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ATD LEVEL III

DCM LEVEL III

PRINCIPLES OF PUBLIC FINANCE AND TAXATION

TUESDAY: 24 November 2020.

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 2019.

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.)
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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	25%
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

Investment deduction allowance

**Shipping investment deduction
(Ships over 125 tonnes)**

Extraction expenditure:

Written off over 5 years (20%)

Commissioner's prescribed benefit rates

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

(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) Highlight six different entities whose accounts the Auditor-General is required to audit and report on within six months after the end of each financial year as provided in the Constitution of Kenya, 2010. (6 marks)
- (b) Describe four principles of public finance as outlined in Chapter 12 of the Constitution of Kenya, 2010. (8 marks)
- (c) Outline three contents of a Budget and Outlook Paper that the National Treasury is required to prepare and submit to cabinet for approval by 30 September in each financial year. (6 marks)

(Total: 20 marks)

QUESTION TWO

- (a) Discuss three roles of the Senate as provided under Article 96 of the Constitution of Kenya, 2010. (6 marks)
- (b) Propose four factors that influence tax shifting in your country. (4 marks)
- (c) The following information was extracted from the records of Masters Wholesalers Ltd., a registered business for value added tax (VAT) purposes for the month of March 2020:

	Sh.
Sales: Standard rate	3,581,500
Zero rate	1,800,000
Exempt	205,000
Purchases: Standard rate	1,486,250
Zero rate	750,000
Telephone (20% private)	217,500
Printing and stationery	228,375
Equipment	373,665
Purchase of business vehicles	2,586,800
Repairs and maintenance (business vehicles)	194,300
Fuel for business vehicle (regular and premium)	859,140

Additional information:

- All the standard rate sales as shown above were on credit. They are recorded on gross before accounting for discount. The company grants a 5% discount to customers who settle within ten days but none for later payments. 80% of the customers takes advantage of the discount.
 - Debit notes exclusive of VAT were received from suppliers during the month as follows:

Suppliers registered for VAT	Sh.40,925
Suppliers not registered for VAT	Sh.34,500
 - A customer owing Sh.95,990 from the month of February was declared bankrupt and a receiver manager appointed to manage the process.
 - Refund claims amounting to Sh.25,000 that Masters Wholesalers Ltd. had made with the revenue authorities two years prior, were approved during the month of March 2020.
 - The input VAT in relation to exempt supplies was negligible.
- All transactions are inclusive of VAT at the appropriate rate where applicable.

Required:

For the month of March 2020, compute for Masters Wholesalers Ltd.:

- (i) Input tax. (6 marks)
- (ii) Output tax. (3 marks)
- (iii) VAT payable or refundable. (1 mark)

(Total: 20 marks)

QUESTION THREE

- (a) Angela Lopez, a landlady with several residential units remits her tax under the rental residential income tax regime. This is her only business activity. Details of her transactions for the year ended 31 December 2019 were as follows:

	Sh.
Caretaker's wages	315,000
Mortgage interest	280,000
Rental income	2,000,000
Donations to charity	120,000
Insurance: Life	60,000
Fire	340,000
Rent and rates	87,000

Required:

- (i) Tax liability for Angela Lopez for the year ended 31 December 2019 in accordance with her tax obligation. (2 marks)
- (ii) Advise Angela Lopez on tax due dates and applicable rate for her rental business. (2 marks)
- (iii) Explain to Angela Lopez the penalty payable (if any) assuming she paid her total tax liability for the year 2019 on 10 January 2020. (2 marks)
- (b) Josphat Kakah is employed as a Finance Manager for Daima Ltd. The following information has been availed in relation to the income and benefits received by Josphat Kakah for the year ended 31 December 2019:
- Basic salary Sh.309,000 per month (PAYE Sh.85,000 per month).
 - The company provided him with a 2000cc saloon car, driver and fuel for official and private use. The car had been leased from Avenue Motors at Sh.45,000 per month.
 - He stays in a fully furnished company's house at Eastpark Estate. The company furnished the house at a cost of Sh.230,000. He is deducted Sh.20,000 per month from his salary as rent for the house. The fair rental value of such houses in the estate is Sh.45,000 per month.
 - The following deductions were made from his salary during the year:

	Sh.
• Contributions to registered pension scheme:	
Compulsory contribution	12,960
Voluntary contribution	150,000
• Loan repayment	840,000
• Life assurance premiums	600,000
• Subscription to Golf club	80,000
• Contribution to home ownership saving plan (HOSP)	128,000
 - His annual grocery bills amounting to Sh.68,000 were settled by the company.
 - He worked out of office for eight days in December 2019 and the company paid him daily subsistence allowance of Sh.4,500 for each of the eight days.
 - During the year, he received Sh.480,000 as a reimbursement for medical expenses incurred. The company operates a medical scheme for its senior managers only.
 - He was entitled to the following monthly allowances with effect from 1 July 2019:

	Sh.
Entertainment allowance	17,500
Risk allowance	10,000
Attendance allowance	16,000
 - He received a year end bonus in December 2019 of Sh.180,000 payable to executive staff and the best employee of the year.

Required:

- (i) Taxable income for Josphat Kakah for the year ended 31 December 2019. (12 marks)
- (ii) Tax payable (if any) on the income computed in (b) (i) above. (2 marks)
- (Total: 20 marks)**

QUESTION FOUR

- (a) Explain the term "pre-shipment inspection" as used under customs duty. (2 marks)
- (b) Outline four categories of goods and services that are not chargeable to excise duty as per section 7 of the Excise Duty Act, 2015. (4 marks)
- (c) Karim, Hasan and Mohamed are partners operating as Kahamo Enterprises. They share profits and losses in the ratio of 2:2:1 respectively.

The following is the income statement for the partnership for the year ended 31 December 2019:

Income	Sh.	Sh.
Gross profit		6,000,000
Discount received		240,000
Profit on sale of machinery		350,000
Trading receipts		160,000
Interest on drawings		<u>420,000</u>
		7,170,000

	Sh.	Sh.
Expenditure		
Purchases	4,000,000	
Legal fees	480,000	
Interest on capital:		
Karim	240,000	
Hasan	180,000	
Mohamed	200,000	
Value added tax (VAT)	212,000	
Provision for legal claims	340,000	
Office expenses	400,000	
Salaries and wages	2,400,000	
Advertisement expenses	382,000	
Instalment tax	500,000	
Subscription to trade associations	180,000	
Conveyance fees	56,000	
Drawings by partners:		
Karim	82,000	
Hasan	120,000	
Debt collection expenses	72,000	
General expenses	<u>1,600,000</u>	<u>(11,444,000)</u>
Reported loss		<u>(4,274,000)</u>

Additional information:

1. Legal fees included Sh.140,000 paid as a penalty for dealing in illegal goods and Sh.340,000 for drafting the partnership deed.
2. Advertisement expenses included Sh.250,000 for erecting a billboard.
3. Salaries and wages included partners' salaries as follows:

	Sh.
Karim	300,000
Hasan	400,000
Mohamed	280,000

4. General expenses include:

	Sh.
Cash embezzled by cashier	260,000
Office partitioning	420,000
Partners' medical expenses	800,000
School fees for partners children	120,000

5. Interest on drawings related to Sh.180,000 and Sh.240,000 charged to Hasan and Mohamed on their drawings.

Required:

- (i) Adjusted partnership profit or loss for the year ended 31 December 2019. (10 marks)

- (ii) Distribution schedule of the profit or loss calculated in (c) (i) above. (4 marks)

(Total: 20 marks)

QUESTION FIVE

- (a) Victor Mahugu obtained a personal identification number (PIN) during the year 2019. He did not commence his intended business operation. He has approached you for an advice on whether he is expected to file any return or not for the financial year 2019.

Required:

- Advise Victor Mahugu on whether he is required to file any return. (2 marks)

- (b) Identify four circumstances under which a late objection could be accepted by commissioner of domestic taxes. (4 marks)

(c) Mwangazi PLC is a manufacturing company. The company commenced operations after having incurred the following expenditure on 1 October 2018:

	Sh.
Factory building	4,840,000
Processing machinery	3,200,000
Staff canteen	1,280,000
Godown	720,000
Borehole	960,000
Trailer	280,000
Tractor	784,000
Computers	150,000
Fax machine	42,000
Generator	168,000
Water pump	70,000
Wheelbarrows	24,000
Motor bike	145,000
Saloon cars (each Sh.2,500,000)	5,000,000
Pick up	820,000
Furniture and fittings	360,000
Weighing scale	90,000

Additional information:

1. Factory building includes space for a store Sh.40,000, warehouse Sh.560,000, offices Sh.320,000 and retail shop Sh.250,000.
2. The Godown was fitted with air conditioning machines amounting to Sh.270,000.
3. During the year 2019, the company constructed a factory extension at Sh.1,800,000 which was put into use as packaging section. A packaging machine was installed at a cost of Sh.480,000.
4. One of the saloon car was involved in an accident in July 2019 and the company received insurance compensation of Sh.1,000,000.
5. Purchased forklift on 1 July 2019 for Sh.700,000.
6. All assets in class II were disposed of for Sh.490,000 on 1 September 2019.

Required:

Capital allowances due to Mwangazi PLC for the years ended 31 December 2018 and 31 December 2019.

(14 marks)

(Total: 20 marks)

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