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ATD LEVEL III

DCM LEVEL III

PRINCIPLES OF PUBLIC FINANCE AND TAXATION

TUESDAY: 21 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 | |
|--|---------------|--------|--------------|---------|
| | (Sh.) | (Sh.) | (Sh.) | (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% | | | |
| (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 |

Extraction expenditure:

Written off over 5 years (20%)

Commissioner's prescribed benefit rates

| | Monthly rates | Annual rates |
|---|---------------|--------------|
| | Sh. | Sh. |
| Services | | |
| (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) Outline five responsibilities of the parliamentary budget office as provided under the Public Finance Management Act. (5 marks)
- (b) In a tax seminar, one of the facilitators noted that “the Public Finance Management Act prevails in case of any inconsistency on certain matters with any other legislation”.
- With reference to the above statement, highlight five such matters where the Act prevails. (5 marks)
- (c) Identify five key county budget documents citing their importance in the budget process. (10 marks)
- (Total: 20 marks)**

QUESTION TWO

- (a) Discuss five benefits that a country stands to gain by adopting an Integrated Financial Management Information System (IFMIS) in the management of public funds. (5 marks)
- (b) The Tax Procedures Act 2015, specifies information that the Commissioner should include in the default assessment to a taxpayer.
- In light of the above statement, describe five categories of such information. (5 marks)
- (c) The following are the transactions of Wasafi Traders for the month of November 2018. The business was registered for value added tax (VAT) on 1 June 2018:

| | Sh. | Sh. |
|---|---------------|--------------------|
| Income: | | |
| Sales | | 6,800,000 |
| Expenditure: | | |
| Purchases from VAT registered suppliers | 3,480,000 | |
| Purchases from VAT unregistered suppliers | 1,800,000 | |
| Depreciation | 350,000 | |
| Electricity | 58,000 | |
| Printing and stationery | 250,560 | |
| Motor vehicle parking charges | 62,640 | |
| Hotel accommodation | 275,500 | |
| Computer software | 69,600 | |
| Salaries and wages | 1,800,000 | |
| Water bill | 17,400 | |
| Legal fees | 139,200 | |
| Repairs and maintenance | 870,000 | |
| Motor vehicle fuel | <u>58,000</u> | |
| | | <u>(9,230,900)</u> |
| | | <u>2,430,900</u> |

Additional information:

- The reported sales include goods sold to a customer in Rwanda of Sh.536,000.
- An invoice of Sh.1,002,240 issued to Salama Traders had been omitted from the records during the month.
- Motor vehicle fuel and repairs and maintenance relates to the van used to supply goods to customers.
- All transactions are inclusive of value added tax (VAT) at the standard rate of 16% where applicable.

Required:

- A value added tax (VAT) account for the month of November 2018 for Wasafi Traders. (10 marks)
- (Total: 20 marks)**

QUESTION THREE

- (a) Propose four ways through which the revenue authority in your country could use to prevent tax evasion. (4 marks)
- (b) Outline four objectives of fiscal policies in your country. (4 marks)
- (c) Hawa Hamandi who holds a dual citizenship, had been living in Australia since May 2012. She returned to the country on 9 December 2017 and opened a beauty and cosmetics shop on 5 January 2018.

On 1 July 2018, she got formal employment with Ncallay Ltd., a food processing industry as a chief nutritionist.

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

1. Basic salary Sh.150,000 per month (PAYE Sh.45,000 per month).
2. She was paid overtime amounting to Sh.29,000 during the year and hardship allowance of Sh.22,000 per month.
3. The employer provided her with free lunch worth Sh.6,000 per month.
4. House allowance Sh.80,000 per month.
5. Up to 30 September 2018, she used her personal vehicle for official duties and the employer reimbursed a monthly mileage allowance of Sh.38,000.
6. On 1 October 2018, she was provided with a saloon motor vehicle (2400cc) purchased by the company on 1 March 2017, at a cost of Sh.2,500,000.
7. She attended a seminar for five days outside her workstation and received a per diem of Sh.14,000 from the employer.
8. The company paid Sh.90,000 school fees for each of her three children during the year. This was treated as an allowable deduction in the company's books.
9. The employer bought a Sh.105,000 air ticket to facilitate Hawa Hamandi to visit the rest of her family in Australia during her annual leave.
10. The company paid for her Sh.15,000 and Sh.92,000 as pension contribution and life insurance premium respectively during the year. The pension fund was non-contributory.
11. She bought a residential house on 31 August 2018 through mortgage of Sh.6,000,000 provided by Pearl Bank Ltd. at an interest rate of 18% per year. She moved into the house on 2 September 2018.
12. She offers part time professional services. During the year, she received Sh.142,500 (net) as professional fees.
13. The net loss from the beauty and cosmetic shop amounted to Sh.375,000. This was after deducting the following:

| | Sh. |
|---|-----------|
| Salaries (including to self Sh.300,000) | 1,050,000 |
| VAT paid | 108,000 |
| Pilferage by shop attendant | 420,000 |
| Rent | 240,000 |
| Electricity | 31,000 |
| Furniture and fittings | 200,000 |

Required:

- (i) Total taxable income of Hawa Hamandi for the year ended 31 December 2018. (10 marks)
 - (ii) Tax payable (if any) from the income computed in (c) (i) above. (2 marks)
- (Total: 20 marks)**

QUESTION FOUR

- (a) Citing four reasons, justify why the government levies excise duty in your country. (4 marks)
- (b) Describe four drawbacks of capital allowances as tax incentives in your country. (4 marks)
- (c) Boma Ltd., a manufacturing company, commenced its operations on 1 March 2018 after incurring the following expenditure:

| | Sh. |
|--|-----------|
| Land | 7,000,000 |
| Factory building | 6,200,000 |
| Standby generator | 135,000 |
| Staff quarters | 1,800,000 |
| Processing machinery | 4,500,000 |
| Pick-up | 1,400,000 |
| Computers | 160,000 |
| Processing machinery installation cost | 80,000 |
| Perimeter wall | 840,000 |
| Sign board | 100,000 |
| Warehouse | 1,020,000 |
| Electrical wiring (factory building) | 350,000 |
| Commissioning cost (factory building) | 220,000 |
| Dam | 690,000 |
| Scanner | 56,000 |
| Truck (5 tonnes) | 3,000,000 |

Additional information:

- The pick-up was traded-in on 6 June 2018 at a cost of Sh.1,100,000 for a Toyota Prado. The company paid a balance of Sh.1,700,000 in cash.
- The following buildings were constructed and put into use on 3 July 2018:

| | Sh. |
|-------------------|---------|
| Staff social hall | 990,000 |
| Staff canteen | 760,000 |

- On 8 August 2018, the following assets were acquired on hire purchase terms:

| Asset | Hire Purchase Price Sh. | Cash Price Sh. |
|--------------------|----------------------------|-------------------|
| Equipment | 2,250,000 | 1,310,000 |
| Workshop machinery | 1,900,000 | 1,200,000 |
| Forklift | 1,050,000 | 620,000 |

Required:

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

(12 marks)

(Total: 20 marks)**QUESTION FIVE**

- Outline four types of income subject to withholding tax, indicating the applicable rates for a resident person. (4 marks)

- Relcy Importers Ltd. buys and sells electronic goods. During the year ended 31 December 2018, the company imported goods whose cost at country of export was Sh.400,000. The importer incurred freight charges Sh.80,000, insurance Sh.40,000 and demurrage charges of Sh.20,000. Clearing agents fees was Sh.30,000. The goods were later sold for Sh.925,000 inclusive of value added tax. Assume the duty rate was 25%.

Required:

- Duty paid. (2 marks)
 - Input tax paid. (1 mark)
 - Value added tax payable. (1 mark)
- Hazina Industries Limited, construction engineers submitted the following income statement for the year ended 31 December 2018:

| | Sh. | Sh. |
|---------------------------|----------------|---|
| Gross profit | | 9,600,000 |
| Dividends | | 700,000 |
| Rent income | | <u>1,800,000</u> |
| | | 12,100,000 |
| Less expenses: | | |
| Office rent | 1,240,000 | |
| Salaries and wages | 4,200,000 | |
| Repairs and maintenance | 930,000 | |
| Depreciation | 118,000 | |
| Legal fees | 800,000 | |
| Registration and licences | 350,000 | |
| Computer software | 180,000 | |
| Impairment loss | 500,000 | |
| Director's remuneration | 1,800,000 | |
| General expenses | <u>220,000</u> | |
| Net profit | | <u>(10,338,000)</u> <u>1,762,000</u> |

Additional information:

- Repairs and maintenance comprised the following:

| | Sh. |
|--|----------------|
| Motor vehicle repair | 380,000 |
| Replacement of the iron gate in Director's residence | 100,000 |
| New tiles for the office floor | <u>450,000</u> |
| | <u>930,000</u> |

- Legal expenses include:

| | Sh. |
|---|----------------|
| Formation of the business | 280,000 |
| Defending the Director in an assault case | 150,000 |
| Debt collection | <u>370,000</u> |
| | <u>800,000</u> |

3. Director's remuneration comprised the following:

| | Sh. |
|--|-------------------------|
| Director's fees | 800,000 |
| Compensation for wrongful contract termination | 450,000 |
| Contribution to pension scheme | 320,000 |
| Subscriptions to golf club | <u>230,000</u> |
| | <u>1,800,000</u> |

4. General expenses include:

| | Sh. |
|---------------------------------|-----------------------|
| General provision for bad debts | 120,000 |
| Cash embezzled by the cashier | 50,000 |
| Other expenses | <u>50,000</u> |
| | <u>220,000</u> |

5. The company paid installment tax during the year amounting to Sh.240,000.

6. Capital allowances had been agreed with the Commissioner of Income Tax to be Sh.430,000.

Required:

- (i) Adjusted taxable profit or loss for Hazina Industries Limited for the year ended 31 December 2018. (10 marks)
- (ii) Tax payable by Hazina Industries Limited (if any) for the year ended 31 December 2018. (2 marks)
- (Total: 20 marks)**
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