THE REPUBLIC OF UGANDA

IN THE TAX APPEALS TRIBUNAL OF UGANDA AT KAMPALA

APPLICATION NO. 69 OF 2021

K-FILES LTD .....APPLICANT

VERSUS

UGANDA REVENUE AUTHORITY.....RESPONDENT

BEFORE: DR. ASA MUGENYI, MS. CHRISTINE KATWE MR. SIRAJ ALI.

RULING

This ruling is in respect of what constitutes the proper application of S. 38 of the Tax Procedures Code Act.

The applicant is engaged in the business of records management and offsite storage. Following a review of the applicant's tax position, the respondent issued a demand for the payment of Value Added Tax (VAT) of Shs 103,684,531 as tax outstanding. The applicant`s objection to this demand was disallowed by the respondent on 15th July, 2021. Hence this application.

The following issues were set down for the determination of the tribunal.

i. Whether the applicant is liable to pay the tax assessed?
ii. What remedies are available to the parties?

The applicant was represented by Mr. Elisha Tayebwa and Ms. Winnie Begumisa while the respondent by Mr. Tony Kalungi.

The applicant`s sole witness was Ms. Lilian Mukasa, its managing director. She testified that for the tax periods of July 2010 to July 2021, the applicant declared VAT payable of Shs. 2,765,611,488 and had paid a total of Shs. 2,903,587,133 as principal tax. The witness testified that during a VAT ledger reconciliation by the respondent, she noted a

liability of Shs. 103,684,531 as principal tax without interest or penalty. The witness testified that this arose because the respondent had applied payments made in respect of the principal tax to offset penal and interest charges. The witness testified that as a result the waiver of interest on unpaid tax in excess of the aggregate of principal as at 30th June 2017 by the VAT Amendment Act 2017, the waiver of interest and penalty outstanding as at 30th June 2020 was not taken into account by the respondent in tabulating the applicant`s tax liability. The witness testified that the respondent`s interpretation and implementation of S. 38 of the Tax Procedure Code Act was unfair and unjust.

The respondent did not a present a witness on the date set for hearing.

The applicant submitted that for the period 2010 to 2021, it filed self-assessed returns and duly paid the principal tax due as per the said returns. These payments were made against a Payment Registration Number (PRN) generated. The applicant submitted that the respondent wrongly applied S. 38 of the Tax Procedure Code Act. The applicant submitted that the Order of Payment rule was introduced in the Act in 2016. The first in the order of payment should be principal tax declared, then penal tax and lastly interest due. The applicant submitted that the respondent, erroneously used this provision to off-set the former's principal tax payments towards previous/earlier interest and penalty, unknown to the applicant. The applicant submitted that all its payments were made towards principal tax and no notification of the application of payments towards other tax heads was given by the respondent. The applicant submitted that had the respondent applied S. 38 it would benefit from the interest waivers of 2017 and 2020. S. 65A of the VAT Act waived the excess interest of the aggregate of principal and penalty as at 30th June 2017 and S. 40 of the Tax Procedure Code Act waived penalty and interest as at 30th June 2020.

The applicant contended that the demand of outstanding principal tax by the respondent is unlawful since it paid the tax due in the respective tax periods as per its self-declared assessments for the tax periods of July 2010 to July 2021. The respondent should have

followed the order of payment to clear the principal tax due in the respective tax period upon which the outstanding penalty and interest accruing would have shown in the VAT ledger and would have been waived as of 30th June 2017 and 30th June 2020.

The applicant submitted that it could not have been the intention of the legislature that any payments made towards the payment of tax should be applied to off-set previous taxes. The applicant stated that this position was substantiated by the repeal of S. 38(2) of the Tax Procedure Code Act which stated that if a taxpayer has more than one tax liability at the time a payment is made, subsection (1) applied to the earlier liability first. The applicant submitted that if the legislators intended for the off-setting of all payments made to a certain class i.e. principal tax, it would have said so. The applicant cited *Attorney General v Bugisu Coffee Marketing Association* (1963 EA 39) where the following dicta in *Cape Brandy Syndicate v IRC* ([1921] 1 KB 403); was cited with approval. 'In the construction of tax statutes, the court looks at what is said without any presumption, equity, such that nothing is to be read in and nothing is to be implied.'

The applicant submitted that the ledger provided by the respondent could not reflect the true tax position of the applicant as it was based on an incorrect application of the principal tax. The ledger showed that the respondent unlawfully levied interest which resulted in it paying more tax than what was indicated in the VAT returns. Ms. Mukasa, testified that the VAT declared by the applicant for the tax periods of July 2010 to July 2021 amounted to Shs. 2,765,611,488 and yet it was made to pay Shs. 2,903,587,133 as principal tax. The applicant submitted that the allocation of payment of tax by the respondent of offsetting previous interest and penalty was illegal and contrary to the order of payment rule under the law.

The applicant submitted further that the VAT ledger was not availed to taxpayers for a long time, until mid-2019, at which point the irregularities in application of payments was noticed. Relying on the book titled "Domestic & International Taxation in Uganda: The Law, Principles and Practice" by Joseph O. Okuja, the applicant submitted that it was of the utmost importance that taxpayers must be able to clearly understand the nature and

extent of their rights and obligations, including the consequences of non-compliance. The applicant submitted that it was unfair of the respondent to re-apply its payments without notice, thereby creating a liability that would have otherwise been waived by the 2017 and 2020 tax law amendments on waiver.

In reply, the respondent submitted that the applicant is liable to pay the tax assessed. It submitted that the tax in dispute is contained in the VAT ledger (Exhibit AEX5). The respondent submitted that the applicant`s interest in AEX5 as at June 2017 was Shs. 1,619,234.43 and did not exceed its outstanding principal and penal tax and accordingly there was no interest due to waive. The respondent submitted further that the applicant had not adduced evidence to prove that it had any interest that had exceeded the aggregate of the outstanding principal and penal tax as at 30th June 2017. The respondent submitted therefore that it had correctly taken into account S. 64A (1) & (2) of the VAT Act by waiving any interest due and payable on unpaid tax that exceeded the aggregate of the outstanding principal and penal tax, as at 30th June 2017. The respondent submitted that the applicant`s VAT ledger for June and July 2020 shows that it had taken into account the provisions of S. 40C of the Tax Procedure Code Act, that waived any interest and penalty outstanding as at 30th June 2020.

The respondent submitted that the applicant erroneously argued that the order of payment should be limited to a specific tax being paid for. This is contrary to S. 38 (1) of the Tax Procedure Code Act which recognizes that a tax payer who makes a payment that is less than the "total amount of tax", attracts penal tax and interest. The respondent argued that the use of the words *"total amount of tax"* in S. 38 means that it is the total amount of tax liability that has to be considered and not the specific tax. The respondent submitted further that the Section does not use the phrase specific tax but rather total tax.

The respondent submitted that before S. 38(2) of the Tax Procedure Code Act was repealed it provided that if a taxpayer had more than one tax liability at the time a payment was made, subsection (1) applied it to the earliest liability first. The respondent submitted that S. 38(2) though repealed as at July 2021, it still applied to the applicant's matter since

its ledger covered the period of July 2010 to July 2021.The respondent submitted further that it was not under any obligation to notify the applicant of changes to its ledger positions and that the applicant`s complaint in this regard was among other reasons, time barred. The respondent wound up its arguments by submitting that the applicant had failed to discharge the burden of proof.

In rejoinder the applicant reiterated its earlier submissions.

Having listened to the evidence and perused the submissions of the parties, the following is the ruling of the tribunal.

The dispute between the parties relates to the application of the order of payment under S. 38 of the Tax Procedure Code Act. A further issue relates to whether in reconciling the applicant`s VAT ledger, the respondent took into account the waiver of interest due and payable on unpaid tax in excess of the aggregate of principal and penal tax as at 30th June 2017 under the VAT (Amendment) Act 2017 and the waiver of interest and penalty outstanding as at 30th June 2020 under the VAT (Amendment) Act 2017.

The applicant`s case is that the respondent wrongly applied the provisions of S. 38 of the Tax Procedure Code Act by using payments made by the applicant towards the discharge of its principal tax, to the payment of its penalties and interest. The applicant`s further claim is that if the respondent had correctly applied the provisions of S. 38, the applicant would have benefited from the waivers of interest and penalty accorded under the VAT (Amendment) Act 2017 and the VAT (Amendment) Act 2020.

The respondent argues that it correctly applied the provisions of S. 38 and that in tabulating the applicant`s tax liability it was alive to the waivers of interest and penalty that were provided for under both the VAT (Amendment) Acts of 2017 and 2020.

Before delving further into the matter, it is important to take note of the amendment of S. 38 of the Tax Procedure Code (Amendment) Act 2017. Before this amendment S.38 (1)(a) read as follows-

"When a taxpayer is liable for penal tax and interest in relation to a tax liability and the taxpayer makes a payment that is less than the total amount of tax, penal tax, and interest due, the amount paid is applied in the following order-

i. In payment of the tax liability (emphasis added)
ii. In payment of penal tax and
iii. The balance remaining is applied against the interest due."

After the amendment the Section reads as follows:

"When a taxpayer is liable for penal tax and interest in relation to a tax liability and the taxpayer makes a payment that is less than the total amount of tax, penal tax, and interest due, the amount paid is applied in the following order-

i. In payment of the principal tax (emphasis added)
ii. In payment of penal tax and
iii. The balance remaining is applied against the interest due."

This amendment was achieved by deleting the word `*liability*` after the word `tax` and inserting the word `*principal*` before the word `tax`.

The question which arises in respect of this amendment relates to the intention of the legislature in making the amendment in question. A perusal of the Hansard of 10th May, 2017, which provides a record of the second reading of the Tax Procedures Code (Amendment) Bill 2017 and the Parliamentary Report of the Committee on Finance, Planning and Economic Development on the Tax Procedures Code (Amendment) Bill, 2017, are both silent on this point. The only observation we can come up with is that the word `tax liability` was replaced with the word `principal tax` so as to bring clarity to the application of the section.

A major point of divergence between the parties is the interpretation of the phrase `*total amount of tax*` under S. 38(1). The respondent argues that the use of the words `total amount of tax` means that 'it is the total amount of tax liability that has to be considered and not the specific tax`. To put it simply, the respondent`s argument is that in applying

S. 38(1), the payment made by a tax payer should be applied to the total amount of tax liability comprising of the principal tax, penal tax and interest and not to the specific tax declared in the return. This implies that whenever a tax payer makes a payment such as envisaged under S. 38(1), it will be applied to the payment of principal tax, penal tax and interest all at once. This position is at variance with that taken by the applicant, namely that the payment made by the tax payer ought to be applied to the specific tax liability declared in the tax payer`s return. Whether or not the respondent was correct in its application of S. 38 (1), can only be determined through an examination of it.

The phrase `*total amount of tax*` has been taken out from S. 38(1). The entire provision reads as follows:

> "(1) When a taxpayer is liable for penal tax and interest in relation to a tax liability and the taxpayer makes a payment that is less than the total amount of tax, penal tax, and interest due, the amount paid is applied in the following order-
>
> i. In payment of the principal tax
>
> ii. In payment of penal tax and
>
> iii. The balance remaining is applied against the interest due`.
>
> (2) `If a tax payer has more than one tax liability at the time a payment is made, Subsection (1) applies to the earliest liability first.

Although S. 38 (2) above stood repealed as at July 2021, it has been reproduced for the sake of completeness and for the reason that it is of interest to our case.

It is clear from a reading of S. 38(1) above, that in arriving at its argument in respect of the phrase `total amount of tax` the respondent did not look at the above provision in its entirety. S. 38(2) states that if a tax payer has more than one tax liability at a time, implies that S. 38(1) is referring to a total amount of a specific tax. The respondent construed the above phrase `total amount of tax` in isolation of the rest of the section. This goes against the rule of statutory interpretation that each section in a statute must be construed as a whole. The respondent`s construction of the phrase `total amount of tax` also has the effect of rendering the remainder of the provision redundant..

The respondent has argued that support for its point of view can be found under the now repealed S. 38 (2) of the Tax Procedure Code Act. At paragraph 1 of page 6 of its written submissions the respondent stated as follows-`The foregoing is emphasized by Section 38(2) of the Tax Procedure Code Act which provided that if a taxpayer has more than one liability at the time a payment is made, subsection (1) applies to the earliest liability first. In essence the earlier tax could not be ignored by focusing on a specific tax`.

The construction of S.38 (1) can be found in the respondent`s Note (i) of its Payment Registration Slips, exhibit AEX2 states as follows:

> `For any domestic tax payment, the payment will first be allocated to your oldest liability (of the tax head) in the order of Principal, Penalty and interest, if any.

This position is no different from that taken by the applicant.

We agree with the applicant`s construction and take the view that in its plain, literal and ordinary sense, S. 38(1) means that in cases where a taxpayer is required to pay penal tax, interest and a principal tax and the amount paid by such a tax payer is not sufficient to cover the entire amount of the principal tax, penal tax and interest, the payment made by the tax payer should be used to clear the principal tax first, then the amount remaining should be applied to the penal tax and the balance towards the payment of interest. We believe that this is the same position that is borne out by Note (i) of the Payment Registration Slip above.

A perusal of the applicant`s VAT ledger admitted in evidence as exhibit AEX5, at page 175 of the applicant`s trial bundle shows that payments made by the applicant were applied towards the payment of penal tax and interest instead of the principal tax. This means that the application of S. 38 by the respondent in practice is completely different from the position set out under S. 38 and from the information provided to taxpayers in the Payment Registration Slips.

The respondent has argued that as at June 2017, the applicant`s interest was only Shs. 1,619,234 and did not therefore exceed the outstanding principal and penal tax and that

as at July 2020, the applicant`s interest was in negative, therefore despite the fact that it was alive to and took into account the provisions of both VAT (Amendment) Acts, of 2017 and 2020, there was no interest to be waived. Our own view is that the misapplication of payments by the respondent towards penal tax and interest instead of the principal tax distorted the ledger with the result that the ledger was no longer a correct representation of the applicant`s tax liability. We agree with the applicant that if the respondent had applied all the payments made by the applicant in the order set out under S. 38(1) the applicant would have no outstanding principal tax liability and any outstanding penal tax and interest would have benefited from the waivers mentioned above.

The evidence of the applicant is that if it computed its payments they show that it paid the principal tax. The respondent states that the payments were applied to pay interest and penalty and therefore there is still some principal tax outstanding. The respondent did not notify the applicant on any interest liability. What the applicant calls interest and penalty outstanding is what the respondent calls principal tax outstanding. If the respondent had notified the applicant of any outstanding liability of interest and penalty regularly and in a timely fashion, this dispute would not have arisen. A taxpayer should be treated fairly. S. 40C of the Tax Procedure Code Act waivered any interest and penalty outstanding as at 30th June 2020. If the respondent were to reconcile ledgers, where its uses payments made by taxpayers to first pay interest and penalty and not principal tax one may not be wrong to view it as an attempt to circumvent S. 40C of the Tax Procedure Code Act especially where the legislature did not mention how the interest and penalty it waived should be arrived at. Where there is doubt to the application of a law, the taxpayer takes the benefit.

The applicant's other argument was that S. 65A(1) of the VAT Act provides that "The interest due and payable shall not exceed the aggregate of the principal and penal tax." The applicant's case was that this was not properly taken into account by the respondent. The respondent did not call a witness to show that S. 65A(1) of the VAT Act was taken consideration when making reconciliations in the ledger.

Taking the above into consideration the Tribunal holds that:

i. The outstanding VAT of Shs. 103,684,531 assessed on the applicant is set aside.

ii. Any outstanding interest and penalty as at 30th June 2017 and 2020 are hereby waived in accordance with S. 65 of the VAT Act and S.40 of the TPCA.

iii. The applicant is awarded costs of the application.

Application allowed.

Dated at Kampala this 2nd day of June 2022.

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