



**CERTIFIED PUBLIC ACCOUNTANTS (CPA)**

**ADVANCED LEVEL**

**ADVANCED TAXATION**

**TUESDAY: 18 August 2026. Afternoon Paper.**

**Time Allowed: 3 hours.**

**This paper consists of five (5) questions. Answer ALL questions. Marks allocated to each question are shown at the end of each question. Show ALL your workings. Any assumptions made must be clearly and concisely stated. Do NOT write anything on this paper.**

**RATES OF TAX (For employment income including spouse's employment, self-employment and professional income). Year of income 2025. Assume the following rates of tax applied throughout the year of income 2025:**

| Monthly taxable pay     | Annual taxable pay          | Rate of tax |
|-------------------------|-----------------------------|-------------|
| Sh.1 - Sh.24,000        | Sh.1 - Sh.288,000           | 10%         |
| Sh.24,001 - Sh.32,333   | Sh.288,001 - Sh.388,000     | 25%         |
| Sh.32,334 - Sh.500,000  | Sh.388,001 - Sh.6,000,000   | 30%         |
| Sh.500,001 - Sh.800,000 | Sh.6,000,001 - Sh.9,600,000 | 32.5%       |
| Excess over Sh.800,000  | Excess over Sh.9,600,000    | 35%         |

**Personal relief Sh.2,400 per month (Sh.28,800 per annum).**

| Investment allowance:                                            |                              |                | Prescribed benefit rates of motor vehicles provided by employer |             |            |
|------------------------------------------------------------------|------------------------------|----------------|-----------------------------------------------------------------|-------------|------------|
| Capital expenditure incurred on                                  | Rate of investment allowance | Residual value | Motor vehicle                                                   | Monthly Sh. | Annual Sh. |
| Hotel/manufacturing/hospital/petroleum or gas storage building   | 50% in first year            | 25%            | Saloons/hatch backs/estates up to 1200 cc                       | 3,600       | 43,200     |
| Educational/hostels building                                     | 10% p.a. straight line       | -              | 1201 - 1500 cc                                                  | 4,200       | 50,400     |
| Commercial building                                              | 10% p.a. straight line       | -              | 1501 - 1750 cc                                                  | 5,800       | 69,600     |
| Manufacturing machinery/hospital equipment/ships or aircraft     | 50% in first year            | 25%            | 1751 - 2000 cc                                                  | 7,200       | 86,400     |
| Motor vehicles and heavy earth moving equipment                  | 25% p.a. straight line       | 25%            | 2001 - 3000 cc                                                  | 8,600       | 103,200    |
| Computer software, calculators, copiers and duplicating machines | 25% p.a. straight line       | -              | Over 3000 cc                                                    | 14,400      | 172,800    |
| Furniture/fittings and telecommunication equipment               | 10% p.a. straight line       | -              | Pick-ups/panel vans up to 1750 cc                               | 3,600       | 43,200     |
| Film equipment by local producer                                 | 25% p.a. straight line       | -              | Pick-ups/panel vans over 1750 cc                                | 4,200       | 50,400     |
| Prospecting and mining exploration machinery                     | 50% in first year            | 25%            | Land Rovers/Cruisers                                            | 7,200       | 86,400     |
| Other machinery                                                  | 10% p.a. straight line       | -              |                                                                 |             |            |
| Right to use fibre optic cable or spectrum licence               | 10% p.a. straight line       | -              |                                                                 |             |            |
| Farm works                                                       | 50% in first year            | 25%            |                                                                 |             |            |
| Special Economic Zone                                            | 100% in first year           | -              |                                                                 |             |            |

| Commissioner prescribed benefit rates | Monthly Sh. | Annual Sh. |
|---------------------------------------|-------------|------------|
| Electricity communal or generator     | 1,500       | 18,000     |
| Water communal or borehole            | 500         | 6,000      |
| Agriculture employees: water          | 200         | 2,400      |
| Agriculture employees: electricity    | 900         | 10,800     |

### QUESTION ONE

- (a) A tax agent acting for Lapset Imports Ltd. discovers correspondence showing that senior staff intentionally split customs import entries and misclassified imported components in order to reduce Customs Duty and Value Added Tax. The client instructs the tax agent not to disclose the matter to the Commissioner and threatens to appoint another agent if the matter is reported.

**Required:**

Evaluate **FOUR** professional and ethical actions that the tax agent should take in balancing client confidentiality with statutory disclosure obligations under the Tax Procedures Act. (4 marks)

- (b) Bervic Ltd. has objected to an additional assessment issued by the Commissioner but its supporting documents are incomplete.

**Required:**

Advise the company on **THREE** practical steps it should take to preserve its right to objection and appeal. (6 marks)

- (c) Harmony Precision Ltd. manufactures specialised agricultural equipment. The following information relates to the year ended 31 December 2025:

| Particulars                                                                                                                           | Sh.        |
|---------------------------------------------------------------------------------------------------------------------------------------|------------|
| Accounting profit before tax                                                                                                          | 94,000,000 |
| Depreciation charged in arriving at the profit                                                                                        | 12,500,000 |
| Penalty for late PAYE remittance netted in arriving at the profit                                                                     | 900,000    |
| Legal fees relating to issue of ordinary shares deducted in arriving at the profit                                                    | 1,400,000  |
| General provision for doubtful debts charged in the statement of profit or loss                                                       | 2,200,000  |
| Dividends from a resident company in which Harmony Precision Ltd. holds 20% shares treated as income in arriving at accounting profit | 3,000,000  |

**Additional information:**

- The general provision for doubtful debts was not supported by specific debtor schedules. Specific bad debts written off in the year were already charged in arriving at the accounting profit.
- The company incurred and brought into use the following capital expenditure during the year:
  - Manufacturing building Sh.60,000,000
  - Machinery used for manufacture Sh.40,000,000
  - Computer software Sh.3,000,000
  - Furniture and fittings Sh.4,000,000
- The tax residual values brought forward at 1 January 2025 were:
  - Machinery used for manufacture Sh.12,000,000
  - Computer equipment Sh.2,000,000
  - Furniture and fittings Sh.5,000,000
- Repairs and maintenance expenses already deducted in arriving at the accounting profit include Sh.2,400,000 incurred on replacing worn-out machine parts. The replacement restored the machines to their original operating condition and did not increase production capacity.
- Travelling and accommodation expenses include Sh.600,000 incurred on a director's private holiday. The amount was not treated as a taxable employment benefit.
- Interest income of Sh.1,020,000 from a bank fixed deposit was credited in the statement of profit or loss net of withholding tax at the rate of 15%. The withholding tax certificate is available.
- Administrative expenses include a donation of Sh.1,500,000 to an approved charitable institution supported by the relevant approval documents.

**Required:**

Compute the taxable income and corporation tax payable by Umoja Precision Ltd. for the year ended 31 December 2025. (10 marks)

**(Total: 20 marks)**

## QUESTION TWO

- (a) Distinguish between “trading in Kenya” and “trading with Kenya” for purposes of taxing cross-border business profits. (4 marks)
- (b) Explain **THREE** transfer pricing documentation and risk-management measures that Amani Consulting Ltd. should maintain in line with the Income Tax Act, the Transfer Pricing Rules and OECD principles. (6 marks)
- (b) Amani Consulting Ltd., a Kenyan resident company, provides engineering and digital project-management services in Kenya, Rwanda and Uganda. The following information relates to the year ended 31 December 2025:

| Particulars                                                                            | Sh.        |
|----------------------------------------------------------------------------------------|------------|
| • Profit from Kenyan operations before foreign income and transfer pricing adjustment  | 80,000,000 |
| • Profit attributable to a permanent establishment in Rwanda after deductible expenses | 16,000,000 |
| • Tax paid in Rwanda on the permanent establishment profit                             | 4,000,000  |
| • Gross technical service fees from an unrelated Ugandan customer                      | 12,000,000 |
| • Direct expenses incurred in earning the Ugandan technical service fees               | 2,000,000  |
| • Withholding tax deducted in Uganda under the applicable DTA                          | 1,200,000  |
| • Arm’s length adjustment for undercharging a related non-resident distributor         | 5,000,000  |

### Additional information:

1. Amani Consulting Ltd. has no separate foreign subsidiary. All foreign income is earned directly by the Kenyan company.
2. The Rwanda permanent establishment profit is stated after deducting expenses wholly and exclusively incurred in Rwanda. Head office expenses already allocated to Rwanda should not be deducted again in Kenya.
3. Foreign tax credit is available only to the extent of Kenyan corporation tax attributable to the relevant foreign-source income.
4. The related non-resident distributor performs only routine marketing functions and the Commissioner has issued an arm’s length adjustment based on comparable independent margins.
7. The foreign tax credit should be computed separately for each source of foreign income and should not create a refund or be set off against Kenyan tax on purely Kenyan-source income.
6. Unless otherwise stated, all amounts are before Kenyan corporation tax. Amani Consulting Ltd. has no brought forward tax losses, unutilised foreign tax credits or capital allowance claims for the year.
5. The Ugandan technical service fees were earned without a fixed place of business or dependent agent in Uganda; only withholding tax was deducted at source under the applicable tax rules.

### Required:

Compute the Kenyan taxable income, foreign tax credit and corporation tax payable by Amani Consulting Ltd. (10 marks)  
(Total: 20 marks)

## QUESTION THREE

- (a) Explain **FOUR** events that could trigger a civil or criminal tax investigation by the Commissioner. (4 marks)
- (b) Skates Company Ltd. intends to apply for Alternative Dispute Resolution (ADR) after receiving a VAT automated assessment.

### Required:

Evaluate **FOUR** matters that should be considered before commencing the ADR process. (4 marks)

- (c) Lakeview Appliances Ltd. is registered for VAT and deals in standard-rated, zero-rated and exempt supplies. The following transactions occurred during the month of May 2026:

| Transaction                                                         | Amount<br>Sh. |
|---------------------------------------------------------------------|---------------|
| Standard-rated sales, VAT inclusive                                 | 23,200,000    |
| Credit note issued for returned standard-rated goods, VAT inclusive | 580,000       |
| Zero-rated export sales supported by export entries                 | 8,000,000     |
| Exempt supplies                                                     | 6,000,000     |
| Goods withdrawn by staff at cost, VAT inclusive                     | 1,160,000     |

| Transaction                                                        | Amount<br>Sh. |
|--------------------------------------------------------------------|---------------|
| Sale of an old delivery truck, VAT inclusive                       | 2,320,000     |
| Purchases for taxable supplies, VAT inclusive                      | 11,600,000    |
| Purchases used exclusively for exempt supplies, VAT inclusive      | 3,480,000     |
| Mixed administrative services, VAT inclusive                       | 2,320,000     |
| Purchase of a saloon car for the finance director, VAT inclusive   | 4,640,000     |
| Purchase of a delivery truck, VAT exclusive                        | 5,000,000     |
| Client entertainment expenses, VAT inclusive                       | 580,000       |
| Imported digital support services from South Africa, VAT exclusive | 2,900,000     |
| VAT withheld by a designated withholding VAT agent                 | 320,000       |

**Additional information:**

- Input tax on mixed-use supplies and imported services is apportioned using the turnover method. Treat standard-rated supplies net of returns, zero-rated exports and the taxable disposal of the delivery truck as taxable supplies.
- In January 2023, the company accounted for output VAT of Sh.240,000 on a taxable supply. Only 60% of the invoice was recovered. The unrecovered balance was written off as a bad debt in May 2026.
- Unless otherwise stated, all transactions are inclusive of VAT at the rate of 16% where applicable.

**Required:**

Compute the VAT payable by or refundable to Lakeview Appliances Ltd. For the month of May 2026. (12 marks)  
(Total: 20 marks)

**QUESTION FOUR**

- (a) A property group proposes to hold income-generating commercial buildings through a Real Estate Investment Trust (REIT) rather than through an ordinary property company.

**Required:**

Explain **TWO** tax planning advantages associated with using a REIT structure for qualifying property investments in Kenya. (4 marks)

- (b) Assume that the property group is considering routing future property disposals through a non-resident holding company whose value is substantially derived from immovable property situated in Kenya.

**Required:**

Explain **FOUR** anti-avoidance measures that the Commissioner could apply where the arrangement is implemented mainly to avoid Kenyan tax. (4 marks)

- (c) Rafiki Real Assets Ltd. disposed of the following investments during the year ended 31 December 2025:

| Asset                                                   | Proceeds<br>Sh. | Cost<br>Sh. | Enhancement/<br>transaction costs<br>Sh. |
|---------------------------------------------------------|-----------------|-------------|------------------------------------------|
| Industrial land in Athi River                           | 80,000,000      | 35,000,000  | 15,000,000                               |
| Quoted shares listed at the Nairobi Securities Exchange | 18,000,000      | 11,000,000  | 600,000                                  |

**Additional information:**

- Transaction costs relating to Industrial land in Athi River comprise:  
Sh.
  - Improvement cost 10,000,000
  - Acquisition legal fees 3,000,000
  - Selling costs 2,000,000
- The quoted shares listed at the Nairobi Securities Exchange were traded through a licensed stockbroker.

**Required:**

Compute the capital gains tax payable in Kenya for the year ended 31 December 2025. (4 marks)

- (d) Bahari Lease Services Ltd. acquired photocopying and document-scanning equipment on 1 January 2025 and leased the equipment to professional firms under operating lease agreements. The following information relates to the year ended 31 December 2025:

| Particulars                                              | Amount<br>Sh. |
|----------------------------------------------------------|---------------|
| Cost of photocopying and document-scanning equipment     | 4,800,000     |
| Operating lease rentals received                         | 1,680,000     |
| Refundable security deposits received from lessees       | 360,000       |
| Security deposit forfeited for breach of lease contract  | 60,000        |
| Maintenance costs incurred by Bahari Lease Services Ltd. | 210,000       |
| Insurance paid on leased equipment                       | 120,000       |

**Required:**

- (i) Compute the taxable income from the leasing activity for the year ended 31 December 2025. (6 marks)
- (ii) Explain the tax treatment of refundable security deposits received from lessees. (2 marks)

**(Total: 20 marks)**

**QUESTION FIVE**

- (a) Explain **TWO** criteria that should be applied in evaluating a tax system for a developing economy. (2 marks)
- (b) Sally and Omondi have been in partnership trading as Elgon Traders since 1 January 2024, sharing profits and losses in the ratio of 3:2 respectively. On 1 April 2025, Achieng was admitted as a partner and the profit-sharing ratio changed to 2:2:1 for Sally, Omondi and Achieng respectively. On 30 September 2025, Omondi retired from the partnership and the remaining partners agreed to share profits and losses in the ratio of 3:2 for Sally and Achieng respectively.

The firm had incomplete accounting records. The following information was reconstructed for the year ended 31 December 2025:

1. **Summary of bank receipts and payments:**

| Receipts                                   | Sh.        | Payments                             | Sh.        |
|--------------------------------------------|------------|--------------------------------------|------------|
| Cash sales banked                          | 16,240,000 | Payments to suppliers                | 19,800,000 |
| Receipts from debtors                      | 21,600,000 | Salaries and wages                   | 4,200,000  |
| Bad debt recovered                         | 160,000    | Rent                                 | 1,440,000  |
| Proceeds from disposal of old delivery van | 900,000    | Electricity                          | 620,000    |
| Capital contributed by Achieng             | 4,000,000  | Insurance                            | 480,000    |
| Bank loan received                         | 2,000,000  | Motor vehicle running expenses       | 740,000    |
|                                            |            | Legal and professional fees          | 380,000    |
|                                            |            | Purchase of computers                | 1,200,000  |
|                                            |            | Purchase of furniture and fittings   | 800,000    |
|                                            |            | Income tax penalty                   | 120,000    |
|                                            |            | Subscriptions to a professional body | 90,000     |

2. **Assets and liabilities were as follows:**

| Item                                           | 1 January 2025<br>Sh. | 31 December 2025<br>Sh. |
|------------------------------------------------|-----------------------|-------------------------|
| Inventory                                      | 3,000,000             | 4,200,000               |
| Trade receivables                              | 2,800,000             | 3,600,000               |
| Trade payables                                 | 2,400,000             | 3,100,000               |
| Rent prepaid                                   | 90,000                | 120,000                 |
| Electricity accrued                            | 80,000                | 110,000                 |
| Insurance prepaid                              | 50,000                | 70,000                  |
| Furniture and fittings, tax written down value | 1,600,000             | -                       |
| Old delivery van, tax written down value       | 2,400,000             | -                       |

3. Salaries and wages include monthly salaries paid to partners as follows: Sally Sh.60,000 for twelve months; Omondi Sh.50,000 for nine months; and Achieng Sh.40,000 for nine months.
4. Legal and professional fees include Sh.160,000 incurred in drafting the partnership admission and retirement deed.
5. The old delivery van was disposed of on 30 June 2025 for Sh.900,000. The computers and furniture were acquired on 1 May 2025 and were used wholly in the business.

**Required:**

- (i) Compute the adjusted taxable income of the partnership for the year ended 31 December 2025. (8 marks)
  - (ii) Allocate the taxable income computed in (b)(i) above among the partners for the year ended 31 December 2025. (4 marks)
- (c) Baraka County SACCO Society Ltd. is a designated primary co-operative society registered and carrying on business as a credit and savings co-operative society. The following information relates to the year ended 31 December 2025:

| Particulars                                                                                           | Amount<br>Sh. |
|-------------------------------------------------------------------------------------------------------|---------------|
| Interest on loans advanced to members                                                                 | 21,600,000    |
| Gross interest income from fixed deposits with a commercial bank<br>(withholding tax deducted at 15%) | 1,200,000     |
| Loan appraisal and ledger fees charged to members                                                     | 1,800,000     |
| Gross rental income from SACCO Plaza                                                                  | 2,400,000     |
| Interest rebate paid in cash to members                                                               | 5,400,000     |
| Dividends declared and paid to members from the year surplus                                          | 3,200,000     |
| Staff costs and administrative expenses, depreciation and tax penalties                               | 8,250,000     |

**Additional information:**

1. Only fifty per cent of gross interest from non-members is taxable.
2. Loan appraisal and ledger fees, and rental income from property, are chargeable income.
3. Interest rebates, dividends paid to members, staff costs, depreciation and tax penalties should not be deducted in computing the deemed taxable income of this SACCO.

**Required:**

Compute the taxable income and tax payable by Baraka County SACCO Society Ltd. for the year ended 31 December 2025.

(6 marks)  
(Total: 20 marks)

.....

# CERTIFIED PUBLIC ACCOUNTANTS (CPA)

## ADVANCED LEVEL

### ADVANCED TAXATION

**TUESDAY: 21 April 2026. Afternoon Paper.**

**Time Allowed: 3 hours.**

**This paper consists of five (5) questions. 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. Do NOT write anything on this paper.**

**RATES OF TAX (For employment income including wife's employment, self-employment and professional income).**

**Year of income 2025. Assume the following rates of tax applied throughout the year of income 2025:**

| Monthly taxable pay<br>(Sh.) | Annual taxable pay<br>(Sh.) | Rate of tax<br>% in each Sh. |
|------------------------------|-----------------------------|------------------------------|
| 1 - 24,000                   | 1 - 288,000                 | 10%                          |
| 24,001 - 32,333              | 288,001 - 388,000           | 25%                          |
| 32,334 - 500,000             | 388,001 - 6,000,000         | 30%                          |
| 500,001 - 800,000            | 6,000,001 - 9,600,000       | 32.5%                        |
| Excess over 800,000          | Excess over 9,600,000       | 35%                          |

**Personal relief Sh.2,400 per month (Sh.28,800 per annum).**

| Investment allowance:                                                                                 | Rate of investment allowance        | Residual value<br>(25% per year on equal instalments) | Prescribed benefit rates of motor vehicles provided by employer<br>(i) Saloons, Hatch Backs and Estates |
|-------------------------------------------------------------------------------------------------------|-------------------------------------|-------------------------------------------------------|---------------------------------------------------------------------------------------------------------|
| Capital expenditure incurred on:                                                                      |                                     |                                                       | Monthly rates (Sh.)    Annual rates (Sh.)                                                               |
| (a) <b>Buildings:</b>                                                                                 |                                     |                                                       |                                                                                                         |
| • Hotel building                                                                                      | 50% in the first year of use        | 25%                                                   | Up to 1200 cc    3,600    43,200                                                                        |
| • Building used for manufacture                                                                       | 50% in the first year of use        | 25%                                                   | 1201 - 1500 cc    4,200    50,400                                                                       |
| • Hospital buildings                                                                                  | 50% in the first year of use        | 25%                                                   | 1501 - 1750 cc    5,800    69,600                                                                       |
| • Petroleum or gas storage facilities                                                                 | 50% in the first year of use        | 25%                                                   | 1751 - 2000 cc    7,200    86,400                                                                       |
| • Educational/hostels building                                                                        | 10% per year on straight line basis |                                                       | 2001 - 3000 cc    8,600    103,200                                                                      |
| • Commercial building                                                                                 | 10% per year on straight line basis |                                                       | Over 3000 cc    14,400    172,800                                                                       |
| (b) <b>Machinery:</b>                                                                                 |                                     |                                                       | (ii) Pick-ups, Panel Vans (unconverted)                                                                 |
| • Machinery used for manufacture                                                                      | 50% in the first year of use        | 25%                                                   | Up to - 1750 cc    3,600    43,200                                                                      |
| • Hospital equipment                                                                                  | 50% in the first year of use        | 25%                                                   | Over 1750 cc    4,200    50,400                                                                         |
| • Ships or aircraft                                                                                   | 50% in the first year of use        | 25%                                                   |                                                                                                         |
| • Motor vehicles and heavy earth moving equipment                                                     | 25% per year on straight line basis |                                                       | (iii) Land Rovers/Cruisers    7,200    86,400                                                           |
| • Computer software, calculators, copiers and duplicating machines                                    | 25% per year on straight line basis |                                                       |                                                                                                         |
| • Furniture and fittings                                                                              | 10% per year on straight line basis |                                                       |                                                                                                         |
| • Telecommunication equipment                                                                         | 10% per year on straight line basis |                                                       |                                                                                                         |
| • Film equipment by a local producer                                                                  | 25% per year on straight line basis | 25%                                                   |                                                                                                         |
| • Machinery used to undertake operations under prospecting rights and exploration under mining rights | 50% in the first year of use        |                                                       |                                                                                                         |
| • Other machinery                                                                                     | 10% per year on straight line basis |                                                       |                                                                                                         |
| (c) Purchase/acquisition of right to use fibre optic cable by telecommunication operation             | 10% per year on straight line basis |                                                       |                                                                                                         |
| (d) Farm works                                                                                        | 50% in the first year of use        | 25%                                                   |                                                                                                         |
| (e) Special Economic Zone (SEZ)                                                                       | 100% investment allowance           |                                                       |                                                                                                         |

**Commissioner's prescribed benefit rates:**

| Services                                                | Annual rates<br>Sh. | Monthly rates<br>Sh. |
|---------------------------------------------------------|---------------------|----------------------|
| (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) Professional tax practitioners often find themselves in conflict between their duty of confidentiality to the client and their legal obligations under the Tax Procedures Act, regarding the disclosure of information to the Commissioner.

**Required:**

Evaluate **THREE** ethical dilemmas a practitioner faces when discovering a client has deliberately undervalued imported goods to evade Customs Duty and Value Added Tax, citing how a practitioner should balance client privilege with the statutory power of the Commissioner to enter premises and seize evidence under Section 60 of the Act. (6 marks)

- (b) Balala and Halali have been in a partnership since 1 January 2023, sharing profits and losses in the ratio of 3:2. On 1 July 2025, they admitted Busita as a partner and the profit-sharing ratio became 2:2:1. On 1 October 2025, the firm was converted into a limited liability company, Zawadi Ltd. The partners had not been keeping proper books of account.

The following reconstructed information is available for the year ended 31 December 2025:

**Summary of bank transactions:**

| Receipts and payments account for the year ended 31 December 2025 |               |                                            |               |
|-------------------------------------------------------------------|---------------|--------------------------------------------|---------------|
| Receipts                                                          | Sh."000"      | Payments                                   | Sh."000"      |
| Balance brought forward (1 January 2025)                          | 5,200         | Trade creditors                            | 28,400        |
| Receipts from trade debtors                                       | 54,000        | Rent (including deposit)                   | 4,200         |
| Cash sales (banked)                                               | 12,800        | Purchase of Mercedes Benz                  | 9,600         |
| Sale of old delivery van                                          | 1,100         | Neon sign and digital security system      | 2,400         |
|                                                                   |               | Legal fees                                 | 800           |
|                                                                   |               | General office expenses                    | 8,500         |
|                                                                   |               | Staff salaries (Net of PAYE)               | 14,200        |
|                                                                   |               | Balance carried forward (31 December 2025) | 5,000         |
|                                                                   | <u>73,100</u> |                                            | <u>73,100</u> |

**Additional Information:**

- Technical analysis revealed that total sales and purchases were found to be undercast by 20% in the reconstructed records.
- Trade debtors as at 1 January 2025 and 31 December 2025 were Sh.4.5 million and Sh.7.2 million respectively, while trade creditors were Sh.3.1 million and Sh.4.8 million respectively.
- General office expenses included: Sh.400,000 donation to a registered political party; Sh.250,000 for e-TIMS accounting server and Sh.600,000 for a non-resident consultant's digital system support.
- Partner salaries before conversion: Sh.3.6 million (allocated equally). After conversion, directors' fees paid amounted to Sh.1.2 million.
- During the year, the partners withdrew goods for personal use originally included in bulk purchases. These were valued at cost price of Sh.600,000 for Balala and Sh.400,000 for Halali.
- Zawadi Ltd. issued 12% debentures of Sh.10 million to an external investor upon its conversion on 1 October 2025.
- Restructuring and Capital Gains Tax: On 1 October 2025, the partnership transferred freehold land (Cost Sh.15 million, market value Sh.25 million) to Zawadi Ltd. The partners maintained identical shareholding proportions in the new company.
- Social Health Insurance Fund (SHIF): Staff salaries include Sh.450,000 in contributions made by the firm to the SHIF on behalf of employees.
- e-TIMS Compliance: Purchases worth Sh. 2.8 million were from a small-scale supplier who did not issue e-TIMS invoices. The firm issued its own tax invoices as provided under Section 23A of the Tax Procedures Act.

**Required:**

- (i) A statement showing the adjusted taxable profit or loss for the Partnership and Zawadi Ltd. for the year ended 31 December 2025 in a columnar format. (12 marks)
- (ii) Total taxable income for each partner for the year ended 31 December 2025. (2 marks)

**(Total: 20 marks)**

## QUESTION TWO

- (a) Under Section 7A of the Income Tax Act, tax is chargeable on dividends distributed out of untaxed gains or profits.

**Required:**

Analyse the circumstances under which a company becomes liable to tax on distributed dividends, citing how the shortfall distribution tax mechanism is intended to discourage excessive retention of profits. (4 marks)

- (b) Platinum Holdings Ltd., is a Kenyan resident company with a 100% shareholding in Chilley Ltd., and a Branch in Tanzania. The group's consolidated annual turnover is Sh.120 billion. The results for the year ended 31 December 2025 was as follows:

|                                                                       | Platinum Ltd.<br>(Head Quarter-HQ)<br>Sh."000" | Chilley Ltd.<br>Sh."000" | Tanzania Branch<br>Sh."000" |
|-----------------------------------------------------------------------|------------------------------------------------|--------------------------|-----------------------------|
| Gross profit                                                          | 1,460,000                                      | 720,000                  | 480,000                     |
| Management fees (from Tanzania Branch.)                               | 80,000                                         | -                        | -                           |
| <b>Expenses:</b>                                                      |                                                |                          |                             |
| Staff costs                                                           | 280,000                                        | 165,000                  | 95,000                      |
| Interest (Non-resident bank)                                          | 110,000                                        | 96,000                   | 42,000                      |
| Depreciation                                                          | 74,000                                         | 58,000                   | 31,000                      |
| Legal fees                                                            | 22,400                                         | 11,500                   | 6,800                       |
| Earnings Before Interest, Tax, Depreciation and Amortisation (EBITDA) | -                                              | 320,000                  | -                           |

**Additional information:**

- Chilley Ltd.'s interest of Sh.96 million was to a non-resident bank. EBITDA was Sh.320 million.
- Legal fees for Platinum Ltd. included Sh. 8 million for trademark infringement and Sh.5 million for an environmental audit.
- Platinum Ltd. sold inventory to Chilley Ltd. at a 25% markup. Inventory worth Sh.140 million remained in Chilley's Ltd. stores at year-end.
- Tanzania branch Corporate Tax was paid in Tanzania at 30%. Assume Kenya has a Double Taxation Agreement (DTA) with Tanzania. And that the amount under Tanzania Branch is stated in Kenya shillings.
- Platinum Ltd's. staff costs include Sh.15 million for an unregistered pension scheme and Sh.12 million direct gratuity payments.
- Platinum Ltd. sold an office building for Sh.60 million (cost Sh. 40 million, net book value Sh.25 million).
- Platinum Ltd. management fees of Sh.80 million (gross) were subject to 15% withholding tax in Tanzania under the DTA.
- The group is required to file a Master File and Local File as provided under the Income Tax Act as its consolidated turnover exceeds the Sh.95 billion threshold.

**Required:**

- (i) Compute the taxable income and tax payable for Platinum Holdings Ltd. (Consolidating HQ and Branch) for the year ended 31 December 2025. (12 marks)
- (ii) Compute the taxable profit for Chilley Ltd., identifying any interest to be carried forward. (4 marks)
- (Total: 20 marks)**

## QUESTION THREE

- (a) In a Tax Master Class, one of the facilitators noted that "International tax relations are shaped by frameworks intended to balance domestic revenue needs with trade facilitation".  
With reference to the above statement:

- (i) Assess the effectiveness of Advance Pricing Agreements (APAs) in providing tax certainty for cross-border transactions involving related persons in Kenya. (4 marks)
- (ii) Evaluate **TWO** anti-avoidance measures a government might deploy to counter the erosion of the tax base caused by entities routing transactions through Tax Havens. (4 marks)

- (b) Valley Petroleum Ltd. is a petroleum contractor involved in exploration and development in Kenya. The following is the financial report for the year ended 31 December 2025:

**Income:**

- Sales of crude oil 1.8 million barrels at USD 78 per barrel (1 USD = Sh.132)
- Sale of natural gas Sh.540 million
- Gain on sale of exploration data Sh.115 million.

**Expenditures:**

- Exploration expenditure Sh.1.4 billion
- Development expenditure (Production commenced 1 April 2025) Sh.4.2 billion
- Decommissioning provision Sh.180 million
- Operating expenses Sh.620 million
- Royalties Sh.210 million
- Interest on non-resident parent loan Sh.125 million.

**Additional information:**

1. Actual transfer to the Decommissioning escrow account was Sh.110 million.
2. Operating expenses included a Sh.25 million penalty for violation of environmental regulations.
3. On 1 March 2025, the parent company disposed of 30% of its stake in the contractor. Kenyan assets derive 80% of their value from immovable property.
4. The contractor incurred Sh.45 million on the construction of a public school and a dispensary as part of social infrastructure.
5. Operating expenses include Sh.60 million paid to a non-resident subcontractor for specialised technical support. Withholding tax at the rate of 10% was deducted but not remitted.
6. The sale of natural gas is subject to a 60% cost recovery limit under the Ninth Schedule to the Income Tax Act.
7. The contractor entered a farm-out agreement where a third party undertook Sh.200 million of exploration work for a 15% interest.
8. The contractor seeks to set off a carried-forward exploration loss of Sh.320 million from a different contract area.

**Required:**

- (i) Prepare a statement showing the adjusted taxable profit or loss for Valley Petroleum Ltd. for the year ended 31 December 2025. (10 marks)
- (ii) Determine the corporate tax payable if any, citing the applicable rate for resident petroleum companies. (2 marks)

**(Total: 20 marks)**

**QUESTION FOUR**

- (a) Discuss **TWO** tax planning avenues available to an importer of industrial machinery to legally minimise the impact of Value Added Tax and Customs Duty, citing the use of a Certificate of Origin. (4 marks)
- (b) Evaluate the procedural requirements and statutory timelines for a registered person to lodge a claim for a refund of excess input tax arising from making zero-rated supplies. (4 marks)
- (c) Uzuli Manufacturers Ltd. is registered for Value Added Tax (VAT) and deals in standard-rated, zero-rated and exempt supplies. The following transactions occurred in the month of March 2026:

**Purchases:**

- Raw materials for taxable goods: Sh.29 million.
- Raw materials for exempt goods: Sh.11.6 million.
- New delivery truck: Sh.14.5 million.
- Saloon car for Managing Director (3,000cc): Sh.8.7 million.
- Fuel for distribution vans: Sh.2.32 million.
- Imported specialised software (Reverse charge): Sh.6.4 million.
- Stationery and electricity (Mixed-use): Sh.1.45 million.
- Specialised packaging materials for export tea: Sh.2.1 million.
- Passenger van (14-seater) for staff commuting: Sh.3.48 million.
- Professional training fees for e-TIMS integration: Sh.232,000.

**Sales:**

- Taxable supplies at standard rate: Sh.58 million.
- Export sales to EAC Partner States: Sh.18 million.
- Exempt supplies: Sh.14 million.
- Blended and packaged tea for local consumption: Sh.4.8 million.

**Additional information:**

1. Input tax on mixed-use items is apportioned as per the formula in Section 17(6) of the VAT Act.
2. A credit note of Sh.1.16 million was issued for standard-rated goods returned.
3. Input tax was disallowed on a raw material import valued at Sh.5 million due to a missing Certificate of Origin.
4. Insurance compensation of Sh.2.4 million was received for taxable raw materials stolen in transit.
5. Disposed of a warehouse forklift for Sh.3.5 million, originally a zero-rated supply for a specific project. This is now deemed an inconsistent use under Section 66A of the VAT Act.
6. Input tax claim of Sh.928,000 for maintenance was rejected due to a non-e-TIMS compliant manual invoice.
7. A customer declared legally insolvent on 15 March 2026 owes Sh.1.5 million for supplies made in January 2024.
8. During the month, the company supplied goods to a designated Withholding VAT Agent who withheld tax of Sh.450,000.
9. The tea blending and packaging project was approved by the Commissioner in writing as qualifying for zero-rating.
10. A reverse charge payment of Sh.1.8 million was made for advertising services provided through a digital marketplace.
11. Hotel and catering expenses of Sh.232,000 were incurred for the regional sales team outside their usual place of work.
12. Management intends to claim input tax of Sh.750,000 on a consignment imported in August 2025.
13. Processed goods worth Sh.1.8 million were supplied to the Kenya Defence Forces Welfare Services.
14. The passenger van (14-seater) above acquired for staff commuting was confirmed by the logbook to have a tare weight of 2,200 kilograms and a load-carrying capacity exceeding 2 tonnes.

Transactions are inclusive of VAT at the rate of 16% where applicable.

**Required:**

Compute the VAT paid by or refundable to Uzuli Manufacturers Ltd., for the month of March 2026. (12 marks)  
(Total: 20 marks)

**QUESTION FIVE**

- (a) As a senior tax consultant, you have been engaged by a Multinational Corporation to conduct a Tax Health Check, advising on why they need to conduct tax health check in addition to statutory financial audit.

With reference to the above statement, Contrast **TWO** objectives of a “Tax Health Check” with that of a “statutory financial audit” as per professional tax practice standards. (4 marks)

- (c) Under Section 89 of the Tax Procedures Act, the Cabinet Secretary may, on recommendation of the Commissioner, waive penalties and interest under specific circumstances related to electronic tax systems.

In relation to the above statement, explain **TWO** circumstances under which a taxpayer may qualify for a waiver of penalties or interest arising from the use of an electronic tax system. (4 marks)

- (c) Benard Kiprotich has been under an in-depth tax investigation covering his personal and business affairs. The Revenue Authority conducted a wealth reconciliation for the years ended 31 December 2024 and 31 December 2025:

| Item                        | 31 December 2023<br>Sh."000" | 31 December 2024<br>Sh."000" | 31 December 2025<br>Sh."000" |
|-----------------------------|------------------------------|------------------------------|------------------------------|
| Residential villa (at cost) | 45,000                       | 45,000                       | 85,000                       |
| Bank balance (Local)        | 7,200                        | (4,100)                      | 10,800                       |
| Offshore portfolio          | 12,000                       | 18,500                       | 25,000                       |
| Motor vehicles              | 18,000                       | 34,500                       | 34,500                       |
| Business inventory          | 11,600                       | 14,800                       | 9,400                        |
| Mortgage loan               | (22,000)                     | (19,500)                     | (40,000)                     |

**Additional information:**

1. Benard's living expenses amounted to Sh.400,000 per month in year 2024; Sh.600,000 per month in year 2025.
2. During year 2025, Benard Kiprotich paid Sh.4.2 million in school fees for his children at a premium international school and Sh.1.5 million in annual subscriptions to exclusive golf and social clubs.
3. In June 2025, he received a cash gift of Sh.15 million from his non-resident father.
4. Investigation revealed unexplained deposits totaling Sh. 8.4 million in a joint bank account in year 2024.
5. Benard Kiprotich owns a commercial mall that generated a net rental income of Sh.12.6 million in year 2025, which was excluded from his returns.
6. In year 2024, he sold a piece of land for Sh.20 million (cost Sh.12 million).
7. Reported business profits for tax purposes for the year 2024 and 2025 were Sh.8.4 million and Sh.10.2 million respectively.
8. Benard Kiprotich received dividends of Sh.3 million from a foreign company located in a preferential tax regime.
9. Benard Kiprotich paid Sh.1.8 million as mortgage interest for the residential villa; he also paid Sh.900,000 for a life insurance policy.
10. During the year 2024, he received Sh.5 million from the settlement of a civil case involving a motor vehicle accident.
11. Investigation found that Benard Kiprotich maintains a digital betting wallet, which showed withdrawals of Sh.2.1 million in year 2025; excise duty of 12.5% was deducted at source.

**Required:**

- (i) Determine for Benard Kiprotich the undeclared income for the years ended 31 December 2024 and 31 December 2025 using the wealth reconciliation method. (10 marks)
- (ii) Advise Benard Kiprotich on whether he could benefit on remission of penalties and interest if he applies under the tax amnesty on penalties, interest and fines as provided under the Tax Procedures (Amendment) Act, 2024, for any tax or interest that could arise from the tax investigation for the year 2024 and year 2025. (2 marks)

**(Total: 20 marks)**

.....

**CERTIFIED PUBLIC ACCOUNTANTS (CPA)**

**ADVANCED LEVEL**

**ADVANCED TAXATION**

**TUESDAY: 2 December 2025. Afternoon Paper.**

**Time Allowed: 3 hours.**

**This paper consists of five (5) questions. 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. Do NOT write anything on this paper.**

**RATES OF TAX (For employment income including wife's employment, self-employment and professional income).**

**Year of income 2024.**

**Assume the following rates of tax applied throughout the year of income 2024:**

| Monthly taxable pay<br>(Sh.) |           | Annual taxable pay<br>(Sh.) |             | Rate of tax<br>% in each Sh. |
|------------------------------|-----------|-----------------------------|-------------|------------------------------|
| 1                            | - 24,000  | 1                           | - 288,000   | 10%                          |
| 24,001                       | - 32,333  | 288,001                     | - 388,000   | 25%                          |
| 32,334                       | - 500,000 | 388,001                     | - 6,000,000 | 30%                          |
| 500,001                      | - 800,000 | 6,000,001                   | - 9,600,000 | 32.5%                        |
| Excess over                  | 800,000   | Excess over                 | 9,600,000   | 35%                          |

**Personal relief Sh.2,400 per month (Sh.28,800 per annum).**

| Investment allowance:                                                                                 | Rate of investment allowance        | Residual value<br>(25% per year<br>on equal<br>instalments) | Prescribed benefit rates of motor vehicles<br>provided by employer<br>(i) Saloons, Hatch Backs and Estates |                           |                          |
|-------------------------------------------------------------------------------------------------------|-------------------------------------|-------------------------------------------------------------|------------------------------------------------------------------------------------------------------------|---------------------------|--------------------------|
| Capital expenditure incurred on:                                                                      |                                     |                                                             |                                                                                                            | Monthly<br>rates<br>(Sh.) | Annual<br>rates<br>(Sh.) |
| (a) <b>Buildings:</b>                                                                                 |                                     |                                                             | Up to 1200 cc                                                                                              | 3,600                     | 43,200                   |
| • Hotel building                                                                                      | 50% in the first year of use        | 25%                                                         | 1201 - 1500 cc                                                                                             | 4,200                     | 50,400                   |
| • Building used for manufacture                                                                       | 50% in the first year of use        | 25%                                                         | 1501 - 1750 cc                                                                                             | 5,800                     | 69,600                   |
| • Hospital buildings                                                                                  | 50% in the first year of use        | 25%                                                         | 1751 - 2000 cc                                                                                             | 7,200                     | 86,400                   |
| • Petroleum or gas storage facilities                                                                 | 50% in the first year of use        | 25%                                                         | 2001 - 3000 cc                                                                                             | 8,600                     | 103,200                  |
| • Educational/hostels building                                                                        | 10% per year on straight line basis |                                                             | Over - 3000 cc                                                                                             | 14,400                    | 172,800                  |
| • Commercial building                                                                                 | 10% per year on straight line basis |                                                             |                                                                                                            |                           |                          |
| (b) <b>Machinery:</b>                                                                                 |                                     |                                                             | (ii) Pick-ups, Panel Vans (unconverted)                                                                    |                           |                          |
| • Machinery used for manufacture                                                                      | 50% in the first year of use        | 25%                                                         | Up to - 1750 cc                                                                                            | 3,600                     | 43,200                   |
| • Hospital equipment                                                                                  | 50% in the first year of use        | 25%                                                         | Over - 1750 cc                                                                                             | 4,200                     | 50,400                   |
| • Ships or aircraft                                                                                   | 50% in the first year of use        | 25%                                                         |                                                                                                            |                           |                          |
| • Motor vehicles and heavy earth moving equipment                                                     | 25% per year on straight line basis |                                                             | (iii) Land Rovers/Cruisers                                                                                 | 7,200                     | 86,400                   |
| • Computer software, calculators, copiers and duplicating machines                                    | 25% per year on straight line basis |                                                             |                                                                                                            |                           |                          |
| • Furniture and fittings                                                                              | 10% per year on straight line basis |                                                             |                                                                                                            |                           |                          |
| • Telecommunication equipment                                                                         | 10% per year on straight line basis |                                                             |                                                                                                            |                           |                          |
| • Film equipment by a local producer                                                                  | 25% per year on straight line basis |                                                             |                                                                                                            |                           |                          |
| • Machinery used to undertake operations under prospecting rights and exploration under mining rights | 50% in the first year of use        | 25%                                                         |                                                                                                            |                           |                          |
| • Other machinery                                                                                     | 10% per year on straight line basis |                                                             |                                                                                                            |                           |                          |
| (c) Purchase/acquisition of right to use fibre optic cable by telecommunication operation             | 10% per year on straight line basis |                                                             |                                                                                                            |                           |                          |
| (d) Farm works                                                                                        | 50% in the first year of use        | 25%                                                         |                                                                                                            |                           |                          |

**Commissioner's prescribed benefit rates:**

**Services**

|                                                | Monthly rates<br>(Sh.) | Annual rates<br>(Sh.) |
|------------------------------------------------|------------------------|-----------------------|
| (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) Brightstar Enterprises Ltd., a manufacturing company has been assessed by the Revenue Authority for the year ended 31 December 2023. The assessment alleges that Brightstar Enterprises Ltd. understated sales and issued a reassessment of corporate income tax amounting to Sh.15 million. In addition, the Revenue Authority has imposed penalties and interest for late filing and payment. Separately, a VAT audit adjustment of Sh.5 million has been made on the basis that some supplier invoices claimed for input VAT were not in proper format. Brightstar Enterprises Ltd. insists that its sales records are complete and audited and that the Revenue Authority findings of understatement is incorrect. The company accepts responsibility for the late filing (attributing it to system failures), though it believes the penalties may be mitigated.

With regards to VAT, Brightstar Enterprises Ltd. maintains that the invoices in question are valid under generally accepted accounting practice, despite lacking some formal invoice formalities. Brightstar Enterprises Ltd. wishes to dispute the assessment and resolve the matter in a timely and cost-effective manner.

### Required:

- (i) Analyse **THREE** steps Brightstar Enterprises Ltd. should take under tax laws or any other related laws in Kenya to properly object the tax assessment issued. (3 marks)
- (ii) Citing **THREE** benefits that might accrue to the company, advise the management of Brightstar Enterprises Ltd. on how to commence alternative dispute resolution (ADR) process. (3 marks)
- (iii) If Brightstar Enterprises Ltd. chooses to appeal before the Tax Appeals Tribunal (TAT), explain **FOUR** preconditions it must satisfy, under Kenyan tax law to make its appeal valid. (4 marks)
- (b) The following are the financial statements for Lakers Ltd., a trading company that imports goods for the year ended 31 December 2024:

**Lakers Ltd.**  
**Statement of profit or loss and other comprehensive income for the year ended 31 December 2024**

|                                     | Sh. "000"       |
|-------------------------------------|-----------------|
| Sales                               | 100,000         |
| Cost of goods sold                  | <u>(60,000)</u> |
|                                     | 40,000          |
| Exchange gain realised              | <u>2,000</u>    |
|                                     | 42,000          |
| Operating expenses                  | (15,000)        |
| Depreciation of plant and equipment | (1,500)         |
| Impairment loss                     | <u>(500)</u>    |
| Operating profit                    | 25,000          |
| Finance costs                       | <u>(2,000)</u>  |
| Profit before tax                   | 23,000          |
| Tax expense                         | <u>(6,900)</u>  |
| Total comprehensive income          | <u>16,100</u>   |

**Lakers Ltd.**

**Statement of financial position as at 31 December 2024**

|                                | Sh. "000"     |
|--------------------------------|---------------|
| <b>Non-current assets:</b>     |               |
| Plant and equipment            | 10,000        |
| <b>Current assets:</b>         |               |
| Inventory                      | 30,000        |
| Trade receivables              | 25,000        |
| Cash and bank                  | <u>5,000</u>  |
|                                | <u>70,000</u> |
| <b>Equity and liabilities:</b> |               |
| Share capital                  | 48,000        |
| Retained earnings              | 5,000         |
| Trade payables and accruals    | 15,000        |
| Current tax payable            | <u>2,000</u>  |
|                                | <u>70,000</u> |

**Additional information:**

1. It was discovered in a customs audit in mid 2025 that certain imported goods recorded in the inventory in year 2024 were undervalued by 20% at import declaration, amounting to Sh.3,000,000 inclusive of penalties and interest.
2. Certificates of origin were missing for some imported consignment (goods from preferential trade partners) during the year 2024 and the preferential duty rates were incorrectly applied, with back duty due amounting to Sh.800,000.
3. Plant and equipment (qualifying imported machinery) attract investment allowances at 10% per annum.
4. Lakers Ltd. has a carried-forward tax loss from prior years of Sh.1,500,000.
5. Lakers Ltd. has incurred interest expense of Sh.500,000 paying bank overdraft.

**Required:**

- (i) Prepare a statement of adjusted taxable profit for the year ended 31 December 2024 for the company, clearly showing adjustments for back duty on missing certificates of origin. (6 marks)
- (ii) Explain **FOUR** moral or ethical issues arising from undervaluation and missing certificates of origin from the perspective of tax compliance. (4 marks)

**(Total: 20 marks)****QUESTION TWO**

- (a) The East African Community (EAC) has implemented several harmonised tax policies to dismantle fiscal barriers and create a unified economic space.

With reference to the above statement, explain **TWO** tax policies within EAC that have promoted trade and economic integration across the EAC region. (4 marks)

- (b) Patrick and John are partners operating a partnership business Jomani Enterprises and sharing profits and losses equally. The business operates through two independent branches; the head office branch in Nakuru and Kericho branch. The partners have received a tax assessment from the Revenue Authority with a taxable income of Sh.684,000 each for the year ended 31 December 2024. They have provided the following details to help in responding to the tax assessment:

1. The following balances were extracted from the books of the partnership on 31 December 2024:

|                                | Head office branch<br>Sh. | Kericho branch<br>Sh. |
|--------------------------------|---------------------------|-----------------------|
| Furniture and fittings at cost | 56,000                    | 48,000                |
| Delivery vans at cost          | 1,280,000                 | 2,830,000             |
| Saloon car at cost             | 3,290,000                 | -                     |
| Inventories                    | 340,000                   | 670,000               |
| Prepaid rent                   | 80,200                    | 40,100                |
| Accrued electricity            | 20,000                    | 30,000                |
| Bank balances                  | 870,000                   | 180,000               |
| Accounts payable               | 458,000                   | 172,000               |
| Capital                        | 8,800,000                 | -                     |
| 10% bank loan                  | 1,500,000                 | -                     |

2. Kericho branch sells goods transferred from head office at cost. However, it is allowed to make purchases from other suppliers and also maintain a separate bank account. During the year, no goods were transferred from the head office to the branch.
3. All goods were sold at both head office and Kericho branch at 30% above cost. All employees were entitled to a commission at the rate of 1% of the sales during the year.
4. Analysis of the bank statement during the year revealed the following:

|                                               | Head office branch<br>Sh. | Kericho branch<br>Sh. |
|-----------------------------------------------|---------------------------|-----------------------|
| <b>Receipts:</b> Deposits of cash collections | 2,380,700                 | 1,360,000             |
| Royalties                                     | 280,000                   | -                     |
| Insurance compensation on stock               | 680,000                   | -                     |
| <b>Payments:</b> Rent expenses                | 250,000                   | 190,000               |
| Stationery                                    | 67,000                    | 88,000                |
| Software                                      | 240,000                   | -                     |

|                              | Sh.       | Sh.     |
|------------------------------|-----------|---------|
| Electricity                  | 130,000   | 68,000  |
| Legal fee                    | 120,000   |         |
| Purchase of goods for resale | 1,820,900 | 980,000 |
| Salaries and wages           | 780,000   | 320,000 |
| Office expenses              | 90,000    | 30,000  |

5. Head office salaries and wages include salary paid to each partner of Sh.20,000 per month. The bank loan had been taken on 1 July 2024.
6. The current account balances as at 31 December 2023 were as shown below:

|                     | Head office branch<br>Sh. | Kericho branch<br>Sh. |
|---------------------|---------------------------|-----------------------|
| Accounts payable    | 142,300                   | 112,200               |
| Inventories         | 85,000                    | 120,000               |
| Accrued rent        | 30,000                    | 25,000                |
| Prepaid electricity | 49,200                    | 22,500                |

7. The partners had withdrawn goods worth Sh.520,000 and Sh.430,000 for Patrick and John respectively. The partnership deed provided for 3% interest on drawings.

**Required:**

- (i) Compute the taxable income of the partnership for the year ended 31 December 2024. (11 marks)
- (ii) Compute the taxable income of each partner from the income computed in (b) (i) above for the year ended 31 December 2024. (3 marks)
- (iii) Advise the partners in relation to the assessment issued by the Revenue Authority. (2 marks)
- (Total: 20 marks)**

**QUESTION THREE**

- (a) Explain **FOUR** strategies your country could adopt to strengthen the tax system by ensuring fairness, efficiency and broad-based economic development. (8 marks)
- (b) Sparkle Oil Ltd. is an oil exploration company operating in Turkwel County. The following is the statement of profit or loss of the company for the year ended 31 December 2024:

|                                    | Sh.“000”         |
|------------------------------------|------------------|
| Revenue                            | 500,000          |
| Gain on sale of exploration assets | 20,000           |
| Royalty income                     | 15,000           |
| Interest income                    | <u>5,000</u>     |
|                                    | 540,000          |
| Operating expenses                 | (200,000)        |
| Depreciation on exploration assets | (10,000)         |
| Decommissioning provision expenses | (5,000)          |
| Exploration and development costs  | <u>(100,000)</u> |
| Operating profit                   | 225,000          |
| Other income                       | 10,000           |
| Other expenses                     | <u>(5,000)</u>   |
| Net profit before tax              | <u>230,000</u>   |

**Additional information:**

- Exploration and development expenditure included:
  - Penalties of Sh.6 million for violating environmental regulations during exploration activities.
  - Cost of constructing production facilities amounting to Sh.16 million in the development phase.
  - Expenses amounting to Sh.2 million spent on seismic studies but lacked e-Tims compliant invoices.
  - Expenses incurred on team-building of Sh.800,000.
- Cost of constructing production facilities, pipelines and storage tanks amounted to Sh.50 million.
- Machinery used for exploration including drilling rigs seismic equipment and exploration vehicles was Sh.30 million.
- Interest on loans of Sh.14 million in respect to loan obtained for financing exploration and development activities. The loan was obtained from a bank where the company's debt to equity ratio was 1.5:1.
- Gain on sale of exploration assets include a loss of Sh.3 million to a specific mining block whose expenditure had been ring fenced.

6. The company is considering selling a 30% stake in its Turkwel operations to a foreign investor at a net gain of Sh.180 million.
7. Royalties payment were made to the government for the right to extract oil amounting to Sh.16 million included in operating expenses.

**Required:**

- (i) Prepare a statement of adjusted taxable profit or loss for the year ended 31 December 2024. (8 marks)
  - (ii) Compute corporate tax payable, if any, for the year ended 31 December 2024. (2 marks)
  - (iii) Explain the tax implication in relation to the following two transactions of Sparkle Oil Ltd.:
    - The proposed indirect transfer of 30% stake in the Sparkle Oil Ltd. (1 mark)
    - The loan obtained from a bank where the company's debt to equity ratio was 1.5:1. (1 mark)
- (Total: 20 marks)**

**QUESTION FOUR**

- (a) As a senior officer with a tax consultancy firm, you are required to conduct a tax health check for a client and you are in the process of developing the scope of the tax health check.

Outline **FOUR** elements that you would include in the scope of the tax health check. (4 marks)

- (b) Alpha Ltd. is a Kenyan company involved in manufacturing and distribution of soft drinks. The company plans to restructure its operations due to financial constraint and market realignment. The restructuring proposal involves the following:
  1. Selling one of the manufacturing plant to a competitor.
  2. Transferring its distribution unit to a newly registered subsidiary, Alpha Logistics Ltd. in which Alpha Ltd. will hold 100% shareholding.
  3. Selling 30% shares of Alpha Ltd. to a foreign private equity fund.
  4. Writing off Sh.12 million in bad debts relating to long-term clients.

**Required:**

Evaluate the tax implication for each of the above proposals. (4 marks)

- (c) You are a senior tax consultant at Smart Tax Consultants. Your firm has been appointed by the board of Speed Bank Ltd., a Tier II commercial bank to conduct a tax compliance review ahead of a scheduled Revenue Authority Audit for the year ended 31 December 2024:

The following data was extracted from the bank's trial balance for the year ended 31 December 2024:

|                                                    | <b>Sh."000"</b> |
|----------------------------------------------------|-----------------|
| Interest income from customer loans                | 480,000         |
| Interest income from treasury bonds                | 65,000          |
| Interest income from interbank placements          | 18,000          |
| Fees and commission income                         | 44,000          |
| Shopping mall lease rental income                  | 8,400           |
| Loss on disposal of assets                         | 15,000          |
| Treasury bills discount income                     | 7,000           |
| Loss on disposal of investment securities          | 4,800           |
| Staff salaries and wages                           | 12,400          |
| Depreciation and amortisation                      | 32,000          |
| Administrative and operating expenses              | 9,500           |
| Cost of a generator                                | 1,500           |
| Customer deposits                                  | 3,600,000       |
| Loan impairment provision                          | 26,000          |
| Legal and professional fees                        | 6,800           |
| Contribution to Kenya Insurance Deposit Protection | 2,300           |
| External audit fees                                | 2,400           |
| Donations to a political party                     | 1,200           |
| Provision for taxation                             | 18,000          |
| Transfer to statutory reserves                     | 10,000          |

**Additional information:**

1. Depreciation and amortisation include Sh.6 million loss arising from a building revaluation adjustment not previously recorded.
2. The accrued interest income from customer loans and interbank placements amounted to Sh.240,000 and Sh.650,000 respectively as at 31 December 2024. Customer deposits includes Sh.24,600,000 interest payable on deposit.
3. Loan impairment provision comprises of Sh.10 million for specific bad debts and Sh.16 million as a general provision.
4. The bank has a shopping mall which comprise of shops whose construction cost was Sh.1,600,000, gym Sh.750,000 and offices at Sh.800,000. The pavements and sewerage systems were constructed at a cost of Sh.350,000.
5. Shopping mall maintenance expenses per month amounted to Sh.200,000. The bank incurred costs of advertising of Sh.630,000, water metres Sh.190,000 and electricity deposits of Sh.560,000 before leasing.
6. Legal and professional fees consist of:
  - Sh.2.4 million negotiation cost for acquisition of a subsidiary.
  - Sh.2.8 million for internal restructuring.
  - Sh.1.6 million for a labour related lawsuit settlement.
7. Administrative expenses include:
  - Sh.6 million for acquisition of a new banking system.
  - Sh.1.2 million for new system licensing.
  - Sh.0.9 million in client entertainment expenses during business retreats.
  - Sh.1.4 million written off in equity investment in an unquoted start up.
8. Loss on disposal of assets includes Sh.8,000,000 on disposal of assets provided by customers as security for loans.

**Required:**

Compute the total taxable income and corporation tax payable, (if any) by Speed Bank Ltd. for the year ended 31 December 2024. (12 marks)

**(Total: 20 marks)**

**QUESTION FIVE**

- (a) The Most Favoured Nation (MFN) status is fundamental in international trade agreements and if well designed, the participating countries may derive major benefits.

**Required:**

Explain **FOUR** benefits that a granting country derives from conferring MFN status to another nation. (4 marks)

- (b) Lucky Ltd. acquired a commercial property under the following terms:
1. An initial deposit of Sh.500,000 was paid at the time of purchase.
  2. The balance was to be paid over 4 years through monthly installments of Sh.35,000 including Sh.12,000 per month as mortgage interest.

The company is evaluating two options for disposing of the property aiming to optimise the tax liability through timing of the sale.

**Disposal options:**

Option 1: Sell the property for Sh.2,400,000 after paying 30 monthly installments.

Option 2: Sell the property for Sh.3,200,000 after completing all payment and incurring additional legal fees of Sh.80,000 and agent commission of Sh.90,000.

**Required:**

Compute capital gains tax in both options and advise the management of Lucky Ltd. on the best option of the property disposal. (4 marks)

- (c) Pritt Enterprises Ltd. is involved in supply of both taxable and exempt goods. The company commenced operations and was registered for value added tax (VAT) on 1 May 2025.

The financial transactions and other details relating to the month of May 2025 are provided as follows:

- May 1: Purchased stock of raw materials 15,000 units at Sh.120 per unit.
- May 4: Imported 8 units of specialised machinery parts at cost, insurance and freight value at Sh.9,500 per unit. Import duty was 20%.
- May 7: Purchased 8,000 units of raw materials from a local unregistered supplier at Sh.80 per unit.

- May 9: Sold 10,000 units of finished goods at Sh.150 per unit. This includes a trade discount of 5% on the gross price.
- May 11: Acquired a new delivery van on hire purchase price of Sh.2,500,000 net of VAT for use in the business. The hire purchase interest was Sh.320,000.
- May 13: Paid Sh.150,000 for a consultant's report on market feasibility which covers both current and future operations. 70% of the cost relate to current operations.
- May 15: Purchased manufacturing consumables for Sh.120,000.
- May 16: An invoice of Sh.110,000 was paid for security services rendered in April 2025.
- May 18: Supplied 35,000 units of finished goods to a non-governmental organisation (NGO) with a valid exemption certificate at a price of Sh.140 per unit.
- May 21: Exported 4,500 units of finished goods to Rwanda at Sh.160 per unit.
- May 24: The directors took goods worth Sh.450,000 for personal use which were not paid for. It is the company's policy not to charge directors VAT on goods for personal use.
- May 26: Purchased on cash 4,000 units of raw materials at Sh.90 per unit exclusive of VAT. The supplier offered a 2% cash discount.
- May 29: Incurred and paid advertising expenses of Sh.30,000 and legal fees on debt collection of Sh.10,000.
- May 31: Received a refund of Sh.25,000 from a supplier for damaged goods returned which were originally purchased on May 26.

All transactions were inclusive of VAT at the rate of 16% where applicable unless otherwise specified.

**Required:**

Compute the VAT paid by or refundable to Pritt Enterprises Ltd. for the month of May 2025.

(12 marks)

**(Total: 20 marks)**

.....



## CPA ADVANCED LEVEL

### ADVANCED TAXATION

**TUESDAY: 19 August 2025. Afternoon Paper.**

**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. Do NOT write anything on this paper.**

**RATES OF TAX (For employment income including wife's employment, self-employment and professional income).**

**Year of income 2024.**

**Assume the following rates of tax applied throughout the year of income 2024:**

| Monthly taxable pay<br>(Sh.) | Annual taxable pay<br>(Sh.) | Rate of tax<br>% in each Sh. |
|------------------------------|-----------------------------|------------------------------|
| 1 - 24,000                   | 1 - 288,000                 | 10%                          |
| 24,001 - 32,333              | 288,001 - 388,000           | 25%                          |
| 32,334 - 500,000             | 388,001 - 6,000,000         | 30%                          |
| 500,001 - 800,000            | 6,000,001 - 9,600,000       | 32.5%                        |
| Excess over 800,000          | Excess over 9,600,000       | 35%                          |

**Personal relief Sh.2,400 per month (Sh.28,800 per annum).**

| Investment allowance:<br><br>Capital expenditure incurred on:                                         | Rate of investment allowance        | Residual value<br>(25% per year<br>on equal<br>instalments) | Prescribed benefit rates of motor vehicles<br>provided by employer<br>(i) Saloons, Hatch Backs and Estates |                           |                          |  |
|-------------------------------------------------------------------------------------------------------|-------------------------------------|-------------------------------------------------------------|------------------------------------------------------------------------------------------------------------|---------------------------|--------------------------|--|
|                                                                                                       |                                     |                                                             |                                                                                                            | Monthly<br>rates<br>(Sh.) | Annual<br>rates<br>(Sh.) |  |
| (a) <b>Buildings:</b>                                                                                 |                                     |                                                             | Up to 1200 cc                                                                                              | 3,600                     | 43,200                   |  |
| • Hotel building                                                                                      | 50% in the first year of use        | 25%                                                         | 1201 - 1500 cc                                                                                             | 4,200                     | 50,400                   |  |
| • Building used for manufacture                                                                       | 50% in the first year of use        | 25%                                                         | 1501 - 1750 cc                                                                                             | 5,800                     | 69,600                   |  |
| • Hospital buildings                                                                                  | 50% in the first year of use        | 25%                                                         | 1751 - 2000 cc                                                                                             | 7,200                     | 86,400                   |  |
| • Petroleum or gas storage facilities                                                                 | 50% in the first year of use        | 25%                                                         | 2001 - 3000 cc                                                                                             | 8,600                     | 103,200                  |  |
| • Educational/hostels building                                                                        | 10% per year on straight line basis |                                                             | Over - 3000 cc                                                                                             | 14,400                    | 172,800                  |  |
| • Commercial building                                                                                 | 10% per year on straight line basis |                                                             |                                                                                                            |                           |                          |  |
| (b) <b>Machinery:</b>                                                                                 |                                     |                                                             | (ii) Pick-ups, Panel Vans (unconverted)                                                                    |                           |                          |  |
| • Machinery used for manufacture                                                                      | 50% in the first year of use        | 25%                                                         | Up to - 1750 cc                                                                                            | 3,600                     | 43,200                   |  |
| • Hospital equipment                                                                                  | 50% in the first year of use        | 25%                                                         | Over - 1750 cc                                                                                             | 4,200                     | 50,400                   |  |
| • Ships or aircraft                                                                                   | 50% in the first year of use        | 25%                                                         |                                                                                                            |                           |                          |  |
| • Motor vehicles and heavy earth moving equipment                                                     | 25% per year on straight line basis |                                                             | (iii) Land Rovers/Cruisers                                                                                 | 7,200                     | 86,400                   |  |
| • Computer software, calculators, copiers and duplicating machines                                    | 25% per year on straight line basis |                                                             |                                                                                                            |                           |                          |  |
| • Furniture and fittings                                                                              | 10% per year on straight line basis |                                                             |                                                                                                            |                           |                          |  |
| • Telecommunication equipment                                                                         | 10% per year on straight line basis |                                                             |                                                                                                            |                           |                          |  |
| • Film equipment by a local producer                                                                  | 25% per year on straight line basis | 25%                                                         |                                                                                                            |                           |                          |  |
| • Machinery used to undertake operations under prospecting rights and exploration under mining rights | 50% in the first year of use        |                                                             |                                                                                                            |                           |                          |  |
| • Other machinery                                                                                     | 10% per year on straight line basis |                                                             |                                                                                                            |                           |                          |  |
| (c) Purchase/acquisition of right to use fibre optic cable by telecommunication operation             | 10% per year on straight line basis |                                                             |                                                                                                            |                           |                          |  |
| (d) Farm works                                                                                        | 50% in the first year of use        | 25%                                                         |                                                                                                            |                           |                          |  |

**Commissioner's prescribed benefit rates:**

**Services**

|                                                | Monthly rates<br>(Sh.) | Annual rates<br>(Sh.) |
|------------------------------------------------|------------------------|-----------------------|
| (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) You have been appointed as a tax advisor to a contractor involved in infrastructure projects for a County Government. The contractor has recently received conflicting tax assessment from both the Revenue Authority relating to withholding tax and County Government relating to contractual service levy. The contractor believes the charges are duplicative and not grounded in clear provisions. The delays in resolving the dispute have stalled payments and strained the contractor's cash flows.

**Required:**

- (i) Explain the tax dispute resolution mechanism available to the contractor under Kenyan tax laws. (4 marks)
  - (ii) Advise the contractor on the steps to take in resolving the tax dispute with the Revenue Authority and County Government. (4 marks)
  - (iii) Propose **FOUR** institutional reforms that the County Government could implement to avoid similar tax disputes with contractors in the future. (4 marks)
- (b) Barani Enterprises Ltd. is a value added tax (VAT) registered business involved in the sale and distribution of both taxable and exempt supplies. The following transactions were recorded in the books of the company for the month of April 2025:

April 2: Sales at standard rate Sh.1,160,000.  
April 4: Sales made as exempt supply Sh.400,000.  
April 6: Purchase of goods for resale on credit Sh.580,000.  
April 9: Purchase of stationery on credit Sh.116,000.  
April 12: Purchase of fuel for company car Sh.87,000.  
April 15: Payment for entertainment expenses for clients Sh.58,000.  
April 18: Purchase of a saloon car for director Sh.1,160,000.  
April 20: Imported raw materials with customs and VAT paid Sh.232,000.  
April 22: Repairs to delivery truck used exclusively for distribution Sh.58,000.  
April 25: Purchase of goods used in both exempt and taxable supplies for Sh.348,000.  
April 28: Rent for business premises to a landlord registered for VAT Sh.116,000.

**Additional information:**

- 1. The company uses turnover-based apportionment for input VAT on mixed-use items.
- 2. Transactions are inclusive of value added tax (VAT) at the rate of 16% where applicable.

**Required:**

- (i) Compute the output VAT for the month of April 2025. (2 marks)
- (ii) Determine the total input VAT incurred and identify which amounts are restricted under the VAT Act, 2013. (3 marks)
- (iii) Calculate the allowable input VAT claimable. (1 mark)
- (iv) Compute the VAT payable or refundable for the month of April 2025. (2 marks)

**(Total: 20 marks)**

### QUESTION TWO

- (a) Treaty policies are central in shaping a country's external tax relations, facilitating trade and investments and ultimately fostering economic co-operation. However, their implementation is subject to hurdles which affect the realisation of their objectives.

**Required:**

Evaluate **FOUR** structural hinderances to the implementation of tax treaty policies in your country. (4 marks)

- (b) Mikah and Janace have been running a partnership business by the name "Jakah Enterprises" from 1 January 2023. They share profits and losses equally having contributed total capital of Sh.6,800,000. They have not been keeping proper books of accounts and have approached you to assist in the computation of their tax liability for the year ended 31 December 2024.

The following details were provided:

1. They sell goods on both cash and credit terms. During the year ended 31 December 2024, they sold 148,300 units on cash basis at a price of Sh.80 per unit.
2. An extract from the statement of financial position as at 31 December 2023 included the following non-current assets:

| Asset                                           | Cost<br>Sh.“000” | Accumulated depreciation<br>Sh.“000” | Net book value<br>Sh.“000” |
|-------------------------------------------------|------------------|--------------------------------------|----------------------------|
| Land and office building<br>(Land Sh.1,500,000) | 7,000            | 1,000                                | 6,000                      |
| Plant and equipment                             | 9,000            | 4,000                                | 5,000                      |
| Furniture and fittings                          | 2,000            | 1,000                                | 1,000                      |

3. Extract of current account had the following balances:

|                       | 31 December 2023<br>Sh.“000” | 31 December 2024<br>Sh.“000” |
|-----------------------|------------------------------|------------------------------|
| Trade debtors         | 1,708,000                    | 6,460,000                    |
| Bank                  | 3,068,000 (Credit)           | 4,169,900 (Debit)            |
| Trade creditors       | 1,340,000                    | 1,868,600                    |
| Subscriptions prepaid | 200,000                      | 140,000                      |
| Salaries owing        | 380,000                      | 950,000                      |
| Electricity accrued   | 248,200                      | 196,800                      |
| Inventory in trade    | 1,400,000                    | 620,000                      |

4. Payments through the bank were as follows:

|                                          | Sh.       |
|------------------------------------------|-----------|
| Cash purchases                           | 3,188,000 |
| Purchase of furniture                    | 204,000   |
| Catering service inclusive of VAT        | 180,000   |
| Motor vehicle fuel inclusive of VAT      | 260,000   |
| Electricity                              | 184,600   |
| Salaries (partners' salaries Sh.900,000) | 1,830,000 |
| Legal fees                               | 138,500   |
| Subscriptions paid                       | 200,000   |

5. Legal fees included Sh.30,500 relating to acquisition of freehold land and office building while electricity paid during the year included a deposit of Sh.40,000.
6. The capital contribution ratio was 3:1 for Mikah and Janace respectively. The partners are entitled to an interest of 10% and 8% per annum of capital contribution for Mikah and Janace respectively.
7. On 1 April 2024, the partnership obtained a bank loan of Sh.2,500,000. The interest rate was 18% per annum. The loan was repayable in 5 equal annual installments but had already fallen into arrears.
8. The partnership was converted into Jaykay Ltd. company on 1 September 2024 under the following terms:
  - The partners were issued with ordinary shares equivalent to capital contribution in the partnership as at the date of conversion.
  - They invited John to be a shareholder upon contribution of Sh.5,000,000 towards ordinary share capital and 8% debenture in the ratio of 3:2.
  - The partners were to become the directors of the company earning a salary of Sh.40,000 each per month. This is not included in the salaries for the year.
  - Land and buildings were revalued to Sh.10,500,000.
9. They purchased a saloon car on 1 October 2024 for Sh.3,300,000 which had 2800cc and computers for Sh.320,000 net of cash discounts of Sh.15,000.
10. Discount received from suppliers during the year amounted to Sh.720,000 while in November 2024, a debtor owing Sh.68,000 was declared bankrupt.
11. Subscriptions were made to Chamber of Commerce.
12. All sales and purchases were inclusive of VAT at the rate of 16%.
13. All revenue and expenses accrued evenly throughout the year unless otherwise stated.

**Required:**

- (i) In a columnar format, determine the taxable income of the partnership and Jaykay Ltd. for the year ended 31 December 2024. (12 marks)
- (ii) Compute taxable income of each partner for the year ended 31 December 2024. (3 marks)
- (iii) Compute tax payable (if any) by Jaykay Ltd. for the year ended 31 December 2024. (1 mark)
- (Total: 20 marks)**

**QUESTION THREE**

- (a) As a regional trade consultant working with the East African Community (EAC) secretariat, explain **FOUR** ways on how the implementation of One Stop Border Posts (OSBPs) have contributed to the growth of regional trade in East Africa. (8 marks)
- (b) Western Mining Ltd. is a company involved in the exploration and extraction of gold and other precious minerals in Kakamega County. The following is the statement of profit or loss and other comprehensive income for the year ended 31 December 2024:

| <b>Western Mining Ltd.</b>                                                                            |                  |                  |
|-------------------------------------------------------------------------------------------------------|------------------|------------------|
| <b>Statement of profit or loss and other comprehensive income for the year ended 31 December 2024</b> |                  |                  |
|                                                                                                       | <b>Sh. "000"</b> | <b>Sh. "000"</b> |
| Revenue (export of goods)                                                                             |                  | 600,000          |
| <b>Cost of sales:</b>                                                                                 |                  |                  |
| Extraction costs (labour, fuel, blasting, water)                                                      |                  | (220,000)        |
| Depreciation - Mining equipment                                                                       |                  | (50,000)         |
| Royalties paid to Ministry of Mining (4% of sales)                                                    |                  | (24,000)         |
| Site restoration provision                                                                            |                  | <u>(10,000)</u>  |
| Gross profit                                                                                          |                  | 296,000          |
| <b>Operating expenses:</b>                                                                            |                  |                  |
| Salaries and wages                                                                                    | 40,000           |                  |
| Administration and head office expenses                                                               | 30,000           |                  |
| Amortisation of exploration license                                                                   | 8,000            |                  |
| Impairment loss on mine development assets                                                            | 6,000            |                  |
| Legal fines for environmental violations                                                              | 2,000            |                  |
| Advertising and marketing expenses                                                                    | <u>5,000</u>     | <u>(91,000)</u>  |
| Operating profit                                                                                      |                  | 205,000          |
| Finance costs (interest on loan from bank)                                                            |                  | (10,000)         |
| Tax expense                                                                                           |                  | <u>(58,500)</u>  |
|                                                                                                       |                  | 136,500          |
| <b>Other compressive income:</b>                                                                      |                  |                  |
| Revaluation gain on freehold mining land                                                              |                  | 20,000           |
| Exchange loss on translation of foreign operations                                                    |                  | <u>(3,000)</u>   |
| Total comprehensive income                                                                            |                  | <u>153,500</u>   |

**Additional information:**

- The company incurred Sh.15,000,000 in construction of roads within the mining site and Sh.12,000,000 in acquiring drilling equipment during the year.
- The exploration license is valid for 4 years commencing 1 January 2023.
- The site restoration provision is based on an estimated costs to be incurred in year 2025.
- The company made a donation of Sh.3,000,000 to a local school project (not approved by the cabinet secretary). This amount was included in administration and head office expenses.
- The company claimed revaluation gain on freehold land on equity but did not sell or dispose of the land.
- The legal fine resulted from non-compliance with environmental regulations under the Mining Act.
- Depreciation was computed using International Financial Reporting Standards (IFRS) rules and not aligned with investment allowances under the Income Tax Act.

**Required:**

- (i) Prepare statement of adjusted taxable profit or loss for Western Mining Ltd. for the year ended 31 December 2024. (8 marks)
  - (ii) Determine the corporate tax, if any, payable by the company for the year ended 31 December 2024. (2 marks)
  - (iii) Identify **TWO** obligations of mining companies operating in Kenya under the Income Tax Act. (2 marks)
- (Total: 20 marks)**

**QUESTION FOUR**

- (a) During a tax seminar on “mitigating tax exposures”, the key note speaker observed that tax risk management plays a critical role in the development of tax planning strategies for an organisation.

**Required:**

- (i) Summarise **FOUR** ways that a tax professional could use to quantify tax risk in an organisation. (4 marks)
  - (ii) Evaluate **FOUR** roles of tax risk management in the development of tax planning strategies of an organisation. (4 marks)
- (b) In an era of evolving tax framework, self-regulation of tax professionals by recognised professional bodies is an important component of the countries tax administration system in maintaining the integrity of the tax system.

**Required:**

Analyse **FOUR** benefits of having self-regulation of tax professionals by professional bodies over government oversight. (4 marks)

- (c) Robert Mwema is a senior software engineer at Steel Ltd. and has provided the following details for the year ended 31 December 2024:
- 1. His gross monthly salary is Sh.250,000 which includes a house allowance Sh.70,000 per annum.
  - 2. He owns 15% shares in Innovatech Ltd., a private consulting company where he receives annual dividend of Sh.600,000.
  - 3. He resides in a house he purchased through a personal loan of Sh.1,500,000 obtained from a bank on 1 September 2023 at an interest rate of 14% per annum repayable over 8 years.
  - 4. He contributes Sh.18,000 per month to a Sacco investment account towards his retirement.
  - 5. He has taken a ten-year education insurance policy where he contributes Sh.3,500 per month for his two children’s university education.
  - 6. Robert Mwema has invested Sh.6,000,000 in a fixed deposit account and 15-year government infrastructure bond on equal basis both earning an annual interest at the rate of 12%.
  - 7. He also owns a rental apartment, which generates monthly rental income of Sh.80,000 but incurs annual maintenance expenses of Sh.120,000 and county land rates of Sh.24,000.

**Required:**

Advise Robert Mwema on **FOUR** tax planning strategies that he could implement to optimise his tax position and legally minimise his annual tax liability from the information provided above. Support your argument with relevant computations where necessary. (8 marks)

**(Total: 20 marks)**

**QUESTION FIVE**

- (a) In the context of tax compliance and advisory, the roles of a tax agent and tax representative are different yet they overlap.

With reference to the above statement, explain **TWO** distinguishing factors between a “tax agent” and a “tax representative”. (4 marks)

- (b) Tax amnesty programs are used by countries in formulating tax policies to encourage tax compliance.

In relation to the above statement, evaluate **FOUR** limitations of using tax amnesty by a country. (4 marks)

- (a) Brick Ltd. engages in construction of both residential and commercial building projects. For the year ended 31 December 2024, the company provided the following details:

1. Purchased 50 acres of land for Sh.2,500,000 per acre in a prime area designated for mixed use development.
2. Cost of environmental impact assessment amounted to Sh.3,200,000 while legal and conveyance fee totalled to Sh.4,800,000.
3. The company constructed 150 residential units on a 40 acre piece of land at a cost of Sh.1,200,000 per unit. This consisted of material and labour cost only.
4. All residential units were sold at Sh.2,800,000 each during the year 2024.
5. Material cost for each residential unit was Sh.800,000 which included VAT at the rate of 16%.
6. Professional fees paid to architects and engineers for the construction inclusive of VAT totalled to Sh.600,000 and Sh.300,000 respectively.
7. A sewerage and water supply system for the entire 50 acre land was installed at a cost of Sh.1,200,000.
8. Interest on a loan for acquiring the 50 acre of land amounted to Sh.6,500,000.
9. Heavy equipment hire costs for the residential development including bulldozers and cranes was Sh.1,000,000 for each of the six months used in the construction.
10. Fees paid to the government for planning and development approvals amounted to Sh.500,000.
11. The company build a 10,000 square metre commercial shopping complex on the remaining 10 acres of land at a cost of Sh.16,800,000 which was rented out on 1 August 2024 at a monthly rent of Sh.960,000.
12. The costs related to the entire land are to be allocated based on land acres used.

**Required:**

- (i) Prepare the statement of adjusted taxable income or loss for Brick Ltd. for the year ended 31 December 2024. (11 marks)
  - (ii) Compute the tax payable, if any, by the company for the year ended 31 December 2024. (1 mark)
- (Total: 20 marks)**

.....



## CPA ADVANCED LEVEL

### ADVANCED TAXATION

**WEDNESDAY: 23 April 2025. Afternoon Paper.**

**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. Do NOT write anything on this paper.**

**RATES OF TAX (For employment income including wife's employment, self-employment and professional income).**

**Year of income 2024.**

**Assume the following rates of tax applied throughout the year of income 2024:**

| Monthly taxable pay<br>(Sh.) | Annual taxable pay<br>(Sh.) | Rate of tax<br>% in each Sh. |
|------------------------------|-----------------------------|------------------------------|
| 1 - 24,000                   | 1 - 288,000                 | 10%                          |
| 24,001 - 32,333              | 288,001 - 388,000           | 25%                          |
| 32,334 - 500,000             | 388,001 - 6,000,000         | 30%                          |
| 500,001 - 800,000            | 6,000,001 - 9,600,000       | 32.5%                        |
| Excess over 800,000          | Excess over 9,600,000       | 35%                          |

**Personal relief Sh.2,400 per month (Sh.28,800 per annum).**

| Investment allowance:                                                                                 | Rate of investment allowance        | Residual value<br>(25% per year<br>on equal<br>instalments) | Prescribed benefit rates of motor vehicles<br>provided by employer<br>(i) Saloons, Hatch Backs and Estates |
|-------------------------------------------------------------------------------------------------------|-------------------------------------|-------------------------------------------------------------|------------------------------------------------------------------------------------------------------------|
| Capital expenditure incurred on:                                                                      |                                     |                                                             | Monthly rates<br>(Sh.)      Annual rates<br>(Sh.)                                                          |
| (a) <b>Buildings:</b>                                                                                 |                                     |                                                             |                                                                                                            |
| • Hotel building                                                                                      | 50% in the first year of use        | 25%                                                         | Up to 1200 cc 3,600 43,200                                                                                 |
| • Building used for manufacture                                                                       | 50% in the first year of use        | 25%                                                         | 1201 - 1500 cc 4,200 50,400                                                                                |
| • Hospital buildings                                                                                  | 50% in the first year of use        | 25%                                                         | 1501 - 1750 cc 5,800 69,600                                                                                |
| • Petroleum or gas storage facilities                                                                 | 50% in the first year of use        | 25%                                                         | 1751 - 2000 cc 7,200 86,400                                                                                |
| • Educational/hostels building                                                                        | 10% per year on straight line basis |                                                             | 2001 - 3000 cc 8,600 103,200                                                                               |
| • Commercial building                                                                                 | 10% per year on straight line basis |                                                             | Over - 3000 cc 14,400 172,800                                                                              |
| (b) <b>Machinery:</b>                                                                                 |                                     |                                                             | (ii) Pick-ups, Panel Vans (unconverted)                                                                    |
| • Machinery used for manufacture                                                                      | 50% in the first year of use        | 25%                                                         | Up to - 1750 cc 3,600 43,200                                                                               |
| • Hospital equipment                                                                                  | 50% in the first year of use        | 25%                                                         | Over - 1750 cc 4,200 50,400                                                                                |
| • Ships or aircraft                                                                                   | 50% in the first year of use        | 25%                                                         |                                                                                                            |
| • Motor vehicles and heavy earth moving equipment                                                     | 25% per year on straight line basis |                                                             | (iii) Land Rovers/Cruisers 7,200 86,400                                                                    |
| • Computer software, calculators, copiers and duplicating machines                                    | 25% per year on straight line basis |                                                             |                                                                                                            |
| • Furniture and fittings                                                                              | 10% per year on straight line basis |                                                             |                                                                                                            |
| • Telecommunication equipment                                                                         | 10% per year on straight line basis |                                                             |                                                                                                            |
| • Film equipment by a local producer                                                                  | 25% per year on straight line basis | 25%                                                         |                                                                                                            |
| • Machinery used to undertake operations under prospecting rights and exploration under mining rights | 50% in the first year of use        |                                                             |                                                                                                            |
| • Other machinery                                                                                     | 10% per year on straight line basis |                                                             |                                                                                                            |
| (c) Purchase/acquisition of right to use fibre optic cable by telecommunication operation             | 10% per year on straight line basis |                                                             |                                                                                                            |
| (d) Farm works                                                                                        | 50% in the first year of use        | 25%                                                         |                                                                                                            |

**Commissioner's prescribed benefit rates:**

**Services**

|                                                | Monthly rates<br>(Sh.) | Annual rates<br>(Sh.) |
|------------------------------------------------|------------------------|-----------------------|
| (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) Laptec Ltd. is a multinational corporation operating in the manufacturing and distribution sector in your country. As the company grows, it faces complex tax challenges related to value added tax (VAT), excise duty and corporation tax compliance. The management of the company has engaged you as a tax consultant to develop a tax risk management strategy to be adopted by Laptec Ltd.'s tax department in the process of managing the organisation tax risks.

**Required:**

Analyse **FIVE** key components to be included in the tax risk management strategy. (5 marks)

- (b) Technology in tax administration fosters a more transparent, accountable and efficient tax system as well as facilitating tax expansion benefiting both the government and taxpayers. This can be enhanced through incorporating the use of artificial intelligence commonly referred to as "AI" in tax administration.

**Required:**

Evaluate **FIVE** ways in which the use of Artificial Intelligence could be used to enhance tax administration in your country. (5 marks)

- (c) Marine Shipping Line Ltd. is a Kenyan resident company that carried on the business of transporting cargo, mails and passengers in the various ports of the world. The company reported the following transactions for the year ended 31 December 2024:

| Income                                                                      | Sh."000"  |
|-----------------------------------------------------------------------------|-----------|
| Revenue generated from carriage of passengers from Kenya to other countries | 851,580   |
| Revenue generated from carriage of cargo and mails from Kenya to China      | 1,147,500 |
| Revenue from carriage of passengers and cargo from China to Kenya           | 2,502,820 |
| Rebate received for meeting destination timelines                           | 12,220    |
| Income from the lease of a ship                                             | 362,500   |

**Expenditure:**

1. The company started its operations on 1 April 2024 and acquired the following assets:

|                      | Sh."000" |
|----------------------|----------|
| Ships: MV Border     | 89,000   |
| MV Queen             | 28,000   |
| MV Olympic           | 20,000   |
| Tools and implements | 6,000    |
| Pick up vans         | 16,000   |
| Mobile cranes        | 10,000   |

2. The following expenses were incurred during the year:

|                                 | Sh."000"  |
|---------------------------------|-----------|
| • Business licences and permits | 40,000    |
| • Port facilities fee           | 132,400   |
| • Catering bills for passengers | 237,800   |
| • Salaries and wages            | 1,118,000 |
| • Estimated default by debtors  | 12,000    |

3. Out of the revenue generated from carriage of passengers and cargo from China to Kenya, Sh.520,000,000 was in respect of passengers who embarked in Kenya as a result of transshipment.

**Required:**

Compute the taxable profit or loss and tax payable (if any) for Marine Shipping Line Ltd. for the year ended 31 December 2024. (10 marks)

**(Total: 20 marks)**

**QUESTION TWO**

- (a) Analyse **THREE** tax planning avenues available to importers of goods in your country. (6 marks)
- (b) Ryan and Michael are in a partnership business trading as RAM Enterprises and sharing profits and losses in the ratio of 3:2 respectively.

The following details relate to the business for the year ended 31 December 2024:

|                                          |                  |
|------------------------------------------|------------------|
|                                          | <b>Sh.</b>       |
| Capital account (1 January 2024): Ryan   | 4,000,000        |
| Michael                                  | 3,200,000        |
|                                          | <b>Sh.</b>       |
| Current account (31 December 2024): Ryan | 600,000 (Credit) |
| Michael                                  | 900,000 (Credit) |
| Inventories as at 1 January 2024         | 6,203,000        |
| Non-current assets                       | 4,200,000        |
| Trade receivables                        | 1,800,000        |
| Trade payables                           | 642,000          |
| Cost of sales                            | 2,469,860        |
| Transport costs                          | 713,000          |
| Interest on business loans               | 390,000          |
| Drawings of goods at selling price: Ryan | 2,250,000        |
| Michael                                  | 2,400,000        |
| Bank                                     | 373,000          |
| General expenses                         | 684,500          |
| Salaries                                 | 2,722,020        |
| Rent                                     | 3,000,000        |
| Electricity                              | 364,000          |
| Depreciation                             | 464,000          |
| Net interest income (Mali Ltd.)          | 200,000          |

**Additional information:**

- Current account balances were extracted after preparing the final accounts of the partnership for the year ended 31 December 2024.
- Sales are made up of 200% of the share of the total profits by the partners and include value added tax (VAT) at the rate of 16%.
- Interest on drawings was charged at 10% on the partners drawings and interest on capital was at 5% per annum.
- Salaries include partners' salary amounting to Sh.880,260 and Sh.760,260 to Ryan and Michael respectively. The partners salaries were included in the current account balances as at 31 December 2024.
- Rent accrued was Sh.120,000 at year end and there was a prepayment of rent Sh.40,000 at the beginning of the year. Electricity owing as at 1 January 2024 was Sh.150,000.
- On 2 September 2024, the business ordered for goods costing Sh.225,000 which were recorded as purchases but were never received as they were stolen while in transit. The transporter later accepted liability and paid a compensation in January 2025 of Sh.200,000. No adjustments had been made in the books in respect of the loss or claim as at 31 December 2024.
- Non-current assets were acquired in the month of January 2024 and comprised the following:

|                   |            |
|-------------------|------------|
|                   | <b>Sh.</b> |
| Computers         | 240,000    |
| Office partitions | 300,000    |
| Furniture         | 120,000    |
| Saloon vehicle    | 2,460,000  |

- There were no opening balances in the current account of partners.

**Required:**

- The partnership taxable profit or loss for the year ended 31 December 2024. (10 marks)
- Taxable income of each partner. (4 marks)

**(Total: 20 marks)**

### QUESTION THREE

- (a) Afri Reach Ltd. is a multinational company registered in Kenya and it has its headquarters in Nairobi. In order to take advantage of investment opportunities arising from the recent treaties within East Africa region, the company intends to open a branch in Tanzania and a subsidiary company in Rwanda (Afri Reach Rwanda).

**Required:**

As a tax consultant, you are required to advise the management of Afri Reach (Kenya) on the following:

- (i) Taxation of the income of the branch in Tanzania and the subsidiary company in Rwanda. (4 marks)
  - (ii) **THREE** methods that the company could use to adjust the transfer prices in arriving at taxable income in Kenya. (3 marks)
  - (iii) **THREE** requirements to be met in order to qualify for double taxation relief in Kenya. (3 marks)
- (b) The following information relate to Summer Ltd., a company registered for value added tax (VAT) purposes and is under tax investigation. The company has engaged you to assist in computation of their VAT payable for the month of December 2024.

|              |                                                                                                                                                                        |
|--------------|------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| December 1:  | Opening inventory 6,400 units each costing Sh.400.                                                                                                                     |
| December 5:  | Purchased goods on credit for Sh.584,000 and sold goods on cash basis at Sh.938,600. The suppliers also issued credit notes of Sh.48,000 and debit notes of Sh.19,200. |
| December 8:  | The company made cash purchases of Sh.1,080,000. The goods were sold in the same day on cash basis at a profit margin of 25%.                                          |
| December 12: | Purchased goods on credit from a VAT non-registered supplier worth Sh.420,000. The goods were sold on cash to VAT registered customer at a markup of 20%.              |
| December 15: | Sold goods valued at Sh.218,000 after removal of their VAT certificate of registration from the business premises. They also did not issue tax invoices on the goods.  |
| December 19: | Sold goods worth Sh.380,000. The customer paid a deposit of Sh.200,000 and the balance was to be received in January 2025.                                             |
| December 20: | Imported goods from China valued at Sh.1,000,000 (cost, insurance and freight). Import duty was at the rate of 25%.                                                    |
| December 23: | It was established that the debt note and credit note for the month were overvalued by Sh.12,000 and Sh.8,400 respectively.                                            |
| December 24: | Exported goods to Uganda worth Sh.680,000.                                                                                                                             |
| December 28: | Purchased goods on cash worth Sh.890,000.                                                                                                                              |
| December 30: | Paid the following expenses:                                                                                                                                           |

|                                                |            |
|------------------------------------------------|------------|
|                                                | <b>Sh.</b> |
| Salaries and wages                             | 880,000    |
| Electricity bill                               | 12,000     |
| Water bill - county government                 | 18,800     |
| Audit fees                                     | 230,000    |
| Rent expense (for three months each Sh.90,000) | 270,000    |
| County government sewerage services fee        | 32,000     |

Transactions are inclusive of VAT at the rate of 16% where applicable.

**Required:**

Ascertain the correct VAT position for Summer Ltd. for the month of December 2024.

(10 marks)

**(Total: 20 marks)**

### QUESTION FOUR

- (a) Explain the term “tax haven” as used in taxation. (2 marks)
- (b) An “out of court tax dispute resolution” has proven to be a practical and efficient method of resolving tax disputes across various sectors from corporate to individual levels and recently has been the most preferred method of resolving tax disputes. However, it faces limitations in respect to tax disputes it can handle hence reducing the options available to taxpayers in the process of having their tax disputes addressed.

**Required:**

Summarise **FOUR** tax disputes which cannot be addressed through an out of court dispute resolution mechanism.

(4 marks)

- (c) Beta Insurance Company Ltd. underwrites three classes of insurance namely; marine, motor vehicle and life insurance. The company operates from its own building, the major part of which is rented for commercial use.

The following details were obtained from the records of the company for the year ended 31 December 2024:

|                                              | Marine<br>Sh.“000” | Motor vehicle<br>Sh.“000” | Life insurance<br>Sh.“000” | Rental activity<br>Sh.“000” |
|----------------------------------------------|--------------------|---------------------------|----------------------------|-----------------------------|
| Management expenses                          | 4,460              | 3,500                     | -                          | 15,480                      |
| Gross premium received in the year           | 194,640            | 345,500                   | 76,690                     | -                           |
| Claims paid                                  | 16,420             | 84,440                    | 23,450                     | -                           |
| Rental income received in the year           | -                  | -                         | -                          | 154,800                     |
| Agency expenses                              | 685                | 1,248                     | 272                        | 12,680                      |
| Allowance for credit loss                    | 5,670              | 1,200                     | -                          | 26,400                      |
| Reserve for unexpired risk January 2024      | 5,360              | 11,896                    | -                          | -                           |
| Claims owing: 1 January 2024                 | 10,380             | 5,970                     | -                          | -                           |
| 31 December 2024                             | 33,960             | 12,660                    | -                          | -                           |
| Legal expenses                               | 1,782              | 648                       | 1,230                      | 12,789                      |
| Commission on reinsurance accepted           | 2,190              | 1,140                     | -                          | -                           |
| Reserve for unexpired risk: 31 December 2024 | 1,680              | 890                       | -                          | -                           |
| Telephone and postage                        | 480                | 360                       | 640                        | 1,320                       |
| Premiums returned                            | 845                | 987                       | 849                        | -                           |
| Furniture and fittings                       | 389                | 680                       | 920                        | 1,280                       |
| Interest income                              | 336                | 540                       | -                          | -                           |
| Commission on reinsurance ceded              | 8,450              | 4,380                     | -                          | -                           |
| Premiums paid to reinsurance company         | 980                | 1,120                     | -                          | -                           |

**Additional information:**

1. The company had installed water pump and a generator costing Sh.120,000 and Sh.480,000 respectively in the building. It was agreed that the usage be apportioned in the ratio of 3:3:2:1 between marine, motor vehicle, life insurance and commercial rental activity respectively.
2. Interest income consisted of 30% interest from outstanding premiums while the balance was from commercial banks fixed deposit account.
3. Legal expenses for commercial rental activity comprised of drawing of 10 years lease agreement, Sh.34,000, conveyance fees Sh.284,000 and breach of tenancy agreement defence Sh.640,000.
4. Life insurance fund balance was revalued by actuary at Sh.600,000,000. As at 31 December 2024, 10% of this fund balance was recommended to be transferred for the benefit of shareholders.

**Required:**

Compute the taxable profit or loss of Beta Insurance Company Ltd. for the year ended 31 December 2024.

(14 marks)

**(Total: 20 marks)**

**QUESTION FIVE**

- (a) Tax practitioners should evaluate whether any tax engagement is likely to pose a conflict of interest that would give rise to threat of compliance with fundamental principles.

With reference to the above statement, explain **FOUR** safeguards that should be put in place when instances of conflicts of interest are detected.

(4 marks)

- (b) Analyse **FOUR** reasons for the introduction of tax anti-avoidance provisions despite tax avoidance being a legal activity.
- (4 marks)
- (c) Patrick Ouma has not been filing his income tax returns for the last three years of operation. He recently received a notice of assessment from the commissioner of taxes showing taxable income of Sh.180,000 and Sh.460,000 for the years ended 31 December 2023 and 31 December 2024 respectively.

He has provided the following details:

- The following account balances were outstanding in the respective years:

|                 | 2023    | 2024      |
|-----------------|---------|-----------|
|                 | Sh.     | Sh.       |
| Trade debtors   | 862,500 | 970,000   |
| Bank balance    | 107,000 | (304,600) |
| Trade creditors | 402,000 | 203,800   |
| Cash in hand    | 80,000  | 110,000   |
| Inventory       | 309,100 | 602,400   |

- The following statement of financial position was provided for the year ended 31 December 2022:

|                                 | Sh. "000"    | Sh. "000"     |
|---------------------------------|--------------|---------------|
| <b>Non-current assets:</b>      |              |               |
| Furniture and fittings          | 800          |               |
| Motor vehicles                  | <u>6,900</u> | 7,700         |
| <b>Current assets:</b>          |              |               |
| Inventory                       | 406          |               |
| Debtors                         | 960          |               |
| Bank balance                    | 804          |               |
| Cash in hand                    | <u>150</u>   | <u>2,320</u>  |
|                                 |              | <u>10,020</u> |
| <b>Financed by:</b>             |              |               |
| Capital (1 January 2022)        | 7,000        |               |
| Net profit for the year         | <u>1,680</u> | 8,680         |
| <b>Non-current liabilities:</b> |              |               |
| Mortgage loan                   | 500          |               |
| <b>Current liabilities:</b>     |              |               |
| Creditors                       | <u>840</u>   | <u>1,340</u>  |
|                                 |              | <u>10,020</u> |

- The following is the summary of expenses incurred during the years:

|                                    | 2023      | 2024      |
|------------------------------------|-----------|-----------|
|                                    | Sh. "000" | Sh. "000" |
| Rent expenses                      | 340,000   | 260,000   |
| Electricity                        | 120,000   | 60,000    |
| Motor vehicle expenses             | 130,000   | 292,000   |
| Telephone expenses                 | 45,000    | 78,000    |
| Drawings of goods per month        | 10,000    | 18,000    |
| Purchase of furniture and fittings | -         | 58,000    |

- The principal repayment on mortgage loan amounted to Sh.10,000 per month. Mortgage interest was charged at the rate of 12% per annum on reducing balance basis.

- The following was agreed with the Revenue Authority:

- Capital allowance at Sh.300,000 per year.
- 60% of rent and electricity related to business while only 40% of motor vehicle and telephone expenses related to business.

**Required:**

- Using suitable computations, advise Patrick Ouma on the action to take. (8 marks)
- Evaluate **FOUR** reliable sources of information the revenue authority could use to prove their case against Patrick Ouma. (4 marks)

**(Total: 20 marks)**

.....



## CPA ADVANCED LEVEL

### ADVANCED TAXATION

**TUESDAY: 3 December 2024. Afternoon Paper.**

**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. Do NOT write anything on this paper.**

**RATES OF TAX (For employment income including wife's employment, self-employment and professional income).**

**Year of income 2023.**

**Assume the following rates of tax applied throughout the year of income 2023:**

| Monthly taxable pay<br>(Sh.) | Annual taxable pay<br>(Sh.) | Rate of tax<br>% in each Sh. |
|------------------------------|-----------------------------|------------------------------|
| 1 - 24,000                   | 1 - 288,000                 | 10%                          |
| 24,001 - 32,333              | 288,001 - 388,000           | 25%                          |
| 32,334 - 500,000             | 388,001 - 6,000,000         | 30%                          |
| 500,001 - 800,000            | 6,000,001 - 9,600,000       | 32.5%                        |
| Excess over 800,000          | Excess over 9,600,000       | 35%                          |

**Personal relief Sh.2,400 per month (Sh.28,800 per annum).**

| Investment allowance:                                                                                 | Rate of investment allowance        | Residual value<br>(25% per year<br>on equal<br>instalments) | Prescribed benefit rates of motor vehicles<br>provided by employer<br>(i) Saloons, Hatch Backs and Estates |                           |                          |
|-------------------------------------------------------------------------------------------------------|-------------------------------------|-------------------------------------------------------------|------------------------------------------------------------------------------------------------------------|---------------------------|--------------------------|
| Capital expenditure incurred on:                                                                      |                                     |                                                             |                                                                                                            | Monthly<br>rates<br>(Sh.) | Annual<br>rates<br>(Sh.) |
| (a) <b>Buildings:</b>                                                                                 |                                     |                                                             | Up to 1200 cc                                                                                              | 3,600                     | 43,200                   |
| • Hotel building                                                                                      | 50% in the first year of use        | 25%                                                         | 1201 - 1500 cc                                                                                             | 4,200                     | 50,400                   |
| • Building used for manufacture                                                                       | 50% in the first year of use        | 25%                                                         | 1501 - 1750 cc                                                                                             | 5,800                     | 69,600                   |
| • Hospital buildings                                                                                  | 50% in the first year of use        | 25%                                                         | 1751 - 2000 cc                                                                                             | 7,200                     | 86,400                   |
| • Petroleum or gas storage facilities                                                                 | 50% in the first year of use        | 25%                                                         | 2001 - 3000 cc                                                                                             | 8,600                     | 103,200                  |
| • Educational/hostels building                                                                        | 10% per year on straight line basis |                                                             | Over - 3000 cc                                                                                             | 14,400                    | 172,800                  |
| • Commercial building                                                                                 | 10% per year on straight line basis |                                                             |                                                                                                            |                           |                          |
| (b) <b>Machinery:</b>                                                                                 |                                     |                                                             | (ii) Pick-ups, Panel Vans (unconverted)                                                                    |                           |                          |
| • Machinery used for manufacture                                                                      | 50% in the first year of use        | 25%                                                         | Up to - 1750 cc                                                                                            | 3,600                     | 43,200                   |
| • Hospital equipment                                                                                  | 50% in the first year of use        | 25%                                                         | Over - 1750 cc                                                                                             | 4,200                     | 50,400                   |
| • Ships or aircraft                                                                                   | 50% in the first year of use        | 25%                                                         |                                                                                                            |                           |                          |
| • Motor vehicles and heavy earth moving equipment                                                     | 25% per year on straight line basis |                                                             | (iii) Land Rovers/Cruisers                                                                                 | 7,200                     | 86,400                   |
| • Computer software, calculators, copiers and duplicating machines                                    | 25% per year on straight line basis |                                                             |                                                                                                            |                           |                          |
| • Furniture and fittings                                                                              | 10% per year on straight line basis |                                                             |                                                                                                            |                           |                          |
| • Telecommunication equipment                                                                         | 10% per year on straight line basis |                                                             |                                                                                                            |                           |                          |
| • Film equipment by a local producer                                                                  | 25% per year on straight line basis | 25%                                                         |                                                                                                            |                           |                          |
| • Machinery used to undertake operations under prospecting rights and exploration under mining rights | 50% in the first year of use        |                                                             |                                                                                                            |                           |                          |
| • Other machinery                                                                                     | 10% per year on straight line basis |                                                             |                                                                                                            |                           |                          |
| (c) Purchase/acquisition of right to use fibre optic cable by telecommunication operation             | 10% per year on straight line basis |                                                             |                                                                                                            |                           |                          |
| (d) Farm works                                                                                        | 50% in the first year of use        | 25%                                                         |                                                                                                            |                           |                          |

**Commissioner's prescribed benefit rates:**

**Services**

|                                                | Monthly rates<br>(Sh.) | Annual rates<br>(Sh.) |
|------------------------------------------------|------------------------|-----------------------|
| (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) Tax practitioners face significant ethical and moral challenges in their work primarily due to the dual obligations they have to the client and the revenue authority. Balancing these responsibilities can be complex as they must navigate conflicting interests while adhering to legal and ethical standards.

**Required:**

Evaluate **THREE** ethical and moral challenges faced by tax practitioners in the professional tax practice. (6 marks)

- (b) Kamaly and Kalangi have been trading as Kaka Enterprises. The entity had reported a net profit of Sh.484,900. However, the reported profit was disputed by the revenue authority during the year of income 2023. The assessed taxable profit for the partnership by the revenue authority was Sh.3,880,000.

The partners have provided the following details to assist them prepare for an adjusted taxable profit which would assist in determining whether the assessment by the revenue authority was fair:

| Receipts and payments (Bank account)   |                  |                       |                  |
|----------------------------------------|------------------|-----------------------|------------------|
|                                        | Sh.              |                       | Sh.              |
| Balance brought forward 1 January 2023 | 1,840,000        | Cash purchases        | 500,000          |
| Receipts from debtors                  | 3,600,000        | Payments to creditors | 1,890,000        |
| Cash sales                             | 720,000          | Electricity           | 188,000          |
| Sale of motor vehicle                  | 360,000          | Telephone             | 172,000          |
| 15% bank loan                          | 400,000          | Purchase of furniture | 350,000          |
| Balance carried forward                | 960,000          | General expenses      | 3,700,000        |
|                                        |                  | Salaries and wages    | 480,000          |
|                                        |                  | Office computers      | 180,000          |
|                                        |                  | Rent expenses         | 240,000          |
|                                        |                  | Insurance             | 96,000           |
|                                        |                  | Advertising           | 84,000           |
|                                        | <u>7,880,000</u> |                       | <u>7,880,000</u> |

**Additional information:**

- The partners contributed capital of Sh.400,000 and Sh.600,000 for Kamaly and Kalangi respectively which was included in the opening balance in the receipts and payments account.
- General expenses included the following items which were debited in the statement of profit and loss account:

|                                                 | Sh.       |
|-------------------------------------------------|-----------|
| • Computer software                             | 90,000    |
| • Donations to a political party                | 300,000   |
| • Defending Kalangi in a land dispute           | 350,000   |
| • Withholding tax                               | 32,000    |
| • Installation of neon signs                    | 48,000    |
| • 15% bank loan repayment inclusive of interest | 200,000   |
| • Lease rental payments                         | 82,000    |
| • Purchase of motor vehicle                     | 1,200,000 |
| • Purchase of piece of land for business        | 742,000   |
| • Purchase of motorbike for office use          | 200,000   |
| • Auditing fees                                 | 96,000    |
| • Partners drawings                             | 360,000   |

- Other details included:

|                                | 1 January 2023 | 31 December 2023 |
|--------------------------------|----------------|------------------|
|                                | Sh.            | Sh.              |
| Creditors for goods            | 550,000        | 1,460,000        |
| Debtors for goods              | 640,000        | 820,000          |
| Salaries and wages accrued     | 120,000        | 89,000           |
| Rent expenses prepaid          | 36,000         | 24,000           |
| Office computers               | 150,000        | 240,000          |
| Inventories for goods in trade | 192,000        | 120,000          |
| Cash at bank                   | 840,000        | 960,000          |

- Salaries and wages included salaries paid to domestic workers for partners amounting to Sh.96,000.
- Total sales and purchases for the year 2023 were undercast by 20%.
- The 15% bank loan of Sh.400,000 relates to repairs to private residence of Kalangi.
- Telephone expenses amounting to Sh.60,000 related to partners personal calls.
- Rent expenses were understated by 25%.

**Required:**

- (i) Prepare a revised statement of adjusted profit or loss for the partnership business. (12 marks)
- (ii) Advise the partners in relation to the assessed profit by the revenue authority as compared to the adjusted taxable profit obtained in (b) (i) above. (2 marks)

**(Total: 20 marks)****QUESTION TWO**

- (a) Bright Star Electronics Enterprise is a small business operating in the retail sector. The business has experienced steady growth in sales over the years. The owner, John Irungu handles most of the financial and accounting tasks. The revenue authority has noticed discrepancies in the tax returns over the last two years where there are significant variations in the reported income and expenses. The business has also claimed several large deductions that appear unusual for the size of the business. These red flags prompted the revenue authority to issue a notice of tax audit. John Irungu has engaged you as a tax agent to assist him in this matter:

**Required:**

- (i) Explain to John Irungu **THREE** objectives of a tax audit initiated by the revenue authority. (3 marks)
- (ii) Analyse **THREE** responsibilities of a tax agent to the client during the tax audit process. (3 marks)
- (b) Ocean Ltd. is a holding company operating through two independent branches, the head office branch and Wekah branch located in a different town. The company acquired 100% shares of Zurih Ltd. in the year 2022. The following information has been provided to assist in determination of taxable income:

|                                              | Head Office Branch<br>Sh. | Wekah Branch<br>Sh. | Zurih Ltd.<br>Sh.    |
|----------------------------------------------|---------------------------|---------------------|----------------------|
| Sales                                        | 345,800,000               | 148,000,000         | 280,000,000          |
| Cost of sales                                | <u>(123,678,000)</u>      | <u>(73,890,000)</u> | <u>(136,800,000)</u> |
| Gross profit                                 | 222,122,000               | 74,110,000          | 143,200,000          |
| <b>Other incomes:</b>                        |                           |                     |                      |
| Profit from sale of marketable securities    | 3,800,000                 | -                   | -                    |
| Dividend: Wezesha Co-operative Society (Net) | 800,000                   | -                   | 640,000              |
| Interest: Banks (Net)                        | <u>300,000</u>            | <u>250,000</u>      | <u>160,000</u>       |
| Total incomes                                | 227,022,000               | 74,360,000          | 144,000,000          |
| <b>Expenses:</b>                             |                           |                     |                      |
| Repairs and maintenance                      | 17,400,000                | 3,850,000           | 8,900,000            |
| Finance charges                              | 20,700,000                | 12,680,000          | 7,560,000            |
| Legal fees                                   | 560,000                   | -                   | 300,000              |
| Depreciation                                 | 9,345,000                 | 5,890,000           | 11,890,000           |
| Computer software                            | -                         | 460,000             | -                    |
| Lorry - scrapped                             | 630,000                   | -                   | -                    |
| Loss on investment                           | 640,000                   | -                   | 890,000              |
| Travelling costs                             | 14,670,000                | 3,690,000           | 9,490,000            |
| Staff pension contribution                   | 26,890,900                | -                   | 13,670,000           |
| Intangible assets written off                | 45,450,000                | 8,960,000           | 19,956,000           |
| Directors allowance                          | 28,670,000                | -                   | 6,850,000            |
| Rent and rates                               | 32,450,000                | 6,700,000           | 16,900,000           |
| Investors loss                               | -                         | 670,000             | -                    |
| Staff salaries                               | <u>23,469,700</u>         | <u>9,880,000</u>    | <u>-</u>             |
|                                              | <u>(220,875,600)</u>      | <u>(52,780,000)</u> | <u>(96,406,000)</u>  |
| Net income                                   | <u>6,146,400</u>          | <u>21,580,000</u>   | <u>47,594,000</u>    |

**Additional information:**

- Head office branch sales include goods sold to Wekah branch and Zurih Ltd. worth Sh.3,450,000 and Sh.10,470,000 which have been marked up by 15%.
- Legal fee for Head office branch and Zurih Ltd. consist of 30% for 100 year lease while the balance was for 5 year lease for Head office and 15 year lease for Zurih Ltd.
- Head office branch finance charges consist of interest on 10% loan of Sh.5,000,000 from Zurih Ltd. advanced on 1 January 2023.
- The insurance company agreed to cover 40% of inventory loss. This has not been adjusted in the above inventory loss.
- Head office branch staff salaries consist of Sh.9,655,000 paid on behalf of Zurih Ltd. and Sh.320,000 for Wekah branch.

**Required:**

- (i) Compute the taxable profit or loss for Ocean Ltd. and Zurih Ltd. for the year ended 31 December 2023. (12 marks)
- (ii) Determine the tax payable if any by Ocean Ltd. for the year ended 31 December 2023. (2 marks)
- (Total: 20 marks)**

**QUESTION THREE**

- (a) Government provides various tax incentives to both individuals and entities with the intention of achieving various tax policy objectives. Analyse **TWO** tax incentives provided by the government to encourage home ownership in your country. (4 marks)
- (b) Tax Information Exchange Agreements (TIEAs) are bilateral agreements between two countries aimed at improving tax compliance and reducing tax evasion. While TIEAs are intended to enhance transparency and ensure that taxpayers are meeting their obligations through information sharing, they also present challenges for developing countries.

**Required:**

Argue **FOUR** cases against Tax Information Exchange Agreements (TIEAs) that are encountered by developing countries. (4 marks)

- (c) Septer Energy Ltd. is a company registered and operating in Kenya in the business of petroleum exploration and extraction. The management of the company has provided the following information to assist in determination of taxable income for the year ended 31 December 2023:

|                                         | <b>Sh.</b>    |
|-----------------------------------------|---------------|
| Disposal of interest in a contract area | 7,890,000     |
| Exploration expenditure                 | 380,000,000   |
| Depreciation                            | 945,000,000   |
| Management and administrative expenses  | 580,000,000   |
| Oil and gas storage facilities          | 15,200,000    |
| Decommissioning costs                   | 580,610,000   |
| Amortisation of intangible assets       | 680,760       |
| Instalment tax paid                     | 7,248,540,000 |
| Hire of saloon cars                     | 3,800,000     |
| Hire of tractors                        | 2,380,000     |
| Custom duty on drilling machines        | 560,000       |
| Sale of natural gas                     | 975,800,000   |
| General expenses                        | 78,000,000    |

**Additional information:**

- Crude oil sold locally 59,000 barrels  
Crude oil sold to a company in UK 1,920,000 barrels  
Crude oil sold to a company in USA 3,381,000 barrels
- The selling prices of crude oil was as follows during the year:
  - Local sales Sh.9,600 per barrel
  - Company in USA: 50 US Dollars per barrel
  - Company in UK : 44 UK£ per barrel
- The average exchange rates were as follows:
  - US dollars to shilling - 1 dollar: Sh.120
  - UK£ to shilling - 1£ : Sh.190
- The following details relate to capital expenditure:

| <b>Item</b>                 | <b>Date</b>      | <b>Cost<br/>(Sh.)</b> | <b>Location</b> |
|-----------------------------|------------------|-----------------------|-----------------|
| Oil rig                     | 1 April 2022     | 12,800,000            | Offshore        |
| Telecommunication equipment | 1 January 2023   | 2,500,000             | Offshore        |
| Pipelines and storage tanks | 1 September 2023 | 10,480,000            | Offshore        |
| Computers                   | 1 January 2023   | 3,000,000             | Onshore         |

**Required:**

- (i) Prepare adjusted taxable profit or loss for Septer Energy Ltd. for the year ended 31 December 2023. (10 marks)
- (ii) Determine the corporate tax payable if any, for the year ended 31 December 2023. (2 marks)
- (Total: 20 marks)**

#### QUESTION FOUR

- (a) (i) Explain the term “treaty shopping” as used in taxation. (2 marks)
- (ii) Evaluate **THREE** obstacles that the government in your country could encounter when dealing with multinational corporations engaging in treaty shopping to undermine government efforts in maximising tax revenue. (6 marks)

- (b) Sokoh Plc, a company registered for value added tax (VAT) purposes buys and sells goods locally and in the foreign markets. The following transactions were extracted from the books of the company for the month of September 2024:

September 2: Purchased goods from local market for Sh.103,240.  
September 4: Imported goods from Japan with a landed cost of Sh.340,000 excluding import duty and value added tax. The import duty rate was 25%  
September 6: Sold goods to the local market for Sh.180,960 on credit.  
September 8: Paid audit fees of Sh.17,400 in respect to establishing an internal control system.  
September 10: Goods valued at Sh.20,880 were returned to the business by credit customers and a credit note issued immediately.  
September 12: Paid for catering expenses Sh.26,680 in respect to a restaurant facility managed by another firm.  
September 14: Sold goods to a firm operating in Egypt for Sh.480,000.  
September 16: Received debit notes for 62,640 in respect to erroneous invoices received earlier.  
September 18: Exported goods to Malawi valued at Sh.240,000.  
September 20: Purchased computer and computer software for Sh.208,800 for use in the business.  
September 22: Supplied unprocessed fruits and milk to Starlight Enterprise for Sh.170,000.  
September 24: Sold goods to Lucky Enterprise for Sh.64,960.  
September 26: Purchased oils and fuel of Sh.9,280 for a generator used in the business.  
September 28: A customer owing the business goods worth Sh.20,300 was declared bankrupt and the debt was written off immediately.  
September 30: Sold goods exempt from VAT for Sh.250,000.

All transactions are inclusive of value added tax (VAT) where applicable unless otherwise stated.

#### Required:

- (i) Calculate the value added tax (VAT) payable by or refundable to Sokoh Plc for the month of September 2024. (10 marks)
- (ii) Advise the management of Sokoh Ltd. on **TWO** omissions that if committed constitute VAT offences. (2 marks)
- (Total: 20 marks)**

#### QUESTION FIVE

- (a) The taxation of capital gains in Kenya represents a significant shift in the country’s tax policy. While its reintroduction has increased government revenue and aligned Kenya with international practices, it also presents challenges. Hence ongoing improvements and adjustments in its administration is crucial for optimising the benefits of capital gains tax while minimising its drawbacks.

#### Required:

- (i) Analyse **TWO** circumstances that constitute transfer of property for purpose of computing Capital Gains Tax. (2 marks)
- (ii) Explain **TWO** challenges encountered in administration of Capital Gains Tax in your country. (2 marks)
- (b) In a tax seminar, one of the facilitators noted that, “generally there are two main types of tax systems that are adopted by different countries, that is, unified tax system and multiple tax systems”.

With reference to the above statement, argue **THREE** cases against multiple tax systems adopted by different countries. (3 marks)

- (c) Tamala Nyambura is a resident of Kenya. During the year ended 31 December 2023, she received the following income:

From employment in Kenya Sh.720,000 gross.

From employment in Zambia Sh.540,000 (net of Sh.78,000 paid as tax in Zambia)

Assume that:

- Kenya has a double taxation agreement with Zambia.
- Income from Zambia has already been converted into equivalent Kenya Shillings.

**Required:**

Compute double taxation relief due to Tamala Nyambura and net tax payable if any for the year ended 31 December 2023. (5 marks)

- (d) Hightec Contractors Ltd. has been in the construction business for many years. The following information relates to one of its construction contracts for the year ended 31 December 2023:

**Balances as at 1 January 2023:**

|                                 | Sh.“000” |
|---------------------------------|----------|
| Material on site                | 30,000   |
| Accrued wages                   | 2,000    |
| Rent prepaid (contract related) | 4,000    |
| Plant (written down value)      | 20,000   |

**Transactions during the year:**

|                                     |         |
|-------------------------------------|---------|
| Material sent to site               | 100,000 |
| Plant purchased                     | 10,000  |
| Wages paid                          | 8,000   |
| Inspection fees                     | 2,000   |
| Subcontractors' fee                 | 1,000   |
| Consultancy fee                     | 3,000   |
| Materials sold (cost)               | 1,500   |
| Casual labour                       | 2,000   |
| Head office expenses                | 3,000   |
| Depreciation (provision)            | 4,000   |
| Rent paid (non-contract related)    | 8,000   |
| Other expenses (allowable)          | 2,000   |
| Value of work certified in the year | 120,000 |
| Cost of work uncertified            | 20,000  |
| Cash received from client           | 80,000  |

**Balances as at 31 December 2023:**

|                                 |        |
|---------------------------------|--------|
| Materials on site               | 50,000 |
| Wages accrued                   | 4,000  |
| Rent accrued (contract related) | 5,000  |

**Additional information:**

1. Investment allowances agreed with the commissioner of revenue authority is at the rate of 10% on plant.
2. The company policy recognises two-thirds of annual profits when they arise for tax purposes.
3. Any contract losses are recognised in full in the year of their occurrence.

**Required:**

- (i) Compute contract profit or loss for the year ended 31 December 2023 for Hightec Contractors Ltd. (6 marks)

- (ii) Determine taxable profit or loss for the year ended 31 December 2023, assuming that there were no other contracts. (2 marks)

**(Total: 20 marks)**

.....

**CPA ADVANCED LEVEL**

**ADVANCED TAXATION**

**TUESDAY: 20 August 2024. Afternoon Paper.**

**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. Do NOT write anything on this paper.**

**RATES OF TAX (For employment income including wife's employment, self-employment and professional income).**

**Year of income 2023.**

**Assume the following rates of tax applied throughout the year of income 2023:**

| Monthly taxable pay<br>(Sh.) | Annual taxable pay<br>(Sh.) | Rate of tax<br>% in each Sh. |
|------------------------------|-----------------------------|------------------------------|
| 1 - 24,000                   | 1 - 288,000                 | 10%                          |
| 24,001 - 32,333              | 288,001 - 388,000           | 25%                          |
| 32,334 - 500,000             | 388,001 - 6,000,000         | 30%                          |
| 500,001 - 800,000            | 6,000,001 - 9,600,000       | 32.5%                        |
| Excess over 800,000          | Excess over 9,600,000       | 35%                          |

**Personal relief Sh.2,400 per month (Sh.28,800 per annum).**

| Investment allowance:<br><br>Capital expenditure incurred on:                                         | Rate of investment allowance        | Residual value<br>(25% per year<br>on equal<br>instalments) | Prescribed benefit rates of motor vehicles<br>provided by employer<br>(i) Saloons, Hatch Backs and Estates |                                    |                                   |
|-------------------------------------------------------------------------------------------------------|-------------------------------------|-------------------------------------------------------------|------------------------------------------------------------------------------------------------------------|------------------------------------|-----------------------------------|
|                                                                                                       |                                     |                                                             |                                                                                                            | <b>Monthly<br/>rates<br/>(Sh.)</b> | <b>Annual<br/>rates<br/>(Sh.)</b> |
| (a) <b>Buildings:</b>                                                                                 |                                     |                                                             | Up to 1200 cc                                                                                              | 3,600                              | 43,200                            |
| • Hotel building                                                                                      | 50% in the first year of use        | 25%                                                         | 1201 - 1500 cc                                                                                             | 4,200                              | 50,400                            |
| • Building used for manufacture                                                                       | 50% in the first year of use        | 25%                                                         | 1501 - 1750 cc                                                                                             | 5,800                              | 69,600                            |
| • Hospital buildings                                                                                  | 50% in the first year of use        | 25%                                                         | 1751 - 2000 cc                                                                                             | 7,200                              | 86,400                            |
| • Petroleum or gas storage facilities                                                                 | 50% in the first year of use        | 25%                                                         | 2001 - 3000 cc                                                                                             | 8,600                              | 103,200                           |
| • Educational/hostels building                                                                        | 10% per year on straight line basis |                                                             | Over - 3000 cc                                                                                             | 14,400                             | 172,800                           |
| • Commercial building                                                                                 | 10% per year on straight line basis |                                                             |                                                                                                            |                                    |                                   |
| (b) <b>Machinery:</b>                                                                                 |                                     |                                                             | (ii) Pick-ups, Panel Vans (unconverted)                                                                    |                                    |                                   |
| • Machinery used for manufacture                                                                      | 50% in the first year of use        | 25%                                                         | Up to - 1750 cc                                                                                            | 3,600                              | 43,200                            |
| • Hospital equipment                                                                                  | 50% in the first year of use        | 25%                                                         | Over - 1750 cc                                                                                             | 4,200                              | 50,400                            |
| • Ships or aircraft                                                                                   | 50% in the first year of use        | 25%                                                         |                                                                                                            |                                    |                                   |
| • Motor vehicles and heavy earth moving equipment                                                     | 25% per year on straight line basis |                                                             | (iii) Land Rovers/Cruisers                                                                                 | 7,200                              | 86,400                            |
| • Computer software, calculators, copiers and duplicating machines                                    | 25% per year on straight line basis |                                                             |                                                                                                            |                                    |                                   |
| • Furniture and fittings                                                                              | 10% per year on straight line basis |                                                             |                                                                                                            |                                    |                                   |
| • Telecommunication equipment                                                                         | 10% per year on straight line basis |                                                             |                                                                                                            |                                    |                                   |
| • Film equipment by a local producer                                                                  | 25% per year on straight line basis | 25%                                                         |                                                                                                            |                                    |                                   |
| • Machinery used to undertake operations under prospecting rights and exploration under mining rights | 50% in the first year of use        |                                                             |                                                                                                            |                                    |                                   |
| • Other machinery                                                                                     | 10% per year on straight line basis |                                                             |                                                                                                            |                                    |                                   |
| (c) Purchase/acquisition of right to use fibre optic cable by telecommunication operation             | 10% per year on straight line basis |                                                             |                                                                                                            |                                    |                                   |
| (d) Farm works                                                                                        | 50% in the first year of use        | 25%                                                         |                                                                                                            |                                    |                                   |

**Commissioner's prescribed benefit rates:**

**Services**

|                                                | Monthly rates<br>(Sh.) | Annual rates<br>(Sh.) |
|------------------------------------------------|------------------------|-----------------------|
| (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) Britany PLC is a medium-sized manufacturing company operating in Kenya, engaged in the production of cosmetic products. In year 2023, the Revenue Authority conducted an audit and issued a tax assessment, alleging that the company had underreported its income and owed an additional Sh.18 million in taxes, penalties and interest.

The company disagreed with the Revenue Authority assessment, citing discrepancies in the audit process and claiming that certain allowable deductions were not considered. However, instead of taking the matter to the Tax Appeals Tribunal (TAT), the company opted to use the Alternative Dispute Resolution (ADR) framework to resolve the dispute.

**Required:**

- (i) Explain to the management of Britany PLC on the steps that will be followed in the Alternative Dispute Resolution (ADR) process. (5 marks)
- (ii) Summarise **THREE** potential benefits to Britany PLC from using ADR instead of proceeding directly to the TAT or the courts. (3 marks)
- (b) Explain **THREE** tax planning strategies that corporations could use to maximise tax benefits when they dispose of business operations in Kenya. (6 marks)
- (c) John Mwema owns a private logistics company which he has been operating for the last six years. Recently, the Revenue Authority conducted an in-depth examination of his tax returns due to inconsistencies in his reported income, expenses, assets and liabilities over the past three years.

The following information was reported by John Mwema and later amended by the Revenue Authority:

Reported figures by the logistic company:

| Year | Gross income<br>Sh. | Business expenses<br>Sh. | Personal expenses<br>Sh. | Living expenses<br>Sh. | Assets<br>Sh. | Liabilities<br>Sh. |
|------|---------------------|--------------------------|--------------------------|------------------------|---------------|--------------------|
| 2021 | 4,000,000           | 3,200,000                | 500,000                  | 300,000                | 10,000,000    | 2,000,000          |
| 2022 | 4,500,000           | 3,600,000                | 600,000                  | 400,000                | 11,000,000    | 2,500,000          |
| 2023 | 5,000,000           | 4,000,000                | 700,000                  | 500,000                | 12,000,000    | 3,000,000          |

Assessed figures by the Revenue Authority after in-depth audit findings:

| Year | Gross income<br>Sh. | Business expenses<br>Sh. | Personal expenses<br>Sh. | Living expenses<br>Sh. | Assets<br>Sh. | Liabilities<br>Sh. |
|------|---------------------|--------------------------|--------------------------|------------------------|---------------|--------------------|
| 2021 | 4,500,000           | 2,900,000                | 600,000                  | 400,000                | 11,000,000    | 1,800,000          |
| 2022 | 5,000,000           | 3,200,000                | 700,000                  | 500,000                | 12,500,000    | 2,300,000          |
| 2023 | 5,500,000           | 3,500,000                | 800,000                  | 600,000                | 14,000,000    | 2,800,000          |

The corporate tax rate is at 30%.

**Required:**

- (i) Determine the additional taxable income for each of the years ending 31 December 2021 to 31 December 2023. (4 marks)
- (ii) Compute the total back duty tax liability that John Mwema's Logistics Company Ltd. owes Revenue Authority for the three years. (2 marks)
- (Total: 20 marks)**

### QUESTION TWO

- (a) Analyse **FOUR** challenges of taxing digital economy by the Revenue Authority of your country. (4 marks)
- (b) Pelly and Mark have been partners trading as Pama Enterprises from 1 January 2021 having contributed Sh.12,000,000 and Sh.15,000,000 as capital for Pelly and Mark respectively. They prepare their accounts to 31 December every year. Due to the need of expanding their business, they decided to admit Colley on 1 May 2023 and changed the business name to Pamac Enterprise. Colley brought in Sh.18,000,000 as his capital contribution. Prior to the admission of Colley, the profit and loss sharing ratio was 2:3 between Pelly and Mark respectively. However, with the admission of Colley they revised the profit and loss sharing ratio to 2:3:4 for Pelly, Mark and Colley respectively.

The following information was extracted from the business records for the year ended 31 December 2023:

1. Assets and liabilities as at 31 December:

|                           | 2022<br>Sh."000" | 2023<br>Sh."000" |
|---------------------------|------------------|------------------|
| Payables                  | 7,200            | 11,050           |
| Accrued salary and wages  | 1,600            | 2,300            |
| Accrued rent              | 1,825            | 2,100            |
| Prepaid electricity bills | 293              | 245              |
| Furniture and fittings    | 600              | 450              |
| Balance at bank           | 7,910            | 9,566            |
| Equipment                 | 670              | 530              |
| Inventory                 | 1,248            | 897              |

2. During the year ended 31 December 2023, the partners banked all cash collections after deducting the following monthly expenses:

|                              | Sh.     |
|------------------------------|---------|
| Repair and maintenance       | 20,000  |
| Stationery                   | 23,700  |
| Sundry expenses              | 32,000  |
| Motor vehicle expenses       | 20,500  |
| Purchase of goods for resale | 190,000 |

3. Payments made through the bank during the year ended 31 December 2023, have been summarised as follows:

|                        | Sh."000" |
|------------------------|----------|
| Rent                   | 2,250    |
| Motor vehicle expenses | 420      |
| Web hosting cost       | 25       |
| Directors allowance    | 450      |
| General expenses       | 10,779   |
| Electricity            | 1,800    |
| Purchase of goods      | 52,640   |
| Floatation cost        | 200      |
| Salaries and wages     | 8,300    |
| Purchase of saloon car | 4,500    |

4. The partnership business was converted into a limited company by the name Pamac Limited on 1 September 2023 and the partners became the directors of the company. Upon conversion, the company issued 8% debentures of Sh.15,000,000.
5. On average, the business sold all goods at a gross profit margin of 30%.
6. Specific provision for bad and doubtful debts as at 1 January 2023 was Sh.8,300,000 while as at 31 December 2023 was Sh.3,400,000.
7. There was no disposal of fixed assets during the year.
8. The partners were charging interest on capital at the rate of 10% per annum.
9. The partners annual salary was Sh.1,000,000, Sh.2,500,000 and Sh.3,000,000 for Pelly, Mark and Colley respectively. The partners salary was not included in the salary and wages for the year.
10. Sales, purchase and expenses accrued evenly throughout the year.

**Required:**

- (i) In a columnar format, determine the taxable income of the partnership and Pamac Limited for the year ended 31 December 2023. (11 marks)
- (ii) Compute taxable income of each partner for the year ended 31 December 2023. (5 marks)

**(Total: 20 marks)**

**QUESTION THREE**

- (a) Superlite Investments Ltd. acquired land from Wema Estate at a cost of Sh.15,600,000 in the year 2019. Other incidental costs incurred in relation to acquisition of the land included the following:

|                                 | Sh.       |
|---------------------------------|-----------|
| Legal fees                      | 464,320   |
| Commissions                     | 3,400,000 |
| Stamp duty                      | 312,040   |
| Survey fees                     | 100,000   |
| Land board consent facilitation | 20,000    |

Superlite Investments Ltd. later sold the land to Express Ltd. on 1 May 2023 at the transfer price of Sh.31,200,000. However, Superlite Investments Limited did not pay capital gains tax at the time of transfer of the land to Express Ltd. The revenue authority issued an assessment on 30 June 2024 that is, after a period of one year and two months had elapsed since the date of transfer.

**Required:**

- (i) Compute the capital gains tax payable by Superlite Investments Ltd. assuming the company had paid on due date. (4 marks)
- (ii) Calculate the penalty and interest charged and the total tax payable by Superlite Investments Ltd., if the company paid after one year and two months from the due date of transfer. (2 marks)
- (iii) The management of Superlite Investments Ltd. are considering on whether to negotiate with the revenue authority, in effort of being exempted from payment of penalties and interest.

**Required:**

Advise the management of Superlite Investments Ltd. on two factors that could be considered by the revenue authority while negotiating for settlement of taxes, penalties and interest. (2 marks)

- (b) The following balances were extracted from the books of Sharp Bank Ltd. on 31 December 2023:

|                                          | Sh. "000" |
|------------------------------------------|-----------|
| Government securities                    | 1,172,000 |
| Loans and advances to customers          | 2,973,200 |
| Cash and balances with central bank      | 628,500   |
| Property, plant and equipment            | 504,000   |
| Interest on loans and advances           | 435,400   |
| Interest on government securities        | 238,200   |
| Foreign exchange income                  | 72,000    |
| Fees and commission income               | 170,200   |
| Deposits with other banks                | 115,000   |
| Other fixed assets                       | 32,000    |
| Interest on placement and bank balances  | 36,000    |
| Non-operating income                     | 17,000    |
| Customers deposits                       | 4,240,000 |
| Deposits and balances due to other banks | 215,000   |
| Depreciation expense                     | 42,000    |
| Directors emolument                      | 12,500    |
| Bad and doubtful debts expenses          | 34,000    |
| Interim dividends paid                   | 25,000    |
| Staff costs                              | 295,000   |
| Interest on customers deposits           | 115,000   |
| Interest on borrowed funds               | 35,000    |
| Ordinary share capital                   | 250,000   |
| Auditors fees                            | 3,500     |
| Contribution to staff provident fund     | 14,500    |
| Loss on sale of fixed asset              | 21,800    |
| General administration expenses          | 142,500   |
| Reserves                                 | 529,000   |
| Legal and professional fees              | 20,000    |

**Additional information:**

1. Taxable profit for the year 2023 had been estimated at Sh.100,000,000 on 1 January 2023 for corporate tax purposes.
2. Final dividend has been proposed at 10%.
3. Accrued interest expense on customers deposit as at 31 December 2023 was Sh.30,000,000.
4. Unrecorded interest income on loans advanced to customers was Sh.1,500,000 as at 31 December 2023.

**Required:**

- (i) Compute the taxable income for Sharp Bank Ltd. for the year ended 31 December 2023. (8 marks)
- (ii) Determine the tax payable if any by Sharp Bank Ltd. for the year ended 31 December 2023. (2 marks)

- (iii) Indicate the due dates, amount of tax payable and any penalty applicable for instalment tax payable by Sharp Bank Ltd. for the year ended 31 December 2023. (2 marks).

**(Total: 20 marks)**

#### QUESTION FOUR

- (a) The Revenue Authority of your country is under pressure from the national government to enhance the tax collection and administration efficiency in a bid to raise sufficient revenue.

To this end the revenue authority is considering adopting the tax base expansion strategies.

#### Required:

Advise the commissioner in charge of the revenue authority on **FIVE** tax base expansion strategies that the revenue authority could adopt. (5 marks)

- (b) The following information relates to Pembe Ltd. for the year ended 31 December 2023:

1. Trading income before tax was reported to be Sh.38,400,000 which included net rental income from a commercial property of Sh.4,800,000.

The rental income was after deducting the following expenses:

|                                            | Sh.       |
|--------------------------------------------|-----------|
| • Advertising before letting               | 400,000   |
| • Mortgage repayment (Interest Sh.360,000) | 1,200,000 |
| • CCTV cameras and partitions cost         | 360,000   |

2. The trading income was before adjusting for the following transactions:

|                                                                                                                                                                                          | Sh.       |
|------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|-----------|
| • Foreign exchange gains unrealised                                                                                                                                                      | 1,926,000 |
| • Insurance compensation on inventory                                                                                                                                                    | 192,000   |
| • Bad debts recovered previously written off                                                                                                                                             | 144,000   |
| • The company had a loan of Sh.24,000,000 with an interest rate of 12% per annum. Accrued interest at year end was Sh.520,000 which was not factored in determining profit for the year. |           |
| • Investment allowances deducted amounted to Sh.8,000,000. However, this was revised to Sh.6,000,000 following an audit and agreement with the revenue authority.                        |           |

3. Other incomes of the company included:

|                                                  |                    |
|--------------------------------------------------|--------------------|
| • Interest income from Mavuno Ltd.               | Sh.480,000 (gross) |
| • Dividend from Biashara Bank Ltd.               | Sh.142,500 (net)   |
| • Dividend from Mazera Co-operative Society Ltd. | Sh.204,000 (net)   |

4. Pembe Ltd. dividend payout ratio is 40% of trading income and 100% for any other income received during the year.
5. Total dividends paid for the year ended 31 December 2023 amounted to Sh.7,600,000.
6. Corporate tax rate is 30%.

#### Required:

Compute the shortfall distribution tax for the year ended 31 December 2023.

(7 marks)

- (c) The following balances were extracted from the books of Bright Sacco Ltd as at 31 December 2023:

|                                      | Sh.     | Sh.        |
|--------------------------------------|---------|------------|
| Dividend from investments            |         | 1,407,400  |
| Rental income                        |         | 2,495,000  |
| Sundry provisions                    |         | 892,500    |
| Interest income SBN Bank             |         | 2,604,500  |
| Interest income CMC Wealth Fund      |         | 804,000    |
| Revaluation reserve                  |         | 2,075,000  |
| Statutory reserve fund               |         | 1,374,000  |
| Entrance fees                        |         | 430,000    |
| Members deposits                     |         | 70,000,000 |
| Share capital                        |         | 6,465,000  |
| Sundry creditors                     |         | 340,815    |
| Bank overdraft                       |         | 615,000    |
| Interest received from members loans |         | 3,200,000  |
| Travelling expenses: Staff           | 88,030  |            |
| Committee members                    | 210,015 |            |

|                                          | Sh.               | Sh.               |
|------------------------------------------|-------------------|-------------------|
| Bank charges                             | 40,000            |                   |
| Bank interest                            | 280,500           |                   |
| Salaries and wages                       | 228,600           |                   |
| Committees education                     | 500,000           |                   |
| Interest on mortgage for rented property | 482,000           |                   |
| Printing and stationery                  | 316,500           |                   |
| Annual general meeting expenses          | 1,070,000         |                   |
| Entertainment                            | 105,000           |                   |
| Audit fees                               | 613,650           |                   |
| Legal fees                               | 440,000           |                   |
| Cash in hand                             | 1,054,000         |                   |
| KUSCCO deposits                          | 2,438,000         |                   |
| SBN Bank savings                         | 3,240,000         |                   |
| Loans to members                         | 69,333,420        |                   |
| Receivables (members)                    | 2,268,500         |                   |
| Investment in CMC Wealth Fund            | 5,540,000         |                   |
| Receivables (non-members)                | 2,250,000         |                   |
| Other investments                        | 2,115,000         |                   |
| Furniture and office equipment           | 90,000            |                   |
|                                          | <u>90,703,215</u> | <u>90,703,215</u> |

**Additional information:**

- The management committee has proposed the payment of honoraria amounting to Sh.1,120,000.
- Outstanding rental income as at 31 December 2023 amounted to Sh.86,000 and as at 1 January 2023 Sh.124,000.
- Dividend from investment companies:
 

|                                                                                 |              |
|---------------------------------------------------------------------------------|--------------|
| Dividend received from Kenya Union of Saving and Credit Co-operatives (KUSCCO). | Sh.1,200,000 |
| Dividend received from Weka Ltd.                                                | Sh.86,050    |
| Dividend received from Apex Ltd. – Uganda.                                      | Sh.121,350   |
- Staff salaries amounting to Sh.315,000 had not been paid as at 31 December 2023.
- Members are to be paid dividend at the rate of 10% per share.
- Accrued interest on members loans as at 31 December 2023 amounted to Sh.480,000. Interest and dividends were stated at the gross amount.

**Required:**

Compute the taxable income and tax payable if any by Bright Sacco Ltd. for the year ended 31 December 2023. (8 marks)

**(Total: 20 marks)**

**QUESTION FIVE**

- (a) Evaluate **FOUR** ethical issues that policy makers are required to consider when designing tax systems. (4 marks)

- (b) In a tax seminar one of the facilitators noted that “most governments in developing countries are faced with challenges of regulating and combating the use of tax haven”.

With reference to the above statement, analyse **FIVE** challenges faced by governments in regulating and combating the use of tax havens. (5 marks)

- (c) (i) Explain the term “value added tax (VAT) reverse charge”. (1 mark)

- (ii) The following information relates to Laser Limited, a company engaged in supply of taxable goods for the month of May 2024. The company was registered for VAT on 1 May 2024.

- Inventory in trade at 1 May 2024 was valued at Sh.813,000.
- The company purchased goods on credit and cash worth Sh.4,750,000 and Sh.2,980,000 respectively. Goods purchased on cash worth Sh.180,000 did not have supporting fiscal receipts.
- The company sold goods worth Sh.8,768,000 during the month. These goods included exempt sales worth Sh.3,670,000 and exports to South Africa worth Sh.1,500,000.
- The company received credit notes and debit notes worth Sh.600,000 and Sh.540,000 respectively.
- During the month, the company purchased a motor vehicle on hire purchase at Sh.4,500,000 to be used in the business. The cash price was Sh.3,800,000.

6. The company imported goods valued at Sh.2,400,000 (Cost, Insurance and Freight). The company incurred clearing and transport cost of Sh.450,000 and Sh.150,000 respectively. This import was not included in the purchases above. The import duty rate during the year was 25%.
7. The company incurred the following expenses during the month:
- |                              | Sh.       |
|------------------------------|-----------|
| Legal expenses               | 350,000   |
| Salary and wages             | 1,334,000 |
| Office rent                  | 580,000   |
| Water from county government | 89,000    |
| Electricity                  | 54,000    |
8. The company could not identify goods sold as exempt when they were purchased and therefore restricted deductible input VAT.
9. Transactions are inclusive of VAT at the rate of 16% where applicable.

**Required:**

Determine value added tax (VAT) payable by or refundable to Laser Limited for the month of May 2024.  
(10 marks)

**(Total: 20 marks)**

.....

**CPA ADVANCED LEVEL**

**ADVANCED TAXATION**

**TUESDAY: 23 April 2024. Afternoon Paper.**

**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. Do NOT write anything on this paper.**

**RATES OF TAX (For employment income including wife's employment, self-employment and professional income).**

**Year of income 2023.**

**Assume the following rates of tax applied throughout the year of income 2023:**

| Monthly taxable pay<br>(Sh.) | Annual taxable pay<br>(Sh.) | Rate of tax<br>% in each Sh. |
|------------------------------|-----------------------------|------------------------------|
| 1 - 24,000                   | 1 - 288,000                 | 10%                          |
| 24,001 - 32,333              | 288,001 - 388,000           | 25%                          |
| 32,334 - 500,000             | 388,001 - 6,000,000         | 30%                          |
| 500,001 - 800,000            | 6,000,001 - 9,600,000       | 32.5%                        |
| Excess over 800,000          | Excess over 9,600,000       | 35%                          |

**Personal relief Sh.2,400 per month (Sh.28,800 per annum).**

| Investment allowance:                                                                                 | Rate of investment allowance        | Residual value<br>(25% per year<br>on equal<br>instalments) | Prescribed benefit rates of motor vehicles<br>provided by employer<br>(i) Saloons, Hatch Backs and Estates |
|-------------------------------------------------------------------------------------------------------|-------------------------------------|-------------------------------------------------------------|------------------------------------------------------------------------------------------------------------|
| Capital expenditure incurred on:                                                                      |                                     |                                                             | Monthly rates<br>(Sh.) Annual rates<br>(Sh.)                                                               |
| (a) <b>Buildings:</b>                                                                                 |                                     |                                                             |                                                                                                            |
| • Hotel building                                                                                      | 50% in the first year of use        | 25%                                                         | Up to 1200 cc 3,600 43,200                                                                                 |
| • Building used for manufacture                                                                       | 50% in the first year of use        | 25%                                                         | 1201 - 1500 cc 4,200 50,400                                                                                |
| • Hospital buildings                                                                                  | 50% in the first year of use        | 25%                                                         | 1501 - 1750 cc 5,800 69,600                                                                                |
| • Petroleum or gas storage facilities                                                                 | 50% in the first year of use        | 25%                                                         | 1751 - 2000 cc 7,200 86,400                                                                                |
| • Educational/hostels building                                                                        | 10% per year on straight line basis |                                                             | 2001 - 3000 cc 8,600 103,200                                                                               |
| • Commercial building                                                                                 | 10% per year on straight line basis |                                                             | Over - 3000 cc 4,400 172,800                                                                               |
| (b) <b>Machinery:</b>                                                                                 |                                     |                                                             |                                                                                                            |
| • Machinery used for manufacture                                                                      | 50% in the first year of use        | 25%                                                         | (ii) Pick-ups, Panel Vans (unconverted)                                                                    |
| • Hospital equipment                                                                                  | 50% in the first year of use        | 25%                                                         | Up to - 1750 cc 3,600 43,200                                                                               |
| • Ships or aircraft                                                                                   | 50% in the first year of use        | 25%                                                         | Over - 1750 cc 4,200 50,400                                                                                |
| • Motor vehicles and heavy earth moving equipment                                                     | 25% per year on straight line basis |                                                             |                                                                                                            |
| • Computer software, calculators, copiers and duplicating machines                                    | 25% per year on straight line basis |                                                             |                                                                                                            |
| • Furniture and fittings                                                                              | 10% per year on straight line basis |                                                             |                                                                                                            |
| • Telecommunication equipment                                                                         | 10% per year on straight line basis |                                                             |                                                                                                            |
| • Film equipment by a local producer                                                                  | 25% per year on straight line basis |                                                             |                                                                                                            |
| • Machinery used to undertake operations under prospecting rights and exploration under mining rights | 50% in the first year of use        | 25%                                                         | (iii) Land Rovers/Cruisers 7,200 86,400                                                                    |
| • Other machinery                                                                                     | 10% per year on straight line basis |                                                             |                                                                                                            |
| (c) Purchase/acquisition of right to use fibre optic cable by telecommunication operation             | 10% per year on straight line basis |                                                             |                                                                                                            |
| (d) Farm works                                                                                        | 50% in the first year of use        | 25%                                                         |                                                                                                            |

**Commissioner's prescribed benefit rates:**

**Services**

|                                                | Monthly rates<br>(Sh.) | Annual rates<br>(Sh.) |
|------------------------------------------------|------------------------|-----------------------|
| (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) SpeedTech Corporation is a multinational technology company operating in Kenya. The company provides digital services to consumers in the country.

**Required:**

Analyse the impact of digital service tax on SpeedTech Corporation's operations in Kenya. (4 marks)

- (b) The following information was extracted from the books of Henry and Titus who operate a partnership business and share profits and losses in the ratio of 3:2 respectively:

1. An extract from the statement of financial position as at 31 December 2022 revealed the following information about the partnership:

| Asset                  | Cost/net book value | Sh."000" |
|------------------------|---------------------|----------|
| Freehold land          | Cost                | 64,000   |
| Office equipment       | Net book value      | 4,160    |
| Furniture and fittings | Net book value      | 4,800    |
| Delivery vans          | Net book value      | 8,000    |

The net book values as at 31 December 2022 were the same as the tax written down values.

2. Current assets and liabilities as at 31 December 2022 were reported as follows:

|                   | Sh."000" |
|-------------------|----------|
| Stock             | 8,800    |
| Trade receivables | 640      |
| Bank overdraft    | 480      |
| Cash in hand      | 64       |

3. On 1 January 2023, each partner contributed additional capital of Sh.5,000,000. Interest on capital was at the rate of 5% per annum.

4. Sales proceeds that were banked in the year amounted to Sh.160,000,000. The accountant had paid the following expenses from sales proceeds before banking the balance:

|                                     | Sh.              |
|-------------------------------------|------------------|
| Office rent                         | 32,000 per month |
| Office expenses                     | 8,000 per week   |
| Laptop for office use               | 40,000           |
| Salaries and wages - casual workers | 3,600 per week   |
| Carriage outwards                   | 5,200 per week   |
| Salary to partners: Henry           | 16,000 per month |
| Titus                               | 24,000 per month |

5. From the bank, the partnership made the following payments:

|                                      | Sh.         |
|--------------------------------------|-------------|
| Purchase of computers                | 102,400     |
| Purchase of motor cycle for salesmen | 160,000     |
| Staff salaries per month             | 80,000      |
| Purchase of goods for resale         | 124,800,000 |
| Drawings per month: Henry            | 80,000      |
| Titus                                | 64,000      |
| Stellah                              | 36,000      |
| Bank charges per month               | 2,400       |
| Telephone bills per month            | 6,400       |
| Electricity bill per month           | 8,000       |

6. On 1 September 2023, Stellah was admitted as a partner on the following terms:

- She was to contribute capital amounting to Sh.16,000,0000
- She was to receive a salary of Sh.480,000 per annum and commission of 1% on the total sales made after her admission.
- Interest on capital was to be charged at 10% per annum from 1 September 2023.
- Profit and loss sharing ratio was changed to 3:2:1 for Henry, Titus and Stellah respectively.

7. Analysis of other records revealed the following:

- Stock as at 31 December 2023 amounted to Sh.6,400,000.
- Included in the stock at year end were goods which had cost Sh.880,000 but could now be sold for Sh.640,000.

- Trade payables and trade receivables as at 31 December 2023 were Sh.1,280,000 and Sh.1,120,000 respectively.
  - Discount received from suppliers amounted to Sh.576,000 for the year.
  - Sales, purchases and expenses accrued evenly throughout the year.
8. Partners' capital as at 1 January 2023 was contributed equally by Henry and Titus. Assume a 52 weeks year.

**Required:**

- (i) Prepare a statement showing the taxable profit or loss of the partnership before and after admission of Stellah for the year ended 31 December 2023. (12 marks)
- (ii) Allocation of the profit or loss computed in (b) (i) above to the partners. (4 marks)
- (Total: 20 marks)**

**QUESTION TWO**

- (a) Explain **THREE** benefits emanating from the recent changes in Tax Dispute Resolution Mechanisms on taxpayer adherence to regulations and the efficiency of administrative processes in Kenya. (3 marks)
- (b) Describe **FOUR** strategies employed by multinational corporations in mitigating complex tax risks during corporate restructuring across multiple jurisdictions. (8 marks)
- (c) Weddy Associates is a practicing law firm that was registered for VAT in the year 2022. The following transactions were reported by the law firm accountant for the month of October 2023.

- October 2: The firm provided consultation for legal information and advice to Weka Ltd. at a fee of Sh.1,200,000.
- October 5: Offered training services to practicing accountants on alternative dispute resolution during the annual conference and invoiced the Institute of Accountancy Sh.800,000. The payment had not been received at the end of the month.
- October 9: A client by the name Bima Ltd. was declared bankrupt. Weddy Associates had offered arbitration services to the client in April 2023 at a fee of Sh.480,000 but Bima Ltd. had only managed to settle Sh.200,000 by the time it was declared bankrupt.
- October 11: Weddy Associates entered into a contract with Apex Bank Ltd. to review the bank lease agreement following a dispute with the bank's landlord on rent payment. The firm received an advance payment of Sh.400,000 from the bank and the balance of Sh.620,000 was to be received upon submission of the final legal report in November 2023.
- October 16: Royal Ltd. engaged the firm to draft its Memorandum and Articles of Association and register the company with the registrar of companies at a fee of Sh.50,000.
- October 21: Weddy Associates represented RR International Ltd., a diaspora client in arbitration case with a supplier and charged a fee of Sh.2,100,000. The client had only paid 30% of the total fee by end month.
- October 25: Weddy Associates engaged a professional legal firm in the United Kingdom (UK) to train the law firm employees on client mediation and arbitration process at a total fee of Sh.1,800,000 without VAT. The training was conducted just before the end month.
- October 30: The firm represented the following clients in the court in the course of the month and charged the fee as follows:

|                                        | <b>Sh.</b> |
|----------------------------------------|------------|
| Shakir family on property dispute      | 620,000    |
| Bema Ltd. on breach of trade agreement | 1,400,000  |
| Safi hospital on patient negligence    | 360,000    |

The following expenses were incurred by Weddy Associates in the course of the month:

- Electricity paid during the month was Sh.120,000 out of which Sh.20,000 was paid as deposit for the electricity meter to the power and lighting company.
- Rent for the office space Sh.480,000.
- Mandatory annual continuing legal education subscriptions for firm lawyers Sh.360,000.
- Training fee for the advocates Sh.420,000.
- Fuel for partners vehicles Sh.90,000.
- Professional indemnity cover Sh.124,000.
- Purchase of law practice management and accounting software Sh.1,620,000.
- Office computers purchase Sh.2,400,000.
- Stationery Sh.300,000.

Unless otherwise stated, all transactions were inclusive of value added tax (VAT) at the rate of 16% where applicable.

**Required:**

Compute the value added tax (VAT) payable by or refundable to Weddy Associates for the month of October 2023.

(9 marks)

**(Total: 20 marks)**

**QUESTION THREE**

- (a) Explain **THREE** tax reforms aimed at promoting investment and economic growth while ensuring fairness and equity in taxation in your country. (6 marks)
- (b) Masterway Insurance Company Ltd. operates both general insurance policy in respect of motor vehicles and life assurance policy. The following details were obtained from the company records for the year ended 31 December 2023:

|                                                 | <b>Motor vehicle</b> | <b>Life assurance</b> |
|-------------------------------------------------|----------------------|-----------------------|
|                                                 | <b>Sh. "000"</b>     | <b>Sh. "000"</b>      |
| Gross premium                                   | 757,000              | 189,000               |
| Claims paid                                     | 124,900              | 128,000               |
| Management expenses                             | 112,640              | 36,000                |
| Specific provision for bad debts                | 728                  | 2,500                 |
| Reserve for unexpired risk: 1 January 2023      | 968                  | -                     |
| 31 December 2023                                | 716                  | -                     |
| Claims owing: 1 January 2023                    | 119,700              | -                     |
| 31 December 2023                                | 115,120              | -                     |
| General expenses                                | 1,280                | 1,000                 |
| Interest on policy holders outstanding premiums | 240                  | -                     |
| Office utilities                                | 300                  | 120                   |
| Premiums returned                               | 696                  | -                     |
| Commission on reinsurance ceded                 | 684                  | -                     |
| Commission on reinsurance accepted              | 600                  | -                     |
| Agency expenses                                 | 344                  | -                     |
| Premiums paid to reinsurance company            | 4,720                | -                     |

**Additional information:**

1. Life assurance fund balance was valued by an actuary at Sh.270,000,000 as at 31 December 2023. 5% of this fund balance was recommended to be transferred for the benefit of shareholders.  
  
As at 1 January 2023, the life fund had been valued at Sh.240,000,000. 15% of the surplus was recommended to be transferred for the benefit of shareholders.
2. Premiums outstanding for life insurance business were as follows:  
As at 1 January 2023 Sh.15,000,000  
As at 31 December 2023 Sh.12,000,000
3. Masterway Ltd. owns the building which houses its offices and has let extra space to other tenants. The company received net rental income of Sh.1,800,000 for the year ended 31 December 2023. Property management fees amounting to Sh.2,600,000 relating to the rented space for the year had not been deducted.

4. The company had invested in fixed deposits and shares and in the year 2023, the following incomes were earned:

|                                                                                           | Sh.           |
|-------------------------------------------------------------------------------------------|---------------|
| Interest from fixed deposits with a money market fund                                     | 459,000 net   |
| Gross dividend from a foreign company                                                     | 180,000       |
| Dividend from Highrise Ltd. where Masterway Insurance Company Ltd. owns 80% share capital | 820,000 gross |

**Required:**

- (i) Compute the total taxable income or loss for Masterway Insurance Company Ltd. for the year ended 31 December 2023. (12 marks)
- (ii) Tax payable (if any) from the income computed in (b) (i) above. (2 marks)

**(Total: 20 marks)**

**QUESTION FOUR**

- (a) In a tax master class, one of the facilitators noted that “Before accepting a new client in a taxation assignment, tax practitioners should consider whether acceptance of that particular engagement would create any threat to compliance with the requisite fundamental principles”.

In relation to the above statement, propose **FOUR** factors that a tax practitioner should consider in evaluating new clients before acceptance of a new tax assignment. (4 marks)

- (b) John Pritt, a citizen of Rwanda has received two job offers in Kenya for which he has approached you to advise on which job offer to accept.

**Job offer A:**

John Pritt would be employed as a finance officer with African Airway Ltd., a regional airline with its head office in Kenya. The offer provided for the following:

1. Basic salary of Sh.130,000 per month to be increased semi-annually by 10%.
2. A monthly bonus of 5% of the basic salary to be paid on the ninth day of the following month.
3. Fuel allowance of Sh.10 per kilometer where he is estimated to be covering 10,000 kilometers in a year, three quarters of which will be on official duties.
4. He will be provided with free return air ticket worth Sh.16,000 for each travel on 30 June and 31 December each year to visit his family in Rwanda.
5. The company will provide him with a house whose market rental value is Sh.30,000 per month.
6. The employer will deduct Sh.5,000 per month as rent. The house will be fully furnished at a cost of Sh.480,000.

**Job offer B.**

John Pritt would be employed as an accountant by Watts Ltd. The offer provides for:

1. Basic salary of Sh.145,000 per month and an allowance of Sh.5,000 per month for attending finance committee meetings.
2. An annual allowance of Sh.150,000 for the purchase of office attire in line with the company’s dress code.
3. A provision for sending him to their Uganda office on a one month per year job rotation. He will be sent to Uganda in November every year and he will receive his monthly pay as usual. During that month he will attend the finance committee meeting as planned in Kenya, as the company will facilitate him with a return air ticket.
4. He will be provided with a saloon car costing Sh.2,800,000 of 3000 cc.
5. The company will cater for his night watchman’s monthly salary of Sh.18,000. His monthly water bills and electricity bills will also be paid by the company.

**Required:**

- (i) Evaluate the two job offers and advise John Pritt on which job offer to accept based on net annual income using the tax rates for the year 2023 as provided in the tax table. (12 marks)
- (ii) Advise John Pritt on **FOUR** conditions that one is required to meet in order to qualify for double taxation relief in Kenya or your country. (4 marks)

**(Total: 20 marks)**

### QUESTION FIVE

- (a) Explain **FOUR** initiatives undertaken by the revenue authority in your country to entrench ethics and integrity in administration of tax. (4 marks)
- (b) The revenue authority is mandated to actively investigate potential violations of the tax laws and regulations and related financial frauds and schemes.

**Required:**

With reference to the above statement, analyse the procedure followed by the revenue authority tax officers in conducting a particular tax investigation. (6 marks)

- (c) The following information was presented to you by the management of SmartTech Ltd. for the year ended 31 December 2023. The company deals in the sale of a variety of laptop models and sells them entirely to college and university students on hire purchase terms:
1. SmartTech Ltd. buys the laptops at Sh.40,000 each.
  2. The hire purchase price per unit comprises of a deposit of Sh.12,000 plus eight quarterly installments of Sh.6,000. The cash price per unit is Sh.50,000.
  3. For the year ended 31 December 2023, a total of 2,460 laptops were sold and the company had received total cash of Sh.86,600,000 from the sales.
  4. During the last quarter of the year 100 laptops were repossessed and the students had already paid Sh.2,400,000 on the repossessed laptops. This amount was included in the total cash collections for the year.
  5. Expenses incurred in the course of the year comprised of:
    - Rent expense of Sh.420,000. Prepaid rent as at 1 January 2023 and 31 December 2023 amounted to Sh.180,000 and Sh.60,000 respectively.
    - Legal expenses of Sh.1,200,000 out of which Sh.320,000 was in respect of defense against copyright license infringement.
    - Marketing cost of Sh.525,000 out of which 40% was in respect of donation to Leo University research and development fund and Sh.120,000 for erection of a signpost.
    - Salaries and management expenses of Sh.890,000. This included renewal of employment contracts of Sh.100,000 and provision for salary increment of Sh.200,000.
    - Installation of CCTV cameras at Sh.200,000.
  6. SmartTech Ltd. had agreed with the revenue authority that profits for tax purposes should be computed on the basis of proportionate cash collected from the customers for the year sales.
  7. Other incomes of SmartTech Ltd. included:
    - Income from lease of 20 laptops to Leo University at a lease charge of Sh.3,000 per month for the whole year.
    - Sale of five defective laptops at Sh.15,000 each.
    - Dividend from a unit trust of Sh.120,000 gross.

**Required:**

Compute the total taxable income or loss of SmartTech Ltd. for the year ended 31 December 2023. (10 marks)  
(Total: 20 marks)

.....

**CPA ADVANCED LEVEL**

**ADVANCED TAXATION**

**TUESDAY: 5 December 2023. Afternoon Paper.**

**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. Do NOT write anything on this paper.**

**RATES OF TAX (Including wife's employment, self-employment and professional income rates of tax).**

**Year of income 2022.**

| Monthly taxable pay<br>(Sh.) | Annual taxable pay<br>(Sh.) | Rate of tax<br>% in each Sh. |
|------------------------------|-----------------------------|------------------------------|
| 1 - 24,000                   | 1 - 288,000                 | 10%                          |
| 24,001 - 32,333              | 288,001 - 388,000           | 25%                          |
| Excess over - 32,333         | Excess over - 388,000       | 30%                          |

**Personal relief Sh.2,400 per month (Sh.28,800 per annum).**

| Investment allowance:                                                                                       | Rate of investment allowance        | Residual value<br>(25% per year<br>on equal<br>instalments) | Prescribed benefit rates of motor vehicles<br>provided by employer |                           |                          |
|-------------------------------------------------------------------------------------------------------------|-------------------------------------|-------------------------------------------------------------|--------------------------------------------------------------------|---------------------------|--------------------------|
| Capital expenditure incurred on:                                                                            |                                     |                                                             | (i) Saloons, Hatch Backs and Estates                               | Monthly<br>rates<br>(Sh.) | Annual<br>rates<br>(Sh.) |
| (a) <b>Buildings:</b>                                                                                       |                                     |                                                             | Up to 1200 cc                                                      | 3,600                     | 43,200                   |
| • Hotel building                                                                                            | 50% in the first year of use        | 25%                                                         | 1201 - 1500 cc                                                     | 4,200                     | 50,400                   |
| • Building used for manufacture                                                                             | 50% in the first year of use        | 25%                                                         | 1501 - 1750 cc                                                     | 5,800                     | 69,600                   |
| • Hospital buildings                                                                                        | 50% in the first year of use        | 25%                                                         | 1751 - 2000 cc                                                     | 7,200                     | 86,400                   |
| • Petroleum or gas storage facilities                                                                       | 50% in the first year of use        | 25%                                                         | 2001 - 3000 cc                                                     | 8,600                     | 103,200                  |
| • Educational/hostels building                                                                              | 10% per year on straight line basis |                                                             | Over - 3000 cc                                                     | 14,400                    | 172,800                  |
| • Commercial building                                                                                       | 10% per year on straight line basis |                                                             |                                                                    |                           |                          |
| (b) <b>Machinery:</b>                                                                                       |                                     |                                                             | (ii) Pick-ups, Panel Vans<br>(unconverted)                         |                           |                          |
| • Machinery used for manufacture                                                                            | 50% in the first year of use        | 25%                                                         | Up to - 1750 cc                                                    | 3,600                     | 43,200                   |
| • Hospital equipment                                                                                        | 50% in the first year of use        | 25%                                                         | Over - 1750 cc                                                     | 4,200                     | 50,400                   |
| • Ships or aircraft                                                                                         | 50% in the first year of use        | 25%                                                         |                                                                    |                           |                          |
| • Motor vehicles and heavy earth<br>moving equipment                                                        | 25% per year on straight line basis |                                                             |                                                                    |                           |                          |
| • Computer software, calculators,<br>copiers and duplicating machines                                       | 25% per year on straight line basis |                                                             |                                                                    |                           |                          |
| • Furniture and fittings                                                                                    | 10% per year on straight line basis |                                                             |                                                                    |                           |                          |
| • Telecommunication equipment                                                                               | 10% per year on straight line basis |                                                             |                                                                    |                           |                          |
| • Film equipment by a local producer                                                                        | 25% per year on straight line basis |                                                             |                                                                    |                           |                          |
| • Machinery used to undertake<br>operations under prospecting rights<br>and exploration under mining rights | 50% in the first year of use        | 25%                                                         |                                                                    |                           |                          |
| • Other machinery                                                                                           | 10% per year on straight line basis |                                                             |                                                                    |                           |                          |
| (c) Purchase/acquisition of right to use<br>fibre optic cable by telecommunication<br>operation             | 10% per year on straight line basis |                                                             | (iii) Land Rovers/Cruisers                                         | 7,200                     | 86,400                   |
| (d) Farm works                                                                                              | 50% in the first year of use        | 25%                                                         |                                                                    |                           |                          |

**Commissioner's prescribed benefit rates:**

**Services**

|                                                | Monthly rates<br>(Sh.) | Annual rates<br>(Sh.) |
|------------------------------------------------|------------------------|-----------------------|
| (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) Assume that you work for a tax consultancy firm. A client, Masterway Ltd., intends to develop a Transfer Pricing Policy document and has approached your firm for advice on information that it should include in the document.

**Required:**

Advise Masterway Ltd. on **FOUR** items that should be included in a transfer pricing policy document. (4 marks)

- (b) Asili and Tulivu established a partnership business sharing profits and losses in the ratio of 3:2 respectively. The following statement of profit or loss of the business for the year ended 31 December 2022 was provided:

|                                                  | Sh.            | Sh.                |
|--------------------------------------------------|----------------|--------------------|
| Sales                                            |                | 20,184,000         |
| Gain on sale of shares                           |                | 1,056,000          |
| Foreign exchange gain-unrealised                 |                | 450,000            |
| Recovery from insurance on stolen stock          |                | 1,400,000          |
| Discount received                                |                | 552,000            |
| Dividend - Wakaguzi Co-operative Society (gross) |                | <u>153,000</u>     |
| Total incomes                                    |                | 23,795,000         |
| <b>Expenses:</b>                                 |                |                    |
| Purchases                                        | 8,526,000      |                    |
| Purchase of computers                            | 540,000        |                    |
| Partners salaries                                | 2,160,000      |                    |
| Legal fees                                       | 2,040,000      |                    |
| Repairs and maintenance                          | 1,705,200      |                    |
| Rent and rates                                   | 733,800        |                    |
| Interest on loan                                 | 498,600        |                    |
| General expenses                                 | 2,892,000      |                    |
| Motor vehicle expenses                           | 2,520,000      |                    |
| Insurance                                        | 468,000        |                    |
| Preliminary expenses                             | 788,400        |                    |
| Directors fees                                   | 1,800,000      |                    |
| Audit fees                                       | 444,600        |                    |
| Debenture interest                               | 1,080,000      |                    |
| Travelling expenses                              | <u>288,000</u> | (26,484,600)       |
| Net loss                                         |                | <u>(2,689,600)</u> |

**Additional information:**

- Purchases and sales of goods were inclusive of value added tax (VAT) at the rate of 16%.
- Closing inventory was valued at Sh.5,520,000 while opening inventory was 10% of sales net of VAT.
- The partnership was converted into a limited company by the name Asili Ltd. on 1 April 2022.
- Income and expenses accrued evenly throughout the year unless otherwise stated.
- Legal fees comprised:**

|                                       | Sh.              |
|---------------------------------------|------------------|
| Notice for change of business name    | 194,400          |
| Conveyance fees of business premises  | 217,200          |
| Stamp duty                            | 349,800          |
| Acquisition of business loan          | 62,400           |
| Recovery of bad debts                 | 135,000          |
| Signing a 99 year lease agreement     | 385,200          |
| Purchase of Asili's private residence | 450,000          |
| Appeal against tax assessment         | <u>246,000</u>   |
|                                       | <u>2,040,000</u> |

6. **Repairs and maintenance comprised:**

|                              |                  |
|------------------------------|------------------|
| Purchase of furniture        | 288,000          |
| Installation of neon sign    | 180,000          |
| Designing office block       | 1,170,000        |
| Painting of new office block | <u>67,200</u>    |
|                              | <u>1,705,200</u> |

7. **General expenses included:**

|                                                        |         |
|--------------------------------------------------------|---------|
| Registering of patents                                 | 336,000 |
| Negotiating for additional land for business expansion | 168,000 |

8. Interest on loan includes interest on partners capital of Sh.300,000 which was shared according to profit and loss sharing ratio.

**Required:**

Prepare a statement of adjusted taxable profit or loss for the year ended 31 December 2022 for:

- (i) Asili and Tulivu partnership business. (6 marks)
- (ii) Asili Ltd. Company. (7 marks)
- (iii) A schedule showing allocation of adjusted partnership profit or loss computed in (b) (i) above, to the partners. (3 marks)

**(Total: 20 marks)**

**QUESTION TWO**

- (a) Tax agents play a crucial role in helping micro and small enterprises (MSEs) comply with tax obligations.

In light of the above statement, explain **THREE** potential areas the revenue authority may collaborate with tax agents to bridge tax gaps in MSEs in your country. (3 marks)

- (b) Explain **THREE** ways in which the implementation of the Most Favoured Nation (MFN) status may impede the attainment of economic goals of individual member states within the East African Customs Union. (6 marks)

- (c) ABC Ltd. acquired a building in March 2021 for Sh.8,500,000 and later on renovated it at a cost of Sh.465,000. Other costs incurred during the acquisition were valuation fees of Sh.84,000 and legal costs on acquisition of Sh.450,000. The building was later sold in October 2023 for Sh.12,400,000. The costs incurred in the process of selling the building were; advertisement Sh.140,000, agent fees Sh.128,000 and valuation fees Sh.136,000.

**Required:**

Compute the capital gains tax payable by ABC Ltd. (3 marks)

- (d) The following incomes and expenses were extracted from the accounting records of Turkanah Oil Ltd. for the year ended 31 December 2022:

| <b>Income</b>                                                                | <b>Sh. "million"</b> |
|------------------------------------------------------------------------------|----------------------|
| Proceeds from sale of oil (2,800,000 barrels at Sh.15,000 per barrel)        | 42,000               |
| Value of chargeable oil disposed of to local refineries                      | 21,000               |
| Value of chargeable natural gas and other incomes                            | 26,500               |
| Freight charges received from other oil transport                            | 22,800               |
| <b>Expenses:</b>                                                             |                      |
| Royalties paid for crude oil exported                                        | 4,800                |
| Staff accommodation expenses                                                 | 2,820                |
| Royalties incurred in respect of natural gas disposed of to local refineries | 3,420                |
| Interest on loan from foreign subsidiary company                             | 1,890                |
| Employee salaries and emoluments                                             | 8,200                |
| Specific bad debts                                                           | 240                  |
| Exploration and drilling costs of oil wells                                  | 12,960               |
| Contribution to approved pension schemes                                     | 720                  |
| Customs duties on drilling machines                                          | 1,500                |
| General expenses                                                             | 7,800                |
| Petroleum oil tankers (ships)                                                | 1,800                |
| Cost of generator                                                            | 500                  |
| Intangible drilling cost                                                     | 1,380                |
| Administration expenses                                                      | 750                  |
| Exploration costs                                                            | 1,680                |
| Pipeline and storage tank                                                    | 16,920               |
| Buildings-onshore-factory                                                    | 5,400                |
| Fixtures and fittings                                                        | 630                  |
| Purchase of drilling machines                                                | 5,500                |

**Required:**

- (i) Prepare a statement of taxable profit or loss of Turkanah Oil Ltd. for the year ended 31 December 2022. (6 marks)
- (ii) Identify the clarifications that the tax authority may seek from the company concerning exploration and drilling costs. (2 marks)

**(Total: 20 marks)**

### QUESTION THREE

- (a) Tax investigation involves inquiries into a taxpayer's affairs where the revenue authority has reasonable cause to believe that a taxpayer is not tax compliant.

In relation to the above statement, describe **FOUR** circumstances that could trigger tax investigations. (4 marks)

- (b) Explain how the adoption of the following policy frameworks would strengthen revenue mobilisation in your country:

(i) Fiscal policy options. (2 marks)

(ii) Tax policy options. (2 marks)

- (c) Titanic Air Ventures Ltd. is a company incorporated in Kenya that operates a fleet of passenger and cargo aircrafts in Kenya and other neighbouring countries. The trading results for the year ended 31 December 2022 are presented below:

|                                       | Sh. "million" | Sh. "million"     |
|---------------------------------------|---------------|-------------------|
| Revenue                               |               | 106,115           |
| Operating expenditure                 | 66,564        |                   |
| Fleet ownership                       | <u>13,653</u> | <u>(80,217)</u>   |
| Gross profit                          |               | 25,898            |
| <b>Other income:</b>                  |               |                   |
| Interest income (net)                 | 558,025       |                   |
| Bonus shares from associate company   | 174           |                   |
| Fair value gains on fuel derivatives  | 7,482         |                   |
| Gain on hedged exchange differences:  |               |                   |
| Borrowings                            | 1,920         |                   |
| Fuel contracts                        | <u>597</u>    | <u>10,731.025</u> |
| Total income                          |               | 36,629.025        |
| <b>Expenses:</b>                      |               |                   |
| Overheads                             | 24,898.5      |                   |
| Finance costs                         | 2,228         |                   |
| Realised losses on fuel derivatives   | 5,656         |                   |
| Other losses                          | 752           |                   |
| Deferred taxation on cash flow hedges | <u>755</u>    | <u>(34,289.5)</u> |
| Net profit for the year               |               | <u>2,339.525</u>  |

#### Additional information:

|    |                                           |                |
|----|-------------------------------------------|----------------|
| 1. | <b>Revenue comprises of:</b>              | Sh. "million"  |
|    | Cargo freight revenue                     | 8,151          |
|    | Passenger revenue                         | 94,257         |
|    | Handling                                  | 1,968          |
|    | Miscellaneous revenue                     | <u>1,739</u>   |
|    |                                           | <u>106,115</u> |
| 2. | <b>Operating expenditure analysis:</b>    | Sh. "million"  |
|    | Direct expenses                           | 13,938         |
|    | Aircraft fuel and oil                     | 12,795         |
|    | Aircraft landing, handling and navigation | 21,832         |
|    | Passenger services                        | 6,668          |
|    | Commission on sale of air ticket          | 4,869          |
|    | Aircraft passenger and cargo insurance    | 549            |
|    | Crew expenses                             | 2,613          |
|    | Central reservation system                | 2,708          |
|    | Other miscellaneous expenses              | <u>592</u>     |
|    |                                           | <u>66,564</u>  |
| 3. | <b>Fleet ownership costs analysis:</b>    | Sh. "million"  |
|    | Hire of aircrafts                         | 8,880          |
|    | Depreciation on aircrafts and engines     | 4,641          |
|    | Depreciation on rotables and equipment    | 393            |
|    | Aircraft purchase subsidy from government | <u>(261)</u>   |
|    |                                           | <u>13,653</u>  |

|    |                                                |                      |
|----|------------------------------------------------|----------------------|
| 4. | <b>Analysis of overhead costs:</b>             | <b>Sh. "million"</b> |
|    | Administration expenses                        | 15,262.5             |
|    | Staff costs                                    | 522                  |
|    | Legal and professional fees                    | 110                  |
|    | Directors remuneration                         | 16                   |
|    | Audit fees                                     | 2,238                |
|    | General maintenance and supplies               | 2,094                |
|    | Depreciation of buildings and office equipment | 1,290                |
|    | Amortisation of intangible assets              | 546                  |
|    | Selling                                        | 997                  |
|    | Advertising and publicity                      | 413                  |
|    | Bad debts written off                          | <u>1,410</u>         |
|    |                                                | <u>24,898.5</u>      |

5. The company purchased two aircrafts in the course of the year at a total cost of Sh.560 million. This excludes the aircraft purchase subsidy from the government.

**Required:**

Compute the taxable income and tax payable (if any) by Titanic Air Ventures Ltd. for the year ended 31 December 2022. (12 marks)

**(Total: 20 marks)**

**QUESTION FOUR**

- (a) Describe **FOUR** ways through which the Revenue Authority may address potential tax risks associated with the import and export activities of manufacturing firms in your country. (8 marks)
- (b) The following is a statement of profit or loss for Express Commercial Bank Ltd. for the year ended 31 December 2022:

|                                             | <b>Sh. "000"</b> | <b>Sh. "000"</b>   |
|---------------------------------------------|------------------|--------------------|
| <b>Income:</b>                              |                  |                    |
| Interest on loans and advances to customers |                  | 936,480            |
| Royalty income (net of withholding tax)     |                  | 11,400             |
| Rebate on bills discounted                  |                  | 1,800              |
| Interest on Treasury bills and bonds        |                  | 168,000            |
| Interest on placement with Central Bank     |                  | 51,240             |
| Fees and commission income                  |                  | 43,440             |
| Investment revaluation surplus              |                  | 11,232             |
| Profit on sale of motor vehicle             |                  | <u>5,256</u>       |
|                                             |                  | 1,228,848          |
| <b>Expenses:</b>                            |                  |                    |
| Rent and rates                              | 75,250           |                    |
| Staff costs                                 | 347,720          |                    |
| Impairment of intangible assets             | 10,440           |                    |
| Depreciation                                | 42,800           |                    |
| Deposit protection fund contribution        | 16,360           |                    |
| Interest on deposits from other banks       | 62,800           |                    |
| Directors remuneration                      | 26,600           |                    |
| Interest on customer deposits               | 184,200          |                    |
| Audit fees                                  | 2,040            |                    |
| 10% debenture stock                         | 200,000          |                    |
| Redemption reserve                          | 3,240            |                    |
| Purchase of delivery van vehicle            | 3,500            |                    |
| Installation of online banking system       | 32,600           |                    |
| Finance lease rentals                       | 14,860           |                    |
| Loss on sale of equipment                   | 19,640           |                    |
| Finance costs                               | 70,200           |                    |
| Allowance for bad and doubtful debts        | <u>98,160</u>    | <u>(1,210,410)</u> |
| Net profit                                  |                  | <u>18,438</u>      |

**Additional information:****1. Staff costs include:**

|                                      | Sh.“000” |
|--------------------------------------|----------|
| Provision for proposed tax increment | 480      |
| Ex-gratia payment                    | 1,240    |
| Negotiating loans for staff          | 1,000    |
| Retrenchment costs                   | 1,680    |
| Provision for staff leave arrears    | 8,680    |

**2. Directors remuneration include:**

|                                            |       |
|--------------------------------------------|-------|
| Education trip cost for directors children | 1,600 |
| Entertainment allowance for clients        | 1,560 |
| Air tickets for expatriate directors       | 720   |

**3. Allowance for bad and doubtful debt analysis:**

|                                          | Specific provision<br>Sh.“000” | General provision<br>Sh.“000” | Total<br>Sh.“000” |
|------------------------------------------|--------------------------------|-------------------------------|-------------------|
| Balance brought forward 1 January 2022   | 684,000                        | 888                           | 684,888           |
| Charge in the year                       | 108,000                        | 8,640                         | 116,640           |
| Reduction in the year                    | (18,480)                       | -                             | (18,480)          |
| Balance carried forward 31 December 2022 | 773,520                        | 9,528                         | 783,048           |

**Required:**

- (i) Compute the adjusted taxable income and tax payable by Express Commercial Bank Ltd. for the year ended 31 December 2022. (10 marks)
- (ii) Express Commercial Bank Ltd.’s taxable income for the year ended 31 December 2021 was assessed as Sh.260,000,000.

Calculate the tax due as at 31 December 2022 clearly indicating the due dates for the payment of the tax. (2 marks)

**(Total: 20 marks)**

**QUESTION FIVE**

- (a) In a tax dispute resolution mechanism workshop, one of the facilitators noted that, “there is need for establishing a specialised tax court within the country to handle tax appeals from the Tax Appeals Tribunal”.

Justify the above statement, citing **THREE** benefits that could be derived from establishing a specialised tax court. (6 marks)

- (b) You have been appointed as the finance director of Pixes (Kenya) Ltd., which is a subsidiary of Pixes (UK) Ltd. The board of directors of Pixes (Kenya) Ltd. is concerned that the company may currently be incorrectly accounting for value added tax (VAT) following the numerous changes in the Kenyan tax system introduced through the finance Acts. In particular, they have drawn your attention to the following issues:

- VAT treatment on exported taxable services.
- Time of supply on imported taxable services.
- VAT treatment on taxable digital services.

**Required:**

Advise the Board of Directors of Pixes (Kenya) Ltd. on each of the **THREE** issues raised above. (6 marks)

- (c) Alexia Gosselin was resident in Kenya during the year ended 31 December 2022. She has provided the following information on her income both from Kenya and Country Z during the year ended 31 December 2022:

Kenya and Country Z have signed a double taxation agreement.

**Income from Country Z:**

Employment income from Country Z was Zx. 72,000,000 (PAYE Zx. 9,000,000). The applicable foreign exchange rate was Ksh.1: Zx.30.

**Income from Kenya:**

- Basic salary Sh.202,800 net of PAYE of Sh.37,200 per month.
- Subsistence allowance Sh.14,000 per day for 10 days that she worked out of office.
- Medical allowance of Sh.40,000 per month in respect of a policy that covered all employees.
- Commercial property rental income for the year of Sh.2,400,000 after deducting cost of partitions Sh.460,000, mortgage repayment Sh.540,000 (out of which Sh.120,000 was mortgage interest) and agent fees of Sh.180,000.
- Interest income from Mjengo Company Ltd., Sh.405,000 net.

**Required:**

- (i) Compute double taxation relief due to Alexia Gosselin for the year ended 31 December 2022. (6 marks)
- (ii) Net tax liability (if any) payable by Alexia Gosselin in Kenya for the year ended 31 December 2022. (2 marks)

**(Total: 20 marks)**

.....

**CPA ADVANCED LEVEL**

**ADVANCED TAXATION**

**TUESDAY: 22 August 2023. Afternoon Paper.**

**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. Do NOT write anything on this paper.**

**RATES OF TAX (Including wife's employment, self-employment and professional income rates of tax).**

**Year of income 2022.**

| Monthly taxable pay<br>(Sh.) | Annual taxable pay<br>(Sh.) | Rate of tax<br>% in each Sh. |
|------------------------------|-----------------------------|------------------------------|
| 1 - 24,000                   | 1 - 288,000                 | 10%                          |
| 24,001 - 32,333              | 288,001 - 388,000           | 25%                          |
| Excess over - 32,333         | Excess over - 388,000       | 30%                          |

**Personal relief Sh.2,400 per month (Sh.28,800 per annum).**

| Investment allowance:                                                                                       | Rate of investment allowance        | Residual value<br>(25% per year<br>on equal<br>instalments) | Prescribed benefit rates of motor vehicles<br>provided by employer |                           |                          |
|-------------------------------------------------------------------------------------------------------------|-------------------------------------|-------------------------------------------------------------|--------------------------------------------------------------------|---------------------------|--------------------------|
| Capital expenditure incurred on:                                                                            |                                     |                                                             | (i) Saloons, Hatch Backs and Estates                               | Monthly<br>rates<br>(Sh.) | Annual<br>rates<br>(Sh.) |
| (a) <b>Buildings:</b>                                                                                       |                                     |                                                             | Up to 1200 cc                                                      | 3,600                     | 43,200                   |
| • Hotel building                                                                                            | 50% in the first year of use        | 25%                                                         | 1201 - 1500 cc                                                     | 4,200                     | 50,400                   |
| • Building used for manufacture                                                                             | 50% in the first year of use        | 25%                                                         | 1501 - 1750 cc                                                     | 5,800                     | 69,600                   |
| • Hospital buildings                                                                                        | 50% in the first year of use        | 25%                                                         | 1751 - 2000 cc                                                     | 7,200                     | 86,400                   |
| • Petroleum or gas storage facilities                                                                       | 50% in the first year of use        | 25%                                                         | 2001 - 3000 cc                                                     | 8,600                     | 103,200                  |
| • Educational/hostels building                                                                              | 10% per year on straight line basis |                                                             | Over - 3000 cc                                                     | 14,400                    | 172,800                  |
| • Commercial building                                                                                       | 10% per year on straight line basis |                                                             |                                                                    |                           |                          |
| (b) <b>Machinery:</b>                                                                                       |                                     |                                                             | (ii) Pick-ups, Panel Vans<br>(unconverted)                         |                           |                          |
| • Machinery used for manufacture                                                                            | 50% in the first year of use        | 25%                                                         | Up to - 1750 cc                                                    | 3,600                     | 43,200                   |
| • Hospital equipment                                                                                        | 50% in the first year of use        | 25%                                                         | Over - 1750 cc                                                     | 4,200                     | 50,400                   |
| • Ships or aircraft                                                                                         | 50% in the first year of use        | 25%                                                         |                                                                    |                           |                          |
| • Motor vehicles and heavy earth<br>moving equipment                                                        | 25% per year on straight line basis |                                                             |                                                                    |                           |                          |
| • Computer software, calculators,<br>copiers and duplicating machines                                       | 25% per year on straight line basis |                                                             |                                                                    |                           |                          |
| • Furniture and fittings                                                                                    | 10% per year on straight line basis |                                                             |                                                                    |                           |                          |
| • Telecommunication equipment                                                                               | 10% per year on straight line basis |                                                             |                                                                    |                           |                          |
| • Film equipment by a local producer                                                                        | 25% per year on straight line basis |                                                             |                                                                    |                           |                          |
| • Machinery used to undertake<br>operations under prospecting rights<br>and exploration under mining rights | 50% in the first year of use        | 25%                                                         |                                                                    |                           |                          |
| • Other machinery                                                                                           | 10% per year on straight line basis |                                                             |                                                                    |                           |                          |
| (c) Purchase/acquisition of right to use<br>fibre optic cable by telecommunication<br>operation             | 10% per year on straight line basis |                                                             | (iii) Land Rovers/Cruisers                                         | 7,200                     | 86,400                   |
| (d) Farm works                                                                                              | 50% in the first year of use        | 25%                                                         |                                                                    |                           |                          |

| Commissioner's prescribed benefit rates:                | Monthly rates<br>(Sh.) | Annual rates<br>(Sh.) |
|---------------------------------------------------------|------------------------|-----------------------|
| <b>Services</b>                                         |                        |                       |
| (i) Electricity (Communal or from a<br>generator)       | 1,500                  | 18,000                |
| (ii) Water (Communal or from a<br>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) Discuss how the following issues may generate ethical dilemmas to a tax professional:
- (i) Conflict of interest. (3 marks)
  - (ii) Contingent fee tax representations. (3 marks)
- (b) Describe **THREE** criteria for evaluating modern tax systems. (6 marks)
- (c) Summarise **FOUR** signs that may point to tax fraud in a business entity. (4 marks)
- (d) Citing **FOUR** reasons, argue the case for double taxation agreements as tax incentives. (4 marks)
- (Total: 20 marks)**

**QUESTION TWO**

- (a) E and K commenced trading as partners under the name EK Enterprises on 1 January 2022. They share profits and losses equally and were entitled to receive monthly salaries of Sh.240,000 and Sh.288,000 for E and K respectively. The partnership did not maintain a complete set of accounting records. The following is a summary of the partnership's bank statement for the year ended 31 December 2022:

| <b>Bank Statement Summary</b>             |                  |                         |                  |
|-------------------------------------------|------------------|-------------------------|------------------|
| <b>Receipts</b>                           |                  | <b>Payments</b>         |                  |
|                                           | <b>Sh. "000"</b> |                         | <b>Sh. "000"</b> |
| Capital introduced: E                     | 42,000           | Office equipment        | 22,500           |
| K                                         | 30,000           | Salaries and wages      | 10,680           |
| Cash sales                                | 122,400          | Godown rent             | 4,500            |
| Dividend: Weka Co-operative Society (net) | 20,400           | Payment to suppliers    | 118,800          |
| Receipts from debtors                     | 62,400           | Repairs and maintenance | 5,320            |
|                                           |                  | Insurance               | 750              |
|                                           |                  | Interest paid           | 7,344            |
|                                           |                  | Motor vehicle expenses  | 2,022            |
|                                           |                  | General expenses        | 2,616            |
|                                           |                  | Delivery van acquired   | 36,000           |
|                                           |                  | Fines and penalties     | 780              |
|                                           |                  | Electricity bill        | 540              |
|                                           |                  | Medical expenses        | 7,560            |
|                                           |                  | Balance carried forward | 57,788           |
|                                           | <u>277,200</u>   |                         | <u>277,200</u>   |

**Additional information:**

- As at 31 December 2022, the partnership owed suppliers Sh.9,360,000 while the amount owed by customers was Sh.10,740,000.
- Rebate received from suppliers amounted to Sh.1,590,000 and discount allowed to customers amounted to Sh.1,416,000.
- Bad debts amounted to Sh.984,000 out of which Sh.240,000 relate to a loan advanced to E that was overdue.
- Closing stock was valued at Sh.7,440,000 as at 31 December 2022.
- Salaries and wages include salary to the partners for the year.
- Included in the interest expense is interest on partners' capital contribution at the rate of 8% per annum.
- The annual rent for the godown was Sh.5,400,000.
- As at 31 December 2022, electricity and insurance owing amounted to Sh.300,000 and Sh.153,600 respectively.
- The following payments were made in cash from cash sales before banking:

|                                    | <b>Sh.</b> |
|------------------------------------|------------|
| Motor vehicle expenses (per annum) | 1,656,000  |
| Wages (per annum)                  | 1,944,000  |
| Sundry expenses (per annum)        | 420,000    |
| Weekly drawings: E                 | 86,400     |
| K                                  | 46,800     |

(Assume 52 weeks in a year).

**Required:**

- (i) Compute the adjusted partnership profit or loss for the year ended 31 December 2022. (8 marks)
- (ii) Distribute the profit or loss to the partners and thus ascertain the taxable income for each partner. (3 marks)
- (b) Alternative Dispute Resolution (ADR) methods are utilised by revenue authorities to resolve and expedite tax related disputes on a timely basis. While ADR mechanisms present many advantages, they also face certain challenges when applied to tax matters.
- Explain **SIX** challenges faced in the administration of ADR in your country. (6 marks)
- (c) Analyse the Income Tax Act provisions in relation to taxation of collective investment schemes. (3 marks)
- (Total: 20 marks)**

**QUESTION THREE**

- (a) Evaluate **FOUR** methods that multinational companies operating in Kenya can use in order to adjust transfer prices for purposes of computing taxable income as provided under the Transfer Pricing Rules (2006). (4 marks)
- (b) Nalo Ltd. started a small merchandise business on 1 January 2022. The company did not maintain a set of complete records and as such has not filed income tax returns for the year of income 2022. The Revenue Authority has sent the company a demand notice of Sh.2,200,000 as the tax due for the year 2022.

The company director has approached you and requested that you assist in ascertaining the correct tax liability and also advise him on whether to object the demand notice.

The following details have been availed:

1. Analysis of the bank account for the year ended 31 December 2022 revealed the following:

| <b>DR</b>                              |                   | <b>CR</b>                    |                   |
|----------------------------------------|-------------------|------------------------------|-------------------|
|                                        | <b>Sh.</b>        |                              | <b>Sh.</b>        |
| Balance brought forward 1 January 2022 | 1,940,000         | Fixtures and fittings (cost) | 366,000           |
| Cheques from customers                 | 1,299,200         | Suppliers of goods           | 1,392,000         |
| Refund from suppliers                  | 83,530            | Bank charges                 | 29,600            |
| Rental income                          | 1,040,000         | Delivery van at cost         | 1,000,000         |
| Sale of fixtures                       | 96,000            | Salaries and wages           | 1,060,000         |
| Cash sales                             | 8,816,000         | Computers at cost            | 480,000           |
|                                        |                   | Rent and rates               | 124,000           |
|                                        |                   | Electricity                  | 116,000           |
|                                        |                   | Telephone and postage        | 125,800           |
|                                        |                   | Refunds to customers         | 74,240            |
|                                        |                   | Computer software cost       | 120,000           |
|                                        |                   | Balance carried forward      | <u>8,387,090</u>  |
|                                        | <u>13,274,730</u> |                              | <u>13,274,730</u> |

2. Other information obtained from the books of accounts included:

|                            | <b>1 January 2022</b> | <b>31 December 2022</b> |
|----------------------------|-----------------------|-------------------------|
|                            | <b>Sh.</b>            | <b>Sh.</b>              |
| Inventory                  | 4,320,000             | 2,250,000               |
| Suppliers of goods         | 478,200               | 239,200                 |
| Trade debtors              | 348,000               | 960,000                 |
| Accrued electricity        | 66,000                | 116,000                 |
| Lorry                      | 1,400,000             | 1,400,000               |
| Prepaid wages and salaries | 320,000               | 140,000                 |
| Rent and rates owing       | 45,000                | 17,000                  |

3. All non-current assets were acquired in the course of the year. The cost of fixtures sold was Sh.220,000.
4. Opening and closing inventories were undervalued and overvalued by 20% and 10% respectively.
5. Cash purchases amounted to Sh.2,400,000. All sales and purchases are inclusive of value added tax (VAT) at the rate of 16%.
6. The business issued credit notes of Sh.34,800 for goods returned by credit customers and received discount from suppliers of Sh.52,000.

**Required:**

- (i) Prepare a statement showing the correct adjusted taxable income and tax payable (if any) for the year ended 31 December 2022. (10 marks)
- (ii) Advise the director on the action to take on the demand notice. (3 marks)
- (c) The Revenue Authority of your country intends to introduce a tax on digital assets in the next government budget. During public participation forums, most citizens rejected the proposed digital tax since they were not conversant with digital assets.

Citing an example, explain what “digital assets” entail.

(3 marks)

**(Total: 20 marks)**

**QUESTION FOUR**

- (a) Assume that your country has continued to face challenges in addressing tax deficits. Over the past few years, the revenue from taxation has not fully met the country’s development needs.

**Required:**

As a tax expert, advise the revenue authority in your country on **FIVE** possible reasons for the shortfall in tax collection. (10 marks)

- (b) KK Realtors are in the real estate business. They rent out two prime highrise buildings, one a residential apartment and the other an office block. They are registered for the monthly residential rental obligation as well as filing for value added tax (VAT).

Details of their transactions for the month of December 2022 are provided below:

| Incomes:                                              | Sh. “000” |
|-------------------------------------------------------|-----------|
| Rent: Apartment                                       | 1,248,450 |
| Office block                                          | 7,244,200 |
| <b>Expenses:</b>                                      |           |
| Garbage collection                                    | 75,864    |
| Sewerage                                              | 92,800    |
| Repairs and maintenance (outsourced to local company) | 144,420   |
| Housing agents fee (5% of income)                     | ?         |
| Security firm (eight day and eight night guards)      | 464,000   |
| Insurance                                             | 580,000   |
| Interest on bank loan                                 | 139,200   |
| Caretakers’ salaries                                  | 92,800    |
| Webhosting (by South Africa-based company)            | 67,280    |
| Audit and assurance fee                               | 1,334,000 |
| Telephone and electricity                             | 52,952    |
| Other staff salaries                                  | 992,496   |
| Architect’s fee (based in France)                     | 184,730   |

The following additional information is provided:

1. With the exception of housing agents fee, webhosting and architect’s fee, a quarter of the expenses relate to the residential business while the rest relate to the office block.
2. Housing agents fee accrues based on the amount paid for income collected from each property.
3. Webhosting and architects fee could not be directly attributed to either the residential apartment or office block.
4. Tenants of the office block are agents for withholding value added tax (VAT) and withholding rental income.
5. The figures provided are quoted inclusive of VAT where applicable.

**Required:**

- (i) Calculate the tax payable under the VAT and income tax obligations by KK Realtors for the month of December 2022. (7 marks)
- (ii) Show the withholding tax collected under the obligations in (b)(i) above, if any, as well as the net rent income received by KK Realtors, as cash. (3 marks)

**(Total: 20 marks)****QUESTION FIVE**

- (a) Explain **THREE** reasons why investment allowances as tax incentives have not achieved the intended objectives in your country. (3 marks)
- (b) Tax risks are broadly classified into specific and generic categories.

Analyse **TWO** types of risks in each category. (4 marks)

- (c) Johnson Shauri has not been maintaining proper books of accounts since the inception of his business in year 2019. The following balances were obtained from the available business records for the four year period ended 31 December 2022:

|                              | 31 December<br>2019<br>Sh.“000” | 31 December<br>2020<br>Sh.“000” | 31 December<br>2021<br>Sh.“000” | 31 December<br>2022<br>Sh.“000” |
|------------------------------|---------------------------------|---------------------------------|---------------------------------|---------------------------------|
| Leasehold property           | 11,760                          | 11,760                          | 11,760                          | 11,760                          |
| Motor vehicles               | 5,040                           | 4,720                           | 9,360                           | 10,760                          |
| Furniture                    | 864                             | 864                             | 864                             | 864                             |
| Bank overdraft               | 1,288                           | 1,400                           | 1,210                           | 1,115                           |
| Loss on sale of investment   | -                               | 100                             | -                               | -                               |
| Accounts receivable          | 432                             | 504                             | 408                             | 600                             |
| Mortgage loan                | 2,080                           | 1,840                           | 1,620                           | 1,500                           |
| Inventory                    | 620                             | 572                             | 482                             | 520                             |
| Computers                    | 620                             | 720                             | 840                             | 720                             |
| Bank account                 | 240                             | 268                             | 272                             | 286                             |
| Personal clothes and effects | 60                              | 80                              | 100                             | 120                             |

The following additional information was obtained:

- Drawings of goods and provision for taxation for the year 2019 were Sh.600,000 and Sh.360,000 respectively and has been accumulating at a rate of 10% annually.
- Capital allowances were agreed at a total of Sh.920,000 for each of the four years.
- Donations to a political party in the year 2020 amounted to Sh.142,000.
- Gifts from relatives for the year 2021 were Sh.840,000.
- Contingent liability in respect of a pending court case in the year 2022 was Sh.1,000,000.
- Rent paid on behalf of a close friend was Sh.605,000 in the year 2022.
- Living expenses were estimated at Sh.800,000 in the year 2019 and had been increasing at the rate of 15% cumulatively each year.

**Required:**

- (i) Compute the taxable income or loss of Johnson Shauri for the three-year period ended 31 December 2020, 2021 and 2022. (10 marks)
- (ii) Summarise **THREE** specific actions that a tax practitioner could undertake upon discovery of an irregularity in the client's business. (3 marks)

**(Total: 20 marks)**

.....

**CPA ADVANCED LEVEL**

**ADVANCED TAXATION**

**TUESDAY: 25 April 2023. Afternoon Paper.**

**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. Do NOT write anything on this paper.**

**RATES OF TAX (Including wife's employment, self-employment and professional income rates of tax).**

**Year of income 2022.**

| Monthly taxable pay<br>(Sh.) | Annual taxable pay<br>(Sh.) | Rate of tax<br>% in each Sh. |
|------------------------------|-----------------------------|------------------------------|
| 1 - 24,000                   | 1 - 288,000                 | 10%                          |
| 24,001 - 32,333              | 288,001 - 388,000           | 25%                          |
| Excess over - 32,333         | Excess over - 388,000       | 30%                          |

**Personal relief Sh.2,400 per month (Sh.28,800 per annum).**

| Investment allowance:                                                                                       | Rate of investment allowance        | Residual value<br>(25% per year<br>on equal<br>instalments) | Prescribed benefit rates of motor vehicles<br>provided by employer |                           |                          |
|-------------------------------------------------------------------------------------------------------------|-------------------------------------|-------------------------------------------------------------|--------------------------------------------------------------------|---------------------------|--------------------------|
| Capital expenditure incurred on:                                                                            |                                     |                                                             | (i) Saloons, Hatch Backs and Estates                               | Monthly<br>rates<br>(Sh.) | Annual<br>rates<br>(Sh.) |
| (a) <b>Buildings:</b>                                                                                       |                                     |                                                             | Up to 1200 cc                                                      | 3,600                     | 43,200                   |
| • Hotel building                                                                                            | 50% in the first year of use        | 25%                                                         | 1201 - 1500 cc                                                     | 4,200                     | 50,400                   |
| • Building used for manufacture                                                                             | 50% in the first year of use        | 25%                                                         | 1501 - 1750 cc                                                     | 5,800                     | 69,600                   |
| • Hospital buildings                                                                                        | 50% in the first year of use        | 25%                                                         | 1751 - 2000 cc                                                     | 7,200                     | 86,400                   |
| • Petroleum or gas storage facilities                                                                       | 50% in the first year of use        | 25%                                                         | 2001 - 3000 cc                                                     | 8,600                     | 103,200                  |
| • Educational/hostels building                                                                              | 10% per year on straight line basis |                                                             | Over - 3000 cc                                                     | 14,400                    | 172,800                  |
| • Commercial building                                                                                       | 10% per year on straight line basis |                                                             |                                                                    |                           |                          |
| (b) <b>Machinery:</b>                                                                                       |                                     |                                                             | (ii) Pick-ups, Panel Vans<br>(unconverted)                         |                           |                          |
| • Machinery used for manufacture                                                                            | 50% in the first year of use        | 25%                                                         | Up to - 1750 cc                                                    | 3,600                     | 43,200                   |
| • Hospital equipment                                                                                        | 50% in the first year of use        | 25%                                                         | Over - 1750 cc                                                     | 4,200                     | 50,400                   |
| • Ships or aircraft                                                                                         | 50% in the first year of use        | 25%                                                         |                                                                    |                           |                          |
| • Motor vehicles and heavy earth<br>moving equipment                                                        | 25% per year on straight line basis |                                                             |                                                                    |                           |                          |
| • Computer software, calculators,<br>copiers and duplicating machines                                       | 25% per year on straight line basis |                                                             |                                                                    |                           |                          |
| • Furniture and fittings                                                                                    | 10% per year on straight line basis |                                                             |                                                                    |                           |                          |
| • Telecommunication equipment                                                                               | 10% per year on straight line basis |                                                             |                                                                    |                           |                          |
| • Film equipment by a local producer                                                                        | 25% per year on straight line basis |                                                             |                                                                    |                           |                          |
| • Machinery used to undertake<br>operations under prospecting rights<br>and exploration under mining rights | 50% in the first year of use        | 25%                                                         |                                                                    |                           |                          |
| • Other machinery                                                                                           | 10% per year on straight line basis |                                                             |                                                                    |                           |                          |
| (c) Purchase/acquisition of right to use<br>fibre optic cable by telecommunication<br>operation             | 10% per year on straight line basis |                                                             | (iii) Land Rovers/Cruisers                                         | 7,200                     | 86,400                   |
| (d) Farm works                                                                                              | 50% in the first year of use        | 25%                                                         |                                                                    |                           |                          |

**Commissioner's prescribed benefit rates:**

**Services**

|                                                | Monthly rates<br>(Sh.) | Annual rates<br>(Sh.) |
|------------------------------------------------|------------------------|-----------------------|
| (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) Analyse **FOUR** roles of an arbiter in a tax alternative dispute resolution (ADR) process. (4 marks)
- (b) Sema and Tena are partners running a small hardware business in your town. They are facing a tax audit by the Revenue Authority for failure to maintain complete records. They have approached you to assist them in ascertaining the taxable profit or loss for the year ended 31 December 2022.

The following information has been provided to you:

- The partnership deed provides that:
  - Profits and losses will be shared in the ratio of 2:1 for Sema and Tena respectively.
  - Each partner will be entitled to a monthly salary of Sh.90,000 and a bonus to be agreed from time to time.
  - Partners would be allowed to withdraw up to Sh.250,000 in cash with no interest. Any excess cash withdrawals would be subject to interest at the rate of 12% per annum.
  - No interest is charged on withdrawal of goods by partners.
- On 1 September 2022, the partners admitted Vuna and the profit and loss sharing ratio was revised to equal basis for the three partners. Vuna was entitled to interest on capital like the other partners at the rate of 10% per annum. She was not entitled to any salary or bonus for the year ended 31 December 2022.
- Extract of account balances were as follows:

|                                                          | 31 December 2022 | 31 December 2021 |
|----------------------------------------------------------|------------------|------------------|
|                                                          | Sh.              | Sh.              |
| Accrued bonus due to partners                            | 1,000,000        | 900,000          |
| Inventory                                                | 350,000          | 260,000          |
| Accounts payable                                         | 3,000,000        | 2,600,000        |
| Prepaid advertising                                      | 210,000          | 440,000          |
| Outstanding electricity bill                             | 26,000           | 20,000           |
| Accounts receivable                                      | 3,900,000        | 2,700,000        |
| Accrued salaries and wages (excluding partners salaries) | 510,000          | 230,000          |
| Accumulated depreciation                                 | 700,000          | 440,000          |
| Capital: Sema                                            | 720,000          | 720,000          |
| Tena                                                     | 480,000          | 480,000          |
| Vuna (Admitted 1 September 2022)                         | 540,000          | -                |

- Extracts of cash payments during the year were as follows:
 

|                                                  | Sh.       |
|--------------------------------------------------|-----------|
| Paid to suppliers of goods for resale            | 9,000,000 |
| Bonus paid to partners shared equally            | 1,300,000 |
| Cash withdrawn: Sema                             | 300,000   |
| Tena                                             | 350,000   |
| Loan interest                                    | 48,000    |
| Advertising                                      | 250,000   |
| Salaries and wages (including partners salaries) | 4,390,000 |
| Motor vehicle expenses                           | 340,000   |
| Electricity                                      | 90,000    |
| Computer software                                | 70,000    |
| Purchase of office equipment                     | 62,000    |
| Employee welfare costs                           | 300,000   |
- Receipts channeled through the bank account were as follows:
 

|                                         | Sh.        |
|-----------------------------------------|------------|
| Proceeds from sale of computers         | 55,000     |
| Royalty income (net of withholding tax) | 380,000    |
| Credit sales                            | 15,600,000 |
- Cash purchases and cash sales amounted to Sh.900,000 and Sh.2,400,000 respectively and were value added tax (VAT) inclusive.
- The partners had withdrawn goods for personal use as follows:
 

|      | Sh.     |
|------|---------|
| Sema | 210,000 |
| Tena | 70,000  |

No entries were made in the books to record these withdrawals.
- Hardware goods valued at Sh.60,000 were destroyed in a flood in July 2022. The insurance company agreed to pay Sh.40,000 as compensation but by 31 December 2022, the amount had not been received.
- Assume that revenues and expenses accrued evenly throughout the year, unless otherwise specified.

**Required:**

- (i) Prepare a statement of taxable profit or loss of the partnership for the year ended 31 December 2022. (11 marks)
  - (ii) A schedule showing allocation of the profit or loss to the partners for the year ended 31 December 2022. (5 marks)
- (Total: 20 marks)**

**QUESTION TWO**

- (a) During the period between 1 July 2015 and 30 June 2020, Chris Alexo earned income of Sh.18,000,000 which he did not declare to the revenue authority. The tax thereon amounted to Sh.6,000,000 with penalties and interest of Sh.1,500,000 and Sh.600,000 respectively. In the year 2021, Chris Alexo applied for relief under the voluntary tax disclosure programme (VTDP) and the approval was done in August the same year. He thereafter paid Sh.3,000,000 to offset the tax due. During the year ended 31 December 2022, Chris Alexo settled Sh.1,500,000 of the principal tax but accrued further penalties of Sh.250,000 and interest of Sh.100,000. He estimates that he can only pay Sh.1,000,000 during the year 2023. This will result into additional penalties and interest of Sh.100,000 and Sh.60,000 respectively.

**Required:**

Compute the tax, penalties and interest (if any) for the relevant years to be waived or paid by Chris Alexo under the VTDP. (8 marks)

- (b) Rick Lenon, a citizen of United Kingdom was recruited in London by Faux PLC, an international non-governmental organisation (NGO) with its head office in Nairobi, Kenya. Its activities are carried on in the Eastern Africa and Horn of Africa region through field stations, except in Kenya where the head office is based.

The following details relate to his earnings in Kenya Shillings for the year ended 31 December 2022:

1. His basic salary for the year aggregated to Sh.12,000,000.
2. He was provided with air tickets valued at Sh.360,000 to visit his family.
3. Owing to the environment in the field stations, hardship allowance of Sh.1,200,000 was paid.
4. His movement to and from the field stations outside Kenya was facilitated by Faux PLC in form of air tickets that costed Sh.4,800,000 in the year.
5. During the year, he was away in the foreign field stations for more than 156 days.
6. In an arrangement where Faux PLC has with a five-star hotel in Kenya, he consumed meals valued at Sh.270,000 which were paid for by the employer.
7. Assume that he was an “other-than-resident” employee for the year 2022.

**Required:**

Determine taxable income and tax liability (if any) in Kenya for Rick Lenon for the year ended 31 December 2022. (6 marks)

- (c) The national treasury in your country recently issued a draft national tax policy for public participation and discussion.

**Required:**

- (i) Explain **THREE** objectives of a national tax policy. (3 marks)
  - (ii) Describe **THREE** practical challenges that a national tax policy is aimed at addressing. (3 marks)
- (Total: 20 marks)**

**QUESTION THREE**

- (a) The tax laws and regulations in most developing countries have been changing in recent years. This rapid change in legislation may expose tax payers to the risk of non-compliance.

**Required:**

- (i) Explain the term “tax health checks”. (2 marks)
- (ii) Describe **FOUR** reasons why businesses should conduct regular tax health checks. (4 marks)

- (b) Saika Ltd. is a company engaged in real estate development. The company constructed eight, two-bedroomed residential houses for sale and three commercial buildings in different locations in the country.

The company has presented the following information relating to the properties development as at 31 December 2022:

**Residential houses:**

1. Cost of acquisition of land where the houses were constructed was Sh.10,000,000. The company had incurred the following costs in relation to land acquisition; stamp duty Sh.1,800,000, brokerage fees Sh.800,000 and legal fees to facilitate the purchase Sh.360,000.
2. The following costs were incurred on construction:
  - Material cost for each house was Sh.4,350,000 inclusive of value added tax (VAT) at a rate of 16%.
  - Architectural and surveying fee was Sh.1,624,000 inclusive of VAT. The company paid Sh.50,000 for each house to the county government for approval of the construction.
  - Professional fees for engineers amounted to Sh.3,480,000 inclusive of VAT.
  - Labour cost was Sh.400,000 for each house per month. It took the company nine months to complete the construction.
  - The construction was financed by Ujenzi Housing Bank with a loan of Sh.80,000,000 at an interest rate of 12% per annum. The loan was to be repaid at year end when all houses were sold. Only 70% of the loan was used on the houses. The balance was used to finance construction of the commercial buildings.
  - Drainage system and sewerage line cost Sh.960,000 for all houses.
  - The company leased equipment for construction at a total lease charge of Sh.2,000,000.
3. Other costs incurred included:
  - Cost of landscaping the entire land where the houses were constructed Sh.300,000.
  - Legal fees of Sh.180,000 to settle disputes in relation to the title deed of the land.
4. All the houses were sold by 31 December 2022 at a selling price of Sh.12,500,000 per house. The following costs were incurred in selling the houses:
  - Legal fees Sh.120,000 per house.
  - Valuation fee for all houses Sh.1,200,000
  - Advertising to find a buyer Sh.1,000,000 for all houses.

**Commercial buildings:**

- The commercial buildings were constructed at a total cost of Sh.30,000,000 each. This included shops at Sh.2,200,000, gym and steam bath Sh.1,450,000 and a swimming pool for the tenants at Sh.2,400,000.
- The commercial buildings were leased on 1 October 2022 at a monthly rent of Sh.1,200,000 each. Key money received on signing the lease agreement amounted to Sh.1,000,000 per building.
- The tenants were required to pay a monthly premium charge for extra services provided of Sh.200,000 per house.
- Maintenance expenses per month amounted to Sh.300,000.
- The company incurred advertising costs of Sh.400,000 of which Sh.120,000 was incurred before leasing the buildings.
- Installation of CCTV cameras cost Sh.180,000 on each building and insurance for the whole year amounted to Sh.480,000 for all the buildings.

**Required:**

Compute the total taxable income and tax payable (if any) by Saika Ltd. for the year ended 31 December 2022.

(14 marks)

**(Total: 20 marks)**

**QUESTION FOUR**

- (a) As a professional tax practitioner undertaking tax advisory for the small and micro enterprises (SME) sector, explain **FOUR** aspects of compliance with the tax code in your country that constitute the major pain points for the SME sector. (4 marks)
- (b) Tusaidiane SACCO is a deposit taking cooperative society. The SACCO has a clear separation of its back-office activities (BOSA) and its front-office activities (FOSA).

|                                           | Sh. “000” |
|-------------------------------------------|-----------|
| Interest income: BOSA (from members)      | 1,300,000 |
| FOSA                                      | 820,000   |
| Commission received from Visa Card (FOSA) | 80,000    |
| Rental income (net of allowable expenses) | 30,000    |
| Dividends from Cooperative Bank (net)     | 78,375    |
| Foreign exchange gains realised           | 16,000    |
| Capital gains                             | 9,000     |
| Other operating income                    | 23,000    |
| Administration and governance expenses    | 79,000    |
| Salaries and wages                        | 168,000   |
| Interest on deposits: BOSA                | 420,000   |
| FOSA                                      | 280,000   |
| Sales and marketing costs                 | 53,800    |
| Insurance expense                         | 25,000    |
| Allowance for doubtful debts              | 300,000   |
| Asset impairment                          | 226,000   |
| Repairs and maintenance                   | 8,000     |
| Computers and printers                    | 25,500    |
| Software                                  | 12,800    |
| Furniture and fittings                    | 9,700     |
| Audit and accounting fee                  | 5,600     |
| Motor vehicle running expenses            | 1,300     |
| Rent and rates                            | 84        |
| Interest on loans (BOSA and FOSA)         | 12,540    |

1. The foreign exchange gains realised and other operating income were earned equally between the BOSA and FOSA business.
2. Expenses accrued in the ratio of 3:2 between BOSA and FOSA businesses respectively unless indicated otherwise.
3. Not included in the information provided is the purchase cost of a Toyota Van for Sh.2,000,000 to be used for the SACCO's marketing sensitisation campaigns.

The taxable income or loss (if any) and the tax payable for Tusaidiane SACCO for the year ended 31 December 2022. (8 marks)

- |                                          | Sh. “000” |
|------------------------------------------|-----------|
| Sales : A                                | 2,000,000 |
| : B                                      | 2,500,000 |
| Disposal of interest (gross) 54% of A    | 5,400,000 |
| Development expenditure : A              | 280,000   |
| : B                                      | 320,000   |
| : C                                      | 190,000   |
| Cost of disposal of interest             | 1,200,000 |
| Exploration expenditure : A              | 210,000   |
| : B                                      | 175,000   |
| : C                                      | 100,000   |
| Loose tools : A                          | 90,000    |
| : B                                      | 76,000    |
| Decommissioning expenditure : A          | 80,500    |
| : C                                      | 33,200    |
| Decommissioning refund from account: B   | 66,300    |
| Machinery for exploration operations : A | 154,900   |
| : B                                      | 208,400   |
| : C                                      | 110,100   |

**Additional information:**

1. The C contract area is mostly under exploration and has not yet reached the commercial levels of production.
2. The Company's Directors hold the company's governance and supervisory meetings outside the country.
3. The loose tools and machinery for exploration were brought in new during the year.

**Required:**

Determine the taxable income or loss and tax payable (if any) for Venture Miners Ltd. for the year ended 31 December 2022. (8 marks)

**(Total: 20 marks)**

**QUESTION FIVE**

- (a) The Revenue Authority of your country has been undertaking tax reforms in a bid to improve tax collection and tax compliance. To this end, the Authority has formulated a three-year corporate plan that runs from the year 2021/2022 – 2023/2024. So far, most of the corporate plan priorities remain elusive and hence the Revenue Authority has not been able to achieve most of its strategic objectives.

**Required:**

Analyse **FOUR** reasons that may have contributed to the Revenue Authority being unable to achieve the strategic objectives. (4 marks)

- (b) The following transactions related to Miki Traders Ltd. for the month of December 2022:

| 1. | Sales and purchases transactions:                                                                                                                       | Within the country<br>Sh. | Outside the country<br>Sh. |
|----|---------------------------------------------------------------------------------------------------------------------------------------------------------|---------------------------|----------------------------|
|    | Sales                                                                                                                                                   | 4,200,000                 | 1,800,000                  |
|    | Purchases                                                                                                                                               | 2,280,000                 | 3,000,000                  |
|    | Sales returns                                                                                                                                           | 360,000                   | -                          |
|    | Purchase returns                                                                                                                                        | 186,000                   | -                          |
|    | Understatements: Sales                                                                                                                                  | 540,000                   |                            |
|    | : Purchases                                                                                                                                             | 288,000                   | -                          |
| 2. | Purchase of capital items:                                                                                                                              |                           |                            |
|    | Office furniture and fittings                                                                                                                           | 84,000                    |                            |
|    | Delivery truck on hire purchase                                                                                                                         | 3,600,000                 | (cash price Sh.3,000,000)  |
| 3. | Expenses:                                                                                                                                               |                           |                            |
|    | Medical fees                                                                                                                                            | 180,000                   |                            |
|    | Sewerage service by government                                                                                                                          | 6,000                     |                            |
|    | Casual labour                                                                                                                                           | 480,000                   |                            |
|    | Office rent                                                                                                                                             | 240,000                   |                            |
|    | Hire of taxis for staff                                                                                                                                 | 28,800                    |                            |
|    | Customer satisfaction survey by a management consultant                                                                                                 | 165,000                   |                            |
|    | Renovation of existing buildings                                                                                                                        | 780,000                   |                            |
|    | Penalties for late payment of VAT                                                                                                                       | 18,000                    |                            |
| 4. | Imported goods were stated at Cost Insurance and Freight (CIF) value and were subject to customs duty at a rate of 25% on their entry into the country. |                           |                            |
| 5. | Miki Traders donated goods worth Sh.150,000 and cash for Sh.120,000 to a children's home. The goods were not included in the above sales.               |                           |                            |
| 6. | Transactions are stated as VAT inclusive at a rate of 16% where applicable.                                                                             |                           |                            |

**Required:**

- (i) Compute the VAT payable or refundable by Miki Traders Ltd. for the month of December 2022. (7 marks)
- (ii) Comment on the VAT payable/refundable. (1 mark)

- (c) Malezi Trust was formed in the year 2021 for the benefit of Alex Malezi's two children, Mona and Nora. The following information was provided to you by the trustees in respect of the trust's income and expenses for the year ended 31 December 2022:

1. The trustee reported a trading profit of Sh.160,000,000 for the year. This was after deducting the following expenses:
  - Printing and stationery Sh.1,000,000.
  - Legal fees of Sh.6,000,000 out of which Sh.1,200,000 was in respect of defending one of the trustee involved in an illegal business deal.
  - Tax consultancy fees Sh.2,400,000.
  - Purchase and installation of accounting software Sh.2,000,000.
  - Trustees salary as per the trust agreement Sh.10,000,000.
  - Loan repayment (interest Sh.1,100,000) Sh.8,000,000.
  - Lease charges were Sh.3,000,000 out of which Sh.600,000 was in respect of drafting 10 year lease agreement.
  - Preliminary expenses in respect of the trust formation Sh.3,400,000.
2. The trading profit was before taking into account the following capital expenditure:
 

| Asset           | Date of first use | Amount (Sh.) |
|-----------------|-------------------|--------------|
| Warehouse       | 1 April 2022      | 3,500,000    |
| Delivery truck  | 5 March 2022      | 1,750,000    |
| Saloon vehicle  | 1 January 2022    | 3,800,000    |
| Sports pavilion | 1 September 2022  | 1,200,000    |
3. The trustees received gross rental income from commercial properties of Sh.120,000,000 and gross interest income from fixed deposits of Sh.20,000,000. Fee paid to investment managers in charge of the rental properties and fixed deposits amounted to Sh.12,000,000.
4. Additional information:
  - Each beneficiary is entitled to  $\frac{1}{4}$  share of the net distributable income.
  - Fixed annuity to each beneficiary was Sh.10,000,000 (gross).
  - The trustees made Sh.6,000,000 to Mona and Sh.3,000,000 to Nora as discretionary payments as per the agreement.

**Required:**

- (i) Compute the income tax payable on the trust income for the year ended 31 December 2022. (6 marks)
  - (ii) Compute the amount due to each beneficiary for the year ended 31 December 2022. (2 marks)
- (Total: 20 marks)**

.....



## CPA ADVANCED LEVEL

### ADVANCED TAXATION

**TUESDAY: 6 December 2022. Afternoon Paper.**

**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. Do NOT write anything on this paper.**

**RATES OF TAX (Including wife's employment, self-employment and professional income rates of tax).**

**Year of income 2021.**

**Assume that the following rates of tax applied throughout the year of income 2021:**

| Monthly taxable pay<br>(Sh.) | Annual taxable pay<br>(Sh.) | Rate of tax<br>% in each Sh. |
|------------------------------|-----------------------------|------------------------------|
| 1 - 24,000                   | 1 - 288,000                 | 10%                          |
| 24,001 - 32,333              | 288,001 - 388,000           | 25%                          |
| Excess over - 32,333         | Excess over - 388,000       | 30%                          |

**Personal relief Sh.2,400 per month (Sh.28,800 per annum).**

| Investment allowance:                                                                                       | Rate of investment allowance     | Residual value<br>(per year on<br>reducing<br>balance) | Prescribed benefit rates of motor vehicles<br>provided by employer |                           |                          |
|-------------------------------------------------------------------------------------------------------------|----------------------------------|--------------------------------------------------------|--------------------------------------------------------------------|---------------------------|--------------------------|
| Capital expenditure incurred on:                                                                            |                                  |                                                        | (i) Saloons, Hatch Backs and Estates                               | Monthly<br>rates<br>(Sh.) | Annual<br>rates<br>(Sh.) |
| (a) <b>Buildings:</b>                                                                                       |                                  |                                                        | Up to 1200 cc                                                      | 3,600                     | 43,200                   |
| • Hotel building                                                                                            | 50% in the first year of use     | 25%                                                    | 1201 - 1500 cc                                                     | 4,200                     | 50,400                   |
| • Building used for manufacture                                                                             | 50% in the first year of use     | 25%                                                    | 1501 - 1750 cc                                                     | 5,800                     | 69,600                   |
| • Hospital building                                                                                         | 50% in the first year of use     | 25%                                                    | 1751 - 2000 cc                                                     | 7,200                     | 86,400                   |
| • Petroleum or gas storage facilities                                                                       | 50% in the first year of use     | 25%                                                    | 2001 - 3000 cc                                                     | 8,600                     | 103,200                  |
| • Educational/hostels building                                                                              | 10% per year on reducing balance |                                                        | Over - 3000 cc                                                     | 14,400                    | 172,800                  |
| • Commercial building                                                                                       | 10% per year on reducing balance |                                                        |                                                                    |                           |                          |
| (b) <b>Machinery:</b>                                                                                       |                                  |                                                        | (ii) Pick-ups, Panel Vans<br>(unconverted)                         |                           |                          |
| • Machinery used for manufacture                                                                            | 50% in the first year of use     | 25%                                                    | Up to - 1750 cc                                                    | 3,600                     | 43,200                   |
| • Hospital equipment                                                                                        | 50% in the first year of use     | 25%                                                    | Over - 1750 cc                                                     | 4,200                     | 50,400                   |
| • Ships or aircraft                                                                                         | 50% in the first year of use     | 25%                                                    |                                                                    |                           |                          |
| • Motor vehicles and heavy earth<br>moving equipment                                                        | 25% per year on reducing balance |                                                        |                                                                    |                           |                          |
| • Computer software, calculators,<br>copiers and duplicating machines                                       | 25% per year on reducing balance |                                                        |                                                                    |                           |                          |
| • Furniture and fittings                                                                                    | 10% per year on reducing balance |                                                        |                                                                    |                           |                          |
| • Telecommunication equipment                                                                               | 10% per year on reducing balance |                                                        |                                                                    |                           |                          |
| • Film equipment by a local producer                                                                        | 25% per year on reducing balance |                                                        |                                                                    |                           |                          |
| • Machinery used to undertake<br>operations under prospecting rights<br>and exploration under mining rights | 50% in the first year of use     | 25%                                                    |                                                                    |                           |                          |
| • Other machinery                                                                                           | 10% per year on reducing balance |                                                        |                                                                    |                           |                          |
| (c) Purchase/acquisition of right to use<br>fibre optic cable by telecommunication<br>operation             | 10% per year on reducing balance |                                                        | (iii) Land Rovers/Cruisers                                         | 7,200                     | 86,400                   |
| (d) Farm works                                                                                              | 50% in the first year of use     | 25%                                                    |                                                                    |                           |                          |

**Commissioner's prescribed benefit rates:**

**Services**

|                                                | Monthly rates<br>(Sh.) | Annual rates<br>(Sh.) |
|------------------------------------------------|------------------------|-----------------------|
| (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) The tax law envisages various approaches and levels of resolving tax disputes, including the administrative decisions, quasi-judicial process involving tax appeals tribunal (TAT), formal judicial process involving the High Court or appeal to the Court of Appeal and alternative dispute resolution. Some of the relevant laws include the Tax Procedures Act, Tax Appeals Tribunal Act and other relevant tax laws.

### Required:

With reference to the above statement and quoting relevant tax provisions, explain the application of each of the following in tax disputes settlement:

- (i) Tax appeals tribunal. (3 marks)
  - (ii) High Court. (3 marks)
  - (iii) Court of Appeal. (3 marks)
  - (iv) Out of Court settlement. (3 marks)
- (b) Consider the following hypothetical case:  
Axe Ltd., incorporated in your Country, signed a service agreement to provide marketing and liaison services to the related non-resident entities located in the United Kingdom (UK). Under the agreement, Axe Ltd. was to be compensated off cost plus mark-up basis. The related non-resident entities executed separate agreements with distributors of their products who they invoiced directly. The revenue authority imposed value added tax (VAT) on the above marketing services provided by Axe Ltd.

On the other hand, Axe Ltd. argued that the marketing support services enhanced brand awareness of the products sold by the non-resident entities in your country. On this basis, the services were exported, hence zero-rated.

The above case has been brought before the tax tribunal.

### Required:

Discuss **TWO** factors that the Tribunal might consider in ruling in favour of Axe Ltd. (4 marks)

- (c) Explain **TWO** ethical principles governing the services provided by tax practitioners. (4 marks)
- (Total: 20 marks)**

## QUESTION TWO

- (a) Mawingu Ltd. is a foreign subsidiary company operating a fleet of passenger and cargo aircrafts in Country A. The flights are between Country A and other countries. The operating results for the year ended 31 December 2021 are as follows:

|                                                        | Sh. "000" |
|--------------------------------------------------------|-----------|
| Income from cargo freight: Country A/Country B         | 567,720   |
| Income from passengers' freight: Country A/Country C   | 765,000   |
| Income from passengers' freight: Country C/Country A   | 1,001,880 |
| Income from cargo loaded into aircraft on other routes | 630,000   |
| Salaries and other costs                               | 1,530,000 |
| Depreciation                                           | 288,000   |
| General allowance for credit loss                      | 72,000    |
| Capital expenditure (cost Sh.2,000,000,000)            | 1,750,000 |
| Compensation costs for stolen baggage                  | 23,600    |

### Additional information:

- 1. Salaries and other costs include: Sh. "000"
  - Purchase of twin engines 117,000
  - Use of airport facilities 32,400
  - Hotel bills for passengers 37,800
  - Accommodation for airline crew 9,000
  - Gift to airport staff 10,800
- 2. Investment allowances were agreed with the Revenue Authority at 85% of depreciation charged in the account.
- 3. Assume a corporation tax rate of 30%.

**Required:**

- (i) Compute adjusted taxable profit or loss of Mawingu Ltd. for the year ended 31 December 2021. (8 marks)
- (ii) Compute tax payable (or refundable) for Mawingu Ltd. (2 marks)
- (b) ZamZam Company Ltd. purchased a property whose cash price was Sh.1,264,000 under the following terms:
- The deposit paid for the purchase of the property was Sh.400,000.
  - The balance of the purchase price was to be paid over a 3-year period at a monthly instalment of Sh.40,000 inclusive of Sh.16,000 per month as mortgage interest.

**Required:**

Assuming the property was sold as follows:

Option I: For Sh.2,000,000 after payment of twenty-four instalments.

Option II: For Sh.2,680,000 after full payment of all the instalments, cost of valuation Sh.54,000 and legal fees Sh.72,000.

Calculate capital gains tax under each option.

(6 marks)

- (c) Darubini Ltd. is under tax investigation by the Revenue Authority, accused of obstructing/hindering the investigation officer in the exercise of his function.

Highlight **FOUR** aspects that may constitute obstruction in the above case.

(4 marks)

**(Total: 20 marks)**

**QUESTION THREE**

- (a) A, B and C have been trading in a small size partnership sharing profits and losses in the ratio of 2:2:1 respectively. C retired from the partnership on 31 August 2021 while A and B agreed to continue with the business charging interest on capital at the rate of 15% per annum as in the previous period when C was still in the partnership.

Due to the changes in the partnership, goodwill was valued at Sh.1,200,000 and was to be written off immediately.

The following trial balance was extracted as at 31 December 2021:

|                                      | Sh.               | Sh.               |
|--------------------------------------|-------------------|-------------------|
| <b>Capital account:</b> A            |                   | 1,680,000         |
| B                                    |                   | 1,400,000         |
| C                                    |                   | 840,000           |
| <b>Current account:</b> A            |                   | 67,200            |
| B                                    |                   | 56,000            |
| C                                    |                   | 44,800            |
| <b>Drawings:</b> A                   | 78,400            |                   |
| B                                    | 67,200            |                   |
| C                                    | 56,000            |                   |
| Inventory (1 January 2021)           | 252,000           |                   |
| Purchases and sales                  | 4,200,000         | 7,720,000         |
| Discount received                    |                   | 124,000           |
| Bad debts recovered – general        |                   | 193,200           |
| Salaries and wages                   | 722,400           |                   |
| Legal and professional fees          | 1,904,000         |                   |
| Rent and rates                       | 168,000           |                   |
| Insurance                            | 70,000            |                   |
| Sundry expenses                      | 50,400            |                   |
| Trade receivables and payables       | 308,000           | 224,000           |
| Allowance for doubtful debts         |                   | 11,200            |
| Land at cost                         | 2,800,000         |                   |
| Delivery lorry                       | 896,000           |                   |
| Depreciation                         | 448,000           |                   |
| Cash at bank                         | 676,000           |                   |
| Dividends: Sasa Co-operative Society |                   | 336,000           |
|                                      | <u>12,696,400</u> | <u>12,696,400</u> |

**Additional information:**

- Sales and purchases were inclusive of value added tax (VAT) at the rate of 16%. Cash sales amounted to Sh.358,400 (VAT inclusive) and were excluded from the above accounts.
- The following assets were acquired by the business immediately after retirement of C.

**Sh.**

|            |           |
|------------|-----------|
| Computers  | 150,000   |
| Saloon car | 3,120,000 |

- Legal and professional fees include:

**Sh.**

|                                    |         |
|------------------------------------|---------|
| Stamp duty                         | 168,000 |
| Negotiating a bank overdraft       | 158,200 |
| Recovery of bad debts              | 245,000 |
| Signing a 99 year lease agreement  | 228,400 |
| Purchase of A's private residence  | 350,000 |
| Preparation of employment contract | 82,000  |

- Interest on drawings was charged at the rate of 10% per annum.
- Inventory at year end was valued at Sh.364,000 and the partnership had consistently undervalued inventory at each year end by 20%.
- Salary and wages include partners' salary of Sh.420,000 shared by the partners according to the profit and loss sharing ratio.
- Allowance for doubtful debts was to be increased to Sh.24,800 at year end. Bad debts written off amounted to Sh.40,000 of which Sh.8,000 relates to general bad debts.
- Prepaid insurance at the beginning of the year amounted to Sh.8,000 while insurance owing at year end amounted to Sh13,000.
- Accrued sundry expenses as at 1 January 2021 and 31 December 2021 amounted to Sh.10,000 and Sh.2,000 respectively.
- C was paid all his dues on 15 September 2021. The profits and losses were to be shared equally after C's retirement.
- Unless otherwise stated, assume that all revenues and expenses accrued evenly throughout the year.

**Required:**

- Prepare a statement of adjusted taxable profit or loss for the partnership for the year ended 31 December 2021. (10 marks)
  - Determine the taxable income for each partner. (6 marks)
- (b) The Commissioner is empowered to cancel or terminate the license of any person acting as a tax agent at any time. Summarise **FOUR** circumstances under which this may be possible. (4 marks)
- (Total: 20 marks)**

**QUESTION FOUR**

- (a) The African Growth and Opportunity Act (AGOA) is a United States Trade Act enacted in year 2000 as a legislation that significantly enhances market access to the United States for qualifying Sub-Sahara African countries.

Analyse **THREE** conditions that the above countries must meet in order to qualify and be eligible for AGOA consideration. (6 marks)

- (b) Mijengo Contractors Ltd. is a resident firm engaged in the property development business. As at 1 January 2021, the firm secured two construction contracts namely X and Y which are to be completed within a period of two years. The information relating to the contracts is as flows:

|                                                | <b>Contract X</b> | <b>Contract Y</b> |
|------------------------------------------------|-------------------|-------------------|
|                                                | <b>Sh.</b>        | <b>Sh.</b>        |
| Gross Contract Price                           | 22,500,000        | 20,900,000        |
| <b>Direct costs incurred in the year 2021:</b> |                   |                   |
| Materials                                      | 2,500,000         | 1,800,000         |
| Direct labour                                  | 2,000,000         | 3,600,000         |
| Consultancy fee                                | 300,000           | 260,000           |
| Subcontracting fee                             | 1,420,000         | 2,030,000         |
| Other direct costs                             | 34,500            | 45,500            |

**Additional information:**

- Contract X's material cost includes material costing Sh.240,000 that remained at the site as at 31 December 2021, while under contract Y, material costing Sh300,000 was sold during the year.
- The company estimates that costs to be incurred to complete the contract work will be 150% of the contract costs incurred in the current year for both contracts.
- The company computes taxable revenue on the basis of the percentage of completion method for the two contracts.
- Analysis of general and administrative expenses for the year is as follows:

|                                                                                   | <b>Sh.</b> |
|-----------------------------------------------------------------------------------|------------|
| Office salaries                                                                   | 850,000    |
| Renewal of construction license                                                   | 186,600    |
| Pension contributions                                                             | 236,000    |
| Billboard cost and billboard erection cost                                        | 202,000    |
| Purchase of computers and software (of which software cost amounted to Sh.30,000) | 210,000    |
| Depreciation                                                                      | 29,500     |
| Subscriptions due to contractors association                                      | 35,680     |
| Interest on overdue loan                                                          | 22,000     |
| Legal fee on defense against claim of breach of contract                          | 80,000     |
| Rent for the office premises                                                      | 614,000    |
| Utilities                                                                         | 245,600    |

- Other income received by the company included:
 

|                                                |                 |
|------------------------------------------------|-----------------|
|                                                | <b>Sh.</b>      |
| Interest income from Upland Bank               | 348,800 (Gross) |
| Dividend income from Lima Co-operative Society | 360,000 (Gross) |
| Royalties income (net of tax)                  | 695,000         |

**Required:**

- Compute the total taxable income for Mijengo Contractors Ltd. for the year ended 31 December 2021.  
(12 marks)
  - Compute the tax payable (if any) by Mijengo Contractors Ltd.  
(2 marks)
- (Total: 20 marks)**

**QUESTION FIVE**

- Zamon UK is a multinational corporation in UK with a wholly owned subsidiary, Zamon XL based in your country. In the year ended 31 December 2021, Zamon XL produced 50,000 kilograms of coffee from its farm at a cost of Sh.200 per kilogram exclusively meant for export to Zamon UK at a predetermined price of Sh.300 per kilogram although the market price was Sh.600 per kilogram. Zamon UK sold all the coffee in the UK market at Sh.1,200 per kilogram.

**Additional information:**

- Tax rates are as follows:

|                 | <b>UK</b> | <b>Your country</b> |
|-----------------|-----------|---------------------|
| Income tax      | 21%       | 30%                 |
| Import duty     | 10%       | -                   |
| Withholding tax | -         | 10%                 |

- The subsidiary repatriates all profits as dividends.

**Required:**

Compute the total tax lost by the Revenue Authority as a result of this transfer pricing arrangement. (5 marks)

- Comparability analysis in transfer pricing arrangements involves comparison of the conditions in a controlled transaction with the conditions that would have been made had the parties been independent and undertaking a comparable transaction under comparable circumstances.

**Required:**

Evaluate **THREE** comparability factors that could be identified in commercial and financial relations between related parties in determining the arm's length price under transfer pricing. (6 marks)

- (c) Popote Ltd. is a manufacturer of vatable goods and the company is fully registered for value added tax (VAT) purposes. The company had the following transactions for the year ended 31 December 2021 which included VAT at the rate of 16% where applicable.

|                            | <b>Sh."000"</b> |
|----------------------------|-----------------|
| Sales at standard rate     | 10,680          |
| Sales at zero rate         | 2,400           |
| Delivery van purchased     | 3,600           |
| Exempt sales               | 4,800           |
| Purchases at standard rate | 7,200           |
| Purchases at zero rate     | 1,800           |
| Rent for factory building  | 1,200           |
| Audit and accountancy      | 720             |
| Printing and stationery    | 960             |

**Additional information:**

1. Sales at standard rate include 20% which is in respect of export sales to another country.
2. Purchases at a standard rate include imported vatable raw materials of Sh.1,500,000 exclusive of duty at 25%.
3. The company confirmed that the value of goods purchased at standard rate and sold in the same state amounted to Sh.2,000,000 in the course of the year.
4. Bad debts recovered previously written off amounted to Sh.240,000.

**Required:**

Compute the following for Popote Ltd. for the year ended 31 December 2021:

- |       |                            |                          |
|-------|----------------------------|--------------------------|
| (i)   | Input tax claimable.       | (6 marks)                |
| (ii)  | Output tax.                | (1 mark)                 |
| (iii) | VAT payable or refundable. | (2 marks)                |
|       |                            | <b>(Total: 20 marks)</b> |

.....



## CPA ADVANCED LEVEL

### ADVANCED TAXATION

**TUESDAY: 2 August 2022. Afternoon paper.**

**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. Do NOT write anything on this paper.**

**RATES OF TAX (Including wife's employment, self-employment and professional income rates of tax).**

**Year of income 2021.**

**Assume that the following rates of tax applied throughout the year of income 2021:**

| Monthly taxable pay<br>(Sh.) | Annual taxable pay<br>(Sh.) | Rate of tax<br>% in each Sh. |
|------------------------------|-----------------------------|------------------------------|
| 1 - 24,000                   | 1 - 288,000                 | 10%                          |
| 24,001 - 32,333              | 288,001 - 388,000           | 25%                          |
| Excess over - 32,333         | Excess over - 388,000       | 30%                          |

**Personal relief Sh.2,400 per month (Sh.28,800 per annum).**

| Investment allowance:                                                                                       | Rate of investment allowance     | Residual value<br>(per year on<br>reducing<br>balance) | Prescribed benefit rates of motor vehicles<br>provided by employer |                           |                          |
|-------------------------------------------------------------------------------------------------------------|----------------------------------|--------------------------------------------------------|--------------------------------------------------------------------|---------------------------|--------------------------|
| Capital expenditure incurred on:                                                                            |                                  |                                                        | (i) Saloons, Hatch Backs and Estates                               |                           |                          |
|                                                                                                             |                                  |                                                        |                                                                    | Monthly<br>rates<br>(Sh.) | Annual<br>rates<br>(Sh.) |
| (a) <b>Buildings:</b>                                                                                       |                                  |                                                        | Up to 1200 cc                                                      | 3,600                     | 43,200                   |
| • Hotel building                                                                                            | 50% in the first year of use     | 25%                                                    | 1201 - 1500 cc                                                     | 4,200                     | 50,400                   |
| • Building used for manufacture                                                                             | 50% in the first year of use     | 25%                                                    | 1501 - 1750 cc                                                     | 5,800                     | 69,600                   |
| • Hospital buildings                                                                                        | 50% in the first year of use     | 25%                                                    | 1751 - 2000 cc                                                     | 7,200                     | 86,400                   |
| • Petroleum or gas storage facilities                                                                       | 50% in the first year of use     | 25%                                                    | 2001 - 3000 cc                                                     | 8,600                     | 103,200                  |
| • Educational/hostels building                                                                              | 10% per year on reducing balance |                                                        | Over - 3000 cc                                                     | 14,400                    | 172,800                  |
| • Commercial building                                                                                       | 10% per year on reducing balance |                                                        |                                                                    |                           |                          |
| (b) <b>Machinery:</b>                                                                                       |                                  |                                                        | (ii) Pick-ups, Panel Vans<br>(unconverted)                         |                           |                          |
| • Machinery used for manufacture                                                                            | 50% in the first year of use     | 25%                                                    | Up to - 1750 cc                                                    | 3,600                     | 43,200                   |
| • Hospital equipment                                                                                        | 50% in the first year of use     | 25%                                                    | Over - 1750 cc                                                     | 4,200                     | 50,400                   |
| • Ships or aircraft                                                                                         | 50% in the first year of use     | 25%                                                    |                                                                    |                           |                          |
| • Motor vehicles and heavy earth<br>moving equipment                                                        | 25% per year on reducing balance |                                                        |                                                                    |                           |                          |
| • Computer software, calculators,<br>copiers and duplicating machines                                       | 25% per year on reducing balance |                                                        |                                                                    |                           |                          |
| • Furniture and fittings                                                                                    | 10% per year on reducing balance |                                                        |                                                                    |                           |                          |
| • Telecommunication equipment                                                                               | 10% per year on reducing balance |                                                        |                                                                    |                           |                          |
| • Film equipment by a local producer                                                                        | 25% per year on reducing balance |                                                        |                                                                    |                           |                          |
| • Machinery used to undertake<br>operations under prospecting rights<br>and exploration under mining rights | 50% in the first year of use     | 25%                                                    |                                                                    |                           |                          |
| • Other machinery                                                                                           | 10% per year on reducing balance |                                                        |                                                                    |                           |                          |
| (c) Purchase/acquisition of right to use<br>fibre optic cable by telecommunication<br>operation             | 10% per year on reducing balance |                                                        | (iii) Land Rovers/Cruisers                                         |                           |                          |
|                                                                                                             |                                  |                                                        |                                                                    | 7,200                     | 86,400                   |
| (d) Farm works                                                                                              | 50% in the first year of use     | 25%                                                    |                                                                    |                           |                          |

**Commissioner's prescribed benefit rates:**

**Services**

|                                                | Monthly rates<br>(Sh.) | Annual rates<br>(Sh.) |
|------------------------------------------------|------------------------|-----------------------|
| (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) With reference to the services provided by tax practitioners, explain the difference between “tax health checks” and “tax audits”, clearly isolating the salient features of each. (6 marks)
- (b) In one of the recent tax cases decided by the Tax Appeals Tribunal, the Tribunal allowed an application for extension to file an appeal out of time.

A summary of the case facts was as follows:

1. The taxpayer missed on the statutory deadline for filing the Notice of Appeal and Memorandum of Appeal due to factors beyond their control.
2. The revenue authority countered that the objection decision was issued in time via the email provided on the iTax platform and that they were not under any obligation to follow up with the taxpayer on the receipt of the email.
3. In a rejoinder, the taxpayer stated that they were unaware and did not find any email and further that they were unaware of the existence of the Objection Decision until later when applying for a tax compliance certificate.

**Required:**

Based on the above case and introducing any other relevant facts, discuss four factors that the Tax Appeals Tribunal might have considered in arriving at its decision above. (8 marks)

- (c) Tax treaties represent an important aspect of the international tax rules of many countries. Experts estimate that over 3,000 bilateral income tax treaties are currently in effect, and the number is growing.

**Required:**

With reference to the above statement, describe three objectives of international tax treaties. (6 marks)

**(Total: 20 marks)**

### QUESTION TWO

- (a) Bale Ltd., a small scale retailer operates two sales outlets, one at the head office and the other at the branch. For the year ended 31 December 2021, the following results of the head office and the branch were presented to you:

|                                         | <b>Head office</b>  | <b>Branch</b>      |
|-----------------------------------------|---------------------|--------------------|
|                                         | <b>Sh.</b>          | <b>Sh.</b>         |
| Gross profit                            | 12,200,000          | 7,000,000          |
| Gain on shares sold                     | 30,000              | -                  |
| Insurance recovery                      | 30,000              | 9,000              |
| Gain on sale of land and building       | -                   | 600,000            |
| Interest income: Lex Bank               | 180,000             | -                  |
| Bonus shares                            | 120,000             | -                  |
| Interest income: Beta Microfinance      | <u>200,000</u>      | <u>-</u>           |
| Total gross income                      | 12,760,000          | 7,609,000          |
| <b>Expenses:</b>                        |                     |                    |
| Staff salaries                          | 240,000             | 90,000             |
| Maintenance expenses                    | 80,000              | 58,000             |
| Preliminaries expenses                  | 100,000             | 30,000             |
| Retrenchment costs                      | 2,500,000           | 1,300,000          |
| Rent, rates and insurance paid          | 410,000             | 110,000            |
| Goodwill written off                    | 20,000              | -                  |
| Legal and accountancy fees              | 330,000             | 120,000            |
| Depreciation                            | 180,000             | 70,000             |
| Interest on overdue tax                 | 80,000              | -                  |
| Subscription to golf club for directors | 105,000             | 109,000            |
| Donations                               | 100,000             | 70,000             |
| General administrative expenses         | 360,000             | 140,000            |
| Purchase of a lorry                     | 3,200,000           | -                  |
| Loss of stock                           | 200,000             | 500,000            |
| Loan interest                           | 360,000             | -                  |
| Directors' remuneration                 | 1,500,000           | 830,000            |
| Pension contribution                    | <u>685,000</u>      | <u>155,000</u>     |
| Total expenses                          | <u>(10,450,000)</u> | <u>(3,582,000)</u> |
| Net profit                              | <u>2,310,000</u>    | <u>4,027,000</u>   |

**Additional information:**

1. Goods worth Sh.600,000 were transferred from the head office to the branch at 10% below the normal selling price.
2. 70% of insurance recovery was in respect of stocks destroyed by fire, the balance was on compensation on capital items.
3. Staff salaries include provision for leave accruals equal to a third of the total salaries for head office and the branch.
4. The interest income recorded in the books of Bale Ltd. was gross although Bale Ltd. received net of withholding tax.
5. Bonus shares were from a company where Bale Ltd. has 30% control.
6. Rent, rates and insurance paid for the branch: At the beginning of the year, rent accrued amounted to Sh.24,000 and as at 31 December 2021 rent prepaid was Sh.42,000. These had not been adjusted for in the accounts.
7. The lorry purchased was imported and duty paid was Sh.130,000. This was omitted from the cost of the lorry.
8. Retrenchment cost analysis.

|                              | <b>Head office</b> | <b>Branch</b>    |
|------------------------------|--------------------|------------------|
|                              | <b>Sh.</b>         | <b>Sh.</b>       |
| Provision for staff gratuity | 800,000            | 500,000          |
| Pension payments             | <u>1,700,000</u>   | <u>800,000</u>   |
|                              | <u>2,500,000</u>   | <u>1,300,000</u> |

9. Loss of stock: Fire razed down a warehouse where goods are stored before they are transported to the head office and branch. VAT at 16% was included in the stocks destroyed by fire.
10. 20% of loan interest relates to a loan obtained to finance purchase of shares.

**Required:**

- (i) Compute the combined adjusted taxable profit or loss for the year ended 31 December 2021. (10 marks)
  - (ii) Compute the tax payable (or refundable) for the year ended 31 December 2021 based on your results in (a) (i) above. (2 marks)
- (b) (i) A tax agent is an important stakeholder in the Alternative Dispute Resolution (ADR) process. Analyse the roles of a tax agent in relation to the ADR process. (4 marks)
- (ii) Explain the circumstances under which the Commissioner may cancel the license of a tax agent. (4 marks)

**(Total: 20 marks)****QUESTION THREE**

- (a) The following information relates to Pete Masa who works in both Kenya and in the United Kingdom.
- During the year of income 2021, he earned £30,000 from employment, PAYE deducted was £4,200.
  - His employment income in Kenya was Sh.1,960,000 (PAYE deducted Sh.384,000) in the year.
  - The employer provided accommodation to his family which lives in Kenya. The house is fully furnished at a cost of Sh.340,000.
  - He also received consultancy fees of Sh.720,000 and net royalties of Sh.95,000.

Note: Assume the average exchange rate during the year was £1 = Sh.120.

**Required:**

- Calculate tax payable by Pete Masa for the year of income 2021. Assume Kenya and United Kingdom have signed a double taxation agreement. (6 marks)
- (b) Explain four measures that a tax revenue authority might adopt to reduce tax gaps or revenue leakages in taxation of the digital economy. (4 marks)
- (c) Explain the tax implications of the following:
- (i) Where two or more entities enter into a joint venture agreement or partnership. (4 marks)
  - (ii) Where shareholders are wholly or partly paid in cash for forfeiting their shares in a cessation of business. (2 marks)
- (d) Explain four possible tax implications of transferring or selling a subsidiary to another subsidiary where both belong to the same parent company. (4 marks)

**(Total: 20 marks)**

**QUESTION FOUR**

- (a) Riziki Insurance Company Ltd. was incorporated in the year 2019. The company deals with different classes of insurance. The following trial balance was extracted from the books of account as at 31 December 2021:

|                                              | Sh.               | Sh.               |
|----------------------------------------------|-------------------|-------------------|
| Property, plant and equipment                | 10,200,000        |                   |
| Provision for depreciation                   | 805,000           |                   |
| Investment in government securities          | 1,200,000         |                   |
| Gross premiums received from direct clients: |                   |                   |
| Motor vehicle                                |                   | 3,000,000         |
| Fire                                         |                   | 2,500,000         |
| Gross premiums received from agents:         |                   |                   |
| Motor vehicle                                |                   | 2,000,000         |
| Fire                                         |                   | 1,200,000         |
| Commission on reinsurance accepted:          |                   |                   |
| Motor vehicle                                | 600,000           |                   |
| Fire                                         | 200,000           |                   |
| Commission on reinsurance ceded:             |                   |                   |
| Motor vehicle                                |                   | 700,000           |
| Fire                                         |                   | 300,000           |
| Sundry receivables                           | 750,000           |                   |
| Bank balance                                 | 90,000            |                   |
| Directors' fees                              | 495,000           |                   |
| Reinsurance premiums paid:                   |                   |                   |
| Motor vehicle                                | 400,000           |                   |
| Fire                                         | 150,000           |                   |
| Unearned premiums as at 1 January 2021:      |                   |                   |
| Motor vehicle                                |                   | 4,800,000         |
| Fire                                         |                   | 2,500,000         |
| Claims outstanding as at 1 January 2021:     |                   |                   |
| Motor vehicle                                |                   | 1,100,000         |
| Fire                                         |                   | 840,000           |
| Claims paid:                                 |                   |                   |
| Motor vehicle                                | 2,770,000         |                   |
| Fire                                         | 2,110,000         |                   |
| Legal costs on claims:                       |                   |                   |
| Motor vehicle                                | 280,000           |                   |
| Fire                                         | 130,000           |                   |
| Sundry expenses on motor vehicle claims      | 220,000           |                   |
| Provision for bad and doubtful debts:        |                   |                   |
| Motor vehicle                                | 370,000           |                   |
| Fire                                         | 320,000           |                   |
| Management expenses:                         |                   |                   |
| Motor vehicle                                | 450,000           |                   |
| Fire                                         | 380,000           |                   |
| Investment income                            |                   | 4,150,500         |
| Premiums returned:                           |                   |                   |
| Motor vehicle                                | 800,000           |                   |
| Fire                                         | 700,000           |                   |
| Profit and loss account                      |                   | 329,500           |
|                                              | <u>23,420,000</u> | <u>23,420,000</u> |

**Additional information:**

- Claims intimated and outstanding as at 31 December 2021 amounted to Sh.750,000 for motor vehicle insurance and Sh.480,000 for fire insurance.
- Unearned premium is maintained at 80% and 50% of the net premiums received for motor vehicle and fire insurance respectively.
- Investment allowances have been agreed with the Commissioner at Sh.1,200,000 for the year ended 31 December 2021.
- Investment income analysis:
 

|                                                | Sh.           |
|------------------------------------------------|---------------|
| • Interest received from Government securities | 2,040,000 net |
| • Interest received from local banks           | 760,500 net   |
| • Dividend received from a Ugandan company     | 450,000 gross |
| • Dividend received from a local company       | 900,000 net   |
- Fees paid to investment managers amounted to Sh.750,000 for the year ended 31 December 2021.

**Required:**

- (i) Taxable income or loss for Riziki Insurance Company for the year ended 31 December 2021. (8 marks)
- (ii) Compute the tax payable, if any. (2 marks)
- (b) Zawadi Associates provides consultancy services to various clients whose terms of contract allow clients to pay for the services either before or after the provision of the service. The following information is provided regarding the firm's transactions for the months of October, November and December in year 2021.

| Nature of service                              | Value of service | Service provision date | Payment date                 |
|------------------------------------------------|------------------|------------------------|------------------------------|
| Audit services to XL Supermarkets              | 700,000          | 25 October 2021        | 5 November 2021              |
| Training services to Kyle Securities           | 240,000          | 3 November 2021        | Not yet paid                 |
| Accountancy services: Watoto Children's Home   | 600,000          | 5 December 2021        | 20 November 2021             |
| Debt collection services to Zuwela Computers   | 820,000          | 9 November 2021        | 30 November 2021             |
| Strategic Plan development: Bazo (Rwanda) Ltd. | 2,150,000        | 10 November 2021       | Not yet paid                 |
| Management consultancy: Sylok Investments      | 1,440,000        | 13 November 2021       | 40% paid on 13 November 2021 |
| Internal controls reviewed: Lema Ltd.          | 960,000          | 18 November 2021       | 10% paid on 7 October 2021   |
| Financial consultancy to W Ltd.                | 1,200,000        | 20 November 2021       | 1 December 2021              |

**Additional information:**

- Sylok Investments was declared bankrupt on 30 November 2021.
- On 5 November 2021, Zawadi Associates renewed its national industrial training license for Sh.30,000 and paid for legal fees Sh.360,000 to follow up on clients who were not paying as per the agreed date.
- Electricity bill paid on 10 November 2021 was Sh.270,000 out of which Sh.100,000 was payment for outstanding bill for October 2021 and Sh.20,000 was in respect of additional deposits as demanded by the power company.
- Fuel consumed for partners' vehicles amounted to Sh.90,000 during the month of November 2021.
- Computers purchased for business use cost Sh.240,000 in November 2021.
- Zawadi Associates paid rent for the month of November 2021 amounting to Sh.180,000 on 5 November 2021.
- Transactions have been stated inclusive of VAT at the rate of 16% where applicable, unless otherwise stated.

**Required:**

- (i) Compute the VAT payable by (or refundable to) Zawadi Associates for the month of November 2021. (7 marks)
- (ii) Zawadi Associates is planning to engage a firm of financial management consultants from South Africa to facilitate online training on financial management assignments.

Advise Zawadi Associates on the tax point in respect of such services.

(3 marks)

**(Total: 20 marks)**

**QUESTION FIVE**

- (a) A recent publication from a leading international advisory group opines that, of all forms of tax incentives, tax holidays are the most popular among developing countries.

**Required:**

Discuss four limitations of tax holidays in developing countries.

(4 marks)

- (b) In the recent months, the Revenue Authority reports have indicated achievement of tax collection targets.

**Required:**

Explore the factors that might have led to this achievement.

(4 marks)

- (c) John Malih has been trading as a sole proprietor for the past 4 years. The revenue authority suspects that the business has been involved in tax fraud since it commenced operations.

The firm has submitted the following records since its operations from 1 January 2018 to 31 December 2021:

|                             | 1 January<br>2018 | 31 December<br>2018 | 31 December<br>2019 | 31 December<br>2020 | 31 December<br>2021 |
|-----------------------------|-------------------|---------------------|---------------------|---------------------|---------------------|
|                             | Sh. "000"         | Sh. "000"           | Sh. "000"           | Sh. "000"           | Sh. "000"           |
| Business premises           | 144,000           | 160,000             | 172,000             | 152,000             | 160,000             |
| Plant and machinery         | 68,000            | 72,000              | 87,000              | 82,000              | 92,000              |
| Motor vehicles (commercial) | 22,000            | 24,000              | 24,000              | 26,000              | 24,000              |
| Inventory                   | 9,000             | 11,200              | 16,200              | 22,000              | 14,800              |
| Trade receivables           | 7,690             | 8,630               | 8,600               | 7,800               | 8,200               |
| Private residence           | 16,400            | 32,400              | 32,400              | 32,400              | 32,400              |
| Trade payables              | 14,900            | 19,200              | 20,400              | 18,100              | 15,200              |
| Bank loan                   | 22,400            | 21,800              | 19,400              | 7,900               | 18,900              |
| Loan from a friend          | 1,580             | 1,320               | 1,180               | 1,690               | 1,020               |
| Mortgage loan               | 7,800             | 7,800               | 7,800               | 7,800               | 7,800               |
| Cash                        | 7,400             | 9,600               | 7,800               | 8,260               | 8,840               |

**Additional information:**

- During the year ended 31 December 2021, a motor vehicle was disposed of for Sh.2,600,000 (cost was Sh.2,000,000).
- Interest on mortgage was at a rate of 15% per annum on reducing balance basis. The maximum mortgage interest allowed is Sh.300,000 per annum.
- His personal expenses for each of the four years were as follows:

| Year | Sh.     |
|------|---------|
| 2021 | 340,000 |
| 2020 | 178,000 |
| 2019 | 296,000 |
| 2018 | 162,400 |
- Ignore capital allowances.

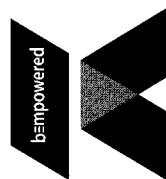
**Required:**

Determine the taxable income of John Malih for each of the four years ended 31 December 2018, 2019, 2020 and 2021.

(12 marks)

**(Total: 20 marks)**

.....



**kasneb**

**CPA ADVANCED LEVEL**

**ADVANCED TAXATION**

**TUESDAY: 5 April 2022. Afternoon paper.**

**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. Do NOT write anything on this paper.**

**RATES OF TAX (Including wife's employment, self-employment and professional income rates of tax).**

**Year of income 2021.**

**Assume that the following rates of tax applied throughout the year of income 2021:**

| Monthly taxable pay<br>(Sh.) | Annual taxable pay<br>(Sh.) | Rate of tax<br>% in each Sh. |
|------------------------------|-----------------------------|------------------------------|
| 1 - 24,000                   | 1 - 288,000                 | 10%                          |
| 24,001 - 32,333              | 288,001 - 388,000           | 25%                          |
| Excess over - 32,333         | Excess over - 388,000       | 30%                          |

**Personal relief Sh.2,400 per month (Sh.28,800 per annum).**

| Investment allowance:                                                                                       | Rate of investment allowance     | Residual value<br>(per year on<br>reducing<br>balance) | Prescribed benefit rates of motor vehicles<br>provided by employer |                           |                          |
|-------------------------------------------------------------------------------------------------------------|----------------------------------|--------------------------------------------------------|--------------------------------------------------------------------|---------------------------|--------------------------|
| Capital expenditure incurred on:                                                                            |                                  |                                                        | (i) Saloons, Hatch Backs and Estates                               |                           |                          |
|                                                                                                             |                                  |                                                        |                                                                    | Monthly<br>rates<br>(Sh.) | Annual<br>rates<br>(Sh.) |
| (a) <b>Buildings:</b>                                                                                       |                                  |                                                        | Up to                                                              | 1200 cc                   | 3,600                    |
| • Hotel building                                                                                            | 50% in the first year of use     | 25%                                                    | 1201 -                                                             | 1500 cc                   | 4,200                    |
| • Building used for manufacture                                                                             | 50% in the first year of use     | 25%                                                    | 1501 -                                                             | 1750 cc                   | 5,800                    |
| • Hospital buildings                                                                                        | 50% in the first year of use     | 25%                                                    | 1751 -                                                             | 2000 cc                   | 7,200                    |
| • Petroleum or gas storage facilities                                                                       | 50% in the first year of use     | 25%                                                    | 2001 -                                                             | 3000 cc                   | 8,600                    |
| • Educational/hostels building                                                                              | 10% per year on reducing balance |                                                        | Over                                                               | 3000 cc                   | 14,400                   |
| • Commercial building                                                                                       | 10% per year on reducing balance |                                                        |                                                                    |                           | 172,800                  |
| (b) <b>Machinery:</b>                                                                                       |                                  |                                                        | (ii) Pick-ups, Panel Vans<br>(unconverted)                         |                           |                          |
| • Machinery used for manufacture                                                                            | 50% in the first year of use     | 25%                                                    | Up to                                                              | 1750 cc                   | 3,600                    |
| • Hospital equipment                                                                                        | 50% in the first year of use     | 25%                                                    | Over                                                               | 1750 cc                   | 4,200                    |
| • Ships or aircraft                                                                                         | 50% in the first year of use     | 25%                                                    |                                                                    |                           | 50,400                   |
| • Motor vehicles and heavy earth<br>moving equipment                                                        | 25% per year on reducing balance |                                                        |                                                                    |                           |                          |
| • Computer software, calculators,<br>copiers and duplicating machines                                       | 25% per year on reducing balance |                                                        |                                                                    |                           |                          |
| • Furniture and fittings                                                                                    | 10% per year on reducing balance |                                                        |                                                                    |                           |                          |
| • Telecommunication equipment                                                                               | 10% per year on reducing balance |                                                        |                                                                    |                           |                          |
| • Film equipment by a local producer                                                                        | 25% per year on reducing balance |                                                        |                                                                    |                           |                          |
| • Machinery used to undertake<br>operations under prospecting rights<br>and exploration under mining rights | 50% in the first year of use     | 25%                                                    |                                                                    |                           |                          |
| • Other machinery                                                                                           | 10% per year on reducing balance |                                                        |                                                                    |                           |                          |
| (c) Purchase/acquisition of right to use<br>fibre optic cable by telecommunication<br>operation             | 10% per year on reducing balance |                                                        | (iii) Land Rovers/Cruisers                                         |                           |                          |
|                                                                                                             |                                  |                                                        |                                                                    | 7,200                     | 86,400                   |
| (d) Farm works                                                                                              | 50% in the first year of use     | 25%                                                    |                                                                    |                           |                          |

**Commissioner's prescribed benefit rates:**

**Services**

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

|                  | Monthly rates<br>(Sh.) | Annual rates<br>(Sh.) |
|------------------|------------------------|-----------------------|
| (i) Water        | 200                    | 2,400                 |
| (ii) Electricity | 900                    | 10,800                |

## QUESTION ONE

(a) The following facts relating to a hypothetical tax case in your country have been presented to you. The case related to the applicability of withholding tax on interest accrued in the audited books of a taxpayer.

1. Ale Ltd. entered into an agreement with a contractor under which it agreed to pay interest on any contractual fees paid late. A number of payments due to the contractor were delayed and incurred interest. The interest was not actually paid but the obligation to pay was accrued as a liability in the respondent's books.
2. As interest is a business expense, Ale Ltd. expensed it as a tax deductible item thereby reducing its corporation tax liability. The revenue authority undertook an audit and demanded payment on the withholding tax on the accrued interest. Following the demand, Ale Ltd. filed the matter before a tax tribunal.
3. The revenue authority claimed that by recognising accrued interest as a liability in its books of account, Ale Ltd. acknowledged that interest was credited to the account of the third party and therefore fell within the definition of the term "paid" under applicable tax laws.
4. At the tax tribunal, Ale Ltd. presented the following arguments:
  - The term "paid" in tax law can only mean delivery of money and discharge of settlement.
  - Since Ale Ltd. neither settled the outstanding contractual fee nor paid any interest charged, even though the interest was recognised as a liability in its books of account, no withholding tax was due for that transaction.
  - As per tax laws, tax is withheld upon payment of the expenses thus payment is a necessary pre-requisite for withholding tax to apply.
  - The settlement of an obligation may be through receipt of cash, cheque or other mode of settlement or discharge and an accrual is therefore not a discharge of a debt. Payment denotes the discharge of a debt or liability and it was premature for the revenue authority to demand payment of the withholding tax before the actual payment of interest. By doing so, the revenue authority clearly exceeded its powers.

### Required:

As a Certified Public Accountant and tax expert, you have been engaged by the revenue authority to counter the arguments by Ale Ltd. for consideration by the Tax Tribunal.

Prepare your professional opinion making reference to the facts above, applicable tax laws and decided tax cases to support your position. (12 marks)

(b) The following information was extracted from the accounting records of Sambamba Sports Club, a small-size members club as at 31 December 2021:

| 1. Receipts                         | Sh.               | Payments                               | Sh.               |
|-------------------------------------|-------------------|----------------------------------------|-------------------|
| Balance brought forward             | 288,000           | Salaries and wages                     | 254,000           |
| Subscriptions                       | 2,500,000         | New equipment                          | 690,000           |
| New members entrance fee            | 600,000           | Repairs and maintenance                | 124,000           |
| Dividend: Weco Co-operative Society | 884,000           | Furniture                              | 240,000           |
| Interest: Excel Bank Kenya          | 2,140,000         | Office expenses                        | 415,000           |
| Dinner dance                        | 723,000           | Printing and stationery                | 168,000           |
| Beverage sales-members              | 657,000           | Purchase of beverages                  | 497,000           |
| Investment income                   | 2,400,000         | Dinner dance expenses                  | 315,000           |
|                                     |                   | Refund of subscriptions                | 45,000            |
|                                     |                   | Legal fee on acquisition of investment | 25,000            |
|                                     |                   | Transport                              | 248,000           |
|                                     |                   | Fee to investment managers             | 1,100,000         |
|                                     |                   | Balance carried forward                | <u>6,071,000</u>  |
|                                     | <u>10,192,000</u> |                                        | <u>10,192,000</u> |

2. Extracts from the statement of financial position as at 31 December 2021 were as follows:

|                               | Sh.       |
|-------------------------------|-----------|
| Furniture and fittings (cost) | 240,000   |
| Equipment (cost)              | 690,000   |
| Investment (cost)             | 3,500,000 |
| Subscription in arrears       | 300,000   |
| Accrued salaries              | 68,000    |
| Stock of beverages            | 184,000   |
| Subscriptions in advance      | 85,000    |

3. The dividend and interest income were stated at the gross amount.
4. Stock of beverages at the beginning of the year were Sh.162,000.
5. Subscription in arrears written off in the year amounted to Sh.288,000.

**Required:**

The taxable income (or loss) and tax payable if any, by Sambamba Sports Club for the year ended 31 December 2021.

(8 marks)

**(Total: 20 marks)**

**QUESTION TWO**

- (a) Describe six factors to be considered when developing mitigation strategies for taxation risks. (6 marks)
- (b) Amua and Beba have carried on business for the last several years under the trade name AB partnership. They share profits and losses equally with capital contributed earning interest at the rate of 10% per annum.

The following details relate to AB partnership's transactions for the year ended 31 December 2021.

1. Amua and Beba capital accounts reflect credit balances of Sh.1,200,000 for each.
2. On 1 April 2021, they introduced a new partner Chanda who was to contribute Sh.1,200,000 as his share of capital. They agreed on this day to share profits and losses in the ratio of capital contributed proportional to the period of the year it was invested and that this sharing ratio be backdated to the start of the year 2021.
3. The costs incurred during the year were as follows:
 

|                                                          | Sh.       |
|----------------------------------------------------------|-----------|
| Salaries and wages for staff                             | 1,083,000 |
| Electricity and telephone                                | 389,400   |
| Repairs and maintenance                                  | 294,400   |
| Deprecation and impairments                              | 420,000   |
| General insurance                                        | 471,000   |
| Debenture interest (paid by ABC Ltd.)                    | 150,360   |
| Directors fees (including Sh.507,720 partners' salaries) | 1,015,440 |
| Legal expenses                                           | 510,240   |
| Medical contributions for partners and directors         | 651,840   |
| Drawings: Amua                                           | 99,000    |
| Beba                                                     | 101,400   |
| Chanda                                                   | 65,400    |
| Rent and rates                                           | 315,960   |
| Motor vehicle running expenses                           | 500,760   |
| Printing and stationery                                  | 32,520    |
4. The following assets were purchased during the year:  
Furniture and fittings Sh.192,000 and a pick-up for Sh.2,160,000.
5. During the months of the partnership, the total salaries to partners were Sh.507,720. The salaries were to be apportioned according to the period each partner served in the partnership business.
6. The cost of sales during the year was Sh.21,600,000. Sales were uniform at a margin of 25%.
7. The partnership was converted into a limited liability company, ABC Ltd. on 1 July 2021 with the partners becoming the new directors of the company. The new firm was listed on the Securities Exchange but not for purpose of raising additional capital. The costs incurred in listing were Sh.100,000.
8. The sales and expenses accrued evenly throughout the year unless otherwise indicated.

**Required:**

- (i) A schedule showing separately the profit or loss for the partnership and the company for the year ended 31 December 2021. (10 marks)
- (ii) Tax payable (or refundable) by ABC Ltd. from the profit or loss computed in (b) (i) above. (2 marks)
- (iii) A schedule showing the distribution of profits among the partners. (2 marks)

**(Total: 20 marks)**

### QUESTION THREE

- (a) Evaluate four factors to be considered in determining the appropriate methods for transfer pricing for multinational corporations in your country. (8 marks)
- (b) Mika Ltd. sold a machine to Bora Ltd., an associate enterprise and in turn Bora Ltd. sold the same machine to Ceda Ltd., an independent party at a sales margin of 30% for Sh.4,000,000. Bora Ltd. had incurred Sh.40,000 as expenses in shipping the machine to Ceda Ltd.

**Required:**

Calculate the arms length price charged to Ceda Ltd.

(2 marks)

- (c) Petro Ltd. is a company in the business of exploration and production of oil and gas in your country. The company reported a petroleum profit of Sh.143,600,000 in the year ended 31 December 2021. This figure excludes crude oil produced but not sold valued at Sh.4,200,000. The following expenses comprising capital and revenue expenditures were deducted in arriving at the reported profit.

|                                            | Sh.       |
|--------------------------------------------|-----------|
| Geophysical staff salaries                 | 789,000   |
| Legal costs for title deeds                | 562,400   |
| Dry hole contributions                     | 448,000   |
| Drilling and test development costs        | 942,600   |
| Capital losses from previous year          | 192,800   |
| Memorandum of understanding credit         | 2,840,000 |
| Royalties on domestic sales                | 3,600,000 |
| Royalties on export sales                  | 5,760,000 |
| Non-productive rent                        | 2,374,800 |
| Customs duty on plant and equipment        | 672,300   |
| Purchase of assets for offshore operations | 7,840,000 |
| Provision for restoration of wells         | 1,575,000 |
| Petroleum investment allowance             | 9,262,000 |

**Additional information:**

- Petroleum investment allowance included depreciation of equipment of Sh.378,200.
- Off-shore operations included a tractor purchased at Sh.920,000 for use on site in your country.
- Computers and computer software was for Sh.780,000 and Sh.360,000 respectively, for use in the country offices.
- The offices were partitioned at a cost of Sh.1,480,000

**Required:**

- (i) A statement of computation of petroleum profit or loss for the accounting period ended 31 December 2021. (7 marks)
- (ii) Tax payable, if any, by the company. (3 marks)

**(Total: 20 marks)**

### QUESTION FOUR

- (a) You have been engaged by the revenue authority in your country to develop a stakeholder engagement action plan. This is part of the measures to enhance tax awareness, increase compliance and enhance efficiency in tax administration.

**Required:**

Discuss the stakeholder engagement processes or initiatives that you would include in your action plan, including the objective of each process or initiative. (10 marks)

- (b) The following information relates to two businesses which are registered for value added tax (VAT) purposes:

- Bebabeba Supermarket Ltd.**  
They operate a soft drinks dispensing machine which uses special tokens which resemble coins. During the month of July 2021, the machine dispensed drinks worth Sh.300,000 inclusive of VAT. This dispensing machine is slotted with tokens after every one and a half months, that is, on restocking drinks in any month, the tokens are emptied midway the following month. The machine was restocked during the month of July 2021.
- Supa Bread Ltd.**  
The firm bakes ordinary bread. During the month of August 2021 they made sales amounting to Sh.20,000,000, excluding VAT. They have arranged with a distribution company, who ensure bread is delivered to customers. The distribution company raised an invoice of Sh.2,000,000 for services rendered for August 2021.

The electricity company also sent Supa Bread Ltd. a bill of Sh.3,000,000 for the month. The firm also hired advisory services from an overseas company and were billed Sh.1,000,000. The above figures are quoted inclusive of VAT unless stated otherwise.

**Required:**

For each of the two companies, or as otherwise stated, compute:

- (i) The output VAT, if any, for the specified period. (2 marks)
  - (ii) The input VAT (if any), (for Supa Bread Ltd.). (1 mark)
  - (iii) The VAT payable (or refundable) for the specified period based on the information provided only. (2 marks)
  - (c) Define the term “reverse charge” and indicate when it would apply (if at all) to Supa Bread Ltd. (2 marks)
  - (d) Explain the difference between a tax agent and a tax representative. (3 marks)
- (Total: 20 marks)**

**QUESTION FIVE**

- (a) Describe four constraints faced by the revenue authority in your country in the assessment and collection of taxes from the micro, small and medium enterprises (MSMEs). (4 marks)
- (b) Discuss how the revenue authority of your country might deal with taxpayers’ apathy in filing tax returns. (4 marks)
- (c) Haraka Ltd. started operations on 1 January 2021 in the business of leasing vehicles and computers.

The following information relates to the company’s transactions for the year ended 31 December 2021.

1. The company leased the following assets in the course of the year.
  - Six delivery vans to Zito Ltd. for six months at Sh.30,000 each per month.
  - Four pickup vehicles to Chama Ltd. in Uganda for Sh.400,000 per month for six months.
  - Twenty computers to Upper University at a monthly lease of Sh.4,000 each for the whole year.
  - A BMW vehicle to B Ltd. for use by one of its directors at a monthly lease charge of sh.60,000.
  - Two Landcruiser Prado vehicles to Z Contractors at an annual lease charge of Sh.1,440,000 in total. The lease contract for one vehicle was cancelled on 30 June 2021 after Z Contractors failed to pay lease charges for 4 months in the year.
  - The delivery vans to Zito Ltd. were returned upon lease expiry and Haraka Ltd. leased them to Sokoni Supermarket for four months at Sh.24,000 each per month.
2. Haraka Ltd. incurred the following expenses in the course of the year:
 

|                                 | <b>Sh.</b> |
|---------------------------------|------------|
| General administration expenses | 1,600,000  |
| Legal expenses                  | 480,000    |
| Repairs and servicing           | 320,000    |

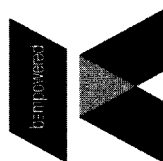
  - Legal expenses included Sh.120,000 for defence against claims of breach of the lease contract.
3. Investment allowances have been agreed with the revenue authority to be Sh.620,000 for the year.
4. Haraka Ltd. had other incomes as follows:
  - Rental income from residential property Sh.2,400,000 per annum.
  - Dividend from Sifa Mutual Fund Sh.36,000 gross.
  - Interest from money market fund Sh.120,000 gross.
  - Royalties of Sh.360,000 net of advertising expenses of Sh.60,000, renewal of patents Sh.40,000 and research costs of Sh.80,000.

**Required:**

Compute:

- (i) The taxable income or loss for Haraka Ltd. for the year ended 31 December 2021. (10 marks)
  - (ii) The tax payable (if any) by Haraka Ltd. for the year ended 31 December 2021. (2 marks)
- (Total: 20 Marks)**

.....



**kasneb**

**CPA ADVANCED LEVEL**

**ADVANCED TAXATION**

**THURSDAY: 16 December 2021.**

**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 2020.**

**Assume that the following rates of tax applied throughout the year of income 2020:**

| Monthly taxable pay<br>(Sh.) | Annual taxable pay<br>(Sh.) | Rate of tax<br>% in each Sh. |
|------------------------------|-----------------------------|------------------------------|
| 1 - 24,000                   | 1 - 288,000                 | 10%                          |
| 24,001 - 40,667              | 288,001 - 488,000           | 15%                          |
| 40,668 - 57,334              | 488,001 - 688,000           | 20%                          |
| Excess over - 57,334         | Excess over - 688,000       | 25%                          |

**Personal relief Sh.2,400 per month (Sh.28,800 per annum).**

| Investment allowance:                                                                                       | Rate of investment allowance     | Residual value<br>(per year on<br>reducing<br>balance) | Prescribed benefit rates of motor vehicles<br>provided by employer |                           |                          |
|-------------------------------------------------------------------------------------------------------------|----------------------------------|--------------------------------------------------------|--------------------------------------------------------------------|---------------------------|--------------------------|
| Capital expenditure incurred on:                                                                            |                                  |                                                        | (i) Saloons, Hatch Backs and Estates                               |                           |                          |
|                                                                                                             |                                  |                                                        |                                                                    | Monthly<br>rates<br>(Sh.) | Annual<br>rates<br>(Sh.) |
| (a) <b>Buildings:</b>                                                                                       |                                  |                                                        | Up to 1200 cc                                                      | 3,600                     | 43,200                   |
| • Hotel building                                                                                            | 50% in the first year of use     | 25%                                                    | 1201 - 1500 cc                                                     | 4,200                     | 50,400                   |
| • Building used for manufacture                                                                             | 50% in the first year of use     | 25%                                                    | 1501 - 1750 cc                                                     | 5,800                     | 69,600                   |
| • Hospital buildings                                                                                        | 50% in the first year of use     | 25%                                                    | 1751 - 2000 cc                                                     | 7,200                     | 86,400                   |
| • Petroleum or gas storage facilities                                                                       | 50% in the first year of use     | 25%                                                    | 2001 - 3000 cc                                                     | 8,600                     | 103,200                  |
| • Educational/hostels building                                                                              | 10% per year on reducing balance |                                                        | Over - 3000 cc                                                     | 14,400                    | 172,800                  |
| • Commercial building                                                                                       | 10% per year on reducing balance |                                                        |                                                                    |                           |                          |
| (b) <b>Machinery:</b>                                                                                       |                                  |                                                        | (ii) Pick-ups, Panel Vans<br>(unconverted)                         |                           |                          |
| • Machinery used for manufacture                                                                            | 50% in the first year of use     | 25%                                                    | Up to 1750 cc                                                      | 3,600                     | 43,200                   |
| • Hospital equipment                                                                                        | 50% in the first year of use     | 25%                                                    | Over - 1750 cc                                                     | 4,200                     | 50,400                   |
| • Ships or aircraft                                                                                         | 50% in the first year of use     | 25%                                                    |                                                                    |                           |                          |
| • Motor vehicles and heavy earth<br>moving equipment                                                        | 25% per year on reducing balance |                                                        |                                                                    |                           |                          |
| • Computer software, calculators,<br>copiers and duplicating machines                                       | 25% per year on reducing balance |                                                        |                                                                    |                           |                          |
| • Furniture and fittings                                                                                    | 10% per year on reducing balance |                                                        |                                                                    |                           |                          |
| • Telecommunication equipment                                                                               | 10% per year on reducing balance |                                                        |                                                                    |                           |                          |
| • Film equipment by a local producer                                                                        | 25% per year on reducing balance |                                                        |                                                                    |                           |                          |
| • Machinery used to undertake<br>operations under prospecting rights<br>and exploration under mining rights | 50% in the first year of use     | 25%                                                    |                                                                    |                           |                          |
| • Other machinery                                                                                           | 10% per year on reducing balance |                                                        |                                                                    |                           |                          |
| (c) Purchase/acquisition of right to use<br>fibre optic cable by telecommunication<br>operation             | 10% per year on reducing balance |                                                        | (iii) Land Rovers/Cruisers                                         | 7,200                     | 86,400                   |
| (d) Farm works                                                                                              | 50% in the first year of use     | 25%                                                    |                                                                    |                           |                          |

**Commissioner's prescribed benefit rates:**

**Services**

|                                                | Monthly rates<br>(Sh.) | Annual rates<br>(Sh.) |
|------------------------------------------------|------------------------|-----------------------|
| (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) As economies continue to recover from the impact of the COVID-19 pandemic, tax collection in many countries continues to face challenges. This trend has resulted in some revenue authorities resorting to some drastic measures to boost tax revenue.

One recent measure taken is monitoring of social media accounts and postings to assess taxation compliance.

**Required:**

Justifying your response with practical reasons, argue the case for or against monitoring of social media accounts to assess taxable capacity and compliance.

(Note: marks will be awarded for only one position taken).

(6 marks)

- (b) A delegation comprising government officials and entrepreneurs from a neighbouring country has visited your country, which is a beneficiary of the African Growth and Opportunity Act (AGOA) to learn more on AGOA and its benefits.

**Required:**

Prepare a brief to be presented to the delegation covering the following:

- (i) Background information on AGOA. (2 marks)
- (ii) Conditions to be considered as an AGOA beneficiary country. (3 marks)
- (iii) Trade benefits provided under AGOA. (3 marks)

- (c) Alternative Dispute Resolution (ADR) is a method of handling tax disputes outside the Judicial process. All applications for ADR should go through a suitability test before the application is submitted for ADR.

**Required:**

- (i) Summarise the disputes that may not be suitable for the ADR mechanism. (3 marks)
- (ii) Describe the documents that must be submitted to support and facilitate the ADR discussions. (3 marks)

(Total: 20 marks)

## QUESTION TWO

- (a) The following information relates to Msanii Sacco Ltd. for the year ended 31 December 2020:

**Income statement for the year ended 31 December 2020**

| Income                                                   | Sh. "000" | Sh. "000" |
|----------------------------------------------------------|-----------|-----------|
| Interest from members' loans                             |           | 16,200    |
| Interest from Treasury bills                             |           | 3,200     |
| Interest from government infrastructure bonds: (5 years) |           | 1,800     |
| Interest from ABA Bank                                   |           | 1,500     |
| Rental income                                            |           | 3,200     |
| Dividend from Mazao Sacco                                |           | 1,000     |
| Dividends from Sopa Co-operative Ltd.                    |           | 600       |
| Gross income                                             |           | 27,500    |
| <b>Expenditure:</b>                                      |           |           |
| Office expenses                                          | 5,600     |           |
| General expenses                                         | 1,400     |           |
| Credit loss (bad debts)                                  | 60        |           |
| Repairs of rental property                               | 1,300     | (8,360)   |
| Net profit                                               |           | 19,140    |

**Additional information:**

1. Office expenses include:
- |                                              |           |
|----------------------------------------------|-----------|
|                                              | Sh. "000" |
| • Salaries to Sacco employees                | 1,200     |
| • Salary to the caretaker of rental property | 200       |
| • Purchase of office computers               | 400       |
2. General expenses include depreciation of Sh. 484,000 and non-performing loans to members of Sh. 620,000 which were written off.
3. Corporate tax rate during the year was 25%.

**Required:**

- (i) Adjusted taxable profit or loss for the year ended 31 December 2020.  
Hint: Start with the reported profit.

(6 marks)

- (ii) Tax liability for the year ended 31 December 2020.

(2 marks)

- (b) Triplecom Insurance Company Ltd. is a resident company carrying on both general and life assurance businesses. The following information relates to the insurance company's business for the year ended 31 December 2020:

|                                         | General insurance<br>Sh. "000" | Life assurance<br>Sh. "000" |
|-----------------------------------------|--------------------------------|-----------------------------|
| Profit on sale of investments           | 14,200                         | -                           |
| Premium received in the year            | 15,450                         | 100,000                     |
| Commission ceded                        | 8,000                          | -                           |
| Premium returned                        | 374                            | -                           |
| Recovery from reinsurance company       | 1,200                          | -                           |
| Premiums paid to reinsurance company    | 7,680                          | -                           |
| Commission expenses                     | 1,050                          | 2,960                       |
| Management expenses                     | 2,034                          | 25,000                      |
| Travelling expenses                     | 1,200                          | 2,400                       |
| Marketing expenses                      | 314                            | 1,820                       |
| Fees paid to investment managers        | 900                            | -                           |
| Legal expenses relating to claims       | 740                            | 120                         |
| General expenses                        | 8,490                          | 4,640                       |
| Bad and doubtful debts                  | 468                            | 1,280                       |
| Claims paid in the year                 | 9,800                          | -                           |
| Bonus utilised in reduction of premiums | 180                            | -                           |

**Additional information:**

- Claims outstanding for general business were as follows:
  - As at 1 January 2020 Sh.6,640,000.
  - As at 31 December 2020 Sh.7,000,000.
- General expenses under general insurance include cost of computers Sh. 800,000 and cost of saloon car Sh.3,260,000.
- Reserves for unexpired risks for general insurance were as follows:
  - As at 1 January 2020 Sh.3,240,000.
  - As at 31 December 2020 Sh.6,200,000.
- The Life assurance fund balance was valued by an actuary at Sh. 310,000,000 as at 31 December 2020. 8% of this fund balance was recommended to be transferred for the benefit of shareholders. At the beginning of the year, the fund had been valued at Sh.250,000,000. 10% of the surplus was recommended to be transferred for the benefit of shareholders.
- Outstanding premiums in respect of life insurance business were as follows:
  - As at 1 January 2020 Sh.12,000,000.
  - As at 31 December 2020 Sh.9,200,000.
- Other income received by Triplecom Insurance Company Ltd. comprised:
  - Interest from fixed deposit account Sh.780,000.
  - Dividend received from qualifying company Sh.3,000,000 (net).
  - The company owns the building which houses its offices. Part of the office space is rented out to other tenants. In the year to 31 December 2020, the company received Sh.2,800,000 net rental income from their estate agents. Property management fees amounting to Sh.3,200,000 for the year to 31 December 2020 had not been deducted.

**Required:**

The taxable income or loss for Triplecom Insurance Company Ltd. for the year ended 31 December 2020. (12 marks)  
(Total: 20 marks)

### QUESTION THREE

- (a) You have been appointed as the first tax consultant of ABC International PLC, a newly incorporated company in your country.

**Required:**

Draft a letter to the Revenue Authority for income tax registration for ABC International PLC.

(4 marks)

- (b) Reward Investment Company Ltd., a company registered for value added tax (VAT) purposes, provided the following details in respect to the month of January 2021:

1. Purchased goods on credit for Sh.696,000 and for Sh.464,000 in cash respectively.
2. Invoices were issued for sales of Sh.371,200 to non-VAT registered customers. The invoices issued included exempt sales amounting to Sh.174,000 and the balance were at standard rate.
3. Purchased goods for Sh.672,800 from VAT registered businesses. However, goods valued at Sh.139,200 were returned to suppliers.
4. Received a debit note for erroneous invoicing of goods valued at Sh.73,080.
5. Issued credit notes for Sh.26,680 in respect of returns by credit customers.
6. Settled electricity bills amounting to Sh.32,480.
7. Settled audit fees of Sh.27,840 by cash.
8. Received credit notes of Sh.62,640 for invoices received which had been overcast.
9. Exported goods to Dubai for Sh.690,000.
10. Imported goods from Zambia for Sh.250,000 when import duty was at 20%.
11. Total goods sold as exempt supplies during the month amounted to Sh.494,000. These supplies could not be traced from goods purchased at the standard rate.
12. Catering services to employees amounted to Sh.58,000 from a local restaurant.
13. A debtor for goods valued at Sh.45,240 was declared bankrupt and a bad debt relief granted.

All transactions are stated inclusive of VAT at the rate of 16% where applicable unless otherwise stated.

**Required:**

Prepare a statement showing the following with regard to the transactions above:

- Input and output VAT.
- Deductible input tax.
- VAT payable by or refundable to Reward Investment Company Ltd.
- Comments on the VAT payable or refundable.

(10 marks)

- (c) Describe the types of risk that require an organisation to develop a tax risk management framework. (6 marks)

**(Total: 20 marks)**

### QUESTION FOUR

- (a) Describe the features that indicate the possible existence of a tax haven. (6 marks)

- (b) Lipa and Mali are in partnership trading as Lima Enterprises where they share profits and losses in the ratio of 2:1 respectively.

On 1 April 2020, Sasa was admitted with one-third of the profit without altering the existing profit-sharing ratio of Lipa and Mali.

The following income statement for the year ended 31 December 2020 was provided by the partnership:

|                     | Sh.     | Sh.       |
|---------------------|---------|-----------|
| Gross profit        |         | 2,960,000 |
| <b>Less:</b>        |         |           |
| Salaries and wages: |         |           |
| Staff               | 360,000 |           |
| Partners            | 428,000 |           |
| Interest on capital | 150,000 |           |
| Current Account:    |         |           |
| Lipa                | 42,000  |           |
| Mali                | 48,000  |           |
| Insurance           | 24,500  |           |
| Motor expenses      | 32,500  |           |
| Electricity bills   | 58,000  |           |
| Legal expenses      | 142,400 |           |

|                            | Sh.            | Sh.              |
|----------------------------|----------------|------------------|
| Audit and accountancy fees | 47,500         |                  |
| Depreciation               | 128,400        |                  |
| Purchase of furniture      | 240,000        |                  |
| Provision for bad debts    | 18,400         |                  |
| Telephone and postage      | 14,200         |                  |
| General expenses           | <u>354,000</u> | <u>2,087,900</u> |
| Net profit                 |                | <u>872,100</u>   |

**Additional information:**

- Insurance represents Mr. Mali's life insurance policy for his family.
- Interest on capital was prorated and shared according to the profit and loss sharing ratios.
- Legal expenses included: expenses related to drawing of new partnership deed of Sh.28,000 on admission of Mr. Sasa, conveyance fees of Sh.14,900 and Sh.36,000 for negotiating a loan facility.
- General expenses included cost of computers of Sh.90,000 and computer software of Sh.45,000.
- The firm imported a motor car for use in the partnership business for Sh.800,000. This excluded import duty of 25% and value added tax at 16%.

Note: Assume that income and expenses accrued evenly during the year.

**Required:**

- Prepare a statement of adjusted taxable profit or loss for the year ended 31 December 2020. (10 marks)
  - Total taxable income for each partner. (4 marks)
- (Total: 20 marks)**

**QUESTION FIVE**

- As a tax manager at the revenue authority in your country, prepare a brief on the following:
  - Process of being appointed a tax agent. (2 marks)
  - Requirements for recognition as a tax expert by the revenue authority. (4 marks)
- Linda Obari has been operating a retail business since year 2016. She has not been maintaining proper books of account over the years and is therefore under investigation by the revenue authority.

The following details were obtained from her business records:

|                      | 31 December<br>2016 | 31 December<br>2017 | 31 December<br>2018 | 31 December<br>2019 | 31 December<br>2020 |
|----------------------|---------------------|---------------------|---------------------|---------------------|---------------------|
|                      | Sh.                 | Sh.                 | Sh.                 | Sh.                 | Sh.                 |
| Equipment            | 2,345,670           | 2,391,840           | 2,395,350           | 2,210,000           | 2,285,000           |
| Investment in shares | 300,000             | 150,000             | 270,000             | 320,000             | 325,000             |
| Bank balance         | 3,000               | 4,500               | 6,000               | 7,000               | 7,500               |
| Inventory            | -                   | 303,000             | 540,000             | 620,000             | 685,000             |
| Debtors              | -                   | 180,000             | 450,000             | 720,000             | 830,000             |
| Building             | -                   | <u>2,050,000</u>    | <u>2,050,000</u>    | <u>2,050,000</u>    | <u>2,050,000</u>    |
|                      | <u>2,648,670</u>    | <u>5,079,340</u>    | <u>5,711,350</u>    | <u>5,927,000</u>    | <u>6,182,500</u>    |
| Financed by:         |                     |                     |                     |                     |                     |
| Capital              | 2,648,670           | 2,844,340           | 3,254,350           | 3,239,000           | 3,263,500           |
| Bank loan            | -                   | 1,425,000           | 1,566,000           | 1,716,000           | 1,866,000           |
| Creditors            | -                   | <u>810,000</u>      | <u>891,000</u>      | <u>972,000</u>      | <u>1,053,000</u>    |
|                      | <u>2,648,670</u>    | <u>5,079,340</u>    | <u>5,711,350</u>    | <u>5,927,000</u>    | <u>6,182,500</u>    |

**Additional information:**

## 1. Personal expenses:

|                                  | 31 December<br>2017<br>Sh. | 31 December<br>2018<br>Sh. | 31 December<br>2019<br>Sh. | 31 December<br>2020<br>Sh. |
|----------------------------------|----------------------------|----------------------------|----------------------------|----------------------------|
| Repairs of house                 | 172,000                    | -                          | 180,000                    | -                          |
| House manager salary             | 259,000                    | 302,000                    | 344,000                    | 358,000                    |
| Cash withdrawn from bank account | 192,000                    | 220,000                    | 300,000                    | 340,000                    |
| School fees                      | 228,000                    | -                          | -                          | -                          |
| House expenses                   | 163,000                    | 331,600                    | 356,000                    | 382,000                    |

## 2. Non-business income:

|                             | 31 December<br>2017<br>Sh. | 31 December<br>2018<br>Sh. | 31 December<br>2019<br>Sh. | 31 December<br>2020<br>Sh. |
|-----------------------------|----------------------------|----------------------------|----------------------------|----------------------------|
| Rental income               | 182,000                    | 166,560                    | 120,000                    | 218,000                    |
| Interest from bank deposits | 2,750                      | 14,970                     | 20,000                     | 22,000                     |

3. For the year ended 31 December 2017, salaries paid to Linda Obari's husband by the business amounted to Sh.312,000 and this was increased every year by 15%.

4. She received Sh.360,000 in cash as inheritance in the year 2019 from her late father.

**Required:**

(i) Compute Linda Obari's correct taxable income or loss for the years ended 31 December 2017 to 2020. (10 marks)

(ii) Describe the factors that a revenue authority considers in ascertaining the adequacy of living expenses under back duty investigations. (4 marks)

**(Total: 20 Marks)**

.....

**CPA ADVANCED LEVEL**

**PILOT PAPER**

**ADVANCED TAXATION**

**December 2021.**

**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 2020.**

**Assume that the following rates of tax applied throughout the year of income 2020:**

| Monthly taxable pay<br>(Sh.) | Annual taxable pay<br>(Sh.) | Rate of tax<br>% in each Sh. |
|------------------------------|-----------------------------|------------------------------|
| 1 - 24,000                   | 1 - 288,000                 | 10%                          |
| 24,001 - 40,667              | 288,001 - 488,000           | 15%                          |
| 40,668 - 57,334              | 488,001 - 688,000           | 20%                          |
| Excess over - 57,334         | Excess over - 688,000       | 25%                          |

**Personal relief Sh.2,400 per month (Sh.28,800 per annum).**

| Investment allowance:                                                                                 | Rate of investment allowance     | Residual value<br>(per year on reducing balance) | Prescribed benefit rates of motor vehicles provided by employer |                        |                       |
|-------------------------------------------------------------------------------------------------------|----------------------------------|--------------------------------------------------|-----------------------------------------------------------------|------------------------|-----------------------|
| Capital expenditure incurred on:                                                                      |                                  |                                                  | (i) Saloons, Hatch Backs and Estates                            | Monthly rates<br>(Sh.) | Annual rates<br>(Sh.) |
| (a) <b>Buildings:</b>                                                                                 |                                  |                                                  | Up to 1200 cc                                                   | 3,600                  | 43,200                |
| • Hotel building                                                                                      | 50% in the first year of use     | 25%                                              | 1201 - 1500 cc                                                  | 4,200                  | 50,400                |
| • Building used for manufacture                                                                       | 50% in the first year of use     | 25%                                              | 1501 - 1750 cc                                                  | 5,800                  | 69,600                |
| • Hospital buildings                                                                                  | 50% in the first year of use     | 25%                                              | 1751 - 2000 cc                                                  | 7,200                  | 86,400                |
| • Petroleum or gas storage facilities                                                                 | 50% in the first year of use     | 25%                                              | 2001 - 3000 cc                                                  | 8,600                  | 103,200               |
| • Educational/hostels building                                                                        | 10% per year on reducing balance |                                                  | Over - 3000 cc                                                  | 14,400                 | 172,800               |
| • Commercial building                                                                                 | 10% per year on reducing balance |                                                  |                                                                 |                        |                       |
| (b) <b>Machinery:</b>                                                                                 |                                  |                                                  | (ii) Pick-ups, Panel Vans (unconverted)                         |                        |                       |
| • Machinery used for manufacture                                                                      | 50% in the first year of use     | 25%                                              | Up to - 1750 cc                                                 | 3,600                  | 43,200                |
| • Hospital equipment                                                                                  | 50% in the first year of use     | 25%                                              | Over - 1750 cc                                                  | 4,200                  | 50,400                |
| • Ships or aircraft                                                                                   | 50% in the first year of use     | 25%                                              |                                                                 |                        |                       |
| • Motor vehicles and heavy earth moving equipment                                                     | 25% per year on reducing balance |                                                  |                                                                 |                        |                       |
| • Computer software, calculators, copiers and duplicating machines                                    | 25% per year on reducing balance |                                                  |                                                                 |                        |                       |
| • Furniture and fittings                                                                              | 10% per year on reducing balance |                                                  |                                                                 |                        |                       |
| • Telecommunication equipment                                                                         | 10% per year on reducing balance |                                                  |                                                                 |                        |                       |
| • Film equipment by a local producer                                                                  | 25% per year on reducing balance |                                                  |                                                                 |                        |                       |
| • Machinery used to undertake operations under prospecting rights and exploration under mining rights | 50% in the first year of use     | 25%                                              |                                                                 |                        |                       |
| • Other machinery                                                                                     | 10% per year on reducing balance |                                                  |                                                                 |                        |                       |
| (c) Purchase/acquisition of right to use fibre optic cable by telecommunication operation             | 10% per year on reducing balance |                                                  | (iii) Land Rovers/Cruisers                                      | 7,200                  | 86,400                |
| (d) Farm works                                                                                        | 50% in the first year of use     | 25%                                              |                                                                 |                        |                       |

| Commissioner's prescribed benefit rates:<br>Services    | Monthly rates<br>(Sh.) | Annual rates<br>(Sh.) |
|---------------------------------------------------------|------------------------|-----------------------|
| (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) Explain the meaning of “alternative dispute resolution”. (2 marks)

(b) All tax disputes can be resolved through alternative dispute resolution (ADR) with some exceptions.

With reference to the above statement, describe the exceptions. (6 marks)

(c) Omari Hassan has approached you as the tax expert, to advise him on which of the following two job offers to accept. Hassan has received two offers of employment both of which require him to report for duty next year on 1 January 2022.

He has provided you with the following information

Job offer A: Maua Growers Ltd.

Terms of employment:

1. A basic salary of Sh.1,680,000 per annum.
2. Free housing for him and his family within the farm, with free water and electricity. The water is from a borehole sunk in the farm. The electricity is also generated within the farm.
3. Free supply of the farm produce subject to a maximum value of Sh.50,000 per month.
4. Reimbursement of medical expenses incurred on self and family subject to a maximum of Sh.125,000 per month. The reimbursement policy only applies to the senior managers.
5. Payment of his children’s school fees amounting to Sh.180,000 per annum by the employer. The employer will not expense it in his books of account.
6. His annual subscription fee to the sports club amounting to Sh.50,000 would be paid for by the employer.
7. He would be required to register as a member of the Institute of Certified Public Accountants. The employer would pay the annual subscription fee of Sh.18,000.

Job offer B: Kilwa Dishes Ltd.

Terms of employment:

1. A basic salary of Sh.2,160,000 per annum.
2. Free housing and meals but only for self.
3. Monthly entertainment allowance of Sh.15,000.
4. Payment by the employer of his medical expenses subject to a maximum of Sh.800,000 per annum. The medical scheme covers all hotel employees.
5. Payment by the employer of his life assurance premiums amounting to Sh.5,000 per month.
6. Reimbursement by the employer of his annual subscriptions for the Journal of Certified Public Accountants amounting to Sh.2,500 per annum.
7. A one week fully paid holiday package worth Sh.150,000 for his wife and children to visit him and reside at the hotel once per year. The package would also include visits by the family to neighbouring tourist attractions.

Omari Hassan has further provided the following additional information:

- His annual average medical expenses are as follows:

|                                | Sh.     |
|--------------------------------|---------|
| Self                           | 150,000 |
| Wife and children              | 300,000 |
| Total average medical expenses | 450,000 |

- His consumption of the farm produce under job offer A would average about Sh.300,000 per annum.

Hint: Your evaluation should include both taxable and non-taxable benefits. Use year 2020 tax rates.

**Required:**

Evaluate the two job offers and advise Omari Hassan on which offer to accept based on expected net annual income. (12 marks)

**(Total: 20 marks)**

## QUESTION TWO

- (a) Under Section 24 of the Income Tax Act, a company is required to adhere to the rules under the shortfall distribution. If a company is unable to pay the required amount, it has to make a representation to the tax department.

In relation to the above provision, explain four factors that must be included in its representation. (4 marks)

- (b) Explain the meaning of thin capitalisation in relation to an entity. (3 marks)

- (c) The management of Bituls Ltd. has received a notice from the Commissioner for Domestic Taxes stating that the company is subject to the income tax rules on thin capitalization. The management intends to object to the Commissioner's directive and have approached you for advice.

An extract of the company's statement of financial performance revealed the following:

|                        | Sh."000"  |
|------------------------|-----------|
| Goodwill               | 43,500    |
| Land                   | 220,000   |
| Plant and machinery    | 310,100   |
| Office equipment       | 146,250   |
| Inventory              | 88,890    |
| Accounts receivable    | 97,890    |
| Bank balance           | 29,210    |
| Ordinary share capital | 445,000   |
| Share premium          | 53,000    |
| Profit and loss        | (42,300)  |
| 10% loan               | 1,650,000 |

Supporting your answer with suitable computations, advise the management of Bituls Ltd.:

- (i) On the possible outcome of its objection. (4 marks)
- (ii) The interest tax shield due to Bituls Ltd. based on your advice in (c) (i) above. (2 marks)
- (d) (i) Explain the taxable incomes of a life assurance company. (3 marks)
- (ii) The following information relates to Beta Life Assurance Company Limited for the year ended 31 December 2020:

The fund balance was valued by an actuary at Sh.220 million as at 31 December 2020. 40% of this fund balance was recommended to be transferred for the benefits of shareholders.

|                              | Sh."million" |
|------------------------------|--------------|
| Received during the year     | 120          |
| Outstanding as at: 1 January | 60           |
| 31 December                  | 40           |

Management expenses and commissions paid during the year amounted to Sh.40 million and Sh.6 million respectively.

The company had no other income during the year.

### Required:

Taxable income of Beta Life Assurance Company Limited for the year ended 31 December 2020. (4 marks)  
(Total: 20 marks)

## QUESTION THREE

- (a) (i) Explain how a company operating in Kenya but with its headquarters in another country may avoid taxation through transfer pricing. (5 marks)
- (ii) A few countries and regions in the world have established themselves as tax havens. Briefly summarise three benefits that might accrue to an investor in a tax haven. (3 marks)
- (b) Mary and Khadija are in a partnership trading as Mahadi enterprises: They share profits and losses in the ratio of 3:2 for Mary and Khadija respectively.

The partners presented the following statement of profit and loss of the partnership for the year ended 31 December 2020.

|                               | <b>Sh.</b>          |
|-------------------------------|---------------------|
| Sales                         | 8,400,000           |
| Closing stock                 | 1,176,000           |
| Rental income                 | 522,480             |
| Dividend received (net)       | 54,240              |
| Foreign exchange gain         | 54,960              |
| Interest income (net)         | 120,000             |
| Discount received             | 84,000              |
|                               | <u>10,411,680</u>   |
| Opening stock                 | 960,000             |
| Purchases                     | 4,080,000           |
| Salaries and wages            | 1,440,000           |
| Insurance                     | 288,000             |
| Travelling expenses           | 187,200             |
| Salaries and wages: Mary      | 720,000             |
| Khadija                       | 480,000             |
| Rent rates                    | 558,000             |
| Interest expense              | 1,872,000           |
| Goodwill written off          | 120,000             |
| Medical expenses for partners | 240,480             |
| Legal expenses                | 144,240             |
| Bank charges                  | 91,680              |
| Stamp duty                    | 180,000             |
| Loss on sale of equipment     | 19,200              |
| VAT paid                      | 39,120              |
| Purchase of furniture         | 57,600              |
| Depreciation                  | 48,000              |
|                               | <u>(11,525,520)</u> |
| Net loss                      | <u>(1,113,840)</u>  |

**Additional information:**

- On 1 April 2020 Abby was admitted as a partner. She contributed Sh.960,000 as her share of capital and goodwill. The profit and loss sharing ratio was revised to 2:2:1 for Mary, Khadija and Abby respectively with effect from 1 April 2020. Abby was not entitled to a salary for the year ended 31 December 2020.

- Interest expenses comprised:

|                           | <b>Sh.</b>       |
|---------------------------|------------------|
| Interest on capital: Mary | 432,000          |
| Khadija                   | 480,000          |
| Abby                      | 48,000           |
| Interest on loan          | 672,000          |
| Fridge benefit tax        | 240,000          |
|                           | <u>1,872,000</u> |

- All transactions relating to equipment and furniture occurred after 1 April 2020.
- All other revenues and expenses accrued evenly throughout the year.

**Required:**

- Determine the adjusted profit or loss of the partnership for the year ended 31 December 2020. (8 marks)
  - Allocate the profit or loss computed in (b) (i) above to the partners. (4 marks)
- (Total: 20 marks)**

**QUESTION FOUR**

(a) BSI Fly High Ltd. presented the following trading results for the year ended 31 December 2020:

**Statement of comprehensive income for the year ended 31 December 2020**

|                                             | Sh.“million” | Sh.“million”        |
|---------------------------------------------|--------------|---------------------|
| Turnover                                    |              | 70,743              |
| Direct cost                                 | 44,376       |                     |
| Fleet ownership                             | <u>9,102</u> | <u>(53,478)</u>     |
| Gross profit                                |              | 17,265              |
| Other incomes                               |              |                     |
| Interest income (net)                       | 372          |                     |
| Fair value gains/losses on fuel derivatives | 6,140        |                     |
| Shares of results of associated company     | 77           |                     |
| Gain/loss on hedged exchange differences:   |              |                     |
| On borrowings                               | 1,280        |                     |
| Gain on hedged fuel contacts                | <u>398</u>   | <u>8,267</u>        |
| Total income                                |              | <u>25,532</u>       |
| Less: Expenses                              |              |                     |
| Overheads                                   | 15,426       |                     |
| Finance cost                                | 1,485        |                     |
| Realised losses on fuel derivatives         | 3,771        |                     |
| Other losses/gains                          | 501          |                     |
| Deferred taxation on cash flow hedges       | 503          | <u>(21,686)</u>     |
| Total profits/loss                          |              | <u><u>3,846</u></u> |

**Additional information:**

|                                                               |               |
|---------------------------------------------------------------|---------------|
| 1. Turnover includes                                          | Sh.“million”  |
| Passenger revenue                                             | 62,838        |
| Freight and mail                                              | 5,434         |
| Handling                                                      | 1,312         |
| Others                                                        | <u>1,159</u>  |
|                                                               | <u>70,743</u> |
| 2. Analysis of operating expenditure:                         |               |
| • Direct cost                                                 | 9,292         |
| Aircraft fuel and oil                                         | 8,530         |
| Aircraft landing, handling and navigation                     | 14,555        |
| Passenger services                                            | 4,445         |
| Commissions on sales                                          | 3,246         |
| Aircraft passenger and cargo insurance                        | 366           |
| Crew route expenses                                           | 1,742         |
| Central reservation system (net) and frequent flier programme | 1,805         |
| Others                                                        | <u>395</u>    |
|                                                               | <u>44,376</u> |
| • Fleet ownership costs                                       |               |
| Hire of aircraft and engines                                  | 5,920         |
| Depreciation on air craft and engines                         | 3,094         |
| Depreciation on rotatables and other equipment                | 262           |
| Amortisation of refurbishment costs                           | -             |
| Air craft purchases subsidy                                   | <u>(174)</u>  |
|                                                               | <u>9,102</u>  |
| Overheads                                                     |               |
| Administration                                                | 10,175        |
| Employee costs                                                | 348           |
| Legal and professional fees                                   | 73            |
| Director’s remuneration                                       | 11            |
| Audit fees                                                    | <u>1,492</u>  |
|                                                               | <u>12,099</u> |
| Establishment                                                 |               |
| General maintenance and supplies                              | 1,163         |
| Depreciation of buildings vehicle and other equipment         | 860           |
| Amortisation of intangible assets and prepaid operating lease | <u>364</u>    |
|                                                               | <u>2,387</u>  |

|                           | Sh. "million" |
|---------------------------|---------------|
| Selling                   |               |
| Advertising and publicity | 665           |
| Bad debts expense         | <u>275</u>    |
|                           | 940           |
| Total overheads           | <u>15,426</u> |

**Required:**

- (i) Compute adjusted taxable income for the year ended 31 December 2020. (10 marks)
- (ii) Tax payable, if any for the year. (2 marks)
- (b) (i) In Kenya, tax agents are individuals or companies that prepare taxes on behalf of the tax payers, they also offers professional assistance to people or companies that do not want to prepare taxes on their own.
- In light of the above statement, explain circumstances under which a tax agent's license may be canceled. (4 marks)
- (ii) Bandari Realtors' Ltd. provided the following information relating to the sale of their properties in the year 2020.
- Sale proceeds were Sh.2,000,000 and the incidental costs were; Legal fees - Sh.100,000; Advertisement - Sh.50,000; Agent's commission - Sh.200,000 and Valuation fees - Sh.150,000.
  - Cost of acquisition/construction was Sh.1,500,000 and the other relevant/ incidental costs were as follows: Legal cost on acquisition - Sh.60,000; Valuation - Sh.70,000; Costs to change the roof of property - Sh.130,000; Legal cost to defend title Sh.50,000; investment allowance had been allowed totaling Sh.450,000 over the years.

**Required:**

Compute the capital gains tax.

(4 marks)

**(Total: 20 marks)**

**QUESTION FIVE**

- (a) Explain the challenges in implementing special economic zones (SEZs). (8 marks)
- (b) Customs audit is the process of verifying that the business is in compliance with the customs legislation through the examination of books and records of a business to prevent commercial fraud.
- In relation to the above statement, explain the objectives of a customs audit. (4 marks)
- (c) In case of back duty the tax department will reject the accounts presented to them and will advise the taxpayer to provide another set of accounts prepared by a reputable firm of auditors. Where presentation of accounts is not possible, the taxpayer's income could be computed through capital statements.

**Required:**

Explain other circumstances under which capital statements are applicable in computation of income. (4 marks)

- (d) Outline the documents which must accompany a claim for VAT refund under Section 24 (Bad Debts). (4 marks)
- (Total: 20 marks)**

.....



kasneb

CPA PART III SECTION 6

ADVANCED PUBLIC FINANCE AND TAXATION

THURSDAY: 2 September 2021.

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 2020.

Assume that the following rates of tax applied throughout the year of income 2020:

| Monthly taxable pay<br>(Sh.) | Annual taxable pay<br>(Sh.) | Rate of tax<br>% in each Sh. |
|------------------------------|-----------------------------|------------------------------|
| 1 - 24,000                   | 1 - 288,000                 | 10%                          |
| 24,001 - 40,667              | 288,001 - 488,000           | 15%                          |
| 40,668 - 57,334              | 488,001 - 688,000           | 20%                          |
| Excess over - 57,334         | Excess over - 688,000       | 25%                          |

Personal relief Sh.2,400 per month (Sh.28,800 per annum).

| Investment allowance:                                                                                 | Rate of investment allowance     | Residual value<br>(per year on<br>reducing<br>balance) | Prescribed benefit rates of motor vehicles<br>provided by employer |                           |                          |
|-------------------------------------------------------------------------------------------------------|----------------------------------|--------------------------------------------------------|--------------------------------------------------------------------|---------------------------|--------------------------|
| Capital expenditure incurred on:                                                                      |                                  |                                                        | (i) Saloons, Hatch Backs and Estates                               |                           |                          |
|                                                                                                       |                                  |                                                        |                                                                    | Monthly<br>rates<br>(Sh.) | Annual<br>rates<br>(Sh.) |
| (a) <b>Buildings:</b>                                                                                 |                                  |                                                        | Up to 1200 cc                                                      | 3,600                     | 43,200                   |
| • Hotel building                                                                                      | 50% in the first year of use     | 25%                                                    | 1201 - 1500 cc                                                     | 4,200                     | 50,400                   |
| • Building used for manufacture                                                                       | 50% in the first year of use     | 25%                                                    | 1501 - 1750 cc                                                     | 5,800                     | 69,600                   |
| • Hospital buildings                                                                                  | 50% in the first year of use     | 25%                                                    | 1751 - 2000 cc                                                     | 7,200                     | 86,400                   |
| • Petroleum or gas storage facilities                                                                 | 50% in the first year of use     | 25%                                                    | 2001 - 3000 cc                                                     | 8,600                     | 103,200                  |
| • Educational/hostels building                                                                        | 10% per year on reducing balance |                                                        | Over - 3000 cc                                                     | 14,400                    | 172,800                  |
| • Commercial building                                                                                 | 10% per year on reducing balance |                                                        |                                                                    |                           |                          |
| (b) <b>Machinery:</b>                                                                                 |                                  |                                                        | (ii) Pick-ups, Panel Vans<br>(unconverted)                         |                           |                          |
| • Machinery used for manufacture                                                                      | 50% in the first year of use     | 25%                                                    | Up to - 1750 cc                                                    | 3,600                     | 43,200                   |
| • Hospital equipment                                                                                  | 50% in the first year of use     | 25%                                                    | Over - 1750 cc                                                     | 4,200                     | 50,400                   |
| • Ships or aircraft                                                                                   | 50% in the first year of use     | 25%                                                    |                                                                    |                           |                          |
| • Motor vehicles and heavy earth moving equipment                                                     | 25% per year on reducing balance |                                                        |                                                                    |                           |                          |
| • Computer software, calculators, copiers and duplicating machines                                    | 25% per year on reducing balance |                                                        |                                                                    |                           |                          |
| • Furniture and fittings                                                                              | 10% per year on reducing balance |                                                        |                                                                    |                           |                          |
| • Telecommunication equipment                                                                         | 10% per year on reducing balance |                                                        |                                                                    |                           |                          |
| • Film equipment by a local producer                                                                  | 25% per year on reducing balance |                                                        |                                                                    |                           |                          |
| • Machinery used to undertake operations under prospecting rights and exploration under mining rights | 50% in the first year of use     | 25%                                                    |                                                                    |                           |                          |
| • Other machinery                                                                                     | 10% per year on reducing balance |                                                        |                                                                    |                           |                          |
| (c) Purchase/acquisition of right to use fibre optic cable by telecommunication operation             | 10% per year on reducing balance |                                                        | (iii) Land Rovers/Cruisers                                         |                           |                          |
|                                                                                                       |                                  |                                                        |                                                                    | 86,400                    | 7,200                    |
| (d) Farm works                                                                                        | 50% in the first year of use     | 25%                                                    |                                                                    |                           |                          |

Commissioner's prescribed benefit rates:

Services

Monthly rates

Annual rates

- (i) Electricity (Communal or from a generator)  
(ii) Water (Communal or from a borehole)

1,500  
500

18,000  
6,000

**Agriculture employees: Reduced rates of benefits**

- (i) Water  
(ii) Electricity

200  
900

2,400  
10,800

### QUESTION ONE

- (a) One of the recent trends in the field of taxation is the introduction of digital services tax (DST).

**Required:**

- (i) Explain the meaning and operations of the digital services tax (DST). (3 marks)
- (ii) Describe three types of transactions where DST is applicable. (3 marks)

- (b) Poxmax Enterprises is a resident company that deals in asset leasing. For the year ended 31 December 2020, the company reported the following transactions:

1. Assets leased in the course of the year:

- Manufacturing machinery to Pendo Ltd. at an annual lease cost of Sh.4,200,000.
- Ten saloon cars to Samtech Tours for four months at Sh.40,000 each per month.
- At the end of the four months, Samtech Tours returned four saloon cars and renewed the lease for the others for an additional three months at a discounted pay by 10%.
- Five lorries to Athi Ltd. at an annual lease of Sh.800,000 per lorry. However, the lease was terminated after 9 months after it was found that the lorries had serious mechanical problems.
- Six pickup vehicles to Fahari Ltd. in Rwanda for Sh.200,000 per month for the whole year.
- Computers to Digitech Ltd. at an annual lease of Sh.200,000.

2. Poxmax Enterprises incurred the following expenditure in the course of the year:

- |                                                                                                                           | Sh.       |
|---------------------------------------------------------------------------------------------------------------------------|-----------|
| • Purchase of manufacturing machine for leasing                                                                           | 6,000,000 |
| • Installation costs and repairs of the manufacturing machine before use                                                  | 240,000   |
| • Purchase of two saloon cars each at Sh.2,100,000                                                                        | 4,200,000 |
| • Purchase of a lorry (4 tonnes)                                                                                          | 1,800,000 |
| • Administration expenses                                                                                                 | 2,400,000 |
| • Legal expenses of Sh.240,000 out of which Sh.100,000 was in respect of defence of an alleged breach of lease agreement. |           |
| • Marketing costs were Sh.300,000 with Sh.80,000 being for erection of a billboard for advertising.                       |           |

3. The following additional information was provided:

- A pickup vehicle whose written down value as at 1 January 2020 was Sh.420,000 was sold upon expiry of lease in 2020 for Sh.580,000.
- The written down values of the following assets as at 1 January 2020 were:

|                    | Sh.       |
|--------------------|-----------|
| Lorries (4 tonnes) | 4,000,000 |
| Computers          | 420,000   |
| Motor vehicles     | 1,200,000 |
| Furniture          | 180,000   |

- Other incomes of Poxmax Enterprises include:
  - (i) Interest income from Ufanisi Deposit taking micro finance Sh.240,000 (net).
  - (ii) Dividend income from Wananchi Sacco Sh.120,000 (net).
  - (iii) Royalties income of Sh.400,000 (net).
- Corporate tax rate applicable during the year was 25%.

**Required:**

The adjusted taxable income or loss and tax payable (if any) for Poxmax Enterprises for the year ended 31 December 2020.

(14 marks)

**(Total: 20 marks)**

### QUESTION TWO

- (a) Discuss the responsibilities of the Senate Budget Committee or its equivalent in public finance management. (4 marks)

- (b) There are clear differences between debt management in the private sector and in the public sector. However, the main objective of debt management in both sectors is the sustainability of the institutions concerned.

**Required:**

Describe the salient features that distinguish debt management in the public sector as compared to the private sector. (6 marks)

- (c) Oil Merchants Ltd. is in the petroleum business. The following information was extracted from the books of accounts of the company for the year ended 31 December, 2020:

- Crude oil exported 140,000 barrels.
- Domestic crude oil sales 50,000 barrels.
- Posted price per barrel for crude oil exported Sh.505.
- Posted price per barrel for domestic crude oil Sh.102.
- Miscellaneous income Sh.800,000.
- Administrative expenses Sh.8,850,000.
- Income from oil refinery business Sh.1,000,000.
- Royalty on oil exported Sh.5,000,000.
- Royalties on local sales Sh.1,060,000.
- Value of chargeable oil sold as per audited financial statements Sh.60,000,000.
- Customs duty on plant and machinery essential to the company in its operation Sh.150,000.
- Capital expenditure on petroleum tanks Sh.19,000,000.
- Intangible drilling costs Sh.5,000,000.
- Losses from previous year are classified as follows:
  - Loss from 2019 refinery business Sh.2,000,000.
  - Loss from 2019 petroleum business Sh.3,000,000.
- Administrative expenses of Sh.8,850,000 included above comprised:
  - Depreciation Sh.1,000,000.
  - Stamp duty on increase of ordinary share capital Sh.500,000.
  - Loss on foreign exchange transactions Sh.60,000.
  - Defending a driver on traffic offence Sh.16,000.

**Required:**

A statement of taxable profit or loss of Oils Merchants Ltd. for the year ended 31 December 2020. (10 marks)  
(Total: 20 marks)

**QUESTION THREE**

- (a) The resource mobilisation department is instrumental in enabling the government to execute its mandate and responsibilities to the citizens.

**Required:**

Evaluate the roles played by the resource mobilisation department in the National Treasury or a similar body in your country. (4 marks)

- (b) The following information was presented to you by the management of Credit Lenders Ltd. as at 31 December 2020. The company deals in the sale of manufacturing machines on hire purchase terms:

1. The company purchases the machines at Sh.600,000 each.
2. The hire purchase price per unit comprises of a deposit of Sh.160,000 and eight quarterly instalments of Sh.80,000. Cash price per unit is Sh.700,000.
3. During the year ended 31 December 2020, the company sold 4,080 manufacturing machines of which collections of Sh.569,600,000 were received at year end.
4. During the year, the company repossessed 80 machines which had been sold earlier in the year. The customer had already paid Sh.6,400,000 on the units which was included in the total cash collections for the year. The repossessed units were valued at Sh.520,000 each at year end.
5. Expenses incurred in the course of the year included:

|                                                  | Sh.                                                                                                 |
|--------------------------------------------------|-----------------------------------------------------------------------------------------------------|
| • Rent expenses                                  | 420,000                                                                                             |
| • Legal expenses                                 | 1,200,000 (of which Sh.320,000 was in respect of defence against illegal importation of a machine). |
| • Advertising and marketing                      | 525,000                                                                                             |
| • Salaries and management expenses               | 890,000                                                                                             |
| • Purchase of a mobile forklift (in August 2020) | 2,800,000                                                                                           |
6. Other incomes included:
  - Royalties of Sh.289,750 net of withholding tax.
  - Dividend from Uzima Co-operative Society Sh.120,000 net of withholding tax.
7. The Revenue Authority has reached an agreement with the company whereby profit for tax purposes will be determined on the basis of proportionate cash collected from the customers for the year's sales.

**Required:**

Taxable profit or loss for Credit Lenders Ltd. for the year ended 31 December 2020. (12 marks)

- (c) A Single Customs Territory (SCT) is the full attainment of the customs union achievable through removal of trade restrictions and minimisation of internal border controls.

**Required:**

Explain the benefits of a single customs territory (SCT).

(4 marks)

**(Total: 20 marks)**

**QUESTION FOUR**

- (a) Describe the tax planning opportunities that could be derived in relation to the financial management decisions in a company. (6 marks)
- (b) Jirani and Mwema have been partners trading as JM Traders since 1 January 2019. They have not filed individual income tax returns for the year ended 31 December 2020. The Commissioner for Domestic taxes has issued an estimated assessment of Sh.940,800 to each of the partners for the year ended 31 December 2020. They share profits and losses in the ratio of 2:3 to Jirani and Mwema respectively. They are preparing to appeal against the assessment and have approached you for tax advice with the following details:

**Cashbook summary**

|                                          | Sh.              |                            | Sh.              |
|------------------------------------------|------------------|----------------------------|------------------|
| Balance brought forward (1 January 2020) | 912,000          | Payment to creditors       | 1,056,000        |
| Capital: Jirani                          | 720,000          | Purchase of furniture      | 240,000          |
| Mwema                                    | 1,080,000        | Motor vehicle expenses     | 168,000          |
| Receipts from debtors                    | 2,040,000        | Electricity expenses       | 93,600           |
| Cash sales                               | 1,200,000        | Rent expenses              | 472,800          |
| Rent income                              | 696,000          | Purchase of motor vehicles | 720,000          |
| Sale of furniture                        | 204,000          | Salaries and wages         | 576,000          |
|                                          |                  | Office partitions          | 216,000          |
|                                          |                  | General expenses           | 528,000          |
|                                          |                  | Balance carried forward    | 2,781,600        |
|                                          | <u>6,852,000</u> |                            | <u>6,852,000</u> |

**Additional information:**

- Sales and purchases for the year were understated and overstated respectively by 20%.
- All the cash sales were paid into the bank with the exception of Sh.528,000 which was debited in the income statement as general expenses but related to the following items:
  - Partners children school fees Sh.96,000.
  - Purchase of goods Sh.240,000.
  - Tax appeal expenses 48,000.
  - Insurance policy for partners life Sh.84,000.
  - Computer software Sh.60,000.
- The partners are entitled to interest on capital at the rate of 10% per annum on their capital contributions. The interest on capital was included in the figure for purchases for the year.
- The cost of furniture sold was Sh.192,000 and had accumulated depreciation of Sh.16,800 as at 1 January 2020. The profit on disposal was credited to the income statements for the year ended 31 December 2020.
- Other information provided was as follows:

|                              | 31 December 2019<br>Sh. | 31 December 2020<br>Sh. |
|------------------------------|-------------------------|-------------------------|
| Inventories                  | 297,600                 | 434,400                 |
| Creditors for goods          | 480,000                 | 336,000                 |
| Debtors for goods            | 288,000                 | 432,000                 |
| Electricity expenses prepaid | 566,400                 | 36,000                  |
| Rent owing                   | 93,600                  | 52,800                  |
| Salaries and wages owing     | 24,000                  | 72,000                  |
| Furniture                    | 192,000                 | 240,000                 |

6. The business reported a net loss of Sh.509,400 for the year ended 31 December 2020 after deducting the following expenses:

- Salaries and wages for the year ended 31 December 2020 which included partners salaries for Jirani Sh.120,000 and Mwema Sh.96,000.
- Rent expense for the year included 20% for private residence for Jirani while electricity included 30% electricity bills paid on behalf of Mwema's private house.
- Capital allowances in respect of the business had not been considered. However, depreciation had been debited in the income statement. The depreciation was at the rate of 20%.

**Required:**

With supporting computations:

- (i) Advise the partners on the accuracy of the estimated assessment issued for the year of income 2020. (8 marks)
- (ii) Prepare a schedule of total taxable income for each partner for the year of income 2020. (6 marks)
- (Total: 20 marks)**

**QUESTION FIVE**

- (a) Your country has been experiencing growth in the number of projects initiated through public private partnerships (PPPs). However, this growth appears to be declining in the last few years.

**Required:**

Evaluate the possible factors that could have contributed to this trend. (6 marks)

- (b) The following information was obtained from the financial records of Alemao Commercial Bank Ltd. for the year ended 31 December 2020:

|                                                    | <b>Sh. "000"</b> |
|----------------------------------------------------|------------------|
| Interest on advances                               | 697,200          |
| Contribution to deposit protection fund            | 147,000          |
| Operating lease rentals                            | 9,720            |
| Interest on government securities                  | 21,900           |
| Interest paid on deposits                          | 7,110            |
| Interest on placement and bank balances            | 3,990            |
| Loss on disposal of collaterals                    | 1,260            |
| Fees and commission expenses                       | 2,130            |
| Losses from investment in securities               | 1,185            |
| Purchase of equipment                              | 1,800            |
| Depreciation                                       | 744              |
| Transfer to statutory reserves                     | 939              |
| Losses on stock brokerage dealings                 | 522              |
| Gain on foreign exchange dealings                  | 2,205            |
| Discounts on bills purchased                       | 493.5            |
| Auditors remuneration                              | 1,179            |
| Provision for bad and doubtful debts               | 810              |
| Investments in government securities               | 2,775            |
| Bills receivable and for collection                | 471              |
| Guarantees and performance bonds                   | 567              |
| Interest accrued and paid                          | 2,961            |
| Bills for collection, acceptances and endorsements | 705              |
| Rebates on bills discounted                        | 438              |
| Provision for taxation                             | 600              |
| General charges recovered                          | 375              |
| Commission on exchange and brokerage               | 1,176            |

**Additional information:**

- Contribution to deposit protection fund includes investment revaluation surplus of Sh.972,000.
- Included in transfer to statutory reserves is an amount paid for exchange and commission of Sh.72,000.
- Discounts on bills purchased include interest and discount paid of Sh.58,500.
- Provision for bad and doubtful debts include specific bad debts at the beginning and at the end of the year amounting to Sh.102,000 and Sh.210,000 respectively.
- The corporate tax rate applicable during the year was 25%.

**Required:**

- (i) A statement showing the taxable profit or loss for Alemao Commercial Bank Ltd. for the year ended 31 December 2020. (12 marks)
- (ii) Tax payable (or refundable) by the bank from the income computed in (b) (i) above. (2 marks)
- (Total: 20 marks)**

.....



**kasneb**

**CPA PART III SECTION 6**

**ADVANCED PUBLIC FINANCE AND TAXATION**

**FRIDAY: 27 November 2020.**

**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 2019.**

| Monthly taxable pay<br>(Sh.) | Annual taxable pay<br>(Sh.) | Rate of tax<br>% 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<br>(Sh.) | Annual rates<br>(Sh.) |
|---------------------------------|--------------------------------------|------------------------|-----------------------|
| <b>Capital allowance:</b>       | (i) Saloons, Hatch Backs and Estates |                        |                       |
| <b>Wear and tear allowance:</b> | Up to 1200 cc                        | 3,600                  | 43,200                |
| Class I 37.5%                   | 1201 - 1500 cc                       | 4,200                  | 50,400                |
| Class II 30%                    | 1501 - 1750 cc                       | 5,800                  | 69,600                |
| Class III 25%                   | 1751 - 2000 cc                       | 7,200                  | 86,400                |
| Class IV 12.5%                  | 2001 - 3000 cc                       | 8,600                  | 103,200               |
| Software 20%                    | Over 3000 cc                         | 14,400                 | 172,800               |

**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%**

**Investment deduction allowance 100%**

**Shipping investment deduction (Ships over 125 tonnes) 100%**

**Extraction expenditure:**

Written off over 5 years (20%)

**Commissioner's prescribed benefit rates**

| Services                                         | Monthly rates<br>(Sh.) | Annual rates<br>(Sh.) |
|--------------------------------------------------|------------------------|-----------------------|
| (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) Three countries; X, Y and Z established an economic trading block some years back. One of the key objectives of the trading block was to promote the harmonisation of tax systems and policies among the three countries. However, this objective has not been realised to date.

**Required:**

Discuss five possible challenges to the harmonisation of tax systems and policies among the three countries above.

(5 marks)

- (b) With reference to public-private partnerships (PPPs):

(i) Explain the role and composition of a petitions committee.

(4 marks)

(ii) Describe the moneys that are required to be paid into the public private partnership project facilitation fund.

(3 marks)

- (c) Summarise five functions of the Directorate of Public Debt Management.

(5 marks)

- (d) Taxation has generally contributed to economic development and empowerment of the population in most countries. However, taxation may also result in certain negative consequences on the society.

**Required:**

Discuss three negative impacts of taxation in a country.

(3 marks)

**(Total: 20 marks)**

### QUESTION TWO

- (a) The following financial information was extracted from the books of Oil Drillers and Exporters Ltd. for the year ended 31 December 2019:

| Income                                                                                                        | Sh.        |
|---------------------------------------------------------------------------------------------------------------|------------|
| • Proceeds of oil sold to foreign subsidiary company (50,000 barrels of crude oil at Sh.500 per barrel)       | 25,000,000 |
| • Value of oil disposed of to local refineries                                                                | 125,000    |
| • Freight charges received from other oil companies for transporting their crude oils to neighbouring country | 190,000    |
| • Sale of natural gas                                                                                         | 160,000    |
| <b>Expenditure</b>                                                                                            |            |
| • Staff accommodation expenses                                                                                | 60,000     |
| • Wages and salaries for employees                                                                            | 15,000     |
| • Annual compensation paid to local people for disturbance during petroleum exploration                       | 75,000     |
| • Royalties incurred in respect to crude oil exported                                                         | 42,000     |
| • Interest on loan from a foreign subsidiary company                                                          | 31,250     |
| • Specific bad debts written off                                                                              | 8,500      |
| • Depreciation of non-current assets (Class IV)                                                               | 45,100     |
| • Exploration and drilling costs in respect to cement and casing of oil wells                                 | 24,500,000 |
| • Contribution to approved provident fund                                                                     | 65,000     |
| • Custom duties on imported equipment                                                                         | 21,500     |
| • General expenses                                                                                            | 65,000     |

**Additional information:**

- Non-current assets comprised; drilling machines Sh.900,000, Furniture Sh.240,000 and saloon car Sh.2,800,000 acquired during the year.
- Staff accommodation expenses include management fees of Sh.18,000 for a director from a foreign subsidiary company.
- Lorries for transporting crude oil comprised:  
7.5 tonnes lorry Sh.2,400,000.  
4.2 tonnes lorry Sh.1,800,000.

**Required:**

A statement of taxable profit or loss for the year ended 31 December 2019.

(12 marks)

- (b) Evaluate four factors inhibiting efficient administration of value added tax in your country.

(8 marks)

**(Total: 20 marks)**

### QUESTION THREE

- (a) M and K are in partnership trading as MK enterprises. The partners deposited Sh.4,000,000 and Sh.6,000,000 into the business account as their initial capital before commencing trading. They also agreed to share profit and loss in the ratio of their initial capital contribution and interest on capital at 5% per annum on outstanding capital balances.

On 1 January 2018, the firm purchased the following assets for use in the business:

|                         | Sh.       |
|-------------------------|-----------|
| Saloon car              | 2,400,000 |
| Computers               | 80,000    |
| Furniture and fittings  | 96,000    |
| Fax machine             | 48,000    |
| Switchboard             | 64,000    |
| Bookshelf               | 18,000    |
| Office kitchen utensils | 9,000     |
| Office television set   | 54,000    |
| Carpets                 | 36,000    |
| Safe for cash office    | 45,000    |

The firm's books were kept in a single entry bookkeeping. The details for the accounting records for the year ended 31 December 2018 obtained were as follows:

1. Sales for the year was Sh.1,860,000 out of which Sh.360,000 was on credit and the balance was cash banked.
2. The following monthly expenses were paid from cash proceeds before banking the proceeds from cash transactions:

|                         | Sh.   |
|-------------------------|-------|
| Transport expenses      | 6,000 |
| Telephone and postage   | 5,600 |
| Office meals            | 5,000 |
| Repairs and maintenance | 4,800 |

3. The bank statements summary for the full year showed payments made during the year as follows:

|                            | Sh.       |
|----------------------------|-----------|
| Rent payment               | 325,000   |
| Purchase of 3 tonnes lorry | 1,800,000 |
| Purchase of motor bike     | 90,000    |
| Office expenses            | 1,460,000 |
| Advertising                | 240,000   |

4. The office expenses paid in note (3) above included:

|                                 | Sh.     |
|---------------------------------|---------|
| Partners' salaries: M           | 270,000 |
| K                               | 360,000 |
| Employees' pension contribution | 420,000 |
| Donations to society for blind  | 78,000  |
| Tax consultancy fees            | 32,000  |
| Training of partners' children  | 28,000  |
| Motor vehicle insurance         | 24,000  |

The business failed to file returns for the year of income 2018 and on 1 July 2019, they received an estimated assessment of Sh.78,000 from the revenue authority for each partner.

#### Required:

- (i) Using the above information, prepare a statement that will form the basis of contesting the estimated assessment for the year of income 2018. (14 marks)
  - (ii) Advise the partners on the appeal position. (2 marks)
- (b) Citing four reasons, argue the case for continued provision of tax incentives by a country that is experiencing budget deficits. (4 marks)

(Total: 20 marks)

#### QUESTION FOUR

- (a) Describe four tax policy challenges that the government is facing in the taxation of digital economy in your country. (8 marks)
- (b) Anita Warazo has been operating a sole-proprietorship business since 1 January 2015.

The following information was obtained from the books of the business for the past five years:

| Year                    | 2015<br>Sh."000" | 2016<br>Sh."000" | 2017<br>Sh."000" | 2018<br>Sh."000" | 2019<br>Sh."000" |
|-------------------------|------------------|------------------|------------------|------------------|------------------|
| Current account balance | 485 (Dr)         | 600 (Cr)         | 960 (Cr)         | 350 (Dr)         | 560 (Cr)         |
| Treasury bonds          | 1,450            | 940              | 740              | 648              | 780              |
| Pick up (cost)          | 900              | 900              | 1,600            | 1,600            | 1,600            |
| Computers (cost)        | 150              | 150              | 200              | 200              | 200              |
| Inventory               | -                | 170              | 240              | 280              | 376              |
| Trade receivables       | 720              | 600              | 560              | 700              | 840              |
| 10% Mortgage loan       | -                | -                | 4,000            | 4,000            | 4,000            |
| Trade payables          | 460              | 640              | 800              | 560              | 720              |
| Bank loan               | 370              | 348              | 400              | 400              | 380              |
| Leasehold property      | 1,400            | 1,400            | 1,400            | 1,400            | 1,400            |
| Cash in hand            | 560              | 840              | 540              | 600              | 760              |
| Furniture and fittings  | 400              | 400              | 300              | 300              | 300              |
| Personal saloon car     | -                | 480              | 480              | 480              | 480              |

#### Additional information:

- All non-current assets were stated at cost and where the fair value changed was either due to additional asset acquired or disposed of.
- Furniture and fittings whose cost was Sh.100,000 was disposed of on 1 January 2017 for Sh.68,000.
- In the year 2016, the proprietor made drawings of Sh.38,000.
- Anita Warazo paid school fees for her children from business current account of Sh.138,000 per annum for the years 2016 and 2017.
- A leasehold property included a property valued at Sh.400,000 inherited from her late father.
- In the year 2018, she paid insurance premium of Sh.42,000 for her private residence.
- She contributed to a fundraising in 2019 of Sh.60,000 for supporting a church function.
- The non-current assets qualified for capital deductions where applicable.
- Leasehold property comprised a warehouse (cost Sh.1,000,000) while the inherited property was a dwelling house.

#### Required:

- (i) Prepare a capital statement showing taxable income for the years 2016 to 2019. (10 marks)
- (ii) Comment on the tax position of Anita Warazo for each of the years of income. (2 marks)
- (Total: 20 marks)**

#### QUESTION FIVE

- (a) Globalisation, diversification and expansion have forced companies to form groups where a large number of transactions are between related parties.

In light of the above statement:

- (i) Explain the terms "related party transactions" and "transfer pricing". (4 marks)
- (ii) Evaluate two benefits that may accrue to an entity that applies transfer pricing in transactions between related parties. (4 marks)
- (b) Albert Kimeli is an employee of Rwaka Ltd. He has provided the following information relating to his income:
- He earns a basic salary of Sh.60,000 per month.
  - He is paid house rent allowance of Sh.30,000 per month.
  - His wife, Lavena Kimeli is also employed at a salary of Sh.54,000 per month with Tops Ltd. where Kimeli holds 20% of the shares.
  - They both live in a house which is owned by the wife. The house was constructed through borrowed funds at an interest rate of 15% per annum.

5. The employer paid school fees for the children of Albert Kimeli.
6. He was a member of an unregistered pension scheme where the employer made contributions towards the scheme on his behalf.
7. The wife runs a farming business where she earned Sh.400,000 from sale of farm produce.
8. He is contemplating securing a bank loan for his children's education or an education insurance policy that will equally cater for children's education.

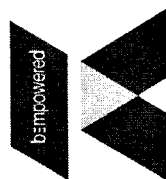
**Required:**

Suggest a scheme of tax planning that would minimise the tax liability of the family of Mr and Mrs Kimeli for the year of income and subsequent years.

(12 marks)

**(Total: 20 marks)**

.....



kasneb

CPA PART III SECTION 6

ADVANCED PUBLIC FINANCE AND TAXATION

THURSDAY: 20 May 2021.

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 2020.

Assume that the following rates of tax applied throughout the year of income 2020:

| Monthly taxable pay<br>(Sh.) | Annual taxable pay<br>(Sh.) | Rate of tax<br>% in each Sh. |
|------------------------------|-----------------------------|------------------------------|
| 1 - 24,000                   | 1 - 288,000                 | 10%                          |
| 24,001 - 40,667              | 288,001 - 488,000           | 15%                          |
| 40,668 - 57,334              | 488,001 - 688,000           | 20%                          |
| Excess over - 57,334         | Excess over - 688,000       | 25%                          |

Personal relief Sh.2,400 per month (Sh.28,800 per annum).

| Investment allowance:                                                                                 | Rate of investment allowance     | Residual value<br>(per year on<br>reducing<br>balance) | Prescribed benefit rates of motor vehicles<br>provided by employer |                           |                          |
|-------------------------------------------------------------------------------------------------------|----------------------------------|--------------------------------------------------------|--------------------------------------------------------------------|---------------------------|--------------------------|
| Capital expenditure incurred on:                                                                      |                                  |                                                        | (i) Saloons, Hatch Backs and Estates                               | Monthly<br>rates<br>(Sh.) | Annual<br>rates<br>(Sh.) |
| (a) Buildings:                                                                                        |                                  |                                                        | Up to 1200 cc                                                      | 3,600                     | 43,200                   |
| • Hotel building                                                                                      | 50% in the first year of use     | 25%                                                    | 1201 - 1500 cc                                                     | 4,200                     | 50,400                   |
| • Building used for manufacture                                                                       | 50% in the first year of use     | 25%                                                    | 1501 - 1750 cc                                                     | 5,800                     | 69,600                   |
| • Hospital buildings                                                                                  | 50% in the first year of use     | 25%                                                    | 1751 - 2000 cc                                                     | 7,200                     | 86,400                   |
| • Petroleum or gas storage facilities                                                                 | 50% in the first year of use     | 25%                                                    | 2001 - 3000 cc                                                     | 8,600                     | 103,200                  |
| • Educational/hostels building                                                                        | 10% per year on reducing balance |                                                        | Over - 3000 cc                                                     | 14,400                    | 172,800                  |
| • Commercial building                                                                                 | 10% per year on reducing balance |                                                        |                                                                    |                           |                          |
| (b) Machinery:                                                                                        |                                  |                                                        | (ii) Pick-ups, Panel Vans<br>(unconverted)                         |                           |                          |
| • Machinery used for manufacture                                                                      | 50% in the first year of use     | 25%                                                    | Up to - 1750 cc                                                    | 3,600                     | 43,200                   |
| • Hospital equipment                                                                                  | 50% in the first year of use     | 25%                                                    | Over - 1750 cc                                                     | 4,200                     | 50,400                   |
| • Ships or aircraft                                                                                   | 50% in the first year of use     | 25%                                                    |                                                                    |                           |                          |
| • Motor vehicles and heavy earth moving equipment                                                     | 25% per year on reducing balance |                                                        |                                                                    |                           |                          |
| • Computer software, calculators, copiers and duplicating machines                                    | 25% per year on reducing balance |                                                        |                                                                    |                           |                          |
| • Furniture and fittings                                                                              | 10% per year on reducing balance |                                                        |                                                                    |                           |                          |
| • Telecommunication equipment                                                                         | 10% per year on reducing balance |                                                        |                                                                    |                           |                          |
| • Film equipment by a local producer                                                                  | 25% per year on reducing balance |                                                        |                                                                    |                           |                          |
| • Machinery used to undertake operations under prospecting rights and exploration under mining rights | 50% in the first year of use     | 25%                                                    |                                                                    |                           |                          |
| • Other machinery                                                                                     | 10% per year on reducing balance |                                                        |                                                                    |                           |                          |
| (c) Purchase/acquisition of right to use fibre optic cable by telecommunication operation             | 10% per year on reducing balance |                                                        | (iii) Land Rovers/Cruisers                                         | 86,400                    | 7,200                    |
| (d) Farm works                                                                                        | 50% in the first year of use     | 25%                                                    |                                                                    |                           |                          |

Commissioner's prescribed benefit rates:

Services

(i) Electricity (Communal or from a generator)

(ii) Water (Communal or from a borehole)

Agriculture employees: Reduced rates of benefits

(i) Water

(ii) Electricity

Monthly rates

(Sh.)

1,500

500

200

900

Annual rates

(Sh.)

18,000

6,000

2,400

10,800

### QUESTION ONE

- (a) There are different types of public private partnership (PPP) contracts depending on the type of project, level of risk transfer, investment level and the desired outcome.

**Required:**

Citing relevant examples, describe four types of public private partnership contracts. (4 marks)

- (b) During a conference held by the Organisation for Economic Co-operation and Development (OECD) on policies for rebuilding post covid-19 economies, one speaker noted that “once countries stabilise their fiscal recoveries amid the Corona virus crisis, they should seize the chance to build their economies through taxation policy”.

**Required:**

Evaluate six tax policy measures that developing countries should adopt for rebuilding Post-Covid 19 economies. (6 marks)

- (c) The following details were obtained from the records of Maendeleo Bank Ltd. for the year ended 31 December 2020:

1. The net loss for the year was Sh.22,160,000 after the following had been recorded:

|                                                             | Sh.          |
|-------------------------------------------------------------|--------------|
| Income from trading activities of a foreign bank subsidiary | 980,000      |
| Gain on sale of shares                                      | 294,000      |
| Fees and commission income                                  | 1,460,500    |
| Interest from government treasury bills                     | 936,400      |
| Interest on deposits with other banks                       | 1,740,600    |
| Interest on loans and advances to customers                 | 12,460,300   |
| Contributions to deposit protection fund                    | 428,000      |
| Interest on customer deposits                               | 8,484,000    |
| Rent and rates                                              | 864,000      |
| Directors emoluments                                        | 1,480,000    |
| Income from foreign exchange dealings                       | 1,243,600    |
| Depreciation                                                | 445,300      |
| Provision for interest expenses                             | 184,400      |
| Auditors fees                                               | 236,800      |
| Loss on disposal of collaterals                             | 1,560,000    |
| Installment tax                                             | 724,800      |
| Installation of a new online banking system                 | 1,820,000    |
| Staff costs                                                 | 1,680,000    |
| Operating lease rentals                                     | 268,200      |
| Capital redemption reserve                                  | 920,000      |
| 12% debenture stock                                         | 1,200,000    |
| Purchase of double cabin pickup - October 2020              | 2,400,000    |
| Profit and loss account                                     | 964,000 (Dr) |
| Rebate on bills discounted                                  | 296,000      |

2. Staff costs include:
- |                                     |         |
|-------------------------------------|---------|
|                                     | Sh.     |
| Provision for salary increase       | 220,000 |
| Cost of negotiating loans for staff | 140,000 |
| Senior staff club membership        | 360,000 |

3. The online banking system was installed in May 2020 and it included the cost of computer software of Sh.200,000 and new computers at a cost of Sh.620,000.

**Required:**

Statement of adjusted taxable income or loss for Maendeleo Bank Ltd. for the year ended 31 December 2020. (10 marks)

(Total: 20 marks)

### QUESTION TWO

- (a) A number of countries have enacted legislation on public financial management (PFM) which have their main objects as follows:

- Provide for the effective management of public finances by the national and county governments.
- Oversight responsibility of parliament and county assemblies.
- Provide for the different responsibilities of government entities and other bodies.

**Required:**

Discuss the key provisions of the PFM Act, 2012 or equivalent legislation in your country, with regard to regulation of grants administration. (6 marks)

- (b) Assume that you are a senior government officer managing public investments. The Cabinet Secretary in your Ministry is set to present a paper to a group of local and international investors on why the government should continue participating in public investments.

The Cabinet Secretary has approached you for input in preparation of the paper for presentation.

**Required:**

Explain four grounds that you would propose for inclusion in the paper, defending the government's participation in public investments. (8 marks)

- (c) Many developing countries have resorted to increased reliance on public debt in order to finance their expenditure. This strategy has however resulted in negative impacts on projected economic growth rates.

**Required:**

With reference to the above statement, describe the negative implications of increased public debt in financing of recurrent expenditure by a government. (6 marks)

**(Total: 20 marks)**

**QUESTION THREE**

- (a) Citing examples, differentiate between a "tax waiver" and a "tax amnesty." (2 marks)

- (b) Dera Suppliers Limited deals in both taxable and non-taxable supplies.

The following transactions were extracted from the company's records for the month of September 2020:

|                                     | Sh.       |
|-------------------------------------|-----------|
| Purchases from local market         | 912,000   |
| Sales to local market               | 1,710,000 |
| Imports (exclusive of customs duty) | 600,000   |
| Export sales - South Africa         | 700,000   |
| - Nigeria                           | 350,000   |
| Purchase of lubricants              | 456,000   |
| Restaurant services paid            | 63,840    |
| Tax consultancy fees                | 45,600    |
| Printing and stationery             | 17,100    |
| Electricity bills paid              | 31,920    |
| Exempt sales                        | 480,000   |
| Ambulance services                  | 20,000    |
| Postage services                    | 8,000     |
| Audit fees                          | 68,400    |

**Additional information:**

- Sales to the local market include goods supplied to Marine Fisheries and Fish Processors Ltd. for Sh.114,000.
- Goods purchased at standard rate could not be directly identified from exempt sales.
- The company received debit notes and credit notes of Sh.22,800 and Sh.36,480 respectively from suppliers.
- The customs duty for imported goods was at 20%.
- The company issued debit notes of Sh.74,100 in respect to sales at standard rate.
- Sales and purchases to and from the local market were inclusive of VAT at the rate of 14% plus other transactions where applicable.
- A debtor of goods valued at Sh.28,500 was declared bankrupt and a debt relief waiver granted.

**Note:** Assume transactions are quoted as inclusive of VAT at the rate of 14%, unless otherwise specified.

**Required:**

Indicating any non-deductible input-tax and exempt supplies, compute:

- |       |                                        |           |
|-------|----------------------------------------|-----------|
| (i)   | Total input tax.                       | (4 marks) |
| (ii)  | Total output tax.                      | (2 marks) |
| (iii) | Deductible input tax.                  | (4 marks) |
| (iv)  | Value added tax payable or refundable. | (2 marks) |

- (c) Ali Salama is a resident tax payer in Kenya. During the year of income 2020, he had Sh.4,380,000 from employment in Kenya. He had also received Sh.480,000 from the United Kingdom (UK), which has a double taxation relief treaty with Kenya. Tax deducted in UK was equivalent to Sh.80,000.

**Required:**

- |      |                                         |           |
|------|-----------------------------------------|-----------|
| (i)  | Double taxation relief in Kenya.        | (4 marks) |
| (ii) | Tax payable in Kenya by Mr. Ali Salama. | (2 marks) |

**(Total: 20 marks)**

**QUESTION FOUR**

- (a) Discuss the factors that may have inhibited the full integration of the customs union in your regional trading block. (6 marks)
- (b) Jamji Manufacturers Ltd. presented the following statement of profit and loss and other comprehensive income for the year ended 31 December 2020:

|                                       | Sh. "000" | Sh. "000"       |
|---------------------------------------|-----------|-----------------|
| Turnover                              |           | 384,900         |
| Cost of sales                         |           | (98,200)        |
| Gross profit                          |           | 286,700         |
| <b>Other incomes:</b>                 |           |                 |
| Gain on foreign exchange transactions |           | 42,600          |
| Capital gain on sale of motor vehicle |           | 14,200          |
| Refund of import duty                 |           | 8,400           |
| Investment income                     |           | <u>12,000</u>   |
|                                       |           | 363,900         |
| <b>Less expenses:</b>                 |           |                 |
| Purchase of copyright                 | 24,800    |                 |
| Design of company website             | 1,200     |                 |
| Directors fees                        | 4,600     |                 |
| Donations to charitable institutions  | 200       |                 |
| Depreciation expense                  | 1,640     |                 |
| Advertisement                         | 450       |                 |
| Professional fees                     | 448       |                 |
| General expenses                      | 3,640     |                 |
| Legal costs                           | 1,840     |                 |
| Loan repayment                        | 312       |                 |
| Provision for bad debts               | 142       |                 |
| Impairment loss of a building         | 280       |                 |
|                                       |           | <u>(39,552)</u> |
| Net profit                            |           | <u>324,348</u>  |

**Additional information:**

1. On 1 July 2020, the company acquired Jilo Ltd., a manufacturing company for Sh.56,000,000 and took over all assets and liabilities, which included;

|                          |                  |
|--------------------------|------------------|
| <b>Assets:</b>           | <b>Sh. "000"</b> |
| • Factory building       | 14,800           |
| • Furniture and fittings | 1,400            |
| • Processing machinery   | 8,600            |
| • Lorry (4 tonnes)       | 1,500            |
| • Computers and printers | 600              |
| • Delivery van           | 840              |

**Liabilities:**

|                  |       |
|------------------|-------|
| • 15% bank loan  | 6,000 |
| • Trade payables | 1,720 |
| • Bank overdraft | 1,480 |

Jilo Ltd. had operated for only 6 months and had not claimed any investment allowances before it was closed down by the Environmental Authority.

2. Turnover includes goods sold to the company's branch of Sh.72,000,000. It was established that at the end of the accounting period, 20% of these goods had not been sold by the branch.
3. Professional fees included: **Sh."000"**

|                                 |     |
|---------------------------------|-----|
| • Management fees               | 280 |
| • Tax consultancy fees          | 148 |
| • Audit fees                    | 252 |
| • Preparing of tender documents | 185 |
| • Environmental assessment fees | 360 |
4. General expenses included: **Sh."000"**

|                                   |       |
|-----------------------------------|-------|
| • Installation of Neon signs      | 420   |
| • Car grant to a director         | 1,800 |
| • Partition of an office block    | 560   |
| • Directors Christmas party       | 240   |
| • Branch closure costs            | 180   |
| • Repayment of hire purchase loan | 120   |
5. Legal costs comprised: **Sh."000"**

|                                                             |              |
|-------------------------------------------------------------|--------------|
| • Drafting sale agreement between the company and Jilo Ltd. | 458          |
| • Defending a company against breach of contract            | 386          |
| • Negotiating a bank loan                                   | 168          |
| • Preparing copyright documents                             | 172          |
| • Drafting lease agreements (50 years)                      | <u>656</u>   |
|                                                             | <u>1,840</u> |
6. Provision for bad debts include 15% of debts amounting to Sh.600,000 from a company which was declared irrecoverable.
7. The corporate tax rate during the year was 25%.

**Required:**

- (i) A statement of adjusted taxable profit or loss for the year ended 31 December 2020. (12 marks)
  - (ii) Tax liability and the instalments for the year 2020, assuming the actual profits were made. (2 marks)
- (Total: 20 marks)**

**QUESTION FIVE**

- (a) The Tax Authority in your country has appointed you as a tax auditor for digital services in Abacus Ltd.

Describe three specific operational aspects in Abacus Ltd. that would constitute evidence of existence of digital services in the company. (6 marks)

- (b) Safari Aviators Ltd. is an air transport company registered in the United Kingdom. On their scheduled flights to East Africa, the company's planes land in Nairobi to connect passengers to other destinations in Africa. Ticketing and other transactions are done through an airline agent in Nairobi, Kenya, who would sell tickets and meet other necessary obligations on behalf of Safari Aviators Ltd.

The agent sold Sh.12,690,000 worth of tickets on behalf of the company in year 2020. The following expenses were incurred in carrying out airline operations in Kenya.

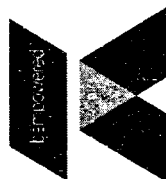
|                                    | Sh.         |
|------------------------------------|-------------|
| • Salaries for security officers   | 1,480,000   |
| • Furniture for Agency offices     | 240,000     |
| • Trade subscriptions              | 96,000      |
| • Computers                        | 180,000     |
| • Purchase of Aircraft (UK) cost   | 126,000,000 |
| • Jet fuel                         | 4,900,000   |
| • Covid-19 tests for staff members | 148,000     |
| • Upgrading Agency website         | 60,000      |
| • Airline Authority clearance fees | 360,000     |
| • Purchase of saloon car           | 3,500,000   |

**Additional information:**

1. 15% of ticket sales are allowed annually by the Tax Authority in UK to cover for depreciation of other office equipment.
2. 2% of total ticket sales are allowed annually to cover head office expenses relating to the agency.
3. Operating expenses for the agency are allowed in full.
4. 5% of the investment allowance is allowable to the agent for tax purposes on investment in aircrafts.

**Required:**

- (i) A statement of adjusted taxable income or loss for the year ended 31 December 2020. (8 marks)
  - (ii) Comment on any further information you may seek from the airline agency to facilitate accuracy of tax liability. (2 marks)
- (c) Explain two ways through which proper tax planning may contribute to economic stability of a country. (4 marks)
- (Total: 20 marks)**
- .....



**kasneb**

**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<br>(Sh.) |          | Annual taxable pay<br>(Sh.) |           | Rate of tax<br>% 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 | Annual rates |         |
|--------------------------------------------|-------|-----------------------------------------|--|---------------|--------------|---------|
|                                            |       |                                         |  | (Sh.)         | (Sh.)        |         |
| <b>Capital allowance:</b>                  |       | (i) Saloons, Hatch Backs and Estates    |  |               |              |         |
| <b>Wear and tear allowance:</b>            |       | Up to                                   |  | 1200 cc       | 3,600        | 43,200  |
| Class I                                    | 37.5% | 1201                                    |  | 1500 cc       | 4,200        | 50,400  |
| Class II                                   | 30%   | 1501                                    |  | 1750 cc       | 5,800        | 69,600  |
| Class III                                  | 25%   | 1751                                    |  | 2000 cc       | 7,200        | 86,400  |
| Class IV                                   | 12.5% | 2001                                    |  | 3000 cc       | 8,600        | 103,200 |
| Software                                   | 20%   | Over                                    |  | 3000 cc       | 14,400       | 172,800 |
| <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%  | (ii) Pick-ups, Panel Vans (unconverted) |  |               |              |         |
| <b>Investment deduction allowance</b>      | 100%  | Up to                                   |  | 1750 cc       | 3,600        | 43,200  |
|                                            |       | Over                                    |  | 1750 cc       | 4,200        | 50,400  |
| <b>Shipping investment deduction</b>       | 100%  | (iii) Land Rovers/Cruisers              |  |               | 7,200        | 86,400  |
| (Ships over 125 tonnes)                    |       |                                         |  |               |              |         |

**Extraction expenditure:**

Written off over 5 years (20%)

**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                |

### 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<br>Sh."000" | Office complex<br>Sh."000" |
|-----------------------------------------------------------|------------------------------|----------------------------|
| <b>Balance as at 1 January 2018:</b>                      |                              |                            |
| 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                    |
| <b>Transactions undertaken during the year:</b>           |                              |                            |
| 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                     |
| <b>Balance carried forward:</b>                           |                              |                            |
| 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<br>Sh."000" | Office<br>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)**

.....



## CPA PART III SECTION 6

### ADVANCED PUBLIC FINANCE AND TAXATION

THURSDAY: 23 May 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<br>(Sh.) | Annual taxable pay<br>(Sh.) | Rate of tax<br>% 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<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%                    |                       |
| (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               |

**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**

**Investment deduction allowance**

**Shipping investment deduction**

(Ships over 125 tonnes)

**Extraction expenditure:**

Written off over 5 years (20%)

**Commissioner's prescribed benefit rates**

| Services                                         | Monthly rates<br>Sh. | Annual rates<br>Sh. |
|--------------------------------------------------|----------------------|---------------------|
| (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) Many governments' particularly in developing countries have implemented various taxation policies to achieve fiscal and other objectives. Unfortunately, in some of these countries, the noble objectives of the taxation policies appear not to have been realised.

**Required:**

Evaluate four reasons which, in your assessment, have contributed to the failure of taxation policies to achieve their intended objectives. (8 marks)

- (b) With regard to the government's responsibilities in public finance management:

(i) Discuss three roles of the Cabinet Secretary for the National Treasury and Planning or equivalent office in your country, with regard to public debt management. (6 marks)

(ii) Summarise three responsibilities of the State Corporations Advisory Committee (SCAC) or equivalent body in your country. (3 marks)

- (c) Describe three ways in which monies paid into the Public Private Partnership Project Facilitation Fund may be applied. (3 marks)

**(Total: 20 marks)**

### QUESTION TWO

- (a) Various legislations provide for penalties on taxpayers who engage in tax avoidance schemes.

In light of the above statement, outline four categories of tax avoidance schemes that a taxpayer might be investigated for in your country. (4 marks)

- (b) Dawida Ltd. is a real estate developer. During the year ended 31 December 2018, the company earned the following incomes from rented properties:

|                                         | Sh.        |
|-----------------------------------------|------------|
| Rental income                           | 19,400,000 |
| Sale of timber used during construction | 288,600    |
| Sale of unused paint                    | 92,400     |

The rented property is a commercial building constructed at a cost of Sh.48,460,000 and was occupied on 1 January 2018 upon completion on 31 December 2017.

The cost of construction of the commercial building comprised the following:

|                 | Sh.        |
|-----------------|------------|
| Shops (cost)    | 16,800,000 |
| Offices         | 17,240,000 |
| Showroom        | 9,460,000  |
| Sewerage system | 1,640,000  |

The following additional costs and expenses were incurred by the company:

1. A standby generator at a cost of Sh.600,000 and a powerhouse at a cost of Sh.280,000 were acquired.
2. CCTV surveillance cameras were installed at a cost of Sh.720,000.
3. A stone perimeter wall was constructed at a cost of Sh.1,480,000.
4. Electricity expenses incurred during the year amounted to Sh.492,800 while insurance expenses amounted to Sh.360,000.
5. Water tanks costed Sh.540,000 excluding the cost of water pumps of Sh. 248,000.
6. Land Cruiser motor vehicle of 3500cc whose cost was Sh. 2,800,000 was purchased and used for security surveillance purposes.
7. A parking bay for shoppers was constructed at a cost of Sh.4,670,000.
8. Other expenditure comprised purchase of fire extinguishers at Sh.182,000, county rates amounting to Sh.94,800, real estate agents commission amounting to Sh.138,400 and parking metres amounting to Sh.280,000.

**Required:**

- (i) Statement of taxable rental income for the year ended 31 December 2018. (10 marks)

- (ii) Tax liability, if any, for Dawida Ltd. for the year ended 31 December 2018. (2 marks)

- (iii) Highlight any additional information to be sought from the company to help determine the accuracy of the tax computed. (4 marks)

**(Total: 20 marks)**

### QUESTION THREE

- (a) (i) Explain four factors to be considered when selecting the most appropriate transfer pricing method. (4 marks)
- (iv) A Ltd. sold a processing machine to B Ltd., an associate company. B Ltd. sold the same machine to C Ltd., an independent party, for Sh.400,000 at a profit margin of 30%. B Ltd's incidental costs before selling to C Ltd. were Sh.4,000.

Using the resale price method, calculate the arms length price/transfer price of the machine. (4 marks)

- (b) Peter Samoei is an employee of Zawadi Ltd. and earns a salary of Sh.140,000 per month, while his wife Sabina Wanga works in Lindi Ltd., a firm in which Mr Samoei controls 18% of the share capital. Her salary is Sh.60,000 per month. Sabina Wanga owns the house which is occupied by the family, for which the market rental value is Sh.45,000 per month. The house was constructed in year 2017 at a cost of Sh.6,000,000 borrowed from a Sacco at an interest rate of 12% per annum. Sabina Wanga has insured the house and paid insurance premiums of Sh.4,800 per month and city county rates of Sh.6,900 per annum.

Mr Samoei paid insurance premiums for his family of Sh.4,600 with an insurance company incorporated in Uganda, but operating in Kenya. Zawadi Ltd. paid school fees of Sh.80,000 for the couple's children which was expensed in the firm's income statement.

#### Required:

Suggest four tax planning schemes that could minimise the tax liability of the family. (8 marks)

- (c) Explain four benefits that might accrue from the effective use of information communication technology (ICT) in tax administration. (4 marks)

(Total: 20 marks)

### QUESTION FOUR

- (a) It is important for shareholders to understand the taxation impact of transactions involving mergers or transfers of assets before approving such transactions.

With reference to the above statement, evaluate three tax implications of transactions involving mergers or transfers of assets for consideration to another company. (6 marks)

- (b) Solomon Omariba started a merchandise business, Solo Traders, on 1 January 2016. He had not filed individual income tax returns for the years of income 2016 and 2017. The revenue authority announced a tax amnesty, where one qualified provided they filed returns for the year of income 2018.

Mr Omariba has provided the following details to you to assist in filing his returns:

1. An analysis of the cash book for the year ended 31 December 2018 is as shown below:

#### Cash book – Bank Column

|                                     | Sh.              |                                     | Sh.              |
|-------------------------------------|------------------|-------------------------------------|------------------|
| 1 January 2018 balance brought down | 970,000          | Fixtures and fittings (acquisition) | 183,000          |
| Cash sales                          | 4,408,000        | Suppliers of goods                  | 696,000          |
| Cheques from customers              | 649,600          | Bank charges                        | 14,800           |
| Refunds from suppliers              | 41,760           | Motor vehicle (acquisition)         | 500,000          |
| Rent income                         | 520,000          | Salaries and wages                  | 480,000          |
| Sale of fixtures                    | 248,000          | Office computers (acquisition)      | 240,000          |
|                                     |                  | Rent and rates                      | 62,000           |
|                                     |                  | Electricity expenses                | 58,000           |
|                                     |                  | Telephone and postage               | 62,640           |
|                                     |                  | Refunds to customers                | 37,120           |
|                                     |                  | Computer software                   | 60,000           |
|                                     |                  | Balance carried down                | 4,443,800        |
|                                     | <u>6,837,360</u> |                                     | <u>6,837,360</u> |

2. Other information obtained from the books of account included:

|                            | 1 January 2018 | 31 December 2018 |
|----------------------------|----------------|------------------|
| Inventory                  | 4,320,000      | 225,000          |
| Suppliers of goods         | 278,400        | 139,200          |
| Trade debtors              | 174,000        | 487,200          |
| Accrued electricity        | 66,120         | 113,680          |
| Prepaid rent income        | 180,000        | 240,000          |
| Motor vehicles             | 1,400,000      | 1,800,000        |
| Prepaid salaries and wages | 320,000        | 140,000          |
| Fixtures and fittings      | 450,000        | 170,000          |

3. Non-current assets are stated at cost. However, the business had charged depreciation in the income statement.
4. Opening and closing inventories were overvalued and undervalued by 20% and 10% respectively.
5. All operating expenses and non-current assets comprise 40% non-business activities.
6. Total sales and purchases are inclusive of value added tax at the rate of 16%.
7. The business had issued credit notes of Sh.34,800 for goods returned by credit customers.
8. The cost of fixtures disposed of was Sh.220,000.
9. From the accounting records, the accountant had reported a net loss of Sh.186,400.

**Required:**

A statement showing the corrected adjusted taxable income of Solo Traders for the year of income 2018. (14 marks)  
(Total: 20 marks)

**QUESTION FIVE**

- (a) Discuss four benefits that could accrue to parties involved in a tax dispute through the use of Alternative Dispute Resolution (ADR) in your country. (8 marks)
- (b) The following are the year 2018 records of the Trustees of the late Kalume Tajiri Children Settlement created in favour of his three children; Baraka, Khalifi and Mwanga.

|                     | Sh."000" |
|---------------------|----------|
| Gross rental income | 800,000  |
| Trading income      | 310,000  |
| Dividends (gross)   | 160,000  |
| Sundry income       | 90,000   |

**Additional information:**

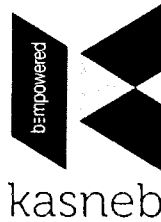
- Each beneficiary is entitled to 1/5 share of the net distributable income.
- Interest on debt repayment by the settlement is Sh.14,000,000.
- Fixed annuity to beneficiary is Sh.120,000,000 (gross).
- Trustees remuneration per "Trust Deed":
  - Fixed salary Sh.80,000,000 each.
  - 2% of total computed income.
- Under the terms of the Trust Deed, the trustees made the following discretionary payments to Baraka, Khalifi and Mwanga; Sh.120,000,000, Sh.100,000,000 and Sh.60,000,000 respectively.
- Trading income was before taking into account capital expenditure as follows:
 

|                 | Sh.              |
|-----------------|------------------|
| Godown          | 3,500,000        |
| Staff canteen   | 750,000          |
| Parking bay     | 800,000          |
| Sports pavilion | <u>1,950,000</u> |
|                 | <u>7,000,000</u> |
- Administrative and other expenses amounted to Sh.160,000,000.
- The children did not have other income.

**Required:**

- (i) A statement of income tax payable by the trustees on the trust income for the year of assessment 2018. (8 marks)
- (ii) The amount due to each beneficiary for the year of assessment 2018. (4 marks)  
(Total: 20 marks)

.....



## CPA PART III SECTION 6

### ADVANCED PUBLIC FINANCE AND TAXATION

THURSDAY: 29 November 2018.

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 2017.

| Monthly taxable pay<br>(Sh.) | Annual taxable pay<br>(Sh.) | Rate of tax<br>% in each Sh. |
|------------------------------|-----------------------------|------------------------------|
| 1 - 11,180                   | 1 - 134,164                 | 10%                          |
| 11,181 - 21,715              | 134,165 - 260,567           | 15%                          |
| 21,716 - 32,249              | 260,568 - 386,970           | 20%                          |
| 32,250 - 42,782              | 386,971 - 513,373           | 25%                          |
| Excess over - 42,782         | Excess over - 513,373       | 30%                          |

Personal relief Sh.1,280 per month (Sh.15,360 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%                   | (i) Saloons, Hatch Backs and Estates<br>Up to 1200 cc 3,600 | 43,200                |
| Class II 30%                    | 1201 - 1500 cc 4,200                                        | 50,400                |
| Class III 25%                   | 1501 - 1750 cc 5,800                                        | 69,600                |
| Class IV 12.5%                  | 1751 - 2000 cc 7,200                                        | 86,400                |
| Software 20%                    | 2001 - 3000 cc 8,600                                        | 103,200               |
|                                 | Over 3000 cc 14,400                                         | 172,800               |

**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%

**Investment deduction allowance**

100%

**Shipping investment deduction  
(Ships over 125 tonnes)**

100%

**Extraction expenditure:**

Written off over 5 years (20%)

**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              |

### QUESTION ONE

- (a) Country Y has a fast growing economy. Various government ministries and state corporations in the country are currently engaged in a number of capital projects. The country recently developed an electronic project monitoring information system (e-ProMIS) to capture information on projects implemented by the ministries, state corporations and counties. As a result, all government organisations were required to upload their projects in the system and update them regularly.

**Required:**

Discuss four specific objectives that Country Y might realise from the e-ProMIS. (8 marks)

- (b) Over the last few years, Country Z's rising public debt has been a point of discussion in most macroeconomic outlook discussions, with organisations such as the World Bank and global rating agencies raising concerns.

**Required:**

Discuss three measures that the government of Country Z could take to reverse the above trend. (6 marks)

- (c) Explain three objectives of tax modernisation programmes which have been recently undertaken in a number of developing economies. (6 marks)

**(Total: 20 marks)**

### QUESTION TWO

- (a) Maendeleo Ltd. is a manufacturing company operating through a number of branches. 75% of the share capital of Maendeleo Ltd. is held by a foreign company, Export Line Ltd. The following information relates to Maendeleo Ltd.'s operations for the year ended 31 December 2017:

|                                             | Sh."000"     | Sh."000"         |
|---------------------------------------------|--------------|------------------|
| Turnover                                    |              | 1,948,000        |
| Cost of goods sold                          |              | <u>(562,000)</u> |
| Gross profit                                |              | 1,386,000        |
| Foreign exchange gain                       |              | 14,840           |
| Goods transferred to a branch               |              | 3,000            |
| Insurance recovery for stolen motor vehicle |              | 968              |
| Proceeds from sale of factory extension     |              | <u>4,690</u>     |
|                                             |              | 1,409,498        |
| Less expenses:                              |              |                  |
| Directors emoluments and staff costs        | 16,890       |                  |
| Pension contribution for staff              | 4,200        |                  |
| Staff recruitment costs                     | 1,148        |                  |
| Purchase of furniture                       | 420          |                  |
| Penalties on overdue VAT                    | 164          |                  |
| Impairment loss of factory extension        | 150          |                  |
| Mortgage interest                           | 364          |                  |
| Goodwill written off                        | 162          |                  |
| Loan interest                               | 1,286        |                  |
| Depreciation                                | 1,480        |                  |
| General office expenses                     | <u>1,348</u> | <u>(27,612)</u>  |
| Net profit                                  |              | <u>1,381,886</u> |

**Additional information:**

- The cost of construction of the factory extension that was disposed of during the year was Sh.2,800,000. The factory extension was repainted at a cost of Sh.75,000 while the revaluation fee for disposal purposes was Sh.146,800. Impairment loss was due to increased insecurity in the area.
- The branch sold 80% of the goods transferred from the head office, and 10% of these goods were sold to a customer who was later declared bankrupt.
- Loan interest related to a loan advanced by Export Line Ltd.
- Directors emoluments include management fees of Sh.4,840,000 paid to Export Line Ltd.
- The capital expenditure records obtained from the company's books showed the following as at 1 January 2017:

|                                   | Sh."000" |
|-----------------------------------|----------|
| Factory building                  | 24,800   |
| Perimeter wall around the factory | 6,820    |
| Sewerage system                   | 2,400    |

|                         | Sh. "000" |
|-------------------------|-----------|
| Staff quarters          | 7,600     |
| Processing machinery    | 3,700     |
| Delivery van            | 1,750     |
| Forklift                | 980       |
| Parking and loading bay | 2,500     |
| Furniture               | 680       |

The capital expenditure was incurred on 1 January 2016 when the company commenced operations in Kenya. The cost of the factory building includes a godown Sh.800,000, retail shop Sh.400,000, show room Sh.800,000 and staff canteen Sh.1,900,000.

The capital allowances for year 2016 were claimed as appropriate.

6. Cost of goods sold includes purchases of Sh.174,000,000 inclusive of value added tax at the rate of 16%. •

**Required:**

- (i) A statement of adjusted taxable profit or loss for the year ended 31 December 2017. (12 marks)
  - (ii) Tax liability for the year. (2 marks)
  - (iii) Compute any other tax payable by the company. (2 marks)
- (b) Highlight four reasons why capital allowances as tax incentives might not have achieved their intended objective to the government in your country. (4 marks)

**(Total: 20 marks)**

**QUESTION THREE**

- (a) Tasia Ltd. is a merchandising company operating in Kenya. The following details of transactions were extracted from the company's records during the month of September 2017:

|                                               | Sh. "000" |
|-----------------------------------------------|-----------|
| Sales at standard rate                        | 6,960,000 |
| Exports to Egypt                              | 1,200,000 |
| Purchases at standard rate                    | 4,060,000 |
| Purchase of delivery van oils and fuels       | 371,200   |
| Repairs of office furniture                   | 23,200    |
| Audit fees                                    | 60,320    |
| Wages                                         | 480,000   |
| Purchase of stationery                        | 55,680    |
| Electricity bills not settled                 | 46,400    |
| Exempt supplies/sales                         | 1,500,000 |
| Legal fees                                    | 40,600    |
| Purchases from traders not registered for VAT | 134,000   |
| Sales at zero rate                            | 400,000   |

**Additional information:**

1. The value added tax accountant established that 20% of the standard rate purchases were sold as standard rate sales.
2. Sales at standard rate included goods valued at Sh.139,200 sold to a credit customer who was declared bankrupt during the month.
3. A customer returned goods sold at standard rate valued at Sh.29,000 to the company, and a credit note was issued immediately.
4. Credit suppliers issued debit notes in respect to supplies at standard rate amounting to Sh.580,000.
5. The accountant established that an invoice of Sh.180,000 from a foreign supplier was not recorded in the books. The import duty for these goods was at a rate of 20%.

Transactions are inclusive of VAT at a rate of 16% where applicable.

**Required:**

- (i) Deductible input tax. (6 marks)
- (ii) Output tax. (4 marks)
- (iii) Value added tax payable (if any). (2 marks)
- (iv) Assuming that you are a VAT auditor, outline additional information that you might seek from the company to help you ascertain the accuracy of the VAT declared. (2 marks)

**CA61 Page 3**  
**Out of 4**

- (b) Safari Ltd. imported goods from China with an assessable value of Sh.500,000. Customs duty imposed included basic customs duty at 20% and an additional duty for this category of goods at 15%. Other levies included railway levy at 2%, secondary education cess of 2% and higher education cess at 1% of duty paid.

**Required:**

- (i) Total value of goods imported. (3 marks)
- (ii) Total duty payable. (3 marks)
- (Total: 20 marks)**

**QUESTION FOUR**

- (a) Mafuta Petroleum Company Ltd. has provided the following details for the year ended 31 December 2017:

|                                      | Sh. "000" |
|--------------------------------------|-----------|
| Sale of crude oil - export           | 834,900   |
| Sale of natural gas                  | 43,375    |
| Other incidental income              | 4,537.5   |
| Production expenses                  | 217,800   |
| Administration costs                 | 290,400   |
| Intangible drilling costs            | 45,375    |
| Non-productive rentals               | 18,150    |
| Royalties on export                  | 4,537.5   |
| Royalties on local sales             | 1,815     |
| Provision for restoration of wells   | 136,125   |
| Custom duties on plant and machinery | 27,225    |

The following additional information is provided:

- Memorandum of Understanding (MOU) credit Sh.18,150,000.
- Petroleum investment allowance has been agreed at Sh.13,612,500.
- Depreciation included in production expenses amounted to Sh.36,300,000.
- Capital allowances agreed with the Revenue Authority amounted to Sh.54,450,000.

**Required:**

- (i) A statement of taxable profit or loss for the year ended 31 December 2017. (8 marks)
- (ii) Tax liability. (2 marks)
- (iii) Explain the significance of "Memorandum of Understanding (MOU)" in the petroleum industry. (2 marks)
- (b) Fanikisha Ltd. intends to acquire Matatizo Ltd. The nature of the acquisition is such that Matatizo Ltd. will cease to operate with all its assets and liabilities taken over by Fanikisha Ltd.

You are a tax senior with Uwezo Consultants. The management of Fanikisha Ltd. have approached you to undertake a tax due diligence on Matatizo Ltd. prior to the acquisition.

**Required:**

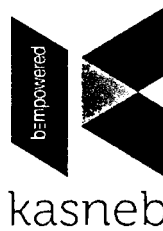
- Discuss four areas you would focus on in your due diligence. (8 marks)
- (Total: 20 marks)**

**QUESTION FIVE**

- (a) One of the steps in a tax audit process is the preliminary review of a taxpayer's file.
- (i) Outline three reasons for the preliminary review of a taxpayer's file. (3 marks)
- (ii) Summarise three other activities that should be undertaken before the commencement of the tax audit. (3 marks)
- (b) Certain countries have attracted high net worth individuals due to their status as tax havens.
- (i) Explain the term "tax haven". (2 marks)
- (ii) Summarise four characteristics of a tax haven. (4 marks)
- (c) In certain circumstances, a contracting authority may consider a privately initiated investment proposal for a project without subjecting the proposal to a competitive procurement process.

- Describe four such circumstances. (8 marks)
- (Total: 20 marks)**

.....



## CPA PART III SECTION 6

### ADVANCED PUBLIC FINANCE AND TAXATION

THURSDAY: 24 May 2018.

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 2017.

| Monthly taxable pay<br>(Sh.) | Annual taxable pay<br>(Sh.) | Rate of tax<br>% in each Sh. |
|------------------------------|-----------------------------|------------------------------|
| 1 - 11,180                   | 1 - 134,164                 | 10%                          |
| 11,181 - 21,715              | 134,165 - 260,567           | 15%                          |
| 21,716 - 32,249              | 260,568 - 386,970           | 20%                          |
| 32,250 - 42,782              | 386,971 - 513,373           | 25%                          |
| Excess over - 42,782         | Excess over - 513,373       | 30%                          |

Personal relief Sh.1,280 per month (Sh.15,360 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%                   | (i) Saloons, Hatch Backs and Estates |                       |
| Class II 30%                    | Up to 1200 cc 3,600                  | 43,200                |
| Class III 25%                   | 1201 1500 cc 4,200                   | 50,400                |
| Class IV 12.5%                  | 1501 1750 cc 5,800                   | 69,600                |
| Software 20%                    | 1751 2000 cc 7,200                   | 86,400                |
|                                 | 2001 3000 cc 8,600                   | 103,200               |
|                                 | Over 3000 cc 14,400                  | 172,800               |

**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%

**Investment deduction allowance** 100%

**Shipping investment deduction** 100%  
(Ships over 125 tonnes)

**Extraction expenditure:**

Written off over 5 years (20%)

**Commissioner's prescribed benefit rates**

| Services                                         | Monthly rates<br>Sh. | Annual rates<br>Sh. |
|--------------------------------------------------|----------------------|---------------------|
| (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) The following was an extract of a speech delivered by a County Governor during a recent National Devolution Conference in your country.

“Today, a number of counties are heavily indebted with loans most of which were inherited from the defunct local authorities. This state of affairs threatens the long term financial sustainability of such counties”.

**Required:**

Discuss three strategies that county governments could put in place to manage long outstanding debts. (6 marks)

- (b) The Project Facilitation Fund (PFF) was established under the Public Private Partnership (PPP) framework to meet certain objectives.

**Required:**

(i) Describe the broad objective of establishing the Project Facilitation Fund (PFF). (2 marks)

(ii) Summarise four areas in which the PFF could be applied. (4 marks)

- (c) The Public Investments Committee (PIC) of the National Assembly undertakes an oversight role over public projects.

**Required:**

Identify two projects or activities in which the PIC is specifically excluded from overseeing. (2 marks)

- (d) Summarise six ethical principles that are specifically applicable to a tax practitioner acting on behalf of a client.

(Note: You are not required to discuss the general principles of ethics). (6 marks)

**(Total: 20 marks)**

### QUESTION TWO

- (a) Mafuta International Ltd., a petroleum exploration company provided the following financial information for the year ended 31 December 2017:

|                                                       |                   |
|-------------------------------------------------------|-------------------|
| Crude oil exported                                    | 1,400,000 barrels |
| Crude oil sold locally for further refining           | 750,000 barrels   |
| Exploration costs                                     | Sh.16,000,000     |
| Incidental income from petroleum operations           | Sh.1,250,000      |
| Management and administration expenses                | Sh.14,000,000     |
| Depreciation                                          | Sh.750,000        |
| Provision for bad debts (specific debts Sh.1,250,000) | Sh.2,450,000      |
| Non-productive rent                                   | Sh.1,156,000      |

The schedule of qualifying capital expenditure was provided as follows:

| Capital expenditure item  | Date of acquisition | Location | Amount<br>Sh. |
|---------------------------|---------------------|----------|---------------|
| Plant and machinery       | July 2015           | Offshore | 6,000,000     |
| Fixtures and fittings     | July 2015           | Onshore  | 2,000,000     |
| Building                  | February 2016       | Onshore  | 4,000,000     |
| Pipeline and storage tank | February 2017       | Offshore | 4,000,000     |

**Additional information:**

- The international market price of crude oil during the year was US\$12 per barrel. The average exchange rate of the US\$ to the shilling (Sh.) was \$1 = Sh.105.
- The crude oil sold locally was disposed of at Sh.35 per barrel.

**Required:**

Tax liability (or refund) for Mafuta International Ltd. for the year ended 31 December 2017. (12 marks)

- (b) One of the tax incentives provided to oil and gas exploration companies is the capital allowance on extraction expenditure.

Discuss four other tax incentives provided to oil and gas exploration companies in your country. (8 marks)

**(Total: 20 marks)**

### QUESTION THREE

- (a) Jua and Kali have been trading as partners under a trade name Juakali Enterprises since 1 January 2016. They have not filed individual income tax returns for the year ended 31 December 2017. The Commissioner of Domestic Taxes has issued an estimated assessment of Sh.784,000 to each of the partners for the year ended 31 December 2017. They share profits and losses in the ratio of 2:3 to Jua and Kali respectively. They are preparing to appeal against the assessment and have approached you for tax advice with the following details:

| Cash book summary                        |                  |                           |                  |
|------------------------------------------|------------------|---------------------------|------------------|
| Dr.                                      | Sh.              | Cr.                       | Sh.              |
| Balance brought forward (1 January 2017) | 760,000          | Payments to creditors     | 880,000          |
| Capital: Jua                             | 600,000          | Purchase of furniture     | 200,000          |
| Kali                                     | 900,000          | Motor vehicle expenses    | 140,000          |
| Receipts from debtors                    | 1,700,000        | Electricity expenses      | 78,000           |
| Cash sales                               | 1,000,000        | Rent expenses             | 394,000          |
| Rent income                              | 580,000          | Purchase of motor vehicle | 600,000          |
| Sale of furniture                        | 170,000          | Salaries and wages        | 480,000          |
|                                          |                  | Office partitions         | 180,000          |
|                                          |                  | General expenses          | 440,000          |
|                                          |                  | Balance carried forward   | <u>2,318,000</u> |
|                                          | <u>5,710,000</u> |                           | <u>5,710,000</u> |

#### Additional information:

- The cost of furniture sold was Sh.160,000 and had accumulated depreciation of Sh.14,000 as at 1 January 2017. Profit on disposal was credited to the income statement for the year ended 31 December 2017.
- All the cash sales were paid into the bank with the exception of Sh.440,000 which was debited in the income statement as general expenses, but related to the following items: partners' children school fees, Sh.80,000, purchase of goods Sh.200,000, tax appeal expenses Sh.40,000, insurance policy for partners' life Sh.70,000 and computer software Sh.50,000.
- Other information provided was as follows:

|                              | 31 December 2016 | 31 December 2017 |
|------------------------------|------------------|------------------|
|                              | Sh.              | Sh.              |
| Inventories                  | 248,000          | 362,000          |
| Creditors for goods          | 400,000          | 280,000          |
| Debtors for goods            | 240,000          | 360,000          |
| Electricity expenses prepaid | 472,000          | 30,000           |
| Rent owing                   | 78,000           | 44,000           |
| Salaries and wages owing     | 20,000           | 60,000           |
| Furniture                    | 160,000          | 200,000          |

- The business reported a net loss of Sh.424,500 for the year after deducting the following expenses:
  - Salaries and wages for the year ended 31 December 2017 which included partners' salaries for Jua Sh.100,000 and Kali Sh.80,000.
  - Rent expense for the year included 20% for private residence for Jua while electricity included 30% electricity bills paid on behalf of Kali's private house.
  - Capital allowances in respect of the business had not been considered. However, depreciation had been debited in the income statement. The depreciation was at the rate of 20%.
- Sales and purchases for the year were understated and overstated respectively by 20%.
- The partners are entitled to interest on capital at the rate of 10% per annum on their capital contributions. The interest on capital was included in the figure for purchases for the year.

#### Required:

- With supporting computations, advise the partners on the accuracy of the estimated assessment issued for the year of income 2017. (9 marks)
- Prepare a schedule of total taxable income for each partner for the year of income 2017. (5 marks)

Hint: Start with the adjusted net loss.

- (b) Transfer pricing remains a major threat in bridging the tax revenue gap in your country.

In light of the above statement, evaluate three factors to be considered in the selection of an appropriate transfer pricing method. (6 marks)

(Total: 20 marks)

#### QUESTION FOUR

- (a) Jakes Air Safaris Ltd. is a foreign company operating a fleet of passenger and cargo aircrafts in Kenya, Middle East and Far East. The operating results for the year ended 30 September 2017 are as follows:

|                                                           | Sh. "000" |
|-----------------------------------------------------------|-----------|
| Income from cargo freight (Kenya/China)                   | 1,567,720 |
| Income from passengers and freight (Kenya/Middle East)    | 1,765,000 |
| Income from passengers and freight (South Korea to Kenya) | 1,001,880 |
| Income from cargo loaded into aircraft on all routes      | 630,000   |
| Salaries and other expenses                               | 1,548,000 |
| Accumulated depreciation on aircraft                      | 88,000    |
| General provision for bad debts                           | 72,000    |

**Additional information:**

|                                                                                                                   | Sh. "000" |
|-------------------------------------------------------------------------------------------------------------------|-----------|
| 1. Salaries and other expenses include:                                                                           |           |
| Purchase of plane engines                                                                                         | 117,000   |
| Use of airport facilities                                                                                         | 32,400    |
| Hotel bills for first class passengers                                                                            | 37,800    |
| Accommodation for airline crew                                                                                    | 9,000     |
| Gifts to airport staff                                                                                            | 10,800    |
| 2. The airline has a fleet of four aircrafts whose total cost before accumulated depreciation was Sh.360,000,000. |           |

**Required:**

- (i) A statement of total taxable profit of Jakes Air Safaris Ltd. for the year ended 30 September 2017. (8 marks)
- (ii) Tax liability, if any, for the airline for the year ended 30 September 2017. (2 marks)
- (b) The revenue authority in your country recently established a Medium Taxpayers Office (MTO) as part of the tax reforms.

**Required:**

Discuss five objectives of the MTO.

(10 marks)

**(Total: 20 marks)**

#### QUESTION FIVE

- (a) The following is the income statement of Savanna Ltd., a manufacturing company for the year ended 31 December 2017:

|                                         | Sh.            | Sh.              |
|-----------------------------------------|----------------|------------------|
| Gross profit                            |                | 11,520,000       |
| Foreign exchange gain                   |                | 148,000          |
| Dividends from Hazina Cooperative (net) |                | 68,000           |
| Dividends from subsidiary company       |                | <u>244,000</u>   |
|                                         |                | 11,980,000       |
| <b>Less expenses</b>                    |                |                  |
| Directors emoluments                    | 6,480,000      |                  |
| Provision for depreciation              | 250,000        |                  |
| Office furniture                        | 360,000        |                  |
| Computer software                       | 90,000         |                  |
| Donations                               | 25,500         |                  |
| Legal expenses                          | 648,000        |                  |
| Dividends paid                          | 120,000        |                  |
| Corporation tax                         | 375,000        |                  |
| Salaries and wages                      | <u>674,000</u> | <u>9,022,500</u> |
| Net profit                              |                | <u>2,957,500</u> |

**Additional information:**

- The company operates in a factory building whose construction cost at the time of first operation on 1 January 2003 was Sh.4,800,000. The cost of this building is included in the directors emoluments. The company installed processing machinery costing Sh.2,800,000 in year 2003.
- On 1 July 2017, the company acquired portable packaging machine at a cost of Sh.420,000, computers Sh.240,000 and weighing scale machine Sh.48,000.
- On 1 October 2017, the company put into use a staff canteen constructed at a cost of Sh.780,000 and a godown whose cost was Sh.600,000.

4. Legal expenses include:
- Costs for disposal of banned packaging material Sh.27,000.
  - Negotiating a loan agreement Sh.36,000.
  - Processing legal documents for a new factory plant Sh.19,800.
  - Defending a company against a law suit for smuggled goods by a director Sh.94,000.
  - Preparing patent documents for registration Sh.52,800.
5. Gross profit was overstated by 20% and includes a figure for purchases of Sh.340,000 which had been understated by 15%.
6. Directors allowance include management fees of Sh.495,000 from a director of one of the subsidiary companies.
7. Interest on a loan of Sh.96,000 from head office was included in the directors emoluments. The interest was to be treated as received from a thinly capitalised company.

**Required:**

- (i) A statement of adjusted taxable profit or loss for the year ended 31 December 2017. (12 marks)
- (ii) Tax liability, if any, for the year ended 31 December 2017. (2 marks)
- (iii) Comment on payment of tax for the year ended 31 December 2017, assuming that tax had been paid during the year 2017 based on previous year's tax of Sh.2,400,000. (2 marks)

Note: Use capital allowance rates applicable in the year of asset acquisition.

- (b) Discuss two roles of the Directorate of Portfolio Management under the National Treasury or equivalent ministry in your country. (4 marks)

**(Total: 20 marks)**

.....



## 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<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/Film producers buildings 100%                            |                        |                       |
| From 1 January 2010 - Commercial building: (Shop, office or show room) 25% |                        |                       |
| <b>Farm works allowance 100%</b>                                           |                        |                       |
| <b>Investment deduction allowance 100%</b>                                 |                        |                       |
| <b>Shipping investment deduction (Ships over 125 tonnes) 100%</b>          |                        |                       |
| <b>Extraction expenditure:</b>                                             |                        |                       |
| Written off over 5 years (20%)                                             |                        |                       |
| <b>Commissioner's prescribed benefit rates</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                |

|                                         |        |         |
|-----------------------------------------|--------|---------|
| (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  |

### 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              |              | <u>(36,200)</u> |
| 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                   | <u>1,394</u> | <u>(15,972)</u> |
| Net profit                           |              | <u>30,428</u>   |

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

|                            | 2016<br>Sh. “000” | 2015<br>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<br>Sh. "000" | 2015<br>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:**

- 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        |
- The credit purchases figure was overstated by 60%.
- 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.
- The figure for sales was understated by 20%.
- 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.
- There were no acquisitions or disposals of fixed assets during the year 2016.
- 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:**

- A statement of adjusted taxable profit or loss for the year ended 31 December 2016. (13 marks)
  - 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> |

- He constructed an extension to the premises in year 2015 at a cost of Sh.625,000.
- 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  |

- He withdrew goods worth Sh.5,000 per annum from the business for his personal use.
- 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.
- 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  |

- 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**

- 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:**

- The company replaced all doors in the residential house with metallic doors at a cost of Sh.96,000.
- 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             |              | (11,000)     |
| 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> | (11,163)     |
| Net profit                          |              | <u>7,521</u> |

**Additional information:**

- 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%.

- 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> |

- 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> |

- 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> |

- 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.
- 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:**

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

(Total: 20 marks)

# KASNEB

## CPA PART III SECTION 6

### ADVANCED PUBLIC FINANCE AND TAXATION

THURSDAY: 25 May 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<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%                   | (i) Saloons, Hatch Backs and Estates<br>Up to 1200 cc 3,600 | 43,200                |
| Class II 30%                    | 1201 - 1500 cc 4,200                                        | 50,400                |
| Class III 25%                   | 1501 - 1750 cc 5,800                                        | 69,600                |
| Class IV 12.5%                  | 1751 - 2000 cc 7,200                                        | 86,400                |
| Software 20%                    | 2001 - 3000 cc 8,600                                        | 103,200               |
|                                 | Over 3000 cc 14,400                                         | 172,800               |

#### 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%

**Investment deduction allowance** 100%

**Shipping investment deduction** 100%  
(Ships over 125 tonnes)

#### (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

#### Extraction expenditure:

Written off over 5 years (20%)

#### Commissioner's prescribed benefit rates

| Services                                         | Monthly rates<br>Sh. | Annual rates<br>Sh. |
|--------------------------------------------------|----------------------|---------------------|
| (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) A government's debt portfolio is usually the largest financial portfolio in a country. It often contains complex and risky financial structures and can generate substantial risk to the government's balance sheet.

**Required:**

In the context of the above statement:

- (i) Explain the term "public debt management". (2 marks)
- (ii) Discuss five guidelines for effective public debt management. (10 marks)
- (b) Assess four factors that might hinder the optimal growth of the East African Community (EAC) or the equivalent trading block in your region. (8 marks)

**(Total: 20 marks)**

### QUESTION TWO

- (a) The privatisation of state corporations continues to be witnessed in a number of countries, particularly in the developing world.

**Required:**

Discuss four benefits likely to be realised from the above trend.

(8 marks)

- (b) The following information was obtained from the financial records of Mali Commercial Bank Ltd. for the year ended 31 December 2016:

|                                                  | Sh."000" |
|--------------------------------------------------|----------|
| Interest on advances                             | 464,800  |
| Contribution to deposit protection fund          | 98,000   |
| Operating lease rentals                          | 6,480    |
| Interest on government securities                | 14,600   |
| Interest paid on deposits                        | 4,740    |
| Interest on placement and bank balances          | 2,660    |
| Loss on disposal of collaterals                  | 840      |
| Fees and commission expenses                     | 1,420    |
| Losses from investment in securities             | 790      |
| Purchase of equipment                            | 1,200    |
| Depreciation                                     | 496      |
| Transfer to statutory reserves                   | 626      |
| Losses on stock brokerage dealings               | 348      |
| Gain on foreign exchange dealings                | 1,470    |
| Discounts on bills purchased                     | 329      |
| Auditor's remuneration                           | 786      |
| Provision for bad and doubtful debts             | 540      |
| Investment in government securities              | 1,850    |
| Bills receivable and for collection              | 314      |
| Guarantees and performance bonds                 | 378      |
| Interest accrued and paid                        | 1,974    |
| Bills for collection, acceptance and endorsement | 470      |
| Rebate on bills discounted                       | 292      |
| Provision for taxation                           | 400      |
| General charges recovered                        | 250      |
| Commission on exchange and brokerage             | 784      |

**Additional information:**

- Contribution to deposit protection fund includes investment revaluation surplus of Sh.648,000.
- Included in transfer to statutory reserves is an amount paid for exchange and commission of Sh.48,000.
- Discounts on bills purchased include interest and discount paid of Sh.39,000.
- Provision for bad and doubtful debts include specific bad debts at the beginning and end of the year amounting to Sh.68,000 and Sh.140,000 respectively.

**Required:**

- (i) A statement showing the taxable profit or loss for Mali Commercial Bank Ltd. for the year ended 31 December 2016.

(10 marks)

- (ii) Tax payable by (or refundable to) the bank.

(2 marks)

**(Total: 20 marks)**

### QUESTION THREE

- (a) Your country has been experiencing growth in the number of projects initiated through public-private partnerships (PPPs). However, this growth appears to be declining in the last few years.

**Required:**

Evaluate three possible factors that could have contributed to the above trend.

(6 marks)

- (b) Wema and Nenda have been running Wenda Enterprises as a partnership, sharing profits and losses in the ratio of 2:3 respectively. The following is the statement of comprehensive income for the firm for the year ended 31 December 2016:

|                                                | Sh.            | Sh.                     |
|------------------------------------------------|----------------|-------------------------|
| Sales                                          |                | 5,220,000               |
| <b>Less: Cost of goods sold</b>                |                | <b>(2,047,000)</b>      |
| Gross profit                                   |                | 3,173,000               |
| Rental income                                  |                | 148,800                 |
| Foreign exchange gain                          |                | 120,200                 |
| Interest on fixed deposit account              |                | <u>80,000</u>           |
|                                                |                | 3,522,000               |
| <b>Less: Expenses</b>                          |                |                         |
| Purchase of CCTV cameras                       | 96,000         |                         |
| Impairment loss on godown                      | 124,600        |                         |
| Website development                            | 130,000        |                         |
| Debenture interest                             | 56,000         |                         |
| Audit fees                                     | 48,400         |                         |
| Salaries and wages                             | 300,000        |                         |
| Directors' allowances                          | 280,000        |                         |
| Legal expenses                                 | 250,000        |                         |
| Loss on rented property                        | 36,200         |                         |
| Purchase of foreign currency                   | 344,900        |                         |
| Advertising expenses                           | 224,200        |                         |
| Purchase of computers                          | 180,000        |                         |
| Insurance                                      | 94,200         |                         |
| Medical expenses                               | 49,600         |                         |
| Bank charges                                   | 82,400         |                         |
| Purchase and installation of computer programs | <u>120,000</u> | <b>(2,416,500)</b>      |
| Net profit                                     |                | <u><u>1,105,500</u></u> |

**Additional information:**

- The business was converted into a limited liability company trading as Dawadu Ltd. with effect from 1 October 2016 and retaining the partners as directors of the new company.
- The cost of goods sold included opening stock of Sh.576,000 which was overcast by 20%, purchases of Sh.2,146,000 inclusive of 16% VAT and closing stock of Sh.675,000 which was undercast by 10%.
- All revenues and expenses accrued evenly throughout the year except for specific expenses relating to Dawadu Ltd. as a company.
- Salaries and wages included partners' salaries of Sh.120,000.
- Legal expenses comprised:

|                                     |                |
|-------------------------------------|----------------|
|                                     | Sh.            |
| Acquisition of company's title deed | 50,000         |
| Negotiating debenture stock         | 100,000        |
| Demand letters to customers         | 40,000         |
| Drafting Memorandum of Association  | <u>60,000</u>  |
|                                     | <u>250,000</u> |
- Wema was paid consultancy fees of Sh.54,000 for installing CCTV cameras in the premises.
- Advertising expenses include a neon sign costing Sh.92,000.
- The sales figure was inclusive of VAT at the rate of 16%.
- Directors' allowances include commission paid to Nenda of Sh.60,000 for negotiating a business contract.

**Required:**

- Separate statements of adjusted taxable profit or loss for Wenda Enterprises and Dawadu Ltd. for the year ended 31 December 2016. (Hint: Start with the net profit). (12 marks)
- Tax payable by (or refundable to) Dawadu Ltd. for the year ended 31 December 2016. (2 marks)

(Total: 20 marks)

#### QUESTION FOUR

- (a) Describe three tax planning opportunities that could be derived from the financial management decisions in a company. (6 marks)
- (b) The following transactions relate to Sawela Ltd. for the month of April 2017:

|                                                | Sh.       |
|------------------------------------------------|-----------|
| Purchase of goods at standard rate             | 626,400   |
| Exported goods to South Africa                 | 380,000   |
| Sales at standard rate                         | 1,113,600 |
| Audit fees                                     | 37,120    |
| Purchase of fuel and oil for delivery van      | 29,000    |
| Telephone bills                                | 17,400    |
| Exempt sales                                   | 400,000   |
| Exported goods to Zambia                       | 220,000   |
| Catering services                              | 41,760    |
| Purchase of stationery                         | 20,880    |
| Cost of assigning a debt for consideration     | 100,000   |
| Car park services provided by county authority | 50,000    |
| Treatment and supply of natural water          | 40,000    |
| Purchase of first aid boxes and kits           | 30,000    |

#### Additional information:

1. The company issued debit notes and credit notes of Sh.24,360 and Sh.34,800 respectively in respect to taxable supplies at standard rate.
2. The company returned goods invoiced at Sh.29,000 to suppliers because they were of a wrong type. A credit note was received immediately.
3. The company imported goods valued at Sh.320,000 (cost, insurance and freight). These goods were not included in the purchases figure. Import duty was at the rate of 20%.
4. The company transferred a branch as a going concern to another registered company at a cost of Sh.450,000 at the end of April 2017.
5. The company could not identify purchases at standard rate that were sold as exempt and therefore restricted deductible input tax.
6. Transactions are inclusive of VAT at the rate of 16% where applicable.

#### Required:

Determine the VAT payable by (or refundable to) Sawela Ltd. for the month of April 2017.

(14 marks)

(Total: 20 marks)

#### QUESTION FIVE

- (a) The development of an effective tax policy for a country requires critical consideration of certain factors at macro-economic level.

#### Required:

Discuss three such factors.

(6 marks)

- (b) A and B are partners trading as AB Enterprises, sharing profits and losses equally.

The following is the statement of comprehensive income for the partnership for the year ended 31 December 2016:

|                          | Sh."000" | Sh."000" |
|--------------------------|----------|----------|
| Sales                    |          | 40,450   |
| Less: Sales returns      |          | (1,200)  |
|                          |          | 39,250   |
| Less: Cost of goods sold |          | (19,550) |
| Gross profit             |          | 19,700   |
| Discount received        |          | 350      |
|                          |          | 20,050   |
| Less: Expenses           |          |          |
| Rent                     | 1,850    |          |
| Bad debts                | 400      |          |
| Wages and salaries       | 6,100    |          |
| Loan interest            | 400      |          |

|              | Sh."000"   | Sh."000"        |
|--------------|------------|-----------------|
| Depreciation | 4,200      |                 |
| Insurance    | 1,450      |                 |
| Repairs      | 300        |                 |
| Electricity  | <u>750</u> | <u>(15,450)</u> |
| Net profit   |            | <u>4,600</u>    |

The partnership is under tax investigation and the assessor obtained the following details from the firm's records for the year ended 31 December 2016:

- Balances of assets and liabilities:
 

|                                         | 1 January 2016<br>Sh."000" | 31 December 2016<br>Sh."000" |
|-----------------------------------------|----------------------------|------------------------------|
| Inventory                               | 6,100                      | 4,200                        |
| Machinery                               | 84,600                     | 97,000                       |
| Rent prepaid                            | 800                        | -                            |
| Rent owing                              | -                          | 950                          |
| Debtors                                 | 9,300                      | 7,500                        |
| Loan from bank at 8% interest per annum | 6,000                      | 6,000                        |
| Loan interest owing                     | -                          | 200                          |
- Receipts and payments were as follows:
 

|                       | Sh."000" |
|-----------------------|----------|
| Receipts:             |          |
| Receipts from debtors | 26,400   |
| Cash sales            | 72,400   |
| Payments:             |          |
| Loan interest paid    | 400      |
| Electricity           | 750      |
| Rent                  | 240      |
| Purchase of machinery | 16,400   |
- Rent expense related to A's private residence. In addition, electricity paid includes Sh.50,000 for A's private residence.
- The firm issued credit notes amounting to Sh.1,200,000 which was erroneously posted as Sh.200,000 to the relevant ledgers.
- Included in the sales figure is Sh.30,000 for interest on drawings by B and proceeds on disposal of machinery Sh.1,450,000. The machinery had cost Sh.4,000,000 with an accumulated depreciation of Sh.200,000.
- Receipts from debtors include Sh.440,000 contributed by a new partner C as his capital on 1 October 2016. The profit and loss sharing ratio changed to 2:2:1 for A, B and C respectively.
- Purchases amounted to Sh.19,250,000 which included goods withdrawn by B valued at Sh.300,000.
- Salaries and wages include accrued salaries to the partners of Sh.2,400,000 shared equally among all the three partners per month as applicable.

**Required:**

As a tax assessor, compute the net profit for tax purposes for the year ended 31 December 2016 indicating the taxable income for each partner. (14 marks)

(Total: 20 marks)

.....

|              | Sh."000"   | Sh."000"        |
|--------------|------------|-----------------|
| Depreciation | 4,200      |                 |
| Insurance    | 1,450      |                 |
| Repairs      | 300        |                 |
| Electricity  | <u>750</u> | <u>(15,450)</u> |
| Net profit   |            | <u>4,600</u>    |

The partnership is under tax investigation and the assessor obtained the following details from the firm's records for the year ended 31 December 2016:

- Balances of assets and liabilities:
 

|                                         | 1 January 2016<br>Sh."000" | 31 December 2016<br>Sh."000" |
|-----------------------------------------|----------------------------|------------------------------|
| Inventory                               | 6,100                      | 4,200                        |
| Machinery                               | 84,600                     | 97,000                       |
| Rent prepaid                            | 800                        | -                            |
| Rent owing                              | -                          | 950                          |
| Debtors                                 | 9,300                      | 7,500                        |
| Loan from bank at 8% interest per annum | 6,000                      | 6,000                        |
| Loan interest owing                     | -                          | 200                          |
- Receipts and payments were as follows:
 

|                       | Sh."000" |
|-----------------------|----------|
| Receipts:             |          |
| Receipts from debtors | 26,400   |
| Cash sales            | 72,400   |
| Payments:             |          |
| Loan interest paid    | 400      |
| Electricity           | 750      |
| Rent                  | 240      |
| Purchase of machinery | 16,400   |
- Rent expense related to A's private residence. In addition, electricity paid includes Sh.50,000 for A's private residence.
- The firm issued credit notes amounting to Sh.1,200,000 which was erroneously posted as Sh.200,000 to the relevant ledgers.
- Included in the sales figure is Sh.30,000 for interest on drawings by B and proceeds on disposal of machinery Sh.1,450,000. The machinery had cost Sh.4,000,000 with an accumulated depreciation of Sh.200,000.
- Receipts from debtors include Sh.440,000 contributed by a new partner C as his capital on 1 October 2016. The profit and loss sharing ratio changed to 2:2:1 for A, B and C respectively.
- Purchases amounted to Sh.19,250,000 which included goods withdrawn by B valued at Sh.300,000.
- Salaries and wages include accrued salaries to the partners of Sh.2,400,000 shared equally among all the three partners per month as applicable.

**Required:**

As a tax assessor, compute the net profit for tax purposes for the year ended 31 December 2016 indicating the taxable income for each partner. (14 marks)

(Total: 20 marks)

.....

# KASNEB

## CPA PART III SECTION 6

### ADVANCED PUBLIC FINANCE AND TAXATION

THURSDAY: 24 November 2016.

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 2015.

| 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%                   | (i) Saloons, Hatch Backs and Estates<br>Up to 1200 cc | 3,600                 |
| Class II 30%                    | 1201 - 1500 cc                                        | 4,200                 |
| Class III 25%                   | 1501 - 1750 cc                                        | 5,800                 |
| Class IV 12.5%                  | 1751 - 2000 cc                                        | 7,200                 |
| Software 20%                    | 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%

**Investment deduction allowance** 100%

**Shipping investment deduction** 100%  
(Ships over 125 tonnes)

#### Extraction expenditure:

Written off over 5 years (20%)

#### Commissioner's prescribed benefit rates

| Services                                         | Monthly rates<br>Sh. | Annual rates<br>Sh. |
|--------------------------------------------------|----------------------|---------------------|
| (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) Tax havens have increasingly been used as avenues for tax avoidance. The Organisation for Economic Co-operation and Development (OECD) specifies three key factors in considering whether a jurisdiction is a tax haven.

**Required:**

- (i) Citing two examples of countries considered as tax havens, evaluate the three factors referred to in the above statement. (7 marks)
- (ii) Explain the terms "tax arbitrage" and "transfer pricing" in the context of international taxation systems. (4 marks)
- (b) Ali and Baba are partners in a small firm trading as Alibaba Enterprises. They share profits and losses in the ratio of 2:3 respectively.

The following extracts were obtained from the records of the firm for the year ended 31 December 2015:

1. **Partners' current account extracts:**

|          | Debit      |             |                      | Credit     |             |
|----------|------------|-------------|----------------------|------------|-------------|
|          | Ali<br>Sh. | Baba<br>Sh. |                      | Ali<br>Sh. | Baba<br>Sh. |
| Drawings | 40,000     | 60,000      | Balance brought down | 100,000    | 200,000     |
|          |            |             | Salaries to partners | 70,000     | 120,000     |
|          |            |             | Interest on capital  | 50,000     | 40,000      |

2. **Assets and liabilities:**

|                            | 1 January 2015<br>Sh. | 31 December 2015<br>Sh. |
|----------------------------|-----------------------|-------------------------|
| Saloon car (cost)          | 2,400,000             | 2,160,000               |
| Trade receivables          | 1,800,000             | 960,000                 |
| Donations                  | -                     | 140,000                 |
| Salaries and wages accrued | 840,000               | 1,600,000               |
| Electricity prepaid        | 170,000               | 200,000                 |
| Furniture                  | 200,000               | 180,000                 |
| Inventories                | 360,000               | 500,000                 |
| Trade payables             | 1,500,000             | 1,200,000               |

3. **Extracts from the bank statement:**

|                                   | Sh.       |
|-----------------------------------|-----------|
| Payments to suppliers for goods   | 840,000   |
| Receipts from customers           | 2,200,000 |
| Payments for computers (hardware) | 600,000   |
| Payments for computer software    | 120,000   |
| Catering fees                     | 90,000    |
| Electricity                       | 60,000    |
| Salaries and wages                | 700,000   |
| Legal fees                        | 160,000   |

4. Legal fees amounting to Sh.48,000 relate to costs of negotiating purchase of business premises while electricity paid included a deposit of Sh.15,000 to the power company.
5. Each partner had obtained a 10% loan of Sh.200,000 from the partnership for acquiring their private assets. The interest on loan was included in their share of interest on capital.

**Required:**

- (i) A statement of adjusted taxable profit or loss of the partnership for the year ended 31 December 2015. (7 marks)
- (ii) Total taxable income (loss) for each partner. (2 marks)
- (Total: 20 marks)**

## QUESTION TWO

- (a) Mr. S. Bora has been running a retail business since 1 January 2011. He had not been maintaining proper accounting records. The revenue authority provided an estimated tax assessment and penalties of Sh.84,000. He is planning to appeal against the assessment and has availed the following information to you to assist in filing supportive documents for the appeal.

### Assets and liabilities:

|                    | Year ended 31 December: |             |             |             |             |
|--------------------|-------------------------|-------------|-------------|-------------|-------------|
|                    | 2011<br>Sh.             | 2012<br>Sh. | 2013<br>Sh. | 2014<br>Sh. | 2015<br>Sh. |
| Household property | 480,000                 | 560,000     | 380,000     | 400,000     | 450,000     |
| Computers - office | -                       | -           | 150,000     | 105,000     | 180,000     |
| Inventories        | 100,000                 | 200,000     | 280,000     | 420,000     | 380,000     |
| Bank overdraft     | -                       | 96,000      | 80,000      | 150,000     | 140,000     |
| Office premises    | 1,800,000               | 1,720,000   | 1,640,000   | 1,840,000   | 1,680,000   |
| Personal clothes   | 20,000                  | 36,000      | 40,000      | 28,000      | 24,000      |
| Creditors          | 360,000                 | 420,000     | 280,000     | 240,000     | 320,000     |
| Equipment - office | 94,000                  | 160,000     | 120,000     | 160,000     | 150,000     |
| Debtors            | 160,000                 | 260,000     | 180,000     | 120,000     | 194,000     |
| Bank loan          | 170,000                 | 360,000     | 100,000     | 94,000      | 136,000     |
| Mortgage loan      | 800,000                 | 800,000     | 800,000     | 800,000     | 800,000     |

### Additional information:

- Office equipment costing Sh.40,000 was disposed of at Sh.60,000 in 2013. The gain on disposal was not recorded anywhere in the books.
- Legal expenses of Sh.48,000 on purchase of office equipment on 1 January 2012 was not capitalised.
- Living expenses for his family from year 2012 was Sh.80,000 per year and increased cumulatively at a rate of 10% per annum.
- In years 2014 and 2015, he donated Sh.160,000 and Sh.92,000 respectively to a political party registered in his country.
- Capital allowances agreed with the commissioner of domestic taxes for each year amounted to Sh.56,000.
- Business expenses allowable by the commissioner for each year were capped at Sh.24,000.
- The bank statement records reveal that Mr. Bora had paid school fees of Sh.84,000 in 2013 for his children from the business bank account.
- Household property for 2012 include property that Mr. Bora inherited from his father amounting to Sh.80,000
- Mortgage loan relates to office premises. The interest on the loan was 10% per annum on the principal amount.

### Required:

- A capital statement for each of the years ended 31 December 2012, 2013, 2014 and 2015. (8 marks)
  - Revised taxable income and tax payable by Mr. Bora from tax arrears arising from undeclared income. Note: Use year 2015 tax rates. (2 marks)
  - Advise Mr. Bora on the intended appeal. (2 marks)
- (b) The following information was extracted from the books of Michezo Sporting Members Club for the year ended 31 December 2015. The club's manager did not submit income tax returns as he argued that the club was exempted from taxation. He has consulted you for professional advice.

### Additional information:

- The club received gross income during the year ended 31 December 2015 amounting to Sh.35 million which was analysed as follows:

|                                 | Sh.               |
|---------------------------------|-------------------|
| Entrance fees                   | 4,770,000         |
| Members subscriptions           | 15,900,000        |
| Interest on late subscriptions  | 795,000           |
| Interest income (fixed deposit) | 2,544,000         |
| Dividend income                 | 1,272,000         |
| Royalties                       | 1,908,000         |
| Rent income                     | 6,360,000         |
| Gain on property transfers      | <u>1,451,000</u>  |
|                                 | <u>35,000,000</u> |

2. Operating expenses amounted to Sh.6,360,000.
3. Interest and dividend income were stated gross of tax.

**Required:**

- (i) Advise the club's manager on the circumstances under which members clubs are taxed in your country. (2 marks)
  - (ii) Assess whether Michezo Sporting Members Club is subject to taxation for the year ended 31 December 2015 and the applicable tax liability (if any). (6 marks)
- (Total: 20 marks)**

**QUESTION THREE**

- (a) Jamboree Sacco Society Ltd. reported the following income and expenditure for the year ended 31 December 2015:

| Income                                                   | Sh.              |
|----------------------------------------------------------|------------------|
| Gross rental income                                      | 840,000          |
| Interest on savings account                              | 160,000          |
| Interest on members loans                                | 1,840,000        |
| Interest on fixed deposit account                        | 560,000          |
| Interest on treasury bills                               | <u>435,000</u>   |
|                                                          | 3,835,000        |
| Less expenses:                                           |                  |
| • Repainting of rented property                          | 156,000          |
| • Interest on loans for money invested in treasury bills | 114,000          |
| • Administration expenses                                | 496,000          |
| • Legal expenses relating to rented property             | <u>72,000</u>    |
|                                                          | <u>(838,000)</u> |
|                                                          | <u>2,997,000</u> |

**Additional information:**

1. The Sacco declared dividends and bonuses of Sh.980,000.
2. Corporation tax is at a rate of 30%.

**Required:**

- (i) Total taxable profit for the Sacco for the year ended 31 December 2015. (6 marks)
  - (ii) Tax payable by the Sacco for the year ended 31 December 2015. (2 marks)
- (b) Ms Avril Chemu constructed a house in a high class residential estate. The following details relate to the building costs as at the date of completion, 31 December 2012:

|                                                       | Sh.        |
|-------------------------------------------------------|------------|
| • Cost of acquiring a half acre plot                  | 8,000,000  |
| • Obtained a fixed 15% mortgage loan (1 January 2011) | 10,000,000 |
| • Conveyance fees                                     | 200,000    |
| • Valuation fees                                      | 360,000    |
| • Building materials (including government subsidy)   | 4,600,000  |
| • Labour for construction workers                     | 560,000    |
| • Painting                                            | 300,000    |
| • Stamp duty                                          | 320,000    |
| • Received government subsidy on building materials   | 600,000    |

The house was completed on 31 December 2012 and Ms Chemu moved in with her family.

**Additional information:**

1. After two years of stay, Ms Chemu opted to sell the house. On 1 March 2015, she secured a buyer at a purchase price of Sh. 20,000,000.
2. The following expenses were incurred in the process of finding a buyer:

|                         | Sh.     |
|-------------------------|---------|
| Agent's commission      | 400,000 |
| Advertising expenses    | 48,000  |
| Valuation fees          | 240,000 |
| Repainting of the house | 80,000  |
| Legal fees              | 160,000 |

3. The capital deductions accumulated for the two years (2013 and 2014) in respect of wear and tear and industrial building deduction amounted to Sh.420,000.
4. The construction of the house was financed through the mortgage loan, with the balance from the mortgage loan used to buy a motor vehicle (saloon). She repaid the full mortgage on 31 December 2014.

**Required:**

The capital gain and tax payable (if any) by Ms Chemu from the sale of the house.

(12 marks)

**(Total: 20 marks)**

**QUESTION FOUR**

- (a) Some scholars have raised concern over the apparent mismatch between taxation policy and the economic agenda of certain countries, where increased tax revenue did not necessarily translate into higher standards of living for the citizenry.

**Required:**

Explain four factors that could have contributed to the above scenario.

(4 marks)

- (b) Mr. Sylvanus Jirani was a resident of Kenya in the year of income 2015. During part of the year, he was in United Kingdom (UK) and earned income amounting to UK £43,500. Taxes paid on UK income amounted to £8,700. His employment income from Kenya was KSh.950,000 (PAYE deducted KSh.184,800). Further, he had provided consultancy services at a fee of KSh.190,000 (net of withholding tax).

Other income comprised the following:

1. Rental income of KSh.400,000 after deducting; cost of furniture KSh.36,000, estate agents fees before letting KSh.48,000 and caretakers wages KSh.8,000 per month.
2. Patent rights where he received net royalty income of KSh.95,000. Expenses relating to patent rights were; registration of patent KSh.8,900 and operating expenses KSh.18,000.

Assume the applicable exchange rate was KSh.100 to £1. Kenya has signed a double taxation agreement with UK.

**Required:**

- (i) Double taxation relief (if any) due to Mr. Sylvanus Jirani for the year of income 2015. (8 marks)
- (ii) Tax payable (or refundable) by Mr. Jirani for the year of income 2015. (4 marks)
- (c) Summarise four uses of funds deposited in the public private partnership (PPP) project facilitation fund. (4 marks)

**(Total: 20 marks)**

**QUESTION FIVE**

- (a) The Council of the Institute of Certified Public Accountants of Country X is developing a Code of Ethics to manage the conduct of its Council members.

**Required:**

Propose three provisions for inclusion in the above referenced Code of Ethics to prevent cases of conflict of interest among Council members. (3 marks)

- (b) With reference to the operations of the Public Investments Committee (PIC) in your country:
  - (i) Describe three functions of the PIC. (3 marks)
  - (ii) Explain two matters which the PIC is specifically excluded from dealing with. (2 marks)
- (c) Msanifu Insurance Company Ltd. is a resident insurance firm carrying on both general and life assurance businesses.

The following information relates to the insurance company's business for the year ended 31 December 2015:

|                                 | General insurance<br>Sh. "000" | Life assurance<br>Sh. "000" |
|---------------------------------|--------------------------------|-----------------------------|
| Investment income               | 13,780                         | -                           |
| Insurance premium received      | 15,450                         | 100,000                     |
| Insurance and management fees   | -                              | 25,000                      |
| Premium returned                | 374                            | -                           |
| Reinsurance commission received | 1,360                          | -                           |

|                                            | Sh. "000" | Sh. "000" |
|--------------------------------------------|-----------|-----------|
| Premiums paid to reinsurance company       | 4,680     | -         |
| Agency expenses                            | 1,350     | 1,960     |
| Management expenses                        | 1,934     | -         |
| Travelling expenses                        | 1,800     | 2,400     |
| Advertising                                | 364       | 820       |
| General expenses                           | 8,490     | 4,640     |
| Bad debts (specific)                       | 368       | 1,080     |
| Income from exercise of subrogation rights | 1,250     | -         |
| Recoveries of reinsurance                  | 150       | -         |

**Additional information:**

- Investment income comprised:
  - Fixed deposit account Sh.780,000.
  - Dividend received from qualifying company Sh.3,000,000 (net).
  - Rental income Sh.10,000,000.
- General expenses include cost of computers Sh.800,000 and furniture and fittings Sh.1,260,000.
- Reserves for unexpired risk for general insurance business were as follows:  
As at 1 January 2015 Sh.3,240,000.  
As at 31 December 2015 Sh.6,200,000.
- Claims paid during the year ended 31 December 2015 amounted to Sh.7,600,000 for general business.
- Life assurance fund balance was valued by an actuary at Sh.300,000,000 as at 31 December 2015. 25% of this fund balance was recommended to be transferred for the benefit of shareholders.
- Claims outstanding for general business were as follows:  
As at 1 January 2015 Sh.5,640,000.  
As at 31 December 2015 Sh.6,000,000.

**Required:**

The taxable income or loss for Msanifu Insurance Company Ltd. for the year ended 31 December 2015. (12 marks)  
(Total: 20 marks)

.....

# KASNEB

## CPA PART III SECTION 6

### ADVANCED PUBLIC FINANCE AND TAXATION

THURSDAY: 26 May 2016.

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 2015.

| 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 (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%   |

#### (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 |

#### 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%

Investment deduction allowance 100%

Shipping investment deduction 100%

(Ships over 125 tonnes)

#### (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

#### Extraction expenditure:

Written off over 5 years (20%)

#### Commissioner's prescribed benefit rates

| Services                                       | Monthly rates<br>Sh. | Annual rates<br>Sh. |
|------------------------------------------------|----------------------|---------------------|
| (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 FIVE

- (a) Country Z has recently been admitted into a regional economic block. As part of the country's full integration into the economic block, it is required to undertake certain legislative and other reforms.

**Required:**

Advise Country Z on four fundamental reforms that could be considered in the process of integration into the economic block. (8 marks)

- (b) Mjengo Ltd. is a real estate development company. In the year ended 31 December 2015, the company provided the following information:

- Bought 100 acres at Sh.6,000,000 each for building low cost houses in an approved development area.
- Cost of surveying was Sh.4,600,000 and conveyance fees amounted to Sh.6,960,000.
- The cost of constructing each unit was Sh.1,450,000. The company constructed 240 units on a 20 acre piece of land.
- All the units were sold at a price of Sh.1,600,000 in the year 2015.
- Building materials for constructing each unit amounted to Sh.742,400 inclusive of VAT at the rate of 16%.
- Professional fees paid to quantity surveyors inclusive of VAT was Sh.417,600 and for civil engineers was Sh.243,600.
- Drainage system and sewerage line cost Sh.960,000 for connecting all units built and to be built on 100 acres.
- The interest on loan to acquire the 100 acres was Sh.7,800,000.
- Hire expenses for bulldozers used in the construction was Sh.600,000 for each of the three months used for the construction.
- Charges paid to the government in respect of approval of plans were Sh.678,000.
- Cost of constructing a site office was Sh.800,000.
- Hire cost for a saloon car for the site manager was Sh.40,000 per month.
- A commercial building was also constructed at a cost of Sh.5,600,000 in a part of the land. The building was rented at a monthly rent of Sh.480,000 with effect from 1 May 2015.
- The costs relating to the total 100 acres are to be apportioned according to the acreage used.

**Required:**

- (i) Statement of adjusted taxable profit or loss for Mjengo Ltd. for the year ended 31 December 2015. (10 marks)
- (ii) Tax payable by Mjengo Ltd. (if any) for the year ended 31 December 2015. (2 marks)

(Total: 20 marks)

.....

**Additional information:**

1. Turnover and purchases were inclusive of VAT at the rate of 16%.
2. The turnover excludes cash sales. During the year ended 31 December 2015, the business paid the following expenses out of cash sales:

|                         | Sh.     |
|-------------------------|---------|
| Telephone and postage   | 48,000  |
| School fees             | 142,800 |
| Repairs and maintenance | 94,600  |
| Insurance               | 36,600  |

3. The bank balance is included in the cash and cash equivalents. The following details were included in the bank statement:

|                        | Sh.       |
|------------------------|-----------|
| Personal expenses      | 294,000   |
| General expenses       | 792,800   |
| Rent and rates         | 68,400    |
| Hire purchase interest | 29,600    |
| Payments to creditors  | 2,460,000 |
| Receipts from debtors  | 5,890,000 |

4. The following assets used by the business were not included in the assets register:

|                   | Sh.       |
|-------------------|-----------|
| Computers         | 368,000   |
| Fax machine       | 120,000   |
| Saloon car        | 2,800,000 |
| Delivery van      | 720,000   |
| Computer software | 150,000   |

The Revenue Authority has established that the statement of financial position forms a good basis for recomputing the taxable profit. All expenses are to be adjusted on the basis of the statement of financial position.

**Required:**

- (a) Using suitable computations, confirm the accuracy or otherwise of the taxable profit of Weka Enterprises for the year ended 31 December 2015. (15 marks)
  - (b) Summarise five types of preliminary information that you might require from the business in order to further ascertain the accuracy of the taxable profit. (5 marks)
- (Total: 20 marks)**

**QUESTION THREE**

- (a) Tax information exchange agreements (TIEAs) are increasingly forming part of the agenda during bilateral and multilateral trade discussions among various countries.
  - (i) Explain the nature of tax information exchange agreements. (2 marks)
  - (ii) Citing three reasons, discuss the purpose of TIEAs. (6 marks)
- (b) Zawadi Ltd. has been in operation since 1 January 2014. The company is under a tax investigation relating to value added tax (VAT) transactions.

The following details were obtained from the company's records for the month of September 2015:

- Stock in trade brought down in the month of September 2015 was valued at Sh.719,200.
- Sales ledger records in the company's books showed an amount of Sh.1,786,400 while as per VAT returns, it was Sh.1,429,120.
- The company had not claimed input tax on a building put into use on 1 January 2014 at a cost of Sh.2,784,000. However, in September 2015, the company set-off the input tax against the output tax for the month.
- Purchases amounting to Sh.174,000 did not have supporting fiscal receipts. The total purchases amounted to Sh.928,000.
- Since 1 January 2014, the company had not been filing VAT returns on time and all the penalties are outstanding.

- The company had imported goods on cost, insurance and freight (CIF) terms of Sh.450,000. The clearing and transport costs amounted to Sh.80,000 and Sh.60,000 respectively. The goods were later sold at a mark up of 20%. Import duty on these goods was at a rate of 20%.
- Tax officers established that imports were understated by Sh.150,000 as per import documents.
- Input tax on fuels and oils for motor vehicles used in the business amounted to Sh.51,200.
- Returns outward journal was understated by Sh.139,200 while the purchases ledger was overstated by Sh.174,000.
- Debit notes received by the company were overstated by Sh.232,000.
- Credit notes issued to customers were overstated by Sh.162,400.
- Input tax on catering services amounting to Sh.12,800 had been debited in the VAT account.
- Further examination revealed that VAT records needed recomputation to establish the correct VAT position.

Transactions are inclusive of VAT at a rate of 16% where applicable.

**Required:**

Analyse the above records and compute the correct VAT position for Zawadi Ltd. for the month of September 2015.

(12 marks)

**(Total: 20 marks)**

**QUESTION FOUR**

- (a) Evaluate four features that distinguish tax havens from other taxation regimes. (8 marks)
- (b) Salama Insurance Company Ltd. provided the following financial records for the year ended 31 December 2015:

|                                              | Sh.        |
|----------------------------------------------|------------|
| Gross premium                                | 14,890,000 |
| Reserves for unexpired risk (1 January 2015) | 486,000    |
| Re-insurance premiums paid                   | 384,000    |
| Claims paid                                  | 9,364,000  |
| Claims due: 1 January 2015                   | 670,000    |
| 31 December 2015                             | 800,000    |
| Life assurance fund                          | 1,240,800  |
| Commission on reinsurance ceded              | 760,200    |
| Commission on reinsurance accepted           | 1,940,000  |
| Foreign exchange loss                        | 342,500    |
| Rent income                                  | 678,300    |
| Purchase of computers                        | 300,000    |
| Cost of computer software                    | 150,000    |
| Claims recovered on reinsurance              | 562,800    |
| Agency expenses                              | 1,380,700  |
| Investment income                            | 1,824,300  |
| Management salaries                          | 948,200    |
| Repair of rented property                    | 28,800     |
| Neon signs                                   | 48,000     |
| Depreciation                                 | 150,400    |
| Legal expenses relating to claims            | 64,800     |
| Rent and rates                               | 760,400    |

**Additional information:**

1. The company operates both general insurance business and life insurance business in the same building where rent and rates are shared in the ratio of 2:3 respectively.
2. Agency expenses include general manager's salary of Sh.280,000 working in the life insurance business.
3. Investment income includes dividends of Sh.114,000 net of tax from a subsidiary company and Sh.78,400 from proceeds of sale of a car involved in an accident.
4. Gross premium includes sale of insurance policies to life insurance company amounting to Sh.748,400.
5. The company constructed a commercial building with shops, offices and showroom at a cost of Sh.6,400,000 on 1 January 2015. Rent income from the property amounted to Sh.5,536,400 before deducting capital allowances and expenses amounting to Sh.84,600.

**Required:**

- (i) A statement of taxable profit or loss for the year ended 31 December 2015. (10 marks)
- (ii) Tax payable (if any). (2 marks)

**(Total: 20 marks)**

**CA61 Page 4  
Out of 5**

### QUESTION FIVE

- (a) Country Z has recently been admitted into a regional economic block. As part of the country's full integration into the economic block, it is required to undertake certain legislative and other reforms.

**Required:**

Advise Country Z on four fundamental reforms that could be considered in the process of integration into the economic block. (8 marks)

- (b) Mjengo Ltd. is a real estate development company. In the year ended 31 December 2015, the company provided the following information:

- Bought 100 acres at Sh.6,000,000 each for building low cost houses in an approved development area.
- Cost of surveying was Sh.4,600,000 and conveyance fees amounted to Sh.6,960,000.
- The cost of constructing each unit was Sh.1,450,000. The company constructed 240 units on a 20 acre piece of land.
- All the units were sold at a price of Sh.1,600,000 in the year 2015.
- Building materials for constructing each unit amounted to Sh.742,400 inclusive of VAT at the rate of 16%.
- Professional fees paid to quantity surveyors inclusive of VAT was Sh.417,600 and for civil engineers was Sh.243,600.
- Drainage system and sewerage line cost Sh.960,000 for connecting all units built and to be built on 100 acres.
- The interest on loan to acquire the 100 acres was Sh.7,800,000.
- Hire expenses for bulldozers used in the construction was Sh.600,000 for each of the three months used for the construction.
- Charges paid to the government in respect of approval of plans were Sh.678,000.
- Cost of constructing a site office was Sh.800,000.
- Hire cost for a saloon car for the site manager was Sh.40,000 per month.
- A commercial building was also constructed at a cost of Sh.5,600,000 in a part of the land. The building was rented at a monthly rent of Sh.480,000 with effect from 1 May 2015.
- The costs relating to the total 100 acres are to be apportioned according to the acreage used.

**Required:**

- (i) Statement of adjusted taxable profit or loss for Mjengo Ltd. for the year ended 31 December 2015. (10 marks)
- (ii) Tax payable by Mjengo Ltd. (if any) for the year ended 31 December 2015. (2 marks)

(Total: 20 marks)

.....

# KASNEB

## CPA PART III SECTION 6

### ADVANCED PUBLIC FINANCE AND TAXATION

THURSDAY: 26 November 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>             | (i) Saloons, Hatch Backs and Estates    |                       |
| <b>Wear and tear allowance:</b>       | Up to 1200 cc                           | 3,600                 |
| Class I 37.5%                         | 1201 1500 cc                            | 4,200                 |
| Class II 30%                          | 1501 1750 cc                            | 5,800                 |
| Class III 25%                         | 1751 2000 cc                            | 7,200                 |
| Class IV 12.5%                        | 2001 3000 cc                            | 8,600                 |
| Software 20%                          | Over 3000 cc                            | 14,400                |
| <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%                                    |                       |
|                                       | (ii) Pick-ups, Panel Vans (unconverted) |                       |
|                                       | Up to 1750 cc                           | 3,600                 |
|                                       | Over 1750 cc                            | 4,200                 |
|                                       | (iii) Land Rovers/Cruisers              | 7,200                 |
| <b>Shipping investment deduction</b>  | 40%                                     |                       |
| <b>Mining allowance:</b>              |                                         |                       |
| Year 1 -                              | 40%                                     |                       |
| Years 2 - 7 -                         | 10%                                     |                       |

#### 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              |

### QUESTION ONE

- (a) A recent study on public financial management in developing countries identified a growing interest by governments to establish and enhance public private partnerships (PPPs) as one of the ways of achieving sustainable development. In some of the countries covered by the study, a public private partnership (PPP) unit had been established within the mainstream government structure.

**Required:**

- (i) Explore three possible reasons for the growing interest in public private partnerships particularly among developing countries. (3 marks)
- (ii) Explain three functions of a public private partnership unit as established by a government. (3 marks)
- (iii) Summarise three challenges likely to face the implementation of public private partnerships in your country. (3 marks)
- (b) Country X has undertaken a number of infrastructural projects as part of its long-term development initiatives. This has however resulted in the government borrowing heavily from both the domestic market and the foreign market. As a result, interest rates have risen significantly, a situation that has affected other critical sectors of the country's economy.

**Required:**

In the context of the above scenario, advise the government of Country X on four approaches that it could use to manage its public debt. (8 marks)

- (c) In the context of monitoring of public projects by public entities, outline three objectives of electronic project monitoring information systems (e-PROMIS). (3 marks)

**(Total: 20 marks)**

### QUESTION TWO

- (a) In recent times, public financial management has generated a lot of interest from governments, the public, donors among other stakeholders.

**Required:**

Discuss four distinctive features of financial management in the public sector as compared to the private sector.

(8 marks)

- (b) According to legislation on investment promotion, an applicant may apply for an investment certificate from a public investment board.

**Required:**

In the context of the above statement:

- (i) Outline three conditions that an applicant is required to fulfill in order to obtain an investment certificate. (3 marks)
- (ii) Describe five areas that could be considered by the public investment board before grant of an investment certificate. (5 marks)
- (c) Citing two examples, discuss the relevance of the international financial market in the context of public financial management in your country. (4 marks)

**(Total: 20 marks)**

### QUESTION THREE

James and Katana established a partnership business, sharing profits and losses in the ratio of 3:2 respectively. The following is the income statement of the partnership for the year ended 31 December 2014:

|                                         | Sh. | Sh.              |
|-----------------------------------------|-----|------------------|
| Sales                                   |     | 6,728,000        |
| Unrealised foreign exchange gain        |     | 150,000          |
| Capital gain on sale of shares          |     | 352,000          |
| Recovery from insurance on stock stolen |     | 480,000          |
| Goods transferred to a branch at cost   |     | 184,000          |
| Dividends from Kali Cooperative Society |     | 51,000           |
|                                         |     | <u>7,945,000</u> |

|                         | Sh.           | Sh.              |
|-------------------------|---------------|------------------|
| Less expenses:          |               |                  |
| Purchases               | 2,842,000     |                  |
| Purchase of computers   | 180,000       |                  |
| Partners salaries       | 720,000       |                  |
| Legal fees              | 680,000       |                  |
| Repairs and maintenance | 568,400       |                  |
| Rent and rates          | 244,600       |                  |
| Interest on loan        | 166,200       |                  |
| General expenses        | 964,000       |                  |
| Motor vehicle expenses  | 840,000       |                  |
| Insurance               | 156,000       |                  |
| Preliminary expenses    | 262,800       |                  |
| Directors fees          | 600,000       |                  |
| Audit fees              | 148,200       |                  |
| Debenture interest      | 360,000       |                  |
| Travelling expenses     | <u>96,000</u> | <u>8,828,200</u> |
| Net loss                |               | <u>(883,200)</u> |

#### Additional information:

- The partnership was converted into a limited liability company by the name Kaka Ltd. on 1 October 2014. Incomes and expenses accrued evenly throughout the year unless otherwise stated.
- Purchases and sales were inclusive of value added tax at a rate of 16%.
- Closing stock was valued at Sh.1,840,000 while opening stock was at 10% of sales net of value added tax.
- Legal fees comprised:

|                                                 |                |
|-------------------------------------------------|----------------|
|                                                 | Sh.            |
| Petition to Association of Manufacturers        | 80,000         |
| Notice for change of business name              | 64,800         |
| Conveyance fees of business premises            | 72,400         |
| Stamp duty                                      | 36,600         |
| Negotiating a business loan                     | 20,800         |
| Recovery of bad debts                           | 45,000         |
| Signing a 100-year lease agreement              | 128,400        |
| Purchase of partner's private residence - James | 150,000        |
| Appeal against tax arrears                      | <u>82,000</u>  |
|                                                 | <u>680,000</u> |
- Repairs and maintenance comprised:

|                                   |                |
|-----------------------------------|----------------|
|                                   | Sh.            |
| Purchases of furniture            | 96,000         |
| Installation of neon sign         | 60,000         |
| Designing an office block         | 140,000        |
| Cost of partitioning office block | 250,000        |
| Repainting of business premises   | <u>22,400</u>  |
|                                   | <u>568,400</u> |
- General expenses included; registering of patent rights Sh.64,000, floatation costs Sh.48,000 and negotiating costs for an additional piece of land for business expansion at Sh.56,000.
- Interest on loan includes interest on partners' capital of Sh.100,000 which was shared according to profit and loss sharing ratio.

#### Required:

- A statement of adjusted taxable profit or loss for the business for the year ended 31 December 2014. (14 marks)

**Hint: Start with gross profit.**

- Comment on the tax position of James, Katana and the company. (4 marks)
  - Citing examples, advise James and Katana on two areas of tax avoidance that they could explore for the business. (2 marks)
- (Total: 20 marks)**

#### QUESTION FOUR

- Highlight four factors to be considered when selecting an appropriate transfer price. (4 marks)

- (b) Mjengo Ltd. is in the real estate business. During the year ended 31 December 2014, the company acquired ten houses each at Sh.4,000,000 before incurring the following expenses:
- 10% interest on mortgage loan of Sh.10,000,000.
  - Conveyance fees for each house Sh.40,000.
  - Estate agent's valuation fees per house Sh.28,000.
  - Repairs undertaken for two houses Sh.44,000.
  - Cost of repainting the houses Sh.84,000.
  - The impairment loss of the houses was estimated at Sh.150,000.
  - Legal expenses amounting to Sh.36,000 were incurred in defending a title for a house with defective ownership documents.

Mjengo Ltd. sold each house at Sh.5,800,000. The cost for advertising the houses was Sh.160,000, estate agent's commission Sh.180,000, insurance Sh.72,000, valuation fees Sh.150,000 and legal fees Sh.148,000.

**Required:**

Determine the following:

- |       |                                           |           |
|-------|-------------------------------------------|-----------|
| (i)   | Transfer value.                           | (3 marks) |
| (ii)  | Adjusted cost.                            | (3 marks) |
| (iii) | Capital gains tax.                        | (1 mark)  |
| (iv)  | Due date for filing of capital gains tax. | (1 mark)  |
- (c) Rigs Drilling Ltd. is a mining company dealing with petroleum products. During the year ended 31 December 2014, the following details were extracted from the company's financial statements:

|                                     | Sh"000"   |
|-------------------------------------|-----------|
| Geological costs                    | 84,680    |
| Exploratory drilling costs          | 146,400   |
| Acquisition costs                   | 19,800    |
| Lifting costs                       | 12,600    |
| Lease operating costs               | 64,780    |
| Costs of refining crude oil         | 18,240    |
| Oil and natural gas revenue         | 9,840,000 |
| Depletion and depreciation          | 34,980    |
| Share based compensation            | 24,670    |
| General and administrative expenses | 78,340    |
| Reversal of litigation expenses     | 9,680     |
| Finance expenses                    | 6,400     |
| Decommissioning costs               | 4,280     |
| Drilling machines                   | 18,300    |
| Investment income                   | 464,000   |
| Impairment losses                   | 5,680     |
| Intangible drilling costs           | 3,420     |
| Professional fees                   | 2,600     |
| Loan repayment                      | 840       |
| Tractor                             | 1,500     |
| Derivatives oil losses              | 480       |
| Restructuring expenses              | 848       |
| Forklift                            | 1,800     |

**Additional information:**

- Intangible drilling costs include Sh.420,000 for a well which failed to yield crude oil and was abandoned.
- Restructuring expenses include Sh.582,000 paid to a consultancy firm that restructured the capital structure of the company.
- Exploratory drilling costs include:
  - Plant and machinery Sh.4,800,000.
  - Erection of rigs and tankage Sh.1,600,000.
  - Pipes and storage tanks Sh.9,480,000.
  - Factory building Sh.48,400,000.
- Professional fees include Sh.800,000 for services provided by the general manager of the parent company.

**Required:**

A statement showing the taxable profit or loss for the year ended 31 December 2014.

(8 marks)  
(Total: 20 marks)

CA61 Page 4  
Out of 6

**QUESTION FIVE**

(a) Summarise three legal provisions relating to double taxation relief as applicable in your country. (3 marks)

(b) Lima Ltd. is a company incorporated in your country. The company controls 80% of the share capital of Shamba Ltd. which is also incorporated in your country. The following is a statement of comprehensive income of Lima Ltd. for the year ended 31 December 2014:

|                                    | Sh. "000" | Sh. "000" |
|------------------------------------|-----------|-----------|
| Gross profit                       |           | 59,220    |
| Less:                              |           |           |
| Depreciation                       | 4,872     |           |
| Legal expenses                     | 508       |           |
| Loan interest                      | 819       |           |
| Electricity                        | 378       |           |
| Salaries and wages                 | 9,387     |           |
| Telephone                          | 357       |           |
| Patent royalties paid              | 756       |           |
| Travel expenses                    | 785       | 17,862    |
|                                    |           | 41,358    |
| Other income                       |           |           |
| Patent royalties received          | 2,772     |           |
| Loan interest received             | 193       |           |
| Dividend received from Shamba Ltd. | 5,628     | 8,593     |
| Net income                         |           | 49,951    |

**Additional information:**

- The loan interest paid included the following:
  - Interest of Sh.285,000 relating to a loan acquired to purchase office equipment.
  - Interest of Sh.258,000 relating to a loan used to acquire shares of Shamba Ltd.
- Salaries and wages include passages of Sh.1,008,000 paid to a director who relocated to another country.
- Travel expenses include Sh.155,000 paid to a new employee hired from a foreign country.
- The loan interest received relates to a loan issued to an employee of the company to purchase a residential house.
- Not included in other income was rent received of Sh.1,638,000 from one lease, gross of a loss of Sh.397,000 made on another lease.
- An operating loss of Sh.189,000 had been carried forward for the previous eight years. This loss was included in salaries and wages expense as at 31 December 2014.
- Royalties of Sh.145,000 were due for receipt as at 31 December 2014 but had not been recorded in the books.
- Legal expenses included:
  - Sh.176,000 paid on disposal of some property and equipment.
  - Sh.48,000 incurred on debt collection.
  - Sh.78,000 incurred on defending the company against a claim for breach of contract.
- Patent royalties received were from Shamba Ltd. while those paid were to a Ugandan company.
- Capital allowances for the year ended 31 December 2014 were agreed with the commissioner at Sh.1,932,000.

**Required:**

A statement of adjusted taxable profit or loss for the year ended 31 December 2014. (10 marks)

(c) Amos Akida, a businessman, is facing a tax investigation by the revenue authority which suspects that he has been under-declaring income for the four years from year 2011 to year 2014.

You are the head of a team from the revenue authority conducting an investigation on Amos Akida. He has submitted to your team records of his private and business assets and liabilities from 1 January 2011 to 31 December 2014 as shown below:

|                            | 1 January<br>2011 | 31 December<br>2011 | 31 December<br>2012 | 31 December<br>2013 | 31 December<br>2014 |
|----------------------------|-------------------|---------------------|---------------------|---------------------|---------------------|
| Assets and liabilities     | Sh. "000"         | Sh. "000"           | Sh. "000"           | Sh. "000"           | Sh. "000"           |
| Factory premises           | 48,000            | 54,000              | 56,000              | 52,000              | 54,000              |
| Plant and machinery        | 24,000            | 25,000              | 38,000              | 34,000              | 36,000              |
| Motor vehicle (commercial) | 12,000            | 14,000              | 14,000              | 15,000              | 20,000              |
| Inventory                  | 4,600             | 5,200               | 9,000               | 10,000              | 8,000               |
| Trade receivables          | 3,950             | 4,540               | 3,640               | 3,530               | 3,980               |
| Private residence          | 8,240             | 14,600              | 14,600              | 14,600              | 14,600              |
| Trade payables             | 7,280             | 8,640               | 9,420               | 8,360               | 7,890               |

|                    | Sh. "000" | Sh. "000" | Sh. "000" | Sh. "000" | Sh. "000" |
|--------------------|-----------|-----------|-----------|-----------|-----------|
| Bank loan          | 10,900    | 10,000    | 9,870     | 7,640     | 9,840     |
| Loan from a friend | 800       | 700       | 600       | 870       | 640       |
| Mortgage loan      | 3,780     | 3,780     | 3,780     | 3,780     | 3,780     |
| Cash balance       | 3,400     | 5,400     | 3,600     | 3,760     | 4,670     |

**Additional information:**

1. The cash balance on 31 December 2012 included Sh.600,000 inherited from a relative on 30 August 2012.
2. His living expenses for each of the four years were as follows:

**Year ended 31 December:**

|                       | 2011   | 2012    | 2013   | 2014    |
|-----------------------|--------|---------|--------|---------|
| Living expenses (Sh.) | 85,000 | 140,000 | 90,000 | 165,000 |

3. Interest on mortgage is at the rate of 15% per annum.
4. There were no disposals of non-current assets during the period under investigation.

**Required:**

Taxable income of Amos Akida for each of the four years ended 31 December 2011, 2012, 2013 and 2014.

Ignore capital allowances.

(7 marks)

**(Total: 20 marks)**

.....

# 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<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%                   | (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                |
|                                 |                                      | 172,800               |

#### 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% |

#### 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              |

### 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 Vilolet 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:**

- (i) Advise on the correct VAT position for the company for the period between May 2015 and August 2015.

(6 marks)

- (ii) Comment on any information that you have not used in (c) (i) above.

(4 marks)

(Total: 20 marks)

.....