Kampala Associated Advocates

TAX

Taxation of Gratuity, Pension and Terminal Benefits in Uganda

KAA HOUSE,
Plot 41 Nakasero road,
P.O. Box 9566, Kampala

Telephone: +0312244100
Fax: +256 414 349 954
E-mail: info@kaa.co.ug

legal ALERT

Taxation of Gratuity, Pension and Terminal Benefits in Uganda

The taxation of gratuity, pension and terminal benefits as employment income is a contentious subject in Uganda, more so with pension and gratuity that has often been interpreted to have a similar meaning. The Supreme Court and Constitutional Court have made significant decisions settling this contention. Below is a tax alert regarding those decisions:

1. Uganda Revenue Authority v Siraje Hassan Kajura SCCA No. 09 of 2015

Background

The Respondent was an employee in Dairy Corporation, which following the Government Policy for Public Enterprise Reform and Divestiture of 1991 was restructured. As a result, the Respondent together with 160 other employees were declared redundant.

The Minister of Finance was mandated to ensure that provision is made for payment of compensation to employees who are declared redundant as a result of restructuring of public enterprises. As a result, the Respondent and the other employees were given a terminal package that was comprised of salary, gratuity, long service award, transport, home allowance, leave allowance, settlement allowance and payment in lieu of notice.

This terminal package however, was subjected to Pay As You Earn Tax by the Appellant. This led to the Respondent bringing a representative action against the Appellant contending that the package was not taxable. The High Court found in favour of the Respondent and the Court of Appeal upheld the decision of the High Court. The Appellant being dissatisfied with the decision of the Court of Appeal, lodged a further appeal to the Supreme Court.

The Parties' Arguments

The Appellant contended that the gist of the appeal was premised on the finding of the learned Justices of Appeal that terminal benefits paid to the Respondent were not taxable under the provisions of Section 19 of the Income Tax Act ("ITA"). The Appellant argued that this was wrong and contrary to the law. The Respondent in response submitted that the taxation of the retrenchment benefits was elaborately resolved by the lower courts and that section 19 (1) of the ITA is inapplicable to the taxing of the Respondent's terminal benefits.

Findings of the Court

The Court noted that the question at hand was whether retrenchment packages are taxable under the provisions of the Income Tax Act in particular Section 19 of the ITA. The Court further noted that this question raised a need to interpret Section 19 (1) (a) of the ITA. It states that:

"Subject to this Section, employment income means any income derived by an employee from any employment and includes the following amounts, whether of a revenue or capital nature:

a) Any wages, salary, lease pay, payments in lieu of lease, overtime pay, fees, commission, gratuity, bonus or the amount of any traveling , entertainment, or utilities, cost of living, housing, medical or other allowances;"

The Court opined that while the term retrenchment packages is not expressly provided for under the ITA, the retrenchment benefits received by the Respondents by necessary implication fall squarely within the ambit of Section 19 (1) (a). The Court relied on Section 19 (6) of the ITA to buttress this, it that states that:

"For the purposes of this Section, an amount or benefit is derived in respect of employment if it:

a) Is provided by an employer or a third party under an arrangement with the employer or an associate of the employer;

b) Is provided to an employee or to an associate of an employee and;

c) Is provided in respect of past, present, or prospective employment."

The Court noted that the Respondents were employees of the Defunct Diary Corporation who were laid off after their employer was privatized under the Privatization Unit (a third party) and they were paid because they were employees of the Defunct Diary Corporation, they were paid in respect of their employment with the Corporation and therefore all the elements in Section 19 (6) of the ITA exist in the packages paid to the Respondents. The Court therefore held that the packages paid to the Respondents properly fall under employment income.

The Court further held that the language used in Section 19 of the ITA does provide for exempt employment income. However retrenchment packages are not included on the list of exempt income and therefore the Appellant was right and had the mandate to tax the same.

The Court further made reference to persuasive precedents in which the Courts have found that terminal benefits or retrenchment packages are liable for taxation as employment income. Some of the precedents include:

a) Nkote Charles & Anor v URA HCCS No. 107 of 2009 in which the Court observed that;

"The consent decree already cited in this judgment recognized that two categories of emoluments accrue at the termination of somebody's employment. The Income Tax Act cited by both Counsel also makes the distinction between gratuity which included in the definition of Employment income under S. 19(1) and pension which, under S.21(1)(n) of the same Act is exempt from tax. This distinction made under the Act and recognized by the consent Decree is the key to determining the issue as to whether the taxation by PAYE from the Plaintiffs was lawful. ***This distinction is a clear indication that while Terminal Benefits are taxable under the Act, Pension is not. So the answer to the issue is that the taxation of PAYE from the Plaintiffs' Terminal benefits was lawfully done…. "***

b) Namtiti Patrick Bukene & Anor v URA & Anor HCCS No. 203 of 2013 in which the Court held that;

"I am therefore persuaded to rely on those sections and the authorities cited to hold that **terminal benefits or golden handshakes are in other words gratuity and they are compensation from a terminated contract and are taxable under S. 19 (1) (d) of the ITA. If they were exempt, the legislature would have expressly stated so under S.21 of the ITA…***For the above reasons, I find that the Plaintiff's terminal benefits in issue were subject to taxation."*

The Court concluded that the claim by the Respondents that their packages were exempt from taxation and were a "thank you" payment was not based on law but on mere sentiments.

2. Rogers Kinobe Binega v The Attorney General & Uganda Revenue Authority Constitutional Petition No. 01 of 2016

The Constitutional Court of Uganda recently pronounced itself on a similar issue in the aforementioned case, a detailed brief is set out below:

Background

The Petitioner an advocate and employee of the Office of the Inspectorate of Government (IGG) averred that the terms of his employment entitle him to gratuity equivalent to 30% of basic salary for each completed year of employment. The Petition against the Respondents was based on the reliance by the Respondent on Section 19 (1) (a) of the ITA to tax gratuity paid to pensioners and other staff of the IGG in contravention of Article 254 (2) of the Constitution of the Republic of Uganda 1995 which prohibits taxation of pension. The Petition further challenged the constitutionality of Section 19 (1) (a) of the ITA which defines employment income to include gratuity and thus making it liable to tax.

The Parties' Arguments

The Petitioner contended that the words "Pension" and "Gratuity" though different in name and rate of computation are part of the same genre, species or "nomenclature of benefits" payable in addition to or over and above the salary of a public officer. The Petitioner invited Court to breathe life into Article 254 (2) of the Constitution by reading the word "Gratuity" into it. The Respondents contended that the Petitioner's submission was not tenable because the framers of the Constitution did not include gratuity under Article 254 (2) of the Constitution for it to be exempt from taxation. They further contended that if the framers of the Constitution intended to exempt any other employment benefit due to the employee from taxation, they would have couched the article differently.

Findings of the Court

The Court noted that Article 254 (1) and (2) of the Constitution deal with the right of a public officer on retirement to receive such pension as is commensurate with his or her rank, salary and length of service. It further provides that "the pension" payable shall be exempt from income tax.

The Court further noted that words "Pension" and "Gratuity" have different meaning and are not interchangeably used. The Court stated the word gratuity is clearly distinguished from the word pension. It means a lump sum paid when a person does not qualify for pension. However, when a person qualifies for pension, he/she is paid both gratuity and pension, where the word 'pension' is used to mean a periodic and regular payment as envisaged in Article 254 (1) of the Constitution. The Court pointed out that the Petitioner is not eligible for pension under the Pensions Act, the gratuity he was entitled to was not a retirement benefit or a pension, it was gratuity upon a contract coming to an end by the expiry of term of time or other forms of termination except dismissal.

The Court opined that Section 19 (1) (a) of the Income Tax Act is a section of general application to all categories of employees including those in the public service and private sector employment and cannot on that basis be declared unconstitutional because it taxes gratuity. The Court further noted that the ITA in addition to pension, expressly exempts any contribution or similar payment by any employer made to a retirement fund for the benefit of the employee or any of his or her dependents from taxation.

In conclusion, the Court held that the ITA exempts all forms of pension and retirement benefits paid to a retirement fund through periodic contributions from tax. It does not exempt gratuity and other allowances specified in Section 19 (1) (a) of the ITA. The Court further held that in the context of Article 254 of the Constitution, the word "pension" used therein is consistent with the use in the Pension Act, The National Social Security Act and the Income Act and does not include in its ambit gratuity.

Significance

The aforementioned authorities give tax payers and litigators a clear understanding of what amounts to gratuity, pension and terminal benefits. They also finally settle the contention of their taxation as employment income. Terminal benefits and gratuity are taxable under Section 19 (1) (a) of the Income Tax Act as employment income whereas pension is exempt from taxation as per the provisions of the Constitution and the Income Tax Act.

TAX TEAM

OSCAR KAMBONA,
Senior Partner
okambona@kaa.co.ug

BRUCE MUSINGUZI
Partner
bmusinguzi@kaa.co.ug

THOMAS KATTO
ASSOCIATE
Associate
tkatto@kaa.co.ug

BARBRA MUSIIMENTA
Associate
bmusiimenta@kaa.co.ug

MARTHA MUTAMBA
Legal Assistant
mmutamba@kaa.co.ug

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