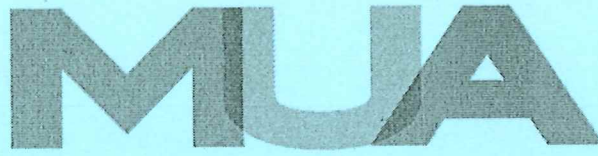


The
Management
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UNDERGRADUATE UNIVERSITY EXAMINATIONS

SCHOOL OF MANAGEMENT AND LEADERSHIP

DEGREE OF BACHELOR OF MANAGEMENT AND LEADERSHIP

BML 304 : TAXATION

DATE: 20TH JULY 2022

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. Distinguish between a direct and indirect tax. (2 marks)
- b. List and explain any three deductions that may be available against gains or profits from employment. (3 marks)
- c. Should citizens feel obliged to pay tax? Explain. (2 marks)
- d. Bonface Huka is a resident individual and a pharmacist who has been employed by Sawa Hospital since his early retirement from the public service in 2016. The following details were availed to you in respect of his earnings for the year ended 31 December 2021.
1. He received a monthly basic salary of sh. 184,000 from Sawa Hospital. Additional one-month's basic salary was paid to him in December 2021 as bonus. PAYE deducted during the year was sh. 897,600.
 2. A commission of sh. 199,000 was paid to him for the promotion of drugs under identified brands during the year.
 3. During the year, he was sent to Mombasa for a four-day conference and was paid daily subsistence allowance of sh. 18,000 by the hospital.
 4. He has a fixed deposit account of sh. 1,500,000 at Broad Bank Ltd from which he received an interest of sh. 105,000 during the year.
 5. 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.
 6. He was provided with a saloon car of 2000 cc by the hospital for personal and official duties on 1 July 2021. The saloon car had an initial cost of sh. 2,800,000.
 7. The hospital has a medical cover for all staff. He was entitled to a maximum cover of shs. 180, 000 per annum while he utilized sh. 74,000 on medical bills during the year.
 8. During the year, he was provided with a house. The market value of the house was sh.120, 000 per month and he contributed sh. 20,000 per month as nominal rent.
 9. During the year, the hospital settled his bills as follows; telephone sh. 68,000, water sh. 18,200 and electricity sh. 24,600.

10. The hospital contributed 5% of his basic salary towards a registered pension scheme while he contributed an equal amount to the scheme.
11. The hospital paid subscription fees on his behalf to the Pharmacy and Poisons Board amounting to sh. 54,000 during the year.
12. He was reimbursed private entertainment expenses of sh.120,000 by the hospital during the year.

Required:

- i. Taxable income for Bonface Huka for the year ended 31 December 2021. **(12 marks)**
- ii. Tax payable (if any) on the income computed in (i) above. **(6 marks)**

QUESTION TWO

Teddy, Racheal and Michael are partners under the name Teram Enterprises. They share profits and losses in the ratio 4:3:3. The partners have presented the following income statement for the year ended 31 December 2021:

	Shs		Shs
Salaries and Wages	280,000	Gross Profit	2,300,000
Rent, rates and taxes	150,000	Miscellaneous income	150,000
Office expenses	204,000	Discounts	80,000
Printing and stationery	64,000	Farming income	132,000
Instalment tax paid	45,000	Profit on sale of shares	100,000
Advertising	73,000	Interest on deposits	120,000
Interest on capital			
Teddy	60,000		
Rachael	70,000		
Michael	80,000		
Legal Fees	82,000		
Commission to partners			
Teddy	45,000		
Michael	35,000		
Depreciation	92,000		
Bad debts	68,000		
General expenses	99,000		
Donation to famine relief	100,000		
General reserves	120,000		
Local taxes on property	12,000		
Electricity	46,000		
Showroom expenses	117,000		
Net profit	1,040,000		
	2,882,000		2,882,000

Additional information:

1. It has been the firm's practice to value the stocks at the cost price; however, the closing stock amounting to Shs. 180,000 was valued based on net realizable value, which is 10% less of its cost price.
2. Salaries and wages include salaries amounting to Shs. 40,000 paid to Racheal.
3. Advertising includes Shs. 10,000 spent on advertising campaign to introduce a new product in the market.
4. Legal fees include a sum of Shs. 12,000 paid as parking fine and penalty to the county government.

5. Capital allowances have been agreed with the commissioner of income tax at Shs. 90,000.
6. Teddy's other income includes Shs. 120,000 consultancy fee. He has brought forward partnership business loss of Shs. 135,000 from the assessment of the year of income 2019.
7. Rachael has income of Shs. 200,000 from bet winnings. She has brought forward partnership business loss of Shs. 135,000 from assessment of the year of income 2019.

Required

- i. Taxable profit or loss of the partnership for the year ended 31 December 2021. **(10 marks)**
- ii. Allocation schedule of profit and loss calculated in (i) above. **(3 marks)**
- iii. Total taxable income of each of the partners for the year of income 2021. **(2 marks)**

QUESTION THREE

Pareto limited has provided the following income statement for the year ended 31 December 2021

Income Statement		
Income	Shs	Shs
Gross Profit		6,290,000
Dividends(Net)	675,000	
Foreign exchange gain	175,000	
Rent received (Commercial building)	580,000	
Interest received from Fahari Bank Ltd. (net)	289,000	
Bad debts recovered	370,000	
Insurance claim	785,000	
Profit on sale of equipment	88,000	
Sale of debentures	4,200,000	
		7,162,000
		13,452,000
Less: Expenses		
Salaries and wages	1,450,000	
Increase in provision for bad and doubtful debts	145,000	
Contribution to N.S.S.F	78,000	
Advertising	710,000	
Stationery	400,000	
Depreciation	280,000	
Subscriptions	1,140,000	
Trading Loss	390,000	
Interest	760,000	
Transport	150,000	
Legal Costs	365,000	
	5,868,000	(5,868,000)
Net Profit		7,584,000

Additional information:

1. Dividends comprise:

	Shs.
Dividends from Beta Ltd	505,000
Dividends from Bona Cooperative Society	170,000

2. Foreign exchange gains comprise:

	Shs
Amount of realized foreign exchange gain	125,000
Amount of unrealized foreign exchange gain	50,000

3. Bad debts recovered relate to:

	Shs
Bad debts on sale of furniture	130,000
Bad debts on credit sale of goods	240,000

4. Insurance claim related to:

	Shs
Insurance compensation on loss of profit	380,000
Insurance claim on loss of motor vehicle	405,000

5. Advertising comprise:

	Shs
Advertising through daily newspapers	280,000
Advertising on passenger shed at bus stops	430,000

6. Subscriptions related to:

	Shs
Annual subscription fee to chamber of commerce and industry	530,000
Subscriptions to employees' sports club	610,000

7. Interest comprise:

	Shs
Interest on debentures	580,000
Interest on loan acquired to build commercial rental houses	110,000
Interest on money borrowed to pay tax and penalties	70,000

8. Legal costs comprise:

	Shs
Appeal to tax tribunal	155,000
Defending business property rights	120,000
Registration of lease agreement (100 years)	90,000

9. Capital allowances were agreed with the commissioner of revenue authority at Shs. 960,000

Required: Adjusted taxable income for Pareto Limited for the year ended 31 December 2021 and tax payable. **(15 marks)**

QUESTION FOUR

Timexa Limited provided the following details with respect to its fixed assets for the year of income 2021

1.	Building Sh.	Class I Sh.	Class II Sh.	Class III Sh.	Class IV Sh.
	1,400,000	460,000	610,000	800,000	6,200,000

2. The industrial building had been constructed sometimes back in 2015 at a cost of Sh.1, 600,000. Fixed machines were Sh.2, 000,000. Due to an oversight, no investment deduction was claimed.
3. During the year the following assets were purchased:
 - Patents Sh.200, 000
 - Computers Sh.390, 000
 - Stamping machine Sh.800, 000
 - Land Sh.530, 000
4. A car for use by the directors was involved in an accident and written off. No recoveries were made.
5. In December, all computers were sold as one lot for Sh.1, 220,000.

Required: Capital allowances for Timexa Limited for year of Income 2021. **(15 marks)**

QUESTION FIVE

Pepo Limited (VAT No. 00012Y) made the following purchases and sales during the first two weeks of January 2022. Prices shown are inclusive of VAT at the standard rate of 16 percent.

		PURCHASES		SALES	
		Unit	Price per Unit	Unit	Price per Unit
			Sh.		Sh.
January	1	100	1,400	10	1,800
	2			20	1,800
	5			50	1,800
	7	75	1,600		
	10			20	1,800
	12	-		50	2,000
			<u>175</u>		<u>150</u>

There were no opening stocks at the beginning of the month. The physical inventory confirmed that there were 25 units in stock as at 31 January 2022.

Required:

- i. The VAT account for Pepo Limited. (7 marks)
- ii. What are the requirements with respect to any sales made by Pepo Limited? (5 marks)
- iii. Specify when and how VAT computed under (i) is payable. (3 marks)

QUESTION SIX

a. You are provided with the following details:

1. Installing a system of ventilation in the factory.
2. Legal expenses incurred when acquiring a new building
3. Giving the factory a fresh coat of paint
4. Replacing 200 tiles on a roof damaged by wind
5. Expenditure incurred in demolishing part of a wall to make room for a recently purchased machine.

Required: From an Income Tax perspective, indicate for each of the above items whether it is capital or revenue expenditure. Explain. (5 marks)

b. A group of BML and BCOM students has invited you to discuss the matters listed below: In each of the cases, provide explanatory notes and computations for use in your discussions with students.

- i. A manager who is on full-time employment where he draws sh.80, 000 per month. He is housed by the employer in a rented house where rent payable to the landlord is Sh.720, 000 per annum. **(2 marks)**
- ii. The manager makes an annual contribution of Sh.84, 000 to a registered pension fund. **(2 marks)**
- iii. The manager is provided with a motor car whose purchase cost was Sh.1, 200,000. **(2 marks)**
- iv. A high school boy aged 15 years inherits Sh.300, 000 from his grandfather and wins Sh.100, 000 in the national lottery. **(2 marks)**
- v. A retired civil servant on an annual pension of Sh.180, 000 per annum signed a service contract with effect from 1 January 2021. The contract was for three years at an annual salary of Sh.440, 000. The contract was terminated by the employer on 31 December 2021. The employee was paid compensation amounting to Sh.560, 000. **(2 marks)**

RATES OF TAX

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

Year of Income 2021.

Monthly taxable pay (shillings)			Annual taxable pay (shillings)			Rates of tax % in each shilling
1	-	12,298	1	-	147,580	10%
10,165	-	23,885	147,581	-	286,623	15%
19,741	-	35,472	286,624	-	425,666	20%
29,317	-	47,059	425,667	-	564,709	25%
Excess over	-	47,059	Excess over	-	564,709	30%

Personal relief Shs. 1,408 per month (Shs. 16,896 per annum)**Prescribed benefit rates of motor vehicles provided by employer**

				Monthl y rates (Shs)	Annual rates (Shs)
Capital allowances:	(i)	Saloon, Hatch Backs and Estates			
Wear and tear allowances		Upto	-	1200	3,600
Class I	37.5 %	1201	-	1500	4,200
Class II	30%	1501	-	1750	5,800
Class III	25%	1751	-	2000	7,200
Class IV	12.5 %	2001	-	3000	8,600
Software	20%	Over	-	3000cc	14,400
Industrial building allowance:					
Up to 2009	2.5%	(ii)	Pick-ups, Panel Van (Unconverted)		
From January 2010	10%	Upto	-	1750	3,600
Hotels	10%	Over	-	1750	4,200
Hostels/Education/Film producers buildings		(iii)	Land Rover/Cruisers		
From 1 January 2010	100%				7,200
Commercial building: (Shop, Office or Show room)	25%				86,400
Farm works allowance	100%				
Investment deduction allowance	100%				
Shipping investment deduction (Ships over 125 tonnes)	100%				
Extraction expenditure:					

Written off over 5 years 20%

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
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%