

THE PUBLIC ACCOUNTANTS EXAMINATIONS BOARD

A Committee of Council of ICPAU

CPA (U) EXAMINATIONS

LEVEL THREE

TAXATION - PAPER 13

Date

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

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 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

	Note	2007 Shs	2006 Shs
Turnover	1	89,800,000	83,129,464
Cost of sales	2	<u>(32,174,000)</u>	<u>(47,666,401)</u>
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)		<u>(92,374,000)</u>	<u>(65,845,970)</u>
Operating profit/(loss)		(47,568,000)	(31,138,120)
Finance costs	4	<u>(23,500,000)</u>	<u>(2,796,479)</u>
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	5	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	6	21,500,000	25,515,750
Insurance & security		1,130,000	1,250,719
Rent & Rates	7	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	8	4,000,000	1,518,750
Management fees		8,300,000	8,910,000
Donation	9	4,000,000	-
		<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 stock which was stated at 95%. The justification for this by management was to make provision for any mis-recording in the stocks. Closing stock 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 10 ii)	1,770,000
Recoveries of trade debts written off in the year ended 30.4.06	2,500,000
Reversal of bad debt allowed in tax computation of 30 April 06	1,180,000
Receipt in respect of bad debt disallowed in tax computation of 30 April 06	1,050,000
Total	6,500,000

4. Included in finance cost is an interest paid of Shs 10 million (gross) for the money borrowed from Daminex (U) Limited (DUL). The balance was exchange loss of which 80% of the loss 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 Ushs. 2,000,000 for the company shareholders' residence. Management did not tax this benefit on the shareholders.
7. Professional fees include audit fees (Shs 2.5 million), tax consultancy (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 as follows:

Name of the organization who received the donations	Amount (Shs)
Church of Uganda - to build church house	2,000,000
To registered political parties in Uganda	750,000
FUFA	1,000,000
New social club	250,000
Total	4,000,000

9. During the year, the following were additions and disposals to the fixed assets:

Nature of addition	Additions Cost Shs	Disposal Cost Shs	WDV as at 1. 5. 2006 (Shs)
Computers	4,000,000	-	3,600,000
Furniture and equipment	4,000,000	3,000,000	2,460,000
Motor vehicles	40,000,000	-	15,300,000
Plant and machinery	10,000,000	-	2,130,000
Total	58,000,000	3,000,000	23,490,000

Note:

- (i) Motor vehicle additions include a BMW which cost Shs. 35 million, the balance was for a Toyota Dyna.
 - (ii) The disposal on equipment relate to a machine which cost Shs 3million four years ago, with accumulated depreciation of Shs. 2.62million and proceeds on disposal of Shs. 2.15 million.
 - (iii) Included in the additions of furniture and equipment is Shs 1,500,000 relating to furniture and the rest of the equipment is machinery 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 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:

- (a) 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. **(25 Marks)**

Question 1(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) The board of directors decided 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 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. **(6 marks)**

- (ii) It was agreed that effective 1 July 2007, Mr Musizi transfers 40% of his shares and Mrs Musizi 12% of her shares to the new investor (CL). The market value of shares at 1 July 2007 was Shs 500 per share while the par value of the shares was Shs 100. **(2 marks)**

- (iii) In order to bail the company out of an intending receivership pursued by one of the major creditors, FUL borrowed Shs. 50 million from Daminex (U) Limited (DUL) a company in which FUL controls 45%. FUL paid Shs. 10 million as interest to DUL. No withholding tax was deducted on this transaction. **(4 marks)**

- (iv) On 1 July 2007 the board also appointed Mr. Muvule, a son to Mr. and Mrs. Musizi who is a marketing professional, as the head of the marketing department of FUL. 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 he was given 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. **(3marks)**

Required:

Draft a letter to the management of FUL advising them of the tax implications of each of the board resolutions (i) – (iv) indicated above.

SECTION B

Question 2

Mr. Kadodi is employed by Chorgam Consultants Limited ("CCL") a company dealing in real estates. He is employed as a 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 US\$ 5 million. During the year, PAYE of Shs 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 US\$'000 12 months	Property in Tanzania TShs'000 6 months
Rental income received	40,000	10,500
Rental expenses:		
Water & electricity	(3,500)	(950)
Security & council rates	(5,500)	(1,350)
Repairs and maintenance	(15,000)	(3,200)
Total expenses	(24,000)	(5,500)
Net income	16,000	5,000

The exchange rate of US\$ 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, 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\$ 4,500,000 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 Ushs. 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 UShs. 7,000,000 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.

(Total 15 marks)

Question 3

KARL Uganda Limited ("KARL") is a leading whole sale company dealing in cars. 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 Ushs. 100,000,000. The building was sold at Ushs. 300,000,000. The net book value of the building at the time of its sale was Ushs. 50,000,000. The profit on disposal that was recognised in the financial statements of KARL on this transaction is Ushs. 250,000,000.

Kakeka Plaza:

Is a commercial building in Jinja that was constructed at Ushs. 200,000,000 and put to use by KARL in January 2001. The net book value at the point of its sale was Ushs. 130,000,000. The proceeds on sale were Ushs. 500,000,000, leading to a profit recognised in the books of account of Ushs. 370,000,000. Kakeka Plaza was the only building owned by KARL that was constructed after July 2000. The tax WDV as at 1 January 2007 was Ushs 140,000,000.

Required:

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

Question 4

MN Enterprises was started by Mr. Mukene and his girl friend Ms. Nsonzi in January 2005 after their senior six exams. 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 Ushs. 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 to Uganda Revenue Authority.

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

- (i) VAT on electricity bills that has been claimed during the month in respect of the MN Enterprise offices was charged based on the total amount outstanding of Shs.147,500. The actual amount billed for the month was only Shs 90,000.

You also noted that there was a bill relating to the Muyenga residence for the partners on which input tax of Shs. 18,000 has been claimed.

- (ii) VAT that had been claimed on telephone bills is as follows: MN Enterprises offices in Kikuubo Shs 14,400 and Shs 21,600 for the telephone line in the partners 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.
- (iii) There was VAT of Shs 72,000 in respect of rent paid to the land lord for the month of November 2007. However, there was a sub-tenant who occupied 20% of the space. This sub-tenant closed business in September 2007.
- (iv) During the month, a RAV 4 was purchased for Ms Nsonzi at a cost of Shs 15 million. The VAT claimed in respect of this car was Shs 3 million.
- (v) In put VAT of Ushs. 216,000 was claimed in respect of maintenance and repairs of a Mark II car for Mr Mukene, and Ushs. 75,000 was claimed in respect of the partnership pick up.
- (vi) Other input VAT correctly claimed amounted to Shs 6,520,000.
- (vii) The company invoiced a customer for a computer and its accessories for Shs 2,295,000. This invoice was raised VAT inclusive.
- (viii) The branch in Uganda of an international NGO Uganda hired MN Enterprises 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 headquarters in Washington for payment which they settled. No VAT was charged.
- (ix) 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.

- (x) VAT of Shs 1,250,000 relating to a debtor who had not paid for one and half years was written off in the November 2007 VAT return.
- (xi) 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.
- (xii) 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 and suggest any corrective measures and ways to minimize exposure (if any). **(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 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. Smith John, 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 for 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 ended 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 a legal advice and now requires a tax advice on these two options:

Option one: To repatriates the profits as dividends.

Option two: To repatriate income through management fees

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.

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

(5 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 the tax law.

Mr. Charles Kutesi the Managing Director of IUL, while having dinner at Hotel Equatorial over heard 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 the 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 Uganda residents. Mr Kutesi received an email from the Managing Director of the parent company in Iceland requesting for advice on the 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 300million, the Share capital of IUL is Shs 30 million, it 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 mentioned above.

(15 marks)

Question 7

The organizers of a Small and Medium Enterprises (SME) workshop had invited an official of URA to clarify on some of the tax issues, but no body turned up. They have been informed that your firm's offices are located near Fairway Hotel where the workshop is taking place. When the chief organizer called your partner for assistance, he instead sends 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 the members considered these assertions as valid statements. You are also given a copy of the four 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)

Appendix**TAXA RATES****RESIDENT INDIVIDUAL TAX RATES**

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 TAX RATES

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

END