UNIVERSITY EXAMINATIONS: 2013/2014

EXAMINATION FOR THE MASTERS OF SCIENCE (MSC) IN COMMERCE (FINANCE AND ACCOUNTING)

MFA 602 ADVANCED TAXATION PRACTICE (EVE)

DATE: APRIL, 2014 **TIME: 3 HOURS**

INSTRUCTIONS: Answer Question One and Any Other Three Questions

QUESTION ONE (31 MARKS)

RATES OF TAX (Including wife's employment, self employment and professional income rates of tax).
Year of income 2013.

Monthly taxable pay (Shillings)	Annual taxable pay (Shillings)	Rates of tax % in each shilling
1 - 10164	1 - 121968	10%
10165 - 19740	121969 - 236880	15%
19741 - 29316	236881 - 351792	20%
29317 - 38892	351793 - 466704	25%
Excess over 38892	Excess over - 466704	30%

Personal relief Kshs. 1162 per month (Kshs.13,944 per annum)

Capital allowances:

(i) Wear and tear allowances:

Class I	37.5%
Class II	30%
Class III	25%
Class I V	12.5%

(ii) Industrial building allowances:

Industrial buildings	2.5%
Hotels	10%

(iii) Farm work allowances **100 %**

Prescribed benefit rates of motor vehicles provided by employer

	Monthly rates Kshs.	Annual Rates Kshs.
(i) Saloons, Hatch Backs & Estates		
Up to 1200 cc	3600	43200
1201- 1500 cc	4200	50400
1501- 1750 cc	5800	69600
1751- 2000 cc	7200	86400
2001- 3000 cc	8600	103200
Over 3000 cc	14400	172800

(iv) Shipping investment deduction 40%	**(iv) Pick-ups, Panel Vans (Unconverted)**			
(v) Mining allowance:		Up to 1750 cc	3,600	43,200
Year 1 - 40%		Over 1750 cc	4,200	50,400
Year 2-7 - 10%	**(vi) Land Rovers/ Cruisers**		7200	86400
	OR 2% of the initial capital cost of the vehicle for each month.			

Commissioner's prescribed benefit rates	**Monthly rates Kshs.**	**Annual rates Kshs.**
Services	1500	18000
(i) Electricity (common or from generator)	500	6000
(ii) Water (Communal or from a borehole)		
(iii) Provision of furniture (1% of cost to employer) If hired, the cost of hire should be brought to charge		
(iv) Telephone (Landline and mobile phones)	30% of bills	
(i) Water	200	2,400
(ii) Electricity	900	10800

QUESTION ONE

(a) "Multinational Corporations may adopt certain structures for their Kenyan subsidiaries that shift profits out of Kenya to countries where profits are taxed less and thus divert part of Kenya's revenue abroad".

Required:

With reference to the statement above and Section 18(3) of the Income Tax Act (Cap.470):

(i) Outline the characteristics of transactions that may constitute transfer pricing. (4 Marks)

(ii) Identify four methods of determining an appropriate transfer price as provided in the Organization for Economic Co-operation and Development (OECD) model. (4 Marks)

(b) One of the challenges faced by a number of countries is how to finance their budget deficits. The problem is compounded by the fact that some of the alternatives available for financing the budget deficit might negatively impact the country.

Required:

Citing one disadvantage in each case, briefly explain four measures that a government could undertake to finance a budget deficit. (4 Marks)

(c) Discuss four challenges associated with the harmonization of taxation policies across regions and trading blocks. (8 Marks)

(d) A number of revenue authorities in the region have embarked on various tax modernization programmes. Discuss three goals of such modernization programmes. (6 Marks)

(e) Describe three types of tax assessments that may originate from the Commission for Domestic Taxes. (5 Marks)

QUESTION TWO (23 MARKS)

Mr. Wekesa Msafiri is an importer of goods from India. He operates from premises, which he has rented at Kshs. 5,000 per month. He prepares his accounts to 31 December 2013.He presented the following accounts with his self-assessment for the year of income 2013:

TRADING AND PROFIT AND LOSS ACCOUNT

FOR THE YEAR 31 DECEMBER 2013

		Kshs.	Kshs.
Sales			15,100.000
Less: Cost of Sales			
Opening Stock		2,005,000	
Purchases		9,160,000	
		11,165,000	
Closing stock		(902,000)	
Cost of Sales			10,263,000
Gross profit			**4,837,000**
Less expenses;			
General expenses		1,970,600	
Salaries		2,024,600	
Rent paid		65,000	
Rates		28,000	
Car expense		382,000	
Depreciation	- Car	13,000	
	- Furniture	10,000	
Carriage outwards		234,000	
Hire purchase interest		2,500	
Total expenses			**4,730,300**
Surplus for the year			**106,700**

BALANCE SHEET AS AT 31 DECEMBER 2013

	Kshs.	Kshs.
	2013	**2012**
Fixed Assets		
Motorcar	52,000	65,000
Furniture	90,000	100,000
	142,000	**165,000**
Current Assets		
Stock in trade	902,000	2,005,000
Debtors	1,000,400	240,000
Prepaid rates	7,000	5,000
Balance at bank	2,418,000	270,600
Cash in hand	6,700	5,900
	4,334,400	**2,526,500**
Current liabilities:		
Creditors	3,213,400	1,102,000
Accrued rent	5,000	10,000
Due for hire purchase	-	27,900
	3,218,400	**1,139,900**
Net current assets	**1,115,700**	**1,386,800**
Net assets	**1,257,700**	**1,551,600**
Capital Account:		
Balance on 1 January	**1,551,600**	**987,400**
Profit for the year	***106,700***	***600,000***
	1,658,300	1,587,400
Less: drawings	400,600	35,800
Net capital	**1,257,700**	**1,551,600**

A request for information for an in-depth inquiry produced the following:

1) Mr. Wekesa buys good for resale only from one manufacturer in India, who allows a rebate of 3% of the goods purchased by him in excess of Kshs. 5, 000,000 in a calendar year. The rebate due for the year ended 31 December 2013 was Kshs. 124, 800.

2) All goods are sold at a standard gross profit margin of 40% on selling price. Any rebate due is to be ignored for the purpose of fixing the selling price.

3) Stock at cost on 31 December 2013 amounted to Kshs. 902,000

4) Weekly cash expenses out of cash sales (before depositing the same in the bank) have been Kshs.

	Kshs.
Drawings	2,500
Carriage outwards	4,500
Petrol	400
Sundries	200

Cash in hand on 31 December 2013 amounting to Kshs. 6,700.

5) Depreciation on motor car and furniture is provided at 25% and 12.5% respectively on straight-line method. Wear and tear allowances have been agreed at Kshs. 13,000 and Kshs. 10,000 respectively.

6) Mr. Mizigo's bank statements for the year reveal the following payments:

	Kshs.
Paid for purchase of goods	10,105,000
Car expenses	36,800
Rent	65,000
Rates for the year	28,000
Hire purchase instalment (final payments)	30,400
Salaries	1,024,600
General expenses	1,560,600
Drawings	370,600
Bank balance as at 31 December 2013 was	2,418,000

7) Hire purchase interest was Kshs. 2,500

Required:

a) An in-depth assessment report of the account of Mr. Mizigo to determine the accuracy or otherwise of the accounts. The report should be in an analytical form, showing a comparative statement of their accounts as presented by Mr. Mizigo and your own presentation. Do not compute the tax due. (19 Marks)

b) The accounts presented herein had been audited and an audit certificate issued. From your finding in (a) above, could the auditor suffer any consequences under the provisions of section 111 of the Income Tax Act? (4 Marks)

QUESTION THREE (23 MARKS)

a) State the major tax consideration you will take into account while advising your client regarding doing business as a partnership or a private company. (6 Marks)

b) Mr. Mjongoi, a contractor, prepares his accounts to 31st August each year. For the year ended 31st August 2010 he submitted the installment tax return on 31 May 2010 and paid an installment tax of Kshs. 44,000 on the due date. He failed to submit the self-assessment and was issued with a notice of estimated assessment on estimated income of Kshs. 2,000,000 on 28th February of 2011. He expects his income to be higher than the estimated. The self-assessment and accounts were submitted on 30th May 2011. The tax payable for the year 2009 was Kshs. 160,000.

Required:

(i) What action would you advise Mr. Mjongoi to take on receipt of estimated assessment? (2 Marks)

(ii) What action will the Commissioner take if the self-assessment return and account reflect an income of Kshs. 2,400,000. (1 Mark)

(iii) Calculate the tax payable and the date tax was payable (6 Marks)

(iv) Assume the tax is not paid by 30th June 2011. Calculate late filing return penalty, late payment penalty and late payment interest payable by 30th June 2011. (6 Marks)

(v) Why does the Commissioner impose stiff penalties and interest? (2 Marks)

QUESTION FOUR (23 MARKS)

(a) Assume that recently, a team of foreign investors visited your country to explore opportunities for capital investment. One of the areas that the investors were keen to know was whether country had entered into a tax information exchange agreement (TIEA) with their country.

Required:

Citing one benefit, describe the nature and operation of TIEAs. (5 Marks)

(b) Advancements in Information Communication Technology (ICT) among other areas have resulted in both positive and negative effects on the administration of tax.

Discuss six positive effects and four negative effects of technological advancements on the administration of tax in your country. (12 Marks)

(c) Mr. Charles Matata works partially in Kenya and partially in Canada. His family is based in Kenya. During the year ended 31 December 2013, Mr. Matata earned an equivalent of Kenya shillings 3,600,000 from his employment in Canada. He paid an equivalent of Kenya shillings 480,000 as tax on the income.

He also earned Kshs. 1,800,000 as consultancy fee in Kenya in addition to employment income of Kenya Kshs. 1,200,000 (PAYE Kshs. 400,000). His employer in Kenya provided his family with accommodation. The monthly rent was Kshs. 60,000 which was paid by the employer.

Required:

Tax liability of Mr. Charles Matata for the year ended 31 December, 2013. (6 Marks)

QUESTION FIVE (23 MARKS)

Mr. Artexus Maina retired from the civil service in 2003. Upon his retirement, he ventured into a number of businesses whose details are provided below.

1. He registered a company, Samoa Ltd., on 1 January 2003 with himself and his wife, Mrs. Maina, as the directors. The company deals in the importation and sale of sewing machines. Mr. and Mrs. Maina also own a dress-making shop which purchases sewing machines from Samoa Ltd.
2. He holds the following investments:
   - Ordinary shares in a number of companies, some of which are registered in Kenya and others in Uganda. The companies are quoted on the securities exchange market of the country in which they are registered, although a few of the companies are cross-listed on both the securities exchange markets.
   - Two government infrastructure bonds, one with a maturity of 2½ years and the other with a maturity of 8 years.
   - Shares and deposits in Wastaafu Sacco Ltd.
   - Deposits in a collective investment scheme.
3. On 1 January 2009, Mr. Maina leased out a rocky part of his land to a construction company as a quarry. The lease contract provided for a royalty of Kshs. 10 per construction stone extracted from the quarry by the lessee. The royalties payable to Mr. Maina were subject to a minimum rent of Kshs. 50,000 per annum with short workings being recoverable within a period of two

years after their occurrence.

The revenue authority has raised a number of issues with Mr. Maina concerning his income and transactions for the year ended 31 December 2009. Mr. Maina has approached you for advice on these issues, which are summarized below:

i) Samao Ltd. has been making losses since the commencement of operations in 2003. As at January 2009, the company had brought forward accumulated losses of Kshs. 2,000,000 of which Kshs. 400,000 arose in the first year of the company's operations. However, for the year ended 31 December 2009, the company reported a profit of Kshs. 1,800,000. The revenue authority intends to tax this profit in full in the year ended 31 December 2009.

ii) For purposes of determining whether Samoa Ltd. should register for VAT based on the amount of taxable supplies, the revenue authority aggregated the taxable supplies of the company with those of the dress-making shop.

iii) During the year ended 31 December 2009, Mr. Maina received a dividend of Kshs. 12,000 from his shares held in a company registered in Uganda but which was cross-listed on the Nairobi Stock Exchange in Kenya. He also sold some shares held in a Kenyan registered company and realized a profit of Kshs. 1,400. The shares were sold through the Uganda Securities Exchange. The revenue authority intends to charge withholding tax on both incomes.

iv) He received the following interest income from the infrastructure bonds during the year:

Bond maturity (years)	Interest received (Kshs.)
2 ½	14,000
8	7,500

The revenue authority intends to subject both incomes to withholding tax as the final tax.

v) He earned dividend and interest on deposits amounting to Kshs. 2,000 and Kshs. 12,500 respectively from Wastaafu Sacco Ltd. during the year. The revenue authority intends to charge withholding tax at 5% on the dividend income and at 15% on the interest income.

vi) He received an income of Kshs. 46,000 from the collective investment scheme during the year. The revenue authority intends to treat this income as exempt from tax.

vii) He received a royalty of Kshs. 50,000 from the leasing of the quarry. The actual number of construction stones extracted from the quarry during the year was 3,000. The revenue authority intends to charge withholding tax at the rate of 5% as a final tax on the royalty income of Kshs. 50,000.

Required:

(a) With reference to the Sixth Schedule of the Value Added Tax (VAT) Act, explain to Mr. Maina:

(i) The conditions under which a person is deemed to be related to another for purposes of determining taxable supplies. (5 Marks)

(ii) Relevance of determining whether a relationship exists between or among persons. (3 Marks)

(b) Advise Mr. Maina on the correctness or otherwise of the intended action by the revenue authority on each of the issues raised in relation to his income and transactions for the year ended 31 December 2009. Your advice should include a comment on the correct tax treatment of issues raised where, in your opinion, the intended treatment by the revenue authority is country to tax law and regulations. (15 Marks)

QUESTION SIX (23 MARKS)

(a) The following statement was made by the tax manager of a leading professional firm of accountants during a seminar on ethics and other standards of practice for tax practitioners:

"Tax advice is recognized as a valuable service provided by practitioners. The form of advice may be oral or written and the subject matter may range from routine to complex. In deciding on the form of advice provided to a tax payer, a practitioner should exercise professional judgement".

Required:

With reference to the above statement, briefly explain five factors that a tax practitioner should consider in deciding whether to provide oral or written advice to a tax payer. (5 Marks)

(b) Discuss in detail the major steps involved in a tax research process (8 Marks)

(c) Describe the opportunities available for corporate tax planning in your country under the following headings:

(i) Use of debt in the capital structure. (4 Marks)

(ii) Procuring business inputs (local and imports). (3 Marks)

(iii)Offshore business structures. (3 Marks)