Court upholds URA's sh24b tax against telecom firm

By Michael Odeng

The Court of Appeal has upheld a withholding tax assessment of sh24.2b issued by Uganda Revenue Authority (URA) against ATC Uganda Limited, declaring that withholding tax is applicable when interest is not paid but capitalised.

In a judgement dated March 27, a panel of three Court of Appeal Justices, led by Justice Stella Alibateese, dismissed ATC's assertions and upheld earlier decisions by the Tax Appeals Tribunal and the High Court.

"The appeal is hereby dismissed with costs to URA," Alibateese ruled. Justices Eva Luswata and Jesse Byaruhanga Rugyema concurred with the judgment of Justice Alibateese.

Court heard that ATC had secured a seven-year shareholder loan of $124.5m (about sh462b) from its Netherlands-based parent company, UTI, which was incorporated in June 2012 to finance the acquisition of MTN Uganda's tower business.

The loan attracted interest at 6.56% per annum, with a provision that accrued interest would be added to the principal during the initial period.

BETWEEN THE LINES

The Tax Appeals Tribunal and the High Court both rejected the argument, prompting ATC to appeal against their decisions at the Court of Appeal.

Following an audit, URA assessed withholding tax of sh24.2b on interest accrued between 2012 and 2017. ATC objected, arguing that withholding tax becomes payable only when interest is paid, not when it accrues or is capitalised.

The Tax Appeals Tribunal and the High Court both rejected the argument, prompting ATC to appeal against their decisions at the Court of Appeal.

COURT PROCEEDINGS

In her judgment, Justice Alibateese ruled that capitalising accrued interest amounts to conferring value to the lender and is, therefore, deemed payment for tax purposes.


Justice Alibateese


URA's Kyokunda

"Even without actual cash flow, a taxpayer is deemed to have paid interest at the point of capitalisation," she ruled, adding that this triggers withholding tax regardless of whether money physically changes hands.

On the interpretation of the phrase "when paid" under the Income Tax Act, the court found no error in the earlier decisions, holding that converting accrued interest into a principal increases the lender's benefit and constitutes payment.

The justices observed that capitalisation benefits the lender by increasing the recoverable principal base, as accrued interest is added to the original principal.

"The borrower becomes liable for interest on the enlarged principal amount. This results in a higher total debt obligation, with future interest accruing on the increased balance if payment is not made," Alibateese noted.

The justices also said the lender earns compound interest on both the original principal, and the capitalised interest, thereby enhancing the overall return over time, adding that capitalisation also prevents the loss of accrued interest and allows for the postponement of payment without extinguishing or waiving the debt.

"Where a borrower is unable to pay interest immediately, capitalisation ensures that the lender's entitlements are preserved," the judge observed.

Conversely, the justices noted that the borrower also derives a benefit from capitalisation, as it defers immediate payment obligations. This postponement, according to the justices, helps the borrower avoid default or enforcement proceedings, resulting in a restructuring of the debt.

The court also dismissed ATC's argument that URA improperly relied on the financial statements of its foreign parent company. It ruled that Uganda has the authority to tax such interest under domestic law and the Netherlands-Uganda double taxation agreement, and that using the lender's records for verification was lawful.

The justices explained that capitalisation of accrued interest occurs where interest that has accrued but has not been paid is added to the principal sum of the loan, so that it becomes part of the outstanding principal.

URA'S RESPONSE

The Uganda Revenue Authority commissioner for legal services and board affairs, Catherine Donovan Kyokunda, welcomed the decision, saying it affirms the authority's assessments and legal work.

She said the ruling reinforces URA's commitment to ensuring all due taxes are identified and collected, noting that exchange of information with foreign jurisdictions was key in establishing the tax liability.