



UNDERGRADUATE UNIVERSITY EXAMINATIONS
SCHOOL OF MANAGEMENT AND LEADERSHIP
DEGREE OF BACHELOR OF MANAGEMENT AND LEADERSHIP

BML 304 : TAXATION

DATE: APRIL 2020

DURATION: 2 HOURS

MAXIMUM MARKS: 70

INSTRUCTIONS:

1. Write your registration number on the answer booklet.
2. **DO NOT** write on this question paper.
3. This paper contains **SIX (6)** questions.
4. Question **ONE** is compulsory.
5. Answer any other **THREE** questions.
6. Question **ONE** carries **25 MARKS** and the rest carry **15 MARKS** each.
7. **Write all your answers in the Examination answer booklet provided.**

QUESTION ONE

- a) Is Value Added Tax (VAT) a direct or indirect tax? Explain **(2 marks)**
- b) What are the rules governing the payment of VAT? Specify the additional tax that may arise from failure to comply with VAT regulations/rules.

(6 marks)

- c) Examine any four main canons of taxation as highlighted by Adam Smith.

(8 Marks)

- d) Mr. Mark is a Chief Finance Officer with Polianto Ltd. He has provided you with the following information on his income for the year ended 31 December 2018

1. He is paid a basic salary of Sh.75, 000 per month (PAYE Sh.15, 000 per month).
2. He is housed by the employer in a house leased at Sh 30,000 per month. The house was furnished by the employer at a cost of Sh 200,000, his private telephone charges averaging Sh1, 800 per month are also paid by the employer.
3. He is a member of a golf club where the employer contributes Sh 5,000 per month for him.
4. He holds a life assurance policy with Jubilee Assurance Company Ltd. The employer paid the premiums on the policy for year 2018 amounting to Sh 48,000.
5. He is a member of a registered collective investment scheme. During the year, he earned an income of Sh.40, 000 from the scheme. The scheme invests in shares and fixed deposit accounts.
6. He separated with his wife on 1 October 2018. With effect from 31 October 2018, he has been paying alimony of sh20, 000 per month to his wife as required by a court order.
7. He is provided with a motor vehicle (2000cc) by the employer which was purchased on 1 January 2017 at a cost of Sh1, 500,000.
8. He contributed Sh 25,000 per month towards a registered pension scheme.

9. On 1 December 2018, his monthly salary was increased by ten per cent backdated to 1 July 2018.

Required:

Taxable income of Mr. Mark for the year ended 31 December 2018. (9 marks)

QUESTION TWO

The directors of Totale engineering Company Limited presented the following Profit and Loss for the year ended 31 December 2018:

	Sh.
Revenues	
Sales	30,780,000
Interest on Government Securities	<u>50,000</u>
Gross income	30,830,000
Expenses:	
Purchases	24,000,000
Wages	2,320,000
Carriage inwards	370,000
Rent	300,000
Insurance	190,000
Trade expenses	100,000
Repairs:	
Building	300,000
Machinery	56,000
Advertising	254,000
Legal charges	80,000
Audit fees	70,000
Depreciation	3,017,000
Provision for doubtful debts	104,000
Debenture interest	600,000
Interim dividend	400,000
Proposed dividend	<u>731,300</u>
	<u>32,892,300</u>
Net Loss	2,062,300

The following additional information is provided:

1. Purchase returns and sales returns were Sh.500,000 and Sh.700,000 respectively. These were left out while preparing the trial balance.
2. Wages include Sh.25,000 per month paid to a “consultant” who helps the company whenever there is a problem with the VAT department. VAT of Sh.560,000 remains unpaid and the “consultant” promises to find a way of getting it written off. Full PAYE is deducted from his salary.
3. Trade expenses include an amount of Sh.60,000 travel expenses to Korea for the Director as part of the National Chamber of Commerce Trade and Industry promotion tour.
4. Repairs to machinery include small loose tools written off by Sh.10,000
5. Bad debts which are specifically bad are Sh.74,000
6. Capital allowances have been agreed at Sh.2,000,000.

Required:

- (a) Taxable profits for the year of income 2018. **(10 marks)**
- (b) Tax payable if any for 2018. Comment on the results. **(5 marks)**

QUESTION THREE

- a) Define the term qualifying expenditure **(2 marks)**
- b) Name and briefly explain items which may be included in the qualifying expenditure for the purposes of investment deductions. **(4 marks)**
- c) Kalamuka Maize Millers Limited purchased a building on 1 January 2017, for Sh.4,000,000. It was brought into use on the same day. The sellers construction cost comprised:

	Sh.
Land	200,000
Architects fees	40,000
Leveling land	60,000
Construction (including offices sh.160,000)	1,700,000 2,000,000

B.B. Ltd. purchased the whole of the Kalamuka Maize Millers Ltd. on 31 December 2017 and continued with the same business of milling maize. The following amounts were paid for assets purchased.

	Sh.
Goodwill	10,000
Land and buildings	4,000,000
Milling machines	1,800,000
Tractor and lorry	1,600,000
Motor vehicle	1,200,000

B.B Ltd. Incurred the following additional costs:

	Sh.
Extension to building	800,000
Security wall	100,000
Additional boiler	1,000,000
New sorter and conveyer – fixed to fabric of building	1,200,000 600,000
Fixtures and fittings.	

B.B Ltd. sold some surplus assets as follows:

Date	Particulars	Sh.
1-7-2018	Milling machines	200,000
1-9-2018	Damaged fixtures and fittings	8,000
1-9-2018	Lorry	180,000

B.B. Ltd's financial year ended on 30 September 2018.

Required: The capital deductions claimable for the year ended 31 December 2018.

(9 marks)

QUESTION FOUR

The partners of Mehta Brothers(S.Mehta, N.Mehta and M.mehta) reported a loss of Sh.250,000 for the year ended 31 August 2017 after deducting the following expenses:

	Sh.
Salaries and wages	450,000
Partners drawings	360,000
Loss on sale of investment	15,000
Professional fees	120,000
Travelling expenses	650,000
Purchases	5,250,000
Repairs and maintenance	320,000
Depreciation	650,000
Rent and rates	240,000
Telephone	60,000
Postage and stationery	175,000
Bank charges and interest	24,000
Salaries to partners:	
S. Mehta	50,000
M. Mehta	50,000
N. Mehta	100,000
Donations	20,000
Purchase of computer	200,000
Bad debts written off	65,000
Interest on capital:	20,000
S. Mehta	20,000
M. Mehta	

Notes:

1. Agreed written down values of the assets as at 31 August 2017.
Class I - Sh.1,250,000; Class III - Sh.250,000; Class IV - Sh.375,000.
2. The partners share profits and losses equally after salaries and interest.
3. The wife of S. Mehta is a full time employee of the company and was paid a salary of Sh.120,000 during the year.
4. The partners have no other source of income other than from the partnership.

Required:

Calculate the taxable profit (loss) of the partnership for the year ended 31 August 2005 and taxable income of each partner. **(15 Marks)**

QUESTION FIVE

- a) Explain the term "Resident" in relation to an individual? **(5 marks)**
- b) Define tax planning and explain five ways in which an individual can use tax planning to reduce the tax liability. **(10 marks)**

QUESTION SIX

- a) Briefly explain the effect of taxation on distribution and production. **(6marks)**
- b) Distinguish between tax evasion and tax avoidance. **(4 marks)**
- c) The recent debate relating to importation of goods through the port of Mombasa has had one of its issues the amount of tax assessed. Specify and explain clearly at least three ways in which the Government may lose tax revenue on imports. **(5 marks)**

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

YEAR OF INCOME 2017

Taxable Employment Benefits - Year 2017

Monthly taxable pay (shillings)		Annual taxable pay (shillings)		Rates of tax % in each shilling
1	- 11,180	1	- 134,164	10%
11,181	- 21,714	134,165	- 260,567	15%
21,715	- 32,248	260,568	- 386,970	20%
32,249	- 42,781	386,970	- 513,373	25%
Excess over	- 42,781	Excess over	- 513,373	30%

Personal relief Shs. 1,280 per month (Shs. 15,360 per annum)

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 10%	(ii) Pick-ups, Panel Van (Unconverted)		
Hotels 10%	Upto 1750 cc	3,600	43,200
Farm works allowance 33.3%	Over 1750 cc	4,200	50,400
Investment deduction allowance:	(iii) Land Rovers/Cruisers	7,200	86,400
2003 - 70%	OR 2% of the initial capital cost of the vehicle for each month, whichever is higher.		
2004 - 100%			
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
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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%