THE REPUBLIC OF UGANDA

IN THE TAX APPEALS TRIBUNAL AT KAMPALA

TAT APPLICATION NO. 03 OF 2019

NATIONAL SOCIAL SECURITY FUND ==========================APPLICANT

VERSUS

COMMISSIONER GENERAL, UGANDA REVENUE AUTHORITY == RESPONDENT

BEFORE DR. ASA MUGENYI, MR. GEORGE MUGERWA, MR. SIRAJ ALI

RULING

This ruling is in respect of an application challenging an income tax assessment of Shs. 42,196,249,077 for the period 2005 to 2012 in respect of interest paid to members' accounts under the National Social Security Fund (NSSF) Act.

The applicant is a statutory body established under the NSSF Act to receive contributions from its members and pay out benefits as required by the Act. In 2013, an audit by the respondent revealed that the applicant claimed as an allowable deduction interest paid in respect of contributions made by its members. The respondent disallowed the said deduction and issued an assessment of Shs. 30,521,703,065 as principal tax and penal interest of Shs. 12,196,875,941 to the applicant. The applicant objected to the said assessment on the ground that it was entitled to deduct such interest under S. 25(1) of the Income Tax Act. The respondent made an objection decision maintaining its position that the applicant was not entitled to make the said deduction.

The following issues were set down for determination;

1. Whether the interest payable to NSSF members is a deductible allowance under the Income Tax Act?
2. Whether the applicant is liable to pay penal interest?
3. What remedies are available?

The applicant was represented by Mr. Oscar Kambona, Mr. Bruce Musinguzi and Mr. Thomas Katto while the respondent by Ms. Nakku Mwajuma, Mr. Alex Ssali Alideki and Mr. Ronald Baluku.

Under the NSSF Act, employers and employers, who are known as its members, are required to make monthly contributions to the applicant. The applicant pays interest to employees as required by the NSSF Act. The applicant has been treating the interest paid to members' account from the contributions received as allowable deductions under S. 25(1) of the Income Tax Act.

The applicant's sole witness, Mr. Patrick Ayota, its Deputy Managing Director testified that that the dispute between the parties is whether the interest paid to members is an allowable deduction under S. 25 of the Income Tax Act. He stated that the applicant was established for the purpose of receiving member's monetary contributions, investing them and repaying the amounts with interest in accordance with the NSSF Act. The applicant invests the monies received from contributions in government bonds, treasury bills, other securities, equity investments and in properties such as land and rental property. Mr. Ayota testified the applicant pays interest for using the member's contributions in accordance with S. 35 of the Act to the members when they become eligible: Either when they attain the age of 55, or when a member dies and has survivors, or when a member is terminally ill, or when a member leaves the private sector or when a member emigrates from Uganda. The minimum rate of interest payable by the applicant to its members is 2.5% per annum. However the Minister has the discretion to determine interest payable to members which he declares not later than 1st October of each year. He contended that the interest paid is the cost of borrowing the member's money and is not a return on capital. The witness contended that the interest is considered a debt obligation. This relates to the requirement to pay back the money from members. Mr. Ayota said the monies received are assets and the members accounts are characterized as liabilities on the balance sheet. The witness testified that interest expenses are deducted from the gross income. The respondent in a letter of 23rd August 2001 confirmed that such interest was accepted as an allowable deduction.

The respondent's witness, Mr. Henry Martin Saka, its Commissioner Domestic Taxes testified that an audit it carried out on the applicant revealed that the latter was considering interest it paid to its members as an allowable deduction. He stated that the respondent disallowed this expense and recomputed the tax payable on the ground that such interest ought to have been incurred in the production of income. He contended that there were a number of indicators that showed that the interest was not incurred in the production of income. For instance interest was determined after operations of the applicant and after the closure of accounts. The second indicator was interest was determined through a procedure of the applicant as opposed to well established principles of borrowing money, where the lender is involved in the determination of interest. The witness stated that the characteristics were more akin to a distribution of profits to members rather than payment of interest. Mr. Saka contended that interest incurred by banks was deductible as an expense because banks are in the business of trading in money in the normal course of their business as opposed to the applicant who is involved in many other businesses.

In its submissions, the applicant submitted that it provides social security services to its members. The members make contributions which are invested by it. The applicant's only source of income is its investments. The applicant submitted that under the NSSF Act, it is mandated to pay interest to its members on the contributions made by them.

The applicant submitted that S. 25(1) of the Income Tax Act provides that a person is allowed a deduction for interest incurred during the year of income in respect of a debt obligation to the extent that the debt obligation has been incurred by the person in the production of income included in gross income. The applicant submitted that in order for a tax payer to be entitled to claim an interest deduction under S. 25(1) it has to show that: i) The tax payer has incurred interest. ii) The interest must have been incurred as a result of a debt obligation. iii) To the extent that the debt obligation was incurred in the production of income. iv) The income from the debt obligation is included in the person's gross income.

The applicant discussed each of the grounds set out above. On the first ground that the tax payer incurred interest during the year of income, the applicant submitted that under S. 2(kk) of the Income Tax Act, interest is defined as "any payment, including a discount or premium, made under a debt obligation which is not a return of capital." The applicant submitted that under S. 35 of the NSSF Act, the interest payable by the applicant to its members is declared by the Minister after the end of the year of income. The interest is 2.5% p.a. or higher as declared by the Minister. The applicant submitted that the interest in S. 35 is computed on a member's balance at the beginning of the year of income and not the end. For instance, if for the financial year June 2013 to June 2014 the Minister declares the rate of interest by 1st October 2014 the said interest would be applied to the said financial year.

On the second ground, that interest was paid as a result of a debt obligation, the applicant submitted that a debt obligation is defined under S. 2(s) of the Act as "an obligation to make a repayment of money to another person including accounts payable and the obligations arising under promissory notes, bills of exchange and bonds." The applicant submitted that it has an obligation under S. 19 of the NSSF Act, to repay the contributions from its members in the form of benefits with interest from investments made. The applicant submitted that the debt obligation would exist irrespective of whether interest is charged or not. The applicant submitted further that the interest payable to members for using their funds is similar to the cost of borrowing for the fund. If the applicant did not use member's funds but borrowed from banks to invest, it would pay interest to the banks and that interest would be tax deductible. The applicant submitted that Mr. Henry Saka admitted that the interest being paid by financial institutions was an allowable deduction for them. Similarly, interest paid by the applicant to its members as a result of their contribution should be deductible.

On the third ground, that interest must be incurred in the production of income, the applicant cited **Commissioner for Inland Revenue v Allied Building Society** *1963(4) SA 1(A)* and **Commissioner for Inland Revenue v Standard Bank of South Africa Ltd** (*81/85) 1985 ZASCA 63* and the testimony of Mr. Patrick Ayota that the member's

contributions are used in the production of its income and argued that without the income earned by the applicant through the use of its members contributions the applicant would not be in a position to pay interest. The applicant concluded therefore that the interest is incurred in the production of income.

On the last ground, the applicant submitted that the investment income that it earns constitutes its gross income under S. 17 of the NSSF Act. Mr. Ayota submitted that the applicant earns income by investing monies from the member's contributions which constituted its gross income.

The applicant submitted that the decision to deduct the interest expense was based on the advice of the respondent in its letter of 23rd August 2001 which stated that interest to member's accounts was an allowable deduction. The letter created a legitimate expectation in its mind that interest expense was an allowable deduction. The applicant cited **Republic v Kenya Revenue Authority Ex parte Universal Corporation Ltd** *M.A 460 of 2013* and ***Solar Now Services Ltd v URA*** *Application No. 3 of 2017* to contend that that it would be unfair and an abuse of the respondent's power to demand taxes amounting of to Shs. 42,196,249,077 when the letter allowed it to deduct interest.

The applicant submitted that it is not liable to pay penal interest. Citing S. 136 of the Income Tax Act it submitted that since the interest paid by the applicant to its members is a deductible expense, no penal taxes would arise. Without prejudice, it should not be penalized for relying on the respondent's advice as stated in the letter.

In reply, the respondent submitted that the interest paid to NSSF members by the applicant is not an allowable deduction since it fails to satisfy the conditions for deductibility under S. 25 of the Income Tax Act which are: a) That a debt obligation arose. b) That the debt obligation is incurred by a person in the production of income. c) That this income is included in gross income.

The respondent referred to *Black's Law Dictionary* 9th Edition to define 'debt' as "a liability on a claim, a specific sum of money due by the agreement or otherwise". It argued that since S.25 of the Income Tax Act mentions interest in respect of a debt obligation, there must be a debtor- creditor relationship. The intention of the law was to provide for deduction of interest where a taxpayer is indebted to another. The respondent argued that the interest members receive at the end of the year is a dividend or a profit earned by members and does not have bearing to interest arising from a debt obligation. The situation is different from where a person borrowed money from a bank at an agreed interest rate and is obliged to pay monthly instalments. The interest rate in banks is pre-determined at the time of execution of the loan agreement which sets out the terms of borrowing. Using the definition of "interest" in the Kenya NSSF Act and Sections 35 and 35(7) of the Uganda NSSF Act, the respondent submitted that the interest paid to NSSF members is like a dividend and is not from a debt obligation, but investment income. Interest is determined at the end of the year at the applicant's annual general meeting or by a Minister's declaration. The respondent argued that since the interest is determined at the year end, it did not constitute an existing obligation which arose in the course of that year and cannot be incurred as an expense for tax purposes. It cited **AM Bisley & Co. Ltd v CIR** *(1985) TNZTC 5082* where the court held that "A particular expenditure is incurred for tax purposes in any year if it constitutes an existing obligation which arose in the course of that year."

The respondent submitted that S. 25(1) of ITA does not apply to the applicant as there is no debtor- creditor relationship but rather a trust and fiduciary relationship. The respondent cited **National Security Fund v Makerere University Guest House** *Civil Suit No. 525/2015* where the court stated that the fund belongs to members and it is trust fund held for the benefit of its members and from which benefits are paid out of whereupon the members account is closed. The respondent cited Philip .H. Pettit *"Equity and the Law of Trust* "(1976) 4th Edition which defined 'trust' to mean a right of property held by one person called the trustee for the benefit of another person. The respondent argued that a trust creates an obligation under which a person to whom property is conveyed or transferred is bound in equity to deal with the property as such. The applicant owes a

fiduciary duty to its members and it is supposed to manage their funds and earn profits which are eventually distributed to them. The fund profits are not in the form of interest as provided for under the Income Tax Act.

The respondent submitted that the employers and employees are mandatorily required by law to contribute savings to the applicant, therefore a debt obligation does not arise as there is legal compulsion. S. 7 of the NSSF Fund Act provides for compulsory registration of employers and eligible employees. It concluded that the interest and contributions are made to a members account under a compulsory scheme established by the government for the benefit of the workers.

The respondent submitted that it was not bound by its letter of 23rd August 2001 where it indicated that interest paid to the applicant's members constituted an allowable deduction under S. 25 of the Income Tax Act. The respondent submitted that its letter of 20th November 2013 disallowing the said interest as an expense took precedence over the previous letter.

The respondent submitted that S. 136 of the Income Tax Act provides for the imposition of penal interest on unpaid tax. The respondent submitted also Article 17 of the Constitution requires every citizen to pay taxes promptly. The respondent submitted further that the law did not permit it to waive penal interest.

In rejoinder, the applicant argued that the respondent was wrong to treat the interest paid to its members as a dividend or profit. The interest envisaged under S. 35 of the NSSF Act is not a dividend because members of the fund are not shareholders. The applicant contended that under S. 22 of Public Enterprises Reform and Divestiture Act Cap. 98, the applicant is 100% fully owned by government. It averred hat the applicant is not a trust. The applicant contended that the issue of trust was a new argument introduced by the respondent contrary to S. 16(4) of the Tax Appeals Tribunal Act. The applicant cited **Steel Corporation Of East Africa Ltd v Uganda Revenue Authority** *H.C.C.A 2010* where it was held that cases have to be decided on the issues on record.

The applicant also submitted that the penalty imposed by the respondent under S.136 of the ITA Act is illegal. In the alternative, the applicant prayed that should the tribunal find that the principal tax is due and payable, then it should not be penalized because it was the fault of the respondent.

Having listened to the evidence and read the submissions of the parties, this is the ruling of the tribunal.

The applicant is established by the NSSF Act S.2, "into which there shall be paid all contributions and all other payments made in accordance with this Act and out of which there shall be paid all benefits and other payments required by this Act." Under Sections. 7, 11, 12 and 13 of the Act, employers and employee, who were deemed members, are supposed to make contributions to the Fund. Under S. 30 of the Act, the monies in the funds are invested. Under S. 35 of the Act the Minister of Finance and Economic Development declares interest payable to the beneficiaries. S. 35(1) reads;

> "Subject to this section, interest at the rate declared by the Minister calculated on the balance standing to the credit of the account of the members of the funds on the first day of the financial year shall be added to the account of every member of the fund for each financial year throughout which it has been open if no benefit has been paid out"

The rate of interest applicable is 2.5% p.a. The Minister may declare a higher rate.

The issue in this dispute is whether the interest paid to NSSF members' account is a deductible allowance under the Income Tax Act? S. 25(1) of the Income Tax Act which provides for interest as a deductible allowance reads;

> "Subject to this Act, a person is allowed a deduction for interest during the year of income in respect of a debt obligation to the extent that the debt obligation has been incurred by the person in the production of income included in gross income."

The applicant treated the interest paid to member's account as an allowable deduction under S. 25(1) of the Income Tax Act, which the respondent objects to on the ground that it should be considered as a return on an investment.

In order to decide the above issue, the Tribunal will divide it into the following sub-issues.

i) Whether the contributions by the applicant's members create a debt obligation within the meaning of Sections 25(1) and 2(s) of the Income Tax Act?

ii) Whether the amount referred to as interest under S. 35 of the NSSF Act qualifies as interest for the purposes of Sections 25(1) and 2(kk) of the Income Tax Act?

iii) Whether the interest is incurred "in the production of Income included in the gross income"?

On sub issue i), the term "debt obligation" is defined under S. 2(s) of the Income Tax Act as "an obligation to make a repayment of money to another person, including accounts payable and the obligations arising under promissory notes, bills of exchange and bonds." Under S.2 of the Act there is an obligation to make a repayment of money to another person. These includes accounts payable, which is defined by *Black's law Dictionary* 10th Edition as "an account reflecting a balance owed to a creditor; a debt owed by an enterprise in the normal course of business dealing". Notes payable are debts created by formal legal instruments. (See *Financial & Managerial Accounting* – Belverd E- Needles, Marian Powers, Susan v Crosson). A promissory note is defined under S. 82 of the Bills of Exchange Act, as "an unconditional promise in writing made by one person to another, signed by the maker, engaging to pay on demand or at a fixed or determinable future time, a sum certain in money, to, or to the order of, a specific person or to bearer." A bill of exchange is defined under the same S. 2 as "an unconditional order in writing addressed by one person to another, signed by the person giving it, requiring the person to whom it is addressed to pay on demand or at a fixed or determinable future time a sum certain in money, to, or to the order of, a specific person or to bearer". A bond is described by Silvester E. Quindry, "*Bonds & Bondholders; Rights and Remedies*" as follows;

> "The distinguishing feature of a bond is that it is an obligation to pay a fixed sum of money at a definite time, with a stated interest, and it makes no difference whether a bond is designated by that name or some other, if it possesses the characteristics of a bond.

The said list is not exclusive. However the common thread is that there is a debt owed by one person to another creating an obligation to pay.

Under the *ejusdem generis* rule of statutory construction, where general words follow an enumeration of two or more things, they apply only to persons or things of the same general kind or class, specifically mentioned. In other words one should use the specific objects or things explicitly set forth in the Statute to determine what other objects or things the legislature intended to include. Applying the said rule of construction to the facts of our case, in determining whether the contributions made to the NSSF constitute a debt obligation within the meaning of Sections 25(1) and 2(s) of the Income Tax Act, we must determine whether these contributions are things of the same general kind or class of the other items specifically mentioned in S. 2(s). Accounts payables and notes payable which are things of same general kind or class are current liabilities in a company's balance sheet. *Black Law Dictionary* 10th Edition p. 1054 defines current liability as "a business liability that will be discharged wit current assets or by creating other current liabilities within a year." "Also termed short- term debt." It is apparent that the intention of the legislature was to restrict the meaning of the term "debt obligation" to debts payable by a company within a short period or namely, a company's current liabilities. For an item to be included, among the things specifically mentioned under S. 2(s) it must be a current liability in a company's balance sheet In other words, The contributions made to NSSF are not current liabilities in the applicant's balance sheet because they may not be payable within a short period.

Under Sections 11 and 12 of the NSSF Act an employer deducts 15% of the employee's salary which it remits to NSSF. The employer's contribution is 10% while that of the employee is 5%. NSSF has no obligation to repay the employer the amount it contributes. The employer cannot be considered to be a lender or creditor. The interest that members are entitled to is added to the account of the member under S. 35 of the Act. The obligation to pay to the member is conditional. Mr. Ayota, testified that the contributions are paid back to the members when they become eligible: Either when they attain the age of 55, or when a member dies and has survivors, or when a member is physically or mentally disabled, or when a member leaves the private sector or when a member emigrates from Uganda. All these are set out in the NSSF ACT. Mr. Ayota's testimony shows that save for the attainment of the age of 55 years, the other conditions for eligibility are uncertain.

The relationship between NSSF has been discussed in court decisions. In **National Security Fund v Makerere University Guest House** *Civil Suit No. 525/2015* the court stated that "the fund belongs to the members and it is a trust fund held for the benefit of its members and from which benefits are paid out of whereupon the members account is closed." The court further went on to state that "the money is supposed to be invested so that members get a return of profit on their investment." The court noted that:

> "A trust is an arrangement whereby money or property is owned and managed by a person, persons, a corporation or organization for the benefit of another person or persons. The manager is called the trustee who is the legal owner of the trust property and who is under a duty imposed by law or equity to hold the property for the benefit of one or more individuals or organizations called the beneficiary of the trust property. In express trusts the beneficiary is named in the instrument creating the trust. The trustee owe a fiduciary duty to the beneficiaries and in this suit the trust is created and governed by the NSSF Act managed by a board and employees who are charged with management of the property of the members until when the property is transferred back to the beneficiary for whom the trust is created by Parliament. They are required to pay back with interest and do not have a beneficial interest in the fund other than reasonable remuneration and lawful fees and charges."

The above decision clearly summarizes the obligations of NSSF in respect to its members. What is clear is the relationship between NSSF and the members is that of trustee-members or beneficiaries who may not be named. The beneficiaries of the Fund to do not necessarily have to be the members who contributed. The beneficiaries in the event of death maybe the estate of the deceased employee. The relationship between NSSF and members is not that of a debtor/creditor. NSSF owes a fiduciary duty to the members and beneficiaries. The contributions by the applicant's members do not create a debt obligation within the meaning of Sections 25(1) and 2(s) of the Income Tax Act as what is involved is a trustee-members'/beneficiaries' relationship.

The Second ground the Tribunal has to consider is: Whether the interest under S. 35 of the NSSF Act qualifies as interest for the purposes of Sections 25(1) and 2(kk) of the Income Tax Act? We have already stated that under S. 35 of the NSSF Act, NSSF puts

interest on the members' accounts. The Income Tax Act does not define interest. However, the term "interest" under S. 2(kk) of the Income Tax Act is interpreted to include—

> "(i) any payment, including a discount or premium, made under a debt obligation which is not a return of capital;
> (ii) any swap or other payments functionally equivalent to interest;
> (iii) any commitment, guarantee, or service fee paid in respect of a debt obligation or swap agreement; or
> (iv) a distribution by a building society;"

Mr. Ayota, testified that the applicant's members expect to earn a return from their contributions which he likened to the cost of borrowing their money. The applicant contends that the interest it pays to the members accounts falls within S. 2(kk) of the Income Tax Act. On the other hand, the respondent contends that what the applicant pays its members is not interest but a return on investment.

The term interest has a wide meaning. *Black's Law Dictionary* 10th Edition p.934 defines it as "1. The object of any human desire or profit of a financial nature... A legal share in something." However *Black's Law Dictionary* p. 938 defines interest rate as "The percentage that a borrower must pay to a lender for the use of the money." The Income Tax Act is concerned with the interest a borrower pays a lender for the use of its money.

In the Australian decision of **The Federal Commissioner of Taxation v Century Yuasa Batteries Pty Ltd** *(1998) 82 FCR 288*, the Federal Court defined "interest" as follows; "interest is the return, consideration or compensation for the use or retention by one person of a sum of money belonging to or owed to another..." So the question is, whether interest, under S. 35 of the NSSF Act, is compensation for the use of the contributions made to the applicant by its members. The Tribunal thinks that the interest paid by NSSF may be compensation for use of members' contributions.

The definition of interest **in The Federal Commissioner of Taxation v Century Yuasa Batteries Pty Ltd** (supra) includes money owed to another. The Income Tax Act S. 25(1) mentions a debt obligation. This implies the existence of a lender-borrower relationship.

Therefore the interest should be in respect to one a borrower pays a lender. We already stated that for interest to be paid under the NSSF Act certain conditions must be met. S. 19 of the NSSF Act sets out conditions where beneficiaries of the fund may receive their benefits. These are i) age and withdrawal benefit, when a member attains the age of 55 years, ii) invalidity benefit when a member of the fund is subject to such physical or mental disability as to lead to permanent total incapacity iii) Emigration grant when a member emigrates permanently from Uganda to a country with which no reciprocal arrangement under the Act. iv)Survivor's benefit paid to the dependent relatives of a deceased's member. An NSSF member does not have the right to make a demand for immediate repayment of his contribution. NSSF is not a borrower. It is an investor/trustee. Though interest paid under the NSSF Act is compensation, the intention of the legislature was that it ought to have arisen as a debt obligation or under a lender- borrower relationship.

Lastly, S 25(1) requires that for interest to be allowed as a deduction it should have been incurred in the production of income. In **Ralli Estates Ltd v The Commissioner of Income Tax** *[1961] 1 E.A 48 [P.C]* Lord Denning stated:

> "Their Lordships prefer therefore to turn back to the words of the Act and ask whether the payments were expenses wholly or exclusively incurred "in the production of income" of the payer and this means that you must look at the purpose of the payments. Were they paid in order to acquire a capital asset? Or for a capital purpose? If so, they are capital expenditure. But if for an income purpose they are revenue expenditure.

Mr. Ayota testified that the applicant uses the contributions to make investments such as the purchase of government bonds, treasury bills, other securities, equity investments in high profile companies and investment in properties such as land and rental property. However after making such investments and earning profits, NSSF pays interest to the members' account. The question that arises is that is the interest paid to the member's account a payment for production of income, or of an expense of capital nature or is it a return on investment. Justice Madrama in **National Security Fund v Makerere University Guest House** (supra) stated that "the money is supposed to be invested so that members get a return of profit on their investment." He further states that NSSF is required to pay back with interest." The said interest is not a payment of an expense of income or capital nature but a return of investment. The members of NSSF are like

shareholders who invest in a company's ventures with an intention of obtaining dividends. Returns on investments like dividends are issued after all expenses have been deducted and profits taxed.

S. 38 of the NSSF Act provides that any benefit paid under this Act shall be exempt from income tax. S. 1 defines a benefit to mean any benefit payable under the Act. S. 35 of the Act provides that interest shall be put on the member's account. S. 19 provides for the benefits payable. S. 19(3) states the amount of the benefits payable shall be the balance on the members account in the fund at the date of payment. The benefit includes the contribution paid by members plus interest. This implies that the interest paid on member's account is also exempt from income tax. For an item to be taxable or exempt from income tax it must have been realized after all expenses have been paid, profits realized and taxed. After profits have been taxed what remains to be issued are the returns on investment like dividends. Therefore if interest is not taxable and is a return on investment then it cannot be an expense incurred in the production of income included in the gross income. If all the parties had read S. 38 of the NSSF Act and understood it, this dispute would not be there. It resolves the whole dispute *ab initio*. The intention of the legislature was NSSF was supposed to pay interest after the realization of taxed profits.

Having determined that;

a) The contributions by the applicant's members do not constitute a debt obligation within the meaning of Sections 25(1) and 2(s) of the Income Tax Act;
b) The amount referred to as interest under S.35 of the NSSF Act does not qualify as interest for the purposes of Sections. 25(1) and 2(kk) of the Income Tax Act?
c) The interest paid by the applicant was not incurred in the production of income included in the gross income.

We find that the interest payable to the NSSF members is not a deductible allowance under the Income Tax Act.

As an alternative argument, the applicant submitted that the respondent's letter of 23rd August 2001, created a legitimate expectation in its favour that interest was an allowable

deduction. The said letter was written to the Chief Accountant by the Commissioner, Large Taxpayer's department. It states that interest to members' accounts has been revisited and accepted as an allowable deduction. It is apparent that the respondent's said letter did not reflect the correct position of the law. The said letter is for the returns for the years 1993 to 1998. The dispute before the Tribunal is for the period 2005 to 2012. Most likely the applicant deducted interest as an allowable deduction for the years 1993 to 1998 which the respondent is not seeking to recover in this application.

However the said letter created an expectation that interest paid by the applicant was a deductible allowance. Legitimate expectation arises from a conduct, practice or treatment whereby one reasonably expects a benefit to arise. The High Court of Kenya in **Republic and Others v Attorney General** *[2006] 2 EA 265* stated that:

> "The principle which justifies the importance of procedural protection has come to be known as legitimate expectation. Such an expectation arises where a person responsible for taking a decision has induced in someone who may be affected by the decision a reasonable expectation that he will receive or retain a benefit...."

In **Council of Civil Services Union v Minister for Civil Service** *[1985] AC 374* Lord Fraser said:

> "A legitimate expectation may arise either from an express promise given on behalf of a public authority or from the existence of a regular practice which the claimant can reasonably expect to continue..."

In **R v IRC, ex p MFK Underwriting Agencies Ltd.** [1989] STC 873 Bingham LJ. Linked the concept of legitimate expectation with estoppel in saying:

> "If in private law a body would be ... estopped from so acting a public authority should generally be in no better position. The doctrine of legitimate expectation is rooted in fairness."

He went to say that:

> "...If a public authority so conducts itself as to create a legitimate expectation that a certain course will be followed it would often be unfair if the authority were permitted to follow a different course to the detriment of the one who entertained the expectation..."

Therefore it is not in dispute where a party has been unfairly treated it may rely on the doctrine of legitimate expectation.

However the question is: is the doctrine helpful where there is a statutory obligation? The Tribunal has already held that interest paid by the applicant cannot be considered as an allowable deduction. Is the respondent's letter of 23rd August 2001 helpful? In **Tullow v Uganda Revenue Authority** *TAT 4 of 2011* the Tribunal held that to rely on the doctrine of legitimate expectation, the expectation has to be legal. It cannot be used to legalize an illegality. There are number of court decisions to that effect. These include the following. In **Al Fayed and others v Advocate General for Scotland** [2004] S.T.C 1703, the court noted:

> "...under our domestic law a legitimate expectation can only arise on the basis of a lawful promise, representation or practice. There can be no legitimate expectation that a public body will continue to implement an agreement it has no power to do so.

In **R v Inland Revenue Commissioners ex parte MFK Underwriting Agents Limited** (supra), the court stated that:

> "Every ordinary sophisticated taxpayer knows that the Revenue is a tax-collecting agency, not a tax-imposing authority. The taxpayers' only legitimate expectation is, prima facie that he will be taxed according to statute, not concession or a wrong view of the law. ... 'One should be taxed by law, and not be untaxed by concession'."

In **Republic v National Environment Management Authority ex-parte Sound Equipment Limited** *[2010] eKLR*, the court stated that (p. 8-9):

> "A legitimate expectation cannot arise where the respondent had acted contrary to, i.e. the law...
>
> The law cannot allow an individual to retain a benefit which is the subject of the legitimate expectation, if creating or maintaining the benefit is beyond the power of the public body or officer."

As regards estoppel, in **KM Enterprises Ltd and Others v Uganda Revenue Authority** *HCT-00-CC-CS-0599-2001* Egonda Ntende J. held that the exercise of statutory powers and duties, could not be fettered or overridden by agreement, estoppel, lapse of time, mistake and such other circumstances. Relying on these decisions, we find that the respondent should not, in the exercise of its statutory duty of collecting taxes be fettered by its letter of 23rd August 2001.

The last issue before the Tribunal was: Whether the applicant should pay penal interest. The assessment the respondent issued had penal interest of Shs. 12,196,875,941 arising from the failure to pay the principal tax. The applicant argued that it didn't fail to pay tax nor was it required to pay tax. The Tribunal has already held that the applicant is liable to pay the principal tax. In respect of penal interest S. 136 of the Income Tax Act reads:

> "A person who fails;
>
> a) To pay any tax, including provisional tax;
>
> b) To pay any penal tax;
>
> c) To pay to the Commissioner, any tax withheld or required to be withheld by the person from a payment to another person, on or before the due date for payment is liable to interest at a rate equal to two percent per month on the amount unpaid calculated from the date on which the payment was due until the date payment was made."

Penal interest is a sanction or a punishment imposed by law for failure to pay tax in accordance with the law. For the applicant, to be found liable to pay the penal tax of Shs. 12,196,875,941 it must be shown that the applicant either failed to pay the principal and or the penal tax in time.

In **Informer No. TCI/002/07/06 v Uganda Revenue Authority** *HCCT-00-CV-CS-0579-2007* the court noted that if a person fails to pay tax imposed under the Statute on or before the due date, he is liable to pay a penal tax on the unpaid tax at the rate specified in the law. In **Uganda Project Implementation and Management Centre v Uganda Revenue Authority** *Constitution Petition 18 of 2007* the court noted that

> "Service delivery by Government is dependent upon prompt payment of taxes and taxes due and payable under the Act is considered a debt to Government. See section 35 of the Act. In this regard the tax payers are not given a lee way to determine when they should pay their taxes. That is why there is provision for imposing penalties and interest if taxes are not paid in time."

So when was the applicant required to pay the principal tax?

Black's Law Dictionary 10th Edition p.478 defines due date as "the date on which something is supposed to happen, especially as a matter of requirement." At p. 282 chargeable is defined to mean inter alia "requiring tax to be paid." S. 4 of the Income Tax

Act provides that "a tax known as income tax shall be charged for each year of income and is imposed on every person who has chargeable income for the year of income." S. 15 provides that "the chargeable income of a person for a year of income is the gross income of the person for the year less total deductions allowed under the Act." S. 2 defines a year of income to mean the 12 months ending on 30th June and includes a substituted and transitional year of income. A reading of the said Sections show that the chargeable income is supposed to be paid at the end of the year of income i.e. 30th June, which is supposed to be the due date, unless there is a substituted year of income. The penal tax has been calculated against the principal sum of Shs. 30,521,703,065 which the applicant ought to have paid for the period 2005 to 2012, if the interest paid to the applicant's members had not been considered as allowable deductions. There is no evidence that the applicant paid the principal tax on or before the due dates for the said years. If it had done so, the matter would not be in the Tribunal.

The applicant contended that it failed to pay the tax in time due to the advice of the respondent in its letter of 23rd August 2001. When S.136 of the Income Tax is juxtaposed with S. 65 of the VAT Act which beings with "Where a person knowingly or recklessly" commits an offence under the said section he is liable to pay penal tax, one cannot fail to notice that S. 136 imposes a strict liability to pay penal tax. That is a taxpayer who does not pay tax in time is liable to pay penal tax without the need to prove negligence on its part. We do sympathize with the applicant, but that is the law. In **Inland Revenue Commissioners v Duke of Westminster** *[1936] A.C.1* the court stated "... the words of a statute must be adhered to, and that so-called equitable constructions of them are not permissible." S. 136(3) of the Act provides that "Where good cause is shown, in writing, by the person liable for payment of interest, the Minister may, on the advice of the Commissioner, remit, in whole or in part, any interest charged under this Section." *Black's Law Dictionary* 10th Edition p.1486 defines remit as "To pardon or forgive". Just as much as we would wish to help the applicant, the powers to remit are vested in the Minster and not the Tribunal. It is only the Minister who can remit penal tax on the advice of the Commissioner, which he would be required to present before Parliament by Article 152 of the Constitution. We do not want to usurp those powers. The applicant can still show

good cause to the Minster. We accordingly find that the applicant is liable to pay the penal interest.

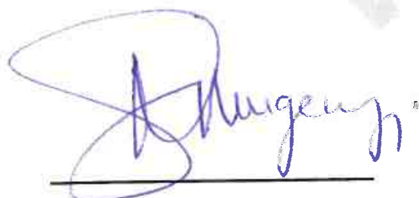
The court notes that the letter of 23rd August 2001 was for the years 1993 to 1998. The dispute before the Tribunal is for years 2005 to 2012. For the years 1993 to 1998 the applicant paid less tax on the basis of the letter. Any penal interest imposed for the years 2005 to 2012 may offset the shortage of tax paid for the years 1993 to 1998. So though the penal interest may be unfair, it is equitable. The applicant as custodian of the NSSF Act ought to have known that S. 38 of the Act does not allow the respondent to treat interest as an allowable deduction under S. 25 of the Income Tax Act. The respondent's statement that interest was an allowable deduction was retracted by the respondent's letter of 20th November 2013. Since 2013 to the filing of this application in 2019 the principal tax, apart from the 30% deposit, has not been paid. For the 6 years, from 2013 to 2019 penal interest has not been calculated nor demanded.

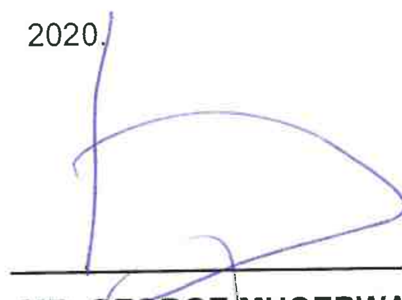
Having found, that the interest payable, to the applicant's members, is not a deductible allowance under the Income Tax Act and that the applicant is liable to pay penal interest, we order as follows;

1. The principal tax of Shs. 30,521,703,065 is due and payable by the applicant.
2. The applicant is liable to pay penal interest of Shs. 12,196,879,941
3. The respondent is awarded costs of this application.

It is so ordered.

Dated at Kampala this 27th day March 2020.





DR. ASA MUGENYI
CHAIRMAN

MR. GEORGE MUGERWA
MEMBER

THE REPUBLIC OF UGANDA

IN THE TAX APPEALS TRIBUNAL AT KAMPALA

TAT APPLICATION NO. 03 OF 2019

NATIONAL SOCIAL SECURITY FUND ==========================APPLICANT

VERSUS

COMMISSIONER GENERAL, UGANDA REVENUE AUTHORITY == RESPONDENT

RULING

I have had the opportunity of reading the ruling of my colleagues, the preparation of which I was substantially involved in. I agree that the principal tax should be paid. However I differ on the payment of penal interest. I would therefore wish to address the issue whether the applicant is liable to pay Penal Interest?

Penal interest is provided for under S. 136 of the Income Tax Act which states as follows;

"A person who fails;

a) To pay any tax, including provisional tax;
b) To pay any penal tax;
c) To pay to the Commissioner, any tax withheld or required to be withheld by the person from a payment to another person, on or before the due date for payment is liable to interest at a rate equal to two percent per month on the amount unpaid calculated from the date on which the payment was due until the date payment was made."

A reading, of the above provision, implies that penal interest is in the nature of a sanction or a punishment, for failing to pay tax, in accordance with the timelines set out under the law. It is to be implied, that penal tax will only be imposed, if the failure to pay the tax in time, was either willful or negligent, since something penal must necessarily be imposed for the commission of a wrong or for a negligent act.

For the applicant, to be found liable to pay the penal tax of Shs. 12,196,875,941, it must be shown, that the applicant's failure to pay the tax in question was either willful or negligent.

The penal tax has been calculated against the principal sum of Shs. 30,521,703,065.This principal sum, is a tabulation of the tax, the applicant ought to have paid for the period 2005 – 2012, if the interest paid to the applicant's members had not been considered as allowable deductions. The respondent's letters dated 23rd August 2001 and 20th November 2013, show that for the period 2005 to 2012, it was the position of the respondent that interest paid to the applicant's members was an allowable deduction. Consequently, in computing its taxes, the applicant, deducted the amounts representing the said interest, as expenses based on the position communicated to it by the respondent, that the said interest was deductible. All this, as the respondent's letters show, was done with the approval and knowledge of the respondent. No evidence has been led, by the respondent, to show that the applicant's failure to pay the tax, in question, in time, was either willful or negligent.

As far, as we can see, the penal interest has been applied retroactively, from the year 2005 to 2012 on the principal sum of Shs. 30,521,703,065. Penal interest can only be applied retroactively, if it can be shown that, the liability to pay tax had arisen at that point. However, in the instant case, where the assessment to pay tax was only made in the year 2014, we fail to see how the applicant can be required to pay penal interest in respect of a tax, that it had been made to believe, it was not liable to pay. I accordingly find that the applicant is not liable to pay the penal interest.

Dated at Kampala this 27th day March 2020.

MR. SIRAJ ALI
MEMBER