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KIRIRI WOMENS' UNIVERSITY OF SCIENCE AND TECHNOLOGY
UNIVERSITY EXAMINATION, 2019/2020 ACADEMIC YEAR
FOURTH YEAR, FIRST SEMESTER EXAMINATION
FOR THE DEGREE OF BACHELOR OF SCIENCE
BUSINESS ADMINISTRATION

Date: 9th December, 2019
Time: 2.30pm – 4.30pm

KAC 402 - TAXATION

INSTRUCTIONS TO CANDIDATES

ANSWER QUESTION ONE (COMPULSORY) AND ANY OTHER TWO QUESTIONS

QUESTION ONE (30 MARKS)

- a) In the context of income taxes, briefly explain the following:
- i) Taxation at source (2 Marks)
 - ii) Taxation of wife's employment income (2 Marks)
 - iii) Tax avoidance (2 Marks)
 - iv) Taxation of pension income (2 Marks)
 - v) Penalties for submitting fraudulent tax returns (2 Marks)
- b) Explain the concept of the "incidence of a tax" clearly outlining its importance to policy makers. (6 Marks)
- c) Mr. Mbotela is employed by Jamii Bank Ltd as an Accountant. He has presented the following details to be used in the computation of his taxable income for the year ended 31 December, 2018:
- 1. He received a basic salary of Sh. 60,000 per month (PAYE Sh. 7,000). He also received an overtime allowance equivalent to 10% of his monthly pay.
 - 2. His employer paid his hospital bills averaging Sh. 4,000 per month.
 - 3. His employer provided him with the following
 - i) A car, which was acquired at a cost of Sh. 300,000. This car has an engine capacity of 2000cc.
 - ii) A house. The employer deducted Sh. 2,500 from Mr. Mbotela's salary every month to cover rent for the house.
 - iii) A gardener and a night watchman.
 - 4. He contributes Sh. 8,000 per month to a registered pension scheme while the employer contributes an equal amount.

5. For the year ended 31 December 2018, the employer provided Mr. Mbotela with tea and snacks valued at Sh. 3,000.
6. Mr. Mbotela attended a one-day seminar and received Sh. 2,500 from his employer as allowances. He donated 10% of this amount to a local children's home.
7. He was nominated the employee of the year on 31 December 2018. This award carried a cash gift of Sh. 45,000.
8. Mr. Mbotela operates a savings account with Post Bank Ltd. During the year ended 31 December 2018, the bank credited his account with Sh. 2,000 being interest on the balance in his account.
9. In the month of November 2018, he received compensation from an insurance company amounting to Sh. 80,000. This was in relation to household furniture destroyed by fire.
10. On 5 November 2018, he started offering part-time tax consultancy services. He made a profit of Sh. 70,000 from the consultancy before deducting operating expenses of Sh. 18,000 and Sh. 4,000 relating to the acquisition of furniture.
11. His wife, Mrs. Mbotela, operates a grocery. She made a net-profit of Sh. 50,000 after deducting the following:

	Sh.
Rent of stall	10,000
Hire of van	22,000
School fees for children	108,000
Advertisement expenses	6,000

Required:

- i) Mr. Mbotela's taxable income for the year ended 31 December 2018
(10 Marks)
- ii) Tax payable on the taxable income computed in (i) above.
(4 Marks)

QUESTION TWO (20 MARKS)

Gatwiri, Kiende and Kanyiri are partners, operating a supermarket in Meru town. They share profits and losses in the ratio 2:2:1 respectively. During the year ended 31 December 2018, the partners reported a loss of Sh.4, 425,000 after deducting the following:

	Sh.
Interest on capital:	
Gatwiri	232,000
Kiende	232,000
Kanyiri	348,000
Salaries to partners:	
Gatwiri	400,000
Kiende	420,000
Kanyiri	576,000
Motor vehicle running expenses	304,000
Repairs and maintenance	96,000
Office expenses	240,000
Goodwill	400,000
Loss on investment	600,000
Postage and telephone	170,000
Water and electricity	136,000
Subscriptions to Kenya National chamber of Commerce	128,000
Salaries and wages	712,000
Donations	300,000
Bad debts written off	346,000
Rent, rates and licences	160,000
Professional fees	960,000
Depreciation	1,760,000
Purchase of lorry	1,331,000
Dividend receive (Net)	264,000
Insurance recovery on motor vehicle	520,000

Notes:

- Offices included cost of office cabinet of Sh.110, 000.
- Travelling expenses amount to Sh.12, 000 per month related to personal use.
- Provision for bad and doubtful debts account

	Sh.		Sh.
Bad debts	246,000	General b/f)	330,000
Specific (c/f)	192,000	Specific (b/f)	152,000
General (c/f)	<u>390,000</u>	Profit and loss account	<u>346,000</u>
	<u>828,000</u>		<u>828,000</u>

- Kiende had taken goods worth Sh.70, 000 for her own use.
- Wear and tear allowances agreed with the commissioner amounted to Sh.706, 000.
- Included in repairs and maintenance is Sh.80, 000 paid for office partitions in 2018.

Required:

- The taxable profit (loss) from the partnership business (14 Marks)
- Show the distribution among the partners as at 31 December 2018 and tax payable thereon. (6 Marks)

QUESTION THREE (20 MARKS)

You are provided with the following information concerning Bimak Ltd., a company that makes its accounts to 31 December every year.

The company bought an industrial building from Mr. Kujenga at a cost of Sh.20, 000,000 in 2015. Mr. Kujenga had constructed the building in 2014 at a cost of Sh.16,600,000 which included the cost of land amounting to Sh.4,000,000, a canteen for workers for Sh.2,400,000, showroom costing Sh.600,000 and offices costing Sh.1,500,000. The building however, had not been put into any use in 2015.

In the same year, Bimak Ltd. made the following additions to the building:

A warehouse at a cost of Sh.3, 600,000

Labour quarters costing sh.2, 400,000

Extension to the factory building to accommodate machines at a cost of Sh.4, 200,000.

Before commencing manufacturing on 1 July 2016, Bimak Ltd. acquired the following additional assets:

Processing machinery - Sh.5, 200,000

Labour Cruiser - Sh.1, 200,000

A three-ton lorry - Sh.2, 600,000

A tractor - Sh.3, 600,000

Furniture and fittings - Sh.1, 200,000

Bimak Ltd. converted one of the director's Mercedes Benz vehicles into company's use. It was valued at Sh.1,500,000 and was used entirely for the company's business.

Computers - Sh.1, 600,000

Photocopier - Sh. 240,000

Saloon car - Sh.1, 200,000

In the year 2017, Bimak Ltd continued expanding and acquired/constructed the following:

Additional processing machinery - Sh.2, 400,000

An additional factory extension was constructed at a cost of sh.4, 600,000 which included an administrative office costing Sh.1, 000,000. These were brought into use with effect from 1 September 2017.

A fire exit was also constructed at a cost of Sh.900,000 and brought into use on 1 July 2017.

The management disposed of the following assets in the year 2013:

Processing machinery Sh.1,200,000

One of the computers purchased in 2016 for sh.120,000 was traded in with another one valued at Sh.300,000. The trade-in-value was sh.150,000.

The Mercedes Benz was disposed of at Sh.600, 000.

In the year 2018, Bimak Ltd. decided to strengthen the security at the factory by building a stone perimeter fence at a cost of Sh.1, 800,000. This was brought into use with effect from 1 June 2018.

The company bought a Range Rover for the Chief Executive at a cost of Sh.2,400,000.

Required:

- a) Bimak Ltd.'s capital allowances for each of the years ended 31 December 2016, 2017 and 2018. (16 Marks)
- b) Obtain the written down values of the assets as at 31 December 2014. (4 Marks)

QUESTION FOUR (20 MARKS)

- a) Using two examples in each case, differentiate between allowable and non-allowable expenses under the Income Tax Act. (4 Marks)
- b) The directors of PQR Limited have presented you with the following profit and loss account for the year ended 31 December 2018:

	Sh.	Sh.
Gross profit		29,826,000
Less: Operating expenses		
Salaries and wages	8,000,000	
Reserves for contingencies	1,580,000	
Hire purchase interest	413,000	
Laundry expenses	434,000	
Legal and professional fees	400,000	
Depreciation	2,450,000	
Dividends paid	1,600,000	
Repairs and maintenance	872,000	
Insurance premiums	320,000	
VAT paid	168,000	
Bad and doubtful debts	228,000	
Advertising	1,200,000	
Bank charges	170,000	
Water and electricity	1,200,000	
Rent and rates	3,020,000	
Subscriptions and donations	371,000	
Telephone and postage	1,204,000	
Sundry expenses	600,000	
Motor vehicle running expenses	<u>2,300,000</u>	<u>26,530,000</u>
Net profit		<u>3,296,000</u>

Additional information:

- Salaries and wages include Sh.66,000 paid to the Income Tax Department as penalties and interest on delayed submission of PAYE deductions.
- Hire purchase interest relates to loans obtained to purchase a delivery van sh.146,000 and the Chairman's personal car Sh.267,000.
- The company directors and senior managers are given free laundry services at the company's laundry. The cost of cleaning their personal clothing for the year ended 31 December 2018 was sh.133,000.
- Legal and professional expenses include sh.146,000 incurred while defending the Managing Director in a private suit against him.
- Repairs and maintenance include the cost of acquiring a second hand laundry machine for sh.167,000.
- Bad and doubtful debts are made up of a 10% general provision against the debtors balance as at 31 December 2018 and a full provision of Sh.93,000 owed by Orient Finance Ltd. that has been placed under receivership. The debtors balance as at 31 December 2018 was Sh.1,350,000.

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| 7. | Subscriptions and donations comprise: | Sh. |
| | Subscription to Rhino golf Club for the Managing Director | 260,000 |
| | Subscription to the Chamber of Manufacturing and Commerce | 63,500 |
| | Donation of books to the Watoto School for the Handicapped | 35,000 |
| | Annual subscription for Finance Manager paid to the Institute of Certified Public Accountants of Kenya | 12,500 |
8. Sundry expenses include sh.263,000 paid to Health Africa for the Managing Director's medical cover. He is the only one in the company covered by the medical scheme.
9. Wear and tear allowances for the year ended 31 December 2018 have been agreed at Sh.4,320,000.

Required:

- i) PQR Ltd.'s adjusted profit (or loss) for tax purposes for the year ended 31 December 2018. (14 Marks)
- ii) Corporation tax (if any) payable by PQR Ltd. for the year ended 31 December 2018. (2 Marks)

QUESTION FIVE (20 MARKS)

- a) Mr. Allan Muvozi is a Ugandan businessman wishing to invest in Kenya. He has approached you for professional advice on the tax implications of various forms of business.

Required:

Explain to him four tax advantages enjoyed by a sole proprietorship over a company.

(8 Marks)

- b) Mr. John Mpole accepted voluntary retirement from the Civil Service on 1 January 2018. He received a golden handshake of Sh. 2 million. He is now considering six possible investments as listed below:
1. Purchase ordinary shares in Kenya Airways Limited.
 2. Purchase ordinary shares in Uganda Breweries Limited.
 3. Open a fixed deposit account with Kenya Commercial Bank Limited.
 4. Purchase government Treasury bills.
 5. Open a savings account with Kenya Post Office Savings Bank Limited.
 6. Subscribe for debentures in National Bank of Tanzania Limited.

Required: For each of the investments above, advise Mr. Mpole on the income tax consequences.

(6 Marks)

- c) List and briefly explain three ways in which a government can reduce its budget deficit.

(6 Marks)

RATES OF TAX

(Including wife's employment, self-employment and professional income rates of tax)

YEAR OF INCOME 2018

Taxable Employment Benefits - Year 2018

Annual Income [Kshs]		Monthly Income [Kshs]	Tax Rate [%]	Cumulative Tax Per Month	Cumulative Tax p.a
0 – 134,164		0 – 11,180	10%	1,118	13,416
134,164 – 260,567		11,180 – 21,714	15%	2,698	32,376
260,567 – 386,970		21,714 – 32,248	20%	4,805	57,657
386,970 – 513,373		32,248 – 42,781	25%	7,439	89,258
513,373 and above		42,781 and above	30%		
*Relief				1,280	15,360
Prescribed benefit rates of motor vehicles provided by employer					
				Monthly rates (Sh.)	Annual rates (Sh.)
Capital allowances:		(i)	Saloon, Hatch Backs and Estates		
Wear and tear allowances			Upto - 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
Industrial building allowance:			Over - 3000 cc	14,400	172,800
Industrial buildings	2.5%	(ii)	Pick-ups, Panel Van (Unconverted)		
Hotels	10%				
Farm works allowance	100%		Upto 1750 cc	3,600	43,200
Investment deduction allowance:			Over 1750 cc	4,200	50,400
2003 -	70%	(iii)	Land Rovers/Cruisers	7,200	86,400
2004 -	100%		OR 2% of the initial capital cost of the vehicle for each month, whichever is higher.		
2005 -	100%				
Shipping investment deduction 40%					
Mining allowance:					
Year 1	40%				
Year 2 - 7	10%				

Commissioner's prescribed benefit rates

Services

		Monthly rates Sh.	Annual rates Sh.
(i)	Electricity (Communal or from a generator)	1,500	18,000
(ii)	Water (Communal or from a borehole)	500	6,000
(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	
Agricultural employees: Reduced rates of benefits			
(i)	Water	200	2,400
(ii)	Electricity	900	10,800

Low interest rate employment benefit:

The benefit is the difference between the interest charged by the employer and the prescribed rate of interest.

Other benefits:

Other benefits, for example servants, security, staff meals etc are taxable at the higher of fair market value and actual cost to employer.

The current VAT rate is 16%