



CPA PART III SECTION 6

ADVANCED PUBLIC FINANCE AND TAXATION

THURSDAY: 23 May 2019.

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 2018.

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.)
<b>Capital allowance:</b>		
<b>Wear and tear allowance:</b>		
Class I	37.5%	
Class II	30%	
Class III	25%	
Class IV	12.5%	
Software	20%	
<b>Industrial building allowance:</b>		
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%	
<b>Farm works allowance</b>	100%	
<b>Investment deduction allowance</b>	100%	
<b>Shipping investment deduction (Ships over 125 tonnes)</b>	100%	
<b>Extraction expenditure:</b> Written off over 5 years (20%)		
<b>Commissioner's prescribed benefit rates</b>		
	Monthly rates Sh.	Annual rates Sh.
<b>Services</b>		
(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) Many governments particularly in developing countries have implemented various taxation policies to achieve fiscal and other objectives. Unfortunately, in some of these countries, the noble objectives of the taxation policies appear not to have been realised.

**Required:**

Evaluate four reasons which, in your assessment, have contributed to the failure of taxation policies to achieve their intended objectives. (8 marks)

- (b) With regard to the government's responsibilities in public finance management:
- (i) Discuss three roles of the Cabinet Secretary for the National Treasury and Planning or equivalent office in your country, with regard to public debt management. (6 marks)
- (ii) Summarise three responsibilities of the State Corporations Advisory Committee (SCAC) or equivalent body in your country. (3 marks)
- (c) Describe three ways in which monies paid into the Public Private Partnership Project Facilitation Fund may be applied. (3 marks)
- (Total: 20 marks)**

### QUESTION TWO

- (a) Various legislations provide for penalties on taxpayers who engage in tax avoidance schemes. In light of the above statement, outline four categories of tax avoidance schemes that a taxpayer might be investigated for in your country. (4 marks)
- (b) Dawida Ltd. is a real estate developer. During the year ended 31 December 2018, the company earned the following incomes from rented properties:

	Sh.
Rental income	19,400,000
Sale of timber used during construction	288,600
Sale of unused paint	92,400

The rented property is a commercial building constructed at a cost of Sh.48,460,000 and was occupied on 1 January 2018 upon completion on 31 December 2017.

The cost of construction of the commercial building comprised the following:

	Sh.
Shops (cost)	16,800,000
Offices	17,240,000
Showroom	9,460,000
Sewerage system	1,640,000

The following additional costs and expenses were incurred by the company:

1. A standby generator at a cost of Sh.600,000 and a powerhouse at a cost of Sh.280,000 were acquired.
2. CCTV surveillance cameras were installed at a cost of Sh.720,000.
3. A stone perimeter wall was constructed at a cost of Sh.1,480,000.
4. Electricity expenses incurred during the year amounted to Sh.492,800 while insurance expenses amounted to Sh.360,000.
5. Water tanks costed Sh.540,000 excluding the cost of water pumps of Sh. 248,000.
6. Land Cruiser motor vehicle of 3500cc whose cost was Sh. 2,800,000 was purchased and used for security surveillance purposes.
7. A parking bay for shoppers was constructed at a cost of Sh.4,670,000.
8. Other expenditure comprised purchase of fire extinguishers at Sh.182,000, county rates amounting to Sh.94,800, real estate agents commission amounting to Sh.138,400 and parking metres amounting to Sh.280,000.

**Required:**

- (i) Statement of taxable rental income for the year ended 31 December 2018. (10 marks)
- (ii) Tax liability, if any, for Dawida Ltd. for the year ended 31 December 2018. (2 marks)
- (iii) Highlight any additional information to be sought from the company to help determine the accuracy of the tax computed. (4 marks)

**(Total: 20 marks)**

**QUESTION THREE**

- (a) (i) Explain four factors to be considered when selecting the most appropriate transfer pricing method. (4 marks)
- (iv) A Ltd. sold a processing machine to B Ltd., an associate company. B Ltd. sold the same machine to C Ltd., an independent party, for Sh.400,000 at a profit margin of 30%. B Ltd's incidental costs before selling to C Ltd. were Sh.4,000.

Using the resale price method, calculate the arms length price/transfer price of the machine. (4 marks)

- (b) Peter Samoei is an employee of Zawadi Ltd. and earns a salary of Sh.140,000 per month, while his wife Sabina Wanga works in Lindi Ltd., a firm in which Mr Samoei controls 18% of the share capital. Her salary is Sh.60,000 per month. Sabina Wanga owns the house which is occupied by the family, for which the market rental value is Sh.45,000 per month. The house was constructed in year 2017 at a cost of Sh.6,000,000 borrowed from a Sacco at an interest rate of 12% per annum. Sabina Wanga has insured the house and paid insurance premiums of Sh.4,800 per month and city county rates of Sh.6,900 per annum.

Mr Samoei paid insurance premiums for his family of Sh.4,600 with an insurance company incorporated in Uganda, but operating in Kenya. Zawadi Ltd. paid school fees of Sh.80,000 for the couple's children which was expensed in the firm's income statement.

**Required:**

Suggest four tax planning schemes that could minimise the tax liability of the family. (8 marks)

- (c) Explain four benefits that might accrue from the effective use of information communication technology (ICT) in tax administration. (4 marks)

**(Total: 20 marks)**

**QUESTION FOUR**

- (a) It is important for shareholders to understand the taxation impact of transactions involving mergers or transfers of assets before approving such transactions.

With reference to the above statement, evaluate three tax implications of transactions involving mergers or transfers of assets for consideration to another company. (6 marks)

- (b) Solomon Omariba started a merchandise business, Solo Traders, on 1 January 2016. He had not filed individual income tax returns for the years of income 2016 and 2017. The revenue authority announced a tax amnesty, where one qualified provided they filed returns for the year of income 2018.

Mr Omariba has provided the following details to you to assist in filing his returns:

1. An analysis of the cash book for the year ended 31 December 2018 is as shown below:

**Cash book – Bank Column**

	Sh.		Sh.
1 January 2018 balance brought down	970,000	Fixtures and fittings (acquisition)	183,000
Cash sales	4,408,000	Suppliers of goods	696,000
Cheques from customers	649,600	Bank charges	14,800
Refunds from suppliers	41,760	Motor vehicle (acquisition)	500,000
Rent income	520,000	Salaries and wages	480,000
Sale of fixtures	248,000	Office computers (acquisition)	240,000
		Rent and rates	62,000
		Electricity expenses	58,000
		Telephone and postage	62,640
		Refunds to customers	37,120
		Computer software	60,000
		Balance carried down	4,443,800
	<u>6,837,360</u>		<u>6,837,360</u>

2. Other information obtained from the books of account included:

	1 January 2018	31 December 2018
Inventory	4,320,000	225,000
Suppliers of goods	278,400	139,200
Trade debtors	174,000	487,200
Accrued electricity	66,120	113,680
Prepaid rent income	180,000	240,000
Motor vehicles	1,400,000	1,800,000
Prepaid salaries and wages	320,000	140,000
Fixtures and fittings	450,000	170,000

3. Non-current assets are stated at cost. However, the business had charged depreciation in the income statement.
4. Opening and closing inventories were overvalued and undervalued by 20% and 10% respectively.
5. All operating expenses and non-current assets comprise 40% non-business activities.
6. Total sales and purchases are inclusive of value added tax at the rate of 16%.
7. The business had issued credit notes of Sh.34,800 for goods returned by credit customers.
8. The cost of fixtures disposed of was Sh.220,000.
9. From the accounting records, the accountant had reported a net loss of Sh.186,400.

**Required:**

A statement showing the corrected adjusted taxable income of Solo Traders for the year of income 2018. (14 marks)  
(Total: 20 marks)

**QUESTION FIVE**

- (a) Discuss four benefits that could accrue to parties involved in a tax dispute through the use of Alternative Dispute Resolution (ADR) in your country. (8 marks)
- (b) The following are the year 2018 records of the Trustees of the late Kalume Tajiri Children Settlement created in favour of his three children; Baraka, Khalifi and Mwanga.

	Sh."000"
Gross rental income	800,000
Trading income	310,000
Dividends (gross)	160,000
Sundry income	90,000

**Additional information:**

1. Each beneficiary is entitled to 1/5 share of the net distributable income.
2. Interest on debt repayment by the settlement is Sh.14,000,000.
3. Fixed annuity to beneficiary is Sh.120,000,000 (gross).
4. Trustees remuneration per "Trust Deed":
  - Fixed salary Sh.80,000,000 each.
  - 2% of total computed income.
5. Under the terms of the Trust Deed, the trustees made the following discretionary payments to Baraka, Khalifi and Mwanga; Sh.120,000,000, Sh.100,000,000 and Sh.60,000,000 respectively.
6. Trading income was before taking into account capital expenditure as follows:

	Sh.
Godown	3,500,000
Staff canteen	750,000
Parking bay	800,000
Sports pavilion	1,950,000
	<u>7,000,000</u>

7. Administrative and other expenses amounted to Sh.160,000,000.
8. The children did not have other income.

**Required:**

- (i) A statement of income tax payable by the trustees on the trust income for the year of assessment 2018. (8 marks)
  - (ii) The amount due to each beneficiary for the year of assessment 2018. (4 marks)
- (Total: 20 marks)**

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