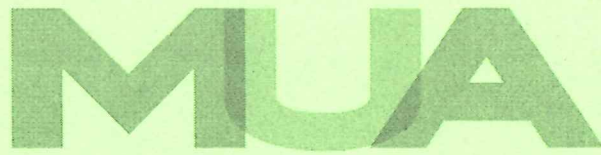


The
Management
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UNDERGRADUATE UNIVERSITY EXAMINATIONS

SCHOOL OF MANAGEMENT AND LEADERSHIP

DEGREE OF BACHELOR OF MANAGEMENT AND LEADERSHIP

BML 304 : TAXATION

DATE: 29TH JULY 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.

QUESTION ONE

- a. Specify the rules relating to payment of Income tax under the Pay as You earn rules. **(3 marks)**
- b. Describe the consequences of failure to deduct and pay tax under PAYE **(3 marks)**
- c. Explain three deductions that may be available against gains or profits from employment. **(3 marks)**
- d. It is common in Kenya to have individuals who cannot distinguish between taxes and charges. Differentiate between a tax and National Social Security Fund deductions. **(6 marks)**
- e. Mr. Patel Shah provided the following information for the year ended 31 December 2023:

1. He was employed as a full time director of Active Power Limited at a salary of Sh.80,000 per month (PAYE Sh.31,200 per month was deducted).
2. Free goods worth Sh.30,000 were received from the company in the year for personal use.
3. He enjoyed free medical treatment under a medical scheme operated by the company which was assessed at Sh.50,000 in the year.
4. Mr. B Shah and his wife operate a company fully owned by them whose taxable income has been agreed at Sh.200,000 after charging wife's salary of Sh.120,000 (PAYE sh.22,000).
5. Active Power Limited provided him with free housing from 1 August 2023 prior to which he lived in his own house.

His wife also works as a nurse in a private hospital and earned Sh.20,000 per month (PAYE Sh.4,000). Rent from property owned was Sh.30,000 per month from August 2023. Repair and painting of Sh.11,500 before letting. The house had a mortgage of Sh.2,000,000 and Sh.600,000 was paid of which Sh.330,000 was capital

Required:

- i. Total taxable income of Mr. Patel Shah for 2023. **(8 marks)**
- ii. Tax payable/repayable on the income computed above. **(2 marks)**

QUESTION TWO

- a. Explain clearly the nature of a public good with specific reference to provision of education in Kenya today and the role taxes play under such circumstances. **(10 marks)**
- b. Describe the principle of cost sharing and the extent to which it influences the level of taxation? **(5 marks)**

QUESTION THREE

- a. Explain whether Value Added Tax (VAT) is a direct or indirect tax **(2 marks)**
- b. Explain the rules governing the payment of VAT and specify the additional tax that may arise from failure to comply with those rules. **(5 marks)**
- c. Mr. Mali Mingi is a hardware merchant. He purchases cement from Athi Cement Ltd. which he then sells to his customers. Both Mali Mingi and Athi Cement Ltd. require a profit margin of 20% on cost. Cement attracts 18% VAT. If the cost of production by Athi Cement Ltd. is Sh. 220 per bag of 50Kg. At what price should Mali Mingi sell a bag of cement including VAT? **(5 marks)**
- d. What VAT is payable to the Collector of VAT by Mr. Mali Mingi per 50 Kilograms bag? **(3 marks)**

QUESTION FOUR

The following balances are extracted from the books of Tatu Limited for the year ended 30 April 2023

Particulars	Sh.
Share capital:	
3,000,000 ordinary shares (fully paid)	3,000,000
800 8% redeemable preference shares	80,000
Share premium account	50,000
General reserves	200,000
Preference share redemption	96,000
Block capital (at cost less depreciation)	1,910,000
Net profit for the year (before tax)	842,000
Debtors (unsecured, considered good)	60,000
Creditors	50,000
Profit and Loss Account (Cr 1 May 2022)	20,000
Interim dividend	150,000
Unpaid dividend	18,000
Other current assets	1,150,000
Investments	390,000
Preliminary expenses	12,000

Income tax paid, under dispute for the year ended 30 April 2022	200,000
Advance payment of income tax	440,000

You are provided with the following additional information:

1. Market value of the investment is Sh.355,000. Investment which cost Sh.40,000 had been sold in the year and realized a profit of Sh.12,500 which is included in the above profits.
2. The disputed income tax of the year ended 30 April 2022 is per revised assessment. Original self-assessment indicated an amount of Sh.96,000 which had been paid.
3. Preference shares are redeemable on 1 April 2025, at a premium of 20% but no entries were recorded in the books for giving effect thereto except for the payment standing to the debit of preference share redemption account.
4. Preliminary expenses represent the balance after amortization. The original amount incurred to pay wages before commencement of business was Sh.20,000 and is being amortized over 5 years. The amortization charge is debited to the profit and loss account.
5. Other current assets include stocks of Sh.90,000 which had been written down by 10% as provision for future plans decline. The amount was debited to the profit and loss account.

Required:

- a. Comment on reasons why a tax payer may appeal to the Local Committee.
(4 marks)
- b. Describe how each of the five issues above affect the tax position of Tatu Limited?
(5 marks)
- c. Compute revised taxable profits of Tatu Limited for the year ended 30 April 2023 and show tax payable.
(6 marks)

QUESTION FIVE

- a. Distinguish between farm works deductions and capital deductions. (5 marks)
- b. John Moturi, a farmer, constructed a farmhouse on 2 January 2021 for Sh.6,000,000 and incurred the following additional expenditure:

Date	Items	Sh.
2.1.2021	Cattle dip	1,000,000
30.6.2021	Irrigation system	1,500,000
30.9.2021	Labour quarters	2,400,000
30.10.2021	Milking machinery	1,120,000

John Moturi sold the farm on 2.1.2022 to his brother, Peter Muturi, who is also a farmer. Their sale agreement contained the following particulars:

	Sh.
Cattle dip	1,200,000
Farmhouse	6,700,000
Irrigation system	1,200,000
Milking machinery	980,000
Labour quarters	2,800,000

Required:

Calculate the capital deductions due to John Moturi and Peter Muturi for the years 2021, 2022 and 2023. (10 marks)

QUESTION SIX

A, K and M are in a partnership of selling imported clothes, handbags and shoes. They have provided the following information for the year of income 2023:

	Sh.
Net loss after deducting the following:	(1,080,000)
Rent	180,000
Legal costs	75,000
Salaries and wages	300,000
Donations: Turkana Food Relief Fund	50,000
Electricity and water	35,000
Repairs to business premises	65,000
Stationery	12,000
Vehicle expenses	90,000
Audit and accountancy	24,000
Advertising	65,000
Depreciation:	
Car	10,000
Building	33,000

Salaries:	K	240,000
	M	240,000
	A	360,000
Interest on capital	K	80,000
	M	80,000
	A	120,000
Bad debts		40,000
Loss on sale of shares		8,000
Political party membership: K		6,000
Withdrawals by M		5,000
Dresses taken by A for her own use		12,000
School fees paid for A's children		55,000

Additional information:

1. Wear and tear deductions were estimated at Sh.16,000.
2. Fifty per cent of vehicle expenses was for personal use.
3. Salaries and wages include Sh.30,000 paid to A's daughter for assisting in the business during the school holidays.
4. Rent analysis:

Payment for Partners residence	Sh. 80,000
Business	Sh.100,000
5. Legal costs included a payment of Sh.15,000 paid to an arbitrator to settle a personal dispute between K and M.
6. Bad debt analysis:

General provision	10,000
Specific provision	12,000
Written-off	8,000
A's son (defaulter)	<u>10,000</u>
	<u>40,000</u>
7. Advertising:

Advertising campaign	28,000
Cost of new sign board	5,000
Sale of clothes	9,000
A's birthday expenses	<u>23,000</u>
	<u>65,000</u>
8. Other incomes (included in trading profit)

Dividends from shares KCB Ltd.	19,000
Rental income: sub-letting business premises	22,000
Gain on sale of furniture	<u>13,000</u>
	<u>54,000</u>

Required:

- i. Taxable income (loss) for the partnership business and distribution among the partners for 2023 if they share profits and losses in the ratio 2:1:1. **(12 marks)**
- ii. Determine the taxable income of each partner. **(3 marks)**

RATES OF TAX

(Including wife's employment, self-employment and professional income rates of tax).
Year of Income 2023.

Monthly Pay Bands (Ksh.)	Annual Pay Bands (Ksh.)	Rate of Tax (%)
On the first Shs. 24,000	On the first Shs. 288,000	10
On the next Shs. 8,333	On the next Shs.100,000	25
On the next Shs. 467,667	On the next Shs. 5,612,000	30
On the next Shs.300,000	On the next Shs. 3,600,00	32.5
On all income above Shs. 800,0000	On all income above Shs. 9,600,000	35
Personal Tax Relief		
2,400	28,800	

Prescribed benefit rates of motor vehicles provided by employer

				Monthly rates (Shs)	Annual rates (Shs)
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
Software	20%	Over	-	3000cc	14,400 172,800
Industrial building allowance:					
Up to 2009	2.5%	(ii)	Pick-ups, Panel Van (Unconverted)		
From January 2010	10%	Upto		1750 cc	3,600 43,200
Hotels	10%	Over		1750 cc	4,200 50,400
Hostels/Education/Film producers buildings		(iii)	Land Rover/Cruisers		
From 1 January 2010	100%				7,200 86,400
Commercial building: (Shop, Office or Show room)	25%				
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%