

THE PUBLIC ACCOUNTANTS EXAMINATIONS BOARD

A Committee of the Council of ICPAU

CPA(U) EXAMINATIONS

LEVEL THREE

TAXATION – PAPER 13

TUESDAY, 14 DECEMBER 2004

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. Tax rates are provided on page 10.
6. Please read further instructions on the answer book

SECTION A**Question 1**

Bushenyi Millers Ltd, a Uganda resident company has a 100% owned subsidiary, ZIM Distributors Ltd. ZIM Distributors is resident in the country of Zambia. Bushenyi Millers has its head office in Bushenyi town and processes maize flour and sells about 60% of it in Zambia, through its subsidiary company. All the maize is processed in Uganda.

The financial forecast results of Bushenyi Millers for the year ending 30 June 2005 is Shs 580,000,000 arrived at after crediting and charging the following items of income and expenditure:

Income

	Note	Shs '000
Treasury Bills interest		25,000
Interest income	1	7,650

Expenditure

Cost of sales	2	500,000
Depreciation		250,000
Bad debts provision	3	170,000
Stock provision	4	45,000
Legal fees	5	65,000
Staff costs	6	950,000
Loan interest		120,000

The forecast results for ZIM Distributors Ltd for the year ended 30 June 2005 is as follows:

	Shs '000	Shs '000
Trading/Taxable profits		950,000
Corporation tax (at 35%)		<u>(332,500)</u>
Distributable profits		617,500
Dividend payment		
Net amount	586,625	
Withholding tax at 5%	<u>30,875</u>	
		<u>(617,500)</u>
Retained profit		<u>Nil</u>

Dividend income will be paid before 30 June 2005 and the figures have been translated to the Uganda shilling equivalent.

Notes

1. The company charges interest on outstanding debts of more than 60 days. The projected income is net of 15% withholding tax.
2. 75% of the cost of sales are purchases that have been subjected to VAT at the rate of 17%. The cost of sales are VAT inclusive where applicable.
3. Bad debts provisions account is analyzed as follows:

Bad Debts Provision Account

	Shs '000		Shs '000
Trade bad debts written off	25,000	Balance b/f	75,000
Staff debts written off	15,000		
Balance c/f	<u>205,000</u>	Income Statement	<u>170,000</u>
	<u>245,000</u>		<u>245,000</u>

4. Stock provisions account is analyzed as follows:

Stock Provision Account

	Shs '000		Shs '000
		Balance b/f	12,000
Stock written off	7,500		
Stolen stock	19,000	Income Statement	45,000
Balance c/f	<u>30,500</u>		
	<u>57,000</u>		<u>57,000</u>

5. Legal fees include Shs 2,000,000 on stamp duty on share capital. The balance relates to trade debt recovery.
6. Staff debts include the following:
- | | |
|----------------------------|-----------------|
| | Shs '000 |
| NSSF employee contribution | 45,000 |
| NSSF company contribution | 90,000 |
| Staff accommodation | 24,000 |
| Pension costs | 65,000 |
7. Bushenyi Ltd has a tax loss brought forward from the previous year of Shs 150,000,000.
8. The company has a factory in Bushenyi Town which it built in 1999 at a cost of Shs 750,000,000.

The tax written down values for depreciable assets is as follows:

	Shs '000
Class I	150,000
Class II	75,000
Class IV	120,000

During the year the company decided to sell all its motor vehicles at a cost of Shs 25,000,000. The company purchased a maize milling plant at a cost of Shs 120,000,000.

Required

- (a) Calculate Bushenyi Ltd's corporation tax payable for the year ending 30 June 2005 after taking into account income earned from ZIM Distributors Ltd.

(16 marks)

- (b) Bushenyi Ltd is contemplating to dissolve ZIM Distributors Ltd and replace it with a branch. Assuming that the Zambian government taxes profits earned by branches at 35% and that repatriated profits are not subjected to further tax, advise the company from a tax perspective as to whether or not it should dissolve the subsidiary. Base your arguments on the forecast results of 2005 and support your conclusions with appropriate workings.

Assume that the Zambia tax profits adjusted under Zambia tax law are equivalent to Zambia tax profits adjusted under Uganda tax law.

(11 marks)

- (c) Briefly describe the self-assessment rules that apply to Bushenyi Millers Ltd. In particular mention how Bushenyi Millers will comply with these rules for the year ending 30 June 2005.

(3 marks)

- (d) Bushenyi Millers is not VAT registered. The company has approached you to advise its management on the following:

- (i) Whether it is required by law to register for VAT. Management would in particular like to know whether it should charge VAT on maize floor sold within Uganda and that exported to other countries.

(3 marks)

- (ii) Whether it is beneficial to register for VAT and the financial gains it can achieve based on the 30 June 2005 projected figures.

(5 marks)

- (iii) Whether it should charge VAT on the old equipment it plans to sell during the year.

(2 marks)

Total 40 marks)

SECTION B**Question 2**

Moses Kayana is the Finance Manager of Inform Ltd. His employment terms are as follows:

Annual Basic Salary	Shs 42,000,000
Medical Allowance	Shs 150,000 per month
Mileage Allowance	Shs 300,000 per month

The company rents a house for Moses at a monthly fee of Shs. 850,000.

Moses is entitled to annual leave of 30 working days per year. His employment terms are such that in the month of taking leave, he is paid a leave allowance equivalent to one-month basic salary net of taxes.

During the year to 30 June 2004, Inform Ltd remitted Pay As You Earn (PAYE) of Shs 10,080,000 to Uganda Revenue Authority (URA) in respect of Moses Kayana's employment income.

In March 2004, Moses took his annual leave and during that period he got a Management Consultancy Contract in Kigali, Rwanda, which he completed within 4 weeks. He was paid US Dollars 4,000 net of withholding tax. Withholding tax rate on management fees in Rwanda is 20%. The average exchange rate for the month of March 2003 was Shs 1,900 for 1 US Dollar.

Moses Kayana is also a partner in Kafulu Certified Public Accountants. The other partners in Kafulu are Nancy A and Oded K. The profit sharing ratio of Moses: Nancy: Oded is 3:2:1. For the year ended 30 June 2004, the firm made taxable profits of Shs 48,000,000 before taking into account capital allowances of Shs 60,000,000. The partnership paid salaries of Shs 10,000,000, Shs 3,000,000 and Shs 5,000,000 to Moses, Nancy and Oded respectively which it did not record in its books.

Required

Mr. Kayana has approached you for advise on the following:

- (a) The partnership tax profits/losses attributable to each partner of Kafulu Certified Public Accountants for the year ended 30 June 2004.
- (b) The amount of outstanding tax payable by Moses Kayana for the year ended 30 June 2004, if any.

(6 marks)**(9 marks)****(Total 15 marks)**

Question 3

Kuchi Enterprises commenced business in 2001. The company has not registered for VAT though its records show it should have been VAT registered effective from 1 January 2004. The company's two months results are shown below.

Kuchi Enterprises		
Monthly Income Statement		
	Jan-04	Feb-04
	Shs '000	Shs '000
Sales		
VAT Standard Rated	70,000	120,000
VAT Zero Rated	20,000	24,000
VAT Exempt	-	<u>80,000</u>
	90,000	224,000
Purchases	(47,000)	(50,000)
Opening inventory	(14,000)	(15,000)
Closing inventory	15,000	27,000
Other Expenses		
on standard rated sales	(39,500)	(84,500)
on zero rated sales	(7,000)	(17,300)
on exempt sales	-	(28,000)
on overheads	-	<u>(65,000)</u>
Profit/(losses)	<u>(2,500)</u>	<u>(8,800)</u>

Notes:

1. The purchases figures for January 2004 are made up of 80% standard rated purchases and 20% Zero rated purchases.
2. The purchases figures for February 2004 are made up of 70% standard rated purchases, 10% Zero rated purchases and 20% exempt purchases. All the exempt purchases were sold during the month.
3. The sales figures are VAT inclusive where applicable.
4. Purchases are VAT exclusive where applicable.
5. The company paid VAT on all its other expenses. The figures are however VAT exclusive

Required:

- (a) The director of the company has contacted you to check the months of January and February 2004 and advise whether the company is at all exposed on the VAT side and if yes, to quantify such exposure as at 30 November 2004

(10 marks)

- (b) Basing on your findings in (a) above, advise the company on how it could minimize its VAT exposure, if any.

(5 marks)**(Total 15 marks)**

Question 4

Africa Steels Ltd is a company that deals in the manufacture of steel products. The company is situated in Jinja and on 1 June 2003 it commissioned its new factory for production. The cost incurred to build the factory is analyzed as follows:

Factory costs

	Shs '000
Purchase of the land	250,000
Compensation for squatters	50,000
Municipal Council bribes	20,000
Factory construction cost	750,000
Factory plant and machinery	350,000

The company sold its old factory building during the year 2003 at a price of Shs 550,000,000. The building disposed off was constructed at a cost of Shs 350,000,000 and put to first use on 1 January 1999.

During the year 2003, the company sold off the Managing Director's Mercedes Benz at a cost of Shs. 55,000,000 and replaced it with another ML Benz at a cost of Shs 120,000,000. The disposed car was bought on 30 June 2001 at a cost of Shs 75,000,000

The tax written down values brought forward of the company's depreciable assets as at 1 January 2003 are as follows:

	Shs '000
Class II	150,000
Class III	450,000

Required

Advise the Managing Director on:

- (a) The tax treatment of the above transactions. **(8 marks)**
- (b) Whether the capital gains/losses earned by Africa Steels Ltd during the year ended 31 December 2003 are subject to tax, and if yes, how much and at what rate of tax will the gains/losses be taxable. **(7 marks)**

(Total 15 marks)

SECTION C**Question 5**

In examining the requirement of a good tax system, it is stated that a tax system should be designed so as to meet the requirements of equity in burden distribution, efficiency in resource use, economy in collection, and ease of administration.

Required:

With illustrations, discuss the extent to which the Uganda Graduated Tax System meets the above four requirements.

(15 marks)**Question 6**

You have been approached by the Institute of Certified Public Accountants of Uganda (ICPAU) to give a talk on income tax in Uganda. ICPAU wants you to specifically address the following questions:

- (a) Describe the anti-avoidance provisions contained in the Income Tax Act and discuss how these have been effective in controlling tax evasion.
(6 marks)
- (b) Examine the difference between paying a non resident shareholder dividends as opposed to interest? Discuss, with illustrations, how this difference affects the Uganda tax base.
(5 marks)
- (c) Discuss how the Uganda income tax law has tried to address the tax impact resulting from the way dividends and interest paid to non-resident shareholders is treated for tax purposes.
(4 marks)

(Total 15 marks)**Question 7**

Discuss how the following will be treated for Uganda tax purposes:

- (a) Discuss how rental income equivalent to Shs 25,000,000 earned in 2003 by Mr. Wilson Smith from his rental properties in Norway will be treated for Uganda income tax purposes given that Smith is a citizen of Norway and during that period he was in Uganda on a one year consultancy contract which commenced on 1 January 2003.
(3 marks)
- (b) CBK Insurance Ltd is a company that deals in the provision of insurance services to the general public. During the year to 30 June 2003 the company made profits of Shs 850 million, which it wishes to pay out to its shareholders. The company is wholly owned by Mr. Mugaga an individual resident in Mauritius.

Some consultants recently informed the Finance Manager that it is tax efficient for the company to pay Mr. Mugaga management fees instead of dividends. By doing so the company and Mr. Mugaga will ultimately pay

less tax. In light of this brilliant idea, CBK wishes to pay the Shs 850 million as management fees and they have contacted you to advise them on the tax implication of the proposed transaction.

In Mauritius dividends earned abroad are not taxable, yet management fees are taxed at 20%.

Required:

- (i) Advise CBK Insurance Ltd on the VAT and income tax implication of the proposed transaction.

(9 marks)

- (ii) Advise the management of CBK on how they should proceed with the transaction.

(3 marks)

(Total 15 marks)

TAX RATES

RESIDENT INDIVIDUAL INCOME TAX RATES

Chargeable Income	Tax Rate
Not exceeding Shs. 1,560,000	Nil
Exceeding Shs. 1,560,000 but not exceeding Shs. 2,820,000	10% of the amount by which chargeable income exceeds Shs 1,560,000
Exceeding Shs. 2,820,000 but not exceeding Shs. 4,920,000	Shs. 126,000 plus 20% of the amount by which chargeable income exceeds Shs 2,820,000.
Exceeding Shs 4,920,000	Shs 546,000 plus 30% of the amount by which chargeable income exceeds Shs 4,920,000.

NON-RESIDENT INDIVIDUAL INCOME TAX RATES

Chargeable Income	Tax Rate
Not exceeding Shs. 2,820,000	10%
Exceeding Shs. 2,820,000 but not exceeding Shs. 4,920,000	Shs 282,000 plus 20% of the amount by which chargeable income exceeds Shs 2,820,000
Exceeding Shs 4,920,000	Shs 702,000 plus 30% of the amount by which chargeable income exceeds Shs 4,920,000.

SMALL BUSINESS TAXPAYERS TAX RATE

Gross Turn Over	Tax Payable
Where gross turnover of a taxpayer does not exceed Shs. 5,000,000 a year.	Nil.
Where gross turnover of a taxpayer exceeds Shs. 5,000,000 but does not exceed Shs. 20,000,000 a year.	Shs 100,000.
Where gross turnover of a taxpayer exceeds Shs. 20,000,000 but does not exceed Shs. 30,000,000 a year.	Shs. 250,000 or 1% of gross turnover, whichever is the lower.
Where gross turnover of a taxpayer exceeds Shs. 30,000,000 but does not exceed Shs. 40,000,000 a year.	Shs. 350,000 or 1% of gross turnover, whichever is the lower.
Where gross turnover of a taxpayer exceeds Shs. 40,000,000 but does not exceed Shs. 50,000,000 per annum.	Shs. 450,000 or 1% of gross turnover, whichever is the lower.