BUDGET SERIES 2026/27

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Who pays Uganda's new tax on foreign lenders?

A man counts US Dollars in a bank. Parliament last week passed the Income Tax (Amendment) Bill 2026 that imposes a 5 percent withholding tax on interest paid by Ugandan companies to foreign lenders. PHOTO/MICHAEL KAKUMIRIZI

INTEREST PYMENTS

A company, for instance, sending Shs100 abroad as interest must now send Shs105 to ensure the lender nets Shs100. URA receives Shs5.

The foreign lender receives exactly what it always received. The Ugandan borrower pays more.

The tax does not land where it appears to land. Instead, it passes through the foreign lender and returns, via the gross-up mechanism, to the Ugandan company that borrowed in the first place.

2026/2027 Budget.

DEOGRATIUS WAMALA

Uganda presents itself as a country that is open for business, one where foreign capital is welcome and the costs of setting up are manageable. But its tax authority is indifferent.

The Uganda Revenue Authority wants a cut on interest paid to foreign lenders.

Governments that need foreign capital but make it more expensive to provide are engaged in a particular kind of self-defeat.

Uganda, a country that cannot finance its own development from domestic savings alone, is contemplating exactly that.

Parliament last week passed the Income Tax (Amendment) Bill, 2026, which imposes a 5 percent withholding tax on interest paid by Ugandan companies to foreign lenders, effectively removing an exemption that had kept the cost of cross-border borrowing competitive.

This change will raise the price of the foreign debt that Uganda depends on to build its roads, power its homes, scale businesses and connect its communities.

But is this tax a wise policy?

Borrowing to build

Uganda is, by the formal finding of its own Tax Appeals Tribunal, a net importer of capital. Its domestic investment needs outstrip what national savings can finance.

Uganda's tenfold growth strategy requires investment to reach 40 percent of Gross Domestic Product (GDP) by 2040.

Gross domestic savings currently stand at roughly 24 percent of GDP, meaning the gap between what Uganda saves and what it needs to invest cannot be closed from within.

Foreign capital, in that sense, becomes the plan.

The gap is closed by foreign debt; from development finance institutions, commercial banks and infrastructure funds that deploy capital across emerging markets and have no shortage of alternatives if Uganda becomes difficult.

The country's National Development Plan III mentions the word "infrastructure" 355 times, a sign that it is important, and that is capital intensive.

Section 82(5) of the Income Tax Act has, until now, provided the assurance foreign lenders needed. It exempts interest paid by a Ugandan company on debentures issued outside Uganda, where the interest flows to a qualifying foreign financial institution and leaves the country.

The provision was a deliberate policy to reduce the cost of capital, attract the foreign funding and get the infrastructure built.

The trigger

The stakes of that exemption were tested; and confirmed, in a 2025 ruling by Uganda's Tax Appeals Tribunal.

The case involved Kalangala Infrastructure Services (KIS), a company that partnered with government to bring roads, electricity, clean water and ferry services to Bugala Island, a remote community in Lake Victoria accessible only by boat.

To finance the project, KIS issued loan notes to Nedbank of South Africa, which syndicated the facility, bringing in the Emerging Africa Infrastructure Fund (EAIF), a Mauritius-based vehicle backed by UK Aid, the African Development Bank and FMO of the Netherlands, to cover $7 million of the $12 million required.

Between 2015 and 2020, KIS paid interest on those loans, treating the payments as exempt under section 82(5).

URA disagreed. It assessed withholding tax of over Shs1.8 billion, arguing that EAIF; because it lends only to infrastructure projects, did not qualify as a financial institution of a public character.

The Tribunal rejected that reasoning, arguing that if sector-specific lending disqualifies a lender from public character status, then a bank that lends only to farmers would equally fail the test.

EAIF was licensed, regulated, raised funds from public and private sources, and its financing delivered roads and electricity to the people of KIS, a sufficient section of the public.

Kalangala won. Costs were awarded against URA. The ruling reaffirmed the policy logic behind section 82(5).

Ian Mutibwa, a tax partner at SM&CO Advocates, distils that: "The Kalangala case clearly stipulated what the law says at this point in time, that if you raise a debenture out of Uganda for purposes of raising money out of Uganda and interest is paid out of Uganda, that interest is exempt."

That brought on some sort of clarification around this grey area.

Key data

5%

The Income Tax (Amendment) Bill, 2026, imposes a 5% withholding tax on interest paid by Ugandan companies to foreign lenders.

24%

Uganda's Gross domestic savings currently stand at roughly 24 percent of Gross Domestic Product.

National Treasury's response

The ink on that ruling was barely dry before the Finance Ministry moved to reverse its effect.

The Income Tax (Amendment) Bill, 2026 imposes a 5 percent withholding tax on the category of interest that KIS covers.

As Mutibwa puts it: "What the law is coming to say after that case is that interest should attract a 5 percent withholding tax as you are paying the foreign lender."

URA argues that the existing exemption risks "transferring revenues to foreign jurisdictions" and ignores the basic principle that "interest is income that should be subject to tax."

The proposal is to "remove the exemption and tax interest paid to a foreign bank in the same way as interest earned by a financial institution in Uganda."

The current arrangement, URA contends, amounts to "donating tax to a foreign country", since interest earned from Uganda is taxed only where the lender resides, not in Uganda.

The revenue target from this move is Shs15 billion. Its logic is that interest is income and Uganda should not finance the tax revenues of Mauritius or South Africa. But abstract propositions, applied without accounting for commercial reality, have a way of producing consequences their authors did not intend.

The gross-up problem

Sheila Ann Pacuto, an associate in the banking and finance team at ENSafrica Uganda, a corporate law firm, identifies the contractual trap: "Many cross-border loan agreements require borrowers to 'gross up' interest payments to preserve the lender's net return. Where these clauses apply, the burden of any new withholding tax would fall on Ugandan borrowers."

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Mutibwa makes the macro consequence explicit: "Uganda imports a lot of foreign capital. We are a net importer of debt. So, most agreements that you do; debt agreements, usually push that liability on the borrower. So the cost of debt will increase by 5 percent."

The uncomfortable logic

URA's three justifications each deserve a direct answer.

On revenue: the Shs15 billion target assumes the base stays constant.

If the tax raises borrowing costs sufficiently to deter investment, Uganda may collect less on existing flows than it foregoes from projects that never get financed.

A tax that shrinks the base it draws from is not obviously a gain.

The exemption favours offshore debt over domestic capital. But the reason it does so is that Uganda cannot supply enough domestic capital to meet its needs.

Levelling the playing field makes sense only if there is enough onshore debt to replace what offshore financing provides. There is not.

East African peers already impose withholding taxes on cross-border interest at comparable or higher rates.