



CPA PART III SECTION 6

ADVANCED PUBLIC FINANCE AND TAXATION

THURSDAY: 29 November 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) Country Y has a fast growing economy. Various government ministries and state corporations in the country are currently engaged in a number of capital projects. The country recently developed an electronic project monitoring information system (e-ProMIS) to capture information on projects implemented by the ministries, state corporations and counties. As a result, all government organisations were required to upload their projects in the system and update them regularly.

Required:

Discuss four specific objectives that Country Y might realise from the e-ProMIS. (8 marks)

- (b) Over the last few years, Country Z's rising public debt has been a point of discussion in most macroeconomic outlook discussions, with organisations such as the World Bank and global rating agencies raising concerns.

Required:

Discuss three measures that the government of Country Z could take to reverse the above trend. (6 marks)

- (c) Explain three objectives of tax modernisation programmes which have been recently undertaken in a number of developing economies. (6 marks)

(Total: 20 marks)

QUESTION TWO

- (a) Maendeleo Ltd. is a manufacturing company operating through a number of branches. 75% of the share capital of Maendeleo Ltd. is held by a foreign company, Export Line Ltd. The following information relates to Maendeleo Ltd.'s operations for the year ended 31 December 2017:

	Sh."000"	Sh."000"
Turnover		1,948,000
Cost of goods sold		<u>(562,000)</u>
Gross profit		1,386,000
Foreign exchange gain		14,840
Goods transferred to a branch		3,000
Insurance recovery for stolen motor vehicle		968
Proceeds from sale of factory extension		<u>4,690</u>
		<u>1,409,498</u>
Less expenses:		
Directors emoluments and staff costs	16,890	
Pension contribution for staff	4,200	
Staff recruitment costs	1,148	
Purchase of furniture	420	
Penalties on overdue VAT	164	
Impairment loss of factory extension	150	
Mortgage interest	364	
Goodwill written off	162	
Loan interest	1,286	
Depreciation	1,480	
General office expenses	<u>1,348</u>	<u>(27,612)</u>
Net profit		<u>1,381,886</u>

Additional information:

- The cost of construction of the factory extension that was disposed of during the year was Sh.2,800,000. The factory extension was repainted at a cost of Sh.75,000 while the revaluation fee for disposal purposes was Sh.146,800. Impairment loss was due to increased insecurity in the area.
- The branch sold 80% of the goods transferred from the head office, and 10% of these goods were sold to a customer who was later declared bankrupt.
- Loan interest related to a loan advanced by Export Line Ltd.
- Directors emoluments include management fees of Sh.4,840,000 paid to Export Line Ltd.
- The capital expenditure records obtained from the company's books showed the following as at 1 January 2017:

	Sh."000"
Factory building	24,800
Perimeter wall around the factory	6,820
Sewerage system	2,400

	Sh. "000"
Staff quarters	7,600
Processing machinery	3,700
Delivery van	1,750
Forklift	980
Parking and loading bay	2,500
Furniture	680

The capital expenditure was incurred on 1 January 2016 when the company commenced operations in Kenya. The cost of the factory building includes a godown Sh.800,000, retail shop Sh.400,000, show room Sh.800,000 and staff canteen Sh.1,900,000.

The capital allowances for year 2016 were claimed as appropriate.

6. Cost of goods sold includes purchases of Sh.174,000,000 inclusive of value added tax at the rate of 16%.

Required:

- (i) A statement of adjusted taxable profit or loss for the year ended 31 December 2017. (12 marks)
- (ii) Tax liability for the year. (2 marks)
- (iii) Compute any other tax payable by the company. (2 marks)
- (b) Highlight four reasons why capital allowances as tax incentives might not have achieved their intended objective to the government in your country. (4 marks)

(Total: 20 marks)

QUESTION THREE

- (a) Tasia Ltd. is a merchandising company operating in Kenya. The following details of transactions were extracted from the company's records during the month of September 2017:

	Sh. "000"
Sales at standard rate	6,960,000
Exports to Egypt	1,200,000
Purchases at standard rate	4,060,000
Purchase of delivery van oils and fuels	371,200
Repairs of office furniture	23,200
Audit fees	60,320
Wages	480,000
Purchase of stationery	55,680
Electricity bills not settled	46,400
Exempt supplies/sales	1,500,000
Legal fees	40,600
Purchases from traders not registered for VAT	134,000
Sales at zero rate	400,000

Additional information:

- The value added tax accountant established that 20% of the standard rate purchases were sold as standard rate sales.
- Sales at standard rate included goods valued at Sh.139,200 sold to a credit customer who was declared bankrupt during the month.
- A customer returned goods sold at standard rate valued at Sh.29,000 to the company, and a credit note was issued immediately.
- Credit suppliers issued debit notes in respect to supplies at standard rate amounting to Sh.580,000.
- The accountant established that an invoice of Sh.180,000 from a foreign supplier was not recorded in the books. The import duty for these goods was at a rate of 20%.

Transactions are inclusive of VAT at a rate of 16% where applicable.

Required:

- (i) Deductible input tax. (6 marks)
- (ii) Output tax. (4 marks)
- (iii) Value added tax payable (if any). (2 marks)
- (iv) Assuming that you are a VAT auditor, outline additional information that you might seek from the company to help you ascertain the accuracy of the VAT declared. (2 marks)

- (b) Safari Ltd. imported goods from China with an assessable value of Sh.500,000. Customs duty imposed included basic customs duty at 20% and an additional duty for this category of goods at 15%. Other levies included railway levy at 2%, secondary education cess of 2% and higher education cess at 1% of duty paid.

Required:

- (i) Total value of goods imported. (3 marks)
- (ii) Total duty payable. (3 marks)
- (Total: 20 marks)**

QUESTION FOUR

- (a) Mafuta Petroleum Company Ltd. has provided the following details for the year ended 31 December 2017:

	Sh. "000"
Sale of crude oil - export	834,900
Sale of natural gas	43,375
Other incidental income	4, 537.5
Production expenses	217,800
Administration costs	290,400
Intangible drilling costs	45,375
Non-productive rentals	18,150
Royalties on export	4, 537.5
Royalties on local sales	1,815
Provision for restoration of wells	136,125
Custom duties on plant and machinery	27,225

The following additional information is provided:

1. Memorandum of Understanding (MOU) credit Sh.18,150,000.
2. Petroleum investment allowance has been agreed at Sh.13,612,500.
3. Depreciation included in production expenses amounted to Sh.36,300,000.
4. Capital allowances agreed with the Revenue Authority amounted to Sh.54,450,000.

Required:

- (i) A statement of taxable profit or loss for the year ended 31 December 2017. (8 marks)
- (ii) Tax liability. (2 marks)
- (iii) Explain the significance of "Memorandum of Understanding (MOU)" in the petroleum industry. (2 marks)
- (b) Fanikisha Ltd. intends to acquire Matatizo Ltd. The nature of the acquisition is such that Matatizo Ltd. will cease to operate with all its assets and liabilities taken over by Fanikisha Ltd.

You are a tax senior with Uwezo Consultants. The management of Fanikisha Ltd. have approached you to undertake a tax due diligence on Matatizo Ltd. prior to the acquisition.

Required:

- Discuss four areas you would focus on in your due diligence. (8 marks)
- (Total: 20 marks)**

QUESTION FIVE

- (a) One of the steps in a tax audit process is the preliminary review of a taxpayer's file.

- (i) Outline three reasons for the preliminary review of a taxpayer's file. (3 marks)
- (ii) Summarise three other activities that should be undertaken before the commencement of the tax audit. (3 marks)

- (b) Certain countries have attracted high net worth individuals due to their status as tax havens.

- (i) Explain the term "tax haven". (2 marks)
- (ii) Summarise four characteristics of a tax haven. (4 marks)

- (c) In certain circumstances, a contracting authority may consider a privately initiated investment proposal for a project without subjecting the proposal to a competitive procurement process.

Describe four such circumstances. (8 marks)

(Total: 20 marks)