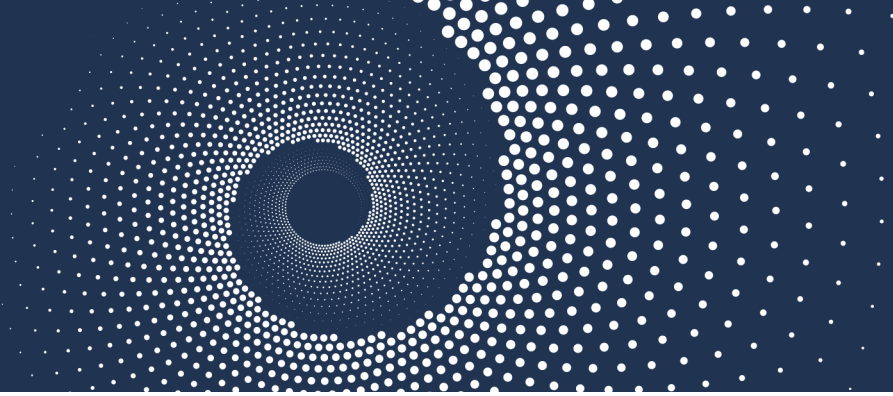




Chestnut Uganda Limited V Uganda Revenue Authority Tat Application No. 140 of 2022

The Tax Appeals Tribunal has ruled that Chestnut Uganda Limited was entitled to a deduction of revenue expenditures and losses incurred in the production of rental income from the letting out of advertising space (billboards and advertising wraps) at the Arena Mall while it was still under construction.

The Applicant contended that the expenses incurred in the production of rental income through the letting of advertising space at Arena Mall were deductible under Sections 22 and 5 of the Income Tax Act. The Applicant further argued that the construction of Arena Mall was not a business in itself but a commercial activity, and that the expenses incurred in generating income from advertising space during the construction phase should therefore be allowed as deductions.

The Applicant also submitted that the Respondent's disallowance of these expenses adversely affected its accumulated losses for the years 2017–2019 and subsequent years by reducing the amount of losses available for carry forward, thereby imposing financial constraints on the business.

URA, on the other hand, maintained that the expenses should have been capitalised because they related to advertising activities conducted at Arena Mall while the mall was still under construction and not yet operational. URA further argued that the advertising income was merely incidental to the mall's development and that the claimed costs were not incurred in generating income but rather related to the construction of the mall itself. Additionally,

URA contended that certain expenses, including audit fees, professional and legal fees, power costs, and general office expenses, were neither adequately substantiated nor declared in the Applicant's tax returns.

In determining the matter, the Tribunal relied on Sections 22 and 5 of the Income Tax Act and held that, for the Applicant to succeed, it had to satisfy the following conditions under Section 22(1)(c):

- ✓ The Applicant earned rental income.
- ✓ The expenses claimed by the Applicant were incurred in the generation of the said rental income.
- ✓ The expenses incurred by the Applicant in deriving the rental income were not incurred by an individual or a partnership.
- ✓ The expenses in question were not of a capital nature.

The Tribunal observed that rental income under the Income Tax Act comprises two key elements. First, it must be an amount derived from the lease of immovable property. Second, rental income can only arise after deducting the expenditures and losses incurred in deriving that amount. Accordingly, an amount derived from the lease of immovable property can only properly be regarded as rental income where the related expenditures and losses have been deducted.

Having established that the Applicant earned rental income through the letting of advertising space at Arena Mall, the Tribunal proceeded to examine whether the expenses claimed were

incurred in generating that income. It found that the costs in question were necessary for the day-to-day operation of the business. These included personnel costs, costs of managing relationships with advertising firms, tax compliance and audit fees, and professional and legal fees that were necessary to facilitate and maintain the contractual arrangements from which the income was derived.

With regard to URA's argument that the expenses were capital in nature, the Tribunal referred to Section 22(3)(b) of the Income Tax Act, which prohibits deductions for capital expenditure or amounts included in the cost base of an asset. It further relied on the distinction between capital and revenue expenditure as set out in *Vivo Energy Uganda Limited v Uganda Revenue Authority*, TAT No. 29 of 2019. Applying those principles, the Tribunal concluded that none of the expenses claimed by the Applicant were capital in nature. Rather, expenses such as administration costs, record-keeping expenses, Companies Act filing fees, tax compliance costs, audit fees, professional and legal fees, general office expenses, bank charges, advertising and marketing costs, security expenses, billboard-related costs, lighting expenses, and equipment hire costs were revenue expenditures incurred in the ordinary course of the Applicant's business. These expenses were incurred to maintain the business and facilitate the earning of current income.

The Tribunal also rejected URA's assertion that the Applicant had failed to provide evidence linking the expenses to the production of rental income. It found that the Applicant had complied with URA's request for a breakdown of expenses and had expressly indicated its willingness to provide any additional supporting information. The Tribunal noted that URA had not sought further information and that the alleged failure to provide supporting documentation did not form part of either the objection decision or URA's Statement of Reasons. Consequently, the Tribunal found that the allegation was unsupported by the evidence before it.

Finally, the Applicant sought recognition of an accumulated assessed loss of UGX 1,309,951,029 carried forward from 2019. The Tribunal noted that the Applicant's amended 2020 tax return had already been accepted by URA and held that, if the return had indeed been accepted, the assessed loss would already accrue to the Applicant under Section 36 of the Income Tax Act relating to carry-forward losses.

This decision reaffirmed that expenses incurred wholly and exclusively in the production of income remain deductible notwithstanding that they arise within a broader capital project. It also highlights the importance of examining the true nature and purpose of an expense, rather than the status of the asset or project with which it is associated.

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