

# Tax Watch

## Tax (Amendment) Bills 2019

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### General overview

The Tax Amendment Bills 2019 with proposed changes to the tax laws were presented to Parliament at the end of March 2019. If passed into law, the changes will come into effect from 1 July 2019.

### Income Tax (Amendment) Bill

#### Ring fencing of rental income

A company earning rental income from more than one rental property will be required to account for the income and expenses on each property separately. This ring-fencing will mean that tax losses of one property cannot be offset against the profits on another property.

The term “rental property” is not defined, so it is not clear whether this will be determined based on separate tenants, separate legal title or separate physical location. The necessity for this change is not clear, but it will certainly increase the burden of compliance for property owners and real estate developers. The URA will be expected to provide guidelines on how this will be applied in practice, including required amendments to the tax return forms.

#### Tax Incentives for Investors

The 2018 exemptions linked to industrial parks and free zones have been amended or extended as follows:

- Ten year exemption for income of a developer from letting or leasing facilities in an industrial park or free zone with an investment of USD 50 million or more. The amendment increases the existing exemption period (from five years) and reduces the investment threshold (from USD 100 million).
- Ten year exemption for income of an operator within an industrial park or free

zone, or other person carrying on business outside the industrial park or free zone, whose investment capital is at least USD 10 million for a foreigner or USD 2 million for citizens. The amendment increases the existing exemption period (from five to ten years), and reduces the investment threshold (from USD 15 million to USD 10 million for foreigners and from USD 5 million to USD 2 million for citizens).

- Introduction of an exemption for income of an operator within an industrial park or free zone, or an operator who owns a single factory or other business outside the industrial park or free zone, whose investment capital is at least USD 10 million for a foreigner or USD 2 million for a citizen. The exemption is limited to the following activities:

- Processing of agricultural goods;
- manufacture or assembly medical appliances, building materials, automobiles, household appliances;
- manufacture of furniture;
- vocational or technical institutes;
- logistics and warehousing, information technology or commercial farming.

Other requirements are that 70% of raw materials should be locally sourced, subject to availability, and the operator should employ at least 60% citizens. This new exemption seems



to favour industrialisation in connection with local materials.

#### **Definition of a citizen**

Linked to the tax incentives above, there is a new definition of the term “citizen” to mean:

- a) a natural person who is a citizen of a Partner State of the East African Community (EAC);
- b) a company or body incorporated under the laws of a Partner State of the EAC in which at least 51% of the shares are held by a person who is a citizen.

A citizen was not defined before, and therefore was only expected to capture Ugandan nationals and businesses. The proposed definition is also included in the Amendment Bills for VAT, Excise Duty and Stamp Duty.

EAC citizens and entities will therefore also benefit from preferential benefits such as lower capital investment requirements, and duty exemptions on specified items under the specific Acts. The inclusion is linked to the commitments in the EAC treaty on equal treatment of goods, services and persons from partner states.

#### **Exemption for interest paid on “infrastructure bonds”**

This exemption applies to listed bonds, notes or other similar securities used to fund public infrastructure or social services with a maturity period of at least five years. This is designed to encourage infrastructure development.

#### **Exclusion of financial institutions and insurance companies from interest limitation**

The Bill proposes to exclude financial institutions and insurance companies from the interest deduction limitation in section 25 (whereby interest deductibility is limited to 30% of Tax EBITDA). This is a welcome amendment as the financial services sector has

been advocating for the pre-July 2018 position to be restored. The exclusion appears to have been an oversight when the new rules were introduced last year, and therefore there is a good case for the correction to be made retrospective from 1 July 2018.

#### **Turnover tax on loss-making entities.**

A proposed amendment to section 38 seeks to re-introduce the turnover tax that was rejected in the 2018 amendments. A taxpayer who has carried forward losses for a consecutive period of seven years will be required to pay a tax at a rate of 0.5% on gross turnover, starting in the eighth year and each year thereafter while the losses persist.

The Bill does not state the years of income for which this amendment will apply. For example there may be companies that are already loss-making whose eighth year of tax losses commences on or after 1 July 2019. Tax losses are currently carried forward for an indefinite period. The 0.5% rate on gross revenue may be too high, especially in industries that are highly capital intensive like oil and gas, public utilities and telecoms. Also for investments made in government securities, tax withheld (20%) is a final tax meaning the tax rate may go as high as 20.5% for loss-makers.

Clarity as to which years of income this amendment will apply to should be included in the Act. We also suggest that some exceptions should be considered, for example parastatals that provide public goods or services.

#### **WHT on purchase of a business or business asset**

A resident person who purchases a business or business asset will be required to withhold tax at a rate of 6% on the gross payment. This change likely targets business and property acquisitions by businesses but will in

fact catch any asset purchased by a resident person including items such as trading stock or office supplies. The term “business asset” is defined to include any asset for use in a business but it is not clear if this is to be determined from the point of view of the vendor or purchaser. The transaction will not be eligible for exemption under the existing WHT exemption list. It is arguable whether such a new withholding tax is necessary given that many taxpayers are already required to deduct 6% WHT on purchases of goods and services.

#### **Reduced 10% WHT on long term government securities**

The Bill introduces a reduced 10% WHT rate (currently 20%) on government securities with a maturity period of at least 10 years. This is presumably designed to serve as an incentive for investors to lend to the government on a long term basis. Short term (less than 10 years government securities) will however continue to be subject to the existing WHT rate of 20%. It is not clear how the reduced WHT rate will apply to long term treasury bonds that are acquired on the secondary market with less than 10 years to maturity.

#### **Definition of beneficial owner**

The Bill introduces a definition of “beneficial owner” to mean a natural person. Coupled with a related amendment to section 88(5), this may mean that tax treaty benefits will only be available to foreign individuals.

Currently, section 88(5) states that a tax reduction or exemption under a double tax agreement “shall not be available to any person who receives that 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**”. The amendment removes the wording in bold and limits the beneficial owner to a natural person, thereby implying that a foreign entity resident in a treaty country would be excluded from claiming benefits under the double tax agreement. We see no rationale for limiting tax treaty benefits in this way and presume that the definition wording will need to be corrected.

#### **TIN number required for any government licence**

A proposed amendment to section 135 states that a local authority, government institution or regulatory body shall not issue a licence or any form of authorisation necessary for purposes of

conducting any business in Uganda, to any person without a Taxpayer Identification Number (TIN). The prior wording only required a TIN as part of the application but did not strictly prevent the issue of a license in the absence of a TIN.

This is aimed at widening the tax net as all persons carrying on any trade would be expected to be tax registered before obtaining any licence, including annual licence renewals.



## Value Added Tax (Amendment) Bill

### Re-introduction of VAT withholding

Following the suspension of last year's VAT withholding provisions, the Minister proposes to reintroduce VAT withholding but this time at a lower rate of 6% (previously the full 18% was required to be withheld), and also provides an exemptions for compliant taxpayers.

The exemption for compliant taxpayers is understood to apply to the supplier and is expected to operate in a similar manner to the current WHT exemption list (i.e. 6 monthly renewal conditional on good VAT compliance behaviour). This should reduce the tax compliance burden and cash flow implications for withholding agents. However the administrative burden for designated VAT withholding agents will continue.

### Regulations for Islamic financial transactions

The Minister shall make regulations for the equivalent tax treatment of supplies made in the course of Islamic financial transactions. This will provide clarity on how VAT will apply to the various Islamic banking products. A similar proposal was included in the 2018 Bill but removed in the final Act.

### Tax incentives for investors

The Bill proposes a new tax incentive that exempts services for feasibility studies, design and construction, locally produced materials for construction of premises or infrastructure and furniture or fittings for technical or vocational institute operators machinery and

equipment whose investment capital is at least USD 10 million in case of foreigners or USD 2 million in case of citizens.

The investment threshold for a foreign operator is reduced from USD 15 million to USD 10 million and from USD 5 million to USD 2 million for citizens (to match the thresholds for income tax and other incentives). This applies to:

- the supply of services to conduct a feasibility study and design, the supply of locally produced materials for the construction of a factory or a warehouse and the supply of locally produced raw materials and inputs or machinery and equipment to an operator within an industrial park or free zone, or to an operator who owns a single factory or other business outside the industrial park or free zone, for investment in the following sectors:
  - Processing agricultural goods;
  - Manufacture or assembly of medical appliances, building materials, automobiles, household appliances;
  - Manufacture of furniture;
  - Carrying on business in logistics and warehousing, information technology or commercial farming;

The operator must also use at least 70% locally sourced raw materials, subject to availability, and employ at least 60% citizens.

The investment threshold for certain existing exemptions for hotel or tourism

facility developers is reduced from USD 15 million to USD 10 million.

In addition, the investment capital threshold for the exemptions for developers of industrial parks and free zones is reduced from USD 100 million to USD 50 million.

### Exempt supplies

The list of exempt supplies in the Second Schedule is expanded to include the following:

- aircraft insurance services;
- rice mills;
- agricultural sprayers;
- drugs and medicines not manufactured in Uganda;
- imported mathematical sets and geometry sets used for technical and vocational education;
- woodworking machines;
- welding machines and sewing machines.

### Zero-rating for drugs and medicines manufactured in Uganda

The current Act provides for zero rating of the supply of drugs and medicines regardless of whether they are imported or manufactured locally in Uganda. The Bill restricts zero rating to drugs and medicines manufactured in Uganda, while the supply of other drugs and medicines will now be exempt.

This distinction in the tax treatment is aimed at benefitting local manufacturers as they will be able to claim input tax credits on their local purchases and imports.



## Excise Duty (Amendment) Bill

### Regulations for Islamic financial transactions

As with VAT, the Minister may make Regulations for prescribing the equivalent tax treatment of supplies made in the course of Islamic financial transactions.

### Registration requirement

The Bill replaces the current licensing requirement with a new process for annual registration of the premises of manufacturers, importers, and providers of excisable goods and services. The general registration approach is similar but includes the following changes:

- i. removes application and renewal fees for a license;
- ii. excludes retailers and retailing activity;
- iii. defines the timeframe within which a registered person should apply for renewal of the certificate of registration (i.e. 30 days before the expiry of the certificate);

- iv. imposes a fine of UGX 400,000 for each day that a person operates without a certificate of registration.

### Interest on unpaid duty

The Bill introduces a uniform interest penalty of 2% per month, compounded, on late payment of all excise duty.

Currently, the Act only provides for interest on unpaid duty in relation to manufactured or imported goods, with no penalty applying to excise duty on services.

### Incentives for Investors

The Bill provides a new exemption for materials used in the construction of premises and other infrastructure, machinery and equipment or furnishings and fittings for technical or vocational

institute operators, whose investment capital is at least USD 10 million in case of a foreigner or USD 2 million in case of a citizen.

The Bill also aligns the capital investment thresholds for the existing duty exemptions on construction materials for developers of industrial parks and free zones (to USD 50 million) and for investors in certain sectors (to USD 10 million and USD 2 million for foreigners and citizens respectively).

### Reduction in duty rates

The Bill proposes to reduce the excise duty applicable to non-alcoholic beverages as per the table below. This will mostly impact soda manufacturers, since fruit and vegetable juices and water fall under different categories:

Paragraph	Dutiable Good or service	FY19 Rates Rates	Proposed new rates FY20
5(a)	Non-alcoholic beverages not including fruit or vegetable juices	12% or UGX 200 per litre, whichever is higher	11% or UGX 185 per litre, whichever is higher



## Tax Procedures Code (Amendment) Bill

### Definition of tax return

The definition of “tax return” has been amended to mean a return or other document listed under Schedule 4.

Schedule 4 has been introduced and lists VAT, income tax, withholding tax, excise duty, lotteries and gaming tax and stamp duty returns.

The stamp duty return has been added despite the Stamp Duty Act not being a tax law to which the Tax Procedures Code Act applies. The Schedule 4 list is also different from the list of tax returns in section 16(7) of the Act.

### Commitment by government to pay tax on behalf of taxpayers

The Bill introduces section 40A which imposes a specific requirement for the

Minister to pay any tax arising from a commitment made by the Government to pay tax on behalf of a person or owed from Government for aid funded projects. This section aligns with the Ministry obligation to pay tax on behalf of a taxpayer, for example under an investment incentive arrangement.

Furthermore, all outstanding taxes not paid by Government as at 30 June 2019 will be written off. This is to ensure that the backlog of accumulated taxes not paid in the past is waived and will enable the Government to start the next fiscal year with a clean slate.

### Voluntary disclosure of offences

The new section 66(1a) allows compounding of an offence with waiver of interest or fines when a taxpayer

voluntarily discloses the offence to URA prior to commencement of court proceedings and makes full payment of the outstanding tax. This will encourage voluntary disclosure of past tax omissions with reduced fiscal consequences.

### Payment to informers

The payment made to tax-informers who provide information to URA that results in a recovery of a tax or duty, is reduced from 10% to 5% of the amount recovered.

The rate of 10% was imposed under section 8 of the Finance Act 2014 which has been repealed. Government has stated that the 10% rate was considered to be too high.





## The Stamp Duty (Amendment) Bill

### Revision of stamp duty rate on bank guarantees, insurance performance bonds, and indemnity bonds

The Bill proposes to set a fixed stamp duty rate of UGX 100,000 for the following instruments:

- bank guarantees;
- insurance performance bonds;
- indemnity bonds;
- similar debt instruments.

Bank guarantees are currently not listed separately and have been subject to duty of UGX 15,000 (which is the duty applicable to bonds) while insurance performance bonds have been subject to a fixed rate of UGX 50,000.

The proposed amendment means that the duty applicable to these instruments will be adjusted upwards. On the other hand, indemnity bonds are currently subject to duty at the rate of 1% of the total value.

The proposed amendment will provide a uniform duty rate for transactional documents issued by banks and insurance companies. However, it does not address the uncertainty between a “bond” and an “indemnity bond”, which has been a contentious issue for banks that issue documents in the category of bonds to their customers.

The rate of stamp duty applicable to a “bond” remains UGX 15,000 while an indemnity bond will be subject to a fixed rate of UGX 50,000.

### Incentives for investors

In line with the changes for other taxes, the investment thresholds for the Strategic Investment Project exemptions have been reduced to USD 50 million for developers of industrial parks or free zones, and to USD 10 million and USD 2 million for foreigners and citizens respectively in relation to specific sectors. In addition, there is a new exemption for certain instruments executed by a vocational institute operator meeting the USD 10 million or USD 2 million investment thresholds.

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