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# Investing in Uganda

## Some key tax aspects

## 1. Introduction

Uganda continues to be an interesting investment destination for multinational groups of companies ('MNCs') and we expect its attractiveness to increase as the country moves towards oil development in future. Tax is a critical area for investors to consider and the purpose of this article is to provide a brief overview of some key Ugandan tax considerations in structuring new investments in the country.

## 2. Branch or subsidiary?

The first question a potential investor will need to consider is whether to establish activities via a new Ugandan subsidiary or a branch of a foreign legal entity ('FLE'). A branch does not have a separate legal personality from the FLE which created it and any acts and liabilities of the branch are attributable in law to the FLE itself. In contrast, a subsidiary of a FLE is a separate legal person and as a result of limited liability rules the FLE cannot usually be held liable for acts and liabilities of the subsidiary beyond the cost of the shares that it holds unless it has provided a specific contractual undertaking such as a parental guarantee.

The taxation of branches and subsidiaries is similar under Ugandan tax legislation so for most MNCs tax will not be a deciding factor in the choice. Both pay income tax on profits at 30% and both must account for VAT on goods or services they supply and withholding tax on certain payments they make, etc. The main difference relates to profit repatriation: a subsidiary must withhold tax on any dividends or other distributions of profit to its shareholders; a branch does not have the legal competence to pay dividends therefore the Income Tax Act ('ITA') requires it to pay an additional tax on the post-tax profits it is deemed to repatriate to its head office under a formula provided in the ITA. The current rates of dividend withholding tax and branch profits tax under the ITA are aligned at 15%.

Commercial factors such as the duration and nature of the activities to be carried out are likely to be key to the decision between a branch and a subsidiary. For long-term investors, creating a local subsidiary with its own management and capital structure will send a signal to customers and other stakeholders that the MNC is committed to the Ugandan market. It may even be a formal legal requirement for certain activities such as retail banking and telecoms. It may also make it easier to involve local investors, e.g. via a listing on the Uganda Stock Exchange. Examples of activities where branches are often preferred include major construction projects, drilling and other technical work associated with mining, oil and gas development and production or other kinds of limited duration service contracts. The hallmarks of such projects are a defined work scope, timeframe and a specific customer or customer base.

## 3. Capital structure

Most businesses will require capital to start activities and a critical early decision will be whether to provide this in the form of equity or debt.

Risk capital will usually be provided via equity, usually in the form of share capital in the case of a subsidiary, though interest-free loans from the parent are occasionally utilised. In the case of a branch such risk capital can be advanced via the branch's account with its head office (analogous to equity), which is administratively less complex than issuing shares. Shareholders are rewarded via dividends linked to the profits made by a company which are not deductible in calculating profits for tax or other purposes. Profits of a branch may be repatriated to the head office without formality.

Financing of less risky activities may be funded via interest-bearing debt either from a related party or from a commercial lender. In the case of the latter security may be provided via a parental guarantee and/or security over the assets and cash-flows of the borrower. Lenders are remunerated by payment of interest which is not usually linked to the profitability of the borrower. Though debt and equity fulfil a similar economic function in the business, from an accounting perspective interest is an expense rather than an allocation of profit. For this reason, MNCs have historically sought to minimise tax by maximising the use of tax-deductible, intra-group interest payments to group finance companies in low tax locations. A subsidiary which has a high ratio of debt to equity is referred to as 'thinly capitalised' and most jurisdictions, including Uganda, have rules to restrict tax deductions in such cases (see below for more information).

In some cases, a parent company, or head office of a branch may contribute assets instead of subscribing for shares in cash or advancing funds via the head office account. Capital assets are usually subject to a customs duty rate of 0% on importation and relief from import VAT may also be available. Such assets will be treated as acquired at market value for the purposes of calculating any tax depreciation available.

## 4. Dividends

A dividend is a distribution of the profits of the company issuing the related shares which is not an expense for accounting purposes or tax deductible. Uganda's domestic tax law applies a 15% withholding tax on the payment of a dividend. This may be reduced under the terms of an applicable double tax treaty (see below).

A foreign shareholder will usually need to include dividends in its taxable income in the location where it is tax resident. A credit against the domestic tax liability on dividend income may be provided for any foreign withholding tax deducted. In certain circumstances, such as satisfaction of a minimum shareholding requirement, the jurisdiction of the shareholder's residence may provide an exemption from tax for foreign dividend income, termed a 'participation exemption'. A similar exemption may be available to the head office in respect of the taxable profits of its foreign branch.

## 5. Interest

Like dividends, interest is subject to a 15% withholding tax under Uganda's domestic tax law although this may be reduced under an applicable double tax treaty (see below).

Interest is an expense for tax and accounting purposes, rather than a distribution of the profits of the payer. Tax deductions for interest payments are restricted under the ITA for companies which form part of a group in accordance with the following

formula:

- the payer must calculate its taxable profits for the year;
- to this amount should be added the interest expense for the year and also depreciation and amortization expenses;
- the maximum deduction for all interest is restricted to 30% of the resulting amount; and
- any interest which is disallowed may be included in the interest expense for the following year, subject to a three year carry forward limit and the further operation of the formula.

This limit on interest deductions is applied to all interest, including that payable to third parties.
Branches are subject to the same limitation. As a branch and its head office are part of the same legal person, any 'payment' of interest between the branch and head office will be disregarded for tax purposes and not deductible.

## 6. Intra-group transactions

Most subsidiaries and branches will have transactions with affiliates, for example:

- management and other service charges relating to information, technology, communications, accounting, legal and other specialist services;
- royalties in respect of intellectual property such as use of brands, trademarks, technology and know-how;
- secondment charges in respect of expatriate staff;
- lease of equipment; or
- purchase of goods such as stock-in-trade, consumable materials and capital equipment.

Payments of royalties, lease rentals and for services of various kinds provided from outside Uganda give rise to a range of tax issues. The ITA applies withholding tax at a rate of 15% (which may be reduced under an applicable double tax treaty – see below). If any part of the service is provided by the service-provider's staff whilst in Uganda, it will be necessary to determine whether the service provider itself needs to register a branch here for tax purposes. In addition, these types of payments will give rise to a reverse charge VAT liability, i.e. the service recipient will itself need to account for the input VAT on the payments at the rate of 18%. In most cases reverse charge VAT may not be taken as a credit against output VAT, so it is a cost to the user.

In the case of the importation of goods purchased from a related party, the Ugandan entity will need to consider any applicable customs duty and fees, Infrastructure Development Levy (at 1.5%) import VAT (at 18% based on the customs value) and import withholding tax (effectively a prepayment of the annual income tax on the importer's profits). Unlike reverse charge VAT, import VAT can in most circumstances be treated as creditable input VAT.

Transactions with companies which are part of the same MNC will be subject to Uganda's transfer pricing rules. Detailed regulations based on the arm's length principle were introduced in 2011 to supplement the ITA and a similar approach applies for VAT purposes. The East African Community Customs Management Act includes detailed guidance on valuation for customs purposes.

Special issues arise in the case of transactions between and Ugandan branch and its head office as these are part of the same legal person. Charges from the head office to the branch are not deductible per se, though reasonable allocations of third-party costs should be, subject to the normal rules regarding withholding tax, transfer pricing and reverse charge VAT.

## 7. Tax implications of sale or closure

Closure or sale of a branch or subsidiary will give rise to a wide range of tax issues. These should be approached with care, so it is advisable to give them consideration even when planning the initial investment.

The disposal of a branch takes the legal and tax form of the disposal of the branch assets including goodwill (if any), with proceeds exceeding the tax depreciated value being treated as a taxable gain. VAT should be accounted for on the sale subject to an exemption which may be available for the transfer of a business, or part of a business as a going concern. Following such a disposal the repatriation of any after-tax profits will be subject to branch profits tax at the rate of 15%. As the branch has no separate legal personality it cannot be sold, so it will usually be de-registered following the sale.

In case of a branch created for a specific construction project, at the end of the project branch assets may be repatriated and the branch de-registered. In this case there is no sale of assets, but they are treated as sold at market value for tax purposes with any resulting gains being subject to income tax as if there had been an actual sale. The export of assets will be zero-rated

for VAT purposes.

The sale of a company implies the transfer of shares by existing shareholders. In a case where the shares are sold by residents (either companies or individuals) any gain on the sale will be taxable income. The position in the case of the sale by non-resident shareholders is more complex. Capital gains derived from the disposal of shares in a company which derives its value principally from immovable property, either directly or indirectly, are Ugandan source income and taxable under the ITA. It was recognised that this might limit the ability of Uganda to tax gains realised by non-residents on share transactions, so the scope of tax was widened in 2018 by the introduction of two additional provisions:

- capital gains derived directly or indirectly from the change in ownership by 50% or more of a Ugandan company are also Ugandan source income and taxable under the ITA.
- where the underlying ownership of a Ugandan company changes by 50% or more over the course of a three-year period, that company is treated as disposing of all assets and liabilities at their market values and immediately reacquiring them at the same value, thus crystallising any latent gains.

There is therefore the potential for some transaction structures to lead to taxation both at the level of the seller and that of the company which is sold.

The sale of shares in a Ugandan company will also entail payment of stamp duty at the rate of 1.5% of the consideration. Share transactions are not subject to VAT.

The formal closure and de-registration of a company will usually involve the disposal of assets, settlement of debts and repatriation of net proceeds to the shareholders. Any payment to the shareholders exceeding the capital subscribed will be treated as a distribution and subject to withholding tax at the rate of 15%.

## 8. Double tax treaties

Uganda has implemented 9 tax treaties which restrict its taxing rights in respect of certain income and gains. The following table shows the rates of withholding tax applicable to income payable to residents of each of the 9 treaty partner countries.

| Treaty country | Dividends | Interest | Royalties | Technical fees |
|---|---|---|---|---|
| Denmark | 10%/15% | 10% | 10% | 10% |
| India | 10% | 10% | 10% | 10% |
| Italy | 15% | 15% | 10% | 10% |
| Mauritius | 10% | 10% | 10% | 10% |
| Netherlands | 0%/5%/15% | 10% | 10% | 0% |
| Norway | 10%/15% | 10% | 10% | 10% |
| South Africa | 10%/15% | 10% | 10% | 10% |
| UK | 15% | 15% | 15% | 15% |
| Zambia | 0% | 0% | 0% | 0% |

Notes

- Rates of withholding tax on dividends vary under some treaties depending on the proportion of share capital held by the recipient.
- Withholding tax applies to 'technical fees' (as defined) where the recipient provides services but does not create a permanent establishment in Uganda.

Some treaties also limit Uganda's right to tax gains on the disposal of shares in a Ugandan company by a resident of the treaty jurisdiction; for example a resident of the Netherlands may be taxed by Uganda on a gain derived from the disposal of immovable property in Uganda but not on the sale of shares in a Ugandan company that derives its value from immovable property.

The benefits of tax treaties have come under scrutiny in recent years and the Netherlands treaty in particular has been heavily

criticised by some commentators for facilitating tax avoidance by investors. The ITA was amended in 2016 to make it clear that whilst tax treaties override the provisions of domestic tax law, they will not apply where the resident of the treaty partner country is not the beneficial owner of the relevant income and does not have economic substance in that country.

## 9. Conclusions

Potential investors face key decisions in relation to the tax implications of structure they wish to adopt:

- Should the investment take the form of a subsidiary or the branch of an existing foreign entity?
- How much capital will be required to fund the investment and how much of this should be in the form of equity, and how much in the form of debt?
- What will be the tax consequences of intra-group payments including dividends, interest, management charges, purchases of goods, etc?
- What will be the tax consequences of an ultimate exit, either at the end of a project or by sale to a third party?
- Are any benefits under a double tax treaty potentially applicable?

The answers to these questions will vary depending on the nature of the planned investment and the investor's future intentions. Critical legal and commercial issues will also need to be considered. For more information about commercially focused tax and legal investment structures, please contact your usual Cristal adviser for further information.

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Denis is the Managing Partner at Cristal Advocates where he also leads the energy and tax practice. He is qualified both as a Lawyer and Chartered Accountant with vast experience serving various industries in Sub Saharan Africa. Before joining Cristal Advocates, he had worked for close to 10 years with Deloitte and Touche where he started his career and rose to senior managerial positions.

At Deloitte, he lived and worked in Uganda, Kenya, Tanzania and the United Kingdom for over 6 years and subsequently became the firm's chief of staff for the Energy and Resources Industry Group seeing him play a lead advisory role in Uganda, Kenya, Tanzania, Mozambique, South Sudan, Somalia and Ethiopia.

Denis is widely published and a regular commentator in the local, regional and international media and speaker at various forums regarding the taxation and financing of energy projects as well as the protection of large capital projects within the framework of international investment law.

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Bill is a Senior Advisor with Cristal Advocates. He has concentrated on working with energy companies with a particular focus on cross border transactions and M&A since 1989 and is a leading global energy and tax practitioner with wide international experience. Between 1986 and 1998, he worked in London with the UK tax authorities and Big Four accounting firms. From 1998 to 2004, he was based in Kazakhstan working across the Caspian region with Deloitte. He was in the region at the time it was developing its infrastructure for crude oil production with international investment following the collapse of the Soviet Union.

From 2004 to 2008, he worked in Russia where he led Deloitte's oil and gas industry group and established Deloitte's office in Sakhalin. He moved to East Africa in 2009 leading Deloitte's energy and resources industry group in Uganda, Kenya, Tanzania, Rwanda, Ethiopia and Mozambique. He was initially based in Kampala, Uganda later relocating to Dar es Salaam, Tanzania. Bill returned to the UK in 2014 supporting Deloitte UK teams working on outbound projects investing in Africa and was a key member of Deloitte UK's energy and resource practice until his retirement from the firm in September, 2018.

Bill is a graduate of Oxford University and completed his inspectors' training with the UK Inland Revenue in 1989. ■

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John leads the public policy and advocacy practice at the firm and combines unique public and private sector experience.

Prior to joining Cristal Advocates, he had worked as a Private Secretary to the President of the Republic of Uganda. During this time, he participated in several public and private sector engagements that included advising and coordinating activities relating to oil and gas as well as infrastructural projects of national significance. John had earlier worked with the Post Bank Uganda Limited and Shonubi Musoke and Co. Advocates.

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Dickens leads the oil and gas practice at Cristal Advocates. He has an in depth appreciation of Uganda's oil and gas sector having served as the maiden Company Secretary of the Uganda National Oil Company (UNOC) and the Uganda Refinery Holding Company Limited (URHC). UNOC represents the Government of Uganda commercial interests in the oil and gas sector while URHC represents government interests in the refinery project as well as managing the petrol based industrial park.

Dickens was instrumental in UNOC's formation and initial period of operation and also served as its head of Contracts, Negotiations and Advisory until May 2018. Prior to joining UNOC, Dickens was Legal Counsel at the Petroleum Directorate of the Ministry of Energy playing key legal advisory roles on the negotiation and implementation of PSAs, Joint venture and other oil and gas agreements. He was also part of the team that shepherded the process of enacting the current Ugandan oil and gas Legislations and Regulations including the local content requirements.

He is a certified project control specialist (IFP) and holds a Master of Laws Degree in Petroleum Law and Policy from the University of Dundee in the United Kingdom, a Post Graduate Diploma in Legal Practice and a Bachelor of Laws degree from Makerere University. ■

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He joined Cristal Advocates from Kizza, Tumwesige, and Ssemambo Advocates. He previously worked with the Advocates Coalition for Development and Environment (ACODE). He also undertook a traineeship with the oil and gas division of Webber Wetzel in Johannesburg, South Africa.

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