THE REPUBLIC OF UGANDA

IN THE TAX APPEALS TRIBUNAL AT KAMPALA

APPLICATION NO. 40 OF 2018

1. **UMEME LIMITED**
2. **UGANDA ELECTRICITY DISTRIBUTION COMPANY LIMITED (UEDCL) =====================APPLICANTS**

VERSUS

COMMISSIONER GENERAL
UGANDA REVENUE AUTHORITY ===================RESPONDENT

BEFORE DR. ASA MUGENYI, AND MRS. CHRISTINE KATWE.

RULING

This ruling is in respect of an application to determine which of the applicants is entitled to claim depreciation allowance in respect of assets acquired by the 1st applicant, and initial allowances for items placed by it, under concession agreements to supply electricity.

On 1st March 2005, the applicants entered a concession arrangement for the supply and distribution of electricity for 20 years. The 2nd applicant owns the electricity distribution network assets and the 1st applicant as the operator was assigned and licensed to use, maintain, and upgrade the said assets. The 2nd applicant, under a lease and assignment agreement, transferred to the 1st applicant moveable, immoveable property, and other rights. As a result, the applicant was granted possession of the concession assets. The management of the electricity distribution system in Uganda requires the 1st applicant to maintain and operate the distribution network, to collect revenues from customers based on prevailing tariffs, to make investments in the maintenance of the distribution network assets and to return control of them, including new investments to the 2nd applicant at the end of the concession period. After March 2005, the applicant purchased several assets in its upgrade, maintenance, and expansion of the distribution network. The applicant claimed for depreciation and initial allowances when computing its tax liability which was rejected by the respondent.

The following issues were set down for determination.

1. Who is entitled to claim depreciation and initial allowances?
2. What remedies are available to the parties?

The applicant was represented by Mr. Oscar Kambona, Mr. Bruce Musinguzi and Mr. Thomas Kato while the respondent by Mr. Daniel Kasuti and Ms. Nakku Mwajuma.

This application was filed by the 1st applicant to determine whether it is entitled to claim depreciation and initial allowances under the Income Tax Act. The 2nd applicant being the owner of the assets in the dispute was joined as a party to the proceedings at the insistence of the tribunal for the purpose of it defending its interests and addressing as who of the two is entitled to the said deductions under the Income Tax Act. It was entitled to a right to be heard before any decision affecting it is made. The applicants having tendered in their exhibits in the joint trial bundle felt this dispute involved interpretation of questions of law and called no witness. The respondent called one witness.

The respondent's witness, Mr. Hassan Mahmood Muyingo, an officer working with its Domestic Taxes Department testified that on 1st March 2005 the 1st applicant took over the distribution and supply of electricity in Uganda from the 2nd applicant under a 20-year concession. The 1st applicant was assigned and licensed to use and upgrade the electricity distribution assets. To operationalize the concession the applicants signed a Lease and Assignment agreement setting out the terms and obligations of the parties. Under the agreement the 1st applicant was granted possession of the concession assets but not the ownership. Ownership remained with the 2nd applicant. The 1st applicant had the exclusive rights to use the assets and had an obligation to maintain and retire the distribution network assets and related systems. It had to retransfer the assets back to the 2nd applicant after the expiry of 20 years. The investment by the 1st applicant in the distribution network is recoverable by a tariff arrangement where an annual capital recovery charge is factored in the tariffs charged to customers. Investment not recovered through the tariff arrangement at the time of the retransfer of assets will be paid to the applicant as a buy-out amount.

Sometime in 2012 the 1st applicant wrote to the respondent seeking approval for capital deductions on the concessionary assets. The respondent disallowed the capital allowances claimed and raised an assessment of Shs. 6,636,835,000 for the period 2005 to 2009. The 1st applicant objected on the grounds that the concession asset ought to be divided between operating lease and finance lease. It requested that the review period be extended from 31st December 2008 to 31st December 2011 which was done and tax payable was adjusted to Shs. 4,146,996,000. The respondent responded that the concession assets do not belong to the 1st applicant as it is fully compensated and hence no depreciation deduction is allowable. The respondent granted the 2nd applicant the right to benefit from the capital deductions allowable. Various meetings were held, and objections made. On 17th July 2019, the respondent made an objection decision in which it considered errors pointed out and revised the assessment to Shs. 66,115,136,000.

In respect of the first issue, the 1st applicant submitted that it took over distribution and supply of electricity in Uganda from the 2nd applicant on 1st March 2005 under a 20-year concession. Under the Lease and Assignment agreement the 1st applicant was granted possession of the leased assets, but ownership remained with the 2nd applicant. The 1st applicant was granted the exclusive right to use, repair, modify/upgrade and expand the electricity distribution system in Uganda. The 1st applicant submitted that the leased assets included motor vehicles, motorcycles, furniture, computers, office equipment, communications equipment, substations, transformers, voltage lines and electrical tools. The contention between the parties is: who between the 1st and 2nd applicant can claim depreciation and initial allowance for the assets. The 1st applicant submitted that its claim is confined to the assets purchased by it after the concession date and not those purchased before by the 2nd applicant. Under the Lease and Assignment agreement S. 2.9 the 1st applicant was entitled to modify the equipment it uses in the distribution of electricity at its expense. Modification included upgrade of the distribution system. The applicant added new assets: motor vehicles, motorcycles, computers, office equipment substations, transformers, voltage lines, and electrical tools.

The 1st applicant claimed it is entitled to depreciation and initial allowance on the above assets which is provided for under the Income Tax Act. The 1st applicant cited S. 27 which provides that a person is allowed a deduction for the depreciation of the person's depreciable assets. S. 2(u) defines a depreciable asset to mean any plant or machinery, or any implement, utensil or similar article used or ready to be used to produce income included in the gross income. S. 27(9) states the cost base of a depreciable asset is added to a pool in the year of income in which the asset is placed in service. Under S. 52 the cost base of an asset is the amount paid in respect of the asset. The 1st applicant argued that for a person to be allowed depreciation allowance it must be shown that: a) The person incurred an expenditure in acquiring the depreciable asset; b) The depreciable asset must be wholly or partly used or held for use in the production of income included in the gross income; c) The cost base of that asset (the expenditure incurred in acquiring the asset) is added to the person's pool of assets.

The 1st applicant submitted that it incurred expenditure to purchase the assets added to the distribution network after the concession date. This was done in accordance with S. 2.9 of the Lease and Assignment agreement. The first applicant cited **Lupton (Inspector of Taxes) v. Cadogan Gardens Developments Ltd, Carlton Towers Ltd v Moore (Inspector of Taxes), Carlton Tower Ltd v Inland Revenue Commissioners [1971] 3 All ER 460**, for the submission that the person who incurred the expenditure in acquiring an asset should be the one entitled to a depreciation allowance in respect of such an asset. The 1st applicant submitted therefore that it was entitled to claim the depreciation allowance in respect of the said assets.

The 1st applicant submitted further that it uses the assets in question in the production of income. It cited **Steel Corporation of East Africa Ltd v Uganda Revenue Authority** TAT No. 4 of 2008 where the applicant held and used the assets between 1972 and 1994. It was held the applicant is entitled to wear and tear on the written down values of these assets as at the end of accounting year 1993. S. 2.2 of the Lease and Assignment agreement and its preamble allowed the company to use, occupy, operate, and maintain the assigned interests. As such the 1st applicant submitted that since the assets in question are used by it in the production of income it is the only party entitled to claim depreciation in respect of the said assets.

In respect of the last condition, the 1st applicant submitted that under S. 27(9) of the Income Tax Act, the cost base of the asset should be added back into a pool in a year of income. The first applicant submitted that since it incurs the expenditure for the purchase of the assets in question it is entitled to the cost base for these asset which should be added to its pool in the year of income in which the assets are obtained. The 1st applicant cited **Mukwano Enterprises Ltd v Uganda Revenue Authority** TAT Application No. 06 of 2018 where the Tribunal defined the cost base. The 1st applicant argued that it takes out an insurance policy in respect of the said assets at its own cost. Therefore the 2nd applicant ceded to it ownership of the assets and can therefore not claim any depreciation in respect of the said assets because the 1st applicant is deemed the owner and therefore entitled to the depreciation allowance.

In respect of initial allowance, the 1st applicant submitted that it is entitled to initial allowance under S. 27A of the Income Tax Act. The 1st applicant cited **Steel Corporation of East Africa v Uganda Revenue Authority** TAT 4 of 2008 where the applicant was entitled to initial allowance for the assets in the year the assets were acquired and first put to use The applicant argued that it placed into service plant and machinery to achieve the objective of modifying the distribution system. It purchased assets after the agreement to expand the network and the assets purchased were placed into service outside a fifty kilometers radius from Kampala.

The 1st applicant submitted that in a letter of 7th March 2014 the respondent argued that the former was not entitled to claim depreciation because the Lease and Assignment agreement was governed by IFRIC (International Financial Interpretation Committee) 12. According to the respondent, the concession assets in line with IFRIC 12 are not recognized as property, plant and equipment. The respondent also rejected its claim for the depreciation allowance because of the 1st applicant's recognition of the assets in its 2008 financial statements as intangible assets. The respondent contended that the assets fail to meet the criteria under S. 27(1) of the Income Tax Act. The basis of using IFRIC 12 was S. 40 of the Income Tax Act. The said Section allows a taxpayer to prepare its books of account in line with Generally Acceptable Accounting Principles (GAAP). The rationale for use of GAAP is to ensure that taxpayers the world over present their affairs consistently. The 1st applicant argued that the determination of who qualifies for deprecation should be based under the Income Tax Act and not IFRIC 12. The applicant cited **Mukwano Enterprises Ltd v Uganda Revenue Authority** TAT No. 06 of 2018 where the Tribunal noted that International Accounting Standards may be used if they are in harmony with the Income Tax Act. The 1st applicant argued where the Income Tax Act is clear accounting standards cannot override it. The 1st applicant argued that it should not be denied its right to a depreciation allowance on the basis of IFRIC 12 where the assets in question are recognized as intangibles despite the clear right to a depreciation allowance under S. 27 of the Income Tax Act.

The 1st applicant contended that under Paragraph 8.3 of the Support Agreement the Government of Uganda undertook to allow it to depreciate for tax purposes all investments made pursuant to the agreements to the full extent permitted under the laws of Uganda. The Government and the respondent are bound by the agreement signed. The 1st applicant submitted it had a legitimate expectation that it would be entitled to the depreciation.

The 2nd applicant contended that the Lease and Assignment agreement clearly indicates that the title to the leased assets and any upgrades or modifications lies with it. It argued that S. 2.18(a) of the agreement which states that the lease agreement should not be interpreted as the 1st applicant taking over the 2nd applicant's business. The 2nd applicant also cited S. 2.9(b) of the agreement which vests title to all acquisitions made by the 1st applicant onto the 2nd applicant as legal owner. The 2nd applicant argued that whereas it ceded possession of the leased assets including the right to make modifications, ownership and control of the assets remained with it. It also relied on a statement in the 1st Annual Report for the year 2015 that the concession agreement did not convey to the 1st applicant the right to control the use of the investments in the distribution network but rather the right to operate and use the assets and charge customers. The 2nd applicant argued that the 1st applicant should not lay claim to the leased assets because under the Lease and Assignment agreement the latter is fully compensated for the said assets under the Tariff Compensation plan. Under the terms of the Lease and Assignment agreement the burden of paying for any expenditure relating to the distribution system is borne by the 2nd applicant and the customers on the distribution network through the Tariff Compensation plan. It therefore argued that the capital expenditure in respect of the said acquisitions lay with it and allowable tax benefits should accrue to it.

The 2nd applicant cited S.40 of the Income Tax Act which requires taxpayers to conform to Generally Accepted Accounting Principles (GAAP) for their tax accounting. The 2nd applicant submitted that the Institute of Certified Public Accountants of Uganda (ICPAU) established under the Accountants Act 2013, is mandated to regulate, and maintain accountancy standards in Uganda. In exercise of this mandate, ICPAU adopted the International Financial Reporting Standards (IFRS) formerly known as the International Accounting Standards (IAS) as Uganda's national accounting standard. The 2nd applicant argued that where the Income Tax Act is silent on the tax treatment of a matter recourse should be made to the IFRS. It argued further that the accounting treatment of service concession arrangements is governed by IPSAS 32 and IFRIC 12 which apply to public bodies and private entities, respectively. The 2nd applicant submitted that the accounting treatment influences the tax position. It submitted that the 1st applicant's financial statements are prepared in conformity with IFRS, specifically with IFRIC 12 as stated in its Annual Report. That accordingly in line with IFRIC 12, the assets added to the distribution network are not recognized as property, plant and equipment but as intangible assets. The 2nd applicant contended that it being a public body, it also conforms to IPSAS (International Public Sector Accounting Standard) 32 which specifically deals with service concession agreements focusing on their governmental accounting consequences. IPSAS 32 provides that if the grantor controls or regulates the services provided by the operator and controls any significant residual interest in the service concession asset at the end of the term of the arrangement, the grantor must recognize the underlying assets as its own. The 2nd applicant submitted that in compliance with IPSAS 32, it recognizes the leased assets in its books as plant property and equipment. It is the party entitled to the capital and initial allowances under S. 27 and S. 28 of the Income Tax Act. The 2nd applicant argued that under IFRIC 12 and IPSAS 32 service concession arrangements are not lease transactions. It contended that control must be interpreted in line with the relevant accounting standards and not in its ordinary meaning. The legal title as well as control over the leased assets remains with it, accordingly it was the right party to claim capital and initial allowances over the leased assets.

The 2nd applicant also argued that under S. 27 of the Income Tax Act capital allowances can only be claimed by an owner of plant property and equipment unless the transaction in question is a finance lease in which case the 1st applicant would be entitled to the capital allowances. The 2nd applicant submitted that since the transaction in question was not a finance lease the 1st applicant was not entitled to claim the capital and initial allowances. The 2nd applicant submitted that ownership generally is represented by legal title. It cited **Mukwano Industries Ltd v URA** HCCS No. 1 of 2008 where the High Court observed that capital allowance deductions are claimable by the holder of the legal title to the property. The 2nd applicant submitted therefore that as the legal owner it was the party entitled to the capital and initial allowances.

In reply, the respondent submitted that a person is allowed a deduction for the depreciation of a person's depreciable assets under S. 27(1) of the Income Tax Act. The respondent submitted that the terms 'person' and 'depreciable assets' were defined under S. 2 of the Act to include a government, subdivision of government and a plant or machinery respectively. The respondent submitted that the only condition of the applicant which is acceptable for claiming depreciable allowance is: the depreciable asset must be wholly or partly used or held for use in the production of income included in the gross income. The respondent submitted that for an asset to be granted capital deductions, the following conditions must be fulfilled a) the asset must be owned by the taxpayer; or b) the asset must be owned under a finance lease, c) it must be used for the purpose of business or profession and d) it should be wholly or partly used during the relevant accounting period.

The respondent argued that for one to claim depreciation allowance, the asset must be owned wholly or partly by the taxpayer. The respondent submitted that the 1st applicant was not the owner of the assets added to the electricity distribution network. The respondent cited S. 2 of Income Tax Act which provides that a depreciable asset means any plant or machinery or any implement among others that is wholly or partly used or held ready for use by a person in the production of income. The respondent argued that the 1st applicant being an operator in the service concession arrangement was using the assets on behalf of the 2nd applicant. The respondent referred to the 1st applicant's audited books where it is stated that "the company has access to operate the infrastructure to provide the public service on behalf of government". In the service concession agreement, it was agreed that the 1st applicant receives possession of the concession assets but not ownership. The respondent contended that the 1st applicant's audited books of account and financial statements indicate that ownership of the leased assets lay with the 2nd applicant. The respondent cited **Afgri Uganda Limited v Uganda Revenue Authority** TAT 18 of 2019 where the Tribunal noted the financial statements are signed by the directors of a company and reflect the true position of a company's affairs. The respondent submitted therefore that the 2nd applicant was the rightful party to claim the capital allowance.

The respondent contended that lease assets added to the electricity network may be classified as either operating or finance leases. The respondent further contended that an operating lease is not entitled to capital allowances. The asset must be owned under a finance lease. The respondent cited S. 59 of the Income Tax Act which provides that where a where a lessor leases property to a lessee under a finance lease the lessee is treated as the owner of the property. S. 59(2) provides that a lease property is a finance lease if the lease term exceeds seventy-five per cent of the effective life of the leased property or where the lessee has an option of purchase of the property or the estimated residual value of the property at the expiration of the lease is less than twenty per cent of its fair market value at the commencement of the lease. The respondent argued that the 1st applicant does not have the option to purchase the property at the expiration of the lease. The respondent submitted that from the onset it was intention of the parties that all the assets are transferred back to the 2nd applicant at the end of lease. The respondent contended that any lease arrangement not qualifying as a finance lease was an operating lease under the Income Tax Act. The 1st applicant should not claim depreciation allowance for those assets added to the distribution network as they are operating leases.

The respondent also contended that depreciation is allowed where the depreciable asset owned by the taxpayer is used for the purposes of business or profession. The respondent cited **Liquidators of Pursa (1954) 25 ITR 265 (SC)** where it was explained that the expression “used for the purpose of the business” meant that the assets must be used by the owner for the purposes of carrying on the business and earning profits therefrom. The respondent contended that the 1st applicant’s role is to distribute and supply power on behalf of the 2nd applicant meaning the business is for the latter and not for the former. The 1st applicant cannot claim depreciation allowance since it does not have title to the assets.

The respondent submitted that S. 27A of the Income Tax Act provides for initial allowance to a person who places an item of eligible property into service for the first time outside a radius of fifty kilometers from the boundaries of Kampala. S. 27(3) defines “item of eligible property” to mean plant, machinery among others wholly used in the production of income. The respondent argued that the 1st applicant placed plant and machinery on behalf of the 2nd respondent who was the owner of the assets. The respondent argued that a lessee s not entitled to claim capital allowances. Therefore, the right person to claim initial allowance is the 2nd applicant.

The respondent submitted further that the 2nd applicant has an unconditional obligation to compensate the 1st applicant for any investment through the tariff compensation plan under the Lease and Assignment Agreement. The respondent felt that 1st applicant could not claim for the depreciation allowance when it is compensated for all its investments towards the modification of the distribution system.

The respondent submitted that though the 1st applicant contended that the former had relied on IFRIC 12 stated in its audited books of accounts 2015, it did not deny the first applicant's claim on the said IFRIC 12. The respondent submitted that its adjustments were premised on Sections 27, 28 and 31 of the Income Tax Act. The respondent submitted that imposition of tax in Uganda is a creature of the law.

The respondent further submitted that 1st applicant's claim that the Distribution and Support Agreement allowed the company to depreciate for tax purposes is not tenable. The 1st applicant cannot rely on contractual obligation to do away with statutory duty.

In rejoinder, on the argument that the 1st applicant recoups the expenditure it incurs through the tariff arrangement, it argued that returns obtained are not fully retained by it. The power tariff charged enables the 1st applicant recover costs incurred in the provision of electricity. The end user tariffs are comprised of the power supply price and the distribution price. The power supply price is the price the 1st applicant purchases electricity from the 2nd applicant while the distribution price is the price for the distribution of electricity to end users.

In respect of the application of accounting standards to determine which party is entitled to capital allowances, the 1st applicant cited **Mukwano Enterprises Limited v Uganda Revenue Authority** TAT 6 of 2018 where the Tribunal held that where the Income Tax Act is clear accounting standards cannot override it. The 1st applicant argued that its presentation in the financials should not be used as a basis to deny the 1st applicant depreciation allowance.

The 1st applicant disputed the conditions set by the respondent in determining who may claim for depreciation allowance, such as the asset be owned by the taxpayer, the asset must be under a finance lease etc. The 1st applicant contended that S. 27 of the Income

Tax Act refers to a ‘person’ being entitled to deduction for depreciation and not owner. It cited **Mukwano Enterprises Limited v Uganda Revenue Authority** (supra) where it was held that “Ownership implies the right to possess a thing, regardless of any actual or constructive control.” The Tribunal held that the Income Tax Act does not mention operating and finance lease. The 1st applicant cited **Cape Brandy Syndicate v Inland Revenue Commissioners** (1921) 1 KB 64 where the court stated that in a taxing Act one must look merely at what is clearly said. The 1st applicant contended that S. 27 does not state anywhere that a person must be operating under a finance lease to claim a depreciation allowance.

The 1st applicant argued that it is entitled to depreciation allowance as the person who incurs expenditure which is used in the production of income. It is the 1st applicant who fulfills the conditions in the Lease and Assignment agreement and is entitled to the allowances.

The 1st applicant also argued that respondent cannot selectively choose to rely on certain provisions of the agreement and ignore others. The 1st applicant cited **State of Punjab & others v Dhanjit Singh Sandhu** Civil Appeal 5698-5699 of 2009 where the court stated the law does not permit a person to both approbate and reprobate. This is based on the principle of election which postulates that no party can accept and reject the same instrument. The respondent also cited **Rajasthan State Industrial Development and Investment Corporation and another v Diamond and Gem Development Corporation Ltd and another** AIR 2013 SC where it was stated that “ a Party cannot be permitted to “blow hot and cold”, “fast and loose” or “approbate and reprobate”. Where one knowingly accepts the benefits of a contract or conveyance or an order, it is estopped from denying the validity or binding effect of such contract or conveyance or order. The 1st applicant contended that the respondent having knowingly accepted the benefits of the concession agreements cannot turn around ignore and contest the agreements.

In its rejoinder, the 2nd applicant reiterated its position that it is the legal and economic owner of the assets in question. The title to the assets lies with it. The 1st applicant always recoups all monies spent on purchases for asset additions and modifications. The 1st applicant is guaranteed the recovery of its capital expenditure under the agreements.

Having listened to the evidence and read the submissions of the parties, this is the ruling of the Tribunal.

Sometime around 1st March 2005, the applicants entered a concession agreement for the supply of and distribution of electricity to consumers for 20 years. The 2nd applicant owns the distribution network and the 1st applicant as the operator was assigned and licensed to use, maintain, and upgrade the electricity distribution assets.

The 1st applicant contends that under the concession agreement there were two form of assets: those that were transferred to the 1st applicant from the 2nd applicant and those that were brought into existence as part of the modification and upgrade of the distribution system as required by the concession agreements. The 2nd applicant, under a lease and assignment agreement, transferred to the 1st applicant moveable, immoveable and other rights, which made up the electricity supply distribution system. S. 2.1 of the Lease and Assignment agreement defined the leased assets as:

> "Any and all land and land interests, and interests in moveable and non- moveable property owned by UEDCL, including plant and equipment, tools, vehicles, buildings, furniture, office, equipment, management information systems and all other facilities and equipment used principally to distribute electricity and supply electric power as of the date of this agreement: …"

Under S. 2.1(b) the 2nd applicant delivered the leased assets to the 1st applicant. It was agreed in the Lease and Assignment agreement that at the end of the concession period it would retransfer the assets. In respect of the new assets, S. 2.9 of the agreement read:

> "After the Transfer Date, the Company, at its sole expense, shall have the right and obligation to make all Modifications necessary to cause the Distribution System to be in compliance with all the requirements of the Laws of Uganda and Licenses (each a "Required Modification). In addition, the company at its expense, from time to time shall have the right to make any optional Modification that the Company may deem desirable in the proper conduct of its business: …"

Under S. 1.1 the company under the agreement was the 1st applicant. It was necessary for the 1st applicant to acquire new assets to modify the distribution system. After March 2015, the 1st applicant purchased several assets in the upgrade and expansion of the distribution network.

The assets acquired by the 1st applicant from the 2nd applicant are not in contention but those acquired because of the modification of distribution network. The contention between the parties arose from the tax treatment of the new concession assets. The dispute was in respect of the provision of capital allowance and initial allowance. While the 2nd applicant is deemed to be the underlying owner of the concession assets the 1st applicant is the user and lessee of the assets.

The 1st applicant argued that under the agreements the major duty to pay taxes fell on it. This implied that it was entitled to the deductions of both allowances. The Lease and Assignment agreement S. 6.1 provides that:

> "All central, local, district, administrative, municipal, or other lawful taxes, duties, levies or other impositions incurred or applicable to the company, the Distribution Systems or in the Leased Assets, Assigned Interests or Other Rights from the Transfer Date until the termination of this Agreement shall be paid by the Company in a timely fashion; provided however that, UEDCL shall be liable for all such taxes, duties, levies and impositions related to the Distribution system or UEDCL's interests in the Lease Assets, Assigned Interests and Other rights that are levied with respect to the period before the Transfer Date whether imposed before or after the Transfer date; provided further, notwithstanding any other provision in this Agreement, the company shall be liable for any stamp tax payable as a result of the transfer by UEDCL of its interest in customer accounts receivables pursuant to Section 2.4(a)."

This was reechoed in the Clause 8.1 of the Distribution Support Agreement which read:

> "The Company shall be subject to all central, local, district, administrative, municipal or other lawful taxes, duties, levy or other impositions incurred or applicable under the Laws of Uganda including but not limited to, all customs duties, income taxes and other taxes in Uganda; provided however the Company shall be entitled to receive all of the Concessions, reductions and exemptions from taxation applicable to the Company and its interests under the Lease Agreement, if any, under the Laws of Uganda or any applicable

> agreements, provided further that the Company shall be allowed to deduct for tax purposes any expenses incurred by it in fulfilling its obligations under the Privatization Agreements and the Licenses to the full extent permitted under the Laws of Uganda in existence from time to time."

Clause 8.3 of the Support Agreement also provided that:

> "The GOU shall allow the Company to depreciate for tax purposes all the investments in Modifications made pursuant to the Privatization Agreements to the full extent permitted under the Laws of Uganda in exercise from time to time."

The 1st applicant contended that under said agreements it was entitled to the deductions.

Tax liability is a creature of statute. Article 152 of the Constitution provides that no tax shall be imposed except under the authority of an Act of Parliament. To impose tax liability on a taxpayer, the respondent is required to look at the statute imposing the tax and not at the contract between parties. This is because the respondent cannot impose the terms of a contract on any party as it is not party to the contract. To this end, it was held by Egonda Ntende J. in **J.K.M Enterprises and Others in Uganda Revenue Authority** HCCS 599 of 2001, that:

> "… exercise of statutory powers and duties cannot be fettered or overridden by agreement, estoppels, lapse of time and such other circumstances."

The above authority was cited by Hellen Obura J. in **Heritage Oil and Gas Limited v Uganda Revenue Authority** Civil Appeal 14 of 2011 where she said:

> "The rationale for making tax matters statutory and not contractual is to enable Government to achieve the objectives of taxation which, as stated by **Prof. D.J. Bakibinga** in his book titled**: Revenue Law in Uganda** are: to raise revenue; to achieve economic stability and development; and to bring about income distribution. Taxation is a tool by which the sovereign state extracts finances or funds from its people and property to provide public revenue to support Government expenditures and public expenses. It is the most reliable source of funds for most developing economies and therefore subjecting it to the whims and negotiation skills of contractors and Government officials would create uncertainty and inequity on the amounts payable and cause economic instability."

This appeal arose from a decision of the Tax Appeals Tribunal which had held that tax matters are statutory and not contractual. Therefore, the arguments of the parties that the concession agreements-imposed tax liability on the 1st applicant and therefore it should be entitled to deductions is inconceivable. The respondent is required to look at the tax imposing Acts of Parliament. Likewise, for the respondent to argue that the 1st applicant is compensated when it recoups the expenditure it incurs through the tariff arrangement under the concession agreements and therefore is not entitled to deductions is also inconceivable. It is not the duty of the respondent to level the ground where there are imbalances or inequities in a contract. Its duty is to read the statutes and apply them. The argument that the parties to the agreement agreed to use IFRIC12 to determine which party should be allowed the deductions under the concession is also irrelevant.

Having stated the above, the question is: what does the law say about deductions on capital and initial allowances? In respect of depreciation allowance, S. 27 of the Income Tax Act provides that:

> "(1) A person is allowed a deduction for the depreciation of the person's depreciable assets, other than an asset to which section 26(2) applies, during the year of income as calculated in accordance with this section."

A depreciable asset is defined under S. 2(u) to mean:

> "Any plant or machinery, or any implement, utensil or similar article which is wholly or partly used, or held ready for use, by a person in the production of income included in gross income and which is likely to lose value because of wear and tear or obsolescence:"

S. 27(9) of the Income Tax Act further provides that:

> "The Cost base of a depreciable asset is added to a pool in the year of income in which the asset is placed in service."

S. 52(2) of the Income Tax Act defines:

> "(2) The cost base of an asset purchased, produced or constructed by the taxpayer is the amount paid or incurred by the taxpayer in respect of the asset, including incidental expenditures, of a capital nature incurred in acquiring the asset, and includes the market value at the date of acquisition of any consideration in kind given for the asset."

Having read the said Sections, the parties gave different conditions for a person to be allowed a depreciation allowance. The 1st applicant argued that it must be shown that:

1) The person incurred an expenditure in acquiring the depreciable asset.

2) The depreciable asset must be wholly, or party used or held for use in the production of income included in gross income.
3) The cost base of that asset (the expenditure incurred in acquiring the asset) is added to the person's pool of assets.

On the other hand, the respondent argued that the following conditions must be met for one to be granted capital deductions:

1) The asset must be owned by the taxpayer; or
2) The asset must be owned under a finance lease.
3) It must be used for the purpose of business or profession; and
4) It should be wholly or partly used during the relevant accounting period.

The respondent cited **Christine Mugume "Managing Taxation in Uganda"** as the source of its conditions. The 2nd applicant was agreeable with the respondent that the asset must be owned by the taxpayer.

Taxes are a creation of statute. The beginning point is that, when reading a statute, words should be given a literal meaning. Nothing should be implied in, and nothing should be implied out. In **Cape Brandy Syndicate v Inland Revenue Commissioners** (1921) 1 K.B 64 at 71 Rowlatt J. held that:

> "…in a taxing Act one has to look merely at what is clearly said. There is no room for any intendment; there is no equity about tax. There is no presumption as to a tax. Nothing is to be read in, nothing is to be implied, one can only look fairly at the language used."

So, the question is: Where did the conditions of the parties as to entitlement to capital allowances come from?

A casual reading of S. 27(1) and S. 2 of the Income Tax Act together show that for one to be allowed allowance for a depreciable asset, the plant, machinery or any implement inter alia must be wholly or partly used or held ready for use by a person in the production of income. The Section is clear. The item or asset in question should be wholly or partly used or held ready for use by a person in the production of income. The word "use" is defined by **Black's Law Dictionary** 10th Edition p. 1776 as: "1. To employ for the accomplishment of a purpose;" The definition of ownership by **Black's Law Dictionary** (supra) p. 1200 as: "The bundle of rights allowing one to use, manage and enjoy property, including the right to convey it to others, Ownership implies the right to possess a thing, regardless of any actual or constructive control." The said definition was cited in **Mukwano Enterprises Limited v Uganda Revenue Authority** TAT 6 of 2018. However, what is important to note that S. 27 and S.2 of the Income Tax Act does not require that for one to use a depreciable asset he must be the owner of the asset. A statute must be read as a whole. Sections 27 and 2 of the Income Tax Act should be read together with S. 22 of the Income Tax Act which is the enabling Section. The relevant S. 22(1)(a) of the Income Tax Act reads:

> "(1) Subject to this Act, for the purposes of ascertaining the chargeable income of a person for a year of income, there shall be allowed as a deduction –
>
> (a) all expenditures and losses incurred by the person during the year of income to the extent to which the expenditures or losses were incurred in the production of income included in gross income;"

All that is required is for one to use the depreciable asset in the production of income included in gross income during the year of income. In **Lupton (Inspector of Taxes) v Cadogan Gardens Development Ltd Carlton Tower Ltd v Moore (Inspector of Taxes) Carlton Tower Ltd v Inland Revenue Communication [**1971] 3 ALL ER 460 where court held that;

> "It would appear that the legislature regarded the obligation on a lessee to maintain the plant and deliver it up in good condition at the end of the term as sufficiently imposing a burden of wear and tear to justify an allowance….."

Likewise a party that is using an asset should be entitled to depreciable allowance to enable them replace or repair it. How will a lessee maintain an asset it is using after purchasing it, if it is the lessor claiming the deductible allowances? Under S. 2.9 of the Lease and Assignment agreement the company, which was the 1st applicant, at its expense makes all modifications on the distribution network for the supply and distribution of electricity. The 1st applicant was the person using the depreciable assets in the production of income. It was the party incurring the expenses in the production of income and not the 2nd applicant.

In this case the 2nd applicant leased the concession assets to the 1st applicant. The respondent cited S. 59 of the Income Tax Act which reads:

"**Finance Leases**

(1) Where a lessor leases property to a lessee under a finance lease, for the purpose of this Act –

(a) The lessee is treated as the owner of the property; and

(b) The lessor is treated as having made a loan to the lessee, in respect of which payments of interest and principal are made to the lessor equal in amount to the rent payable by the lessee.

(2) The interest component of each payment under the loan is treated as interest expense incurred by the lessee and interest income derived by the lessor.

(3) A lease of property is a finance lease if –

(a) the lease term exceeds seventy-five per cent of the effective life of the leased property.

(b) the lessee has an option to purchase the property for a fixed or determinable price at the expiration of the lease; or

(c) the estimated residual value of the property to the lessor at the expiration of the lease term is less than twenty per cent of its fair market value at the commencement of the lease.

(4) For the purposes of subsection (3), the lease term includes any additional period of the lease under an option to renew."

The respondent contended that the 1st applicant does not have an option to purchase the property for a fixed or determinable price at the expiration of the lease. Therefore, it is a finance lease. S. 59 of the Income Tax Act falls under Part VII of the Income Tax Act that deals with miscellaneous rules for determining chargeable income. It is concerned with how to treat the income of a lessor under a finance lease which it describes. It is not concerned with deductible allowances from gross income which falls under Part II which deals with imposition of tax. In this matter we are concerned with which of the two, the lessor or lessee is entitled to capital and initial allowance and not how the income received by the lessor should be treated.

The 2nd applicant cited **Mukwano Enterprises Limited v Uganda Revenue Authority** HCCA 1 of 2008 where it argued that the High Court observed that capital allowance deductions are claimable by the holder of the legal title to the property. The issue in that case was whether expenditure in acquiring leasehold interest qualifies for intangible assets allowance under the Income Tax Act. It was not about whether it was the lessor or lessee who is entitled to capital allowance. An owner or the person holding legal title to a property maybe entitled to capital allowance if he uses the asset in the production of income. The Section is concerned with usage and not ownership.

In its letter of 7th March 2014, the respondent argued that the applicant was not entitled to claim depreciation because the Lease and Assignment agreement was governed by IFRIC (International Financial Reporting Standards) 12. The respondent submitted that in its audited books the applicant admitted that the concession is within the scope of IFRIC12. The respondent also argued that according to the audited books it was the intention of the parties that all the assets are transferred back to the 2nd applicant. This led to the conclusion that the lease between the applicants is an operating lease. It was also contended that according to IFRIC 12, the concession assets are not recognized as property, plant and equipment. The Tribunal notes that the Income Tax Act does not mention an operating lease anywhere. It is difficult to impute that if a lease is not a finance lease it is an operating lease under the Income Tax Act when it does not define it. A finance lease in the reporting standards is different from that in the Income Tax Act. Under the reporting standards it is juxtaposed with an operating lease which it defines whereas in the Income Tax Act it is not. It would be as difficult to apply the definition in the reporting standards to the Income Tax Act as putting a square peg in a round hole.

On the other hand the 2nd applicant cited the IPSAS (International Public Sector Accounting Standards) 32 which provides that if the grantor controls or regulates the services provided by the operator and controls any significant residual interest in the service concession asset at the end of the term of the arrangement, the grantor must recognize the underlying assets as its own. The Tribunal already noted that the Income Tax Act states the person who uses the asset and incurs expenditure of the asset in the production of income is entitled to deduct capital allowance. The purpose of International Accounting Standards is to ensure uniformity, consistency and continuity in accounting systems among members. In **Mukwano Enterprises Limited v Uganda Revenue Authority** Application 6 of 2018 the Tribunal noted that:

> "S. 40(1) [of the Income Tax Act] requires a taxpayer to use generally accepted accounting principles. There are so many accounting principles that are in conformity with principles of taxation. By using generally accepted accounting principles a taxpayer will be able to manage most of its tax affairs. As long as the accounting principles applied by the taxpayers are in conformity with the Income Tax Act they shall be inadvertently applied."

Therefore, if IFRIC 12 and IPSAS 32 are not in conformity with the Income Tax Act they are inoperable as far as the taxation of income of businesses is concerned.

In respect of initial allowances, S. 27A of the Income Tax Act reads:

> "(1) A person who places an item of eligible property into service for the first time outside a radius of fifty kilometres from the boundaries of Kampala during a year of income is allowed a deduction for that year of an amount equal to fifty percent of the cost base of the property at the time it was placed in service."

S. 27(3) of the Act defines 'item of eligible property' to mean "plant and machinery wholly used in the production of income included in the gross income." It lists down the items that are not included in the said definition. The respondent contended that the 1st applicant is not entitled to initial allowance as it is only the lessor who is entitled to claim it in respect of the leased asset.

S. 27A mentions that a 'person' who places the item is entitled to the initial allowance. S. 2 of the Income Tax Act defines a person to include "an individual, a partnership, a trust, a company, a retirement fund, a government, a political subdivision of a government and a listed institution." The word "places" is defined in **Oxford Advanced Learner's Dictionary** 6th Edition p. 885 inter alia as "to put something in a particular space." In our considered wisdom, we think that if any of the listed person mentioned places an item of eligible property outside the said radius of Kampala, it is entitled to initial allowance. The said Section does not mention that it must be a lessor or a lessee. If it is the lessor then it will be entitled to the initial allowance. If it is the lessee then it is the party entitled to initial allowance. Therefore, it is irrelevant whether the item was placed by a lessor or a lessee as long as it is any of the above-mentioned persons who places the item as prescribed by law. In **Kumi Orthopedic Centre v Uganda Revenue Authority** Application 23 of 2018 the tribunal noted that:

> "Initial allowance under S.27A (formally S.28) of the ITA was intended to give some incentive to investor who put certain items of eligible property into service for the first time with exception of goods or passenger transport vehicle …"

S. 27A is more concerned with the person who places the item of eligible property for the first time to encourage investment outside Kampala.

S. 27A should be read together with S. 4 of the Income Tax which requires the person to be a taxpayer. The said Section should also be read together with S. 22 of the Income Tax Act that allows for a deduction; it must be in the production of income included in the gross income. In this matter, there is no evidence to show that the 1st applicant was claiming for initial allowance on items of eligible property it did not place outside the radius of Kampala as prescribed by law. The dispute between the parties was not about who placed the items of eligible property but who was entitled to claim. S. 2.9 of the Lease and Assignment agreement placed the burden on the 1st applicant to do the necessary modifications at its expense.

All in all, when parties are interpreting statutes, they should be wary of assigning conditions to the statutory provisions which may distort the intention of the legislature. There should be no presumptions at what the law means when it is clear. The statutory provisions should be given a plain meaning as far as possible. A revenue collection body should avoid shifting the goal posts by formulating new conditions not provided for, when a taxpayer tries to score when claiming its entitlements. Where the application of a law creates doubt, the taxpayer should be given the benefit of the doubt.

Taking all the above into consideration, the Tribunal finds that this application has merit. The 1st applicant is entitled to claim depreciation and initial allowances. The respondent is directed to adjust the 2nd applicant's tax liability in line with the ruling as to depreciation and initial allowances taking into consideration that they are an entitlement of the 1st applicant. The application is granted. The respondent will meet the costs of the 1st applicant. The 2nd applicant will meet its own costs. We so order.

Dated at Kampala this day of 2020.

DR. ASA MUGENYI	**MS. CHRISTINE KATWE**
CHAIRMAN	**MEMBER**

THE REPUBLIC OF UGANDA

IN THE TAX APPEALS TRIBUNAL AT KAMPALA

APPLICATION NO. 40 OF 2018

1. **UMEME LIMITED**
2. **UGANDA ELECTRICITY DISTRIBUTION COMPANY LIMITED (UEDCL) =====================APPLICANTS**

VERSUS

COMMISSIONER GENERAL
UGANDA REVENUE AUTHORITY ===================RESPONDENT

BEFORE MR. SIRAJ ALI

RULING

I have heard the opportunity to read the ruling of my colleagues. I wish to state as below.

Who is entitled to claim depreciation and initial allowances?

The resolution of this issue turns on the interpretation of S. 6.1 of the Lease and Assignment Agreement concluded between the 1st and 2nd applicants on 17th May, 2004. This agreement was admitted into evidence as AE11 (A). S. 6.1 of the said agreement states as follows:

> Section 6.1 Taxes
>
> "All central, local, district, administrative, municipal or other lawful taxes, duties, levies, or other impositions incurred or applicable to the Company, the Distribution System or in the Leased Assets, Assigned Interests or Other Rights from the Transfer Date until the termination of this Agreement shall be paid by the Company in a timely fashion; provided however, that UEDCL shall be liable for all such taxes, duties, levies and impositions related to the Distribution System or UEDCL's interests in the Lease Assets, Assigned Interests and Other Rights that are levied with respect to the period before the Transfer Date whether imposed before or after the Transfer Date; provided, further notwithstanding any other provision in this Agreement, the Company shall be liable for any stamp tax

payable as a result of the transfer by UEDCL of its interest in customer accounts receivables pursuant to Section 2.4(a).

A reading of the above clause shows that the duty to pay taxes during the pendency of the Lease and Assignment agreement including taxes arising from the use of the Leased Assets rests on the 1st applicant.

It is common knowledge that when a duty to perform an act is placed on a person by law or by contract, it is to be implied that the person required to perform the act is entitled to all benefits and reliefs accorded by law or contract to persons performing such acts. Deductions are benefits or reliefs tied to the payment of taxes. Only persons paying taxes are entitled to claim deductions under the Income Tax Act. The term "deduction" has been defined in Black's Law Dictionary as "*An amount subtracted from gross income when calculating adjusted gross income or from adjusted gross income when calculating taxable income."*

Depreciation allowances provided for under S. 27 of the Income Tax Act and Initial allowances provided for under S. 27A are both deductions accorded to taxpayers meeting the requirements set out under the respective provisions. As between the first and second applicants there is a contractual obligation on the first applicant to pay the relevant taxes in accordance with S. 6.1 of the Lease and Assignment Agreement. There is a corresponding contractual obligation on the second applicant not to lay claim to the deductions due to the first applicant in its performance of its contractual obligations of paying the taxes arising from its use of the Leased Assets.

It is clear from the evidence before us that tax in respect of the use of the Leased Assets is paid by the first applicant. No evidence has been led by the second applicant to show that tax in respect of the use of the Leased Assets is being paid by the second applicant. It therefore follows that deductions including the depreciation and initial allowances accrue to the first applicant as the party not only required to pay the taxes under the Lease and Assignment Agreement but as the party paying the said taxes.

We find that the second applicant's claim to the depreciation and initial allowances is in breach of the terms of the Lease and Assignment Agreement and that the first applicant is the party entitled to both the depreciation and initial allowances.

This conclusion is sufficient to dispose of this matter. I consider that the rest of the arguments made by the parties were conclusively resolved by the Consent Judgment entered by the 1st applicant and the respondent in Civil Suit No. 570 of 2014 at the Commercial Division of the High Court. There is therefore no need to address them.

Dated at Kampala this day of 2020.

MR. SIRAJ ALI
MEMBER