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.

<table>
<thead>
<tr>
<th>Monthly taxable pay (Sh.)</th>
<th>Annual taxable pay (Sh.)</th>
<th>Rate of tax % in each Sh.</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>121,968</td>
<td>10%</td>
</tr>
<tr>
<td>10,165</td>
<td>236,880</td>
<td>15%</td>
</tr>
<tr>
<td>19,741</td>
<td>235,792</td>
<td>20%</td>
</tr>
<tr>
<td>29,317</td>
<td>466,704</td>
<td>25%</td>
</tr>
<tr>
<td>Excess over</td>
<td>Excess over</td>
<td>30%</td>
</tr>
</tbody>
</table>

Personal relief Sh.1,162 per month (Sh.13,944 per annum)

Prescribed benefit rates of motor vehicles provided by employer

<table>
<thead>
<tr>
<th>Monthly rates (Sh.)</th>
<th>Annual rates (Sh.)</th>
</tr>
</thead>
<tbody>
<tr>
<td>(i) Saloons, Hatchbacks and Estates</td>
<td></td>
</tr>
<tr>
<td>Up to 1200 cc</td>
<td>3,600</td>
</tr>
<tr>
<td>1201</td>
<td>4,200</td>
</tr>
<tr>
<td>1501</td>
<td>5,800</td>
</tr>
<tr>
<td>1751</td>
<td>7,200</td>
</tr>
<tr>
<td>2001</td>
<td>8,600</td>
</tr>
<tr>
<td>Over 3000 cc</td>
<td>14,400</td>
</tr>
<tr>
<td>172,800</td>
<td></td>
</tr>
<tr>
<td>(ii) Pick-ups, Panel Vans (unconverted)</td>
<td></td>
</tr>
<tr>
<td>Up to 1750 cc</td>
<td>4,200</td>
</tr>
<tr>
<td>Over 1750 cc</td>
<td>50,400</td>
</tr>
<tr>
<td>(iii) Land Rovers/Cruisers</td>
<td></td>
</tr>
<tr>
<td>7,200</td>
<td>86,400</td>
</tr>
</tbody>
</table>

Industrial building allowance:
- Up to 2009 2.5%
- From 1 January 2010 10%
- Hostels/Education/Film producers buildings 100%
- Commercial building: Shop, office or show room 25%

Farm works allowance 100%

Shipping investment deduction (Ships over 125 tonnes) 100%

Extraction expenditure: Written off over 5 years (20%)

Commissioner’s prescribed benefit rates

<table>
<thead>
<tr>
<th>Services</th>
<th>Monthly rates (Sh.)</th>
<th>Annual rates (Sh.)</th>
</tr>
</thead>
<tbody>
<tr>
<td>(i) Electric (Communal or from a generator)</td>
<td>1,500</td>
<td>18,000</td>
</tr>
<tr>
<td>(ii) Water (Communal or from a borehole)</td>
<td>500</td>
<td>6,000</td>
</tr>
<tr>
<td>Agriculture employees: Reduced rates of benefits</td>
<td></td>
<td></td>
</tr>
<tr>
<td>(i) Water</td>
<td>200</td>
<td>2,400</td>
</tr>
<tr>
<td>(ii) Electricity</td>
<td>900</td>
<td>10,800</td>
</tr>
</tbody>
</table>
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:

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

Statement of financial position as at 31 December 2016:

<table>
<thead>
<tr>
<th></th>
<th>2016 Sh. “000”</th>
<th>2015 Sh. “000”</th>
</tr>
</thead>
<tbody>
<tr>
<td>Non-current assets:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Business premises</td>
<td>3,200</td>
<td>3,500</td>
</tr>
<tr>
<td>Plant and equipment</td>
<td>26,400</td>
<td>28,000</td>
</tr>
<tr>
<td>Saloon car</td>
<td>800</td>
<td>860</td>
</tr>
<tr>
<td></td>
<td>30,400</td>
<td>32,360</td>
</tr>
</tbody>
</table>
2016                      2015
Sh. "000"  Sh. "000"

Current assets:
Inventories          11,600     11,200
Debtors             12,800     15,200
Cash and cash equivalents    14,200     8,600
                        69,600     67,360

Financed by:
Capital                30,000     30,000
Add: net profit        30,428     24,240
                        60,428     54,240

Current liabilities:
Creditors             4,572      3,120
Bank overdraft        10,000     10,000
                        69,600     67,360

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.83,840 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.950,000.
   - 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 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:

<table>
<thead>
<tr>
<th>Fixed assets:</th>
<th>Sh. &quot;000&quot;</th>
</tr>
</thead>
<tbody>
<tr>
<td>Premises</td>
<td>2,000</td>
</tr>
<tr>
<td>Furniture and fittings</td>
<td>1,000</td>
</tr>
<tr>
<td>Motor vehicles</td>
<td>500</td>
</tr>
<tr>
<td></td>
<td>3,500</td>
</tr>
</tbody>
</table>
Current assets:

<table>
<thead>
<tr>
<th></th>
<th>Sh. “000”</th>
<th>Sh. “000”</th>
</tr>
</thead>
<tbody>
<tr>
<td>Stock</td>
<td>250</td>
<td></td>
</tr>
<tr>
<td>Debtors</td>
<td>160</td>
<td></td>
</tr>
<tr>
<td>Bank balance</td>
<td>81</td>
<td></td>
</tr>
<tr>
<td>Cash in hand</td>
<td>9</td>
<td>500</td>
</tr>
<tr>
<td><strong>Total assets</strong></td>
<td><strong>4,000</strong></td>
<td></td>
</tr>
</tbody>
</table>

Capital: 1 January 2011 3,000
Net profit for the year 300
Drawings (500) 2,800
Mortgage loan 1,000
Creditors 200

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:

<table>
<thead>
<tr>
<th>Year</th>
<th>2012</th>
<th>2013</th>
<th>2014</th>
<th>2015</th>
<th>2016</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sh.</td>
<td>300,000</td>
<td>250,000</td>
<td>200,000</td>
<td>150,000</td>
<td>100,000</td>
</tr>
<tr>
<td>Interest earned</td>
<td>25,000</td>
<td>20,000</td>
<td>15,000</td>
<td>10,000</td>
<td>5,000</td>
</tr>
</tbody>
</table>

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:

<table>
<thead>
<tr>
<th>Sh. “000”</th>
<th>Sh. “000”</th>
</tr>
</thead>
<tbody>
<tr>
<td>Turnover</td>
<td>27,400</td>
</tr>
<tr>
<td>Less cost of goods sold</td>
<td>(11,600)</td>
</tr>
<tr>
<td>Gross profit</td>
<td>15,800</td>
</tr>
</tbody>
</table>

**Add other income:**
- 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: 300

**Total other income:** 18,684

**Less expenditure:**
- 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: 3,496

**Net profit:** 7,521

**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 overcost by 10% and closing stock was undercost by 30%.
2. Legal expenses comprised:
   - Acquisition of bank loan: 90
   - Setting customers disputes: 42
   - Preparation of memorandum of association: 260
   - Liquidation costs: 468
   - Patent rights: 340
   - Notices to defaulting debtors: 40

**Total legal expenses:** 1,240

3. General expenses comprised:
   - 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: 551

**Total general expenses:** 4,840

4. Bad debts analysis:

<table>
<thead>
<tr>
<th>Bad debts account</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sh. “000”</td>
</tr>
<tr>
<td>Bad debts</td>
</tr>
<tr>
<td>Balance carried down: Specific provision</td>
</tr>
<tr>
<td>General provision</td>
</tr>
<tr>
<td>205</td>
</tr>
</tbody>
</table>

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.125,000, 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)