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TAX ALERT

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High Court clarifies on the application of withholding tax on accrued interest

On 18th February 2022, the commercial division of the High Court upheld the decision of the Tax appeals Tribunal (TAT) in the case of ATC Uganda Limited Vs Uganda Revenue Authority [Civil Appeal No.32 of 2020] in regard to accounting for WHT on accrued interest deemed to have been paid to Uganda Tower Interco B.V (UTI) (ATC's parent company domiciled in Netherlands).

Background of the case

In the financial year 2017-2018, URA audited ATC and discovered that ATC didn't account for WHT on interest for the period of January 2012 to December 2017 and later on issued assessment. ATC filed an objection to the URA assessment on the grounds that whereas interest had been accrued and was capitalized, it was never paid within the meaning of S.2(xx) and S.47 of the Income Tax Act (ITA).

S.2(xx) states that "payment" includes any amount paid or payable in cash or kind, and any other means of conferring value or benefit on a person.

S.47(1) provides that subject to subsection (2), interest in the form of any discount, premium, or deferred interest shall be taken into account as it accrues.

Further, subsection 2 states that where the interest referred to in subsection (1) is subject to withholding tax, the interest shall be taken to be derived or incurred when paid.

The objection was disallowed and ATC being dissatisfied with the objection decision appealed to TAT for review. This was mainly on the question of law. TAT later ruled in favour of URA stating that by converting interest and adding it to the principal loan (compounding or capitalizing the interest) as provided for in clause 3.3 and 3.4 of the shareholder loan agreement, ATC was actually paying the interest which means ATC had obligation to pay withholding tax.

According to clause 3.3, accrued interest was to be added to the principal outstanding on the date when each interest period ended. Clause 3.4 allowed for accrued interest to be paid in arrears on the last day of each interest period. However, it was also stated that where there is insufficient cash flow for such period, the entire accrued interest would be automatically added to the outstanding principal amount.





Appeals to High Court

ATC being dissatisfied with the TAT ruling, appealed to the High Court on grounds that:

- 1) The Tax Appeal Tribunal erred in law when it ruled that by converting interest and adding it to the principal loan (PLA) under clause 3.3 and 3.4 of the Shareholder Loan Agreement, ATC was paying the interest under the shareholding Loan Agreement, and thereby erroneously held that:
 - a) The conversion of interest and adding it to the principal loan (PLA) was a payment of the interest on the loan within the meaning of Sections 2(xx) and 47(2) of the Income Tax Act
 - b) The conversion of interest and adding it to the principal loan (PLA) was a payment of the interest on the loan within the meaning of Sections 2(xx) and 47(2) of the Income Tax Act
- 2) The Tax Appeals Tribunal erred in law when it held that ATC was liable to pay the assessed WHT, including the penalty
- 3) The Tax Appeals Tribunal erred in law when it relied on UTI's audited books of accounts to hold that ATC had paid

However, the appeal to High Court was premised mainly on the question that, whether interest is deemed to have been paid when capitalized (automatically added to the principal amount at the end of every interest period) and if so, whether such interest is subject to WHT.

Arguments of the parties.

ATC borrowed money from its parent company (UTI) with interest formalized in the shareholder loan agreement. The principal and all interest accrued was payable within 7 years from the effective date (being 29th January 2012) of the loan.

ATC through its representative argued that the time the assessment for WHT was issued, for the period 2012-2017 (7 year period) had not lapsed nor had it (ATC) paid any interest to its parent company and that on account of non-payment, ATC didn't withhold tax.

URA's counsel agreed with the finding and holding of the Tax Appeals Tribunal that the interest was paid at the end of each interest period when it was converted into loan because according to the clause 3 of the shareholder agreement, interest accrued during each interest period on the principal amount and such accrued interest was automatically capitalized and added to the principal amount outstanding at the end of each interest period.

It is important to note that ATC expensed the accrued/capitalized interest in its

books of accounts and also UTI recognised interest income from ATC in its audited books of accounts and subsequently paid tax in accordance with the Netherlands' tax laws.

Decision of the High Court

On ground one including a) and b) and ground two, the High Court agreed with TAT which relied on clause 3.3 and 3.4 of the shareholder agreement and found that interest was paid at the end of each interest period when it was converted into loan and ATC was liable to pay the withholding tax including penalty. Therefore ground one and two failed.

On ground three, the court addressed the legality of relying on the audited books of accounts of UTI and relied on Article 11 of the Netherlands-Uganda Tax Treaty on double taxation which provides for taxation of interest income in the contracting state and the right of state to tax such interest income. The court indicated that TAT was perfectly right to refer to the books of accounts as evidence of payment of interest. Therefore ground three failed as well.





BDO's take away from the case.

The decision sets forth a fundamental principle on timing of Withholding tax on accrued interest and the importance of documentation in tax matters. It also points to the need of harmonizing financial statements within the Group since these may be considered in establishing a tax liability.

Below we summarize the key points notable from the decision

- Withholding tax on interest is applicable when the interest is paid. Both TAT and High court relied on the terms mainly clause 3.3 and 3.4 of shareholder loan agreement to rule that interest was paid for purposes of withholding tax. Whereas the interest had not actually been paid to the lender, the action of converting it to principal loan amount was deemed to be a payment subject to withholding tax. Therefore, it's advisable to take note how loan agreements are structured.
- Both ATC and UTI recognised interest expense and interest income respectively in their books of accounts. The tax authority can request for books of accounts of an entity outside Uganda and this can be used as evidence for tax purposes in Uganda.
- The fact that tax was paid in Netherlands by the non-resident on income accrued from Uganda does not take away the right of Uganda Revenue Authority to tax it in Uganda.

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