

THE PUBLIC ACCOUNTANTS EXAMINATIONS BOARD

A Committee of the Council of ICPAU

CPA(U) EXAMINATIONS

LEVEL THREE

TAXATION – PAPER 13

WEDNESDAY, 12 DECEMBER 2007

INSTRUCTIONS TO CANDIDATES:

1. Time allowed: **3 hours**.
2. Section **A** has one compulsory question 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 12.
6. Please read further instructions on the answer book.

SECTION A

Question 1

Foresta (Uganda) Limited

- (a) Foresta (Uganda) Limited ("FUL") is a company incorporated in Uganda dealing in timber and related products. Mr. and Mrs. Musizi, the founders of FUL, started the company in 1995 with Mr. Musizi owning 70% of the shares and the balance owned by his wife. The company, whose offices are located in Mbale town, had a steady growth under the stewardship of Mr. Musana, the managing director who was appointed in 1995. FUL was registered for VAT with effect from 1 July 1999.

FUL's management has appointed your firm as tax advisors and has availed you with the following information in order to provide them with the relevant tax advice:

The income statement of FUL for the year ended 30 April 2007 and comparative figures for the year ended 30 April 2006 are as follows:

Detailed Income Statement		2007	2006
	Note	Shs	Shs
Turnover	1	89,800,000	83,129,464
Cost of sales	2	(32,174,000)	(47,666,401)
Gross profit		57,626,000	35,463,063
Other income	3	6,500,000	-
Sales and marketing expenses		(19,320,000)	(755,213)
Administration expenses (see below)		(92,374,000)	(65,845,970)
Operating profit/(loss)		(47,568,000)	(31,138,120)
Finance costs	4	(23,500,000)	(2,796,479)
Profit/(loss) before taxation		(71,068,000)	(33,934,599)
Taxation at 30%		-	-
Profit/(loss) for the year		<u>(71,068,000)</u>	<u>(33,934,599)</u>
Administrative Expenses			
Staff costs		35,000,000	10,656,826
Motor Vehicle running and maintenance		4,011,000	7,426,590
Utilities & telephone		1,150,000	1,276,394
Clearing and forwarding		1,611,000	1,789,481
Bank charges and others		272,000	302,063
Machine repair and maintenance		1,360,000	151,923
Depreciation	5	21,500,000	25,515,750
Insurance & security		1,130,000	1,250,719
Rent & rates	6	5,600,000	1,148,402
Provision for bad debts		3,430,000	4,775,788

Travel and transport		1,010,000	1,123,284
Professionals fees	7	4,000,000	1,518,750
Management fees		8,300,000	8,910,000
Donations	8	<u>4,000,000</u>	<u>-</u>
		<u>92,374,000</u>	<u>65,845,970</u>

The notes to the accounts are as follows:

1. Included in turnover is an amount of Shs 3,933,330 relating to an invoice to Uganda Wildlife Authority (UWA) dated 12 February 2007 that was VAT inclusive. UWA purchased office furniture during the year and deducted 6% withholding tax on this transaction. The income from UWA was recorded gross in the books.
2. The cost of sales figure includes closing inventory which was stated at 95%. The justification for this by management was to make provision for any mis-recording in the inventories. Closing inventory was stated at a cost of Shs 12.54 million.
3. Other income consist of the following:

Nature of income	Amount (Shs)
Profit on disposal of equipment [Note 9 (ii)]	1,770,000
Recovery of trade debts written off in the year ended 30 April 2006	2,500,000
Reversal of bad debt allowed in tax computation of 30 April 2006	1,180,000
Receipt in respect of bad debt disallowed in tax computation of 30 April 2006	<u>1,050,000</u>
Total	<u>6,500,000</u>

4. Included in finance cost is interest paid of Shs 10 million (gross) for money borrowed from Daminex (U) Limited (DUL). The balance was an exchange loss of which 80% was realized.
5. Included in depreciation is Shs 2.2 million relating to leasehold premises. The policy of the company is to depreciate leasehold assets over their useful life.
6. Rent and rates included payment of Shs 2 million for the company's shareholders' residence. Management did not tax this benefit on the shareholders.
7. Professional fees include audit fees (Shs 2.5 million), tax consultancy fees (Shs 1 million) and legal fees of Shs 500,000. 60% of the legal fees was paid in respect of formation of one of the branches of FUL.

8. The amount spent on donations during the year is analysed as follows:

Recipient	Amount Shs '000
Church of Uganda - to build church house	2,000
Registered political parties in Uganda	750
Federation of Uganda Football Associations (FUFA)	1,000
New social club	<u>250</u>
Total	<u>4,000</u>

9. During the year, the following were additions and disposals to the non-current assets:

Asset	Additions Cost Shs '000	Disposal Cost Shs '000	WDV as at 1 May 2006 Shs '000
Computers	4,000	-	3,600
Furniture and equipment	4,000	3,000	2,460
Motor vehicles	40,000	-	15,300
Plant and machinery	<u>10,000</u>	<u>-</u>	<u>2,130</u>
Total	<u>58,000</u>	<u>3,000</u>	<u>23,490</u>

Note:

- (i) Motor vehicle additions include a BMW motor car which cost Shs 35 million, the balance was for a Toyota Dyna truck.
 - (ii) The profit on disposal of equipment relate to a machine which cost Shs 3 million four years ago, with accumulated depreciation of Shs 2.62 million and proceeds on disposal of Shs 2.15 million.
 - (iii) Additions to furniture and equipment include Shs 1,500,000 for furniture, the rest being machinery which is used in furniture production.
10. The company paid a provisional tax of Shs 500,000 for the year ended 30 April 2007.
11. The agreed adjusted loss for the year ended 30 April 2006 with URA was Shs 1.25 million.
12. Assume that the self assessment return will be filed on 31 December 2007.

Required:

Compute chargeable income and tax payable by FUL for the year ended 30 April 2007, providing explanation for any adjustments and indicating the due date for filing the self assessment return, and resulting penalties if any.

(29 marks)

- (b) FUL started performing poorly in the year 2006 and due to declining performance and lack of working capital, the shareholders decided to look for an investor to inject in more capital. Consequently, on 1 June 2007, Congo Limited ("CL") a company registered in the Democratic Republic of Congo ("DRC") acquired 52% of the share capital of FUL. The original share capital of FUL was Shs 10 million with par value of shares at Shs 100.

In order to restructure the company, the new board of directors of FUL convened a board meeting on 1 June 2007 and made a number of resolutions as indicated below:

- (i) To terminate the services of the Managing Director with effect from 1 July 2007. His terminal benefits of Shs 25 million were fully paid in July 2007. No tax was deducted based on an argument that it was compensation for loss of office and therefore not an employment income.

In order to bridge the gap of the Managing Director (MD), on 1 July 2007 FUL signed a management contract with Managex Limited ("ML"), a company registered in the Republic of Nigeria which specializes in turning around companies. The terms of the contract were to charge 10% of FUL's previous year's turnover as management fees. There is no double taxation agreement between Uganda and Nigeria.

- (ii) To appoint Mr. Muvule, a son to Mr. and Mrs. Musizi who is a marketing professional, as the head of the marketing department of FUL effective 1 July 2007. The board agreed to pay him a gross salary of Shs 2 million per month, and he was also allocated a company car to be used for both business and private purposes throughout the year. He was not expected to make any contribution in respect of this car. The car had been purchased 2 years ago at Shs 30 million and by the time it was allocated to him, its market value was Shs 18 million. FUL has been deducting PAYE from only his gross salary of Shs 2 million per month.

Required:

Draft a letter to the management of FUL advising them on the tax implications of each of the board resolutions (i) and (ii) above.

(11 marks)**(Total 40 marks)****SECTION B****Question 2**

Mr. Kadodi is employed by Chorgam Consultants Limited ("CCL"), a company dealing in real estates. He is employed as Manager for Finance & Administration. The accounting period for the company is 30 June. Mr. Kadodi owns 30% of the shares in MAPPEX (U) Limited, a resident company dealing in electronics. He also has a fixed deposit account with Barclays Bank (U) Limited.

In January 2007, he was sent by CCL to Tanzania for a period of five months to carry out a special assignment. His monthly gross salary is UShs 5 million. During the year, PAYE of UShs 17,970,000 was remitted by CCL to URA in respect of Mr. Kadodi.

The short period Mr. Kadodi spent in Tanzania, he bought a commercial property in Arusha, Tanzania which earned him rental income. Mr. Kadodi also purchased a residential house in Ntinda, Kampala from which he also earned rental income.

Mr. Kadodi availed to you his financial records from which you ascertained the following:

	Property in Uganda	Property in Tanzania
	UShs'000	TShs'000
	12 months	6 months
Rental income received	<u>40,000</u>	<u>10,500</u>
Rental expenses:		
Water & electricity	(3,500)	(950)
Security & council rates	(5,500)	(1,350)
Repairs and maintenance	<u>(15,000)</u>	<u>(3,200)</u>
Total expenses	<u>(24,000)</u>	<u>(5,500)</u>
Net income	<u>16,000</u>	<u>5,000</u>

The exchange rate of Ushs to Tshs is 3:1

On 30 June 2007 Mr. Kadodi received dividends of TShs 1.8 million (net of withholding tax) from a Tanzanian company, which deals in real estate property and operates in Tanzania. He bought shares in this company in January, 2007 while he was in Tanzania. The withholding tax rate on dividends in Tanzania is 10%.

Mr. Kadodi owns a garage in Nateete, a suburb in Rubaga Division. During the year he paid a provisional tax of US\$ 2 million in respect of the garage business. The profit before tax made by the garage for the year ended 30 June 2007 was US\$ 7,200,000.

During the year ended 30 June 2007, Mr. Kadodi also received interest of US\$ 680,000 net of withholding tax from Barclays Bank (U) Limited. As his fortunes indicated, MAPPEX (U) Limited declared dividends and Mr. Kadodi received a dividend of US\$ 4.5 million net of withholding tax.

Due to frequent load-shedding, the company fueled Mr. Kadodi's home generator on a monthly basis. The generator's monthly fuel expense to Mr. Kadodi was US\$ 380,000. The generator was fueled for the whole year.

Way back on 1 July 2006, CCL advanced an interest free loan of US\$ 500,000 to Mr. Kadodi re-payable in one year's time. Again on 5 July 2006, CCL advanced another interest free loan to Mr. Kadodi of US\$ 7 million on similar terms as the first one.

Note: The statutory rate as at 1 July 2006 was 7.04%.

Required:

Compute the total tax payable by Mr. Kadodi for the year ended 30 June 2007, indicating the outstanding tax if any.

(15 marks)

Question 3

KARL Uganda Limited ("KARL") is a leading wholesale company dealing in motor vehicles. The company won the deal to supply CHOGM vehicles and in a bid to get the required capital the board of directors which sat in March 2007 decided to sell some of their properties. The Chairman of the board would like to be advised on the tax implications of the sale decisions for the properties detailed below:

Kamuli Plaza:

Kamuli Plaza is a commercial building with shops in Iganga town that was acquired by KARL in April 1998 at a cost of Shs 100 million. The building was sold at Shs 300 million. The net book value of the building at the time of disposal was Shs 50 million. The profit on disposal that was recognised in the financial statements of KARL on this transaction is Shs 250 million.

Kakeka Plaza:

Is a commercial building in Jinja that was constructed at Shs 200 million and put to use by KARL in January 2001. The net book value at the point disposal sale was Shs 130 million. The proceeds from the sale were Shs 500 million, leading to

a profit recognised in the books of Shs 370 million. Kakeka Plaza was the only building owned by KARL that was constructed after July 2000. The tax WDV as at 1 January 2007 was Shs 140 million.

Required:

Draft a report in which you detail the tax implications of the sale of each of the commercial properties mentioned above.

(15 marks)

Question 4

MN Enterprises Ltd was started by Mr. Mukene and his girlfriend Ms. Nsonzi in January 2005 after their BSC (Computer Science), third year examinations. A year later, the business which is located in Kikuubo in Kampala central business area was registered for VAT. Their major line of business is that of selling computers and related products. The second year of business was very successful leading to a profit of Shs 100 million. In January 2007 they decided to diversify their business and started providing Information Technology (IT) consultancy.

Their accountant, a brother to Ms Nsonzi was very inexperienced and lacked basic knowledge of taxation in general and VAT in particular. Mr. Mukene is not satisfied with the work done by the accountant. He has approached you to carry out a review of VAT return for November 2007 before the accountant files it with Uganda Revenue Authority.

In your review of the November 2007 records, the following were observed:

- (i) VAT that had been claimed on telephone bills is as follows: MN Enterprises Ltd's offices in Kikuubo Shs 14,400 and Shs 21,600 for the telephone line in the shareholders' Muyenga home. The VAT claimed in the return was the actual amount billed for the month of November 2007 as indicated on the telephone invoices.
- (ii) Input VAT of Shs 216,000 was claimed in respect of maintenance and repairs of a Mark II motor car for Mr. Mukene, and Shs 75,000 was claimed in respect of the company's pick-up truck.
- (iii) Other input VAT correctly claimed amounted to Shs 6,520,000.
- (iv) The company invoiced a customer for a computer and its accessories for Shs 2,295,000. This invoice was raised VAT inclusive.
- (v) The branch in Uganda of an international NGO hired MN Enterprises Ltd to provide consultancy services as regards its IT systems at an agreed fee of Shs 5 million (exclusive of VAT). The accountant sent the invoice to the NGO's headquarters in Washington for payment which they settled. No VAT was charged.

- (vi) The company had a management contract with Uganda Revenue Authority (URA) where Shs 15 million was the agreed monthly fee (VAT exclusive). The company billed URA on 15 November 2007 but did not account for the VAT in the November return since by 30 November 2007 it had not received payment.
- (vii) The accountant did not charge VAT on a rental invoice of Shs 12 million in relation to a commercial building owned by MN Enterprises. The accountant treated such a supply as zero rated.
- (viii) Other invoices seen had output VAT of Shs 6,500,000 which was verified and found correct.

Required:

Advise Mr. Mukene on the correct VAT payable for the month of November 2007 giving reasons for your suggestions.

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

Comutex Pty is a conglomerate company registered in the Republic of South Africa (RSA) dealing in a number of unrelated businesses. One of its leading businesses is in the transport industry. The company has been in the business for a decade and operates in a number of countries in Africa and Latin America.

Mr. John Smith, the Managing Director of Comutex Pty has a number of personal businesses in Uganda. He is currently in the country on a business trip. He has been reliably informed that your firm of certified public accountants has a reputation of providing tax advice to a wide range of clients. He has approached you for tax advice on following issues:

- (i) Comutex Pty from South Africa owns 100% shares in Comutex (Uganda) Limited ("CUL") a company incorporated in 2001 to deal in transport. During the year ending 31 December 2007, the company anticipates to make a taxable profit of Shs 120 million. He would like to be advised on the most tax efficient way of repatriating his profit to RSA. His lawyer has already provided legal advice and now requires tax advice on the following options:

Option 1: To repatriate the profits as dividends.

Option 2: To repatriate income through management fees.

Required:

Advise Mr. Smith on the best option to take.

(10 marks)

- (ii) Mr. Smith through his company CUL wishes to buy part of the business of Nyange Limited. He has an option to either buy it as a going concern or to purchase just a few individual assets.

Required:

Advise Mr. Smith on the tax implications of buying a business either as a going concern or otherwise.

(5 marks)

(Total 15 marks)

Question 6

ICE (U) Limited ("IUL"), a company dealing in general merchandise has been using 30 June as their year end. However, in order to have the accounting period match with that of their parent company, they decided to change the accounting date to 31 December with effect from 1 July 2006. The managing director would like to know whether the change is allowed under Uganda's tax law.

Mr. Charles Kutesi, the Managing Director of IUL, while having dinner at Hotel Equatorial overheard one of the senior government tax officials telling a group of people on the next table that a number of taxpayers, especially individuals are not disclosing their worldwide incomes to Uganda Revenue Authority. Charles was not sure what the tax official meant by his statement and its tax implications.

ICE Limited ("ICE") which owns 75% shares in IUL is a company registered in Iceland, the balance of 25% shares in IUL are owned by Ugandan residents. Mr Kutesi received an email from the Managing Director of the parent company in Iceland requesting for advice on Uganda's thin capitalization policy. Mr. Kutesi is unsure of the term and requires your advice as a tax consultant on this matter.

According to the information available as at 1 July 2006, ICE advanced IUL a loan of Shs 300 million. The share capital of IUL is Shs 30 million. IUL had an accumulated profit of Shs 30 million and share premium of Shs 20 million. Interest debited in the income statement for the year ended 30 June 2006 was Shs 60 million.

Required:

Advise Mr. Kutesi on the tax interpretation and implications in regard to the issues raised above.

(15 marks)

Question 7

The organizers of a Small and Medium Enterprises (SME) workshop had invited a tax consultant to clarify on some tax issues, but no body turned up. They have been informed that your firm's offices are located near the Hotel where the workshop is taking place. When the chief organizer called your partner for assistance, he instead sent you to the workshop to clarify a few tax issues that may arise.

On your arrival at the workshop, you are informed that all the members attending the workshop lack tax knowledge and that they considered these assertions as valid statements. You are also given a copy of the assertions listed below, which you need to clarify, and correct any misrepresentation of tax law where necessary.

Required:

Prepare a brief on each of the assertions presented below:

- (i) Estimated and other income tax assessments after tax audits issued by Uganda Revenue Authority are final and must be paid by the taxpayer.
(5 marks)
- (ii) There is no difference between taxation of an employee from that of an independent consultant.
(5 marks)
- (iii) Presumptive tax is payable every month by small taxpayers at a rate determined by a URA officer who visits the taxpayer.
(5 marks)

(Total 15 marks)

TAX RATES**Resident Individual Income Tax Rates**

Annual chargeable Income	Rate of Tax
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

Annual chargeable Income	Rate of Tax
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 Rates

Gross Turnover	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 a year.	Shs 450,000 or 1% of gross turnover, whichever is the lower.