

THE PUBLIC ACCOUNTANTS EXAMINATIONS BOARD

A Committee of the Council of ICPAU

PRINCIPLES OF TAXATION – PAPER 10

ATC(U) EXAMINATIONS

LEVEL III MODEL EXAMINATION PAPER

MAY 2002

INSTRUCTIONS TO CANDIDATES

1. Time allowed: **3 hours**
2. Attempt all questions in Section **A**, **two** questions in Section **B** and any **two** questions in Section **C**.
3. Section **A** has **twenty** compulsory multiple-choice questions each carrying 1 mark.
4. Section **B** has **two** compulsory questions of 25 marks each.
5. Section **C** has **three** questions and only **two** questions are to be attempted. Each question carries 15 marks.

SECTION A

Question 1

- (i) The income tax rate of trusts is:
- a. 25%
 - b. 30%
 - c. 35%
 - d. 45%
- (ii) Companies which apply International Accounting Standards, account for their income taxes, using:
- a. Cash or accrual basis.
 - b. Cash basis.
 - c. Modified cash basis.
 - d. Accrual basis.
- (iii) Dividend income received by A Ltd from B Ltd, in which it owns 25% of the voting power, would be:
- a. Subject of withholding tax of 15%.
 - b. Subject to withholding tax of 15% which is final tax.
 - c. Subject to withholding tax of 10%.
 - d. Exempt from withholding tax.
- (iv) Uganda has double tax treaties with the following countries, except:
- a. Rwanda.
 - b. United Kingdom.
 - c. Norway.
 - d. South Africa.
- (v) Which of the following constitute designated industrial buildings:
- i. Soap factories.
 - ii. Hotel buildings.
 - iii. Mining operations.
 - iv. Approved hospitals.

- a. (i), (ii) and (iii)
 - b. (ii), (iii) and (iv)
 - c. (i), (iii) and (iv)
 - d. (i), (ii), (iii) and (iv)
- (vi) Quality Printers Ltd.(QPL) has acquired a used printing machine from Vogue Printers Ltd.(VPL). Which of the following statements is correct in regard to capital allowances of this machine?
- a. QPL can only claim for wear and tear allowance on the written down value.
 - b. QPL can claim both initial, and wear and tear allowances on the machine's cost price.
 - c. QPL is not entitled to any capital allowances.
 - d. The cost base for capital allowances will be the original cost incurred by VPL and QPL can only claim allowance on the written down value.
- (vii) Which of the following is correct?
- a. Resident companies must seek for the Commissioner General's approval before they can offset withholding tax incurred.
 - b. Customs duties are allowable deductions under the Income Tax Act 1997.
 - c. Expenditure on trademarks is a depreciable asset.
 - d. Royalties paid to a non-resident person are exempt from tax.
- (viii) Which of the following is a mismatch?
- a. Reverse charge.
 - b. Balancing charge.
 - c. Balancing deduction.
 - d. Pooling system.
- (ix) Which of the following are examples of direct taxes?
- i. Tax paid under the PAYE system.
 - ii. Corporation tax.
 - iii. Withholding tax.
 - iv. Value added tax.

- a. (i) and (ii)
- b. (ii), (iii) and (iv)
- c. (i), (ii) and (iii)
- d. (i), (ii), (iii) and (iv)

Use the information below to answer questions (x) – (xi):

Lucky Traders had the following transactions for the month of June 2001:

| | Sales Shs '000 | Purchases Shs '000 |
|----------------|---------------------------|-------------------------------|
| Standard rated | 14,000 | 14,040 |
| Zero rated | 10,000 | 9,000 |
| Exempt | 2,000 | 1,800 |

The sales quoted are exclusive of VAT while the purchases are VAT inclusive, where applicable.

- (x) What was the company's input tax?
- a. Shs 2,380,000
 - b. Shs 2,040,000
 - c. Shs 2,386,800
 - d. Shs 3,916,800
- (xi) Compute the company's VAT liability for June 2002:
- a. Shs 197,200 (payable).
 - b. Shs 340,000 (payable).
 - c. Shs 6,800 (refund)
 - d. Shs 340,000 (payable).
- (xii) Which of the following is not an exempt supply of a VAT registered trader?
- a. Supply of meat to Grand Imperial Hotel.
 - b. Sale of maize flour to traders in Nakawa Market.
 - c. Sale of medical gloves to Jinja Main Hospital.
 - d. Export of millet flour to Kisumu, Kenya.

(xiii) Which of the following is true?

- a. A taxable person must issue a tax invoice only when he makes a taxable supply to another taxable person.
- b. A taxable person must issue a tax invoice on all his sales to other taxable persons.
- c. A taxable person must issue a tax invoice on all his sales.
- d. A taxable person must issue a tax invoice on all his taxable supplies.

(xiv) Which of the following is an allowable deduction?

- a. A bad debt written off due to delayed payment.
- b. Computer software installed by a bank.
- c. Excise duty.
- d. Income tax paid to URA.

(xv) According to the VAT Statute 1996, employment services are:

- a. Exempt supplies.
- b. Taxable supplies.
- c. Zero rated supplies.
- d. Standard rated supplies.

(xvi) A gift may be taxable:

- a. If an employee receives it because he is the holder of an office of employment without any special conditions being laid down.
- b. If it is received by an employee from a customer.
- c. If there is no legal attachment to the payer.
- d. All the above.

(xvii) Which of the following is correct?

- i. Capital gains tax is a tax arising on the disposal of a non-depreciable business asset.
- ii. Capital gains tax applies to business assets disposed off.
- iii. No capital gains tax is applied to private assets.
- iv. The Chief Government Valuer must determine the market value of immovable property for capital gains purposes.

- a. (i) and (ii).
 - b. (i), (ii) and (iii).
 - c. (i), (iii) and (iv).
 - d. (i), (ii), (iii) and (iv).
- (xviii) Capital gains tax applies to qualifying assets disposed off on or after:
- a. 30 June 1997.
 - b. 1 July 1997.
 - c. 31 March 1998.
 - d. 1 April 1998.
- (xix) Which of the following incidental capital expenditures are not included in the cost base for capital gains purposes?
- a. Stamp duty.
 - b. Valuation costs to arrive at a chargeable gain.
 - c. Structural adjustments on a building as a condition of sale.
 - d. Fees paid for professional advice.
- (xx) When was income tax introduced in Uganda?
- a. 1940.
 - b. 1952.
 - c. 1960.
 - d. 1962.

SECTION B

Question 2

KKL (U) Ltd is a company incorporated in Uganda. It deals in general merchandise and commenced business on 1 January 1997. The start up costs amounted to Shs 20,000,000. The company's financial statements for the year ending 31 December 2001 indicated a net profit before taxation of Shs 20,000,000. The following information is available:

1. Included in the financial statements are:
 - i. Depreciation charge of Shs 11,000,000.
 - ii Staff housing allowances of Shs 16,000,000, paid portionally throughout the year.
 - iii The company's contribution to National Social Security Fund was Shs 10,000,000.
 - iv Training costs: Shs

| | |
|--|------------------|
| Personnel Manager's tuition fees for Masters degree in Management at Uganda Management Institute | 4,000,000 |
| Accountant's tuition fees for levels 3 and 4 of CPA(U) | <u>1,800,000</u> |
| | <u>5,800,000</u> |
 - v Unrealised foreign exchange loss of Shs 4,000,000.
 - vi Summary of bad debts:

| | |
|--|-------------------|
| Bad debts written off: <u>Shs</u> | |
| Bankrupt customer | 3,000,000 |
| Former employee's salary advance | 1,000,000 |
| Specific provision for bad debts | 8,000,000 |
| General provision for bad debts | <u>10,000,000</u> |
| | <u>22,000,000</u> |
 - vii Interest income from: Shs

| | |
|---|------------------|
| Investment in treasury bills | 4,500,000 |
| Fixed deposit account with Stanbic Bank | <u>3,000,000</u> |
| | <u>7,500,000</u> |

| | | | |
|------|---|---|------------------|
| viii | Legal expenses: | | <u>Shs</u> |
| | Debt collection activities | | 6,000,000 |
| | Registration of land title of the rental property | | <u>1,000,000</u> |
| | | | <u>7,000,000</u> |
| ix | The income earned from rental property was Shs 2,000,000 per month. The property was rented out throughout the year. The costs incurred on its maintenance were Shs 12,000,000. | | |
| x | Sale of non-current assets: | | |
| | <u>Date of Sale</u> | <u>Item</u> | <u>Shs</u> |
| | 31.3.2000 | Old computer (purchased in 1998) | 700,000 |
| | 01.6.2001 | Motor vehicle (purchased in 1997) | 3,000,000 |
| | 20.8.2001 | Office furniture (purchased in 1997) | <u>500,000</u> |
| | | | <u>4,200,000</u> |
| xi | Profit on sale of non-current assets – Shs 1,200,000. | | |
| xii | Capital expenditure: | | |
| | <u>Date</u> | <u>Item</u> | <u>Shs</u> |
| | 10.1.2001 | 2 computers | 3,600,000 |
| | 01.2.2001 | Computer software - Accounting package | 1,500,000 |
| | 30.3.2001 | Toyota Prado for the Managing Director (40% for personal use) | 40,000,000 |
| | 01.8.2001 | Office furniture and fittings. | 3,000,000 |
| xiii | Donations: | | <u>Shs</u> |
| | Kabaka's birthday ceremony | | 2,000,000 |
| | Makerere University – Scientific Research | | 3,000,000 |
| | ICPAU Annual Seminar | | <u>1,000,000</u> |
| | | | <u>6,000,000</u> |

The donations were intended to improve the company's image. Makerere University and ICPAU are exempt organizations.

| | | |
|-----|--|-------------------|
| xiv | Taxes and penalties paid: | <u>Shs</u> |
| | Value Added Tax (net) | 12,500,000 |
| | Withholding tax on government supplies | 3,000,000 |
| | Provisional tax | 2,000,000 |
| | Customs and Excise duties | 4,000,000 |
| | Penalty for late filing of VAT returns | <u>1,000,000</u> |
| | | <u>22,500,000</u> |

2. Further information:

i. The agreed tax loss at 31 December 2000 was shs 5,250,000.

ii. The tax written down values for depreciable assets at 31 December 2000 were:

| | |
|-----------|------------|
| Class I | <u>Shs</u> |
| | 30,000,000 |
| Class II | 20,000,000 |
| Class III | 12,000,000 |

iii. The directors proposed dividends of Shs 5,000,000 on 31 December 2001. The dividends were paid on 31 January 2002.

Required:

- a. Compute KKL Ltd's tax liability for the year ended 31 December 2001. (20 marks)
- b. Comment on the treatment of items 1 (ii), (iv), (vi), (vii), (ix), (xiii) and 2 (iii). (5 marks)

(Total 25 marks)

Question 3

Mr. James Osogo is the Managing Director of Equator Motors Ltd. He received the following income during the year of income 2000/2001:

| | | |
|------|--|-------------|
| 1. | Employment income & benefits: | <u>Shs</u> |
| i. | Basic salary | 108,000,000 |
| ii. | Bonus | 9,000,000 |
| iii. | Payment in lieu of leave | 13,500,000 |
| iv | 10% Company contribution to NSSF (Shs 6,525,000 was deducted from his emoluments and remitted to NSSF) | 13,050,000 |
| v. | Medical allowance | 7,200,000 |

| | | |
|-------|---|------------|
| vi. | Accommodation – annual rental paid by employer (He paid Shs 500,000 per month to the company towards rent) | 12,000,000 |
| vii. | Loan at interest rate of 15% (Bank of Uganda rate was 25%) | 50,000,000 |
| viii. | Reimbursement of traveling costs while on company business | 1,000,000 |
| ix | Lunch valuation (lunch is provided to all the staff) | 1,500,000 |
| x. | Provision of a housekeeper, gardener and chef | 20,000,000 |
| xi. | He was provided with a company car effective 1 January 2001 for private use. The company incurs all the operational costs. The market value of the car is Shs 45,000,000. | |

| | | |
|----|--------------------------|------------|
| 2. | Rental income: | <u>Shs</u> |
| | 2 houses at Muyenga | 36,000,000 |
| | 6 apartments at Kansanga | 21,600,000 |
| | 3 houses at Naalya | 12,600,000 |

| | | |
|--|--|------------|
| | He incurred the following expenses on his rented properties: | <u>Shs</u> |
| | Repairs & maintenance | 15,000,000 |
| | Legal fees to acquire land titles for Muyenga houses | 3,000,000 |
| | Tarmacing parking yards of Naalya houses | 6,000,000 |
| | Security expenses | 13,200,000 |

3. Business Income:
- He runs a grocery shop at Wandegaya from which he earned a taxable profit of Shs 3,000,000.
 - He also runs a restaurant on Kampala Road, which made a tax adjusted loss of Shs 5,000,000.

Required:

- Compute Mr. James Osogo's taxable income and tax thereon for the year 2000/2001. (20 marks)
- Give five examples of employment income or benefits that are exempt from tax. (5 marks)

(Total 25 marks)

SECTION C

Question 4

- a. One of the objectives of taxation is raising government revenue to finance public activities like road construction. Uganda, Kenya and Tanzania are in the process of establishing a customs union.

Required:

Define the term “Customs Union” and state whether it would be beneficial or disadvantageous for Uganda to join the customs union. (6 marks)

- b. Give and explain the cardinal principles of a good tax system. (9 marks)

(Total 15 marks)

Question 5

- a. Walugembe & Company Ltd purchased a saloon car for office use on 1 March 2000 for Shs 6,500,000. The company decided to sale the car to Mr. Magezi on 31 August 2001, for Shs 7,000,000.

The Accounts Officer is still puzzled on whether to treat the transaction as a zero rated or exempt supply.

Required:

Advise the Accounts Officer on the correct treatment of the transaction in accordance with the VAT Statute, 1996. (6 marks)

- b. Write short notes on the following:
- i. Tax identification numbers. (3 marks)
 - ii. Tax clearance certificate. (3 marks)
 - iii. Tax point. (3 marks)

(Total 15 marks)

Question 6

- a. Kuts Construction Ltd holds a certificate of incentives. Some of the company's shareholders are residents while others are non-residents. The Company's directors are proposing to pay dividends of Shs 100 million but are not sure of the tax implications of their proposal.

Required:

Advise the directors on the tax implications of their proposal. **(6 marks)**

- b. Write short notes on the following:

i. Voluntary VAT registration. **(3 marks)**

ii. Compulsory VAT registration. **(3 marks)**

iii. Self Assessment **(3 marks)**

(Total 15 marks)