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CPA PART III SECTION 6

ADVANCED PUBLIC FINANCE AND TAXATION

WEDNESDAY: 27 November 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 (Sh.)	Annual rates (Sh.)
Capital allowance:		
Wear and tear allowance:		
Class I 37.5%	(i) Saloons, Hatch Backs and Estates	
Class II 30%	Up to 1200 cc	3,600
Class III 25%	1201 1500 cc	4,200
Class IV 12.5%	1501 1750 cc	5,800
Software 20%	1751 2000 cc	7,200
	2001 3000 cc	8,600
	Over 3000 cc	14,400
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%	(ii) Pick-ups, Panel Vans (unconverted)	
Investment deduction allowance 100%	Up to 1750 cc	3,600
	Over 1750 cc	4,200
Shipping investment deduction (Ships over 125 tonnes) 100%	(iii) Land Rovers/Cruisers	7,200
		86,400

Extraction expenditure:

Written off over 5 years (20%)

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) Examine four reasons for the increased importance of information exchange programmes in relation to taxation among various countries. (4 marks)

- (b) The following information relates to Majani Ltd:

1. The company has been operating in your country for over 20 years.
2. The company's accounts for the year ended 31 December 2018 could not be signed by the directors until 1 August 2019 when the Chief Executive Officer (CEO) returned from a medical trip abroad.
3. Following the delay in signing the accounts, the revenue authority imposed a late returns penalty of Sh.484,840 on the company.

Required:

As a tax consultant, draft a letter of objection to the revenue authority indicating the grounds of appeal in compliance with tax legislation. (6 marks)

- (c) Sharon and Primus are partners running a hardware business. They have approached you to assist them prepare the partnership returns for the year ended 31 December 2018. The following information has been presented to you:

1. The partnership agreement provides that:
 - Profits and losses will be shared in the ratio of 2:1 for Sharon and Primus respectively.
 - Partners will be allowed to withdraw up to Sh.100,000 in cash without being charged interest. Any excess withdrawals will be subject to interest at a rate of 8% per annum.
 - Each partner will be entitled to a monthly salary of Sh.60,000 per month. However, no salary would be paid to any partner in the months of January, May and September due to expected low sales based on analysis of past trends. Partners would be entitled to a commission.
2. The balances in the books of account as at 31 December 2018 and 31 December 2017 included the following:

	31 December 2018	31 December 2017
	Sh.	Sh.
Accrued commission due to partners	400,000	360,000
Accounts payable (trade)	2,000,000	1,600,000
Accrued advertising expense	610,000	340,000
Prepaid royalty income	160,000	100,000
Accounts receivable (trade)	5,900,000	1,700,000
Accrued salaries and wages (partners excluded)	410,000	130,000
Accumulated depreciation	600,000	340,000

3. Extracts of cash payments during the year were as follows:

	Sh.
Commission paid to partners equally	100,000
Purchases (goods for sale)	1,000,000
Advertising expenses	150,000
Salaries and wages (partners excluded)	1,390,000
Motor vehicle expenses	240,000
Electricity expenses	80,000
Office partitions	60,000
Purchase of office equipment	97,000
Meals to employees	200,000
Loan interest	35,000
Cash withdrawn by partners - Sharon	160,000
- Primus	100,000

4. All receipts were channeled through the account and included the following:

	Sh.
Sales (all were on credit terms)	1,600,000
Royalty income	240,000
Proceeds from sale of office equipment	45,000
Computer leasing charges	6,000

5. The partners withdrew hardware goods for personal use as indicated below:

	Sh.
Sharon	110,000
Primus	60,000

6. In December 2018, some of the hardware goods which were valued at Sh.60,000 were destroyed by fire. Compensation of Sh.35,000 was received from the insurance company.

Required:

- (i) Taxable profit or loss of the partnership for the year ended 31 December 2018. (8 marks)
- (ii) A schedule showing the partners allocation of taxable income or loss. (2 marks)

Hint: Ignore opening and closing inventory.

(Total: 20 marks)

QUESTION TWO

- (a) A number of countries have external resources departments as part of stimulating economic growth. Explain four roles of such departments. (4 marks)
- (b) Discuss three reasons for the failure of a number of projects under public private partnerships (PPPs). (6 marks)
- (c) Xyeng China Company (K) Ltd. has been engaged in the building 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.

According to the revenue authority's assessment, the company is supposed to pay Sh.5.6 million, whereas the company's assessment of the VAT payable is Sh.3.9 million.

You have been provided with the following additional details relating to the company's transactions during the assessment period:

Purchases	Delivery date	Invoice date	Invoice amount(Sh.)	Payment date
Drilling machines	5 February 2019	10 March 2019	5,220,000	4 April 2019
Mobile crane	20 February 2019	8 March 2019	3,045,000	10 April 2019
Concrete mixer	18 February 2019	26 February 2019	3,770,000	2 May 2019
Poker vibrator	26 February 2019	12 March 2019	906,250	7 April 2019
Photocopying machine	12 March 2019	4 April 2019	174,000	5 May 2019
2 Forklifts	6 April 2019	20 April 2019	1,584,125	6 May 2019
700 Tonnes of cement	26 March 2019	4 April 2019	28,125,565	12 May 2019
Bottled mineral water	12 March 2019	8 April 2019	137,460	30 April 2019
Executive boardroom table	19 March 2019	4 April 2019	145,000	12 May 2019
Postal rental box	2 February 2019	24 February 2019	13,920	15 March 2019
Paint from ABC Ltd.	14 April 2019	20 April 2019	3,117,500	12 May 2019
Petrol for trucks engaged in construction work	12 March 2019	19 March 2019	1,200,960	8 April 2019

Additional information:

- The company had negotiated a contract of Sh.84 million exclusive of VAT on 1 February 2019, for which it received a progress payment of Sh.52 million on 27 March 2019. The invoice had been raised earlier on 15 March 2019 based on the Architect's certificate for the value of work certified.
- The company had also on 18 February 2019 secured a tile fixing contract of Sh.18 million exclusive of VAT for which an installment payment of Sh.7.2 million was received on 12 March 2019 ahead of the completion date on 24 May 2019. The invoice was raised for full payment on completion. By the end of May 2019, the balance of the payment had not been received from the client.

The above transactions are inclusive of VAT where applicable unless otherwise stated.

Required:

Advise Xyeng China Construction Company (K) Ltd. on:

- (i) The correct VAT position for the company for the period between February 2019 and May 2019. (8 marks)
- (ii) What action to take based on your analysis in (c) (i) above. (2 marks)

(Total: 20 marks)

QUESTION THREE

- (a) Country X has recently proposed to change the regulations on taxation of Savings and Credit Co-operation Societies (Saccos). This change will entail taxing most of the income and exempting only the interest earned from members. The proposed changes will also double the withholding tax rate on dividends paid by Saccos.

Required:

With reference to the above scenario, explain four effects of the proposed legislative changes on Saccos. (4 marks)

- (b) Discuss three incentives provided by your country to spur the growth of the housing and construction sector. (6 marks)

- (c) Maisha Mema Insurance Company Limited provided the following information for the year ended 31 December 2018:

	Sh."000"
Gross premiums received	30,000
Claims paid	4,000
Commission ceded	800
Commission accepted	20
Claims recovered on reinsurance	3,000
Foreign exchange gains realised	3,500
Dividends from life assurance fund	2,000
Rental income (commercial building)	1,600
Bad debts provision	500
Investment income	1,200
Reserve for unexpired risks (1 January 2018)	1,000
Legal expenses related to claims	400
Agency fees	400
Management fees	120
Repairs on rental properties	200
Entertainment expenses	400
Purchase of furniture	600
Purchase of computer	300
Reinsurance premiums paid	4,000
Returned premiums	5,000

Additional information:

1. Reserves for unexpired risks on 31 December 2018 were Sh.200,000.
2. Claims outstanding on 1 January 2018 and 31 December 2018 were Sh.600,000 and Sh.900,000 respectively.
3. Premiums outstanding on 1 January 2018 and 31 December 2018 were Sh.6,000,000 and Sh.12,000,000 respectively.
4. Agency fees included Sh.200,000 relating to the life assurance business.
5. Legal fees included Sh.100,000 relating to settlement of a tax dispute.
6. Investment income comprised:

	Sh.
Interest from bank	850,000 (net)
Interest from treasury bonds	350,000 (gross)

Required:

- (i) Taxable profit or loss of Maisha Mema Insurance Company Limited for the year ended 31 December 2018. (8 marks)

- (ii) Tax payable (if any) from your computations in (c) (i) above. (2 marks)

(Total: 20 marks)

QUESTION FOUR

- (a) One-stop border posts (OSBPs) are a fairly recent cross-border trade initiative which have significantly changed the way neighbouring countries conduct business with each other.

Required:

- (i) Explain the meaning of OSBPs. (2 marks)

- (ii) Summarise four benefits of OSBPs. (4 marks)

- (b) Describe four functions of tax agents. (4 marks)

- (c) Benita Contractors Ltd. operates in the construction industry. On 1 November 2016, the company won a tender for the construction of two projects, a hospital and an office complex. Construction of the projects commenced on 1 January 2017. The following details relate to the two projects for the year ended 31 December 2018:

	Hospital project Sh."000"	Office complex Sh."000"
Balance as at 1 January 2018:		
Materials	6,000	4,000
Accrued salaries and wages	1,500	1,200
Plant (written down value)	190,000	150,000
Cost of work done	200,000	200,000
Value of works certified to date	200,000	160,000
Transactions undertaken during the year:		
Material delivered to site		
From store	10,000	14,000
From supplier	100,000	128,000
Plant purchased at cost	-	120,000
Sub contractors fee	-	18,000
Consultancy fees	30,000	29,000
Inspection fee	10,000	5,000
Salaries and wages	120,000	180,000
Head office expenses	-	2,000
Material transferred out	10,000	17,000
Material sales	-	22,000
Plant lease charges	400	500
Direct expenses	3,000	2,000
Cash received from sub contractor	300,000	600,000
Cumulative value of work certified as at 31 December 2018	700,000	860,000
Value of work uncertified in the year	30,000	42,000
Balance carried forward:		
Material on site	40,000	50,000
Accrued wages	1,000	2,000

Additional information:

1. Consultancy fees for the hospital project include Sh.40,000 prepaid for the year 2019.
2. Wear and tear allowance on plant was provided at the rate of 12.5% per annum.
3. Direct expenses accrued and not reflected above were as follows:

	Hospital Sh."000"	Office Sh."000"
As at 1 January 2018	200	-
As at 31 December 2018	1,000	400

Required:

A schedule showing the taxable profit and tax payable (if any) by Benita Contractors Ltd. as at 31 December 2018.

(10 marks)

(Total: 20 marks)

QUESTION FIVE

- (a) The Cabinet Secretary responsible for matters relating to public investments should prepare and submit a consolidated report to the National Assembly at the end of each financial year.

Evaluate the significance of any four information contained in the consolidated report.

(8 marks)

- (b) Explain four ways through which the Public Debt Management office may enhance the functions of the commission on revenue allocation in your country.

(4 marks)

- (c) Discuss four fiscal responsibility principles that the National Treasury and Planning must enforce when managing the national government public finance in your country.

(8 marks)

(Total: 20 marks)

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