



MUEO

MOI UNIVERSITY

OFFICE OF THE CHIEF ACADEMIC OFFICER

UNIVERSITY EXAMINATIONS

2018/2019 ACADEMIC YEAR

THIRD YEAR END OF SEMESTER EXAMINATIONS

FOR THE DEGREE OF BACHELOR OF BUSINESS MANAGEMENT

COURSE CODE: **BBM 303**

COURSE TITLE: **TAXATION I**

DATE: 3RD DECEMBER, 2018

TIME: 9.00 AM-12.00 PM

INSTRUCTION TO CANDIDATES

- SEE INSIDE

THIS PAPER CONSISTS OF (6) PRINTED PAGES

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BBM 303: TAXATION 1

MAIN EXAMINATION: 1st SEMESTER, 2018/2019 ACADEMIC YEAR

Instructions: Answer Question *ONE* and Any Other *THREE*

Tax rates for individuals (Natural Persons)

An individual is taxed at graduated scale rates such that the higher the income, the higher the tax as follows: These rates are effective on 1st January, 2018. These rates of tax include wife's employment, self-employment and professional income rates of tax.

Monthly taxable pay (shillings)	Annual taxable pay (shillings)	Rates of tax %
0 - 12,298	0 - 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 Shs. 1,280 per month (Shs. 15,360 per annum)

Prescribed benefit rates of motor vehicles provided by employer

Capital allowances:	Monthly	Annual
Wear and tear allowances	(i) Saloon, Hatch Backs and Estates	
Class I 37.5%	Upto - 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
Industrial building allowance:	Over - 3000 cc	14,400 172,800
Industrial buildings 10%	(ii) Pick-ups, Panel Van (Unconverted)	
Hotels 10%	Upto 1750 cc	3,600 43,200
Farm works allowance 100%	Over 1750 cc	4,200 50,400
Investment deduction allowance:	(iii) Land Rovers/Cruisers	7,200 86,400
2005 to date - 100%	OR 2% of the initial capital cost of the vehicle for each month, whichever is higher.	

Shipping investment deduction 40%

Mining allowance:

Year 1	40%
Year 2 - 7	10%

Commissioner's prescribed benefit rates

Services	Monthly rates	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
(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

The current VAT rate is 16%

QUESTION ONE

- a. During a tax seminar, a facilitator noted that “one of the current challenges facing the Kenya revenue authority is failure to collect the targeted revenue set out in the national budget. Discuss the measures that Kenya revenue authority has taken to enhance revenue collection in Kenya. (4 Marks)
- b. Explain any case where a business can close the year with a negative balance in any class of wear and tear elaborating on how such a balance would be treated. (2 Marks)
- c. Outline the challenges that may affect the operations of the recently introduced itax system in Kenya. (4 Marks)
- d. Babu is a resident individual and a qualified pharmacist who has been employed by Eldoret Hospital since his early retirement from the public service in 2017. The following details were availed to you in respect of his earnings for the year of income 30th June, 2018:
1. He received a monthly basic salary of Sh. 184, 000 from Eldoret Hospital. Additional one month’s salary was paid to him in June 2018 as a bonus. PAYE deducted during the year was Sh. 897, 000.
 2. Pension received from the public service was Sh. 540, 000 as a lump sum amount.
 3. A commission of Sh. 199, 000 was paid to him for the promotion of drugs under identified brands during the year.
 4. During the year, he was sent to Mombasa for a four day medical conference and was paid daily subsistence allowance of Sh. 18, 000 by the hospital.
 5. He has a fixed deposit account of Sh. 1, 500, 000 at the Diamond Bank Ltd. from he received an interest of Sh. 105, 000 during the year.
 6. He has a life insurance policy where he contributes 40% of the premiums, while the employer contributes 60%. Annual premiums as per the insurance policy during the year was Sh. 460, 000.
 7. He was provided with a saloon car of 2000 cc by the hospital for personal and official duties on 31st December, 2017. The saloon car had an initial cost of Sh. 2, 800, 000.
 8. The hospital has a medical cover for all employees. He was entitled to a maximum cover of Sh. 180, 000 per annum while he utilized Sh. 74, 000 on medical bills during the year.
 9. During the year, he was provided with a house. The market value of the house was Sh. 120, 000 p.m. and he contributed Sh. 20, 000 p.m. as nominal rent.
 10. During the year, the hospital settled his bills as follows: telephone Sh. 68, 000, water Sh. 18, 200 and electricity Sh. 24, 600.
 11. The hospital contributed 5% of his basic salary towards a registered pension scheme while he contributed an equal amount to the scheme.
 12. The hospital paid subscription fees on his behalf to the Pharmacy and Poisons Board amounting to Sh. 54, 000 during the year.
 13. He was reimbursed private entertainment expenses of Sh. 120, 000 by the hospital during the year.

Required:

- i) Taxable income for Mr. Babu for the year of income ended 30th June, 2018. (10 Marks)
 - ii) Tax payable (if any) on the income computed above. (2 Marks)
 - iii) Comment on any information not used. (3 Marks)
- (Total = 25 Marks)**

QUESTION TWO

- a. Outline any five specified sources of income as stipulated in Section 3 (2) of the Income Tax Act. (5 Marks)
 - b. Explain the treatment of the following as provided under the employer's PAYE regulators:
 - i) Tax free remunerations. (1 Mark)
 - ii) Payment in lieu of leave. (1 Mark)
 - iii) Personal relief granted to persons leaving the country. (1 Mark)
 - c. Distinguish between the following terms as used in taxation
 - i) Self-assessment and normal assessment (2 Marks)
 - ii) Balancing charge and trading receipt (3 Marks)
 - iii) Forward and Backward Shifting (2 Marks)
- (Total = 15 Marks)**

QUESTION THREE

- a. Discuss the treatment of royalties in taxation (3 Marks)
- b. Chege and Telek have been partners trading as Chetel Traders. On 1st September, 2017, they admitted in the business and changed the partnership name to CHETELOP Traders. Prior to the admission of Lopez, the profit and loss sharing ratio was 2:3 between Chege and Telek respectively. However, with the admission of Lopez, they revised the profit and loss sharing ratio to 2:3:1 for Chege, Telek and Lopez respectively. The partners have presented the following income statements for the year ended 31st December, 2017.

Income	Sh.	Sh.
Gross profit		4, 500, 000
Foreign exchange gain		234, 000
Interest on bank deposit (net)		90, 000
Insurance compensation for stolen vehicle		300, 000
Profit on disposal of computers		<u>160, 000</u>
		5, 284, 000

Expenditure

General expenses	2, 625, 000
Salaries and wages	1, 800, 000
Interest on capital:	
Chege	120, 000
Telek	105, 000
Lopez	22, 500

Legal expenses	365,625	
Loss on sale of assets	11,400	
Stamp duty on lease agreements	6,120	
Licenses and permits	10,800	
Subscriptions to trade associations	42,000	
Conveyance fees	12,500	
Rent and rates	180,000	
Mortgage interest	180,000	
Repairs on computers	45,000	
Furniture purchased (cost)	63,000	
Bank charges	60,000	
Repair and maintenance	560,000	
Bad and doubtful debts	123,750	
Depreciation	193,400	(6,626,095)
Net profit (Loss)		<u>(1,342,095)</u>

Additional information:

- General expenses comprise:** Sh.

Embezzlement by cashier	900,000
Staff Christmas party	600,000
Replacement of car engine	105,000
Partition of an office	450,000
Partners private insurance policy	570,000
- Salaries and wages include Sh. 525,000, Sh. 600,000 and Sh. 235,000 paid to Chege, Telek and Lopez respectively.
- Mortgage interest relates to a partner's residential house.
- Assume that the income accrued evenly throughout the year.
- Legal expenses comprise:** Sh.

Parking fines paid to county government	11,400
Legal fees for breach of contract	150,000
Drafting a tender document	13,500
Drafting a lease agreement (100 years)	6,750
Defending a partner in a tax case	9,000
Legal costs of debt collection	174,975
- Repair and maintenance costs comprise:** Sh.

Purchase of weighing scale	252,000
Installation of CCTV cameras	224,000
Fixing a leaking roof	84,000
- Bad and doubtful debts comprise:** Sh.

Specific bad debts	74,250
General provision for bad debts	49,500

8. Capital allowances was agreed with the commissioner of revenue authority at Sh. 260, 800.

Required:

- i) Adjusted taxable profit or loss for the partnership for the year ended 31st December, 2017. (8 Marks)
 - ii) Allocation of profit or loss to the partners (4 Marks)
- (Total = 15 Marks)**

QUESTION FOUR

- a. Discuss the functions of the commission of revenue allocation (CRA) or its equivalent as provided in the Kenyan constitution. (12 Marks)
 - b. Outline three instances when the commissioner of domestic taxes or equivalent office holders in Kenya may cancel a personal identification number (PIN). (3 Marks)
- (Total = 15 Marks)**

QUESTION FIVE

- a. Outline five main effects of the current 8% VAT rate on fuel prices to the consumers. (5 Marks)
- b. Silver Breeze Company Limited commenced operations on 1st July, 2017 after incurring the following expenditure.

	Sh. "000"
Processing machinery	6, 200
Factory land and buildings	10, 500
Delivery van	2, 600
Water pump	420
Computers	380
Staff canteen construction	960
Lorry (4 tonnes)	3, 200
Furniture	180
Digital weighing machines	250
Computer software	320
Staff clinic construction	1, 200
Tractor	2, 800

Additional information:

- 1. Factory land and buildings include factory land purchased at a cost of Sh. 5, 800, 000.
- 2. A perimeter wall was constructed at a cost of Sh. 960, 000 during the year.
- 3. A godown and staff quarters were constructed at a cost of Sh. 2, 800, 000 and 1, 600, 000 respectively and put into use from 1st April, 2018.

Required:

Capital allowances due to Silver Breeze Company Limited for the year of income ended on 30th June, 2018.

(10 Marks)
(Total = 15 Marks)

QUESTION SIX

- a. Distinguish between objection and appeal as used in administration of income tax in Kenya. **(4 Marks)**
- b. Summarize four actions that revenue authority in Kenya could take against taxpayers for recovery of overdue. **(4 Marks)**
- c. Regressive taxes present an unmatched opportunity for any developing country to increase its revenue collection from taxes. Elucidate the validity of this assertion. **(4 Marks)**
- d. Explain the term custom duty and Excise duty as used in taxation. **(3 Marks)**

(Total = 15 Marks)

