

**THE REPUBLIC OF UGANDA**  
**IN THE TAX APPEALS TRIBUNAL OF UGANDA AT KAMPALA**  
**APPLICATION NO. 57 OF 2021**

**ABSA BANK UGANDA LIMITED ..... APPLICANT**

**VERSUS**

**UGANDA REVENUE AUTHORITY..... RESPONDENT**

**BEFORE DR. ASA MUGENYI, MR. GEORGE MUGERWA, MS. CHRISTINE KATWE**

**RULING**

This application is in respect of Value Added Tax (VAT), Income Tax and Withholding Tax (WHT) assessments of Shs. 3,470,666,962.

The applicant provides banking services. The respondent conducted an audit on the applicant for January 2014 to May 2020. It issued assessments totaling to Shs. 5,986,029,322 on the following grounds;

- i) That the applicant did not declare VAT on lease rentals
- ii) It claimed unrealized foreign exchange and losses.
- iii) The respondent disallowed interest expenses.
- iv) The respondent imposed WHT on bank charges on services by foreign corresponding banks.

**Issues**

- 1. Whether the applicant is liable to pay the taxes assessed by the respondent?
- 2. What remedies are available to the parties?

The applicant was represented by Ms. Belinda Nakiganda, Mr. Cephas Birungi while the respondent by Ms. Patricia Ndagire and Mr. Donald Bakashaba.

On 1<sup>st</sup> September 2023, the parties entered into a partial consent wherein the respondent made adjustments on the applicant's tax position which are summarized as follows:

- i) Income tax assessment of Shs. 2,925,943,297 was adjusted to Shs. 1,683,237,749
  - ii) VAT was adjusted from Shs. 2,329,082,529 to Shs. 1,156,425,590
- Shs. 3, 568,154,943 was left for determination of the Tribunal as follows
- i) Shs. 731,003,496 in regard to non-declaration of WHT on charges paid by customers to corresponding banks (nostro charges).
  - ii) Shs. 1,156,425,590 in regard to non-declaration of VAT on initial customer deposits.
  - iii) Shs. 1,683,237,876 in regards of disallowed interest expense.

The dispute relates to assessments issued on non-declaration of WHT on charges paid to corresponding banks, non-declaration of VAT on initial customer deposits and disallowed interest expenses.

The applicant's first witness, Mr. Alvin Asingwire, its Head of Tax stated that the respondent conducted an audit on the applicant for January 2014 to May 2020. The respondent issued VAT, income tax, Local Excise Duty and WHT assessments which were eventually reduced. The first dispute is in respect of lease rentals. He stated that the applicant offered credit facilities to companies such as Biryia Agencies, Eagles Air Limited, KEA America Limited, Blessed Tree Planters and Agro Distributors. He contended the supplies were for financial services which are VAT exempt under the VAT Act and therefore the assessments should be vacated. This dispute was resolved and is not part of what was remitted to the Tribunal for determination.

The second dispute is in respect of VAT assessed on initial deposits made by the applicant's customers on purchase of assets. He stated that the applicant enters contracts for capital asset financing where the customers use the assets purchased to get loans to complete payment of the purchase price. The applicant collects periodic payments from the customers as payments of the loan. It accounts for VAT on the lease

payments but not the initial deposits made to the supplier. The witness contended that the payment is made by the borrower directly to the supplier without the involvement of the applicant. He stated that the respondent computed VAT on the full value of the asset as opposed to the amount disbursed by the applicant. He prayed the VAT assessment of Shs. 2,329,082,529 should be vacated. However, the consent settlement put the VAT outstanding at Shs. 1,156,425,590,

The third dispute was in respect of interest of Shs. 5,610,792,921 which was disallowed by the respondent resulting in a tax liability of Shs. 1,683,237,876. The witness contended that the expense is an allowable deduction as it is a business expense. The applicant prepares its accounts on an accrual basis. The interest incurred by banks is not deferred.

The last dispute was in respect of WHT imposed on international payments. He stated that the applicant facilitates international payments initiated by its customers. It entails customer initiating transfers through various options such as telegraphic transfers (TT). For each transfer, the applicant and the corresponding bank charges fees for the transfer. He further narrates that the bank charges for both banks are debited off the customer's account with the amount to be transferred. The applicant bank recognizes its bank charges as income, which is duly accounted for and remitted to URA. The applicant remits the amount to be transferred and its bank charge to the correspondent bank. He contended that applicant should not be charged WHT on the fee by the corresponding bank because the fee is charged to the customer and not it. The obligation to withhold tax is on the customer and not the local bank.

The applicant's second witness, Mr. Emmanuel Kiberu Mulambuzi, its financial controller testified that the respondent conducted an audit on the applicant and issued assessments on the latter. The applicant objected. He stated that the applicant disputes assessments on foreign exchange amounting to Shs. 1,242,705,421. He testified that in 2015 there was an unrealized loss of Shs. 1,181,546. It was not included in the 2015 income tax computation but in 2016 when it was realized. He stated the transactions in 2015 had maturity dates within 2016. In 2016, the applicant had an unrealized gain of Shs.

635,228,269 and it made adjustments. He stated that in 2018, the respondent made adjustments of Shs. 3,596,033,550 relating to government securities for foreign exchange. He contended that the amount was erroneously included in the adjustment and the additional tax of Shs. 1,242,705,421 should be vacated.

The respondent's witness, Ms. Racheal Katende, an officer in its domestic taxes department testified that applicant provides full and partial asset lease financing facilities to its customers. The suppliers of the assets would issue the applicant invoices which have the full price of the asset inclusive of VAT. The applicant would claim 100% input VAT on the full invoice amount regardless of the quantum of its contribution to the purchase of the asset. Shs contended that the applicant was obliged to account output VAT on the full invoice amount. She stated that the unaccounted output VAT of Shs. 1,156,425,590 was determined and incorporated in the applicant's VAT computations.

She stated that the second dispute is in respect of non- declaration of WHT on charges paid to corresponding banks. The applicant opened accounts in foreign banks which it uses to facilitate transactions in different currencies. The foreign corresponding banks charge the applicant per transaction and the charge is passed on to customers. She stated that the applicant's customers have no relationship with the foreign bank but only with the applicant. The charges by the foreign corresponding banks are remitted to the foreign banks by the applicant as per the service agreements and cash payments. She stated that applicant did not withhold tax on the remittances. The respondent issued the applicant a WHT assessment of Shs. 731,003,496.

The witness stated that the respondent also discovered that the applicant was treating unpaid interest expense as an allowable deduction. The applicant claimed both paid and accrued interest as allowable deductions leading to less chargeable income and paid less tax. The applicant accrues interest expense on its customer accounts but pays and withholds tax at the date of maturity. The respondent therefore made adjustments that only allowed actual interest expense paid upon maturity. Interest expense that was not

actually paid was disallowed. This resulted in an income tax liability of Shs. 1,683,237,748.

The applicant submitted that exempt lease rental is not subject to tax. It submitted that the agricultural credit facility loan to Biryia Agencies is exempt from VAT. Under the agricultural credit facility all goods purchased were for agricultural purposes. It submitted that under S. 19 of the VAT Act a supply of goods and services is exempt if it is specified in the Second Schedule. Paragraph 1(c) of the Schedule exempts the supply of financial services. Paragraph 2(b) defines financial services to include granting, negotiating, and dealing with loans. The applicant provided a loan to Biryia at an interest rate of 12% which was an agricultural loan facility and should be exempted from VAT. It submitted that in alternative, S. 21 of the VAT Act provides that the taxable value of a taxable supply is the total consideration paid in money or in kind by all persons for that supply. The applicant submitted that the bank of Uganda gave a directive that a loan of Shs. 1,624,036,960 is given which is the taxable supply and the applicant is entitled to claim input on it.

The applicant submitted that on capital asset financing, the respondent computed VAT on the initial deposits by customers. It contended that this payment is not to the applicant and is not towards the facility. It submitted that S. 21(4) of the VAT Act provides that the taxable value of a taxable supply is the amount of the rental payments due or received. It stated that it is not disputed that customers pay for the initial deposit say 20% and the applicant finances the other 80%. It submitted that the initial deposit is not money received by the applicant. VAT is due on the money paid to the applicant. S. 28 of VAT Act allows a taxpayer to claim credit for taxable supplies. The applicant submitted that it rightly claimed input VAT. It submitted that the Tribunal has powers to remit the matter back to the respondent to rectify any errors.

In respect of the income tax assessment of Shs. 1,683,237,876, the applicant submitted that accrued interest is an allowable deduction under the Income Tax Act. It submitted that the applicant accrues interest from customers' fixed deposits and makes payments. The applicant submitted that S. 2(xx) of the Income Tax Act defines payment to include

any amount paid or payable in cash or kind. The term paid or payable included amounts paid and amount accrued. The applicant submitted that interest was an accrued expense incurred in the production of income under S. 25 of the Income Tax Act.

In respect of WHT on fees paid to foreign banks, the applicant submitted that nostro charges are deducted outside Uganda and should not attract WHT. The money paid is for the customer and the applicant is an agent, thus WHT should be charged on customers and not banks.

In reply, the respondent submitted that the relationship between the applicant and the foreign banks is made under cash management service agreements. In determining whether the income is sourced in Uganda, the fee charged by the foreign bank is for cash management services provided to the applicant which is referred to as a 'nostro charge'. This payment constitutes payments sourced in Uganda as per Sections 79, 78, 83 and 120 of the Income Tax Act. S. 79(q) of the Income Tax Act provides that payments of a management charge to a non-resident form part of incomes sourced in Uganda where it has been paid by a resident person. S. 2(hhh) defines a resident person as a resident individual, resident company, resident trust, resident partnership, resident retirement fund. S. 10(a) to define a resident company as one incorporated or formed under the laws of Uganda, although the issue of residency was not in question

The respondent submitted that S. 78(c) of the Income Tax Act defines a management charge to mean any payment made to a person, other than a payment of employment income, as a consideration for any management services, however calculated. Consideration is defined under S. 2(na) to include the total amount in money or of payment in kind, paid or payable for the supply of goods, services and includes duties, levies, fees and charges. The respondent cited *Metropolitan Life Limited v Commissioner for the South African Revenue Service* A 232/2007 where the court defined service as.

"Services means anything done or to be done, including the granting, assignment, cession, or surrender of any right or the making available of any facility or advantage..."

It further cited *Goal Relief Development Organization v Uganda Revenue Authority* Application 77 of 2021 where it was stated that.

"Management services are not defined. Management is defined by Black's Law Dictionary 10<sup>th</sup> edition at page 1104 as "the act or system of controlling and making decisions for business or department..." The head office provides support and administrative work when it seeks grants which can amount to managerial services... Taking the above into consideration, Ireland head office was rendering management services to the Applicant which ought to have withheld taxes."

The respondent cited *DFCU Bank v Buwembo & 3 others* Civil Suit 262 of 2011 where it was stated that nostro accounts are accounts opened by a bank in other foreign banks to handle its foreign exchange transactions. It also cited *Standard Chartered Bank Zimbabwe Limited v Zimbabwe Revenue Authority* Civil Appeal SC 145/15 where it was stated that

"The fees and charges in issue are raised by the banks holding the nostro accounts in respect of transactions undertaken by them on behalf of the appellant which issues instruction on behalf of its clients in Zimbabwe and pays on behalf of those clients using its nostro accounts. These transactions clearly amount to services of a managerial or administrative nature within the meaning of para 1(1) of the 17<sup>th</sup> Schedule... It follows that the appellant, as payer of the fees, was obliged to withhold the non-resident tax and remit such tax to the Commissioner within 30 days."

The respondent submitted that where management services are paid, the person making the payment had an obligation to withhold taxes. The respondent cited *Kenya Commercial Bank Limited v Kenya Revenue Authority* [2016] EKLK where it was stated that

"As long as the expense is debited from the banks accounts, it is deemed to have been paid and withholding tax becomes immediately payable."

The respondent submitted that the payment of nostro charges constituted a payment for management service provided by the foreign bank to the applicant who has an obligation to withhold taxes under Sections 120, 123, 124 and 127(2)(b) of the Income Tax Act.

The respondent submitted that the applicant provided asset lease financing facilities where an asset may be fully or partially financed depending on the customer's needs. The applicant received and claimed 100% input tax on the purchase of the asset leased

by the customer. The respondent made an objection decision insisting that the applicant was obliged to account for output VAT on full invoice amount.

The respondent cited S. 28 of the VAT Act which entitles a taxpayer to claim input VAT. It submitted that the invoice must reflect the amount of input VAT. The applicant did not pay the entire amount itself and only paid a portion of the input tax and therefore could not claim the entire amount. The respondent cited *NCBA Bank Uganda Limited v URA Application 15 of 2020* where it was stated that.

"If the applicant was claiming input VAT on the whole amount that is the initial consideration plus its contribution, then it should have accounted likewise in the output VAT."

The respondent argued that the above case was similar to this one. If the applicant collected output VAT on the facilities it was mandated to account for them to the respondent. The applicant ought to have account for VAT of Shs. 1,156,4254,590.

In respect of interest expenses, the respondent submitted that the applicant was assessed WHT of Shs. 1,683,237,876 on disallowed interest expense. The applicant claimed paid out and accrued interest as allowable deduction. The respondent submitted that it is trite law that where interest is subject to WHT, it shall be incurred when paid. The respondent cited S. 47(2) of the Income Tax Act which provides that "Where the interest referred to in subsection (1) is subject to withholding tax, the interest shall be taken to be derived or incurred when paid." The respondent cited S. 25 of the Act which provides that

"(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."

The respondent submitted that the applicant claiming both paid out and accrued interest as an allowable deduction would lead to less chargeable income.

The respondent submitted that the financial statements indicate the interest paid. Had interest been credited to the recipients, it would have had corresponding WHT remitted. In this case, there was no WHT remitted since the applicant made no payment. The

respondent cited *Primarosa Flowers Limited v The Commissioner of Income Tax* Income Tax Appeal 18 of 2013 where it was noted that "In this matter, there was no dispute that interest had not been paid during the period under review; and neither was any posting made in that connection in the appellant's books of account..." The respondent also cited *ATC v Uganda Revenue Authority* Application 32 of 202 where it was held that the import of S. 47 of the Income Tax Act is that the requirement to withhold tax arises at the time interest is paid and not when it accrues. It also cited *Afgri v Uganda Revenue Authority* Civil Appeal 35 of 202 where it was held that the applicant having paid interest it was liable to WHT.

In rejoinder, the applicant submitted that any transactions on the nostro accounts happened between the foreign bank and the applicant's foreign account and thus not subject to WHT. The respondent has no jurisdiction to tax transactions in foreign countries since the transaction do not happen in Uganda. The applicant submitted that Sections 79(q) and 120 of the Income Tax Act are not applicable. It cited *ITO v Hong Kong & Shanghai Banking Corporation Ltd* (ITAT Mumbai) where it was held that "the transaction charges paid on nostro account were in the nature of bank charges for maintaining the accounts with banks outside India." It was further stated that no tax therefore was required to be deducted as source from the transaction charges paid on nostro account and the disallowance made was not sustainable. The applicant also cited *Standard Chartered Bank Zimbabwe Ltd. v Zimbabwe Revenue Authority* CA SC 145/15 which quoted *Sun fresh Enterprises Limited t/a Bulembe Safaris v Zimra* 2004 (1) ZLR where it was stated that payment of a commission by a foreign client to a foreign marketing agent of a local safari operator outside the country did not constitute payment of fees from within Zimbabwe.

The applicant submitted that the respondent computed a VAT liability on the initial deposit by the customer to the supplier which payment is neither made to the bank nor a payment towards the facility offered. Accordingly, the payment is made directly to the supplier directly without the bank's involvement and that "initial deposit" is not the bank's money. The applicant cited Section 14(2) and (5) of the VAT Act which provides that a supply

occurs under a finance lease on the earlier of the date on which payment is due or received. Further S. 21(4) provides that the taxable value of a taxable supply of goods under a rental agreement, as defined in S. 14, as the amount of the rental payments due or received. The applicant concluded that the respondent unlawfully assessed the output VAT on monies that is not due or payable to the applicant contrary to the VAT Act and thus the assessments should be vacated.

On input tax for capital financing, the applicant submitted that some assets are sourced locally while others imported and hence there should be a difference in tax treatment by the respondent. Where the supplier is not from Uganda and the invoice should have no VAT as its not applicable. The applicant submitted for locally purchased assets, the supplier provides an invoice in the applicant's name with the total amount of good purchased. The applicant argued that S. 28(1)(a) of the VAT Act allows a taxpayer to claim credit for taxable supplies. The applicant cited *Warid Telecom v Uganda Revenue Authority* Application 24 of 2011 where it was held that input tax is allowed on taxable supplies by the person. The applicant concluded that the respondent unlawfully charged output tax on the applicant instead of disallowing VAT as required by the Act.

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

The parties entered a consent settlement where Shs. 3,568,154,943 was left for determination of the Tribunal as follows

- i) Shs. 731,003,496 in regard to non-declaration of WHT on charges paid by customers to corresponding banks (nostro charges).
- ii) Shs. 1,156,425,590 in regard to non-declaration of VAT on initial customer deposits.
- iii) Shs. 1,683,237,876 in regards to disallowed interest expense.

However, a proper calculation of the above amounts is Shs.3,570,666,962

The applicant submitted on a dispute in respect of lease rentals. It submitted that the applicant offered credit facilities to Biryia Agencies, Eagles Air Limited, KEA America

Limited, Blessed Tree Planters and Agro Distributors. The applicant submitted that the credit facility loans are not subject to tax. The respondent did not reply to the said submissions. The Tribunal notes that when the parties entered the partial consent settlement the issue of lease rentals or the said credit facilities was not among those agreed to be sent to it for determination. Therefore, the Tribunal will not address it as it will be acting outside the jurisdiction the parties vested in it.

The first dispute the Tribunal will address is in regard to the WHT assessment of Shs. 731,003,496 on charges paid by customers to corresponding banks known as nostro charges. The applicant did not dispute that nostro charges made on nostro accounts. In an article by Ashish Kumar Srivastav published on the Wall Street Mojo, a nostro account is defined as

"The account that a country's bank holds in the bank of another country in the foreign currency. It helps the bank which has the account in the bank of another country by simplifying the exchange and trading process for the foreign currencies."

The respondent conducted an audit of the applicant for January 2014 to May 2020. It claimed that the applicant was under an obligation to withhold taxes on management charges paid to corresponding banks on its nostro accounts.

The respondent contends that the nostro charges are management charges under S. 78(c) of the Income Tax Act. S. 78 defines a management charge to mean any payment made to a person, other than a payment of employment income, as a consideration for any management services. In *Goal Relief Development Organization v Uganda Revenue Authority* Application 71 of 2021 the Tribunal noted that; "management services are not defined." However, it stated that management is defined in *Black's Law Dictionary* 10<sup>th</sup> Edition p.1104 as "the act or system of controlling and making decisions for business or department..." In *Standard Chartered Bank Zimbabwe Limited v Zimbabwe Revenue Authority* Civil Appeal SC. 145/15 it was stated

"The fees and charges in issue are raised by the banks holding the nostro accounts in respect of transactions undertaken by them on behalf of the appellant which issues an instruction on behalf of its clients in Zimbabwe and pays on behalf of those clients using

its nostro accounts. These transactions clearly amount to services of a managerial or administrative nature."

The payments made by the applicant to the corresponding banks were in respect of business decisions for transactions between the banks. It is not in dispute that the applicant made payment for services. Those charges can be considered as management charges under S. 78 of the Income Tax Act

The question is what is the nexus between the charges paid to foreign banks by the applicant and the liability to pay income tax. S. 79 of the Income Tax provides for when income is sourced in Uganda. S. 79(q) provides that income is sourced in Uganda to the extent to which it is a management charge paid by a resident person. S. 2(he) defines person to include a resident company. S. 10(a) of the Income Tax Act states that a company is a resident company for a year of income if it is incorporated or formed under the laws of Uganda. It is not in contention that the applicant was incorporated in Uganda. The applicant is a resident person in Uganda. S. 83 of the Income Tax Act imposes taxes on management charges. S. 83 states that.

"(1) Subject to this Act, a tax is imposed on every non-resident person who derives any dividend, interest, royalty, rent, natural resource payment, agency fee in case of Islamic financial business, or management charge from sources in Uganda.

(2) The tax payable by a non-resident person under this Section is calculated by applying the rate prescribed in Part IV of the Third Schedule to this Act to the gross amount of the dividend, interest, royalty, rent, natural resource payment, agency fee in case of Islamic financial business, or management charge derived by a non-resident person."

The applicant also did not dispute that a tax is imposed on management charges from sources in Uganda. However, it contends that its clients should be the one to withhold taxes on monies sent for the transactions done or the nostro charges. The respondent on the other hand contended that the applicant should be the one to withhold taxes. S. 120 of the Income Tax Act states who should withhold taxes on international payments. It reads

"(1) Any person making a payment of the kind referred to in Section 83, 85 or 86 shall withhold from the payment the tax levied under the relevant Section."

In *Standard Chartered Bank Zimbabwe Limited v Zimbabwe Revenue Authority* (supra) it was held that

"It follows that the appellant, as payer of the fees, was obliged to withhold the non-resident tax and remit such tax to the Commissioner within 30 days."

In *Kenya Commercial Bank Limited v Kenya Revenue Authority* [2016] EKLK it was stated that.

"As long as the expense is debited from the banks accounts, it is deemed to have been paid and withholding tax becomes immediately payable."

Though the applicant pays the nostro charges on behalf of its clients, it is the one that actually effects payment, therefore it has an obligation to withhold taxes on behalf of its clients. It does not make legal sense for the clients to withhold taxes when the nostro accounts are held by the applicant. The respondent was justified to conclude that the applicant was under an obligation to withhold taxes at a rate of 15% under S. 120 of the Income Tax Act. Therefore, the applicant is liable to pay the WHT assessment of Shs. 731,003,496 on charges paid to corresponding banks.

The second dispute is in respect of a VAT assessment of Shs. 1,156,425,590 issued by the respondent on the applicant in regards to VAT on initial customer deposits. The respondent contends that the applicant did not account for output tax on initial deposits made by its customers when purchasing assets. The applicant enters contracts for capital asset financing whereby its customers use their assets as security for loan facilities in order to purchase them. The applicant collects periodic payments from the customer as payments of the loan. The applicant accounts for VAT on its contribution but not the initial deposit to the supplier. The applicant contended that the payment is made by the customer directly to the supplier without the involvement of the applicant. For instance, if the initial deposit is 20% the applicant will finance and account for 80%. He stated that the respondent computed VAT on the full value of the asset as opposed to the amount disbursed by the applicant. It submitted that the initial deposit is not money received by the applicant. VAT is due on the money paid by the applicant. S. 28 of VAT Act allows a taxpayer to claim credit for taxable supplies. The applicant submitted that it rightly claimed input VAT.

The applicant submitted that S. 21(4) of the VAT Act provides that the taxable value of a taxable supply is the amount of the rental payments due or received. It stated that it is not disputed that customers pay for the initial deposit say 20% and the applicant finances the other 80%. It submitted that the initial deposit is not money received by the applicant. VAT is due on the money paid to the applicant. S. 28 of VAT Act allows a taxpayer to claim credit for taxable supplies. The applicant submitted that it rightly claimed for input VAT.

The respondent submitted that the suppliers of the assets issue the applicant invoices which have the full price of the asset inclusive of VAT. The applicant would claim 100% input VAT on the full invoice amount regardless of its contribution to the purchase of the asset. The respondent contended that the applicant was obliged to account output VAT on the full invoice amount. It stated that the unaccounted output VAT of Shs. 1,156,425,590 was determined and incorporated in the applicant's VAT computations. The applicant did not dispute this. If the applicant claimed input VAT on the full invoice amount, then it should pay output VAT which is similar to what it claimed. One cannot claim input VAT more than the output VAT it paid. The dispute ceases to be one of whether the applicant should collect VAT on initial deposits paid by the client but one of accountability. What did the applicant account for? In *NCBA Bank Uganda Limited v URA Application 15 of 2020* whose facts are similar to this one, the Tribunal stated that.

"If the applicant was claiming input VAT on the whole amount that is the initial consideration plus its contribution, then it should have accounted likewise in the output VAT."

Therefore, the Tribunal holds that the applicant should account for the output VAT by paying the same corresponding input VAT it claimed. The Tribunal notes that if you seek equity then you must come with clean hands. The applicant cannot be seen to claim 100% input tax credit on the client's initial deposit and contribution and yet it paid output tax which was equivalent to the contribution. The Tribunal holds that the respondent was justified to issue an assessment of Shs. 1,156,425,590 in regard to non-declaration of VAT on the initial customer deposits.

The third dispute relates to an income tax assessment of Shs. 1,683,237,748 arising from disallowed interest expenses. The respondent disallowed interest of Shs. 5,610,792,921 which resulted in a tax liability of Shs. 1,683,237,876. The applicant contended that the interest is an allowable deduction as a business expense. It submitted that that it prepares its accounts on an accrual basis. The respondent contended that the applicant was treating unpaid interest expense as an allowable deduction. The applicant claimed both paid and accrued interest as allowable deductions leading to less chargeable income and therefore paid less tax. The applicant accrues interest expense on its customer accounts but pays and withholds tax at the date of maturity. The respondent made adjustments where it only allowed actual interest expense paid on maturity which resulted in an income tax liability of Shs. 1,683,237,876.

The Income Tax Act allows for cash-based accounting methods and accrual basis. S. 41 of the Income Tax Act states that.

"A taxpayer who is accounting for tax purposes on a cash basis derives income when it is received or made available and incurs expenditure when it is paid."

On the other hand, S. 42 provides for accrual basis. It states that

"(1) A taxpayer who is accounting for tax purposes on an accrual basis-

- (a) derives income when it is receivable by the taxpayer; and
- (b) incurs expenditure when it is payable by the taxpayer.

(2) Subject to this Act, an amount is receivable by a taxpayer when the taxpayer becomes entitled to receive it, even if the time for discharge of the entitlement is postponed or the entitlement is payable by instalments."

Further S. 42(3) mentions accuracy

"(3) Subject to this Act, an amount is treated as payable by the taxpayer when all the events that determine liability have occurred and the amount of the liability can be determined with reasonable accuracy, but not before economic performance with respect to the amount occurs".

S. 2(xx) of the Income Tax Act defines payment to include any amount paid or payable in cash or kind. The term paid or payable included amounts paid and amount accrued.

The Income Tax Act allows for interest as a deductible expense. S. 25 of the 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 the gross income."

The respondent cited S. 47 of the Income Tax Act which states

"(1) Subject to subsection (2), interest in the form of any discount, premium, or deferred interest shall be taken into account as it accrues.

(2) Where the interest referred to in subsection (1) is subject to withholding tax, the interest shall be taken to be derived or incurred when paid."

In *ATC v Uganda Revenue Authority* Application 32 of 202 it was held that the import of S. 47 of the Income Tax Act is that the requirement to withhold tax arises at the time interest is paid and not when it accrues. In *Afgri v Uganda Revenue Authority* Civil Appeal 35 of 202 it was held that the applicant having paid interest it was liable to WHT. S. 47 of the Income Tax Act deals with WHT on interest that has been paid or is due. S. 25 of the Act deals with allowing interest as a deductible expense. The two Sections are talking of different concepts, one being withholding tax and the other allowable deductions.

The applicant states it used the accrual accounting method. When interest accrues, it means that the interest amount is accumulating over time, even if it has not been physically paid out or received by the lender or borrower. Therefore, when a taxpayer uses the accrual method interest has not yet been paid but is accruing. S. 41(1)(b) of the Income Tax Act allows a taxpayer to incur expenditure when it is payable by the taxpayer. Therefore, a taxpayer can incur an interest expense when it is payable under the accrual accounting system.

Though the applicant submitted that it used the accrual accounting method, it treated accruable or unpaid and paid interest as allowable deductions. The applicant contradicts itself when it considers accrual interest as a deductible allowance when using an accrual accounting method, then allows paid interest also as allowable deductions using the cash-based accounting system. It would lead to a situation where the interest is allowed twice as a deductible expense. It was using both the accrual and cash basis accounting methods. The problem the applicant creates by treating unpaid and paid interest as allowable deductions is that, as the respondent noted, it leads to less chargeable income.

Under accrual accounting system, revenue is recorded when a sale is made whether or not cash is received. Similarly, expenses are recorded when goods and services purchased are received, not when they are paid for. Accrual accounting requires transactions to be recorded in the time period in which they occur, regardless of when the actual cash flows for the transaction are received. When using the accrual basis accounting, if the applicant treats accrued interest as a deduction, then it would have to treat the accruable income that would give rise to the accrued interest in the gross income. That is income which has not yet been received but is due if the said interest accrues. If accrual income is not included in the income statement of the financials, it means that the accrual interest was not used in the production of income included in the gross income under S. 25 of the Income Tax Act. The applicant's financial statements, exhibits AEX 20 to 23, do not show that its gross income included accrual income. By using paid income under the cash-based accounting system while treating accrued interest as deductible but not accruable income under the accrual basis, the applicant distorted the chargeable income and tax it ought to pay. The applicant should use one accounting method and not both unless it wants to create confusion.

S. 42(3) of the Income Tax Act requires one to use the accrual basis where there is reasonable accuracy. Ascertaining accurate accruable income for banks may be difficult because some loans may be written off and while others are paid up before maturity which make it difficult to ascertain accruable income and accruable interest.

Taking the above into consideration, the applicant by treating accrued interest as a deductible without considering the accrued income, distorted the chargeable income. Based on the above the Tribunal upholds the assessment of Shs. 1,683,237,876.

Taking all into consideration, the Tribunal dismisses this application with orders that the applicant is liable to pay:

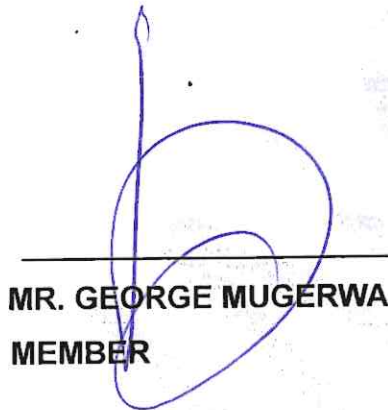
1. Shs. 731,003,496 for non-declaration of WHT on charges paid to corresponding banks.

2. Shs. 1,156,425,590 in regards to non-declaration of VAT on the initial customer deposits.
3. Shs. 1,683,237, 876 in regards to disallowed interest expense.
4. Costs of this application

Dated at Kampala this 22nd day of November 2023.



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



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



**MS. CHRISTINE KATWE**  
**MEMBER**