THE REPUBLIC OF UGANDA

IN THE MATTER OF THE TAX APPEALS TRIBUNAL

TAT APPLICATION NO 26/2010

HERITAGE OIL & GAS LIMITED …… APPLICANT

VERSUS

UGANDA REVENUE AUTHORITY …… RESPONDENT

RULING

This ruling is in respect of an application challenging an income tax assessment of US$ 404,925,000 against the applicant by the respondent arising out of a Sale and Purchase Agreement (SPA) where the applicant sold its share in Production Sharing Agreements (PSAs) and a Joint Operating Agreement (JOA) to Tullow Uganda Limited (hereinafter called 'Tullow').

Briefly the facts of the application agreed on by the parties are that: the applicant was incorporated in The Bahamas and later registered as a tax resident by continuation in Mauritius in 2010. On the 1st July and 8th September 2004, the applicant entered into Production Sharing Agreements (PSAs) for petroleum where it was awarded licences of exploration in Blocks 1 and 3A respectively in the Albertine Graben. The licences were valid at the time of the transaction on the 26th January 2010. As on the 26th January 2010, the applicant had 50% participating interest with Tullow in the licences. The applicant spent US$ 150,000,000 under the licences. The applicant made discoveries of oil in Block 3A.

On the 26th January 2010, the applicant entered into a Sale and Purchase Agreement (SPA) with Tullow where the former transferred its 50% interest to

the latter. On the 6th July 2010, the respondent issued an assessment of US$ 404,925,000 as income tax. On the 26th July 2010, the applicant executed an addendum to the Sale and Purchase Agreement (SPA). On the 18th August 2010 the applicant objected to the assessment. On the 12th November 2010 the respondent made an objection decision. The applicant being dissatisfied with the objection decision filed this application.

The issues agreed upon by the parties are:

(1) Whether the sale of the applicant's 50% interest to Tullow is taxable in Uganda?
(2) Whether the assessment was proper?
(3) What remedies are available to the parties?

The applicant called one witness, Mr. Paul Richard Atherton, its director. Mr. Atherton gave his evidence by way of video conferencing. The Evidence Act does not provide for video conferencing. The respondent did not object to the applicant's use of video conferencing. S.22 of the Tax Appeals Tribunal Act provides that a proceeding before a tribunal shall be conducted with as little formality and technicality as possible, and the tribunal shall not be bound by the rules of evidence and may inform itself on any matter in such manner as it may direct. In line with the said section the Tribunal having cautioned itself on the use of such evidence especially in respect to the demeanor of the witness it allowed it. Mr. Atherton gave his testimony on oath. The witness was subject to cross-examination. The witness was composed and the Tribunal finds his evidence reliable. The Tribunal will give it the same weight as any other evidence given ordinarily before it.

Mr. Atherton testified that the applicant was awarded on the 1st July and the 8th September 2004 interests in Blocks 1 and 3A respectively. The interests were awarded by Production Sharing Agreements (PSAs) between the Government of Uganda and the applicant, exhibits A4 (i) and (ii). Under a Joint Operating Agreement (JOA), exhibit A8, the applicant nominated Heritage Oil and Gas (Uganda) Limited as its operator. The applicant owns 99.9% of the capital of the said Ugandan company. The applicant was given two licences for the two blocks which it held with another holder and eventual buyer, Tullow.

He further testified that the applicant and Tullow as licence holders had the exclusive right to undertake exploration activities in the licenced areas. The PSAs provided a right only to explore hydrocarbons. It did not provide for ownership of the land, the use of the property and did not allow the licence holders to take any oil or hydrocarbons from the licenced areas. During the exploration the applicant only took very small samples of oil for analysis after approval had been sought and granted by the Government through the Petroleum Exploration Production Department, under the Ministry of Energy. The samples were never sold. Mr. Atherton stated that all the assets under the PSAs belonged to the government.

Mr. Atherton informed the Tribunal that the PSAs gave the licence holders an exclusive right to explore for up to six years. The PSAs allowed both licence holders a right to negotiate for a production licence with the government. There was no guarantee that a production licence would be issued. He testified that the applicant and Tullow applied for a production licence which was rejected by the Government. Under the production licence, the applicant would have obtained a right to produce and sell hydrocarbons for more than 20 years. In the event a production licence was issued and oil sold the costs would be

recovered. The applicant also had a right to receive a share of the profits from the oil. Mr. Atherton stated that the applicant did not share in the oil because it was not awarded a production licence. The applicant had a right to assign its interests.

Mr. Atherton further testified that the applicant sold its interests to Tullow under a Sale and Purchase Agreement (SPA) for US$ 1,350,000,000 on the 26th January 2010. Consent was obtained from the Government of Uganda. The applicant sold only its exploration right. There was a further US$ 100,000,000 which was paid by Tullow. Mr. Atherton testified that the applicant spent about US$ 182,000,000 in connection with the licence operations in Uganda, which expenses the respondent did not take into consideration when computing its tax liability. During cross examination he testified that when objecting to the respondent the applicant only referred to a figure of US$ 150,000,000 as expenses. The costs incurred by the applicant were for a multiplicity of activities including management, supervision, legal fees, travel, marketing, drilling, analysis, processing, sizing and interpreting data.

Mr. Atherton told the Tribunal that the applicant was registered by continuation in Mauritius on the 15th March 2010. Prior to that, the applicant was registered in The Bahamas. The change in registration was based on corporate planning. It was not purposely done to take advantage of the benefit Mauritius could offer in light of the transaction with Tullow.

He testified that during the period the applicant was in Uganda the respondent had never requested it to file any tax returns. The applicant never submitted any returns because it held only contractual rights in Uganda. The applicant is not a drilling company. The drilling is done by a third party. It files its tax returns

in Mauritius. The applicant had no oil business in Mauritius. The applicant moved its operations after it notified the government of its intention to sell its shares. The sale was concluded in Holland. It was negotiated in Channels Islands, primarily in Jersey with some discussions in London.

The respondent called three witnesses. The first witness was Mr. Ernest Tumwine Rubondo the Commissioner for Petroleum Exploration and Production in the Ministry of Energy Development. His roles include monitoring and regulating companies which are licenced to undertake petroleum exploration, development and production in the country. He dealt with the applicant who had entered into a PSA with the Government of Uganda in respect of oil exploration in the Semiliki basin. The Agreement expired in 2004. Subsequently the applicant entered into separate PSAs with Energy Africa for exploration areas 1 and 3A. Energy Africa was eventually acquired by Tullow.

He contended that the PSAs gave the applicant an exclusive right to exploration, development and production of petroleum in the specified areas. The exclusive right meant that no other party had access to the specified areas. It also gave the licensee a right to recover the costs expended on exploration from the sale of any oil produced. It also gave the applicant a right to share with the government of Uganda the oil produced in the ratios stipulated in the agreements.

He informed the Tribunal that under the agreements the applicant had to do two activities. The first one was exploration. The second activity was production under a production licence in the event the exploration was successful. The licensee was required to pay annual surface rentals for the areas it held and pay training fees annually. After signing the PSAs the applicant entered into a

Joint Operating Agreement (JOA) and assigned Heritage Oil and Gas (Uganda) Limited to carry out the work on the ground. The companies went ahead to perform the contracts. He testified that the government has never received from the applicant an application for a production licence. The applicant had not reached the production stage.

On 2nd February 2010, the applicant requested for consent to sell its participating interest to Tullow, exhibit R 17(2). Subsequently the Minister gave a conditional consent in 2010 for the sale to proceed. The condition was that taxes should be paid. Later the Ministry received information that the sale had taken place. He said that Tullow became entitled to the rights that the applicant had in the PSAs covering exploration areas 1 and 3A. These rights included exploration appraisal, production, a right to recovery of costs and sharing the oil proceeds, exploration rights and development rights. At the time of the sale on the 26th January 2010, the applicant had an exploration licence for area 1. The licence for exploration area 3A had expired because the PSA had also expired. Tullow took over the rights of the applicant under the PSAs.

The second witness of the respondent was Mrs. Allen Kagina, its Commissioner General. She testified that the applicant signed PSAs with Uganda which gave it rights to explore, develop and produce petroleum in areas 1 and 3A. The Petroleum Act required that at each stage, the licensee, the owner of the PSA applies for a relevant licence. The applicant obtained licences for exploration arising from the PSAs which it sold before it could move to development and production. The Sale and Purchase Agreement (SPA) was negotiated and concluded in Uganda. She testified that when the SPA came to her notice she constituted a team to study the nature of the sale and to establish whether there was tax due on the sale. The team found out that the

applicant sold its interests in areas 1 and 3A and had gained income from the sale. Although the applicant was a non-resident company it taxable under the Income Tax Act of Uganda. The activity on which the tax was based was exploration that added value to the licence. After establishing that tax was due, she asked the Commissioner for Domestic Taxes to calculate the tax. An assessment was raised and sent to the applicant. The tax assessed was Capital Gains Tax. The tax demanded was US$ 404,925,000. The applicant objected, the respondent made an objection decision and the applicant appealed to the Tribunal. The respondent issued an agency notice against Tullow which paid the tax in dispute on behalf of the applicant.

The Commissioner General testified that at the time of signing the PSAs, before the government approved the sale, the applicant was incorporated in The Bahamas. Later the applicant registered in Mauritius. She complained that the applicant was moving from one jurisdiction to another in order to reduce its tax liability. All the jurisdictions the applicant registered in were 'tax havens'. She was also aware that the applicant was registered as a foreign company in Uganda.

The applicant and officials from the government of Uganda engaged in a number of meetings. At first the applicant indicated that no taxes were payable. Later the applicant expressed its willingness to pay taxes. It was willing to pay a certain amount as *ex gratia*. At first it wanted to pay US$ 36,000,000 claiming that the level of activity was 10% of the activities carried out. Later the applicant revised the offer to US$ 120,000,000 basing on the Double Taxation Agreement. The government rejected the position and stated that the tax payable was 30% of the income received.

In cross-examination the Commissioner General reiterated her position that the tax due was Capital Gains Tax. For Capital Gains Tax to exist there must be a gain. The gain made by the applicant was in the value of the asset it sold to Tullow. The gain was US$ 1,450,000,000. The cost base for the Capital Gains Tax was US$ 250,000 the amount paid for the signature bonuses. When computing the tax the expenses of US$ 150,000,000 incurred by the applicant were not considered because they were recoverable under the PSAs. She further testified that on signing the PSAs the applicant was issued licences over areas 1 and 3A. On issuing the licences the applicant paid for the signature bonuses.

She further testified that the applicant has never furnished the respondent with tax returns. The tax assessed was in United States dollars. The Commissioner General contended that there is nothing in the Income Tax Act that stops her from assessing taxes in dollars or any currency. The transaction between the applicant and Tullow was in dollars and they kept their account in dollars. The taxes payable were eventually converted to Uganda Shillings. No tax audit was carried out on the non-resident company.

The respondent's last witness was Mr. Moses Kajubi, its Commissioner of Domestic Taxes. He received instruction from the Commissioner General to review the transaction between the applicant and Tullow. He worked with a team to determine the tax liability of the applicant. They were given a number of documents to review.

In the PSAs, they discovered that the applicant had interests and rights. These included the rights to explore, develop and to produce oil from the designated land. They had a right to carry out operations on the said land which was

actually done by an affiliated company called Heritage Oil and Gas (Uganda) Limited. There was also a right to cost recovery under the agreement. The costs were to be recovered when actual production of oil commences in the designated areas. Under the PSAs, recoverable costs were those incurred in the exploration, production and development. The applicant also had a right to a share in the profit of oil produced.

The Commissioner testified that under the SPA they discovered that the applicant sold an assignable interest in the Production Sharing Agreements (PSAs), Joint Operating Agreement (JOA), licences, authorizations and permits. The following rights were assigned: a right to explore, a right to search, a right to develop, a right to bore, a right to produce, a right to get samples, a right to take oil and dispose of the oil produced from designated areas in the PSAs.

Having looked at the documents, the team then considered the consideration. The consideration was composed of the base price of US$ 1,350,000,000 and a contingent amount of US$ 150,000,000 which was later reduced to US$ 100,000,000. The team then determined the costs incurred by the applicant. They were two signature bonuses of US$ 250,000. The said cost was subtracted from the purchase consideration and the balance of US$ 1,349,750,000 was subjected to income tax of 30% arriving at a net tax of US$ 404,925,400. An assessment of the said amount was issued on the 26th July 2010 on the applicant. The respondent expected the applicant to pay the tax immediately the assessment was issued without notice to the applicant because the respondent thought the applicant was going out of Uganda permanently, as it was a non-resident and had no tangible assets in Uganda.

The applicant was also purportedly changing tax jurisdictions – treaty shopping in a tax avoidance scheme.

In cross examination, the Commissioner stated that applicant had never been taxed before. The Commissioner was not clear as to whether at the time the assessment was raised the rights to cost recovery and to a profit share had materialized. The respondent did not communicate the computation of the tax in Uganda Shillings to the applicant. The Minister gave the applicant a conditional consent that when the applicant met the tax obligation the consent becomes effective. If the applicant had not fulfilled the terms in the Minister's consent the transaction would not have taken place.

In its submission, the applicant argued that the proceeds it received pursuant to the sale transaction were not income derived from sources in Uganda. The applicant contended that S. 79(g) provides that income is derived from sources in Uganda to the extent to which it is derived from the disposal of an interest in immovable property located in Uganda.The applicant contended that S.79 of the Income Tax Act was not applicable to the transaction in issue. It contended that 50% participating interest sold was not an "interest in immovable property".

The applicant contended that the principal right sold to Tullow was the one to conduct "Petroleum Operations" within the contract areas for the term of the exploration licence and any production licence granted. A production licence is not granted automatically. Though Article 13 of the PSAs gave the parties percentages for production sharing it was not applicable because the production licence was not granted. Tullow had only the right to explore. The licences did not allow the applicant and Tullow to take any oil or hydrocarbons from the licence areas. Small samples were taken but they remained the

property of the Government. The exploration licences did not confer on the holder the right to take possession of or ownership of any oil from the exploration areas or to create any rights in respect of the land.

The applicant contended that a contractual licence or permission to search for petroleum does not create an interest in land. A licence is a mere permission which makes it lawful for a licensee to do what would otherwise be a trespass. It provides a defense to an action in tort, but confers no estate or interest in land. A licence prevents a conduct from being criminal under Section 2(3) of the Petroleum Act. The applicant cited John T. Mugamba in *"Principles of Land Law in Uganda"* page 132 who states that;

> "A licence is a permission given to a licensee to enter the licensor's land for some specified purpose or purposes which would otherwise be trespass… A licence differs from a lease in that it does not create an interest in land. This was stated more than three centuries ago in *Thomas V. Sorell.* In that case, Vaughan CJ said that:
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> > 'A dispensation of licence properly passeth no interest, nor alters or transfers property in anything, but only makes an action lawful, which without it would have been unlawful."

The applicant also cited *Halsbury's Law of England* 3rd Edition, volume 23, paragraph 1026, page 430, where it states that a license does not create any estate or interest in the property to which it relates; it only makes an act lawful which without it would be unlawful.

The applicant also referred to Megarry and Wade *"The Law of Real Property"* 7th Edition, paragraphs 15 – 25 which states that "the mere fact that a contract concerns land will not bring it within the ambit of the section if it is not one for the disposition of an interest in land. Thus neither a contract to grant a licence nor a contractual licence itself is within the section because a licence creates no interest in property."

The applicant submitted that Article 22(1) of the PSAs provided that "All land shall become the property of the Government as soon as it is acquired by the licensee ..." The said Article excluded the applicant from any interest in land. The applicant cited the case of *Agip (K) Limited V Vora* [2002] 2 EA 285 where the court held that a respondent who had been operating a petrol service station on an appellant's land under various operator licence agreements did not have a proprietary interest in the land since the agreements expressly excluded such proprietary interest.

The applicant argued that in contrast where a licence involves a right to enter and take away something that forms part of the land or of the soil, for example minerals, the right granted is a *profit a prendre*. A *profit a prendre*, being the right to take away something that is treated as part of the land, is an "interest in land". *See Meggary and Wade, "The Law of Real Property",* 3rd Edition page 818*.* John T. Mugamba in *"Principles of Land Law in Uganda"* at page 148 states that where a licence involves a right to enter and take away something that forms part of the land or of the soil, for example minerals, gravel, timber or clay, the grant is a *profit a prendre*. A *profit a prendre* constitutes an interest in land. Such an interest would be registrable under the Registration of Titles Act. See *Settlement Fund Trustees V Nurani* [1970] EA 1.

The applicant contended that interests in land are interests in immovable property. Whether objects such as title deeds, fixtures or growing crops are to be regarded as movable or immovable is determined by the law of the place of the land in question. The applicant's licence to search for petroleum does not constitute an interest in land. The rights created by an exploration licence are not governed by general land law. The applicant contended that the Income

Tax (Amendment) Bill 2011 sought to amend the law to introduce a definition of immovable property to include a licence. This shows that a licence has never been immovable property. Furthermore the applicant contended that the licence for Block 3A had expired. An expired licence cannot constitute an interest in immovable property.

The applicant also contended that the sale of the assets took place outside Uganda. The income cannot be attributed to activities in Uganda because what took place in Uganda was after the purchase price had been determined. The applicant's witness testified that the contract was negotiated in the Channel Islands, primarily Jersey with some discussions in the United Kingdom (London) and also in the Netherlands. The activity to which the income is attributable is the initial transaction between ENI and the applicant where the purchase price was determined. Tullow exercised its pre-emptive rights to purchase the applicant's interest. This was not an activity that occurred in Uganda.

On the second issue, the applicant contended that the assessment by the respondent on the applicant was invalid and not properly issued in accordance with the provisions of the law. The applicant stated that the assessment was issued under S. 95(2) of the Income Tax Act which provides for situations where a taxpayer defaults in furnishing a return of income for a year of income; or where the Commissioner General is not satisfied with a return of income. The applicant contended that it has never filed tax returns in Uganda hence it could not have defaulted. The applicant files tax returns in Mauritius. The applicant submitted that the Commissioner General in her objection decision claims to have issued the assessment under the provisions of S. 96(3), 95(4) and 92(8) of the Income Tax Act. In the assessment she claims to have issued

it under S. 95(2). The purported grounds in the objection decision are not mentioned in the assessment and are different. The power to issue an assessment under S. 95(2) did not apply. Hence the assessment was invalid.

The applicant further submitted that on the 6th July 2010, when the assessment was issued the applicant had derived no income from the transaction. No payment had been received by the applicant. Though the applicant and Tullow had made an agreement of sale the conditions had not been fulfilled. The assessment was purportedly issued at a time when the Government had not provided its unconditional consent to the assignment of the applicant's rights to Tullow. Under S. 44(1) of the Petroleum (Exploration and Production) Act a transfer of licence shall be of no effect without the approval of the Minister. Under S. 51 of the Income Tax Act a taxpayer is treated as "having disposed of an asset when the asset had been sold...." The assessment was therefore issued at a time when no disposal had occurred.

The applicant averred that the respondent had no authority to issue the assessment. Though S. 98(3) of the Income Tax Act provides that no notice of assessment shall be quashed or deemed to be void for want of form the applicant contended that the issue in this matter is not over a technical mistake, defect or omission but relates to a fundamental question on the issuance of the assessment.

The applicant objected to the issuing of the assessment in dollars. S. 57 of the Income Tax Act provides that chargeable income under the Act shall be calculated in Uganda Shillings. The computation and calculations were made in US dollars. As a result the assessment was void for failure to comply with a statutory provision.

As regards the cost base, the applicant contended that Mr. Atherton during his testimony told the Tribunal that it spent US$ 182,435,000. The testimony on the actual amount was not disputed nor challenged by the respondent. In the event the assessment was not invalid, it excluded the applicant's costs in respect of exploration activities. The costs were substantial. The assessment was fundamentally flawed for failure to take the costs incurred into consideration.

The applicant contended that S. 22(c) of the Income Tax Act relied on by the respondent was not applicable. Deductions allowed under S. 22 in respect of the expenditure and losses must relate to the relevant year of income. The respondent deducted the cost of the signature bonus before the relevant year of income (or financial year) had come to an end. S. 22(c) has no application because it does not govern the question of costs in connection with capital gain. A separate regime applies in relation to costs incurred in connection with assets disposals giving rise to capital gain within S. 18(1) (a) and Part VI of the Income Tax Act. The question that arises under S.18 (1) is: what is the amount of the gain on the disposal of a business asset as ascertained under Part VI and S.50 of the Income Tax Act? The amount of the gain is the excess of the consideration received for the disposal over the cost base of asset at the time of the disposal as per S. 50.

The applicant also contended that S.22(c) does not exclude the applicant's expenditure on exploration activities because the provisions relating to what is called "cost recovery" in the PSAs relate to no more than the production sharing rights of the Government and licensee in the event production ensues. Furthermore S.22(c) does not apply because it requires certainty so far as

recoverability is concerned. The applicant argued that the respondent contradicted itself in its evidence. The Commissioner General told the Tribunal that “we asked for invoices to prove the costs and we did not get them.” The objection decision made no reference to an alleged failure by the applicant to furnish invoices.

The applicant prayed for orders that the assessment of the respondent be set aside because S. 79(g) of the Income Tax Act is not applicable. The assessment did not take into account the allowable costs of US$ 182,435,000. In the event the Tribunal finds that tax is payable, it should be calculated in accordance with S. 57 of the Income Tax Act, that is, in Uganda Shillings at the rate prevailing on the date of transfer. Therefore the assessment should be varied. The applicant also prayed that in the event the Tribunal finds that there is no tax due or payable in relation to the assessment it directs the immediate release of US$ 121,477,500 currently being held as a refundable deposit in respect of the disputed tax. The applicant also prayed for the costs of the suit.

The respondent in reply submitted that the Constitution provides that no tax shall be imposed except under the authority of an Act of Parliament. S.17 (1) of the Income Tax Act provides for taxation of business income. S.17 (2) provides that the gross income of a non-resident person includes only income derived from sources in Uganda. Under S.79 (g) of the Income Tax Act income is derived from sources in Uganda to the extent to which it is derived from the disposal of an interest in immovable property located in Uganda. S.18 of the Income Tax Act provides that business income means any income derived by a person carrying on a business and includes the following amounts, whether of a revenue or capital nature; the amount of any gain, as determined under Part VI of the Act. Part VI of the Income Tax Act S. 50(1) provides that the amount

of any gain arising from the disposal of an asset is the excess consideration received for the disposal over the cost base of the asset at the time of the disposal. Under S. 51(b) of the Income Tax Act a person is treated as having disposed of an asset when the asset has been sold, exchanged, redeemed or distributed by the taxpayer.

The respondent contended that what the applicant sold were rights and interests in immovable property under Article 2.1 of the SPA which are catered for under S.79 of the Income Tax Act. The respondent contended that the *Black's Law Dictionary* 8th Edition defines interest as "the object of any human desire; especially advantage or profit of a financial nature, a legal share in something; all or part of a legal or equitable claim to a right in property" A right is defined as "A power, privilege or immunity secured to a person by law, a legally enforceable claim that another will do or will not do a given act". The respondent contended that the applicant sold the entire bundle of its rights, title and interests in the interest documents, including its 50% participating interest in the rights and obligations derived from both the PSAs and JOA. The applicant did not have only a right to explore hydrocarbons but a bundle of rights. The respondent requested the Tribunal to reject the applicant's narrow and selective argument that it only passed on a "mere" exploration licence.

The respondent further contended that the bundle of rights and interests sold under the SPA created an interest in immovable property in Uganda. The respondent averred that the applicant's reference to the application of common law to the licence was not proper because the respondent was granted statutory licences pursuant to the Petroleum (Exploration and Production) Act. The applicant cannot claim to be a mere licensee at common law. The licence under the Uganda statutory regime enjoys statutory protection under the Act.

John S. Lowe stated in *Oil and Gas Law in a Nutshell* (2010) 5th Edition at page 40 that "the mineral interest in Oil and Gas is a right to search for, develop and produce oil and gas from the described premises and in states that have adopted the ownership in place theory, the present right to possess the oil and gas is placed under property." The Uganda Petroleum regime creates rights and obligations on the contractor and government. These rights are interests in immovable property.

The respondent further submitted that the exploration licence was more than a mere permission to explore for oil in land. The respondent cited the authority of *Glenwood Lumber Co. Ltd V Phillips* [1904] A.C 405 where the Lord Davey said "it is not however a question of words but substance. If the effect of the instrument is to give the holder exclusive right of occupation of the land though subject to certain reservations or to a restriction of the purposes for which it may be used, it is in law, a demise of the land itself". Further in *Street V Mountford* [1985] 2 ALL ER 289 the House of Lords held that when exclusive possession is granted in lieu of only rent payable therefore, the presumption that the instrument is that of a lease become stronger.

The respondent contended that applicant's submission that a licence is movable property is inapplicable because a mere licence is not assignable. The respondent submitted that the licence issued was not a bare licence but one coupled with an interest thereby creating an interest in immovable property. Unlike a bare licence, the respondent enjoyed a statutory licence protected by the Petroleum (Exploration and Production) Act. The respondent enjoyed exclusive possession; rights of ingress and egress statutorily protected from revocation and had the right to assign its interest. The applicant had rights to exploration, development and production of petroleum in the specified areas.

Without prejudice, the respondent contended that the applicant had rights of variable or fixed payments as consideration for the working of, or right to work, mineral deposits, sources and other natural resources. These are the rights the applicant sold to Tullow in the SPA. In *Commissioner of Income Tax V P.V.A.L Kulandangan Chattir* Civil Appeal 2451/2000 it was held that; "Disposal of the property or the capital asset itself is as much a form of method of use of the immovable property as such, and the words direct use… Or uses in any other form are sufficiently wide enough to include within its scope the transfer, sale or exchange of the property."

The respondent submitted that the applicant is a non-resident person which is evidenced by the certificate of registration by continuation dated 15th March 2010. The respondent contended that the applicant is domiciled in Mauritius. Uganda and Mauritius have a Double Taxation Agreement. The Agreement provides that a non-resident is taxed on income derived from sources in Uganda. The respondent contended that the income derived by the applicant was from the sale of its interest in immovable property in Uganda under S. 79(g) of the Income Tax Act and was therefore taxable under Articles 6 and 14(1) of the Double Taxation Agreement. In *Commissioner of Income Tax V P.V.A.L Kulandangan Chattir* (supra) it was found that the immovable property in question is situate in Malaysia and income derived from that property. It was held that the business income out of rubber plantations cannot be taxed in India because of the close economic relations between the assessee and Malaysia in which the property is located.

The respondent also contended that the Double Taxation Agreement provides the authority in defining immovable property and not common law. This is

because statutory law takes precedence over common law. The respondent contended that the Double Taxation Agreement defines immovable property in Article 6 as to have the meaning under the law of the Contracting State where the property is situated. The term shall include usufruct of immovable property and rights to variable or fixed payments as consideration for the working or right to work, mineral deposits, sources and other natural resources. *Black's Law Dictionary* 8th Edition defines usufruct as "a right to use and enjoy the fruits of another's property for a period without damaging or diminishing it…" The respondent contended that under the PSAs the applicant was not only given exclusive rights to work and use the property but also the right to enjoy the fruits of the use of government's property in the form of cost recovery and profit oil.

The respondent further argued that if the applicant contends that S.79 (g) of the Income Tax Act is inapplicable the income of the applicant is still taxable under S. 79(s) of the Act because it is attributable to activities carried out in Uganda. The respondent contended that the applicant carried out exploration activities and discovered millions of barrels of oil in Uganda. It carried out exploration activities that added significant value to the asset that enabled it to sell it at US$ 1,450,000,000. Hence the income derived from the sale is attributable to the activities in Uganda.

The respondent cited the authority of *Vodafone International Holdings B.V. V Union of India and another* Writ petition 132 of 2010 where HTIK sold its shares in GCP which owned a stake in HEL (an Indian company) to Vodafone. India sought to tax the transaction and was challenged by Vodafone. Vodafone challenged the transaction on the ground that the asset was not situated in India. The agreements were signed outside India. The Supreme Court of India

in dismissing Vodafone's appeal held the law has postulated the existence of a nexus with India which invokes taxing jurisdiction. The nexus is provided in the case of the first category from a business connection in India; in the second by the situs of the property in India, in the third from any asset or source of income in India and in the fourth by the situs of the capital asset which is transferred in India.

The respondent also cited the case of *Rhodesia Metals Limited (Liquidator) V Commissioner of Taxes* (1941) 9 ITR 45 where the Privy Council stated that "source means not a legal concept but something which a practical man would regard as a real source of income. The ascertaining of the actual source is a practical hard matter of fact. Whatever maybe the right view of the source of receipts derived from trading in commodities, their lordships find themselves dealing with a case where the sole business operation of an English company is the purchase of immovable property in Southern Rhodesia and its development in that territory for purposes of transfer in that territory at a profitable price. The only proper conclusion appears to be that the company received a sum in question from a source within the territory, namely, the mining claims which they had acquired and developed there for the purpose of obtaining the particular receipt."

Counsel for the respondent also cited *A.R. Krishnamurthy & A.R Rajagopalan V Commissioner of Income Tax* [1981] 133 ITR 922 where it was held that the term property would include, "in the case of land, the right to enjoy such land and there was a transfer for a consideration of Rs. 5 lakhs of such right of enjoyment in the land and that, therefore it is a case of transfer of capital asset. The general right of the owner to be in possession could be regarded as a capital asset, though that is also one of the incidence of ownership as any other

right in the property. We have already seen that the rights of the owner of a land include a right to be in possession and enjoyment as well. The right of enjoyment vested in the assessee in the present case the right to exploit the land by extracting clay. The right of exploitation of the land formed part of the cost of acquiring the land. The land by itself may have no value except for its usefulness in extracting clay. Therefore the value of the right to excavate clay in the land in terms of money must have formed part of the price paid by the assessee for the land".

As regards the assessment, the respondent contended that the Commissioner General has powers under Sections 92(8), 95, 96(3) and 158 of the Income Tax Act to issue assessments. Under the said sections the powers granted by the Commissioner General override the requirement of issuing an assessment with a due date of 45 days from the date of assessment. The respondent contends that the applicant was about to leave the country and was selling its only known asset.

The respondent contended that the applicant was not entitled to raise the objection relating to the currency of the assessment. The said objection was not one of the grounds in the objection to the Commissioner General. Under S.16 of the Tax Appeals Tribunal Act an applicant is limited to the grounds stated in the taxation objection unless the Tribunal orders otherwise.

The respondent further contended that S. 57 of the Income Tax Act provides that chargeable income shall be calculated in Uganda shillings. The law does not positively and exclusively create an obligation on the Commissioner to assess tax in Uganda shillings. Calculation and assessment are not the same. The respondent relied on the case of *Cape Brandy Syndicate V IRC* 1921 [1]

KD 64, 71 where the court stated that “in a taxing enactment, one has to look at what is clearly said. There is no room for any intendment. There is no equity about a tax. There is no presumption as to a tax. Nothing to be read in, nothing to be implied. One can only look fairly at the language used.”

The respondent further relied on S. 98(3) of the Income Tax Act which provides that no notice of assessment, warrant, or other document purporting to be made “shall be quashed or deemed void or voidable for want of form…” The applicant cited the authorities of *Baylis (Inspector of Taxes) V Gregory* (1986) STC 22, *JP Construction Services Limited V Uganda Revenue Authority* TAT Application 17 of 2009 and *Cable Corporation (U) Limited V Uganda Revenue Authority* Appeal 1 of 2011.

The respondent further contended that in the event the Tribunal finds that the assessment was improper it can exercise its powers under S. 19 (c) of the Tax Appeals Tribunal Act to vary the assessment and substitute it with the corresponding tax payable in Uganda Shillings in line with the Bank of Uganda exchange rate as at 26th July 2010 when the assessment was issued.

As regards the costs of exploration, the respondent contended that under S. 102 of the Income Tax Act, the onus is on the taxpayer to prove that the assessment by the Commissioner is excessive or erroneous. No evidence was adduced either before the Commissioner or during the hearing to support the claim of the exploration costs of about US$ 182,000,000. The respondent further claimed that the said exploration costs do not meet the requirement of S. 52(2) of the Income Tax Act because they are not expenses of a capital nature. They were also not incurred at the acquisition of the asset.

The respondent contended that it was the signature bonuses worth US$ 250,000 which were expenditures incurred to acquire an asset. Paragraph 6 of the 8th Schedule to the Income Tax Act defines petroleum capital expenditures as development and production expenditures. The exploration expenditures are characterized as petroleum operating expenditures under paragraph 6(2) of the 8th Schedule.

The respondent submitted that since all the exploration, development, production and operating expenditures incurred by the licensee are recoverable the effect was to remove any such expenditure from the cost base for purposes of computation of capital gains tax. The respondent contended that the exploration costs are recoverable by Tullow by virtue of it being a successor in title under the SPA. The right to cost recovery was part of the bundle of rights that was passed on to Tullow for a consideration of US$ 1,450,000,000. The respondent contended that to allow the applicant to include the costs under the cost base would create a mischief because the said costs maybe deductible twice, first in the hands of the applicant and then in the hands of Tullow on the commencement of commercial production.

The respondent contended that S. 22(2) (c) of the Income Tax Act is applicable because it does not allow deductions for costs that are recoverable under a contract, whether by a third party or otherwise. The respondent further argued that the applicant's claim cannot fit within S. 52(6) of the Income Tax Act because the treatment of such costs is otherwise provided for under S. 22(2) (c) of the Act.

In its rejoinder, the applicant contended that the respondent conceded to the common law position that a licence does not create an interest in land. The

applicant had contended the interest of immovable property is determined by common law and not by statute. The applicant contended there is no authority for statutory licence. The contractual rights and obligations, and provisions of the Petroleum Act do not give an interest in land or immovable property.

The applicant reiterated that the licence did not dispose of anything deemed to be immovable property within Article 6(2) of the Double Taxation Agreement. Article 6(2) of the Double Taxation Agreement does not define "immovable property" for the purpose of S. 79 of the Income Tax Act. The applicant was not granted a production licence. A person who holds a production licence does not have a right to use and enjoy the fruits of another's property without damaging or diminishing it within the meaning of usufruct in the Double Taxation Agreement. Producing oil is the process of deliberately removing and diminishing property. The applicant had no rights to variable or fixed payments as consideration for the working of, or the right to work, mineral deposits, sources and other natural resources.

The applicant contended that the respondent's emphasis on the former's right to assign its exploration licence is misconceived. A right does not become an interest in land because it is assignable. The assignability does not convert a right into an interest in land. The applicant did not have power to effect transfer of its exploration licence without the approval of the Minister.

The applicant submitted that its case is contrary to Article 14 of the Double Taxation Agreement. The applicant contended that if it had realized a capital gain from the disposal of immovable property in Uganda the Double Taxation Agreement would permit Ugandan taxation of the gain. S .79(g) would not conflict with the Double Taxation Agreement provisions. The applicant did not

dispose of immovable property located in Uganda that falls within the terms of Article 14(4) of the Agreement.

The applicant also contended that cases referred to by the respondent were not relevant to the present case. These included the cases of *Vodafone International Holding B.V. V Union of India* (supra) and *Rhodesia Metals Limited (In liquidation) V Commissioner of Taxes* (supra), *Krishnamurthy V Commissioner of Income Tax*. The facts of this application are different from the facts of the said cases. The cases involved different statutory wording from the Income Tax Act. In *Rhodesia Metals* case (supra), Lord Atkins stated "decisions on the words of one statute are seldom of value in deciding on different words in another statute."

The applicant submitted that the respondent's reliance on the meetings between its officials and those of the government is not helpful as the meetings took place after the purchase price had been determined. Further the meetings related to the question of the government's consent to the proposed transaction under S. 44 of the Petroleum Act.

As regards the assessment, the applicant contended that the Commissioner does not have prerogative powers to issue tax assessments. Their powers to issue assessments are statutory. An act without statutory power is a nullity. The Commissioner cannot purport to issue an assessment under S. 95(4) when she has no basis upon which to make a judgment that chargeable income has accrued to the assessee. The respondent's submission that the Commissioner has powers under S. 95(4) to issue an assessment payable in the event that a future contingency occurs is plainly wrong.

In respect of the calculation of the assessment in dollars, the applicant contended that a failure to comply with the clear provisions of the law amounts to an illegality and this can be pointed out to the Tribunal at any stage regardless of whether or not it was specifically raised in the objection to the Commissioner. In *Kyagalanyi Coffee Limited V Francis Senabulya* Civil Appeal 41 of 2006 it was held "Acting in disregard of the mandatory requirement of the law, as the Appellant did, rendered the transaction an illegality. Any illegality, once brought to the attention of court, cannot be sanctioned or tolerated by a court of law. It is not absolutely necessary that an illegality has to be pleaded. It is enough that it is brought to the attention of court at any time before the conclusion of the proceedings before it. No amount or type of admission or pleadings or even conduct of a party to court proceedings can turn an illegality into a legality".

The applicant contended that Mr. Atherton's testimony of the costs incurred by the applicant of US$ 182,435,000 was unchallenged. Therefore the applicant did not have to prove this point. Furthermore S. 52(2) of the Income Tax Act provides the amount paid or incurred by the taxpayer in respect of an asset are to be taken into account in determining the cost base. There is no exclusion of the costs on the ground that they are of a capital nature. The respondent's contention is inconsistent with S. 52(6) which provides that "Unless otherwise provided in this Act, expenditures incurred to alter or improve an asset which have not been allowed as a deduction are added to the cost base of the asset." The applicant contended that S.52 (2) includes but does not limit incidental expenditures of a capital nature incurred in acquiring an asset. Furthermore the said section does not limit costs to those incurred at the time of acquisition. It considers the amount paid or incurred by the taxpayer in respect of the asset.

The Tribunal having heard the evidence of the witnesses and read the hefty submissions of the parties makes its ruling as hereunder. We have already stated that the evidence of the applicant's witness was given the same weight as that of any witness ordinarily before the Tribunal.

The applicant was incorporated in The Bahamas (exhibits R6 and R7) and later registered by continuation in Mauritius (exhibit R8). It was also registered in Uganda (exhibit A11). S.2 (vv) of the Income Tax Act states that a "non-resident person has the meaning in S.14. S.14 (1) reads that subject to Subsection (2), a person is a non-resident person for a year of income if the person is not a resident person for that year. Under S. 2(iii) a resident person includes a resident company. S. 2(fff) states that a resident company has the meaning in S. 10 which provides that;

> "A company is a resident person for a year of income if it:
>
> (a) is incorporated or formed under the laws of Uganda.
>
> (b) has its management and control exercised in Uganda at any time during the year of income; or
>
> (c) undertakes the majority of its operations in Uganda during the year of income."

Though the applicant was registered in Uganda it was not a resident person as it did not meet the requirements in S.10. It was a non-resident person under S.14 of the Income Tax Act.

The jurisdiction of a state to tax a non-resident taxpayer is based on the existence of a nexus connecting the person sought to be taxed with the jurisdiction which seeks to tax. The connection can be based on the residence of the person or the business connection within the territory of a taxing state or a situation within the state where the money or property from which the taxable income is derived. Residence is not a necessary condition for tax liability if

there is sufficient connection between the source of income, profit, or gain and the taxing jurisdiction then such income, profit or gain maybe taxable. The applicant had business in Uganda which qualified it to be a taxpayer.

Mr. Atherton told the Tribunal that the applicant files its tax returns in Mauritius. The applicant was registered by continuation in Mauritius on 15th March 2010. That was after it had entered into the SPA. Apparently it appears the applicant was filing tax returns in Mauritius before it was registered. Though the documents tendered in evidence show that the applicant has offices in other parts of the world, St. Helier (Jersey), St. Peters Port (Guernsey, Channel Islands) and Kings Road (London), it is not disputed that the applicant is a taxpayer of Mauritius. Both Uganda and Mauritius may have a claim to tax the income obtained by the applicant. Unless where it is expressly provided or implied, the Income Tax Act is applicable to foreigners who have by coming to Uganda for a short or long period made themselves subject to the Ugandan jurisdiction. However tax legislation is enacted on the premise that it is not the duty of a state to enforce tax legislation of another state. If both Uganda and Mauritius exercised their right to tax simultaneously this would result in double taxation of the applicant which would be unfair.

In order to ensure that the income of a taxpayer of both states is taxed only once, both Uganda and Mauritius entered into an agreement. Uganda and Mauritius have a Double Taxing Agreement which entered in force on the 21st July 2004. The said Agreement is titled “The Convention between the Republic of Mauritius and The Government of the Republic of Uganda for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with respect to taxes on Income (herein called the Double Taxation Agreement). S. 88(6) (a) of the Income Tax Act of Uganda provides that international agreement means that

an agreement with a foreign government providing for the relief of international double taxation and prevention of fiscal evasion. Both parties do not dispute that the Double Taxation Agreement applied to the applicant as it is domiciled in Mauritius and was a non-resident taxpayer in Uganda.

S.88 (1) of the Income Tax Act provides that an international agreement entered into between the Government of Uganda and that of a foreign country shall have the effect as if the agreement was contained in the Act. Therefore in the event of any dispute involving a taxpayer of both Mauritius and Uganda the Double Taxation Agreement provisions will be read together with the Income Tax Act. S. 88 (2) of the Income Tax Act states that;

> "To the extent that the terms of an international agreement to which Uganda is a party are inconsistent with the provisions of this Act, apart from subsection (5) of this section and Part X which deals with tax avoidance, the terms of the international agreement prevail over the provisions of this Act."

The Income Tax Act should rhyme with the Double Taxation Agreement and if there is any disharmony the Agreement shall prevail as far as it is not in respect of tax avoidance and conflicting with S. 88(5) of the Act.

On the 1st July and 8th September 2004 the applicant entered into Production Sharing Agreements (PSAs) with the government of Uganda. The object of the PSAs as stated in the title was to provide for petroleum exploration, development and production in Blocks 1 and 3A situated in the Albertine Graben. The applicant, together with Tullow, was given exploration licenses under the PSAs. Article 14 of the PSAs required the licensees to pay all central taxes or other taxes levied. The Tribunal is not concerned with the taxes under the Production Sharing Agreements. The dispute before the Tribunal concerns tax liability arising from Sale and Purchase Agreement (SPA) to which the government was not a party.

The applicant entered into a Sale and Purchase Agreement (SPA), exhibit A6, with Tullow on the 26th January 2010. The object of the agreement was for the applicant to sell its 50% participating interest in Blocks 1 and 3A to Tullow. In the said agreements Article 7.2 provided that any Non-Transfer taxes arising in respect of the transaction, including any capital gains tax shall be borne by the seller. This clause is superfluous in the sense that tax obligations are created by Acts of Parliament and not by agreements.

The applicant disputes that there is tax liable. The applicant and the respondent do not seem to agree on what was sold by the former. Before the Tribunal can address the issue of tax liability it shall first ascertain what was sold to Tullow. What was sold can only be ascertained by looking at the four corners of the pages comprised in the SPA. Article 2.1 of the SPA provided that;

> "Subject to the terms and conditions of this Agreement, the Seller agrees to sell to the Buyer, and the Buyer agrees to purchase from the Seller for the Consideration set out in Article 3.1 the Assigned Interest with effect from and Including the Closing Date…."

Article 1 of the SPA defined assigned interest to mean all the seller's rights, titles and interests in the interest documents, which included:

> "(a) the unencumbered and divided 50% (fifty percent) Participating Interest of the Seller in the rights and obligations derived from the PSAs and JOA in respect of the Blocks; and
>
> (b) all the Seller's rights and obligations under the JOA in respect of Operatorship."

The SPA requires one to look at the PSAs and JOA to ascertain the rights, titles and interests thereunder that were sold.

In order to arrive at what the applicant sold, the Tribunal will restrict itself to the SPA and the documents it referred to, that is the JOA and PSAs only, so as to

respect the parties 'freedom to contract'. In the PSAs, exhibits A4 (i) and (ii), the seller who was a licensee had inter alia the following rights, titles and interests which we shall state very briefly:

Under Article 3 the seller was entitled to an exploration licence. Under Article 1.1.27 an exploration licence meant the petroleum exploration licence referred in Article 3.1 and granted pursuant to Section 9 of the Act. Under S. 9 of the Petroleum (Exploration and Production) Act the Minister may grant a petroleum exploration licence in respect of any block or blocks. S.12 of the Act provides that the licence shall grant the licensee "the exclusive right to explore for petroleum, and to carry on such operations and execute such works as may be necessary for that purpose, in the exploration." Under Article 3.3 of the PSAs the licensee had the exclusive right to conduct Petroleum Operations within the Contract Area for the term of the Exploration Licence and Production Licence granted. Under S. 20 of the Act the holder of a petroleum exploration licence who has made a discovery of petroleum in his or her exploration area may apply for a petroleum production licence. Hence an exploration licence gives the holder a right to negotiate for a petroleum production licence in the event of a discovery of oil in the exploration area.

Under Article 12 the seller had a right to cost recovery. Article 12.2 states that all exploration, development, production and operating expenses as defined in Annex C incurred by the Licensee shall be recovered as was specified in the Article. Article 13 provided for production sharing. Under Article 13.2 the Government/Licensee profit oil split was to be based on incremental production. In other words, the licensee was entitled to oil proceeds in the event of production. The rates in Articles 12 and 13 were amended by an Addendum, exhibits A5 (i) and (ii). Under Article 16.1 the licensee had a right to

pipeline transportation for export of all petroleum to which it was entitled to. Under Article 17 the licensee had marketing and lifting options. Under Article 17.2 the Licensee had a right to purchase all or any of the Government's Production Sharing attributable to Article 13. Under Article 19 the Licensee had rights in respect of natural gas. Under Article 22 the licensee had a right to use all land under the Agreement rent-free (save in respect of surface rentals payable) until the Agreement is terminated. However the said land and all equipments and other assets became the property of the government. The Licensee had unlimited and exclusive use of such equipments and assets. Under Article 24 the licensee had a right to assign its rights and privileges, duties and obligations under the Agreement with the consent of the Government.

Under the JOA, exhibit A8, the applicant had a participating interest which under Article 1.45 meant the undivided percentage interest of each party in the rights and obligation from the contract and the agreement. The contract(s) were the PSAs. Under Article 32 the participating interest was 50%. Under Article 3.3 (A) of the JOA, the applicant had rights and interests in and under the Contract(s), of all joint property, and any hydrocarbons produced from the contract area. Under the said Agreement the applicant through its wholly owned subsidiary Heritage Oil and Gas (U) Ltd had rights and duties stated under Article 4.2. These included the rights, functions and duties of an operator under the Contract and the applicant had exclusive charge of and conduct of all joint operations. Under Article 4.6 there was a limit on the liability of an operator. Article 7.9 dealt with the use of property. Under Article 9.1 each party had a right and obligation to own, take in kind and separately dispose of the share of total production available to it from any exploitation area pursuant to the contract.

The licences were issued under Article 3.1 of the PSAs and in pursuant of Section 9 of the Petroleum (Exploration and Production) Act. It would be inconceivable to say that the applicant sold only its rights under the licences to Tullow for US$ 1,450,000,000. The exploration licences which were last renewed on the 12th September 2008 and 5th May 2009 for Blocks 3A and 1 respectively, exhibits R1, were issued jointly to the applicant and Tullow as "one licensee". The licences did not sever or demarcate the portion of the contract area of which each co- licence holder would explore. As the applicant cited John T. Mugamba's in *Principles of land Law in Uganda* page 142 "a licence is permission given to a licensee to enter the Licensor's land for some specified purpose or purposes which would otherwise be trespass". Permission cannot be severed. The effect of the sale under the SPA did not have substantial effect on the rights under the licence because Tullow already had permission to explore for petroleum in the said areas under the licences as a joint holder. The applicant paid US$ 250,000 for the licenses as signature bonuses. There is evidence that oil was discovered. Without the discovery the applicant could not have sold its interests for US$ 1,450,000,000. Definitely for licences that were bought for US$ 250,000 it is inconceivable that it would be sold more than ten times its price, of course without taking into consideration the licences were jointly owned. The applicant sold more than a licence to Tullow. Tullow was eyeing the pot of 'black gold' at the end of the rainbow when it purchased the applicant's interests. Both the PSAs and JOA created rights and interests which the applicant sold to Tullow. It sold inter alia, the right to cost recovery, the right to entitlement to proceeds in event of production and also the rights, privileges, immunities mentioned in the PSAs and JOA. The applicant sold its participatory interest to Tullow and of course the corresponding entitlements thereto. The Tribunal agrees with the respondent

that the applicant sold a bundle of rights and interests to Tullow and therefore earned income. The sale of the applicant's rights and interests was a sale of property.

Having discussed what the applicant sold, the Tribunal shall now address the issue whether what was sold is taxable. In *Vodafone International Holdings B.V. V Union of India and another* Writ Petition 1325 of 2010 it was stated that the nexus connecting a person to the jurisdiction which seeks to tax may arise as a result of the physical presence of the non-resident. The nexus may also arise where the source of income originates in the jurisdiction.

The respondent contended that the applicant sold interests in immovable property. Article 6.1 of the Double Taxation Agreement between Mauritius and Uganda provides that income derived by a resident of a Contracting State from immovable property (including income from agriculture or forestry) situated in the other Contracting State may be taxed in that other state. The question is: Did the sale of the applicant's interest in Blocks 1 and 3A amount to immovable property under the law?

The law of Uganda that governs taxation of income from immovable property is the Income Tax Act. S. 4(1) of the Income Tax Act provides that there shall be a tax known as income tax to be charged for each year of income and is hereby imposed on every person who has chargeable income for the year of income. Under S. 15 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 for the year. S. 17(1) provides that the gross income of a person for the year is the total amount of business income, employment income and property income. S. 17(2) states that for purposes of Subsection (1) the gross income of

a non- resident person includes only income derived from sources in Uganda. S. 17(3) provides that unless otherwise, Part V of the Act which deals with accounting principles shall apply in determining the amounts derived for purposes of the Act. Part VI, in particular S.50, deals with the gains and losses on disposal of assets.

S. 18 of the Income Tax Act deals with taxation of business income. Business income refers to any income derived by a person carrying on a business and includes the amount of any gain derived by a person on the disposal of a business asset. Under S. 2(g) of the Act "business" includes any trade, profession, vocation or adventure in the nature of trade, but does not include employment; Under S. 2(h) "business asset" means an asset which is used or held ready for use in a business, and includes any asset held for sale in a business and any asset of a partnership or a company. Since the applicant disposed of a business asset, Part VI of the Act applies.

It is not in dispute that the applicant is a non-resident person. However the Act, S. 17(2) requires for a non-resident person, income should be derived from sources within Uganda. The source of income of a non-resident person is determined in accordance with the source rules stated in S.79 of the Income Tax Act. The respondent relied on S. 79 (g) of the Income Tax Act which reads as follows; Income is derived from sources in Uganda to the extent to which it is-

> "(g) derived from the disposal of an interest in immovable property located in Uganda or from the disposal of a share in a company the property of which consists directly or indirectly principally of an interest or interest in such immovable property, where the interest or share is a business asset;"

The respondent contends that the bundle of rights and interests the applicant sold to Tullow amounted to an interest in immovable property. The applicant

contends that the sale of its rights and interest did not amount to an interest of immovable property under S. 79(g) of the Income Tax Act. The respondent also relies on S. 79(s) which reads that income is derived from a source which is attributable to any activity which occurs in Uganda, including an activity conducted through a branch in Uganda.

Article 6.2 of the Double Taxation Agreement provides that the term "Immovable property" shall have the meaning which it has under the law of the Contracting State in which the property in question is situated. The term shall in any case include "property accessory to immovable property, livestock and equipment used in agriculture and forestry, rights to which the provision of general law respecting landed property apply, usufruct of immovable property and rights to variable or fixed payments as consideration for the working of, or the right to work, mineral deposits, sources and other natural resources." *Halsbury Laws of England* 5th Edition, Volume 19, Paragraph 676, page 1 states that whether property is movable or immovable is determined by the law of the place where the property is situated.

The Tribunal notes that there is no statutory definition of immovable property in Uganda. The applicant submitted that the Income Tax (Amendment) Bill 2011 attempts to introduce a definition of immovable property which the respondent denied. The applicant argued that the fact that the Bill attempts to introduce a licence as immovable property means that currently it (a licence) is not immovable property. The Tribunal wishes to state that as long as a bill is a draft it is not law. The Tax Appeals Tribunal cannot speculate about or on the intentions of Parliament. In the absence of a statutory definition of immovable property the Tribunal will resort to rules of statutory interpretation to guide it to

define an interest in immovable property under S. 79(g) of the Income Tax Act. The Tribunal will also be guided by the Double Taxation Agreement.

The basic principles of statutory interpretation are not to be found in any statute. They have been developed from decisions of courts. The basic rule is that a tax must be expressly imposed upon the subject by the clear words of the statute. In *Vodafone International Holdings B.V. V Union of India* (supra) at page 61 it is stated that the principle of law is that in interpreting fiscal legislation, the court is guided by the plain language and the words used. Courts follow interpretative techniques which promote certainty in the application of law. In *Rennel V IRC* [1962] Ch. 329 it was stated by Donovan J. that "Nevertheless, in the end, one simply has to look at the words of the statute and construe them fairly and reasonably, and if such a construction yields anomalous results in particular cases, it is a common place that they be accepted, whether it be the crown or the taxpayer who is thereby advantaged. The Tribunal agrees with the respondent's citation of *St. Aubyn V Attorney General* [1951] 2 ALL ER 473 at 485 where it was stated that "it is a well established rule, that the subject is not to be taxed without clear words for that purpose; and also that every Act of Parliament must be read according to the natural construction of its words.." The Tribunal wishes to emphasize that the words of the Act must be given their natural meaning.

What does "natural construction of words" mean? In defining words the Tribunal should look at what the ordinary man in the street would construe them to be. The tax laws like any other statute are intended to be applied to also the ordinary man on the street and not only to the lawyers and the accountants in their air conditioned offices. The law should be clear so that the ordinary man on the street should be able to understand his tax liability. The

law should not be used by the tax collector to obscure tax liability and impose a heavier tax burden on the taxpayer or to avoid payment of tax by the taxpayer. The accountants who make tax statements, the auditors who verify them, the tax collectors, the policy makers and the legislators who make the tax law are in most cases laymen. There is a maxim – "*Benigne faciendae sunt interpretationes propter simplicitatem laicorum, ut res magis valeat quam pereat; et verba intentioni, non e contra, debent inservire"* meaning constructions (of written instruments) are to be made liberally, for the simplicity of laymen, in order that the matter may have effect rather than fail (or become void); and words must be subject to the intention, not the intention to the words. See *Black's Law Dictionary* 8th Edition, page 1707. In *Canada Trustco Mortgage V Canada* [2005] 2 S.C.R. 601, 2005 SCC 54 at paragraph 11 it was held that taxpayers are entitled to rely on the clear meaning of taxation provisions in structuring their affairs. Where the words are precise and unequivocal, those words will play a dominant role in the interpretative process.

In *Haji Nasser Kibirige Takuba V Kawempe Local Government Council and 2 others* 2008 U.L.R 571 the court held that where attributing the ordinary grammatical meaning of words used in a statute would result into disharmony, that is to say inconsistency, incongruity, repugnancy, illogicality or outright absurdity within the statute itself or between the statute and its purpose or object or between the statute and another statute, then court could modify the ordinary meaning so far as is necessary to avoid absurdity and produce harmony and effectiveness of the law. The court further held that absurdity in law is anything which is so irrational, unnatural or so inconvenient that it cannot be reasonably supposed to have been within the intention of the men and women of ordinary intelligence and discretion such as members of public who enacted the law.

Also the intention of Parliament should be clearly discerned. Where the meaning of a statute is clearly expressed, a court will not have regard to any contrary intention or belief of parliament. Where the meaning of the statute is not clear it should, if possible, be construed so as to carry out the expressed or presumed intention of Parliament. In *Stubart Investments Ltd. V the Queen* [1984] 1 S.C.R 536 the court held that "the words of an Act are to be read in their entire context and in their grammatical and ordinary sense harmoniously with the scheme of the Act, the object of the Act, and the intention of Parliament. In *Vodafone International Holdings B.V. V Union of India* (supra) it was stated that where the words of a statute give rise to more than one reasonable interpretation, the ordinary meaning of words will play a lesser role, and greater recourse to the context and purpose of the Act may be necessary.

Having stated the guiding rules of statutory interpretation, the Tribunal will now address itself to what the Income Tax Act meant by "interest in immovable property" in S. 79(g). This shall be done in light of the Double Taxation Agreement.

While land law is important in defining "immovable property" the meaning should not differ much from the ordinary sense. The *Oxford Advanced Learner's Dictionary* 6th Edition, page 598 defines "immovable" as "that cannot be moved". At page 935, the said dictionary defines property as 'a thing or things that are owned' or 'a possession or possessions'. *Black's Law Dictionary* 8th Edition, page 765 defines "immovable property" as property that cannot be moved; an object so firmly attached to land that it is regarded as part of the land. It considers in its legal aspect, immovable property to include a piece of land. It is not disputed that the ordinary and or legal meaning of 'immovable

property' consists of land. Blocks 1 and 3A of the Albertine Graben are pierces of land and therefore constitute immovable property.

The nearest interpretation of what constitutes land is provided under the Interpretation Act. S. 2(ll) of the Act provides that "land" includes messuages, tenements, hereditaments, houses and buildings of any tenure and land covered by water. Under the Petroleum (Exploration and Production Act) S. 1(p) Land includes land beneath water and the subsoil thereof. These definitions do not mention all what land is or what it excludes. At common law the definition of land includes everything that is attached to it. John T. Mugamba's in *Principles of land Law in Uganda* at page 51 says that: "The common law definition of land includes everything that attaches to it. This proposition is summed up in yet another Latin maxim: *quic quid plantatur solo, solo cedit*. Literally translated, it means that which attaches to the land goes with it." At page 52 he says that: "A fixture is a thing attached to land in such a way that in law it becomes part of the land". *Megarry's Manual of the Law of Real Property* 6th Edition, page 19 states that:

> "The general rule is "*quicquid plantatur solo, solo cedit*" (whatever is attached to the soil becomes part of it). Thus if a building is erected on land and objects are attached to the building, the word "land" prima facie includes the soil, the building and objects fixed to it;"

It is clear that land is immovable property and that Blocks 1 and 3A are land. The Tribunal will discuss later whether the things attached to land are immovable property.

However S. 79(g) of the Income Tax Act mentions "interest in immovable property". The Double Taxation Agreement stated that immovable property shall have the meaning under the law of the Contracting State where the property is situated. The Income Tax Act defines immovable property to include

an “interest” in ‘immovable property’. The Double Taxation Agreement Article 6 states that land shall include property accessory to immovable property. The word ‘accessory’ as an adjective is defined by the *Oxford Advanced Learner’s Dictionary* 6th Edition, page 6 as “not the most important when compared to others”. *Black’s Law Dictionary* (supra) at page 15 defines ‘accessory’ as something of a secondary or subordinate importance. In *Vodafone International Holdings B.V. V Union of India (supra) at* page 54 the court stated that “the acquisition of an interest in a joint venture does amount to the acquisition of a capital asset. The acquisition of a bundle of interests amounted to acquisition of property in India.” Therefore an ‘interest’ is property. The Income Tax Act deemed it necessary to include it as a property accessory to immovable property. This does not offend the Double Taxation Agreement. The pertinent issue before the Tribunal is now whether what the applicant sold to Tullow amounted to an ‘interest’ in ‘immovable property’ under S.79 (g) of the Act.

The Income Tax Act gives a definition of ‘interest’ in S. 2(kk) which reads;

> “Interest” includes—
> (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;”

The above ‘interest’ is not what is contemplated by S. 79(g) of the Income Tax Act. There is another ‘interest’ which the Act omitted to define.

Black’s Law Dictionary 8th Edition, page 828 defines a second type of ‘interest’ as;

> "1. The object of any human desire; esp., advantage or profit of a financial nature <conflict of interest>. 2. A legal share in something; all or part of a legal or equitable claim to or right in property <right, title, and interest>. Collectively, the word includes any aggregation of rights, privileges, powers, and immunities; distributively, it refers to any one right, privilege, power, or immunity.

The layman's *Oxford Advanced Learner's Dictionary* 6th Edition at page 625 defines interest inter alia to mean "a good result or an advantage for somebody or something"; "a share in business" and "to attract your attention and make you feel interested".

The Tribunal already noted that the applicant sold its bundle of rights, interests, privileges and powers under the PSAs or its legal share in Blocks 1 and 3A to Tullow. These included its right to recovery of costs and an entitlement to a profit in the event of production. It sold its participatory interest to Tullow which is almost the same as its share in business. The applicant sold its legal share and or share of the business in the PSAs and JOA. Under the above definition of the dictionary it would be correct to say it sold its 'interest' to Tullow. However the interest has to be in immovable property. A question arises as to whether what the applicant sold to Tullow included an "interest" in immovable property.

The Double Taxation Agreement Article 6 states that immovable property shall include usufruct of immovable property. The term 'usufruct' is not defined in the Agreement. *Black's Law Dictionary* 8th Edition, page 1580 defines usufruct as;

> "A right to use and enjoy the fruits of another's property for a period without damaging or diminishing it, although the property might naturally deteriorate over time."

The Tribunal already stated that under Article 22 of PSAs a licensee was allowed to use the areas rent-free subject to surface rentals. Under Article 12 of

the PSAs the licensee is entitled to recovery of costs and under Article13 to oil profits in the event of production. The applicant had a right to enjoy the fruits of the government land. Under Article 25 of the PSAs a licensee is required to use the area in such a way that there is no danger or damage to persons, property or environment. When exploring and drilling for oil, the land is expected to deteriorate. In short the licensee was granted a usufruct over Blocks 1 and 3A under the PSAs.

The Double Taxation Agreement Article 6 states that when defining immovable property regard may be made to the Land Laws of the Contracting State in which the property is situate. The applicant contended that it sold only a licence. The applicant further contended that a licence does not create any estate or interest in property. The Tribunal agrees with the applicant that a licence is permission given to a licensee to enter a licensor's land for some specified purpose or purposes which would otherwise be trespass. However the Tribunal has already held that what the applicant sold to Tullow was not only its rights in the licence but also other entitlements, rights, powers and interests. Did the other interests include an 'interest' in 'immovable property'?

The applicant's definition of an 'interest' is so intertwined with the concept of ownership of 'immovable property'. The thin line between the applicant's perception of 'interest' and 'immovable property' is so blurred that one may think the words are being used interchangeably. When the applicant talks of interest one may think that it is talking of ownership of immovable property or title. The words should be looked at singularly or separately. The Tribunal does not think that the legislature would have added the words 'interest in' to 'immovable' 'property' if they were to have no effect. Interest should be looked at separately and given its ordinary or legal meaning. When referring to

Halsbury's Laws of England, the applicant submitted that a licence does not create any estate or interest in the property to which it relates. What the applicant is talking about is the concept of 'proprietary interest' which is similar to the concept of estate in real property under land law which differs from the ordinary and legal meaning of 'interest'. An interest does not only have to be proprietary. An interest is an interest, whether legal or equitable, proprietary or non-proprietary, business or legal. For instance a beneficiary to an estate of a deceased or a trust may have a legal interest (as opposed to a business one) in immovable property which crystallizes on his registration as proprietor. A proprietary interest gives the owner title to property and a right to control possession. A non- proprietary interest may give a right to possession or a potential right to a future title e.g. a mortgage. In land law there are non-proprietary interests such as charges, mortgages and other equitable interests. A licence in itself gives unrestricted or a qualified right to entry and possession. A licence exclude others persons other than the licence holder from enjoying the same rights in the land under the licence. This exclusivity creates an ordinary "interest" in property whether it is immovable or not. Under S.12 of the Petroleum (Exploration and Production) Act the licence holder has the exclusive right to explore for petroleum and to carry out such operations and execute such works as maybe necessary in the exploration area. No other person can interfere with the possession of the licence holder unless as provided for in the licence. In its ordinary meaning, a licence creates an "interest" in land. In *Cape Brandy Syndicate V IRC* [1921] 1 KB 64 at 71 it was stated that

> "In a taxing Act one has to look merely at what is clearly said. There is no room for any intendment. There is no equity about tax. There is no presumption as to tax. Nothing is to be read in, nothing is to be implied. One can only look fairly at the language used."

The applicant's definition of interest presupposes only proprietary interest. Words should be subject to intention and not intention to words. When taking into consideration the case of *Haji Nasser Kibirige Takuba V Kawempe Local Government Council and 2 others (supra)* the word "interest" should be given its ordinary and wide meaning as envisaged by "men and women of ordinary intelligence and discretion such as members of public who enacted the law." The Tribunal does not think that it was the intention of the legislature when enacting the Income Tax Act to tax only the owners of proprietary interests who sell their interests in immovable property. Otherwise non-resident taxpayers who are owners of developments on public land and customary land ('bibanjas') would get away scot-free without paying taxes on capital gain on the disposal of the developments. When defining 'immovable property' in the Income Tax Act, regard may be made to the land laws and tenure system in Uganda.

The words "immovable property" are considered as one term in Article 6 of the Double Taxation Agreement. Article 6.2 clearly states that the term "immovable property…." Likewise in order to align the Income Tax Act with the Agreement one should consider the words "immovable property" as one term and not the words "interest in immovable property" as one term. If this was so, the Tribunal would have agreed with the applicant that the term "interest in immovable property" refers to estate in real property. Under the Income Tax Act interest is merely property accessory to immovable property.

Black's Law dictionary (supra) when defining 'interest' mentions a 'legal claim to something' whether it is 'legal or equitable'. Both parties did not fully address the Tribunal on the fact that in land law there are legal and equitable interests

in land. In *John Katarikawe V William Katwiremu* [1977] HCB 187 it was held that;

> "In a land system based on registration there are basically two interests, the registered estate and other registrable interests such as mortgages and charges. Equity will, however intervene to protect other unregistrable interests in limited circumstances. Registered interests, especially the registered estate are known as rights in rem and bind the whole world. The other rights are rights in personam; such rights may often arise from contracts for sale of land before transfer. The purchaser acquires an equitable interest in the nature of a right in personam enforceable only against the vendor."

Financial interests in land usually create claims or interests in land. Where there are registered they are legal; where they are not the interests are equitable. Under Article 22 of the PSAs, the licensee had a right to continued use of the property rent- free (save in respect of surface rentals payable) until the Agreement is terminated. Under Article 29.1 of the PSAs the licensee was required to pay an annual charge in respect for the area. Under Article 29.2 the annual rentals payable were to be paid in advance. Though the PSAs were not leases they had effect of renting out the areas to the licensee. Though they claimed to allow the licensee to use the land rent-free the consideration was actually the surface rentals. The applicant was allowed to develop/use the land and drill for oil. The right to explore for oil was granted by a statutory licence which is different from the right to use the land rent-free subject to surface rentals. The right to use the blocks rent-free or subject to surface- rentals granted an equitable interest to the applicant. It was a 'right in personam', binding on the Government. As long as the PSAs are running the Government cannot dispose of Blocks 1 and 3A as it wishes without taking into consideration the rights and interests of the licensee.

In order to bring the issue of ‘interest in immovable property’ to rest, the Tribunal will refer to a decision of the Supreme Court of Canada in *Montreal Trust Company V Minister of National Revenue* [1962] S.C.R. 570. In that case, Lodestar Drilling Co. was incorporated to carry on the business of contractors for drilling oil well. Under its charter it was empowered to acquire and sell mineral rights. In 1952 Lodestar purchased a half interest from Trans Empire Oils Limited in a farm-out agreement. The terms of the purchase were that Lodestar would drill a test well within a certain time and to a certain depth at its sole risk and expense, and would thereby earn an undivided half interest in the Trans Empire lease. The estimated cost of drilling the well was more than what the company wanted to risk and it therefore sold one half of its own one half interest to Reality Oils Limited for $27,500. Lodestar proceeded to drill the test well at its own expense and found nothing. The Minister re-assessed the company for the taxation year 1952 adding the $27,500 to the declared income for the taxation year 1952, and disallowing part of the 1953 loss previously claimed. What is important to note is that the Court (at page 577) stated that at the time the agreement was made with Reality Company the company had an equitable interest only in the leasehold interest referred to. [Lodestar was not the owner of the lease or lease holder it just had a future interest]. The leasehold interest of the Trans Empire Oils Limited was an interest in land and the interest of Lodestar Company at the time of the sale to the Reality Company was a right to acquire such an interest. When Lodestar drilled the well to completion no production was obtained and the well and the leasehold interest were abandoned. The court held that these circumstances do not, however, affect the disposition to be made of this case. The issue in the said case was inter alia whether the item of $27,500 was properly added to the income by the notice of re-assessment. The court held that the $27,500 received by Lodestar was realized from the sale of a capital asset and not

income in its hands. There was nothing in the evidence to support the view that the sale of half the company's interest in the farm-out agreement was an activity in the nature of a trade in such properties within the meaning of that expression in S. 139 (e) of the Income Tax Act. This was an isolated transaction the company not having purchased or sold properties of this nature during the thirteen years of its life. In the above case no oil was ever produced; this did not stop the court from holding that Lodestar had an equitable interest. Lodestar never obtained the leasehold as the project was abandoned.

Until the promulgation of the Income Tax Act 1997, capital gains were not taxable. Until then only gains or losses on the sale of depreciable assets were taken into account when determining chargeable income. This is the point of departure from the above Canadian Supreme Court decision. The Income Tax Act of 1997 introduced the taxation of the gain or loss on the sale of non-depreciable assets.

The respondent submitted that the applicant is liable to Capital Gains Tax. The Income Tax Act does not mention nor define 'Capital Gains Tax'. *Black's Law Dictionary* 8th Edition page 1496 defines capital gains tax as a tax on income derived from the sale of a capital asset. On page 222 it defines capital gain as the profit realized when a capital asset is sold or exchanged. Under S. 18(1) (a) of the Income Tax Act when carrying on business the amount of any gain whether of a capital or revenue nature derived by a person from a disposal of a business asset is taxable. Under S. 2(g) of the Income Tax Act business includes any trade, profession, vocation or adventure in the nature of trade. There is an English adage that says; "if it looks like a duck, walks like a duck, quacks like a duck it must be a duck." It would be appropriate to say that the

tax on any gains received from the disposal of a business asset or capital gains in the nature of trade taxed under S.18 is Capital Gains Tax.

Article 14 of the Double Taxation Agreement provides that gains derived by a resident of a Contracting State from the alienation of immovable property, referred to in Article 6, and situated in the other Contracting State may be taxed in that other State. Hence capital gains tax is allowed under Article 6 of the Double Taxation Agreement, which Article also defines the term "immovable property" to include "property accessory to immovable property…" S. 88 of the Income Tax Act provides that an international agreement shall have the effect as if the Agreement was contained in the Act. Accessory as a noun is defined by the *Oxford Advanced Learner's Dictionary* (supra) at page 6 as "an extra pierce of equipment that can be added to something". *Black's Law Dictionary (supra)* defines 'immovable property' to include an object so firmly attached to land that it is regarded as part of the land. The Tribunal has already discussed that at common law what is part of land becomes part of it. Article 6 of the Double Taxation Agreement provides that property accessory to immovable property is included in immovable property. The Tribunal has already stated that land is immovable property. Therefore fixtures, equipments or structures attached to land should be included as immovable property. Fixtures include buildings, masts, oil rigs and other developments attached to land. Article 22.2 of the PSAs mentions equipments and other assets which include fixed assets as compared to movable ones acquired and owned by the licensee for use in the Petroleum Operations. Under Article 22.3 the Licensee shall have unlimited and exclusive use of such equipment and assets. If the said equipment is fixed or so firmly attached to land it qualifies under Article 6 of the Double Taxation Agreement as 'immovable property'. The Tribunal does not think that it was that intention of Parliament that if foreign company installed television or

communication masts on land with the 'mere' permission of landowners and disposes them it should get away without paying taxes on the capital gain. Therefore the sale by the applicant of its interests in the said fixtures or property attached to land was a sale of an 'interest' in 'immovable property'.

The applicant does not dispute that the sale of its interests in Blocks 1 and 3A was not in the nature of trade. Under S. 18 of the Tax Appeals Tribunal Act and S. 102 of the Income Tax Act the burden of proving that a taxation decision, where it is an objection decision, is excessive or is erroneous is on the applicant. Despite that, the Tribunal notes that in the Constitution of the applicant, exhibit R9, the objects of the company, under clause 2.1, include the carrying on of business in any part of the world in connection with the exploration of natural resources including crude oil. Clause 2.2 allows the party to prospect for and deal in natural resources. Clause 2.3 allows the company to exchange any concessions, grants, claims, licences, leases, options, rights etc. Under clause 2.4 the company could do any act that is incidental or conducive to the attainment of the company's object. Therefore it is not disputable that the sale of the company's participating interest under the PSAs and JOA to Tullow was in the nature of trade. This is buttressed by the fact that the proceeds received by the applicant were treated as income. Exhibit R4 dated 2nd August 2010 shows that the applicant made a declaration of a special dividend to its shareholders on the completion of the sale of the company's entire interest in Blocks 1 and 3A in Uganda to Tullow. There can be no dividend unless there is income. This income obtained should therefore be liable to tax.

Part of the property the applicant sold to Tullow was a bundle of rights, which the Tribunal has already discussed. The *Black's Law Dictionary* (supra) defines a right to include;

> "..... 3. A power, privilege, or immunity secured to a person by law <the right to dispose of one's estate>. 4. A legally enforceable claim that another will do or will not do a given act; a recognized and protected interest the violation of which is a wrong <a breach of duty that infringes one's right>. 5. *(Often pl.)* The interest, claim or ownership that one has in tangible or intangible property…"

A right creates a chose in action. A chose in action is defined by the *Black's Law Dictionary* to include the "right to bring an action to recover a debt, money or thing". A chose in action is movable and intangible property. These rights are chose in actions pertaining to Blocks 1 and 3A which is immovable property. Without the immovable property, the said rights could not have arisen. Under Article 6 of the Double Taxation Agreement property accessory to immovable property is included in immovable property. Hence the rights sold to Tullow in respect of Blocks 1 and 3A should be included in immovable property.

The Double Taxation Agreement does not restrict the Contracting State to tax only income from immovable property. The Agreement allows for the taxation of business profits, shipping and air transport, associated enterprises, dividends, interest, royalties inter alia. The Income Tax Act of Uganda also does not limit itself to taxing income by non-residents from immovable property. S. 79 has other rules which may determine the source of income of a non-resident. The most important requirement is that income must be sourced in Uganda.

S. 79 (s) of the Income Tax Act states that "any income attributable to any other activity which occurs in Uganda, including an activity conducted through a branch in Uganda is taxable". The applicant objected to the application of the above section on the ground that the SPA was discussed and signed outside Uganda. The tax liability of a non-resident arises where the source of income originates and where the contract is signed is not of paramount importance. The question as to where income has accrued is a question of fact. In

Vodafone International Holdings B.V. V Union of India and another (supra) an agreement in respect of a sale of assets situated in India was signed outside India. The money was paid and received outside India. The court held that "the source of profits and gains of business is indubitably and the place of their accrual is where the business is carried on.... the situs of the capital asset is the crucial jurisdictional condition that must be fulfilled in order to attract chargeability to tax of income arising from the transfer of a capital asset..." The essence of the said decision is that the activity where a transaction takes place has a bearing on where the tax is liable.

S. 79(s) states that the income should be attributable to an activity which occurs in Uganda. An activity is defined under the *Black's Law Dictionary* 8th Edition p.36 to mean the collective acts of one person or two or more persons engaged in a common enterprise. The common enterprise the applicant was engaged in with the government of Uganda was located in Uganda. The common enterprise involved the activity of exploration of oil which was situated in Uganda. The Tribunal notes that the SPA concerned the sale of rights and interests inter alia arising from immovable property, Blocks 1 and 3A, situated in Uganda. In order to complete the sale there was need to obtain the consent of the Government of Uganda. All these activities had their nexus in Uganda. What was abroad were discussions and signing of documents but the income obtained from the sale of the applicant's interest arose from activity based in Uganda. Hence any income derived from the said activity is liable to taxation in Uganda.

S. 79(s) of the Income Tax Act can be read together with Article 7 of the Double Taxation Agreement. Article 7 of the Double Taxation Agreement provides that the profits of an enterprise of a Contracting State shall be taxable only in that

state unless the enterprise carries on business in the other Contracting State through a permanent establishment situated therein. If the enterprise carries on business, the profits of the enterprise may be taxed in the other state but only so much of them as are attributable to that permanent establishment. Under Article 5, for the purposes of the Agreement, the term “permanent establishment” means a fixed place of business through which the business of an enterprise is wholly or partly carried on. Under Article 5(2) (g) of the Double Taxation Agreement the term “permanent establishment’ shall include a mine, an oil or gas well, a quarry or any other place of extraction of natural resources.” Oil was discovered in Block 3A. Under Article 5(3) (a) the permanent establishment likewise encompasses a building site, a construction, installation or assembly project or supervisory activities in connection therewith only if the site, project or activity lasts more than 6 months. It is not denied that the applicant did not carry on business through permanent establishments in Uganda namely the structures in Blocks 1 and 3A. These permanent establishments are immovable property. Under Article 5(6) of the Double Taxation Agreement an enterprise shall be deemed to have a permanent establishment if its agent of an independent status is acting in the ordinary course of their business. Heritage Oil and Gas (U) Limited is deemed to have been acting in the ordinary course of business of exploration for the applicant. Under the Double Taxation Agreement one would look at where the permanent establishments which are the subject of the sale are, and not where the agreement was signed.

The difference between Articles 6 and 7 is that under Article 7 of the Double Taxation Agreement there is need for apportioning the tax from the business profits when it arises from more than one jurisdiction. The profits of the enterprise may be taxed in the other state but only so much of them as are

attributable to the permanent establishment. The income which results from the activity has to be apportioned so as to determine what part of the income can be attributable to the business which is carried on in the taxing jurisdiction. In this matter before the Tribunal though the applicant had a nexus with the Mauritius by virtue of it being a taxpayer in its jurisdiction the permanent establishments were not in Mauritius. Mr. Atherton testified that the applicant has no oil business in Mauritius.The SPA was negotiated in the Channel Islands with some discussions in the United Kingdom (London) and in the Netherlands. Other than Uganda and Mauritius the Double Taxation Agreement does not confer jurisdiction to tax business profits on the states where the SPA was discussed and signed. The applicant did not adduce evidence or submit that there is another taxing jurisdiction other than Mauritius and Uganda. Apart from the discussion and signing of the SPA, which was not in Mauritius the applicant did not adduce any evidence to show that the business profits subject of the taxation in this application wholly could not be attributed to the permanent establishments in Uganda. The applicant did not discharge the burden on it under S. 18 of the Tax Appeals Tribunal Act and S.102 of the Income Tax to prove that income obtained by the applicant or a portion thereof cannot be attributed to the permanent establishments in Uganda.

The Tribunal has already held that the sale of the applicant's bundle of interests and rights was a sale of property. The property sold was both immovable and moveable for instance the chose in actions. The moveable property was accessory to immovable property and is deemed under the Double Taxation Agreement to be immovable property. S.88 of the Income Tax Act requires that the Double Taxation Agreement should be read together with the Act. The Tribunal therefore holds that the applicant's sale of its interests in Blocks 1 and 3A under the Sale and Purchase Agreement (SPA) was a sale of an interest in

immovable property which is taxable under the Income Tax Act. In the event the Tribunal was said to be wrong in stating that the applicant sold an interest in immovable property (which it still holds rightfully and maintains as its position), the sale of the bundle of interests and rights would still fall under S. 79(s) of the Income Tax Act and Article 7 of the Double Taxation Agreement as the applicant earned business profit which is taxable. Issue one is therefore resolved in favour of the respondent.

On the second issue the applicant contended that at the time the assessment was issued the applicant had not concluded the transaction of sale. No payment had been received by the applicant. No consent had been obtained from the government. Therefore no assessment was due.

The applicant further contended the assessment was invalid because it was issued under the wrong law. The assessment was made under S. 95 of the Income Tax Act on the basis that the applicant had defaulted to furnish a return. The applicant contends it never defaulted to file a return. It files its returns in Mauritius. It cannot be deemed to have defaulted. The year of income had not ended and the return was not due. S. 95 of the Income Tax Act reads;

> "(1) Subject to section 96, the Commissioner shall, based on the taxpayer's return of income and on any other information available, make an assessment of the chargeable income of a taxpayer and the tax payable thereon for a year of income within seven years from the date the return was furnished.
>
> (2) Where—
>
> (a) a taxpayer defaults in furnishing a return of income for a year of income; or
>
> (b) the commissioner is not satisfied with a return of income for a year of income furnished by a taxpayer, the commissioner may, according to the

commissioner's best judgment, make an assessment of the chargeable income of the taxpayer and the tax payable thereon for that year.

(3) Where the commissioner has made an assessment under subsection (2) (b), the commissioner shall include with the assessment a statement of reasons as to why the commissioner was not satisfied with the return.

(4) In the circumstances specified in section 92(8), in lieu of requiring a return of income, the commissioner may, according to the commissioner's best judgment, make an assessment of the chargeable income of the taxpayer and the tax payable thereon for the year of income."

S.95 (4) allows the Commissioner General to use her best judgement in lieu of requiring a return of income under S. 92(8) to make an assessment. The applicant contends that the respondent did not ask it to furnish a return. Therefore the applicant argued that the commissioner had no powers to issue an assessment.

The applicant also complained that the Commissioner not only cited the wrong rules but also the rules cited in the assessment differed from what was in the objection decision. The Commissioner instead of referring to the rules cited in the assessment, i.e. S. 95, in her objection decision she relied on S. 92(8) of the Income Tax Act. S.92 (8) reads that;

"(8) Where, during a year of income—

(a) a taxpayer has died;

(b) a taxpayer has become bankrupt, wound-up or gone into liquidation;

(c) a taxpayer is about to leave Uganda indefinitely;

(d) a taxpayer is otherwise about to cease activity in Uganda; or

(e) the commissioner otherwise considers it appropriate,

the commissioner may, by notice in writing, require the taxpayer or the taxpayer's trustee, as the case may be, to furnish, by the date specified in the notice, a return of income for the taxpayer for a period of less than 12 months."

Under S. 92(8) of the Income Tax Act, the respondent contended that Commissioner may require the taxpayer of furnish a return when a taxpayer is

about to leave indefinitely. The section uses the word “may” and not “shall” which means the Commissioner has the discretion to ask the taxpayer to furnish a return. In other words the Commissioner also has the option of not asking the taxpayer to furnish a return. The Commissioner is required to exercise her discretion. Administrative discretion must be exercised reasonably.

S.93 of the Income Tax Act provides for a situation where the Commissioner may not require a return of income. S. 93 of the Income Tax Act. reads;

> “Unless requested by the Commissioner by notice in writing, no return of income shall be furnished under this Act for a year of income—
>
> (a) by a non resident person where section 87 applies to all the income derived from sources in Uganda by the person during the year of income;”

Under S. 87 the tax imposed on a non-resident person under sections 83, 84, 85 and 86(1) is a final tax on the income on which the tax has been imposed. Under S. 85 a tax is imposed on every non-resident person deriving income under a Ugandan-source services contract. Under S. 85 (4), a “Ugandan-source services contract” means a contract, other than an employment contract, under which— (a) the principal purpose of the contract is the performance of services which gives rise to income sourced in Uganda. This section is not applicable in the current case. The SPA is not a Ugandan-source service contract.

S. 95(4) of the Income Tax Act provides that in the circumstances specified in section 92(8), in lieu of requiring a return of income, the commissioner may, according to the commissioner’s best judgment, make an assessment of the chargeable income of the taxpayer and the tax payable thereon for the year of income. S. 95(4) does not stop a taxpayer from filing a return of income when the Commissioner has issued an assessment. The Act is silent as to the time or

stage when a taxpayer may furnish a return. A prudent taxpayer can still furnish a return when objecting to an assessment of the Commissioner General. The Commissioner General is still obliged to consider it when making an objection decision. The applicant's complaint is that the Commissioner never asked for a return and therefore could not in lieu of the return issue an assessment. Did the Commissioner General exercise her discretion and judgment rationally firstly by not requiring the applicant to furnish a return and secondly by issuing an assessment in lieu of the return?

A tribunal like a court will not interfere in the exercise of a discretion of an administrative officer unless under certain exceptions. Due to the doctrine of separation of powers, the legislature in order to avoid interfering with the executive in the execution of it duties it grants public officers discretionary powers to exercise their statutory duties. The Tribunal, like the legislature does not want to descend into the arena of the administration of the affairs of a public body. *Halsbury's Law of England* 3rd Edition, Volume 30, paragraph 1326, page 687 states that;

> "Where public bodies are given a discretion in the exercise of powers conferred upon them by statute, the courts will not interfere with the exercise of that discretion so long as it is exercised bona fide and reasonably; nor will the decision of an administrative body be interfered with by the courts if there is anything on which that body could reasonably have come to its conclusion."

In *Breen V Amalgamated Engineering Union* [1971] 2. QB 1 Lord Denning underlined the importance of an unfettered discretion by stating that;

> "The discretion of a statutory body is never unfettered. It is a discretion which is to be exercised according to law. That means at least this: the statutory body must be guided by relevant consideration and not by irrelevance. If its decision is influenced by extraneous consideration which it ought not to have taken into account, then the

decision cannot stand. No matter that the statutory body may have acted in good faith; nevertheless the decision will be set aside.”

In *Twinomuhangi Pastoli V Kabale District Local Government Council, Katarishangwa Jack & Beebwajuba Mary* [2006] 1 HCB 30 Kasule Ag. J. (by then) held inter alia that;

“1. *In order to succeed in an application for judicial review, the applicant has to show that the decision or act complained of is tainted with illegality, irrationality and procedural impropriety…”*

2. *Illegality is when the decision making authority commits an error of law in the process of taking the decision or making the act, the subject of the complaint. Acting without jurisdiction or ultra vires, or contrary to the provisions of a law or it's principles are instances of illegality.*
3. *Irrationality is when there is such gross unreasonableness in the decision taken or act done, that no reasonable authority, addressing itself to the facts and the law before it, would have made such a decision. Such a decision is usually in defiance of logic and acceptable moral standards.*
4. *Procedural impropriety is when there is failure to act fairly on the part of the decision making authority in the process of taking a decision. The unfairness may be in the non- observance of the Rules of natural Justice or to act with procedural unfairness towards one to be affected by the decision. It may also involve failure to adhere and observe procedural rules expressly laid down in a statute or legislative instrument by which such authority exercises jurisdiction to make a decision.”*

The question is did the Commissioner act legally or exercise her discretion properly or with impropriety when she issued an assessment when the taxpayer had not received income nor filed a tax return, nor had obtained consent from the government?

The normal practice is that taxes are charged on income derived by the taxpayer. However there are times when income maybe chargeable when it

has actually not been received for instance when goods have been sold on credit, or rental income where provisional returns based on estimated receipts have been filed. The law does not expressly prohibit the Commissioner General from issuing an assessment when income has not been received. There is also no law that prohibits the Commissioner General from issuing an assessment before the taxpayer files a return. It is also not explicitly provided in the Income Tax Act that an assessment should only be issued when government has granted consent. What the law does not prohibit it usually allows.

The Law merely requires the Commissioner General to exercise her discretion when requiring a taxpayer to furnish a return and use her best judgement when issuing an assessment under S. 92(8) and S. 95(4) of the Income Tax Act respectively. As regards the Commissioner General exercising her discretion in issuing an assessment before the applicant had filed a return, the Tribunal has to look at the circumstances of the case before it. In respect of an officer exercising judgment in *Van Boeckel V Customs and Excise Commissioners* [1981] 2 ALL ER 505 it was stated “that officer is to make an assessment to the best of his judgment against a person who is in default as regards supplying information. He must not act dishonestly, or vindictively or capriciously because he must exercise judgment in the matter.” The court stated that “what the words “best of their judgment, envisage, in my view, is that the Commissioners will fairly consider all material placed before them and, on that material, come to a decision which is reasonable and not arbitrary as to the amount of tax which is due…”

The Commissioner General testified that the applicant was treaty shopping. It was registering in different jurisdictions in order to reduce its tax liability. Registration per se does not confer a taxpayer status on a person. It is the

business activity or operations, offices and incorporation of the person that confer taxpayer status. Though the fear of the respondent was unfounded that by the applicant moving from jurisdiction to jurisdiction it would not meet its tax obligations in Uganda, the Tribunal notes that the applicant was selling its only asset In Uganda and was about to leave. The applicant was aware that it had tax obligations arising from the sale of its interests to Tullow. Otherwise it would not have offered to give the government an '*ex gratia* payment'. This shows the applicant was reluctant to pay the due and owing tax. This was sufficient to compel the Commissioner General exercise her judgment and issue an assessment. The judgment of the Commissioner General, to issue an assessment when a return had not been filed and when the applicant had sold its only asset and was about to leave the country, cannot amount to 'gross unreasonableness'. The Tribunal does not fault the judgment of the Commissioner General. The Commissioner General did not act dishonestly, vindictively or capriciously.

In *Twinomuhangi Pastoli V Kabale District Local Government Council, Katarishangwa Jack & Beebwajuba Mary* (supra) the court also held that "it is recognised that each statute has to be interpreted on the basis of its own language for words derive their colour and content from their context and the object of the legislation is a paramount consideration. When Parliament prescribes the manner or form in which a duty is to be performed or power exercise, it seldom lays what will be legal consequences of failure to observe its prescriptions. The court must therefore formulate their own criteria for determining whether the procedural rules are to be regarded as mandatory, in which case disobedience will render void or voidable what has been done. To create own criteria, court must consider the whole scope and purpose of the statute and then assess the importance of the impugned provision in relation to

the general object intended to be achieved by the Act. The Tribunal notes that the Income Tax Act gave the Commissioner General discretion to use her best judgement in issuing an assessment. The Act did not lay down the consequences in the event the Commissioner failed to exercise her best judgement. The Tribunal holds that it is not the intention of the Act that in the event the Commissioner General failed to exercise her best judgement the tax liability of the taxpayer would be waived.

There was also contention that no ministerial consent has been obtained. The Sale and Purchase Agreement was signed on the 26th January 2010. The assessment was issued on 6th July 2010. The consent of the government was obtained on the 6th July 2010. The consent of government was granted on the same day the assessment was issued. There is no evidence to indicate that the assessment was issued at a time earlier than the consent. The Tribunal notes that the assessment was issued after the Sale and Purchase Agreement had been signed. It is not disputed that the transaction was eventually consummated by payment of consideration.

S. 44 of the Petroleum (Exploration and Production) Act provides that a transfer of licence shall be of no effect without the approval of the Minister. Under S. 44(3) the Minister may give his approval subject to such conditions as he or she may deem necessary in the circumstance. The Minister had given a condition that taxes should be paid. The condition stated in the consent letter of 6th July 2010, exhibit R12 reads;

> *"For the avoidance of doubt, this approval shall not become effective unless Heritage Oil and Gas Limited has paid the taxes or demonstrated to the satisfaction of the Government of Uganda that the said taxes shall be paid immediately upon demand."*

Apparently the Minister had already deemed that taxes were payable by the applicant. The said letter was copied to the Commissioner General. There is no way the applicant would have known its tax liability unless it was assessed and a tax assessment issued. In order to effect the said decision the Commissioner General issued the assessment. The assessment was issued on the same day as the consent. Hence it cannot be said that the assessment was void. Furthermore it is also apparent that when the consent was obtained on 6th July 2010 and the condition stated therein satisfied, it acted retrospectively to validate all transactions including the Sale and Purchase Agreement (SPA) of 26th January 2010. If the Tribunal were to say otherwise, it would mean that the SPA and the monies obtained by the applicant thereunder were illegal, which the Tribunal does not wish to hold. There is no evidence or submission to that effect. Hence the decision by the Commissioner General to issue an assessment on the day the consent was granted or before the condition therein satisfied is not one which a tribunal would call 'in defiance of logic and acceptable moral standards'.

The Tribunal also finds there was no procedural impropriety. The applicant was allowed to object to the respondent's actions which it did, an objection decision was made to that effect. Therefore it was not denied its right to be heard under natural justice. There was no serious anomaly and miscarriage of justice occasioned to the applicant.

The applicant also contended that S. 57 of the Income Tax Act provides that chargeable income under the Act shall be calculated in Uganda Shillings. The respondent was required to issue the assessment in Uganda Shillings which it did not. The respondent retaliated to this ground by arguing that it was not raised in its objection decision. S. 16 of the Tax Appeals Tribunal Act provides

that;

> "where an application for review relates to a taxation decision that is an objection decision, the applicant is, unless the Tribunal orders otherwise, limited to the grounds stated in the taxation objection to which the decision relates."

The Tribunal notes that the applicant did not raise the issue of the calculation in dollars in its objection. It was not addressed in the objection decision. The applicant did not raise the said issue in its pleading nor was it addressed during the scheduling. The Tribunal did not make an order allowing the applicant to raise the said averment. On this ground alone the submission of the applicant as regards assessment of the tax in shillings shall not be entertained by the Tribunal.

The applicant argued that once an illegality is brought to the attention of a court, it cannot be sanctioned or tolerated. The Tribunal agrees with the applicant that once an illegality is brought to its attention it should not be ignored. We have already stated above that once a public body acts illegally the Tribunal will interfere in its execution of statutory duties. The question is; was the calculation of the tax in dollars illegal? The Tribunal does not think so. The duty of the Tribunal is to interpret the law as it is and not read it to suit the parties. The Tribunal already stated that in interpreting a statute words should be given their ordinary meaning whatever anomaly it may have. There is a difference between 'calculating' and 'assessing' taxes in shillings. The failure to clearly state that the assessment should be in shillings was a result of poor legislative draftsmanship. The effect of such a lack of clarity is to make S. 57 redundant. It is difficult for a taxpayer to prove to the Tribunal that its assessment was not calculated in shillings in light of S. 18 of the Tax Appeals Tribunal Act. The calculation is usually done in the absence of a taxpayer. The respondent may not admit its omission to calculate in shillings and as the onus

is on the taxpayer to prove the omission it may never be proved to the satisfaction of the Tribunal. In any case the Section does not indicate the legal consequences of the failure of the Commissioner to calculate in any currency other than shillings. This section as it stands adds no value to the Act.

The applicant submitted that the respondent's reliance on S. 95(2) to issue the assessment was wrong. The reasons given in the objection decision differed from what is in the assessment. The applicant cited the wrong section of the law in the assessment. S. 98(3) of the Income Tax Act provides that;

> "No notice of assessment, warrant or other document purporting to be made issued or executed under this Act:
>
> (a) Shall be quashed or deemed to be void or voidable for want of form; or
>
> (b) Shall be affected by reason of mistake, defect, or omission therein, if it is, in substance and effect, in conformity with this Act and the person assessed or intended to be assessed or affected by the document, is designated in it according to common intent and understanding."

Any defect in an assessment does not wash away a taxpayer's tax liability. Likewise an objection is not invalid because it did not cite the correct rules stated in the assessment. This goes to want of form and not to substance. On this note in *Cable Corporation Ltd V Uganda Revenue Authority* Civil Appeal 1 of 2001 Madrama J. referred to S. 43 of the Interpretation Act when looking at the effects of anomalies on instruments. The court held that the question of form of the decision cannot be raised so long as its content amounts to an objection decision that addressed the specific question of deferred interest and withholding tax. This is commanded by S. 43 of the Interpretation Act which provides that;

> "Where any form is prescribed by any Act, an instrument or document which purports to be in such form shall not be void by reason of any deviation from that form which

does not affect the substance of the instrument or document or which is not calculated to mislead."

Hence if there is any failure by the respondent to cite the proper rules on the assessment or in the objection decision or to calculate the taxes in shillings or where a premature assessment is given this does not vitiate the assessment.

The applicant contends that it incurred an expense of US$ 182,435,000 which was not considered by the respondent when assessing its income tax liability. The applicant submitted that Mr. Atherton's evidence on the expense was not disputed or challenged by the respondent. The Commissioner General testified that they asked the applicant for invoices to prove those costs and they did not get them. Mr. Atherton did not disclose the source of his information in respect of US$ 182,435,000. He was not involved in the said expenditure. There is no audited statement of account to verify the said expenditure. There was no evidence adduced to show how the said expenditure was incurred. The applicant ought to have adduced the relevant evidence to show the expenditure other than relying on hearsay evidence. The Tribunal notes that the applicant did not raise the said expenditure in its objection to the Commissioner General nor was it addressed in the objection decision. During the Scheduling the parties agreed that the applicant had incurred costs of US$ 150,000,000. The Tribunal will go by the US$ 150,000,000 as the amount of US$ 182,435,000 was not raised in the objection and addressed in the objection decision.

When computing the tax liability the respondent excluded most of the costs incurred by the applicant. Under S.15 of the Income Tax Act chargeable income refers to gross income of the person less total deductions allowed under the Act for the year. S. 22 of the Income Tax Act deals with deductions in order to at arrive at chargeable income. S. 22 of the Income Tax Act provides;

"(1) 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—

(a) all the expenditures and losses incurred by the person during the year of income to the extent to which the expenditure or losses were incurred in the production of income included in gross income;

(b) the amount of any loss as determined under Part VI, which deals with gains and losses on the disposal of assets, incurred by the person on the disposal of a business asset during the year of income, whether or not the asset was on revenue or capital account."

S. 22 (2) further provides;

"(2) Except as otherwise provided in this Act, no deduction is allowed for –

(b) subject to subsection (1), any expenditure or loss of a capital nature, or any amount included in the cost base of an asset.

(c) any expenditure or loss which is recoverable under any insurance, contract or indemnity";

Hence under S. 22 a deduction is not allowed where it is included in the cost base of an asset. Also under 22(2) (b), if an expenditure is recoverable it should not be included as a deduction.

Article 12 of the PSAs provides for cost recovery. Article 12.3 provides that the Licensee shall carry forward to subsequent years all unrecovered costs until full recovery is completed. It is clear the PSA which is a contract provided for expenditure which is recoverable. Under S.22 (2) (c) of the Income Tax Act, such expenditure ought not to be included as a deduction because it is recoverable. When the applicant sold its rights in the PSA to Tullow, this included the right to cost recovery. Therefore it is only logical that the said expenditures ought not to be included in computing the chargeable income of the applicant.

The applicant contended that S.22 of the Income Tax Act is not applicable to transactions involving capital gain. The applicant's submission that S. 22 of the Income Tax Act does not apply when calculating capital gains is misconceived. Deductions are always allowed when computing chargeable income. If a non-resident taxpayer is not allowed to deduct expenses under S.22 its tax liability would be higher. This would be unfair because the expenses it incurred to obtain the taxable income would be ignored. Part VI deals with capital gains. Capital gains and chargeable income are not the same. When a taxpayer receives a capital gain, expenses incurred in the course of business or obtaining the gain are deductable unless as otherwise provided by the Act. In the event the said expenses are not deductible the Income Tax Act provides they can be added to the cost base. Part VI S. 52(6) provides that

> "Unless otherwise provided under this Act, expenditures incurred to alter or improve an asset which have not been allowed as a deduction are added to the cost base of the asset."

This shows that S.22 is relevant in determining expenditures to be allowed or not when calculating capital gains under S.52 (6) of the Act. Deductions not allowed under S.22 but have been incurred to alter or improve the asset should be added to the cost base of the asset.

Apart from the costs of the signature bonuses which were included in the cost base the Income Tax Act allowed the applicant other deductions which were not allowed under S. 22 to be added but ought to have been included if they altered or improved the asset. Under S.102 of the Income Tax Act and S. 18 of the Tax Appeals Tribunal Act the onus is on the taxpayer to prove that the assessment made by the Commissioner is excessive or erroneous. At the scheduling it was agreed that the applicant incurred costs of US$ 150,000,000. The Tribunal cannot discern from the said US$ 150,000,000 which amount was

used to alter or improve the assets or interests which were sold to Tullow. Mr. Atherton testified that the applicant incurred costs for a multiplicity of activities including management, supervision, legal fees, travel, marketing, drilling, analysis, processing, sizing and interpreting data were incurred in the acquisition of the asset. The applicant did not adduce evidence to show which of the said activities and costs incurred in respect thereof were used to alter and improve the interests or assets. By looking at the figure of US$ 150,000,000 the Tribunal cannot arrive at an amount that ought to be deducted and was not and should be added to the cost base.

Computing capital gain under S. 18 is determined under Part VI which deals with gains and losses on disposal of assets. S. 49 states that Part VI applies for the purposes of determining the amount of any gain or loss arising on the disposal of an asset where the gain is included in gross income or the loss is allowed as a deduction under this Act. Under S. 50 (1) the amount of any gain arising from the disposal of an asset is the excess of the consideration received for the disposal over the cost base of the asset at the time of the disposal. Under S.51 (1) (a) A taxpayer is treated as having disposed of an asset when the asset has been sold, exchanged, redeemed or distributed by the taxpayer. Under S.52(2) (2) 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 of any consideration in kind given for the asset. It is not in dispute that the applicant sold his interest or capital to Tullow for US$ 1,350,000,000. It has already been held that the applicant made a capital gain. Article 9 of the PSAs provides that upon the signing of the agreement the licensee shall pay to the Government a sum of US$ 300,000 as signature bonuses. The applicant actually incurred a

cost of US$ 250,000 for the signature bonuses. The respondent rightly treated it as the cost base and deducted it from the amount of the disposal of the asset leaving a gain of US$ 1,349,750,000 which was rightfully taxed.

Having regard to all the circumstances of this application and for the reasons we have stated above the Tribunal holds that the applicant has failed to satisfy the requirement that the assessment by the respondent was excessive and or erroneous. This application is dismissed with costs to the respondent.

Dated at Kampala this ……. day of……2011

……..	…….	……
Asa Mugenyi	Stephen Akabway	Pius Bahemuka
Chairman	Member	Member