

Ortus Africa

**Business Rescue and Turnaround in Uganda During  
and After COVID-19**

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## 1. Overview

The COVID-19 pandemic has caused and continues to cause unforeseen business risks and disruptions. Its impact and magnitude to the national and global economy has not yet been conclusively ascertained. The **Ortus Africa COVID Response Team** has explored some possible solutions for affected entities, relying on our multi-disciplinary team comprising of lawyers/Advocates, business analysts and advisors, tax professionals and financial analysts with a combined experience of over 180 years of professional service handling high-stake matters both domestically and internationally.

## 2. Possible Solutions

The team has come up with bespoke solutions for different entities detailed below:

### 2.1. Companies

The Insolvency Act of 2011 creates the following rescue mechanisms for both domestic and foreign companies:

#### 2.1.1. Provisional Administration

This is triggered by a special board resolution and notice appointing a provisional administrator, where there is reason for the Board to believe that the company is or will be unable to pay its debts as they fall due. Upon agreement to settle with its creditors, the company can benefit from this remedy by applying to the High Court for an Interim Protective Order.

The purpose of this order is to put a moratorium/freeze on the Company assets as the provisional administrator takes charge to rescue the company. There should be a reasonable prospect of saving the whole or part of the company as a going concern, and approval of an administration deed, and a more advantageous realization of the company's assets than would be realized if the company were to be liquidated.

Administration commences with execution of an administration deed by the company in a general meeting and appointment of the administrator. The general rule is that a person bound by the administration deed must not make an application for the liquidation of the company or proceed with such an application.

Except with the leave/permission of the court and in accordance with the terms as the court may impose, a person bound by the deed must also not take steps to enforce any charge (whether floating or fixed) over any of the company's assets, commence execution proceedings or levy distress (attach) against the company or its assets.

#### 2.1.2. Compromise or arrangement with creditors

This can be triggered by an application to Court to sanction a scheme of arrangement. Before approving the arrangement or compromise, the Court has the discretion to hear the official receiver or require a report from the official receiver regarding the terms of the scheme and the conduct of the directors and other officers of the company seeking to benefit from this rescue remedy.



### 2.1.3. Reconstructions and amalgamations

These are also permitted subject to restrictions contained in the Companies Act, 2012. Every company intending to amalgamate/merge must provide an amalgamation proposal and the proposed incorporation documents of the amalgamated entity detailing the proposed name, share structure, and accounting reference date. The amalgamating company must also provide a Board resolution with Directors' undertaking that the amalgamation is in the best interests of the shareholders and the amalgamated company will be solvent immediately after the time at which the amalgamation is to become effective.

- It is imperative to note that in practice, consensual and out-of-court processes are common, especially with financial institutions acceding to solutions such as waiver of penal interest, halting enforcement actions, waiving events of default, and good faith renegotiations with a view of sacrificing shorter term cramdowns for longer term benefit. One of such available tools is the Pre-packaged (pre-pack) insolvency sale. This is an arrangement where sale of the entire or part of a company's business or assets is negotiated prior to appointment of an administrator or shortly after an administrator's appointment. It is advantageous because it shortens and simplifies the insolvency process for all the parties involved.

We have reviewed a letter from the Permanent Secretary of the Ministry of Finance, Planning and Economic Development/Secretary to the Treasury of Uganda addressed to all Accounting Officers of Central and Local Governments to the effect that the following are the priority payments of government during the COVID-19 lockdown;

- Salaries, wages and pensions for all Ministries, Departments, Agencies and Local Governments.
- Health sector payments to the Ministry of Health, Regional Referral Hospitals and other Health facilities.
- Security sector payments to the Ministry of Defence, Uganda Police, Prisons, State House and Office of the President.

There is no confirmed position that payment of government arrears will be priority payments during this time, and thus, businesses with claims against the government are advised to explore other income sources or innovative solutions with their creditors.

### 2.2. Regulated Entities

Regulated entities such as financial institutions like banks, telecommunication companies, insurance companies, Brokerage Firms and pension sector operators are governed by sector-specific regulations and directives issued by regulators. Key interventions include;

- Application for waiver or reduction of annual license fees arising from business downturn arising from COVID-19 risk.
- Lobbying for regulatory amnesty on key regulatory requirements such as on classification of loans and their impacts on the bottom line, to relax the number of restructures that can be allowed and other compliance targets that may affect quality of credit and liquidity parameters arising from failure by clients to perform their obligations and the submission of monthly reports to enable the lean staff to focus on core business operations.
- Injection of new capital from group level to Ugandan subsidiaries in the event of distress to stabilize operations.
- Early disclosure of distress to the regulator to effectively trigger the various rescue remedies as provided for in major statutes like the Financial Institutions Act, 2004 (as amended), the Insurance Act, 2017 and the Capital Markets Authority Act, Cap.84.
- Effective tax planning to mitigate liability and penalties.
- Key contract reviews to receive proper advice on *force majeure*, frustration, termination, variation, assignment and transfer.
- Prioritizing supplier payments to essential service providers rendering critical services related to core operations during COVID-19.

In terms of Central Bank policy, the Bank of Uganda has taken a number of measures such as undertaking to provide exceptional liquidity assistance for up to one year to supervised financial institutions that may require the facility.

The Central Bank has also proposed to waive limitations on restructuring of credit facilities at financial institutions that may be at risk of distress arising from COVID-19 interruptions, and intervene in the foreign exchange market to smoothen volatility arising from the global financial markets.

Banks have been permitted to structure loans more than twice in case of any distress arising from Covid19 within 12 months. Previously, they were permitted to restructure only twice.

The Monetary Policy Committee (MPC) has also reduced the Central Bank Rate by 1 percentage to 8 percent for the month of April. We anticipate that this will trigger supervised financial institutions to lower interest rates on loans.

### **2.3. Municipal and Public Entity (Statutory Bodies) Restructuring**

The COVID-19 pandemic has created new concerns around credit rating and default risks. However, due to a possible projected shortfall in tax and revenue collections by the Uganda Revenue Authority (URA), Kampala Capital City Authority (KCCA), and other municipal and local authorities, there may be difficulty in meeting municipal and other public entity (statutory bodies) obligations. We propose;

- Development of a more effective Municipal and Statutory bodies restructuring strategy focusing on economic recovery, lean management, operating efficiencies, and liability reduction.
- Implementation/execution-oriented planning and public management facilitating quicker decision-making and reduction of bureaucratic processes. This can be facilitated by emergency legislation to expedite welfare payments, tax reliefs for critical infrastructure such as ICUs and scientific COVID-19 clinical trials.
- Disbanding and merging some of the Ministries, Departments and Agencies of Government and public sector entities for more efficiencies and cost effectiveness.
- Operationalizing quick revenue-generating Public Private Partnerships (PPPs) that are able to replenish public reserves through liquidity support and collateral monetization schemes.
- Special protective legislation prohibiting vulture purchase of distressed sovereign debt and attachments of unprotected key government and municipal assets.
- Aggregation (grouping of several municipalities into a single administrative structure for provision of key services). This enables consolidation of staff, budgets and drives efficiencies of scale.
- Allowing and supporting options of private treaties in the sale and disposal of distressed assets, debt and portfolios.
- Requests for supplementary budgets and recapitalization from the Ministry of Finance, Planning and Economic Development where such a window exists.
- The use of more electronic avenues of collection to reduce operational costs associated with collection.

### **2.4. Sovereign/National Debt Sustainability**

Uganda has received temporary reprieve as international lenders will most likely provide some debt relief such as deferred payments and suspension of interest on sovereign debt during the subsistence of the COVID-19 pandemic. Some other alternatives to explore include;

- Comprehensive sovereign debt analysis to determine key default risks and mitigation options.
- Debt rescheduling through lengthening periods of old pre-existing debt obligations.
- Triggering odious debt provisions in respect of illegal debt arrangements offending major laws such as the Public Finance Management Act, 2015 (as amended) to terminate such obligations.
- Clawbacks and better tracking options on unspent votes from Ministries, Departments and Agencies of Government to be remitted back to the consolidated fund for future deployment.
- Quantitative easing mechanisms to try and benefit from seigniorage and later issuing financial instruments to mop up the excess liquidity from the economy in the medium term.

### **2.5. Start-ups and early-stage companies**

Uganda's start-up ecosystem is nascent and thus warrants special consideration, because of the unique nature of exposure involved, by way of instruments such as Simple Agreements for Future Equity (SAFEs), Keep It Simple Security (KISS), and convertible notes introduced into the ecosystem by angel investors and venture capitalists. Some key rescue interventions include;

- Negotiating the "haircut" value with your investor or investee in order to progressively determine the value of the start-up as new information and responses emerge.
- Seeking regulatory relief on major transactions such as recapitalizations and acquisitions that require real-time interventions.
- Seeking non-debt finance from grant funders, angel and impact investors.
- Withholding of dividend and bonus payments to shareholders, founders and key employees.

Temporarily suspending operations to avoid further exposure and liability if there is no revenue being generated.

Considering arrangements such as “equity for services” to retain key advisors such as business analysts, legal counsel, financial advisors, et cetera.

## 2.6. Cross-border aspects and practical considerations

Uganda’s Insolvency Act provides for cross-border insolvency proceedings in line with the UNCITRAL Model Law on Cross-Border Insolvency. Foreign representatives are required to obtain formal recognition, and foreign creditors have the same rights regarding commencement and participation in insolvency proceedings as creditors in Uganda.

Key practical considerations to note include;

- Debt factoring and invoice discounting are also potential solutions for quick cash to stabilize cash-flow and protect entities against default.
- Valuation of distressed assets requires a robust and defensible commercial analysis, due to uncertainty in economic outlook and value recovery profile of such assets.
- Blended approaches to rescue and work-outs must be considered because of the various methodologies considered when triangulating the value range and assessing risk adjustment for such assets.
- Insolvency practitioners and business owners must consider adequate rescue/restructuring plans with realistic expectations. Rescue plans that prolong the agony of insolvent companies and lead to further erosion of value may present leeway for professional negligence complaints.
- Insolvency Practitioners must be aware of potential conflict of interest situations likely to arise from some mandates and how to effectively navigate such risks.
- Practitioners and business owners must be cognizant of potential delays in critical services such as perfection of securities and registration of documents arising from temporary closure of the lands registries and the Uganda Registration Services Bureau (URSB).

- We shall keep track of any emergency legislation or practice directions in key areas such as liability of directors for wrongful trading, e-signatures and virtual board meetings.

## 3. Tax implications

Without any other economic relief directed at companies in distress, the tax implications for corporate rescues largely depend on the mode adopted by the company or its shareholders.

### 3.1. Company Voluntary Arrangements (CVAs)

As already noted under Section 2.1.2, Companies, with the sanction of Court may enter into legally binding schemes of arrangement with their creditors as alternative procedures to liquidation. The company continues to trade as before and the directors remain in control. There are important tax implications to take note of via the CVA procedure.

#### 3.1.1. Corporation Tax

- In a CVA there is no cessation of business for corporation tax purposes. Thus, the directors and company remain in control; and in respect of corporation tax assessments and returns, these remain the responsibility of the company.
- The full or partial release of a debt represents a profit for the debtor company. From a Corporation Tax perspective, the release of a debt obligation therefore is deemed to be taxable income derived by the taxpayer.
- Corporation Tax due for the pre CVA period falls into the CVA arrangement and post CVA Corporation Tax Returns will be prepared by the company in the normal way.

#### 3.1.2. Value Added Tax (VAT)

- There is no automatic VAT deregistration in a CVA and all VAT Returns normally remain the company’s responsibility.



- Any outstanding liability as at the date of approval of the CVA will be included in URA's claim in the CVA.
- Any VAT repayments due at the commencement of the CVA will go to the Company but these will be subject to any set-off by URA in accordance with the Law. This is often disappointing to the debtor company as it will affect cash flow.
- VAT bad debt relief will be available to suppliers whose bills remain unpaid in whole or in part for 2 years following the CVA, subject to the usual conditions.

### 3.1.3. PAYE

- Assuming the business is continued by the company and they retain their employees, they operate PAYE in the normal way. Therefore, the ongoing operation of PAYE remains the responsibility of the company.
- If there are any employees who have to be laid off as a result of a CVA, their terminal benefits (if any) are taxable income in accordance with the provisions of the Income Tax Act. Being a lump sum and irregular payment, the company should detail these payments in schedule 4 of the PAYE return to avoid instances of overstating or understating PAYE.
- The ability to reduce employee numbers and include the liabilities in a CVA can be a crucially important saving for the company.
- The full or partial release of a debt represents a profit for the debtor company. From a Corporation Tax perspective, the release of a debt obligation therefore is deemed to be taxable income derived by the taxpayer.
- Corporation Tax due for the pre CVA period falls into the CVA arrangement and post CVA Corporation Tax Returns will be prepared by the company in the normal way.

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## 3.2. Provisional Administration

The details of provisional administration have been laid out under Section 2.1.1; but briefly entails protecting a company from its creditors while a restructuring plan is worked out. It differs from a CVA in that the rescue is administered by an Insolvency Practitioner who controls the process.

### 3.2.1. Corporation Tax

There are important tax planning issues in administrations, especially in respect of hive downs and prepacks (a process whereby the sale of a business and / or any assets of the company is agreed before the appointment of an administrator) and these will be part of the pre-administration planning process.

Some of the matters to consider are:

- Whether the business continues and if so will it be transferred to a new company (newco) via a prepack. If so, the Income Tax Act provides a roll-over relief for the company in administration on the transfer of its business assets subject to the conditions contained in the Act. The conditions include;
  - The transfer is made to a shareholder being a resident company;
  - Immediately prior to the transfer, the transferee held at least a 50% of the voting power of the company in administration;

### 3.2.2 Value Added Tax (VAT)

For VAT purposes, the company is responsible for all returns up to the date of administration and the administrator is responsible for post administration returns. This is an important distinction between a CVA and an Administration.

If the trade is being transferred via a hive down or prepack, the Transfer of Going Concern (TOGC) rules may apply for VAT purposes.

### 3.2.3. PAYE

Assuming the business is continued by the company and they retain their employees, they operate PAYE in the normal way. However, the company is responsible for all returns up to the date of administration and the administrator is responsible for post administration returns.

### 3.2.4. Uganda Revenue Authority preferred creditor status

- In accordance with the Income Tax Act and the Insolvency Act, the Commissioner of the Uganda Revenue Authority is a preferential debtor; and any tax withheld by a company in accordance with Part XIII and any other incidental provisions of the income Tax Act does not form a part of the estate in liquidation.
- In practice, the obligation to account for taxes befalls the administrator on the date of their appointment. It is therefore imperative that as soon as they are appointed, they undertake a review of all tax withheld and remit the same to URA.

### 3.3. Reconstructions and amalgamations

From a tax perspective, reconstructions and amalgamations are usually viewed as re-organisations measures. However, URA is also cognisant of the tax avoidance schemes that may be executed under the guise of a reconstruction/amalgamation.

Broadly, the tax legislations in Uganda provide for important reliefs for legitimate business re-organisations including roll-over relief under Section 77 of the Income Tax Act; and tax exemption for transfer of business as a going concern under Paragraph 1(k) of the second schedule of the VAT Act.

#### 3.3.1. Roll-over relief:

- Roll-over relief is relief from capital gains tax where a business has disposed of its business assets and used all or part of the proceeds to buy new assets. The tax is postponed to the time the new asset is being disposed of.
- The Income Tax Act provides for tax neutral treatment where a company or group of resident companies is reorganised without any significant change in the underlying ownership or control of the company or group.
- The Act further categorises re-organisations into 5 forms including;
  - A transfer of assets to a related company following which the stock of the transferee is distributed;
  - A transaction in which persons are allotted shares or debentures of a company in close proportion to their holdings of shares in the company, and any case where there is more than one class of shares and the rights attached to any class are altered;

- A merger or amalgamation where all or substantially all the assets and liabilities of one or more companies are transferred to a single transferee company and the transferor companies cease to exist by operation of law;
- Where two or more companies transfer their assets and liabilities to a single newly established company;
- A corporate division where all or substantially all the assets of one company are transferred in exchange for shares in two or more newly established or pre-existing companies, except where the assets are already in the hands of a subsidiary.

- The underlying qualification for all the categories is that there is no economic gain at the point of the reconstruction; and a mere sale of a share from one person to another does not constitute re-organization.
- Due to the potential for a tax avoidance scheme to be imputed by URA in re-organisations, we advise that companies seek private rulings prior to undertaking such transactions.

### 3.4. VAT exemption

- Transfer of Going Concern (TOGC) rules may apply for VAT purposes where a VAT registered business transfers its business assets as part of the transfer of a business as a going concern to another VAT registered business.
- Transfer of a going concern” includes the disposal of any part of a business which is capable of separate operation.

On this understanding, the supply would be VAT exempt where the following conditions are met;

- The supplier disposes of any part of a business which is capable of separate operation (for example a branch of a business).
- Both the seller and the buyer must be registered as taxable persons for VAT.
- The Agreement of Sale which should be duly executed must make it absolutely clear that the property is a whole or part of the Seller's business which is being sold as a going concern.
- Activities of the business must continue after the business is transferred to the purchaser for at least two (2) years.

- The supplier supplies to the recipient all of the facilities that are necessary for the continued operation of the enterprise being sold. This may include premises, plant & equipment, stock in trade, intangible assets such as goodwill, contacts and licenses, and all the operating structure and process of the enterprise.
- The supplier carries on or will carry on the business until the day of the supply (whether or not as a part of a larger business carried on by the supplier) and that the nature of the business will not change after the transaction.
- The transferor and transferee shall within 21 days of the transfer, notify the Commissioner General in writing of the details of the transfer in accordance with section 19 (2) of the VAT Act, Cap.349.

#### 4. Conclusion

Restructuring may take the form of organizational restructuring or financial restructuring. The private sector has enough tools such as joint ventures, equity carve-outs, spin-offs, split-offs, strategic partnerships and alliances, divestitures, voluntary liquidation, set off, netting, debt-for-equity swaps, bail outs, bail-ins, among other options as discussed above to preserve value (minimize losses) and create new value. The public sector will also have to redress the fiscal challenges in new and unprecedented ways with a mixture of short-term, mid-term and long-term solutions. Since Uganda's economy is largely dominated by SMEs and an informal sector, we foresee a blended dual-approach in terms of formal and informal (out-of-court) processes.

We also hope that with the right skills mix and innovative advice, should liquidation become inevitable as a last-resort mechanism, it ought to be done in the most professional and empathetic manner due to the unprecedented challenges arising from COVID19. We look forward to professionally contributing to this paradigm shift from a liquidation culture to a rescue/turnaround culture.





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