

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

**BML 304 : TAXATION**

**DATE: 3<sup>rd</sup> AUGUST 2023**

**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) Mr. Kamau is employed by Cavington Ltd as a Marketing Manager. He has provided you with the following information on his income for the year ended 31 December 2022

1. He is paid a basic salary of Sh.200, 000 per month (PAYE Sh.30, 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. 400,000, his private telephone charges averaging Sh3,800 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 Kenedia Assurance Company Ltd. The employer paid the premiums on the policy for year 2022 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 2022. With effect from 31 October 2022, 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 2022 at a cost of Sh1, 500,000.
8. He contributed Sh. 25,000 per month towards a registered pension scheme.
9. On 1 December 2022, his monthly salary was increased by ten per cent backdated to 1 July 2022.

**Required:**

- (i) Taxable income of Mr. Kamau for the year ended 31 December 2022. (9 marks)
- (ii) Comment on any information not used. (1 mark)

b) Taxation yields both positive and negative effect in the economy. Examine the effect of taxation on production using the following parameters;

- i) The benefit principle
- ii) The ability to pay principle
- iii) The cost of service principle

Briefly explain each theory stating clearly its applicability. (15 marks)

#### QUESTION TWO

a) Define a direct tax and explain some of its benefit (5 marks)

(b) Describe the principles or canons of taxation as laid down by Adam Smith.

(10 marks)

#### QUESTION THREE

(a) Demonstrate the conditions when VAT on bad debts is claimable (3marks)

(b) Explain the meaning of the term "tax point" in relation to the value added tax on the sale of goods. (4Marks)

(c) Explain the following in relation to the Value Added Act, 2013

- i) exempt supply (3marks)
- ii) zero-rated supply (3marks)
- iii) Taxable supply (2marks)

**QUESTION FOUR**

You have been approach by the Directors of Demolley Investment Ltd a private company prepares its accounts at 31<sup>st</sup> December each year to assist them in preparing the taxable income for year ended 31<sup>st</sup> December 2022. You have been provided with the following information.

<b>Profit and Loss Account for the year 2022.</b>	<b>Sh.</b>
General administrative expenses	70,000
Director's fees and expenses	10,000
Repairs and renewals	24,000
Subscriptions and donations	4,000
Bad Debts	16,000
Preliminary expenses	6,000
Retirement benefit	100,000
Rent, rates and insurance	60,000
Patents written off	5,000
Legal and accountancy	83,000
Interest on overdue tax	5,000
Interest in lieu of dividends	10,000
Depreciation	20,000
Net profit before taxation	<u>222,000</u>
	<u>575,000</u>
Gross profit b/d	560,000
Bad debts previously	
Written off	2,000
Dividends (Gross)	10,000
Post office savings	
Bank interest	<u>3,000</u>
	<u>575,000.</u>

**Notes:**

<b>a. Repairs and Renewals:</b>	<b>Shs</b>
Redecoration of an existing business	6,000

Renovation to new building	10,000
Partition and carpeting of old building to Create extra office for Personnel Manager	<u>8,000</u>
<b>b. Subscription and donations:</b>	
National Chamber of Commerce and Industry	2,000
Kenya Red Cross Society	1,000
Sporting facilities for Staff	<u>1,000</u>
	<u>4,000</u>
<b>c. Bad Debts:</b>	
This is on account of a loan given to a supplier and who was adjudged a bankrupt during the year.	
<b>d. Preliminary expenses:</b>	Shs
Balance of stamp duty on issue of share Capital	4,000
Secretarial Services fees now written off	<u>2,000</u>
	<u>6,000</u>
<b>e. Retirement Benefits:</b>	
N.S.S.F contribution	10,000
Pension to Management Staff	80,000
Contribution to approved Provided Fund	<u>10,000</u>
	<u>100,000</u>
<b>f. Legal and Accountancy:</b>	
Staff Services Agreement	4,000
Contract for purchase of a new business	11,000
Audit fee	60,000
Income Tax - Appeal to Local Committee	4,000
Lease preparation (5 Year lease)	<u>4,000</u>
	<u>83,000</u>
<b>g. Interest in lieu of dividends</b>	
The company did not pay dividends in 2012 but instead decided to pay interest at 10% on the share issued and fully paid.	

**h. Dividends:**

These were from a subsidiary company where ABC Limited holds 75% of the issued share capital.

**Required:**

Compute corporation tax liability for 2013. Ignore wear and tear deductions and State the dates when such tax would be paid. (15Marks)

**QUESTION FIVE**

- a) Define the term "Resident" in relation to an individual, as per the Kenya income tax act (CAP 470) , and explain the various criteria in determining an individual as a "resident" as stipulated by the Act (5 marks)
- b) Rai, Sai and Tai are former school mates who were doing business together. The business is not registered but they registered themselves as equals in it. They keep proper books of account and have been able to provide the following profit and loss account for the year ended 31 December 2022.

## Profit and Loss Account

	Sh.		Sh.
Establishment expenses	800,000	Gross profit	1,908,000
Rent of business premises owned by all of them jointly	180,000	Sundry receipts	80,000
Interest expense	80,000	Interest Income	72,000
Stationery and printing	120,000	Profit on sale of shares	200,000
Light and heating	40,000	Gross income from farming	340,000
General farm expenses	294,000	Lottery winnings	800,000
Repair of premises	40,000	Dividend (Gross)	120,000
Depreciation	300,000		
Interest on partner's capital:			
Rai	80,000		
Tai	120,000		
Salary to Sai	160,000		
Commission to partners:			
Rai	96,000		
Sai	96,000		
Tai	96,000		
Bad debts	240,000		
Gifts, present and charity	40,000		
Donation to child welfare	200,000		
Interest on loan taken to pay			
Income tax	20,000		
Legal charges	120,000		
Net profit	398,000		
	3,520,000		3,520,000

Additional information:

1. Capital allowances have been agreed as follows: Wear and Tear allowances sh.180,000; Farm works deductions sh.120,000.
2. The partners had borrowed Sh.400,000 with a hope of investing it on fixed securities to earn more income interest rates nevertheless declined. Interest expense of Sh.80,000 and interest income of Sh.72,000 relate to the loan.
3. Legal charges include Sh.40,000 paid to finish a case in the customs department.
4. In 2022, the partners brought forward losses amounting to Sh.800,000 from this business.

**Required:**

Compute taxable income derived from the partnership. (10 marks)

**QUESTION SIX**

- a) Briefly explain the types of capital allowance as provided for by the income Tax Act. (5 marks)
- b) Under the Tax Procedures Act 2015, the commissioner of income tax has laid down fines and penalties on failure to remit Value Added Tax (VAT) and Pay as you earn (PAYE) tax. Describe the fines and penalties of the above (4 marks)
- c) Demonstrate with use of relevant examples the emerging trends recently experienced in Kenya taxation system (6Marks)

**TAXATION 1 (Principles and Concepts)****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.)
<b>Capital allowances:</b>				
		(i) Saloon, Hatch Backs and Estates		
<b>Wear and tear allowances</b>		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
<b>Industrial building allowance:</b>		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
<b>Farm works allowance</b>	33.3%	Over 1750 cc	4,200	50,400
<b>Investment deduction allowance:</b>		(iii) Land	7,200	86,400
2003	- 70%	Rovers/Cruisers		
2004	- 100%	OR 2% of the initial capital cost of the vehicle for		

each month, whichever is higher.

2005	-	100%
<b>Shipping investment deduction 40%</b>		
<b>Mining allowance:</b>		
Year 1		40%
Year 2 - 7		10%

**Commissioner's prescribed benefit rates**

Services	Annual rates	Monthly rates	
		Sh.	Sh.
(i)	Electricity (Communal or from a generator) 18,000	1,500	
(ii)	Water (Communal or from a borehole) 6,000	500	
(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%