

ANALYSIS OF DOUBLE TAXATION ON FOREIGN INVESTMENT IN UGANDA

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Declaration

I, Muhumuza Steven do hereby declare that the work presented in this dissertation arises out of my own research, I certify that it has never been submitted or examined in any university as an academic requirement for any award.

Sign

Date



.....

11/00/2018.

Approval

This dissertation has been submitted with the approval of Mrs. NAKAMATE FLAVIA^T as the university supervisor.

Signed

Date of Approval

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11/10/18

Dedication

First I give praise and thanks to the Almighty GOD and to my family Pastor Jan Eitel and Council Steve Greg for giving me the strength and the capacity to complete this work successfully. For all he has done to me, for his blessings, guidance, wisdom, knowledge, favors and endless blessings throughout my life and this far.

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Abstract

To increase inward foreign direct investment (FDI), policy-makers increasingly resort to the ratification of double taxation treaties (DTTs). However, the effectiveness of DTTs in inducing higher FDI is still open to debate, as the empirical evidence of existing studies is anything but conclusive. In contrast to earlier approaches, we use a largely unpublished dataset on bilateral FDI stocks, covering a much larger and more representative sample of host and source countries. Controlling for standard determinants of FDI and employing various econometric specifications, our results indicate that DTTs do lead to higher FDI stocks and that the effects are substantively important as well.

CHAPTER ONE

INTRODUCTION TO THE STUDY

1.0 Introduction

This chapter presents the introduction of the study, it involves the background of the study, the statement of the problem, the purpose of the study, the objectives of the study and the research questions, scope of the study, the significance of the study, the research methodology and the literature review.

1.1 Background of the study

In this age of globalization, most developing countries want to become integrated with the international economy. However, they face significant challenges in this pursuit, including the need to increase tax revenues. Hence tax policy makers have to analyze the prevailing conditions in the country and determine the relevant mix of taxes that can raise sufficient revenue. Many developing countries, Uganda included, have increasingly begun to restructure their tax systems for this specific purpose. Despite numerous tax reforms that were intended to improve the economic and social situation by supporting infrastructure and increasing the quality of public goods provided by the government, the situation in Uganda remains fragile, and the country remains among the poorest in the world. Based on the current approved budget for the financial year 2005/2006, a widening budget deficit of 9.2% compared to the previous financial year of 8.6% was reported¹. The persistence of budget deficits on this scale makes the case for a review of the existing mix and structure of Uganda's main taxes.

One of the most flexible ways to raise per capita incomes and to support increases in real GDP growth rates is through taxation. Taxation is a sovereign right of the

¹ Uganda, Ministry of Finance, Planning and Economic Development, *Background to the Budget for Financial Year 2005/06* (Kampala: New Vision Publication), online: New Vision <http://www.enteruganda.com/brochures/strategy_intro.html>, [hereafter referred to as *Background to Budget 2006*].

state used to transfer resources from private to public use in order to achieve the economic and political goals of society.² Taxation is not the only means through which governments can develop resources to finance public expenditure.³ Governments can and do “commandeer resources” directly from the people. This method would be practicable only in war times, however, and would be rejected by the masses in peaceful times. Governments sometimes print the money they need to function,⁴ although it is recognized that this method drives inflation. Developing countries make heavy use of domestic and foreign borrowing, but this is not an adequate alternative to increasing tax revenues.⁵ The majority of the people in developing countries receive very low incomes, if any, from which the government cannot borrow. And it may not be constructive for a government to rely on foreign aid as there are many deleterious consequences flowing from aid dependency. Thus taxation emerges as one of the most effective domestic tools that governments have direct control over to develop the resources needed to meet their social, economic, and political goals.

The problem faced by all developing countries and this of course includes Uganda is that developing countries face many generic and specific obstacles in implementing tax systems that can meet their unique needs and that will also finance the necessary level of public spending in the most efficient way.⁶ Developing countries would like to increase their tax-to-GDP ratios in order to reduce budget deficits, improve the services they provide, and optimize the effectiveness of their tax structures. Like most developing countries, the government of Uganda has embarked on numerous tax reforms over the last several decades: it has created a revenue agency, the Uganda Revenue Authority; it has harmonized the tariff code, restructured the tax system, minimized tax exemptions, and updated tax laws such

² Richard M. Bird, *Tax Policy and Economic Development* (Baltimore: John Hopkins Press, 1992) at 3-4 [hereafter referred to as ‘Bird, 1992’].

³ Bird, 1992.

⁴ Ibid

⁵ Ibid

⁶ Vito Tanzi and Howell H. Zee, *Tax Policy for Emerging Markets: Developing Countries* (Washington D.C.: IMF, Fiscal Affairs Department, 2000) (Working Paper WP/00/35) [hereafter referred to as ‘Tanzi and Zee, 2000’].

as the Income Tax Act of 1997; and it has established a strong tax investigation and litigation system.⁷

Although Uganda's revenue performance has improved remarkably in nominal terms from 1986 to 2006 as a result of these changes, it is still comparatively low and clearly does not meet Uganda's needs as measured against optimal levels of public expenditure for the country⁸. It is therefore accurate to conclude that the government must improve its tax policy to increase government revenues, but in a way that takes the realities of Uganda's social and economic structures into consideration. The challenge of inefficient domestic revenue mobilization carries important policy implications for Uganda (among which are included bad public services and increase⁹ debt), because domestic revenue production has not improved significantly despite the many changes the government has made. While several piecemeal efforts have been implemented in Uganda, concrete ideas on how the overall tax system can be improved remain scarce.

Double taxation is generally defined as the imposition of comparable taxes in at least two countries on the same taxpayer with respect to the same subject matter and for identical periods⁹. This may occur if one country claims taxing authority based on the residence or the citizenship of the taxpayer, while another country postulates taxing authority based on where the income originates. Another potential source of twofold taxation could be the fact that both countries claim either a certain taxpayer as a resident or that an income arises within its country¹⁰. Also, different methods for the determination of the internal transfer price applied in two states can lead to a double taxation, e.g., a company has a production facility in two countries and delivers intermediate goods from the plant in country A to the factory in country B. If domestic rules in B set a value of 80 USD as appropriate, but country A ascertains a value of 100 USD, then revenues of 100 USD in the source country stand vis-à-vis expenses of only 80 USD in the recipient country.

⁷ Torgny Holmgren, *et al.*, *Aid and Reform in Uganda -- Country Case Study* (Washington, D.C.: World Bank, 1999), online: World Bank <www.worldbank.org/research/aid/africa/papers.html> [hereafter referred to as 'Holmgren'].

⁸ Holmgren.

⁹ OECD 2005

¹⁰ Doernberg 2004

Even though measures to prevent double taxation can be implemented unilaterally, countries have on a very large scale resorted to the conclusion of DTTs. By burdening economic activity in a foreign country twice, double taxation is often believed to have a negative effect on the total amount of FDI as well as on the allocation of FDI across countries. In the words of Egger et al. (2006: 902): "One of the most visible obstacles to cross border investment is the double taxation of foreign-earned income." One major purpose of DTTs is thus the encouragement of FDI. Tax relief to foreign investors from double taxation is not the only purpose of DTTs, however. Another important purpose is the exchange of information. DTTs help to combat tax evasion and tax avoidance and to prevent double non-taxation by making information from one contracting state available to the other contract partner. In principle, these other aspects of DTTs could discourage FDI.

In addition, also other regulations, calculation methods and definitions are harmonised in a tax treaty, mitigating the uncertainty an investor faces when dealing with foreign fiscal systems and lessening the administrative effort. The tax authorities of either country profit from this harmonisation, as the variety of different legislations they have to deal with is reduced. Closely related to the anti-tax-avoidance objective of exchanging information and setting rules for transfer-price calculation is the argument that DTTs may help to reduce harmful international tax competition from tax havens. Even though tax treaties are an insufficient measure (due to their bilateral character) to completely avoid harmful tax competition, they contain some regulations to at least mitigate the problem: the permanent establishment rule and the provisions against treaty shopping limit the circle of beneficiaries and curb (along with the transfer pricing restrictions) the opportunities to channel income through tax havens¹¹. Lastly, similar to BITs, the benefits of concluding DTTs may go beyond any concrete treaty provision in that countries may acquire "international economic recognition" or, in the words of Rosenbloom, a "badge of international economic respectability" with a dense network of DTTs.

¹¹ However, another perspective is that a wide treaty network has the unintentional consequence of opening up the benefits of harmful preferential tax regimes offered by treaty partners (OECD 1998). The OECD advises countries against entering DTTs with tax havens (OECD 1998).

1.2 Statement of the Problem

Developing countries face formidable challenges in trying to establish effective and efficient tax systems.¹² The purpose of DTAs, first introduced in 1919, is to eliminate international double taxation, thereby promoting exchanges of goods and services as well as movement of capital and persons between and across countries. But what has happened over time is the manipulation of DTAs by multinational corporations who use them (the agreements) to avoid their tax obligations. Already, Africa is bleeding as a result of illicit financial flows, with Uganda, according to a report by the African Union/Economic Commission for Africa High Level Panel on Illicit Financial Flows from Africa, losing an estimated Shs2 trillion every year to illegal activities by multinational companies. The report says corporations in Africa deny the continent its due share of revenue through tax evasion, money laundering and false declaration. Other illegal methods used by the corporations include: overpricing, transfer pricing (inside dealings/trading), money laundering and corruption.

Several corporations operating in Uganda take advantage of DTAs with any of the aforementioned countries or tax haven jurisdictions, to either pay very little or no taxes at all despite making the earnings from here. To deal with this situation, domestic laws on taxes take care of this problem. DTA simply tries to short change our domestic laws on taxation hence the need for review. As a result many developing countries are beginning to re-examine the treaties they have signed in the past. Rwanda and South Africa have successfully renegotiated their agreements with Mauritius, while Argentina and Mongolia have cancelled or renegotiated several agreements. It is against this background that this research aims to analyze and review the double taxation policy on foreign investment in Uganda.

1.3 Purpose of the Study

The purpose of this study is to analyze the double taxation policy on foreign investment in Uganda.

¹² Vito Tanzi and Howell H. Zee, *Tax Policy for Emerging Markets: Developing Countries* (Washington, D.C.: IMF, 2000) (Working Paper WP/00/35) [hereafter referred to as 'Tanzi and Zee, 2000'].

1.4 Objectives of the Study

- I. To evaluate the current trends in the development and coverage of Double Taxation Treaties (DTTs).
- II. To identify the various benefits and costs of Double Taxation Treaties to Uganda and other countries.
- III. To analyze the legal and institutional framework on double taxation treaties in Uganda

1.5 Research Questions

- I. What are the current trends in the development and coverage of Double Taxation Treaties (DTTs)?
- II. What are the various benefits and costs of Double Taxation Treaties to Uganda and other countries?
- III. What is the legal and institutional framework on double taxation treaties in Uganda?

1.6 Scope of the Study

1.6.1 Time Scope

The study will be based on Uganda's tax policy from 2000 to 2018, during this time the country has embarked on several negotiations and review of taxation policies including the double tax policy on foreign investment.

1.6.2 Content Scope

The research aims at analyzing the international and domestic legal framework on double taxation on foreign investment, it will further analyze the benefits and trends in the development and coverage of double taxation treaties in Uganda and other developing countries.

1.6.3 Geographical Scope

The study will be focused on Uganda with information from the URA and the UIA.

1.7 Significance of the study

The study is of importance to the International Legal Regime including WTO, IMF, among other world trade organizations and the Ugandan government as it aims at analyzing the benefits and weaknesses of the DTTs in Uganda.

The study is also important to African countries and other Third World Countries that are currently negotiating new DTTs and how these treaties have been manipulated hence it is vital to the East African Community at large.

The study is also important to the researcher as it is a requirement for the accomplishment of the award of a Bachelors Degree in Laws of Uganda.

1.8 Literature Review

The literature is based on opinions and concepts from other authors. Investment has a very important role in economic development for both developed nations and emerging economies. It helps in economic and financial stabilization of the economy, proper exploitation of natural and human resources. Leading to lower unemployment rates and potentially welfare and prosperity of nations¹³.

Recently, while globalization is gaining momentum, there is exponential increase in cross- border trade and interconnectedness of world economy. That has led to a never-ending need to the assessment of tax systems of various nations in order to ensure equitable tax treatment to citizens and corporations in a vibrant global economy. This trend has led to need to study how tax treatment effect on the movement of private citizens and from one country or another. Such movement is often triggers double taxation on income earned in one country by citizens of another country. Besides, There other dilemma is that some countries base tax on place of residence or country of citizenship of taxpayers, whereas, other countries base the tax on the origin of incomes or revenues (Doernberg, 2004)¹⁴.

However, the problem becomes more complex since taxation systems of different countries define income source differently, leading to another complication to the

¹³ Neumayer and Spess, 2005; Alfaro et al., 2010

¹⁴ Sayyar et al., 2014; Yazdani and Aris, 2015; Elhabib et al., 2014

already complex situation. This will become even worse if the tax rate for both countries is higher than 50%, leading to an anomaly situation where an assessed taxpayer living in one state earned income in a foreign state. If this taxpayer is taxed by both countries he will be left with a negative income, so he needs to use his prior good year savings or to sell the family jewelry (if any) to pay tax. Marus (2012) argues that this phenomenon occurs due to countless structures of the tax systems, diverse controls of the tax jurisdiction, multiplicity of controls of the tax jurisdiction and contradictory interpretation of technical terms¹⁵.

Mike (2013) argues that international double taxation has undesirable consequences for both developed and developing nations. For developed nations, excessive financial savings in contrast to few available investment opportunities may lead to economic recession. In contrast, developing countries will be denied access to funds to materialize economic development in their respective countries. Therefore, that problem has affected the whole society by snowballing the tax liability on private citizens, reluctance of foreign capital from contributing to economic life cycle and obstructing the freedom of extensions of investments within the country. This may lead to a lack of production. Thus, causing a shortage of national income and reducing employment opportunities. Hence, tax legislators have tried to solve this problem by adjusting some tax legislation or resorting to international conventions whether through the signing of an agreement between individual countries or by entering into a collective agreement. This highlights the need to identify the role of treaties for double taxation in attracting foreign direct investment to developing nations¹⁶.

Implementing a double taxation treaty is not something that happens overnight. In fact, less developed countries spent years of efforts and other very scarce resources to discuss, implement and finalize these treaties with developed nations. In addition, less developed nations also forgo potential tax revenues. Most often these treaties favor residence-based over source-based taxation. The forgone tax incomes and the money invested in negotiations with developed nations in addition to other

¹⁵ Ibid

¹⁶ Ibid

implementation cost , can only make sense if the expected benefits in terms of FDI out-weight such costs. This paper critically reviews the literature on the impact of implementing double taxation treaties on attracting FDI inflows to developing nations. This review is further augmented with a synopsis of economic models used by policy makers to analyse potential tax impact on FDI decisions¹⁷.

The effect of double taxation treaties on foreign direct investment is inconclusive base on the review of the literature. Several researchers claim that there is an evidence of a positive relationship. However other researchers provide contradicting evidence. Developing countries entering into these agreements signal to the international community a spirit of openness and willingness to adopt internationally accepted tax standards. In addition, also the reduction of withholding tax rates and the relief from double taxation may encourage FDI. On the other hand, DTTs may hamper FDI, as they also allow the exchange of information between the tax authorities. Hence, it is an empirical question as of whether or not DTTs help to attract FDI. So far, the empirical evidence on this issue is inconclusive. Consequently, from the above, this study a review of literature to what extent double taxation treaties attracting foreign direct investment.

A properly designed tax system is a corner stone of every country's sovereignty. Therefore, no two or more countries may tax the identical income arising from a cross-border transaction, this called double taxation. To preclude double taxation, countries enter into treaties known as double taxation treaties DTTs. DTTs preclude double taxation in one of two ways (i) allocating taxation rights exclusively to one signatory country or (ii) providing mechanisms where both signatory countries are granted taxation rights. In case where both signatory countries are granted taxation rights, DTTs provide some exemptions and credits as a mechanism to sidestep double taxation¹⁸.

Customarily, DTTs are signed to avoid double taxation that results when two or more countries intend to tax the same income. Moreover, it is often claimed that DTTs, which also provide mechanisms to exchange information between the tax

¹⁷ Egger and Merlo, 2011

¹⁸ Lang, 2013

authorities of the signatory countries, can help prevent tax avoidance and evasion. Besides avoiding double taxation, DTTs also serve other purposes. These include (i) allocating taxation rights between signatory countries, (ii) providing legal certainty, (iii) preventing tax avoidance, (iv) combating tax evasion and, (v) attracting foreign direct investment¹⁹.

There is a different discussion coming from the perspective of developing countries, calling for rethinking the international tax system. How do the international tax system in general and double tax agreements in particular impact developing countries? It is also being discussed whether developing countries at all benefit from the signature of Double Tax Treaties (DTTs) under the current internationally accepted standards (Neumayer, 2007).

The main objective is the eradication of double taxation, as identified by the OECD as a major challenge to FDI inflow (OECD, 2013). Treaties may also help in mitigating ambiguity for the foreign investor on their tax burden on profits and incomes earned in a foreign country. Moreover, DTTs may reveal the commitment to attracting foreign capital (Christians, 2005). However, there are substantial costs to the less developed nations in implementing DTTs. The costs that are common to DTTs can take years to negotiate, and once it is signed it still needs to be endorsed in the corresponding countries before it is actually effective, a process that can take another two to three years, or even longer. Developing countries also have to relinquish some tax returns to execute a DTT with a developed nation to get capital foreign investment²⁰.

Although there are relatively few empirical evidences on the impact of double taxation treaties DTTs on foreign direct investment FDI movement, these few studies show conflicting findings ranging from an evidence of a positive impact, no statistically significant impact, to an evidence of an inverse impact. Besides, Blonigen and Davies (2002), in a study conducted to analyze the impact of DTTs on

¹⁹ Daurer, 2013

²⁰ Fabian et al., 2005

bilateral FDI outflows within OECD countries. Using data for the period 1982–92 found that the existence of DTTs is associated with larger bilateral FDI flows²¹.

In contrast, Blonigen and Davies (2004) in study conducted using data for the period 1980 to 1999 to examine the impact of US double taxation treaties on inbound and outbound FDI, found that the relationship between DTTs and both outbound and inbound FDI flows to be statistically insignificant. Contrary to the above finding Egger et al. (2004) found a negative impact of newly implemented DTTs on FDI using data for the years 1985 to 2000. In spite of, a abundant literature on the factors for attracting FDI into developed countries such as Blonigen (2005), Carr et al. (2001), Schneider and Frey (1985), the empirical specifications used in studies on the impact of DTTs on FDI have several deficiencies, including, data availability and limited time horizons of studies.

Double taxation treaties are of paramount importance to abolishing the negative impact of double taxation and to attracting foreign direct investments (FDI) to developing countries. However, implementing a double taxation treaty is not something that happen overnight. In fact Developing countries spent time, efforts and other scarce resources to discuss, implement and finalize double taxation treaties (DTTs) with developed nations. In addition, they forgo potential tax revenues, as such treaties typically favor residencebased over source-based. The forgone tax incomes and the money invested in negotiations with developed nations in addition to other implementation cost can only make sense if the expected benefits in terms of FDI out-weight such costs. Several studies have revealed that there is a positive impact of implementing double taxation treaties and attracting foreign direct investment to developing countries.

²¹ Baker, 2014

CHAPTER TWO

UNDERSTANDING OF DOUBLE TAXATION IN UGANDA'S TAX TREATY NETWORK

2.0 Introduction

This section critically examines the explanations given by various stakeholders for Uganda's tax treaties. One surprising outcome from our interviews is that hardly anyone familiar with Uganda's tax treaties, whether in the private sector or in government, or even at the Uganda Investment Authority (UIA), believes that tax treaties have much effect on the amount of inward investment into the country. Despite this, most of the reasons offered up for tax treaties in Uganda still relate to investment promotion. Here we critically examine each in turn.

2.1 Investment promotion and 'tax sparing'

Aside from its 1968 treaty with Zambia, independent Uganda did not successfully conclude a tax treaty until 1992, when it signed with the UK. But it did negotiate before that time. For example, drafts were exchanged with the UK in the 1970s. It is unclear from British government records why these negotiations failed, but Uganda's demand for a 40 per cent withholding tax on royalties, consistent with its domestic legislation, was clearly an obstacle.²²

Talks with the UK were also revived in the early 1980s, but it appears that it was not until the start of the 1990s that Uganda decided it was willing to make the sacrifices demanded by the UK in order to obtain a tax treaty.²³ This change of heart coincided with reforms to create a more attractive environment for investors, many of which were embodied in the 1991 Investment Code Act.

The role played by tax treaties in this new investment framework was set out by Uganda's Minister for Finance, Planning and Economic Development in 1993, announcing that the government would 'embark on negotiating double taxation

²² Correspondence from archived Inland Revenue file IR 40/17815.

²³ Interview with Finance Ministry official, Kampala, September 2017

agreements with identified major trading partners'.²⁴ As the Minister explained, the purpose of the treaties was to 'ensure that the effectiveness of current incentives is not eroded by the absence of complementary tax credits' because 'in the absence of any complementary tax holidays with the home countries of foreign investors, the revenue foregone by reducing a company's tax liability in Uganda represents a revenue gain by the Ministry of Finance in the home country'.²⁵ The reasoning was that by including tax sparing provisions in a treaty, the treaty partner would agree to allow a credit for taxes due but foregone by Uganda due to investment incentives, thus ensuring that the benefit from the tax incentives accrued to the multinational investors at whom they were targeted. To underline the link with investment incentives, in the early 1990s the UIA also participated in treaty negotiations.²⁶

It took some time for the negotiating programme announced in 1993 to come to fruition, but three of Uganda's subsequent tax treaties did include such tax sparing provisions: South Africa (1997), Italy (2000) and Mauritius (2003).¹⁰ After 1993, however, two other factors combined to undermine this rationale for treaty negotiation. First, in 1998, the OECD published *Tax Sparing: a Reconsideration*, which highlighted the potential negative impacts of tax sparing arrangements in tax treaties, in particular that they could potentially be abused, and that they created an incentive to repatriate profits quickly rather than reinvest them in a country (OECD 2012). This OECD report on its own did not halt the spread of tax sparing provisions, although it did suggest some best practice in the area.

A second development was the spread of territorial tax systems throughout the OECD countries, under which a capital-exporting country exempts the foreign-source income of its outward investors from further taxation (PWC 2013). Under a territorial system, overseas investors automatically keep the gains from any tax concessions in the host country, whether or not a tax treaty is in place. Italy was already operating an exemption system at the time the treaty with Uganda was

²⁴ Mr. J. Mayanja Nkangi, quoted in Hansard, 25.6.93.

²⁵ Ibid

²⁶ Interview with UIA official, Kampala, September 2017

signed, and both South Africa and the UK now also exempt foreign-source dividends from direct investments from further taxation.

2.2 Relieving double taxation

Although their negotiated content indicates that tax sparing ceased to be Uganda's main justification for tax treaties, it continued to sign them – with Norway (1999), Denmark (2000), the Netherlands (2004), India (2004) and Belgium (2007). A treaty with China was concluded in 2012, but has not yet been ratified. According to statements made in budget speeches, Uganda has also negotiated with Egypt, the Seychelles, Sudan, Turkey and the United Arab Emirates.²⁷

The government's rationale for these treaties, set out by successive finance ministers when laying the treaties before parliament, has changed since 1992. According to Mr G. Ssendula in 2001, it was now 'to protect taxpayers against double taxation, and to ensure that the tax system does not discourage direct foreign investment'; Dr Ezra Suruma concurred in 2006, that 'the purpose of this agreement is to reduce tax impediments to cross-border trade and investment and assisting tax administration in information sharing'.²⁸

The difficulty with this view is that there are very few instances in which potential double taxation on investors in Uganda in the absence of these treaties can really be identified. All Uganda's treaty partners take unilateral steps to relieve double taxation: the European countries all treat foreign-source dividends from direct investments as tax-exempt, as does South Africa; India, China and Mauritius provide a tax credit. Australian investors, by far the biggest non-treaty bloc according to Uganda's investment statistics, seem to have had no concerns about tax when investing in Uganda, which may be because that country also exempts foreign source dividends.²⁹

Another argument often touted is that investor confidence is boosted by inclusion of the mutual agreement procedure (MAP) in Uganda's tax treaties, which provides a

²⁷ Budget speeches, Hansard 10 June 2004, 12 June 2008, 19 September 2016

²⁸ Budget speeches, Hansard 14 June 2011 and 15 June 2016.

²⁹ Although Uganda is not a substantial outward investor itself, it also relieves double taxation for Ugandan residents through a credit for taxes paid abroad.

procedure for resolution of claims of double taxation. However, it is also a good indicator of post-treaty complaints of double taxation. Revenue officials indicate that, after twenty-two years, Uganda has yet to enter into a MAP.³⁰ A potential new case with the UK cited by Uganda Revenue Authority (URA) officials does not seem to concern double taxation, but is about which of two options provided in that treaty's management fees article should be used.

This is not to say that potential double taxation issues don't exist. Kenya, with which Uganda does not have a treaty,³¹ does not give a credit for taxes paid overseas unless a tax treaty is in place. Instead, it allows Kenyan companies to deduct foreign taxes paid as an expense, which arguably entails some double taxation. Differences in definition or interpretation can also create double taxation in some instances: for example, where a fee paid to a company in one country for providing a service to a company in the other is regarded by both countries as originating within their borders. From Uganda's perspective, it is unlikely (but not impossible) that this alone is sufficient reason for a treaty.

In any event, the trite rationale that 'treaties relieve double taxation, which attracts investment', which still dominates discussion of tax treaties in Uganda, simply does not hold in the case of Uganda's existing treaties. While in the absence of tax treaties there would no doubt be some investors who would be inconvenienced by some double taxation, it cannot be assumed that, in the absence of a treaty, a definite flow of investments would be choked off due to significant double taxation.

2.3 Treaties as tax incentives

There may be no major double taxation problem, but tax treaties may still attract investment into Uganda because of their effect on single taxation. This is because many of Uganda's major investment partners exempt foreign income from taxation altogether. Hence, the lower withholding taxes and other restrictions on source taxation in Uganda's tax treaties effectively act as tax incentives, lowering the overall cost for firms from these countries of investment in Uganda.

³⁰ Interview with URA officials, Kampala, September 2014.

³¹ Kenya and Uganda are both signatories to the EAC's multilateral tax treaty, which has yet to be ratified by all member states.

Although this is no doubt positive for investors, there was a startling consensus across the stakeholders we interviewed that tax treaties were not a primary consideration for investors in deciding whether or not to invest in Uganda. A MoFPED official, despite the statements made by past finance ministers, stated boldly that ‘nobody comes to invest because you have a tax treaty. When you see the rationale to attract investment, it sounds laudable. But when you look at the evidence, it’s not the case’.³² According to an accountant in a tax advisory firm, ‘it is a secondary factor you take into account in terms of structuring’.³³ A tax lawyer agreed: It would seem to me that tax is a secondary consideration. From our experience we have seen investors are looking to the economic drivers: business-based, rather than tax-based. A business will say ‘now we have decided where we are going to work, let’s get a tax expert to structure it’.³⁴

Unlike other developing countries, promotional literature from Uganda’s Investment Authority does not mention its network of tax treaties.³⁵ An official there told us that investors are not interested in tax treaties: ‘to most of them it is not an important thing’.³⁶ Indeed, tax treaties are not mentioned anywhere in a comprehensive survey of investors conducted by the UIA and Uganda’s National Bureau of Statistics.³⁷ Among economic and financial factors affecting business, more than half of those surveyed said corporate tax had a low or no effect; only 15 per cent said it had a significant negative effect, which was second to bottom among the thirteen factors listed.³⁸

Uganda’s investment statistics, presented in Table 1, shed some further light on this. Inward foreign direct investment (FDI) stocks reported by Uganda are

³² Interview with Finance Ministry official, Kampala, September 2014.

³³ Interview with tax adviser, Kampala, September 2014.

³⁴ Interview with tax adviser, Kampala, September 2014.

³⁵ The list of ‘Reasons for investing in Uganda’ at <<http://www.ugandainvest.go.ug/index.php/investment-guide>>.

³⁶ Interview with UIA official, Kampala, September 2014.

³⁷ Uganda Bureau of Statistics, *Investor Survey Report 2012* (Kampala, 2012).

³⁸ Two tax advisers interviewed independently in London explained the role of tax factors in investment decisions slightly differently. According to them, businesses will calculate a risk-adjusted return on investment, including estimates of the likely tax cost as well as the risk of incurring higher or lower taxes than expected. In that case, tax does play a role in investors’ decision-making, but it is still secondary in comparison to business-related factors. It is more likely that tax would be the tie-breaker between two viable potential investments.

dominated by \$3.7 billion from the Netherlands, but the Netherlands (whose data on outward investments exclude special purpose vehicles used in treaty shopping) reports only \$179 million of FDI in Uganda. This suggests that 95 per cent of investment coming into Uganda from the Netherlands originates elsewhere. Investment from Mauritius into Uganda, at \$381 million, does not appear to be as large as one might expect, given the talk of Mauritius in Kampala tax circles. But the fact that it exceeds investment from both South Africa and Kenya is notable. 'Most of the companies investing in Africa have been setting up through a hub in Mauritius', a tax adviser stated.³⁹ URA officials concurred, with one asserting that 'there is a lot of treaty shopping. A lot of companies trading in Uganda have their HQs in Mauritius'.⁴⁰

The second biggest source of investments, also much bigger than any others, is Australia, which has no treaty with Uganda. New investment in Uganda's oil industry has come from the French company Total and the Chinese National Offshore Oil Corporation, neither based in countries that have tax treaties with Uganda.

Table 1 Investment stock in Uganda, 2012

Home country	Treaty?	FDI equity stock in Uganda in 2012 (US\$)	FDI debt stock in Uganda in 2012 (US\$)
Netherlands	Yes	3,729	198
Australia	No	1,736	412
United	Yes	688	136

³⁹ Interview with tax advisers, Kampala, September 2014.

⁴⁰ Interview with URA officials, Kampala, September 2014.

Kingdom			
Mauritius	Yes	381	86
Kenya	No	312	105
Switzerland	No	99	14
India	Yes	99	9
United States	No	94	9
Bermuda	No	88	1
South Africa	Yes	64	45
Norway	Yes	28	1
Denmark	Yes	3	11
Belgium	Yes	-26	28

Source: IMF (2014).

In conclusion, we might observe that the only treaty for which there is evidence of a major impact on investment into Uganda is the Dutch one, but this effect has been to encourage treaty shopping rather than to stimulate significant amounts of Dutch investment. When private sector tax advisers were asked what would

happen if the Dutch treaty were cancelled, they stated that investors would simply restructure, and were unlikely to withdraw their investments.

2.4 Fiscal cooperation

Tax treaties nowadays also may include provisions for cooperation between tax authorities in the form of information exchange and assistance in the collection of taxes. Broader arrangements for mutual assistance are also available through multilateral conventions. As Table 2 shows, however, Uganda's bilateral treaty network is somewhat patchy in its provision of some of these benefits.

Table 2 Fiscal cooperation provisions in Uganda's tax treaties⁴¹

	Zambia	UK	South Africa	Norway	Denmark	Italy	Mauritius	India	Netherlands	Belgium	China
Date of signature	1968	1992	1997	1999	2000	2000	2003	2004	2004	2007	2012
Information exchange	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Collection of taxes	No	No	Yes	Yes	Yes	No	No	Yes	Yes	Yes	No

⁴¹ IBFD (2014) states that this treaty was signed in 2012, MofPED officials claim it has not yet been signed.

Information exchange provisions allow a revenue authority from one country to obtain information about its taxpayers that the other country may hold for example, if the other country is the home country of a multinational whose subsidiary the first country is auditing, or if an individual being investigated has savings in the other country. Revenue officials indicated that Uganda has historically made at the most 'maybe one request per year' using the powers in its tax treaties,⁴² although this situation may be improving: between the URA's Tax Investigations Department becoming the competent authority with powers to administer tax treaties in March 2014 and an interview conducted in June 2015, the URA had made eight new requests for information (Kangave et al. 2016). Uganda is part of a pilot automatic tax information exchange project with the UK, but URA officials indicated that, even under this, they do not expect to gain much in the short- to medium-term. So while this might be an important tool to combat tax evasion in principle, in practice it is a tool from which Uganda is only just starting to benefit.

There may be more benefit to Uganda from the legal basis created by modern treaties for the tax authority of one country to collect taxes on behalf of the other. A URA official explained that this could be important for the URA in cases such as the Zain capital gains dispute (discussed below), or in cases of short duration permanent establishments, where the taxpayer concerned no longer has any assets in Uganda by the time that an assessment is raised.⁴³ It is unfortunate that many of Uganda's treaties, including the potential one with China, do not include this provision.

Having noted these advantages, it is important to realise that Uganda does not need bilateral tax treaties to obtain them. They can be obtained through two multilateral conventions. One, initiated by the African Tax Administration Forum (ATAF), covers African countries including Mauritius, but is not yet in force. The other, which is in force and which Uganda signed in November 2015, was initiated by the Council of Europe and the OECD, and covers all Uganda's treaty partners. Multilateral conventions have further advantages. First, they provide for broad

⁴² Interview with URA officials, Kampala, September 2014.

⁴³ Interview with URA officials, Kampala, September 2014.

mutual assistance, and on a multilateral basis, which, for example, would permit joint assessment of a multinational by a consortium of tax authorities. This issue was thrown up as a result of a multi-country investigation conducted by the NGO ActionAid into the multinational brewery SABMiller, which owns Uganda's main brewery, Nile (Hearson and Brooks 2010). The report provoked a desire in African tax authorities to conduct their own investigations, to combine forces and examine apparently similar tax avoidance practices across the continent. Unfortunately, they lacked the legal authority to do so, needing a single multilateral treaty covering all the relevant countries.

CHAPTER THREE

CHALLENGES IN IMPLEMENTING DOUBLE TAXATION TREATIES

3.0 Introduction

It would be unfair to say that Uganda has negotiated badly in the past. In fact, among sub-Saharan countries its treaties are among the best when it comes to the protection of some taxation rights such as withholding taxes on management fees. However, this makes Uganda a good performer within a region that has systematically negotiated away large chunks of its taxing rights, especially in comparison with other regions⁴⁴. In this section we demonstrate that a lifting of these low expectations leads very quickly to a much more negative assessment of Uganda's tax treaty network. It should be made clear that treaties are about taxing rights, not tax rates or even revenue. This means that the question to be asked when accepting a limitation in a treaty is not 'How much tax should investors into Uganda pay?', but 'How much should Uganda constrain its right to levy tax now and in the future?' The first is a question to be asked by reference to the current economic situation and economic policy. The second entails anticipating future events and priorities. In signing a treaty, a country accepts limitations on what future governments, or even the same government in different economic circumstances, can do. The maximum withholding tax rates and other restrictions in treaties should be considered in this context of restricting future actions, rather than in terms of advisable tax policy in the current economic situation.

3.1 Uganda's treaty network is much less favourable than the UN model treaty

MoFPED officials suggested to us that, in its negotiations, Uganda has generally followed the UN model tax convention, but sought to include an article permitting withholding taxes on management service fees.⁴⁵ Most negotiating partners' own opening positions are likely to have begun from the OECD model. The UN model is

⁴⁴ Dauer and Krever 2012

⁴⁵ Ibid

described in its title as a model for treaties 'between developed and developing countries', and is the most widely-recognised articulation of a good balance of taxing rights between developed and developing countries. Using it as an opening position has evidently not served Uganda well as a tool to achieve this eventual balance.

3.1.1 Withholding tax rates

As noted earlier, tax treaties set maximum rates at which withholding taxes can be levied on cross-border payments, specifically dividends, interest, royalties and management or technical service fees. In Uganda's tax code, these payments are all taxed at 15 per cent, but the treaty rates shown in Table 3 are mostly lower than this. Uganda has indeed been broadly successful at maintaining the right to levy a withholding tax on management fees paid to foreign companies, and the other withholding tax rates have historically compared well to those of many other African countries. However, these rates have trended down since its first treaty with the UK, in particular in the more recent treaties with the Netherlands, Belgium and China. It is worth noting the recent experience of Zambia, whose generous concessions to China appear to have created a precedent, pushing down withholding taxes quite significantly in a subsequent renegotiation with the UK⁴⁶.

Uganda's treaties generally set maximum rates that are below the rates in its domestic law. Only the Mauritius treaty comes close, at 2.6 billion shillings (about US\$1 million). These figures exclude the cost of lower withholding taxes on royalties and management fees, where data is not available, but which are likely to create significant further costs. 'We realised that a lot of money was flying out through management fees', a Finance Ministry official told us.⁴⁷

⁴⁶ Hearson 2014

⁴⁷ Interview with Finance Ministry official, Kampala, September 2014.

Table 4 Estimated revenue foregone due to reduced WHTs in treaties (Ugandan shillings, billion)

	FDI stock in Uganda		Estimated return on FDI		WHT foregone	
	Equity	Debt	Dividends	Interest	Dividends	Interest
Netherlands	9,899	525	414	22	21 to 62*	1.1
Mauritius	1,012	229	42	9.6	2.1	0.5
India	263	23	11	1.0	0.5	0.0
South Africa	169	119	7.1	5.0	0.4	0.2
Norway	77	1.9	3.2	0.1	0.2	0.0
Denmark	9	30	0.4	1.3	0.0	0.1

Source: IMF (2014). Assumes a uniform 4.1% return on FDI from Uganda based on <data.worldbank.org>.

*Treaty rate is most likely 0%, but for some companies it may be 5% (for holdings below 50%) or 15% (for companies not composed of shares).

3.1.2 The definition of permanent establishment

Withholding tax rates are a first line of defence against tax avoidance, since they discourage abusive transfer pricing payments. Because they are levied on the gross value of payments, however, they can lead to onerous levels of taxation if margins are slim, unlike taxation of net profits; in the case of branches, which do not remit profits as dividends, profit taxation is necessary. Effective taxation of net profits in such circumstances depends on building a broad definition of permanent establishment, which sets the minimum threshold of activity before a company can have tax levied on its profits, into treaties. Many of Uganda's treaties lack this. 'Withholding tax rates are nothing', a Finance Ministry official told us. 'You can have high rates and then you've given out a lot in PEs'.⁴⁸

As an example of this debate, one particular concern for the MoFPED is the taxation of oil exploration activities. The treaties with the Netherlands and Denmark include a special oil exploration permanent establishment (PE) to tax the profits from such activities, the threshold for which is a minimum presence in the country of thirty days. Several tax advisers, however, felt that withholding taxes levied on the fees paid to specialist service providers in the oil industry would have been a more effective option, since it is easier for their oil industry clients to avoid being taxed as a PE. One said that Uganda should be asking, 'What is it we can have a quick win on, which will not have so much complexity in terms of enforcement?' He continued, 'Oil service providers, for example, will always structure to avoid PE risk'.⁴⁹

A first weakness in the PE definitions within Uganda's tax treaties is the absence from most of them of the UN service PE provision, which expands the PE threshold to encompass service providers who are physically present in the country but do not operate from a 'fixed base', otherwise the starting point of the PE definition. The UN service PE provision is contained in half of recent treaties signed by developing countries⁵⁰. Furthermore, none of Uganda's treaties include the less commonly used UN 'limited force of attraction' provision, which would allow inclusion of all a multinational's profits from similar activities in Uganda within the profits of its

⁴⁸ Interview with Finance Ministry official, Kampala, September 2014.

⁴⁹ Interview with tax adviser, Kampala, September 2014.

⁵⁰ Wijnen et al. 2012

permanent establishment. Both this and the service PE provision would expand the tax base of multinational enterprises operating in Uganda.

Another weakness is in the length of time a construction site must be in place before it meets the PE definition. In common with around half the recent treaties signed by developing countries, Uganda has consistently obtained a six-month construction PE, which is more advantageous than the twelve months specified in the OECD model and the most common length in recent treaties signed by developing countries. But the six- and four-month thresholds in Uganda's tax treaties may not be short enough in an era where, as one Finance Ministry official pointed out, 'the Chinese can do things in three months'.

3.1.3 Capital gains

Finally, the treaties' capital gains provisions are problematic, because they restrict Uganda's right to tax gains realised by foreign investors on sales of Uganda-based assets. First, only the India and China treaties include an anti-avoidance provision that would allow Uganda to tax sales of companies overseas that are vehicles for the ownership of immovable property in Uganda. This provision has been included even in the OECD model, and is found in almost two-thirds of recent treaties signed by developing countries. Its absence is at the heart of the Airtel case. Second, only Uganda's treaties with India and Norway permit it to tax the sale of shares in a Ugandan company by foreign residents. This provision is also included in the UN model. Combined, these two omissions are a recipe for serial losses, discussed further below.

3.2 There is evidence of significant revenue loss due to preventable treaty shopping

Treaty shopping refers to the practice of establishing a conduit company in a country with a favourable network of tax treaties, and usually a low effective tax rate, to take advantage of the benefits of those treaties rather than the less generous terms (if there is a treaty at all) negotiated between the investor's home

country and the destination of their investment⁵¹. As already noted, the vast majority of investment from the Netherlands into Uganda appears not to originate there. Given that it enables a zero rate on dividends, it is easy to see why. According to a URA official, 'The ones claiming [reduced taxation] under the DTAs are many, about one per day. The worst culprits are Mauritius, Netherlands. There is a lot of treaty shopping. A lot of companies trading in Uganda have their HQs in Mauritius'. Consider Uganda's booming mobile communications sector. Major investments come from countries that have a treaty with Uganda, but they have been structured via third countries with more favourable treaties. Bahti Airtel is headquartered in India, but its investment is structured via the Netherlands; MTN is headquartered in South Africa, with its investment structured via Mauritius⁵².

An important advantage to investors of Uganda's treaties with the Netherlands and Mauritius is that they provide an easy treaty shopping route to avoid Ugandan capital gains tax. The treaties prevent Uganda from taxing the sale of shares in Ugandan companies by a Dutch or Mauritian resident, and may allow foreign investors to avoid capital gains tax on the sale of immovable property in Uganda simply by structuring the purchase through a vehicle in the Netherlands or Mauritius. The issue of 'indirect transfers' of capital assets has been highlighted by the United Nations (Cui 2014), IMF (2014a: 28) and OECD (2014b), the latter stating in its recent report to the G-20 development working group that: Developing countries report that the profit made by the owner of an asset when selling it (for example, the sale of a mineral licence) is often not taxed in the country in which the asset is situated. Artificial structures are being used in some cases to make an 'indirect transfer'; for example through the sale of the shares in the company that owns the asset rather than the sale of the asset itself⁵³.

It is therefore concerning that, as Table 4 shows, so few of Uganda's treaties include provisions concerning the taxation of gains from the alienation of shares,

⁵¹ Cooper 2014

⁵² Kalinaki 2014; MTN Group Plc 2014

⁵³ OECD 2014

whether general shares or those in property-rich companies. The Dutch and Mauritian treaties present a particular problem here: with around 11 trillion Ugandan shillings (US\$4 billion) of direct investment stocks in Uganda coming through these two countries, a potential billion dollars of capital gains tax is at risk that might otherwise be payable in Uganda.

As one example, the URA is currently in dispute with Zain Telecom over \$85 million of capital gains tax in exactly such an indirect transfer case. The sale of Celtel Uganda Ltd from Zain Telecom to Bahti Airtel took place via a network of holding companies in the Netherlands. The URA maintains that Celtel Uganda was a company consisting predominantly of immovable capital, and that as such it should be able to tax the transfer even though it took place in the Netherlands.⁵⁴ Unfortunately, because the Uganda-Netherlands treaty does not contain a clause concerning property-rich companies, it allocates the right to tax this transaction to the Netherlands. When the case moves from technicalities to substance, the URA will no doubt point to section 88(5) of the Income Tax Act, an anti-treaty shopping provision which provides that: Where an international agreement provides that income derived from sources in Uganda is exempt from Ugandan tax or is subject to a reduction in the rate of Ugandan tax, the benefit of that exemption or reduction is not available to any person who, for the purposes of the agreement, is a resident of the other contracting state where 50 per cent or more of the underlying ownership of that person is held by an individual or individuals who are not residents of that other Contracting State for the purposes of the agreement.

There is a lot of uncertainty among tax professionals in both public and private sectors about whether an Income Tax Act such as this one can override the provisions of a tax treaty.⁵⁵ Section 88(2) of the Act gives treaties precedence over domestic law except for clause 88(5) and other anti-avoidance rules, but Uganda is also a signatory to the Vienna Convention on the Law of Treaties which may prevent 'treaty overrides' in domestic law. This case may provide some useful jurisprudence, but, absent a favourable court judgement, Uganda can only

⁵⁴ Court of Appeal of Uganda, *Commissioner General, URA versus Zain International BV*, 2012.

⁵⁵ Interviews with tax advisers and with URA officials, Kampala, September 2014.

safeguard its taxing rights effectively by including anti-avoidance provisions within its treaties themselves. Furthermore, the 'underlying ownership' concept is relatively untested, and according to tax advisers there is an absence of procedural guidance from the URA explaining how taxpayers can demonstrate compliance. A concern mentioned by Ugandan tax advisers is the application of the underlying ownership concept to public limited companies, whose shareholders are numerous, geographically diverse, and constantly changing.⁵⁶

The OECD (2014a) is currently developing a general anti-abuse rule for inclusion in model treaties, based on a different form of anti-avoidance rule a principle purpose test. Uganda would be well advised to follow this aspect of the OECD's Base Erosion and Profit Shifting (BEPS) project, and to consider incorporating a rule along these lines into its treaties (none currently contains an anti-abuse rule), as well as amending its domestic law to match. It may be able to do so through participating in the proposed multilateral instrument to introduce amendments into existing tax treaties.

In any event, the Zain case could have been prevented without the need for a general abuse clause if Uganda had simply ensured that the specific anti-abuse rule relating to capital gains tax provided for by both the UN and OECD model treaties at article 13(4) was incorporated into its treaties, as it is in half of recent treaties signed by developing countries⁵⁷. The UN model contains a number of such specific anti-abuse rules, but their incorporation into Uganda's treaties is patchy.

Some, such as the 'beneficial owner' and 'special relationship' wording in the UN and OECD model clauses on WHT are present in all Uganda's treaties. However, several others are barely included, if at all. This includes the incorporation of a dependent agent maintaining stock in the definition of permanent establishment, and the limited force of attraction and capital gains provisions discussed earlier.

⁵⁶ Interviews with tax advisers, Kampala, September 2014.

⁵⁷ Wijnen and de Goede 2013

CHAPTER FOUR

BENEFITS AND PROBLEMS OF DOUBLE TAXATION MODEL TREATIES

4.0 Introduction

As noted earlier, Uganda may have opened its treaty negotiations with a preference for the UN model, but it rarely obtained UN model provisions for many articles. The UN model is a compromise position between developed and developing countries, developed by a group of tax officials nominated by both developed and developing countries: in other words, it is the outcome developing countries should aim for, not the opening position from which they should begin negotiations. There is a need for a model that fulfils this latter role. Precedent is powerful in treaty negotiations, and any changed approach to negotiations must bear this in mind, rather than plucking articles from nowhere. The best way to build precedent at this point is twofold: first, shape internationally-accepted models to reflect Uganda's policy goals; second, negotiate strategically among like-minded countries to create precedent. Here we consider some examples.

4.1 Uganda and the UN model

Model tax treaties don't stay static, they evolve. If Uganda is to adopt the UN model as its own negotiating model, it should be involved in shaping that model to reflect its own concerns. For example, the committee that updates the UN model treaty is currently considering the introduction into the treaty of a provision permitting withholding taxes on management service fees, which has always been a priority for Uganda in negotiations. The provision has been the subject of much disagreement among committee members.⁵⁸ If it is adopted, this may help bolster Uganda's position in negotiations, but a weaker version than that currently used by Uganda could have the opposite effect.

There is no Ugandan member on the UN tax committee, and indeed there has not been since the committee was given its current status in 2005. It would still be

⁵⁸ Observation at UN committee annual sessions, 2013 and 2014.

possible to influence the UN's work, for example by attending meetings as an observer: many observers make verbal contributions to committee meetings, where they have the benefit of speaking on behalf of their country, rather than in a personal capacity as committee members do. However, Uganda has not attended a UN committee session since 2004, nor does it appear to have submitted written comments to recent UN consultation exercises.⁵⁹ Another possibility would be to coordinate with the actual UN committee members, for example those from Africa of which there are five, from Ghana, Zambia, Senegal, South Africa and Morocco. Finance Ministry officials indicate that they do not take this opportunity either.⁶⁰

An important reason to engage with the work of the UN committee is the role its commentary may play in any treaty dispute arising from a clause based on the UN model. Unlike the OECD model, countries cannot enter observations or reservations on the text or commentary; instead the commentary notes any difference of opinion between members concerning the treaty's interpretation. If Uganda wishes the treaty to be interpreted in a particular way, it would need to ensure that the commentary reflects this, or else include an exchange of notes with each negotiated treaty to clarify its intentions.

4.2 Uganda and the OECD model

Uganda is a more frequent participant in the OECD's annual tax treaties forum than at the UN. Unlike the UN committee session, however, this is not generally a meeting at which decisions are taken about the treaty model: that happens at meetings of Working Party 1 and the Committee on Fiscal Affairs, which Uganda is not entitled to attend. Non-members are, however, able to enter formal observations on the OECD model treaty and its commentary, and many developing countries do. Currently, Ivory Coast, Gabon and the Democratic Republic of Congo are the only sub-Saharan states to have entered observations on the OECD model⁶¹.

Uganda has accepted OECD model clauses in many instances, but it has not entered any observations on the OECD model treaty. This means it may find itself bound in

⁵⁹ Attendance lists on file with the authors

⁶⁰ Interview with Finance Ministry officials, Kampala, September 2014.

⁶¹ Vega and Rudyk 2011

any treaty disputes by the interpretation of the treaty as articulated by OECD members. It also means that when negotiating partners bring the OECD model to the table, Uganda cannot point to an internationally-recognised articulation of its own response to that model.

Perhaps more importantly, by not recording any observations Uganda contributes to a tacit acceptance of the OECD model provisions, rather than supporting an emerging developing country position in opposition to more residence-based provisions that would strengthen developing countries' hands. For example, in 2010 the OECD made changes to article 7 of the model convention that substantially changed the balance of taxing rights from the operating countries of multinationals to their head office countries. Objections to this change were registered on behalf of Argentina, Azerbaijan, Brazil, Bulgaria, Colombia, Hong Kong, Indonesia, Latvia, Malaysia, Romania, Russia, Serbia, Singapore, South Africa and Thailand (OECD 2014c). This declared opposition is surely useful for developing countries wishing to prevent the inclusion of the new OECD provision in a treaty.

4.3 Uganda and the EAC model

In contrast to the OECD and UN models, Ugandan government officials indicated that they have participated actively in the formulation of the EAC model treaty for negotiations with third countries. Uganda's influence can be seen in the inclusion of a general limitation of benefits clause, which is similar to, but clearer than, that in Uganda's own legislation. Another strength of the EAC model is the inclusion of a management fees article with a 10 per cent withholding tax.

In other areas, the EAC model treaty would permit less taxation by Uganda of inward investment than one based on the UN model. It has a weaker definition of permanent establishment (e.g. delivery locations are excluded from the definition), and it lacks the UN paragraph 13(5) permitting source country taxation of capital gains from the sale of general shares. It also uses the weaker OECD definition of a property-rich company in paragraph 13(4), which can be avoided through the use of a partnership or trust.

In its quantitative articles, the EAC model makes the mistake of starting from a position that should be a final compromise, rather than the basis for opening negotiations. Perhaps most significantly, it begins with a six-month threshold for a permanent establishment for construction projects and services, despite an awareness in Uganda that many projects might fall below this threshold. It also specifies maximum withholding tax rates of 7.5 per cent on shares where the recipient owns more than 50 per cent of the company paying shares, well below the rate in most of Uganda's treaties. Withholding taxes on interest and royalty payments are set at 15 per cent, the same as Uganda's domestic law, but reduced to 10 per cent for related parties, a concession that surely should only be made, if at all, during negotiations in exchange for a benefit. The rate on management fees could also have been set at 15 per cent in the model.

Finally, the EAC model includes a most favoured nation (MFN) clause in its withholding tax articles. This is in article 14: If after the signature of this Agreement under any Convention or Agreement between a Contracting State and a third State, the Contracting State should limit its taxation at source on management or professional fees to a rate lower or a scope more restricted than the rate or scope provided for in this Agreement on the said items of income, then as from the date on which the relevant Contracting State Convention or Agreement enters into force the same rate or scope as provided for in that Convention or Agreement on the said items of income shall also apply under this Convention.

An MFN clause can strengthen a country's position in subsequent negotiations, because both sides appreciate the costs of agreeing to a lower rate. But, once triggered, those costs can be significant. A particular problem with this clause is that it is bilateral: in a treaty with a developed country, it could be triggered by that developed country concluding a subsequent agreement with lower withholding tax, even though any benefits from the resulting lower rate would overwhelmingly accrue to the developed country.

Such an incident occurred with the April 2003 Venezuela-Spain treaty. In May 2006, the bilateral MFN clause in its interest article was triggered through a kind of

domino effect: Estonia and The Netherlands signed a treaty granting exclusive source taxation rights over interest: this activated the MFN clause in the September 2003 Spain-Estonia treaty, which in turn activated the MFN clause in the Venezuela-Spain treaty. As a result, 'Venezuela's treaty with Spain has undoubtedly become the most favorable tax treaty executed by Venezuela to date' (Escobar 2006). An MFN clause, just like a six-month PE definition, a 7.5 or 10 per cent WHT, and numerous smaller UN provisions that have not been carried across into the EAC model,⁶² should not be conceded in a model. It should be kept in reserve for treaty negotiations, only to be given up, if at all, in return for something else.

4.4 Uganda and the COMESA model

Documentation from the Common Market of Eastern and Southern Africa (COMESA) model treaty project indicates that Uganda was one of the few members of the group not to attend meetings at which this model was developed.⁶³ In fact, it appears that URA officials did participate in the project at some point, but not the Ministry of Finance.⁶⁴ Like the EAC model, the COMESA model has some strengths in comparison to the UN model, but its protection of source taxing rights is weaker than both the EAC and UN models. For example, its PE definition omits both delivery units and dependent agents maintaining stock; it also follows the less-expansive OECD definition of royalties. The model does not specify withholding tax rates, which may be preferable to the compromise rates specified in the EAC model, but is less beneficial than higher rates would be. Unlike the EAC model, it does not include an article on technical service fees.

There are two main advantages to the COMESA model. The first is the inclusion of anti-treaty shopping provisions. Main purpose tests, which disqualify taxpayers from the lower rates if the main purpose of the transaction is to benefit from those lower rates, are included in some of the withholding tax articles, to complement the

⁶² For example: source taxation of shipping in article 8 of the UN model, which is probably less interesting for a landlocked country; inclusion of payments for the use of equipment within the definition of royalties; taxation of senior managers in article 16 of the UN model.

⁶³ COMESA project documents, on file with the authors.

⁶⁴ Interviews with URA and Finance Ministry officials, Kampala, September 2014.

'beneficial owner' and 'special relationship' anti-avoidance provisions.⁶⁵ Second, member states can also enter reservations, which would allow Uganda to open its negotiations from a stronger position than that in the COMESA model itself. Uganda has already entered some reservations, including one indicating that it prefers to include an article allowing it to impose a withholding tax on management fees.

4.5 Uganda needs an ambitious new model treaty

There is no current model treaty that it would be advisable for Uganda to use as an opening position in negotiations. It is not satisfactory to rely on any one of these models. Instead, Uganda should develop its own model, taking into account its domestic law, and cherry picking from the best of its existing treaties and from the EAC, COMESA, UN and OECD models. Provisions that seem of little importance to Uganda, such as on shipping, should be included, but could be given up as part of horse-trading during negotiations. Uganda should enter reservations on important provisions at COMESA and the OECD, and ensure that commentaries to the EAC and UN model reflect its views.

A Ugandan model could include, for example:

1. All elements of the UN model PE definition, with a 90-day or lower period for construction sites and service PEs, as provided in Ugandan law.
2. 15 per cent WHT rates across the board, including on technical service fees, as in Uganda's treaty with the UK and its domestic legislation, with main purpose tests for passive income as in the COMESA model.
3. All capital gains provisions from the UN model.
4. The Limitation of Benefits or Principal Purpose clause from the EAC model or the forthcoming new OECD provision.
5. Exchange of information and collection of taxes provisions from the UN and EAC models.

⁶⁵ Notably, Mauritius has entered a reservation on these articles.

CHAPTER FIVE

CONCLUSION AND RECOMMENDATIONS

5.0 Introduction

None of the reasons articulated by the government of Uganda in the past or present for concluding tax treaties seem to hold up in the current context. Provisions for tax sparing are largely unnecessary and possibly undesirable. Double tax relief can be obtained unilaterally. Mutual assistance, clearly a priority for the URA, is not always delivered by Uganda's current treaties, and in any event would be more comprehensive and effective when obtained through multilateral agreements.

5.1 Conclusion

Meanwhile, none of Uganda's treaties meet the standards set out in the UN model. At present there is a major problem in the form of treaty shopping through the Dutch treaty, which should be the top priority for renegotiation. However, renegotiating priorities should not stop at treaty shopping. The weak permanent establishment provisions in Uganda's treaties mean there is a pool of inward investment of indeterminate size that Uganda cannot currently tax. Perhaps more significant is the major lack of source taxing rights over capital gains made by inward investors. The high-profile Zain and Heritage court cases indicate that Uganda wishes to tax capital gains when business interests in Uganda are sold on by overseas investors, but Uganda's treaties are not fit for this purpose.

Re-evaluating its current treaties against existing standards may not be enough, however. If Uganda decides that tax treaties are desirable, it needs a stronger model than those currently available to it. This should present a best-possible scenario, so that the eventual outcome of negotiations is closer to the reasonable compromise position embodied by the UN model. The EAC and COMESA models contain some ambitious elements, but overall they are no stronger as opening positions than the UN model. Uganda also needs more robust domestic laws to

bolster its negotiating position and ensure that it can interpret its treaties expansively, and to ensure that other investment promotion instruments do not further weaken its taxing rights.

Furthermore, Uganda should ask itself not just, 'Why sign new treaties?' and 'How should existing treaties be renegotiated?', but also 'Why keep existing treaties?' Path dependence may well be an important answer. Investor surveys do reveal that Uganda's stable political and economic regime is one of its most important assets in attracting investment (Uganda Bureau of Statistics 2012). There may therefore be concern that cancelling tax treaties might create what a tax adviser described as negative PR. Alternatively, a reputation for stability may cushion Uganda against fears that treaty cancellations are a prelude to a dramatic shift towards discriminatory or unfair taxation.

5.2 Recommendations

A suggested course of action for Uganda's review could include the following steps:

Identify the areas where tax treaties and domestic legislation leave it most vulnerable to revenue loss. This includes PE definition (treaty and domestic), treaty shopping (treaty and domestic), withholding taxes (treaty) and capital gains (treaty and PSAs).

Incorporate an assessment of tax foregone due to tax treaties into the government's annual statement of tax expenditure.

Formulate an ambitious Ugandan model by applying a 'best available' approach to existing models (EAC, COMESA, UN), current treaties and domestic legislation, none of which are currently adequate. This might include:

All elements of the UN model PE definition, with a 90-day period for construction sites and service PEs as per Ugandan law.

15 per cent withholding tax rates across the board, including on technical service fees, as per Uganda's treaty with the UK and its domestic legislation, with main purpose tests for passive income as per the COMESA model.

All capital gains provisions from the UN model.

The Limitation of Benefits clause from the EAC model or the forthcoming new OECD provision.

Exchange of information and collection of taxes provisions from the UN and EAC models.

Identify red lines within the Ugandan model. This should certainly include items c, d and e from the above list.

Based on investment and remittance data, request renegotiation of treaties that have the greatest actual (or potential in terms of capital gains) cost. At first sight, this appears to be the treaties with the Netherlands, Mauritius, UK and China. These renegotiations should be conducted on the basis of an improved distribution of taxing rights in Uganda's favour, not a balanced negotiation.

Ensure that future updates to provisions of model treaties that Uganda uses, or to their commentaries and reservations/observations, reflect the positions set out in this new Ugandan model.

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