

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 Annual taxable pay Rate of tax  
(Sh.) (Sh.) % 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: Capital expenditure incurred on:	Rate of investment allowance	Residual value (25% per year on equal instalments)	Prescribed benefit rates of motor vehicles provided by employer (i) Saloons, Hatch Backs and Estates Monthly Annual rates rates (Sh.) (Sh.)
(a) Buildings:			
• 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) Machinery:			(ii) Pick-ups, Panel Vans (unconverted) 43,200
• Machinery used for manufacture	50% in the first year of use	25%	Up to - 1750 cc 3,600 50,400
• 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%	
• 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	10% per year on straight line basis		
• Machinery used to undertake operations under prospecting rights and exploration under mining rights	25% per year on straight line basis	25%	
• Other machinery	50% in the first year of use		
(c) Purchase/acquisition of right to use fibre optic cable by telecommunication operation	10% per year on straight line basis		(iii) Land Rovers/Cruisers 7,200 86,400
(d) Farm works	10% per year on straight line basis		
	50% in the first year of use	25%	

Commissioner's prescribed benefit rates: Monthly rates Services Annual rates  
(Sh.) (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 ~~role~~ an arbiter in a tax alternative dispute resolution (ADR) process. (4 marks) 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:

1. 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.

2. 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.

3. 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 -

4. 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

5. 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

6. Cash purchases and cash sales amounted to Sh.900,000 and Sh.2,400,000 respectively and were value added tax (VAT) inclusive.

7. 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.

8. 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.

9. 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

- FOUR
- (a) As a professional tax practitioner undertaking tax advisory for the small and micro enterprises (SME) sector, explain 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).

Solutions to the questions available.  
Call 0719525000

Details of their operations for the year ended 31 December 2022 are as follows:

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



Additional information:

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.

Required:

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

- (c) Venture Miners Ltd. are petroleum contractors. They have been granted by your government three licenses for the A, B and C contract areas in the Oil Basin. Details of their drilling and sale of petroleum for the year ended 31 December 2022 are as follows:

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.
- . The Company's Directors hold the company's governance and supervisory meetings outside the country. The loose tools and machinery for exploration were brought in new during the year.

2  
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 Outside the country

Sh. 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.

Transactions are stated as VAT inclusive at a rate of 16% where applicable.

6.

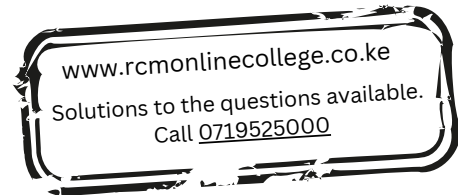
Required:

- (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)
- .....

