders using the services of transporters should ensure that the prices offered to farmers did not exceed Shs. 280 per kg. By April 2016, 14 months after the price was fixed by the tea factories, the applicant was selling Shs. 320 per kilogram, an increment of Shs. 40. The price of the applicant was above the price set by the different stakeholders. It would have been a different matter if the price was below that set by the stakeholders. One cannot say the applicant's price to Kijura Tea Company was not at arm's length.

Further the applicant contended that its price did not include transport charges which varied from where the out growers came from. The applicant contended that the respondent did not state whether the Shs. 500 per kilogram paid to out growers included transport costs.

The field report the respondent conducted was on 12<sup>th</sup> September 2018. The income tax period in issue is April 2016 to March 2017. The prices of tea is not static. One cannot use the price of tea in September 2018 to ascertain the price from April 2016 to March 2017. The prices at the auction market in September 2018 may have increased. The said inspection report is not signed. Furthermore it does not disclose which unrelated companies and their officials the respondent interacted with. No sale invoices of unrelated companies are attached. Further, the interview was not representative of the local green leaf market, only five out growers were interviewed. The minutes of the stakeholders show that there are more than 5 tea factories in the Toro tea growing region which rely on hundreds of individual out growers for their supply of green leaf.

The respondent's representatives ought to have interviewed out growers selling green leaf to Kijura Tea Company to establish what price they were charging. The representatives only interviewed out growers selling their green leaf to Rusekere Growers Tea Company, McLeod Russell Uganda Limited and Mabale Growers Tea Factory Limited. This would enable establish if the differences between the applicant's sale price and that of other out growers were not due to distortions arising from factors like transport costs or the quality of green leaf. The report does not state the locations of fields of the five to determine the distance between their fields and the tea factories. The report does not show whether the out growers incurred additional expenses such as transport. The respondent's failure to take these factors into account substantially affect the credibility of the field inspection report.

From the evidence before us, we have failed to find sufficient justification for the adjustment by the respondent of the applicant's sales price. We accordingly find that there was no under-declaration by the applicant of its sales of green leaf to Kijura Tea Company limited for the financial year 2016/2017. We also find that the average price adjustment by the respondent was, for the above reasons, not in conformity with the law.

The last issue was whether there was loss incurred by the applicant for the year ending 31<sup>st</sup> March 2017 which was not recognized by the respondent? S. 20 of the Tax Procedures Code Act provides for self-assessments by taxpayers. Under S. 20(2) provides as follows;

“Where a tax payer liable to income tax has submitted a self-assessment return in the prescribed form for a year of income and the tax payer has an assessed loss for the year, the tax payer is treated as having made an assessment of the amount of the loss for that year being that amount set out in the return”.

S. 23(1)(a) of the Tax Procedures Code Act grants the respondent powers to make an additional assessment amending a tax assessment made for a tax period to ensure that for an assessed loss under the Income Tax Act, the tax payer is assessed the correct amount of the assessed loss for the period.

The applicant has submitted that it declared an assessed loss of Shs. 220,785,115 for the tax period 2016/2017. It contended that the respondent disallowed the assessment because it could not be verified. When an application is filed in the Tribunal the burden is placed on the applicant under S. 18 of the Tax Appeals Tribunal Act to prove that the assessment is excessive or the taxation decision would have been made differently. In this case the onus is on the taxpayer to prove the loss. The applicant has not furnished the Tribunal the returns and or financial statement for the tax period in issue to show the loss. The burden would shift to the respondent to show why it did not allow the loss whereby the applicant would rebut the reasons advanced by the former. However, the respondent submitted that during mediation the parties reduced the loss to Shs. 135,628,522. The respondent's witness Mr. Gabriel Muwonge Musonero also admitted in paragraph 9 of his witness statement that the loss has been verified and reduced to Shs. 135,628,522. If the respondent has admitted to the loss incurred by the applicant, it shall stand. The applicant may still avail the respondent with information showing the remaining loss of Shs, 85,156,593 for it to verify.

Having determined that the applicant did not under declare its sales and its loss is reduced, this application is allowed with costs to the applicant.

It is so ordered.

Dated at Kampala this 29<sup>th</sup> day of march 2021.

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**DR. ASA MUGENYI**  
**CHAIRMAN**

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**MR. GEORGE MUGERWA**  
**MEMBER**

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**MR. SIRAJ ALI**  
**MEMBER**