



CPA PART III SECTION 6

ADVANCED PUBLIC FINANCE AND TAXATION

THURSDAY: 30 November 2017.

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 2016.

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.)
<b>Capital allowance:</b>		
<b>Wear and tear allowance:</b>		
Class I	37.5%	
Class II	30%	
Class III	25%	
Class IV	12.5%	
Software	20%	
<b>Industrial building allowance:</b>		
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%	
<b>Farm works allowance</b>	100%	
<b>Investment deduction allowance</b>	100%	
<b>Shipping investment deduction (Ships over 125 tonnes)</b>	100%	
<b>Extraction expenditure:</b>		
Written off over 5 years (20%)		
<b>Commissioner's prescribed benefit rates</b>		
	<b>Monthly rates Sh.</b>	<b>Annual rates Sh.</b>
<b>Services</b>		
(i) Electricity (Communal or from a generator)	1,500	18,000
(ii) Water (Communal or from a borehole)	500	6,000
<b>Agriculture employees: Reduced rates of benefits</b>		
(i) Water	200	2,400
(ii) Electricity	900	10,800

### QUESTION ONE

- (a) The following extract is from a leading global newspaper on matters of taxation and finance:

#### Avoiding tax may be legal, but can it ever be ethical?

“Rather than hiding behind the business case for tax avoidance, companies need to be transparent about their tax planning. Avoiding tax and bending the rules of the tax system is not illegal unlike tax evasion; it is operating within the letter, but perhaps not the spirit of the law. Businesses may therefore be complying with the law, but are they acting ethically?”.

**Required:**

Citing four areas, discuss the moral and ethical issues against tax avoidance with specific reference to operations of multinational corporations (MNCs). (8 marks)

- (b) The following statement was made by the Commissioner General of your country’s revenue authority during an international conference to discuss the challenges of taxation in the era of electronic commerce (e-commerce) and mobile commerce (m-commerce).

“The rapid growth of electronic commerce and mobile commerce fuelled by the developments in digital technology has shaped a revolution in global retail trade that is opening up markets across borders and continents. The growth in e-commerce and m-commerce has imposed a number of challenges to the government in relation to the tax system”.

**Required:**

With reference to the above statement, analyse three challenges of taxing businesses and transactions arising from the adoption of e-commerce and m-commerce. (6 marks)

- (c) The Common Market for Eastern and Southern Africa (COMESA) has played a key role in enhancing trade and integration within its jurisdiction.

**Required:**

(i) Summarise four specific objectives of COMESA. (4 marks)

(ii) Some experts have argued that COMESA has been overtaken by globalisation and should be dissolved.

**Required:**

Citing two reasons, support the above view. (2 marks)

**(Total: 20 marks)**

### QUESTION TWO

- (a) Masai Traders commenced trading on 1 January 2014. The following are the financial statements and supporting records for the years ended 31 December 2016 and 2015:

**Statement of comprehensive income for the year ended 31 December 2016:**

	Sh. “000”	Sh. “000”
Sales		82,600
Less cost of goods sold		(36,200)
Gross profit		46,400
<b>Less expenses:</b>		
Legal expenses	7,700	
Impairment loss on business premises	4,800	
Depreciation on plant and equipment	1,600	
Interest expense	478	
Salaries and wages	1,394	(15,972)
Net profit		<u>30,428</u>

**Statement of financial position as at 31 December:**

	2016 Sh. “000”	2015 Sh. “000”
<b>Non-current assets:</b>		
Business premises	3,200	3,500
Plant and equipment	26,400	28,000
Saloon car	<u>800</u>	<u>860</u>
	30,400	32,360

	2016 Sh. "000"	2015 Sh. "000"
<b>Current assets:</b>		
Inventories	11,600	11,200
Debtors	12,800	15,200
Cash and cash equivalents	<u>14,200</u>	<u>8,600</u>
	<u>69,000</u>	<u>67,360</u>
<b>Financed by:</b>		
Capital	30,000	30,000
Add: net profit	<u>30,428</u>	<u>24,240</u>
	60,428	54,240
<b>Current liabilities:</b>		
Creditors	4,572	3,120
Bank overdraft	<u>4,000</u>	<u>10,000</u>
	<u>69,000</u>	<u>67,360</u>

**Additional information:**

1. During the year 2016, payments through the bank comprised the following:

	Sh. "000"
Conveyance fees for business land title deed	128
Payments to creditors	2,488
Salary to wife	260
Mortgage interest; personal residence	184
Defending business against illegal trade	160
Revenue stamps	16
2. The credit purchases figure was overstated by 60%.
3. Receipts from debtors amounted to Sh.9,600,000. A debtor owing goods valued at Sh.85,840 inclusive of 16% VAT was declared bankrupt during the year and the debt written off. The write off was included in the interest expense.
4. The figure for sales was understated by 20%.
5. Business premises included:
  - A factory building at a cost of Sh.960,000.
  - Warehouse Sh.540,000.
  - Staff canteen Sh.600,000.

All these were put into use on 1 January 2014.
6. There were no acquisitions or disposals of fixed assets during the year 2016.
7. Plant and equipment acquired in the year 2015 includes:
  - Weighing scale Sh.14,000.
  - Furniture Sh.240,000.
  - Computers Sh.324,000.
  - Forklift Sh.400,000.
  - Lorry (2 tonnes) Sh.960,000.

The rest of the assets were categorised under Class IV for purposes of wear and tear allowance.

**Required:**

- (i) A statement of adjusted taxable profit or loss for the year ended 31 December 2016. (13 marks)
- (ii) State three areas or items that you might require further clarification on from Masai Traders for accurate computation of any tax due. (3 marks)

- (b) Various governments have established agencies to broadly enhance efficiency and effectiveness of state corporations. In some countries, this agency is called the State Corporations Advisory Committee (SCAC).

**Required:**

- Summarise four specific responsibilities of SCAC or its equivalent body in your country. (4 marks)
- (Total: 20 marks)**

**QUESTION THREE**

(a) Describe three ways through which the government might redeem public debt. (6 marks)

(b) Andrew Mole is an employee of Sombea Ltd. He has presented the following information:

1. His salary per month is Sh.80,000 which includes house allowance of Sh.20,000 per month.
2. His wife is employed at a salary of Sh.20,000 per month with Faza Ltd. where Andrew Mole holds 15% of share capital.
3. The house in which the family lives in is owned by his wife. The house was constructed in the year ended 31 December 2016 through an 18% mortgage loan of Sh.5,000,000 repayable over a period of 10 years.
4. Their children attend a nearby primary school. Mole has been saving Sh.12,000 per month for his children's secondary school education and Sh.20,000 per month with his Sacco to be withdrawn upon retirement.
5. His wife has insured the house and pays insurance premiums of Sh.5,000 per month and county government rates of Sh.24,000 per annum.

**Required:**

Evaluate three possible schemes of tax planning that Andrew Mole and family could use to minimise their tax liability for the year of income 2016. (6 marks)

(c) Sambamba Public Limited Company is in the merchandising business. The Revenue Authority suspects that the company has not been paying the correct amount of tax from business activities over a period of four months.

The following details were obtained from the company's accounting records for the specified period below:

1. During the month of January 2016, the company purchased goods for Sh.754,000 and sold goods for Sh.788,800. The suppliers also issued credit notes of Sh.29,000 and received debit notes of Sh.69,600. The company had filed a nil VAT return for the month of January 2016.
2. In the month of February 2016, the company did not file VAT returns despite making sales of Sh.522,000. The company had charged a profit margin of 20%.
3. To avoid inspection, the company removed their VAT certificate of registration from the business premises and failed to issue tax invoices for goods valued at Sh.417,600 during the month of March 2016 with respect to goods sold.
4. In the month of April 2016, the company secured a huge supply contract with the government after successfully obtaining a tax compliance certificate through fraudulent accounting records.

Transactions are inclusive of value added tax (VAT) at the rate of 16% where applicable.

**Required:**

- (i) The amount of tax payable, if any, by the company plus any interest and penalties arising from the above transactions for the four months to April 2016. (6 marks)
- (ii) Comment on the information you might require from the company to determine the accuracy of the VAT payable, if any. (2 marks)

**(Total: 20 marks)**

**QUESTION FOUR**

(a) Discuss three measures that the central government could put in place to enhance financial accountability and transparency at the county level. (6 marks)

(b) Peter Chawawa started a retail business on 1 January 2011. He has not been filing income tax returns for the six years to 31 December 2016.

An investigation of his affairs revealed the following:

1. The balance sheet of the retail business as at 31 December 2011 was as shown below:

	Sh. "000"	Sh. "000"
<b>Fixed assets:</b>		
Premises		2,000
Furniture and fittings		1,000
Motor vehicles		<u>500</u>
		3,500

	Sh. "000"	Sh. "000"
<b>Current assets:</b>		
Stock	250	
Debtors	160	
Bank balance	81	
Cash in hand	<u>9</u>	<u>500</u>
<b>Total assets</b>		<b><u>4,000</u></b>
Capital: 1 January 2011	3,000	
Net profit for the year	300	
Drawings	<u>(500)</u>	2,800
Mortgage loan		1,000
Creditors		<u>200</u>
		<b><u>4,000</u></b>

2. He constructed an extension to the premises in year 2015 at a cost of Sh.625,000.  
 3. The following account balances were outstanding in the respective years as shown below:

	2012	2013	2014	2015	2016
	Sh.	Sh.	Sh.	Sh.	Sh.
Trade debtors	173,000	190,000	208,000	230,500	253,000
Bank balance	109,000	194,000	281,000	409,500	(32,000)
Trade creditors	230,000	241,000	253,000	272,000	291,500
Cash in hand	10,000	10,000	10,000	10,000	10,000
Stock	255,000	302,500	332,500	366,000	402,500

4. He withdrew goods worth Sh.5,000 per annum from the business for his personal use.  
 5. The principal repayments on each mortgage loan amounted to Sh.250,000 per annum from 31 December 2012. The mortgage interest paid in each of the four years ended 31 December 2012, 2013, 2014 and 2015 amounted to Sh.100,000, Sh.75,000, Sh.50,000 and Sh.25,000 respectively.  
 6. His wife opened a savings account in a commercial bank in year 2012. The balances in this account after crediting the interest earned were as follows:

	2012	2013	2014	2015	2016
	Sh.	Sh.	Sh.	Sh.	Sh.
Savings account	300,000	900,000	100,000	725,000	750,000
Interest earned	25,000	75,000	90,000	70,000	60,000

7. His living expenses and wear and tear allowances were agreed with the revenue authorities as follows:

	2012	2013	2014	2015	2016
	Sh.	Sh.	Sh.	Sh.	Sh.
Living expenses	300,000	400,000	450,000	500,000	600,000
Wear and tear	155,500	130,500	109,000	73,000	157,000

**Required:**

Compute the annual taxable income of Peter Chawawa from year 2012 to year 2016.

(14 marks)

(Total: 20 marks)

**QUESTION FIVE**

- (a) Mawela Property Developers Ltd. purchased a residential house on 1 January 2015 through a 12% per annum mortgage loan of Sh.4,000,000. The company incurred the following expenses in obtaining the loan:

- Audit fees Sh.48,400.
- Valuation of the house Sh.120,000.
- Legal fees for conveyance Sh.80,000.

**Additional information:**

1. The company replaced all doors in the residential house with metallic doors at a cost of Sh.96,000.
2. On 31 December 2016, the company sold the house at a price of Sh.8,000,000 after incurring the following expenses:
  - Repairs of the house Sh.78,000.
  - Advertisement Sh.24,200.
  - Agent's commission Sh.12,000.
  - Valuation fee Sh.148,000.
  - Legal fees Sh.42,800.

**Required:**

Compute the capital gain or loss arising from the sale of the above house.

(6 marks)

(b) Dawa Ltd. provided the following income statement for the year ended 31 December 2016:

	Sh. "000"	Sh. "000"
Turnover		27,400
Less cost of goods sold		<u>(11,000)</u>
Gross profit		16,400
<b>Add other income:</b>		
Capital gain on sale of assets		468
Insurance recovery on motor vehicle		450
Dividends from subsidiary company		942
Foreign exchange gain		124
Interest on fixed deposit		<u>300</u>
		18,684
<b>Less expenditure:</b>		
General expenses	4,840	
Impairment loss	390	
Bad debts	485	
Advertising	248	
Donations to disaster fund	150	
Property tax	136	
Branch closure costs	178	
Legal expenses	1,240	
Staff costs	<u>3,496</u>	<u>(11,163)</u>
Net profit		<u>7,521</u>

**Additional information:**

1. The cost of goods sold includes opening stock valued at Sh.2,200,000, while closing stock was stated at Sh.2,800,000. The opening stock was overcast by 10% and closing stock was undercast by 30%.

2. Legal expenses comprised:

	Sh. "000"
Acquisition of bank loan	90
Settling customers disputes	42
Preparation of memorandum of association	260
Liquidation costs	468
Patent rights	340
Notices to defaulting debtors	<u>40</u>
	<u>1,240</u>

3. General expenses comprised:

	Sh. "000"
Purchase of processing machinery	800
Purchase of factory building	1,280
Provision for corporation tax	394
Purchase of furniture	360
Directors allowances	480
VAT appeal	120
Credit notes received	135
Delivery van	720
Debenture interest	<u>551</u>
	<u>4,840</u>

4. Bad debts analysis:

**Bad debts account**

	Sh. "000"		Sh. "000"
Bad debts	178	Balance brought down: Specific provision	240
Balance carried down: Specific provision	560	General provision	180
General provision	<u>167</u>	Profit and loss account	<u>485</u>
	<u>905</u>		<u>905</u>

5. Staff costs include: staff development cost Sh.96,000, staff welfare expenses Sh.200,000, pension contribution Sh.1,480,000 and personal computers Sh.360,000.

6. Advertising include: neon sign Sh.129,000, depreciation of delivery van Sh.24,000, carriage outwards Sh.9,000 and hire of billboards Sh.86,000.

**Required:**

- (i) A statement of adjusted taxable profit or loss for the year ended 31 December 2016. (12 marks)
- (ii) Corporation tax payable, if any, by Dawa Ltd. (2 marks)

**(Total: 20 marks)**