TAX APPEALS TRIBUNAL

IN THE TAX APPEALS TRIBNAL AT KAMPALA

TAT APPLICATION NO. 31/2007

AISHA TUMUSIIME……………………………………………APPLICANT

VERSUS

UGANDA REVENUE AUTHORITY…………….............RESPONDENT

RULING

This applicant filed this application challenging the assessment of 105,278,239/= as Value Added Tax (VAT) by the respondent on its importation of rice.

The agreed facts are:- The applicant is a VAT registered trader who over the years imported and sold rice. The respondent comprehensively audited the applicant and confirmed a VAT repayment of shs. 37,356,319/= (Thirty seven million three hundred fifty six thousand three hundred nineteen shillings). Subsequently on 18/10/2007 the respondent revised the assessment earlier made to Shs. 105,278,239/= (One hundred and five million two hundred seventy eight thousand two hundred thirty nine shillings). The respondent claimed that it had realised that the applicant had erroneously classified rice as zero rated supply, an over sight not recognised by the respondent's previous audit team.

The applicant objected to the assessment on 18/10/2007. The respondent confirmed the assessment on the ground that rice being an exempt supply, the respondent had apportioned the in-put tax according to section 28(7) of

the VAT Act. The respondent contended that it relied on the Commissioner General's practice note dated 14/11/2007 which is to the effect that all imported rice is considered to be unprocessed agricultural produce which falls under the second schedule of the VAT Act that provides for exempt supplies. The applicant had also applied for the Standard Alternative Method (SAM) from the respondent in a letter dated 2/1/2007.

At the Scheduling Conference the following issues were agreed:-

1. Whether all imported rice fell under the second schedule of the VAT Act at the time of importation?

2. Whether the assessment leading to the tax of shs 105,278,239/= was correct?

3. Whether the Commissioner-General's practice notice dated 14/11/2007 has retrospective effect?

4. Whether the respondent was in order to revise the assessment earlier computed at shs.37,356,319/=

5. Whether the standard Alternative Method (SAM) was the proper method to use in assessing the tax.

6. Remedies available to the parties.

However in it's submission the applicant addressed only Issues 1, 3 and 6. The respondent addressed all the issues. This is inconsequential as issue 1 determines the outcome of issue 2 and 4.

Each party called one witness. The applicant's witness Mr. Sowed Tumusiime who is its proprietor testified that the applicant imports rice, sugar and salt. The respondent had informed the applicant that rice imported was considered zero rated for the purposes of payment of VAT. As a result the applicant had an over payment of Shs. 37,356,319/= in tax. Later the Commissioner General of the respondent passed a practice notice which classified all imported rice as an exempt supply. The applicant was prejudiced by application of the practice note retrospectively.

Mr. Sowed testified that the applicant imported three types of rice;- pad rice, white rice and brown rice. The applicant tendered in an exhibit A7 which contained charts showing the process of rice milling. The process of milling white rice involves cleaning, hulling, milling, polishing, grading, sorting and packing. Brown rice processing involves passing rough rice though shelter machines which remove the hull, producing the bran layers still intact around the kernel. From the said chart it can be perceived that the processing of white rice is more elaborate than brown rice. Brown rice is produced at the initial stages of processing and involves the removing of the husk which is a low value addition activity. Unfortunately the charts did not indicate the processing of pad rice. The charts mentioned other types of rice i.e. parboiled and basmati rice. On an analysis of the chart, while it can be stated on a balance of probability that the costs involved in processing white rice is more that 5% of the value of the product, this cannot be stated with certainty in respect of brown rice. The percentage may be lower. The tribunal was left in doubt in respect of pad rice. The applicant did not adduce any evidence to show whether the rice which is the subject matter of this application was white, pad or brown rice. So it cannot state whether the processing of the imported rice in this application constituted more than 5% of the costs. In fact the applicant's witness testified that he is not a miller.

The respondent called one witness Mr. Alvin Mutebi who was the officer who reviewed the assessment of the applicant. He stated that during the review he discovered that mistakes had been made classifying the item of the applicant. The previous audit had classified the items as zero rated. He re-classified them as exempt supplies. The witness relied on practice note issued by the Commissioner General under S. 79 of the VAT Act. The VAT payable in respect of the goods came out as a result of the input tax and output tax which was reflected in the returns

In its submission the applicant contended that the rice they imported was subjected to processing which is much wider than what is provided for in paragraph 3 of the second schedule of the VAT Act that defines unprocessed food stuffs and unprocessed agricultural produce so as to constitute an exempt supply. The rice they imported was not only sorted and dried as provided for in the said paragraph 3 but was also subjected to hulling, milling, polishing, and grading. The applicant contended that the rice it imported was "processed" and not "unprocessed" and consequently does not fall under the second schedule of the VAT Act and therefore can not be an exempt supply. This in effect means that not all imported rice falls under schedule two of the VAT Act.

The applicant further submitted that the documents A5(1) and A5(2) which are the basis of assessments have no columns for exempt supplies. Furthermore documents A5(2) and R7 which are the basis of the respondent's assessments are contradictory. Assessments with such contradictions should not be allowed to stand. Therefore the assessed tax figure of shs105,278,239/= is wrong and should not stand. The respondent was therefore wrong to revise the assessment earlier computed as tax credit of shs 37,356,319/=.

The applicant contended that the general rule of statutory interpretation is that no law shall be construed to have a retrospective operation unless such a construction appears very clearly in the terms of the law or arises by necessary and distinct implication. This principal was upheld in the case of *West V Gwynne* (1911)2 ch1 and affirmed in the *Ugandan case of Lex Uganda Advocates and Solicitors V Attorney General* Misc. Application 322 of 2008 arising in Misc. Cause 123 of 2007. The practice notice relied on by the respondent is not a statute and therefore has less binding effect. Since the notice does not state that it has a retrospective effect, it cannot therefore be retrospective.

The applicant contended that the Uganda Constitution Article 152 provides that *"No tax shall be imposed except under the authority of an Act of Parliament."* The practice notice issued by the Commissioner General attempted to amend paragraph 3 of the Second Schedule of the VAT Act such that the test of 5% value addition is no longer relevant. Consequently the practice notice which attempts to amend the Law without going through parliament is illegal and has no effect retrospective or otherwise.

The applicant also contended that it applied to use the Standard Alternative Method (SAM) in a letter dated 3/1/2006. However the applicant submits that SAM is irrelevant and not applicable in the present case because there is no exempt supply. That it may apply in future if the practice notice is held to be valid.

The respondent in reply submitted that all rice imported by the applicant fell under the 2nd schedule of the VAT Act. The respondent contended that imported rice is unprocessed food and is within the meaning of paragraph 1(a) of the 2nd schedule of the VAT Act which provides for exempt supplies to include:-

> *"the supply of unprocessed food stuffs unprocessed agricultural products and livestock"*

The respondent contended that paragraph 3 of the 2nd schedule of the VAT Act defines unprocessed to include:-

> "*low value added activity such as sorting, drying, salting, filleting, deboning, freezing chilling or bulk packaging, where, except in the case of bulk packaging, the value added does not exceed 5% of the total value of the supply"*

The respondent contended that the applicant does not own a mill and therefore could not have added value to the rice.

The respondent also submitted that the applicant has not proved any trail of value addition that exceeds 5%.The respondent further contends that exhibits A7, A8 (1) and A8 (2) fall short of indicating value addition. In the alternative the respondent submitted that should the Tribunal rule that the rice had more than 5% value addition, then it falls under neither the 2nd schedule of the VAT Act nor the 3rd schedule hence making it standard rated.

The respondent submitted that therefore the tax assessment of shs 105,278,239/= was correct. The applicant agreed with the first assessment which had an overpayment of shs 37,356,319/=. The figures in the first assessment were used for the second assessment. The only difference is that in the latter assessment the input tax was apportioned whereas in the earlier assessment no apportionment was done.

The respondent also submitted that the practice notice of 13/11/2007 had no retrospective application. This is because a practice note does not amend the law. Its purpose is to ensure consistency and provide guidance to taxpayers and the respondent's officers. It is a statement of the Commissioner General's interpretation of the law.

The respondent submitted that the Standard Alternative Method (SAM) was not the proper method to be used in assessing the tax for the period under review ie: Jan 2002 to July 2005. This is because the applicant applied to the respondent to use SAM by letter dated 3/1/2006 after the audit was already completed. The VAT Regulations provide that SAM can only be used when a taxpayer applies to the Commissioner General demonstrating that the provisions of Section 28(7) are disadvantageous to him/her and the Commissioner General authorizes the use in writing. In the present case no application was made until after the audit was completed. The proper method to use is therefore apportionment under Section 28 of the VAT Act.

The respondent prayed that the Tribunal orders the applicant to pay the assessed tax of shs 105,278,239/= and dismiss the application with costs to the respondent.

After evaluating the evidence adduced and submissions of both parties, the Tribunal makes the following findings and rulings on the agreed issues:-

On issue one, the relevant provisions of the Law that deal with whether imported rice is exempt or zero rated are in the second and third schedule of the VAT Act. Paragraphs 1(a) and 3 of the Second Schedule to the VAT Act deal with exempt supplies while paragraph 1 (f) of the Third schedule deal with zero rated supplies.

Paragraph 1 (a) of the Second Schedule reads that the following supplies are specified as exempt supplies for the purposes of section 19—

> *"1 (a) the supply of unprocessed foodstuffs, unprocessed agricultural products and Livestock"*

A strict interpretation of these provisions means that where imported rice is unprocessed it is an exempt supply whereas if it is processed it is not an

exempt supply. The definition of unprocessed as stated in Paragraph 3 of the schedule which reads

> "for the purposes of paragraph 1 (a) of this schedule, the term "unprocessed" includes low value added activity such as sorting drying, salting, filleting, deboning, freezing, chilling, or bulk packaging, where, except in the case of packaging, the value added does note exceed 5% of the total Value of the Supply."

This means that any other activities such as "transportation" which ordinarily is also value addition are not considered in the test of "unprocessed" under paragraph 3 of the Second Schedule. The 5% value addition must be in the processing of the products.

Under S. 79 of the VAT Act the Commissioner General is allowed to issue practice notes to guide tax payers. The said section reads

> *"(1) To achieve consistency in the administration of this Act and to provide guidance to taxpayers and officers of the Uganda Revenue Authority, the Commissioner General may issue practice notes setting out the Commissioner General's interpretation of this Act.*
>
> *(2) A practice note is binding on the Commissioner General until revoked.*
>
> *(3) A practice note is not binding on a taxpayer."*

Exercising her powers the Commissioner General issued a practice note which was

> *"to inform the general public and officers of Uganda Revenue Authority that all imported rice is <u>considered</u> to be unprocessed agricultural produce for the purposes of the Value Added Act and therefore falls under the provisions of the second schedule which provides for exempt goods."*

The tribunal notes that the Commissioner General used the word "considered" in determining that imported rice is unprocessed. There is no empirical evidence that shows that all imported rice is unprocessed for purposes of the Act. The respondent did not adduce any evidence to show how the Commissioner General reached that consideration.

The literal rule of statutory interpretation requires people to follow statutes as they are: they should not speculate as to parliament's intention. Courts just like public servants are bound by the words of a statute when the words of a statute are clear. The words must be applied with nothing added and nothing taken away. More precisely a statute cannot be extended to a case not within its terms nor curtailed by leaving out a case that the statute literally includes. As Lord Diplock stated in *Duport Steels V Sirs* [1980] 1 All. E.R. 529

> *"If this be the case it is for the Parliament, not for the judiciary , to decide whether any changes should be made to the law as stated in the Acts "*

Likewise the Commissioner General cannot make any additions or subtractions to an Act of Parliament. As already stated by counsel of the applicant when referring to Article 152 of the Constitution the power to impose or remove a tax vests in Parliament.

The Commissioner General should endeavor to determine whether imported rice is unprocessed or processed for the purposes of the Act factually and not by making legal assumptions. The Tribunal also notes that like the applicant the Commissioner General is not a miller. If it is impractical to determine whether all imported rice is unprocessed or processed then the Commissioner General may refer to the said law to the relevant authorities for revision. However S. 79(2) states that a practice notice is binding on the Commissioner General until revoked. Though the practice notice is binding on the Commissioner General the tax player is given the leeway to challenge her interpretation. This is because the Commissioner General cannot be the final judge in her own cause.

Since imported rice maybe processed or unprocessed the Tribunal rules that not all imported rice is an exempt supply. It is only that rice which is unprocessed within the meaning of paragraph 3 of the Second Schedule that is exempt. The Tribunal agrees with the applicant that not all imported

rice is exempt supply. The practice notice issued on 14/11/2007 is not binding on the tax payer- applicant. Issue one is answered in the negative.

The Tribunal shall address issue 2 and 4 together. In order to determine what should be the proper assessment of the applicant regard has to be made whether the imported rice was standard rated, exempt or zero rated supply. By standard rated supply reference is made to S.24 (1) and S. 78(2) of the VAT Act. Under S. 24(1) of the Act a tax payable on a taxable transaction is calculated by applying the rate of tax to the taxable value of the transaction. The said tax is known as Value Added Tax. The rate of tax is specified in section 78(2).

S. 1 of the VAT Act states that an exempt import has the meaning in S. 20. S. 20 of the VAT Act provides

> *"An import of goods is an exempt import if the goods -*
>
> *(a) are exempt from customs duty under the Fifth Schedule of the East African Community Customs Management Act, 2004 ; or*
>
> *(b) would be exempt had they been supplied in Uganda."*

S. 19 of the VAT provides for supplies that would be exempt in Uganda. S. 19 states that a supply of goods or services is an exempt supply if it is specified in the Second Schedule. The relevant paragraph in this application which concerns imported rice is paragraph 1(a) which exempts *"the supply of unprocessed foodstuffs, unprocessed agricultural products and Livestock."* As already stated Paragraph 3 of the said Schedule defines unprocessed to include low value added activity such as sorting drying, salting, filleting, deboning, freezing, chilling, or bulk packaging, where, except in the case of packaging, the value added does not exceed 5% of the total Value of the Supply."

Companies that supply and sell VAT exempt good are not required to register for VAT. This means that they cannot reclaim any VAT on their

business purchases. VAT is not charged, and therefore it cannot be reclaimed on goods and services that are exempt from VAT. This explains why when the applicant's imported rice was assessed as an exempt supply in the second audit the tax liability is 105,278,239/=. The respondent had apportioned the in-put tax according to section 28(7) of the VAT Act.

If a supply is not an exempt one then it must either be zero rated or standard rated. If imported rice is shown to be processed (i.e. more than 5% value addition in the processing) then it is either a zero rated supply or a standard rated supply. Zero rated supply is provided in S. 24 of the Vat Act. S. 24(4) provides that the rate of tax imposed on taxable supplies specified in the Third Schedule is zero. The relevant paragraph that concerns rice is Paragraph 1(f) of the Third Schedule of the VAT Act which reads that the following supplies are specified for the purposes of section 24(4) as zero rated -

> *(f) the supply of cereals where the cereals are grown milled, or produced in Uganda.*

This means that only rice grown, milled or produced in Uganda is zero rated. Imported rice cannot be zero rated because it is not grown or produced in Uganda. Imported rice can therefore be standard rated or an exempt supply. It is exempt where it processing was less than 5% of the value.

The first assessment of the applicant was a tax credit of Shs. 37,356,319/= where its imported rice was considered to be zero rated. Where a business makes zero rated supplies, it may reclaim the VAT it pays on purchases and expenses associated with those supplies.

Zero rate of VAT is especially important for goods businesses that export services from Uganda to consumers abroad. Since Vat is a local consumption tax it makes sense to treat goods exported as subject to zero rate because the goods are not going to be consumed in Uganda. Having

found that the imported rice of the applicant could not be considered a zero rated supply the Tribunal rules that the first assessment of a tax payment of Shs. 37,356,319/= was incorrect.

As already stated S. 79 of the VAT Act provides that a practice note is not binding on a tax payer though it binds the Commissioner General. This means that if the Commissioner General states that a tax payer's supply is exempt she cannot turn around and state that it is a standard or zero rated supply. If a tax payer challenges the Commissioner General's assessment and interpretation the onus shifts to the tax payer to prove otherwise. S. 18 of the Tax Appeals Tribunal Act reads

> *In a proceeding before the a tribunal for a review of a taxation decision, the applicant has the burden of proving that-*
>
> *(a) Where the taxation decision is an objection decision in relation to an assessment, the assessment is excessive; or*
>
> *(b) In any other case, the taxation decision should not have been made or should have been made differently.*

Hence the burden of proof lied with the applicant to show that the rice it imported was not an exempt supply. Imported rice can be a standard rated or an exempt supply. If value added during processing exceeds 5% of the total value of the supply then it is standard rated.

As already stated the applicant did not discharge the burden bestowed on it by the law. The applicant informed the tribunal that it imported three kinds of rice. It tendered in a chart to show the processing of kinds of rice. It did not inform the tribunal the kind of rice which was the subject of this application. Was it brown or white rice? The applicant merely stated that it was the clearing agents who were paying the taxes. The clearing agents simply told the applicant the taxes and it paid. No clearing agent was called to testify on the type of rice. Nevertheless a clearing agent may not be in a position to clarify on the processing of rice. The applicant further informed the tribunal

that it did not own a mill. So it is not in a position to indicate the value addition to rice supplied during processing.

The Tribunal noted that the applicant agreed with that the original assessment of a tax credit of shs. 37,356,319 was the correct. The applicant's prayer in fact is that this assessment should be restored. Having come to the conclusion that the imported rice was not zero rated, the Tribunal rules that the respondent was right in apportioning the in-put tax. The Tribunal also noted that both parties agree that the same figures were used in the original assessment and the latter assessment, the only difference being the apportionment of input tax, the latter assessment must be correct.

The Tribunal therefore finds that in the present case there is no clear proof of more than 5% value addition. The Tribunal agrees with the respondent that the applicant exhibits fall short of indicating what percentage of value addition was made in processing the rice. The Tribunal therefore rules that imported rice is exempt if unprocessed and standard rated if processed. The applicant's imported rice was therefore properly treated by the respondent as unprocessed and consequently exempt.

In respect to issue 3 the Tribunal notes that a practice notice is not law. It has no legal effect as it does not bind the tax payer. A practice notice is a administrative tool designed to facilitate revenue collection. Under section 79 of the VAT Act a practice notice is intended to achieve consistency in the administration of the Act and to provide guidance to taxpayers and officers of the respondent. It is therefore the Commissioner General's interpretation of the Act and is binding on the Commissioner General until revoked but not binding on a taxpayer. It is a starting point in revenue collection where both parties may make reference to it as to the position of the law on the tax in issue. A tax payer has the option of either complying with the practice notice

or challenging it. Where a tax payer complies with the practice notice or fails to successfully challenge it, it applies retrospectively as to the date of which the law it seeks to interpret became effective. However where a practice notice is successfully challenged it can not be applied retrospectively as it is not a correct interpretation of the law.

In the present case however, the practice note attempts to amend the Law by nullifying the 5% value addition test to determine if rice is processed or unprocessed. The Tribunal therefore agrees with the applicant and rules that the practice note does not bind the applicant retrospectively.

On issue 5, the Standard Alternative Method (SAM) is provided for under the VAT regulations. The Regulations provide that SAM can only be used when a taxpayer has applied to the Commissioner General demonstrating that the provisions of section 28(7) is disadvantageous to him/her and the Commissioner General authorizes the use in writing. It is therefore applicable from the date of authorization. In the present case the Applicant applied for use of the SAM on 3.1.2006 after the audit was finalized. Therefore the Tribunal rules that the Standard Alternative Method was not the proper method to use in assessing the tax.

On Issue 6 It was not proved that the value added in processing of all imported rice may not exceed 5% of the total value of the supply. The Tribunal rules that all imported rice is not an exempt supply. The Tribunal therefore finds that the practice notice of 14/11/2007 was not a correct interpretation of the law. However the tribunal notes that applicant failed to prove that all the rice it imported was processed and therefore exempt with the meaning of S. 19 of the VAT Act. The Tribunal further rules that the respondent was in order to revise the assessment earlier computed at a tax credit of shs 37,356,319/= to a tax payable of shs 105,278,239/= which is

the correct assessment. It is hereby decreed that the Applicant should pay the tax assessed of shs 105,278,239/=

The law is that a successful party is usually entitled to the costs of the suit. In this application both parties were successful in some but not all issues. The applicant with success challenged the practice notice issued by the Commissioner General. The Tribunal agreed with the applicant that not all imported rice is an exempt supply. However the applicant failed to prove that it was not liable to pay the taxes assessed. The Tribunal also notes that if was not the oversight of the respondent when making the first audit this application would not have arisen. Considering all the circumstances of this case, each party should bear its own costs.

Asa Mugenyi	Martin Fetaa	Pius Bahemuka
Chairman	**Member**	**Member**