

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%	
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

(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) 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

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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%.

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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:

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- (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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