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Client Tax Update No. 1/2020

Review of the Proposed 2020 Amendments to the Tax Laws

GENERAL OVERVIEW

The Tax Amendment Bills 2020 were tabled before Parliament by the Minister of Finance on 31st March 2020 with proposed changes to the Income Tax, VAT, Stamp Duty and Excise Duty laws. Customarily, if passed into law, the changes will take effect from 1 July 2020.

The Bills have been tabled while the country is deeply immersed in dealing with the global pandemic of the corona virus. This may ultimately affect some of the proposals in the Bills which were included long before the corona pandemic and its sweeping effects on the global and local economy could be anticipated.

The Bills have also been at a time when major changes are taking place at the helm of Uganda Revenue Authority with the resignation of Ms. Doris Akol as Commissioner General and the appointment of Mr. John Musinguzi to replace her. This was preceded by other changes in the top leadership of the tax collector at the end of February 2020.

We have reviewed the Tax Amendment Bills and in this publication, summarize the key proposals for reform under the different tax heads and offer our quick analysis on possible implications.

PROPOSED AMENDMENTS UNDER THE INCOME TAX AMENDMENT BILL, 2020

Introduction of a minimum tax rate for taxpayers with declared liability of less than 0.5% of gross income

The bill proposes that a taxpayer whose declared tax liability for a consecutive period of five years of income is an arithmetic average of less than 0.5 percent of gross income shall pay a minimum tax at a rate of 0.5 percent of the gross turnover after the sixth year.

This proposal appears to target persons that consecutively declare tax losses and is the Government's third attempt at introducing a minimum tax rate, having withdrawn similar proposals in the 2018 and 2019 income tax amendment bills.

Tax losses under the current law may be carried forward indefinitely with no obligation to pay tax in any of the years where tax losses are incurred. If this proposal is approved, it will mean that tax payers who genuinely incur business losses or make "small" profits (less than 0.5% of gross income) for a consecutive period of five years will be required to pay a compulsory minimum tax at a rate of 0.5% of the gross turnover. This proposal will also affect businesses that require large capital investment as they usually may not return profits by the fifth year.

Increase of Rental Tax and Other Changes

The Bill has proposed several changes to the rental tax regime.

- Increment in Rental tax to 30%

Currently, the rental tax rate for individuals is 20% and 30% for persons other than individuals.

The Bill proposes to streamline the rental tax rate for all persons including individuals, companies and trustees earning rental income by introducing a standard tax rate of 30%.

If approved, it would mean that individuals in the rental business will no longer enjoy the preferential rate of 20% over their non-individual competitors as they will all have to pay the new standard 30% rate.

- Separate accounting where tax payer owns more than one building

The Bill reintroduces the proposal to require any person who earns rental income from more than one building should be required to account for the income and expenses of the buildings and pay tax for each of the buildings separately. This proposal was previously included in the 2019 Income Tax amendment bill however was not adopted in the final law.

If approved, it would mean that the expenses or losses incurred on one property cannot be offset against the profits of another property which would significantly increase the burden of compliance for real estate owners and developers.

- Allowable expenses for rental income increased to 50% from 20%

The Bill proposes that for purposes of calculating rental tax, 50% of the rental income should be allowed as expenditures and losses incurred by persons [including companies] in the production of such income. Currently, only 20% of the rental income is allowed as expenditures and losses incurred by an individual in the production of the rent.

The Bill also proposes to remove interest paid to financial institutions to acquire or construct premises that generate rental income as an allowable expense under section 22 of the Income Tax Act.

It appears that the Government, with these proposals on rental tax, aims to level the playing field for all persons that earn rental income by standardizing the deductions allowable for this type of income.

It remains to be seen how the industry, particularly commercial real estate developers who typically borrow heavily to finance their projects will react to this proposal as it has given with one hand (increased deductible costs to 50%) but taken with another (disallowed interest paid to financial institutions).

Exemption of Income for operators of Industrial Parks

The Bill seeks to introduce further qualifying factors to the exemption available to operators of industrial parks, free zones or any other person carrying on business outside the free zone whose investment capital is USD 10 million in the case of a foreigner and USD 1 million in the case of a citizen. The changes include;

- *Requirement to employ at least one hundred citizens instead of 60% citizens under the current law;*
- *Expansion of the scope of qualifying businesses to include the manufacture of tyres, footwear, mattresses or toothpaste;*
- *Requirement to declare in the operator's tax return for a year of income, the qualifying income and its related expenses.*

Both qualifying income and expenses have been defined in the Bill complete with formulas to derive them.

The requirement to employ 100 citizens as one of the conditions to qualify for this exemption may meet cheers from local content advocates however investors may view this as stringent. Further, the proposals on qualifying income and expenses may be viewed as increasing the compliance burden for these investors.

Withholding tax on Purchase of Land

The Bill seeks to introduce a withholding tax that appears to target disposal of "residential" land between two residents. The Bill provides that a resident person who purchases land, other than land which is a business asset, from a resident person shall be required to withhold tax at a rate of 0.5% of the purchase price. This essentially means that all land transactions between residents would require the seller to withhold tax and remit the purchase price to the buyer less 0.5% of the purchase price. Whereas this may lower the actual cash received by the buyer, the 0.5% would be a credit towards tax assessed against or declared by the buyer.

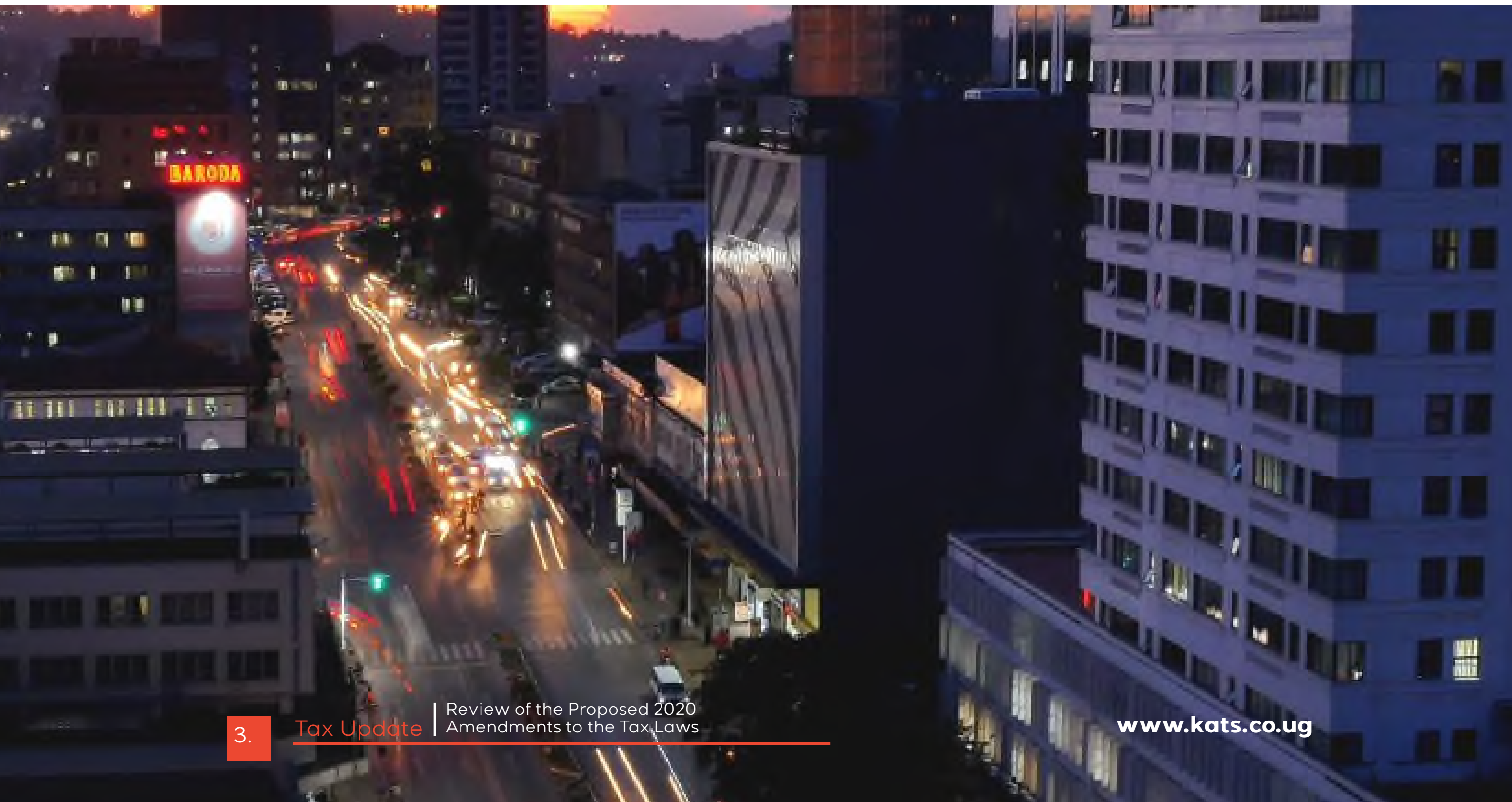
This proposal follows the introduction of a 6% withholding obligation on resident persons acquiring a business or business asset in 2019. It appears that tax payers may have found a way round this provision by claiming that the disposed land was residential and did not qualify as a business asset, hence this proposal.

Withholding Tax on Payments to Insurance and Advertising Agents

The Bill seeks to introduce a specific obligation on insurance service providers to withhold tax at a rate of 10% on any payments made as commissions to insurance agents. This amendment is an attempt by the Government to streamline the application of withholding tax on commissions to insurance agents and likely, a direct response to the Judgment of Justice Richard Wabwire in the case of ***APA Insurance & 22 Ors v URA (Civil Appeal No. 29 of 2018)*** in which it was held that insurance agents are not employees of insurance companies and therefore insurance companies are not required to deduct PAYE from the commissions paid to them.

The brief background is that, in 2007 URA issued a Practice Note that exempted withholding tax on payments of premium to insurance brokers and agents. In 2014, the tax body interpreted the Practice Note indicating that the exemption did not extend to commissions and also stated that insurance brokers and agents qualified as professionals whose fees are subject to WHT at 6% under the Income Tax Act.

In 2017 however, URA changed its position by classifying insurance agents as



employees of insurance companies and required insurance service providers to remit PAYE on the agents' behalf effective December 2017. This position led the insurance companies to the Tax Appeals Tribunal in 2017 and later the High Court in 2018 to appeal the TAT decision.

The proposal to include a specific provision in the law to impose a withholding tax obligation on insurance companies when making payments of commission to insurance agents therefore comes with little surprise.

The policy considerations behind proposing a higher withholding tax on insurance agents (10%) however are not clear. It can reasonably be anticipated that the agents will try to push this cost to the companies who will in turn pass it on to the consumers thereby effectively increasing the cost of insurance services in Uganda.

Similarly, the new proposals also require any person who makes payment for a commission to an advertising agent to withhold tax on the gross amount of the payment at a proposed rate of 10%.

Withholding tax on Agricultural Supplies

The Bill seeks to reintroduce withholding tax at a rate of 6% on agricultural supplies which had been specifically exempted by virtue of section 8 of the Income Tax (Amendment) Act, 2019.

It is not clear what the policy considerations are for dropping withholding tax at 1% on agricultural supplies only to reintroduce the tax a year later at a higher rate of 6%.

Requirement to obtain a Tax Clearance Certificate by passenger or freight transport service providers.

Providers of passenger transport services or freight transport services shall under the proposed amendment be required to obtain a tax clearance certificate from the Commissioner General of Uganda Revenue Authority before renewal of their operational licenses.

This follows the introduction of Advance Tax for passenger transport and freight transport service providers in 2017.

By this proposal, the Government appears to further tighten the tax compliance measures for this sector by conditioning the grant of their operation licenses on tax clearance.

Introduction of a New Tax Regime for small businesses

Under the Bill, it is proposed that the current presumptive regime under Parts I and II of the Second Schedule is substituted by a new regime that seeks to effectively streamline and reduce the tax payable by small businesses whose gross annual turnover ranges between UGX 10,000,000 (Uganda Shillings Ten Million) – UGX 150,000,000 (Uganda Shillings One Hundred and Fifty Million only).

The Bill seeks to drop the classification of small tax payers and determination of tax payable by these payers based on the nature of business (e.g. general trade, salons, clinics, garages, carpentry etc.) and physical location i.e. in Kampala or its divisions, Municipalities or towns and trading centers under the current law.

The proposal in the Bill appears to seek a uniform standard for small tax payers across the board hinged on two parameters only i.e. the gross annual turnover and whether the tax payer keeps records. Where the tax payer has no records, a fixed tax is imposed. However, if the tax paper keeps records, then different thresholds may apply. For instance, a tax payer with an annual turnover of UGX 10-20 million may pay UGX 80,000 (Uganda Shillings Eighty Thousand) if the tax payer does not maintain records. However if the same tax payer maintains records, then they will be required to pay 0.4% of the annual turnover in excess of UGX 10M. The new rates are summarized in the table below:

Gross Turnover per annum (UGX)	Tax Rate per annum without records (UGX)	Tax rate per annum with records (UGX)
< 10,000,000	Nil	Nil
10,000,000 - 30,000,000	**80,000**	**0.4 %** of turnover in excess of 10,000,000
30,000,000 - 50,000,000	**200,000**	**80,000** plus **0.5%** of turnover in excess of 30,000,000
50,000,000 - 80,000,000	**400,000**	**180,000** plus **0.6%** of turnover in excess of 50,000,000
80,000,000 - 150,000,000	**900,000**	**360,000** plus **0.7%** of turnover in excess of 80,000,000.

Other Proposals

- The Bill proposes that the expenses of a person who purchases goods or services from a supplier who is designated to use the e-invoicing system shall not be allowed unless the expenses are supported by e-invoices or e-receipts. URA intends to introduce the e-invoicing system and it is understood that the project may already be at pilot stage but has not yet been implemented. This proposal is therefore premature.
- The bill proposes that the income of the Deposit Protection Fund established under section 108 of the Financial Institutions Act, 2016 should be exempted from Income tax.
- The bill requires withholding tax agents making international payments, payment of interest to a resident person or a payment for goods and services to furnish a return of withholding tax not later than fifteen days after the end of every month to which the withholding tax relates.

PROPOSED AMENDMENTS UNDER THE VALUE ADDED TAX (AMENDMENT) BILL, 2020.

The Bill contains proposals to amend the Value Added Tax Act Cap.349 (the "Current Act") as follows;

Expansion of the Pre - VAT Registration Period for which Manufacturers can claim an Input Tax Credit.

The Bill proposes to expand the pre-VAT registration period for which manufacturers can claim input tax from 6 months under the Current Act to 12 months.
Under section 28(3) of the Current Act, a credit is allowed to a taxable person on becoming registered for input tax paid or payable in respect all taxable supplies and import of goods, including capital assets, made to / or imported by the person prior to the person becoming registered provided that;

i) *The supply or import was for use in the business of the taxable person;*
ii) *The goods are on hand at the date of registration; and*
iii) *The supply or import occurred not more than six months prior to the date of registration.*

The Bill seeks to amend the current Act by inserting the words "or in case of manufacturers, not more than twelve months before the date of registration" at the end of above subsection (3).

This is good news for manufacturers, as it means that, if approved, they will now be allowed to claim VAT incurred on inputs for a longer period (one year) prior to the date of registration for VAT. This will effectively reduce the VAT burden on manufacturers whose projects have long lead times i.e. more than 6 months. However, for projects with longer lead times such as large manufacturing projects, the Bill may only alleviate but not extinguish the pre-VAT registration tax burden.

Also, this Bill does not address the issue of impact on cash flows as the VAT is only claimable after registration.

Commercial Building Owners to account for VAT for each Building Separately.

The Bill seeks to introduce section 28(4a) in the Current Act requiring an owner of more than one commercial building to account for

VAT for each commercial building separately. Further, the section also seeks to prohibit the commercial building owner from claiming tax credits on inputs used in the construction of an incomplete building against the tax collected from a completed commercial building.

This mirrors the provisions in the Income Tax Amendment Bill which also restrict a commercial building owner from deducting expenses from an incomplete building against the profits of a complete building. Refer to our comments on the Income Tax Bill above.

Restriction on the Tax Credit Claimable for Purchases from e-invoicing designated suppliers.

The Bill proposes to introduce section 28 (4b) in the current Act which seeks to restrict the tax credit allowed to taxable persons on the purchase of goods and services from a supplier who is designated to use the e-invoicing system. The proposal is that such taxable persons should only claim a tax credit on expenses supported by e-invoices or e-receipt.
Refer to our comments on a similar proposal under the Income Tax Bill above.

Restriction of the period within which excess input credit may be offset

Under Section 42(2a) of the Current Act, a person is allowed a refund or credit on input tax paid on taxable supplies in stock or stock in transit that is lost due to fire, theft, accident or force majeure.

The Bill proposes to introduce section 42(2b) to limit the period within which a taxable person may offset the input credit under section 42(2a) above i.e. for a maximum period of three months after which, the taxable person shall claim a refund in accordance with section 42(1) of the current Act.

This proposal, if approved, would effectively limit a tax payer's discretion on how to utilize the input credit arising from loss of goods by forcing the tax payer to use up the credit in three months and if it remains, to mandatorily apply for a refund.

Expansion of the List of VAT Exempt Supplies

The Bill seeks to expand the list of exempt supplies for purposes of Section 19 and the Second Schedule to the Current Act to include trailers for agricultural purposes and Combine harvesters, the supply of digital stamps for purposes implementing tax verification, quality and safety system, the supply of processed milk, liquefied gas and importantly the supply of the following imported services—

(i) Software and equipment installation services to manufactures;
(ii) Services incidental to tele-medical services; and
(iii) Royalties paid in respect of agricultural technologies;

This proposal on exemption of the specified imported services, if approved, will significantly reduce the VAT burden for manufacturers who have been paying reverse VAT for these services which are not locally available. Even though the manufacturers will not be allowed a credit for these services, at least the impact on cash flows will be reduced.

The Bill also seeks to exempt the supply of accommodation in tourist hotels and lodges located up-country as a measure to further incentivize the local tourism industry.

The Bill also proposes that the exemption offered to operators within industrial parks, free zones or any other person carrying on a qualifying business outside the industrial park or free zone is substituted to introduce changes similar to the ones discussed under section 21 of the Income Tax Amendment for 2020. Please refer to our comments on the proposed amendment to section 21 of the Income Tax Bill.

Other Amendments

Inclusion of the Islamic Development Bank as a Public International Organization.

The Bill seeks to amend the First Schedule to the current Act to include the Islamic Development Bank as a Public International Organization. The proposal is in line with Section 14 of Income Tax (Amendment) Act 2020 which amends Section 21 and the First Schedule of the Income Tax Act to exempt the income of Islamic Development Bank from tax.

PROPOSED AMENDMENTS UNDER THE EXCISE DUTY (AMENDMENT) BILL, 2020

The Bill seeks to amend the Excise Duty Act, 2014 to vary excise duty in respect of excisable goods. Notably, the Bill proposes that the Excise Duty on Motor Spirit (gasoline) is increased from the current rate of UGX 1,200 per litre to UGX 1,350 per litre (a 12.5% increase). This proposal may have to be reviewed in light of the current economic slump. The affordability of fuel should be a key factor in the post COVID-19 plans for revival of the economy.

Below, we summarize the proposed amendments to Schedule 2 of the Excise Duty Act;

No.	ITEM	CURRENT DUTY	PROPOSED DUTY
1.	Cigarettes		
a)	Soft cap - Locally Manufactured	Shs. 55,000 per 1000 sticks (2017).	Shs 75,000 per 1000 sticks
b)	Hinge lid - Locally Manufactured	Shs. 80,000 per 1000 sticks (2017).	Shs 120,000 per 1000 sticks
2.	Beer		
a)	Malt Beer	60% or Shs. 1860 per litre, whichever is higher (2017).	60% or Shs 2,050 per litre whichever is higher
b)	Beer whose local raw materials content, excluding water, is at least 75% by weight of its constituent	30% or Shs. 650/= per litre, whichever is higher (2017).	30% or Shs 790 per litre whichever is higher
c)	Beer produced from barley grown and malted in Uganda	30% or shs.950 per litre, whichever is higher (2017).	30% or Shs 1115 per litre whichever is higher
3.	Spirits		
a)	Undenatured spirits made from locally produced raw materials	60% or Shs 2,000 per litre whichever is higher (2018).	60% or Shs 1500 per litre whichever is higher
c)	Ready to drink spirits	80% or Shs 1500 per litre whichever is higher (2018).	80% or Shs 1700 whichever is higher
4.	Wine		
a)	Wine made from locally produced raw materials	20% or Shs 2,000 per litre whichever is higher (2018).	20% or Shs 2300 whichever is higher

5.	Beverages		
a)	Non-alcoholic beverages not including fruit or vegetable juices	12%or Shs 200 per litre whichever is higher (2018).	12% or Shs 250 per litre whichever is higher
b)	Fruit juice and vegetable juice, except juice made from at least 30% of pulp from fruit and vegetables grown in Uganda	13% or Shs. 300 per litre, whichever is higher (2017).	12% or Shs 250 per litre whichever is higher
8.	Fuel		
a)	Motor spirit (gasoline)	Shs 1200 per litre (2018)	Shs 1350 per litre
b)	Gas oil (automotive, light, amber for high speed engine)	Shs 880 per litre (2018)	Shs 1030 per litre

11.	Sacks and bags of polymers of ethylene and other plastics under its HS codes 3923.21.00 and 3923.29.00 except vacuum packaging bags for food, juices, tea and coffee, Sacks and bags for direct use in the manufacture of sanitary pads;	120%	120% or Shs. 10,000 per kilogram of the plastic bags

15.	Lubricants HS codes 2710.19.51, 2710.19.52, 3403.19.00 and 3403.99.00 including motor vehicle lubricants except aircraft Lubricant		15%

19.	Motorcycles at first registration	Shs. 200,000 (2018)	Shs 300,000

25.	Other fermented beverages including cider, perry, mead, spears, near beer		60% or Shs. 950 per litre whichever is higher.

PROPOSED AMENDMENTS UNDER THE STAMP DUTY (AMENDMENT) BILL, 2020

The Bill primarily seeks to amend the Stamp Duty Act, 2014 to introduce an obligation to pay stamp duty on professional Licences or certificates. The Bill proposes that the Schedule to the current Act is amended by introducing item 63A on professional Licence or certificate with a stamp duty of UGX 100,000.

If approved, it appears that all professionals may be required to pay stamp duty before obtaining their annual professional licenses/certificates. Lawyers for example would be required to pay an additional UGX 100,000 on top of other Uganda Law Society and Law Council fees annually in order to renew their practicing certificates. This is likely a move to widen the tax base by the Government amidst its aggressive local revenue collection targets. However, the proposal adds a significant burden to professionals who are already paying fees to their umbrella associations as well as other taxes such as PAYE and NSSF contributions.

Conclusion

The proposals in the tax amendment bills discussed in this publication are all subject to the approval of Parliament and subsequently, assent of the President of Uganda before gaining the force of law. In deliberating these proposals, Parliament should be cognizant of the negative effects that the corona virus will have on the economy, and should consider withdrawing certain proposals, particularly those whose net effect would be to further suffocate the economy such as the proposals to tax loss making companies and increase excise duty on gasoline. The law makers should also push for inclusion of measures to mitigate the impact of the corona pandemic on the Ugandan economy either in the final laws or separately in subsidiary legislation.

This publication was prepared by the Tax Team at Katende Ssempebwa & Company Advocates. Should you require any clarifications, additional information or specific tax advice, please contact our Mr. Sim Katende or Sophia Nampijja.

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