

THE PUBLIC ACCOUNTANTS EXAMINATIONS BOARD

A Committee of Council of ICPAU

CPA (U) EXAMINATIONS

LEVEL TWO

TAXATION - PAPER 11

THURSDAY, 19 JUNE 2008

INSTRUCTIONS TO CANDIDATES

1. Time allowed: **3 hours**
2. Section **A** has **one** compulsory question carrying 30 marks..
3. Section **B** has **three** questions and only **two** questions are to be attempted. Each question carries 20 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 8.
6. Please read further instructions on the answer book.

SECTION A

Question 1

AB Capital Limited, "The Company", with head offices in Kasese, deals in general merchandise and consultancy services. In the year ended 31 December 2007, the company's profit was UShs 1,500,000,000 and it was arrived at after crediting and charging the following items:

Income

		UShs
Proceeds on the disposal of fixed assets	(Note 1)	150,000,000
Miscellaneous income	(Note 1)	92,000,000
Foreign exchange gains	(Note 2)	25,000,000
Gain on revaluation of fixed assets		50,000,000

Expenses

Depreciation		205,000,000
Staff Costs	(Note 3)	600,000,000
Contribution to a staff retirement fund		70,000,000
Bad debts	(Note 4)	80,000,000
Leasehold amortization	(Note 5)	56,000,000
Repairs and Maintenance	(Note 1)	170,000,000

The company earned net investment income of UShs 600,000,000 from its 100% owned subsidiary in South Africa. Uganda and South Africa have a double taxation agreement that provides for withholding tax on dividends at 10%. Tax was withheld in South Africa.

AB Capital Limited also offered services to companies in Kenya, Tanzania, and Rwanda and received net incomes equivalent of UShs 150 million, U Shs 80 million and UShs 70 million respectively. The withholding tax rates are 20% in Kenya, 15% in Tanzania and 30% in Rwanda.

The company had prepaid income tax on the imports amounting to UShs 50 million but the original receipts were misplaced. The accountant had photocopies of the receipts.

Notes:

1. The company, in 2007 sold land and buildings it had acquired in 2001 at UShs 150,000,000. The additional leasehold improvements amounted to UShs 75,000,000 which was required before the building could be put to commercial use in 2002. In the current year the building caught fire and the company spent UShs 80 million on repairs which have been included in repairs and maintenance. Before the close of the year, the Insurance Company of Uganda which had insured the building wrote to the company stating that they will make good 90% of the loss suffered

as a result of the fire. In addition to this, the insurance company paid US\$ 20 million under loss of profits policy and this amount was not included in the income for the year ended 31 December 2007.

2. The exchange gain relates to a building loan that the company got to construct a boundary wall around the building. 50% of it was realized.
3. Staff costs include the following:

	US\$
Relocation costs for staff	55,000,000
Staff feeding at the staff canteen	22,000,000
NSSF employer contribution	65,000,000
Staff computer courses fees	6,000,000
Accountancy degree courses fees	7,000,000
PAYE audit bill for junior staff	15,000,000
Taxes paid on directors' behalf	26,000,000

4. The bad debt account includes the following:
 - Provision for director's debts US\$ 15,000,000.
 - Staff fraud covered by insurance policy: US\$ 12,000,000.
 - Bad debt recovery relating to previous year US\$ 5,000,000.
5. The company acquired a ten year lease for a warehouse at US\$ 500 million. It is being amortised over a ten year period on a straight line basis. The US\$ 6,000,000 included in the amortised expense related to lawyers' fees.
6. A South African company provided the company with management services in the year 2007 amounting to US\$ 40,000,000.
7. The company had an agreed tax loss brought forward of US\$ 100,000,000 as at 1 January 2007.
8. The company's additions and disposal of plant and machinery for the year were as follows:

Purchases:

	US\$ '000
i. Office Furniture	35,000
ii. Computers	75,000
iii. Computer software	15,000
iv. Motor vehicles – saloon cars	25,000
v. One Pajero Station Wagon	70,000

9. The tax written down values of the company's depreciable assets as at 1 January 2007 were as follows:

	US\$ '000
Class I	15,000
Class II	120,000
Class III	280,000
Class IV	760,000

Required

- (a) Calculate the corporation tax payable by AB Capital Limited for the year ended 31 December 2007, showing in detail all your workings
(25 marks)
- (b) Comment on the tax impact of the following transactions in the VAT and income tax computations:
- (i) The debt the company forgave its South African subsidiary of US\$ 20 million, which was included in the expenses.
(2 marks)
 - (ii) Staff expenses accrual of US\$ 42 million and staff debts written off of US\$ 20 million that were omitted from the expenses.
(2 marks)
 - (iii) Trade bad debts of US\$ 50 million that were over two years old given that no earlier VAT relief was claimed.
(1 marks)

(Total 30 marks)

SECTION B**Question 2**

Afro Gel Associates is a firm that deals in the provision of legal and advisory services to the public. Afro Gel Associates is a partnership between Angela and Gerald.

Information availed from the firm's records show the following:

1. The profit sharing ratio between Angela and Gerald is 3: 2.
2. In January 2007 the Partner's monthly salaries were, Angela – US\$ 6,500,000 and Gerald - US\$ 8,000,000.
3. Interest on capital payable by the partnership to the partners is 20%.
4. Interest on capital due to the partners is based on the opening balance of the individual's capital account.
5. Partners adjust their salaries every year and the adjustments take effect on 1 April of the relevant year.

The following has been established from the partnership's return of income and accounts for the year ended 31 December 2007:

1. Profits per return and accounts is US\$ 95,000,000 after allowing for the following:
 - (i) Partner's salaries and interest on capital.
 - (ii) Depreciation of fixed assets of US\$ 20,000,000.
 - (iii) Staff rent of US\$ 20,000,000, which includes Gerald's rent of US\$ 8,500,000.

2. Partner's capital accounts are as follows:

Partner	Balance as at	
	31 December 2007	1 January 2007
	UShs	UShs
Angela	15,000,000	14,500,000
Gerald	14,500,000	17,000,000

3. The partners increased their salaries by 20%.

4. Agreed capital deductions for the year are UShs 19,500,000.

Required:

(a) Compute the partnership's taxable profit for the year ended 31 December 2007.

(10 marks)

(b) Compute taxable profits attributable to each partner

(5 marks)

(c) Compute each partner's tax liability for the year ended 31 December 2007.

(5 marks)

(Total 20 marks)

Question 3

Jessica Kizito is a Ugandan citizen who is resident for Uganda tax purposes. She is the Managing Director of Spoonworth Clothing Uganda Limited.

Below were her earnings and dealings within the financial year ended 30 June 2007:

Jessica's monthly gross salary is UShs 5,600,000. She is required to contribute 5% of her salary to the National Social Security Fund, the firm contributing a further 10% on her behalf.

The company caters for her medical expenses up to the tune of UShs 800,000 per month. In the event that she has not fully utilised the allowance, she receives cash at the end of the year in respect of the balance. She received UShs 3,200,000 in respect of the medical allowance during the year.

She is given housing allowance of UShs 500,000 per month.

The company caters for staff lunch on an equal basis at the staff canteen. Her lunch cost the company UShs 1,250,000 during the year ended 30 June 2007.

She is entitled to free clothing from the company's clothing line worth UShs 500,000 per month to enable her maintain the company dress code.

The firm paid for her air passage into Uganda worth UShs 2,000,000. She is also entitled to air tickets once a year for her and her husband worth UShs 4,500,000 in total, which she received.

She is entitled to a company car for both business and private use. She was the first user for the car which cost US\$ 35,000,000. She makes a monthly contribution of US\$ 300,000 every month for use of the car.

Jessica Kizito bought 20,000 shares in Spoonworth Clothing Uganda Ltd on 15 June 2007 at Shs 800 per share. The market price per share at that date was Shs 1,000. No dividends were paid.

Jessica Kizito owns a block of flats in Makindye. The complex has 6 units with a monthly rental of each unit being US\$ 450,000. The flats were occupied for the whole year. She incurred plumbing and roof repairs of US\$ 2,300,000 which catered for blocked plumbing and roof repairs.

Required:

Compute Ms. Kizito's chargeable income and tax thereon for the year ended 30 June 2007.

(20 marks)

Question 4

Uganda Millers Ltd, a Ugandan resident company, has invested in a new milling business during the year 2006 worth US\$ 20 billion. Of this amount, land cost 50% of the investment, buildings were 20%, 20-ton trucks -20% and the balance was plant and machinery.

The company urgently requires raising funds and is looking at different options of disposing off the business and the assets.

Required:

Advise the company on the necessary requirement to follow as well as the VAT, income tax and stamp duty implications if they decide to:

- (a) sell the assets on piece meal basis. **(4 marks)**
 - (b) sell the business as a going concern. **(4 marks)**
 - (c) transfer the business to another resident company in return for 51% shares. **(6 marks)**
 - (d) lease the assets to the bank in return for monthly rentals. **(3 marks)**
 - (e) sell of shares. **(3 marks)**
- (Total 20 marks)**

SECTION C**Question 5**

You are a Tax Director with Capital Developers Limited. The incoming expatriate Managing Director has requested you to brief him on capital gains under the Ugandan tax law.

Required:

Write a memo to the Managing Director highlighting the following:

- (a) Definition of capital gains in the Ugandan tax law context. **(2 marks)**
- (b) The assets on which capital gains is levied. **(3 marks)**
- (c) The basis of computation. **(3 marks)**
- (d) Cases where capital gains can be avoided and the requirements for one to obtain such exemption.

(7marks)**(Total 15 marks)****Question 6**

- (a) Highlight the different customs valuation methods approved by the General Agreement on Trade and Tariffs (GATT) / World Trade Organization (WTO). **(4 marks)**
- (b) Explain how import and export duties can be used in a country's trade policy. **(3 marks)**
- (c) What are the benefits of the East Africa Customs Union? **(3 marks)**
- (d) What are the obstacles to trade within the East Africa Customs Union and how can they be overcome.

(5 marks)**(Total 15 marks)****Question 7**

- (a) Differentiate a finance lease from an operating lease for income tax purposes. Include in your discussion the resulting tax implications. **(5 marks)**
- (b) Under what circumstances can an individual be exempted from income tax under the income tax laws of Uganda? **(3 marks)**
- (c) Discuss the objections and appeals procedures under the VAT and income tax laws of Uganda.

(7 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.