Tax Alert

High Court Reinforces Purpose-Based Approach to Interest Deductions

May 2026

Trevor Lukanga Bwanika
Associate Director, Tax
trevor.b.lukanga@pwc.com

Hilda Kamugisha
Manager, Tax and Legal Business Solutions
hilda.kamugisha@pwc.com

Ivy Winnie Lumonya
Senior Associate, Tax and Legal Business Solutions
ivy.lumonya@pwc.com

Marion Sanyu Senoga
Senior Associate, Tax
marion.senoga@pwc.com

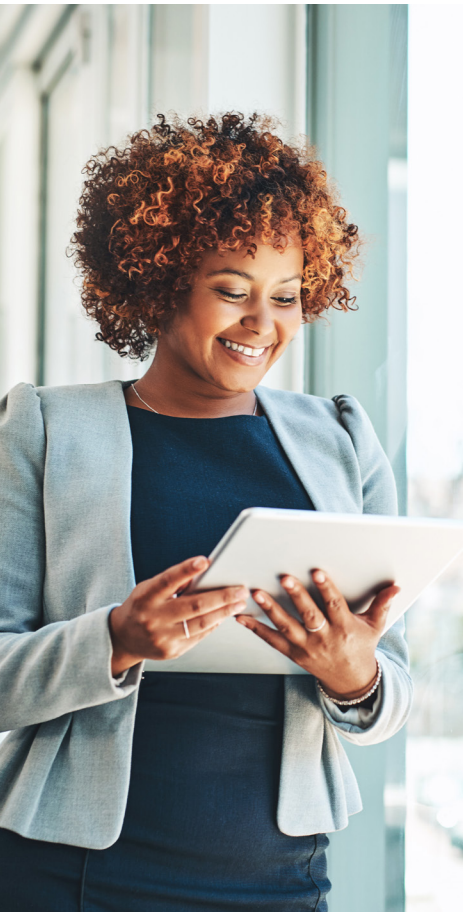
On 30 March 2026, the High Court (Commercial Division) clarified the deductibility of interest under section 25(3) of the Income Tax Act in respect to a "group". Court held that the 30% EBITDA interest limitation is not intended to apply to all taxpayers in a group of companies irrespective of the loan circumstances. Consequently, the Court set aside the decision of the Tax Appeals Tribunal which had held that common underlying ownership alone was sufficient to trigger the 30% EBITDA interest limitation.

Background

The taxpayer, a Ugandan incorporated company engaged in trading activities, obtained loan financing from an independent Ugandan commercial bank to fund its business operations.

Following a tax audit covering the 2019, 2020 and 2021 years of income, the Uganda Revenue Authority ("URA") issued additional income tax assessments on the basis that the taxpayer had overstated its interest expense deductions.

The URA applied the interest limitation of 30% of tax Earnings Before Interest, Tax, Depreciation and Amortisation ("EBITDA") under section 25(3) of the Income Tax Act ("ITA"). The URA contended that even though the loan was from a third-party lender, the taxpayer was a member of a "group" due to common underlying ownership with other companies. The taxpayer shared common underlying ownership with two entities: one in Kenya and another in Tanzania. Accordingly, the taxpayer's interest expense did not qualify for a full tax deduction because it was limited to 30% of its EBITDA because it's part of a group.



The taxpayer objected to the assessments, arguing that the interest arose from independent third-party bank loans used solely in its business and therefore fell outside the scope of section 25 of the ITA. The objection was disallowed and, on appeal, the Tax Appeals Tribunal ("TAT") upheld the URA's position that common underlying ownership alone was sufficient to trigger the 30% EBITDA interest limitation under section 25(3) of the ITA.

The taxpayer appealed to the High Court, stating:

The Tribunal erred in disregarding the application of a "group of companies" under the Companies Act and the definition of a "group" contained in the ITA. TAT also failed to evaluate the evidence on record, including the use and application of the borrowed funds by the taxpayer, thereby concluding that the taxpayer was a member of a group.

Submissions by Parties

The Taxpayers' Submissions

The taxpayer submitted that it was not a member of a group for purposes of section 25 of the ITA, arguing that the Companies Act is the substantive law on company membership and that no such group existed under company law. This is because under the Companies Act, membership requires subscription to the Memorandum and Articles of Association, which was not the case between the three companies.

The taxpayer further argued that section 25(5) of the ITA is ambiguous, as to whether it applies to foreign companies not registered in Uganda.

The taxpayer also contended that the Tribunal failed to evaluate material evidence showing that the loan was obtained from an independent third-party commercial bank, used solely in the taxpayer's business, and did not result in any intra-group benefit or profit shifting within the other members of the group.

Relying on Parliamentary Hansard, the taxpayer argued that section 25(3) was intended to prevent profit shifting, address base erosion by multinational groups, and prevent intra group lending arrangements used to strip profits from the Ugandan tax base via interest deductions, which conditions were absent in this case.

URA's Submissions

The URA submitted that section 25(5) of the ITA provides a clear and self-contained definition of a "group" based on common underlying ownership, which is distinct from company law concepts, and that reference to the Companies Act was therefore inappropriate.

The URA argued that the taxpayer and the other companies shared common shareholders which was not in contention and accordingly constituted a group under the ITA. URA further submitted that the source and use of the borrowed funds were irrelevant, as the interest restriction applies based on group membership alone. This URA position was upheld by the Tribunal hence the appeal to the High Court.

Decision of the High Court

The High Court partially allowed the appeal, setting aside the TAT's decision while rejecting some of the appellant's grounds.

Court held that the definition of a “group” under section 25(5) of the ITA is a specific provision that prevails over the Companies Act and is clear and unambiguous, including its application to foreign companies. Accordingly, provided the taxpayer is under common underlying ownership, they are a group of companies under section 25, whether or not they are foreign companies.

However, the Court departed from the Tribunal’s strict literal approach and held that section 25 must be interpreted purposively. The Court found that the provision was intended to prevent profit shifting, particularly among multinational enterprises.

The Court held that the Tribunal erred in failing to evaluate whether the taxpayer’s third-party borrowing fell within that mischief that section 25(3) was meant to remedy. Additionally, Court found that the Tribunal ought to have evaluated the economic reality and use of the borrowed funds by the taxpayer, rather than limiting its inquiry to shareholding structure alone. Consequently, the Court allowed the appeal, set aside the Tribunal’s decision, and awarded costs to the taxpayer.

Key Takeaways

1. The 30% EBITDA interest limitation rule is not intended to apply mechanically to all taxpayers with common underlying ownership.

2. Third-party debt, obtained from independent lenders and used solely in the taxpayer’s business, should not be restricted under section 25(3) where it does not result in profit shifting.

3. Courts should increasingly adopt a purposive interpretation of tax statutes, particularly with respect to anti avoidance provisions.

4. Substance and economic reality remain critical in assessing the application of interest deductibility restrictions.

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