REPUBLIC OF UGANDA

IN THE TAX APPEALS TRIBUNAL AT KAMPALA REGISTRY

APPLICATION NO. 29 OF 2017

VIVO ENERGY UGANDA LIMITED ..... APPLICANT

VERSUS

UGANDA REVENUE AUTHORITY.....RESPONDENT

RULING

This ruling is in respect of an application challenging the decisions of the respondent in respect of the treatment of premium and rent paid by a lessee to various landlords under the Income Tax Act and the imposition of penalty on a provisional tax return.

The facts of the dispute are: The applicant has leases for it service stations where it conducts its business. The applicant pays premiums and rent. The premium and rent were treated as deductible expenses by the respondent. The respondent imposed penalty on the applicant for purportedly filing an amended provisional return out of time.

The following issues were set down for resolution:

1. Whether the premium and rent paid by the applicant are deductible expenses under the Income Tax Act?
2. Whether it was proper to impose penalty under S. 154 of the Income Tax Act on the applicant?

The applicant was represented by Mr. Joseph Luswata while the respondent was represented by Mr. Ronald Baluku and Ms. Patricia Ndagire.

The applicant's first witness was Mr. Stephen Chomi, its head legal. He filed a witness statement. In his testimony he said that the applicant deals in fuel retail

business. The applicant imports into Uganda fuel including petrol, diesel and lubricants and distributes them through a retail network of petrol stations across the country. The service stations are on land which is leased and subleased from various landlords including the Uganda Land Commission, District Land Boards, Kingdom Land Boards, Church Land Boards and Ugandan individuals. The applicant pays monthly rent and premium to the landlords. The premium is usually a one-off payment for the period of the lease or sublease. In some cases, no premium is paid at all instead only rent is paid. The rent may be paid monthly, after six months or annually in advance.

Mr. Stephen Chomi stated for the period 2003 to 2008 the applicant incurred Shs. 4,691,505,907 and Shs. 771,659,368 as advance rent and premium paid to the landlords of the various petrol stations. The total expense was Shs. 5,463,168,000. In accounting for the income for the said period the applicant amortized the rent and premium over the period of payment and treated the expenses as deductible for tax purposes.

The applicant's second witness was Mr. Ronald Akankwasa, its tax consultant. The witness is the Chief Executive Officer of Destiny Consultants Limited. He stated that the tax payment procedure in the years 2001 to 2004 was that a tax payer who has filed a tax return would be given a payment advice form where he or she would pay the assessed tax in the bank. Sometimes the tax return would be acknowledged on being filed but there were instances when the return was acknowledged afterwards.

The applicant's third witness was Ms. Kate Kabaingi Kiiza who currently is the Chief Finance Officer of DFCU bank. She formerly was a Financial Controller and later Finance Manager of the applicant. While she was the Finance Manager the respondent carried out a tax audit on the applicant for the years 2003 to 2008 and raised a number of issues including that of the treatment of rent and premium paid under the Income Tax Act. After several meetings and correspondences, the

respondent maintained its decision of treating rent and premium as a non-deductible expense. The respondent also imposed a penalty on the applicant under S. 154 of the Income Tax Act.

Ms. Kate Kiiza testified that she filed the provisional tax return with the respondent on the 30th December 2003. The respondent issued a bank payment advice form for payment on which the applicant paid Shs. 3,459,974,812. The respondent acknowledged receipt of the provisional tax return on 1st March 2004. The witness contended that a taxpayer would not be issued a bank payment form unless that tax payer had filed a return.

In cross examination, Ms. Kate Kiiza testified that the respondent contended that although the applicant had paid income tax the second provisional return was filed out of time. She also testified that the ownership of the applicant is majority non – Ugandans. As such it cannot own land but lease it. During the lease the applicant would build petrol stations on the land. The applicant would amortize the payments. She stated that the financial year of income of the applicant is from January to December. She confirmed that the applicant filed an amended return on the 30th December 2003. She denied that the return was filed on the date the stamp of respondent stated which is 1st March 2004. She reiterated her position that the applicant filed its return in time.

The respondent called one witness, Mr. Charles Kabunga, its Supervisor Audit. His roles as an auditor were to examine the financial records and other documents of taxpayers. The respondent audited the applicant and gave a position on its findings. He stated that the applicant holds interest in land by way of leasehold. The respondent followed the decision of *Mukwano Industries Ltd v URA* HCT -00-CC-CA-0001-2008 where it was held that ownership of land as leasehold is ownership of a tangible asset.

The witness testified that the applicant objected to the audit findings of the respondent. The respondent rejected the objection on the grounds that the applicant holds land by way of leasehold which is a tangible asset as held by the above decision. The witness also testified that the applicant filed and submitted that amended provisional return on the 1st March 2004 after the year of income had ended on 31st December 2003. The witness admitted that he was not the one who received that amended provisional return.

In its submission, the applicant submitted that it is a foreign company prohibited by the Constitution and the Land Act from holding land in perpetuity. The applicant by virtue of its citizenship status holds interests in land in the form of leases, subleases and tenancies for varying periods from 5 to 99 years from, inter alia, Uganda Land Commission, District land Boards, Buganda Land Boards, Church Land Boards. On these lands the applicant put petrol stations from which it sells its petroleum products. The applicant pays premium and rent. Premium is paid once while rent is paid periodically. The applicant submitted that at times rent is paid in advance for the period of the lease. For the period 2003 to 2008 the applicant had several leases and paid Shs. 4,691,506,907 in rent and Shs. 771,659,368 in premium. The applicant claimed the said payments as deductions. In 2012 an audit carried out by the respondent reversed the deductions asserting that premium and rental payments for leaseholds amount to capital expenditure and therefore not deductible.

The applicant submitted that premium and prepaid rent is deducted by the applicant on an annual basis under what in accounting is called the "Matching Principle" already embedded in S. 43 of the Income Tax Act which reads: "Where a deduction is allowed for an expenditure incurred on a service or other benefit which extends beyond thirteen months, the deduction is allowed proportionately over the years of income to which the service or other benefit relates."

The applicant submitted that S. 1 of the Land Act defines a leasehold land tenure to mean "the holding of land for a given period from a specified date of commencement on such terms and conditions as may be agreed upon by the lessor and lessee." *Black's Law Dictionary* defines a lease as "a contract by which a rightful possessor of real property conveys the right to use or occupy the property in exchange for consideration usually rent." Rent on the other hand is defined by S. 2(ccc) of the Income Tax Act as "any payment, including premium of or like amount, made as consideration for use or occupation of, or the right to use or occupy, land or buildings".

The applicant cited *King v Earl of Cardogan* (1915) 3 KB 484 where the court said "premium" means a cash payment made to the lessor and representing or supposed to represent the capital value or difference between the actual rent and the best rent that might otherwise be obtained. It is a very familiar expression to everybody who has the forms and powers of granting leases. It is in fact the purchase money which the tenant pays for the benefit which he gets under the lease."

The applicant contended that S. 22 of the Income Tax Act allows as deductions any expenditure incurred in a year of income in production of income included in the gross income of a taxpayer. S.22 (2) (b) of the Act provides that no deduction is allowed for expenditure of a capital nature or in respect on any amount included in the cost base of an asset. The applicant submitted that whereas 'cost base of an asset' is defined in the act, 'expense of a capital nature' and 'expense of a revenue nature' are not defined.

The applicant submitted that there are a number of principles on expenditure of capital and revenue nature. The question whether a payment is capital or revenue is a question of law is stated *in Voadafone Cellure Limited v Shaw* (Inspector of Taxes) (1997) STC 734. There is no single test or infallible criterion for distinguishing between capital and revenue payments. *Van Den Beghs Limited v*

Clark (1935) AC 431 at 438. Tests that may be useful in one set of facts maybe neither relevant nor significant in another set of facts *T.C. Nchanga Consolidated Cooper Mines Limited* (1964) AC 948. There is no rule whereby the treatment of expenditure in the hands of the taxpayer determines its character. So an item can be of a revenue expense for the payer and capital receipt for the recipient. *Vodafone* Case (supra).

The applicant submitted that there are at least two tests that are applied in determining whether an expense is of a capital or revenue nature. The first one is the "once for all test". It contends that if an expenditure is made once for all, it is normally a capital expenditure, whereas recurrent expenditures are revenue expenses. *Vallamborosa Rubber Company Limited v Farmer* (1910) TC 529. Rowlatt J in *Ounsworth v Vickers* (1915) 6TC 671,675 said the distinction was between expenditure to meet a continuous demand and expenditure made once and for all.

The second test is the "enduring asset or advantage" test which is sometimes referred to as the "Atherton test" where it was set out as:

> "When an expenditure is made not once for all, but with a view to bringing into existence an asset or advantage for the enduring benefit of a trade, I think there is very good reason (in the absence of special circumstances leading to the opposite direction) for treating such an expenditure as properly attributable not to revenue but to capital." Per *Viscount Cave in Atherton v British Insulated and Helsby Cables Limited* (192) AC 205: 10TC 155.

The applicant submitted that if the two tests are properly applied premium payments which are one-off payments would qualify for a capital expenditure and are therefore not deductible because they are an expenditure of a capital nature or an amount included in the cost base of an asset. It is a payment that brings into being an asset of enduring advantage or benefit. Rent, on the other hand, which is an expense that is likely to recur is a deductible expense under S. 22(1) (a) of the

Income Tax Act. It is a payment made for the day to day use or of a continuation of an advantage.

The applicant cited *Vodafone Cellular Ltd v Shaw* (1997) STC 734 where the Court of Appeal held that where a lump sum payment was made to commute or extinguish a contractual obligation to make recurring payments , the payment was prima facie a revenue payment. The applicant further submitted that for purposes of the Income Tax Act, premium in fact means rent. The Act overrides case law and since the Act suggest that rent is the same as premium and rent is deductible as recurrent expenditure then premium too is deductible under S. 22(1) (a).

The applicant cited *Halsbury's Laws of England* 5th Edition para. 58 p. 319 which states:

> "Capital expenditure and capital sums do not include:
> in relation to the person incurring the expenditure or paying the sum:
> (a) Calculating the profits or gains of a trade, profession or vocation or property business carried on by the person."

The applicant submitted that from the definition above expenditure that is deducted in calculating the profits of a business is not regarded as capital expenditure. The applicant submitted that capital expenditure would then be expenditure that is not considered when calculating the profits of a business. The applicant contended that the cost of purchasing land is not included in calculating the profits of the business and is therefore a capital expenditure. On the other hand, the amortized lease cost (rent) considered in calculating the profits of a business is therefore a revenue expenditure.

The applicant cited *Black's Law Dictionary* which defines capital expenditure as "an outlay of funds to acquire to improve a fixed asset." The same dictionary defines a lease as "a contract by which a rightful possessor of real property conveys the right to use or occupy the property in exchange for consideration usually in return for payment of rent." The applicant contended that a lease would therefore not qualify

as capital expenditure because it is not an acquisition of land but rather a temporary acquisition of the right to use the land.

As regards the penalty imposed on the applicant, it submitted that the respondent came across the provisional tax return bearing a URA receipt dated 1st March 2004. The respondent concluded that the return was filed late and imposed a penalty of Shs. 91,191,746 under S. 154 of the Income Tax Act on the applicant. Under S. 122 of the Income Tax Act every tax payer is required to furnish an estimate of the chargeable income to be derived for a year of income. The estimate of the chargeable income is the basis of the payment of the provisional tax in the year of income. The applicant contended that it did file an estimate of chargeable income for the year 2003 on 30th June 2003. The applicant not having accurately stated it chargeable income filed a revised estimate on which it paid full provisional tax for 2003 by December 2003. This was contained in the uncontroverted evidence of Kate Kabaingi who prepared and submitted in the return on 30th December 2003. The tax paid by the applicant corresponded with the return filled before the tax paid.

The applicant stated in its evidence that the return was filed before March should be believed because of a number of reasons. The applicant's witness Kate Kabaingi Kiiza testified that she saw and touched the contested document. The respondent's witness, Charles Kabunga did not state that he was employed by the respondent at the time the revised return was received. The late submission of the return occurred in 2003 but the issue was raised in 2012 during an audit. This suggests that those in charge in URA knew that the return was filed in time but acknowledged later. Ms. Kate Kabaingi testified that due to collection pressures acknowledgement of documents would be done at a later date than when actually received.

In reply the respondent submitted that the applicant pays premium which is paid at once and rent which is paid periodically for leaseholds. The respondent contended

that the leaseholds are assets to the applicant and are declared as such per the applicant's financial reports and statements for the year ending 2007. The respondent contended that the premium and rent should be considered as capital expenses and should form the cost base of the applicant's assets for purposes under S. 52(2). The respondent contended that the said payments are not deductible.

The respondent cited S. 22(2) (b) of the Income Tax Act which provides that no deduction is allowed for any expenditure or loss of a capital nature, or any amount included in the cost base of an asset. S. 52(2) of the Income Tax Act provides that the cost base of an asset purchased or constructed by the taxpayer is the amount paid or incurred by the taxpayer in respect of the asset including incidental expenses of a capital nature. S. 2 of the Act defines a business asset to mean an asset used or held for use in business, and includes any asset for sale. Article 237(3) of the Constitution and S. 2 of the Lands Act provide that the land tenure system in Uganda includes leasehold. S. 3(5) of the Land Act defines a leasehold tenure as "a form of tenure under which one person namely the landlord or lessor grants or is deemed to have granted another person namely the tenant or lessee, exclusive possession of land usually but not necessarily for a period defined." The respondent submitted that leasehold is one way of ownership of land in Uganda and thus an asset in the applicant's business. This item is reflected as an asset in the applicant's Annual Report ending 31st December 2007. The respondent contended that the applicant's claim that a lease should be construed as an acquisition of a right to use land and not an acquisition of land is misleading. The respondent submitted that what the applicant obtained was ownership and exclusive possession of land from the different lessors who wholly assigned the said land to the applicant who became the owner of the land and constructed fuel structures on it.

The respondent cited *Mukwano Industries (U) Ltd v Uganda Revenue Authority* HCCT -00-CC-CA- 001- 2008 where the appellant Mukwano Industries acquired

four leasehold properties, and incurred expenses in acquiring the leases. It was held that the expenditure incurred by the appellant in acquiring leasehold was for the acquisition of tangible assets and does not qualify for claiming intangible asset allowance under the Income Tax Act. The respondent submitted that the said decision is binding on the Tax Appeals Tribunal in respect of the treatment of expenses incurred for the acquisition of land. The respondent cited *Attorney General v Uganda Law Society* Constitutional Appeal no. 1 of 2006 where the Supreme Court held that "under the doctrine *of stare decisis*, which is a cardinal rule in our jurisprudence, a court of law is bound to adhere to its previous decision save in exceptional cases where the previous decision is distinguishable or was overruled by a higher court on appeal..."

The respondent cited *Halsbury's Law of England* 4th Edition Re-issue Volume 23 Paragraph 234 page 191 where it is stated that "a payment which is the price of acquisition of a fixed capital asset of the business is a capital payment and is not deductible in ascertaining profits or gains." *Halsbury's Law* further explains the test used to determine whether money spent on the acquisition of an asset should be regarded as capital expenditure to include money spent on improving the asset or making it more advantageous.

The respondent cited *Gali India Limited v The Joint Commissioner of Income* ITA 956/2011 and 957/2011 where the High Court judge stated that "in cases of an agreement in which the annual payment of rent, other than the nominal rent, is required, the amount of the lease premium, cannot be said to be payment of rent in advance and in such cases the premium will be in the nature of capital expenditure incurred for obtaining leasehold rights and no amortization will be allowable." The court further stated that "Costs incurred for land is always capital in nature unless an assessee is dealing in land. No depreciation is allowable on such cost of land; therefore there is no question for allowing amortization of such cost of land".

The respondent cited *British Insulated and Helsby Cables v Atherton* [1925] ALL ER 629 where Viscount Cave said in respect of what constitutes capital expenditure that "it may further be of some significance, that if as a result of a payment, something is brought into existence which is an asset or an advantage" and if it is "for the enduring benefit of a trade." The applicant also cited *Regent Oil Co. Limited (Inspector of Taxes) v Inland Revenue Commissioners* [1965] 3 ALL ER 174 where it was decided that: "in examining the nature of payments which were made and which are in issue, it is important to consider not so much why the payments were made but for what they were made. If the motive is making payments and is noted or becomes manifest the more relevant inquiry must be made as to whether some asset or advantage was acquired and, if so what was its nature." The respondent submitted that the applicant imports into Uganda fuel products including petrol, diesel and lubricants and distributes them through a retail network of service stations around the country.

As regards the penalty imposed on the applicant, the respondent submitted that it imposed it under S. 154 of the Income Tax Act having found that the applicant had understated its chargeable income for the year ending 31st December 2003. The respondent cited S. 154 of the Income Tax Act which provides that a provisional taxpayer, whose estimate or revised estimate of chargeable income is less than ninety percent of the taxpayer's chargeable income, is liable to pay penal tax. S. 112 (5) of the Income Tax Act provides that a provisional taxpayer's estimate shall remain in force for the whole of the year of income unless the taxpayer furnishes a revised return. The respondent submitted that if a taxpayer does not file a revised provisional tax within the year of income the provisional filed at first instance will remain in force for the whole year of income.

The respondent submitted that applicant's provisional income tax return for the year 2003 was filed and received on the 30th June 2003. The provisional income tax return had a self-assessment return of Shs. 18,666,666,667. The respondent however received an amended provisional income tax return dated 30th December

2003 on the 1st March 2004 with chargeable income of Shs. 22,927,439,372. The return was stamped received on 1st March 2004. The respondent submits that the filing of the return was out of time. The respondent submits that the applicant filed one provisional income tax return. The respondent cited S. 101 of the Evidence Act where the burden of proof lies on the person who is bound to prove the existence of the fact. The respondent asserted that the applicant has actually failed to prove by documentary evidence that it filed the said revised provisional return and was received by the respondent on or before the 31st December 2003.

In rejoinder the applicant contended that the case of *Mukwano Industries Limited v Uganda Revenue Authority* (supra) was not applicable to this case. It did not discuss the tax treatment of premium and rent and whether there are deductible or not. In the said case there was one single payment for the acquisition of leases and incidental payments happened at the same time. The above case dealt with the application of S.31 of the Income Tax Act while this case is concerned with S. 21 of the Income Tax Act. The applicant stated that the *Gali* case was merely persuasive. It decided that the premium on leases is a capital expense. The question on whether rent on leases is capital was not decided.

Having listened to the evidence, perused through the exhibits and read the submissions this is the ruling of the Tribunal.

The applicant holds land under leasehold ranging from 5 to 99 years from various land boards. For occupying the said land the applicant pays premium and rent. The rent is paid periodically but at times in advance. Premium is paid off once. For the period 2003 to 2008 the applicant paid Shs. 4,691,506,907 in rent and Shs. 771,659,358 in premium. The applicant claims that said payments should be amortized and deducted in every financial year when ascertaining its chargeable income. The respondent contends that the premium and rent amount to capital expenditure and are therefore not deductible.

The Income Tax Act provides for deductible allowances in S. 22 which reads:

> "Subject to this Act, for the purposes of ascertaining the chargeable income of a person for a year of income there shall be allowed as a deduction- ..."

Under the said Section assessable income is deductible to the extent that it is incurred in gaining or producing assessable income or carrying business with the said purpose. Other expenditures that are incurred in the course of business which do not have the purpose of producing income are excluded from computing the assessable income. The relevant Section for the purposes of this application is S. 22(2) which provides:

> "(2) Except as otherwise provided in this Act, no deduction is allowed for –
>
> (a) any expenditure or loss incurred by a person to the extent to which it is of a domestic or private nature
>
> (b) Subject to subsection (1), any expenditure or loss of a capital nature, or any amount included in the cost base of an asset:"

The Act does not state what an expenditure or loss of a capital nature are. As regards cost base S. 2 provides that in relation to an asset it has the meaning in S. 52. S. 52(2) reads:-

> "The Cost base of an asset purchased, produced or constructed by the taxpayer is the amount paid or incurred by the taxpayer in respect of the asset, including incidental expenditures of a capital nature incurred in acquiring the asset, and includes the market value at the date of acquisition of any consideration in kind given for the asset."

So the question is, do the rent and premium paid by the applicant for acquiring the various leases an expenditure of a capital nature or should they be amounts included in the cost base of an asset?

We already stated that the Income Tax Act does not state what an expenditure of a capital nature is. In order to understand what an expenditure of capital nature is one has to know that there are two types of expenditures. These are expenditures of a revenue nature in contrast to those of a capital nature. Revenue expenditures are put in the income statement or the profit and loss account while capital expenditures go in the balance sheet.

Revenue expenditures are those incurred in the daily operation of the company or the day to day running of the company. These are expenses incurred to maintain the business and benefit the current expenditure. There are expenses incurred in the normal course of business. They are expenditures incurred for the purpose of keeping a profit earning asset in condition to earn profits. They are expenditures incurred in the production of income. In *Commissioner of Income Tax v Hutchings Biemer Ltd* [1969] EA 681 a large part of the respondent's income consisted of property owned by it, including warehouses and go downs. The respondent incurred legal costs in trying to recover possession of two go downs from two tenants who had refused to quit by litigation. It was held that the expenditure was not for the purpose of bringing a capital asset into existence but for the purpose of increasing revenue to be obtained from rents. Duffus V.P. said:

> "I do not consider that this was an expenditure designed to improve the capital position of the appellant company or the creation of a new asset; in my view this expenditure was expenditure essential to the earning of profit; that it was incurred for the direct purpose of producing profit."

If expenditure is incurred with the purpose of earning profit it would be an expenditure of a revenue nature.

Capital expenditure, on the other hand, is expenditure incurred to benefit future periods. Capital expenditure creates a benefit of an enduring nature. They increase the earning capacity of a company. It can also be considered as money spent for the purchase of long term assets and includes assets such as buildings and machines or that has the effect of increasing the capacity, efficiency, lifespan of a fixed asset. The character of the expenditure is ordinarily determined by reference to the nature of the asset acquired or the liability being discharged by the company. The character of the advantage sought in acquiring the asset is in most cases the most critical and determining factor in deciding the nature of the expenditure.

An expenditure of a capital nature is incurred with the purpose of bringing in existence an asset or an advantage for the enduring benefit of a trade. In the

Commissioner of Income Tax v Overland Co. Ltd. [1961] EA 729 the respondent acquired a plot of land for the construction of a multi-storey car park and to finance the building made an issue of debenture stock and obtained a loan. The company paid interest on the debenture stock and loan and also paid ground rent and rates. The commissioner disallowed the company claims to treat the expenses as either wholly and exclusively incurred in the production of income or were expenditure of a revenue nature. The court held that all the payments were part of the expenditure necessary to acquire and bring into existence of a capital asset for the enduring benefit of the company's business and although only part of the total expenditures so incurred, were nevertheless payments of a capital nature and not allowable deductions. Sir Alastair Forbes V-P. referred to the judgment of Lord Cave in *British Insulated V Helsby Cables* [1926] AC 205 (at p.213) where it was stated that:

> "When an expenditure is made not only once for all, but with a view to bringing in existence an asset or advantage for the enduring benefit of a trade, I think there is very good reason (in the absence of special circumstances leading to the opposite direction) for treating such an expenditure as properly attributable not to revenue but to capital."

He concluded:

> "In my opinion the expenditure by the company on rent and rates during the period of construction is part of the whole sum expended by the company for the purpose of acquiring the multi-storey car-park, and is properly to be regarded as expenditure of a capital, and not of a revenue nature."

In order for expenditure to be one of capital nature it must be one paid for the acquisition of a capital asset and not a stock in trade. In *Golden Horse Show (New) Ltd v Thurgood* [1934] 1 KB 548 a taxpayer company claimed to be entitled to deduct, in computing profits, the purchase price of dumps of tailings from gold mines. Their claim that the dumps were not capital assets but from part of the stock in trade was upheld by Romer L.J. who stated:

> "The question to be decided in this case is whether the dumps are to be regarded as fixed capital or as circulating capital. If they are the former, it is conceded by the

appellants that the assessment made on them is correct. If on the other hand, they are floating or circulating capital it is conceded that the cost of them to the appellants must be debited in the profit and loss account, the account being credited with the cost price of what was left of the dumps at the end of the year of assessment."

Concerning the distinction between fixed capital and circulating capital, Romer L.J. observed thus:

> "The determining factor must be the nature of trade in which the asset is employed. The land upon which a manufacturer carries on his business is part of his fixed capital. The land with which a dealer in real estate carries on his business is part of his circulating capital. The machinery that a dealer in machinery buys and sells is part of his circulating capital, as is the coal that a merchant buys and sells in the course of its trade."

Before an expense is declared to be of a capital nature it is important to determine whether it was expensed on a fixed asset or a stock in trade. *B.P. Australia Ltd v Federal Commissioner of Taxation* (1965) 112 CLR 386 the court noted that fixed capital is prima facie that on which you look to get on a return by your trading operations. Circulating capital is that which comes back in your trading operations.

There is no single decisive test to ascertain whether expenditure is of a revenue or capital nature. In *Vodafone Cellular Ltd and others v Shaw* (Inspector of Taxes) 1997 STC 734 it was held that the question whether a payment was a capital or revenue was a question of law. There was no single test for distinguishing between capital and revenue payments. However courts have applied several aspects in determining the nature of the gain by the taxpayer. In *Van Der Bergs, Limited v Clark (Inspector of Taxes)* AC 431 the court noted while each case is found to turn upon its own facts, and no infallible criterion has emerged, nevertheless the decisions are useful illustrations as to the kind of considerations which may be borne in mind in approaching the problem of discriminating a capital expense from that of a revenue one.

In *B.P. Australia Ltd v Court of Taxation of Commonwealth of Australia* [1966] AC 224 it was stated that in distinguishing between capital and revenue payments the following matters should be considered:

"(1) The character of the advantage sought and in this its lasting qualities may play a part;

(2) The manner in which it is to be used, relied upon or enjoyed and in this and under the former head recurrence may play a part;

(3) The means adopted to obtain it; that is by providing a periodical reward or outlay to cover its use or enjoyment for periods commensurate with the payment or by making a final provision or payment so as to secure future use or enjoyment."

Courts have emphasized the commercial point of view and noted that whatever is substituted for revenue expenditure should normally be considered as capital expenditure. In *Commissioner of Taxes and Nchanga Consolidated Cooper mines* [1964] AC 948 Heyworth Talbort noted that "Whether expenditure is of a capital nature is to be answered by what the law holds to be in accordance with sound principles of commercial accounting." The court also noted that "An examination of the authorities shows that various tests have been formulated as what is expenditure of a capital nature." In the *Vodafone Case* (supra) the court noted the nature of the payment and nature of the advantage obtained by the payment were important.

Having stated the law, the Tribunal has now to decide whether the expenses on rent and premium were capital or revenue in nature. The applicant paid rent and premium for the various leases. Rent is defined in *Black's Law Dictionary* 10th Edition p. 1322 as "consideration paid periodically for the use or occupancy of property". The rents in the leases were paid periodically but the premiums were one off payments. The relevant definition of premium which may be of assistance in this matter is in the New Zealand case of *Syme v Commissioner of Stamps* (1910) 29 N.Z.L.R. where Edwards J said:

> "It seems to me clear that here the word 'premium' is used as meaning a sum of money paid as the consideration, or part of the consideration, for a lease which under the contract is made payable independently of the continuance of the terms

granted by the lease, and to which the incidents of rent reserved by a lease do not attach".

The rent paid by the applicant was independent of the premium. However S. 2 (ddd) of the Income Tax Act defines rent to mean "any payment, including a premium of like amount, made as consideration for use or occupation of, or the right to use or occupy land or buildings." Under the Income Tax Act premium is considered as rent. Does this affect the treatment of the payment? Can one consider premium as payment of a capital nature and rent of a revenue nature or vice versa? Or do they each affect the cost base differently? The Tribunal does not think so. They are all costs incurred in acquiring interests in land. How they are worded does not affect the effect on acquiring the said interests. It is the nature of the advantage gained that matters.

In the *Vallambrosa Rubber Co. Ltd V Farmer (Surveyor of Taxes)* (supra) the court said that in determining revenue expenditure it is a thing that recurs every year while a capital expenditure is spent once. The court however noted:

> "Now, I don't' say this consideration is absolutely final or determinative, but in a rough way I think it is not a bad criterion of what is capital expenditure as against what is income expenditure to say that capital expenditure is a thing that is going to be spent once and for all, and income expenditure is going to recur every year."

The Tribunal notes that the applicant paid rent annually and premiums were one-off payments. In some situations the applicant was paying of the rent in advance. In such situations there would be no recurrence of payment of rent. That is why the applicant was seeking to amortize the payments in the profit and loss account. Hence the mode of payment by the applicant cannot be absolutely final or determinative in deciding whether they amounted to revenue expenditure. In *B.P. Australia Ltd v Federal Commissioner of Taxation* (supra) the court commenting on how the nature of expenditure is determined said:

> "The solution to the problem is not found by any rigid test or description. It has to be derived from many aspects of the whole set of circumstances some of which may point in one direction, some in the other. One consideration may point so clearly that it dominates other and vaguer indications in the contrary direction. It is

> a commonsense appreciation of all the guiding features which must provide the ultimate answer. Although the categories of capital and income expenditure are distinct and easily ascertainable in obvious cases that lie far from the boundary, the line of distinction of often hard to draw in border line cases; and conflicting considerations may produce a situation where the answers turns on questions of emphasis and degree. The answer "depends on what the expenditure is calculated to effect from a practical and business point of view, rather than upon the juristic classification of the legal rights, if any, secured, employed or exhausted in the process."(per Dixon J. in Hallstrom's Case (1946) 72 CLR 634, at p 648)".

Since the said consideration of the recurrence of the payments in the *Vallambrosa Rubber* case is not final the Tribunal will also consider other facts of the case and weigh them. One may approach the problem by considering the character of the advantage sought where the recurrence of payments play their part.

The Tribunal has to decide whether the expenses incurred by the applicant were for future benefits. Were the payments for rent and premium for an acquisition of a fixed asset? *Black's Law Dictionary* (supra) p. 125 defines an asset as an item that is owned and has value. At p. 126 for fixed asset the Dictionary states one has to look at capital asset. Capital asset is defined at p. 126 as a "long term asset used in the operation of a business or used to produce goods or services, such as equipment, land, or an industrial plant – also termed fixed asset." The land leased by the applicant was for a long term. The leases conferred interests on the applicant in land which was capital in nature. The applicant contended that that the leases do not grant ownership to the lessee. At the expiry of the lease the land reverts to the landlord. *Black's Law Dictionary* (supra) p. 1138 defines ownership as the bundle of rights allowing one to use, manage and enjoy property, including the right to convey to others. Ownership implies the right to possess a thing, regardless of any actual or constructive control. In *Stokes (Inspector of Taxes) v Costain Property Investments Limited* [1984] STC 204 there were expenses incurred on provision of machinery or plant. The plant and machinery installed by tenant become landlord's fixtures. Fox LJ stated "I can only conclude that machinery and plant comprised in a lease as landlord's fixtures do not belong to

the lessee". He observed that "he cannot remove them from the building. He cannot dispose of them except as part of the hereditament and subject of the provisions of the lease and for the term of the lease." The court dismissed the appeal seeking to reverse a decision that the taxpayer is not entitled to capital allowances.

The period of time one has the exclusive right to use and possess property does not affect ownership. It does not matter whether the lease is for 5 years or 99 years, as long as there is ownership. In *Gali India Limited v The Joint Commissioner of Income tax* ITA 956/2011 ad ITA 957/2011 the assessee which was engaged in the manufacture of hydrocarbon and distribution of natural gases entered into lease arrangements with local municipalities, in respect of land. The lease arrangements were for long periods ranging between 60-95 years. The various clauses in the leases allowed the appellant rights to construct buildings and upon expiry of the term of the lease the land vested in the landlord. The appellant submitted that it does not have ownership rights and the lease hold rights are available only for specified period. All the land will revert back to its original owner at the end of the lease period. The court stated that the arrangements do not confer outright ownership rights to the lessee is beside the point as the enjoyment of the land as a lessee in such cases is substantially that of the owner itself. In other words, barring the right to alienate or outright sale of the property in unqualified manner, all rights of enjoyment in respect of leased properties are with the assesse.

A lease is different from a normal tenancy agreement hiring premises. The terms of the lease granted the applicant the exclusive right to use and occupy the property in exchange of consideration for a period of time. During that time the applicant has rights of ownership. It can convey the property to third parties. It cannot be said that the applicant is not the owner of the land during the terms of the lease. For a normal tenancy agreement the tenant does not have the exclusive rights to own the premises he rents. He cannot alter the premises without the landlord's consent.

He cannot convey it to third parties. Rent paid for such premises in considered as a revenue expenditure as it is incurred for the operation of the business. While rent and premium paid for leases is incurred to acquire a fixed asset. In *Gali India Limited v Joint Commissioner of Income Tax* (supra) the Court held that:

> "in the case of an agreement in which annual payment of rent, other than nominal rent is required, the amount of lease premium cannot be said to be payment of rent in advance and in such cases the premium will be in the nature of capital expenditure incurred for obtaining lease hold rights and no amortization will be allowed."

The court further observed that:

> "Cost incurred for land is always capital in nature unless the assesse is dealing in land. No depreciation is allowable on such cost of land; therefore, there is no question for allowing amortization of such cost of land."

The court visited another decision of *Madras Industrial Investment Corporation Ltd.* 225 ITR 802 (SC) and stated it was aware that the leased land contained a dilapidated structure, and since it could not be used by the assesse, the parties therefore agreed that the assesse could construct upon the land at its own consideration but at the same time it would have no right or title in the new construction. The court noted that there are Supreme Court rulings that upheld the Revenue's contention that expenditure towards the acquisition of lease amounted to "bringing into existence an asset or advantage for enduring benefit of the business" and was properly attributable by way of capital expenditure.

In *Mukwano Industries (U) Limited v Uganda Revenue Authority* HCT- 00- CC- CA- 0001- 2008 the issue before the Court was whether expenditure incurred in acquiring a leasehold interest in land and building qualified to be an intangible asset under S. 31 of the Income Tax Act. The Tribunal is dealing with whether the rent and premium payments by the applicant were capital expenditure under S. 22 of the Income Tax Act. In essence the Tribunal is dealing with the acquisition of capital asset. We think there is a difference between a capital asset and an intangible asset. A capital asset may be either intangible or tangible. In the above case the High Court dealt with S. 31 of the Income Tax Act which is different from

S. 22 of the Income Tax Act. Therefore the High Court case may not be binding in the present case. It is merely persuasive especially in respect of definitions of the terms which are found in both Sections. In both cases the issue of leasehold conferring ownership is apparent. In the above case the court stated:

> "According to Words and Phrases, legally defined, Vol. 3, a lease is an instrument in proper form by which the condition of a contract of letting and finally ascertained and which is intended to vest the right of exclusive possession in the lessee. The Black's Law Dictionary defines "tenure" as "a right, term or mode of holding lands or tenements in subordination to a superior." In Uganda land is owned either under the customary, freehold or leasehold tenure system. The ownership is for the limited period as provided in the respective lease agreements and certificates of title. The statutory provisions which govern land ownership in Uganda show that ownership of land is not always in perpetuity. It could be for a limited period depending on the tenure system which it is owned."

The above decision confirms the Tribunal's finding that when one acquires a lease interest in land it obtains exclusive possession of the land for the period specified in the lease. That acquisition is one of ownership of a capital asset. The Tribunal does not see any reason why it should differ from the High Court in respect of a leasehold interest conferring ownership in land.

In *Regent Oil Co. Ltd v Stick (Inspector of Taxes* [1965] 3 ALL ER 174 where there were leases of premises to oil company for premiums and sub-leases back to proprietor at nominal rent. There were covenants binding proprietor to use company oil. It was held that the lump sum payments were expenditure of a capital nature, and therefore were not deductible in computing the taxpayer's profits for the purposes of income tax and the profits tax. The court reasoned that the payments were made for the acquisition of interests in land which were assets of capital nature. Lord Reid noted that the lump sum payments for ten and five years were also capital expenditure having regard to the transactions being by lease and sub-lease. Lord Wilberforce reasoned inter alia that the asset or advantage gained was for earning future profits and its character was that of fixed, not circulating capital. He said according to the nature of the payments, the commercial and legal

nature of the advantage gained, the use to be made of the advantage all pointed to the payments being capital expenditure.

In conclusion, the Tribunal notes that the applicant deals in fuel and lubricants which are its stock in trade and not land. The applicant leased land from various land boards to enable it operates its petrol stations. The said leases conferred ownership on the applicant on the land for the period specified in the leases. The said leases were an acquisition of a capital asset by the applicant. Hence the costs incurred by the applicant were capital in nature. Therefore the Tribunal finds that the payments of rent and premium by the applicant to the landlords were for the acquisition of a capital asset and are therefore not deductible allowance under S.22 of the Income Tax Act. The said payments are amounts to be considered in the cost base of an asset under S. 52(2) of the Income Tax Act. The first issue is found in favour of the respondent. The Tribunal is indebted to counsel of both sides for the vigorous, well researched and diligent arguments and authorities cited which enabled it make the above decision.

The second issue was on the imposition of penalty on the applicant by the respondent. The applicant's financial year runs from January to December. Under S. 122 of the Income Tax Act every tax payer is required to furnish an estimate of the chargeable income to be derived for a year of income. For the year 2003, the applicant estimated and paid provisional tax of Shs. 19,666,666,667. The applicant subsequently revised its estimated provisional tax to Shs. 22,927,431,372. The applicant made payment of an additional tax of Shs. 3,459,794,812 to the respondent on 30th December 2003. The payment on 30th December 2003 is not in dispute. It is the time of filing the revised provisional return which is in dispute. The applicant said it filed the revised tax estimate on 30th December 2003. The respondent contends that the revised tax estimate was filed and stamped 1st March 2004.

The respondent contends that the revised tax estimate ought to have been filed on or before the 31st December 2003. The failure to do so attracted penalty under S. 154 of the Income Tax Act which reads:

> "A provisional taxpayer whose estimate or revised estimate of chargeable income for a year of income under S. 211 is less than ninety per cent of the taxpayers actual chargeable income assessed for that year, is liable for penal tax equal to the twenty per cent of the difference between the tax calculated in respect of the taxpayer's estimate, as revised, of chargeable income and the tax calculated in respect of ninety per cent of the taxpayer's actual chargeable income for the year of income."

The respondent contended that because the revised estimate filed by the applicant was out of time S. 154 should apply and penal tax be imposed using the provisional assessment filed by the latter.

The applicant's witness Ms. Kate Kabainga Kiiza testified that she filed the revised tax return exhibit 2(c) personally on 30th December 2003. She received the bank advice form, exhibit 2(d), and paid Shs. 3,459,974,812 being the extra income tax. The tax paid by the applicant corresponded with the amount on the revised tax estimate. The respondent relied on the date indicated on the stamp of the revised tax return. A perusal of the revised tax return shows that it has two stamps: one of Taxpayer service indicating 1st March 2004 and the second of Large Tax payer Unit 4th March 2004. The said stamps do not have any signatures of the persons who received them. It is not clear whether the stamp of 1st March 2004 was from the reception where returns are received as it only reads Taxpayer Service. Was it received at the reception and sent to the Taxpayer service on 1st March 2004? The applicant's witnesses Ms. Kiiza testified that at times due to pressure of work the persons who receive the returns to not stamp the actual date received. This was also echoed in the testimony of Mr. Ronald Akankwasa. The respondent did not call the staff who received the return to confirm which day the return was filed. The register where returns were recorded was not adduced in evidence. The amount the applicant paid on the 30th December 2003 corresponds with the amount indicated in revised provisional return. There is doubt as to how the applicant

would have paid the taxes without filing the revised tax estimate. S.133 of the Evidence Act provides that subject to the provisions of any other law, no particular number of witnesses in any case be required for the proof of any fact. The evidence of Ms. Kiiza suffices to prove the date of filing the return. The testimonies of Ms. Kate Kabainga Kiiza and Mr. Ronald Akanwasa were not controverted. Where doubt is raised the benefit of the doubt is given to the tax payer. In the circumstance the Tribunal will set aside the assessment of the penal tax of Shs. 91,191,746. The second issue is decided in farvour of the applicant.

The application by the applicant is partially successful, that is, on the second issue. The assessment of the penal tax is set aside. The applicant is awarded half the costs of the application. We so order.

Dated at Kampala this 21st day of December 2018.

DR. ASA MUGENYI MR. GEORGE W. MUGERWA MS. CHRISTINE KATWE