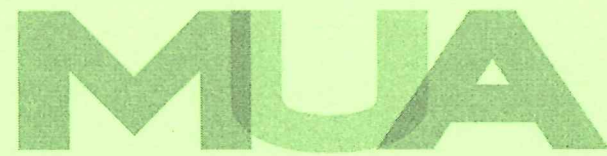


The
Management
University
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UNDERGRADUATE UNIVERSITY EXAMINATIONS

SCHOOL OF MANAGEMENT AND LEADERSHIP

DEGREE OF BACHELOR OF COMMERCE

BCM 412: PRINCIPLES OF TAXATION

DATE: 7TH AUGUST 2024

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.

Read the following details of information extracted from income tax guides and use them to answer questions for which the information is relevant.

QUESTION ONE

Arthur Maxwell has approached you with a view to obtaining help in determining his taxable income for the year ended 31st December 2023. He has provided you with the following information:

i. Business Income

He runs a small kiosk that generate taxable income of Sh.60,000. In 2022, he had a tax loss of Kshs.40,000 from this business.

ii. Wife’s Income

His wife was employed by Maendeleo Ltd. as the Finance Director. Her salary was Kshs. 52,000 per month. Additional benefits include:

- Company car 1800 cc. The cost of the car was Kshs. 500,000.
- Apartment in South C (market value of rent Kshs.20,000 per month)
- Staff gifts of worth Kshs.1,000 per month

iii. Investment Income

- Dividends

	Withholding Tax (Kshs)	Net (Kshs)
Kenya Breweries Ltd	2,000	18,000
HFCK Ltd	1,000	9,000
CMC Ltd.	4,000	36,000

- Interest

	Withholding Tax (Kshs)	Net (Kshs)
Kenya Commercial Bank Savings Account	2,000	18,000
HFCK – Housing Development Bond	7,000	63,000
Post Office Savings Bank	-	20,000
15% 2010 Treasury Bonds	1,500	13,500

- iv. Employment Income
Arthur Maxwell was employed by UBA Limited as the General Manager – Sales. His salary was Kshs.40,000 per month and a bonus of 2% on total sales revenue. He had a car of 2000cc which he used to visit customers otherwise his wife would pick and drop him at the place of work each day using her official car.
- v. UBA Limited insures all its sales against default from customers. The cost of the insurance was Kshs.10,000 which represents 0.001 percent of sales. The company also paid Kshs. 20,000 to cover the life of Artur Maxwell and his household items.
- vi. PAYE of Kshs.130,000 was deducted from Arthur Maxwell’s pay but due to an oversight in the part of the Accountant the tax was not paid to KRA. His wife’s PAYE was Kshs.180,000 in the year.

Required:

- a) Evaluate Mr. Maxwell's and his wife’s total taxable income for the year 2023
(15 marks)
- b) Determine the tax liability due from Mr. Maxwell and his wife
(5 marks)
- c) Comment on information not used to evaluate the total taxable income in (a) above
(2 marks)
- d) Explain whether Mr. Maxwell is to blame for failure of his company to remit the PAYE deducted from his salary.
(3 marks)

QUESTION TWO

- a) The following are the transactions of ABC Limited, a firm registered for VAT.
The following transactions relate to the month of January 2024:

Date	Particulars
1	Purchased zero rated supplies worth Kshs. 96,000
2	Purchased goods worth Kshs. 84,000 from Max, a VAT non-registered business
4	Sold goods worth Kshs. 108,000
5	Purchased exempt supplies worth Kshs. 40,000

6	Bought goods worth Kshs. 132,000
7	Sold goods worth Kshs. 156,000
10	Bought goods worth Kshs. 75,000
12	Sold goods worth Kshs. 138,000
15	Bought goods worth Kshs. 162,000
18	Sold goods Kshs. 198,000
20	Sold goods sh. 138,000
25	Sold goods worth Kshs. 228,000
27	Purchased supplies Kshs. 174,000
30	Sold goods worth Kshs. 204,000

All supplies are standard-rated except where otherwise specified. While all purchase prices quoted are inclusive of VAT, sales prices quoted are exclusive of VAT.

Required:

Prepare a VAT account for the month ended 31st January 2024 and show the VAT due or VAT refundable (10 marks)

b) Explain the term 'stamp duty' and cite any three (3) documents that require stamp duty in Kenya. (5 marks)

QUESTION THREE

a) Evaluate three conditions that must be fulfilled for a taxpayer to qualify for a double taxation relief (3 marks)

b) Explain three types of taxpayers that submit returns of income (6 marks)

c) Assess four reasons why the Kenyan government imposes a limit to the age of vehicles imported into the country. (6 marks)

QUESTION FOUR

a) Sam, Arthur and Paul Enterprises is a partnership manufacturing canned beef.

The partners are Sam, Arthur and Paul. At the end of the year, the following

Profit and Loss Account extracts were prepared:

Particulars	Kshs.
Salaries and wages	450,000
Partners drawings	360,000
Loss on sale of investment	15,000
Professional fees	120,000
Travelling expenses	650,000
Rent and rates	240,000
Purchases	5,2250,000
Repairs and maintenance	320,000
Depreciation	650,000
Telephone	60,000
Postage and stationery	175,000
Bank charges and interest	24,000
Salaries to partners:	
Sam	50,000
Arthur	50,000
Paul	100,000
Donations	20,000
Purchase of computer	200,000
Bad debts written off	65,000
Interest on capital:	
Sam	20,000
Arthur	20,000
Paul	100,000

Additional Information:

- i. The loss for the period was reported as Kshs. 250,000.
- ii. Agreed written down values of the assets as at 31 August 2023.
Class I – Kshs.1,250,000; Class III – Kshs.250,000; Class IV – Kshs.375,000.
- iii. The partners share profits and losses equally after salaries and interest.
- iv. The wife of Sam is a full time employee of the company and was paid a salary of Kshs.120,000 during the year.

- v. The partners have no other source of income other than from the partnership.

Required:

Determine the taxable profit (loss) of the partnership for the year ended 31 August 2023 and taxable income of each partner. (9 marks)

- b) Examine three canons of taxation that may be applied by the Kenyan government in the equitable distribution of the tax burden in Kenya (6 marks)

QUESTION FIVE

- a) Alternative Dispute Resolution (ADR) is a mechanism that expedites the resolution of tax disputes. Examine three roles of the parties to the ADR process (6 marks)
- b) At the end of the month an employer is required to compile a list of all the employees from whom he has deducted tax and submit the information to the Commissioner via PAYE (Pay As You Earn). Explain the procedure of filing PAYE deducted from employees (6 marks)
- c) Examine the two economic effects of taxation (3 marks)

QUESTION SIX

- a) KCC Creameries Ltd. buys milk from dairy farmers at Khs. 5 per litre and after processing sells it at Kshs. 10. Assuming that a tax of 20% is imposed on every litre of milk sold, propose four ways through which the tax can be shifted (4 marks)
- b) Assess four grounds upon which a company/ business can be de-registered for VAT purposes (4 marks)
- c) Explain the difference between tax evasion and tax avoidance (3 marks)
- d) Examine two methods used by the Commissioner of Domestic Taxes to collect tax that has been assessed and has not been paid on the due date (3 marks)

COMMISSIONER'S PRESCRIBED BENEFIT RATES (EXTRACT FROM PAYE GUIDE)

A SERVICES

	Monthly Rates (Ksh)	Annual Rates (Ksh)
Electricity (communal or from a generator)	1,500	18,000
Water (communal or from a borehole)	500	6,000
Provision of furniture (1% of cost to employer). If hired, the cost of hire should be brought to charge		
Telephone (Landline and Mobile Phones)	30% of bills	

B AGRICULTURAL EMPLOYEES REDUCED RATES OF BENEFITS

	Monthly Rates (Ksh)	Annual Rates (Ksh)
Water	200	2,400
Electricity	900	10,800

C MOTOR CARS BENEFIT

	Monthly Rates (Ksh)	Annual Rates (Ksh)
(i) Saloon Hatch Backs and Estates		
Up to 1200 cc.	3,600	43,200
1201 to 1500 cc.	4,200	50,400
1501 to 1750 cc.	5,800	69,600
1751 to 2000 cc.	7,200	86,400
2001 to 3000 cc.	8,600	103,200
Over 3000 cc.	14,400	172,800
(ii) Pick-ups, Panel Van Unconverted		
Up to 1750cc.	3,600	43,200
Over 1750 cc.	4,200	50,400
(iii) Land Rovers/Cruisers	7,200	86,400

Investment incentives - Capital deductions

The Income tax Act provides several capital deductions which are illustrated below.

o **Industrial buildings deductions**

Applicable Rates

- i) Industrial Building-2.5% capital deduction applicable within the first Forty (40) years of operation.
- ii) Hotels - 10% capital deduction applicable within the first 10 years of operation
- iii) Hostels and Educational Buildings certified by the commissioner - 50% capital deduction for the first 2 years of operation. These buildings include; Laboratory, Workshops, Accommodation halls, classrooms, dining halls/cafeteria, other halls for use by the students, administration building, sporting facilities and staff quarters.
- iv) Building in uses for training of film producers, actors or crew - 100% capital deduction.
- v) Rental residential building approved by the minister in a planned developed area - 25% capital deduction.
- vi) Commercial building- 25% capital deduction in a developed area.

o **Farm works deductions**

Applicable rates

Farmhouse- Allow 1/3 of the expenditure on one house. Employee houses qualify.
Any other immovable buildings for the proper operation of the farm deduct 100% of the whole amount.

o **Wear and tear deductions**

Categories & Applicable Rates

Class	Applicable Rates
Class I	37.5% on Reducing balance basis
Class II	30% on Reducing balance basis
Class III	25% on Reducing balance basis

Class IV	12.5% on Reducing balance basis
Class V	20% on Straight line basis

o **Investment deductions**

Applicable rates

- Investments situated within Nairobi, Mombasa and Kisumu - 100% investment allowance
- Investments worth 200 Million Kenya shillings situated outside Nairobi, Mombasa, Kisumu attract a 150% investment allowance .
- Investment Deduction-Manufacturing Under Bond- For production of export goods under bonded warehouses
- Investment Deduction-Export Processing Zones- 100% investment deduction
- Shipping Allowance - applies to the purchase of a new and unused power driven ship of more than 125 tons gross or the purchase and subsequent refitting for the purpose of that business of a used power-driven ship of more than 125 tons- 100% investment deduction

Residents Individual Income Tax Rates and Relief – Effective 1st January 2017
(KRA Public Notice Based On Finance Act 2016)

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 Kshs. 1,280 per month (Kshs. 15,360 per annum)

