

# THE PUBLIC ACCOUNTANTS EXAMINATIONS BOARD

*A Committee of the Council of ICPAU*

## CPA(U) EXAMINATIONS

### LEVEL THREE

#### TAXATION – PAPER 13

**TUESDAY, 17 JUNE 2003**

#### 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

Rich Rice Uganda Limited is a Ugandan resident company, which produces rice. The company makes up accounts up to 31 December. In the year ended 31 December 2002, the company's profit was Shs 405,000,000 and it was arrived at after charging and crediting the following items:

<b>Expenditure:</b>	<b>Shs '000'</b>
Patent Rights (gross) <b>(Note 1)</b>	150,000
Foreign exchange loss <b>(Note 2)</b>	25,960
Bad Debts <b>(Note 3)</b>	119,220

<b>Income</b>	
Bank Interest <b>(Note 4)</b>	15,975
Dividend <b>(Note 5)</b>	55,000
Sundry Income <b>(Note 6)</b>	

The turnover for the period ending 31 December 2002 was Shs 1,600,000,000. The following additional information relates to the company's results for the year ended 31 December 2002.

#### Notes:

1. The patent royalties were paid to Basmati Rice Limited in India and the equivalent amounts are as follows:

		<b>Shs '000'</b>
31 March	Paid	28,000
30 June	Paid	42,000
31 December	Payable	80,000

2. The foreign exchange loss was arrived at as follows:

	<b>Shs '000'</b>
Exchange gain on the payment for equipment imported	(2,040)
Exchange loss on translation of the loan balance of \$0.2m at 31 December 2002	28,000
Profit and Loss account	25,960

3. The Bad Debts account is as follows:

	Shs '000'		Shs '000'
Trading Account	3,200	Balance as at 1/1/02	
Loan to employee written off	2,400	Specific	22,000
Balance as at 31/12/02		General	4,800
Specific	34,000	Recovery of Bad debts previously written off	1,680
General	8,100	Profit and Loss Account	19,220
	<u>47,700</u>		<u>47,700</u>

4. Bank interest:  
Shs 15,975,000 net of 15% withholding tax account was credited to the company's bank in Standard Chartered Bank on 20 November 2002.
5. Dividend.  
On 1 June 2002, the company received a dividend of Shs 55,000,000 from a Ugandan resident company, Mabale Packers Limited in which it controls only 10% of the voting rights.
6. Sundry Income:  
The company received sundry income as follows:

	Shs '000'
Gain on sale of old plant	24,800
Hire of tractors	<u>43,000</u>
	<u>67,800</u>

**Required:**

- (a) Calculate the corporation tax payable by Rich Rice Uganda Limited for the year ended 31 December 2002, showing in detail all your workings as well as brief explanatory notes on your tax treatment of the items in notes 1 to 6 above (where applicable).

**(26 marks)**

- (b) Explain briefly Rich Rice Uganda Limited's withholding tax Implications in respect of its payment of the patent rights to Basmati Limited of India.

**(5 Marks)**

- (c) Rich Rice is considering spending the following amounts during the 2003 year of income:
- (i) Shs 160,000,000 in scientific research and expenditure in new Varieties of Basmati Rice suitable for the Uganda climate.
  - (ii) Shs 5,000,000 charitable donation to The Aids Support Organisation (TASO)
  - (iii) Shs 300,000,000 to acquire an additional 15% shares in Mabale Parkers Limited, which will give Rich Rice Uganda Limited 25% control of voting rights in Mabale Parkers Limited.

**Required:**

Briefly comment on the tax implication of all the above three proposed transaction by Rich Rice Uganda Limited.

**(9 marks)**

## **SECTION B**

### **Question 2**

Your client, Stuart Pearce has been trading for six months now and has been registered for VAT since he started trading. He operates a retail shop selling telephone handsets and airtime. He has asked you to review his sales and purchases records with a view to ensuring that all the VAT has been properly accounted for on both his sales and the purchases for the last six months.

During the course of the review, you have made the following observations.

- 1 VAT on sundry income earned on the sale of furniture of Shs 977,000 was not declared in the VAT return of March 2002;
- 2 He incurred VAT of Shs 5,675,000 on purchases of capital goods and Shs 2,700,000- on services prior to registering for VAT
- 3 He claimed VAT of Shs 4,657,2509 on the purchase of the Toyota Corona that he uses for the business.
- 4 He has been claiming the full input VAT (i.e. 100%) on all his business Telephone costs.
- 5 He offset VAT of Shs 700,000 relating to a bad debt of three months ago, against his output VAT in his March 2003 VAT return.

## Required

Briefly explain the correct VAT implications of all the above transactions, and where applicable advise Stuart Pearce on the action he needs to take to correct any wrong VAT treatment there may be in any of the above observations.

### Question 3

Uganda Basket Makers, Kenya Basket Makers and Tanzania Basket Makers are all companies based in Uganda, Kenya and Tanzania respectively owned by the same holding company based in UK. Every two years, the Finance managers in the different countries are required to relocate to the other country other than their own to obtain a regional experience.

Effective July 2002, Mr Kawaida who has been with the Tanzanian Company for the last three years will be relocating to Kampala, in Uganda for a period of 2 years.

During this period, the following payments will be made to him or on his behalf;

- 1 Travel expenses for the moving of his property including household items from Dar es Salaam to Kampala. The total cost is equivalent to \$US 2,000 (US\$1 = Ushs 1,950)
- 2 His wife and 2 children will visit him twice a year. Mr Kawaida will pay for their travelling expenses himself and will be reimbursed by the company. He estimates that this will be Shs 4,500,000 per annum
- 3 His salary of Shs 48 million per annum will be paid to him in Uganda although he has expressed a desire that half of the money should be remitted to his Standard Chartered Bank Account in Dar es Salaam.
- 4 For the first six months of his employment, he will live rent-free in a flat owned by the company. The estimated market rent for these flats is Shs 7,200,000 per annum. The company also pays for the electricity and water to the extent of Shs 3,000,000 per annum. However, he has the option of, the company could pay him Shs 9,000,000 per annum as a housing allowance and rent his own accommodation.
- 5 Mr Kawaida will have the sole use of a Pajero acquired new on 1 January 2003 at a cost of Shs 54,000,000 for the outgoing Finance Manager. While on official business, he will be paid a mileage allowance of Shs 2,000 per kilometre.

**Required:**

(a) Mr Kawaida is not familiar with the Ugandan tax laws and has come to you requesting you for tax advise on the implications on each of the above components of his employment package and in particular the following:

- |       |                               |                |
|-------|-------------------------------|----------------|
| (i)   | Relocation expenses           | <b>2 Marks</b> |
| (ii)  | His family's travel expenses  | <b>2 Marks</b> |
| (iii) | Salary                        | <b>2 Marks</b> |
| (iv)  | Housing expenses              | <b>2 Marks</b> |
| (v)   | Sole use of the company's car | <b>2 Marks</b> |

(b) Assuming Mr Kawaida takes up the position in Uganda commences his employment on 1 July 2003; estimate his gross employment income assessable for the period ended 30 June 2004.

**5 marks**

**Question 4**

Kamengo Limited has been trading in Ntinda Industrial Area, Kampala since 1 January 1998. The total cost of the company's factory building as at 1 January 1998 was Shs 495,000,000 as follows:

Item	Shs '000
Land	200,000
Canteen	40,000
Manufacturing area	100,000
General office	75,000
Store and warehouse	80,000
<b>Total</b>	<b>495,000</b>

The company constructed a new store for raw materials on which construction work commenced in August 2000 and completed in March 2002 at a cost of Shs 78 million. The store was put into use on 1 April 2002.

On 1 January 2002, the tax written down values of the company's depreciable assets was as follows:

	Shs '000
Plant and Machinery	178,000
Furniture and Fittings	45,000
Motor Cars	27,000

On 3 May 2002, a new car, Nissan Terrano was bought for the Managing Director. The car that was used by him previously had cost Shs 45 million in July 2000 and was sold for Shs 25 million in May 2002.

A new precision engineering machine was purchased on 3 August 2002 for Shs 42 million.

**Required:**

Compute the maximum capital allowances and the Industrial Buildings Allowances that the company can claim for the 2002 year of income assuming it has a 31 December accounting date.

**(15 Marks)**

**SECTION C****Question 5**

Upmarket Ultra Limited is a manufacturing company that makes up its accounts up to 30 June.

In May 2002, you were invited to the company's meeting where the following matters were discussed. The company's directors were particularly interested in hearing your advice on the tax implications of the proposed transactions;

- (i) The company is planning to sell off the commercial building on Plot 2 Kampala Road. The value of the property as at 31 March 1998 was Shs 580 million and the market value is currently Shs 890million;
- (ii) The company has incurred Shs 15 million in legal and consultancy fees in an attempt to make this property ready for sale;
- (iii) At Plot 2 Kampala Road, the company was running a division of Graphics that was separate from the manufacturing operation. This division is to be sold as a going concern to Nkrumah Printing Services Limited;

**Required:**

Briefly outline the tax implications of all the above three proposed transactions, and advise Upmarket Ultra Limited on any potential tax planning opportunities in respect to the transactions, if any.

### Question 6

- (a) Outline the three tests used to establish whether a company is resident in Uganda for the tax purposes?  
(3 marks)
- (b) Explain the tax implications of a company being resident in Uganda for tax purposes?  
(3 marks)
- (c) Explain the rules relating to foreign tax credit relief for a Ugandan resident person.  
(3 marks)
- (d) Kiddo Limited is a Uganda is a Uganda resident company. In the year ended 30 June 2002 Kiddo Limited had taxable profits of Shs 5,200,000 and received overseas dividends (net of 35% withholding tax) of Shs 13,000,000.

Compute Kiddo Limited's Corporation tax liability for the year ended 30 June 2002.

(6 marks)

### Question 7

You are required to state the tax implications on the following transactions:

1. Due to contraction of the trade, a works manager who has been with the company for 12 years was made redundant. His redundancy entitlement was Shs 24 million and the total lumpsum paid to him was Shs 85 million (including the Shs 24 million);
2. Shs 15 million was recovered from the insurance company in respect of damage of the fork lift;
3. The company purchased a staff van for Shs 30 million excluding VAT;
4. In order for the company to boost its sales, it has entered into a promotion code named "*Bifuna*". Under this promotion, for every purchase of 100 Units of the product, the buyer was entitled to get 1 unit free,
5. A sole trader in the grocery business carried out an end of year stock take and on realising that most of his stock was damaged and some had expired, he wrote off stock of Shs 18 million in his inventory records.

(15 Marks)