



2024 tax proposal to make loan recoveries more expensive.

TAX

INSIGHTS

Imagine having to lose an extra 18% on recovery of a bad debt! Section 5 (1)(ab) in the Value Added Tax (Amendment) Bill, 2024, seeks to introduce a new category of persons liable to pay VAT i.e., recipients of the proceeds of an auction.

Previously, in 2023, the VAT Act was amended by inserting Section 10(4), to specify that the supply of goods by auction is treated as a supply of goods made by the auctioneer as the supplier in the course of auctioning goods.

Under the 2024 Bill, it is proposed that VAT on the supply of goods through an auction be paid by the recipient of the proceeds of the auction.

In essence, the above amendment requires mortgagees such as banks, which are the recipients of money made from an auction, to pay VAT of 18% of the proceeds of the auction. To cement this, the Bill proposes to further amend Section 10(4) of the Act to the effect that the supply of goods through auction by an auctioneer in the course of auctioning goods is to be treated as a supply of goods by the recipient of the proceeds of the auction.

Therefore, the obligation to pay VAT for goods purchased through an auction has been shifted from the

auctioneers to the persons on whose behalf such auctioneers work, e.g., Banks and judgment creditors.

At Odds with the Nature of Financial Services

The proposed amendment comes at a time when the High Court has already held that when one aspect of a financial institution is exempt under a provision of the law, it cannot be subject to tax under another provision. In the case of **Luwaluwa Investment Limited V. Uganda Revenue Authority (Civil Appeal No. 43 of 2022)**, Court was dealing with an issue of withholding tax on the proceeds from sale of mortgaged prop

erty. Court was called upon to determine whether money received from an auction of mortgaged property can be subject to withholding tax under Section 118(B) of the Income Tax Act, yet interest paid to financial institutions is already exempt under Section 117(2) of the same Act. In coming to the conclusion that the two sections were in conflict, Court considered the nature of a mortgage as follows:

The sale of mortgaged property is really the bank swapping its non-liquid asset for a liquid one namely money and a profit. The mortgaged property is merely another form of a Bank holding its capital and interest.

This is the purpose of conferring the lien upon it by law. Accordingly, in disposing the same, the bank is obtaining a refund of capital and interest which are not amenable to withholding tax in accordance with the Income Tax Act.

In addition to the above, Court held that money received from an auction of mortgaged property is not subject to withholding tax because there is no withholding tax payable by a borrower when repaying the principal sum borrowed from a financial institution as this does not qualify as income received by a financial institution but a mere refund of the sums advanced by the Financial Institution and a bank's interest income is exempt from withholding tax.

The above decision applies equally to the proposed amendment. To put the above case into context, if the borrower fully repays the loan and the mortgage is discharged, no VAT is chargeable upon repayment and issuing of a mortgage discharge instrument. In the same way, where the mortgaged property is sold by the bank, no VAT should be payable, given that the intention is to recover the capital and interest from the mortgaged property as if the original borrower had paid it. This is especially so on the basis that dealings in loans by financial institutions are exempt from VAT.

Additionally, Section 31 of the Mortgage Act 2009 requires banks to account for the proceeds of the sold property by applying them to recovery of the outstanding principal loan amounts, interest and charges and other payments listed thereunder. Thereafter, any surplus is paid back to the borrower. By selling mortgaged property, the bank is merely put in the same position as it would have been if the borrower had paid their outstanding loan and interest. If anything, the bank may actually be put in a loss position, where the proceeds of the sale are insufficient.

Increasing the Cost of Borrowing & Recovery in Uganda

It should be noted that the proposed amendment if passed, is bound to increase the burden on borrowers, who will take the heat for the newly-imposed VAT. The banks will transfer the burden of the 18% VAT to the borrowers, and many loan agreements will be drafted to provide for such a position.

This will unnecessarily burden already distressed taxpayers, the effect of which will increase the non-performing loans, given that 18% of the said loans will become income to the government at the expense of the taxpayer.

The proposed amendment is clearly telling the taxpayers, *“pay your loans, or if you fail and the bank sells your property, you will incur an additional 18% VAT”*.

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