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CPA PART III SECTION 6

ADVANCED PUBLIC FINANCE AND TAXATION

THURSDAY: 20 May 2021.

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 2020.

Assume that the following rates of tax applied throughout the year of income 2020:

Monthly taxable pay (Sh.)	Annual taxable pay (Sh.)	Rate of tax % in each Sh.
1 - 24,000	1 - 288,000	10%
24,001 - 40,667	288,001 - 488,000	15%
40,668 - 57,334	488,001 - 688,000	20%
Excess over - 57,334	Excess over - 688,000	25%

Personal relief Sh.2,400 per month (Sh.28,800 per annum).

Investment allowance:	Rate of investment allowance	Residual value (per year on reducing balance)	Prescribed benefit rates of motor vehicles provided by employer (i) Saloons, Hatch Backs and Estates:
Capital expenditure incurred on:			Monthly rates (Sh.)
			Annual rates (Sh.)
(a) Buildings:			Up to 1200 cc 3,600 43,200
• Hotel building	50% in the first year of use	25%	1201 - 1500 cc 4,200 50,400
• Building used for manufacture	50% in the first year of use	25%	1501 - 1750 cc 5,800 69,600
• Hospital buildings	50% in the first year of use	25%	1751 - 2000 cc 7,200 86,400
• Petroleum or gas storage facilities	50% in the first year of use	25%	2001 - 3000 cc 8,600 103,200
• Educational/hostels building	10% per year on reducing balance		Over - 3000 cc 14,400 172,800
• Commercial building	10% per year on reducing balance		
(b) Machinery:			(ii) Pick-ups, Panel Vans (unconverted)
• Machinery used for manufacture	50% in the first year of use	25%	Up to - 1750 cc 3,600 43,200
• Hospital equipment	50% in the first year of use	25%	Over - 1750 cc 4,200 50,400
• Ships or aircraft	50% in the first year of use	25%	
• Motor vehicles and heavy earth moving equipment	25% per year on reducing balance		
• Computer software, calculators, copiers and duplicating machines	25% per year on reducing balance		
• Furniture and fittings	10% per year on reducing balance		
• Telecommunication equipment	10% per year on reducing balance		
• Film equipment by a local producer	25% per year on reducing balance		
• Machinery used to undertake operations under prospecting rights and exploration under mining rights	50% in the first year of use	25%	
• Other machinery	10% per year on reducing balance		
(c) Purchase/acquisition of right to use fibre optic cable by telecommunication operation	10% per year on reducing balance		(iii) Land Rovers/Cruisers 86,400 7,200
(d) Farm works	50% in the first year of use	25%	

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) There are different types of public private partnership (PPP) contracts depending on the type of project, level of risk transfer, investment level and the desired outcome.

Required:

Citing relevant examples, describe four types of public private partnership contracts. (4 marks)

- (b) During a conference held by the Organisation for Economic Co-operation and Development (OECD) on policies for rebuilding post covid-19 economies, one speaker noted that "once countries stabilise their fiscal recoveries amid the Corona virus crisis, they should seize the chance to build their economies through taxation policy".

Required:

Evaluate six tax policy measures that developing countries should adopt for rebuilding Post-Covid 19 economies. (6 marks)

- (c) The following details were obtained from the records of Maendeleo Bank Ltd. for the year ended 31 December 2020:

1. The net loss for the year was Sh.22,160,000 after the following had been recorded:

	Sh.
Income from trading activities of a foreign bank subsidiary	980,000
Gain on sale of shares	294,000
Fees and commission income	1,460,500
Interest from government treasury bills	936,400
Interest on deposits with other banks	1,740,600
Interest on loans and advances to customers	12,460,300
Contributions to deposit protection fund	428,000
Interest on customer deposits	8,484,000
Rent and rates	864,000
Directors emoluments	1,480,000
Income from foreign exchange dealings	1,243,600
Depreciation	445,300
Provision for interest expenses	184,400
Auditors fees	236,800
Loss on disposal of collaterals	1,560,000
Installment tax	724,800
Installation of a new online banking system	1,820,000
Staff costs	1,680,000
Operating lease rentals	268,200
Capital redemption reserve	920,000
12% debenture stock	1,200,000
Purchase of double cabin pickup - October 2020	2,400,000
Profit and loss account	964,000 (Dr)
Rebate on bills discounted	296,000

2. Staff costs include:

	Sh.
Provision for salary increase	220,000
Cost of negotiating loans for staff	140,000
Senior staff club membership	360,000

3. The online banking system was installed in May 2020 and it included the cost of computer software of Sh.200,000 and new computers at a cost of Sh.620,000.

Required:

Statement of adjusted taxable income or loss for Maendeleo Bank Ltd. for the year ended 31 December 2020. (10 marks)
(Total: 20 marks)

QUESTION TWO

- (a) A number of countries have enacted legislation on public financial management (PFM) which have their main objects as follows:

- Provide for the effective management of public finances by the national and county governments.
- Oversight responsibility of parliament and county assemblies.
- Provide for the different responsibilities of government entities and other bodies.

Required:

Discuss the key provisions of the PFM Act, 2012 or equivalent legislation in your country, with regard to regulation of grants administration. (6 marks)

- (b) Assume that you are a senior government officer managing public investments. The Cabinet Secretary in your Ministry is set to present a paper to a group of local and international investors on why the government should continue participating in public investments.

The Cabinet Secretary has approached you for input in preparation of the paper for presentation.

Required:

Explain four grounds that you would propose for inclusion in the paper, defending the government's participation in public investments. (8 marks)

- (c) Many developing countries have resorted to increased reliance on public debt in order to finance their expenditure. This strategy has however resulted in negative impacts on projected economic growth rates.

Required:

With reference to the above statement, describe the negative implications of increased public debt in financing of recurrent expenditure by a government. (6 marks)

(Total: 20 marks)

QUESTION THREE

- (a) Citing examples, differentiate between a "tax waiver" and a "tax amnesty." (2 marks)
- (b) Dera Suppliers Limited deals in both taxable and non-taxable supplies.

The following transactions were extracted from the company's records for the month of September 2020:

	Sh.
Purchases from local market	912,000
Sales to local market	1,710,000
Imports (exclusive of customs duty)	600,000
Export sales	700,000
- South Africa	
- Nigeria	350,000
Purchase of lubricants	456,000
Restaurant services paid	63,840
Tax consultancy fees	45,600
Printing and stationery	17,100
Electricity bills paid	31,920
Exempt sales	480,000
Ambulance services	20,000
Postage services	8,000
Audit fees	68,400

Additional information:

- Sales to the local market include goods supplied to Marine Fisheries and Fish Processors Ltd. for Sh.114,000.
- Goods purchased at standard rate could not be directly identified from exempt sales.
- The company received debit notes and credit notes of Sh.22,800 and Sh.36,480 respectively from suppliers.
- The customs duty for imported goods was at 20%.
- The company issued debit notes of Sh.74,100 in respect to sales at standard rate.
- Sales and purchases to and from the local market were inclusive of VAT at the rate of 14% plus other transactions where applicable.
- A debtor of goods valued at Sh.28,500 was declared bankrupt and a debt relief waiver granted.

Note: Assume transactions are quoted as inclusive of VAT at the rate of 14%, unless otherwise specified.

Required:

Indicating any non-deductible input-tax and exempt supplies, compute:

- | | | |
|-------|--|-----------|
| (i) | Total input tax. | (4 marks) |
| (ii) | Total output tax. | (2 marks) |
| (iii) | Deductible input tax. | (4 marks) |
| (iv) | Value added tax payable or refundable. | (2 marks) |

- (c) Ali Salama is a resident tax payer in Kenya. During the year of income 2020, he had Sh.4,380,000 from employment in Kenya. He had also received Sh.480,000 from the United Kingdom (UK), which has a double taxation relief treaty with Kenya. Tax deducted in UK was equivalent to Sh.80,000.

Required:

- | | | |
|------|---|-----------|
| (i) | Double taxation relief in Kenya. | (4 marks) |
| (ii) | Tax payable in Kenya by Mr. Ali Salama. | (2 marks) |

(Total: 20 marks)

QUESTION FOUR

- (a) Discuss the factors that may have inhibited the full integration of the customs union in your regional trading block. (6 marks)
- (b) Jamji Manufacturers Ltd. presented the following statement of profit and loss and other comprehensive income for the year ended 31 December 2020:

	Sh. "000"	Sh. "000"
Turnover		384,900
Cost of sales		<u>(98,200)</u>
Gross profit		286,700
Other incomes:		
Gain on foreign exchange transactions		42,600
Capital gain on sale of motor vehicle		14,200
Refund of import duty		8,400
Investment income		<u>12,000</u>
		363,900
Less expenses:		
Purchase of copyright	24,800	
Design of company website	1,200	
Directors fees	4,600	
Donations to charitable institutions	200	
Depreciation expense	1,640	
Advertisement	450	
Professional fees	448	
General expenses	3,640	
Legal costs	1,840	
Loan repayment	312	
Provision for bad debts	142	
Impairment loss of a building	280	
		<u>(39,552)</u>
Net profit		<u>324,348</u>

Additional information:

1. On 1 July 2020, the company acquired Jilo Ltd., a manufacturing company for Sh.56,000,000 and took over all assets and liabilities, which included;

Assets: Sh. "000"

- | | | |
|---|------------------------|--------|
| • | Factory building | 14,800 |
| • | Furniture and fittings | 1,400 |
| • | Processing machinery | 8,600 |
| • | Lorry (4 tonnes) | 1,500 |
| • | Computers and printers | 600 |
| • | Delivery van | 840 |

542.5

Liabilities:

• 15% bank loan	6,000
• Trade payables	1,720
• Bank overdraft	1,480

Jilo Ltd. had operated for only 6 months and had not claimed any investment allowances before it was closed down by the Environmental Authority.

2. Turnover includes goods sold to the company's branch of Sh.72,000,000. It was established that at the end of the accounting period, 20% of these goods had not been sold by the branch.
3. Professional fees included: **Sh."000"**
- | | |
|---------------------------------|-----|
| • Management fees | 280 |
| • Tax consultancy fees | 148 |
| • Audit fees | 252 |
| • Preparing of tender documents | 185 |
| • Environmental assessment fees | 360 |
4. General expenses included: **Sh."000"**
- | | |
|-----------------------------------|-------|
| • Installation of Neon signs | 420 |
| • Car grant to a director | 1,800 |
| • Partition of an office block | 560 |
| • Directors Christmas party | 240 |
| • Branch closure costs | 180 |
| • Repayment of hire purchase loan | 120 |
5. Legal costs comprised: **Sh."000"**
- | | |
|---|--------------|
| • Drafting sale agreement between the company and Jilo Ltd. | 458 |
| • Defending a company against breach of contract | 386 |
| • Negotiating a bank loan | 168 |
| • Preparing copyright documents | 172 |
| • Drafting lease agreements (50 years) | <u>656</u> |
| | <u>1,840</u> |
6. Provision for bad debts include 15% of debts amounting to Sh.600,000 from a company which was declared irrecoverable.
7. The corporate tax rate during the year was 25%.

Required:

- (i) A statement of adjusted taxable profit or loss for the year ended 31 December 2020. (12 marks)
- (ii) Tax liability and the instalments for the year 2020, assuming the actual profits were made. (2 marks)
- (Total: 20 marks)**

QUESTION FIVE

- (a) The Tax Authority in your country has appointed you as a tax auditor for digital services in Abacus Ltd.

Describe three specific operational aspects in Abacus Ltd. that would constitute evidence of existence of digital services in the company. (6 marks)

- (b) Safari Aviators Ltd. is an air transport company registered in the United Kingdom. On their scheduled flights to East Africa, the company's planes land in Nairobi to connect passengers to other destinations in Africa. Ticketing and other transactions are done through an airline agent in Nairobi, Kenya, who would sell tickets and meet other necessary obligations on behalf of Safari Aviators Ltd.

The agent sold Sh.12,690,000 worth of tickets on behalf of the company in year 2020. The following expenses were incurred in carrying out airline operations in Kenya.

	Sh.
• Salaries for security officers	1,480,000
• Furniture for Agency offices	240,000
• Trade subscriptions	96,000
• Computers	180,000
• Purchase of Aircraft (UK) cost	126,000,000
• Jet fuel	4,900,000
• Covid-19 tests for staff members	148,000
• Upgrading Agency website	60,000
• Airline Authority clearance fees	360,000
• Purchase of saloon car	3,500,000

Additional information:

1. 15% of ticket sales are allowed annually by the Tax Authority in UK to cover for depreciation of other office equipment.
2. 2% of total ticket sales are allowed annually to cover head office expenses relating to the agency.
3. Operating expenses for the agency are allowed in full.
4. 5% of the investment allowance is allowable to the agent for tax purposes on investment in aircrafts.

Required:

- (i) A statement of adjusted taxable income or loss for the year ended 31 December 2020. (8 marks)
 - (ii) Comment on any further information you may seek from the airline agency to facilitate accuracy of tax liability. (2 marks)
- (c) Explain two ways through which proper tax planning may contribute to economic stability of a country. (4 marks)
(Total: 20 marks)
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