

THE PUBLIC ACCOUNTANTS EXAMINATIONS BOARD

A Committee of the Council of ICPAU

CPA(U) EXAMINATIONS

LEVEL THREE

TAXATION – PAPER 13

TUESDAY, 21 JUNE 2005

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

Lira Cotton Ltd is a resident company in Uganda that purchases and processes cotton for supply to textile industries. The company's head office is in Kampala and has a 30 June accounting date. The company has been in operation for the last seven years and on 1 July 2003, it expanded its operations into Kenya by opening a branch in Nairobi.

Lira Cotton Ltd made profits of Ushs. 1,200,000,000 during the year ended 30 June 2004. Its cotton sales for the year amounted to Ushs 6,500,000,000 of which 60% was from local sales made within Uganda, and 40% from export sales to Kenya. The company envisages the export sales to increase to 60% in the year ending 30 June 2005.

The net profit of Ushs 1,200,000,000 includes a profit before tax of Ushs 550,000,000, after translation, from the Kenya branch. During the year, the company paid a tax equivalent to Ushs 192.5 million (i.e. 35%), to the Kenya government in respect of the profits earned in the country. It was also established that the tax adjusted profit from the branch in Kenya is equal to the branch accounting profits.

The following information relates to the tax year 30 June 2004.

1. The company constructed an office block at Ushs 850,000,000 and occupied it on 1 November 2003. The company also re-valued its freehold land from Ushs 750,000,000 to Ushs 900,000,000 and paid valuation fees of Ushs 28,000,000 for the valuation exercise. The valuation fees and the net increase in value as a result of valuation were both posted to the income statement.
2. The company sold 150,000 of its shares in The New Vision Corporation at Ushs 45,000,000, but excluded the gains/losses of the disposal from its financial statements. Before the sale, the company had 200,000 shares in New Vision, which it had purchased at Ushs 35,000,000, in 2002.
3. The Tax Written Down Values of the company's depreciable assets as at 30 June 2003 were as follows:

	Ushs '000s
Class I	350,000
Class II	95,000
Class III	125,000
Class IV	150,000

4. **Computers:** During the year, 10 of the company's computers with a net book value of Ushs 35,000,000 went obsolete before expiry of the warranty period. The computer supplier replaced the 10 computers with new ones

valued at Ushs 45,000,000 at no extra cost. The net result of this transaction was booked in the company's income statement. The company also installed a computer net work system during the year valued at Ushs 95,000,000.

5. **Motor Vehicles:** A section of the fence collapsed on two vehicles during a rain storm. One of the vehicles (Toyota Corona) which cost Shs 25,000,000 in 1998 and had NIL book value at the time was destroyed completely. It was replaced with a similar one at a cost of Ushs 35,000,000. The second one, a land cruiser, with a net book value of Ushs 12,000,000 was sold off at Ushs 7,500,000. The net result of the transactions was booked in the income statement.

During the year, the company also acquired a heavy commercial vehicle at Ushs 85,000,000.

6. **Furniture & Fittings:** The company replaced its furniture and fittings during the year. It sold the furniture with a book value of Ushs 55,000,000 at a profit of Ushs, 21,000,000. The profit was booked in the company's income statement.

The sold furniture was replaced with new furniture at a cost of Ushs. 105,000,000.

7. Company expenses included the following:

	Ushs '000
Depreciation charge	250,000
NSSF Company & employees Contribution	112,500
Pay As You Earn (PAYE)	217,500
Net Salary	495,000
Pension payment to retired staff	50,000

8. Other income, includes a debt recovery of Ushs 75,000,000 in respect of bad debts written off in the year ended 30 June 2000. Included in this amount are bad debts of Ushs 42,000,000 that were allowed in the 2000 tax computation. The balance was disallowed in the 2001 tax computation.
9. The Company paid provisional tax of Ushs 50,000,000 during the year ended 30 June 2004.
10. On 1 October 2003, the company paid technical assistance fees of Ushs 150,000,000 to Techno Serve Ltd, a Zimbabwe resident company for provision of consultancy advice in respect of designing and installing an agro-based information management system.

Required:

- (a) Advice the company on its corporation tax due to Uganda Revenue Authority (URA), for the year ended 30 June 2004; include penal taxes where applicable. Illustrate your advice with detailed workings.

(25 marks)

- (b) The company got a new Managing Director during the year and he would like you to advise him on the following issues:

- (i) The payments on which to withhold tax and the corresponding withholding tax rates. The company would like you to quantify any identifiable withholding tax liability from the information provided above, since it did not withhold tax during the year.

(5 marks)

- (ii) Whether the company has any VAT liabilities for the year to 30 June 2004, given that it is not VAT registered. In case the company has VAT exposures, The Managing Director would like you to quantify the VAT liabilities and risk the company faces for not settling them.

(3 marks)

- (iii) The strategies the company can use to minimize input VAT on purchases given that the company expects to make sales of Ushs 9,000,000,000 during the next year, and anticipates to pay Input VAT on purchases of Ushs 2,000,000,000.

60% of the sales are expected to be from exports and the balance from local sales. 50% and 30% of Input VAT is expected to be in respect of export and local sales respectively, and the balance of 20% is expected to be in respect of general overheads. The company would like you to illustrate your advice with full workings based on the projected figures.

(7 marks)**(Total 40 marks)**

SECTION B**Question 2**

Kyinyega Rash is resident in Uganda and is employed as a Senior Consultant by BIT Consult, a multinational management consultancy firm with offices around Africa. He is paid a monthly salary of Ushs 7,500,000 before deduction of taxes.

He worked in Ethiopia in the months of August 2003 and September 2003 and during that period he paid tax equivalent to 10% of his monthly salary to the Ethiopian tax authority. He also worked in Botswana in the months of January 2004 and February 2004 but no payroll taxes were paid to the Botswana government.

The company paid travel costs amounting to Ushs 3,500,000 in respect of Kyinyega's travel to Botswana of which 65% of the expenses related to his wife and child who accompanied him during that period. During the year, the company remitted tax of Ushs 2,172,500 on a monthly basis to Uganda Revenue Authority.

Mr. Kyinyega was also a partner in ABC Certified Public Accountants, and was entitled to 45% of the firm's profits. During the year, the firm made a tax adjusted loss of Ushs 70,000,000. At the end of December 2003, he resigned from the firm when his interest in the firm was valued at Ushs 85,000,000 after taking into account the tax loss. His fellow partners bought his interest in the firm at Ushs 105,000,000.

Mr. Kyinyega owned residential properties he constructed at Ushs 150,000,000. He earned a gross rental income of Ushs 25,000,000 during the year and incurred security expenses of Ushs 2,500,000, maintenance costs of Ushs 15,000,000, land rates of Ushs 1,500,000, and legal fees of Ushs 9,500,000. He sold off the properties at the end of December 2003 at Ushs 250,000,000. This is the first time Mr. Kyinyenga has disposed such assets.

Required:

- (a) Advise Mr. Kyinyega on his annual tax liability for the year ended 30 June 2004 and his obligation to file tax returns.

(9 marks)

- (b) Advise the company on:

- (i) The Pay As You Earn (PAYE) treatment of Kyinyega's salaries while on secondment to work in Ethiopia and Botswana, as indicated above.

(4 marks)

- (ii) The PAYE treatment of temporary staff seconded to the company from other countries.

(2 marks)**(Total 15 marks)**

Question 3

Cowboy Consultants Ltd has been in business for the last two years and has been registered for VAT since commencement of business. The company deals in financial advisory services, supply of computers and design of computer software. The company would like you to review its operations for VAT compliancy and explore ways of legally minimizing VAT liabilities. You have been requested to review the month of April 2005 and base your advice on your findings got from that period.

The following observations were made during the review of the company's April 2005 transaction:

- (i) VAT return for the month of April 2005 with a VAT payable of Ushs 23,400,000 was filed to URA on 18 May 2005.
- (ii) The company charges VAT on computer sales and financial advisory services. During the month the company made computer sales worth Ushs 81,900,000 inclusive of VAT; it also invoiced Ushs 150,000,000, VAT exclusive in respect of financial consultancy assignments.
- (iii) The company has a one year management consultancy contract with UTV and charges a monthly fee of Ushs 45,000,000, VAT exclusive. The company is expected to bill the April 2005 fees on 15 May 2005 and it is in the month of May that it will account for output VAT.
- (iv) Included in the billed consultancy work is an assignment worth Ushs 75,000,000, in respect of advisory work provided to a Norway based company in regard to its branch in Uganda. The company did not charge VAT on the amount on the understanding that it is an export of a service since the fees were paid by the Norway head office company.
- (v) The company made a VAT offset of Ushs 4,500,000 relating to an outstanding debt expected to go bad against its output VAT for the month of May 2005. The debt has been outstanding for the last one year.
- (vi) The company purchased equipment of Ushs 76,050,000 VAT inclusive. It was advised not to claim the input VAT but to capitalize it and consider it as a cost of the equipment.
- (vii) In addition to (iv) and (v), the company incurred input VAT of Ushs 9,500,000 on its purchases during the month and claimed the entire amount as Input VAT.

Required

- (a) Advise the company on the VAT implications of your findings and indicate to them what the actual VAT liability should have been.
(12 marks)
- (b) Where applicable advise the company on the corrective actions they may need to take and any tax planning opportunities could explore.
(3 marks)

(Total 15 marks)

Question 4

General Medical Services Ltd is a Uganda resident company that plans to set up a hospital in Mukono town. The company is thinking of two options of setting up the hospital. The first option is for it to buy an existing building and modify it to its specifications, or it may construct one from scratch, under the second option. The company has approached JJ Property Masters which has given them the following details:

Under Option 1, JJ Property Masters has a complete building it proposes to sell to the company at Ushs 750,000,000, VAT exclusive. The building was built and put to use on 1 July 1997 and has been used as a warehouse since then. The company expects modification works on the building to cost Ushs 100,000,000, VAT inclusive. Documents indicate that the building was built at a cost of Ushs 450,000,000 on a piece of land purchased at Ushs 75,000,000. Under this option modification work will be carried out by General Medical Services Ltd.

Under Option 2, the company may purchase a piece of land from JJ Property Masters at Ushs 150,000,000 and construct the hospital at a total cost of Ushs 850,000,000, VAT inclusive. Construction work is expected to be carried out by General Medical Services Ltd.

The hospital has an accounting date of 30 June and expects to make a tax profit before capital allowances, of Ushs 150,000,000 and Ushs 250,000,000 in the years ending 30 June 2005 and 30 June 2006 respectively.

Required:

The company would like you to advise it on the following:

- (a) The VAT implication of the transactions with JJ Property Masters.
(4 marks)
- (b) The tax efficient option it should use to set up the hospital. Base your advice on the financial results of the first two years and illustrate your conclusion with detailed workings.
(11 marks)

(Total 15 marks)

SECTION C**Question 5**

- (a) The Uganda government has proposed to increase the VAT rate from 17% to 18%. Discuss how the increase may impact on the economy. **(8 marks)**
- (b) Mr. Ichuli Kafulu is a small scale business consultant. He performed consultancy work for a number of individuals who paid him cash. He knows that there is no chance for URA to find out his true income, he therefore reports only a third of the income to URA. Discuss whether Mr Ichuli is engaging in tax avoidance or tax evasion. **(2 marks)**
- (c) Mr. Kali owns ABC Ltd. The company made a net tax profit of Shs 75 million before tax which he would like to withdraw from the company, either as a salary bonus or a dividend. The company and Mr Kali are tax resident in Uganda. Advise Mr Kali on the most tax efficient way of doing this. Support your discussion with detailed workings. **(5 marks)**
- (Total 15 marks)**

Question 6

Jo Ray entered into a joint venture with Kibaks to start up a construction company in Uganda called Enkoni Construction Company. The company is tax resident in Uganda. Jo Ray owns 65% of the company's shares and he is non-resident for Uganda tax purposes. Kibaks owns 35% of the company's shares and he is tax resident in Uganda.

The company's total share capital is Ushs 100,000,000 and anticipates to make an estimated annual net profit of Ushs 750,000,000 (after finance costs) if an additional capital of Ushs 450,000,000 is injected into the company's operations. The company could borrow this money from a local bank at an interest rate of 20%, however Ray and Kibaks agreed to provide the needed capital in the ratio of their share holding and lend it to the company at an annual interest charge of 35%.

Required:

- (a) Discuss the term Thin Capitalisation as used in the context of the Income Tax Act, and its rationale in taxation. **(5 marks)**
- (b) Advise the company of the tax implication resulting from the way the operations of the company are being financed. Illustrate your discussions with appropriate workings. **(10 marks)**
- (Total 15 marks)**

Question 7

You have been contracted by the Uganda government as a tax policy expert and recently you were invited by the Think-Tank Association of Uganda to present a talk on the challenges of increasing the Uganda tax base. With illustrations, you are required to present a concept paper discussing the following:

- (a) The impact of low tax revenues on the Uganda business sector. **(5 marks)**
- (b) Ways the Government of Uganda could use to alter its tax system to increase tax revenue. **(10 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.