

THE PUBLIC ACCOUNTANTS EXAMINATIONS BOARD

A Committee of Council of ICPAU

CPA (U) MODEL EXAMINATIONS

LEVEL TWO

TAXATION - PAPER 11

APRIL 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 12
6. Please read further instructions on the answer book.

SECTION A

Question 1

- (a) Bukonzo United Manufacturers Limited ("BUML") is a resident company operating in the trading centre of Muhokya in Kasese District. The main business is that of processing and manufacture of enamel utensils. After reaching a turnover of Shs 50 million in the year 2000, they were registered for VAT.

Due to poor performance, the Board of Directors approved management's proposal to hire services of a tax consultant to advise management on a number of tax issues and compliance. The following is an extract from the income statement for the year ended 30 June 2007 from the books of BUML.

	Note	Shs'000
Sales		920,000
Direct costs	1	<u>(258,000)</u>
Gross profit		662,000
Other income	2	139,000
Sales and marketing expenses	3	(40,000)
Distribution costs	4	<u>(220,100)</u>
Net finance costs	5	(147,700)
Other Overheads	6	<u>(246,900)</u>
Profit before taxation		146,300
Taxation at 30%		<u>(43,890)</u>
Profit for the year		<u>102,410</u>

Notes to the accounts are as follows:

- Direct costs include depreciation of Shs 15 million. Also included in this item is the total contracted consultancy fees of Shs 60 million relating to a Nigeria based company dealing in research on enamel product manufacture. The Nigerian company completed and issued a certificate of 75% of work done on 30 June 2007. However, BUML paid the bill on 1 August 2007. Other costs relate to direct labour and direct materials.
- Other income consists of:

	Shs '000
Gross rental income from company's flats in Kasese town	102,500
Receipt relating to a provision which was disallowed by URA in tax computation of 2006	6,500
Other incomes	<u>30,000</u>
Total	<u>139,000</u>

3. Sales and marketing expenditure includes Shs 4.2 million spent on installing a billboard along Kasese road on 1 May 2007 to advertise the company's products. The balance was media advertising.
4. Distribution costs include
- | | |
|---|----------------|
| | Shs '000 |
| Depreciation | 45,000 |
| Amortisation of computer software | 5,000 |
| Legal fees in respect of: | |
| Issue of new shares | 16,000 |
| Debt collection | 24,500 |
| Court case with disgruntled shareholder | 20,000 |
| Other allowable costs | <u>109,600</u> |
| | <u>220,100</u> |
5. Included in net finance costs is interest payable of Shs 117.6 million of which 25% relates to Managing Director's personal loan. The balance relates to loan acquired to boost the company's working capital. The other component is a realized exchange loss of Shs 30.1 million.
6. Other overheads are analysed as follows: -
- | | |
|--|----------------|
| | Shs '000 |
| Deferred tax | 12,500 |
| Purchase of equipment of a capital nature-each costing less than Shs 800,000 | 6,500 |
| Construction of new block – (see note) | 100,000 |
| Repair and maintenance – to overhaul mining machine engine | 20,000 |
| Loss on disposal of equipment | 15,000 |
| Others allowable expenses | <u>92,900</u> |
| | <u>246,900</u> |

Note:

Included in the Shs 100 million is the cost of land of Shs 17.5 million, and Shs 5 million to unofficially quicken the process of approving the plan. The balance was spent on building materials and labour. The building was put to use effective 1 July 2006.

7. The following were additions and disposals during the year of income:

Nature of addition/disposal	WDV as at 1. 7. 2006 (Shs' 000)	Additions Cost (Shs' 000)	Disposal Cost (Shs'000)
Class II	45,000	-	-
Motor vehicles –(note i)		60,000	
Class I	34,500	-	-
Class IV	46,000	-	-
Class III (note ii)	85,000	-	150,000
Intangible assets – computer software	-	20,000	-
Total	<u>210,500</u>	<u>80,000</u>	<u>150,000</u>

- (i) Included in additions for the motor vehicle is Shs 60 million spent on the purchase of a Fuso truck (10 tonnes).
- (ii) A machine which had cost Shs 150 million eight years ago, had an accumulated depreciation of Shs 120 million and cash received of Shs 15 million.
- 8 Annual Industrial Building Allowance (IBA) for the existing building agreed with URA at Shs 5 million.
- 9 The first and second installments of provisional tax for the year totalled to Shs 40 million.
- 10 The agreed adjusted loss for year ended 30 June 2006 with URA-Kasese Office was Shs 150 million.
- 11 Withholding tax deducted at source during the year was Shs 1.5 million.
- 12 The company requested for an extension of 2 months within which to file the return, which was granted by URA.
- 13 The Self Assessment return was filed on 1 April 2008.

Required:

- (a) Compute chargeable income and tax payable by BUML for the year ended 30 June 2007: where appropriate provide brief explanation for any adjustments and penal tax for late submission of return if any.

(28 Marks)

- (b) What additional tax (if any) is payable by BUML for understating the provisional tax?

(2 marks)

(Total 30 marks)

SECTION B

Question 2

- (a) Mr. Magezi, the Chairman of Bugembe Millers Ltd (BML) has sought your advice on the tax implications of the terms of contract for one of their newly recruited technical staff. You are required to review the month of June 2007. According to the contract, Mr. Kacumisi, a fresh graduate from Makerere University was appointed on a 12 month's probation on 1 July 2006 and was to be confirmed as Production Engineer of BML with effect from 1 July 2007 if he is found suitable and resourceful. The following were some of his terms:

- (i) Monthly basic salary of Shs 2.5 million.
- (ii) Provision of a company car available 24 hours.
- (iii) Company house at Shs 4.8 million per annum.

From his file availed to you by the Finance Manager, you established the following information relating to the month of June 2007.

- (i) Value of the food consumed by Mr. Kacumisi during the month of June 2007 amounted to Shs 400,000. The Company runs a restaurant which is exclusively for its senior officers.
- (ii) He contributed 5% of his basic salary and the company contributed 10% of his basic salary to NSSF.
- (iii) In addition to his annual sick pay allowance of Shs 3 million, which he received in June 2007, he also received medical services valued at Shs 1.5 million. However, junior officers attend a government hospital.
- (iv) Shs 3.5 million was paid towards school fees of which Shs 2.5 million relates to his masters degree and the balance was for a professional course relevant to his job.
- (v) He was paid hardship allowance of Shs 300,000 per month due to the nature of his job.
- (vi) Bills paid for him were Shs 500,000 for water and electricity. However, the arrears of May's bill was Shs 200,000.
- (vii) The market value of the car on 1 July 2006 when he was first given the company car was Shs 45 million. The car had cost Shs 80 million in 2000. No deduction was made towards this benefit.
- (viii) Included in the amount paid for domestic servants of Shs 500,000 was total gross income of Shs 200,000 for his security guard.
- (ix) Mr Kacumisi's private business incurred a loss of Shs 1.5 million which was fully paid by the company.

- (x) His employment terms are such that in the month of taking leave, he is paid a leave allowance equivalent to 70% of one month's basic salary. His leave fell due in June 2007.
- (xi) Due to Kacumisi's busy office, he was unable to take his leave, and the company paid him Shs. 1,240,000 as a compensation for not taking his leave.
- (xii) He received an annual bonus salary of one and half month's salary on 30 June 2007.

Required:

Advise the Chairman on the tax payable by Mr. Kacumisi for the month of June 2007.

(15 marks)

- (b) Assume Mr. Kacumisi's service was terminated on 30 June 2007, and in his termination letter, the following conditions were stated:
 - To receive a total sum of Shs 100 million; and
 - That the compensation so paid was on condition that he could not work in a similar company or related industry or start a similar company or otherwise similar to that of BML.

Required:

What additional tax will be payable by Mr Kacumisi on his terminal benefits?

(2 marks)

- (c) Mr. Bwambale was unsure whether a technical resource person hired by the company was self employed or an employee of BML for tax purposes.

Required:

Advise Mr. Bwambale on how he could establish whether the person is an employee or self employed.

(3 marks)

(Total 20 marks)

Question 3

Mr. Shapu was appointed a radio consultant by Airwaves Radio (U) Limited (ARUL) in May 2007. His basic salary was Shs 1.8 million per month. He was employed for a period of 5 months by ARUL.

During the year to 31 December 2007, ARUL remitted Pay As You Earn (PAYE) of Shs 3.2 million to Uganda Revenue Authority (URA) in respect of Shapu's employment income.

In September 2007, he was privately contracted by Radio Mews, a Democratic Republic of Congo (DRC) company to do some work for them. Shapu decided to request for leave which was approved. The negotiated contract was ZShs 162,500 which was paid net of withholding tax at a rate of 35%. Use exchange rate of UShs: ZShs of 40:1.

As an ambitious young man, Shapu convinced friends of his, Annette and Diana, and registered SAD & Partners dealing in event management. No partnership agreement was made. However, records available revealed that Mr. Shapu contributed 60% of the capital required to start this firm, while the other two partners contributed the difference equally.

During the period to 31 December 2007, their firm was boosted by a hefty contract secured by Annette from CHOGM Secretariat and registered a taxable profit of Shs. 150 million. This profit was arrived at after deducting Shs 80 million (inclusive of PAYE) as salaries paid to the partners in the ratio of 2:5:3 for Shapu (S), Annette (A), Diana (D) respectively. PAYE remitted to URA was Shs 5 million, 12.5 million and 7.5 million for S:A:D respectively

Other expenses debited to the income statement included Shs 20 million as "facilitation" to secure the contract, depreciation of Shs 7.5 million for the assets of the firm and partners' private expenses of Shs 42.5 million based on their capital contribution sharing ratio.

No capital allowances were claimed. However, records indicated that the capital allowance were Shs 9 million. Also included in income was interest payable on partners' drawings of Shs 4.5 million. Only Shapu drew money from the partnership. The firm's insurance premium of Shs 15 million had not been recorded in the books. Mr. Shapu, the Managing Partner, has approached you to advise him on the tax payable by him and his partners.

Required

- (a) Advise Mr. Shapu on the partnership profit/losses attributable to each partner of SAD & Partners for the year ended 31 December 2007.

(10 marks)

- (b) The outstanding tax payable by Shapu for the year ended 31 December 2007, if any

(10 marks)

(Total 20 marks)

Question 4

Trust Uganda Limited ("TUL") is a real estate company in Uganda which was incorporated in 1999. TUL wishes to enter into partnership with Faith International Limited ("FIL") a company incorporated in Republic of Ghana also dealing in real estate management. There are a number of areas Mr. Twaha the Managing Director of TUL would like to be advised on before he signs the deal with the Ghana based company. TUL closes its books every 31 March. Below are the issues to be addressed:

- (1) TUL intends to sell 60% of the shares to FIL. As a consideration, FIL was expected to pay Shs 1,500 per share payable on the date of signing the deal. The share capital of TUL was Shs 50 million (50,000 shares).

(3 marks)

- (2) A management charge of Shs 100 million per annum would be payable by TUL to FIL for the services to be rendered to TUL.

(3 marks)

- (3) In order to raise Shs 250 million to inject in the new business, TUL decided in March 2007 to dispose one of its commercial buildings which they had acquired in 1999 at a cost of Shs 180 million. The highest bidder had quoted Shs. 240 million. The book value at the date of proposed disposal was Shs 140 million giving a profit on disposal of Shs 100 million which was to be credited to the income statement of TUL.

(7 marks)

- (4) The directors were advised to buy a new car for the Managing Director (MD) in the year ended 31 March 2007 which they agreed. The MD's car, a Mark II, was perceived as portraying a poor image on the company and so they decided to dispose of it with a view of buying a better one. The mark III which cost Shs 75 million on 1 April 2005 was bought by a staff at Shs 40 million.

(7 marks)

Required:

Advise Mr. Twaha on the tax implications of each of the above mentioned issues.

(Total 20 marks)

SECTION C

Question 5

- (a) Kato Enterprises is VAT registered and deals in mixed goods. Mr. Kato's accountant is unsure of the VAT implication of supplying mixed sales. During the month of December 2007, the input VAT incurred by the business was Shs 20 million of which 25% was VAT on private expenditure.

Given that total standard rated sales (excl of VAT) was Shs 300 million, while zero rated and exempt sales Shs 100 million and Shs70.5 million respectively, advise Mr. Kato, what VAT they will claim in the December 2007 VAT return.

(4 marks)

- (b) Yellow Couriers (U) Limited ("YCUL") is a VAT registered business dealing in general merchandise. Mr. Yellowman the Managing Director has received a VAT audit report from URA containing a number of issues which he is not conversant with. The transactions for the month of January 2008 include standard rated supplies valued at Shs 124.5 million (VAT inclusive), while standard rated purchases and expenses were Shs 68.6 million (VAT exclusive).

Below are some of the issues raised in the URA report:

- (i) The company had supplied raw milk and beef worth Shs 18 million (VAT inclusive) to its main customer, Classica Hotel in Kampala.
- (ii) An amount of Shs 10.2 million (VAT inclusive) was recorded as a payment to a transporter for transporting company's goods from Mombasa to Kampala.
- (iii) The company bought vehicles worth Shs 30 million from a Rwandan based company and no VAT had been claimed. The motor vehicle cost details were as follows: Landcruiser – Shs 6,000,000, Omnibus (delivery van) – Shs 9,000,000 and single cabin pickup – Shs 15,000,000.
- (iv) The company incurred Shs 18 million to hold its senior staff strategic workshop in Kalangala Classic Hotel –Ssesse Islands. Of this expenditure, 30% related to accommodation while the rest was direct expenses for business purposes. No VAT was claimed.
- (v) The company sold 50 of its heifers from its farm in Kayunga Ranch at Shs 25 million (VAT inclusive).
- (vi) Salaries for staff of Shs 45 million was recorded as VAT inclusive.
- (vii) The company supplied 200 guest chairs to CHOGM Secretariat at Shs 25 million (VAT exclusive).

Required:

Prepare an amended output and input VAT account taking into consideration the transactions highlighted in the URA audit report

(11 marks)

(Total 15 marks)

Question 6

- (a) What are the general external tariffs applicable under the East African Customs Unions?

(3 marks)

- (b) Explain the meaning of the term "rules of origin" as applicable under the East African Customs Union.

(3 marks)

- (c) Explain **three** problems of implementing the East African Customs Union.

(3 marks)

- (d) Explain **six** problems associated with smuggling and suggest remedies.

(6 marks)

(Total 15 marks)

Question 7

Mr. Musisi, the Chairman of the Board of Directors of Musisi Agricultural Products Limited (MAPL) has approached your firm for advice on the tax implication of the following:

- (a) MAPL is located in Namanve industrial park. The business's turnover in the first year of trading was Shs 10 million.

Advise him whether MAPL should register for VAT.

(3 marks)

- (b) During the year ended 31 December 2007, MAPL incurred expenditure of Shs 350 million. Included in the expenditure was Shs 30 million for acquisition of land, Shs 15 million for land clearance and the balance for green house construction.

Advise Mr. Musisi how much farm works allowance MAPL can claim in the year of income ended 31 December 2007.

(3 marks)

- (c) During the year ended 30 June 2007, Mr. Musisi received interest of Shs 5.6 million net of withholding tax from Centenary Bank Limited.

Advise him on how this transaction is treated for tax purposes.

(2 marks)

- (d) MAPL applied in writing to the Commissioner General of URA to have their accounting year end as 31 December which was accepted. If the projected taxable income during the year of income 2007 was Shs 200 million.

Advise Mr. Musisi how much tax MAPL should pay as first and second provisional tax and the due dates for filing and paying the tax.

(4 marks)

- (e) Mr. Musisi has residential houses for letting in Najjanankumbi, Kampala. During the year ended 30 June 2007, the gross income from the houses was Shs 36 million. He incurred expenses of Shs 12 million giving net income of Shs 24 million. He made a tax payment of Shs 7.2 million which is 30% of net rental income.

Advise Mr. Musisi whether he paid the right amount of tax.

(3 marks)

(Total 15 marks)

-END-

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 plus 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 plus 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 plus 1% of gross turnover, whichever is the lower.