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CASE NOTE

Margaret Akiiki Rwaheru v Uganda Revenue Authority

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Abstract

Value Added Tax (VAT) is a tax on the value added at each stage of the production and distribution process and on the importation of goods. VAT registered importers in Uganda are charged the statutory VAT rate of 18 per cent, however, importers that are not VAT registered are charged both the 18 per cent and an additional 15 per cent, which is designated "Domestic VAT". The statutory basis of the 15 per cent is unclear. Domestic VAT appears to be a tax created by the Uganda Revenue Authority in a bid to raise revenue from a largely non-compliant base. The legality of the tax was challenged in *Margaret Akiiki Rwaheru and 13,945 Others v Uganda Revenue Authority*. The court ruled that Domestic VAT was irregular when applied to importers who qualified to register for VAT but had not registered, but was illegal when applied to importers who did not qualify to register for VAT. Despite this ruling, the URA has continued to charge all importers Domestic VAT, regardless of whether they qualify to register for VAT. This article seeks to re-examine the legality of Domestic VAT.

Keywords

Taxation, VAT, tax disputes, importation, Uganda

INTRODUCTION

Value Added Tax (VAT) was introduced in Uganda with the enactment of the Value Added Tax Act (VAT Act) in 1996.[1] VAT was initially charged at a single rate of 17 per cent but this was increased to 18 per cent in 2005.[2] VAT is a broad-based tax on consumption collected at different stages of the supply chain on the value added at each stage. Each VAT registered trader charges the purchaser VAT as if the purchaser were a final consumer. If the purchaser is VAT registered, the law allows them to claim an input credit for the tax where the purchase was for use in the business and not personal consumption.[3]

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1 Cap 349.

2 The Value Added Tax (Rate of Tax) Order SI No 51 of 2005.

3 VAT Act, sec 28(1).

VAT is charged on every "taxable supply".[4] A taxable supply is defined as the supply of non-exempt goods or services made in Uganda by a taxable person for consideration as part of his or her business.[5] A taxable person is defined as a person who is registered or is required to be registered for VAT.[6] VAT is also levied at the point of importation.[7] Unlike VAT on taxable supply, VAT on importation is charged on goods and services without consideration as to whether they are to be used as part of a business activity. The taxable value of imported goods is the customs value of the goods.[8] To the VAT registered importer, VAT on imported goods is an input tax on which credit can be claimed.[9]

In an ideal situation, VAT registration would be mandatory for all traders dealing in VATable supplies (items that are not exempt from VAT). However, small and medium enterprises (SMEs) are exempt from VAT registration, primarily because the administrative and compliance costs would exceed the VAT revenues from their activity.[10] In Uganda, the initial threshold for VAT registration was a gross turnover of UGX 20 million (USD 5,700). This resulted in a bloated VAT taxpayer register that included many traders who were unable to cope with the rigorous accounting needed for compliance. To ease the administrative burden, the VAT threshold was increased to UGX 50 million (USD 14,300).[11] In 2015, the threshold was further increased to UGX 150 million (USD 43,000).[12] If businesses meet the threshold but do not register voluntarily, the Uganda Revenue Authority (URA)[13] can register them.[14] When a person qualifies to register but does not register, the penalty is double the tax that would have been due had they registered when they were supposed to.[15]

FACTS

In *Margaret Akiiki Rwaheru and 13,945 Others v URA* (*Rwaheru v URA*),[16] the plaintiff brought a suit in a representative capacity on behalf of herself and 13,945 others, seeking a declaration that a tax known as "Domestic VAT", which had

4 Id, sec 4.
5 Id, sec 18(1).
6 Id, sec 6.
7 Id, sec 4.
8 Id, sec 23.
9 Id, sec 28(1)(b). Except in a few instances, import VAT is generally disallowed as an input credit for services.
10 WJ Turnier "Accommodating to the small business problem under a VAT [sic]" (summer 1994) 47/4 *The Tax Lawyer* 963 at 963.
11 G Cawley and J Zake "Tax reform" in F Kuteesa et al (eds) *Uganda's Economic Reforms: Insider Accounts* (2010, Oxford University Press) 103 at 109.
12 VAT Act, sec 7(2), amended by the Value Added Tax (Amendment) Act No 5 of 2015.
13 The URA is the country's tax administration body set up under the Uganda Revenue Authority Act cap 198.
14 VAT Act, sec 8(6).
15 Id, sec 65(1).
16 [2014] UGCOMMC 2.

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been charged on the goods that she, and those she represented, had imported, had no legal basis and was therefore unconstitutional. In addition to the statutory import VAT of 18 per cent, importers who were not VAT registered were being charged a tax called Domestic VAT at a rate of 15 per cent. The total combined VAT paid by a non-registered importer was therefore 33 per cent. Domestic VAT was charged on imported VATable goods with a value of UGX 4 million (USD 1,150) or more. Once it was determined that the value of the goods exceeded UGX 4 million and that the importer was not VAT registered, the additional 15 per cent charge known as Domestic VAT was added automatically. The VAT Act does not provide for a "Domestic VAT" tax and there is no other statute that provides for it. Nonetheless, the tax has been charged since 1 March 2002.[17]

COURT PROCEEDINGS

The URA admitted to collecting Domestic VAT, so the plaintiffs applied for judgment on admission, leaving the only question for the court to determine to be whether the URA was lawfully mandated to collect Domestic VAT.

The plaintiffs argued that, under article 152(1) of the Ugandan Constitution (the Constitution), no tax can be imposed except under the authority of an act of Parliament and Domestic VAT was not authorized by Parliament. They further challenged the rate of 15 per cent, arguing that it too had no basis in law, as the only rate provided by statute was 18 per cent.

The URA argued that the commissioner general had powers under section 32(1)(c) of the VAT Act to assess the amount of VAT payable, once she had reasonable grounds to believe that a person would become liable to pay tax but was unlikely to pay the amount due. That section provided that: "[w]here the Commissioner General has reasonable grounds to believe that a person will become liable to pay tax but is unlikely to pay the amount due, the Commissioner General may make an assessment of the amount of tax payable by that person."

The URA further asserted that Domestic VAT was not charged at 15 per cent, rather that the figure was arrived at by applying the 18 per cent to an assumed mark-up on the supply of the goods imported. The 15 per cent was a fraction representing the expected value added on imports between the stages of importation and sale in the domestic market, taking into account costs incurred as well as the profit margin. The URA claimed that this figure was arrived at as a result of a survey it had done, although no survey report was submitted as evidence. "Domestic VAT" was therefore simply an advance VAT assessment under a different name for administrative convenience. The URA argued that the plaintiff was free to file returns and claim a refund or

17 O Tindyebwa "Why does URA collect domestic VAT?" (13 June 2007) *Daily Monitor* (Kampala), available at: <https://allafrica.com/stories/200706130361.html> (last accessed 8 April 2020).

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pay the tax depending on the difference between the input and output tax. Finally, the URA argued that the law prescribed a procedure for objecting to VAT assessments, which the plaintiffs had not explored. In rejoinder, the plaintiffs argued that the VAT Act required the URA to register a person before assessing them for VAT on taxable supplies. Charging Domestic VAT as an advance assessment for the future taxable supply of imported goods amounted to charging the tax without first registering the person for it.

DECISION

The court noted that the URA had not shown any evidence of the alleged survey on which it claimed to base its computation of the mark-up. However, the court proceeded without the survey, as it would have primarily been useful in explaining how the rate of 15 per cent had been arrived at, not whether Domestic VAT had a legal basis.

The court accepted the URA's argument that Domestic VAT was an assessment under section 32 of the VAT Act. The court considered that, while other provisions of the VAT Act, such as section 31 that imposes a duty to file returns, refer to a "taxable person", section 32 (which allows the commissioner general to make assessments) refers to a "person". A taxable person under the VAT Act is defined as a person who is registered or is required to be registered for VAT.[18] The court concluded that Parliament deliberately omitted the use of the phrase "taxable person" and instead used "person" under section 32(1) of the VAT Act, with the result that a person does not have to be VAT registered when the commissioner general, on reasonable grounds, believes them to be unlikely to pay the tax due.

However, the court noted that, in making the assessment under section 32(1)(c), section 32(3) requires the commissioner general to use "the best information available" to her to estimate the tax payable. The court considered that applying a fixed rate of 15 per cent for every taxpayer, regardless of the value of the item imported, breached this requirement. The court noted that the law treats a person making a taxable supply and a person importing goods as separate and distinct, even if they are sometimes the same person. VAT on imported goods is an input tax payable by any importer, whereas VAT on taxable supplies is an output tax payable upon making a taxable supply. Thus, while VAT on imported items is applied regardless of their purpose, VAT on taxable supplies is restricted to business activity. Domestic VAT blurred this distinction by charging both taxes at the same time. As a result of blurring this distinction, Domestic VAT was applied regardless of whether there would be a subsequent taxable supply of the imported goods as part of a business activity, which is a legal prerequisite for VAT on taxable supply to apply under the VAT Act.[19] The URA had to assume that the imported goods

18 VAT Act, sec 6.
19 Id, sec 18(1).

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would be supplied in a business activity in order to apply Domestic VAT, yet this was not necessarily so. Individuals could import items for private use. According to the court, the question of whether a subsequent taxable supply would take place was a question of fact on which some modicum of evidence was necessary before the commissioner general could legally make her assessment. The Domestic VAT procedure was grounded more in administrative convenience for the URA than in actual facts. Some objective criteria for each specific case were necessary before Domestic VAT could be charged. The court found it "objectionable to make a general conclusion with regard to the possibility of any person or persons being unlikely to pay tax which will become due before considering the merits of each case".[20] Therefore, section 32(1)(c) could only be invoked on one taxpayer at a time and could not be applied in blanket form to cover a general category of taxpayers as the URA was doing.

The court concluded that Domestic VAT was an irregular, but not illegal, assessment when made in respect of an importer who qualified to register for VAT but had not registered. In such a scenario it had to be charged on a case-by-case basis and on the basis of information leading to a reasonable belief that the supplier of the taxable supply was unlikely to pay the VAT. Domestic VAT was, however, illegal when charged in respect of importers who did not qualify to register for VAT and where there was no reasonable basis for believing that they qualified or were going to make a subsequent taxable supply.

Regarding the plaintiffs, the court held that the question of whether any of the plaintiffs had ever supplied the imported goods as taxable supplies in Uganda was a fact necessary to finalize their suit on the merits. The plaintiffs were therefore required to object to the Domestic VAT assessment through the procedures provided for by the VAT Act.

COMMENTARY

Continued application of Domestic VAT

Despite this ruling, the URA has continued to charge Domestic VAT on every importer of VATable items who is not VAT registered. However, in the aftermath of the ruling, the URA expunged any reference to Domestic VAT from its issued guidelines.[21] The URA's official description of Uganda's tax structure makes no mention of Domestic VAT.[22] The taxpayer will only encounter it on the assessment at the point of payment for import duties. The tax has resulted in considerable revenue since the ruling, which was delivered on 10 January 2014. Import VAT paid by persons who were not VAT registered amounted

20 *Rwaheru v URA*, para 62.

21 The URA's guidelines on importation included a reference to Domestic VAT, as was highlighted in *Rwaheru v URA*: URA "What is Value Added Tax (VAT)?" (vol 2/4, FY 2016–17).

22 URA Research and Planning Division "Uganda's tax structure FY 2017/18" (2018, URA).

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to UGX 15 billion (USD 4.3 million) for the financial year 2014–15[23] and UGX 30.7 billion (USD 8.7 million) for the financial year 2015–16.[24]

The URA's continued application of Domestic VAT is a blatant violation of the court's ruling, which required a case-by-case application of advance VAT assessments. The URA has been able to get away with this because of the court's somewhat ambiguous ruling. Although the court concluded that Domestic VAT was illegal when applied to persons who did not qualify to register for VAT, the court agreed with the URA that the plaintiffs had to go through the statutory objections process in order to prove that they did not qualify to register. This means that, even when the importer does not qualify for VAT registration either because they are not making a subsequent taxable supply or because they do not meet the threshold for registration, the URA can charge Domestic VAT and the importer would have to go through the statutory objections and appeals process to secure a remedy. This process is tedious, time consuming and tilted in favour of the URA such that the taxpayer is likely to find it easier to pay the assessment than to object and appeal against it.[25] Given the nature of this process, and the fact that most taxpayers who can prove that they do not qualify to register for VAT are likely to be in the lower income bracket and would find the costs involved very high, the URA can continue to charge Domestic VAT illegally, with little risk of a law suit.

Statutory and constitutional interpretation

The court's ruling in this case is at odds with the general understanding that tax statutes are to be strictly construed. The court acknowledged that the blanket application of a rate of 15 per cent as an advance assessment on persons who qualify to register for VAT was contrary to the statute, which clearly envisages a case-by-case application, although it concluded that this was irregular not illegal. Tax statutes are strictly construed. Where the language of a tax statute is plain and unambiguous, the words of the statute should be given their ordinary and strict interpretation.[26] This approach is rooted in the fact that tax statutes have the effect of depriving one of ownership of one's property

23 URA *Annual Report 2014/15* (2015, URA) at 52.

24 URA *Annual Report 2015/16* (2016, URA) at 74.

25 The objections and appeals procedures are as follows. Any person dissatisfied with an assessment may lodge an objection with the URA commissioner general within 45 days of receiving the assessment. She must then issue a decision affirming, reducing, increasing or otherwise varying the assessment within 90 days from the date the objection is filed. A person dissatisfied with an objection decision may within 30 days of receiving the decision apply to the Tax Appeals Tribunal (TAT) to have the decision reviewed. TAT was set up under the authority of the Constitution and an act of Parliament to review decisions by the URA. A taxpayer must deposit 30% of the tax assessed by the URA before contesting a final resolution of an objection before TAT: TPC Act, secs 24 and 25.

26 *Ntale v URA* [2012] UGCOMMC 80.

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guaranteed under the Constitution.[27] As such, they are statutes that limit people's rights and therefore should be strictly construed.[28] Any departure from the words of a tax statute should ordinarily be treated as illegal, not merely irregular.

The court's ruling is also at odds with the requirement that the purpose and effect of any action be taken into consideration in determining its constitutionality.[29] The full implications of Domestic VAT were not considered by the court. The court did not consider the fact that Domestic VAT creates a penalty for non-registration that is not rooted in statute. Charging Domestic VAT on an importer who qualifies to register for VAT, but has not registered, in effect creates the denial of input tax credit as another penalty for non-compliance with VAT registration requirements. Given the strict construction that tax statutes require, only penalties prescribed by law should be applied. Where the importer does qualify to register for VAT but has not registered, the proper procedure under the VAT Act would be to register the importer for VAT and then assess them.[30] Assessing them without a VAT registration denies the importer the opportunity to claim import VAT as an input tax credit. While this may be perceived as not particularly egregious given that the importer has been non-compliant by not registering, denying a non-compliant taxpayer the right to claim input tax credit is not one of the penalties prescribed under the law. The VAT Act already prescribes a penalty of double the tax due for non-registration after an importer qualifies.[31] Considering that tax statutes are strictly construed, no other penalty can be legally applied except that specified by statute.

Consideration of VAT registration requirements

Significantly, the court limited its analysis of Domestic VAT to whether the person assessed would make a subsequent taxable supply, without consideration of whether they meet the registration threshold. This presupposes that every importer of VATable items above the value of UGX 4 million engages in business activity with a gross turnover of UGX 150 million and should therefore be VAT registered. In 2002 when Domestic VAT was instituted, importation was difficult and expensive, requiring considerable resources. It was only relatively large businesses that were able to engage in importation. Moreover, the VAT threshold for registration was a gross turnover of only UGX 50 million. It was therefore reasonable to assume that there was a very high chance that every importer qualified to register for VAT. Today this is not the case. The internet and other technological developments have revolutionized the way cross-border business is carried out. Communication across

27 The Constitution, art 26.
28 *URA v Rabbo Enterprises (U) Ltd* SCCA No 12 of 2004.
29 *Attorney General v Silvatori Abuki* SCCA No 1/98.
30 VAT Act, sec 8(6).
31 Id, sec 65(1).

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continents has been simplified such that today's importers need not have the kind of resources that previous importers had.[32] SMEs with a gross turnover well below UGX 150 million are now able to engage in importation, which was previously the preserve of large businesses with well-established overseas contacts. Ordinary individuals that are not even engaged in business are similarly able to import items directly for personal use. These do not qualify for VAT registration yet are still charged Domestic VAT.

Moreover, Domestic VAT makes importation disproportionately more expensive for SMEs that do not meet the VAT threshold. Most VAT registered businesses probably already enjoy several other advantages over SMEs yet, when they import items, they only pay 18 per cent import VAT, which is subsequently treated as an input tax credit thereby lowering the impact of this levy. However, an SME that is not VAT registered because it does not meet the UGX 150 million threshold will have to pay import VAT at 18 per cent and also Domestic VAT at 15 per cent, making a total of 33 per cent, and will not be able to claim an input tax credit. The result is that, if both a larger VAT registered business and an SME import the same VATable items for resale, the SME will be at a considerable competitive disadvantage when it comes to pricing for the local market. Domestic VAT thus discriminates against smaller businesses and gives larger businesses an added advantage at importation. This goes against the generally accepted principle that tax liability should be based on the taxpayer's ability to pay and to meet the costs of compliance.[33] Domestic VAT subverts this principle by disproportionately burdening small businesses, thus inhibiting their growth.

Subsequent changes to the law

The URA's continued charging of Domestic VAT is especially egregious given the changes in tax law that have taken place since *Rwaheru v URA*. Central to the court's ruling that Domestic VAT has its roots in statute was the wording of section 32(1)(c) of the VAT Act. In particular, the court considered that the provision stated that the commissioner general could assess a "person" rather than a "taxpayer". This was critical to the court's determination that one did not have to be registered for VAT in order to be assessed for Domestic VAT. In 2014, section 32(1)(c) was repealed and a similar provision was enacted as section 22 of the Tax Procedure Code Act (TPC Act). Section 22(1) of the TPC Act provides: "[t]his section applies where the Commissioner is satisfied that there is a risk that a taxpayer may delay, obstruct, prevent or render ineffective payment or collection of tax that has not yet become due". Section 22(2)(c) provides: "the Commissioner may make an assessment of a tax period in relation to a taxpayer of the tax payable by the taxpayer for the period".

32 One study revealed that 37% of SMEs have access to the internet and use it primarily for communication with suppliers: *National Small Business Survey of Uganda* (March 2015, Financial Sector Deepening Uganda) at 29.

33 V Thuronyi *Tax Law Design and Drafting* (1996, International Monetary Fund) at 30.

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Notably, the new provision refers specifically to a "taxpayer" and not a "person" as the previous one did. Section 3 of the TPC Act defines a taxpayer as "a taxable person whose total input tax credits for a tax period are equal to or exceed the person's total output tax for the period". This is a significant departure from the words in the statute that underpinned the court's ruling that persons who were not registered for VAT could be charged Domestic VAT. The words of a taxing statute should make it clear that a particular tax is imposed. No assumption as to the intention behind the statute can be made if the words do not make a particular tax clear.[34] The literal rule must be adhered to even when its results are anomalous.[35] The only reasonable interpretation of the law as it now stands is that the commissioner general must register the non-compliant person for VAT before assessing them. Further, the TPC Act introduces a requirement that, in order to make that assessment, the commissioner general must be "satisfied" that a taxpayer will not pay the tax when it becomes due. The requirement that the commissioner general be "satisfied" means that the person to be affected must have had a chance to explain their position before the decision is made.[36] This means that the commissioner general must first ascertain or at least have reasonable grounds to believe that the importer will be making a subsequent taxable supply and have a gross turnover of UGX 150 million or more before making the assessment. Applying a blanket rule that treats every importer who is not registered for VAT as non-compliant without any consideration of each case therefore violates this requirement. Domestic VAT charged on non-registered taxpayers who have not been given an opportunity to explain their position as required by law is illegal.

CONCLUSION

Rwaheru v URA serves to highlight the potential abuse of taxing power when used arbitrarily. In *International School of Uganda Ltd v Commissioner General URA*, the court stated that the URA "has no authority to choose who to tax because the question of who should pay tax is determined by an Act of Parliament under Article 152(1) of the Constitution of the Republic of Uganda".[37] Domestic VAT is a blatant breach of this rule. The case also highlights the need for clarity in judgments and rulings. One of the reasons the URA has found it easy to ignore this judicial decision is its ambiguous ruling

34 *Ntale v URA* [2012] UGCOMMC 80.

35 *IRC v Hinchy* [1960] 1 All ER 505.

36 In *Re HK (An Infant)* [1967] 1 All ER 226, Lord Parker CJ held (at 230) that, before an immigration officer can decide whether a prospective immigrant satisfies the statutory criteria for entry to the UK, the officer is required "to let the immigrant know what his immediate impression is so that the immigrant can disabuse him". See also *Secretary of State for Education and Science v Metropolitan Borough of Tameside* [1976] 3 All ER 665; JH Grey "Discretion in administrative law" (1979) 17/1 *Osgoode Hall Law Journal* 107 at 118.

37 HCCA No 004 of 2016, para 32.

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that found an illegal action to be merely irregular. A clear unambiguous condemnation of the URA's breach of statutory provisions would have been much harder to ignore. In this regard it is interesting to compare the ruling in *Rwaheru v URA* with that in an English case in which the tax administration made a similar claim to arbitrary authority. In *Vestey v Inland Revenue Commissioners*,[38] the UK Inland Revenue purported (on the basis of a provision in the Income Tax Act that sought to curb tax avoidance through the creation of non-resident trusts) to exercise administrative discretion in apportioning income of each year arising from a trust between the beneficiaries on a "just and reasonable basis", and assessed them accordingly. The Inland Revenue claimed to have discretion in assessing one or more or all of the individuals whatever sums its officers saw fit. The House of Lords rejected the Inland Revenue's arguments. Lord Wilberforce asserted:

> "Taxes are imposed on subjects by Parliament. A citizen cannot be taxed unless he is designated in clear terms by a taxing Act as a taxpayer, and the amount of his liability is clearly defined. A proposition that whether a subject is to be taxed or not, or that, if he is, the amount of his liability is to be decided (even though within a limit) by an administrative body, represents a radical departure from constitutional principle. It may be that the Revenue could persuade Parliament to enact such a proposition in such terms that the courts would have to give effect to it: but, unless it has done so, the courts, acting on constitutional principles, not only should not, but cannot, validate it."[39]

One of the URA's roles is "to advise the Minister on revenue implications, tax administration and aspects of policy changes relating to all taxes".[40] The URA should lobby for a change in the law rather than imposing an illegal tax that has no clear statutory basis and that feeds further into the public's perception that taxes are arbitrary and oppressive. As stated in *Vestey*, "[a] tax system which enshrines obvious injustices is brought into disrepute with all taxpayers accordingly, whereas one in which injustices, when discovered, are put right (and with retrospective effect where necessary) will command respect and support".[41]

CONFLICTS OF INTEREST

None.

38 [1979] 3 All ER 976.
39 Id at 984.
40 URA Act, sec 3(1)(b).
41 *Vestey v IRC* [1979] Ch D 177 at 198 at first instance, per Mr Justice Walton.

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