



**kasneb**

**CPA PART III SECTION 6**

**ADVANCED PUBLIC FINANCE AND TAXATION**

**THURSDAY: 2 September 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) <b>Buildings:</b>			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) <b>Machinery:</b>			(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
<b>Agriculture employees: Reduced rates of benefits</b>		
(i) Water	200	2,400
(ii) Electricity	900	10,800

### QUESTION ONE

- (a) One of the recent trends in the field of taxation is the introduction of digital services tax (DST).

**Required:**

- (i) Explain the meaning and operations of the digital services tax (DST). (3 marks)
- (ii) Describe three types of transactions where DST is applicable. (3 marks)
- (b) Poxmax Enterprises is a resident company that deals in asset leasing. For the year ended 31 December 2020, the company reported the following transactions:

1. Assets leased in the course of the year:

- Manufacturing machinery to Pendo Ltd. at an annual lease cost of Sh.4,200,000.
- Ten saloon cars to Samtech Tours for four months at Sh.40,000 each per month.
- At the end of the four months, Samtech Tours returned four saloon cars and renewed the lease for the others for an additional three months at a discounted pay by 10%.
- Five lorries to Athi Ltd. at an annual lease of Sh.800,000 per lorry. However, the lease was terminated after 9 months after it was found that the lorries had serious mechanical problems.
- Six pickup vehicles to Fahari Ltd. in Rwanda for Sh.200,000 per month for the whole year.
- Computers to Digitech Ltd. at an annual lease of Sh.200,000.

2. Poxmax Enterprises incurred the following expenditure in the course of the year:

- |  | Sh. |
|--|-----|
|--|-----|

3. The following additional information was provided:

- A pickup vehicle whose written down value as at 1 January 2020 was Sh.420,000 was sold upon expiry of lease in 2020 for Sh.580,000.
- The written down values of the following assets as at 1 January 2020 were:

	Sh.
Lorries (4 tonnes)	4,000,000
Computers	420,000
Motor vehicles	1,200,000
Furniture	180,000

- Other incomes of Poxmax Enterprises include:
  - (i) Interest income from Ufanisi Deposit taking micro finance Sh.240,000 (net).
  - (ii) Dividend income from Wananchi Sacco Sh.120,000 (net).
  - (iii) Royalties income of Sh.400,000 (net).
- Corporate tax rate applicable during the year was 25%.

**Required:**

The adjusted taxable income or loss and tax payable (if any) for Poxmax Enterprises for the year ended 31 December 2020. (14 marks)

**(Total: 20 marks)**

### QUESTION TWO

- (a) Discuss the responsibilities of the Senate Budget Committee or its equivalent in public finance management. (4 marks)

- (b) There are clear differences between debt management in the private sector and in the public sector. However, the main objective of debt management in both sectors is the sustainability of the institutions concerned.

**Required:**

Describe the salient features that distinguish debt management in the public sector as compared to the private sector. (6 marks)

(c) Oil Merchants Ltd. is in the petroleum business. The following information was extracted from the books of accounts of the company for the year ended 31 December, 2020:

- Crude oil exported 140,000 barrels.
- Domestic crude oil sales 50,000 barrels.
- Posted price per barrel for crude oil exported Sh.505.
- Posted price per barrel for domestic crude oil Sh.102.
- Miscellaneous income Sh.800,000.
- Administrative expenses Sh.8,850,000.
- Income from oil refinery business Sh.1,000,000.
- Royalty on oil exported Sh.5,000,000.
- Royalties on local sales Sh.1,060,000.
- Value of chargeable oil sold as per audited financial statements Sh.60,000,000.
- Customs duty on plant and machinery essential to the company in its operation Sh.150,000.
- Capital expenditure on petroleum tanks Sh.19,000,000.
- Intangible drilling costs Sh.5,000,000.
- Losses from previous year are classified as follows:
  - Loss from 2019 refinery business Sh.2,000,000.
  - Loss from 2019 petroleum business Sh.3,000,000.
- Administrative expenses of Sh.8,850,000 included above comprised:
  - Depreciation Sh.1,000,000.
  - Stamp duty on increase of ordinary share capital Sh.500,000.
  - Loss on foreign exchange transactions Sh.60,000.
  - Defending a driver on traffic offence Sh.16,000.

**Required:**

A statement of taxable profit or loss of Oils Merchants Ltd. for the year ended 31 December 2020. (10 marks)  
**(Total: 20 marks)**

**QUESTION THREE**

(a) The resource mobilisation department is instrumental in enabling the government to execute its mandate and responsibilities to the citizens.

**Required:**

Evaluate the roles played by the resource mobilisation department in the National Treasury or a similar body in your country. (4 marks)

(b) The following information was presented to you by the management of Credit Lenders Ltd. as at 31 December 2020. The company deals in the sale of manufacturing machines on hire purchase terms:

1. The company purchases the machines at Sh.600,000 each.
2. The hire purchase price per unit comprises of a deposit of Sh.160,000 and eight quarterly instalments of Sh.80,000. Cash price per unit is Sh.700,000.
3. During the year ended 31 December 2020, the company sold 4,080 manufacturing machines of which collections of Sh.569,600,000 were received at year end.
4. During the year, the company repossessed 80 machines which had been sold earlier in the year. The customer had already paid Sh.6,400,000 on the units which was included in the total cash collections for the year. The repossessed units were valued at Sh.520,000 each at year end.
5. Expenses incurred in the course of the year included:

	<b>Sh.</b>
• Rent expenses	420,000
• Legal expenses	1,200,000 (of which Sh.320,000 was in respect of defence against illegal importation of a machine).
• Advertising and marketing	525,000
• Salaries and management expenses	890,000
• Purchase of a mobile forklift (in August 2020)	2,800,000
6. Other incomes included:
  - Royalties of Sh.289,750 net of withholding tax.
  - Dividend from Uzima Co-operative Society Sh.120,000 net of withholding tax.
7. The Revenue Authority has reached an agreement with the company whereby profit for tax purposes will be determined on the basis of proportionate cash collected from the customers for the year's sales.

**Required:**

Taxable profit or loss for Credit Lenders Ltd. for the year ended 31 December 2020. (12 marks)

- (c) A Single Customs Territory (SCT) is the full attainment of the customs union achievable through removal of trade restrictions and minimisation of internal border controls.

**Required:**

Explain the benefits of a single customs territory (SCT).

(4 marks)

**(Total: 20 marks)**

**QUESTION FOUR**

- (a) Describe the tax planning opportunities that could be derived in relation to the financial management decisions in a company. (6 marks)
- (b) Jirani and Mwema have been partners trading as JM Traders since 1 January 2019. They have not filed individual income tax returns for the year ended 31 December 2020. The Commissioner for Domestic taxes has issued an estimated assessment of Sh.940,800 to each of the partners for the year ended 31 December 2020. They share profits and losses in the ratio of 2:3 to Jirani and Mwema respectively. They are preparing to appeal against the assessment and have approached you for tax advice with the following details:

**Cashbook summary**

	Sh.		Sh.
Balance brought forward (1 January 2020)	912,000	Payment to creditors	1,056,000
Capital: Jirani	720,000	Purchase of furniture	240,000
Mwema	1,080,000	Motor vehicle expenses	168,000
Receipts from debtors	2,040,000	Electricity expenses	93,600
Cash sales	1,200,000	Rent expenses	472,800
Rent income	696,000	Purchase of motor vehicles	720,000
Sale of furniture	204,000	Salaries and wages	576,000
		Office partitions	216,000
		General expenses	528,000
		Balance carried forward	<u>2,781,600</u>
	<u>6,852,000</u>		<u>6,852,000</u>

**Additional information:**

- Sales and purchases for the year were understated and overstated respectively by 20%.
- All the cash sales were paid into the bank with the exception of Sh.528,000 which was debited in the income statement as general expenses but related to the following items:
  - Partners children school fees Sh.96,000.
  - Purchase of goods Sh.240,000.
  - Tax appeal expenses 48,000.
  - Insurance policy for partners life Sh.84,000.
  - Computer software Sh.60,000.
- 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.
- The cost of furniture sold was Sh.192,000 and had accumulated depreciation of Sh.16,800 as at 1 January 2020. The profit on disposal was credited to the income statements for the year ended 31 December 2020.
- Other information provided was as follows:

	31 December 2019 Sh.	31 December 2020 Sh.
Inventories	297,600	434,400
Creditors for goods	480,000	336,000
Debtors for goods	288,000	432,000
Electricity expenses prepaid	566,400	36,000
Rent owing	93,600	52,800
Salaries and wages owing	24,000	72,000
Furniture	192,000	240,000

6. The business reported a net loss of Sh.509,400 for the year ended 31 December 2020 after deducting the following expenses:

- Salaries and wages for the year ended 31 December 2020 which included partners salaries for Jirani Sh.120,000 and Mwema Sh.96,000.
- Rent expense for the year included 20% for private residence for Jirani while electricity included 30% electricity bills paid on behalf of Mwema'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%.

**Required:**

With supporting computations:

- (i) Advise the partners on the accuracy of the estimated assessment issued for the year of income 2020. (8 marks)
- (ii) Prepare a schedule of total taxable income for each partner for the year of income 2020. (6 marks)
- (Total: 20 marks)**

**QUESTION FIVE**

- (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 the possible factors that could have contributed to this trend. (6 marks)

- (b) The following information was obtained from the financial records of Alemao Commercial Bank Ltd. for the year ended 31 December 2020:

	<b>Sh. "000"</b>
Interest on advances	697,200
Contribution to deposit protection fund	147,000
Operating lease rentals	9,720
Interest on government securities	21,900
Interest paid on deposits	7,110
Interest on placement and bank balances	3,990
Loss on disposal of collaterals	1,260
Fees and commission expenses	2,130
Losses from investment in securities	1,185
Purchase of equipment	1,800
Depreciation	744
Transfer to statutory reserves	939
Losses on stock brokerage dealings	522
Gain on foreign exchange dealings	2,205
Discounts on bills purchased	493.5
Auditors remuneration	1,179
Provision for bad and doubtful debts	810
Investments in government securities	2,775
Bills receivable and for collection	471
Guarantees and performance bonds	567
Interest accrued and paid	2,961
Bills for collection, acceptances and endorsements	705
Rebates on bills discounted	438
Provision for taxation	600
General charges recovered	375
Commission on exchange and brokerage	1,176

**Additional information:**

- Contribution to deposit protection fund includes investment revaluation surplus of Sh.972,000.
- Included in transfer to statutory reserves is an amount paid for exchange and commission of Sh.72,000.
- Discounts on bills purchased include interest and discount paid of Sh.58,500.
- Provision for bad and doubtful debts include specific bad debts at the beginning and at the end of the year amounting to Sh.102,000 and Sh.210,000 respectively.
- The corporate tax rate applicable during the year was 25%.

**Required:**

- (i) A statement showing the taxable profit or loss for Alemao Commercial Bank Ltd. for the year ended 31 December 2020. (12 marks)
- (ii) Tax payable (or refundable) by the bank from the income computed in (b) (i) above. (2 marks)
- (Total: 20 marks)**
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