TAX ALERT

Using a foreign trademark in a business amounts to importing a service and attracts payment of VAT in Uganda.

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Some companies usually do business using foreign trademarks that are licensed under franchise arrangements. This allows a locally registered entity to locally use a trademark owned by a foreign company, usually for a fee and subject to certain standards as specified. Considering the nature of the arrangement, which on the face of it, offers a business advantage to the local entity; there has always been an issue as to whether the local/ Ugandan company is considered as having imported a service into Uganda?

This issue was the subject of a ruling by the Tax Appeals Tribunal in the case of Apollo Hotel Corporation Ltd v Uganda Revenue Authority TAT Application No. 68 of 2018.

Brief facts;

In 2008, Apollo Hotel Corporation Ltd (the Applicant) entered into an international license agreement with Sheraton International Inc. a company incorporated in the United States of America. The agreement granted the Applicant the right to operate its hotel in Kampala under the trademarked brand name "Sheraton" and also to use Sheraton International's centralized reservation system by paying franchisee fees to Sheraton International. URA raised a tax assessment of VAT amounting to Ugx. 398,418,285 on the franchise fees. Apollo objected to the assessment and the matter was left for determination by the Tribunal.

The main issue was whether the use of the brand name "Sheraton" and the provision of the centralized reservation system amounted to a supply of an "imported service" for purposes of VAT?

Submissions

The Applicant argued that the use of the centralized reservation system did not amount to an imported service since the system has its server in the United States of America and Sheraton International has no presence in Uganda. That no service was brought into Uganda by the franchisor. That the use of the name "Sheraton" on a non-exclusive basis did not amount to an import of a service and that since the franchisor is located in the United States and the Applicant is a taxable persons, the conditions under Section 16 and 18(8) of the Act had not been fulfilled.
In reply, URA contended that the Applicant had received services from a foreign company and made payment for them hence taxable under the Act. That Sections 18 and 16 apply to a taxable supply and not to import of services.

Tax Appeal's Tribunal ruling.

On 27th August 2021, the Tribunal dismissed the Application holding that;

i. The use of the trademarked brand name "Sheraton" and the provision of the centralized reservation system amounted to a supply of an imported service.

ii. That VAT was only due on the principal service namely, the right to operate the hotel under the trademark name "Sheraton" using the centralized reservation system.

In reaching its holding, the Tribunal relied on the case of Sagar Ratna Restaurants Pvt Ltd & Ors v The Value Added Tax Officer Where the Delhi High Court in India found that the use of the trademark McDonalds amounted to a service and not goods for purposes of VAT. The Tribunal thus concluded that the use of the brand name Sheraton under the agreement amounted to service and not goods.

The Tribunal also invoked the destination principle which provides that services supplied from a foreign jurisdiction and consumed in one's own jurisdiction are considered as imported services. The Tribunal thus reasoned that the Sheraton brand and reservation system were supplied for use in Uganda by Sheraton International Inc. and were used by the Applicant in Uganda. It follows that these services were imported services for the reason that they were supplied from a foreign jurisdiction and consumed in Uganda.

Effect of the decision

The above decision by the Tribunal sets a precedent that all companies in Uganda which are running businesses using foreign trademarks by paying franchise fees must withhold VAT on payments to those foreign persons. The principle in the decision is of wide application and will most likely affect all business operating under the franchise arrangements in Uganda.

This decision is a great win for URA in its attempt to tax the digital economy and the intangible intellectual property rights. The use of the centralized reservation system which is located in the United States of America is similar to the running of most digital platform based businesses.

This poses a challenge for taxation under the permanent establishment principle which provides for taxation only when an entity has a physical presence in a foreign jurisdiction. The decision provides a window for the taxation of the digital economy.

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