THE REPUBLIC OF UGANDA

IN THE TAX APPEALS TRIBUNAL OF UGANDA AT KAMPALA

APPLICATION NO. 46 OF 2018

UGANDA ELECTRICITY TRANSMISSION COMPANY LTD……APPLICANT

VERSUS

UGANDA REVENUE AUTHORITY…… RESPONDENT

CORAM DR. ASA MUGENYI, DR. STEPHEN AKABWAY, MR. GEORGE MUGERWA

RULING

This ruling is in respect of Value Added Tax (VAT) and Withholding Tax (WHT) assessments issued on the applicant for design services purportedly done abroad for installation of transmission lines in Uganda and whether the applicant can claim VAT input credit.

On 10th June 2013, the applicant entered an engineering, procurement and construction (EPC) contract for plant design, installation, and commissioning of the Kawanda-Masaka transmission line with KEC International Ltd, a company based in India. In 2015, the applicant entered another EPC contract for the procurement of plant design, installation and commissioning of the Nkenda-Hoima transmission line with the same company. The contracts were donor funded. Under the EPC contracts, KEC International limited was responsible for all the activities from design, procurement, construction, commissioning, and hand over of the project to the applicant. The applicant and the contractor agreed on a lamp sum. They were turnkey contracts. KEC International Ltd performed the contracts by providing the design, supply, and installation of transmission lines which the applicant paid for.

The applicant claimed for VAT input refund which was rejected by the respondent. The respondent conducted an audit and issued a VAT assessment of Shs. 1,997,205,815 on the applicant on the purported ground that it had imported services. The respondent also issued a withholding tax assessment of Shs. 1,666,291,708.

Issues

1. Whether the applicant was liable to pay VAT on the design services?
2. Whether the applicant is entitled to a VAT input refund as claimed?
3. Whether the applicant is liable to pay withholding tax?
4. What remedies are available?

The applicant was represented by Mr. Bruce Musinguzi and Mr. Thomas Kato while the respondent by Ms. Patricia Ndagire.

The gist of this application revolves around the VAT and WHT liability of the applicant on services provided by a contractor from abroad. The applicant also claimed for VAT input which was rejected by the respondent.

The applicant's first witness, Mr. Godfrey Rwatooro, its Principal Project Accountant testified that the applicant purchases bulk electricity and distributes it. To achieve its goals, it engages companies to design routes for the transmission lines. After determining the feasibility of the routes, the applicant contracts companies to procure design, supply and install transmission lines after obtaining funds from the government. The contracted company designs, tests the plant and equipment, imports and installs them.

On 10th June 2014, the applicant entered an Engineering, Procurement and Construction (EPC) contract with KEC International Limited, for the procurement of plant design, supply, and installation of the Kawanda- Masaka transmission line. On 26th April 2015, the applicant entered another EPC contract for the Nkenda- Hoima transmission line. He testified that KEC International Limited is based in India though it is registered in Uganda. It is VAT registered also. The applicant paid for the services but did not account for VAT. In May and June 2016, the applicant was issued VAT invoices of Shs. 944,584,816.

The applicant's second witness, Mr. Innocent Owino an engineer working with it testified that on 4th February 2011, feasibility studies were conducted for Nkenda- Hoima and Kawanda- Masaka transmission lines by SMEC international Limited which was also

responsible for designing. After the design services the applicant then contracted KEC International Limited for the procurement of the plant, design, supply, and installation of transmission lines. For the Nkenda- Hoima and Kawanda- Masaka transmission lines KEC international limited was contracted to implement the works of SMEC international. The applicant did not contract KEC to provide design services since this was already done by SMEC International. However, in manufacturing the transmission equipment, KEC international would determine the shape and size as part of the design services.

The respondent's witness Mr. Godfrey Bazzekuketa, a supervisor in its Domestic Taxes department testified that the assessment on the applicant arose from an audit. He testified that the audit revealed that the applicant entered a contract with KEC international, an Indian company. The contract involved engineering, procurement, and construction. He testified further that KEC international limited established a branch known as KEC Uganda limited to do the construction work. KEC Uganda limited was found to have income for construction work while income for engineering and procurement was attributed to KEC International limited. He testified that KEC Uganda declared design income of US$ 1,520,931.29 out of a fee of US$ 3,401,307.45. KEC Uganda limited indicated that it was an error as the services were provided by KEC International limited but it only did the billing. He contended that since the design services were done by a non-resident person the applicant ought to have accounted for VAT and WHT. Therefore, WHT and VAT assessments off Shs. 2,672,785,435 were issued on the applicant and input tax of Shs. 944,584,816 was disallowed.

The applicant submitted that the issue is whether the design services under the EPC contracts can be split from the entire contract and considered an imported service on which VAT is due. The respondent contended that the design services were billed for separately and therefore the applicant should have paid VAT. The applicant contended that the design services were incidental and an integral part of the EPC contracts and ought to be considered as a supply of goods. The design services were incidental to the supply, installation, and commissioning of the transmission lines. The applicant contended that the design services were made in India and not in Uganda thus they were imported.

The applicant submitted that the contract between itself and KEC International limited for the Kawanda- Masaka Transmission line Exhibit AE1 page 3, Paragraph 2 provided that:

> "Whereas the employer desires to engage the contractor to design, manufacturer, test deliver, install, complete and commission certain facilities, viz. Lot 1: Kawanda –Masaka 220 Kv Transmission Line ("facilities")" and the contractor has agreed to such engagement upon and subject to the terms and conditions herein after appearing.

The applicant submitted that the design and engineering services should be treated as imported services and are part of the supply installation and commissioning of the transmission lines. The applicant cited S. 12 (1) of the VAT Act that states that "A supply of services incidental to the supply of goods is part of the supply of goods." *Black's Law Dictionary* 11th Edition page 911 defines 'incidental' to mean; "Subordinate to something of greater importance, having a minor role." In *URA v Total (U)* Ltd. CA No. 11 of 2012 the tribunal relied on the definition of the word "incidental" in the *Oxford Advanced Learner's Dictionary* and *Cambridge International Dictionary of English*, in which it was defined to mean "Happening in connection with something of greater importance. The applicant submitted that 'incidental' is a minor occurrence to something bigger. It also cited *Card Protection Plan Ltd. v Commissioners Customs and Excise* [2001] UKHL 4 where the court stated that:

> "A service must be regarded as ancillary to the principal service if it does not constitute for customers an aim in itself but a means of better enjoying the principal supplied."

It also cited *URA v Uganda Taxi Operators and Drivers Association Civil Appeal No. 13 of 2015 [2017] (SCA)* where the court found that:

> "No proper passenger transport system could exist without services rendered by the appellant. In essence the services of the appellant were incidental to the supply of the passenger transport services."

The applicant submitted that in supplying the transmission lines, KEC was required to design the plant and the machinery for the transmission line. In manufacturing the equipment some design services were involved for purposes of meeting the project specific requirements. The applicant submitted that in *Apollo Hotel v URA* App No. 68 of 2018 it was held that.

> "The right to operate the hotel under the Sheraton brand name and the centralized reservations system did not constitute an aim itself but merely a means of better enjoying the principal service supplied."

The applicant concluded that the design services were incidental supply to the principal supply of the installation of a transmission line.

The applicant submitted further that S. 18(1) of the VAT Act provides that "A taxable supply is a supply of goods or services other than an exempt supply made in Uganda by a taxable person for consideration as part of his or her business activities." S. 20 of the Act provides that: "An import of goods is an exempt import if the goods are exempt from customs duty under the 5th Schedule of the EACCMA. Under Paragraph 10 of the 5th Schedule, goods and equipment's imported or purchased for use in donor funded projects are exempt imports. The applicant submitted that the contracts were donor funded.

On the second issue, the applicant submitted that it was entitled to input credit on invoices issued to it by KEC Uganda Ltd of Shs. 944,584,816 wrongly issued. The applicant's contended that the input VAT on the supplies made to it qualify to be creditable under S. 28 of the VAT Act which provides that a credit is allowed to a taxable person for the tax payable in respect of all taxable supplies made during the tax period. The applicant further submitted that the VAT was declared by KEC Uganda Limited as output tax and the respondent has not refunded the output VAT wrongly declared.

On the third issue, the applicant submitted that the respondent relied on Sections 85 and 79 of the Income Tax Act to impose WHT for the services availed by KEC International limited. The applicant submitted that S. 79 provides that income is sourced from Uganda to the extent that it has been derived by a non-resident person carrying on business through a branch in Uganda or for provision of services paid by a resident person. The applicant contended that the services should have been provided in Uganda which was not the case.

In reply, the respondent submitted that the applicant is liable to pay VAT on the design services provided by a non-resident person and that they are not incidental to the supply

of the plant and equipment as alleged. The respondent submitted that the project leading to the procurement of the EPC contracts was not donor funded and therefore the applicant cannot rely on the same to claim exemption. The respondent submitted that S. 24 (8) defines donor funded as aid-funded project as a project financed by a foreign government or a developmental agency through loans, grants, and donations. The respondent submitted that the two parties agreed that the payment for the plant and equipment supplied from abroad will be financed by the proceeds of the loan from IDA. It contended that the *Black's Law Dictionary* 11th Edition defines 'proceeds' as "a variety of things" but for the instant case means and includes the account arising when the right to payment is earned under a contract right. The respondent submitted that IDA is not defined under the contract, and neither is it reflected as a bank or agency or a foreign government. It further contended that there is no contract or agreement to confirm or prove the exact relationship between the applicant and IDA. There is also no clause in both contracts reflecting that the contracts are donor funded or that the projects is being funded by a donor agent. For tax purpose a project to qualify as an "aid funded project" for tax purposes the project should be funded by a foreign government or a development agency through loans or grants.

The respondent also contended that the provision of design services was not incidental to that of plant equipment and therefore VAT on imported services should have been paid by the applicant. It cited *Uganda Tax Operators and Drivers Association (UTODA) v URA CA* 13 of 2015 [2017] [SCA] where the question of single and separated supplies was discussed. The Supreme Court stated that the question to be asked in determining whether there has been a single supply or supplies has been identified as "was the supply of the item incidental to or an integral part of the supply of the other." The respondent submitted that *Black's Law Dictionary* defines 'incidental' to mean "subordinate to something of greater importance having a minor role". The respondent also cited *Uganda Railways Corporation v URA HCT-00-CC-CA*-38-2014 where Justice Wangutusi came up with the following criteria to determine 'incidental':

(a) Whether the parties looking at the transaction intended to have two distinctive services.
(b) Whether the service creates an end in itself to a customer or is it just a means of better enjoying the principal services.

(c) Whether a single price is being charged for the service and that a single supply from an economy point of view should not be artificially split so as to avoid distorting the VAT mechanism.

The respondent also cited *Canadian National Railway Corporation v Harris* [1946] SCR 352, 386 where "Incidental" was defined as something occurring or liable to occur in fortuitous or subordinate conjunction with something else..." The respondent contended that the design services created an end to itself for the customer considering that these services were not needed to get the right lines for installation, therein not meeting the definition of incidental.

The respondent submitted that its witness testified that KEC India established a branch known as KEC –Uganda where different services were to be divided between two companies. According to RW1, KEC-Uganda provided the construction and installation services while KEC –India was to provide the design services and some plant and equipment from abroad. KEC Uganda was registered for tax purposes and was found to have declared income in relation to the construction as per the EPC contract. It was also discovered that the KEC Uganda had declared part of the design income in both income tax and VAT returns. KEC Uganda admitted that the said declaration was in error on its side since it only helped KEC – India to bill and it made a reversal since these were imported services provided by KEC- India to the applicant.

The respondent cited *URA v COWI A/S* CA 34 OF 2020 where Justice Mubiru stated that a branch in Uganda is distinct from its head office overseas and is therefore considered to be a taxable person for VAT purpose, even though they both form part of the same legal entity. The respondent submitted that the KEC India having established a branch it intended that that the supplies and services contracted to perform were to be separated and performed by two different companies. Hence the supply of design services was an independent service from the supply of the plant and equipment.

The respondent submitted that S. 4(c) of the VAT Act imposes VAT. S. 5(1)(c) of the VAT Act states that the tax payable in the case of a supply of imported services is to be paid by the person receiving the supply. Regulation 13(1) of the VAT Regulations states that

a person who receives imported services other than an exempt service shall account for the tax due on the supply when performance of the service is completed, or when the invoice is received from the foreign suppliers, whichever is the earliest. The respondent submitted that the applicant was required to remit the VAT on the imported services which are the design services since it was the recipient of the said imported service.

The respondent submitted that the applicant ought to have charged WHT on KEC India for the design services since they were provided by a non-resident. The respondent cited S. 85 (1) of the Income Tax Act which provides that a tax is imposed on every non-resident person deriving income under a Ugandan source services contract. S. 120 states that any person making payment shall withhold from the payment that the tax levied.

In rejoinder, the applicant submitted that IDA refers to the International Development Association which is a lending arm of the World Bank. The applicant submitted that it qualifies as an aid funded project.

The applicant submitted that the applicant is entitled to input credit on the VAT incurred for the taxable supplies under S. 28(1) of the VAT Act. KEC Uganda declared the VAT as output tax wrongly and the respondent has not provided evidence to show that this amount was refunded.

Having heard the evidence, perused the exhibits, and read the submissions of both parties this is the ruling of the tribunal.

The applicant entered two agreements with KEC international limited for the installation of electrical transmission lines for Kawanda – Masaka and Nkenda- Hoima routes dated 10th June 2014 and 16th April 2015, respectively. Clause 7.1 of the agreement for the Kawanda- Masaka transmission line read:

> "Unless otherwise expressly limited in the Employer's requirements, the Contractor's obligations cover the provision of all Plant and the performance of all Installation Services required for the design, and manufacture (including procurement, quality assurance, construction, installation, associated civil works, Pre-commissioning and delivery) of the

Plant, and the installation, completion and commissioning of the Facilities in accordance with the plans, procedures, specifications, drawings, codes and other documents as specified in the Section, Employer's Requirements…"

The word 'plant' was defined in Clause 1 to mean

"…permanent plant, equipment, machinery, apparatus, materials, articles and things of all kinds to be provided and incorporated in the Facilities by the Contractor under the Contract…"

The contract of the Nkenda- Hoima transmission line Clause 16. 1 provided that the Contractor shall construct and install the Works in accordance with the Specifications and Drawings. From the above clauses designing the plant and works was part of the project.

KEC international limited is based in India where it was providing the services from. The respondent contended that the supply of services was an imported service liable to VAT. S. 4 of the VAT Act imposes VAT. S. 4(c) imposes VAT of a supply of imported services other than an exempt service. S. 5(1)(c) of the Act provides that in the case of a supply of imported services, other than an exempt service, VAT is to be paid by the person receiving the service. The respondent contended that the supply of design service was an import which required the recipient who was the applicant to pay VAT.

The applicant contended that the supply of services was incidental to an import of exempt goods hence supply was exempt. S. 20 of the VAT Act provides that

"An import of goods is an exempt import if the goods-

(a) Are exempt from customs duty under the 5th Schedule of the EACCMA except compact fluorescent bulb with a power connecting cap at the end and lamps and bulbs made from light emitting Diodes (LED) technology for domestics and industrial use."

Paragraph 10 of the 5th Schedule provides that goods and equipment for use in Aid funded projects are exempt.

The respondent contended that the projects of installation of transmission lines were not donor funded. The Contract of the Kawanda- Masaka line is silent on who financed the project. The contract for the Nkenda- Hoima line shows that the financier is the government of Norway. S. 24 (8) of the VAT Act states that "aid-funded project" means a

project financed by a foreign government or a development agency through loans, grants and donations." Norway is a foreign government. The issue of funding the contract did not arise during the trial. At scheduling it was agreed that the projects were donor funded. The Tribunal feels that addressing the issue at this time may be detrimental to the applicant as no evidence was led on it. It was also not raised in the objection decision.

The dispute between the parties arose as from the evidence of the respondent's witness, when KEC international limited purportedly used KEC Uganda limited to do the construction work. KEC Uganda limited was found to have income for construction work while income for engineering and procurement was attributed to KEC international limited. The respondent's witness testified that KEC Uganda Limited declared design income of US$ 1,520,931.29 out of a fee of US$ 3,401,307.45. The applicant testified that it was KEC international limited that provided the design services. The whole transaction became murky. The respondent's witness testified that KEC Uganda Limited was a branch of the KEC International Limited. Firstly, KEC Uganda Limited being a limited company cannot be a branch of KEC International Limited. It may be a subsidiary, but it is not a branch. Secondly, KEC Uganda limited was not party to the agreements between the applicant and KEC International limited. If the applicant contracted KEC international Limited, then how was KEC Uganda limited doing the construction work? The agreement between Kawanda- Masaka Clause 19.1 provides for approved sub-contractors to be listed in the appendix. The said appendix was not attached or adduced in evidence. The contract of the Nkenda- Hoima Clause 7.1 provides the contractor should not assign or subcontract without the approval of the Employer. No evidence was adduced to show that KEC International approved any subcontract or assignment. The applicant's first witness, Mr. Godfrey Rwatooro stated that under the EPC contracts KEC International Limited was responsible for all the activities from the design, procurement, and construction to commissioning and handover of the project. He stated that KEC International limited was duly registered as a foreign company in Uganda. He does not state what the branch in Uganda provided. He testified that the design was made in India. The applicant's second witness, Mr. Innocent Owino stated the applicant contracted KEC International limited inter alia to do the design services. However, he testified for the Nkenda- Hoima and Kawanda- Masaka transmission lines KEC international limited was contracted to

implement the works of SMEC international. He did not mention where it was located. The contracts for the said lines do not mention subcontracting. It becomes difficult to ascertain who did what. And whether the design services were done abroad or in Uganda.

The Tribunal must ask itself whether the supply of design services was incidental to the supply and installation of the transmission lines. S.12 of the VAT Act provides that:

> "(1) a supply of services incidental to the supply of goods is part of the supply of goods.
>
> (2) A supply of goods incidental to the supply of services is part of the supply of services."

S. 11(3) of the Act provides that a supply of services incidental to the import of goods is part of the import of goods. The Tribunal feels that this would refer to services like clearing and forwarding, transporting, insurance, freight etc. It may not cover designing which may be properly addressed under S. 12 of the VAT Act.

Courts have made decision on what amounts to a supply of service or goods being incidental to the principal supply. In *Canadian National Railway Corporation v Harris* [1946] SCR 352, 386 the meaning given to incidental was "Occurring or liable to occur in fortuitous or subordinate conjunction with". In *Card Plan Limited v Commission Customs and Excise* [2001] UKHL Lord Slynn of Hadley stated

> "……. every supply of a service must normally be regarded as distinct and independent and, secondly, that a supply which comprises a single service from an economic point of view should not be artificially split, so as not to distort the functioning of the VAT system, the essential features of the transaction must be ascertained in order to determine whether the taxable person is supplying the customer, being a typical consumer, with several distinct principal services or with a single service.
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> …. . A service must be regarded as ancillary to a principal service if it does not constitute for customers an aim in itself, but a means of better enjoying the principal service supplied: *Customs and Excise Commissioners V Madgett and Baldwin* (trading as Howden Court Hotel).

In *URA v Uganda Taxi Operators and Drivers Association Civil Appeal No. 13 of 2015 [2017] (SCA)* the court found that:

> "No proper passenger transport system could exist without services rendered by the appellant. In essence the services of the appellant were incidental to the supply of the passenger transport services."

So, the question is was the supply of design services incidental to that of installation of transmission lines.

The word 'design' is defined in *Oxford Advanced Learners Dictionary* 9th Edition p. 404 as "The general arrangement of the different parts of something that is made…" The *Cambridge Advanced Learners Dictionary* 4th Edition p. 410 defines "design" as: "To make or draw plans for something". From the said definitions it is discernable that before one can install transmission lines it needs to draw plans for it to be effected. Clause 7.1 of the contract for Kawanda- Masaka transmission line mentions that installation was to be made in accordance with plans, procedures, specifications, drawings, codes, and other documents. The contract of the Nkenda- Hoima transmission line Clause 16. 1 also provided that the Contractor shall construct and install the Works in accordance with the Specifications and Drawings. Therefore, the supply of the design services was incidental to that of installation of transmission lines. If the supply of the installation of transmission lines was VAT exempt under the East African Community Customs Management Act (EACCMA) then the supply of design services is also exempt as it was an ancillary supply. The VAT assessment of Shs. 1,778,447,976 was uncalled for and is set aside.

The second dispute was whether the applicant was entitled to input VAT. The applicant submitted that VAT was wrongly declared by KEC Uganda as output tax and the respondent has not refunded the VAT. S. 28 of the VAT Act provides for credit of input tax. However, the facts provided by the parties are not clear. The applicant contends that the VAT was wrongly declared by KEC Uganda. So, if the VAT was wrongly declared by KEC Uganda and reversed, there is no evidence that the said tax was declared by KEC International limited, or it filed the relevant returns. The VAT invoices and payments were not adduced as evidence. The Tribunal noted that the supply of installation lines was an exempt supply. We also noted the supply of design service was incidental to that of the installation lines making both supplies exempt. Where there is an exempt supply, input VAT cannot be claimed. It can only be claimed if the supply is standard rated or zero rated. If the supply of design service was incidental to the supply of the installation lines, the price of the service is part of that of the main supply which is exempt.

The respondent submitted that the applicant ought to have withheld tax on the fees it paid to KEC international Limited for the design services. S. 85 of the Income Tax Act states that "a tax is imposed on every non-resident person deriving income under a Ugandan source service contract." S. 85(4) states that a "Uganda-source services contract" means

> "a contract other than an employment contract under which the principal purpose of the contract is the performance of services which gives rise to income sourced in Uganda; and any goods supplied are only incidental to that purpose."

The main purpose of the contracts between the applicant and KEC International limited was the installation of electrical transmission lines. Under income tax, unlike Value Added Tax, the provision of transmission lines is incidental to the supply of services of designing and installation. This is because the lines are installed with the purpose of transmitting electricity which is a provision of services. Installing the transmission line is a provision of services. The supply of the transmission lines is one of goods which is incidental to the supply of services of installation. For the said services KEC International limited derived income under a Ugandan Source service contract. Therefore, it ought to have paid income tax.

S. 120 of the Income Tax Act provides that "Any person making payment of the kind referred to in Sections 83, 85 or 86 shall withhold from the payment that tax levied under the relevant Section." Therefore, the applicant ought to have withhold taxes on the payments made to KEC International limited. S. 124 states that "A withholding agent who fails to withhold tax in accordance with the Act is personally liable to pay to the Commissioner the amount of tax which has not been withheld but the withholding agent is entitled to recover the amount from the payee." Therefore, the respondent was justified to assess the applicant withholding tax of Shs. 1,666,291,708

Since both parties have been successful each party will bear its costs.

In the circumstances we find that:

1. The applicant is not liable to pay VAT of Shs. 1,778,447,976 for the provision of design services.
2. The applicant is not entitled to input credit of Shs. 944,584,816.

3. The applicant is liable to pay withholding tax of Shs. 1,666,291,708.
4. Each party bears its cost.

Dated at Kampala this day of 2022.

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DR. ASA MUGENYI	**DR. STEPHEN AKABWAY**	**MR. GEORGE MUGERWA**
CHAIRMAN	**MEMBER**	**MEMBER**