



CPA PART III SECTION 6

ADVANCED PUBLIC FINANCE AND TAXATION

THURSDAY: 24 May 2018.

Time Allowed: 3 hours.

Answer ALL questions. Marks allocated to each question are shown at the end of the question. Show ALL your workings. Any assumptions made must be clearly and concisely stated.

RATES OF TAX (Including wife's employment, self-employment and professional income rates of tax).

Year of income 2017.

Monthly taxable pay (Sh.)	Annual taxable pay (Sh.)	Rate of tax % in each Sh.
1 - 11,180	1 - 134,164	10%
11,181 - 21,715	134,165 - 260,567	15%
21,716 - 32,249	260,568 - 386,970	20%
32,250 - 42,782	386,971 - 513,373	25%
Excess over - 42,782	Excess over - 513,373	30%

Personal relief Sh.1,280 per month (Sh.15,360 per annum)

Prescribed benefit rates of motor vehicles provided by employer

	Monthly rates (Sh.)	Annual rates (Sh.)
Capital allowance:		
Wear and tear allowance:		
Class I	37.5%	
Class II	30%	
Class III	25%	
Class IV	12.5%	
Software	20%	
(i) Saloons, Hatch Backs and Estates		
Up to 1200 cc	3,600	43,200
1201 - 1500 cc	4,200	50,400
1501 - 1750 cc	5,800	69,600
1751 - 2000 cc	7,200	86,400
2001 - 3000 cc	8,600	103,200
Over 3000 cc	14,400	172,800

Industrial building allowance:	
Up to 2009	2.5%
From 1 January 2010	10%
Hotels	10%
Hostels/Education/Film producers buildings	100%
From 1 January 2010 - Commercial building:	
(Shop, office or show room)	25%

Farm works allowance 100%

Investment deduction allowance 100%

Shipping investment deduction (Ships over 125 tonnes) 100%

Extraction expenditure:
Written off over 5 years (20%)

Commissioner's prescribed benefit rates

Services	Monthly rates Sh.	Annual rates Sh.
(i) Electricity (Communal or from a generator)	1,500	18,000
(ii) Water (Communal or from a borehole)	500	6,000
Agriculture employees: Reduced rates of benefits		
(i) Water	200	2,400
(ii) Electricity	900	10,800

QUESTION ONE

- (a) The following was an extract of a speech delivered by a County Governor during a recent National Devolution Conference in your country.

“Today, a number of counties are heavily indebted with loans most of which were inherited from the defunct local authorities. This state of affairs threatens the long term financial sustainability of such counties”.

Required:

Discuss three strategies that county governments could put in place to manage long outstanding debts. (6 marks)

- (b) The Project Facilitation Fund (PFF) was established under the Public Private Partnership (PPP) framework to meet certain objectives.

Required:

(i) Describe the broad objective of establishing the Project Facilitation Fund (PFF). (2 marks)

(ii) Summarise four areas in which the PFF could be applied. (4 marks)

- (c) The Public Investments Committee (PIC) of the National Assembly undertakes an oversight role over public projects.

Required:

Identify two projects or activities in which the PIC is specifically excluded from overseeing. (2 marks)

- (d) Summarise six ethical principles that are specifically applicable to a tax practitioner acting on behalf of a client.

(Note: You are not required to discuss the general principles of ethics). (6 marks)

(Total: 20 marks)

QUESTION TWO

- (a) Mafuta International Ltd., a petroleum exploration company provided the following financial information for the year ended 31 December 2017:

Crude oil exported	1,400,000 barrels
Crude oil sold locally for further refining	750,000 barrels
Exploration costs	Sh.16,000,000
Incidental income from petroleum operations	Sh.1,250,000
Management and administration expenses	Sh.14,000,000
Depreciation	Sh.750,000
Provision for bad debts (specific debts Sh.1,250,000)	Sh.2,450,000
Non-productive rent	Sh.1,156,000

The schedule of qualifying capital expenditure was provided as follows:

Capital expenditure item	Date of acquisition	Location	Amount Sh.
Plant and machinery	July 2015	Offshore	6,000,000
Fixtures and fittings	July 2015	Onshore	2,000,000
Building	February 2016	Onshore	4,000,000
Pipeline and storage tank	February 2017	Offshore	4,000,000

Additional information:

- The international market price of crude oil during the year was US\$12 per barrel. The average exchange rate of the US\$ to the shilling (Sh.) was \$1 = Sh.105.
- The crude oil sold locally was disposed of at Sh.35 per barrel.

Required:

Tax liability (or refund) for Mafuta International Ltd. for the year ended 31 December 2017. (12 marks)

- (b) One of the tax incentives provided to oil and gas exploration companies is the capital allowance on extraction expenditure.

Discuss four other tax incentives provided to oil and gas exploration companies in your country. (8 marks)

(Total: 20 marks)

QUESTION THREE

- (a) Jua and Kali have been trading as partners under a trade name Juakali Enterprises since 1 January 2016. They have not filed individual income tax returns for the year ended 31 December 2017. The Commissioner of Domestic Taxes has issued an estimated assessment of Sh.784,000 to each of the partners for the year ended 31 December 2017. They share profits and losses in the ratio of 2:3 to Jua and Kali respectively. They are preparing to appeal against the assessment and have approached you for tax advice with the following details:

Cash book summary			
Dr.	Sh.	Cr.	Sh.
Balance brought forward (1 January 2017)	760,000	Payments to creditors	880,000
Capital: Jua	600,000	Purchase of furniture	200,000
Kali	900,000	Motor vehicle expenses	140,000
Receipts from debtors	1,700,000	Electricity expenses	78,000
Cash sales	1,000,000	Rent expenses	394,000
Rent income	580,000	Purchase of motor vehicle	600,000
Sale of furniture	170,000	Salaries and wages	480,000
		Office partitions	180,000
		General expenses	440,000
		Balance carried forward	<u>2,318,000</u>
	<u>5,710,000</u>		<u>5,710,000</u>

Additional information:

- The cost of furniture sold was Sh.160,000 and had accumulated depreciation of Sh.14,000 as at 1 January 2017. Profit on disposal was credited to the income statement for the year ended 31 December 2017.
- All the cash sales were paid into the bank with the exception of Sh.440,000 which was debited in the income statement as general expenses, but related to the following items: partners' children school fees, Sh.80,000, purchase of goods Sh.200,000, tax appeal expenses Sh.40,000, insurance policy for partners' life Sh.70,000 and computer software Sh.50,000.
- Other information provided was as follows:

	31 December 2016	31 December 2017
	Sh.	Sh.
Inventories	248,000	362,000
Creditors for goods	400,000	280,000
Debtors for goods	240,000	360,000
Electricity expenses prepaid	472,000	30,000
Rent owing	78,000	44,000
Salaries and wages owing	20,000	60,000
Furniture	160,000	200,000

- The business reported a net loss of Sh.424,500 for the year after deducting the following expenses:
 - Salaries and wages for the year ended 31 December 2017 which included partners' salaries for Jua Sh.100,000 and Kali Sh.80,000.
 - Rent expense for the year included 20% for private residence for Jua while electricity included 30% electricity bills paid on behalf of Kali's private house.
 - Capital allowances in respect of the business had not been considered. However, depreciation had been debited in the income statement. The depreciation was at the rate of 20%.
- Sales and purchases for the year were understated and overstated respectively by 20%.
- The partners are entitled to interest on capital at the rate of 10% per annum on their capital contributions. The interest on capital was included in the figure for purchases for the year.

Required:

- With supporting computations, advise the partners on the accuracy of the estimated assessment issued for the year of income 2017. (9 marks)
- Prepare a schedule of total taxable income for each partner for the year of income 2017. (5 marks)

Hint: Start with the adjusted net loss.

- (b) Transfer pricing remains a major threat in bridging the tax revenue gap in your country.

In light of the above statement, evaluate three factors to be considered in the selection of an appropriate transfer pricing method. (6 marks)

(Total: 20 marks)

QUESTION FOUR

- (a) Jakes Air Safaris Ltd. is a foreign company operating a fleet of passenger and cargo aircrafts in Kenya, Middle East and Far East. The operating results for the year ended 30 September 2017 are as follows:

	Sh. "000"
Income from cargo freight (Kenya/China)	1,567,720
Income from passengers and freight (Kenya/Middle East)	1,765,000
Income from passengers and freight (South Korea to Kenya)	1,001,880
Income from cargo loaded into aircraft on all routes	630,000
Salaries and other expenses	1,548,000
Accumulated depreciation on aircraft	88,000
General provision for bad debts	72,000

Additional information:

	Sh. "000"
1. Salaries and other expenses include:	
Purchase of plane engines	117,000
Use of airport facilities	32,400
Hotel bills for first class passengers	37,800
Accommodation for airline crew	9,000
Gifts to airport staff	10,800
2. The airline has a fleet of four aircrafts whose total cost before accumulated depreciation was Sh.360,000,000.	

Required:

- (i) A statement of total taxable profit of Jakes Air Safaris Ltd. for the year ended 30 September 2017. (8 marks)
- (ii) Tax liability, if any, for the airline for the year ended 30 September 2017. (2 marks)
- (b) The revenue authority in your country recently established a Medium Taxpayers Office (MTO) as part of the tax reforms.

Required:

Discuss five objectives of the MTO.

(10 marks)

(Total: 20 marks)

QUESTION FIVE

- (a) The following is the income statement of Savanna Ltd., a manufacturing company for the year ended 31 December 2017:

	Sh.	Sh.
Gross profit		11,520,000
Foreign exchange gain		148,000
Dividends from Hazina Cooperative (net)		68,000
Dividends from subsidiary company		<u>244,000</u>
		11,980,000
Less expenses		
Directors emoluments	6,480,000	
Provision for depreciation	250,000	
Office furniture	360,000	
Computer software	90,000	
Donations	25,500	
Legal expenses	648,000	
Dividends paid	120,000	
Corporation tax	375,000	
Salaries and wages	<u>674,000</u>	<u>9,022,500</u>
Net profit		<u>2,957,500</u>

Additional information:

- The company operates in a factory building whose construction cost at the time of first operation on 1 January 2003 was Sh.4,800,000. The cost of this building is included in the directors emoluments. The company installed processing machinery costing Sh.2,800,000 in year 2003.
- On 1 July 2017, the company acquired portable packaging machine at a cost of Sh.420,000, computers Sh.240,000 and weighing scale machine Sh.48,000.
- On 1 October 2017, the company put into use a staff canteen constructed at a cost of Sh.780,000 and a godown whose cost was Sh.600,000.

4. Legal expenses include:
- Costs for disposal of banned packaging material Sh.27,000.
 - Negotiating a loan agreement Sh.36,000.
 - Processing legal documents for a new factory plant Sh.19,800.
 - Defending a company against a law suit for smuggled goods by a director Sh.94,000.
 - Preparing patent documents for registration Sh.52,800.
5. Gross profit was overstated by 20% and includes a figure for purchases of Sh.340,000 which had been understated by 15%.
6. Directors allowance include management fees of Sh.495,000 from a director of one of the subsidiary companies.
7. Interest on a loan of Sh.96,000 from head office was included in the directors emoluments. The interest was to be treated as received from a thinly capitalised company.

Required:

- (i) A statement of adjusted taxable profit or loss for the year ended 31 December 2017. (12 marks)
- (ii) Tax liability, if any. for the year ended 31 December 2017. (2 marks)
- (iii) Comment on payment of tax for the year ended 31 December 2017, assuming that tax had been paid during the year 2017 based on previous year's tax of Sh.2,400,000. (2 marks)

Note: Use capital allowance rates applicable in the year of asset acquisition.

- (b) Discuss two roles of the Directorate of Portfolio Management under the National Treasury or equivalent ministry in your country. (4 marks)

(Total: 20 marks)

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