



**ATD LEVEL II
PILOT PAPER**

PRINCIPLES OF TAXATION

December 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: Capital expenditure incurred on:	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	Monthly rates (Sh.)	Annual rates (Sh.)
(a) Buildings:					
• Hotel building	50% in the first year of use	25%	Up to 1200 cc	3,600	43,200
• Building used for manufacture	50% in the first year of use	25%	1201 - 1500 cc	4,200	50,400
• Hospital buildings	50% in the first year of use	25%	1501 - 1750 cc	5,800	69,600
• Petroleum or gas storage facilities	50% in the first year of use	25%	1751 - 2000 cc	7,200	86,400
• Educational/hostels building	10% per year on reducing balance		2001 - 3000 cc	8,600	103,200
• Commercial building	10% per year on reducing balance		Over 3000 cc	14,400	172,800
(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 7,200 86,400		
(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) “The art of taxation consists in so plucking the goose as to obtain the largest possible amount of feathers with the smallest possible amount of hissing” Jean-Baptiste Colbert.
- (b) In light of the above statement, suggest five factors that tax administrators should consider to minimise negative effects of taxation while maximising on revenue collection. (10 marks)

With reference to the principle of equity in taxation, distinguish between “vertical equity” and “horizontal equity”. (4 marks)

- (c) One of the Urban Counties in Kenya has been battling with perennial budget deficits since inception of counties in the year 2013. Suggest to the county administration possible sources of revenue for supplementing the allocation from the National government (6 marks)

(Total: 20 marks)

QUESTION TWO

- (a) Two groups of tax students were engaged in an argument on taxation of non-cash benefits from employment. One group argued that employees should be taxed only on their salary and other related cash benefits while the other group supported taxation of all cash and non-cash benefits.

Required:

Giving two reasons to justify your choice, identify which of the two groups you would support. (4 marks)

- (b) August Ochieng’ an employee of Embassy bank has provided you with the following information for the year of income 2020.
1. His basic salary was Sh.300, 000 per month (PAYE deducted Sh.65,680). He also received an allowance of Sh.25,000 per month to be spend exclusively in customer entertainment.
 2. The bank provided him with a new 2000 cc car market value Sh.1800, 000. The car was leased from Casino Motors at Sh.45,000 per month. 40% of the cars use is official.
 3. The company pays for private medical insurance for its directors and senior staff. The cost attributable to August Ochieng’ was Sh.240,000 for the year.
 4. The Employer pays Sh. 12,600 per month towards his Life insurance cover but recovers Sh.7,500 against his salary
 5. He paid mortgage interest of shs.320,000 (gross) p.a. on a shs.8000,000 mortgage on his new home
 6. Night out allowance for 13 days he was in Naivasha for seminar Sh. 6400 per day
 7. On 1 September 2020, he obtained a Sh.600,000 loan from his employer. The interest payable on this loan was at the rate of 2% per annum. The governments prescribed rate of interest is 10%
 8. Leave Passages for visiting USA where his family lives 400,000
 9. Embassy bank issued him with 15,000 shares at a price of Sh.23 per share, the shares were trading at Sh.28 on the date of issue
 10. He paid by standing order a contribution of Sh.100, 000 per annum to Borderless World a registered charity.

Other incomes were as follows:

- Dividend from Makuyu cooperative society Sh.255,000 (net)
- Royalties for his online Motivational series Sh.285,000 (net)
- Dividend from EASN Ltd Sh.120,000 gross
- Directors allowances from Government SACCO Sh.40,000 each quarter

Required:

- (i) Determine August Ochieng’s taxable income for the year of income 2020. (12 marks)
- (ii) The tax payable (if any) for the year from the income computed in (b) (i) above. (2 marks)
- (iii) Explain the tax treatment of Loan obtained from the employer. (2 marks)

(Total: 20 marks)

QUESTION THREE

- (a) Gatu Wanderi a farmer in Kirinyanga has Sh.4, 000,000 as compensation for his Land taken over for a government's project. He intends to invest the amount as follows:
1. Construct a bungalow in the neighboring town and rent it out at estimated rent of Sh. 28,000 per month
 2. Buy a piece of land and subdivide it out into plots for resale
 3. Buy a huge piece of land in the Arid north and hold it in speculation for higher prices in the future
 4. Sink a borehole and start selling water in his village
 5. Invest the money in his brothers Mitumba Business with an agreement of joint participation in the profits
 6. Deposit the Money with Fairbank Uganda which pays the highest interest in the region

Advise Gatu Wanderi on the tax implications of each of the above options.

(6 marks)

- (b) Rick, Kent and Antoine have been partners in an entertainment firm. They shared profit and losses in the ratio 3:2:1 respectively up to 30 September when the firm was dissolved.

During the nine months to 30 September 2020, the firm presented the following income statement:

Rick, Kent and Chris Partnership		
Income statement for nine months ended 30/9/2020		
	Sh. "000"	Sh. "000"
Gross profit		13,500
Deduct		
Rent and rates	1200	
Salaries -		
staff	585	
Rick	1125	
Kent	900	
Chris	675	
Depreciation	300	
Balancing deduction	75	
Advertising (Neo-sign)	187.5	
Interest on capital - Rick	450	
Kent	300	
Chris	150	
Commission paid to Chris	60	
Water and electricity	225	
Insurance	142.5	<u>6,375</u>
Net profit		<u>7,125</u>

On 1 October 2020 Kent was employed as a sales manager by Blaze Africa Ltd. The terms of his employment provided for the following

- An annual salary shs.2400,000 (PAYE shs.316,000 per annum)
- His monthly allowances were specified as follows:

Sh.	
Hardship allowance	180,000
Entertainment	120,000
- School fees paid for His MBA classes Sh. 140,000
- He was entitled to end of year bonus of 5% of his annual salary paid pro rata to months of service.
- He contributed 10% of his monthly basic salary to a registered pension fund.

Required:

- (i) The taxable profit or loss of the partnership for the period ended 30 September 2020. (6 marks)
- (ii) Allocation of profit or loss to the partners. (2 marks)
- (iii) Determine Kent's taxable income for the year ended 31 December 2020. (6 marks)

(Total: 20 marks)

QUESTION FOUR

- (a) Explore the benefits of electronic tax register to
- (i) The trader. (2 marks)
- (ii) The Revenue Authority. (2 marks)

- (b) The following transactions relate to Malimwengu Limited, a VAT registered company for the month of September 2021:

1 September: Brought forward merchandise purchased in the previous month for Sh 464,000
3 September: Purchased goods valued merchandise at Sh 185,600
4 September: Sold zero rated merchandise for Sh. 142,000
5 September Sold goods on credit to Wanahawa traders for Sh. 208,800
6 September: Purchased merchandise from a trader at Sh. 190,000. This trader was not registered for VAT purposes.
7 September: Merchandise worth Sh. 37,120 was returned to the suppliers.
9 September: Merchandise sold on 4 September for Sh. 58,000 was returned by customers
11 September: Catering for staff Sh. 92,000
12 September: A client who had purchased merchandise on 4 September was declared bankrupt before paying a balance of Sh. 41,760 due from him.
15 September: Wanahawa Traders paid 160,000 in part settlement of their dues
18 September: Purchased motor vehicles fuel for Sh. 51,840
22 September: Imported merchandise at a cost of Sh. 250,000. Import duty and excise duty were charged at 20% and 10% respectively on top of the import price.
25 September: Purchased merchandise as follows:
From suppliers registered for VAT purposes - Sh.556,800
From suppliers not registered for VAT purposes - Sh.292,000
27 September: Sold merchandise as follows
To customers registered for VAT purposes - Sh.1160,000
To customers not registered for VAT purposes - Sh.580,000
30 September: VAT paid on Utilities
Electricity Sh. 11,600
Telephone Sh. 5,800

All transactions are quoted inclusive of VAT at the rate of 16% where applicable.

Required:

- (i) VAT account for the month ended 30 September 2021. (12 marks)
- (ii) Comment on any Information not used in your computations above (4 marks)

(Total: 20 marks)

QUESTION FIVE

- (a) Explain the options that the Revenue authority might employ to enforce tax compliance to defaulters. (4 marks)
- (b) Explain various strategies deployed by the customs and border control department in maximising revenue collection and curbing illicit trade. (6 marks)
- (c) Looks & Class Limited was established in the year 2020 to manufacture soap for the local market. Before commencement of operations on 1 January 2020, the company spent a total of Sh.9,760,000 to construct a factory. This cost is analysed as follows:

	Sh.
Cost of land	1,000,000
Incinerator (for Burning waste)	200,000
Perimeter Wall	560,000
Factory building costs	<u>8000,000</u>
(Including showroom at Sh. 900,000 and offices Sh. 700,000)	<u>9,760,000</u>

Additional information:

The following assets were constructed or purchased and utilised with effect from 1 January 2020.

	Cost (Sh.)
Power transformer	800,000
Processing machinery (including installation costs at Sh.200,000)	1,900,000
Bridge (connecting the factory to the main road)	600,000
Water pump	150,000
Fork lift (mobile)	1,200,000
Two saloon cars (cost 4.8 million each)	9,600,000
Computers	200,000
Furniture and fixtures	120,000
Pickups	1,500,000
Tractor	1,400,000
Scanners	80,000
Machine for repairing factory plant	400,000
Office curtains	160,000
Fax machine	100,000

Machine for repairing factory plant was acquired on hire purchase terms.

The cash price was 250,000.

Required:

Compute the investment allowances due to Looks and Class Limited for the year of income 2020. (10 marks)

(Total: 20 marks)

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