

THE PUBLIC ACCOUNTANTS EXAMINATIONS BOARD

A Committee of Council of ICPAU

CPA (U) EXAMINATIONS

LEVEL TWO

TAXATION - PAPER 11

THURSDAY, 18 JUNE 2009

INSTRUCTIONS TO CANDIDATES

1. Time allowed: **3 hours 15 minutes.**
The first 15 minutes of this examination have been designated for reading time. You may not start to write your answer during this time.
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

Kanga Ltd is located in Jinja and deals in the production of detergent products. The company is fully registered for all Ugandan taxes. The company's results for the year ended 31 December 2008 were as follows:

	Notes	Shs '000'
Income:		
Revenue from operations		860,000
Foreign exchange gain	1	2,000
Profit on disposal of non-current assets		10,000
Other income		<u>25,000</u>
		897,000
Expenses:		
Staff costs	2	300,000
Advertising	3	98,000
Repairs and maintenance	4	52,000
Utility bills		35,000
Provision for bad debts	5	23,000
Legal fees	6	68,000
Depreciation	7	102,000
Penalty for late payment of tax		6,500
Interest costs		<u>22,000</u>
Net profit		<u><u>190,500</u></u>

Notes:

1. The foreign exchange gain relates to gains arising on revaluation of a US dollar (USD) denominated loan from Standard Bank at the end of the year.
2. Staff costs include the following: **Shs '000'**

Director's Pay as You Earn (PAYE)	15,000
Penalties PAYE for staff	30,000
Compensation to terminated staff	6,000
Staff educational programme by the Institute of Certified Public Accountants of Uganda (ICPAU)	12,000
3. Advertising expenses include the following: **Shs'000**

Newspaper and Radio adverts	30,000
Installation of billboards owned by the company	25,000
Rent for space on other billboards	16,000
4. Repairs and maintenance include the purchase of office equipment of Shs 20 million of which Shs 3 million relates to capital items whose individual cost was less than one million shillings.
5. The provision for bad debts includes a provision for staff bad debts of Shs 3 million. The balance relates to provisions for bad debts for ordinary business.
6. Legal fees were incurred in pursuit of the following: **Shs '000'**

Increase in share capital	40,000
Debt collection	13,000
Purchase of a piece of land	<u>15,000</u>
	<u>68,000</u>
7. Included in depreciation was an operating leasehold amortisation for the year on a straight-line basis on a commercial business property that cost Shs 80 million in 2004. The lease period for this property is 40 years.

Additional information:

- (i) Written down values (WDV) of depreciable assets as at 31 December 2007:

	Shs '000'
Class I	45,000
Class II	130,000
Class III	120,000
Class IV	170,000

- (ii) During the year, the company made the following additions to assets:

Item	Shs '000'
Mercedes Benz (saloon car)	85,000
Pick-up truck (1 ton)	45,000
Tipper truck (10 tons)	65,000
5 computers	15,000
Land	260,000

- (iii) Proceeds from disposal of assets during the year included the following:

	Shs '000'
Three old computers	5,500
One old pick up truck (5 tons)	6,500
One motor truck (9 tons)	15,300

- (iv) The company owns a factory building, which cost Shs 700 million when it was first put to use on 1 January 2004 (initial allowance was claimed in that year). During the year the company put to first use an extension that cost Shs 200 million on 1 July 2008.
- (v) The company had an agreed tax loss of Shs 20 million as at 31 December 2007.
- (vi) Provisional tax paid during the year was Shs 100 million.

Required:

- (a) Compute the final corporation tax payable by Kanga Ltd for the year ended 31 December 2008.
- (26 marks)**
- (b) Discuss any **four** circumstances under which withholding tax is **not** a final tax.

(4 marks)

(Total 30 marks)

SECTION B**Question 2**

KAD Associates is a consultancy firm that provides consultancy services in accountancy and taxation. The partners include; Kamba, Anko and Dadi, sharing profits in the ratio 2:3:4 respectively. The partners have lived in Uganda for a period of over 183 days. In addition to consultancy services, the partners also earn income from rental property located in Bugolobi, Kampala and use the profit sharing ratio to apportion tax arising on the rental income.

The firm's statement of comprehensive income for the year ended 30 June 2008 was as follows:

	Shs'000	Shs'000
Income		
Fees from tax advisory services		180,000
Fees from accountancy services		260,000
Rental and property income		<u>96,000</u>
		536,000
Expenses		
Partners' salaries:		
Kamba	23,900	
Anko	35,600	
Dadi	47,500	
Partners' PAYE	15,000	
Staff salaries	90,000	
Staff PAYE	21,000	
Private partners' expenses	6,000	
Administrative expenses	30,000	
Commission to government officials to win a contract	5,000	
Partners' professional insurance	12,000	
Partners' private insurance policies	60,000	
Depreciation of non-current assets	<u>54,000</u>	<u>400,000</u>
Net Profit		<u><u>136,000</u></u>

Additional information

1. Tax depreciation allowances on the firm's assets were Shs 15 million. Commercial building tax allowance was Shs 3 million.
2. In the previous tax audit, it was agreed with tax authorities that the non-qualifying use of the partnership assets was 15%.
3. Interest on capital payable to the partners is 15%.
4. Interest payable to the partners is based on opening balance of the individual partner's capital account.
5. Included in administrative expenses is Dadi's rent of Shs 5 million and Shs 23 million relating to expenditure on rental property owned by the partnership.
6. Partners' PAYE of Shs 15 million was paid in their profit sharing ratio.
7. The partner's capital accounts are as follows:

Balances as at	1 July 2007	30 June 2008
	Shs '000'	Shs '000'
Kamba	12,300	15,600
Anko	14,400	17,200
Dadi	18,500	20,700

Required:

Compute:

- (a) the partnership's taxable profits for the year ended 30 June 2008.
(11 marks)
 - (b) taxable profits attributable to each partner.
(4 marks)
 - (c) each partner's tax liability for the year ended 30 June 2008.
(5 marks)
- (Total 20 marks)**

Question 3

Mukasa and Sons Ltd, a resident company, commenced business three years ago and is duly registered for value added tax (VAT). The main business of the company is dealing in computers and related products. For the period ended 31 May 2009, the company was engaged in various transactions. It is normal practice for Mukasa and Sons Ltd to engage a consultant to review the transactions before a VAT Return is filed.

You have been contracted by Mukasa and Sons Ltd to review the period ended 31 May 2009 and the following information has been provided to you:

- (i) During the month, the company imported goods. The value of the goods ascertained for purposes of customs duty was Shs 215 million. The amount of customs duty on the imported goods was Shs 25 million. The company also imported computer software worth Shs 10 million.
- (ii) During the month, the company made VAT exclusive standard sales worth Shs 240 million and computer software of Shs 10 million.
- (iii) The company has a two-year management consultancy with Capital Telecom and charges a monthly fee of Shs 50 million VAT inclusive. The company is expected to bill the month of May 2009 fees on 15 June 2009 and subsequently account for output tax in the same month of June 2009.
- (iv) The company did not charge VAT on a rental invoice of Shs 15 million (VAT exclusive) in relation to a commercial building owned by Mukasa and Sons Ltd. The accountant treated the supply as zero-rated.
- (v) The company made a VAT set off of Shs 6 million relating to an outstanding debt expected to go bad, against its output VAT during the month. The debt has been outstanding for the last one and a half years.
- (vi) The company purchased equipment of Shs 63 million VAT inclusive. It was advised not to claim the input VAT but to capitalize it and consider it as a cost of the equipment.
- (vii) Input VAT of Shs 1,500,000 was claimed in respect of maintenance and repairs of one of the Director's private car and Shs 600,000 was claimed in respect of the company's lorry.

Required:

- (a) Advise the company on the VAT implications relating to issues raised in (i) – (vii) above. **(8 marks)**
- (b) Compute the actual VAT liability due. **(9 marks)**
- (c) Outline any **six** common errors and/or problems encountered in the administration of VAT. **(3 marks)**

(Total 20 marks)

Question 4

- (a) Hojan (U) Ltd, a company dealing in general merchandise is a resident company in Uganda. Trojan Company Ltd, a non resident company registered in Egypt owns 85% shares in Hojan. The remaining 15% of the shares in Hojan are owned by a Ugandan resident.

According to information available as at 1 July 2007, Trojan advanced Hojan a loan of Shs 450 million. The share capital of Hojan (U) Ltd was Shs 45 million. Hojan (U) Ltd had an accumulated profit of Shs 40 million and there was a share premium of Shs 20 million. Interest charged in the statement of comprehensive income for the year ended 30 June 2008 was Shs 50 million.

Required:

- (i) Define the term “thin capitalization” as used in the context of the Income Tax Act.

(2 marks)

- (ii) Compute and advise on the income tax effects of the above information on Hojan (U) Ltd.

(5 marks)

- (b) Mango Manufacturers Ltd deals in the manufacture of soft drinks. The company is situated in Kawempe, Kampala. It commissioned its new factory on 1 January 2008. The following data relates to the costs incurred on:

	Shs'000
Purchase of land	300,000
Compensation to squatters	20,000
Construction cost	860,000
Plant and machinery	270,000

The company disposed of its old factory on 1 January 2008 at a price of Shs 350 million.

The old factory building disposed of had been constructed at a cost of Shs 230 million and put to first use on 1 January 2000.

During the year 2008, the company disposal of the Managing Director's Prado vehicle at Shs 34 million and replaced it with another Prado vehicle at a cost of Shs 90 million. The disposed of vehicle was bought on 30 June 2006 at a cost of Shs 65 million.

Required:

- (i) Compute the taxable capital gains/losses due to be incurred by the company for the year ended 31 December 2008.
(9 marks)
 - (ii) Outline the kind of transactions per the Income Tax Act where no capital gains or losses will be recognized or taken into account.
(4 marks)
- (Total 20 marks)**

SECTION C

Question 5

You have been engaged as a tax consultant for Mr. Patel who wishes to invest in any sector that minimizes tax liabilities and maximizes profits. He has specifically requested you to address the following areas:

- (a) The explanation of the term 'tax planning' and advise on the areas to consider in tax planning.
(7 marks)
 - (b) Description of the anti-avoidance provisions as laid out in the Income Tax Act.
(4 marks)
 - (c) Discussion of the challenges of anti-avoidance provisions in controlling tax evasion.
(4 marks)
- (Total 15 marks)**

Question 6

The Minister in charge of Trade and Customs in Uganda has just been appointed and has expressed limited knowledge about the operations of the East African Customs Union. You are a consultant in common markets affairs and the Minister feels you can be of great help.

Required:

- (a) Define the term 'customs union'. **(2 marks)**
- (b) Give **seven** main features of a customs union. **(7 marks)**
- (c) Under a customs union, preferential tariffs may be used on goods that satisfy the set rules of origin. Why is it important for such goods to satisfy the rules of origin? **(2 marks)**
- (d) Give the criteria that is considered by the East African partner states to determine the origin of goods. **(4 marks)**

(Total 15 marks)

Question 7

- (a) Write brief notes on the following:
 - (i) Tax shifting. **2 marks**
 - (ii) Tax burden. **2 marks**
 - (iii) Tax incidence. **2 marks**
- (b) Explain the characteristics of indirect taxes and discuss the case for and against indirect taxes. **(9 marks)**

(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 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.