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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 (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	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

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:

Income	Sh.
• 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	60,000
• Wages and salaries for employees	15,000
• Annual compensation paid to local people for disturbance during petroleum exploration	75,000
• Royalties incurred in respect to crude oil exported	42,000
• Interest on loan from a foreign subsidiary company	31,250
• Specific bad debts written off	8,500
• Depreciation of non-current assets (Class IV)	45,100
• Exploration and drilling costs in respect to cement and casing of oil wells	24,500,000
• Contribution to approved provident fund	65,000
• Custom duties on imported equipment	21,500
• General expenses	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.
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.
4.2 tonnes lorry Sh.1,800,000.

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	2,400,000
Computers	80,000
Furniture and fittings	96,000
Fax machine	48,000
Switchboard	64,000
Bookshelf	18,000
Office kitchen utensils	9,000
Office television set	54,000
Carpets	36,000
Safe for cash office	45,000

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:

1. Sales for the year was Sh.1,860,000 out of which Sh.360,000 was on credit and the balance was cash banked.
2. 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

3. 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

4. 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
Tax consultancy fees	32,000
Training of partners' children	28,000
Motor vehicle insurance	24,000

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:

- (i) 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)
 - (ii) 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	2016	2017	2018	2019
	Sh."000"	Sh."000"	Sh."000"	Sh."000"	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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