

THE PUBLIC ACCOUNTANTS EXAMINATIONS BOARD

A Committee of the Council of ICPAU

CPA(U) EXAMINATIONS

LEVEL THREE

TAXATION – PAPER 13

TUESDAY, 18 DECEMBER 2001

INSTRUCTIONS TO CANDIDATES

1. Time allowed: **3 hours**.
2. Attempt question **one** in Section **A**. It is compulsory and carries 40 marks.
3. Section B has **three** questions and only **two** questions are to be attempted. Each question carries 15 marks.
4. Section C has **three** questions and only **two** questions are to be attempted. Each question carries 15 marks.
5. Please read further instructions on the answer book

SECTION A

Question 1

Victoria Bank Ltd is a government owned financial institution operating in the business of commercial banking. Its profit and loss account for 12 months' period ended 31 December 2000 is as follows:

	Shs '000		Shs '000
Salaries and wages	760,000	Interest income	1,440,000
Heat and light	144,000	Interest from treasury bills	660,000
Travelling expenses	48,000	Dividend income	120,000
Depreciation	127,000	Gain from sale of properties	40,000
Bad debts provision	1,860,000		
Advertising costs	22,000		
Management charges	76,000		
Interest expenses	43,000		
Entertaining	18,000		
Donations	4,000		
General expenses	92,000		
Net loss	(934,000)		
Total	<u>2,260,000</u>		<u>2,260,000</u>

The following information is also relevant

- i. The dividend income is from various other Ugandan companies wholly owned by Victoria Bank Ltd
- ii. The gain from sale of properties was realised on the sale of various premises of the bank's rural branches, which were no longer considered viable for business purposes. The capital gain arising from the sale of these premises has been computed as Shs 18 million.
- iii. Included in salaries and wages are Shs 48 million in respect of the managing director's housing and other domestic related expenses
- iv. Travelling expenses were all incurred by the senior management on business trips
- v. General expenses include the following:

	Shs 000
Subscriptions to the Uganda Institute of Bankers	14,000
Subscription to the golf club for the Managing Director	8,000
Legal fees relating to recovery of bad debts	27,000
Legal fees relating to the issue of new shares	18,000
Surveyor's fees relating to the sale of properties	9,600
vi. All the bad debts provisions are specific provisions provided for in accordance with the Bank of Uganda guidelines	

The bank has tax losses of Shs 108 million brought forward from the previous year of income

Required:

- (a) Compute the bank's chargeable income or tax losses for the year ended 31 December 2000

(10 marks)

- (b) The Government is considering divesting its majority interests in Victoria Bank Ltd, and has identified a non-resident Merchant Bank that is interested in acquiring the Government's majority shareholding. The acquisition of these majority shares will give the Merchant Bank control of Victoria Bank Ltd.

The directors of the Merchant Bank are concerned about the following and have approached your firm for tax advice.

- i. Whether they will be able to utilise the bank's accumulated tax losses after the change of ownership, and what conditions if any they will have to meet, in order to utilise these losses against the bank's future profits.
- ii. Upon acquisition of control of the bank, their head office based in London will charge Victoria Bank Ltd a quarterly management fee of Shs 100 million to cover the cost of management and technical support services provided.
- iii. As soon as the bank starts making profits, it will pay out all its distributable profits in the form of dividends to its shareholders the majority of whom will be the Merchant Bank who are non resident.
- iv. The Merchant Bank plans to issue debentures to another non-resident core investor to raise loan finance. The debentures will attract a fixed annual interest of 10% and this will be paid off shore.
- v. Upon acquiring the majority shareholding in the bank, the Merchant Bank plans to carry out detailed analysis of all the existing non performing assets, and write off all the specific bad debts for which the existing loss reserve is not sufficient to meet the potential losses.

Required:

Prepare brief notes in respect of all the above concerns (i-v) of the Merchant Bank, explaining the tax implications of each of their planned courses of action in (i to v) above, highlighting any tax planning points that may be of interest to the management of the Merchant Bank Ltd.

(20 marks)

- (c) The directors of Merchant Bank Ltd. are anxious to persuade Mr Blythe an expatriate banker to join their company, and take up the position of Managing Director of Victoria Bank Ltd in Uganda upon acquisition by the Merchant Bank Ltd. and have included the following conditions in his contract of service
- (i) Housing – A house will be provided to him free of charge for him to live with his family, in addition to this the company will provide him with a gardener, a cook, a domestic house maid and a security guard.
 - (ii) Passage – the company will pay transport and passage costs from his overseas country to Uganda to enable him come to Uganda to take up the employment.
 - (iii) Gratuity of 20% of basic salary will be paid at the end of his two years of contract.
 - (iv) A car will be provided for official duties as well as for his personal use. The company will meet all the car running expenses.
 - (v) He will be entitled to free medical treatment for himself and his family under the company's private medical scheme, and the company will also contribute 10% of his basic salary into a provident fund on his behalf.

Required :

Mr Blythe has written to you as his tax consultant for advice on the taxation implications of the above conditions before he accepts the appointment. Briefly advise him on each of the above conditions.

(10 marks)

(Total 40 marks)

SECTION B

Question 2

Corporation tax is charged on the chargeable income of corporate bodies under section 5 of the Income Tax Act 1997. For corporation tax purposes, a company ordinarily includes a Limited Company, but also includes a body of persons corporate, an unincorporate and unit trusts.

With the above background on the taxation of companies in Uganda, write short notes on the following:

- (a) When is a company deemed to be resident in Uganda for corporation tax purposes?
(3 marks)
- (b) What is the basis of taxation of non Ugandan resident companies carrying on a trade in Uganda?
(3 marks)
- (c) Generally expenses incurred by a company are allowable for tax purposes if incurred in the production of income (section 23 of the Income Tax Act 1997). However, there are expenses that are specifically disallowed by the Act. Give five examples of such expenses.
(3 marks)
- (d) Explain briefly how dividends from a Ugandan resident company to another Ugandan resident company are taxed, with reference to the Income Tax Act 1997.
(3 marks)
- (e) The concept of trading, for tax purposes is not defined in the Act. The courts in many decided cases have reviewed, however, in practice what constitutes a trade, and the criteria known as the “**badges of trade**” emerged.

List at least three of the six criteria commonly known as the “badges of trade”

(3 marks)
(Total 15 marks)

Question 3

Najja Limited has been trading for many years with an accounting period ending 30th June.

The following data relates to Najja's capital expenditure and disposals for the year ended 30 June 2001.

Date	Item	Cost. Shs'000
05 July 2000	Bought a Toyota Prado	40,000
12 August 2000	Bought a pickup Hilux	37,000
10 September 2000	Bought office furniture and fittings	8,000
22 December 2000	Bought a new three piece suite for home use	6,000
25 January 2001	Sold three old copiers for Shs 500,000 each	1,500
01 May 2001	Bought a new photocopier	2,500

The tax written down values as at 1 July 2000 for the four classes of assets were as follows:

Class 1	Class 2	Class 3	Class 4
Shs 76 million	Shs 113 million	Shs 12 million	Shs 21 million

Required:

- (a) Compute the capital allowances (wear and tear allowances) claimable by Najja Limited for the year ended 30 June 2001
(5 marks)

 - (b) Capital deductions are available in respect of expenditure on industrial buildings in the form of industrial buildings allowances (IBA'S). Give examples of buildings that may qualify for IBA's and the allowances available.
(5 marks)

 - (c) Explain the difference between capital and revenue expenditure for tax purposes, giving two examples of each.
(5 marks)
- (Total 15 marks)**

Question 4

Epsom Golf Club operates a bar for its members and visitors. Mr. Ziwa is the club and bar Manager, and he is responsible for the day to day business affairs of the club

Susan, Ziwa's wife runs a small catering business in the Club's canteen where she sells food and other quick snacks to the club's members and visitors as well as people from outside. The income from Susan's catering business is kept separate from the club's other income and this income is not declared for tax purposes as Susan considers it to be her private income and therefore not taxable.

Mr. Ziwa has recently received notification from the Uganda Revenue Authority which requires him to notify the Commissioner all about the various activities of the Club to enable them plan for their audit of the Club's various tax heads. He has approached you for advice.

Required:

(a) Explain the potential liabilities that Susan is likely to face, both in terms of:

- (i) Income tax, and
- (ii) Value Added Tax due to her apparent lack of compliance.

(3 marks)

(b) Susan has extracted the following information from her records for the past two years:

Sales

Year ending 30 June 2000	Shs 52,000,000
Year ending 30 June 1999	Shs 45,000,000

Purchases

	<u>Fixed assets</u>	<u>Other standard rated purchases</u>
Year ending 30 June 2000	Shs 7m	Shs 3m
Year ending 30 June 1999	Shs 10m	Shs 2.5m

All of the above figures are net of VAT

Required:

Estimate the VAT payable in respect of the above transactions for each of the years.

(3 marks)

(c) On the basis of the above sales figures:

(i) When is Susan required to have registered for VAT?

(2 marks)

(ii) What are the implications of Susan registering her catering business for VAT?

(2 marks)

(iii) If Susan wished to deregister for VAT at some point in future, what process would she have to go through?

(2 marks)

(d) Susan has approached you for advice about the cash accounting VAT scheme. Briefly explain what cash accounting for VAT means, and mention two advantages and disadvantages of the scheme.

(3 marks)

(Total 15 marks)

SECTION C

Question 5

John Mc Perry is a Scottish businessman who has been trading in Uganda for the last five years. He recently approached you with notices of corporation tax assessments from the Commissioner for the past five years demanding in total Shs 175 million in underpaid taxes.

John is concerned about the income assessed on him, as it is in excess of the income he earned and returned in his company's tax returns filed with the Uganda Revenue Authority.

Required:

- (a) Advise John on his rights to object to the assessments raised by the Commissioner and the way to go about it.
(5 marks)
- (b) Explain to John his alternative courses of action if he is dissatisfied with the Commissioner's objection decision.
(5 marks)
- (c) John has decided to engage your services as his tax consultant to appeal against the Commissioner's objection decision to the Tax Appeals Tribunal. Briefly explain the process you will have to go through in filing your client's appeal to the Tax Appeals Tribunal.

(5 marks)

(Total 15 marks)

Question 6

- (a) Capital gains tax was introduced in Uganda by the Income Tax Act 1997, and applies to non-depreciable business assets disposed of on or after 31 March 1998. As a general principle, a capital gain is computed by deducting from the disposal proceeds the base cost of the asset disposed of together with any allowable costs of disposal.

Required:

Write short notes on each of the following:

- (i) When is a taxpayer said to have disposed of a business asset for capital gains tax purposes?
(3 marks)
- (ii) Give three examples where a disposal of a non-depreciable business asset would give rise to neither a capital gain nor a capital loss.

(3 marks)

- (iii) Briefly explain the transitional provisions relating to determining the cost base of non-depreciable assets acquired before 31 March 1998.

(3 marks)

- (b) Mitcham Property Services Company Ltd is in the business of commercial property letting.

The Company acquired a property in March 1988 for Shs 67 million. Legal charges and the professional fees incurred at the time of acquisition of the property were Shs 8 million. The company built an extension to the property in April 1995 for Shs 14 million. The whole property was sold in March 2000 for Shs 120 million, with incidental costs of disposal of Shs 21 million. The estimated market value of the property as at 31 March 1998 is Shs 98 million.

- (i) Compute the capital gain arising on the disposal of the property.

(4 marks)

- (ii) Assuming the company was unable to estimate the market value of the property as at 31 March 1998, how would the base cost of the property disposed be determined.

(2 marks)

(15 marks)

Question 7

Write short notes explaining the tax treatment of each one of the following transactions:

- (a) Income earned by a non-resident professional entertainer for his performance at a show staged at Nile Hotel in Kampala.

(3 marks)

- (b) A VAT registered sole trader taking stock from his shop for his own private consumption.

(3 marks)

- (c) A company making charitable donations to a listed Non Governmental Organisation for good causes.

(3 marks)

- (d) A company dealing in property development and management constructs a new office block for commercial letting.

(3 marks)

- (e) A company makes a lump sum gratuity payment to a long term serving employee who is retiring after 20 years of serving the company.

(3 marks)

(Total 15 marks)