

KASNEB

CPA PART III SECTION 6

ADVANCED PUBLIC FINANCE AND TAXATION

PILOT PAPER

September 2015.

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 2014.**

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 buildings	50%	
From 1 January 2010-		
Commercial building:		
(Shop, office or show room)	25%	
Farm works allowance	100%	
Investment deduction allowance	100%	
Shipping investment deduction	40%	
Mining allowance:		
Year 1	- 40%	
Years 2 - 7	- 10%	

	Monthly rates (Sh.)	Annual rates (Sh.)
(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

Commissioner's prescribed benefit rates

	Monthly rates Sh.	Annual rates 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) Describe the stages involved in the National Government budget process as provided in the Public Finance Management Act 2012 or equivalent legislation in your country. (10 marks)
- (b) (i) Explain the relevance of transparency and accountability in the context of public debt management in your country. (4 marks)
- (ii) Discuss the importance of sound public debt management. (6 marks)
- (Total: 20 marks)**

QUESTION TWO

- (a) Outline the information that is required to be provided by a contracting authority within the framework of the public private partnership (PPP) when preparing a project proposal. (8 marks)
- (b) Explain six functions of the Public Private Partnership Unit (PPPU) as established under the Public Private Partnership Act 2013 or equivalent legislation in your country. (12 marks)
- (Total: 20 marks)**

QUESTION THREE

- (a) Explain how tax planning could be undertaken in the context of:
- (i) Income from investments. (2 marks)
- (ii) Capital structure decisions in corporate entities. (2 marks)
- (b) The promoters of Junefair Company Ltd. are considering the best source of financing for their new company.

The promoters are aware of the two main financing avenues for any company; equity financing and debt financing. They already have raised equity capital amounting to Sh.500 million as their base capital which falls short of their capital requirement of Sh.1 billion. They have approached a consultant to give them advise on how to source the additional Sh.500 million that they require. The consultant has assembled his analysis into two mutually exclusive financing sources based on the promoter's request as follows:

Option - A (Equity only)

	Sh."000"
Base capital - Equity	500,000
Additional capital - All equity	<u>500,000</u>
Total	<u>1,000,000</u>

Option - B (Debt only)

	Sh."000"
Base capital - Equity	500,000
Additional capital - Long term debt	<u>500,000</u>
	<u>1,000,000</u>

It is assumed that both the additional equity and additional debt will require an annual payment of Sh.40 million and Sh.50 million for dividend and interest respectively every year.

Assume that the profit before interest and taxes that the company would post each year is Sh.110 million. The corporate tax rate is 30%.

Required:

Suggest, from a tax planning perspective, the best source of additional financing that the consultant should recommend (4 marks)

- (c) Violet Auma has been offered a job with Apple Electronics (K) Ltd., a foreign company dealing with distribution of smart phones and computers in the East African region. She is due to report on 1 January 2016.

Her terms of employment provide for the following emoluments:

1. She would get a basic salary of Sh.450,000 per month effective from 1 January 2016.

2. The company would make the following additional payments to her per month:
 - Home to office car allowance of Sh.28,500. However, she would be given the option of using a company car. The car that would be allocated to her would be of 2500cc which the company would purchase at a cost of Sh.3,500,000.
 - House allowance of Sh.80,000 per month. However, the company gives her the option of moving to a company house from the commencement of her employment. The house would be rented by the company at Sh.80,000 per month.
3. She would, like all other employees, enjoy the company's pension scheme into which the company would pay Sh.25,000 monthly for her benefit. She would also have to contribute a similar amount into the scheme.
4. An end of the year bonus amounting to Sh.35,500 would be paid to her each year. She however would be given the option of taking a gift of a phone from the company worth the same amount.
5. She would be eligible to be included into the company's attractive medical scheme which only covers management staff. The amount of the benefit is capped at Sh.1,500,000 per year. She however has the option of a free-for-all claim-based medical scheme operated by the employer. The scheme is capped at Sh.1,000,000 per year.

Required:

Recommend the best option for Violet Auma based on the above information.

(12 marks)

(Total: 20 marks)

QUESTION FOUR

- (a) Multi-national corporations (MNCs) that have cross-border inter-company dealings (like purchases and sales) can deliberately move profits from one tax jurisdiction to another by manipulating the transfer price. Such companies, if left unchecked would make inter-company transactions at prices that may lead to low profits or losses in countries with high tax rates.

Required:

Explain the documentation and disclosure requirements imposed by your country to address the above challenges.

(5 marks)

- (b) One major shortcoming of globalisation is that it provides the incentive for tax competition among countries.

In the context of the above statement, explain the meaning of the following:

- (i) Tax competition. (3 marks)
- (ii) Tax haven. (3 marks)
- (c) Outline five harmful effects of tax havens. (5 marks)
- (d) Explain four circumstances under which goods are deemed to have been dumped in your country. (4 marks)

(Total: 20 marks)

QUESTION FIVE

- (a) The main focus of bilateral tax treaties is the elimination of double taxation and fiscal evasion.

Explain the meaning of the following as used in the context of tax treaties:

- (i) Double taxation. (2 marks)
 - (ii) Fiscal evasion. (2 marks)
 - (iii) Treaty shopping. (2 marks)
- (b) Rahab Tola, who is a Kenyan, was employed in the United Kingdom (UK) for the first 6 months in the year 2014 for which she was paid a total of £12,000. She later moved to Kenya where she was employed at a salary of Sh.2,400,000 for the 6 months to the end of the year 2014.

The UK authorities had charged Rahab Tola a tax on her pay amounting to £2,200.

Assume that the applicable foreign exchange rate was Sh.140/£. Kenya has a double taxation agreement with United Kingdom.

Required:

Calculate the amount of double taxation relief due to Rahab Tola for the year 2014. (4 marks)

- (c) China Construction Company (K) Ltd. has been engaged in the building and construction industry for many years. There has been an on-going dispute with the revenue authority as to the amount of value added tax (VAT) that the company is liable to pay.

You have been provided with the following details relating to the company's transactions:

	Purchases	Delivery date	Invoice date	Invoice amount (Sh.)	Payment date
1.	Concrete mixer	10 May 2015	12 June 2015	5,800,00	5 July 2015
2.	Scaffolding pipes	20 May 2015	6 June 2015	1,392,000	10 July 2015
3.	Poker vibrator	6 May 2015	29 May 2015	696,000	2 August 2015
4.	Xerox photocopier	30 April 2015	10 May 2015	928,000	22 May 2015
5.	10 trolleys	12 June 2015	13 May 2015	2,552,000	25 May 2015
6.	Executive boardroom table	21 May 2015	8 June 2015	464,000	30 June 2015
7.	200 tons of cement	27 April 2015	3 May 2015	3,712,000	2 August 2015
8.	Water dispenser for the office	14 May 2015	4 June 2015	92,800	23 June 2015
9.	Paint from Duracoat (K) Ltd.	10 May 2015	15 May 2015	812,000	28 May 2015
10.	Office chairs	1 May 2015	8 May 2015	348,000	26 May 2015

The above amounts are inclusive of VAT at the standard rate of 16% where applicable.

Additional information:

- The company had negotiated a contract for Sh.45,000,000 for which it received a progress payment of Sh.18,000,000 on 25 June 2015. These amounts are exclusive of VAT. The invoice had been raised earlier on 3 May 2015 based on the Architect's certificate for the value of work certified.
- The company had also won a labour-only contract for Sh.12,500,000 (exclusive of VAT) for which an installment payment of Sh.4,000,000 was received on 9 May 2015 ahead of the completion on 17 June 2015. The invoice was raised for full payment on completion. By end of August 2015, the balance of the payment had not been received from the client.

Required:

- Advise on the correct VAT position for the company for the period between May 2015 and August 2015. (6 marks)
- Comment on any information that you have not used in (c) (i) above. (4 marks)

(Total: 20 marks)

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