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CPA PART I SECTION 2

CS PART I SECTION 2

CIFA PART I SECTION 2

CCP PART I SECTION 2

PUBLIC FINANCE AND TAXATION

WEDNESDAY: 22 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 Annual rates

	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%	
(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

**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** 100%

(Ships over 125 tonnes)

**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) Budgetary rules exercise effective control over government entities in public spending and accountability.

With reference to the above statement, identify four ways used by the national government to demand budgetary accountability by the government entities. (4 marks)

- (b) Outline four purposes of Public Finance Management Equalization Fund Regulations, 2015. (4 marks)
- (c) Citing three reasons, justify the importance of information contained in the circulars guiding the budget processes for county governments. (6 marks)
- (d) Describe three functions performed by the Internal Auditor-General Department of the National Treasury in conducting internal auditing of government entities. (6 marks)

(Total: 20 marks)

### QUESTION TWO

- (a) Outline four contents of information that the National Treasury should include in the financial statements in respect to the Contingencies Fund submitted to the Auditor-General. (4 marks)
- (b) Summarise six benefits of applying e-procurement in the public sector. (6 marks)
- (c) The following transactions were extracted from the ledger balances of Sitima Traders, a registered business for value added tax (VAT) purposes for the month of September 2018:

	Sh.
Purchases at standard rate	487,200
Audit fees	41,760
Exports to Malawi	400,000
Sales at standard rate	1,136,800
Purchases of printing materials	29,000
Fuel for delivery van	78,880
Exempt supplies	280,000
Catering for firm employees	81,200
Entertainment expenses	24,360
Telephone expenses	58,000
Payment of water bill	21,000

#### Additional information:

1. The firm received debit notes valued at Sh.23,200 in respect to erroneous invoices issued by suppliers.
2. The firm issued credit notes of Sh.20,880 to credit customers because of price adjustments.
3. Goods imported valued at a cost of Sh.500,000 were not recorded; Freight charges was Sh.40,000 and insurance Sh.20,000. Import duty was charged at 25%.
4. A debtor of goods valued at Sh.32,480 was declared bankrupt, and the debt written off.
5. The firm did not keep proper records for sales and purchases, therefore it was not possible to identify the state of goods sold as exempt.
6. All transactions are inclusive of VAT at a rate of 16% where applicable.

#### Required:

The value added tax (VAT) payable by (or refundable to) Sitima Traders for the month of September 2018. (10 marks)

(Total: 20 marks)

### QUESTION THREE

- (a) Outline four categories of goods which are subject to customs control under the Customs and Excise Act. (4 marks)
- (b) Loki Marete purchased an old building for Sh.2,400,000. The legal cost incurred on transfer was Sh.180,000 and the cost of valuation was Sh.160,000. Other costs included replacement of roof of the building at a cost of Sh.360,000 and cost of sewerage system Sh.78,000. The commissioner accepted accumulated industrial building deduction at Sh.282,000. The building was later sold for Sh.5,840,000 after advertising several times in the newspaper at a cost of Sh.246,000.

#### Required:

The capital gain tax payable by Loki Marete in respect to disposal of the building.

(4 marks)

(c) Halima Ali is a resident individual employed as a finance manager at Motech International Ltd.

She provided the following information relating to her income for the year ended 31 December 2018:

1. Her employment contract indicated the following:
 

	Sh.
Basic monthly salary	250,000
Monthly hardship allowance	45,000
Monthly responsibility allowance	50,000
Monthly commuter allowance	25,000
2. During the year, she received Sh.90,000 as a bonus for the previous years' reported profits.
3. She made a donation of Sh.50,000 to the National Kidney Fund during the year.
4. She was provided with a fully furnished apartment by the employer. The employer paid a monthly rent of Sh.80,000 and the cost of furniture was Sh.320,000.
5. The employer paid her monthly medical insurance premiums of Sh.5,000 during the year.
6. PAYE deducted from her monthly salary was Sh.68,000.
7. The company provided her with a 2,500cc saloon car on 1 October 2018 for official and private use. The car had been purchased for Sh.1,800,000.
8. She contributed Sh.15,000 per month towards a registered pension scheme.
9. She obtained a mortgage loan for the purpose of constructing her residential house from the National Savings Bank. The loan amount was Sh.4,000,000 with a monthly repayment of Sh.232,000. During the year, the total interest paid on the loan was Sh.144,000.
10. The company has a medical scheme for its managers. She was reimbursed Sh.380,000 during the year in respect of medical bills.
11. During the year, she was voted as the best employee and the company rewarded her with a cash of Sh.60,000.
12. The company paid her son's college fees amounting to Sh.120,000 during the year. This amount was treated as an allowable expense in the company's books of account.

**Required:**

(i) Taxable income of Halima Ali for the year ended 31 December 2018. (10 marks)

(ii) Tax liability (if any) from the income computed in (c)(i) above. (2 marks)

**(Total: 20 marks)**

**QUESTION FOUR**

(a) Pareto Ltd. has provided the following income statement for the year ended 31 December 2018:

	Sh.	Sh.
<b>Income:</b>		
Gross profit		6,290,000
Dividends (net)	675,000	
Foreign exchange gain	175,000	
Rent received (commercial building)	580,000	
Interest received from Fabari Bank Ltd. (net)	289,000	
Bad debts recovered	370,000	
Insurance claim	785,000	
Profit on sale of equipment	88,000	
Sale of debentures	<u>4,200,000</u>	<u>7,162,000</u>
		13,452,000
<b>Less expenses:</b>		
Salaries and wages	1,450,000	
Increase in provision for bad and doubtful debts	145,000	
Contribution to N.S.S.F.	78,000	
Advertising	710,000	
Stationery	400,000	
Depreciation	280,000	
Subscriptions	1,140,000	
Trading loss	390,000	
Interest	760,000	
Transport	150,000	
Legal costs	<u>365,000</u>	<u>(5,868,000)</u>
		<u>7,584,000</u>

**Additional information:**

	Sh.	Sh.
1. Dividends comprise:		
Dividends from Beta Ltd.	505,000	
Dividends from Bona Cooperative Society	170,000	
2. Foreign exchange gain comprise:		
Amount of realised foreign exchange gain	125,000	
Amount of unrealised foreign exchange gain	50,000	
3. Bad debts recovered related to:		
Bad debts on sale of furniture	130,000	
Bad debts on credit sale of goods	240,000	
4. Insurance claim related to:		
Insurance compensation on loss of profit	380,000	
Insurance claim on loss of motor vehicle	405,000	
5. Advertising comprise:		
Advertising through daily newspapers	280,000	
Advertising on passenger sheds at bus stops	430,000	
6. Subscriptions related to:		
Annual subscription fee to chamber of commerce and industry		530,000
Subscriptions to employees' sports club		610,000
7. Interest comprise:		
Interest on debentures		580,000
Interest on loan acquired to build commercial rental houses		110,000
Interest on money borrowed to pay tax and penalties		70,000
8. Legal costs comprise:		
Appeal to tax tribunal		155,000
Defending business property rights		120,000
Registration of lease agreement (100 years)		90,000
9. Capital allowances were agreed with the commissioner of revenue authority at Sh.960,000.		

**Required:**

Adjusted taxable income or loss for Pareto Ltd. for the year ended 31 December 2018.

(10 marks)

- (b) Sawa Industries Ltd. manufactures personal hygiene soaps and related products. The company started operations on 1 April 2018 after incurring the following expenditure:

	Sh.
Factory building	5,200,000
Processing machinery	2,400,000
Furniture and fittings	980,000
Godown	1,800,000
Water pump	360,000
Motor vehicle (saloon)	1,600,000
Computers	450,000
Drainage system	320,000
Staff canteen	960,000

**Additional information:**

- On 1 May 2018, the company imported a forklift for Sh.1,200,000 before VAT at the rate of 16% and import duty at 25%.
- A sports pavilion was constructed and utilised with effect from 1 October 2018. The total construction cost was Sh.650,000.
- A borehole was drilled at a cost of Sh.680,000 and utilised with effect from 1 November 2018.
- On 2 December 2018, the company acquired the following additional assets:

	Sh.
Photocopier	180,000
Pick-up	1,900,000
Cash registers	120,000
Conveyor belts	780,000
Fax machine	200,000
Office cabinets (wooden)	160,000
Boilers	920,000

5. The saloon car was disposed of for Sh.1,200,000 in October 2018 and replaced with a delivery van costing Sh.1,500,000.
6. Labour quarters were constructed at a cost of Sh.2,600,000 and the employees moved in the houses on 1 October 2018.

**Required:**

Capital allowances due to Sawa Industries Ltd. for the year ended 31 December 2018.

(10 marks)

**(Total: 20 marks)**

**QUESTION FIVE**

- (a) The Excisable Goods Management System Regulations require for affixing of excise stamps on every package of excisable goods.

Identify two purposes of these stamps.

(2 marks)

- (b) Discuss three measures that the government has undertaken to help reduce the number of tax appeals proceeding to court.

(6 marks)

- (c) Soi and Timothy are brothers engaged in commercial farming. They have been running Mazao Farm as a partnership sharing profits and losses equally.

The following is Mazao Farm's income statement for the year ended 31 December 2018:

	Sh.	Sh.
<b>Income:</b>		
Sale of fruits		2,050,000
Sale of livestock		1,550,000
Profit on sale of tractor		45,000
Sale of milk		480,000
Insurance claim		510,000
Discount received		80,000
Sale of manure		170,000
Interest received		90,000
Rental income		<u>200,000</u>
		<u>4,175,000</u>
<b>Less expenses:</b>		
Salaries	540,000	
Transport	70,000	
Drawings: Soi	350,000	
Timothy	460,000	
Fertilizers	510,000	
Construction of gabion	120,000	
Purchase of milking machine	200,000	
Subscriptions to agricultural research institute	155,000	
Interest	480,000	
Mulching	60,000	
Fuel	140,000	
Rates	30,000	
Presumptive tax	45,000	
Legal costs	80,000	
Wages	620,000	
Clearing land for planting fruits	210,000	
Depreciation	15,000	
Repairs and maintenance	<u>54,000</u>	
		<u>(4,139,000)</u>
		<u>36,000</u>

**Additional information:**

1. Sale of fruits and sale of milk include own consumption of Sh.30,000 and Sh.50,000 for Soi and Timothy respectively.
2. Interest received relates to interest earned from Kenya Post Office Savings Bank (Postbank).
3. Insurance claim is in connection with a partial destruction of the farm house.
4. Salaries relate to salaries paid to partners as follows:

	Sh.
Soi	240,000
Timothy	300,000

5. Rates relate to the rental income from commercial building.  
6. Interest expense include interest on capital to partners as follows:

	<b>Sh.</b>
Soi	105,000
Timothy	125,000

7. Legal costs related to:

	<b>Sh.</b>
Tax appeal	35,000
Recovery of bad debts	22,000
Defending Soi for breach of contract	23,000

8. The following farm works were constructed and put to use on 1 July 2018:

	<b>Sh.</b>
Silo	40,000
Irrigation network	75,000
Cattle dip	150,000

9. Interest on drawings was charged at the rate of 10%.

**Required:**

- (i) Adjusted taxable profit or loss for the year ended 31 December 2018. (8 marks)
- (ii) A schedule showing the distribution of the partner's profit or loss computed in (c)(i) above. (4 marks)
- (Total: 20 marks)**
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