

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%)		

	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
(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

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)

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>	<u>(2,416,500)</u>
Net profit		<u>1,105,500</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

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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>	(15,450)
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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	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>

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	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.		
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