

# KASNEB

CPA PART I SECTION 2

CS PART I SECTION 2

CIFA PART I SECTION 2

CCP PART I SECTION 2

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<br>(Sh.) | Annual taxable pay<br>(Sh.) | Rate of tax<br>% 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<br>(Sh.) | Annual rates<br>(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 buildings           | 50%                    |                       |
| 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</b>  | 40%                    |                       |
| <b>Mining allowance:</b>              |                        |                       |
| Year 1                                | - 40%                  |                       |
| Years 2 - 7                           | - 10%                  |                       |

|   | Monthly rates<br>(Sh.) | Annual rates<br>(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<br>Sh. | Annual rates<br>Sh. |
|---|----------------------|---------------------|
| <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              |

|                              |         |                  |
|------------------------------|---------|------------------|
| Rent and rates               | 240,000 |                  |
| Salaries to partners: Carter | 180,000 |                  |
| Mortgage interest            | 240,000 |                  |
| Repairs on computers         | 60,000  |                  |
| Furniture purchased (cost)   | 84,000  |                  |
| Bank charges                 | 80,000  | (7,845,260)      |
| Reported loss                |         | <u>(452,660)</u> |

**Additional information:**

1. General expenses comprise:

|                                 |                  |
|---------------------------------|------------------|
|                                 | <b>Sh.</b>       |
| Embezzlement by accountant      | 1,200,000        |
| Staff Christmas party           | 800,000          |
| Amount paid to retrenched staff | 760,000          |
| Replacement of car engine       | 140,000          |
| Partition of an office          | <u>600,000</u>   |
|                                 | <u>3,500,000</u> |

2. Salaries and wages include Sh.700,000 and Sh.800,000 paid to Asafa and Bon respectively during the year.  
3. Interest on capital was provided at 45% of the capital contributions.  
4. Legal expenses include:

|   |            |
|---|------------|
|   | <b>Sh.</b> |
| Parking fines paid to county government | 15,200     |
| Legal fees for breach of contract       | 200,000    |
| Drafting of tender documents            | 18,000     |
| Drafting of lease agreements (99 years) | 9,000      |
| Defending a partner in a tax case       | 12,000     |
| Legal cost of debt collection           | 233,300    |

5. Mortgage interest relates to a partner's residential house.  
6. Assume that the income accrued evenly throughout the year.  
7. Ignore capital allowances.

**Required:**

- (i) The adjusted partnership profit or loss for the year ended 31 December 2014. (9 marks)  
(ii) Allocation of the profits or losses in (c) (i) above to the partners. (4 marks)  
**(Total: 20 marks)**

**QUESTION FOUR**

- (a) Outline any five specified sources of income as detailed in Section 3 (2) of the Income Tax Act. (5 marks)  
(b) Compare and contrast the provisions of the Income Tax Act as relates to "Wear and Tear" and "Farm Works Deduction".

Your analysis should be guided by the following key aspects:

- (i) Acquisition of items previously used by another person for the same qualifying business.  
(ii) New items acquired during the year of income. (4 marks)  
(c) Hal Meat Processing Company (HMPC) was established on 1 January 2014 to process meat products for the local market. The company incurred the following costs in constructing relevant structures which were utilised from 1 January 2014:

|                           |            |
|---------------------------|------------|
|                           | <b>Sh.</b> |
| Factory building          | 72,000,000 |
| Labour quarters           | 24,000,000 |
| Show room                 | 950,000    |
| Staff recreation facility | 4,500,000  |
| Retail shop               | 700,000    |
| Perimeter wall            | 1,550,000  |
| Administrative offices    | 1,600,000  |
| Driveway                  | 800,000    |

|                 |           |
|-----------------|-----------|
| Sports pavilion | 2,600,000 |
| Drainage system | 900,000   |
| Loading bay     | 1,200,000 |
| Weigh bridge    | 600,000   |

**Additional information:**

1. A borehole was drilled at a cost of Sh.1,300,000 and utilised with effect from 1 November 2014.
2. On 1 December 2014, the company constructed a factory extension at a cost of Sh.2,650,000 and put to use immediately.
3. The following items were purchased on 1 December 2014:

|                           |            |
|---------------------------|------------|
|                           | <b>Sh.</b> |
| Pick-up                   | 2,400,000  |
| Conveyor belt             | 600,000    |
| Scanners                  | 250,000    |
| Mobile phones             | 260,000    |
| Digital weighing machines | 90,000     |
| Computers                 | 300,000    |

4. The following assets were disposed of during the year:

|               | <b>Disposal Date</b> | <b>Initial Cost (Sh.)</b> | <b>Disposal proceed (Sh.)</b> |
|---------------|----------------------|---------------------------|-------------------------------|
| Computers     | 30 December 2014     | 100,000                   | 60,000                        |
| Mobile phones | 20 December 2014     | 60,000                    | 20,000                        |

**Required:**

Capital allowances due to Hal Meat Processing Company (HMPC) for the year ended 31 December 2014. (11 marks)  
(Total: 20 marks)

**QUESTION FIVE**

- (a) Explain any two cases in which a business can close the year with a negative balance in any class of wear and tear elaborating on how such a balance would be treated. (2 marks)
- (b) Regressive taxes present an unmatched opportunity for any developing country to increase its revenue collection from taxes.

Explain the validity or otherwise of this assertion. (5 marks)

- (c) The following is the trading, profit and loss account of Cobalt Ltd. for the year of income 2014. The company is engaged in furniture making both for the local market and the foreign market:

|                              | <b>Sh."000"</b> |                              | <b>Sh."000"</b> |
|------------------------------|-----------------|------------------------------|-----------------|
| Stock (1 January 2014)       | 450,000         | Sales                        | 3,490,000       |
| Purchases                    | 1,400,500       | Stock (31 December 2014)     | 423,000         |
| Bank charges                 | 30,200          | Interest from Post Bank      | 4,800           |
| Wages to casual workers      | 588,000         | Insurance recovery - van     | 88,000          |
| Insurances                   | 78,000          | Profit on sale of shares     | 54,000          |
| Salaries to permanent staff  | 144,000         | Dividend (net)               | 32,000          |
| NSSF contributions - workers | 13,000          | Income from sale of saw dust | 250,000         |
| NHIF contributions - workers | 14,000          |                              |                 |
| Legal expenses               | 20,400          |                              |                 |
| Bad debts                    | 50,600          |                              |                 |
| Commissions                  | 30,200          |                              |                 |
| Repairs and maintenance      | 120,200         |                              |                 |
| General expenses             | 53,800          |                              |                 |
| Listing expenses - NSE       | 147,600         |                              |                 |
| Delivery van scrapped        | 22,400          |                              |                 |
| Depreciation                 | 193,400         |                              |                 |
| Donations                    | 8,800           |                              |                 |
| Rent and rates               | 83,000          |                              |                 |
| Electricity and water        | 28,100          |                              |                 |

|                               |                  |                  |
|-------------------------------|------------------|------------------|
| Travelling expenses           | 560,300          |                  |
| Pension paid to retired staff | 48,700           |                  |
| Entertainment                 | 17,100           |                  |
| Purchase of office calculator | 3,600            |                  |
| Telephone expenses            | 11,900           |                  |
| Net profit                    | <u>224,000</u>   |                  |
|                               | <u>4,341,800</u> | <u>4,341,800</u> |

**Additional information:**

- Sales of saw dust require a payment of 20% commission on the income to the hawkers who pick up the items from the company premises and deliver them to the market. Such commission has not yet been included in the company books.
- Legal expenses analysis:

|                                |                  |
|--------------------------------|------------------|
|                                | <b>Sh. '000'</b> |
| Preparing a lease for 50 years | 1,200            |
| Collection of business debts   | 2,200            |
| Purchase of directors house    | <u>17,000</u>    |
|                                | <u>20,400</u>    |
- Entertainment expenses relate to customers and staff.
- The company was listed at the Nato Securities Exchange (NSE) at the beginning of the year, a process that led to 42% of the company's shares being offered to the public.
- The capital allowances were agreed at Sh.2,000,000 for the year.

**Required:**

- Adjusted taxable income for the year ended 31 December 2014. (10 marks)
  - Compute the tax payable (if any) on the income in (c) (i) above. (3 marks)
- (Total: 20 marks)**
- .....