

TAX APPEALS TRIBUNAL
IN THE TAX APPEALS TRIBUNAL AT KAMPALA
APPLICATION NO. 32 OF 2018

1. PROF. EMMANUEL TUMUSIIME MUTEBILE
2. DR. LOUIS A. KASEKENDE
3. MS. JUDY OBITRE GAMA
4. MR. SOLOMON O. OKETCHO
5. MR. RICHARD BYARUGABA
6. MS. PELLY RUTAMWEBWA MUGASI
7. MR. EDWARD KATIMBO MUGWANYA
8. MR. ISAAC BONNY TEKO

**AS TRUSTEES OF THE BANK OF
UGANDA BENEFITS SCHEME**

::: APPLICANTS

VERSUS

UGANDA REVENUE AUTHORITY ::::::::::::::::::::::::::::::::::::::: RESPONDENT

**BEFORE DR. ASA MUGENYI, DR. STEPHEN AKABWAY, MR. GEORGE
MUGERWA**

RULING

This ruling is in respect of an application challenging the respondent's income tax assessment of Shs. 106,162,667 on the applicants.

The applicants are trustees of the Bank of Uganda Defined Benefits Scheme which is composed of employees of the bank and its retired staff. The employees in the scheme contribute 4% of their salaries while Bank of Uganda contributes 17.1 % to the scheme per month. The retired members do not contribute anything. The contributions are invested under the scheme. The applicants sought a private ruling from the respondent on tax status of the scheme, whereby the latter ruled that the scheme was not a settlor trust and therefore not tax exempt.

The following issues were agreed upon.

1. Whether the scheme is a tax exempt?
2. What remedies are available?

The applicants were represented by Ms. Ruth Ssebatindira SC and Ms. Olivia Matovu while the respondent was by Ms. Nakku Mwajuma and Mr. Donald Bakashaba.

The contention between the parties revolves around the imposition of corporation tax on the income of a defined benefit scheme where one of the contributors is tax exempt. The applicants contend that they are not liable to tax because their scheme is a settlor's scheme which is exempt from income tax. The respondent argued that the exemption status does not apply to the applicants' scheme.

The applicants' first witness, Mr. Edward Kitimbo Mugwanya, a member of Bank of Uganda Defined Benefits Scheme testified that the scheme is open to all permanent staff of the bank above 18 years and below 55 years of age. He testified that the scheme was set up to provide pension/ annuities for its members upon retirement and the benefit is calculated on accrual factor. The costs and expenses for management and operation of the scheme are paid by the Bank of Uganda and not out of the scheme's income. The Bank of Uganda Defined benefits scheme was established in 1968 by a trust deed. In 1996 and 2005 it was amended. In 2005 the trust deed was amended to provide for a monthly contribution by employees of 2% of their salary. In 2014, Bank of Uganda as a sponsor replaced all the Trust Deeds with a new one called Bank of Uganda Defined Benefits Scheme. The scheme was licensed upon coming into force of Uganda Retirement Benefit Regulatory Authority (URBRA) Act, 2011. The monthly contribution rate was raised to 17.1% for the bank and the member's contribution to 4% of their salary. The bank has the obligation to pay and clear any deficit in the scheme where the unfunded benefits are greater than the value of the assets. The actuarial valuation established that in 2010, there was a deficit 105,500,000,000, in 2012 a deficit of 16,000,000,000, in 2013 Shs 15,000,000,000, in 2014 Shs. 82,000,000,000, in 2015 the actuarial evaluation established a surplus of

Shs. 12,282,000,000. The actuary recommended the reduction in the bank's contribution from 17 to 16 % which would save the bank a contribution of Shs. 621,700,000. The bank is entitled to take benefit of any surplus. The bank has a reversionary interest in the income and the performance of the scheme during its lifetime. The respondent issued a private ruling that the income of the scheme is taxable.

The applicants' second witness, Mr. Abed Mureith testified that he is the actuary of the Bank of Uganda Defined Benefits Scheme. The Defined Benefits Scheme guarantees benefits using a formula irrespective of whether there are adequate assets. When the assets are inadequate the sponsor must make additional contribution to make good the deficit. Bank of Uganda operates two schemes namely the Bank of Uganda Defined Benefits Scheme and Bank of Uganda Defined Contribution Scheme. In the Defined Benefit Scheme, he determines the valuation of the scheme to establish its financial position. He advises the trustees on investment policies, funding requirement and risks. The actuarial valuation for 2011 to 2015 established that the scheme's assets increase and decrease. Where there is a decrease, he advises the bank to fund the deficit and where there is a surplus, he advises the bank to utilize it by for instance by reducing its contribution rate. However when there was a surplus, he advised the bank to maintain the 17% contribution so as assess if the surplus would recur in subsequent years.

The respondent's witness, Mr. Samuel Lwetutte, an officer in its Objections and Appeals Unit testified that the applicants are trustees of the Bank of Uganda Defined Benefits Scheme which was licensed in 2014 as a retirement benefits scheme by the Uganda Retirement Benefit Regulatory Authority (URBRA). The applicants applied for a private ruling that the Scheme as a settlor trust was entitled to be exempt from income tax under S. 71 and S. 21 of the Income Tax Act. The respondent in its private ruling disagreed with the applicants on ground that the scheme is a retirement fund governed by URBRA and any income derived by it is taxable. The applicants objected to a default assessment Shs. 106,162,667 for the period 2010-2016 and filed income tax returns

categorizing its income as exempt on the ground that it is a settlor trust established by the Bank of Uganda whose income is exempt.

The applicants submitted that the Bank of Uganda Defined Benefits Scheme was licensed under the Uganda Retirement Benefit Regulatory Authority Act 2011. They submitted that S. 2(vvv) of the Income Tax Act defines a trust to mean any arrangement affecting property in relation to which there is a trust. Trust deeds were executed for purpose of establishing an arrangement where Bank of Uganda and its employees make monthly monetary contribution to the scheme for the benefits of its employees. The boards of trustee are comprised of six members who are appointed by Bank of Uganda as representative of the employees. The applicants cited Sections.1, 5, (2)(d) and 6(d) of The Uganda Retirement Benefits Regulatory Authority Act and submitted the structure and the character of the scheme is a benefit scheme.

In 2014, the applicants sought a private ruling from the respondent regarding the tax status of the scheme. The respondent ruled that the applicants are not exempt from income Tax as it was not a settlor's Trust. The applicants argued that S.70 (f) of the Act qualifies the scheme to be a settlor trust. S. 70 of the Income Tax Act defines a Settlor as one who has the power to revoke or alter the Trust to acquire a beneficial entitlement in the income of the trust. It submitted that Mr. Edward Katimbo testified that the trust deed has undergone several amendments and the current trust deed was made in 2014. Bank of Uganda has a reversionary interest in the corpus or income of the trust. The applicants contended that **Black's Law Dictionary** 8th edition page 851 defines reversionary interest to mean a future interest left in the transferor or successor in interest. The applicants contended that clauses 17(b) of 1968, 16 of 2005 and 30 of 2014 in the trust deeds show the reversionary interest of the settlor. The employer has the reversionary interest in the surplus of the scheme when it is wound up. The applicants argued that Bank of Uganda bears investment risk and has the obligation to ensure that the scheme is optimally funded to meet the benefits of the members. The applicants concluded that the payment of expenses of the scheme and the oversight role that the bank has over the affairs of the scheme clearly show that it is a settlor.

Under S. 71 it is not liable to pay the tax assessed because it is a settlor trust. Under S. 71(5)(b) of the Income Tax Act the income of such trust is taxed to the settlor or qualified beneficiary and the property owned by the trust is deemed to be owned by the settlor. The income arising from the scheme ought not to be treated separately from that of the settlor. Bank of Uganda is exempt from taxation under S. 21(1) of the Income Tax Act.

In reply, the respondent contended that the applicants are liable to pay the assessed tax. It argued that the contribution from the members and bank of Uganda are invested by the scheme for the benefit of its members. The scheme realizes income from interest on treasury bills, bonds and fixed deposits. The interest received from fixed deposits and government securities is chargeable income. It cited S.8 of the Income Tax Act which provides that a trustee of a trust is charged tax at the rate prescribed in Part III of the Third Schedule to this Act on the chargeable trust income of the trust for a year of income. It also provides that the chargeable income of a retirement fund for a year of income is charged to tax at the rate prescribed in Part III of the Third Schedule. The rate applicable to chargeable income of trustees is 30%. The respondent argued that under Sections 70, 71, 72 and 73 of the Income Tax Act trusts and retirement funds are taxable. The income derived by the scheme is income to the members or its beneficiaries therefore it is taxable. The respondent argued that Clauses 18 and 30 of the Trust Deed 2014 provide that taxes will be paid by the trustees. Any income that is derived by the applicants, scheme from its activities is treated as income derived by the retirement fund and not from the settlor's trust given the purpose and the nature of the trust deed.

The respondent urged the Tribunal to look at substance over form as cited in **Intertake Testing Services International Ltd v Uganda Revenue Authority** Appeal No.5 of 2002. It also cited **In Dominion Taxi Cab Association v MNR** [1954] SCR 82 where the Court held that: "It is well settled that in considering whether a particular transaction brings a party within the terms of the Income Tax Act, its substance rather than its form is to be regarded" In **Placer Dome Inc. v Canada** [1992] 2 CTC 98 at 109, the

Canadian Supreme Court held that: “It is the substance of a transaction that must be looked at in order to determine the true legal rights and obligations of the parties.” It argued that there was no settlor’s scheme but a trust under a retirement benefits scheme.

In rejoinder, the applicants argued that under S. 70 of the Income Tax Act the Settlor has power to revoke or alter the trust so as to acquire a beneficial entitlement in the corpus or income of the trust or have a reversionary interest in the corpus or income of the trust. The use of the word “or” in this Section means a person may satisfy any of the above. The applicants cited **Auto Owners Insurance Company v Stenberg Brothers Inc.** 227 Mich App.45, 51-52; 575 NW2d 79 (1997) where the court held that the use of the word “or” in the statute denotes a disjunctive rather than conjunctive relationship and refers to a choice or alternative between two or more things. The applicants submitted that based on the above authority, the applicants fall under criteria (ii) whereby the bank of Uganda has the reversionary interest in the corpus and income of the trust. Surplus funds under the scheme during winding up and after paying all beneficiaries revert to Bank of Uganda. The applicants further argued that S. 8 (4) of the ITA does not apply. It only applies to trustees and funds with disregard to S.71 of ITA. The principle governing taxation of trusts should not be ignored. The applicants invited the tribunal to apply the doctrine of substance over form. The applicants submitted that in substance, it is the bank of Uganda paying tax. The respondent would indirectly tax the exempt income of a listed institution as provided for under S.21 of the ITA.

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

The applicants are trustees of the Bank of Uganda Defined Benefits Scheme regulated and licensed under the Uganda Retirement Benefit Regulatory Authority Act 2011 under license no. RBS 0001. The objective of Bank of Uganda establishing the scheme was to provide annuities to its members on retirement. The employed members contribute 4% of their salaries while Bank of Uganda contributes 17.1% per month. Retired members

do not contribute anything. The contributions from the members and Bank of Uganda are invested by the scheme for the benefit of its members. The Scheme was governed by a trust deed which was amended in 1995, 2005 and 2014. The Scheme invests the funds in different investments such as bonds, treasury bills and fixed deposit for the benefit of its members. The trustees are a separate legal entity from Bank of Uganda and its members.

The starting point is that income received by trusts is taxable under the Income Tax Act. S. 4 of the Income Tax Act provides that a tax known as income tax shall be charged on every person who has chargeable income for the year of income. S.18 (1)(a) provides that the business income derived by a person carrying on a business includes the amount of any gain or losses on the disposal of business assets whether or not the asset was of a revenue or capital nature. The Scheme invests in bonds, treasury bills and fixed deposits which is a business. S. 1 (yy) of the Income Tax Act defines “person” to include “an individual, a partnership, a trust, a company, a retirement fund, a government, a political subdivision of government and a listed institution.” Under the said Section a retirement fund and a trust are included as taxable persons. The said list is not exhaustive. Under S. 1(III) of the Act, a “retirement fund” means a pension or provident fund established as a permanent fund maintained solely for either or both of the following purposes— (i) the provision of benefits for members of the fund in the event of retirement; or (ii) the provision of benefits for dependents of members in the event of the death of the member. Under S. 1(vvv) a trust is defined to mean “any arrangement affecting property in relation to which there is a trustee’. Under S. 1(www) a trustee includes (iv) any person having the administration or control of property subject to a trust, (v) any person acting in a fiduciary capacity. S. 1 of the Uganda Retirement Benefit Regulatory Authority (URBRA) Act defines a “trustee” to mean a person responsible for managing a retirement benefits scheme in accordance with the scheme rules and legal requirements under the Act. The applicants are trustees established by way of a trust deed to run a retirement fund for the benefit of retired former employees of Bank of Uganda.

S. 8 of the Income Tax Act provides for the liability to pay and rate of income tax for trustees and retirement funds. S. 8(1) of the Act reads.

“(1) Subject to subsection (2) and (3), a trustee of a trust is charged to tax at the rate prescribed in Part III of the Third Schedule to this Act on the chargeable trust income of the trust for a year of income...

(4) The chargeable income of a retirement fund for a year of income is charged to tax at the rate prescribed in Part III of the Third Schedule to this Act.”

Part III of the Third Schedule provides that the income tax applicable to trustees and retirement funds for purposes of S. 8 is 30%. From the above Sections, it is clear that the Income Tax Act provides for taxation of chargeable income of trusts and retirement funds.

The applicants contend that they operate a settlor trust under the Income Tax Act which is exempt by virtue of Bank of Uganda being an exempt institution. S. 71(5) of the Act dealing with principles of taxation and trusts provides:

“(5) A settlor trust or a qualified beneficiary trust –

- (a) Is not treated as an entity separate from the settlor or qualified beneficiary, respectively; and
- (b) the income of such a trust is taxed to the settlor or qualified beneficiary and the property owned by the trust is deemed to be owned by the settlor or qualified beneficiary, as the case maybe.

The applicants contend that Bank of Uganda is a Settlor in this matter. S. 21 (1) (s) of the Income Tax Act provides the income of the Bank of Uganda is exempt from taxation. The Bank of Uganda is established by the Bank of Uganda Act. S. 46 of Bank of Uganda Act provides that the bank shall be exempted from the payment of income tax and profits or capital gains tax in respect of its functions under this Act. S. 4 of the Act provides for the functions of the bank of Uganda. The exemption on income tax for the Bank of Uganda under the Bank of Uganda Act is in respect of functions. The Income Tax Act refers to income received by the Bank. It does not limit it to income arising from carrying out its functions.

So the question is: Are the applicants operating a settlor's trust under the Income Tax Act. S. 70 of the Income Tax Act provides that:

- “(e) “settlor” means a person who has transferred property to, or conferred a benefit on, a trust for no consideration or for a consideration which is less than the market value of the property transferred or benefit conferred at the date of the transfer or conferral: and
- (f) “Settlor trust” means a trust in relation to a whole or part of which, the settlor has-
 - (i) the power to revoke or alter the Trust so as to acquire a beneficial entitlement in the corpus or income of the trust: or
 - (ii) a reversionary interest in the corpus or income of the trust.”

Under S. 70(f) the requirement of a settlor trust can be either the power to revoke or alter the trust or a revisionary interest in the income of the Trust. The Tribunal agrees with the case cited by applicants, **Auto Owners Insurance Company v Stenberg Brothers Inc.** 227 Mich App.45, 51-52; 575 NW2d 79 (1997) where the court held that the use of the word “or” in the statute denotes a disjunctive rather than conjunctive relationship and refers to a choice or alternative between two or more things. The Settlor does not need to have both the requirements. So the question is: Is the applicants' Scheme a settlor's trust?

S. 70 of the Income Tax Act defines a settlor to mean a person who transfers property to a trust. It is not in dispute that Bank of Uganda contributes 17.1 % of employees' salaries per month to the Trust. It also meets the costs of operation and makes good any deficit. **Black's Law Dictionary** 10th Edition, p. 1410 defines property “1. Collectively, the rights in a valued resource such as land, chattel, or an intangible.” Money is an intangible and would qualify to be property. In **Rogge and others** [2012] TC 01747 trust income consisted of payments made by a settlor. The issue was whether he was liable to tax on trust income. Bank of Uganda which made payments to the trust meets the criteria of a “settlor”.

The next question the Tribunal would ask itself is: whether there was a settlors Trust? Under S. 70(f)(i) a settlor should have the powers to alter the Trust to acquire a beneficial entitlement in the corpus or income of the Trust. Under Clause 25 of the Trust

deed of 2014 the powers to amend the Trust deed laid with the Trustees who would do so with the consent of the sponsor. Under S. 25(3) the trustees would authorize payment of any monies of the scheme to the sponsor. **Black's Law Dictionary** 10th Edition page 1358 defines power as "1. The ability to act or not; esp. a person's capacity for acting in such manner as to control someone else's response. 2. Dominance, control, or influence over another; control over one's subordinates." The power to amend or alter the Trust deed to enable the settlor to acquire a beneficial entitlement laid with the trustees and not the sponsor or the settlor. Therefore the perusal of the Trust deed of 2014 does not show that Bank of Uganda which is referred to as the sponsor as having powers to amend the trust deed and the rules.

The second condition under S. 70(ii)(f) was that the settlor should have a reversionary interest in the corpus or income of the trust. **Black's Law Dictionary** 10th Edition p. 934 defines reversionary interest as "A future interest left in the transferor or successor in interest." Clause 30 of the Trust Deed deals with consequences of determination of the Trust. Clause 30.6 reads:

"Any balance of the funds of the Scheme remaining after the purposes of this clause have been fulfilled shall be paid by the liquidator to the sponsor and such refund shall be charged to tax in the hands of the sponsor."

The powers to tax are created by statute and not by contract and deeds. However the contract stated the position of the law, which is the settlor pays the tax. The applicant's witness Mr. Katimbo Mugwanya testified that the bank has the obligation to pay and clear any deficit in the scheme where the unfunded benefits are greater than the value of the assets. The bank is entitled to take benefit of the surplus. He also testified that the bank has a reversionary interest in the income and the performance of the scheme during its lifetime. The bank may earn income in the event its reversionary interest crystallizes. It is without doubt that Bank of Uganda or the sponsor has a revisionary interest in the income of the trust. We already stated that it is not necessary to meet the two conditions under S. 70(f) of the Income Tax Act. Either would do. Therefore the applicant's Bank of Uganda Defined Benefits Scheme qualified to be a settlor's trust under S. 70(f) of the Act.

We already stated that under S. 71(5) of the Income Tax Act that the income of the trust is taxed to the settlor. The respondent cited **Halsbury's Laws of England/Trust Volume 23(2) (Reissue) Para 951 – 1836/18. Settlements/(2) Income of the Settlor/ (1) In General/ 1553** where it is stated:

“Income arising under a settlement during the life of the settlor is treated for all purposes as the income of the settlor and not as the income of any other person, unless the income arises from property in which the settlor has no interest.”

This explains S. 71(5) of the Income Tax Act. It treats income made by a property in a settlor's trust as chargeable to the Settlor and not the trustees or the beneficiaries. This is because the settlor may have powers to alter the trust to acquire beneficial entitlement or has reversionary interest in the property. This is an exception to the general rule under S. 8 of the Income Tax Act where income tax is charged on the trustee on income received from the Trust. It is not a dispute about substance over form but an exception to the general rule. The respondent contended that the charge does not apply to a benefit under an approved pension arrangement. The Bank of Uganda Defined Benefit Scheme is not approved pension arrangement. **Black Law Dictionary** 10th Edition 1315 defines pension as a regular series of payment made to a person for past services or some type of meritorious work. The applicant's scheme involves investing monies and giving returns to the beneficiaries.

To understand the application of Sections 8, 70 and 71 of the Income Tax Act one must understand who the legislature was targeting when the said provisions were enacted. Under S. 8 of the Income Tax Act, the legislature was targeting trustees. **Black's Law Dictionary** 10th Edition p.1748 defines a trustee as “Someone who stands in a fiduciary or confidential relation to another; esp., one who having legal title to property, holds it in trust for the benefit of another and owes a fiduciary duty to that beneficiary.” **Black's Law Dictionary** (supra) p.1582 defines a settlor as “Someone who makes a settlement of property; esp., one who sets up a trust.” When one looks at the Sections it is not difficult to discern that there is fear that when one makes a settlement of property to a settlor's trust the settlor may have control over the trust property so as to benefit from it.

There are tax avoidance schemes where persons set up trusts and vest their property to them with the intention of avoiding taxes. For instance if one gets a beneficiary entitlement to the Trust he set up. If one has powers to make an alteration to the trust deed to obtain a beneficial entitlement or has reversionary interest, the legislature intended to target such persons as liable for the tax for the income received. In **Dunsby** [2020] TC 07755, trust income was treated as the Settlor's. A marketed tax avoidance scheme designed to extract distributable profits was caught by the settlements anti-avoidance legislation. In **Rogge and others** (supra) the court noted that on a literal interpretation of their Income Tax Act it would appear that it was intended to apply to trust income which in case of a settlor interested trust is treated as income of the settlor and not as income of any other person. However in the said case, the court found that the trustees remain the persons receiving the rent and are taxable. S. 71(5)(a) of the Income Tax Act clearly states that a settlor trust or a qualified beneficiary trust is not treated as an entity separate from the settlor or qualified beneficiary. S. 71(5)(b) states the income of such a trust is taxed to the settlor and the qualified beneficiary and the property of the trust is deemed to belong to them. S. 71(1) of the Income Tax Act provides that subject to subsection (5), the income of a trust is taxed either to the trustee or the beneficiaries of the trust. Therefore S. 71(5) which is specific to settlor's trust overrides S. 8 of the Income Tax Act. Sections 70 and 71 are anti-tax avoidance mechanisms targeting persons who create trust but remain the beneficial owners of the settlements.

The effect of S. 71(5) in this application is to shift tax liability from the trustees, the applicants, to the Settlor. In this case the Settlor is Bank of Uganda which is an exempt institution. S. 71 of the Income Tax Act is two-edged. When the legislature was shifting tax liability from a trustee to a settlor under S. 71 it may not have foreseen a situation where the settlor is an exempt institution. The applicants have taken benefit of a gap in the law by using an ingenious way of shifting liability from them to the Settlor. But that is the law. As to whether S. 71 should apply to an institution which is exempt, this is a debate that may go on until the cows come home. The respondent ought to have proceeded against Bank of Uganda which is the settlor and not the applicants who are

the trustees of the Bank of Uganda Defined Benefits Scheme. As to whether Bank of Uganda as an exempt institution can pay tax on income received on a settlor trust that is a story we shall tell you another day, as it is not a party to this application. It is entitled to be heard.

In the circumstances, this application is allowed with costs to the applicants.

Dated at Kampala this 30th day of October 2020.

**DR. ASA MUGENYI
MUGERWA**

CHAIRMAN

DR. STEPHEN AKABWAY

MEMBER

MR. GEORGE