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Tax Alert

Changes to the Income Tax Act effective 1 July 2016

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The Income Tax (Amendment) Act 2016 was assented to on 19 November 2016. The Act came into force on 1 July 2016, and therefore its application is retrospective.

The Act introduces the following changes to the Income Tax Act (ITA):

Exemption of employment income of Members of Parliament

The Act exempts the employment income of a person employed as a Member of Parliament, except for their salary, from tax in Uganda.

This means that only the salary that a Member of Parliament derives from employment as such is subject to income tax in Uganda.

All other income derived by a Member of Parliament, which may include mileage, subsistence, plenary sitting, constituency and medical allowances, is exempt from tax in Uganda.

Carrying forward of tax losses

The Act introduces an amendment to Section 38 of the ITA which clarifies that the ability to carry forward tax losses is subject to the fulfilment of conditions pertaining to any change in control of a company.

Generally, tax losses can be carried forward indefinitely; however, the opportunity for a company to carry forward a tax loss is restricted where there has been a 50% or greater change in the underlying ownership of the company and, for a period of two years thereafter, the company does not carry on the same business or engages in a new business or investment with the primary purpose of utilising the losses against the resultant income.

The amendment clarifies that the restrictions in case of a change in control or underlying ownership of a company take precedence over the general 'carry-forward loss' provisions. This has generally been the approach applied in practice, so the amendment represents a confirmation rather than a significant change.

WHT on rent derived by a non-resident

Rent derived by a non-resident from a source in Uganda was previously included on the list of payments that are subject to withholding tax, but the ITA omitted to impose a specific tax rate.

The amendment now remedies this omission by including rent among the payments to non-residents (such as dividends, interest and royalties) that are subject to the tax rate of 15%. Rent, for this purpose, means a payment for the use of, or right to use, land or buildings.

This means that a tenant paying rent to a non-resident landlord in respect of land or buildings in Uganda is now required to deduct withholding tax on the gross payments at a rate of 15%.

Entitlement to tax treaty benefits

The Act amends section 88(5) of the ITA to provide clarity as to when a non-resident person is entitled to benefit from a tax exemption or reduced tax rate under a double-taxation agreement (DTA). This is an anti-abuse provision intended to prevent the use of conduit entities in treaty countries solely to take advantage of DTA benefits.

The previous section 88(5) restricted the application of DTA benefits where 50% or more of the underlying ownership of the non-resident person was held by individuals resident outside the treaty country. However, the application of this restriction created a number of practical challenges, including a conflict with the concept of 'beneficial ownership' as applied in the treaties and a general question as to the precedence of treaties over domestic law. Further, there was a specific difficulty in establishing the underlying ownership of listed companies and third-party suppliers.

The amendment substantially eliminates these difficulties by rewording section 88(5) as follows:

'Except for a public listed company, where an international agreement concluded by the Government of Uganda with another contracting state provides that income derived by a person resident in such other contracting state from sources in Uganda is exempt from Ugandan tax or is subject to a reduction in the rate of Ugandan tax, the benefit of that exemption or reduction shall not be available to any person who:

a) Receives the income in a capacity which is other than that of a beneficial owner, within the meaning accorded to that term by the relevant international agreement, and who does not have full and unrestricted ability to enjoy that income and to determine its future uses; and

b) Does not possess economic substance in the country of residence.'

The strict interpretation of the above provision is that the treaty benefits will not apply to a person who fails to meet all three conditions, namely the non-resident recipient:

- Is not the beneficial owner of the income;
- Does not have full and unrestricted ability to enjoy the income and determine its future use; and
- Does not have economic substance in the treaty country.

In other words, if you meet any one of the conditions (e.g., the recipient is the beneficial owner of the income) then you are still entitled to apply the DTA benefit.

However, it is possible that the intention was to restrict DTA benefits where any one of the three conditions is not met, and this may be the way that the URA applies the provision in practice.

Further, the restriction does not apply where the non-resident recipient is a public listed company (i.e. such companies are fully entitled to apply the DTA benefits). Note that this appears to apply only to the immediate non-resident entity (rather than the ultimate holding company), so it may have fairly limited application in practice.

This amendment is a positive development and hopefully will enable the URA to administer the application of DTA benefits in such a way as to recognise genuine economic arrangements while preventing abusive fiscal avoidance. However, it remains to be seen how the URA will apply the new provision in practice considering that there are some uncertainties around the interpretation of some key concepts.

Income tax returns for persons employed by diplomatic missions

The amendment introduces a requirement for resident individuals employed by diplomatic missions and other prescribed organisations entitled to diplomatic immunity and privileges to file individual income tax returns to disclose their income and tax payable for a year of income. Previously, the employees of exempt organisations (along with all other employees generally) were not required to file an income tax return if their sole income comprised employment income derived from a single employer, from which tax is withheld at source (via the PAYE system).

The amendment was intended to cater for employees of exempt organisations which do not account for PAYE on their staff salaries by requiring the individual staff to account for tax on their income. However, based on the wording, all the employees of the exempt organisations are required to file personal income tax returns even if the exempt employer is deducting PAYE and remitting the tax to the URA.

Withholding tax on payments for winnings of sports betting and pool betting

The amendment repeals the requirement for a person who makes payments for winnings of sports betting or pool betting to withhold tax on the gross amount of the payment at the rate of 15%. The requirement to withhold tax was previously introduced with effect from 1 July 2014.

This means that the winnings of sports and pool betting are no longer subject to withholding tax in Uganda. Such winnings will continue to be taxed as the property income of the person deriving the income. A person deriving winnings from sports or pool betting will be required to account for tax on the winnings either by filing an individual income tax return or through the presumptive tax regime.

In our view, the withholding of tax by the person paying out the winnings was a better administrative measure than requiring individuals to account for tax on the winnings as property income. This amendment may lead to loss of Government revenue from winnings on sports and pool betting, as it may prove difficult to enforce the tax on the individuals receiving the winnings.

Further, the tax levied on operators of casinos and gaming or betting activities has also been revised upwards from 20% to 35% of the money staked less any payments (winnings) for the period, with effect from 1 July 2016. This is presumably aimed at discouraging investment in casinos and gaming and betting activities.

Withholding tax on payments to international carriers and telecommunication providers

A specific withholding tax obligation was introduced in relation to payments to non-residents who derive income from sources in Uganda from international carriage and telecommunications services. Previously, the legislation imposed tax on such income (as shown in the extracts below) but did not provide specific guidance on how these taxes should be collected, and the onus generally fell on the non-resident recipient to pay the tax directly.

The ITA imposes tax at the rate of 2% on every non-resident person carrying on the business of ship operator, charterer or air transport operator who derives income from the carriage of passengers or cargo which is embarked in Uganda, and on road transport operators who derive income from the carriage of cargo or mail embarked in Uganda.

The Act also imposes tax at the rate of 5% on a non-resident person who carries on the business of transmitting messages by cable, radio, optical fibre or satellite, in respect of income from the transmission of messages by apparatus located in Uganda or the provision of direct-to-home pay TV or internet connectivity services to Ugandan subscribers.

In each case the tax is applied on the gross income of the non-resident and is a final tax.

The amendment specifically provides that these taxes are now to be collected by way of withholding tax to be deducted by the Ugandan payer. Therefore, persons making such payments from 1 July 2016 are required to withhold tax at the 2% and 5% rates as appropriate. However, this obligation does not apply to payments for international air transport because the income of air transport operators is exempt from tax.

Additions to the list of exempt institutions

The International Centre for Research in Agroforestry (ICRAF) and the International Potato Centre have been included as listed institutions in the First Schedule to the ITA. This means that the income of these entities is exempt from income tax.

Presumptive tax

The amendment removes clinics from the presumptive tax regime. This implies that clinics with a turnover below UGX 150 million will no longer be subject to the presumptive tax rates. Presumably, the purpose of the amendment is to ensure consistency with section 4(7) of the ITA, which excludes persons in the business of providing medical or dental services from the presumptive tax category.

There is also an increment in the presumptive tax amount payable by drug shops with a turnover between UGX10 and 20 million from UGX100, 000 to UGX 250, 000.

Petroleum and mining

The Act makes the following changes to Part IXA of the ITA in relation to mining and petroleum operations.

Meaning of licensee

The definition of 'licensee' for the purposes of petroleum and mining operations is re-worded to cover persons undertaking upstream and midstream petroleum activities by reference to the correct respective piece of legislation.

A licensee is now defined as 'a person who has been granted a mining right or a person who the Government has entered into a petroleum agreement as defined in the Petroleum (Exploration Development and Production) Act 2013, or a person licensed under the Petroleum (Refining, Conversion, Transmission, and Midstream) Act 2013'

Previously, the definition incorrectly referred to petroleum agreements (i.e. upstream) as being defined in the midstream legislation (the Petroleum [Refining, Conversion, Transmission, and Midstream] Act 2013), leading to uncertainty as to who was covered. It is now clear that both upstream and midstream operators fall within the special tax rules in Part IXA.

Petroleum exploration information

The definition of 'petroleum exploration information' has been repealed. This definition is redundant as it is not applied anywhere else in Part IXA of the Act.

Allowable deductions for petroleum exploration

For petroleum exploration licenses issued after 31 December 2015, a new provision now limits the deduction of expenditure against petroleum operations to the extent that such limitation is specified in the petroleum sharing agreement (PSA). This enables the Government to agree and enforce special deduction terms in each individual PSA.

Surplus from decommissioning fund returned to a licensee

The Act repeals section 89GD(4)(b), which provided that a surplus in a decommissioning fund that is returned to the licensee upon completion of decommissioning is included in the licensee's gross income. This provision is redundant as such returns are already captured as income under subparagraph (a).

Let's talk

For a deeper discussion on how the above might affect your business, please contact:

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