

# **PUBLIC ACCOUNTANTS EXAMINATIONS BOARD**

*A Committee of Council of ICPAU*

## **CPA(U) EXAMINATIONS**

### **LEVEL TWO**

#### **TAXATION - PAPER 11**

**FRIDAY, 22 JUNE 2012**

#### **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. Write your answer to each question in a separate answer booklet.
7. Please read further instructions on the answer booklet, before attempting any question.

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## SECTION A

### Question 1

Kyampisi Coffee Limited was registered in Uganda in June 2008 and commenced business on 1 July 2008. The company deals in the local purchase, processing and export of coffee and cocoa. The principal company premises and factory are located in Kampala with another smaller factory in Mbale where most of the coffee is sourced. Some plant and machinery is located in Mbale. The following is the company's statement of comprehensive income for the year ended 30 June 2011.

Statement of Comprehensive Income for the year ended 30 June 2011:

	Notes	Shs '000'
Income:		
Turnover		110,000,005
Cost of sales		<u>(97,500,000)</u>
Gross profit		<u>12,500,005</u>
Expenditure:		
Operating expenses (details below)		387,005
Staff expenses	1	935,000
Administration expenses	2	1,189,000
Total expenditure		<u>2,511,005</u>
Net profit before tax		<u>9,989,000</u>
Operating expenses:		
Depreciation		404,000
Amortized pre-paid lease rentals		2,005
Reversal of provisions	3	(73,000)
Bank charges		<u>54,000</u>
		<u>387,005</u>

Notes to the accounts:

1. Included in staff expenses is Shs 80 million that the company paid to Uganda Revenue Authority as a penalty for wrong computation of staff PAYE taxes over the years after a tax audit.

2. Administration costs include the following among other items:

	Shs '000'
Realized exchange loss on legal/professional fees. This amount was unrealized at the end of June 2010.	52,000
Travel expenses for the managing director and his family's vacation.	13,100
Purchase of a personal car for the managing director	56,500
Rent for staff – staff are taxed on the benefit	120,600
Advertising and marketing	237,560
Donation towards organization of PAM awards	24,500

3. The provision that was reversed relates to an amount that had been owing to FBK Packers that was eventually paid during the year. The provision had been made in period ending June 2010.

4. Details relating to non- current assets:-

- (i) Written down values as at 1 July 2010:

	Shs '000
Class I	9,352
Class II	47,050
Class III	83,775
Class IV	391,111

- (ii) Additions to depreciable assets during the year:

	Kampala Shs '000'	Mbale Shs '000'
Computers	3,459	1,040
Office furniture (tables and chairs)	32,700	
Plant and machinery	200,321	122,000
Toyota Land Cruiser	25,200	
5 Yamaha motorcycles		22,000

- (iii) An extra block was added to the buildings in Kampala during the year at a total cost of Shs 115 million. The block was completed and was put to first use on 1 May 2011. The aggregated cost for existing buildings which still have a residual value is Shs 1,250 million. All the buildings were put to use on 1 July 2008.

5. The company's start-up costs in 2008 amounted to Shs 1,500 million.
6. The company paid provisional tax of Shs 1,000 million during the year and had no tax recoverable from previous years.

**Required:**

- (a) Compute the tax adjusted profit, tax liability and tax payable by Kyampisi Coffee Limited for the year ended 30 June 2011. **(28 marks)**
- (b) Advise Kyampisi Coffee Limited on circumstances under which they can deduct bad debts when computing tax payable for a year of income. **(2 marks)**
- (Total 30 marks)**

**SECTION B**

*Attempt two of the three questions in this section.*

**Question 2**

Mr. Nganga is the acting chief executive officer (CEO) of Crown Architects (U) Ltd, an engineering consulting firm based in Uganda with regional headquarters in Nairobi, Kenya. Mr. Nganga is the chief finance officer (CFO) in Nairobi but has moved to act as CEO in Uganda for four months while the company recruits a new CEO. He is a citizen of Kenya and has his permanent home and family in Kenya. Mr. Nganga's terms of employment include the following, among other things:

- (i) His contract commenced on 1 May 2012 and ends on 31 August 2012. His basic salary is Shs 14,500,000 per month payable in arrears.
- (ii) Accommodation is provided to him by the firm and an apartment has been rented for him in Nakasero at Shs 5,750,000 per month.
- (iii) His water and electricity bills are paid by Crown Architects (U) Ltd.
- (iv) Medical insurance is provided for him and his family. A premium of Shs 350,000 is payable to Jumbo Insurance Company by Crown Architects (U) Ltd every month.
- (v) A Toyota Land Cruiser Prado has been purchased for his use during his stay in Uganda after which it will be taken over by the new CEO. The vehicle has cost the company Shs 67,000,000.
- (vi) The company has registered Mr. Nganga for NSSF and it contributes 10% while Mr. Nganga contributes 5% to the same fund.

During the month of May 2012, the following activities took place in respect to Mr. Nganga's employment:

- (i) He took a salary advance of Shs 6 million repayable within four months in equal installments. The current Bank of Uganda interest rate is 8.5% per annum.
- (ii) He was paid a relocation allowance of Shs 5.2 million.

- (iii) A return air ticket was purchased for him to report for duty from Kenya to Uganda and back after his term of employment. The air ticket cost USD 468. The May 2012 URA exchange rate was 1 USD = 2,896 US\$.
- (iv) The human resource department in Kenya has paid into his Uganda bank account Shs 2.5 million. This is a reward in recognition of his performance during the past year while still in the Nairobi office.
- (v) His water and electricity bills for the month of May 2012 amounted to Shs 380,000.

**Required:**

- (a) Compute Mr. Nganga's tax liability and net pay for the month of May 2012. **(17 marks)**
- (b) Identify Mr. Nganga's benefits or allowances that will be exempt from Ugandan tax as per the Income Tax Act of Uganda.

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

Kyetume Boys (U) Ltd deals in the wholesale of assorted products including salt, wheat flour, maize flour, packed juices, and powdered milk. The products are sourced locally or imported. The company was in business for the year ended 31 December 2011 and is registered for value added tax (VAT). The company applies the standard apportionment method to claim for input VAT on its purchases. During the month of December 2011, the company had the following transactions:-

- (i) Sales (VAT inclusive):

	Shs '000'
Standard rated	165,200
Exempt	22,030
Zero rated	<u>137,060</u>
Total	<u>324,290</u>

- (ii) An Isuzu truck was purchased to transport customer products at Shs 75.5 million, VAT exclusive.
- (iii) 150 bags of maize flour were purchased at Shs 12,750,000 VAT exclusive.
- (iv) The company paid insurance for company vehicles to Nice Insurance Company of Shs 3 million.
- (v) The company purchased gifts for the company's 'star' workers for the month for Shs 5 million, VAT inclusive.
- (vi) Purchased office stationery at Shs 6,250,000, VAT exclusive.

- (vii) Purchased home furniture for the new chief executive officer (CEO) at Shs 15 million, VAT inclusive.
- (viii) Imported packed juices (1000 cartons) at Shs 160,850,000 VAT exclusive.
- (ix) The company incurred repairs and maintenance charges for company's pool passenger vehicles at Shs 4.8 million. The vehicles used to transport sales staff to the field.
- (x) Paid security services fees of Shs 3 million, VAT exclusive of which Shs 550,000 was for security services at the managing director's home.
- (xi) The managing director donated 50 cartons of packed juices to Stella Babies Home as a Christmas gift. The company normally sells a carton of packed juice at Shs 250,000, VAT inclusive.

**Required:**

- (a) What type of supplies are the following for VAT purposes?

- Maize and wheat flour
- Packed juices
- Salt
- Milk

**(4 marks)**

- (b) Compute the tax payable/claimable by Kyetume Boys (U) Ltd for the month of December 2011.

**(16 marks)****(Total 20 marks)****Question 4**

Eagle Engineering Group is an oil and gas consulting firm with presence in The Netherlands and Ireland. The firm deals in drilling of oil wells, construction of oil refineries as well as undertaking feasibility studies for oil exploration companies. With the recent discovery of oil in Uganda, Eagle Engineering Group is considering expanding into Uganda.

The company plans to open up a legal entity in Uganda and to send expert staff to Uganda to execute assignments. It will either send its employees or independent consultants. These employees / consultants will be coming to Uganda on a needs basis for periods of not more than 3 months every year. Eagle Engineering Group has not yet decided where the parent company to the Ugandan entity will be based.

The parent company will continue supporting the Ugandan entity by providing management services as well as technical support. These services will be charged to the Ugandan entity.

You are a tax advisor at DSK Consulting which Eagle Engineering Group has approached for tax advice before setting up a Ugandan entity.

**Required:**

- (a) Advise Eagle Engineering Group on whether to open up a branch or subsidiary and give two reasons for your choice.  
**(2 marks)**
- (b) With explanations, advise Eagle Engineering Group on the residence status of the employees / consultants and what their basis of taxation will be.  
**(3 marks)**
- (c) Give your opinion on the income tax implications of Eagle Engineering Group using either its own employees from the parent company or hiring independent consultants to execute assignments in Uganda.  
**(4 marks)**
- (d) Write a memo to the directors of Eagle Engineering Group advising them on the value added tax (VAT) and withholding tax implications of the management services and technical support fees that the Ugandan entity will be paying the parent company.  
**(9 marks)**
- (e) DSK Consulting will charge Eagle Engineering Group USD 5,000 (exclusive of taxes) for the above advice. Giving reasons, what will be the VAT treatment of the above services – will the services be VATable and if yes at what rate?

**(2 marks)**

**(Total 20 marks)**

## SECTION C

*Attempt two of the three questions from this section.*

### Question 5

Kyagulanyi & Sons Ltd deals in the importation, resell and sometimes export of sugar. During the month of December 2011, the company imported 1,000 bags of sugar from the United Arab Emirates (UAE) of 50 kgs per bag. The cost of the sugar was USD 35,714.

The cost of transporting the sugar from the UAE to Mombasa was USD 4,000 and insurance costs of USD 400 from Dubai to Mombasa, Kenya and USD 200 from Mombasa to Kampala, Uganda. The then import rates of sugar were as follows:

Import duty – 75%

Excise duty – Shs 25 per kg

VAT – 18%

Withholding tax (WHT) – 6%. The company is exempted from 6% WHT on imports.

URA imports exchange rate for December 2011 was 1 USD = 2,800 UShs.

Tax is computed based on cost, insurance and freight (CIF) value. The freight value considered is up to Mombasa.

### Required:

- (a) Using the above information, compute the tax payable by Kyagulanyi & Sons Ltd to URA Customs.  
**(7 marks)**
- (b) Uganda is a member of the East Africa Community Customs Union and Common Market. Currently, goods produced within any member state enjoys 0% import duty rate on importation.

Suppose the sugar imported by Kyagulanyi & Sons Ltd was manufactured in Kenya, compute the tax that would be paid by Kyagulanyi & Sons Ltd on importation.

**(6 marks)**

- (c) Give **two** advantages of Uganda being part of the EAC Customs Union and Common Market

**(2 marks)**

**(Total 15 marks)**



**Question 6**

Mr. Mugambwa has been constructing three residential units in Ntinda which were completed in January 2011 at Shs 80 million. During the year ended 31 December 2011, Mr. Mugambwa earned gross rental income of Shs 28 million and incurred security expenses of Shs 3 million, maintenance costs of Shs 5 million and legal fees of Shs 3.5 million. This was the only income for Mr. Mugambwa during the year.

**Required:**

- (a) Distinguish between the tax treatment of rental income of an individual and rental income earned by a company.

**(4 marks)**

- (b) Advise Mr. Mugambwa on his rental tax for the year ended 31 December 2011 and when his return will be due.

**(5 marks)**

- (c) You are a tax advisor at PPK Consulting and Mugambwa has requested you to advise him on how much tax he would have paid had he registered the business as a company.

Compute tax payable had Mr. Mugambwa registered his business as a company for the year ended 31 December 2011.

**(6 marks)**

**(Total 15 marks)**

**Note:** Rental tax for individuals is 20% of chargeable income in excess of Shs 1,560,000.

**Question 7**

- (a) Define and explain the relationship between tax base, tax rate and tax revenue.

**(6 marks)**

- (b) Define the following terms:

- (i) Incidence of tax.
- (ii) Progressive tax.
- (iii) Tax planning.

**(3 marks)**

- (c) Value added tax (VAT) was introduced in Uganda in 1996. Accounting for VAT can be on a cash basis or invoice basis. A proper tax invoice is required to claim input tax on purchases for VAT by registered entities.

**Required:**

Identify **two** advantages and **one** disadvantage of accounting for VAT on a cash basis.

**(3 marks)**

- (d) Outline **three** features of a proper VAT tax invoice.

**(3 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 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.