

THE PUBLIC ACCOUNTANTS EXAMINATIONS BOARD

A Committee of Council of ICPAU

CPA (U) EXAMINATIONS

LEVEL TWO

TAXATION - PAPER 11

TUESDAY, 15 JUNE 2010

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

Wonder Bank Ltd is a financial institution registered to offer small and medium financial services. Its offices are registered in Kotido in Northern Uganda. The bank commenced business on 2 January 2007. The financial performance of the bank for the year ended 31 December 2009 is as follows:

Statement of comprehensive income

	Note	Shs '000'
Net interest income	1	1,050,000
Fees and commission income	2	23,500
Personnel costs	3	(430,000)
Operating expense	4	(338,000)
Impairment of loans and advances	6	<u>(56,400)</u>
Profit before tax		<u><u>249,100</u></u>

Notes to the financial statements:

1. Net interest income:

	Shs '000'
Interest income:	
from loans and advances	876,000
from placements with other banks	33,500
net income from investment securities	158,900
Less interest expenses:	
on time deposits	(8,800)
on demand deposits	(400)
other borrowing costs	<u>(9,200)</u>
	<u><u>1,050,000</u></u>

2. Fees and commission income:

	Shs '000'
Fees and commission charges	19,300
Foreign exchange income	<u>4,200</u>
	<u><u>23,500</u></u>

3. Personnel costs include:

	Shs '000'
Retirement benefit costs	126,000
Staff salaries and wages	256,000
Directors' fees	22,400
NSSF contribution	<u>25,600</u>
	<u><u>430,000</u></u>

The director's fees were not subjected to any withholding tax at the time of payment.

4. Operating expenses include:

Shs '000'

Depreciation of property and equipment	47,000
Loss on disposal of property and equipment	2,560
Administration expenses (Note 5)	270,380
Operating lease rentals	560
Auditors' remuneration	<u>17,500</u>
	<u>338,000</u>

5. Administration expenses:

Shs '000'

Utilities	53,300
Repairs and maintenance	46,800
Subscription to Uganda Bankers' Association	15,000
Costs of Signage for advertising	28,000
Selling and marketing costs	<u>127,280</u>
	<u>270,380</u>

6. Impairment of loans and advances:

Shs '000'

Specific impairment	52,000
General impairment	<u>4,400</u>
	<u>56,400</u>

Additional information:

1. Written Down Value (WDV) 1 January 2009:

Shs '000'

Class I	167,000
Class II	75,000
Class III	Nil
Class IV	64,000

2. Additions of depreciable assets during the year:

Shs '000'

Computer hardware	20,000
Computer software	82,000
Money counting machines	25,000
Furniture and equipment	15,000
Pickup (3 tons)	18,000

3. Disposal proceeds from sale of assets in class II amounted to Shs 15 million. The cost of the assets disposed of wholly qualified for capital allowances at the time of purchase.

4. Wonder Bank Ltd constructed an extension to the business premises of Shs 250 million and brought it into first use on 1 March 2009. The existing business premises had cost Shs 780 million when they were put to their first use in January 2007.
5. Wonder Bank Ltd traded in treasury bills and treasury bonds as follows:
- | | |
|--|------------------|
| Treasury bills: | Shs '000' |
| Income from treasury bills | 66,000 |
| Interest cost on treasury bills | 3,500 |
| Withholding tax paid on treasury bills | 3,960 |
| Treasury bonds: | Shs '000' |
| Income from treasury bonds | 82,000 |
| Interest cost on treasury bonds | 7,400 |
| Withholding tax paid on treasury bonds | 4,920 |
6. The bank supports agriculture and made the following transactions:
- | | |
|--|----------------|
| | Shs'000 |
| Interest income earned on agricultural loans | 15,900 |
| Interest expense on agricultural loans | 2,300 |
| Specific bad debts on agricultural loans | 3,600 |
7. Unrealized gains on foreign exchange during the year were Shs 1,570,000.
8. At start of business, the gross start up costs were Shs 54 million.
9. Provisional tax paid during the year amounted to Shs 124 million.

Required:

- (a) Compute the tax liability of Wonder Bank Ltd as at 31 December 2009.
(27 marks)
- (b) Give any **six** examples of exempt income under the Income Tax Act.
(3 marks)
- (Total 30 marks)**

SECTION B

Question 2

1. Mayanja is a Certified Public Accountant of Uganda working as a chief audit executive with Savanna Bank (U) Ltd. His appointment was effective 1 January 2009 on a permanent basis. The following are the entitlements due to Mayanja as per his appointment letter:
 - (a) A gross salary of Shs 120 million per annum.
 - (b) A car for use on both private and official duties valued at a cost of Shs 60 million. The bank charges him a monthly nominal fee of Shs 150,000 for the use of the car. The number of days relating to private use for the year ended 31 December 2009 were 120.
 - (c) Travel allowance for his spouse of Shs 3 million per annum.
 - (d) He received a reimbursement of Shs 4 million as passage costs to Uganda from Kenya where he previously worked before joining Savanna Bank (U) Ltd.
 - (e) The bank has a loan scheme to staff at an interest rate of 8% per annum. The rate of interest ruling in the market was 16% per annum and the statutory rate was 14% per annum for the year ended 31 December 2009. Mayanja took up a loan of Shs 70 million on 1 May 2009.
 - (f) The bank pays for his membership to Kabira Club of Shs 1.7 million per annum.
 - (g) The bank pays his subscription to the Institute of Internal Auditors Uganda Chapter of Shs 240,000 per annum.
2. Mayanja has three residential houses for letting out in Nsooba. He earns Shs 500,000 per month per house. During the year ended 31 December 2009, he incurred the following costs on the residential houses:
 - (a) Utility bills of Shs 150,000 per month.
 - (b) Salaries and wages to the security guard of Shs 200,000 per month.
 - (c) Repairs and maintenance of the houses of Shs 1.5 million per annum.
3. Mayanja is also a partner with Kande Certified Public Accountants. The other partner is Nambi. Mayanja and Nambi share profits in the ratio 3:2. For the year ended 31 December 2009, the firm made taxable profits of Shs 65million before taking into account capital allowances of Shs 40million. The partnership paid salaries of Shs 3million to Mayanja and Shs 2.5 million to Nambi which was not recorded in the books.

Required:

- (a) Compute the partnership taxable profits/losses attributable to each partner of Kande Certified Public Accountants for the year ended 31 December 2009.

(4 marks)

- (b) Compute the amount of tax payable by Mayanja for the year ended 31 December 2009.

(16 marks)**(Total 20 marks)****Question 3**

- (a) Mande identified a car through the internet from Toyah Motors Ltd's website, a company registered in Japan. Mande made an order in December 2009 for a Toyota Prado Model 1999 invoiced at a price equivalent to Shs 22 million free on board (FOB) Nagoya Japan. Mande paid an equivalent of Shs 3.2 million for shipment from Japan to Mombasa and Shs 250,000 for insurance premium on board. Kangaroo Cargo Movers Ltd charged Mande Shs 1.2 million to transport the vehicle from Mombasa to Kampala.

Additional information:

1. Import duty rate for the vehicle is 25%.
2. Environmental levy is 20% for used vehicles older than 8 years.
3. Vehicle registration fees is Shs 1,018,000.

Mande was given an assessment to clear taxes on importation of the vehicle by Uganda Revenue Authority. He, however, was in doubt of Uganda Revenue Authority's computations since it was his first time to make an import. You are working with Wiser Certified Public Accountants as a tax consultant.

Required:

Recompute all the necessary taxes and advise Mande on the tax due, including registration charges to enable him register his motor vehicle.

(10 marks)

- (b) Qwak Ltd started trading in domestic appliances on 1 January 2009. The company was registered for VAT on 1 August 2009. The following transactions relate to the trading period from 1 January to 31 December 2009.

		Shs '000'
16 January:	Bought office furniture and equipment	7,000
20 February:	Bought additional Furniture	6,000
20 March:	Bought computers	5,500
1 September:	Replacement of furniture	1,200

Bought inventories for trading as follows:

	Shs '000'
20 January	3,000
2 February	7,000
3 April	15,000
20 July	13,000
30 August	25,000
20 December	30,000

Sales at invoice price during the period:

	Shs '000'
March 2009	2,000
April 2009	5,000
May 2009	6,500
June 2009	4,000
July 2009	7,000
August 2009	6,000
September 2009	9,000
October 2009	10,000
November 2009	6,800
December 2009	15,000

Additional information:

1. The sales invoice values are VAT inclusive where applicable.
2. The purchase prices are VAT exclusive.
3. All purchases are made from VAT registered companies.
4. Assume first in first out (FIFO) method of inventory valuation

Required:

Compute input VAT claimable on inventory and capital goods at registration.

(10 marks)

(Total 20 marks)

Question 4

- (a) Tororo Limestone Ltd is a company dealing in the production of cement and other products. The company is situated in Tororo district and commenced business on 1 January 2003 in an old factory that had been acquired from an Indian national who was leaving the country. Management revamped the business on 1 January 2009 with a newly acquired factory building, plant and machinery as follows:

Tax written down values of the depreciable assets 31 December 2008:

Brought forward balances

Shs million

Class II	90
Class III	180

Costs incurred during the year:

Shs million

Purchase of piece of land	150
Bribes to the municipal councillors	10
Construction costs for the factory	550
Plant and machinery	250
Compensation to squatters	30

Management disposed of its old factory building in July 2009 at a price of Shs 250 million. The old factory building had been constructed at a cost of Shs 230 million and put to first use on 1 July 1996. The cost of the land on which the old building is was valued at Shs 80 million at the time the new management acquired the factory in 2003.

During the year 2009, management disposed of the chief executive officer's Prado motor vehicle of Shs 25 million. The motor vehicle had been bought in May 2006 at a cost of Shs 65 million. The car was replaced with an ML Benz at a cost of Shs 85 million in September 2009.

Required:

Compute the capital gains/losses during the year ended 31 December 2009 and the applicable tax thereon.

(10 marks)

- (b) Classic Enterprises Ltd is a company registered in Uganda dealing in cosmetics, and is registered for all taxes. During the year ended 30 June 2009, the company experienced difficulties in operations attributed to the economic crisis that affected operations of various companies. The board of

directors convened a board meeting on 1 July 2009 and passed the following resolutions:

- (i) To terminate the services of the managing director with effect from 1 July 2009 since he was perceived to be more expensive to maintain. Having worked for over 13 years, he was paid terminal benefits of Shs 35 million in the month of July 2009. There was no tax deducted from the terminal benefits on the account that the payment was a compensation for loss of office.
- (ii) To procure the services of a specialist from a renowned restructuring firm, Firms Restructures Limited, registered in the Republic of Djibouti. Classic Enterprises Ltd signed a management contract with Firms Restructures Limited on 1 July 2009. Among the terms of the contract professional fees were to be 10% of the previous year's turnover. There is no double taxation agreement between Uganda and Djibouti. The turnover of Classic Enterprises Ltd as at 30 June 2009 was Shs 167 million.

Required:

You, as a tax consultant with KYQ Certified Public Accountants, draft a report to the management of Classic Enterprises Ltd advising them on the tax implications of each of the above resolutions.

(10 marks)

(Total 20 marks)

SECTION C

Question 5

- (a) Explain the circumstances under which a taxpayer is deemed to have attempted to split income as a tax avoidance measure as provided for in the Income Tax Act.
(3 marks)
- (b) Briefly highlight the expenses that may be incurred during scientific research that would not qualify to be allowed as scientific research expenditure as provided for in the Income Tax Act Cap 340 – Laws of Uganda.
(3 marks)
- (c) Briefly highlight any **five** principles that should be fulfilled for the taxation of trusts under the Income Tax Act.
(5 marks)
- (d) Mr. Mukasa has been working with Excel Manufacturers Limited. He has secured a job with the United Nations and shall be leaving Uganda permanently for Geneva and he has outstanding tax obligations.

Required:

Explain the provisions of recovering such tax obligations.

(4 marks)

(Total 15 marks)

Question 6

- (a) In accordance with the East African Community Customs Management Act 2004, differentiate between prohibited and restricted goods.

(4 marks)

- (b) Outline any **six** reasons why restrictions or prohibitions of goods are made.

(3 marks)

- (c) Briefly explain what temporary imports are, giving examples of such imports.

(5 marks)

- (d) State the conditions under which customs may allow temporary importation.

(3 marks)

(Total 15 marks)

Question 7

- (a) Under the Income Tax Act, the commissioner may be required to refund an amount of tax to a person and pay simple interest at a rate of 2% per month for the period commencing on the date the person made the application for the refund and ending on the last day of the month in which the refund is made.

Required:

State the circumstances under which the commissioner might be required to pay the above interest.

(4 marks)

- (b) Explain the fines and penalties for committing the following offences under the Income Tax Act:

(i) Failure to furnish a return.

(2 marks)

(ii) Failure to maintain proper records.

(2 marks)

(iii) Improper use of tax identification number.

(1 mark)

(iv) Obstructing an officer of the authority.

(1 mark)

- (c) Briefly describe any **five** cannons of taxation.

(5 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.