

**TOPIC THREE:
TAXATION OF BUSINESS INCOME OF CORPORATE BODIES**

BUSINESS INCOME

Define business

Composition of business income

Chargeable income (Gross income – tax allowable deductions)

Expenses (Tax allowable deduction/ non allowable deductions)

Charge tax on chargeable income = Tax obligation/ payable /charged = 30%

Business is defined in the Income Tax Act to include any trade, profession, vocation or adventure in the nature of trade, but does not include employment.

Business incomes are gains, rewards, benefits, and returns, compensations earned out of a business undertaking. Business income means any income derived by a person in carrying on a business and includes the following amounts, whether of a revenue or capital nature:

- The amount of any gain, and losses on disposal of assets, derived by a person on the disposal of a business asset, or on the satisfaction or cancellation of a business debt, whether or not the asset or debt was on revenue or capital account;
- Any amount derived by a person as consideration for accepting a restriction on the person's capacity to carry on business.
- The gross proceeds derived by a person from the disposal of trading stock, i.e. sales.
- Any amount included in the business income of the person under any other section of this Act
- The value of any gifts derived by a person in the course of, or by virtue of, a past, present, or prospective business relationship.
- Interest derived by a person in respect of trade receivables or by a person engaged in the business of banking or money lending.

The definition of business is therefore inclusive rather than specific such that there can be business which does not arise from trade, profession vocation or adventure in the nature of trade.

Trade

Trade has the same meaning as commerce and it involves buying and selling or bartering of goods.

There are many exceptions to this general definition but the following elements are crosscutting:

- The element of profit
- The regularity of the transactions.
- The arrangements and effort, and,
- Compliance with statutory obligations made to make the transactions work.

Any of the above may determine whether a trade is carried out. However, depending on the facts of each case, the existence of these conditions could generally lead to the likelihood of a trade.

Adventure in the Nature of Trade

This refers to transactions where profits arise from activities such as gambling, speculative dealings in commodities, single or one off transactions or unconventional transaction e.g. smuggling.

The definition of an adventure in the nature of trade may appear sometimes to overlap with trade, but if either is proved, the requirements for business definition are satisfied.

The following characteristics may point to an adventure in the nature of trade.

- Profit seeking.
- The way in which the asset was acquired.
- The nature of the asset.
- Modification of the asset prior to sale or use.
- Interval between purchase and sale of the asset.
- Way in which the sale is affected.
- Number of transactions.
- Existence of trading interest in the same field.
- Method of financing the transaction.
- **Profit seeking motive**

It is clear that having an intention to make a profit can indicate a trading activity; however, by itself it is not enough. In the case *Salt v. Chamberlain*, a research consultant made a loss on the Stock Exchange after trying to forecast the market. The loss was made after several years and over 200 transactions. This was not seen as trade as it was capital in nature. It was

concluded that share trading by a private individual can never have the badges of trade pinned to them. These transactions are subject to capital gains tax.

In another case, *Rutledge v. CIR*, the taxpayer was on a business trip to Germany and purchased one million toilet rolls. On returning to the United Kingdom (UK) the sole consignment of toilet rolls was sold to one individual for a profit. The profit made on this large quantity, single purchase and resale item was 'an adventure in the nature of trade. The case was decided on the fact that the purchase was not made for own use or investment purposes

- **Number of transactions**

A single transaction can amount to a trading activity. It is more indicative if there are repeated and systematic transactions, This was clearly displayed in the case of *Pickford v. Quirke* A syndicate purchased a cotton spinning mill with the intension of using it in a trade, however, on purchase of the mill it was in a worse state than first anticipated. The syndicate then decided to strip the mill of its assets and sell it piecemeal, making a profit. This was repeated a number of times with a number of mills. Due to the repeated nature of the transactions it was held that the profits were trading profits end taxable as such.

- **Nature of the asset**

This principle looks at the asset in question, whether personal assets, investments or acquired for use in business like plant and machinery.

An important case in this area was *Marson v. Morton*. This was where land was purchased with the intension to hold it as an investment. No income was generated by the land, however, it did have planning permission. The land was sold later following an unsolicited offer. As the transaction was far removed from the taxpayer's normal activity (potato merchant) and was similar to an investment, the profit realised on the sale was not a trading profit. The transaction was not an adventure in the nature of a trade.

Another case *Wisdom v. Chamberlain*, looked at the principle of 'pride of possession' for assets that generate no income. A taxpayer purchased two large quantities of silver bullion to counter the effects of the devaluation of the pound. The purchase was made following advice and was partly financed by loan. As the purchase was done on a short-term basis in order to realize profit, there was an adventure in the nature of trade and was, therefore, assessed as trading profit.

- **Existence of similar trading transactions or interests**

This is best demonstrated in the case *CIR v. Fraser*. In this case, the taxpayer was a woodcutter who bought a consignment of whisky in bond. He subsequently sold the whisky through an agent at a profit. Within the decision, the judge stated:

The purchaser of a large quantity of a commodity like whisky, greatly in excess of what could be used by himself, his family and friends, a commodity which yields no pride of possession, which cannot be turned to account except by a process of realisation, I can scarcely consider to be other than an adventurer in a transaction in the nature of a trade... Most important of all, the actual dealings of the respondent with the whisky were exactly of the kind that take place in ordinary trade.

- **Changes to the asset**

It is important to take note of any changes or modifications made to an asset that may make it more marketable. In the case *Cape Brandy Syndicate v. CIR*, members of a wine syndicate joined in a separate syndicate to purchase brandy from South Africa. Some was shipped to the East with the remainder being sent to London to be blended with French Brandy, re-casked and sold at a profit. The taxpayer tried to argue that the transaction was of a capital nature from the sale of an investment. It was held that a trade or business was carried on and was assessable as a trading profit.

- **The way the sale was carried out**

The usual guidance is that it is always a pointer if a transaction follows that of an 'undisputed trade'. The case *CIR v. Livingston and others*, involved three unconnected individuals that together bought a cargo vessel. The vessel was converted into a steam-drifter and sold for a profit. The purchase was the first vessel the three individuals bought. An assessment was raised on the profit which was upheld as a trading profit. Within the decision, the judge stated: 'I think the test, which must be used to determine whether a venture such as we are now considering is, or is not, in the nature of "trade", is whether the operations involved in it are of the same kind, and carried on in the same way, as those which are characteristic of ordinary trading in the line of business in which the venture was made.'

- **The source of finance**

Determining the source of finance is important when deciding whether trade is carried on. Finance taken out to purchase an asset, in the first instance, may indicate that to repay the debt the asset would have to be sold. This was demonstrated in the case of *Wisdom v. Chamberlain*, mentioned above,

- **Interval of time between purchase and sale**

The length of time an asset is held is an important indicator of trade. The longer the period of ownership, the greater the chance of the asset being seen as an investment rather than a trade. Another issue looked at is the intention, if you can demonstrate an intention it could indicate the tax treatment. The two key cases on this are *Wisdom v. Chamberlain* and *Marson v. Morton*, both mentioned above.

- **Method of acquisition**

Finally, it is important to look at how an asset is acquired. If it is inherited or gifted, it is a good indication that a trade is not being carried, although this is not always the case. An asset acquired at a market could indicate that it has either been purchased for a trade or an investment.

The case Taylor v. Good, concerned a taxpayer who purchased a house with the intention of using it as a family home. The taxpayer's partner did not approve the house and refused to move in, which forced the taxpayer to sell the house immediately. The purchaser genuinely had the intention of not buying the property for a profit motive. As the sale was a short period of time after purchase it was still not deemed to be a trade.

Within the decision, the judge stated:

“Even if the house was purchased with no thought of trading, I do not see why an intention to trade could not be formed late, What is bought or otherwise acquired (for example, under a will) with no thought of trading cannot thereby acquire an immunity so that, however filled with the desire and intention of trading the owner may later become, it can never be said that any transaction by him with the property constitutes trading. For the taxpayer a non-trading inception may be a valuable asset: but it is no palladium. The proposition that an initial intention not to trade may be displaced by a subsequent intention, in the course of the ownership of the property in question, is, I think, sufficiently established.

Profession

This is a paid occupation especially one which requires advanced education and training. A profession usually involves academic training over long periods of time. Take for example medical Doctors, Lawyers, Engineers, Consultants, Accountants etc providing services other than in employment are treated as carrying on business.

Vocation

This is how one passes one's life when earning a living. More often, it is referred to as a special calling and qualification for a certain kind of work especially for social or religious work. It can thus be used to bring within the scope of income tax any form of regular and continuous profit earning, which does not fall within the categories of trade, business, profession or employment. Earnings from activities related to religion can fall in this category. A vocation is simply a calling or something one does because he/she has special fitness for it e.g. Boxing, Football etc.

The following aspects are considered in determining the taxable business income.

Exempt Income.

Allowable deductions

Non-allowable deductions

Capital Deductions

Allowable Deductions (Sec 22)

These are expenses incurred in the production of income that are allowable for income tax purposes. The following are allowed as a deduction for the purpose of ascertaining the chargeable income of a person for a year of income

In general **an expense is allowed (sec 22(1)) if:-**

- a) All expenditures and losses incurred by the person during the year to the extent to which the expenditures or losses were incurred in the production of income included in the gross income
- b) The amount of any loss on disposal of assets incurred by the person on the disposal of a business asset during the year whether or not the asset was on revenue or capital account
- c) *In case of rental income, the expenditure and losses incurred by a person other than an individual or partnership in the production of such income. Where the expenditure and losses incurred by a person other than an individual or partnership in the production of rental income exceeds fifty percent of the rental income, the allowable deduction shall be fifty percent of the rental income for that year of income."*
- d) Local service tax paid by an individual
- e) 2% of income tax payable by private employers who prove to URA that 5% of their employees on full time basis are persons with disabilities

Specific expenses allowed

Meals, refreshment and entertainment (Sec 23);

A deduction is allowed for expenditure incurred by a person in providing meals, refreshment, or entertainment in the production of income included in the gross income, but only where,

- a) The value is included in the employment income of an employee under Section 19(1)(b) or excluded from employment income by Section 19(2)(d) or (e)
- b) The person's business includes the provision of meals, refreshment and entertainment and the person to whom the meals, refreshment or entertainment have been provided have paid an arm's length consideration for them

Bad debts (Sec 24)

A person is allowed a deduction for the amount of a bad debt written off in the person's accounts during the year of income

A deduction for bad debt is only allowed-

- a) If the amount of the debt claim was included in the person's gross income in any year of income
- b) If the amount of the debt claim was in respect of money lent in the ordinary course of a business carried on by a financial institution in the production of income included in the gross income
- c) If the amount of the debt claim was in respect of a loan granted to any person by a financial institution for the purpose of farming, forestry, fish farming, bee keeping, animal husbandry or similar operations

Interest (sec 25)

Interest incurred on debt obligation acquired for generating income included in Gross Income. A person is allowed a deduction for interest incurred during the year of income in respect of a debt obligation to the extent that the debt obligation has been incurred by the person in the production of income included in gross income. A "debt obligation" includes an obligation to make a swap payment arising under a swap agreement and shares in a building society.

The amount of deductible interest in respect of all debts owed by a taxpayer who is a member of a group, other than a financial institution, *micro-finance deposit taking institution, tier 4 micro-finance institution* or person carrying on insurance business, shall not exceed thirty per cent of the tax earnings before interest, depreciation and amortization

A taxpayer whose interest exceeds thirty per cent of the tax earnings before interest, depreciation and amortization may carry forward the excess interest for not more than 3 years and the excess interest shall be treated as incurred during the next year of income.

Tax earnings before interest, depreciation and amortization mean the sums of the gross income less allowable deductions except interest depreciation and amortisation.

A group means persons other than individuals with common underlying ownership.

Repairs and Minor Capital Equipment (Sec 26)

- a) A person is allowed a deduction for expenditure incurred during the year of income for the repair of property occupied or used by the person in the production of income included in the gross income.
- b) A person is allowed a deduction for expenditure incurred during the year of income in acquiring a depreciable asset except returnable containers with a cost base of less than fifty currency

points. One currency point is equivalent to twenty thousand Uganda shillings. This applies to an asset which functions in its own right and is not an individual item which forms part of a set.

- c) A person is allowed a deduction of an amount representing the diminution in value of returnable containers not being machinery or plant as deduction for each year of income

Start-Up costs (Sec 30)

A person who has incurred expenditure in starting up a business to produce income included in the gross income shall be allowed a deduction of an amount equal to twenty five per cent of the expenditure in the year of income in which the expenditure was incurred and in the following three years of income in which the business is carried on by the person. For purposes of the ITA, "expenditure in starting up a business" means-

- a. in the case of initial public offering, costs incurred in listing the business with the Uganda Stock Exchange;
- b. in any other case, non-recurring preliminary or preopening costs, which are associated, with setting up a business such as fees of an accountant, registration charges, legal fees, costs for promotional and advertising activities, as well as costs for employee training."

Cost of Intangible Assets (Sec 31)

A person who has incurred expenditure in acquiring an intangible asset having an ascertainable useful life is allowed a deduction in each year of income during the useful life of the asset in which the person wholly uses the asset in the production of income included in the gross income of an amount calculated using the formula- A/B where;

A-is the amount of expenditure incurred and

B-is the useful life of the asset in whole years

Where an intangible asset has been disposed of by the person during the year of income, the cost base of the asset is reduced by any deductions allowed under this Section to the person in respect of the asset.

Scientific Research Expenditure (Sec 32)

A person is allowed a deduction for scientific research expenditure incurred during the year of income in the course of carrying on a business, the income from which is included in the gross income.

“Scientific research” means any activities in the fields of natural or applied science for the development of human knowledge;

“Scientific research expenditure”, in relation to a person carrying on business, means the cost of scientific research undertaken for the purposes of developing the person’s business, including any contribution to a scientific research institution which is used by the institution in undertaking research for the purposes of developing the person’s business, but does not include –expenditure incurred for the acquisition of a depreciable or intangible asset; expenditure incurred for the acquisition of land or buildings; or expenditure incurred for the purpose of ascertaining the existence, location, extent, or quality of a natural deposit; and

scientific research institution” means an association, institute, college, or university which undertakes scientific research.

Training Expenditure (sec 33)

An employer is allowed a deduction for expenditure incurred during the year for the training or tertiary education, not exceeding in the aggregate five years, of a citizen or permanent resident of Uganda, other than an associate of the employer, who is employed by the employer in a business, the income from which is included in the gross income.

Permanent resident in this Section means a resident who has been present in Uganda for a period or periods in total of five years or more.

Charitable Donations (Sec 34)

A person is allowed a deduction for a gift made during a year of income to an organization within Section 2(bb)(i)(A) or (B) of the definition of “exempt organization”

The value of a gift is the lesser of-

- a) the value of the property at the time of the making of the gift; or
- b) the consideration paid by the person for the property.

The amount of a deduction allowed under subsection (1) for a year of income shall not exceed five per cent of the person’s chargeable income, calculated before taking into account the deduction under this section

Carry forward losses (Sec 38)

Assessed loss arises where the total amount of income is exceeded by the total deductions allowed to the tax payer. This loss shall be carried forward and allowed as a deduction in determining the tax payer’s chargeable income in the following year of income.

where, for any year of income, the total amount of income included in the gross income of a taxpayer is exceeded by the total amount of deductions allowed to the taxpayer, the amount of the excess, in this Act referred to as an “assessed loss”, shall be carried forward and allowed

as a deduction in determining the taxpayer's chargeable income in the following year of income.

Where, for any year of income, the total farming income derived by a taxpayer who is an individual is exceeded by the total deductions allowed to the taxpayer relating to the production of that income, the amount of the excess, in this Act referred to as an "assessed farming loss", may not be deducted against any other income of the taxpayer for the year of income, but shall be carried forward and allowed as a deduction in determining the chargeable farming income of the taxpayer in the following year of income.

The amount of an assessed loss carried forward for a taxpayer shall be reduced by the amount or value of any benefit to the taxpayer from a concession granted by, or a compromise made with, the taxpayer's creditors *in the course of an insolvency* whereby the taxpayer's liabilities to those creditors have been extinguished or reduced, provided such liabilities were incurred in the production of income included in gross income.

Notwithstanding the provisions of this section, a taxpayer who, after a period of seven years of income, carries forward assessed losses, shall only be allowed a deduction of fifty percent of the loss carried forward in the following year of income and the subsequent years of income in determining the taxpayers chargeable income."

Legal and professional fees like Audit fees, consultancy fees etc are normally allowed as business expenses incurred on business matters relevant for the production of business income.

Premiums paid on short leases are normally allowed. Such leases include leased machinery, buildings, land to mention but a few.

Damages and compensations incurred for the purposes of trade, and on actions relevant to the production of income are allowed. Examples include compensations made to clients on selling defective items to them.

Subscriptions paid or payable to professional and trade associations, which associations are important to enable the business generate revenue are normally allowed as deductible expenses.

Salaries, wages and other remunerations paid to employees are allowable, when the remunerations were made to employees who participated in the production of income or for business purposes. The employer's contributions to approved retirement funds are allowable as business expenses on part of the employer. Redundancy payments and compensations made on retirement or termination of employment contracts are also allowed as business expenses.

Staff defalcations, these are losses faced by the business organization, due to dishonesty of an employee, like embezzlement of cash. They are normally allowed as expenses. However following the case of Curtis v. J & G Oldfield Ltd (1925) defalcations by a person having control over the business organization like a proprietor, shareholder or senior employee may be disallowed as a business expense.

Non Allowable Deductions (Sec 22(2))

Except as otherwise provided in this Act, no deduction is allowed for;

- Any expenditure or loss incurred by a person to the extent to which it is of a domestic or private nature. Expenditure of a domestic or private nature incurred by a person (Sec 22(3) include –
 - i. The cost incurred in the maintenance of a person and the persons family or residence
 - ii. The cost of commuting between the persons residence and work
 - iii. The cost of clothing worn at work except clothing which is not suitable for wearing outside of work and
 - iv. The cost of education of the person not directly relevant to the persons employment or business and the cost of education leading to a degree whether or not it is directly relevant to the persons employment or business
- Any expenditure or loss of a capital nature or any amount included in the cost base of an asset
- Any expenditure or loss which is recoverable under any insurance, contract, or indemnity
- Income tax payable in Uganda or a foreign country
- Any income carried to a reserve fund or capitalized in any way
- The cost of a gift made directly or indirectly to an individual where the gift is not included in the individuals gross income
- Any fine or similar penalty paid to any government or a political subdivision of a government for breach of any law or subsidiary legislation
- A contribution or similar payment to a retirement fund by the employee either for the benefit of the employee or for the benefit of any person
- A premium or similar payment made to a person carrying on a life insurance business on the life of the person making the premium or on the life of some other person
- The amount of a pension paid to any person
- Any alimony or allowance paid under any judicial order or written agreement of separation
- Any expenditure above five million shillings in one transaction on goods and services from a supplier who does not have a tax identification number
- Expenses of a person who purchases goods or services from a supplier who is designated to use the e-invoicing system unless the expenses are supported by e-invoices or e-receipts

Other Deductions

CAPITAL DEDUCTIONS

These are deductions in respect of qualifying capital expenditure. **The deductions enable a taxpayer recover the qualifying capital outlay over a period of time depending on the nature of the capital expenditure.**

Capital deductions cover the following categories.

- **Plant and machinery/ depreciable assets- wear and tear**
- **Industrial Building – Industrial building deduction/ IBD**
- **Farming capital deductions – Farm works and horticulture deduction**

Please note that some capital expenses are already allowable expenses and need not be considered for further deductions e.g. Minor Capital equipment, costs of intangible assets and start-up costs.

Depreciable Assets (Wear & Tear) Sec 27

Depreciable asset means any plant or machinery or any implement, utensil or similar article, which is wholly or partly used, or held ready for use, by a person in the production of income included in the gross income and which is likely to lose value because of wear and tear, or obsolescence

Meaning of plant & Machinery

There is no statutory definition of either plant or machinery for capital deduction purposes. But in the case of Yarmouth v. France (1887), plant is described as: -

"Whatever apparatus used by a business man for carrying on his business, not being stock in trade, but all goods and chattels, fixed or movable, live or dead, which he keeps for permanent employment in his business".

The plant and machinery have their values amortized over their useful years in a manner specified **in the Income Tax Act**. The specified method is somehow different from what is practiced in accounting when providing for depreciation of fixed assets.

A person is allowed a deduction for the depreciation of the person's depreciable assets during the year of income as calculated in the accordance with this section

- 1) **Depreciable assets are classified into three classes** as set out in below

New Depreciation Rates Wef 1/07/2021

Class	Assets include	Rate
1	Computers and data handling equipment	40%
2	Plant and machinery used in farming, manufacturing and mining.	30%
3	Automobiles; buses, minibuses, goods vehicles, construction and earth moving equipment, specialized trucks, tractors, trailers and trailers mounted containers, rail cars, locomotives, and equipment; vessels, barges, tugs, and similar water transportation equipment; aircraft; specialized public utility plant, equipment, and machinery; office furniture, fixtures and equipment; any depreciable asset not included in another class	20%

- 2) A person's depreciable assets shall be placed into separate pools for each class of asset and the depreciation deduction for each pool is calculated according to the following formula;

$A * B$ where

A is the written down value of the pool at the end of the year of income, and

B is the depreciation rate applicable to the pool

Written down value at the beginning of the year as 20m, Purchase computer 5m

Written down value = 20m + 5m = 25m

- 4) The WDV of the pool at the end of the year of income is the total of-
- The WDV of the pool at the end of the preceding year of income after allowing for the deduction for that year and
 - The cost base of assets added to the pool during the year of income reduced but not below zero, by the consideration received from the disposal of assets in the pool during the year of income.

Written down value (WDV) at the end of the year = WDV at the beginning of the year + Acquisitions - Disposals during the year.

- 5) Where the amount of consideration received by a person from disposal during the year of income of any asset or assets in a pool exceeds the WDV of the pool at the end of the year of income disregarding that amount, the excess is included in the business income of the person for that year.

Class 1 written down value = 15m

Disposal proceeds = 20m

Balancing charge/ Gain= 5m is a taxable income

- 6) If the WDV of a pool at the end of the year of income after allowing for the deduction is less than fifty currency points, a deduction shall be allowed for the amount of that WDV.

Written down value (WDV) at the end of the year = WDV at the beginning of the year + Acquisitions – Disposals during the year.

- 7) Where **all assets in a pool** are disposed of before the end of a year of income, a deduction is allowed for the amount of the WDV of the pool as at the end of that year.
- 8) Where a person has incurred **non-deductible expenditures** in respect of a depreciable asset, it applies as if the expenditures incurred in different years of income were incurred for the acquisition of separate assets of the same class.

Class 1 – computers if during the year expenditure is incurred on **software**

- 9) The cost base of the depreciable asset is added to a pool in the year of income in which the asset is placed in service
- 10) Where a depreciable asset is only partly used in the year in the pd'n of income included in the gross income, the depreciation deduction allowed shall be proportionately reduced.
- 11) The cost base of a road vehicle, other than a commercial vehicle is not to exceed shs. 60,000,000
- 12) Where the cost base of a road vehicle is beyond 60,000,000, the person is treated as having acquired two assets-
- a) A depreciable asset being a road vehicle with a cost base equal to 60,000,000

- b) A business asset that is not a depreciable asset with a cost base equal to the difference

Purchased a Prado for the MD at 100m

- (i) Depreciable asset at 60m
- (ii) Business asset at 40m

- 13) Where a road vehicle is disposed of, the consideration received on disposal is apportioned between the two assets based on the ratio of the cost base of each asset to the actual cost base of the asset.

After 2 years disposed a Prado for the MD at 80m which cost 100m

- (iii) Depreciable asset at $(60m/100m) * 80m = 48m$; to the wear and tear schedule
- (iv) Business asset at $(40m/100m) * 80m = 32m$; determine the gain/ loss on disposal, and a gain is taxable income while a loss is a tax allowable deduction.

- 14) Commercial vehicle means-

- a) A road vehicle designed to carry loads of more than half a tone or more than thirteen passengers or

- Prado of seating capacity of 7 passengers = 130m
- Mini bus of seating capacity of 30 passengers = 130m

- b) A vehicle used in a transportation or vehicle rental business

Conditions for claiming depreciable allowance

A depreciable asset will only be considered for depreciation (i.e added to the pool) in the year of income in which the tax payer places the asset into service. This means that no depreciation will be calculated on an asset that has been bought but is not in use.

For an asset to be granted capital deductions, the following conditions must be fulfilled:

- the asset must be owned by the tax payer; or
- the asset must be owned under finance lease;
- it must be used for the purpose of business or profession and
- it should be wholly or partly used during the relevant accounting period

The wear and tear schedule would look as follows

	Class I 40%	Class II 30%	Class III 20%	Total
	UShs	UShs	UShs	UShs
WDV b/f	xxxxxx	xxx	xxxx	
Additions	xxx	xxx	xxx	
Disposals	(xxx)	(xxx)	(xxxx)	
* depreciable amount /WDV = A	yyyyyyyyy			
W&T = A*B	yyyy*40%			
WDV C/f	mmmmm			

*This is what is called WDV at the year end. However, not to confuse it with WDV c/f, the term WDV at the year- end is not usually used in the wear and tear schedule. ** This is the amount that goes in the tax computation

Example

Given the written down values at the beginning of the as follows

Class 1 = 240m

Class 2 = 550m

Class 3 = 120m

Purchases during the year ;

- Plant and machinery of 100m,
- Computers of 50m
- Furniture and fittings of 30m
- MDs Prado at 90m

Disposals ; Computers at 20m, furniture at 15m

Required; Compute the wear and tear / depreciation allowance for the year

Initial allowance on plant and machinery (Repealed effective 1/7/2023)

A person who places an item of eligible property into service for the first time outside a radius of fifty kilometres from the boundaries of Kampala, during a year of income is allowed a deduction for that year for an amount equal to fifty percent of the cost base of the property at the time it was placed into service.

Placing “*an item of eligible property into service for the first time...*” should be interpreted to mean for the first time in the taxpayer’s business. Therefore where taxpayer ‘B’ buys equipment which has been used by taxpayer ‘A’ in his business, taxpayer ‘B’ is entitled to initial allowance in the first year in which he puts the same equipment to use notwithstanding that ‘A’ got initial allowance in respect of the same equipment.

“**item of eligible property**” means plant and machinery wholly used in the production of income included in gross income but does not include—

- (a) goods and passenger transport vehicles;
- (b) appliances of a kind ordinarily used for household purposes; or (c) office or household furniture, fixtures and fittings.

Note that for item to qualify for initial allowance it had to fall within in the definition of an item of eligible property and the rate applicable would depend on the location of the taxpayer.

Implication to depreciation allowance

The cost base of an asset is reduced by the amount of the deduction allowed for purposes of computing wear and tear i.e. the amount included in additions in the depreciation schedule will be cost less initial allowance.

Initial allowance on industrial buildings (*repealed effective 1/7/2023*)

A person who places a new industrial building in service for the first time during the year of income is allowed a deduction for that year of an amount equal to 20% of the cost base of the ‘industrial building at the time it was placed in service.

The cost base of an industrial building qualifying for initial allowance is reduced by the amount of deduction allowed for the purposes of calculating industrial building deduction (IBD) i.e. the qualifying amount of IBD will be cost less initial allowance.

Capital expenditure on the extension of an existing industrial building, would be treated a construction of a separate industrial building and would be entitled to initial allowance if it qualified.

For the purposes of Initial allowance, a new industrial building or extension of an existing industrial building means that building on which construction was commenced on or after 1st July 2000.

Industrial building for initial allowance purposes excludes an approved commercial building; hence, the following could not qualify for initial allowance: an industrial building which is primarily used by the owner or let out for rent, for the purpose of carrying on a business, trade or profession; as an office; as a warehouse or commercial storage facility; or as a workshop.

Industrial buildings deduction (IBD) (Sec 29)

Important definitions

Industrial building means any building which is wholly or partly used or held ready for use, by a person in:

- manufacturing operations;
- research and development into improved or new methods of manufacture;
- mining operations;
- an approved hotel business;
- an approved hospital; or
- approved commercial buildings.

Capital expenditure for industrial building purposes excludes:

- Cost of a depreciable asset installed in an industrial building like partitions; or
- Cost of any rights in or over any land.

Note: a depreciable asset installed in a building includes items that can be removed from the building without substantial damage to the building or affecting the operations of the building like partitions, generator, wall fans, but items that are ordinarily part of the building like electrical wiring works, plumbing works, windows, doors, lifts are part of the building.

Qualifying expenditure for IBD is cost of the industrial building **less initial allowance**, where applicable.

Residue of expenditure (residual value) means;

Capital expenditure incurred on the construction of an industrial building less any deductions allowed and any amounts which would have been allowed deductions if the building was sole used for prescribed uses at all times since construction was completed.

Prescribed uses are those contained in the definition of an industrial building (manufacturing, research and development, mining, approved hotel, approved hospital; or approved commercial buildings).

Note that residential accommodation is not an approved industrial building and does not qualify for IBD.

Also, note that IBD is at times referred to as Industrial Building Allowance (IBA) and this should not be confused with initial allowance.

Rules for computing IBD

i) A person who has incurred capital expenditure in any year on the construction of an industrial building and the building is used in business by the person during the year, the person is allowed a deduction for the depreciation of the building calculated as follows:

IBD/ Depreciation of the building = $A \times B \times C/D$, where:

- A is the depreciation rate applicable to the building — 5% on straight line basis
- B is the capital expenditure incurred in the construction of the building;
- C is the number of days in the year of income during which the asset was used or was available for use; and
- D is the number of days in the year of income (365 days)

IBD is time apportioned unlike wear & tear that is not apportioned.

- i) Where an industrial building is only partly used (business and non-business use) by a person during a year for prescribed uses, IBD shall be proportionately reduced. Where an industrial building is only partly used by a person during a year for prescribed uses, and the construction cost of that part of the building used for non-prescribed use is not more than ten percent (10%) of the total cost of the building, it is treated as wholly used for business use.

Building cost 250m

	A	B	C
Prescribed use	40%	90% and above	not more than 10%
Non- prescribed use	60%	not more than 10%	90% and above
Cost base for IBD	40% *250m	250m	No IBD is allowed

A; IBD = 5% *250m*40%=

B; IBD = 5% *250m

iii) Where a person has made a capital improvement to an industrial building, the cost incurred is treated as construction cost of a separate industrial building. A capital improvement for instance may include adding an additional room to the existing building.

Original building cost 250M in 2020

During the year ending 30th June 2024 an additional room to the building cost 100m completed and put to use on 1st Jan 2024

Required compute the Depreciation for the building/IBD for the year.

(a) Compute IBD for the original building

$$\begin{aligned} \text{IBD} &= A \times B \times C/D \\ &= 5\% \times 250M \times 365/365 = \mathbf{12.5m} \end{aligned}$$

(b) IBD for the additional room

$$\begin{aligned} &= A \times B \times C/D \\ &= 5\% \times 100m \times 182/365 \\ &= \mathbf{2.5m} \end{aligned}$$

$$\text{Total IBD for the year is } \mathbf{12.5m+2.5m= 15m}$$

iv) Where an industrial building is purchased by a person, the person is deemed to have incurred the capital expenditure incurred by the person who constructed the building - **IBD is only on cost of construction not purchase price.**

v) IBD cannot exceed the residue cost (value) at the end of the year. IBD is computed on straight line and the entire cost is claimed for maximum period of 20 years. At any one time, the IBD cannot exceed the residue value. If the residue value is not known, then no IBD can be claimed.

vi) where an industrial building has been disposed during a year of income, the cost base of the building is reduced by any deductions allowed in respect of the industrial building

Cost was 400m in 2015 and the building is disposed after 5 years in the year ending 30th June 2020. Consideration received was 150m.

Carrying amount of the building at the time of disposal

Cost = 400m

IBD = $5\% * 400m * 365/365 = 20m$

Total deductions are $20m * 5\text{years} = 100m$

Carrying amount; $400m - 100m = 300m$

Consideration received = 150m

Loss on disposal; 150m (tax allowable deduction)

vii) Where an industrial building is bought and sold together with land, the value of the land shall be the difference between proceeds and residue value at the time. Land is not depreciated and its disposal gives rise to CGT. Buildings are depreciated and on disposal, a balancing charge or allowance is determined. Where the value of land and buildings is not separated, then it is deemed that the value of proceeds less the residue value of the building will be the value of land.

viii) In cases of disposal of an industrial building with an extension, disposal proceeds shall be reasonably apportioned among the separate industrial buildings.

Farming capital deductions include farm works and horticulture expenditure

Farm works (Sec 35)

Expenditure incurred in acquiring farm works is included in the person's pool for class 3 assets and is depreciated accordingly.

A person carrying on a business of horticulture in Uganda who has incurred capital expenditure on acquisition or establishment of a horticultural plant; or construction of a greenhouse, is allowed a deduction of twenty percent (20%) of the cost in the year of expenditure and in the following four years, that is, five equal installments.

Cost 150 m of the green house = allowable deduction = $150m * 20\% = 30m$ for five years

Apportionment of deductions (Sec 37)

A deduction relating to the production of more than one class of income shall be reasonably apportioned among the classes of income to which it relates

Where a person derives more than one class of income, the deduction allowed under charitable donations shall be allocated ratably to each class of income.

Important definitions

Horticulture Capital expenditure incurred on the establishment of a horticultural plant shall include expenditure incurred in draining or clearing land.

Farm works means any labour quarters and other immovable buildings necessary for the proper operation of a farm, fences, dips, drains, water and electricity supply works, windbreaks, and other works necessary for farming operations carried on to produce income included in gross income, but excludes farm houses or depreciable assets,

Horticulture includes:

- propagation or cultivation of seeds, bulbs, spores, or similar things;
- propagation or cultivation of fungi; or
- Propagation or cultivation in environments other than soil, whether natural or artificial.

Example

Gomba Farmers Limited is involved in farming activities mainly growing flowers in green house for export to Scandinavian countries. During the year ended 30 September 2015, it incurred the following expenditure:

Item	UShs
Clearing and drainage of land	63,500,000
Construction of greenhouses	120,000,000
Construction a fence	44,000,000
Total	227,500,000

Required:

Compute Capital allowances that Gomba Farmers Limited would claim for the year ended 30 September 2015.

Farm works

Construction of the fence = 44,000,000 ; **this is taken to the wear and tear under class 3.**

Class 3 assets are depreciated at 20 %; W&T = 44,000,000* 20% = 8,800,000

Horticulture capital expenditure

Clearing of land 63,500,000

Construction of the greenhouse 120,000,000

Total horticulture expenditure 183,500,000; deduction is 20% of the expenditure for five years starting with the year in which the expenditure was incurred.

Deduction is $183,500,000 * 20\% = 36,700,000$

Total deduction is $36,700,000 + 8,800,000 = 45,500,000$

TAXATION OF INDIVIDUALS

Small business taxpayers (Sec 4(5)) — Presumptive tax

Where the gross turnover of a resident taxpayer for a year of income derived from carrying on a business or businesses is less than one hundred fifty million shillings (effective 1 July 2015), other than those mentioned below, the income tax payable by the taxpayer for the year of income shall be determined in accordance with the Second Schedule of ITA, unless the taxpayer elects by notice in writing to the Commissioner to file a tax return.

A person dealing in the following business does not qualify to account for tax under the small taxpayers' regime:

- Professional services like, medical, dental, architectural, engineering, accounting, legal, or other professional services.
- Public entertainment services.
- Public utility services.
- Construction services.

In this case:

- The tax shall be a final tax on the business income of the taxpayer;
- No deduction shall be allowed for expenditures or losses incurred in the production of the business income; and
- No tax credits shall be used to reduce the tax payable on the business income of the taxpayer, except credit allowed for withholding tax paid or provisional tax paid in respect of amounts included in the gross turnover of the taxpayer.

An election must be lodged with the Commissioner by the due date for the taxpayer's return for the year of income to which it relates.

The above regime is also called presumptive tax.

Presumptive tax otherwise called the small taxpayers regime is a form of assessing tax liability using indirect methods such as income reconstruction or by applying base-line taxation across the entire tax base. Presumptive methods of taxation are thought to be effective in reducing tax avoidance as well as equalizing the distribution of the tax burden. They are suitable where the taxpayers do not keep proper records.

Presumptive tax can be used by an individual taxpayer whose turnover does not exceed 150m (effective 1 July 2015) and who is not prohibited from using it by the ITA. The tax payable by a presumptive tax payer is reduced by;

- any credit allowed for withholding tax paid in respect of amount included in the gross turnover of the taxpayer or;
- any credit allowed for provisional tax paid in respect of amounts included in the gross turnover of the tax payer

Small Business Taxpayers Schedule (effective 1 July 2020)

Gross turnover	Tax rates	Tax rates with records
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	without records	
Where the gross turnover of the taxpayer does not exceed UShs. 10 million per annum	Nil	Nil
Where the gross turnover of the taxpayer exceeds UShs. 10 million but does not exceed UShs. 30 million per annum	Eighty thousand shillings	0.4% of the annual turnover in excess of 10 million shillings
Where the gross turnover of the taxpayer exceeds UShs. 30 million but does not exceed UShs. 50 million per annum	Two hundred thousand shillings	Eight thousand shillings plus 0.5% of the annual turnover in excess of 30 million shillings
Where the gross turnover of the taxpayer exceeds UShs. 50 million but does not exceed UShs. 80 million per annum	Four hundred thousand shillings	One hundred and eighty thousand plus 0.6% of the annual turnover in excess of 50 million shillings
Where the gross turnover of the taxpayer exceeds UShs. 80 million but does not exceed UShs. 150 million per annum	Nine hundred thousand shillings	Three hundred and sixty thousand plus 0.7% of the annual turnover in excess of 80 million shillings

Taxation of individuals (Sec 63)

The chargeable income of each taxpayer who is an individual is determined separately. Gross income of an individual includes business income, employment income and property income. Income from all sources is added up except rental income which is subject to rental tax.

In determining chargeable business income, only income from the individual's business is considered as well as business expenses. For instance; income from sale of an individual's assets does not attract CGT being that it is not a business asset.

Refer to the definitions of business income and gross income as earlier provided under corporation tax Chapter A

Allowable and non-allowable deductions of an individual

- i. An individual is granted all allowable deductions including capital deductions on assets that are owned by the business. For assets to qualify to be the assets of the business, they should have been acquired with funds obtained from the business and the assets are used in the course of running the business. Thus if an individual has his own commercial premises and uses the premises to operate his shop, the premises are his and are not owned by the business but if he makes money and acquires a new building, that would be an asset of the business.
- ii. Private expenditure is not allowable for income tax purposes and there is need to pay attention to transactions involving expenses of the owner being paid by the business like school fees for children, stock appropriation (taking items for private use without paying for them) and drawings. iii. Another common issue is the private use of the assets owned

by the business like using a business vehicle for private errands of the owner. There will be need for apportionment in cases of business and nonbusiness use of assets of the business.

- iv. There is another issue of owner's salary and other personal expenses like lunch and medical expenses. The key principle is that one cannot employ him or herself. That being the case, owner's salary is deemed to be an appropriation of profit and is added back. Salaries paid to other person's including relatives who are employed by the business are allowed. Owner's medical expenses and lunch are expenses of domestic nature and not allowed.

Computation of chargeable income of an individual and tax payable

Important to note:

- i. In dealing with tax computations of individuals with business income, we should remember that there is no legal requirement for individuals to prepare audited accounts so students need to use their accounting skills to come up profit or loss account or its equivalent that will be used for tax computation purposes, where there are no audited accounts.
- ii. When coming up with accounts consider only business transactions leaving out personal transactions of the owner.
- iii. Most individuals have multiple sources of income that would be included in gross income other than rental income that is taxed separately
- iv. There is need to observe whether the person's turnover is below UShs 150m (was 50m up to 30 June 2015) to use small business taxpayers schedule, if the business is not that prohibited for such regime.
- v. Adjustments (add backs, allowables and tax credits) in the tax computation are similar to what we covered under corporation tax except that transactions of the owner need to be scrutinized and added back if settled by funds from the business. vi. Even where the business is trading through registered business name, the taxpayer is the owner as the business name has no legal personality.
- vii. Individual rates (resident and non resident) apply to determine tax payable as used under PAYE.
- viii. Any tax credit like withholding tax or PAYE already paid is allowable against tax payable as the case may be.