

# THE PUBLIC ACCOUNTANTS EXAMINATIONS BOARD

*A Committee of the Council of ICPAU*

## CPA(U) EXAMINATIONS

### LEVEL THREE

#### TAXATION – PAPER 13

**TUESDAY, 13 DECEMBER 2005**

#### INSTRUCTIONS TO CANDIDATES

1. Time allowed: **3 hours**.
2. Section **A** has one compulsory carrying 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**

America Resorts Ltd (ARL) deals in hotel services and tourism consultancy. The company was incorporated in the United States of America (USA) and operates in a number of countries including Uganda. It is registered in Uganda as a branch.

ARL has a hotel in Jinja which it has been operating since 1 January 2003. The company's Uganda financial results for the year ended 31 December 2004 were a profit of Ushs 950,000,000, arrived at after crediting and charging the following items of income and expenditure.

**Income**

	<b>Ushs' 000</b>	
Hotel services	2,106,000	
Hotel Accommodation	1,500,000	
Consultancy Fees	<u>85,410</u>	
	<u>3,691,410.</u>	Note 1

**Expenditure**

	<b>Ushs' 000</b>	
Depreciation	650,000	
Management fees	150,000	Note 2
Bad debts provision	120,000	Note 3
Provision for repairs.	65,000	Note 4
Legal fees	25,000	Note 5
Staff costs	980,000	Note 6
Loan interest	150,000	Note 7

**Notes**

1. The company charged VAT of 17% on all the income it earned during the year to 31 December 2004. The income credited in the company's books in respect of Hotel services and consultancy Fees are VAT inclusive, whereas the Hotel accommodation figures are VAT exclusive.

The Uganda branch conducted a tourism consultancy with the Uganda Tourism Board (UTB) and was paid Ushs 272,600,000. The money was omitted from the branch's books because UTB remitted it directly to ARL head office. The amount paid was net of 6% withholding tax; UTB remitted the tax withheld to URA. VAT was not charged on this amount.

The consultancy fee of Ushs 85,410,000 is in respect of consultancy work, the Uganda branch carried out in Rwanda for Hotel Rwanda.

2. The branch paid management fees of Ushs 150,000,000 to the head office for management services rendered to it during the year.

3. Bad debts provisions account is analyzed as follows:

Bad debts provision account			
	Shs million		Shs million
		Balance b/f	150
Trade bad debts written off**	80		
Write off of loans for a related sister company	45	Profit & Loss a/c	120
Balance c/f	<u>145</u>		<u>-</u>
	<u>270</u>		<u>270</u>

\*\*20% of the trade bad debts written off relate to amounts payable by a related company based in Malaysia.

4. Repairs reserve account

	Shs '000		Shs '000
		Balance b/f	45,000
Repair of equipment	15,000		
Write off of equipment	7,500	Profit & Loss a/c	65,000
Balance c/f	<u>87,500</u>		
	<u>110,000</u>		<u>110,000</u>

5. 30% of the legal fees relate to purchase of land in Bujagali, where the company proposes to build Hotel Cottages. The balance relates to trade debt recovery.
6. Staff costs include the following:

	US\$ million
NSSF employee contribution	40
NSSF company contribution	80
Entertainment	12
Staff accommodation	24
Staff meals**	75

\*\* The company operates a staff canteen where its staff get meals. The nature of meals a staff is entitled to depend on his or her grade and experience.

7. 75% of the interest is in respect of a loan advanced to the branch by the head office. The balance of the interest is in respect to an overdraft facility the branch has with its local bankers.
8. The branch has a tax loss brought forward from the previous year of US\$ 350,000,000.
9. The hotel in Jinja was constructed at a cost of US\$ 2,500,000,000 and was first put to use by the company on 1 January 2003. The hotel modified its rooms and other facilities at a cost of US\$ 750,000,000 to upgrade it to a four-star hotel. The construction work was completed on

30 June 2004. The expense was treated as revenue expenditure and booked in the profit and loss account.

10. The tax written down values for depreciable assets at 1 January 2004 were as follows:

	<b>UShs '000</b>
Class I	450,000
Class II	115,000
Class III	250,000
Class IV	350,000

During the year the company sold all its trucks, which constituted the entire Class III items at a loss of UShs 85,000,000. The loss realized was booked in the profit and loss account. The trucks had an accounting book value of UShs 280,000,000.

During the year the company purchased Computers at UShs 150,000,000; cooling plant at UShs 65,000,000 and 3 saloon motor vehicles, each at a cost of UShs 25,000,000.

### **Required**

- (a) Advise ARL on its corporation tax liability for the year ended 31 December 2004 excluding penal taxes. Support your advice with detailed workings.  
**(23 marks)**
- (b) Advise ARL on the additional tax its supposed to pay at the end of the year if, on 25 June 2004 the company paid provisional tax of UShs 95,000,000 to URA and on 15 December 2004 remitted income of UShs 450,000,000 to its head office.  
**(6 marks)**
- (c) Review the financial statements of ARL from the VAT perspective and advice the company accordingly.  
**(5 marks)**
- (d) Advise ARL on the VAT and income tax implications of disposing a section of its hotel structures to Jinja Municipal Council for construction of a highway road at UShs 1,200,000,000. The disposal is planned for December 2005. The land and hotel structure being disposed of had cost UShs 150,000,000 and UShs 850,000,000 respectively. The structure had been in use from 1 January 2003.

**(Show full workings, including the actual tax liabilities resulting from the disposal)**

**(6 marks)**  
**(Total 40 marks)**

**SECTION B****Question 2**

Rose Shye is a Finance Director with AB International Bank. She is a citizen of the Republic of South Africa and has a four year contract with the Bank which is ending on 31 December 2006. Her employment terms are as follows:

Annual Basic Salary	US Dollars 120,000
Medical Insurance Premium	US Dollars 75,000

The company provides her with a company house which it rents at a monthly rate of US\$ 2,500,000. The Bank pays the tax resulting from provision of the house. The Bank pays one-third of her electricity and water bills which on average amount to a monthly charge of US\$ 240,000.

She is entitled to annual leave of 20 working days per year, and a return air ticket worth US \$ 1,500 to her home country. She takes her leave every November of the year. The company provided her with a car two years ago which cost US\$ 75,000,000. The company fuels the car at a monthly cost of US\$ 500,000. She pays the company US\$ 250,000 per month for use of the car.

During the year to 30 June 2005, the Bank remitted Pay As You Earn (PAYE) of US\$ 65,000,000 to Uganda Revenue Authority (URA) in respect of Rose Shye's employment income.

Rose has rental properties in Botswana and her rental records for the year to 30 June 2005 indicate the following:

Gross Rental fees	US \$ 75,000
Ground Rates	US \$ 1,200
Utility costs	US \$ 2,500
Maintenance	US \$ 10,000
Income tax to Botswana tax authorities	US \$ 7,356

The average exchange rate for the year to 30 June 2005 was US\$ 1,800 to 1 US Dollar.

In 2003, Rose purchased 10 acres of land in Namugogo at a cost of US\$ 50,000,000. She cleared and levelled the land; divided the land into 40 plots, with each having a separate land title and connected each plot to water and electricity supply lines. She incurred an extra cost of US\$ 30,000,000 over a period of two years for these improvements. In January 2005, she sold all the plots each at a cost of US\$ 15,000,000.

**Required:**

Advise Ms Rose Shye of her tax liability for the year ended 30 June 2005  
(15 marks)

**Question 3**

Kalangala Freighters is a newly formed company that is planning to provide water transport services in the areas in Uganda covered by Lake Victoria. On the transport vessel, the company operates a restaurant that provides meals and refreshments.

The company's business plan shows the following forecasts for the month of January 2006 and February 2006.

	<b>Jan-06</b>	<b>Feb-06</b>
	<b>UShs '000</b>	<b>UShs '000</b>
<b>Sales</b>		
Transportation of Passengers	65,000	71,500
Restaurant Sales	17,700	19,470
Hire to Tourists from Europe	29,500	32,450
Transportation of goods	<u>18,880</u>	<u>20,768</u>
	131,080	144,188
<b>Purchases</b>		
Repair of shipping vessels	(47,000)	(49,350)
Purchase of Furniture	(35,000)	-
Fuel Costs	(15,000)	(16,500)
Purchase of oil and other lubricants	(2,000)	(3,000)
Motor vehicle purchase	(45,000)	
Telephone costs	(2,500)	(2,750)
<b>Net Cash Flow</b>	<b>(15,420)</b>	<b>72,588</b>

**Notes:**

1. With regard to sales, the company will not charge extra VAT on its fees; therefore on transactions subject to VAT, the income is deemed to be VAT inclusive where applicable.
2. With regard to purchases, the figures are VAT exclusive. It plans to purchase from VAT registered taxpayers; therefore the company will pay VAT on those purchases subject to VAT.
3. Costs in relation to passenger travel and transportation of goods are standard rated supplies which are subject to VAT.

**Required**

The Chief Finance Officer of Kalangala Freighters is in the process of finalizing the business plan of the company and would like you to advise her on the following issues:

- (a) Whether the company will be required to register for VAT and giving reasons for your advice.  
(3 marks)
- (b) Circumstances when input VAT may not be recoverable; illustrate your comments with examples.  
(3 marks)
- (c) Based on the financial figures for January 2006, the VAT method to use to minimize the VAT payable by the company.  
(9 marks)

**(Total 15 marks)**

**Question 4**

MFL is a microfinance company that deals in the provision of loans to low and medium sized businesses. The company is located in Kampala, and has been in operation for the last 8 years. The company is owned by Mr. Mike Su and his wife who are both residents of Malaysia for tax purposes.

Mike and his wife are financial consultants who plan to provide short term technical assistance to the local company. The shareholders are proposing to charge MFL US\$ 150,000,000, before the year end (i.e. 30 June 2006) as technical assistance fees for their advisory services rendered to the company.

The company is also proposing to sell off the MD's motor vehicle (Toyota Prado) at a price of US\$ 35,000,000. The car to be disposed of was purchased on 1 July 2004 at a cost of US\$ 95,000,000. As at 30 June 2004, the tax written down value of MFL's depreciable assets in Class II was US\$ 5,000,000.

The company is not VAT registered and estimates to generate taxable profits of US\$ 450,000,000 for the year ending 30 June 2006, before taking into account the above proposed transactions.

**Required**

Advise MFL on the VAT and income tax implications of the proposed transactions and indicate their impact on the net tax liability of the company.

**(15 marks)****SECTION C****Question 5**

KAP is an India incorporated company that recently got a contract with the Uganda Government to construct rural based schools.

In order to assess the commercial viability of the project, the management of KAP would like you to advise them on the following tax issues.

- (a) Similarities and differences in the way branches of non-resident companies and resident companies are treated for corporation tax purposes. In your discussion they would like you to advise them on the best option to consider.

**(6 marks)**

- (b) Whether interest to non-resident shareholders is tax deductible. They have an option to incorporate a wholly owned subsidiary where they will invest share capital of US\$ 160,000,000 in the Uganda business and advance a loan of US\$ 560,000,000 at an annual interest rate of 35%. The average lending rate in Uganda is 24%.

**(5 marks)**

- (c) What tax incentives will be available to KAP in Uganda?

**(4 marks)****(Total 15 marks)**

**SECTION C****Question 6**

Namugongo Church (NC) is a Christian based church, of a public character, situated in Kampala and has operated in that area for the last 15 years. NC is registered as a Non-Governmental Organisation (NGO).

URA recently carried out a tax audit on the church's activities for the last year and came up with a total tax assessment of US\$ 185,000,000 analysed as follows:

- (a) Corporation tax of US\$ 45,000,000 based on the net surplus of the church's weekly collections from members' offerings and donations during prayer services.
- (b) Pay As You Earn (PAYE) of US\$ 25,000,000 based on weekly payments the leader of the church gets from the church for conducting prayer services.
- (c) Corporation tax of US\$ 50,000,000 from profits earned from sale of spiritual books and income from Christian based concerts and films.
- (d) Rental tax of US\$ 30,000,000 from rental income earned from church properties. Revenue from these properties is used to expand the church premises.
- (e) Corporation tax of US\$ 35,000,000 from profits earned from transport business. The church owns vehicles that it uses to provide transport services to the general public.

**Required:**

The church administration requires you to advise them on the validity of the assessment and how they should proceed with the tax assessment given that the assessment was received in the past seven days and URA would like them to pay the tax assessed within 14 days from the date of receipt of the assessment.

**(15 marks)****Question 7**

- (a) Discuss the significance of accounting standards in determining corporation tax liabilities of companies. In your discussion indicate the view the tax law has on these standards.

**(3 marks)**

- (b) Richard Com is planning to start up a telecommunication company known as Attal Ltd. Discuss the steps Richard should take and the documents required to register the business for Income Tax and Value Added Tax (VAT)

**(4 marks)**

- (c) Discuss the significance of residence as it applies to income tax.

**(3 marks)**

- (d) Explain the "arms-length principle" and its significance in taxation.

**(5 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.