

THE PUBLIC ACCOUNTANTS EXAMINATIONS BOARD

A Committee of Council of ICPAU

CPA (U) EXAMINATIONS

LEVEL TWO

TAXATION - PAPER 11

THURSDAY, 11 DECEMBER 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 11.
6. Please read further instructions on the answer book.

SECTION A

Question 1

Waiga Industries Limited is a manufacturing company registered in Uganda. Its principal business is the manufacture of carpets. The factory plant is located in Western Uganda and the company is registered for all Ugandan taxes. The following is its detailed income statement for the period ended 31 December 2007.

Income Statement for the Year Ended 31 December 2007

	Shs '000'
Income	
Turnover	1,020,300
Cost of sales (Note 1)	<u>(723,700)</u>
Gross profit	296,600
Other income (Note 2)	<u>55,000</u>
Total gross profit	<u>351,600</u>
Expenditure	
Distribution and marketing expenses	45,600
Administrative costs (See below)	303,630
Finance costs	<u>7,000</u>
Total expenditure	<u>356,230</u>
Net profit (loss) before tax	<u>(4,630)</u>

Analysis of Administrative Costs	Shs '000'
Salaries and wages	110,200
Rent for staff	5,400
Water and electricity (Note 3)	6,550
Life insurance premium	8,210
Office Repairs and maintenance	10,210
Security for business Premises	6,100
Motor vehicle expenses	12,300
Printing and Stationery	10,400
Professional fees (Note 4)	35,100
Telephone (Note 5)	5,210
Depreciation	50,270
Travel and accommodation (Note 6)	17,900
Sales & marketing (Note 7)	15,460
Bad debts (Note 8)	<u>10,320</u>
	<u>303,630</u>

Notes

1. Cost of sales: This includes a penalty of Shs 5 million imposed by government for under-declaration of the value of imported stationery.
2. Other income includes Shs 1 million profit on disposal of one of the motor vehicles.
3. Included in the water bill is Shs 500,000 for water used at one of the Directors' residence but paid for by the company. This was not considered in the PAYE computation of the Director.
4. Professional fees were in respect of purchase and transfer of manufacturing equipment into the company's name and was analysed as follows:

	Shs '000'
Expatriate engineer who installed the machinery	20,000
Legal fees connected to the purchase of the machinery.	10,000
Foreign lawyers who recovered Shs 75 million from a foreign debtor who had bought the company's products.	5,100

5. Telephone bills of Shs 2 million were for a sister company currently experiencing cash flow problems.
6. Travel and accommodation: Shs 8 million relate to staff travel costs to and from their homes to the place of work. This expense was included in the payroll and taxed under the PAYE system. The balance is in respect of staff travel and accommodation while on duty out of their usual workstations.
7. Sales and marketing: Shs 10 million relate to a staff party held at Safari Hotel on the 2nd anniversary of the company's existence.

8. Bad debts include:	Shs '000'
Trade bad debts written off	2,100
Sale of company car to staff	3,120
Provision for doubtful debts	4,050
Unidentified trade debtors.	<u>1,050</u>
	<u>10,320</u>

Auditors had advised that the unidentified debtors be written off, because their existence could not be ascertained. No provision had been made against them in earlier financial statements.

Additional information:

- (a) The company owns 10 computers whose written down value (WDV) at 31 December 2006 was Shs 30 million. 5 more computers were bought and put to use on 1 July 2007 at a cost of Shs 20 million.

- (b) The WDV of the company's manufacturing machinery at 31 December 2006 was Shs 200 million. Additional machinery of Shs 70 million was installed and put to use on 30 June 2007.
- (c) The company bought a new Landcruiser Prado motor vehicle for the Managing Director at a cost of Shs 100 million. It was put to use on 1 October 2007. The old Prado which had been acquired 4 years ago at Shs 40 million had a net book value of Shs 5 million as at 31 December 2006 and was disposed off during the course of the year at a profit of Shs 1 million over its WDV. The company also bought two 15 tonne trailers at a cost of Shs 300 million.
- (d) The company's office furniture and other equipment had a tax WDV as at 31 December 2006 of Shs 50 million and no additions were made in 2007.
- (e) The existing factory building cost Shs 90 million and was constructed in 2000 and first brought to use on 1 July 2001. During the year, an extension to the factory building was made at a cost of Shs 100 million and brought into use on 1 October 2007.

Required:

- (a) Compute the chargeable income and tax payable by Waiga Industries Limited for the year ended 31 December 2007.
(28 marks)
- (b) Advise on the tax implications of the trade debtors written off that were more than 3 years old.
(2 marks)

(Total 30 marks)

SECTION B**Question 2**

- (a) Mr. Quanta is a second-hand clothes dealer at Owino market in Kampala. His total sales for the year ended 30 June 2008 were Shs 41 million. Over the same period he incurred expenditure as follows:

	Shs '000'
Rent	1,000
wages	2,000
drawings	870

Required:

Compute Mr. Quanta's tax liability.

(3 marks)

- (b) In January 2008, Kapere Ltd incurred start-up costs of Shs 20 million at the initial public offering at the Uganda Securities Exchange.

Required:

Advise on the treatment of these costs for income tax purposes.

(4 marks)

- (c) Mr. Buzi is an individual taxpayer with an accounting date of 31 March.

Required:

- (i) Show the dates when Mr. Buzi should pay his provisional tax.
- (ii) What difference would it make if Mr. Buzi was a limited liability company?
- (iii) With reference to (i) and (ii) above, advise as to when the final self assessment return would be due for filing to Uganda Revenue Authority.

(3 marks)

- (d) Mr. Kinda is a Sudanese and was resident in Uganda for a period of less than 183 days for the year of income 2007. Mr. Kinda earned a royalty of Shs 30million from Uganda. His other sources of income were dividends from shares invested on the Nairobi Stock Exchange of Shs 10 million.

Required:

Compute Mr. Kinda's tax liability in Uganda.

(3 marks)

- (e) Karati Limited is a mining company operating in Karamoja dealing in the mining of gold. The company registered a gross revenue of Shs 1,200 million as at 31 October, 2008. Expenditure incurred in deriving that

revenue amounted to Shs 700 million. After several adjustments, the accountant arrived at a chargeable income of Shs 750 million.

Required:

Calculate the rate of tax applicable to Karati Limited to be used in determining their tax liability.

(4 marks)

- (f) Mr. Nkanja has been an employee of XL Limited for over 15 years. He received compensation for termination of his contract of employment of Shs 30 million on 30 September 2008.

Required:

Advise on the amount of taxable benefit due to Mr. Nkanja.

(3 marks)

(Total 20 marks)

Question 3

Zedd is a Manager of Candy Limited, a company dealing in the importation and sale of Candy. Zedd was appointed effective 1 July 2007. His letter of appointment, among other things, contained the following terms of employment:

- (i) Basic monthly salary Shs 5 million, payable in arrears.
- (ii) A company car, which had just been acquired at Shs 40 million.
- (iii) Rent allowance of Shs 700,000 per month plus domestic bills of electricity, telephone and water.
- (iv) Reimbursement of private entertainment expenses not exceeding Shs 200,000 per month.
- (v) Loan facilities from the company not exceeding Shs 20 million at an interest rate of 5% per annum. The loan(s) would be repayable in four years' time.
- (vi) Company to contribute the equivalent of 10% of basic salary to National Social Security Fund and Zedd would be required to contribute 5% of his basic salary to the same Fund.
- (vii) A 30 working days' leave after every year; leave pay being equal to a month's basic salary. The company to meet annual leave travel costs.
- (viii) Medical insurance allowance for self and immediate family amounting to Shs 300,000 per month. The company maintains a medical scheme with an international medical group for all the employees.
- (ix) A hardship allowance of Shs 70,000 per day when deployed to supervise the company's outlets in the remotest parts of the country in addition to a normal subsistence allowance, to cover maintenance costs while on duty.

- (x) Company to pay subscription fees to any professional body that Zedd subscribes to, up to a limit of Shs 300,000 per annum.
- (xi) Appointment is effective 1 July 2007.

Additional information:

Zedd accepted the above terms and reported immediately for duty.

- (i) By 30 June 2008, Zedd had privately used the car during that year for approximately 70 days. He had also paid Shs 300,000 towards expenses related to the car.
- (ii) The company paid subscription fees on his behalf to the Institute of Certified Public Accountants of Uganda (ICPAU) amounting to Shs 250,000.
- (iii) The company paid Zedd rent allowance for a house he got in Muyenga of Shs 700,000 per month and the monthly domestic bills amounted to Shs 200,000.
- (iv) During the twelve months to 30 June 2008, Zedd incurred a total cost of Shs 2 million in respect of entertainment.
- (v) Zedd took a furniture loan of Shs 12 million on 1 March 2008. Assume that the statutory rate of interest at 1 July 2007 was 15%.
- (vi) The annual leave travel expenses amounted to Shs 300,000 and were paid together with leave pay in December 2007.
- (vii) During the financial year Zedd spent a total of 30 working days supervising the company's outlets upcountry.
- (viii) Zedd received alimony from his ex-wife of Shs 10 million on 30 April 2008.

Required:

- (a) Compute Zedd's chargeable employment income for the year ended 30th June 2008 commenting on any information not used.
(16 marks)
- (b) Advise on the tax liability arising out of employment income that Zedd should have paid for the year ended 30 June 2008.

(4 marks)

(Total 20 marks)

Question 4

- (a) Musa and Sons Limited have been trading in the ingredients used in the making confectionaries for the past year of income. The company has been purchasing these standard rated ingredients from non-VAT registered persons. Musa and Sons Limited is registered for VAT. During the month of June 2008 they made standard rated supplies to Mande Limited worth Shs 20 million inclusive of VAT. Mande Limited runs a Bakery at Kibuye

and used the purchased ingredients as raw material in production of confectioneries.

During the same month, Mande Limited produced 20,000 loaves of bread and sold each of them at Shs 2,000 VAT inclusive to Kingo, a Retailer. Kingo sold each loaf to his individual customers at Shs 2,600 inclusive of VAT. Both Mande Limited and Kingo are VAT registered.

Required:

Based on the above information, compute the VAT payable to Uganda Revenue Authority by each person mentioned in the above transactions.

(7 marks)

- (b) Whenta Ltd began business in June 2008, and during the months of June to August 2008, the company purchased goods worth Shs 70 million and Capital assets worth Shs 60 million for use in business to generate income. The company also incurred Shs 3 million on business telephone calls. The costs were inclusive of VAT. The Company applied and was registered for VAT on 1 September 2008. Whenta Ltd would like to lodge a VAT return and also claim input VAT suffered on the goods, capital assets and other business expenses mentioned above.

Required:

Advise the chief accountant of Whenta Ltd on the claim for input VAT before he submits the return to Uganda Revenue Authority.

(5 marks)

- (c) Phanta Bank Ltd, which deals purely in financial services, is tax resident in Uganda. During the month of October 2008, the bank engaged a non-resident consultant to provide them with management advisory services.

The consultant firm hired was resident in South Africa and billed Phanta Bank Ltd for Shs 30 million for the management advisory services provided.

The financial controller of Phanta Bank Ltd has been informed that Uganda has a double tax treaty with South Africa.

Required:

Write a memo to the financial controller of Phanta Bank Ltd advising him on the VAT and withholding tax implications of the payment that he has to make to the South African resident consultant.

(8 marks)

(Total 20 marks)

SECTION C

Question 5

- (a) The East African Customs Union took effect from February 2005, and the member states agreed to a Common External Tariff and Common Internal Tariffs.

Required:

Discuss the difference between Common External Tariffs and Common Internal Tariffs and how they are applied in a customs union.

(6 marks)

- (b) The Treaty establishing the Common Market of Eastern and Southern Africa (COMESA) binds together free independent sovereign states which have agreed to co-operate in exploiting their natural and human resources for the common good of all their people.

Required:

State any **three** principles in pursuit of the aims and objectives of the Treaty.

(3 marks)

- (c) Briefly distinguish between customs duty and excise duty.

(6 marks)

(Total 15 marks)

Question 6

- (a) The Income Tax Act provides for several penalties for different offences. For the following cases under the Income Tax Act, state the penalties due on conviction of any of the offences:

- (i) Mbabale, a sole proprietor failed to maintain proper records of his business for tax purposes.

(2 marks)

- (ii) Mr. Mukasa obstructed officers from Uganda Revenue Authority in performance of their duties at his business premises and forged a tax identification number.

(2 marks)

- (iii) Mr. Mango failed to furnish returns for the year of income 2007.

(2 marks)

- (b) Kalanzi & Company Limited has been in operation for the last five years operating within the normal year of income ending on 30 June. During the recent Board meeting, Kalanzi, one of the directors with reasons, suggested to move a resolution to apply for a substituted year of income.

Required:

- (i) What is a substituted year of income?
(1 marks)
- (ii) Outline the procedures a taxpayer has to go through to apply for a substituted year of income.
(2 marks)
- (c) Write short notes on the following:
- (i) Resident company for any year of income.
(3 marks)
- (ii) Resident trust for any year of income.
(3 marks)
- (Total 15 marks)**

Question 7

- (a) Governments worldwide embrace taxation for various reasons. Khenta, a resident person has always wondered why a country subjects herself to the “unpleasant” experience of levying taxes.
- (b) Supporters of the taxation system, however, assert that as much as the exercise of taxation is unpleasant, it is premised on principles that form its foundation after all.
- (c) Supporters of the taxation system further argue that progressive and regressive tax systems would at some point even-out the imbalance in the tax system.

Khenta is in dilemma about all the above issues. You are a tax consultant, and Khenta has approached you to enlighten him on the above issues.

Required:

Write a report to Khenta, clearly commenting on each of the above issues.
(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.