

THE PUBLIC ACCOUNTANTS EXAMINATIONS BOARD

A Committee of the Council of ICPAU

CPA(U) EXAMINATIONS

LEVEL THREE

TAXATION – PAPER 13

TUESDAY, 22 JUNE 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. Please read further instructions on the answer book

SECTION A

Question 1

CC Bank Ltd is a Uganda resident Bank that deals in the supply of financial services to the general public.

During the year to 31 December 2003, the bank's financial records revealed the following:

	Note	Shs' 000
Income		
Interest Income		5,500,000
Interest expense		<u>(990,000)</u>
Net interest income		4,510,000
Other income	3	<u>500,000</u>
Operating income		<u>5,010,000</u>
Expenditure		
Staff costs	4	1,800,000
Loan Loss Provision	5	650,000
Depreciation		450,000
Management fees	9	250,000
Administration expenses	8	<u>1,000,000</u>
Total expenses		<u>4,150,000</u>
Profit before tax		<u><u>860,000</u></u>

Notes to the financial statements:

- URA carried out a tax audit of the bank and the finally agreed tax assessment showed that the bank had a tax loss of Shs 280,000,000 as at 31 December 2001 and a taxable profit of Shs 150,000,000 for the year ended 31 December 2002.
- The Bank filed a provisional tax return for the year 2003. The return showed a tax liability of Shs 120,000,000 which was paid before the year end.
- Other income includes rental income of Shs 250 million, from a property located on Kampala Road. The property is used for commercial activities and was acquired by the bank at a cost of Shs 3,500,000,000 on 1 January 1999.
- Staff costs are analyzed as follows:

	Shs' 000
Salaries	1,420,000
Staff canteen costs	55,000
NSSF Employer contribution	142,000
NSSF Employee contribution	71,000
Training	45,000
PAYE interest	<u>67,000</u>
	<u>1,800,000</u>

The Bank staff have their meals at the staff canteen. The nature of meals given to staff depends on each individual's grade and position in the bank.

PAYE interest relates to interest charged to the Bank for late payment of Pay As You Earn (PAYE) to URA.

5. Loan loss provision:

	Shs' 000
Specific Bad Debts Provision	555,000
General Bad Debts Provision	<u>95,000</u>
	<u>650,000</u>

The provisions are in respect of loans advanced to customers and are made in accordance with Bank of Uganda guidelines.

- 6 The tax written Down Values of the bank's depreciable assets as at 31 December 2002 were as follows:

Class	Shs' 000
I	155,000
II	45,000
IV	450,000

7. During the year the bank purchased the following assets :

	Shs '000
Computers	150,000
Computer software	200,000
MD's Vehicle (ML Benz)	120,000
Equipment	75,000

The bank sold a fleet of its used vehicles to a tour company in Kampala at a consideration of Shs 95,000,000. The bank made an accounting profit of Shs 24,000,000, which it booked under other income.

8. Administration expenses include the following:

Item	Shs '000	Remarks
Advertising	22,000	Renting of Billboards
Legal fees	150,000	Includes Shs 30 million for revaluation of bank property
Property, plant and equipment write off	50,000	Relates to property, plant and equipment no longer in use
Entertainment	35,000	Relates to entertaining bank customers
Audit fees	65,000	
Bank license fees	3,000	
Cash losses	120,000	
Expensed assets	25,000	Relates to purchase of furniture items costing between Shs 250,000 and Shs 500,000 written off.
Other allowable expenses	530,000	
Total	1,000,000	

9. Management Fees

The bank contracted Delmer Consultants, a Germany Management Consultancy firm to carry out a management systems audit on its operations. The audit was carried out at the bank's premises.

Required:

- (a) Compute the amount of corporation tax CC Bank Ltd owes to Uganda Revenue Authority for the year ended 31 December 2003. Show where applicable the penal taxes due. **(23 marks)**
 - (b) From the information availed in the question compute the amount of withholding tax the bank was supposed to pay to Uganda Revenue Authority for the year ended 31 December 2003. **(5 marks)**
 - (c) Advise the bank of the VAT status of its transaction and quantify, if any, the potential VAT liability the bank has for the year ended 31 December 2003 given that the bank did not pay VAT during the year. **(5 marks)**
 - (d) The Bank intends to dispose the rental property, mentioned in **note 3** of the question, at a consideration of Shs 1,900,000,000. Advise the Bank on the VAT and corporation tax implication of this transaction, clearly pointing out how it can minimize tax on the transaction. **(7 marks)**
- (Total 40 marks)**

SECTION B**Question 2**

Agbo Advocates is a partnership between Agatha and Bob. Information availed from the firm's records show the following:

- (i) The profit sharing ratio between Agatha and Bob is 3: 2
- (ii) In January 2003 the Partners' monthly salaries were, Agatha – Shs 4,500,000 and Bob - Shs 6,000,000.
- (iii) Interest on capital payable by the partnership to the partners is 20%.
- (iv) Interest on capital due to the partners is based on the opening balance of the individual's capital account.
- (v) Partners adjust their salaries every year and the adjustments take effect on 1 April of the relevant year.

The following has been established from the partnership's return of income and accounts for the year ended 31 December 2003:

- (i) Profits per return and accounts is Shs 90,000,000 after allowing the following:
 - Partner's salaries and interest on capital.
 - Depreciation of non-current assets of Shs 16,000,000.
 - Staff rent of Shs 15,000,000, which includes Bob's rent of Shs 7,500,000.

- (ii) Partners' capital accounts are as follows:

Partner	Balance as at	
	31 December 2003	1 January 2003
	Shs '000	Shs '000
Agatha	13,000	12,500
Bob	12,500	15,000

- (iii) The partners increased their salaries by 20%.
- (iv) Agreed capital deductions for the year is Shs 19,500,000.

Required:

- (a) Compute the partnership's taxable profit for the year ended 31 December 2003. (8 marks)
- (b) Compute taxable profits attributable to each partner (3 marks)
- (c) Compute each partner's tax liability for the year ended 31 December 2003. (4 marks)
- (Total 15 marks)**

Question 3

ABC Microfinance Union is a micro-finance institution dealing in the provision of credit finance to small-scale business enterprises. The Union plans to be transformed into a commercial bank. Upon the advice of Bank of Uganda it engaged a transformation advisor to assist it with the transformation process.

ABC Micro Finance Union recruited Richard White, a South African resident individual, as its Transformation Advisor and under his terms of services he is required to carry out his advisory services in Uganda.

Richard estimates the work to last between four and seven months, and the actual period depends on how he negotiates the terms of the contract with ABC Microfinance Union.

The value of the contract is Shs 350,000,000 and Richard's cost computations show the contract expenses to amount to 65% of the contract value.

South Africa taxes its resident taxpayers on their world wide income and the individual income tax rate is 35%. The tax is based on the individuals' net profit.

Required

- (a) Define the term “Double Taxation”.
(2 marks)
- (b) Illustrate how Double Taxation may arise in the case of Richard White. Clearly support your explanations with appropriate tax computations.
(3 marks)
- (c) How do countries eliminate Double Taxation? Include examples in your answer.
(3 marks)
- (d) Advise Richard White on how he could minimize his Uganda tax liability.
(7 marks)
- (Total 15 marks)**

Question 4

Uganda Millers Ltd is a Uganda resident company situated in Mbarara Municipal Council in Western Uganda. It manufactures maize meal flour. The company's accounting date is 31 December and it proposes to acquire a new milling plant on 1 July 2004. The company can acquire the milling plant through a finance lease or through an operating lease. The plant's cash price is Shs 240,000,000.

Finance Lease Conditions

If the company acquires the plant through a finance lease it will pay a monthly fee of Shs 6,000,000 to the leasing company for a period of 5 years. At the end of the fifth year the ownership of the property reverts to Uganda Millers Ltd at no further consideration. During the leasing period the plant remains in the names of the leasing company.

Operating Lease Conditions

If the company acquires the plant through an operating lease, it pays a monthly rental fee of Shs 4,500,000.

The company expects to have a corporation tax liability of Shs 95,000,000 for the year ended 31 December 2004. This estimate does not take into account the proposed acquisition of the milling plant.

Required:

- (a) Compute the total deductions the company would claim during the year to 31 December 2004 if it acquired the milling plant through:
(i) A finance lease.
(ii) An operating lease.
(11 marks)
- (b) Advise the company on the option it should use to acquire the milling plant. Support your advice with appropriate workings.
(4 marks)
- (Total 15 marks)**

SECTION C**Question 5**

- (a) Explain the term “Withholding tax”.
(3 marks)
 - (b) Describe the operation of withholding tax. Include in your discussion the penal taxes associated with failure to comply with withholding tax provisions.
(5 marks)
 - (c) What role does withholding tax play in tax administration?
(7 marks)
- (Total 15 marks)**

Question 6

- (a) Differentiate an Exempt Organization from a Listed Organization for income tax purposes.
(4 marks)
 - (b) What conditions must an organization satisfy for it to qualify as an Exempt Organization for income tax purposes?
(5 marks)
 - (c) Discuss whether under the income tax laws of Uganda, Non-Government Organizations (NGO) are required to pay tax.
(6 marks)
- (Total 15 marks)**

Question 7

Richard Maidi is negotiating for a financial consultancy contract with a major telecommunication company in Uganda. Richard has been told that he could sign the contract as an employee or as an independent consultant.

In order for Richard to decide on which type of contract to take up he would like you to advise him on the following:

- (a) The difference between an employee and an independent consultant.
(4 marks)
 - (b) The VAT consequences of signing the contract as an employee or as an independent consultant.
(4 marks)
 - (c) The income tax consequences of signing the contract as an employee or as an independent consultant. In your response include the option you suggest he should adopt.
(7 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.