THE REPUBLIC OF UGANDA

IN THE MATTER OF THE TAX APPEALS TRIBUNAL

APPLICATION NO TAT 28/2010

HERITAGE OIL & GAS LIMITED ………………… APPLICANT

VERSUS

UGANDA REVENUE AUTHORITY ……………… RESPONDENT

RULING

This ruling is in respect of an application challenging an income tax assessment of US$ 30,000,000 against the applicant by the respondent arising out of a settlement amount of US$ 100,000,000 paid to the applicant to satisfy and discharge Tullow's obligations in relation to a contingent amount under a Sale and Purchase Agreement (SPA).

The facts agreed by the parties are that: the applicant was incorporated in The Bahamas and later registered as a tax resident by continuation in Mauritius in 2010. On the 1st July and 8th September 2004, the applicant entered into Production Sharing Agreements (PSAs) for petroleum where it was awarded licences of exploration in Blocks 1 and 3A respectively in the Albertine Graben. The licences were valid at the time of the transaction on the 26th January 2010. As on the 26th January 2010, the applicant had 50% participating interest with Tullow in the licences. The applicant spent US$ 150,000,000 under the licences. The applicant made discoveries of oil in Block 3A.

On the 26th January 2010, the applicant entered into a Sale Purchase Agreement (SPA) with Tullow in which the applicant was to transfer its 50% interest to the latter. On the 26th July 2010 the applicant and Tullow executed an addendum to the SPA. Under the addendum the parties agreed to a settlement amount of US$ 100,000,000 to satisfy and discharge Tullow's obligations in relation to a contingent amount. On the 19th August 2010, the respondent issued an assessment of US$ 30,000,000 as income tax. On the 1st October 2010, the applicant objected to the assessment. On 1st December 2010 the respondent issued an objection decision.

The issues agreed upon by the parties are

(1) Whether the income tax of US$ 30,000,000 is payable as assessed?

(2) Whether the assessment for US$ 30,000,000 was proper?

(3) What remedies are available to the parties?

During the scheduling of the above application the parties agreed to consolidate the hearing of this application with TAT Application no. 26 of 2010 as the facts were similar and the issues in this application arose from the same transaction. The evidence adduced was supposed to work for both applications. They agreed that the submissions would be handled separately and a separate ruling delivered for each application. Ordinarily the parties would have been required to call witnesses for each application. S.22 of the Tax Appeals Tribunal Act provides that a proceeding before a tribunal shall be conducted with as little formality and technicality as possible, and the tribunal shall not be bound by the rules of evidence and may inform itself on any matter in such manner as it may direct. The Tax Appeals Tribunal was set up to listen to tax matters speedily, inexpensively, informally with less rigidity in the application of the rules of evidence. The said arrangement was a convenient and inexpensive way of handling both applications as it did not involve the witnesses testifying twice. Since it was agreed by both parties the Tribunal had no problem with the arrangement. No miscarriage of justice was occasioned to either party by consolidating the hearing of evidence. In order to address the issues in this application, the Tribunal will restrict itself to the evidence and those portions of the submissions that are relevant to this application.

The applicant called one witness, Mr. Paul Richard Atherton, its director who gave his evidence by way of video conferencing. As already stated, S.22 of the Tax Appeals Tribunal Act provides that the tribunal shall not be bound by the rules of evidence and may inform itself on any matter in such manner as it may direct. The evidence of Mr. Atherton was allowed. His testimony was on oath and he was subjected to cross examination. It was given the same weight as evidence ordinarily before the Tribunal.

Mr. Atherton testified that the applicant was awarded, on the 1st July and 8th September 2004, interests in Blocks 1 and 3A respectively. The interests were awarded in Production Sharing Agreements (PSAs) between the Government of Uganda and itself, Exhibits A4 (i) and (ii). The applicant sold its interests to Tullow under a Sale and Purchase Agreement (SPA) for US$ 1,350,000,000,000/= on the 26th July 2010. There was a further US$ 150,000,000 which could have been paid if the government did not grant the buyer a tax relief. This was settled by a contractual agreement between Tullow and the applicant where US$ 100,000,000 was eventually paid in accordance with Clause 4.4 of the SPA.

The respondent's witness Mrs. Allen Kagina, its Commissioner General, testified that they got an addendum between the applicant and Tullow which showed that the former had received an extra US$ 100,000,000 from the latter. The respondent issued an assessment for US$ 30,000,000. An agency notice was issued to recover the said amount. Mr. Moses Kajubi, the respondent's

Commissioner Domestic Taxes, also confirmed that the applicant received an extra US$100,000,000 which was taxed.

In its submission the applicant submitted that the payment of US$ 100,000,000 was made in settlement of a disputed contingent contractual claim after Tullow breached a term of the SPA. The monies were derived from a settlement of a disputed contingent right under the SPA. The right, or chose in action was plainly not immovable property located in Uganda. So section 79(g) cannot apply. The SPA was also plainly not an activity that occurred in Uganda.

The applicant further contended that the assessment was invalid and not properly issued in accordance with the provisions of the law. The applicant challenged the issue of the assessment under S.95(2) of the Income Tax Act which provides for situations where a taxpayer defaults in furnishing a return of income for a year of income; or the Commissioner General is not satisfied with a return of income. The applicant submitted that the grounds the Commissioner General relied on in the objection decision differed from what was stated in the assessment.

The applicant also contended that the respondent had no authority to issue the assessment. Though S. 98(3) of the Income Tax Act provides that no notice of assessment shall be quashed or deemed to be void for want of form the applicant contended that the issue is not over a technical mistake, defect or omission but relates to a fundamental question on the issuance of the assessment.

The applicant objected to the issuing of the assessment in dollars. S. 57 of the Income Tax Act provides that chargeable income under this Act shall be calculated in Uganda Shillings. The calculations were made in US dollars. As a result the assessment was void for failure to comply with a statutory provision.

The respondent in reply contended that the contingent fee is a creature of the SPA and that it was part and parcel of the consideration for the sale of interests, title and rights that Heritage had in the interest documents. The respondent submitted that under S. 61 of the Income Tax Act, a compensation payment derived by a person takes the character of the item that is compensated. The contingent amount is not separable or severable from the consideration or proceeds received by the applicant for the disposal of its participating interests in Exploration Areas 1 and 3A.

The respondent cited the authority of *Garner (Inspector of Taxes) V Pound Ship owners and Ship breakers Limited* 2000 STC 420 where the House of Lords held that the obligation to obtain the release of restrictive covenants was an inseparable part of the asset which was disposed of and was not undertaken to provide the option as a separate asset. It was further held that in computing the consideration of an asset it might be appropriate to have regard to a contingency where it was directly related to the value of the consideration.

The respondent further submitted that it is trite law that the substance of a transaction overrides its legal form in determining liability to tax. In *Dominion Taxi Cab Association V MNR* [1954] SCR 82 the court held "it is well settled that in considering whether a particular transaction brings a party within the terms of the Income Tax Act, its substance rather than its form to be regarded". In *Placer Dome Inc. V Canada* [1992] 2 CTC 98 at 109 the Canadian Supreme Court held that "it is the substance of a transaction that must be looked at in order to determine the true legal rights and obligations of the parties. Similarly, it is the commercial and practical nature of the transaction, the true legal rights and obligations flowing from it that must be looked at to determine its tax implications."

The respondent further submitted that S. 91 of the Income Tax Act permits the Commissioner to disregard a transaction that does not have substantial economic effect or re-characterize a transaction the form of which does not reflect its substance.

In respect of the currency of the assessment the respondent contended that the law does not positively and exclusively create an obligation on the Commissioner to assess tax in Uganda shillings only. It merely requires the Commissioner to calculate the taxes in Uganda Shillings. The respondent relied on the case of *Cape Brandy Syndicate V IRC* 1921 [1] KD 64, 71 where the court stated that "in a taxing enactment, one has to look at what is clearly said. There is no room for any intendment. There is no equity about a tax. There is no presumption as to a tax. Nothing to be read in, nothing to be implied. One can only look fairly at the language used."

The respondent further relied on S. 98(3) of the Income Tax Act which provides that no notice of assessment, warrant, or other document purporting to be made "shall be quashed or deemed void or voidable for want of form…" The respondent cited the authorities of *Baylis (Inspector of Taxes) V Gregory* (1986) STC 22, *JP Construction Services Limited V Uganda Revenue Authority* TAT Application 17 of 2009 and *Cable Corporation (U) Limited V Uganda Revenue Authority* Appeal 1 of 2011.

The respondent further contended that in the event the Tribunal finds that the assessment was improper it can exercise it powers under S. 19 (c) of the Tax Appeals Tribunal Act to vary the assessment and substitute it with the corresponding tax payable in Uganda Shillings in line with the Bank of Uganda Exchange rate as at July 2010 when the assessment was issued.

In its rejoinder, the applicant contended that the additional payment received by the applicant by the way of settlement of its contingent claim for damages for breach of contract was not in the nature of consideration under the SPA.

As regards the calculation of the assessment in dollars, the applicant contended once a failure to comply with the clear provisions of the law amounts to an illegality this can be pointed out to the Tribunal at any stage regardless of whether or not it was specifically raised in the objection to the Commissioner. In *Kyagalanyi Coffee Limited V Francis Senabulya* (Civil Appeal 41 of 2006) it was held "Acting in disregard of the mandatory requirement of the law, as the Appellant did, rendered the transaction an illegality. Any illegality, once brought to the attention of court, cannot be sanctioned or tolerated by a court of law. It is not absolutely necessary that an illegality has to be pleaded. It is enough that it is brought to the attention of court at any time before the conclusion of the proceedings before it. No amount or type of admission or pleadings or even conduct of a party to court proceedings can turn an illegality into a legality"

The Tribunal has heard all the evidence presented to it and read the submissions of the parties. It therefore rules as hereunder.

The Tribunal notes that the starting point should be that a tax must be expressly imposed upon the subject by the clear words of a taxing Act. Article 152 of the

Constitution of Uganda clearly provides that no tax shall be imposed except under the authority of an Act of Parliament. Where there is no imposition of tax a subject should not be required to pay any tax. The words of the statute must be clear.

Secondly the evidence on record shows that the applicant was a subject of two taxing jurisdictions. The applicant was incorporated in The Bahamas and registered by continuation in Mauritius. Mr. Atherton told the Tribunal that the applicant files its tax returns in Mauritius. In essence it is a taxpayer in Mauritius. It was also registered in Uganda. It had oil exploration activities in Uganda which qualified it to be a taxpayer. The applicant is deemed to be a non-resident person in Uganda under S.14 of the Income Tax Act. As a subject of two taxing jurisdictions it would be unfair to the taxpayer to pay the same tax to each state on the same income.

Uganda and Mauritius have a Double Taxation Agreement titled "The Convention between the Republic of Mauritius and The Government of the Republic of Uganda for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with respect to taxes on Income (herein called the Double Taxation Agreement). In the event of any dispute involving a taxpayer in both Mauritius and Uganda the Double Taxation Agreement provisions will be read together with the Income Tax Act. S. 88 (2) of the Income Tax Act states that

> "To the extent that the terms of an international agreement to which Uganda is a party are inconsistent with the provisions of this Act, apart from subsection (5) of this section and Part X which deals with tax avoidance, the terms of the international agreement prevail over the provisions of this Act."

Hence for a tax to be imposed on a subject it should be provided for first in the international agreement. Secondly it should be imposed by the legislation of the taxing jurisdiction.

The purpose of the Double Taxation Agreement is twofold. First it is to prevent a taxpayer of two countries from being required to pay tax twice in respect of the same transaction. Secondly the Double Taxation Agreement was not entered into with the object of enabling a taxpayer of both states evade paying taxes in either of them. It did not envisage a 'no-man's land' where a taxpayer can relax from paying taxes. It cannot be used as a shield from paying taxes. The Agreement was established to allow a taxpayer either to pay income tax to one state, or apportion the tax payable between the states. In the event a taxpayer pays tax in one state it will get a tax relief in the other.

On the 1st July and 8th September 2004 the applicant entered into Production Sharing Agreements (PSAs) with the government of Uganda. The object of the PSAs, as stated in the title, was to provide for petroleum exploration, development and production in Blocks 1 and 3A, situated in the Albertine Graben. The applicant, together with Tullow, was given exploration licenses under the PSAs. Article 14 of the PSAs required the licensees to pay all central or other taxes levied.

On the 26th January 2010, the applicant entered into a Sale and Purchase Agreement (SPA), with Tullow for the sale of the applicant's 50% participating interest in Blocks 1 and 3A to the latter. Article 2.1 of the SPA reads:

> "… the seller agrees to sell to the Buyer, and the Buyer agrees to purchase from the Seller for the consideration set out in Article 3.1 the assigned interest with effect from and including the closing date."

Article 1 of the SPA defined assigned interest to mean all the Seller's rights, titles and interest in the interest document, including:

> "(a) the unencumbered and divided 50% (fifty percent) Participating Interest of the Seller in the rights and obligations derived from the PSAs and JOA in respect of the Blocks; and
>
> (b) all the Seller's rights and obligations under the JOA in respect of Operatorship."

The SPA requires one to look at the PSAs and JOA to ascertain the rights and interests thereunder that were sold. The PSAs and JOA created rights and interests which the applicant sold to Tullow. It sold inter alia, the right to cost recovery, the right to entitlement to proceeds in event of production and also the rights, privileges, immunities mentioned both in the PSAs and JOA. The applicant sold its participatory interest to Tullow and of course the corresponding entitlements thereto. The applicant sold to Tullow a bundle of rights and interests under the PSAs and therefore earned income.

In *Heritage Oil and Gas (U) Ltd V Uganda Revenue Authority* TAT Application 26/2010 the Tribunal held that income derived from a sale of an interest of immovable property and any income attributable to an activity which occurs in Uganda is taxable. It was held that the sale of the applicant's interests in Blocks 1 and 3A were subject to income Tax. The sale of the applicant's rights included an interest in immovable property under S. 79(g) of the Income Tax Act. The sale also fell within the ambit of S. 79(s) which reads that income is derived from a source which is attributable to any activity which occurs in Uganda, including an activity conducted through a branch in Uganda.

A tax must be expressly imposed upon the subject by clear words of a statute. The applicant contends that the disputed amount of US$ 100,000,000 did not fall under the Income Tax Act as it was not a sale of immovable property. It arose out of a settlement of disputed contractual claim. It also did not arise out of an activity attributed to Uganda. The respondent in reply contended that the applicant's submission goes to 'form versus substance' which is irrelevant.

The applicant does not seem to deny that Uganda has taxing jurisdiction. What the applicant contends is that the Income Tax Act does not provide for the taxation of the settlement amount of a non-resident taxpayer. A taxpayer is allowed to take advantage of an omission in a taxing Act not to pay a tax that is not provided for. Tax law distinguishes between tax avoidance and tax evasion. A taxpayer is allowed to arrange his affairs so that the tax due under the appropriate Acts is less than it would otherwise be. In *IRC V Fisher's Executors* (1926) AC 395 Lord Sumner stated that "the highest authorities have always recognised that the subject is entitled to arrange his affairs as not to attract taxes imposed by the Crown, so far as he can do so within the law, and that he may legitimately claim the advantage of any expressed terms or of any omission that he can find in his favour in taxing Acts."

In Levene V IRC [1928] A.C. 217 it was stated by Viscount Sumner that "it is trite law that His Majesty's subjects are free, if they can, to make their own arrangements, so that their cases may fall outside the scope of the taxing Acts. They incur no legal penalties and, strictly speaking, no moral censure if, having considered the lines drawn by the Legislature for the imposition of taxes, they make it their business to walk outside them..." In *Vodafone International Holdings B.V. V Union of India* Writ Petition 1325 of 2010 the Court said the following principles are now embedded in our jurisprudence:

(i) A transaction or arrangement which is permissible under the law which has the effect of reducing the tax burden of an assessee does not incur the wrath of law

(ii) Citizens and business entities are entitled to structure or plan their affairs with circumspection and within the framework of law with a view to reduce the incidence of tax;

(iii) A transaction which is sham or which is a colourable device cannot be countenanced. A transaction which is sham or a colourable device is one in which the parties while ostensibly seeking to clothe the transaction with a legal form, actually engage in a different transaction altogether. A transaction which serves no business purpose other than the avoidance of tax is not a legitimate business transaction and in the application of fiscal legislation can be disregarded. Such transactions involve only a pretence and a facade to avoid compliance with tax obligations;

(iv) Absent a case of a transaction which is sham or a colourable device, an assessse is entitled to structure business through the instrument of genuine legal frameworks. An act which is otherwise valid in law cannot be disregarded merely on the basis of some underlying motive resulting in some economic detriment or prejudice. In interpreting a fiscal statute it is not the economic result sought to be obtained by making the provision which is of relevance and the duty of the Court is to follow the plain and unambiguous language of the Statute."

The Tribunal respects the applicant's decision to plan its tax affairs in such a way so as to reduce its tax liability. What is not tolerable is where colourable devices are resorted to with an object of avoiding payment of taxes. So, the question before the Tribunal would be: is the applicant's receipt of US$ 100,000,000 not taxable or is it a colourable device? The only way the Tribunal can find out is by looking at the plain and unambiguous language of the statute in light of the Sale and Purchase Agreement. A genuine payment should not be impeached.

The Sales and Purchase Agreement (SPA) in Article 3.1 divided the consideration for the Assigned Interest into two: the Adjusted Purchase Price and a Contingent Amount. Article 3.1 of the SPA reads:

> "The consideration for the Assigned Interest shall be the Adjusted Purchase Price, plus, if applicable, the Contingent Amount.
>
> (a) The Adjusted Purchase Price shall comprise:
>
> (i) The Base Purchase Price; plus or minus, as determined in accordance with Article 3.2.
>
> (ii) The Adjustment Amount
>
> (b) The Contingent Amount shall be $ 150,000,000 (one hundred and fifty million Dollars) or, if applicable, the lower amount resulting from application of Annex 3.
>
> Subject to Article 11.4, payment of the Contingent Amount shall be conditional on the relevant Ugandan Government Entity granting to the Buyer and/or to its relevant Affiliates unconditionally and through appropriate, fully applicable and effective legal instruments the Tax Relief within 2 (two) years from the Closing Date (the "Tax Relief Period").
>
> In the event that the relief is granted by the relevant Uganda Government Entity to the Buyer and/or its relevant Affiliates under terms less favourable to the Buyer than the Tax relief, the Contingent Amount shall be reduced in accordance with the terms set forth in Annex 3."

Article 11 dealt with post closing obligations. That is, inter alia, how and when the contingent amount would be paid. The essence of Article 3.1(b) is that a contingent amount was supposed to be paid to the seller in the event no tax relief was given to the buyer.

In line with the SPA, the applicant and Tullow entered into a further agreement called the addendum dated 26th July 2010 where the amount of US$ 150,000,000 was reduced to US$ 100,000,000. Clause 3.1 of the Addendum in respect of the contingent amount provided:

> "(c) It will, in consideration of the agreement relating to the Contingent Amount set out in clause 4.2 below, on or before the Closing Date pay to the Escrow Agent the amount of one hundred million Dollars (S100,000,000) (the "Settlement Amount")"

Clause 4.2 of the Agreement provided:

> "The parties agree that the payment of the Settlement Amount pursuant to clause 3.1(c) will satisfy and discharge the Buyer's obligations in relation to the Contingent Amount under the Sale and Purchase Agreement, including pursuant to Article 11.1 and 11.3, and settle the parties' dispute as to the enforceability of Article 11.4.

The applicant contended that the said US$ 100,000,000 was therefore a settlement of a contractual obligation. The applicant dealt with the payment of the US$ 100,000,000 as a separate payment.

Under Article 3.1 of the SPA the consideration for the sale had an Adjust Purchase Price and a Contingent Amount. It is clear that the contingent amount, where applicable, was part of the consideration payable to the applicant on the sale of its participatory interest to Tullow. In this case it was applicable and constituted the purchase price. Under the same Article it is also clear that it was a conditional payment dependent on a tax relief being granted to Tullow. It is not appropriate to say that it was an amount paid in breach of the agreement. This is because it depended on the government granting a tax relief. The government was not party to the agreement. The failure or omission of the government to grant a tax relief to the buyer cannot be attributed to either party and therefore cannot be a breach of the agreement. The payment of US$ 100,000,000 was a conditional payment and not one paid in breach of the agreement. It was a settlement amount. This is just for purposes of clarification and does not affect the fact that it was paid.

The contingent amount of US$ 100,000,000 paid to the applicant was a result of contractual rights arising from the Sale and Purchase Agreement. The definition of an asset includes incorporeal property generally. Contractual rights are incorporeal property. *Black's Law Dictionary* 8th Edition defines incorporeal property for the purpose of this application on page 1253 as:

> "1. An in rem proprietary right that is not classified as corporeal property … 2. A legal right in property having no physical existence. Patent rights for example, are incorporeal property…"

Corporeal property is defined as:

> "1. The right of ownership in material things. 2. Property that can be perceived, as opposed to incorporeal property; tangible property."

The payment by Tullow to the applicant in respect of a contractual obligation was therefore a sale of an asset.

Contractual rights can be assessed as an asset for the purposes of Capital Gains Tax. In *O'Brien V Benson's Hosiery (Holdings) Limited* 53TC241 a director had paid the company 50,000 pounds to be released from a service agreement with it. Was the service agreement an asset in the sense that the company had realized value from it? The court considered it had. In extracting a sum of money from the employee in return for releasing him from the contract, the company had turned its rights under the agreement to account. Accordingly those rights were an asset for Capital Gains Tax purposes and the 50,000 pounds was consideration in the form of a capital sum which derived from that asset. The court looked at the 'reality of the matter'. In looking for the asset one has to look for the real rather than the immediate source of the capital sum.

It is not denied that the US$ 100,000,000 was income earned. The question is whether the said payment by Tullow to the applicant is taxable. As already stated before an item can be taxed in the taxing jurisdiction, it should be allowed for in the international agreement and then under the taxing Act. The respondent contended that the applicant sold an interest in immovable property. Article 6.1 of the Double Taxation Agreement between Mauritius and Uganda provides that income derived by a resident of a Contracting State from immovable property (including income from agriculture or forestry) situated in the other Contracting State may be taxed in that other state.

Under the Double Taxation Agreement Article 6, immovable property includes property accessory to the Immovable property. *Black's Law Dictionary* 8th Edition at page 15 defines 'accessory' as something of a secondary or subordinate importance.The said payment was properly paid as accessory to the purchase of Blocks 1 and 3A which are immovable property. Without the purchase of Blocks 1 and 3A the said payment would not have arisen.

In order for a taxpayer to be liable for a tax the law of the Contracting State should also provide so. The tax liability can still be ascertained by looking at the provisions of the Income Tax Act. Under S. 18 of the Income Tax Act business income is taxable. Business income refers to any income derived by a person carrying on a business and includes the amount of any gain derived by a person on the disposal of a business asset. Under S. 2(g) of the Act "business" includes any trade, profession, vocation or adventure in the nature of trade, but does not include employment. In order for a non-resident's income to be taxed the item subject to tax under the Income Tax Act should be provided for in the source rules. S.79 of the Income Tax Act provides for the taxation of non-resident person's income derived from sources within Uganda. S. 79 of the Income Tax Act, inter alia, states that income is derived from sources in Uganda to the extent to which it is:

> "(g) derived from the disposal of an interest in immovable property located in Uganda or from the disposal of a share in a company the property of which consists directly or

indirectly principally of an interest or interest in such immovable property, where the interest or share is a business asset;

....

(s) attributable to any other activity which occurs in Uganda, including an activity conducted through a branch in Uganda."

S.79 (g) of the Income Tax Act provides that income obtained from a sale of an interest in immovable property is taxable. The applicant submitted that the payment of US$ 100,000,000 does not fall under S. 79(g). The applicant argued that the said payment was in respect of a settlement of a legal dispute which is deemed to be movable property.

The Tribunal notes that 'interest in immovable property' under S. 79(g) of the Income Tax Act can be deemed to be an accessory to 'immovable property' under the Double Taxation Agreement. However it is inconceivable to say that the payment of the settlement amount which was a contractual obligation was a payment for an 'interest in immovable property'. The Tribunal notes that though the payment of the US$ 100,000,000 is accessory to the sale of immovable property under the Double Taxation Agreement it may not be deemed to be a payment of an 'interest of immovable property' under S. 79(g) of the Income Tax Act. It would be like fixing a square peg in a round hole. The Income Tax Act S. 88 provides that where there is an inconsistency between an international agreement and the Act the terms of the international agreement prevail over the provisions of this Act. It could be argued the since the said payment is deemed as part of immovable property under the Double Taxation Agreement then it should be deemed so under the Income Tax Act. The Tribunal does not think there is an inconsistency between the Double Taxation Agreement and the Income Tax Act. The 'interest in immovable property' provided under the Income Tax Act is merely a subset of immovable property under Article 6 of the Double

Taxation Agreement though smaller in application. There is no inconsistency, the Act merely falls short in its definition. The Constitution of Uganda provides that no tax should be imposed without authority of an Act of Parliament. The Tribunal has already stated that a tax should be expressly imposed upon the subject by the clear words of a statute. The argument that the payment of the settlement amount of US$ 100,000,000 is taxable as income derived from a sale of an interest of immovable property is untenable.

Though the Tribunal agrees with the applicant that the said payment was not for the sale of an interest of immovable property, the contingent amount was incidental to and part of the consideration. The applicant sold a bundle of rights and interests of which the sale of interest in immovable property was part and parcel of the property sold. For an item of income to be taxed at all it must fall within an express taxing provision contained in the Income Tax Act. Under S. 79 (s) any income attributable to any activity which occurs in Uganda is taxable. The question then is: whether the payment of the US$ 100,000,000 was attributable to an activity which occurred in Uganda.

The Double Taxation Agreement does not restrict the Contracting States from taxing only income from immovable property. Article 7 of the Double Taxation Agreement allows for the taxation of other profits than those derived from the alienation of immovable property. Under the said Article a contracting state is allowed to tax business profits. Under Article 7 business profits are taxable if they can be attributed to the taxing state. Article 7.1 states that the profits of an enterprise of a Contracting State shall be taxable only in that State unless the enterprise carries on business in the other Contracting State through a permanent establishment situated therein. If the enterprise carries on business as aforesaid, the profits of the enterprise may be taxed in the other state but only so much of them as is attributable to that permanent establishment. The term permanent establishment is defined under Article 5 of the Double Taxation Agreement to include a mine, an oil or gas well, a quarry or any other place of extraction of natural resources. The receipt of US$ 100,000,000 by the applicant can be attributed to its business or the sale of its interest of an oil well in Uganda. The payment of the US$ 100,000,000 depended on the grant of a tax relief by the government of Uganda and on the sale of the applicant's interest in the oil well. The government did not grant a tax relief and therefore the payment of the contingent amount was solely attributable to the permanent establishment in Uganda. The receipt of the US$ 100,000,000 was a business profit arising from the SPA and may be taxable.

There are times when the different profits in a transaction sought to be charged may fall apparently within two or more sections or schedules of the same Act. Income can be likened to a fruit tree. When fruits are sold in different stages or states for instance some as raw materials, others as processed goods and others as finished products, different sections of the Income Tax Act may apply to each stage or state. The Law is not static. A.J. Easson in "*Cases and Materials in Revenue Law*" at page 95 states that: "Although the Schedules are mutually exclusive, where an item falls within one Schedule, but may be taxed under more than one Case of that Schedule, the Revenue is entitled to select the Case which is most favourable to it." In *Liver Pool and London and Globe Insurance Company V Bennett* [1913] A.C. 610 the taxpayer company received interest from its investment abroad which was not remitted to its country. Under Case I of Schedule D these "profits" of the taxpayers' business were taxable, under Case IV they escaped tax if not remitted. It was held that the Revenue was entitled to elect for assessment under Case I. If the application of Article 7 of the Double Taxation Agreement and S. 79(s) of the Income Tax Act is more convenient to apply to the taxation of the subject matter, there is no reasonable cause why the respondent should stick to applying Article 6 of the Double Taxation Agreement and S. 79(g) of the Income Tax Act.

The respondent cannot elect to charge the profits under one section to the exclusion of the others if there is another section applicable. The Tribunal having looked at the source rules to determine which sections are relevant or applicable to the transaction, rules that S. 79(s) of the Income Tax Act is applicable. Under S. 79(s) any income attributable to any activity which occurs in Uganda is taxable. The payment of the US$ 100,000,000 is attributable to the sale of the applicant's bundle of interests and rights as stated in the SPA in Uganda. The omission or the failure to obtain a tax relief from the Government is attributable to an event in Uganda. Though the SPA was signed outside Uganda, the activities mentioned are attributable to Uganda. It appears that the applicant did not arrange its tax affairs in a manner so as to reduce its tax liability. In the circumstance the first issue is resolved in favour of the respondent.

On the second issue the applicant contended that the assessment was invalid because it was issued under the wrong law. The assessment was made under S. 95 which mandates the Commissioner to make an assessment of the tax payable by a person who defaults in furnishing a return or where the Commissioner is not satisfied with a return lodged by the taxpayer. The applicant contends it never defaulted to file a return. In the first place it files its returns in Mauritius. A 'Year of Income' is defined in Section 2 of the Tax Act to mean the period of twelve months ending on the 30th June. The year of income had not ended and the return was not due. S. 95 of the Income Tax Act reads:

> "(1) Subject to section 96, the Commissioner shall, based on the taxpayer's return of income and on any other information available, make an assessment of the chargeable

income of a taxpayer and the tax payable thereon for a year of income within seven years from the date the return was furnished.

(2) Where—

(a) a taxpayer defaults in furnishing a return of income for a year of income; or

(b) the commissioner is not satisfied with a return of income for a year of income furnished by a taxpayer, the commissioner may, according to the commissioner's best judgment, make an assessment of the chargeable income of the taxpayer and the tax payable thereon for that year.

(3) Where the commissioner has made an assessment under subsection (2) (b), the commissioner shall include with the assessment a statement of reasons as to why the commissioner was not satisfied with the return.

(4) In the circumstances specified in section 92(8), in lieu of requiring a return of income, the commissioner may, according to the commissioner's best judgment, make an assessment of the chargeable income of the taxpayer and the tax payable thereon for the year of income."

S.95 allows the Commissioner to use her best judgement if she is not satisfied with a return for a year of income. In this case the applicant did not file any tax returns. Therefore the need for the Commissioner General to exercise her best judgement did not arise. Therefore it is argued that the Commissioner had no powers to issue an assessment. However S. 95 allowed the Commissioner to issue an assessment in the circumstances specified in S. 92(8).

The said Section was what the Commissioner referred to in the assessment, instead of S. 95 (4). S92 (8) reads that

"(8) Where, during a year of income—

(a) a taxpayer has died;

(b) a taxpayer has become bankrupt, wound-up or gone into liquidation;

(c) a taxpayer is about to leave Uganda indefinitely;

(d) a taxpayer is otherwise about to cease activity in Uganda; or

(e) the commissioner otherwise considers it appropriate,

> the commissioner may, by notice in writing, require the taxpayer or the taxpayer's trustee, as the case may be, to furnish, by the date specified in the notice, a return of income for the taxpayer for a period of less than 12 months."

Under S. 92(8) of the Income Tax Act the Commissioner may require the taxpayer to furnish a return when a taxpayer is about to leave indefinitely. Before an assessment is issued a taxpayer is required to file a return or maybe requested to file a return. When read together under S. 92(8) an applicant is required to file a return or at least be requested to file one? The section uses the word "may" and not "shall" which means the Commissioner has the discretion to ask the taxpayer to furnish a return. In other words the Commissioner also has the option of not asking the taxpayer to furnish a return. The Commissioner is required to exercise her discretion. Administrative discretion must be exercised reasonably.

S. 95(4) of the Income Tax Act provides that in the circumstances specified in section 92(8), in lieu of requiring a return of income, the commissioner may, according to the commissioner's best judgment, make an assessment of the chargeable income of the taxpayer and the tax payable thereon for the year of income. The applicant's complaint is that the Commissioner never asked for a return and therefore could not in lieu of the return issue an assessment. Did the Commissioner exercise her best judgement reasonably?

In *Heritage Oil and Gas V Uganda Revenue Authority* TAT 26/2011 the Tribunal stated that the Commissioner General exercised her discretion reasonably when she issued an assessment without requiring the applicant to file a return as the applicant was about to leave the country and had sold its only known asset in the country. Since the facts in this application are very similar the Tribunal still holds that the Commissioner General exercised her judgement rationally when she issued an assessment on the applicant.

In *Twinomuhangi Pastoli V Kabale District Local Government Council, Katarishangwa Jack & Beebwajuba Mary* [2006] 1 HCB 30 the court also held that "it is recognised that each statute has to be interpreted on the basis of its own language for words derive their colour and content from their context and the object of the legislation is a paramount consideration. When Parliament prescribes the manner or form in which a duty is to be performed or power exercised, it seldom lays down what will be legal consequences of failure to observe its prescriptions. The court must therefore formulate their own criteria for determining whether the procedural rules are to be regarded as mandatory, in which case disobedience will render void or voidable what has been done. To create own criteria, court must consider the whole scope and purpose of the statute and then assess the importance of the impugned provision in relation to the general object intended to be achieved by the Act." The Tribunal notes that the Income Tax Act gave the Commissioner discretion using her best judgement in issuing an assessment. The Act did not lay down the consequences in the event the Commissioner failed to exercise her best judgement. The Tribunal holds that it is not the intention of the Act that in the event the Commissioner failed to exercise her best judgement the tax liability of the taxpayer would be waived.

The applicant also contended that S. 57 of the Income Tax Act provides that chargeable income under the Act shall be calculated in Uganda Shillings. The respondent was required to issue the assessment in Uganda Shillings which it did not. The respondent contended that this ground was not raised in the objection of the applicant nor by it in its objection decision. S. 16 of the Tax Appeals Tribunal Act provides that;

> "where an application for review relates to a taxation decision that is an objection decision, the applicant is, unless the tribunal orders otherwise, limited to the grounds stated in the taxation objection to which the decision relates."

The Tribunal notes that the applicant did not raise the issue of the calculation in dollars in its objection. It was not addressed in the objection decision. The applicant did not raise the said issue in its pleading nor was it addressed during the scheduling. The Tribunal did not make an order allowing the applicant to raise the said averment.

The Tribunal already stated in *Heritage Oil and Gas Limited V Uganda Revenue Authority* (supra) that in interpreting a statute words should be given their ordinary meaning whatever anomaly it may have. There is a difference between 'calculating' taxes and 'assessing' taxes in shillings. The failure to clearly state that assessment should be in shillings was a result of poor legal draftsmanship. The effect of such a lack of clarity is to make S. 57 redundant. It is difficult for a taxpayer to prove to the Tribunal that its assessment was not calculated in shillings in light of S. 18 of the Tax Appeals Tribunal Act. The calculation is usually done in the absence of the taxpayer. The respondent may not admit the omission to calculate in shillings and as the onus is on the taxpayer to prove the omission this may never be proved to the satisfaction of the Tribunal. This section as it stands adds no value to the Act.

The applicant submitted that the respondent's reliance on S. 95(2) to issue the assessment was void. The reasons given in the objection decision differed from what is in the assessment. The respondent cited the wrong section of the law in the assessment. S. 98(3) of the Income Tax Act provides that;

> "No notice of assessment, warrant or other document purporting to be made issued or executed under this Act
>
> (a) Shall be quashed or deemed to be void or voidable for want of form; or
>
> (b) Shall be affected by reason of mistake, defect, or omission therein, if it is, in substance and effect, in conformity with this Act and the person assessed or intended to be assessed or affected by the document, is designated in it according to common intent and understanding."

Any defect in an assessment does not release the taxpayer scot free from the tax liability. An objection is not invalid because it did not cite the correct rules stated in the assessment. This goes to want of form and not to the substance. In *Cable Corporation Ltd V Uganda Revenue Authority* Civil Appeal 1 of 2001 Madrama J. referred to S. 43 of the Interpretation Act when looking at the effects of anomalies on instruments. The court held that the question of form of the decision cannot be raised so long as its content amounts to an objection decision and addressed the specific question of deferred interest and withholding tax. This is commanded by S. 43 of the Interpretation Act which provides that

> "Where any form is prescribed by any Act, an instrument or document which purports to be in such form shall not be void by reason of any deviation from that form which does not affect the substance of the instrument or document or which is not calculated to mislead."

Hence if there is any failure by the respondent to cite the proper rules on the assessment or in the objection decision or to calculate the taxes in shillings it does not vitiate the assessment.

The issues of deductions was discussed in *Heritage Oil and Gas Ltd V URA* (supra) where it was held that costs incurred by the applicant that are recoverable cannot be deducted under S. 22 of the Income Tax Act. However deductions not allowed under S.22 but have been incurred to alter or improve the asset should be added to the cost base of the asset. It was stated that the Tribunal could not discern from the costs of US$150,000,000 those that had been incurred by the applicant to alter or improve the asset. In this application the asset is the contractual rights that gave rise to the settlement. There is no evidence to show the expenses incurred by the applicant to alter or improve the contractual rights for instance the costs of drawing the addendum.

In the absence of any deductions that were incurred by the applicant to improve the asset the respondent rightfully assessed the tax of the applicant as US$ 30,000,000 having applied the tax rate to the amount of US$ 100,000,000.

Lastly the Tribunal had the opportunity to read both the objection by the applicant dated 1st October 2010 and the objection decision of the respondent dated 1st December 2010 to ensure that all the grievances raised are addressed. There was one item which was not raised as an issue in the main application nor was it addressed by the parties before the Tribunal. However the Tribunal will address it as *obiter dicta*. That is, it does not and will not affect the outcome of the decision of the Tribunal. This is so as to assure the parties that once a matter is brought before the Tribunal it will endeavor to ensure that justice is meted out to all parties with all due fairness, irrespective of the parties' sex, age, race or status. In its objection the applicant stated that it challenges "the jurisdiction of the High Court or a Uganda Tax Tribunal to adjudicate the Dispute". The Tribunal wishes to state that once a party files an application before it, the party submits to the jurisdiction of the Tribunal. It is then the opposite party that is left to challenge the jurisdiction of the court or the Tribunal. In this case the applicant filed its application before the Tribunal and the respondent did not challenge the jurisdiction of the Tribunal. The jurisdiction of the Tribunal is established by an Act of Parliament in accordance with the

Constitution of Uganda. Further the Tribunal also notes that the arbitration clauses referred to by the applicant were provided for in the Production Sharing Agreements. However the dispute as to taxes before the Tribunal arose from the Sale and Purchase Agreement (SPA) which did not provide for an arbitration clause to which the respondent was a party. Once a matter has been filed before the Tribunal it has to be determined or resolved. The Tribunal will not allow cases to gather dust on its shelves.

The Tribunal holds that the applicant is liable to pay the tax assessed. As the application stands, it is dismissed with costs.

Dated at Kampala this ……………………….day of…………………………2011

…………………..	…………………….	…………………
Asa Mugenyi	Stephen Akabway	Pius Bahemuka
Chairman	Member	Member