**FINANCIAL AND BUSINESS MANAGEMENT FOR ROAD CONTRACTORS**

**MODULE THREE SESSION SIX PARTICIPANTS’ NOTES**

**TAX PLANNING**

1. **Session Objectives**

The session objective is to enable trainees to appreciate taxation and anticipate its impact on performance so that they include taxes in their financial plans.By the end of the session trainees will be aware of the common taxes and how they affect their business operations, know the rationale for payment of taxes, analyze the impact of different taxes on profits and become aware of strategy to reduce their tax liability within the law. More specifically, the objectives include to:

1. Identify the rationale for payment of taxes
2. Analyze the impact of different taxes on profits
3. Discover strategy to reduce the tax liability within the law
4. **What is a tax?**

It is a constitutional duty for every citizen to pay taxes as they become due. A tax is a compulsory contribution towards financing of public social services through government. Taxes are collected by the URA on behalf of the people of Uganda. Penalties or prosecution leading to imprisonment may occur in the event of refusal or failure to pay taxes. Road construction companies are expected to have cleared any tax obligations before consideration for bidding or prequalification.

1. **Justification for taxation**

The rationale for taxation includes:

1. Meeting costs of social infrastructure services including road construction. Funds for road construction are collected through the Uganda Road Fund. Other funds from budgetary allocations are channelled through UNRA.
2. Funds collected centrally are transferred to local governments in order to meet costs of services including road construction and rehabilitation,
3. Meet costs of other public goods such as health, education, security and other social services.
4. **Tax planning**

Tax planning involves conceiving of and implementing various strategies in order to minimize the amount of taxes paid for a given period. For a small road construction business, minimizing the tax liability can provide more money for expenses, investment, or growth. In this way, tax planning can be a source of working capital. Deferring taxes enables the business to use that money interest-free, and sometimes even earn interest on it, until the next time taxes are due. Tax planning is a strategy that helps to reduce the amount of taxes actually paid to the URA. A small business should always attempt to **defer** taxes when possible.

The goal of tax planning is to arrange the company financial affairs so as to minimize taxes. There are three basic ways to reduce your taxes: reduce revenues earned; increase tax allowable deductions; use tax credits. Is this the same as tax evasion?

Obtaining tax planning knowledge has powerful profit potential and competitive advantage.

## Tax avoidance and tax evasion

## Tax avoidance is the *legal* utilization of the tax regime to one's own advantage in order to reduce the amount of tax payable by means that are within the law. By contrast, tax evasion is the general term for *efforts not to pay taxes* by *illegal* means. Tax evasion usually entails taxpayers deliberately misrepresenting or concealing the true state of their affairs to the URA to reduce their tax liability, and includes, in particular, *dishonest tax reporting* (such as declaring less income, profits or gains than actually earned; or overstating deductions).

1. **Tax incentives**

A tax incentive can be described as a tax holiday; a temporary reduction or elimination of a tax liability in order to promote a specific consumption; for example low tax on importation of heavy duty road equipment so as to reduce the cost of road construction. Manufacturers of baby foods may have some incentives so as to improve child nutrition. Entrepreneurs must be on the lookout for such incentives because they impact on profits. Knowing what the tax law has to offer can create a competitive edge over competitors who are unaware or don’t care to know. Even if there is a tax consultant, it is advisable for the business owner to keep an eye on tax preparation in order to take advantage of all possible opportunities for deductions and tax savings. It may be advisable for especially small road contractors to get some sessions in tax planning in the middle of each operating year so that there is enough time to apply the strategies to the current year.

1. **Taxes payable and impact on profits**
2. Income tax on employees (PAYE) has no impact on business profits; the company is merely a collecting agent and is required to transfer the amount through e-tax to the URA at least by 15th of the following month. 10% employer’s contribution in favour of NSSF has an impact of increasing all labour and management salaries by 10%. It must always be added to labour costs when budgeting and costing. The total contribution to NSSF of 15% is also payable by the 15th day on the month next. Delays in payment attract penalties which are a direct charge on profits, and such penalties are not tax allowable.
3. Corporation tax impact on profit earnings to be retained and therefore reduced owners equity. The current income tax rate is 30% on taxable profits.
4. VAT- All invoices raised by the business an 18% VAT is added. At the end of month, the billed VAT is payable whether the client has paid or not. However, the business deducts from it any VAT paid by it on inputs such as materials. Only the net VAT is paid over. The final burden of VAT is on the customer or the final consumer. VAT has no direct impact on profits. It has an impact on cash flow if the customers pay after the tax has become due.
5. 6% Withholding tax: Local governments do deduct this tax from suppliers and forward it to URA. It is a tax deposit pending the business having its tax liability ascertained. It is offset against the corporation tax liability of the business. Management should ensure that the tax deducted is actually forwarded to URA and a receipt obtained to support the recovery of the tax.
6. **Tax exemptions or allowable expenses for tax purposes**

A tax is a charge on income after expenses. Some expenses though met by the company may not reduce tax liability; see section 23(b) on meals and refreshments for staff. Expenses that are allowable are indicated under the Income Tax Act section 21(1). The general principle is that all costs ordinarily and necessarily incurred in the normal course of business are allowable for tax purposes. Those excluded are entertainment, donations and untaxed payments to staff such as allowances. Staff medical and staff meals are allowable if provided to all and in kind.

Capital expenditure and depreciation are not allowable expense for taxation. Depreciation is added back to trading profit. Instead tax authority deducts capital allowances for capital items. Capital allowances are an accelerated form of depreciation and therefore acts as a tax incentive to the tax payer who invests in plant and machinery. Assets are written off at a higher rate than depreciation provides for. Bad and doubtful debts are not acceptable expense unless it can be demonstrated that all effort to collect the income has failed. This in practice means being to a court of law first.

* Tax exemptions- insurance for retirement or pension
* Allowable deductions - IBA, W&T,
* Tax credits- earlier payments such as WHT
1. **Payment of taxes**

The method and mode of payment is governed by the Income tax Act. Corporation and other business are expected to file tax returns regularly, within six months of the end of the financial year*.* Corporation tax is payable twice a year, 50% of the estimated tax liability within six months of the commencement of the year and the balance of tax on actual performance within six months of the end of the financial year.

1. **Tax planning strategies**
2. **The choice of accounting and inventory-valuation methods used for closing inventory.**

The method a small business chooses for inventory can lead to substantial tax savings. Inventory valuation is important because businesses are required to reduce the amount they deduct for inventory purchases over the course of a year by the amount remaining in inventory at the end of the year. For example, a business that purchased Ugx 100,000 in inventory during the year but had Ugx 60,000 remaining in inventory at the end of the year could only count Ugx 40,000 as an expense for inventory purchases, even though the actual cash outlay was much larger. Valuing the remaining inventory differently could increase the amount deducted from income and thus reduce the amount of tax owed by the business.

FIFO values the remaining inventory at the most current cost, while LIFO values the remaining inventory at the earliest cost paid that year. LIFO is generally the preferred inventory valuation method during times of rising costs. It places a lower value on the remaining inventory and a higher value on the cost of road construction, thus reducing income and taxes. On the other hand, FIFO is generally preferred during periods of falling prices or in industries where inventory can tend to lose its value rapidly, such as high technology.

1. **The timing of equipment purchases**

The tax law allows capital deductions to enable a tax payer recover the capital outlay over a period. This allowance may be computed for twelve months even if the asset was purchase in the middle of the year. Necessary equipment purchases up to the limit can be timed at year end and still be fully deductible for the year. Businesses may use this to increase deductions for business expenses, thus reducing their taxable income and tax liability. This tax incentive also applies to personal property put into service for business use, with the exception of automobiles and real estate.

1. **Selection of tax favoured benefits and Investments.**

Tax planning also applies to various types of employee benefits that can provide a business with tax deductions, such as contributions to life insurance, health insurance, or retirement plans. As an added bonus, many such benefit programs are not considered taxable income for employees but deductable as business expenses. Finally, tax planning applies to various types of investments that can shift tax liability to future periods, such as treasury bills. Companies can avoid paying taxes during the current period for income that is reinvested in such tax-deferred instruments.

1. **Group activity**
2. Justify the payment of taxes in Uganda and discuss the implications of not paying taxes for a road construction company;
3. List the requirements for tax clearance when bidding and evaluate them
4. Identifying the different taxes and indicate how they affect your business operations;
5. Which are the allowable and disallowable deductions for income tax purposes? List any incentives available to road contractors;
6. State ways in which you may reduce your tax liability.