

Solutions to Questions – Taxation Paper 13

SECTION A

Question 1 (a)

Foresta (Uganda) Limited

Tax computation for the year ended 30 April 2007

	Notes	Amount Shs	Amount Shs	Marks Shs
Profit per accounts			(71,068,000)	0.5 marks
Add back:				
Depreciation	1	19,300,000		1.0 marks
Stock provision	2	660,000		1.0 marks
Unrealised exchange loss	3	2,700,000		1.0 marks
Rent for shareholders	4	2,000,000		0.5 marks
Legal fees	5	300,000		1.0 marks
Donations	6	1,000,000	25,960,000	1.0 marks
Total			(45,108,000)	
Less:				
VAT on sale of furniture to UWA	7	(600,000)		1.0 marks
Profit on disposal of equipment	8(i)	(1,770,000)		0.5 marks
	8(ii)			0.5 marks
	8(iii)			0.5 marks
Bad debt disallowed in year to 30.4.06	8(iv)	(1,050,000)		0.5 marks
Initial allowance	9	(12,375,000)		0.5 marks
Wear & tear	10	(20,858,000)	(36,653,000)	0.5 marks
Adjusted loss for the year			(81,761,000)	0.5 marks
Less: Loss b/f from 2006			(1,250,000)	0.5 marks
Loss c/f to 2008			(83,011,000)	0.5 marks
Tax at 30%			Nil	1.0 marks
Add: penal tax - sec 151	11		400,000	1.0 marks
Total tax payable for the year			400,000	0.5 marks
Less: Tax credits				
Provisional tax		(500,000)		0.5 marks
Withholding tax – UWA	7	(200,000)	(700,000)	1.0 marks
Total tax credit c/f			300,000	0.5 marks

Notes to the PAYE tax computation

Note 1

Depreciation of Shs 2.2m relating to lease hold premises is allowed. However, depreciation of Shs 19.3 million i.e. (21.5m – 2.2m) is not allowed for tax purposes; instead wear and tear allowance for plant and machinery owned or used for business purposes should be claimed.

Note 2

Closing stock was understated, which resulted into understating profits. Therefore, the understatement /provision of Shs 660,000 i.e (12.54*100/95-12.54m) should be added back.

Note 3

Interest on business loan is an allowable expense. However, for tax purposes, unrealised exchange loss is not allowed. Therefore, the unrealised exchange loss of 20% amounting to Shs 2.7 million i.e $20\% \times (23.5 - 10\text{m})$ is not allowable. The expense will however be allowed when realised.

Note 4:

The rent paid for shareholders' residence is an expense of a private nature and therefore not allowable for tax purposes as per section 22(2)(a). This implies that Shs 2 million should be added back.

Note 5:

Legal fees of Shs 300,000 i.e. $(60\% \times 500,000)$ in respect of formation of branch of FUL is not allowed for tax purposes as it yields a benefit of an enduring nature (capital in nature).

Note 6:

Donation to the Church of Uganda and FUFA are allowed for tax purposes under section 34 of the ITA. However, donations to political parties of Shs 750,000 and to the new social club of Shs 250,000 should be disallowed as they don't fulfil the requirements of section 34.

Note 7:

Turnover should be recorded net of output VAT (18%). Since FUL is registered for VAT, then the output VAT of Shs 600,000 i.e. $(3,933,330 \times 18/118)$ should have been included in the VAT return of the month of February 2007. Assuming this was done, sales of FUL were overstated by this VAT amount, and should therefore be eliminated from the sales figure.

UWA was right to charge Withholding tax (WHT) as per section 119 of ITA. Therefore, the 6% withholding tax of Shs 200,000 i.e $(3,933,330 - 600,000) \times 6\%$ is a credit to FUL and should be offset against its tax liability. Since the income was recorded gross of WHT, there is no further adjustment. However, if the income had been recorded net of WHT, there would be a need to gross it up.

Note 8

- (i) Profit on disposal of equipment of Shs 1.77m is not assessable income; hence it should be excluded from the gross income.
- (ii) Recoveries of trade debts written off in the year ended 30 April 2006 of Shs 2.5m must have been allowed (not assessed) in that year. Therefore, in 2007 the recoveries should be assessed. Thus, this amount is properly included in the gross income, and therefore, no adjustment is needed.
- (iii) As in the case of recoveries in (ii) above, since bad debts of Shs 1.18m had been allowed in the year ended 30 April 2006, it should be assessable to tax in year to 30 April 2007 if it has been reversed. Therefore, no adjustment is needed.
- (iv) For bad debt of Shs 1,050,000 disallowed in year to 30 April 2006, a receipt in the year to 30 April 2007 should not be assessable to tax.

Note 9

Initial allowance of Shs 12,375,000 (see note 10) is allowed to items of eligible property (excluding goods and passenger vehicles, office or household furniture, fixtures, and fittings) put to use by a taxpayer for the first time as per section 28 of ITA. The rate applicable is 75% since FUL is located in Mbale which is outside the prescribed areas of Kampala, Jinja, Entebbe, Namanve and Njeru.

Note 10: Wear and tear allowance

Foresta (Uganda) Limited								
Tax computation for the year ended 20 April 2007								
	Class I Shs' 000		Class II Shs' 000		Class III Shs' 000	Class IV Shs' 000		Total Shs' 000
	40%	0.5m	35%	0.5m	30%	20%	0.5m	
WDV at 1 May 2006	3,600,000	0.5m	15,300,000	0.5m	-	4,590,000	0.5m	23,490,000
Additions	4,000,000	0.5m	35,000,000	0.5m	-	14,000,000	0.5m	53,000,000
Less: Disposals	-		-		-	(2,150,000)	0.5m	(2,150,000)
	7,600,000		50,300,000		-	16,440,000		74,340,000
Initial allowance (75%)	(3,000,000)	0.5m	-		-	(9,375,000)	0.5m	(12,375,000)
	4,600,000		50,300,000		-	7,065,000		61,965,000
Wear and Tear Allowance	1,840,000	0.5m	17,605,000	0.5m	-	1,413,000	0.5m	20,858,000
WDV as at 30 April 2007	2,760,000		32,695,000		-	5,652,000		41,107,000
Additions	Cost		Restrict to					
Class II								
BMW	35,000,000	30,000,000	0.5m	Sect.27(11) , part II, 6 th sch. of ITA				
Pickup	5,000,000	5,000,000						
Total	40,000,000	35,000,000						
Class IV	IA		75%	0.5m	(for the rate)			
Furniture	1,500,000							
Equipment	2,500,000		1,875,000					
Plant & mach	10,000,000		7,500,000					
	14,000,000		9,375,000	0.5m				
Total : 9 marks								

Total : 9 marks

Note 11

Since the self assessment return of FUL is to be filed on 31 December 2007 (8 months after the year end), then the return will be filed two months late and penal tax of Shs.200,000 per month would accrue. Final corporation tax returns should be filed not later than 6 months after year end.

If such a delay is envisaged, Management of FUL should in future request for an extension of filing time upto a maximum of 90 days.

(b) Letter to the managing consultant of ML

Date of exam

The Managing Consultant
Managex Limited
C/o Foresta (U) Limited
Mbale

Dear Sir/Madam,

Re: Tax implications of the board resolutions

We refer to your letter where you requested for tax advice on the tax implications of the board resolutions passed on 1 July 2007.

We have studied the board resolutions and now wish to advise as follows:

(1) Board resolution no. (i)

We have identified two major issues which need to be addressed. The issues are: tax on the terminal benefits of the Managing Director (MD) and tax implications of the management contract between Managex and FUL.

(a) Terminal benefits of the MD:

-The compensation for loss of office is a taxable benefit to the MD as per the provisions of section 19(1)(d) of the ITA and as such the employer (FUL) was obliged to deduct PAYE before paying the retiring MD.

- The PAYE regulations require that FUL should have provided Uganda Revenue Authority with the terminal benefits' details to enable the tax authority to compute the tax that the company was supposed to deduct from the terminal pay.

-- It should be noted that since the MD had been employed by FUL for more than ten years, the amount taxable would be 75% of the terminal benefits as per section 19(4) of ITA.

- In this respect FUL's exposure to tax on the terminal pay is Shs. $(25m \times 75\% - 4.92m) \times 30\% + 546,000 = \text{Shs. } 4,695,000$ since the MD did not earn other salary from FUL in the financial year starting 1 July 2007.

(4 marks)

(b) Management contract

-Section 83 of ITA obliges FUL before payment of management fees to ML (non-resident company), to withhold 15% of the gross payment and remit the tax to URA within 15 days after the end of the month when the amount was withheld. This rate applies as there is no double tax treaty between Uganda and Nigeria.

-Therefore the tax payable on management fees is Shs $1,246,941$ (Shs $83,129,464 \times 10\% \times 15\%$).

(2 marks)

(2) **Board resolution no. (ii)**

A key issue identified here is the transfer of shares. We now advise as follows:

Transfer of shares by Mr & Mrs Musizi to CL.

-Mr. & Mrs Musizi are individual shareholders and are not in the business of buying and selling shares, as such no taxable gain on disposal of their shares arises.

-It should however be noted, that stamp duty of 1% of the transfer value of the shares is payable on transfer of the shares to CL.

(2 marks)

(3) **Board resolution no. (iii)**

A pertinent issue identified here is payment of interest from a resident person (company/FUL) to another resident person (company/DUL).

Loan of Shs. 50 million from DUL to FUL:

-If a resident company pays interest to another resident company, the payer company is required by the Income Tax Act to withhold 15% of the gross payment and remit it URA.

-However, the transaction would be exempt from WHT if the two companies are associated, (where the payer company controls at least 50% of its voting power). Since FUL only owns 45% of DUL's share capital, then FUL and DUL are considered not associated and hence withholding tax is payable.

-The WHT exposure is Shs 1.5 million (Shs 10m *15%).

-Withholding tax on interest is an advance tax of DUL, and when deducted FUL should obtain a tax credit certificate and hand it over to DUL to enable them claim their tax credit.

(4 marks)

(4) **Board resolution no. (iv)**

Car benefit for Mr Muvule:

-The board in addition to the salary car allocated a car to Mr. Muvule, and as such a car benefit arises as Mr Muvule uses the car for both business and private purposes.

-The taxable benefit that FUL should take into account when computing Mr. Muvule's PAYE is obtained by applying the formula: $20\% \times A \times B / C - D$.

Where; A = Shs.18 million (market value when the car was first availed to him)

B = 365 days (no. of days the vehicle is available in a year of income)

C = 365 days (no. of days in the year of income)

D = nil (no deduction made towards the benefit)

-Substituting the values of A, B, C and D into the formula above gives the annual benefit of Shs 3.6m (i.e Shs 300,000 as monthly benefit) to be included in his monthly pay for PAYE

purposes. Since his income is already in the 30% bracket, the exposure to tax per month is 30% of 300,000 = 90,000.

(3 marks)

We trust you will be able find our advice useful, but in case you require further clarification on any issue, please do not hesitate to contact us.

Yours faithfully,

Signed – name of the client
For: Tax Consultants Limited

(format 1 mark)

Total marks available

(16 marks)

Total marks restricted to:

(15marks)

SECTION B

Question 2 – Mr. Kadodi

Mr. Kadodi's tax computation for the year ended 30 June 2007

	Notes	Employment Income UShs	Business Income UShs	Property Income UShs	Marks
Rent from Tanzania	1			15,000,000	1.0 marks
Dividends from Tanzania	2			6,000,000	1.5 marks
Interest from Barclays bank	3			-	1.0 marks
Dividends from Mappex	3			-	1.0 marks
Income from garage			7,200,000		0.5 marks
Salary (5m*12)		60,000,000			0.5 marks
Fuel benefit	4	4,560,000			0.5 marks
Loan benefit	5	528,000			1.0 marks
Total		65,088,000	7,200,000	21,000,000	
Chargeable income				93,288,000	1.0 marks
Tax payable: (93,288,000-4,920,000)*30%+546,000					1.5 marks
				<u>27,056,400</u>	
Less: Tax paid in advance					
Withholding tax – Tanzania dividends	2	600,000			0.5 marks
Provisional tax		2,000,000			0.5marks
PAYE deducted		17,970,000			0.5 marks
Total tax at deducted at source				<u>20,570,000</u>	
Income tax outstanding				6,486,400	0.5 marks
Rental tax – Ugandan property	6			6,088,000	2.5 marks
Total tax outstanding				12,574,400	1.0 marks
Total marks					(15.0 marks)

Notes to the tax computation

Note 1

Rent received from Tanzania is treated as property income under section 20. Section 2 of the ITA defines two types of income from property as either rental income under S.5 of ITA or rent under property income as per S.20 of ITA. The rent received from Tanzania should be included in Mr Kadodi's gross income, whereas rental income from Ugandan property should be assessed separately under section 5 of ITA. Thus, the rent to be included in Mr Kadodi's tax computation is US\$ 15 million (net rental income of TShs 5 million * 3 exchange rate). Any tax suffered in Tanzania on this income will be taken credit of.

Note 2

Dividend income from Tanzania is a foreign sourced income. Since resident persons are taxed on worldwide income, therefore, Mr Kadodi's dividend income (which is classified as property income) under S.20 of ITA should be grossed up and converted into Uganda shillings and included in his tax computation. The withholding tax deducted is a foreign tax credit allowed under S.81 of ITA which is restricted to the tax payable in Uganda. This is done to avoid double taxation. Thus gross dividend income is Shs 6 million (TShs 1.8m*100/90*3), and the withholding tax of 10% (Shs 600,000) should be offset against his liability.

Note 3

Section 117(1) of ITA requires any person who pays interest to a resident individual to deduct 15% on interest payable and remit the tax to URA, and that received from Barclays was net as indicated. The, withholding tax deducted at source from interest received by an individual is a final tax as per S.122(a) of ITA. Therefore, it should not be offset from Mr Kadodi's tax liability. Furthermore, the income received should not be subjected to further taxation. This is the reason as to why interest income was excluded from his tax computation.

Withholding tax by a resident company on dividends to an individual is final tax, as such no further tax is assessed and should not be included in gross income.

Note 4

Payment of fuel allowance is a taxable benefit as per the provisions of section 19(1) of the ITA. Therefore, the taxable benefit to be included in his tax computation is what CCL paid which is Shs 4,560,000 (380,000*12).

Note 5

It is important to note that even if one loan was below Shs 1 million, the total loans advanced in the month of July 2006 exceed Shs 1 million. Therefore there is a taxable benefit that was derived by Mr Kadodi. The taxable benefit is the difference between the statutory rate of 7.04% and the rate at which the loan was advanced (0% in this case), thus 7.04%. This gives Shs 528,000 (7,500,000*7.04%) as the annual benefit.

Note 6

Rental tax from Ugandan property	Marks	Shs
Gross rental income	0.5m	40,000,000
Less: 20% allowable expenses – S.5(3)(b) of ITA	0.5m	<u>(8,000,000)</u>
Net		32,000,000
Les: allowable threshold	0.5m	<u>(1,560,000)</u>
Net		<u>30,440,000</u>
Tax at 20%	0.5m	<u><u>6,088,000</u></u>

Question 3 – Kamuli Researchers Limited

Tax implications on sale of commercial properties:

Kamuli Plaza:

VAT:

The sale of Kamuli Plaza being a commercial building attracts VAT at a rate of 18%. As such KARL will be expected to charge VAT on the sale price. The expected output VAT on that sale is Ushs. 54,000,000 i.e. $(300,000,000 * 18\%)$. **(2 marks)**

Corporation tax implications:

The capital gains tax law in Uganda took effect on 1 April 1998. The rate of tax for capital gains tax is 30% and is applicable when non depreciable assets are disposed of.

The gain is computed and added to other business income for tax purposes.

The disposal of Kamuli Plaza would lead to a capital gain since it was not a tax depreciable asset as it did not qualify for industrial building allowance at the time it was acquired, since it was not constructed after 1 July 2000.

Taxable Capital gain = Sale proceeds less cost base of the asset at the time of acquisition if after 31 March 1998.

Therefore the capital gain on disposal of Kamuli Plaza = Shs. $(300,000,000 - 100,000,000) = 200,000,000$ assuming there were no incidental costs.

This implies that for tax purposes the profit recognised in the accounts of Ushs. 250,000,000 will be allowed and instead the capital gain of Ushs. 200,000,000 will be assessed to tax. Effectively there will be an allowance of Ushs. 50,000,000 in the tax computation. **(6 marks)**

Kakeka Plaza:

VAT:

VAT at 18% should be charged on the sale of the building since it is a commercial property. The output VAT due to URA = Shs $(500,000,000 * 18\%) = 90,000,000$. **(1 mark)**

Corporation tax:

Kakeka Plaza was constructed and put to use in January 2001, implying that as a commercial building that was constructed after 1 July 2000, it qualified for Industrial building allowance. **(2 marks)**

Since it qualified for Industrial building allowance its disposal will not attract capital gains tax. **(1 mark)**

The profit on disposal recognised in the books of accounts of Ushs. 370,000,000 should be allowed in the tax computation and instead either a balancing charge or deduction computed in the capital allowances schedule should be taken into account. **(2 marks)**

The tax WDV as at 1 Jan 2007 = Shs. 140 M

The sale proceeds = Shs. 500 M

Therefore since it was the only building qualifying for IBD, the balancing charge is Shs(500m – 140m) = 360M. This should be added back in the tax computation.

Therefore in the tax computation we will effectively allow Ushs. (370m -360m) = 10 M. **(1 mark)**

Question 4 – MN Enterprises

The following are our observations from the tax health check carried out on the VAT return of MN Enterprise for the month of March 2007. Please note that our observations are recorded under notes 1-9 below:

VAT computation for MN Enterprises for the month of March 2007

VAT computation	Notes	Shs	Shs	Marks
Output VAT				
Correctly computed			6,500,000	0.5 marks
VAT on computer	1		-	1.0 marks
VAT on rental	2		2,160,000	0.5 marks
VAT on URA contract	3		2,700,000	1.0 marks
VAT on NGO invoice	4		900,000	1.0 marks
Total Output VAT			12,260,000	1.0 marks
Less input VAT				
VAT on electricity-Kiuubo	5	(16,200)		0.5 marks
VAT on telephone-Kikuubo	6	(12,960)		1.0 marks
VAT on rent	7	(72,000)		0.5 marks
VAT on pickup	8	(75,000)		0.5 marks
VAT on RAV 4	8	-		0.5 marks
VAT on MARK II	8	-		0.5 marks
VAT correctly computed		(6,520,000)		0.5 marks
Total input VAT			(6,696,160)	0.5 marks
Less :VAT on bad debt more than 2 years old	9		-	1.0 marks
VAT payable			5,563,840	0.5 marks

Notes:

Output VAT

- (1) VAT on supply of computer

Supply of computers and accessories are exempt from VAT. Therefore, MN Enterprises should not have charged VAT on computers and its accessories. In that light, MN Ent. needs to issue a credit note (as per S.30 of VAT Act) to the buyer since output VAT charged of Shs 350,085 i.e. $(2,295,000 \times 18/118)$ should not have been charged. The credit note issued shall be used to reduce the output VAT. Therefore, in our computation, we have excluded VAT on sale of computers.

- (2) Since the rented building is commercial, MN Ent. should have charged VAT at 18% to the tenants. The out VAT payable is Shs 2,160,000 $(18\% \times 12m)$.
- (3) VAT is due at the earlier of payment, invoicing, or performance of service. Therefore, since the performance of the service was in November 2007, then VAT should be accounted for in the November 2007 return, and not when the customer is expected to pay. Output VAT on management services to URA $= 15m \times 18\% = 2,700,000$.
- (4) Even though the VAT was paid by the headquarters in Washington, the service was rendered and consumed in Uganda. Therefore, this is not an export of service which is zero rated, but is a standard rated service, and VAT of Shs 900,000 $(5m \times 18\%)$ should be have been charged.

Input VAT

Since MN Enterprises deals in mixed supplies as such there is need to determine how much input VAT can be claimed as highlighted below:

Total sales (excl. VAT):	Taxable Shs.(M)	Exempt Shs.(M)	Total Shs.(M)
<i>Computer $(2.295 \times 100/118)$</i>		1.945	
Other verified sales $(6.5 \times 100/18)$	36.111		
Consultancy	5.00		
URA management contract	15.00		
Rental income	12.00		
Total sales	68.111	1.945	70.056 (1 mark)

Applying the value of taxable sales to total sales gives 97.2% $[68.111m/70.056m \times 100]$. **(1mark)**

Since the ratio of taxable sales to total sales exceeds 95%, all the qualifying input VAT incurred by MN Enterprises should be claimed as per S. 28(9) of VAT Act. **(1mark)**

- (5) VAT paid on electricity bill is only allowed for the month's bill and not on the outstanding balance i.e $shs(90,000 \times 18\%) = 16,200$. The VAT on the electricity bill for the partner's residence of Shs. 18,000 should not have been claimed as that is considered private in nature.

- (6) The VAT on the telephone line for the Kikuubo office is claimable to the extent of 90% (i.e. Ushs 14,400 * 90% = 12,960) and the VAT in respect partners residence is not claimable.
- (7) Since the sub-tenant left in September 2007, the total input VAT on rent should be claimed by MN Enterprises.
- (8) VAT on repairs and maintenance for commercial vehicles is allowable as input VAT since it is assumed to be exclusively used for business, However, input VAT of Shs 3m on purchase of RAV 4 and Shs 216,000 for repairs on Mark II are not claimable (S.28 of the VAT Act).
- (9) VAT on outstanding debt

The time limit within which to claim VAT on bad debt is at least 2 years (S.43(1) of VAT Act). Since the debt has taken only one and half years, no refund should be claimed now. MN will wait until the debt is two years before they can claim for the refund of Shs 1,250,000 on the bad debts, provided reasonable steps were taken to recover the debt but in vain.

Ways of minimising exposure:

- There is need to have a review of the past periods to make a self assessment and declare the taxes due before the tax authorities come up to audit, this would reduce the company's exposure to penalties.
- MN Enterprises should issue a credit note to the one they supplied the computer to correct the VAT wrongly invoiced.

(1 mark)

Question 5: - Comutex (Pty) Limited

The question requires the student to advise Mr Smith on which option to take for each of the two issues: The issues are repatriation of profits to RSA and purchase of a business as a going concern or otherwise.

(a) Repatriation of profits

Option 1

- Dividends are distributed after the income has been subjected to tax at the corporate rate of 30%.
- On payment of dividends, CUL will be obliged to deduct withholding tax on the dividends at a rate of 10%, (since South Africa has a double taxation agreement with Uganda and the withholding tax rate is 10% not 15%)
- This implies that the taxable profits would be subjected to 30% tax and the remaining 70% will be subjected to 10% withholding tax bringing the total tax suffered on the income derived from Uganda to 37%.
- It should however be noted that given the provisions of the double tax treaty with South Africa, tax suffered on dividends in Uganda, is allowed as a tax credit in South Africa, which implies that the 10% withholding tax on dividends can be claimed in South Africa, which is an advantage.

(4.0 marks)

Option 2

Payment of management fees has the following tax implications:

Management fees are allowable expenses to CUL and as such would reduce the taxable income of CUL for corporation tax purposes.

Management fees attract withholding tax at a rate of 10%, which Cumutex Pty would have to suffer in Uganda but could take credit of in South Africa.

Management fees also attract reverse VAT at a rate of 18%, which CUL has to pay to URA on receipt of the invoice but can also claim it as input tax if it is VAT registered.

Mr. Smith should also be informed that management fees are subject to transfer pricing scrutiny by Uganda Revenue Authority as the tax authorities would be interested to know whether the services for which these fees are being charged were actually performed and if so whether the charge meets the arms length principle.

(4.0 marks)

Conclusion:

In light of the above, I would suggest that if the management fees can be supported, and CUL is VAT registered then repatriation of profits through management fees would be more tax efficient than repatriating all the income by payment of dividends.

(2 marks)

(b) Tax implications of either purchasing business as going concern or otherwise

VAT:

When one purchases a business as a going concern no VAT is charged on the transaction, where as VAT would be chargeable if individual assets are purchased.

(1 mark)

The company buying the business as a going concern would be responsible for the VAT assets and liabilities of the business purchased.

(1 mark)

Corporation Tax:

When one buys a business as a going concern, he takes over its assets and liabilities, and as such if it had tax credits it would enjoy them and if there were liabilities it would have to settle them; although in a case where it is not a going concern one will only take into account the assets purchased.

(1 mark)

If it is a going concern the buyer would inherit the tax written down values of the assets taken over; where as if it is not a going concern the individual assets acquired will be treated as new acquisitions.

(1 mark)

Stamp duty:

Stamp duty of 1% on transfer of ownership applies to both situations, whether the business is acquired as a going concern or not. (1mark)

Question 6 - ICE (Uganda) Limited

(1) The effect of changing an accounting period

Section 39 of ITA requires a taxpayer whose accounting period is different from the normal government accounting period (i.e. a period of 12 months to 30 June) to apply in writing to the Commissioner of URA for approval of a substituted year of income before a change is effected. (1 mark)

The Commissioner may only approve the request if there are strong reasons for changing the accounting date. Change of the accounting date as a requirement by the group is normally an acceptable reason. (1 mark)

In this case, ICE Uganda limited is advised to make a formal request to the Commissioner to change the accounting date. (1 mark)

If the change of accounting date is done in July, the company will be required to do the next accounts for six months to December 2006 (i.e. the transitional period). (1mark)

(2) Taxation of residents on world wide income

The income tax law in Uganda requires that all tax resident persons should declare their worldwide income for taxation in Uganda. (1 mark)

Tax resident persons are defined as follows:

Individuals-

- Those with permanent homes in Uganda
- Those that have live in Uganda in a given year of income for 183 days or more
- Those that have been in Uganda for 122 days in a given year of income and for two the preceding years of income (1 mark)

Corporates-

- Those incorporated under the laws of Uganda
- Those whose management and control is exercised in Uganda
- Those that under take the majority of its operations in Uganda (1 mark)

This implies that a resident person that satisfies the above definition should aggregate income from all sources into an annual tax return, and then subject it to taxation either at 30% for companies or graduated individual rates for individuals. This would be different for non resident persons whose only income taxable in Uganda is that sourced in Uganda. (1 mark)

(3) Thin capitalisation policy in Uganda

The Income tax law in Uganda states that where a foreign-controlled resident company which is not a financial institution has a foreign debt-to-foreign equity ratio in excess of 2 to 1 at any time during a year of income, a deduction is disallowed for the interest paid by the company during that year on that part of the debt which exceeds the 2 to 1 ratio. **(2 marks)**

In this case ICE Uganda Limited is foreign controlled since ICE Limited which is a non resident owns more than 50% shareholding in IUL. As such testing for thin capitalisation should be done given that ICE Limited extended a debt to IUL which is foreign debt on which interest is payable. **(1 mark)**

The foreign equity due belonging to ICE Limited is as follows:

- 75% of share capital = $30,000,000 \times 75\% = 22,500,000$
- 75% of share premium = $20,000,000 \times 75\% = 15,000,000$
- 75% of accumulated profits = $30,000,000 \times 75\% = 22,500,000$

Total foreign equity = **60,000,000** **(2 marks)**

Debt to equity = $300:60 = 5:1$, thus restriction of interest due to thin capitalisation applies. The disallowable interest element is $\frac{3}{5} \times 60 = 36\text{m}$ and this should be disallowed. **(2 marks)**

Question 7:

Below please find my comments on the following assertions:

(i) "Tax assessed to a company by URA is final and must be paid by the tax payer"

The income tax law gives the powers to the Commissioner to estimate income in cases where by a taxpayer has not filed a tax return on time. The law also gives powers to the Commissioner to conduct tax audits and assess any tax that is found to be due.

However the same income tax law under S.99 of ITA gives the taxpayer a right to object to the assessment raised by URA, if he/she has valid reasons for objection.

The Income tax law requires that an aggrieved taxpayer is required to pay 30% of the tax assessed or the tax not in dispute, whichever is higher before an objection is considered. The objection should be submitted within 45 days after the notice of assessment.

If URA accepts the objection, then it is expected to amend the assessment. However, if it rejects the taxpayer's objection, then the taxpayer has two options; either to pay the tax assessed, or to appeal to the High court or the Tax tribunal (S.100 of ITA). In case a taxpayer is not satisfied with the High court or Tax Appeals tribunal ruling, may proceed to court of appeal (S.101 of ITA).

Thus, it is not true that tax assessed by URA is always final and must be paid.

(5 marks)

(ii) **“There is no difference between taxation of an employee from that of an independent consultant”**

Employees are taxed under the income tax law by way of the PAYE system, where as Independent consultants are taxed as individuals in business and are expected to file individual tax returns;

The PAYE system puts the obligation of withholding PAYE from the employee's salary on the employer, and in cases where the employee has only one employment he/she would not be required to file an individual tax return. The tax for an employee is declared to Uganda Revenue Authority on a monthly basis using the graduated PAYE rates;

An independent consultant is obliged to file individual returns. He/she is expected to make a provisional tax assessment for a given year, file an individual provisional return and pay the projected tax in four instalments every three months. He is then expected to file a final return and pay any balance of tax due by the end of the sixth month after the end of the tax year;

The withholding tax obligation on a payer as far as an independent consultant is concerned is to either withhold 15% tax (for a non resident) or 6% tax (for a resident);

However care should be taken in the determination of whether one is an independent consultant or an employee, as some consultants may fall into the ambit of being treated as employees depending on how they perform their duties, and the type of contracts they hold.

(5 marks)

(iii) **“Presumptive tax is payable every month by small taxpayers at a rate determined by the URA officer who visits the taxpayer”**

Section 4(5) of ITA provides that where a taxpayer has annual turnover that does not exceed 50 million, a tax commonly referred to as presumptive tax may be charged to such a taxpayer. This is an annual tax based on the taxpayer's annual turnover.

For individuals tax is expected to be paid in four provisional payments every three months.

The tax rates applicable are provided in the second schedule of the Income Tax Act. The table below gives the rates:

Annual turnover (Ushs)	Applicable tax (Ushs)
5m-20m	100,000
>20m-30m	Lower of 250,000 and 1% of turnover
>30m-40m	Lower of 350,000 and 1% of turnover
>40m-50m	Lower of 450,000 and 1% of turnover

Please note that any tax credits in form of provisional tax under S.111(8) and WHT under S.128(3) of ITA can be offset against the tax liability of the taxpayer.

Therefore, it is not true that this tax is paid on a monthly basis like PAYE and VAT, and is not applicable to those with turnover of less than 5 million per annum. It is also not true the rate of tax is determined by URA officer, but by the ITA under second schedule depending on the turnover.

(5.0 marks)

END.