THE REPUBLIC OF UGANDA

IN THE TAX APPEALS TRIBUNAL AT KAMPALA

APPLICATION 21 OF 2021

RWENZORI BOTTLING COMPANY LIMITED ================APPLICANT

VERSUS

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

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

RULING

This ruling is in respect of the treatment of interest expenses under the income tax Act.

The applicant produces bottled water and is a member of Coca Cola Beverages African group of companies. In 2019, it incurred interest expenses from banks and other institutions. It claimed a deduction of interest of Shs. 7,922,420,000 being tax earnings before Interest, Tax, Depreciation, and Amortization (TEBITDA) where the deduction limit was purportedly Shs. 12,610,449,114. On 22nd September 2020, the respondent rejected the deduction on the grounds that the applicant overstated its interest expense by Shs. 253,864,847 and issued an additional assessment of Shs. 76,159,455.

The following issues were set down for determination.

1. Whether the applicant is liable to pay the additional tax assessed?
2. What remedies are available to the parties?

The applicant was represented by Mr. Ronald Kalema while the respondent by Mr. Tony Kalungi.

This dispute involves the treatment of interest expenses met by the applicant under the income tax Act which gave rise to an additional income tax assessment.

The applicant's witness, Mr. John Mukiibi, testified that the applicant is a private company under the Coca Cola Beverages African group. Its business is the production of bottled water under the Rwenzori brand. He stated that the dispute between the parties involves the application of the rules limiting the deduction of interest expense for the group companies under S. 25 of the income tax Act (ITA). He stated that the in July 2018, the Income Tax Act was amended to introduce a fixed ration of interest expense during the year that could be allowed as a deduction for tax purposes. The ratio was fixed at 30% of Tax Earnings before Interest, Tax, Depreciation and Amortization (TEBITDA). He testified that for the fiscal year ending 30th December 2019, the applicant incurred interest costs of Shs. 7,922,420,000 which it claimed after determining that it was less than 30% of the TEBITDA. The applicant determined its TEBTIDA at Shs. 42,034,830,379 which set the maximum allowable interest expense ceiling of 30% at Shs. 12,610,449,114. He stated that the applicant's TEBITDA was determined as follows:

TABLE A

Formula	**Item**	**Amount (Shs)**	**Comment**
A	Chargeable income	17,639,429,990	This is less than the interest expense
B	Interest expense for 2019	7,922,420,000	S. 25(1) of the ITA
C = A + B	Chargeable income before interest expense	25,561,849,990	S. 25(5)(a)(i) of the ITA
D	Depreciation and Amortization	16,472,980,388	S. 26,27, 27A and 29 ITA
E = C + D	**TEBITDA**	**42,034,830,379**	S.25(a)(i)(ii)(iii)
F = 30% X E	30% of TEBITDA	12,610,449,114	Limit as per S. 25(3) of ITA
	Deduction claimed	**7,922,420,000**	Less than 30% of TEBITDA. all allowable

He testified that the respondent did a return examination review on the applicant for the period ending 31st December 2019. After the review, the respondent alleged that the applicant overstated its interest expense by Shs. 253,864,847. The respondent arrived its computation as stated hereunder.

TABLE B

Details	2019 (Shs)
EBITDA as per S. 25 of the ITA	25,561,850,509
Deductible interest (30%)	7,668,555,153
Interest Claimed	7,922,420,000
Overstated Expense	**253,864,847**

He submitted that the difference between the parties' calculation of Shs. 16,472,980,389 resulted from the way the respondent computed its TEBITDA. He contended that the respondent omitted to include the depreciation values when determining TEBITDA. He contended that the respondent's determination of TEBITDA is not in accordance with S. 25 of the income tax Act. He contended that it also violates the guidelines by the Organization for Economic Co-operation and Development (OECD).

The respondent's witness, Mr. Anthony Kibirige, a Supervisor, international tax unit in its large taxpayers' office, under the domestic taxes department testified that S. 25 of the income tax Act is derived from international tax. He submitted that Action 4 of the Base Erosion and Profit Shifting (BEPS) Agenda addressed interest deductions and similar payments; and proposed interventions to be adapted by countries to ensure that multinational enterprises to do not plan using interest deductions as a tool to erode the tax bases in the jurisdictions where they operate. He stated that Uganda like other jurisdictions previously applied the thin capitalization rule to limit excessive deductions of interest, but the Action 4 report and its recommendation pointed out that this method of limiting interest deduction was not effective as entities would easily manipulate the rule to achieve interest deductions that are not commensurate with the level of economic activity. It was recommended that jurisdictions adapt the fixed ratio rule, which grants an entity interest claiming capacity based upon the level of its taxable income; and therefore, Uganda followed suit. The International taxation unit of the respondent made recommendations to the tax policy department in the Ministry of Finance and Economic Development (MOFED) to repeal S. 89 of the income tax Act; and introduce a new rule under S. 25 applying a fixed ratio rule based upon International best practices and the recommendation of the BEPS Action 4 report.

Mr. Anthony Kibirige stated that under S. 25 of the income tax Act; the general rule is that if an entity incurs interest expenditure relating to its economic activity, the expenditure is allowable as a deduction against its taxable income. S. 25(3) requires that notwithstanding the general rule under S. 25(1), a taxpayer's interest claim is restricted to 30% of its tax earnings before interest, depreciation, and amortization; this in effect is the fixed ratio rule. He stated that the respondent's interpretation of S. 25(5)(1) is that gross income less allowable deductions equate to the taxable income of an entity for a given year of income. This position of taxable income is derived by deducting depreciation and amortization and granting capital deductions under Sections 27, 27A and 29 of the income tax Act. As such the further adjustments under S. 25(a)(ii) and (iii) of the Act are superfluous and only serve to grant a double adjustment for these deductions and accordingly any resulting amount would not equate to the taxable earnings of an entity and would negate the intention and purpose of the fixed ratio rule under S. 25(3) of the Act.

He testified that the respondent carried out a return examination compliance review on the applicant for the fiscal year ending 31st December 2019 in respect to the application of S. 25 of the income tax Act. He stated that after verification of the applicant's income tax returns for the fiscal year ending 31st December 2019, the respondent established that interest expense claimed was overstated by Shs. 253,864,847. On 4th December 2020, the respondent disallowed the interest expense of Shs. 253,864,847 and raised an assessment of Shs. 76,159,455 as income tax due in determination of EBITDA. Mr. Anthony Kibirige submitted that the applicant's interpretation of S. 25 of the income tax Act by adding back depreciation defeats the purpose and spirit of law because the amounts of depreciation at any given time are always higher than the amount of interest. This is based on the fact that the applicant is a capital-intensive enterprise.

The respondent's second witness, Mr. Edward Jesse Bazira an officer in its legal services and board affairs department, stated that the respondent carried out a return examination compliance review on the applicant. After verification of the applicant's income tax returns for the fiscal year ending 31st December 2019, the respondent established that interest expense claimed was overstated by Shs. 253,664,847. On 4th December 2020, the respondent disallowed the Shs. 253,864,847 and raised an assessment of Shs. 76,159,455. The basis of the assessment was that in the determination of Tax Earnings Before Interest, Tax, and Amortization (EBITDA) the respondent considered the interest expense for the year as the only adjustment under S. 25(5)(a)(ii) and (iii) of the income tax Act. He stated that on 4th December 2020, the applicant objected to the assessment on grounds that the respondent did not consider the provisions of S. 25(5) arriving at the EBITDA correctly. On 24th February 2021, the respondent issued an objection decision to the applicant disallowing the objection and maintained the assessment on the ground that the applicant never considered that the accounting depreciation as per S. 25 of the income tax Act had already been added back.

The applicant submitted that S. 25(1) of the income tax Act provides that a person is allowed a deduction for interest incurred during the year of income in respect of debt obligation, to the extent it relates to production of business income. S. 25(3) provides that the amount of the deductible interest in respect of all debts owed by the taxpayer who is a member of a group shall not exceed 30% of the tax earnings before interest, tax depreciation and amortization. S. 25(5) provides for the definition of tax earnings before interest, tax, depreciation and amortization (Tax EBITDA) as follows.

> "(a) Tax earnings before interest, tax depreciation and amortization mean the sum of
>
> (i) gross income less allowable deductions, except the interest deduction
>
> (ii) depreciation
>
> (iii) amortization
>
> (b) group means persons other than an individual with common underlying ownership."

The applicant submitted that it is part of a group and as such the limitation in S. 25(3) applies to it. It computed its Tax EBITDA by considering: Gross income less allowable deductions of interest expense, amortization and depreciation.

The applicant submitted that tax EBITDA is the sum of taxable income, interest expense, depreciation and amortization. It submitted that once the words of the statute are clear and unambiguous, they must be given their ordinary meaning. It cited the dictum of Lord Donavan *in Mangin v inland Revenue Commissioner [1971] AC 738*

"First, the words are to be given their ordinary meaning. They are not to be given some other meaning simply because their object is to frustrate legitimate tax avoidance devices. Moral precepts are not applicable to the interpretation of revenue statutes. Secondly, one has to look merely at what is clearly stated. There is no room for any intendment. There is no equity about a tax. There is no presumption as to tax. Nothing is to be read in, nothing is to be implied. One can only look fairly at the language used...Thirdly, the object of the construction of a statute being to ascertain the will of the legislature, it may be presumed that neither injustice nor absurdity was intended."

The applicant submitted that the respondent's additional assessment is erroneous and based on an incorrect application of S. 25(3) and (5).

The applicant submitted that for the fiscal year ending December 2019, it incurred interest expense of Shs. 7,922,420,000. In its final income tax return for the same year, it claimed the full interest expense on the grounds that it was less than 30% of its Tax EBITDA. The applicant determined its Tax EBITDA to be Shs. 42,034,830,379. 30% of the above Tax EBITDA was Shs. 12.610,449,114, as such the entire interest expense would be claimable as it is less than the limit. The applicant submitted that the respondent alleged that the former over claimed the expense by Shs. 253,864,847 on the ground that it did not compute its Tax EBITDA correctly. The respondent alleged that the applicant's EBITDA is Shs. 25,561,850,509. 30% of which would be Shs. 7,668,555,153. The respondent then assessed 30% tax on the alleged overclaim at Shs. 76,159,455 which is the tax in dispute in this matter. The difference between the party's computation of Tax EBITDA is that whereas the applicant added back the tax figures for depreciation and amortization, the respondent did not. The dispute is how it should be used in the prescribed formula for determining tax EBITDA.

The applicant submitted that the respondent considers the requirement to add back depreciation and amortization in S. 25(5)(i) and (ii) as superfluous. It submitted that the respondent does not dispute the quantum of the depreciation and amortization figures of Shs. 16,472,980,389. It simply ignored it for purposes of making the calculation of Tax EBITDA. The applicant contended that the respondent's approach is incorrect for the following reasons. It blatantly ignores the requirement in S. 25(5) to use the sum of chargeable income, interest expense, depreciation, and amortization. The rule requires that the deduction should not exceed a fixed ratio tax earnings which Uganda set at 30%. The OECD has published a report on Action 4 on how countries should implement it. The applicant contends that the guidance in the report mirrors the formula prescribed in S. 25 of the Income Tax Act as amended and as applied by the applicant. An entity's tax EBITDA is equal to its taxable profit after adding back tax values for net interest expense, depreciation, and amortization. These values are determined under the tax rules of the country applying the rule. Non-taxable income such as branch profits or dividend income that benefit from a participation exemption should not be included within tax EBITDA.

In reply, the respondent contended that in interpretation of statutes words should be given their literal meaning. It cited *Cape Brandy Syndicate v IRC* [1921] K.B. 64 which stated that "In a taxing Act, clear words are necessary in order to tax the subject. In a taxing Act, one has merely to look as what is clearly said." The respondent also cited *Uganda Revenue Authority v Siraje Hassan Kajura* SCCA 9 of 2015 where the Supreme Court held that it is a trite principle of taxation that in tax matters one has to look at the language of the tax statutes to determine the taxability of the taxpayer.

The respondent contended that S. 25(3) of the income tax Act requires that notwithstanding the general rule under S. 25(1), a taxpayer's interest claim is restricted to 30% of its tax earnings before interest, depreciation, and amortization, which is the fixed ratio rule. The respondent's interpretation of S. 25(5)(1) of the income tax Act is it is gross income less allowable deductions that equate to the taxable income of an entity for a given year of income. It contended that this is derived by deducting depreciation and amortization and granting capital deductions under S. 27, 27A and 29 of the income tax Act. The respondent submitted that further adjustments under S. 25(5)(a)(ii) and (iii) of the Income Tax Act are superfluous and serve to grant double adjustments for these deductions and accordingly any resulting amount would not equate to the taxable earnings of an entity and would negate the intention and purpose of the fixed ratio rule under S. 25(3).

The respondent submitted that the 2018 amendment to the income tax Act, S. 25 sought to limit the deductible interest claimed by a taxpayer to a proportion of a taxpayer's earnings before interest, tax, depreciation, and amortization (EBITDA). The provision was based on the OECD Action 4 recommendation on limiting interest and similar debt claims by taxpayers. S. 25 of the income tax Act replaced the thin capitalization rule under the then S. 89 of the income tax Act limiting interest deductions based on debt-to-equity ratios. The respondent submitted that during the review of the applicant, it established that the applicant claimed an interest expense of Shs. 7,922,420,000. The audit team disallowed Shs. 253,864,847 and raised an assessment of Shs. 76,159,455. The respondent in its determination of EBITDA considered the interest expense for the year as the only adjustments under the provisions of S. 25(5)(a)(ii) and (iii) are already considered in arriving at the chargeable income.

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

The applicant submitted that it incurred interest expenses of Shs. 7,922,420,000 in 2019 which it claimed on the ground that it was less than 30% of its Tax EBITDA. The applicant determined its Tax EBITDA is Shs. 42,034,830,379. 30% of the Tax EBITDA is Shs. 12,610,449,114, The respondent during the review established that the applicant claimed an interest expense of Shs. 7,922,420,000 out of which the audit team disallowed Shs. 253,864,847 and raised an assessment of Shs. 76,159,455.

The issue in this case involves the interpretation of S. 25 of the income tax Act and its application. S. 25 of the income tax Act reads.

> "(1) Subject to this Act, a person is allowed a deduction for interest incurred during the year of income in respect of a debt obligation to the extent that the debt obligation has been incurred by the person in the production of income included in gross income.
>
> (2) In this section, "debt obligation" includes an obligation to make a swap payment arising under a swap agreement and shares in a building society.
>
> (3) The amount of deductible interest in respect of all debts owed by a taxpayer who is a member of a group, other than a financial institution or person carrying on insurance

business, shall not exceed thirty percent of the tax earnings before interest, tax, depreciation, and amortization.

(4) A taxpayer whose interest exceeds thirty percent of the tax earnings before interest, tax, depreciation, and amortization may carry forward the excess interest for not more than three years and the excess interest shall be treated as incurred during the next year of income.

(5) In this section –

(a) tax earnings before interest, tax, depreciation, and amortization means the sum of-

(i) Gross income less allowable deductions, except a deduction under subsection (1)

(ii) depreciation; and

(iii) Amortization

(b) "group" means persons other than individual, with common underlying ownership."

The previous S. 25 of the income tax Act before the amendment in 2018 read:

"(1) Subject to this Act, a person is allowed a deduction for interest incurred during the year of income in respect of a debt obligation to the extent that the debt obligation has been incurred by the person in the production of income included in the gross income.

(2) In this Section, "debt obligation" includes an obligation to make a swap agreement and shares in a building society."

A comparison of the two Sections shows that there was no limit on the interest deduction a taxpayer has allowed in a fiscal year before the amendment. The old Section was also not concerned with a taxpayer who was a member of a group as defined.

The new S. 25 enabled a taxpayer to carry forward any interest above the limit for not more than three years. S. 1(kk) of the income tax Act states that interest includes –

"(i) any payment, including a discount or premium, made under a debt obligation which is not a return of capital;

(ii) any swap or other payment functionally equivalent to interest;

(iii) any commitment, guarantee, or service fee paid in respect of a debt obligation or swap agreement; or

(iv) a distribution by a building society:"

By limiting the interest that is allowed as a deductible allowance, mean that the income chargeable to tax increases. A party is allowed to carry the excess interest into another fiscal year not more than three years.

Both parties interpreting S. 25 arrived at different computations as shown below. The parties agree that the applicant tax EBITDA is Shs. 42,034,830,379.

TABLE C

	Applicant	**Respondent**
Chargeable income	17,639,429,990	17,639,429,990
+ interest expense	7,922,420,000	7,922,420,000
Income before interest expense	25,561,849,990	25,561,849,990
+ Depreciation and amortization	16,472,980,338	
Tax EBITDA	42,034,830,378	25,561,850,509
30% EBITDA	12,610,449,113	7,668,555,153
Deduction claimed	7,922,420,000	7,668,555,153
Deduction above limit		253,864,847

The difference between the parties' computation is due to the depreciation and amortization of Shs. 16,472,980,389 which the respondent did not include when determining TEBITDA.

When interpreting a statute words should be given their ordinary meaning. In *Cape Brandy Syndicate V IRC [1921] 1 KB 64 at 71* it was stated that

> "In a taxing act one has to look merely at what is clearly said. There is no room for any intendment. There is no equity about tax. There is no presumption as to tax. Nothing is to be read in, nothing is to be implied. One can only look fairly at the language used."

S. 25(3) of the income tax Act states that the amount of deductible interest in respect of all debts shall not exceed thirty percent of the tax earnings before interest, tax, depreciation, and amortization. Therefore the 30% is calculated using the tax earnings, before interest, depreciation, and amortization. In other words, interest, depreciation, and amortization should be added back to chargeable income to determine the 30% limit. Lord Donavan *in Mangin v inland Revenue Commissioner* (supra) opined that words should not to be given some other meaning simply because their object is to frustrate legitimate tax avoidance devices. The intention of S. 25(3), (4) and (5) was to set the limit which interest expenses should not exceed. If Parliament did not want depreciation and amortization to be added, twice as contended by the respondent, it should not have included them. The respondent does not explain why it allows and uses interest expense which is also used twice if it is already included in chargeable income as an allowable deduction, but is offended by the use of depreciation and amortization twice. TEBIDTA is the sum of tax, interest, depreciation and amortization. Why include tax and interest but exclude depreciation and amortization. That would be deliberately distorting the formula. The formula is to limit on expense deduction allowable and is not the same as interest expense deduction allowable. Any interest expense over the limit is carried forward. The legislature had its reasons. The Tribunal cannot subtract, or read out from the Act what is already in. The work of the Tribunal is to interpret statues as clearly stated and not to legislate. If we are to go by the figures agreed by the parties the 30% would be Shs. 12,610,449,114. The interest expense claimed by the applicant of Shs. 7,922,420,000 is below the 30%. There would be no need for the respondent to get a deduction of 253,864,847 above the limit of Shs. 7,668,555,153. Taking the said into consideration, the additional assessment of Shs. 76,159,455 is set aside.

This application is allowed with costs to the applicant.

Dated at Kampala this 25th day of October 2022.

DR. ASA MUGENYI
CHAIRMAN

MR. SIRAJ ALI
MEMBER

THE REPUBLIC OF UGANDA

IN THE TAX APPEALS TRIBUNAL AT KAMPALA

APPLICATION 21 OF 2021

RWENZORI BOTTLING COMPANY LIMITED ================APPLICANT

VERSUS

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

RULING

I have looked at the draft of my colleagues and therefore wish to dissent as follows:

S. 25(4) of the income tax Act states that:

> "A taxpayer whose interest exceeds thirty percent of the tax earnings before interest, tax, depreciation and amortization may carry forward the excess interest for not more than three years, and the excess interest shall be treated as incurred during the next year of income."

The applicant's chargeable income of Shs.17,639,429,990 is inclusive of depreciation and amortization of Shs.16,472,980,338, onto which the applicant has for a second time added on depreciation and amortization of the same amount in table C. The above section neither mentions double depreciation nor double amortization. To include depreciation and amortization for the second time defeats the legislature motive. The respondent was right not to include depreciation and amortization in its computation but instead raised an additional assessment of Shs. 76,159,455. I am of the opinion, that the additional assessment of Shs. 76,159,455 is payable. In my opinion, I would have dismissed this application with costs to the respondent.

Dated at Kampala this 25th day of October 2022.

ChristineKatwe

CHRISTINE KATWE

MEMBER