

KASNEB

CPA PART III SECTION 6

ADVANCED PUBLIC FINANCE AND TAXATION

THURSDAY: 26 May 2016.

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 2015.

Monthly taxable pay (Sh.)	Annual taxable pay (Sh.)	Rate of tax % in each Sh.
0 - 10,164	0 - 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	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
	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 FIVE

(a) Country Z has recently been admitted into a regional economic block. As part of the country's full integration into the economic block, it is required to undertake certain legislative and other reforms.

Required:

Advise Country Z on four fundamental reforms that could be considered in the process of integration into the economic block. (8 marks)

(b) Mjengo Ltd. is a real estate development company. In the year ended 31 December 2015, the company provided the following information:

- Bought 100 acres at Sh.6,000,000 each for building low cost houses in an approved development area.
- Cost of surveying was Sh.4,600,000 and conveyance fees amounted to Sh.6,960,000.
- The cost of constructing each unit was Sh.1,450,000. The company constructed 240 units on a 20 acre piece of land.
- All the units were sold at a price of Sh.1,600,000 in the year 2015.
- Building materials for constructing each unit amounted to Sh.742,400 inclusive of VAT at the rate of 16%.
- Professional fees paid to quantity surveyors inclusive of VAT was Sh.417,600 and for civil engineers was Sh.243,600.
- Drainage system and sewerage line cost Sh.960,000 for connecting all units built and to be built on 100 acres.
- The interest on loan to acquire the 100 acres was Sh.7,800,000.
- Hire expenses for bulldozers used in the construction was Sh.600,000 for each of the three months used for the construction.
- Charges paid to the government in respect of approval of plans were Sh.678,000.
- Cost of constructing a site office was Sh.800,000.
- Hire cost for a saloon car for the site manager was Sh.40,000 per month.
- A commercial building was also constructed at a cost of Sh.5,600,000 in a part of the land. The building was rented at a monthly rent of Sh.480,000 with effect from 1 May 2015.
- The costs relating to the total 100 acres are to be apportioned according to the acreage used.

Required:

- (i) Statement of adjusted taxable profit or loss for Mjengo Ltd. for the year ended 31 December 2015. (10 marks)
- (ii) Tax payable by Mjengo Ltd. (if any) for the year ended 31 December 2015. (2 marks)

(Total: 20 marks)

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Additional information:

1. Turnover and purchases were inclusive of VAT at the rate of 16%.
2. The turnover excludes cash sales. During the year ended 31 December 2015, the business paid the following expenses out of cash sales:

	Sh.
Telephone and postage	48,000
School fees	142,800
Repairs and maintenance	94,600
Insurance	36,600

3. The bank balance is included in the cash and cash equivalents. The following details were included in the bank statement:

	Sh.
Personal expenses	294,000
General expenses	792,800
Rent and rates	68,400
Hire purchase interest	29,600
Payments to creditors	2,460,000
Receipts from debtors	5,890,000

4. The following assets used by the business were not included in the assets register:

	Sh.
Computers	368,000
Fax machine	120,000
Saloon car	2,800,000
Delivery van	720,000
Computer software	150,000

The Revenue Authority has established that the statement of financial position forms a good basis for recomputing the taxable profit. All expenses are to be adjusted on the basis of the statement of financial position.

Required:

- (a) Using suitable computations, confirm the accuracy or otherwise of the taxable profit of Weka Enterprises for the year ended 31 December 2015. (15 marks)
 - (b) Summarise five types of preliminary information that you might require from the business in order to further ascertain the accuracy of the taxable profit. (5 marks)
- (Total: 20 marks)**

QUESTION THREE

- (a) Tax information exchange agreements (TIEAs) are increasingly forming part of the agenda during bilateral and multilateral trade discussions among various countries.
 - (i) Explain the nature of tax information exchange agreements. (2 marks)
 - (ii) Citing three reasons, discuss the purpose of TIEAs. (6 marks)
- (b) Zawadi Ltd. has been in operation since 1 January 2014. The company is under a tax investigation relating to value added tax (VAT) transactions.

The following details were obtained from the company's records for the month of September 2015:

- Stock in trade brought down in the month of September 2015 was valued at Sh.719,200.
- Sales ledger records in the company's books showed an amount of Sh.1,786,400 while as per VAT returns, it was Sh.1,429,120.
- The company had not claimed input tax on a building put into use on 1 January 2014 at a cost of Sh.2,784,000. However, in September 2015, the company set-off the input tax against the output tax for the month.
- Purchases amounting to Sh.174,000 did not have supporting fiscal receipts. The total purchases amounted to Sh.928,000.
- Since 1 January 2014, the company had not been filing VAT returns on time and all the penalties are outstanding.

- The company had imported goods on cost, insurance and freight (CIF) terms of Sh.450,000. The clearing and transport costs amounted to Sh.80,000 and Sh.60,000 respectively. The goods were later sold at a mark up of 20%. Import duty on these goods was at a rate of 20%.
- Tax officers established that imports were understated by Sh.150,000 as per import documents.
- Input tax on fuels and oils for motor vehicles used in the business amounted to Sh.51,200.
- Returns outward journal was understated by Sh.139,200 while the purchases ledger was overstated by Sh.174,000.
- Debit notes received by the company were overstated by Sh.232,000.
- Credit notes issued to customers were overstated by Sh.162,400.
- Input tax on catering services amounting to Sh.12,800 had been debited in the VAT account.
- Further examination revealed that VAT records needed recomputation to establish the correct VAT position.

Transactions are inclusive of VAT at a rate of 16% where applicable.

Required:

Analyse the above records and compute the correct VAT position for Zawadi Ltd. for the month of September 2015.

(12 marks)

(Total: 20 marks)

QUESTION FOUR

(a) Evaluate four features that distinguish tax havens from other taxation regimes. (8 marks)

(b) Salama Insurance Company Ltd. provided the following financial records for the year ended 31 December 2015:

	Sh.
Gross premium	14,890,000
Reserves for unexpired risk (1 January 2015)	486,000
Re-insurance premiums paid	384,000
Claims paid	9,364,000
Claims due: 1 January 2015	670,000
31 December 2015	800,000
Life assurance fund	1,240,800
Commission on reinsurance ceded	760,200
Commission on reinsurance accepted	1,940,000
Foreign exchange loss	342,500
Rent income	678,300
Purchase of computers	300,000
Cost of computer software	150,000
Claims recovered on reinsurance	562,800
Agency expenses	1,380,700
Investment income	1,824,300
Management salaries	948,200
Repair of rented property	28,800
Neon signs	48,000
Depreciation	150,400
Legal expenses relating to claims	64,800
Rent and rates	760,400

Additional information:

1. The company operates both general insurance business and life insurance business in the same building where rent and rates are shared in the ratio of 2:3 respectively.
2. Agency expenses include general manager's salary of Sh.280,000 working in the life insurance business.
3. Investment income includes dividends of Sh.114,000 net of tax from a subsidiary company and Sh.78,400 from proceeds of sale of a car involved in an accident.
4. Gross premium includes sale of insurance policies to life insurance company amounting to Sh.748,400.
5. The company constructed a commercial building with shops, offices and showroom at a cost of Sh.6,400,000 on 1 January 2015. Rent income from the property amounted to Sh.5,536,400 before deducting capital allowances and expenses amounting to Sh.84,600.

Required:

(i) A statement of taxable profit or loss for the year ended 31 December 2015. (10 marks)

(ii) Tax payable (if any). (2 marks)

(Total: 20 marks)

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