

THE PUBLIC ACCOUNTANTS EXAMINATIONS BOARD

A Committee of the Council of ICPAU

CPA(U) EXAMINATIONS

LEVEL TWO

PRINCIPLES OF TAXATION-PAPER 8

TUESDAY, 21 JUNE 2005

INSTRUCTIONS TO CANDIDATES

1. Time allowed: **3 hours**.
2. Attempt **all** questions in Sections **A** and **B** and **one** question from Section **C**.
3. Section **A** has twenty compulsory multiple-choice questions each carrying 1 mark.
4. Section **B** has three compulsory questions, each carrying 20 marks.
5. Section **C** has two questions and only one question is to be attempted. Each question carries 20 marks.
6. **Tax rates** are provided on page 12.
7. Please read further instructions on the answer book.

SECTION A**Question 1**

- (i) Which of the following transactions is subject to VAT at the standard rate of 17%?
- (a) Import of human drugs.
 - (b) Export of mineral water to Kenya.
 - (c) Sale of fresh commodity products.
 - (d) Sale of mineral water.
- (ii) Which of the following taxes is not covered by the Customs Union between Uganda, Kenya and Tanzania that came into force with effect from January 2005?
- (a) Common External Tariff.
 - (b) Internal tariff.
 - (c) Import duty on sensitive products.
 - (d) Tax on import of services.
- (iii) Companies in Uganda are required to submit their final returns to Uganda Revenue Authority. An extension of the return filing date can be granted by the Commissioner for a maximum of:
- (a) 120 days.
 - (b) 90 days.
 - (c) No maximum time limit.
 - (d) 45 days.
- (iv) Roger and Anne Kato are starting a new business which they have confirmed will be in excess of annual turnover of US\$ 60 million. When should they register for income tax?
- (a) Register as soon as they commence business.
 - (b) Wait until the twelfth month.
 - (c) Ignore URA until when they raise an assessment.
 - (d) Wait to register after the third month of commencement of business.
- (v) Uni Ltd paid a telephone bill of Shs 585,000 (VAT inclusive) for May 2005. What is the input VAT claimable by the company?
- (a) Shs 85,000.
 - (b) Shs 76,500.
 - (c) Shs 99,450.
 - (d) Shs 50,000.

- (vi) Mbarara Ltd has received a PAYE assessment of UShs 450 million as a result of under-deduction of PAYE from its staff. What does the law provide for and how should Mbarara Ltd respond the tax assessment?
- (a) The PAYE assessment is not deemed as tax borne by Mbarara Ltd and should object to the assessment within 45 days of assessment.
 - (b) Mbarara Ltd, as a withholding agent, is not liable for under deduction and should ignore URA assessment.
 - (c) Mbarara Ltd, as Withholding agent, should pay the tax under deducted from its employees.
 - (d) The PAYE assessment is deemed as tax of Mbarara Ltd and should object to the assessment within 30 days of assessment.
- (vii) What are the options available to URA in respect of a taxpayer who fails to submit VAT returns by the due date?
- (a) Estimate tax and a penalty of Shs 400,000 by the due date.
 - (b) Accept late VAT returns after due date but impose a penalty of Shs 200,000.
 - (c) Do not accept VAT returns but seal the company for defaulting.
 - (d) Accept late VAT returns after due date but impose a monthly penalty of the greater of Shs 200,000 and 2% of the VAT payable.

The following information relates to questions (viii) to (x)

M/s Nganzu, Mulira and Mkombe are partners in NMM & Partners Associates which, for the year ended 31 December 2004 had income of USHS 600 million. No income tax returns have been filed and Uganda Revenue Authority (URA) is demanding UShs 50,000,000 as withholding tax the partnership should have withheld on foreign payments in October 2004.

- (viii) By what date should NMM & Partners object to URA assessment if not satisfied with URA assessment?
- (a) 31 January 2005.
 - (b) Not relevant because it is a partnership.
 - (c) 45 days after receipt of the assessment.
 - (d) 31 January 2005.
- (ix) Within how many days should URA respond to NMM & Partners objections?
- (a) 90 days.
 - (b) 60 days.
 - (c) 45 days.
 - (d) 30 days.

- (x) What is the consequence of URA's failure to respond within the specified period?
 - (a) The taxpayer is deemed at fault and forfeits rights under tax law.
 - (b) Taxpayer must Appeal to the High Court of Uganda.
 - (c) NMM & Partners should, by notice to the Commissioner General, elect to treat the Commissioner General as having made a decision to allow the objection.
 - (d) Appeal to the Tax Appeals Tribunal.
- (xi) A VAT registered person is required to file returns to URA offices. What is the last date for filing VAT returns?
 - (a) 45 days after end of the month for which VAT return is due.
 - (b) 15th day of the following month.
 - (c) 90 days following the month for which VAT return is due.
 - (d) 30 days of the month following.
- (xii) What is the action URA can take on a person who refuses to register for VAT when he has exceeded the VAT threshold?
 - (a) Compulsorily register such a person from the time when he should have registered and impose penalty.
 - (b) Sue the person in the High Court.
 - (c) Take the person to the Tax Appeals Tribunal.
 - (d) Impose punitive penalty of the greater of Shs 1,000,000 per month from the period he should have registered or interest of 2% per month compounded computed on the tax due.
- (xiii) Which of the following is not a precondition for a company to be considered as resident in Uganda for income tax purposes?
 - (a) Carrying out business for 122 days.
 - (b) Registered under Ugandan laws.
 - (c) Having management control exercised in Uganda.
 - (d) Undertaking majority of its operations in Uganda.
- (xiv) Which of the following is true about an individual who is a resident for tax purposes?
 - (a) He will be called a Ugandan and possess a Ugandan passport.
 - (b) Be taxed only on income from Ugandan sources.
 - (c) Be eligible to Vote in Ugandan elections.
 - (d) Be taxed on both income from Uganda and other worldwide sourced income.

- (xv) Mr Kintu has a building on Nasser road from which he derives a monthly rental income of US\$ 8,000,000. How much will his annual tax be to URA if he has no other income?
- (a) US\$ 27,870,000.
 - (b) US\$ 28,800,000.
 - (c) US\$ 15,048,000.
 - (d) US\$ 13,800,000.
- (xvi) Alexander Kuma is a new investor in property and real estate in his individual capacity. If he is non-resident for tax purposes, which of the following is true in relation to income derived by Kuma from sources in Uganda?
- (a) Be subject to individual rental tax at 20% of the chargeable income in excess of US\$ 1,560,000.
 - (b) Withhold tax from his rental income to the rate of 30%.
 - (c) Withhold tax at 15% on gross rental income as final tax.
 - (d) No withholding tax but the income is subjected to only VAT.
- (xvii) Nina for the month of May 2005 had commercial gross rent amounting to US\$ 20 million and residential rent of US\$ 10 million. How much output VAT should she pay?
- (a) US\$ 5,100,000.
 - (b) US\$ 2,905,983.
 - (c) US\$ 3,400,000.
 - (d) US\$ 1,700,000
- (xviii) Invesco Uganda Limited purchased land which is located in Mbale. Which of the following is true in respect to Initial allowance and tax depreciation rate of the quarry?
- (a) No initial allowance but depreciation rate of 20%.
 - (b) Initial allowance of 50% and Tax depreciation rate of 20%.
 - (c) Initial allowance of 75% and tax depreciation rate of 20%.
 - (d) Neither Initial allowance nor depreciation allowance.
- (xix) Mwine has for the last 5 years been making losses from his merchandising business. How should he utilise the losses if he is making profits from his rental business?
- (a) He can only offset the losses against future merchandise business profits.
 - (b) He should consolidate both merchandise and rental income for tax purposes.
 - (c) He should not pay tax since he is making losses.
 - (d) He can offset losses from merchandise business against rental income.

- (xx) Kente Enterprises had Vatable income in April 2005 of UShs 70 million and bad debts of UShs 20 million that have been outstanding for last 2 years. A decision has been taken to write them off. What are the VAT implications?
- Claim VAT relief on bad debts of UShs 2.9 million but still pay VAT of UShs 11.9 million.
 - Pay VAT of UShs 17.6 million.
 - Pay VAT of UShs 10.17 million.
 - Pay VAT of UShs 8.5 million.

SECTION B

Question 2

East African Mills Ltd (EAM) has been in operation for six years and its year end has traditionally been 31 December.

EAM for the year ended 31 December 2004 had the following transactions:

		Notes UShs'000
Income		
Export Income		300,000
Sale of Plant & Machinery(VAT inclusive)		650,000
Recoveries from bad debts previously disallowed		250,000
Normal trading income on modified machinery		3,000,000
Realised exchange gain		40,500
Profit on sale of car		45,000
Expenditure		
Assets below UShs 1,000,000		160,000
Assets above UShs 1,000,000		255,000
Bad debts provision	3	206,000
VAT disallowed in course of URA audit		55,000
Stolen moneys by a Casual staff		70,000
Purchase of shares in a subsidiary company	5	80,000
Management fees from Kenya net of 20% withholding tax		20,000
Penalties and fines		24,000
Interest expense	5	112,000
Legal expense incidental on acquisition of land		20,800
Sundry income		6,000
Cost of Extension to existing Factory building		555,000
Insurance premiums	4	19,000
Valuation expenses relating to Plant & Machinery	6	18,000
Trade discounts		17,000
Repairs and Maintenance	7	134,500
Company Contribution to retirement fund		95,000
Other expenses	8	15,000

You have also been given the following notes:

1. The Opening Tax Written Down Values as at 1 January 2004 are as follows:

Class I	Shs 100,000,000
Class II	Shs 120,000,000
Class III	Shs 14,000,000
Class IV	Shs 50,000,000

The factory building was built on land bought in 1980 at US\$ 12 million. 20% of the building is a warehouse while the 80% is a factory building. It cost US\$ 900 million inclusive of land. It was completed in January 1986 after RK Construction had failed to complete it on scheduled time for which they paid a penalty of US\$ 50 million.

2. The business income missed out an income of US\$ 150 million in respect to invoices issued on two days namely 1 January 2004 and 31 December 2004.

Also excluded was dividend income from AB Ltd in respect of which East Africa Mills Ltd holds 50% of the shares. The net dividend after withholding tax was US\$ 100,000,000.

3. The Bad debts provision includes US\$ 50 million relating to staff loans.
4. The Premiums paid included directors personal policies amounting US\$ 5 million. The Company has an insurance cost covering such cash loss arising out of staff negligence. Preliminary investigations have indicated that Jubilee Insurance is going to make good this loss.

The company has a fire policy and in this case the Police reports indicated negligence on part of the company.

5. Interest expense was on the loan the company used to purchase Shares in AB Ltd.
6. The Valuation was in relation to requirements to comply with the bank facility to acquire new land.
7. Repair and maintenance includes Shs 50 million for the purchase of a new model central engine which will enable one of the plants to run for an extra ten years.
8. Other expenses included insurance proceeds of US\$ 150 million which was netted off against non-insured expenses including US\$ 30 million that was misappropriated by one of the directors. Others related to incidental selling expenses of a planned disposal of non-current assets that went bad.

Required:

Determine the withholding tax that is available for offset and compute the corporation tax payable by East Africa Mills Limited for the Year of Income ending 31 December 2004.

(20 marks)

Question 3

Mr. Mujuni works for Dove Air as Resident Manager based in Arua with effect from 1 March 2004.

He was employed by Secure Ltd for the first two months of 2004 where he had a monthly salary of US\$ 5,500,000. He was also entitled to maximum bonus of 20% of the company's profits.

As part of deal to go to Arua, he was given 50-air tickets amounting to 5000km air miles. They had a market value of US\$ 35 million.

He was also given Medical cover for self and family with AAR of US\$ 500,000. He was also given a cash allowance of US\$ 290,000 per month by Dove Air.

He was provided with a company car that cost the company US\$ 50 million on 2 March 2005. Before then, he was earning a monthly mileage allowance of US\$ 1,000,000.

Dove Air has a provident fund where staff contribute 20% of their salaries and the company matches it up. Mr Mujuni decided to join it using his grade base salary of US\$ 6.5 million.

In joining Dove Air, he negotiated for a step-up of salary by 50% on grounds that Arua had high social costs. He also negotiated for a monthly payment to his wife of US\$ 500,000 and 5 return tickets to Arua.

When Mr Mujuni was leaving Secure, where he had worked for over ten years, he was given a terminal benefit of US\$ 70 million in recognition of his past good service. No tax was deducted on the terminal benefits.

In addition, Mr Mujuni had earlier bought some Secure Ltd shares at discounted price of US\$ 5 million instead of US\$ 7 million in January which he sold for US\$ 10 million when he was leaving the company.

Mr Mujuni also has a farm on Gayaza Road where he rears goats and on average he has been earning US\$ 2 million as Farm Director and no PAYE was deducted.

In addition to payments received, he was also given a long service award valued at US\$ 4 million in form of electrical appliances.

He was provided with security guards for his house by both employers at a monthly value of US\$ 1 million, which was paid for by Secure Ltd.

As a concession, Dove Air provided Mr Mujuni's wife with a vehicle valued at US\$ 15 million to enable her take the Children to school at Rainbow International School. They also paid school fees of US\$ 3 million per semester.

Required:

- (a) Compute Mr Mujuni's chargeable income and the tax payable for the year ended 31 December 2004, on the basis that he had no other source of income.
(15 marks)
- (b) How can Mr Mujuni optimise the benefits under the Income Tax Act highlighting areas which he would not be taxed on from his employment?
(5 marks)
- (Total 20 marks)**

Question 4

Entebbe Builders is a company dealing in estate business and is part of a group of companies with headquarters in Netherlands and the monthly reporting is a 5 weeks month.

The company also has returnable site containers which it rents to other site developers at a fee.

The company's transactions for the month of April 2005 are as follows:

	Shs '000	
Sales of housing units	105,500	
Commission fees	20,000	Related sale of undeveloped land.
Sales to Embassies	12,000	Accountant unsure how to treat this transaction.
Sale of old vehicles	33,400	The amounts already paid by the buyers.
Grant income	23,500	DANIDA grant.
Reimburse expenses	11,000	This was actual expenses made by good clients.
Rent and deposit for returnable containers	30,000	30% relates to deposit which will be repaid upon return of the containers.

Entebbe Builders completed some of the units which they rented as residential properties earning the company an income of Shs 2 million in April 2005.

The company bought a 20 acre piece of land which they plan to demarcate. A surveyor has given them a bill of Shs 15 million inclusive of VAT. However, no VAT was charged on land purchase of Shs 100 million and legal expenses of Shs 25 million.

The company purchased cement worth Shs 540 million and appropriate tax invoices were received. Upon scrutiny, it was established that Shs 140 million

related to Director's personal developments in Masaka while Shs 59 million worth products were returned to the supplier and credit note received.

In 2002, a commercial building was sold for Shs 150 million but payment of Shs 50 million has not been paid despite all the demands and legal process has proved fruitless. Management has taken a decision to write it off.

They have a shopping Arcade in Entebbe town whose first two floors contain shopping units on which they have spent Shs 37 million worth of materials for modification while Shs 50 million related to residential flats on floors 3 and 4. All the material costs were VAT inclusive and from VAT registered suppliers.

At the end of March 2005 the company had offset available of Shs 13.3 million. However, upon reconciliation in relation to the year ended 31 March 2005, the Finance Manager has found the offset to be erroneous.

The company also incurred the following expenses:

- (i) Repairs to company's fleet of double cabin pick ups and lorries worth Shs 40 million. It also included Shs 5 million in relation to Station wagon Pajeros for the Site Engineer and Toyota corollas for Site Supervisors.
- (ii) Power bills worth Shs 10 million. Umeme's tax invoices had erroneously missed out the word tax invoice.
- (iii) The company imported Plant and Machinery worth Shs 190 million on which withholding tax of Shs 20 million and VAT of Shs 39 million was paid.
- (iv) Trans Uganda, which cleared the items has billed Shs 30 million as VAT on Motor vehicles imported. Of this, 35% related to passenger cars.

Required:

- (a) Compute the VAT payable/refundable for the month of April 2005 giving brief explanations on contentious and unclear issues.
- (b) What should the company officials do if it is to open branches in Mbarara and Mbale in preparation for compliance with the VAT law?

(15 marks)

(5 marks)

(Total 20 marks)

SECTION C

Question 5

- (a) (i) Distinguish between the criteria for cash accounting and accrual accounting under the VAT Statute.
(ii) Who qualifies under each of the basis for VAT accounting? **(5 marks)**
- (b) Explain how VAT works on consultancy services imported in Uganda differentiating how the tax impacts on a company making only taxable supplies as opposed to that which makes both taxable and exempt sales. **(5 marks)**
- (c) What is a Double Taxation Agreement? Why is Uganda keen on having Double Taxation Agreements with her trading partners? **(5 marks)**
- (d) On which income are resident individuals taxed and what is the treatment of tax paid on income derived from other countries? **(5 marks)**
- (Total 20 marks)**

Question 6

- (a) Explain why Customs Union is likely to Create tax Challenges in the East African Countries. Do you believe that the East African Population will benefit from the union? Support your answer. **(8 marks)**
- (b) What benefits are available to investors under the Income Tax Act 1997 as amended? Which areas do you see as opportunity for improvement under Income Tax Act in regard to taxation of large enterprises? **(7 marks)**
- (c) What is Presumptive tax? What are the advantages and disadvantages of this tax system? **(5 marks)**
- (Total 20 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.