



## GARISSA UNIVERSITY

UNIVERSITY EXAMINATION **2017/2018** ACADEMIC YEAR **THREE**  
**SECOND** SEMESTER EXAMINATION

SCHOOL OF BUSINESS AND ECONOMICS

FOR THE DEGREE OF BACHELOR OF BUSINESS MANAGEMENT

COURSE CODE: BBM 303

COURSE TITLE: TAXATION 1

EXAMINATION DURATION: 3 HOURS

**DATE: 09/04/18**

**TIME: 09.00-12.00 PM**

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### INSTRUCTION TO CANDIDATES

- The examination has **SIX (6)** questions
- Question **ONE (1)** is **COMPULSORY**
- Choose any other **THREE (3)** questions from the remaining **FIVE (5)** questions
- Use sketch diagrams to illustrate your answer whenever necessary
- Do not carry mobile phones or any other written materials in examination room
- Do not write on this paper

This paper consists of **TWELVE (12)** printed pages

*please turn over*



**QUESTION ONE (COMPULSORY)**

- (a) Explain the concept of elasticity with respect to:
  - i. Direct Tax **[2 marks]**
  - ii. Indirect Tax **[2 marks]**
- (b) List and explain any three deductions that may be available against gains or profits from employment. **[3 marks]**
- (c) Distinguish between tax evasion and tax avoidance. **(4marks)**
- (d) Suggest possible ways in which the Government of Kenya may prevent loss of tax revenue from imports. **(4marks)**

(a) Mr. Matata has approached you with a view to obtaining help in determining his taxable income for 2015. He has supplied the following information:

1. Employment Income – Mr. Matata

He was employed by Utajiri Limited as the General Manager – Sales. His salary was Sh.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.

2. Business Income

He runs a small garage that generate taxable income of Sh.60,000. In 2004, he had a tax loss of Sh.40,000 from this business.

3. Investment Income

	Withholding Tax Sh.	Net Sh.
Dividends:		
Kenya Breweries Ltd	2,000	18,000
HFCK Ltd.	1,000	9,000
CMC Ltd.	4,000	36,000



Interest:

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

4. Wife's Income

His wife was employed by Mafuta Ltd. as the Finance Director. Her salary was sh.52,000 p.m. Additional benefits to her include: Company car 1800 cc and House at Muthaiga (market value of rent is Sh.20,000 per month).

5. PAYE of Sh.130,000 was deducted from Matata's pay but due to an oversight in the part of the Chief Accountant the tax was not paid to the Collector of Income tax. His wife's PAYE was Sh.180,000 in the year.

**Required:**

- i) Compute total income chargeable to tax and show the tax payable thereon. **[6 marks]**
- ii) Comment on any information not used for computing taxable income above. **[2 marks]**
- iii) Is Matata to blame for failure of the company to pay his PAYE? Explain. **[2 marks]**

**QUESTION TWO**

Njagi and Otiento are partners running a glass making plant and sharing profits and losses in the ratio 3:2 respectively. They have provided the following profit and loss account, notes and explanations for the year ended 31 December 2017:

**Sh.**

Income:

Sales	4,882,000
Sale of old plant (Sh.30,750) and Lorry (Sh.150,000)	180,750
Refund of VAT	21,250



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Post office savings bank interest	5,750
Dividend (net)	<u>42,500</u>
	<b><u>5,132,250</u></b>
Expenses:	
Purchases	1,491,500
Wages	408,750
National Hospital Insurance Fund (NHIF)	35,500
Rent	620,500
Lorry maintenance expenses	1,165,750
Salaries to partners	1,200,000
Otieno's household expenses	86,250
Repairs and maintenance (plant)	233,750
Advertising	75,000
Insurance premiums	156,750
Interest on loan	125,000
Subscription – glass Makers Association	25,000
Donation to Bursary Fund	8,000
Legal expenses	89,000
Bad debts	298,000
Water and electricity	86,250
Depreciation: Furniture and fittings	111,500
Plant	61,750
Total expenses	8,000
	<u>11,500</u>
Net loss for the year	<b><u>(1,165,500)</u></b>



Additional information:

- i) Glass worth sh.65,000 was used by Njagi and Otieno for their private purposes. This amount should be apportioned to the partners in their profit sharing ratio.
- ii) Lorry maintenance expenses include cost of a new lorry sh.750,000 and depreciation charge for the year of Sh.162,500.
- iii) Annual rent for Njagi's house was sh.300,000. This was paid for by the business.
- iv) During the year ended 31 December 2017, new plant was acquired for Sh.200,000. This has been included in the repairs and maintenance costs of plant.
- v) Njagi's personal car insurance was paid for by the business. It amounted to Sh.90,000.
- vi) Interest on loan and the legal expenses relate to Otieno's mortgage loan.
- vii) Bad debts were made up of:

Specific provision      Sh.50,000

General provision      Sh.61,500

- viii) Written down values as at 31 December 2001 were as follows:

Furniture and fittings      Sh. 49,500

Motor vehicles      Sh.107,000

Plant      Sh. 9,000

- ix) Otieno and Njagi received salaries of Sh.800,000 and sh.400,000 respectively.

**Required:**

- a) The adjusted profit or loss for tax purposes for the year ended 31 December 2017.      **[8 marks]**
- b) Division of profit (or loss) between the partners.      **[4 marks]**
- c) Tax payable by each partner for the year ended 31 December 2017.      **[3 marks]**

**QUESTION THREE**

- (a) State the intervals relating to payment of tax instalments      **[4 marks]**
- (b) Outline any two types of taxes in Kenya.      **[2 marks]**





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- i) Salaries and wages include Sh.20,000 contributed by the company to unregistered pension scheme.
- ii) General expenses include Sh.15,000 for donation, Sh.10,000 for contributions to a business pressure group that protects traders of the same kind.
- iii) Taxes represent VAT paid.
- iv) Bad debts (specific) are Sh.180,000.

**Required:**

- i) River Tech Ltd.'s adjusted profit (or loss) for tax purposes for the year ended 31 December 2017. **[7 marks]**
- ii) Corporation tax (if any) payable River Tech Ltd. for the year ended 31 December 2017 **[2 marks]**

**QUESTION FOUR**

- (a) List four circumstances under which duty paid on imports is refundable. **[3 marks]**
- (b) Briefly explain three (3) purpose of taxation in Kenya **[6 marks]**
- (c) Name four incentives given by the government to encourage the growth of capital market in Kenya.
- (d) Explain briefly the meaning of “goods subject to customs control” under the Customs and Excise Act (Cap. 472) **[3 marks]**
- (e) What is the position regarding penalties for failure to submit a self-assessment return for a deceased person? Who is responsible for the submission of returns on behalf of a deceased person **[3 marks]**

**QUESTION FIVE**

- (a) Persons registered for VAT are entitled to input tax deductions for VAT paid on inputs which relate directly to their taxable supplies except where the law prohibits these as non-deductible.  
List items that are prohibited for input tax deduction. **[3 marks]**
- (b) State the circumstances under which a registered person can qualify for bad debt relief as per the VAT regulations. **[2 marks]**



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(c) Zadaa Ltd is a Nakuru based company dealing in a variety of VAT designated goods. The following transactions were recorded for the month of September 2016:

### September

- 1: Opening stock 8,000 units valued at Sh.576,000.
- 5: Imported 10,000 units at Sh.80 per unit being cost, insurance and freight (CIF).
- 8: Purchased 5,000 units from the local market at Sh.60 per unit.
- 9: sold 6,000 units at sh.90 per unit
- 12: Purchased a motor vehicle for Sh.400,000 for use in the business
- 15: Paid Sh.10,000 for photocopy and printing of office documents.
- 16: Purchased oil filters and lubricants for use in the factory for Sh60,000.
- 16: Paid an invoice for Sh.70,000 in respect of fuel for company vehicles. The fuel had been used in August 2006.
- 18: Supplied 3,000 units to a department in the Ministry of Finance at a price of Sh.90 per unit.
- 20: Sold 2,000 units at Sh.85 per unit to a company in Uganda.
- 22: Purchased on credit 2,500 units locally at Sh.80 per unit, before deducting a case discount of 5%.
- 27: Paid electricity expense of Sh.15,000 and telephone expense of Sh.9,000.

The amounts stated above are inclusive of VAT at the rate of 16% where applicable, unless otherwise specified. Assume the rate of import duty is 20%.

### Required:

The VAT account for the year month of September 2016.

[10 marks]





**QUESTION SIX**

- (a) Define the term qualifying expenditure and briefly explain items which may not be included in the qualifying expenditure for the purposes of investment deductions. **[4 marks]**
- (b) Explain reasons why Capital Allowances are generated in Kenya **[3 marks]**
- (c) Mr. Jembe owns a coffee processing factory in Eldoret. The following particulars relate to assets of the factory in 2005.
- i) Purchased a new building from a builder at a cost of Sh.2, 000,000. Administration offices included in the building had an estimated cost of Sh.250, 000.
  - ii) Erected a security wall at a cost of Sh.1,000,000
  - iii) Purchased three microcomputers at a total cost of Sh.300, 000.
  - iv) Other assets of the factory were as follows:

	<b>WDV</b>	<b>Additions</b>	<b>Disposals</b>
	<b>1.1.2005</b>		
	<b>Sh.</b>	<b>Sh.</b>	<b>Sh.</b>
Office furniture	3,200,000	1,200,000	700,000
Computers	200,000	-	80,000
Tractors	12,000,000	-	2,500,000
Lorries (1 ton)	3,000,000	3,000,000	500,000
Processing machines	4,800,000	2,400,000	1,900,000
Saloon cars	3,200,000	4,000,000	200,000
Buildings	10,000,000	-	-
Land	7,500,000	1,000,000	4,000,000

- v) A farm house was constructed in 2005 at a cost of Sh.300, 000. a cattle dip and milking machinery costing Sh.220,000 and sh.450,000 respectively were constructed and purchased during 2005.
- vi) Goodwill and patents carried forward from 2003 were valued at Sh.1, 400,000 on 31 December 2005.



**Required:**

- (a) Capital deductions for Mr. Jembe for the year of income 2005 [6 marks]  
 (b) Comment on any information you have not used in (a) above. [2 marks]

**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
0	-	11,180	0	-	134,164	10%
11,181	-	21,714	134,165	-	260,567	15%
21,715	-	32,248	260,568	-	386,970	20%
32,249	-	42,782	386,971	-	513,373	25%
Excess over	-	42,782	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



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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 2.5% (ii) Pick-ups, Panel Van  
(Unconverted)

Hotels 4.0%

**Farm works allowance** 33.3% Upto 1750 cc 3,600 43,200

**Investment deduction allowance:** Over 1750 cc 4,200 50,400

2003 - 70% (iii) Land 7,200 86,400  
Rovers/Cruisers

2004 - 100% OR 2% of the initial capital cost of the vehicle for  
each month, whichever is higher.

2005 - 100%

**Shipping investment deduction  
40%**

**Mining allowance:**

Year 1 40%

Year 2 - 7 10%

**Commissioner's prescribed benefit rates**



Services	Monthly rates	Annual rates
	Sh.	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

**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%**

NB: ALL THE SOLUTIONS provided are based on year 2017 Tax rates to be used for year 2018 Exam.

(a) not used in (a) above.

**[3 marks]**

