



A Critical Analysis of Directors' Personal Liability in Instances of Tax Evasion and Tax Offences in Uganda

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Abstract

The legal status of a Company as a 'separate legal entity' presents opportunities for the shareholders and directors to actualise their business enterprises through a company without being personally liable for the liabilities of the Company. However, under specified circumstances, the directors may be personally liable on civil or criminal offences committed by the company. The approach is prevalent under tax law in the Turquand case, where the corporate veil is lifted in instances of tax evasion to expose the directors to personal liability. In Uganda, the Courts have been expressly empowered by statutory legislation to lift the corporate veil where the Company or directors are involved in acts of tax evasion or misappropriation of resources. The intention of the legislative intervention in this regard seems to align with the government's efforts to combat tax fraud and tax crimes to improve the much-needed tax revenue collections. However, the statutory provisions and the exceptions to personal liability have some inherent limitations. In some instances, the exceptions are erroneous and vague.

Keywords: Corporate personality, Personal liability, Corporate veil, Tax evasion

INTRODUCTION

The notion of personal liability of directors for the acts or omissions of companies is largely premised on the nature, position and functions associated with the office of a director¹. It is a longstanding common law principle that the directors are the brains, trustees, agents and officers of the company. Therefore, the mind of a company where guilty intent or responsibility is being considered cannot meaningfully be separated from the minds of the directors where the will of the company is to be discerned.²

Secondly, one of the statutory duties of directors³ are to act on the interests of the company⁴ and are part of the statutory duties which are mostly a codification of the fiduciary duties⁵ of directors towards the company at common law. Failure to uphold their duties makes the directors culpable. In the arena of tax law and practice, the liabilities and responsibilities of a director are accentuated by the legal provision that a director is a ‘tax representative’ of the company for tax purposes.⁶ In that capacity, the director is responsible for performing any duty or obligation imposed by a tax law on the company including the submission of tax returns and payment of taxes.⁷ The failure to perform this duty may, under specified circumstances lead to a director being held personally liable for taxes due and payable by the company.⁸ This Article, by way of background, analyses the related concepts of corporate personality, limited liability and corporate veil. The article discusses how the involvement in acts of tax evasion by directors is a statutory ground upon which the corporate veil can be lifted to expose the directors to personal liabilities. The article also analyses the statutory provisions where, subject to specified exceptions, the tax offences committed by companies are ‘treated’ or ‘deemed’ as committed by directors. The exceptions to personal criminal liability are also critiqued and the limitations therein highlighted.

The concepts of corporate personality, limited liability and corporate veil

The concepts can be traced from the leading decision in *Salomon v A Salomon & Co Ltd*⁹ that underlined the notion of separate corporate personality of a company,¹⁰ where it was observed that a legally incorporated company was recognized as any other independent person with its rights and liabilities appropriate to itself. This position was irrespective of whatever may have been the ideas or schemes of those who brought it into existence.

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¹ Bakibinga D.J Company Law in Uganda 2 ed. (2013, The Written Word Publications India).

² Ibid 630 Lord Denning stated that:

A company may in many ways be likened to a human body. They have a brain and a nerve centre which controls what they do. They also have hands which hold the tools and act in accordance with directions from the centre... Others are directors and managers who represent the directing mind and will of the company, and control what they do. The state of mind of these managers is the state of mind of the company and is treated by the law as such... So also in the criminal law, in cases where the law requires a guilty mind as a condition of a criminal offence, the guilty mind of the directors or the managers will render the company themselves guilty.

³ The Companies ActCap. 106 sec. 194.

⁴ Ibid sec194(c)).

⁵ Byan. A. Garner (ed) *Black's Law Dictionary* (8th Ed. Thomson West 2004) 1536.

⁶ Tax Procedure Code Act, sec 2 ‘tax representative’ part (b).

⁷ Ibid sec 14.

⁸ Ibid sec 14(5), sec 14 (7). However, under sec 14 (6) the tax representative may not be personally liable in the specified circumstances.

⁹ *Salomon V. A Salomon & Co Ltd* [1897] AC 22 (HL) cited with approval in *David Lubega Matovu V. Mikwano Investments Limited* Misc Application No. 156 of 2012 (Arising from Misc. Application No. 317 of 2011 and High Court Civil Suit No. 172 of 2011), Commercial Division.

¹⁰ Lord Macnaghten in the cited case (n 9 above) stated that;

The Company is at law a different person altogether from the subscribers...and though it may be that after incorporation the business is precisely the same as it was before, and the same persons are managers, and the same hands receive the profits, the company is not in law the agent of the subscribers or the trustees for them. Nor are the subscribers, as members, liable in any shape or form, except to the extent and in the manner provided by the Act.

Regarding limited liability, it was observed that the company is not in law the agent of the subscribers or the trustees for them. Nor are the subscribers, as members, liable in any form, except to the extent and in the manner provided by the Act.¹¹

A corporate veil has been defined as the legal assumption that the acts of a company are not the actions of its shareholders so that the shareholders are exempt from liability for the company's actions.¹² Corporate veil is therefore synonymous with the concepts of corporate personality and limited liability, which are concepts that underline the separateness of the company as independent person.

The observance of the concepts of corporate personality, limited liability and corporate veil ensures the protection of both shareholders and directors from the liabilities of companies.¹³ In the case of a company limited by shares, the most a member can lose in relation to the liabilities of the company is the amount unpaid for the shares in the company¹⁴ but not yet called up or the unpaid share amount to be called up for purposes of the winding up of the company.¹⁵

It is important to note that the principle of limited liability extends to directors of a company. The directors generally enjoy limited liability under the law except if any unlimited liability relating to them is expressly provided for by the Memorandum of the company.¹⁶

The concept of lifting of the corporate veil

Lifting of the corporate veil refers to disregarding the corporate personality of a company to apportion liability to a person who carries out any act.¹⁷ It involves situations where the law or the courts look beyond the legal personality of the company and hold the directors personally liable for the company's actions. As an exception to applying the concepts of separate corporate personality, limited liability and corporate veil, lifting of the corporate veil envisages apportioning liability to a person who carries out any act and not necessarily the company itself¹⁸. The corporate personality of the company is disregarded and the liability is thus visited on a shareholder or a director acting in the course of his or her duties to a company.¹⁹

In *Salim Jamal & 2 others V. Uganda Oxygen Ltd & 2 others*²⁰ the Supreme Court of Uganda held that;

‘Corporate personality cannot be used as a cloak or mask for fraud.’²¹ Where this is shown to be the case, the veil of incorporation may be lifted to ensure that justice is done and the court does not look helpless in face of such fraud.’

In Uganda, Section 18 of the Companies Act Cap.106²² expressly provide statutory grounds upon which the veil of incorporation can be lifted as follows:

‘The High Court may, where a company or its directors are involved in acts including tax evasion, fraud or where, save for a single-member company, the membership of a company falls below the statutory minimum, may lift the corporate veil’.

Personal liability of Directors for acts of tax evasion resulting from lifting the corporate veil

It is noteworthy from Section 18 Companies Act highlighted above that the involvement of a company or its directors in acts of tax evasion is a statutory ground upon which the High Court can disregard the

¹¹ Ibid.

¹² Black's Law Dictionary 1032.

¹³ Companies Act, sec45.

¹⁴ Ibid sec 3(2)

¹⁵ Ibid sec68.

¹⁶ Ibid sec226.

¹⁷ Companies Act, sec1.

¹⁸ Bakibinga D.J Company Law in Uganda (2006, Fountain Publishers) P.65

¹⁹ Tarinyebwa W.M Company Law: A guide to the Companies Act 1 of 2012 of Uganda (2015, Fountain Publishers).

²⁰ (1997) II KALR 38 Civil Appeal 64 of 1995 Supreme Court of Uganda.

²¹ *Fredrick Zaabwe V. Orient bank & 5 Others* SCCA No.4 of 2006, Supreme Court of Uganda.

²² The Companies Act on 01 July 2013 by virtue of the Companies Act (Commencement) Instrument – SI No. 24 of 2013.

corporate personality of a company to apportion liability to a director who carries out the act(s) of tax evasion²³.

The application for lifting the corporate veil has to be made before the High Court and evidence of involvement by the director in acts by the company involving tax evasion is required to be adduced to the satisfaction of Court before the veil can be lifted and the directors held personally liable.²⁴

It has also been determined by the High Court that the directors against whom personal liability are intended to be imposed by virtue of lifting the veil should be afforded the right to be heard by making them parties to the suit seeking to lift the veil.²⁵

It is yet to be conclusively resolved by the courts whether the involvement in tax evasion by the director should disclose a personal benefit to that director to hold the director personally liable²⁶. The High Court has observed (*per in curium*) that the question of personal benefit to the directors is considered in the context of considerations of whether to hold the director or the company liable for the fraud which has been established.²⁷

Tax evasion and tax offences by Directors of a company

Tax evasion, also termed as tax fraud, refers to the willful attempt to defeat or circumvent the tax law in order to illegally reduce one's tax liability and is punishable by both civil and criminal penalties.²⁸ The 'acts of tax evasion' can be discerned from aspects of noncompliance with tax obligations. Many acts of tax evasion have also been criminalized for example 'fraudulent evasion of the payment of any duty.'²⁹

Tax evasion, a form of financial crime and a deliberate attempt to illegally obtain a tax benefit, has negative impact on the economy. If financial crimes remain unchallenged or unidentified, they can undermine fiscal security leading to poor service delivery and economic retardation.

Tax evasion comes in many forms; the common ones are use of fictitious invoices – where money is channeled as payment for purchase of goods while in actual sense no goods are supplied. Another common scheme is goods smuggling where import or export goods pass through borders illegally, concealed or not declared in violation of the law, and purposely to avoid payment of taxes. These actions constitute tax offences and are prosecutable and punishable by law. Prosecution deters tax evasion, enhances compliance, guarantees optimal realization of revenue, increase stability and predictability in the tax system.

It is therefore important to report and hold responsible perpetrators of economic crimes such as tax evasion, which is one of the offences by bodies of persons, as they are a threat to socio-economic development and national security.

The fight against tax evasion requires carrying out tax audits to ascertain and reveal that there was tax evasion. Through tax audits, a lot of information is gathered on suspected tax evasion which is important and may reveal malpractices by officers of the company such as bribery, conflict of interest, aiding tax evasion, abuse of office among others. Tax audits are one of the ways to curb tax evasion. The other is to encourage whistle-blowers through rewards and assurance of their protection of their identities. This is important to guard against potential retaliation or intimidation.

In Uganda, Section 94 of the Tax Procedures Code Act allows for payment of informers who help in providing information leading to identification of tax or duty not assessed.

²³ Holger F 'Corporate purpose: A management Concept and its implication for company law' (2021) 18 *European Company and Financial Law Review* 161-189

²⁴ David Lubega Matovu case (n. 9).

²⁵ Ibid.

²⁶ Stanbic Bank case (n.1).

²⁷ Ibid

²⁸ Black's Law Dictionary 4573.

²⁹ East African Community Customs Management Act 2004, sec 203(e).

The reward and protection of whistle blowers is therefore important to curb tax evasion perpetuated through companies and is an important mechanism in criminal justice proceedings that aid in the successful prosecution of tax evasion and other criminal cases.

Personal liabilities of Directors for tax offences

Personal criminal liability for a tax offence committed by a company is imposed on, among others, the directors of the company at the time the offence was committed under specified circumstances.³⁰

Where an offence is committed by a company, Section 82(1) of the Tax Procedures Code Act Cap 343 stipulates that,

‘When an offence under a tax law is committed by a company, the offence is treated as having been committed by a person who, at the time the offence was committed, was the chief executive officer, managing director, a director, company secretary, treasurer, or other similar officer of the company; or acting or purporting to act in that capacity.’

However, the above section does not apply to a person if the offence is committed without the consent or knowledge of a person specified and the person has exercised due diligence to prevent the commission of the offence as ought to have been exercised having regard to the nature of the representative’s functions and all other circumstances.³¹

Section 224(4) of the East African Community Customs Management Act 2004 (EACCMA), provides that a body corporate shall be deemed to be liable for an offence where it is proved that such offence has been committed with the consent or connivance of, or is attributable to any neglect on the part of, any director, manager, secretary, or similar officer, of the body corporate.

A clear reading of the above provisions shows that the offences that may be committed by a company under the Tax Procedures Code Act³² and the East African Community Customs Management Act are ‘treated’ or ‘deemed’ respectively as having been committed by the director(s) under the specified circumstances.³³ The criminal liability imposed on directors is also extended to include persons acting or purporting to act in the position, role and function of a director *de facto* (whether authorized or not) but who may not be legally designated as directors under the categories of ‘other similar officer of the company’ or other person ‘acting or purporting to act in that capacity’³⁴ of a director.

On the whole, the parameters of personal criminal liability envisaged under the above provisions have been interpreted by the Supreme Court of India in *Sheoratan Agarwal V. State of Madhya Pradesh*³⁵ when analyzing section 10 of the Essential Commodities Act³⁶ which was similar to Section 224(4) of EACCMA and Section 82(1)(b) TPCA as follows;

³⁰ Tax Procedure Code Act Sec. 82

³¹ Tax Procedures Code Act, sec 82(1)(a).

³² Tax Procedure Code Act, sec 82 (4)

³³ Tax Procedures Code Act, Sec. 82(3)

³⁴ Ibid sec 82(1)(b)

³⁵ 1984 AIR 1824, 1985 SCR (1) 719.

³⁶ The Essential Commodities Act 1955, sec 10 (1) provided that:

If the person contravening an order made under Sec. 3 is a company, every person who, at the time the contravention was committed, was in charge of, and was responsible to, the company, shall be deemed to be guilty of the contravention and shall be liable to be proceeded against and punished accordingly: Provided that nothing contained in this sub- section shall render any such person liable to any punishment if he proves that the contravention took place without his knowledge or that he exercised all due diligence to prevent such contravention. (2) Notwithstanding anything contained in sub- section (1), where an offence under this Act has been committed by a company and it is proved that the offence has been committed with the consent or connivance of, or is attributable to any neglect on the part of, any director, manager, secretary or other officer of the company such director, manager, secretary or other officer shall also be deemed to be guilty of that offence and shall be liable to be proceeded against and punished accordingly.

‘The section appears to our mind to be plain enough. If the contravention of the order made under section 3 is by a company, the persons who may be held guilty and punished are (1) the company, itself (2) every person who, at the time of contravention was committed, was in charge of, and was responsible to, the company for the conduct of the business of the company whom for short we shall describe as the person in charge of the Company, and (3) any director ... of the company with whose consent or connivance or because of neglect attributable to whom the offence has been committed... Anyone of them may be prosecuted and punished. The company alone may be prosecuted.

In Uganda, the High Court in the case of *Sande Pande Ndimwibo & Anor V. Uganda Revenue Authority*³⁷ has observed that the directors have to be accorded a right to be heard in an independent and impartial Court because the tax offences must be proved against the company and against the directors in order for liability to be imposed against the directors.

The High Court has also highlighted that the determination of the criminal liability of the directors for the offences of the company is a question that is determined by the Courts of law³⁸ by prosecution and not by the Revenue Authority administratively transferring the liability of a company to its director(s). In the case of *Ndimwibo case*³⁹, Justice Madrama found that the provisions prescribing the offences between sections 51 and 62 of the Value Added Tax Act, apart from provisions relating to compounding offences under section 64 require prosecution of the accused person, accused with the commission of a penal offence. Section 65 (6) which imposes penalties also presupposes that an offence has been committed.

As observed under the *Ndimwibo* case above, the only exception to the requirement for the prosecution of a director before personal liability can be imposed is when the Commissioner exercises the power to compound the offence prior to the commencement of the court proceedings⁴⁰. Compounding of the offence involves a process where the commissioner exercises his discretion and agrees not to prosecute an accused person who has admitted the offence in writing and agreed to pay a sum of money not exceeding the fine prescribed for the offence.⁴¹

The exceptions to personal criminal liabilities

On a closer examination, it is evident that the law attempts to forestall the unintended personal criminal liability that may be visited on ‘innocent directors’ (for example non -executive directors who unlike Executive Directors do not participate in the operations of the company) by the exception that criminal liability will not be imposed where the offence is committed without the consent or knowledge of a director, and the director has exercised due diligence to prevent the commission of the offence.⁴²

However, the exception to personal liability highlighted above has an inbuilt requirement that a director will need to fulfill all the conditions specified within the section in order to be exempted from personal liability as indicated by the use of the conjunction ‘and’. This requirement makes the exception manifestly self – contradictory, in as far as it would require that a director who had no knowledge of the tax crime should at the same time have exercised due diligence to prevent the commission of the same tax offence that is outside their knowledge.

Whether the use of the conjunction ‘and’ in the context of Section 82(4) of the Tax Procedures Code Act was deliberate or a case of erroneous legal draftsmanship, it has the unintended effect of making the exception to personal criminal liability of directors ineffective and unavailable to deserving directors. There

³⁷ High Court Civil Suit No. 424 of 2012 Commercial Division Justice Madrama.

³⁸ Ibid.

³⁹ Ibid.

⁴⁰ Tax Procedures Code Act, sec 66(1).

⁴¹ Ibid Sec 66(2).

⁴² Tax Procedures Code Act, sec 82(4)

is need for an amendment to Section 82(4) above to replace the conjunction ‘and’ with the conjunction ‘or’ in order to make the exceptions to personal liability severally available to directors that either have no knowledge of the offence or in the alternative, exercise due diligence to prevent the commission of the offence. Indeed, a similar provision that levies personal liability in Section 224(4) of the East African Community Customs Management Act that was highlighted above employs the use of the conjunction ‘or’ within its text to separate the specific instances of a director’s consent, connivance or negligence when personal liability for customs offences will apply.

The other limitation within Section 82(4) of the Tax Procedures Code Act highlighted above is that it requires that a director should have exercised all diligence to prevent the commission of the offence as ought to have been exercised, having regard to the nature of the director’s functions and all other circumstances. It may be difficult to ascertain what ‘all diligence’ entails and when it can be confirmed that ‘all diligence’ was employed. The words ‘all diligence’ are vague and broad, and make the test to be applied to interpret them subjective and inconsistent. The use of the word ‘reasonable diligence’⁴³ where an objective test of ‘someone of ordinary prudence under similar circumstances’ would be applied, is preferred as it enables consistency in the operation and application of this statutory exception to personal liability.

It is also not clear whether a director who has been criminally held liable and sentenced for a tax offence of the company should also be liable to pay any tax liability of the company related to that offence. Section 85 of the Tax Procedures Code Act provides that the amount of any tax due and payable by a taxpayer is not abated by reason only of the conviction or punishment of the taxpayer for an offence under any tax law. Section 201 of the East African Community Customs Management Act also provides that a taxpayer who has been convicted of a fine is liable for payment of the customs duty.

However, it is reasonable to argue that based on these provisions above, in cases where a director has been sentenced for a tax offence of the company, it is the company as corporate tax payer that should be pursued for any tax liability due since, unlike criminal liability, the tax liability of the company is not out rightly treated or deemed to be the ‘personal’ liability of its director(s). Under such circumstances, what is clear is that the tax liability for the unpaid taxes by the company will only be imposed on the director where the veil has simultaneously been lifted on account of involvement in tax evasion. The lifting of the veil is a determination by the Court, and the Revenue Authority has no powers to transfer and enforce the tax liability on a director suspected of committing a tax offence without the due court process, as was observed in the Ndimwibo case.

CONCLUSION

There are express statutory provisions that have empowered courts to lift the veil and apportion liability to the director where he or she is involved in acts of Tax evasion. The directors may also be held criminally liable for the tax offences of companies subject to the exceptions discussed above. Directors should therefore exercise skills diligence caution and utmost care by ensuring that they do not get involved in acts of tax evasion or commit tax offences while discharging their duties and responsibilities lest they suffer personal liability. The Companies Act read together with Tax Procedure Code Act set out the clear parameters under which director’s personal liability will be invoked with clear exception being the director’s participation and knowledge in acts of tax evasion by the company. Failure to take heed of these statutory provisions leaves directors exposed to personal liability.

Under appropriate circumstances, it is advisable that they take out Directors’ and Officers’ liability insurance cover to ensure that they are indemnified against any personal liability which they may suffer in the course of their duty towards the Company.

⁴³ Black’s Law Dictionary 1376 defines ‘reasonable diligence’ as a fair degree of diligence expected from someone of ordinary prudence under circumstances like those at issue.