



MUEO

MOI UNIVERSITY

**OFFICE OF THE DEPUTY VICE CHANCELLOR, ACADEMIC
AFFAIRS, RESEARCH & EXTENSION**

**UNIVERSITY EXAMINATIONS
2015/2016 ACADEMIC YEAR**

THIRD YEAR END OF SEMESTER EXAMINATIONS

**FOR THE DEGREE OF
BACHELOR OF BUSINESS MANAGEMENT**

EXAM CODE:- BBM 303

COURSE TITLE:- TAXATION I

DATE:- 14TH APRIL, 2016

TIME:- 2.00 P.M. – 5.00 P.M.

INSTRUCTION TO CANDIDATES

➤ **SEE INSIDE.**

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BBM 303: TAXATION I

Instructions To Candidates; ANSWER Question ONE and any other FOUR Questions

QUESTION ONE

a). Discuss the four main objectives of taxation in Kenya

(8 marks)

b). Mr. John works for Ventures Ltd as a director and holds 30% of shares in the company. He has approached you for assistance in computing his taxable income and tax liability for the year of income ended 31st December 2015. He has provided you with the following information:

- i. He earned a monthly salary of Kshs. 600,000
- ii. Received gross dividend of Kshs. 360,000
- iii. The company provides a house rented from an estate agent, whose rental value is Kshs 180,000 per month.
- iv. He receives director's fees amounting to Kshs. 90,000 per month.
- v. The company provides a company vehicle which he has free use since he works late at times. The vehicle engine capacity is 2200cc and had costed Kshs. 3,600,000 in the year 2014.
- vi. On 1st January 2015, Mr. John was granted a loan of Kshs. 10 million from the company at an interest rate of 5% per annum repayable in 10 years.
- vii. Mr. John runs a small scale horticultural farm in Eldoret. The profits/(losses) from the farm for the last three years were as follows:

| | |
|---|----------------------|
| Year ended 31 st December 2013 - | Loss Kshs. 960,000 |
| Year ended 31 st December 2014 - | Profit Kshs. 120,000 |
| Year ended 31 st December 2015 - | Profit Kshs. 450,000 |

During the three years the family consumed Kshs. 75,000 of the produce and personal flower usage was valued at kshs 130,000 per year

viii. Mrs John is a nurse and is employed by Ventures Ltd at a salary of Kshs 85,000 per month (PAYE deducted per month is Kshs. 20,000).

ix. She also owns a rental premises in Eldoret. The following were the details of income and expenses for the year of income 2015.

| | |
|----------------------|----------------|
| Gross rent | 1,120,000 |
| Less: | |
| Caretaker's salary | (300,000) |
| Painting | (20,000) |
| Repairs | (60,000) |
| Interest on Mortgage | (240,000) |
| Renovations | (400,000) |
| Net Income | <u>100,000</u> |

The renovations carried out led to an increase of rent

- x. Mrs John is a member of a registered Individual Retirement Benefits Scheme managed by the Kenya Insurance Company. She contributes kshs 20,000 every month towards the scheme.

Required:

- a. Compute the taxable income for Mr. John for the year of income ended 31st December 2015 **(5marks)**
- b. Determine tax payable and specify when it is to be paid. **(3marks)**
- c. Explain whether Mr. John would be blamed for the PAYE not deducted from his emoluments. **(3marks)**

QUESTION TWO

- a. Discuss the various tax incentives that are provided under the Income Tax Act **(3 marks)**
- b. Mapato Ltd is a manufacturing company operating in Nairobi industrial area. The following information was obtained from the books of the company for the ended 31st December 2015
1. The reported profits for the year before capital allowances amounted to Sh4,296,000
 2. The written down values of assets for capital allowance purposes as at 1 January 2015 were as follows:

Shs.

| | |
|------------------------|-----------|
| Computers | 390,000 |
| Plant and machinery | 3,640,000 |
| Tractors | 940,000 |
| Furniture and fittings | 120,000 |
| Motor vehicles | 740,000 |

3. The factory building constructed on 1st January 2010, and put into use on 1st January 2011 had a written down value of Sh1,665,000 as at 1st January 2015.
4. The following assets were constructed or acquired during the year.

Shs

| | |
|--------------------------|-----------|
| Warehouse | 784,000 |
| Security wall | 160,000 |
| Showroom | 348,000 |
| Computer and peripherals | 96,000 |
| Motor vehicles | 2,000,000 |
| Lorry (3 tonnes) | 1,290,000 |
| Office cabinets | 84,000 |
| Conveyor belts | 180,000 |
| Processing machinery | 680,000 |

5. During the year, a motor vehicle (saloon) which was purchased in 2005 for sh600,000 was disposed of for sh240,000
6. The company demolished a factory extension in July 2015 at a cost of Sh180,000 in order to conform to industry safety standards.
7. The company sunk a water borehole at a cost of Sh 560,000 which was put into use on 1st September 2015

Required

- (i) Capital allowances due to the company for the year ended 31 December 2015 **(8 marks)**
- (ii) Adjusted taxable profit or loss for the year ended 31 December 2015 **(4 marks)**

QUESTION THREE

- a) The following is an extract of the profit and loss account for Kamau and Kibet for the period ended 31st December 2008. According to the partnership agreement partners share profits and loss in the ratio 3:2 respectively.

| | Sh. | | Sh. |
|------------------------------|------------------|---------------------------|------------------|
| Interest on capital | | Gross profit from trading | 5,700,000 |
| Kamau | 300,000 | Net dividends received | 255,000 |
| kibet | 150,000 | Sub-letting rent income | 90,000 |
| Goodwill written off | 60,000 | | |
| Bad debts | 300,000 | | |
| Professional expenses | 300,000 | | |
| Motor vehicles expenses | 450,000 | | |
| Depreciation | 900,000 | | |
| Special expenses | 120,000 | | |
| Withholding tax on dividends | 45,000 | | |
| Partnership salaries | - | | |
| Kibet | 900,000 | | |
| Loss on sale of investment | 150,000 | | |
| Repairs and renewals | 90,000 | | |
| Salaries and wages | 1,500,000 | | |
| utilities | 300,000 | | |
| | <u>480,000</u> | | <u>-</u> |
| | <u>6,045,000</u> | | <u>6,045,000</u> |

You are further provided with the following additional information contained in the notes to the partnership accounts for the period.

1. Bad debts account:

| | Sh. | | Sh. |
|---------------|------------------|-----------------|------------------|
| Write-offs | 150,000 | Brought down: | |
| Carried down: | | General | 900,000 |
| General | 1,200,000 | Specific | 450,000 |
| Specific | 330,000 | Recovered | 30,000 |
| | - | Profit and loss | 300,000 |
| | <u>1,680,000</u> | | <u>1,680,000</u> |

2. Professional expenses:

| | Sh. |
|-------------------------------|----------------|
| Audit fee | 150,000 |
| Partners Insurance | 30,000 |
| Legal fees for debt collector | 7,500 |
| Partnership deed | 112,500 |
| | <u>300,000</u> |

3. Special expenses:

| | Sh. |
|---|----------------|
| Penalty for breach of VAT regulations | 60,000 |
| Redundancy pay to an employee (ex-gratia) | 45,000 |
| Christmas gift to the partners spouses | 15,000 |
| | <u>120,000</u> |

4. Loss on sale of investment:

The shares in a quoted company were sold during the year. They had cost Sh. 900,000 and they fetched Sh. 750,000. There were no incidental expenses.

5. Repairs and renewals:

| | Sh. |
|-------------------------------|---------------|
| Office partitions | 30,000 |
| Office carpet | 15,000 |
| Replacement of adding machine | 15,000 |
| General repairs | 30,000 |
| | <u>90,000</u> |

6. Wear and tear allowance schedule:

| | Class II | Class III |
|--------------------|-----------|-----------|
| Written Down Value | 1,350,000 | 840,000 |

7. One third of motor-vehicle expenses is used on private motoring by partners.

Required:

- i. Determine the adjusted profit for tax purposes for the partnership and for each partner. **(9 marks)**
- ii. Compute the tax payable by each partner. **(6 marks)**

QUESTION FOUR

- a) Write short notes on the following:
- i. Exempt supplies (3 marks)
 - ii. Zero-rated supplies (3 marks)
 - iii. Tax invoice (3 marks)
- b). Distinguish between tax evasion and tax avoidance. (6 marks)

QUESTION FIVE

- a. Discuss the principles of an optimal tax system. (6 marks)
- b. The directors of Molo limited have presented you with the following profit and loss account for the year ended 31 December 2015:

| | 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:

- i. Salaries and wages include Sh.66,000 paid to the Income Tax Department as penalties and interest on delayed submission of PAYE deductions.
- ii. Hire purchase interest relates to loans obtained to purchase a delivery van sh.146,000 and the Chairman's personal car Sh.267,000.

- iii. 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 2015 was sh.133,000.
- iv. Legal and professional expenses include sh.146,000 incurred while defending the Managing Director in a private suit against him.
- v. Repairs and maintenance include the cost of acquiring a second hand laundry machine for sh.167,000.
- vi. Bad and doubtful debts are made up of a 10% general provision against the debtors balance as at 31 December 2015 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 2015 was Sh.1,350,000.
- vii. 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 |
- viii. 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.
- ix. Wear and tear allowances for the year ended 31 December 2015 have been agreed at Sh.4,320,000.

Required:

Molo limited adjusted profit (or loss) for tax purposes for the year ended 31 December 2015

(9 marks)

QUESTION SIX

- i. Distinguish between direct and indirect forms of a tax **(6 marks)**
- ii. You are provided with the following data relating to the purchases and sales made by Babadogo limited for the month of January 2016.

| | |
|-----------|---|
| January 1 | Purchased 400 units at Sh. 5,600 per unit |
| | Sold 49 units at Sh. 7,200 per unit on the same day |
| 5 | Sold 80 units at Sh. 7,200 per unit |
| 10 | Sold 200 units at Sh. 7,200 per unit |
| 20 | Purchased 300 units at Sh. 6,400 per unit |
| 25 | Sold 80 units at Sh. 7,200 per unit |
| 31 | Sold 200 units at Sh. 8,000 per unit |

There was no inventory at the beginning of the month but 100 units were in stock at the end of the month.

Required:

- i. The VAT account for the month of January 2016 **(7 marks)**
- ii. On what date is VAT due payable? **(2 marks)**

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).

| Monthly taxable pay (Sh.) | | Annual taxable pay (Sh.) | | Rate of tax % 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 allowances: | | |
| Wear and tear allowance: | | |
| Class I | 37.5% | |
| Class II | 30% | |
| Class III | 25% | |
| Class IV | 12.5% | |
| Software | 20% | |
| Industrial building allowance: | | |
| Up to 2009 | 2.5% | |
| From 1 January 2010 | 10% | |
| Hotels | 10% | |
| Hostels/Education buildings | 50% | |
| Farm works allowance | 100% | |
| Investment deduction allowance | 100% | |
| Shipping investment deduction | 40% | |
| Mining allowance: | | |
| Year 1 | - 40% | |
| Years 2 - 7 | - 10% | |
| (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 |

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 |
| Agriculture employees: Reduced rates of benefits | | |
| (i) Water | 200 | 2,400 |
| (ii) Electricity | 900 | 10,800 |