

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 | 10% | |
| 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 |
| | 1201 - 1500 cc | 4,200 |
| | 1501 - 1750 cc | 5,800 |
| | 1751 - 2000 cc | 7,200 |
| | 2001 - 3000 cc | 8,600 |
| | Over 3000 cc | 14,400 |
| | (ii) Pick-ups, Panel Vans (unconverted) | |
| | Up to 1750 cc | 3,600 |
| | Over 1750 cc | 4,200 |
| | (iii) Land Rovers/Cruisers | 7,200 |

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) 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 | | <u>(2,047,000)</u> |
| 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 program | <u>120,000</u> | <u>(2,416,500)</u> |
| Net profit | | <u><u>1,105,500</u></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:

- 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)
- 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 |

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> | <u>(15,450)</u> |
| 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> | (15,450) |
| Net profit | | <u>4,600</u> |

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| | Machinery | 84,600 | 97,000 |
| | Rent prepaid | 800 | - |
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| | 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. | | |
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