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LEGAL ALERT

Proposed 2023-2024 Tax Amendment:

Uganda Moving Forward to Tax the Digital Economy

By: Kenneth Muhangi & Janice Celine Nantumbwe
KTA Advocates

Introduction

In January 2022, the Uganda Revenue Authority (URA) issued a Public Notice stating that all non-residents providing electronic services to non-taxable persons in Uganda were to collect, file and pay Value Added Tax (VAT) on such services effective July 1st, 2022. This notice was based on **Section 16 (2)(d)** of the **Value Added Tax Act Cap 349** (the 'VAT Act') which provides that a supply of services is deemed to take place in Uganda where the recipient of the service is not a taxable person and the services are electronic services delivered to a person in Uganda at the time of supply.¹

The VAT (Amendment) Bill, 2023 seeks to extend the definition of electronic services and stipulate which persons are under obligation to charge VAT on electronic services. The **Income Tax (Amendment) Bill, 2023** proposes the introduction of a digital service tax on the income derived in Uganda by a nonresident for the provision of digital services.

The expansion of the tax base into the digital economy is a foreseeable development that Uganda's lawmakers have contemplated for a while now. Through rapid technological advancements, businesses that offer digital services have disrupted traditional markets and are now at the heart of the economic activity of sectors such as transport, accommodation, commerce, entertainment, retail, and education.² The justification for taxing digital platforms is based on the income they derive from jurisdictions in which they have no physical presence but operate in, the erosion of tax bases and the concern that such entities appear to have a lower tax rate than traditional competitors.³

The ability of such companies to offer services in countries in which they have no physical presence has challenged the traditional principles of taxation rights. Some international and regional bodies including the Organization of Economic Cooperation and Development (OECD) and the African Tax Administration Forum have developed international or regional approaches to taxing the digital economy.⁴

Through the amendments, Uganda will join other African countries including Kenya and Nigeria that have already introduced taxation on the revenue generated by digital service providers in their respective countries. This comes at a time when Kenya has announced its plans to withdraw its objections to Pillar Two of the OECD and to remove its Digital Services Tax.

This legal insight shall explore the approach Uganda is currently taking to tax the digital economy, the proposed amendments, and the likely implications the proposed amendments will have for businesses operating in the digital economy in Uganda.

1 PwC, 'VAT Treatment of Electronic Services : Tax Update', <https://www.pwc.com/ug/en/assets/pdf/tax-alert-vat-treatment-of-electronic-services.pdf>

2 Ana Cebreiro-Gomez, et.al, 'Digital Services Tax: Country Practice and Technical Challenges', World Bank, pg. 9

3 Ibid

4 Ibid

The Law on VAT on Electronic Services.

The imposition of VAT on electronic services under Uganda's law is not a new development. The provision has existed under the VAT Act since 2011 but was not effectively imposed due to the complications in accounting for the tax once it was charged.⁵

Generally, the law requires that VAT is charged on every taxable supply made by a taxable person. **Section 18(1)** of the Act defines a taxable supply to include a supply of services made in Uganda by a taxable person for consideration as part of his or her business activities.

A taxable person, for purposes of the Act, is a person who is registered for VAT or a person who is not registered but is required to register for VAT with the URA.⁶ A person is required to register for VAT where the taxable turnover of that person for three consecutive months exceeds or is likely to exceed UGX 37,500,000 (Thirty-Seven Million Five Hundred Thousand Uganda Shillings). The VAT Act sets the annual registration threshold at UGX 150,000,000 (One hundred Fifty Million Uganda Shillings).

As to when a supply of services is considered to have taken place in Uganda, **Section 16** states that this occurs where the business of the supplier from which the services are supplied is in Uganda. However, **Section 16 (2) (d)** goes further to extend the scope of this provision to include where the recipient is not a taxable person and the services are electronic services delivered to a person in Uganda at a time of supply.

This provision essentially means that a non-resident person is considered to have made a taxable supply in Uganda where electronic services are supplied to a non-taxable person in Uganda.⁷ A non-taxable person in this context refers to a person who is not registered or required to register for VAT under the Act. Therefore, this usually applies refers to individuals.

Under the current legal regime, where an entity provides electronic services as defined above, and the value of such services exceeds the registration threshold (UGX 37.5 million in any three-month period and UGX150 million in a twelve-month period), then the supplier of such services would be required to register for VAT purposes and charge 18% VAT on the total consideration received from a non-taxable person.⁸ This provision targets entities that supply these services to Uganda but do not have a physical place of business in Uganda.

In terms of determining which customers to charge VAT, a non-resident supplier needs to establish whether the customer is in Uganda. This may be done through a location an internet proxy (IP) address or postal address, a phone number, or the location of the financial institution through which the payment of the service is made.⁹

5 Annet Nantogo, , 'Uganda Set to Collect Taxes from Digital Economy' , Uganda Revenue Authority, <https://thetaxman.ura.go.ug/uganda-set-to-collect-taxes-from-digital-economy/>

6 Section 7, Value Added Tax Cap 349, Laws of the Republic of Uganda

7 Annet Nantogo, (N 5 above)

8 PwC, (N 1 above)

9 Juliet Najjinda, 'Digital Tax: Uganda Departs from Kenya', PwC Uganda

Next, the non-resident needs to determine whether the customer is a taxable person or not. Where the customer is an entity, it can be assumed that they are taxable persons (i.e., that they are registered for VAT or required to register for VAT) and therefore there is no requirement to charge VAT on electronic services rendered to them.

As of last year, URA was in the process of rolling out an Application Programming Interface (API) to make it easier for non-residents to check the status of their Ugandan customers by integrating URA's systems with those of the non-residents. For now, non-residents may use their customers' Tax Identification Numbers (TIN) to verify whether a customer is a non-taxable person for purposes of VAT.¹⁰ This can be done through the URA portal after registration.

In regards to registering for VAT and filing VAT returns may be done through the URA online portal. Nonresidents also have the option of registering and filing returns through a local representative. The law permits a non-resident to appoint a tax representative who takes on the non-resident's filing and payment obligations.¹¹

The Proposed Amendment for VAT on Electronic Services

Under the proposed amendment, the requirement to charge VAT on electronic services would apply to;

- A. the supply of services by persons who carry on business outside Uganda and who do not have a place of business in Uganda (i.e. nonresidents);
- B. where the recipient of the supply is not a taxable person or a person who makes a supply with a total annual value in excess of the annual registration threshold or a government entity that is not registered under **Section 7(5)** of the Act; and
- C. the services and electronic services delivered to a person in Uganda at the time of the supply.¹²

The proposed definition of 'electronic services' has been extended to mean services supplied through an online or digital network by a supplier from a place of business outside Uganda to a recipient in Uganda including;

- a) websites, web-hosting, or remote maintenance of programs and equipment;
- b) software and the updating of software;
- c) images, text, and information;
- d) access to databases;
- e) self-education packages;
- f) music, films, and games including games of chance; or

¹⁰ Ibid

¹¹ PwC, (N 1 above)

¹² Section 16, Value Added Tax Cap 349, Laws of the Republic of Uganda

- g) political, cultural, artistic, sporting, scientific, and other broadcasts and events including television;
- h) advertising platforms;
- i) cab hailing services;
- j) streaming platforms and subscription-based services
- k) cloud storage;
- l) Dataware housing;
- m) any other service as the Minister may by statutory instrument determine.

Therefore, under the proposed amendment, VAT shall apply to imported electronic services, with the scope of electronic services extended to specifically cover advertising platforms such as YouTube, streaming platforms such as Netflix, cloud storage such as Google Drive, and data ware housing such as Microsoft.

Furthermore, under the proposed law, input credit for VAT will not be available the imported electronic services.¹³

The Proposed Amendment to the Income Tax Act: Imposition of Income Tax on Digital Services

Section 86A of the Income Tax (Amendment) Bill, 2023 seeks to introduce a tax with respect to the income a non-resident derives from providing digital services to a customer in Uganda. This tax will be charged at a rate of 5%.¹⁴

The Bill states that income shall be considered as having been derived from a customer in Uganda if the digital service is delivered over the internet, electronic network, or an online platform. The scope of digital services under the Bill includes;

- a) online advertising services;
- b) data services;
- c) services delivered through an online marketplace or intermediation platform, including an accommodation online marketplace, a vehicle hire online market place and any other transport online marketplace;
- d) digital content services, including accessing and downloading of digital content;
- e) online gaming services;
- f) cloud computing services;
- g) data ware housing; and
- h) services, other than those services in this subsection, delivered through a social media platform or an internet search engine;

With regard to how the tax shall be remitted to the tax authority, the Act seemingly places the obligation on the consumer to withhold payments made to the non-resident at a rate of 5% and account for the same to the URA¹⁵.

¹³ TASLAF Advocates, 'The Proposed Tax Law Amendments 2023: A Stakeholder Briefing

¹⁴ Clause 28, The Income Tax (Amendment) Bill, 2023

¹⁵ Clause 17, Ibid

Through the amendment, we see that tax policymakers seek to extend the scope of existing income tax rules rather than introduce a new or stand-alone tax. This maintains the proposed tax in the ambit of income tax and, is possibly subject to international tax treaties.

Implications for Businesses in the Digital Economy

In his book 'The Digital Economy: Promise and Peril in the Age of Networked Intelligence',¹⁶ Don Tapscott coined the term 'digital economy' to show how the internet would change the way we would do business.¹⁷ Today, over five billion people around the world use the internet. Internet users continue to grow, with the latest data indicating that the world's connected population grew by almost 200 million in the twelve months to April 2022.¹⁸ According to Forbes, the culmination of this explosion of consumer connectivity is the digital economy.¹⁹

The digital economy is comprised of a number of components through which it is enabled. These include Internet networks and telecommunication, financial technology, artificial intelligence, data, and the Internet of Things (IoT).

From the ride-hailing industry to the hospitality industry, the digital economy has facilitated new business models, many of which have transformed the mode of traditional business offerings. According to a report by the World Bank, the digital economy is equivalent to 15.5% of the global GDP and as of 2022, is worth almost three trillion dollars.²⁰

In May 2022, the E-Trade and Startup Association of Uganda met with representatives from the Ministry of Finance, Planning, and Economic Development to relay concerns about the taxation of digital platforms in Uganda. This was subsequent to attaining information that the policymakers intended to move forward to impose a digital service tax on entities providing digital services to Uganda. Key among the suggestions made by the Association was to avoid over-taxing local digital platforms that already pay a substantial amount of taxes under the existing taxation structure. The proposed amendments show the policymaker's attempt to focus efforts on nonresident entities as opposed to local ones.

With regards to VAT, the notable implication is that the tax burden shall be borne by the customer. It is however key to note that there is a general international consensus on the imposition of consumption taxes such as VAT on digital services, specifically for Business to Consumer (B2C) transactions.²¹

¹⁶ Don Tapscott, 'Digital Economy: Promise and Peril in the Age of Networked Intelligence, McGraw-Hill, 1st Edition, ISBN 0070633428

¹⁷ Kosha Gada, 'The Digital Economy in 5 Minutes', Forbes, Available at <https://www.forbes.com/sites/koshagada/2016/06.16/what-is-the-digital-economy/?sh=73f19e2a7628>, Accessed on 22/5/2022

¹⁸ Datareportal, 'Digital Around the World, Available at <https://datareportal.com/global-digital-overview>, Accessed on 10/6/22

¹⁹ Kosha Gada, (N 17 above)

²⁰ Ibid

²¹ Ana Cebreiro-Gomez, et.al, pg. 14

Non-resident entities offering electronic services to nontaxable persons, and who meet the registration threshold already have the obligation to register for VAT locally with the URA, charge VAT at a rate of 18% on such services, and account for the same to the URA. Under the proposed amendment, this obligation will extend to entities providing advertising platforms, streaming platforms, cab-hailing services, cloud storage, and data ware housing. This more or less fortifies the position that most of the digital services business models currently existing in the digital economy must charge VAT on their services, where such suppliers are non-resident entities.

As has been the case in many other countries seeking to tax non-residents providing digital services remotely, without any physical or legal presence in the taxing jurisdiction, we may expect to see some difficulty when it comes to the administration of the proposed law. This is a relatively new phenomenon that is still being formulated on a trial-and-error basis.²² The traditional administrative mechanisms may not suffice. The URA has already made strides by providing non-residents with an online portal for VAT registration and filing returns. This is similar to the recommendation stipulated under the OECD International VAT/GST Guidelines. However, when it comes to implementation, the regulator may find it difficult to ensure that non-resident companies charge and declare VAT with respect to non-taxable persons due to the limited means of oversight it has over such entities.

The problem of oversight may be circumvented by the OECD Convention on Mutual Administrative Assistance in Tax Matters which the Parliament intends to localize through an Act.²³ This Convention will assist the government in administrative cooperation with other states in the assessment and collection of taxes.

Concerning the extension of income tax rules applying to the income derived by nonresident entities from the provision of digital services, there is an advantage of being able to use existing taxation concepts and mechanisms.²⁴ In this case, the tax collection mechanism requires the resident to withhold a percentage of the payment to the non-resident. Therefore, there will be an obligation on local entities and individuals alike to withhold tax on the payment of the in-scope services.

This mechanism already exists in Uganda and therefore avoids the issues that come with implementing a new taxation regime. However, difficulties may arise with individuals withholding tax on such transactions. Payments for these services are usually made through third-party intermediaries such as financial institutions. This begs the question as to whether the obligation to withhold shall be on such third parties.

Additionally, difficulty may arise when payments for such services are made by non-residents but provided delivered in Uganda. For instance, fees paid to an accommodation platform may be made by non-residents yet the housing provided is in Uganda.²⁵

²² Ibid, pg. 38

²³ The Convention On Mutual Administrative Assistance In Tax Matters (Implementation) Bill, 2023

²⁴ Ana Cebreiro-Gomez, et.al, pg. 31

²⁵ Ibid

The World Bank says that to foster economic growth and development, governments need sustainable sources of funding for social programs and public investments.²⁶ Programs providing health, education, infrastructure, and other services are important to achieve the common goal of a prosperous, functional, and orderly society and they require that governments raise revenues.

On one hand, it is important to acknowledge the reasons why the government seeks to tax the income derived by nonresidents from the provision of digital services in Uganda. International tax principles on source income strengthen this position. Additionally, it can be argued that such entities benefit from local infrastructure such as broadband and therefore should contribute to their costs.²⁷ However, unilateral approaches such as digital services tax depart from long-established international taxation rules, overburden digital service providers and lead to a possibility of double taxation.

Uganda's proposal to introduce a digital services tax (DST) may have been influenced by that of Kenya and Tanzania. However, Kenya's plan to remove DST and withdraw its objection to Pillar 2 should serve as a point of reference to Uganda on the complications that arise from unilateral approaches and how these may affect international trade and relations.

Furthermore, the definition of digital services under the proposed amendment to the Income Tax Act is not only vague but very wide. Given that a number of digital service providers offer more than one of the 'in scope' digital services, digital service providers may be subject to taxation derived from the income from multiple categories of digital services. For example, an avenue like Google may derive income from advertisement, cloud storage, and from digital content services. The digital economy comprises several business models. It is understandable for policymakers cast the net very wide, but they should be mindful of the need for the law to be precise.

Conclusion

The proposed amendments indicate a clear intention by policymakers to ensure that Uganda takes a share of the financial proceeds made in the digital economy, particularly from the business activities of foreign digital platforms that derive income from Uganda. It is commendable that the policymakers have chosen to focus on nonresident digital platforms as opposed to local ones, somewhat evening out the playing field. It is also creditable that the tax policymakers have not adopted an overly complex taxation structure.

However, as is the case with VAT, the financial burden falls onto the customer, making electronic services more expensive for users in Uganda. This will likely be aggravated by the imposition of a DST as the cost may be pushed onto the end customer. Policymakers must be mindful of fostering Uganda's nascent digital economy which is already hampered by a general lack of affordability of digital services and tools.

²⁶ <https://subnational.doingbusiness.org/en/data/exploretopics/paying-taxes/why-matters>

²⁷ Ana Cebreiro-Gomez, et.al, pg. 11

As far as the administration of the proposed laws goes, policymakers must take into consideration how the laws will be implemented in light of the lack of oversight of such transactions. They should also consider the cost of compliance for both non-resident consumers and local customers.

Authors



**Kenneth
Muhangi**

Partner

Partner and **Head** of Technology, Media, Telecommunication Law and Intellectual Property, KTA Advocates, Uganda's Representative at the **4IR Portfolio** Communities of the Centre for Fourth Industrial Revolution of the **World Economic Forum**. External Advisor to the **Ministry of ICT** on innovation and ICT policy development, Lecturer and Head of Subject IP, School of Law, **Uganda Christian University**.



**Janice Celine
Nantumbwe**

Junior Associate
Executive Assistant to
Kenneth Muhangi

Junior Associate in the technology, media, telecommunication, and intellectual property law practice group. Key areas of expertise include data protection and privacy, telecommunications, payment services, financial technology, software contracts, copyright advisory, trademark advisory, and patent advisory. Has a keen interest and experience in policy lobbying and creation.



Contact Us

-  Floor 3, Plot 4 Hannington Road
Kampala, Uganda, P.O. Box 37366,
-  +256 414 530 114 / +256 414 531 078
-  partners@ktaadvocates.com

