

kasneb

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 - South Africa	700,000
- 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

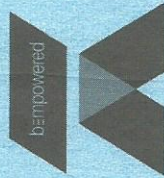
Additional information:

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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**CPA PART III SECTION 6
ADVANCED PUBLIC FINANCE AND TAXATION**

FRIDAY: 27 November 2020.

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 2019.

Monthly taxable pay (Sh.)		Annual taxable pay (Sh.)		Rate of tax % in each Sh.
1	- 12,298	1	- 147,580	10%
12,299	- 23,885	147,581	- 286,623	15%
23,886	- 35,472	286,624	- 425,666	20%
35,473	- 47,059	425,667	- 564,709	25%
Excess over	- 47,059	Excess over	- 564,709	30%

Personal relief Sh.1,408 per month (Sh.16,896 per annum).

Prescribed benefit rates of motor vehicles provided by employer

	Monthly rates		Annual rates	
	(Sh.)	(Sh.)	(Sh.)	(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%
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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) Three countries; X, Y and Z established an economic trading block some years back. One of the key objectives of the trading block was to promote the harmonisation of tax systems and policies among the three countries. However, this objective has not been realised to date.

Required:

Discuss five possible challenges to the harmonisation of tax systems and policies among the three countries above.

(5 marks)

- (b) With reference to public-private partnerships (PPPs):

(i) Explain the role and composition of a petitions committee. (4 marks)

(ii) Describe the moneys that are required to be paid into the public private partnership project facilitation fund. (3 marks)

- (c) Summarise five functions of the Directorate of Public Debt Management. (5 marks)

- (d) Taxation has generally contributed to economic development and empowerment of the population in most countries. However, taxation may also result in certain negative consequences on the society.

Required:

Discuss three negative impacts of taxation in a country.

(3 marks)

(Total: 20 marks)

QUESTION TWO

- (a) The following financial information was extracted from the books of Oil Drillers and Exporters Ltd. for the year ended 31 December 2019:

	Sh.
Income	
• Proceeds of oil sold to foreign subsidiary company (50,000 barrels of crude oil at Sh.500 per barrel)	25,000,000
• Value of oil disposed of to local refineries	125,000
• Freight charges received from other oil companies for transporting their crude oils to neighbouring country	190,000
• Sale of natural gas	160,000
Expenditure	
• Staff accommodation expenses - <i>ARL</i>	60,000
• Wages and salaries for employees - <i>AE</i>	15,000
• Annual compensation paid to local people for disturbance during petroleum exploration - <i>DE</i>	75,000
• Royalties incurred in respect to crude oil exported * - <i>A</i>	42,000
• Interest on loan from a foreign subsidiary company <i>⊗</i>	31,250
• Specific bad debts written off <i>AL</i>	8,500
• Depreciation of non-current assets (Class IV) - <i>D</i>	45,100
• Exploration and drilling costs in respect to cement and casing of oil wells - <i>A</i>	24,500,000
• Contribution to approved provident fund - <i>M</i>	65,000
• Custom duties on imported equipment - <i>DA</i>	21,500
• General expenses - <i>B</i>	65,000

Additional information:

1. Non-current assets comprised; drilling machines Sh.900,000, Furniture Sh.240,000 and saloon car Sh.2,800,000 acquired during the year. *- 20%*
2. Staff accommodation expenses include management fees of Sh.18,000 for a director from a foreign subsidiary company. ✓
3. Lorries for transporting crude oil comprised:
7.5 tonnes lorry Sh.2,400,000. ✓ *- 20%*
4.2 tonnes lorry Sh.1,800,000. ✓ *- class IV*

Required:

A statement of taxable profit or loss for the year ended 31 December 2019.

(12 marks)

- (b) Evaluate four factors inhibiting efficient administration of value added tax in your country.

(8 marks)

(Total: 20 marks)

QUESTION THREE

- (a) M and K are in partnership trading as MK enterprises. The partners deposited Sh.4,000,000 and Sh.6,000,000 into the business account as their initial capital before commencing trading. They also agreed to share profit and loss in the ratio of their initial capital contribution and interest on capital at 5% per annum on outstanding capital balances.

On 1 January 2018, the firm purchased the following assets for use in the business:

	Sh.
Saloon car	III 2,400,000 ✓
Computers	II 80,000 ✓
Furniture and fittings	IV 96,000 ✓
Fax machine	II 48,000
Switchboard	IV 64,000
Bookshelf	II 18,000
Office kitchen utensils	II 9,000
Office television set	II 54,000
Carpets	IV 36,000
Safe for cash office	IV 45,000

M: K 4:6
 10:15
 Interest on Capital = 5%

The firm's books were kept in a single entry bookkeeping. The details for the accounting records for the year ended 31 December 2018 obtained were as follows:

- Sales for the year was Sh.1,860,000 out of which Sh.360,000 was on credit and the balance was cash banked.
- The following monthly expenses were paid from cash proceeds before banking the proceeds from cash transactions:

	Sh.
Transport expenses	6,000 ✓
Telephone and postage	5,600 ✓
Office meals	5,000 ✓
Repairs and maintenance	4,800 ✓

- The bank statements summary for the full year showed payments made during the year as follows:

	Sh.
Rent payment	325,000 ✓
Purchase of 3 tonnes lorry	1,800,000 ✓
Purchase of motor bike	90,000 ✓
Office expenses	1,460,000 ✓
Advertising	240,000 ✓

- The office expenses paid in note (3) above included:

	Sh.
Partners' salaries: M	270,000
K	360,000 ✓
Employees' pension contribution	420,000 ✓
Donations to society for blind	78,000 XDE
Tax consultancy fees	32,000 X
Training of partners' children	28,000 - D.A
Motor vehicle insurance	24,000
	1212,000

The business failed to file returns for the year of income 2018 and on 1 July 2019, they received an estimated assessment of Sh.78,000 from the revenue authority for each partner.

Required:

- Using the above information, prepare a statement that will form the basis of contesting the estimated assessment for the year of income 2018. (14 marks)
 - Advise the partners on the appeal position. (2 marks)
- (b) Citing four reasons, argue the case for continued provision of tax incentives by a country that is experiencing budget deficits. (4 marks)
- (Total: 20 marks)**

QUESTION FOUR

- (a) Describe four tax policy challenges that the government is facing in the taxation of digital economy in your country. (8 marks)
- (b) Anita Warazo has been operating a sole-proprietorship business since 1 January 2015.

The following information was obtained from the books of the business for the past five years:

Year	2015 Sh."000"	2016 Sh."000"	2017 Sh."000"	2018 Sh."000"	2019 Sh."000"
Current account balance	485 (Dr)	600 (Cr)	960 (Cr)	350 (Dr)	560 (Cr)
Treasury bonds	1,450	940	740	648	780
Pick up (cost)	900	900	1,600	1,600	1,600
Computers (cost)	150	150	200	200	200
Inventory	-	170	240	280	376
Trade receivables	720	600	560	700	840
10% Mortgage loan	-	-	4,000	4,000	4,000
Trade payables	460	640	800	560	720
Bank loan	370	348	400	400	380
Leasehold property	1,400	1,400	1,400	1,400	1,400
Cash in hand	560	840	540	600	760
Furniture and fittings	400	400	300	300	300
Personal saloon car	-	480	480	480	480

Additional information:

- All non-current assets were stated at cost and where the fair value changed was either due to additional asset acquired or disposed of.
- Furniture and fittings whose cost was Sh.100,000 was disposed of on 1 January 2017 for Sh.68,000.
- In the year 2016, the proprietor made drawings of Sh.38,000.
- Anita Warazo paid school fees for her children from business current account of Sh.138,000 per annum for the years 2016 and 2017.
- A leasehold property included a property valued at Sh.400,000 inherited from her late father. ✓
- In the year 2018, she paid insurance premium of Sh.42,000 for her private residence. ✓
- She contributed to a fundraising in 2019 of Sh.60,000 for supporting a church function. ✓
- The non-current assets qualified for capital deductions where applicable.
- Leasehold property comprised a warehouse (cost Sh.1,000,000) while the inherited property was a dwelling house.

Required:

- Prepare a capital statement showing taxable income for the years 2016 to 2019. (10 marks)
 - Comment on the tax position of Anita Warazo for each of the years of income. (2 marks)
- (Total: 20 marks)

QUESTION FIVE

- (a) Globalisation, diversification and expansion have forced companies to form groups where a large number of transactions are between related parties.

In light of the above statement:

- Explain the terms "related party transactions" and "transfer pricing". (4 marks)
 - Evaluate two benefits that may accrue to an entity that applies transfer pricing in transactions between related parties. (4 marks)
- (b) Albert Kimeli is an employee of Rwaka Ltd. He has provided the following information relating to his income:

- He earns a basic salary of Sh.60,000 per month. ✓
- He is paid house rent allowance of Sh.30,000 per month. ✓
- His wife, Lavena Kimeli is also employed at a salary of Sh.54,000 per month with Tops Ltd. where Kimeli holds 20% of the shares. ✓
- They both live in a house which is owned by the wife. The house was constructed through borrowed funds at an interest rate of 15% per annum.

5. The employer paid school fees for the children of Albert Kimeli. ✓
6. He was a member of an unregistered pension scheme where the employer made contributions towards the scheme on his behalf. ✓
7. The wife runs a farming business where she earned Sh.400,000 from sale of farm produce. ✓
8. He is contemplating securing a bank loan for his children's education or an education insurance policy that will equally cater for children's education.

Required:

Suggest a scheme of tax planning that would minimise the tax liability of the family of Mr and Mrs Kimeli for the year of income and subsequent years.

(12 marks)

(Total: 20 marks)

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CPA PART III SECTION 6

ADVANCED PUBLIC FINANCE AND TAXATION

WEDNESDAY: 27 November 2019.

Time Allowed: 3 hours.

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Year of income 2018.

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35,473	- 47,059	425,667	- 564,709	25%
Excess over	- 47,059	Excess over	- 564,709	30%

Personal relief Sh.1,408 per month (Sh.16,896 per annum).

Prescribed benefit rates of motor vehicles provided by employer

	Monthly rates		Annual rates	
	(Sh.)	(Sh.)	(Sh.)	(Sh.)
Capital allowance:				
Wear and tear allowance:				
Class I	37.5%			
Class II	30%			
Class III	25%			
Class IV	12.5%			
Software	20%			
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		Annual rates
(i) Electricity (Communal or from a generator)		(Sh.)		(Sh.)
(ii) Water (Communal or from a borehole)		1,500		18,000
		500		6,000
Agriculture employees: Reduced rates of benefits				
(i) Water		200		2,400
(ii) Electricity		900		10,800

(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

(ii) Pick-ups, Panel Vans (unconverted)

Up to	1750 cc	3,600	43,200
Over	1750 cc	4,200	50,400

(iii) Land Rovers/Cruisers

7,200	86,400
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QUESTION ONE

- (a) Examine four reasons for the increased importance of information exchange programmes in relation to taxation among various countries. (4 marks)
- (b) The following information relates to Majani Ltd:
- The company has been operating in your country for over 20 years.
 - The company's accounts for the year ended 31 December 2018 could not be signed by the directors until 1 August 2019 when the Chief Executive Officer (CEO) returned from a medical trip abroad.
 - Following the delay in signing the accounts, the revenue authority imposed a late returns penalty of Sh.484,840 on the company.

Required:

As a tax consultant, draft a letter of objection to the revenue authority indicating the grounds of appeal in compliance with tax legislation. (6 marks)

- (c) Sharon and Primus are partners running a hardware business. They have approached you to assist them prepare the partnership returns for the year ended 31 December 2018. The following information has been presented to you:

- The partnership agreement provides that:
 - Profits and losses will be shared in the ratio of 2:1 for Sharon and Primus respectively.
 - Partners will be allowed to withdraw up to Sh.100,000 in cash without being charged interest. Any excess withdrawals will be subject to interest at a rate of 8% per annum.
 - Each partner will be entitled to a monthly salary of Sh.60,000 per month. However, no salary would be paid to any partner in the months of January, May and September due to expected low sales based on analysis of past trends. Partners would be entitled to a commission.
- The balances in the books of account as at 31 December 2018 and 31 December 2017 included the following:

	31 December 2018	31 December 2017
	Sh.	Sh.
Accrued commission due to partners	400,000	360,000
Accounts payable (trade)	2,000,000	1,600,000
Accrued advertising expense	610,000	340,000
Prepaid royalty income	160,000	100,000
Accounts receivable (trade)	5,900,000	1,700,000
Accrued salaries and wages (partners excluded)	410,000	130,000
Accumulated depreciation	600,000	340,000

- Extracts of cash payments during the year were as follows:

	Sh.
Commission paid to partners equally	100,000
Purchases (goods for sale)	1,000,000
Advertising expenses	150,000
Salaries and wages (partners excluded)	1,390,000
Motor vehicle expenses	240,000
Electricity expenses	80,000
Office partitions	60,000
Purchase of office equipment	97,000
Meals to employees	200,000
Loan interest	35,000
Cash withdrawn by partners - Sharon	160,000
- Primus	100,000

- All receipts were channeled through the account and included the following:

	Sh.
Sales (all were on credit terms)	1,600,000
Royalty income	240,000
Proceeds from sale of office equipment	45,000
Computer leasing charges	6,000

- The partners withdrew hardware goods for personal use as indicated below:

	Sh.
Sharon	110,000
Primus	60,000

- In December 2018, some of the hardware goods which were valued at Sh.60,000 were destroyed by fire. Compensation of Sh.35,000 was received from the insurance company.

Required:

- (i) Taxable profit or loss of the partnership for the year ended 31 December 2018. (8 marks)
- (ii) A schedule showing the partners allocation of taxable income or loss. (2 marks)

Hint: Ignore opening and closing inventory.

(Total: 20 marks)

QUESTION TWO

- (a) A number of countries have external resources departments as part of stimulating economic growth. Explain four roles of such departments. (4 marks)
- (b) Discuss three reasons for the failure of a number of projects under public private partnerships (PPPs). (6 marks)

- (c) Xyeng China Company (K) Ltd. has been engaged in the building industry for many years. There has been an on-going dispute with the revenue authority as to the amount of value added tax (VAT) that the company is liable to pay.

According to the revenue authority's assessment, the company is supposed to pay Sh.5.6 million, whereas the company's assessment of the VAT payable is Sh.3.9 million.

You have been provided with the following additional details relating to the company's transactions during the assessment period:

Purchases	Delivery date	Invoice date	Invoice amount(Sh.)	Payment date
Drilling machines	5 February 2019	10 March 2019	5,220,000	4 April 2019
Mobile crane	20 February 2019	8 March 2019	3,045,000	10 April 2019
Concrete mixer	18 February 2019	26 February 2019	3,770,000	2 May 2019
Poker vibrator	26 February 2019	12 March 2019	906,250	7 April 2019
Photocopying machine	12 March 2019	4 April 2019	174,000	5 May 2019
2 Forklifts	6 April 2019	20 April 2019	1,584,125	6 May 2019
700 Tonnes of cement	26 March 2019	4 April 2019	28,125,565	12 May 2019
Bottled mineral water	12 March 2019	8 April 2019	137,460	30 April 2019
Executive boardroom table	19 March 2019	4 April 2019	145,000	12 May 2019
Postal rental box	2 February 2019	24 February 2019	13,920	15 March 2019
Paint from ABC Ltd.	14 April 2019	20 April 2019	3,117,500	12 May 2019
Petrol for trucks engaged in construction work	12 March 2019	19 March 2019	1,200,960	8 April 2019

Additional information:

- The company had negotiated a contract of Sh.84 million exclusive of VAT on 1 February 2019, for which it received a progress payment of Sh.52 million on 27 March 2019. The invoice had been raised earlier on 15 March 2019 based on the Architect's certificate for the value of work certified.
- The company had also on 18 February 2019 secured a tile fixing contract of Sh.18 million exclusive of VAT for which an installment payment of Sh.7.2 million was received on 12 March 2019 ahead of the completion date on 24 May 2019. The invoice was raised for full payment on completion. By the end of May 2019, the balance of the payment had not been received from the client.

The above transactions are inclusive of VAT where applicable unless otherwise stated.

Required:

Advise Xyeng China Construction Company (K) Ltd. on:

- (i) The correct VAT position for the company for the period between February 2019 and May 2019. (8 marks)
- (ii) What action to take based on your analysis in (c) (i) above. (2 marks)

(Total: 20 marks)

QUESTION THREE

- (a) Country X has recently proposed to change the regulations on taxation of Savings and Credit Co-operation Societies (Saccos). This change will entail taxing most of the income and exempting only the interest earned from members. The proposed changes will also double the withholding tax rate on dividends paid by Saccos.

Required:

- With reference to the above scenario, explain four effects of the proposed legislative changes on Saccos. (4 marks)
- (b) Discuss three incentives provided by your country to spur the growth of the housing and construction sector. (6 marks)
- (c) Maisha Mema Insurance Company Limited provided the following information for the year ended 31 December 2018:

	Sh."000"
Gross premiums received	30,000
Claims paid	4,000
Commission ceded	800
Commission accepted	20
Claims recovered on reinsurance	3,000
Foreign exchange gains realised	3,500
Dividends from life assurance fund	2,000
Rental income (commercial building)	1,600
Bad debts provision	500
Investment income	1,200
Reserve for unexpired risks (1 January 2018)	1,000
Legal expenses related to claims	400
Agency fees	400
Management fees	120
Repairs on rental properties	200
Entertainment expenses	400
Purchase of furniture	600
Purchase of computer	300
Reinsurance premiums paid	4,000
Returned premiums	5,000

Additional information:

- Reserves for unexpired risks on 31 December 2018 were Sh.200,000.
- Claims outstanding on 1 January 2018 and 31 December 2018 were Sh.600,000 and Sh.900,000 respectively.
- Premiums outstanding on 1 January 2018 and 31 December 2018 were Sh.6,000,000 and Sh.12,000,000 respectively.
- Agency fees included Sh.200,000 relating to the life assurance business.
- Legal fees included Sh.100,000 relating to settlement of a tax dispute.
- Investment income comprised:

	Sh.
Interest from bank	850,000 (net)
Interest from treasury bonds	350,000 (gross)

Required:

- (i) Taxable profit or loss of Maisha Mema Insurance Company Limited for the year ended 31 December 2018. (8 marks)
- (ii) Tax payable (if any) from your computations in (c) (i) above. (2 marks)
- (Total: 20 marks)**

QUESTION FOUR

- (a) One-stop border posts (OSBPs) are a fairly recent cross-border trade initiative which have significantly changed the way neighbouring countries conduct business with each other.

Required:

- (i) Explain the meaning of OSBPs. (2 marks)
- (ii) Summarise four benefits of OSBPs. (4 marks)
- (b) Describe four functions of tax agents. (4 marks)

(c) Benita Contractors Ltd. operates in the construction industry. On 1 November 2016, the company won a tender for the construction of two projects, a hospital and an office complex. Construction of the projects commenced on 1 January 2017. The following details relate to the two projects for the year ended 31 December 2018:

	Hospital project Sh. "000"	Office complex Sh. "000"
Balance as at 1 January 2018:		
Materials	6,000	4,000
Accrued salaries and wages	1,500	1,200
Plant (written down value)	190,000	150,000
Cost of work done	200,000	200,000
Value of works certified to date	200,000	160,000
Transactions undertaken during the year:		
Material delivered to site		
From store	10,000	14,000
From supplier	100,000	128,000
Plant purchased at cost	-	120,000
Sub contractors fee	-	18,000
Consultancy fees	30,000	29,000
Inspection fee	10,000	5,000
Salaries and wages	120,000	180,000
Head office expenses	-	2,000
Material transferred out	10,000	17,000
Material sales	-	22,000
Plant lease charges	400	500
Direct expenses	3,000	2,000
Cash received from sub contractor	300,000	600,000
Cumulative value of work certified as at 31 December 2018	700,000	860,000
Value of work uncertified in the year	30,000	42,000
Balance carried forward:		
Material on site	40,000	50,000
Accrued wages	1,000	2,000

Additional information:

1. Consultancy fees for the hospital project include Sh.40,000 prepaid for the year 2019.
2. Wear and tear allowance on plant was provided at the rate of 12.5% per annum.
3. Direct expenses accrued and not reflected above were as follows:

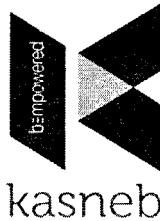
	Hospital Sh. "000"	Office Sh. "000"
As at 1 January 2018	200	-
As at 31 December 2018	1,000	400

Required:

A schedule showing the taxable profit and tax payable (if any) by Benita Contractors Ltd. as at 31 December 2018. (10 marks)
(Total: 20 marks)

QUESTION FIVE

- (a) The Cabinet Secretary responsible for matters relating to public investments should prepare and submit a consolidated report to the National Assembly at the end of each financial year.
Evaluate the significance of any four information contained in the consolidated report. (8 marks)
- (b) Explain four ways through which the Public Debt Management office may enhance the functions of the commission on revenue allocation in your country. (4 marks)
- (c) Discuss four fiscal responsibility principles that the National Treasury and Planning must enforce when managing the national government public finance in your country. (8 marks)
(Total: 20 marks)



CPA PART III SECTION 6

ADVANCED PUBLIC FINANCE AND TAXATION

THURSDAY: 23 May 2019.

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 2018.

Monthly taxable pay (Sh.)	Annual taxable pay (Sh.)	Rate of tax % in each Sh.
1 - 12,298	1 - 147,580	10%
12,299 - 23,885	147,581 - 286,623	15%
23,886 - 35,472	286,624 - 425,666	20%
35,473 - 47,059	425,667 - 564,709	25%
Excess over - 47,059	Excess over - 564,709	30%

Personal relief Sh.1,408 per month (Sh.16,896 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%	
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		
	Monthly rates Sh.	Annual rates Sh.
Services		
(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

(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

(ii) Pick-ups, Panel Vans (unconverted)

Up to 1750 cc	3,600	43,200
Over 1750 cc	4,200	50,400

(iii) Land Rovers/Cruisers

7,200	86,400
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QUESTION ONE

- (a) Many governments' particularly in developing countries have implemented various taxation policies to achieve fiscal and other objectives. Unfortunately, in some of these countries, the noble objectives of the taxation policies appear not to have been realised.

Required:

Evaluate four reasons which, in your assessment, have contributed to the failure of taxation policies to achieve their intended objectives. (8 marks)

- (b) With regard to the government's responsibilities in public finance management:
- (i) Discuss three roles of the Cabinet Secretary for the National Treasury and Planning or equivalent office in your country, with regard to public debt management. (6 marks)
- (ii) Summarise three responsibilities of the State Corporations Advisory Committee (SCAC) or equivalent body in your country. (3 marks)
- (c) Describe three ways in which monies paid into the Public Private Partnership Project Facilitation Fund may be applied. (3 marks)
- (Total: 20 marks)**

QUESTION TWO

- (a) Various legislations provide for penalties on taxpayers who engage in tax avoidance schemes. In light of the above statement, outline four categories of tax avoidance schemes that a taxpayer might be investigated for in your country. (4 marks)
- (b) Dawida Ltd. is a real estate developer. During the year ended 31 December 2018, the company earned the following incomes from rented properties:

	Sh.
Rental income	19,400,000
Sale of timber used during construction	288,600
Sale of unused paint	92,400

The rented property is a commercial building constructed at a cost of Sh.48,460,000 and was occupied on 1 January 2018 upon completion on 31 December 2017.

The cost of construction of the commercial building comprised the following:

	Sh.
Shops (cost)	16,800,000
Offices	17,240,000
Showroom	9,460,000
Sewerage system	1,640,000

The following additional costs and expenses were incurred by the company:

1. A standby generator at a cost of Sh.600,000 and a powerhouse at a cost of Sh.280,000 were acquired.
2. CCTV surveillance cameras were installed at a cost of Sh.720,000.
3. A stone perimeter wall was constructed at a cost of Sh.1,480,000.
4. Electricity expenses incurred during the year amounted to Sh.492,800 while insurance expenses amounted to Sh.360,000.
5. Water tanks costed Sh.540,000 excluding the cost of water pumps of Sh. 248,000.
6. Land Cruiser motor vehicle of 3500cc whose cost was Sh. 2,800,000 was purchased and used for security surveillance purposes.
7. A parking bay for shoppers was constructed at a cost of Sh.4,670,000.
8. Other expenditure comprised purchase of fire extinguishers at Sh.182,000, county rates amounting to Sh.94,800, real estate agents commission amounting to Sh.138,400 and parking metres amounting to Sh.280,000.

Required:

- (i) Statement of taxable rental income for the year ended 31 December 2018. (10 marks)
- (ii) Tax liability, if any, for Dawida Ltd. for the year ended 31 December 2018. (2 marks)
- (iii) Highlight any additional information to be sought from the company to help determine the accuracy of the tax computed. (4 marks)

(Total: 20 marks)

QUESTION THREE

- (a) (i) Explain four factors to be considered when selecting the most appropriate transfer pricing method. (4 marks)
- (iv) A Ltd. sold a processing machine to B Ltd., an associate company. B Ltd. sold the same machine to C Ltd., an independent party, for Sh.400,000 at a profit margin of 30%. B Ltd's incidental costs before selling to C Ltd. were Sh.4,000.

Using the resale price method, calculate the arms length price/transfer price of the machine. (4 marks)

- (b) Peter Samoei is an employee of Zawadi Ltd. and earns a salary of Sh.140,000 per month, while his wife Sabina Wanga works in Lindi Ltd., a firm in which Mr Samoei controls 18% of the share capital. Her salary is Sh.60,000 per month. Sabina Wanga owns the house which is occupied by the family, for which the market rental value is Sh.45,000 per month. The house was constructed in year 2017 at a cost of Sh.6,000,000 borrowed from a Sacco at an interest rate of 12% per annum. Sabina Wanga has insured the house and paid insurance premiums of Sh.4,800 per month and city county rates of Sh.6,900 per annum.

Mr Samoei paid insurance premiums for his family of Sh.4,600 with an insurance company incorporated in Uganda, but operating in Kenya. Zawadi Ltd. paid school fees of Sh.80,000 for the couple's children which was expensed in the firm's income statement.

Required:

Suggest four tax planning schemes that could minimise the tax liability of the family. (8 marks)

- (c) Explain four benefits that might accrue from the effective use of information communication technology (ICT) in tax administration. (4 marks)

(Total: 20 marks)

QUESTION FOUR

- (a) It is important for shareholders to understand the taxation impact of transactions involving mergers or transfers of assets before approving such transactions.

With reference to the above statement, evaluate three tax implications of transactions involving mergers or transfers of assets for consideration to another company. (6 marks)

- (b) Solomon Omariba started a merchandise business, Solo Traders, on 1 January 2016. He had not filed individual income tax returns for the years of income 2016 and 2017. The revenue authority announced a tax amnesty, where one qualified provided they filed returns for the year of income 2018.

Mr Omariba has provided the following details to you to assist in filing his returns:

1. An analysis of the cash book for the year ended 31 December 2018 is as shown below:

Cash book – Bank Column

	Sh.		Sh.
1 January 2018 balance brought down	970,000	Fixtures and fittings (acquisition)	183,000
Cash sales	4,408,000	Suppliers of goods	696,000
Cheques from customers	649,600	Bank charges	14,800
Refunds from suppliers	41,760	Motor vehicle (acquisition)	500,000
Rent income	520,000	Salaries and wages	480,000
Sale of fixtures	248,000	Office computers (acquisition)	240,000
		Rent and rates	62,000
		Electricity expenses	58,000
		Telephone and postage	62,640
		Refunds to customers	37,120
		Computer software	60,000
		Balance carried down	4,443,800
	<u>6,837,360</u>		<u>6,837,360</u>

2. Other information obtained from the books of account included:

	1 January 2018	31 December 2018
Inventory	4,320,000	225,000
Suppliers of goods	278,400	139,200
Trade debtors	174,000	487,200
Accrued electricity	66,120	113,680
Prepaid rent income	180,000	240,000
Motor vehicles	1,400,000	1,800,000
Prepaid salaries and wages	320,000	140,000
Fixtures and fittings	450,000	170,000

- Non-current assets are stated at cost. However, the business had charged depreciation in the income statement.
- Opening and closing inventories were overvalued and undervalued by 20% and 10% respectively.
- All operating expenses and non-current assets comprise 40% non-business activities.
- Total sales and purchases are inclusive of value added tax at the rate of 16%.
- The business had issued credit notes of Sh.34,800 for goods returned by credit customers.
- The cost of fixtures disposed of was Sh.220,000.
- From the accounting records, the accountant had reported a net loss of Sh.186,400.

Required:

A statement showing the corrected adjusted taxable income of Solo Traders for the year of income 2018. (14 marks)
(Total: 20 marks)

QUESTION FIVE

- Discuss four benefits that could accrue to parties involved in a tax dispute through the use of Alternative Dispute Resolution (ADR) in your country. (8 marks)
- The following are the year 2018 records of the Trustees of the late Kalume Tajiri Children Settlement created in favour of his three children; Baraka, Khalifi and Mwanga.

	Sh."000"
Gross rental income	800,000
Trading income	310,000
Dividends (gross)	160,000
Sundry income	90,000

Additional information:

- Each beneficiary is entitled to 1/5 share of the net distributable income.
- Interest on debt repayment by the settlement is Sh.14,000,000.
- Fixed annuity to beneficiary is Sh.120,000,000 (gross).
- Trustees remuneration per "Trust Deed":
 - Fixed salary Sh.80,000,000 each.
 - 2% of total computed income.
- Under the terms of the Trust Deed, the trustees made the following discretionary payments to Baraka, Khalifi and Mwanga; Sh.120,000,000, Sh.100,000,000 and Sh.60,000,000 respectively.
- Trading income was before taking into account capital expenditure as follows:

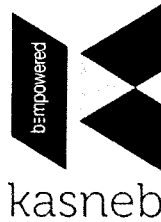
	Sh.
Godown	3,500,000
Staff canteen	750,000
Parking bay	800,000
Sports pavilion	<u>1,950,000</u>
	<u>7,000,000</u>

- Administrative and other expenses amounted to Sh.160,000,000.
- The children did not have other income.

Required:

- A statement of income tax payable by the trustees on the trust income for the year of assessment 2018. (8 marks)
 - The amount due to each beneficiary for the year of assessment 2018. (4 marks)
- (Total: 20 marks)

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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.)	
	(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	

Capital allowance:

Wear and tear allowance:

Class I	37.5%
Class II	30%
Class III	25%
Class IV	12.5%
Software	20%

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>
		1,409,498
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)

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- (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)**

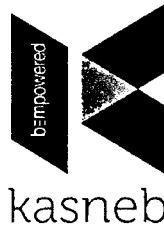
QUESTION FIVE

- (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)

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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:

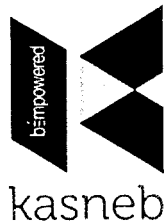
- (i) A statement of adjusted taxable profit or loss for the year ended 31 December 2017. (12 marks)
- (ii) Tax liability, if any. for the year ended 31 December 2017. (2 marks)
- (iii) Comment on payment of tax for the year ended 31 December 2017, assuming that tax had been paid during the year 2017 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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CPA PART III SECTION 6

ADVANCED PUBLIC FINANCE AND TAXATION

THURSDAY: 30 November 2017.

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 2016.

Monthly taxable pay (Sh.)	Annual taxable pay (Sh.)	Rate of tax % in each Sh.
1 - 10,164	1 - 121,968	10%
10,165 - 19,740	121,969 - 236,880	15%
19,741 - 29,316	236,881 - 351,792	20%
29,317 - 38,892	351,793 - 466,704	25%
Excess over - 38,892	Excess over - 466,704	30%

Personal relief Sh.1,162 per month (Sh.13,944 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%	
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		
	Monthly rates Sh.	Annual rates Sh.
Services		
(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

(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
(ii) Pick-ups, Panel Vans (unconverted)		
Up to 1750 cc	3,600	43,200
Over 1750 cc	4,200	50,400
(iii) Land Rovers/Cruisers	7,200	86,400

QUESTION ONE

- (a) The following extract is from a leading global newspaper on matters of taxation and finance:

Avoiding tax may be legal, but can it ever be ethical?

“Rather than hiding behind the business case for tax avoidance, companies need to be transparent about their tax planning. Avoiding tax and bending the rules of the tax system is not illegal unlike tax evasion; it is operating within the letter, but perhaps not the spirit of the law. Businesses may therefore be complying with the law, but are they acting ethically?”.

Required:

Citing four areas, discuss the moral and ethical issues against tax avoidance with specific reference to operations of multinational corporations (MNCs). (8 marks)

- (b) The following statement was made by the Commissioner General of your country’s revenue authority during an international conference to discuss the challenges of taxation in the era of electronic commerce (e-commerce) and mobile commerce (m-commerce).

“The rapid growth of electronic commerce and mobile commerce fuelled by the developments in digital technology has shaped a revolution in global retail trade that is opening up markets across borders and continents. The growth in e-commerce and m-commerce has imposed a number of challenges to the government in relation to the tax system”.

Required:

With reference to the above statement, analyse three challenges of taxing businesses and transactions arising from the adoption of e-commerce and m-commerce. (6 marks)

- (c) The Common Market for Eastern and Southern Africa (COMESA) has played a key role in enhancing trade and integration within its jurisdiction.

Required:

(i) Summarise four specific objectives of COMESA. (4 marks)

(ii) Some experts have argued that COMESA has been overtaken by globalisation and should be dissolved.

Required:

Citing two reasons, support the above view. (2 marks)

(Total: 20 marks)

QUESTION TWO

- (a) Masai Traders commenced trading on 1 January 2014. The following are the financial statements and supporting records for the years ended 31 December 2016 and 2015:

Statement of comprehensive income for the year ended 31 December 2016:

	Sh. “000”	Sh. “000”
Sales		82,600
Less cost of goods sold		(36,200)
Gross profit		46,400
Less expenses:		
Legal expenses	7,700	
Impairment loss on business premises	4,800	
Depreciation on plant and equipment	1,600	
Interest expense	478	
Salaries and wages	1,394	(15,972)
Net profit		<u>30,428</u>

Statement of financial position as at 31 December:

	2016 Sh. “000”	2015 Sh. “000”
Non-current assets:		
Business premises	3,200	3,500
Plant and equipment	26,400	28,000
Saloon car	<u>800</u>	<u>860</u>
	30,400	32,360

	2016 Sh. "000"	2015 Sh. "000"
Current assets:		
Inventories	11,600	11,200
Debtors	12,800	15,200
Cash and cash equivalents	<u>14,200</u>	<u>8,600</u>
	<u>69,000</u>	<u>67,360</u>
Financed by:		
Capital	30,000	30,000
Add: net profit	<u>30,428</u>	<u>24,240</u>
	60,428	54,240
Current liabilities:		
Creditors	4,572	3,120
Bank overdraft	<u>4,000</u>	<u>10,000</u>
	<u>69,000</u>	<u>67,360</u>

Additional information:

1. During the year 2016, payments through the bank comprised the following:

	Sh. "000"
Conveyance fees for business land title deed	128
Payments to creditors	2,488
Salary to wife	260
Mortgage interest; personal residence	184
Defending business against illegal trade	160
Revenue stamps	16
2. The credit purchases figure was overstated by 60%.
3. Receipts from debtors amounted to Sh.9,600,000. A debtor owing goods valued at Sh.85,840 inclusive of 16% VAT was declared bankrupt during the year and the debt written off. The write off was included in the interest expense.
4. The figure for sales was understated by 20%.
5. Business premises included:
 - A factory building at a cost of Sh.960,000.
 - Warehouse Sh.540,000.
 - Staff canteen Sh.600,000.
 All these were put into use on 1 January 2014.
6. There were no acquisitions or disposals of fixed assets during the year 2016.
7. Plant and equipment acquired in the year 2015 includes:
 - Weighing scale Sh.14,000.
 - Furniture Sh.240,000.
 - Computers Sh.324,000.
 - Forklift Sh.400,000.
 - Lorry (2 tonnes) Sh.960,000.
 The rest of the assets were categorised under Class IV for purposes of wear and tear allowance.

Required:

- (i) A statement of adjusted taxable profit or loss for the year ended 31 December 2016. (13 marks)
 - (ii) State three areas or items that you might require further clarification on from Masai Traders for accurate computation of any tax due. (3 marks)
- (b) Various governments have established agencies to broadly enhance efficiency and effectiveness of state corporations. In some countries, this agency is called the State Corporations Advisory Committee (SCAC).

Required:

- Summarise four specific responsibilities of SCAC or its equivalent body in your country. (4 marks)
- (Total: 20 marks)**

QUESTION THREE

(a) Describe three ways through which the government might redeem public debt. (6 marks)

(b) Andrew Mole is an employee of Sombea Ltd. He has presented the following information:

1. His salary per month is Sh.80,000 which includes house allowance of Sh.20,000 per month.
2. His wife is employed at a salary of Sh.20,000 per month with Faza Ltd. where Andrew Mole holds 15% of share capital.
3. The house in which the family lives in is owned by his wife. The house was constructed in the year ended 31 December 2016 through an 18% mortgage loan of Sh.5,000,000 repayable over a period of 10 years.
4. Their children attend a nearby primary school. Mole has been saving Sh.12,000 per month for his children's secondary school education and Sh.20,000 per month with his Sacco to be withdrawn upon retirement.
5. His wife has insured the house and pays insurance premiums of Sh.5,000 per month and county government rates of Sh.24,000 per annum.

Required:

Evaluate three possible schemes of tax planning that Andrew Mole and family could use to minimise their tax liability for the year of income 2016. (6 marks)

(c) Sambamba Public Limited Company is in the merchandising business. The Revenue Authority suspects that the company has not been paying the correct amount of tax from business activities over a period of four months.

The following details were obtained from the company's accounting records for the specified period below:

1. During the month of January 2016, the company purchased goods for Sh.754,000 and sold goods for Sh.788,800. The suppliers also issued credit notes of Sh.29,000 and received debit notes of Sh.69,600. The company had filed a nil VAT return for the month of January 2016.
2. In the month of February 2016, the company did not file VAT returns despite making sales of Sh.522,000. The company had charged a profit margin of 20%.
3. To avoid inspection, the company removed their VAT certificate of registration from the business premises and failed to issue tax invoices for goods valued at Sh.417,600 during the month of March 2016 with respect to goods sold.
4. In the month of April 2016, the company secured a huge supply contract with the government after successfully obtaining a tax compliance certificate through fraudulent accounting records.

Transactions are inclusive of value added tax (VAT) at the rate of 16% where applicable.

Required:

- (i) The amount of tax payable, if any, by the company plus any interest and penalties arising from the above transactions for the four months to April 2016. (6 marks)
- (ii) Comment on the information you might require from the company to determine the accuracy of the VAT payable, if any. (2 marks)

(Total: 20 marks)

QUESTION FOUR

(a) Discuss three measures that the central government could put in place to enhance financial accountability and transparency at the county level. (6 marks)

(b) Peter Chawawa started a retail business on 1 January 2011. He has not been filing income tax returns for the six years to 31 December 2016.

An investigation of his affairs revealed the following:

1. The balance sheet of the retail business as at 31 December 2011 was as shown below:

	Sh. "000"	Sh. "000"
Fixed assets:		
Premises		2,000
Furniture and fittings		1,000
Motor vehicles		<u>500</u>
		3,500

	Sh. "000"	Sh. "000"
Current assets:		
Stock	250	
Debtors	160	
Bank balance	81	
Cash in hand	<u>9</u>	<u>500</u>
Total assets		<u>4,000</u>
Capital: 1 January 2011	3,000	
Net profit for the year	300	
Drawings	<u>(500)</u>	2,800
Mortgage loan		1,000
Creditors		<u>200</u>
		<u>4,000</u>

2. He constructed an extension to the premises in year 2015 at a cost of Sh.625,000.
 3. The following account balances were outstanding in the respective years as shown below:

	2012	2013	2014	2015	2016
	Sh.	Sh.	Sh.	Sh.	Sh.
Trade debtors	173,000	190,000	208,000	230,500	253,000
Bank balance	109,000	194,000	281,000	409,500	(32,000)
Trade creditors	230,000	241,000	253,000	272,000	291,500
Cash in hand	10,000	10,000	10,000	10,000	10,000
Stock	255,000	302,500	332,500	366,000	402,500

4. He withdrew goods worth Sh.5,000 per annum from the business for his personal use.
 5. The principal repayments on each mortgage loan amounted to Sh.250,000 per annum from 31 December 2012. The mortgage interest paid in each of the four years ended 31 December 2012, 2013, 2014 and 2015 amounted to Sh.100,000, Sh.75,000, Sh.50,000 and Sh.25,000 respectively.
 6. His wife opened a savings account in a commercial bank in year 2012. The balances in this account after crediting the interest earned were as follows:

	2012	2013	2014	2015	2016
	Sh.	Sh.	Sh.	Sh.	Sh.
Savings account	300,000	900,000	100,000	725,000	750,000
Interest earned	25,000	75,000	90,000	70,000	60,000

7. His living expenses and wear and tear allowances were agreed with the revenue authorities as follows:

	2012	2013	2014	2015	2016
	Sh.	Sh.	Sh.	Sh.	Sh.
Living expenses	300,000	400,000	450,000	500,000	600,000
Wear and tear	155,500	130,500	109,000	73,000	157,000

Required:

Compute the annual taxable income of Peter Chawawa from year 2012 to year 2016.

(14 marks)

(Total: 20 marks)

QUESTION FIVE

- (a) Mawela Property Developers Ltd. purchased a residential house on 1 January 2015 through a 12% per annum mortgage loan of Sh.4,000,000. The company incurred the following expenses in obtaining the loan:

- Audit fees Sh.48,400.
- Valuation of the house Sh.120,000.
- Legal fees for conveyance Sh.80,000.

Additional information:

1. The company replaced all doors in the residential house with metallic doors at a cost of Sh.96,000.
2. On 31 December 2016, the company sold the house at a price of Sh.8,000,000 after incurring the following expenses:
 - Repairs of the house Sh.78,000.
 - Advertisement Sh.24,200.
 - Agent's commission Sh.12,000.
 - Valuation fee Sh.148,000.
 - Legal fees Sh.42,800.

Required:

Compute the capital gain or loss arising from the sale of the above house.

(6 marks)

(b) Dawa Ltd. provided the following income statement for the year ended 31 December 2016:

	Sh. "000"	Sh. "000"
Turnover		27,400
Less cost of goods sold		<u>(11,000)</u>
Gross profit		16,400
Add other income:		
Capital gain on sale of assets		468
Insurance recovery on motor vehicle		450
Dividends from subsidiary company		942
Foreign exchange gain		124
Interest on fixed deposit		<u>300</u>
		18,684
Less expenditure:		
General expenses	4,840	
Impairment loss	390	
Bad debts	485	
Advertising	248	
Donations to disaster fund	150	
Property tax	136	
Branch closure costs	178	
Legal expenses	1,240	
Staff costs	<u>3,496</u>	<u>(11,163)</u>
Net profit		<u>7,521</u>

Additional information:

1. The cost of goods sold includes opening stock valued at Sh.2,200,000, while closing stock was stated at Sh.2,800,000. The opening stock was overcast by 10% and closing stock was undercast by 30%.

2. Legal expenses comprised:

	Sh. "000"
Acquisition of bank loan	90
Settling customers disputes	42
Preparation of memorandum of association	260
Liquidation costs	468
Patent rights	340
Notices to defaulting debtors	<u>40</u>
	<u>1,240</u>

3. General expenses comprised:

	Sh. "000"
Purchase of processing machinery	800
Purchase of factory building	1,280
Provision for corporation tax	394
Purchase of furniture	360
Directors allowances	480
VAT appeal	120
Credit notes received	135
Delivery van	720
Debenture interest	<u>551</u>
	<u>4,840</u>

4. Bad debts analysis:

Bad debts account

	Sh. "000"		Sh. "000"
Bad debts	178	Balance brought down: Specific provision	240
Balance carried down: Specific provision	560	General provision	180
General provision	<u>167</u>	Profit and loss account	<u>485</u>
	<u>905</u>		<u>905</u>

5. Staff costs include: staff development cost Sh.96,000, staff welfare expenses Sh.200,000, pension contribution Sh.1,480,000 and personal computers Sh.360,000.

6. Advertising include: neon sign Sh.129,000, depreciation of delivery van Sh.24,000, carriage outwards Sh.9,000 and hire of billboards Sh.86,000.

Required:

- (i) A statement of adjusted taxable profit or loss for the year ended 31 December 2016. (12 marks)
- (ii) Corporation tax payable, if any, by Dawa Ltd. (2 marks)

(Total: 20 marks)

KASNEB

CPA PART III SECTION 6

ADVANCED PUBLIC FINANCE AND TAXATION

THURSDAY: 25 May 2017.

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 2016.

Monthly taxable pay (Sh.)	Annual taxable pay (Sh.)	Rate of tax % in each Sh.
1 - 10,164	1 - 121,968	10%
10,165 - 19,740	121,969 - 236,880	15%
19,741 - 29,316	236,881 - 351,792	20%
29,317 - 38,892	351,793 - 466,704	25%
Excess over - 38,892	Excess over - 466,704	30%

Personal relief Sh.1,162 per month (Sh.13,944 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%	
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) A government's debt portfolio is usually the largest financial portfolio in a country. It often contains complex and risky financial structures and can generate substantial risk to the government's balance sheet.

Required:

In the context of the above statement:

- (i) Explain the term "public debt management". (2 marks)
- (ii) Discuss five guidelines for effective public debt management. (10 marks)
- (b) Assess four factors that might hinder the optimal growth of the East African Community (EAC) or the equivalent trading block in your region. (8 marks)

(Total: 20 marks)

QUESTION TWO

- (a) The privatisation of state corporations continues to be witnessed in a number of countries, particularly in the developing world.

Required:

Discuss four benefits likely to be realised from the above trend. (8 marks)

- (b) The following information was obtained from the financial records of Mali Commercial Bank Ltd. for the year ended 31 December 2016:

	Sh. "000"
Interest on advances	464,800
Contribution to deposit protection fund	98,000
Operating lease rentals	6,480
Interest on government securities	14,600
Interest paid on deposits	4,740
Interest on placement and bank balances	2,660
Loss on disposal of collaterals	840
Fees and commission expenses	1,420
Losses from investment in securities	790
Purchase of equipment	1,200
Depreciation	496
Transfer to statutory reserves	626
Losses on stock brokerage dealings	348
Gain on foreign exchange dealings	1,470
Discounts on bills purchased	329
Auditor's remuneration	786
Provision for bad and doubtful debts	540
Investment in government securities	1,850
Bills receivable and for collection	314
Guarantees and performance bonds	378
Interest accrued and paid	1,974
Bills for collection, acceptance and endorsement	470
Rebate on bills discounted	292
Provision for taxation	400
General charges recovered	250
Commission on exchange and brokerage	784

Additional information:

- Contribution to deposit protection fund includes investment revaluation surplus of Sh.648,000.
- Included in transfer to statutory reserves is an amount paid for exchange and commission of Sh.48,000.
- Discounts on bills purchased include interest and discount paid of Sh.39,000.
- Provision for bad and doubtful debts include specific bad debts at the beginning and end of the year amounting to Sh.68,000 and Sh.140,000 respectively.

Required:

- (i) A statement showing the taxable profit or loss for Mali Commercial Bank Ltd. for the year ended 31 December 2016. (10 marks)
- (ii) Tax payable by (or refundable to) the bank. (2 marks)

(Total: 20 marks)

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QUESTION THREE

- (a) Your country has been experiencing growth in the number of projects initiated through public-private partnerships (PPPs). However, this growth appears to be declining in the last few years.

Required:

Evaluate three possible factors that could have contributed to the above trend.

(6 marks)

- (b) Wema and Nenda have been running Wenda Enterprises as a partnership, sharing profits and losses in the ratio of 2:3 respectively. The following is the statement of comprehensive income for the firm for the year ended 31 December 2016:

	Sh.	Sh.
Sales		5,220,000
Less: Cost of goods sold		(2,047,000)
Gross profit		3,173,000
Rental income		148,800
Foreign exchange gain		120,200
Interest on fixed deposit account		<u>80,000</u>
		3,522,000
Less: Expenses		
Purchase of CCTV cameras	96,000	
Impairment loss on godown	124,600	
Website development	130,000	
Debenture interest	56,000	
Audit fees	48,400	
Salaries and wages	300,000	
Directors' allowances	280,000	
Legal expenses	250,000	
Loss on rented property	36,200	
Purchase of foreign currency	344,900	
Advertising expenses	224,200	
Purchase of computers	180,000	
Insurance	94,200	
Medical expenses	49,600	
Bank charges	82,400	
Purchase and installation of computer programs	<u>120,000</u>	(2,416,500)
Net profit		<u><u>1,105,500</u></u>

Additional information:

- The business was converted into a limited liability company trading as Dawadu Ltd. with effect from 1 October 2016 and retaining the partners as directors of the new company.
- The cost of goods sold included opening stock of Sh.576,000 which was overcast by 20%, purchases of Sh.2,146,000 inclusive of 16% VAT and closing stock of Sh.675,000 which was undercast by 10%.
- All revenues and expenses accrued evenly throughout the year except for specific expenses relating to Dawadu Ltd. as a company.
- Salaries and wages included partners' salaries of Sh.120,000.
- Legal expenses comprised:

	Sh.
Acquisition of company's title deed	50,000
Negotiating debenture stock	100,000
Demand letters to customers	40,000
Drafting Memorandum of Association	<u>60,000</u>
	<u>250,000</u>
- Wema was paid consultancy fees of Sh.54,000 for installing CCTV cameras in the premises.
- Advertising expenses include a neon sign costing Sh.92,000.
- The sales figure was inclusive of VAT at the rate of 16%.
- Directors' allowances include commission paid to Nenda of Sh.60,000 for negotiating a business contract.

Required:

- (i) Separate statements of adjusted taxable profit or loss for Wenda Enterprises and Dawadu Ltd. for the year ended 31 December 2016. (Hint: Start with the net profit). (12 marks)

- (ii) Tax payable by (or refundable to) Dawadu Ltd. for the year ended 31 December 2016. (2 marks)

(Total: 20 marks)

QUESTION FOUR

- (a) Describe three tax planning opportunities that could be derived from the financial management decisions in a company. (6 marks)
- (b) The following transactions relate to Sawela Ltd. for the month of April 2017:

	Sh.
Purchase of goods at standard rate	626,400
Exported goods to South Africa	380,000
Sales at standard rate	1,113,600
Audit fees	37,120
Purchase of fuel and oil for delivery van	29,000
Telephone bills	17,400
Exempt sales	400,000
Exported goods to Zambia	220,000
Catering services	41,760
Purchase of stationery	20,880
Cost of assigning a debt for consideration	100,000
Car park services provided by county authority	50,000
Treatment and supply of natural water	40,000
Purchase of first aid boxes and kits	30,000

Additional information:

- The company issued debit notes and credit notes of Sh.24,360 and Sh.34,800 respectively in respect to taxable supplies at standard rate.
- The company returned goods invoiced at Sh.29,000 to suppliers because they were of a wrong type. A credit note was received immediately.
- The company imported goods valued at Sh.320,000 (cost, insurance and freight). These goods were not included in the purchases figure. Import duty was at the rate of 20%.
- The company transferred a branch as a going concern to another registered company at a cost of Sh.450,000 at the end of April 2017.
- The company could not identify purchases at standard rate that were sold as exempt and therefore restricted deductible input tax.
- Transactions are inclusive of VAT at the rate of 16% where applicable.

Required:

Determine the VAT payable by (or refundable to) Sawela Ltd. for the month of April 2017. (14 marks)
(Total: 20 marks)

QUESTION FIVE

- (a) The development of an effective tax policy for a country requires critical consideration of certain factors at macro-economic level.

Required:

Discuss three such factors. (6 marks)

- (b) A and B are partners trading as AB Enterprises. sharing profits and losses equally.

The following is the statement of comprehensive income for the partnership for the year ended 31 December 2016:

	Sh. "000"	Sh. "000"
Sales		40,450
Less: Sales returns		<u>(1,200)</u>
		39,250
Less: Cost of goods sold		<u>(19,550)</u>
Gross profit		19,700
Discount received		<u>350</u>
		20,050
Less: Expenses		
Rent	1,850	
Bad debts	400	
Wages and salaries	6,100	
Loan interest	400	

	Sh. "000"	Sh. "000"
Depreciation	4,200	
Insurance	1,450	
Repairs	300	
Electricity	<u>750</u>	<u>(15,450)</u>
Net profit		<u>4,600</u>

The partnership is under tax investigation and the assessor obtained the following details from the firm's records for the year ended 31 December 2016:

- Balances of assets and liabilities:

	1 January 2016 Sh. "000"	31 December 2016 Sh. "000"
Inventory	6,100	4,200
Machinery	84,600	97,000
Rent prepaid	800	-
Rent owing	-	950
Debtors	9,300	7,500
Loan from bank at 8% interest per annum	6,000	6,000
Loan interest owing	-	200
- Receipts and payments were as follows:

	Sh. "000"
Receipts:	
Receipts from debtors	26,400
Cash sales	72,400
Payments:	
Loan interest paid	400
Electricity	750
Rent	240
Purchase of machinery	16,400
- Rent expense related to A's private residence. In addition, electricity paid includes Sh.50,000 for A's private residence.
- The firm issued credit notes amounting to Sh.1,200,000 which was erroneously posted as Sh.200,000 to the relevant ledgers.
- Included in the sales figure is Sh.30,000 for interest on drawings by B and proceeds on disposal of machinery Sh.1,450,000. The machinery had cost Sh.4,000,000 with an accumulated depreciation of Sh.200,000.
- Receipts from debtors include Sh.440,000 contributed by a new partner C as his capital on 1 October 2016. The profit and loss sharing ratio changed to 2:2:1 for A, B and C respectively.
- Purchases amounted to Sh.19,250,000 which included goods withdrawn by B valued at Sh.300,000.
- Salaries and wages include accrued salaries to the partners of Sh.2,400,000 shared equally among all the three partners per month as applicable.

Required:

As a tax assessor, compute the net profit for tax purposes for the year ended 31 December 2016 indicating the taxable income for each partner. (14 marks)

(Total: 20 marks)

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	Sh. "000"	Sh. "000"
Depreciation	4,200	
Insurance	1,450	
Repairs	300	
Electricity	<u>750</u>	<u>(15,450)</u>
Net profit		<u>4,600</u>

The partnership is under tax investigation and the assessor obtained the following details from the firm's records for the year ended 31 December 2016:

1.	Balances of assets and liabilities:	1 January 2016	31 December 2016
		Sh. "000"	Sh. "000"
	Inventory	6,100	4,200
	Machinery	84,600	97,000
	Rent prepaid	800	-
	Rent owing	-	950
	Debtors	9,300	7,500
	Loan from bank at 8% interest per annum	6,000	6,000
	Loan interest owing	-	200
2.	Receipts and payments were as follows:		Sh. "000"
	Receipts:		
	Receipts from debtors		26,400
	Cash sales		72,400
	Payments:		
	Loan interest paid		400
	Electricity		750
	Rent		240
	Purchase of machinery		16,400
3.	Rent expense related to A's private residence. In addition, electricity paid includes Sh.50,000 for A's private residence.		
4.	The firm issued credit notes amounting to Sh.1,200,000 which was erroneously posted as Sh.200,000 to the relevant ledgers.		
5.	Included in the sales figure is Sh.30,000 for interest on drawings by B and proceeds on disposal of machinery Sh.1,450,000. The machinery had cost Sh.4,000,000 with an accumulated depreciation of Sh.200,000.		
6.	Receipts from debtors include Sh.440,000 contributed by a new partner C as his capital on 1 October 2016. The profit and loss sharing ratio changed to 2:2:1 for A, B and C respectively.		
7.	Purchases amounted to Sh.19,250,000 which included goods withdrawn by B valued at Sh.300,000.		
8.	Salaries and wages include accrued salaries to the partners of Sh.2,400,000 shared equally among all the three partners per month as applicable.		

Required:

As a tax assessor, compute the net profit for tax purposes for the year ended 31 December 2016 indicating the taxable income for each partner. (14 marks)

(Total: 20 marks)

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KASNEB

CPA PART III SECTION 6

ADVANCED PUBLIC FINANCE AND TAXATION

THURSDAY: 24 November 2016.

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 2015.

Monthly taxable pay (Sh.)	Annual taxable pay (Sh.)	Rate of tax % in each Sh.
1 - 10,164	1 - 121,968	10%
10,165 - 19,740	121,969 - 236,880	15%
19,741 - 29,316	236,881 - 351,792	20%
29,317 - 38,892	351,793 - 466,704	25%
Excess over - 38,892	Excess over - 466,704	30%

Personal relief Sh.1,162 per month (Sh.13,944 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%	
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%	
	(i) Saloons, Hatch Backs and Estates	
	Up to 1200 cc	3,600
	1201 - 1500 cc	4,200
	1501 - 1750 cc	5,800
	1751 - 2000 cc	7,200
	2001 - 3000 cc	8,600
	Over 3000 cc	14,400
	(ii) Pick-ups, Panel Vans (unconverted)	
	Up to 1750 cc	3,600
	Over 1750 cc	4,200
	(iii) Land Rovers/Cruisers	7,200

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) Tax havens have increasingly been used as avenues for tax avoidance. The Organisation for Economic Co-operation and Development (OECD) specifies three key factors in considering whether a jurisdiction is a tax haven.

Required:

- (i) Citing two examples of countries considered as tax havens, evaluate the three factors referred to in the above statement. (7 marks)
- (ii) Explain the terms "tax arbitrage" and "transfer pricing" in the context of international taxation systems. (4 marks)

- (b) Ali and Baba are partners in a small firm trading as Alibaba Enterprises. They share profits and losses in the ratio of 2:3 respectively.

The following extracts were obtained from the records of the firm for the year ended 31 December 2015:

1. **Partners' current account extracts:**

	Debit			Credit	
	Ali Sh.	Baba Sh.		Ali Sh.	Baba Sh.
Drawings	40,000	60,000	Balance brought down	100,000	200,000
			Salaries to partners	70,000	120,000
			Interest on capital	50,000	40,000

2. **Assets and liabilities:**

	1 January 2015 Sh.	31 December 2015 Sh.
Saloon car (cost)	2,400,000	2,160,000
Trade receivables	1,800,000	960,000
Donations	-	140,000
Salaries and wages accrued	840,000	1,600,000
Electricity prepaid	170,000	200,000
Furniture	200,000	180,000
Inventories	360,000	500,000
Trade payables	1,500,000	1,200,000

3. **Extracts from the bank statement:**

	Sh.
Payments to suppliers for goods	840,000
Receipts from customers	2,200,000
Payments for computers (hardware)	600,000
Payments for computer software	120,000
Catering fees	90,000
Electricity	60,000
Salaries and wages	700,000
Legal fees	160,000

4. Legal fees amounting to Sh.48,000 relate to costs of negotiating purchase of business premises while electricity paid included a deposit of Sh.15,000 to the power company.
5. Each partner had obtained a 10% loan of Sh.200,000 from the partnership for acquiring their private assets. The interest on loan was included in their share of interest on capital.

Required:

- (i) A statement of adjusted taxable profit or loss of the partnership for the year ended 31 December 2015. (7 marks)
- (ii) Total taxable income (loss) for each partner. (2 marks)
- (Total: 20 marks)**

QUESTION TWO

- (a) Mr. S. Bora has been running a retail business since 1 January 2011. He had not been maintaining proper accounting records. The revenue authority provided an estimated tax assessment and penalties of Sh.84,000. He is planning to appeal against the assessment and has availed the following information to you to assist in filing supportive documents for the appeal.

Assets and liabilities:

	Year ended 31 December:				
	2011 Sh.	2012 Sh.	2013 Sh.	2014 Sh.	2015 Sh.
Household property	480,000	560,000	380,000	400,000	450,000
Computers - office	-	-	150,000	105,000	180,000
Inventories	100,000	200,000	280,000	420,000	380,000
Bank overdraft	-	96,000	80,000	150,000	140,000
Office premises	1,800,000	1,720,000	1,640,000	1,840,000	1,680,000
Personal clothes	20,000	36,000	40,000	28,000	24,000
Creditors	360,000	420,000	280,000	240,000	320,000
Equipment - office	94,000	160,000	120,000	160,000	150,000
Debtors	160,000	260,000	180,000	120,000	194,000
Bank loan	170,000	360,000	100,000	94,000	136,000
Mortgage loan	800,000	800,000	800,000	800,000	800,000

Additional information:

- Office equipment costing Sh.40,000 was disposed of at Sh.60,000 in 2013. The gain on disposal was not recorded anywhere in the books.
- Legal expenses of Sh.48,000 on purchase of office equipment on 1 January 2012 was not capitalised.
- Living expenses for his family from year 2012 was Sh.80,000 per year and increased cumulatively at a rate of 10% per annum.
- In years 2014 and 2015, he donated Sh.160,000 and Sh.92,000 respectively to a political party registered in his country.
- Capital allowances agreed with the commissioner of domestic taxes for each year amounted to Sh.56,000.
- Business expenses allowable by the commissioner for each year were capped at Sh.24,000.
- The bank statement records reveal that Mr. Bora had paid school fees of Sh.84,000 in 2013 for his children from the business bank account.
- Household property for 2012 include property that Mr. Bora inherited from his father amounting to Sh.80,000
- Mortgage loan relates to office premises. The interest on the loan was 10% per annum on the principal amount.

Required:

- A capital statement for each of the years ended 31 December 2012, 2013, 2014 and 2015. (8 marks)
 - Revised taxable income and tax payable by Mr. Bora from tax arrears arising from undeclared income. Note: Use year 2015 tax rates. (2 marks)
 - Advise Mr. Bora on the intended appeal. (2 marks)
- (b) The following information was extracted from the books of Michezo Sporting Members Club for the year ended 31 December 2015. The club's manager did not submit income tax returns as he argued that the club was exempted from taxation. He has consulted you for professional advice.

Additional information:

- The club received gross income during the year ended 31 December 2015 amounting to Sh.35 million which was analysed as follows:

	Sh.
Entrance fees	4,770,000
Members subscriptions	15,900,000
Interest on late subscriptions	795,000
Interest income (fixed deposit)	2,544,000
Dividend income	1,272,000
Royalties	1,908,000
Rent income	6,360,000
Gain on property transfers	<u>1,451,000</u>
	<u>35,000,000</u>

2. Operating expenses amounted to Sh.6,360,000.
3. Interest and dividend income were stated gross of tax.

Required:

- (i) Advise the club's manager on the circumstances under which members clubs are taxed in your country. (2 marks)
- (ii) Assess whether Michezo Sporting Members Club is subject to taxation for the year ended 31 December 2015 and the applicable tax liability (if any). (6 marks)

(Total: 20 marks)

QUESTION THREE

- (a) Jamboree Sacco Society Ltd. reported the following income and expenditure for the year ended 31 December 2015:

Income	Sh.
Gross rental income	840,000
Interest on savings account	160,000
Interest on members loans	1,840,000
Interest on fixed deposit account	560,000
Interest on treasury bills	<u>435,000</u>
	3,835,000
Less expenses:	
• Repainting of rented property	156,000
• Interest on loans for money invested in treasury bills	114,000
• Administration expenses	496,000
• Legal expenses relating to rented property	<u>72,000</u>
	<u>(838,000)</u>
	<u>2,997,000</u>

Additional information:

1. The Sacco declared dividends and bonuses of Sh.980,000.
2. Corporation tax is at a rate of 30%.

Required:

- (i) Total taxable profit for the Sacco for the year ended 31 December 2015. (6 marks)
- (ii) Tax payable by the Sacco for the year ended 31 December 2015. (2 marks)

- (b) Ms Avril Chemu constructed a house in a high class residential estate. The following details relate to the building costs as at the date of completion. 31 December 2012:

	Sh.
• Cost of acquiring a half acre plot	8,000,000
• Obtained a fixed 15% mortgage loan (1 January 2011)	10,000,000
• Conveyance fees	200,000
• Valuation fees	360,000
• Building materials (including government subsidy)	4,600,000
• Labour for construction workers	560,000
• Painting	300,000
• Stamp duty	320,000
• Received government subsidy on building materials	600,000

The house was completed on 31 December 2012 and Ms Chemu moved in with her family.

Additional information:

1. After two years of stay, Ms Chemu opted to sell the house. On 1 March 2015, she secured a buyer at a purchase price of Sh. 20,000,000.
2. The following expenses were incurred in the process of finding a buyer:

	Sh.
Agent's commission	400,000
Advertising expenses	48,000
Valuation fees	240,000
Repainting of the house	80,000
Legal fees	160,000

3. The capital deductions accumulated for the two years (2013 and 2014) in respect of wear and tear and industrial building deduction amounted to Sh.420,000.
4. The construction of the house was financed through the mortgage loan, with the balance from the mortgage loan used to buy a motor vehicle (saloon). She repaid the full mortgage on 31 December 2014.

Required:

The capital gain and tax payable (if any) by Ms Chemu from the sale of the house.

(12 marks)

(Total: 20 marks)

QUESTION FOUR

- (a) Some scholars have raised concern over the apparent mismatch between taxation policy and the economic agenda of certain countries, where increased tax revenue did not necessarily translate into higher standards of living for the citizenry.

Required:

Explain four factors that could have contributed to the above scenario.

(4 marks)

- (b) Mr. Sylvanus Jirani was a resident of Kenya in the year of income 2015. During part of the year, he was in United Kingdom (UK) and earned income amounting to UK £43,500. Taxes paid on UK income amounted to £8,700. His employment income from Kenya was Ksh.950,000 (PAYE deducted Ksh.184,800). Further, he had provided consultancy services at a fee of KSh.190,000 (net of withholding tax).

Other income comprised the following:

1. Rental income of KSh.400,000 after deducting; cost of furniture Ksh.36,000, estate agents fees before letting Ksh.48,000 and caretakers wages Ksh.8,000 per month.
2. Patent rights where he received net royalty income of Ksh.95,000. Expenses relating to patent rights were; registration of patent Ksh.8,900 and operating expenses Ksh.18,000.

Assume the applicable exchange rate was Ksh.100 to £1. Kenya has signed a double taxation agreement with UK.

Required:

- (i) Double taxation relief (if any) due to Mr. Sylvanus Jirani for the year of income 2015. (8 marks)
 - (ii) Tax payable (or refundable) by Mr. Jirani for the year of income 2015. (4 marks)
- (c) Summarise four uses of funds deposited in the public private partnership (PPP) project facilitation fund. (4 marks)

(Total: 20 marks)

QUESTION FIVE

- (a) The Council of the Institute of Certified Public Accountants of Country X is developing a Code of Ethics to manage the conduct of its Council members.

Required:

Propose three provisions for inclusion in the above referenced Code of Ethics to prevent cases of conflict of interest among Council members. (3 marks)

- (b) With reference to the operations of the Public Investments Committee (PIC) in your country:

- (i) Describe three functions of the PIC. (3 marks)
- (ii) Explain two matters which the PIC is specifically excluded from dealing with. (2 marks)

- (c) Msanifu Insurance Company Ltd. is a resident insurance firm carrying on both general and life assurance businesses.

The following information relates to the insurance company's business for the year ended 31 December 2015:

	General insurance Sh. "000"	Life assurance Sh. "000"
Investment income	13,780	-
Insurance premium received	15,450	100,000
Insurance and management fees	-	25,000
Premium returned	374	-
Reinsurance commission received	1,360	-

	Sh. "000"	Sh. "000"
Premiums paid to reinsurance company	4,680	-
Agency expenses	1,350	1,960
Management expenses	1,934	-
Travelling expenses	1,800	2,400
Advertising	364	820
General expenses	8,490	4,640
Bad debts (specific)	368	1,080
Income from exercise of subrogation rights	1,250	-
Recoveries of reinsurance	150	-

Additional information:

1. Investment income comprised:
 - Fixed deposit account Sh.780,000.
 - Dividend received from qualifying company Sh.3,000,000 (net).
 - Rental income Sh.10,000,000.
2. General expenses include cost of computers Sh.800,000 and furniture and fittings Sh.1,260,000.
3. Reserves for unexpired risk for general insurance business were as follows:
 - As at 1 January 2015 Sh.3,240,000.
 - As at 31 December 2015 Sh.6,200,000.
4. Claims paid during the year ended 31 December 2015 amounted to Sh.7,600,000 for general business.
5. Life assurance fund balance was valued by an actuary at Sh.300,000,000 as at 31 December 2015. 25% of this fund balance was recommended to be transferred for the benefit of shareholders.
6. Claims outstanding for general business were as follows:
 - As at 1 January 2015 Sh.5,640,000.
 - As at 31 December 2015 Sh.6,000,000.

Required:

The taxable income or loss for Msanifu Insurance Company Ltd. for the year ended 31 December 2015. (12 marks)
 (Total: 20 marks)

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KASNEB

CPA PART III SECTION 6

ADVANCED PUBLIC FINANCE AND TAXATION

THURSDAY: 26 May 2016.

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 2015.

Monthly taxable pay (Sh.)	Annual taxable pay (Sh.)	Rate of tax % in each Sh.
0 - 10,164	0 - 121,968	10%
10,165 - 19,740	121,969 - 236,880	15%
19,741 - 29,316	236,881 - 351,792	20%
29,317 - 38,892	351,793 - 466,704	25%
Excess over - 38,892	Excess over - 466,704	30%

Personal relief Sh.1,162 per month (Sh.13,944 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%	
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%	
	(i) Saloons, Hatch Backs and Estates	
	Up to 1200 cc	3,600
	1201 - 1500 cc	4,200
	1501 - 1750 cc	5,800
	1751 - 2000 cc	7,200
	2001 - 3000 cc	8,600
	Over 3000 cc	14,400
	(ii) Pick-ups, Panel Vans (unconverted)	
	Up to 1750 cc	3,600
	Over 1750 cc	4,200
	(iii) Land Rovers/Cruisers	7,200

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 FIVE

(a) Country Z has recently been admitted into a regional economic block. As part of the country's full integration into the economic block, it is required to undertake certain legislative and other reforms.

Required:

Advise Country Z on four fundamental reforms that could be considered in the process of integration into the economic block. (8 marks)

(b) Mjengo Ltd. is a real estate development company. In the year ended 31 December 2015, the company provided the following information:

- Bought 100 acres at Sh.6,000,000 each for building low cost houses in an approved development area.
- Cost of surveying was Sh.4,600,000 and conveyance fees amounted to Sh.6,960,000.
- The cost of constructing each unit was Sh.1,450,000. The company constructed 240 units on a 20 acre piece of land.
- All the units were sold at a price of Sh.1,600,000 in the year 2015.
- Building materials for constructing each unit amounted to Sh.742,400 inclusive of VAT at the rate of 16%.
- Professional fees paid to quantity surveyors inclusive of VAT was Sh.417,600 and for civil engineers was Sh.243,600.
- Drainage system and sewerage line cost Sh.960,000 for connecting all units built and to be built on 100 acres.
- The interest on loan to acquire the 100 acres was Sh.7,800,000.
- Hire expenses for bulldozers used in the construction was Sh.600,000 for each of the three months used for the construction.
- Charges paid to the government in respect of approval of plans were Sh.678,000.
- Cost of constructing a site office was Sh.800,000.
- Hire cost for a saloon car for the site manager was Sh.40,000 per month.
- A commercial building was also constructed at a cost of Sh.5,600,000 in a part of the land. The building was rented at a monthly rent of Sh.480,000 with effect from 1 May 2015.
- The costs relating to the total 100 acres are to be apportioned according to the acreage used.

Required:

(i) Statement of adjusted taxable profit or loss for Mjengo Ltd. for the year ended 31 December 2015. (10 marks)

(ii) Tax payable by Mjengo Ltd. (if any) for the year ended 31 December 2015. (2 marks)

(Total: 20 marks)

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Additional information:

1. Turnover and purchases were inclusive of VAT at the rate of 16%.
2. The turnover excludes cash sales. During the year ended 31 December 2015, the business paid the following expenses out of cash sales:

	Sh.
Telephone and postage	48,000
School fees	142,800
Repairs and maintenance	94,600
Insurance	36,600

3. The bank balance is included in the cash and cash equivalents. The following details were included in the bank statement:

	Sh.
Personal expenses	294,000
General expenses	792,800
Rent and rates	68,400
Hire purchase interest	29,600
Payments to creditors	2,460,000
Receipts from debtors	5,890,000

4. The following assets used by the business were not included in the assets register:

	Sh.
Computers	368,000
Fax machine	120,000
Saloon car	2,800,000
Delivery van	720,000
Computer software	150,000

The Revenue Authority has established that the statement of financial position forms a good basis for recomputing the taxable profit. All expenses are to be adjusted on the basis of the statement of financial position.

Required:

- (a) Using suitable computations, confirm the accuracy or otherwise of the taxable profit of Weka Enterprises for the year ended 31 December 2015. (15 marks)
 - (b) Summarise five types of preliminary information that you might require from the business in order to further ascertain the accuracy of the taxable profit. (5 marks)
- (Total: 20 marks)**

QUESTION THREE

- (a) Tax information exchange agreements (TIEAs) are increasingly forming part of the agenda during bilateral and multilateral trade discussions among various countries.
 - (i) Explain the nature of tax information exchange agreements. (2 marks)
 - (ii) Citing three reasons, discuss the purpose of TIEAs. (6 marks)
- (b) Zawadi Ltd. has been in operation since 1 January 2014. The company is under a tax investigation relating to value added tax (VAT) transactions.

The following details were obtained from the company's records for the month of September 2015:

- Stock in trade brought down in the month of September 2015 was valued at Sh.719,200.
- Sales ledger records in the company's books showed an amount of Sh.1,786,400 while as per VAT returns, it was Sh.1,429,120.
- The company had not claimed input tax on a building put into use on 1 January 2014 at a cost of Sh.2,784,000. However, in September 2015, the company set-off the input tax against the output tax for the month.
- Purchases amounting to Sh.174,000 did not have supporting fiscal receipts. The total purchases amounted to Sh.928,000.
- Since 1 January 2014, the company had not been filing VAT returns on time and all the penalties are outstanding.

QUESTION FIVE

(a) Country Z has recently been admitted into a regional economic block. As part of the country's full integration into the economic block, it is required to undertake certain legislative and other reforms.

Required:

Advise Country Z on four fundamental reforms that could be considered in the process of integration into the economic block. (8 marks)

(b) Mjengo Ltd. is a real estate development company. In the year ended 31 December 2015, the company provided the following information:

- Bought 100 acres at Sh.6,000,000 each for building low cost houses in an approved development area.
- Cost of surveying was Sh.4,600,000 and conveyance fees amounted to Sh.6,960,000.
- The cost of constructing each unit was Sh.1,450,000. The company constructed 240 units on a 20 acre piece of land.
- All the units were sold at a price of Sh.1,600,000 in the year 2015.
- Building materials for constructing each unit amounted to Sh.742,400 inclusive of VAT at the rate of 16%.
- Professional fees paid to quantity surveyors inclusive of VAT was Sh.417,600 and for civil engineers was Sh.243,600.
- Drainage system and sewerage line cost Sh.960,000 for connecting all units built and to be built on 100 acres.
- The interest on loan to acquire the 100 acres was Sh.7,800,000.
- Hire expenses for bulldozers used in the construction was Sh.600,000 for each of the three months used for the construction.
- Charges paid to the government in respect of approval of plans were Sh.678,000.
- Cost of constructing a site office was Sh.800,000.
- Hire cost for a saloon car for the site manager was Sh.40,000 per month.
- A commercial building was also constructed at a cost of Sh.5,600,000 in a part of the land. The building was rented at a monthly rent of Sh.480,000 with effect from 1 May 2015.
- The costs relating to the total 100 acres are to be apportioned according to the acreage used.

Required:

(i) Statement of adjusted taxable profit or loss for Mjengo Ltd. for the year ended 31 December 2015. (10 marks)

(ii) Tax payable by Mjengo Ltd. (if any) for the year ended 31 December 2015. (2 marks)

(Total: 20 marks)

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KASNEB

CPA PART III SECTION 6

ADVANCED PUBLIC FINANCE AND TAXATION

THURSDAY: 26 November 2015.

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 2014.**

Monthly taxable pay (Sh.)		Annual taxable pay (Sh.)		Rate of tax % in each Sh.
1	- 10,164	1	- 121,968	10%
10,165	- 19,740	121,969	- 236,880	15%
19,741	- 29,316	236,881	- 351,792	20%
29,317	- 38,892	351,793	- 466,704	25%
Excess over	- 38,892	Excess over	- 466,704	30%

Personal relief Sh.1,162 per month (Sh.13,944 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%	
Industrial building allowance:		
Up to 2009	2.5%	
From 1 January 2010	10%	
Hotels	10%	
Hostels/Education buildings	50%	
From 1 January 2010-		
Commercial building:		
(Shop, office or show room)	25%	
Farm works allowance	100%	
Investment deduction allowance	100%	
Shipping investment deduction	40%	
Mining allowance:		
Year 1	- 40%	
Years 2 - 7	- 10%	

Commissioner's prescribed benefit rates

	Monthly rates Sh.	Annual rates Sh.
Services		
(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) A recent study on public financial management in developing countries identified a growing interest by governments to establish and enhance public private partnerships (PPPs) as one of the ways of achieving sustainable development. In some of the countries covered by the study, a public private partnership (PPP) unit had been established within the mainstream government structure.

Required:

- (i) Explore three possible reasons for the growing interest in public private partnerships particularly among developing countries. (3 marks)
- (ii) Explain three functions of a public private partnership unit as established by a government. (3 marks)
- (iii) Summarise three challenges likely to face the implementation of public private partnerships in your country. (3 marks)

(b) Country X has undertaken a number of infrastructural projects as part of its long-term development initiatives. This has however resulted in the government borrowing heavily from both the domestic market and the foreign market. As a result, interest rates have risen significantly, a situation that has affected other critical sectors of the country's economy.

Required:

In the context of the above scenario, advise the government of Country X on four approaches that it could use to manage its public debt. (8 marks)

(c) In the context of monitoring of public projects by public entities, outline three objectives of electronic project monitoring information systems (e-PROMIS). (3 marks)

(Total: 20 marks)

QUESTION TWO

(a) In recent times, public financial management has generated a lot of interest from governments, the public, donors among other stakeholders.

Required:

Discuss four distinctive features of financial management in the public sector as compared to the private sector. (8 marks)

(b) According to legislation on investment promotion, an applicant may apply for an investment certificate from a public investment board.

Required:

In the context of the above statement:

- (i) Outline three conditions that an applicant is required to fulfill in order to obtain an investment certificate. (3 marks)
- (ii) Describe five areas that could be considered by the public investment board before grant of an investment certificate. (5 marks)

(c) Citing two examples, discuss the relevance of the international financial market in the context of public financial management in your country. (4 marks)

(Total: 20 marks)

QUESTION THREE

James and Katana established a partnership business, sharing profits and losses in the ratio of 3:2 respectively. The following is the income statement of the partnership for the year ended 31 December 2014:

	Sh.	Sh.
Sales		6,728,000
Unrealised foreign exchange gain		150,000
Capital gain on sale of shares		352,000
Recovery from insurance on stock stolen		480,000
Goods transferred to a branch at cost		184,000
Dividends from Kali Cooperative Society		<u>51,000</u>
		7,945,000

	Sh.	Sh.
Less expenses:		
Purchases	2,842,000	
Purchase of computers	180,000	
Partners salaries	720,000	
Legal fees	680,000	
Repairs and maintenance	568,400	
Rent and rates	244,600	
Interest on loan	166,200	
General expenses	964,000	
Motor vehicle expenses	840,000	
Insurance	156,000	
Preliminary expenses	262,800	
Directors fees	600,000	
Audit fees	148,200	
Debenture interest	360,000	
Travelling expenses	<u>96,000</u>	<u>8,828,200</u>
Net loss		<u>(883,200)</u>

Additional information:

- The partnership was converted into a limited liability company by the name Kaka Ltd. on 1 October 2014. Incomes and expenses accrued evenly throughout the year unless otherwise stated.
- Purchases and sales were inclusive of value added tax at a rate of 16%.
- Closing stock was valued at Sh.1,840,000 while opening stock was at 10% of sales net of value added tax.
- Legal fees comprised:

	Sh.
Petition to Association of Manufacturers	80,000
Notice for change of business name	64,800
Conveyance fees of business premises	72,400
Stamp duty	36,600
Negotiating a business loan	20,800
Recovery of bad debts	45,000
Signing a 100-year lease agreement	128,400
Purchase of partner's private residence - James	150,000
Appeal against tax arrears	<u>82,000</u>
	<u>680,000</u>
- Repairs and maintenance comprised:

	Sh.
Purchases of furniture	96,000
Installation of neon sign	60,000
Designing an office block	140,000
Cost of partitioning office block	250,000
Repainting of business premises	<u>22,400</u>
	<u>568,400</u>
- General expenses included; registering of patent rights Sh.64,000, floatation costs Sh.48,000 and negotiating costs for an additional piece of land for business expansion at Sh.56,000.
- Interest on loan includes interest on partners' capital of Sh.100,000 which was shared according to profit and loss sharing ratio.

Required:

- (a) A statement of adjusted taxable profit or loss for the business for the year ended 31 December 2014. (14 marks)

Hint: Start with gross profit.

- (b) Comment on the tax position of James, Katana and the company. (4 marks)
- (c) Citing examples, advise James and Katana on two areas of tax avoidance that they could explore for the business. (2 marks)

(Total: 20 marks)

QUESTION FOUR

- (a) Highlight four factors to be considered when selecting an appropriate transfer price. (4 marks)

(b) Mjengo Ltd. is in the real estate business. During the year ended 31 December 2014, the company acquired ten houses each at Sh.4,000,000 before incurring the following expenses:

- 10% interest on mortgage loan of Sh.10,000,000.
- Conveyance fees for each house Sh.40,000.
- Estate agent's valuation fees per house Sh.28,000.
- Repairs undertaken for two houses Sh.44,000.
- Cost of repainting the houses Sh.84,000.
- The impairment loss of the houses was estimated at Sh.150,000.
- Legal expenses amounting to Sh.36,000 were incurred in defending a title for a house with defective ownership documents.

Mjengo Ltd. sold each house at Sh.5,800,000. The cost for advertising the houses was Sh.160,000, estate agent's commission Sh.180,000, insurance Sh.72,000, valuation fees Sh.150,000 and legal fees Sh.148,000.

Required:

Determine the following:

- | | |
|--|-----------|
| (i) Transfer value. | (3 marks) |
| (ii) Adjusted cost. | (3 marks) |
| (iii) Capital gains tax. | (1 mark) |
| (iv) Due date for filing of capital gains tax. | (1 mark) |

(c) Rigs Drilling Ltd. is a mining company dealing with petroleum products. During the year ended 31 December 2014, the following details were extracted from the company's financial statements:

	Sh"000"
Geological costs	84,680
Exploratory drilling costs	146,400
Acquisition costs	19,800
Lifting costs	12,600
Lease operating costs	64,780
Costs of refining crude oil	18,240
Oil and natural gas revenue	9,840,000
Depletion and depreciation	34,980
Share based compensation	24,670
General and administrative expenses	78,340
Reversal of litigation expenses	9,680
Finance expenses	6,400
Decommissioning costs	4,280
Drilling machines	18,300
Investment income	464,000
Impairment losses	5,680
Intangible drilling costs	3,420
Professional fees	2,600
Loan repayment	840
Tractor	1,500
Derivatives oil losses	480
Restructuring expenses	848
Forklift	1,800

Additional information:

1. Intangible drilling costs include Sh.420,000 for a well which failed to yield crude oil and was abandoned.
2. Restructuring expenses include Sh.582,000 paid to a consultancy firm that restructured the capital structure of the company.
3. Exploratory drilling costs include:
 - Plant and machinery Sh.4,800,000.
 - Erection of rigs and tankage Sh.1,600,000.
 - Pipes and storage tanks Sh.9,480,000.
 - Factory building Sh.48,400,000.
4. Professional fees include Sh.800,000 for services provided by the general manager of the parent company.

Required:

A statement showing the taxable profit or loss for the year ended 31 December 2014.

(8 marks)

(Total: 20 marks)

QUESTION FIVE

(a) Summarise three legal provisions relating to double taxation relief as applicable in your country. (3 marks)

(b) Lima Ltd. is a company incorporated in your country. The company controls 80% of the share capital of Shamba Ltd. which is also incorporated in your country. The following is a statement of comprehensive income of Lima Ltd. for the year ended 31 December 2014:

	Sh. "000"	Sh. "000"
Gross profit		59,220
Less:		
Depreciation	4,872	
Legal expenses	508	
Loan interest	819	
Electricity	378	
Salaries and wages	9,387	
Telephone	357	
Patent royalties paid	756	
Travel expenses	785	<u>17,862</u>
		41,358
Other income		
Patent royalties received	2,772	
Loan interest received	193	
Dividend received from Shamba Ltd.	<u>5,628</u>	<u>8,593</u>
Net income		<u>49,951</u>

Additional information:

- The loan interest paid included the following:
 - Interest of Sh.285,000 relating to a loan acquired to purchase office equipment.
 - Interest of Sh.258,000 relating to a loan used to acquire shares of Shamba Ltd.
- Salaries and wages include passages of Sh.1,008,000 paid to a director who relocated to another country.
- Travel expenses include Sh.155,000 paid to a new employee hired from a foreign country.
- The loan interest received relates to a loan issued to an employee of the company to purchase a residential house.
- Not included in other income was rent received of Sh.1,638,000 from one lease, gross of a loss of Sh.397,000 made on another lease.
- An operating loss of Sh.189,000 had been carried forward for the previous eight years. This loss was included in salaries and wages expense as at 31 December 2014.
- Royalties of Sh.145,000 were due for receipt as at 31 December 2014 but had not been recorded in the books.
- Legal expenses included:
 - Sh.176,000 paid on disposal of some property and equipment.
 - Sh.48,000 incurred on debt collection.
 - Sh.78,000 incurred on defending the company against a claim for breach of contract.
- Patent royalties received were from Shamba Ltd. while those paid were to a Ugandan company.
- Capital allowances for the year ended 31 December 2014 were agreed with the commissioner at Sh.1,932,000.

Required:

A statement of adjusted taxable profit or loss for the year ended 31 December 2014. (10 marks)

(c) Amos Akida, a businessman, is facing a tax investigation by the revenue authority which suspects that he has been under-declaring income for the four years from year 2011 to year 2014.

You are the head of a team from the revenue authority conducting an investigation on Amos Akida. He has submitted to your team records of his private and business assets and liabilities from 1 January 2011 to 31 December 2014 as shown below:

	1 January 2011	31 December 2011	31 December 2012	31 December 2013	31 December 2014
Assets and liabilities	Sh. "000"	Sh. "000"	Sh. "000"	Sh. "000"	Sh. "000"
Factory premises	48,000	54,000	56,000	52,000	54,000
Plant and machinery	24,000	25,000	38,000	34,000	36,000
Motor vehicle (commercial)	12,000	14,000	14,000	15,000	20,000
Inventory	4,600	5,200	9,000	10,000	8,000
Trade receivables	3,950	4,540	3,640	3,530	3,980
Private residence	8,240	14,600	14,600	14,600	14,600
Trade payables	7,280	8,640	9,420	8,360	7,890

	Sh. "000"	Sh. "000"	Sh. "000"	Sh. "000"	Sh. "000"
Bank loan	10,900	10,000	9,870	7,640	9,840
Loan from a friend	800	700	600	870	640
Mortgage loan	3,780	3,780	3,780	3,780	3,780
Cash balance	3,400	5,400	3,600	3,760	4,670

Additional information:

1. The cash balance on 31 December 2012 included Sh.600,000 inherited from a relative on 30 August 2012.
2. His living expenses for each of the four years were as follows:

Year ended 31 December:

	2011	2012	2013	2014
Living expenses (Sh.)	85,000	140,000	90,000	165,000

3. Interest on mortgage is at the rate of 15% per annum.
4. There were no disposals of non-current assets during the period under investigation.

Required:

Taxable income of Amos Akida for each of the four years ended 31 December 2011, 2012, 2013 and 2014.

Ignore capital allowances.

(7 marks)

(Total: 20 marks)

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KASNEB

CPA PART III SECTION 6

ADVANCED PUBLIC FINANCE AND TAXATION

PILOT PAPER

September 2015.

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 2014.**

Monthly taxable pay (Sh.)	Annual taxable pay (Sh.)	Rate of tax % in each Sh.
1 - 10,164	1 - 121,968	10%
10,165 - 19,740	121,969 - 236,880	15%
19,741 - 29,316	236,881 - 351,792	20%
29,317 - 38,892	351,793 - 466,704	25%
Excess over - 38,892	Excess over - 466,704	30%

Personal relief Sh.1,162 per month (Sh.13,944 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%	
Industrial building allowance:		
Up to 2009	2.5%	
From 1 January 2010	10%	
Hotels	10%	
Hostels/Education buildings	50%	
From 1 January 2010-		
Commercial building:		
(Shop, office or show room)	25%	
Farm works allowance	100%	
Investment deduction allowance	100%	
Shipping investment deduction	40%	
Mining allowance:		
Year 1	40%	
Years 2 - 7	10%	
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
(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
(ii) Pick-ups, Panel Vans (unconverted)		
Up to 1750 cc	3,600	43,200
Over 1750 cc	4,200	50,400
(iii) Land Rovers/Cruisers	7,200	86,400

QUESTION ONE

- (a) Describe the stages involved in the National Government budget process as provided in the Public Finance Management Act 2012 or equivalent legislation in your country. (10 marks)
- (b) (i) Explain the relevance of transparency and accountability in the context of public debt management in your country. (4 marks)
- (ii) Discuss the importance of sound public debt management. (6 marks)
- (Total: 20 marks)**

QUESTION TWO

- (a) Outline the information that is required to be provided by a contracting authority within the framework of the public private partnership (PPP) when preparing a project proposal. (8 marks)
- (b) Explain six functions of the Public Private Partnership Unit (PPPU) as established under the Public Private Partnership Act 2013 or equivalent legislation in your country. (12 marks)
- (Total: 20 marks)**

QUESTION THREE

- (a) Explain how tax planning could be undertaken in the context of:
- (i) Income from investments. (2 marks)
- (ii) Capital structure decisions in corporate entities. (2 marks)
- (b) The promoters of Junefair Company Ltd. are considering the best source of financing for their new company.

The promoters are aware of the two main financing avenues for any company; equity financing and debt financing. They already have raised equity capital amounting to Sh.500 million as their base capital which falls short of their capital requirement of Sh.1 billion. They have approached a consultant to give them advise on how to source the additional Sh.500 million that they require. The consultant has assembled his analysis into two mutually exclusive financing sources based on the promoter's request as follows:

Option - A (Equity only)

	Sh. "000"
Base capital - Equity	500,000
Additional capital - All equity	<u>500,000</u>
Total	<u>1,000,000</u>

Option - B (Debt only)

	Sh. "000"
Base capital - Equity	500,000
Additional capital - Long term debt	<u>500,000</u>
	<u>1,000,000</u>

It is assumed that both the additional equity and additional debt will require an annual payment of Sh.40 million and Sh.50 million for dividend and interest respectively every year.

Assume that the profit before interest and taxes that the company would post each year is Sh.110 million. The corporate tax rate is 30%.

Required:

Suggest, from a tax planning perspective, the best source of additional financing that the consultant should recommend (4 marks)

- (c) Violet Auma has been offered a job with Apple Electronics (K) Ltd., a foreign company dealing with distribution of smart phones and computers in the East African region. She is due to report on 1 January 2016.

Her terms of employment provide for the following emoluments:

1. She would get a basic salary of Sh.450,000 per month effective from 1 January 2016.

2. The company would make the following additional payments to her per month:
 - Home to office car allowance of Sh.28,500. However, she would be given the option of using a company car. The car that would be allocated to her would be of 2500cc which the company would purchase at a cost of Sh.3,500,000.
 - House allowance of Sh.80,000 per month. However, the company gives her the option of moving to a company house from the commencement of her employment. The house would be rented by the company at Sh.80,000 per month.
3. She would, like all other employees, enjoy the company's pension scheme into which the company would pay Sh.25,000 monthly for her benefit. She would also have to contribute a similar amount into the scheme.
4. An end of the year bonus amounting to Sh.35,500 would be paid to her each year. She however would be given the option of taking a gift of a phone from the company worth the same amount.
5. She would be eligible to be included into the company's attractive medical scheme which only covers management staff. The amount of the benefit is capped at Sh.1,500,000 per year. She however has the option of a free-for-all claim-based medical scheme operated by the employer. The scheme is capped at Sh.1,000,000 per year.

Required:

Recommend the best option for Vilolet Auma based on the above information.

(12 marks)

(Total: 20 marks)

QUESTION FOUR

- (a) Multi-national corporations (MNCs) that have cross-border inter-company dealings (like purchases and sales) can deliberately move profits from one tax jurisdiction to another by manipulating the transfer price. Such companies, if left unchecked would make inter-company transactions at prices that may lead to low profits or losses in countries with high tax rates.

Required:

Explain the documentation and disclosure requirements imposed by your country to address the above challenges.

(5 marks)

- (b) One major shortcoming of globalisation is that it provides the incentive for tax competition among countries.

In the context of the above statement, explain the meaning of the following:

- (i) Tax competition. (3 marks)
 - (ii) Tax haven. (3 marks)
- (c) Outline five harmful effects of tax havens. (5 marks)
- (d) Explain four circumstances under which goods are deemed to have been dumped in your country. (4 marks)

(Total: 20 marks)

QUESTION FIVE

- (a) The main focus of bilateral tax treaties is the elimination of double taxation and fiscal evasion.

Explain the meaning of the following as used in the context of tax treaties:

- (i) Double taxation. (2 marks)
 - (ii) Fiscal evasion. (2 marks)
 - (iii) Treaty shopping. (2 marks)
- (b) Rahab Tola, who is a Kenyan, was employed in the United Kingdom (UK) for the first 6 months in the year 2014 for which she was paid a total of £12,000. She later moved to Kenya where she was employed at a salary of Sh.2,400,000 for the 6 months to the end of the year 2014.

The UK authorities had charged Rahab Tola a tax on her pay amounting to £2,200.

Assume that the applicable foreign exchange rate was Sh.140/£. Kenya has a double taxation agreement with United Kingdom.

Required:

Calculate the amount of double taxation relief due to Rahab Tola for the year 2014. (4 marks)

- (c) China Construction Company (K) Ltd. has been engaged in the building and construction industry for many years. There has been an on-going dispute with the revenue authority as to the amount of value added tax (VAT) that the company is liable to pay.

You have been provided with the following details relating to the company's transactions:

	Purchases	Delivery date	Invoice date	Invoice amount (Sh.)	Payment date
1.	Concrete mixer	10 May 2015	12 June 2015	5,800,00	5 July 2015
2.	Scaffolding pipes	20 May 2015	6 June 2015	1,392,000	10 July 2015
3.	Poker vibrator	6 May 2015	29 May 2015	696,000	2 August 2015
4.	Xerox photocopier	30 April 2015	10 May 2015	928,000	22 May 2015
5.	10 trolleys	12 June 2015	13 May 2015	2,552,000	25 May 2015
6.	Executive boardroom table	21 May 2015	8 June 2015	464,000	30 June 2015
7.	200 tons of cement	27 April 2015	3 May 2015	3,712,000	2 August 2015
8.	Water dispenser for the office	14 May 2015	4 June 2015	92,800	23 June 2015
9.	Paint from Duracoat (K) Ltd.	10 May 2015	15 May 2015	812,000	28 May 2015
10.	Office chairs	1 May 2015	8 May 2015	348,000	26 May 2015

The above amounts are inclusive of VAT at the standard rate of 16% where applicable.

Additional information:

- The company had negotiated a contract for Sh.45,000,000 for which it received a progress payment of Sh.18,000,000 on 25 June 2015. These amounts are exclusive of VAT. The invoice had been raised earlier on 3 May 2015 based on the Architect's certificate for the value of work certified.
- The company had also won a labour-only contract for Sh.12,500,000 (exclusive of VAT) for which an installment payment of Sh.4,000,000 was received on 9 May 2015 ahead of the completion on 17 June 2015. The invoice was raised for full payment on completion. By end of August 2015, the balance of the payment had not been received from the client.

Required:

- Advise on the correct VAT position for the company for the period between May 2015 and August 2015. (6 marks)
- Comment on any information that you have not used in (c) (i) above. (4 marks)

(Total: 20 marks)

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