



**MASINDE MULIRO UNIVERSITY OF SCIENCE AND
TECHNOLOGY**

(MMUST)

MAIN/BUNGOMA/WEBUYE/KAPSABET/MUMIAS/NAIROBI CAMPUS

UNIVERSITY EXAMINATIONS

2021/2022 ACADEMIC YEAR

**FORTH YEAR SPECIAL/ SUPPLIMENTARY
EXAMINATIONS**

FOR THE DEGREE

OF

BACHELOR OF COMMERCE

COURSE CODE: BCA 422

COURSE TITLE: TAXATION THEORY AND PRACTICE

DATE: FRIDAY, 5TH AUGUST 2022

TIME: 2-4PM

INSTRUCTIONS TO CANDIDATES

Answer **QUESTION ONE** and **ANY OTHER TWO** questions.

TIME: 2 HOURS

MMUST observes ZERO tolerance to examination cheating

This Paper Consists of 7 Printed Pages. Please Turn Over.

RATE OF TAX (including wife's employment, self-employment and professional income rates of tax)

	Annual	Monthly	Rates
On the first	Ksh.134,164	Ksh. 11,180	@ 10%
On the next	Ksh. 126,403	Ksh. 10,534	@ 15%
On the next	Ksh. 126,403	Ksh. 10,534	@ 20%
On the next	Ksh. 126,403	Ksh. 10,534	@ 25%
On all income over	Ksh. 513,373	Ksh. 42,782	@ 30%

Personal relief Sh. 1,280 per month (Sh. 15,360 per annum)

Prescribed benefits rates of motor vehicles provided by employer

			Monthly rates (Sh.)	Annual rates (Sh.)
Capital Allowances:	(i)	Saloons, Hatch backs and estates		
Wear and tear allowance:				
Class I	37.5%	Up to 1200 cc	3,600	43,200
Class II	30%	1201 1500 cc	4,200	50,400
Class III	25%	1501 1750 cc	5,800	69,600
Class IV	12.5%	1751 2000 cc	7,200	86,400
Industrial Building Allowance:		2001 3000 cc	8,600	103,200
Up to 2009	2.5%	Over 3000 cc	14,400	172,800
From January 2010	10%			
Hostels	10.0%			
Hostels/Education Buildings	50.0%			
Farm allowance:	100%			
Investment deduction	100%	Pick-up, panel van (Unconverted)		
		Up to 1750 cc	3,600	43,200
		Over 1750 cc	4,200	50,400
		Land Rovers/Cruisers	7,200	86,400
Shipping investment deduction	40%			
Mining allowance				
Year 1	- 40%			
Year 2-7	- 10%			

Commissioner's prescribed benefit rates

		Monthly rates	Annual rates
		Sh.	Sh.
Services			
(i)	Electricity (Communal or from generator)	1,500	18,000
(ii)	Water (Communal or from borehole)	500	6,000
Agricultural employees: Reduced rates of benefits			
(i)	Water	200	2,400
(ii)	Electricity	900	10,800

QUESTION ONE (30 MARKS) COMPULSORY

- a) Discuss four factors that influence tax shifting in an economy. (4 marks)
- b) Identify four ways in which an individual or firm could engage in —tax avoidance. (4 marks)
- c) Discuss four arguments in favour of progressive taxes in a country(4 marks)
- d) One of the challenges faced by a number of countries today is how to finance their budget deficits, The problem is compounded by the fact that some of the alternatives available for financing the budget deficit might negatively impact on the country.
Required: Citing one disadvantage in each case, briefly explain three measures that a government could undertake to finance a budget deficit.(3marks)
- e) Halima and Cheronno are partners trading as Hache Enterprises and sharing profits and losses in the ratio of 2: 1 respectively.

The partners presented the Following income statement for the year ended 31 December 2017:

Income	Sh.	Sh.
Discount received		3,000,000
Interest on bank deposits (net)		200,000
Farming income		60,000
Foreign exchange gain		280,000
Insurance compensation for stolen motor vehicle		156,000
Discount received		200,000
Expenses:		
General expenses	1,750,000	
Loss on disposal of equipment	30,500	
License and permits	15,200	
Stamp duty	2,600	
Interest on capital – Halima	184,000	
Cheronno	145,000	
Salaries and wages	1,200,000	
Subscriptions to trade association	28,000	
Rent and rates	40,000	
Purchase of furniture	42,000	
Legal expenses	120,000	
Farm works at cost	30,000	(3,578,300)
Net profit		308,700

Additional information:

- i. Salaries and wages include Sh.420, 000 and Sh.630, 000 paid to Halima and Cheronno respectively.
- ii. Rent and rates relate to a period of 15 months commencing 1 January 2013.
- iii. The general expenses comprised of:

	Sh.
Cash embezzled by the cashier	60,000
Partitions of the office	120,000
Partnership's Jubilee celebrations	250,000
Donations to National Disaster Committee	430,000
Other office expenses	350,000

iv. Legal expenses include:

	Sh.
Parking fines paid to the local council	15,000
Defending the partner in an income tribunal	22,300
Drafting tender documents	47,000
Drafting lease documents (100 years lease)	35,500

Required:

- I. Adjusted partnership taxable profit or loss for the year ended 31 December 2017. (10 marks)
- II. Allocation of the taxable partnership profit or loss computed in (e) (I) above. (5 marks)

QUESTION TWO (20 MARKS)

- a) An optimal tax system is one that satisfies the principles of taxation . with reference to the above statement. Explain the four main canon of taxation as advanced by Adam Smiths. (8 marks)
- b) Umeshi Osodo was employed by Metal Max Ltd. as a human resource manager with effect from 1 January 2017. He reported the following incomes for the year ended 31 December 2017:
 - i. Basic salary Sh. 80,000 per month (PAYE Sh. 12,000 per month).
 - ii. The employer paid his annual life insurance premiums at an amount equivalent to 5% of his annual basic salary.
 - iii. He earned a net interest income of Sh. 150,000 during the year from his investments in housing development bonds.
 - iv. The employer provided him with a house whose market rental value was Sh. 50,000 per month. The employer deducted 5% of his basic salary per month as nominal rent.
 - v. Education fees for his two children amounting to Sh. 180,000 were paid by the employer during the year. This amount was charged in the employer's income statement.
 - vi. The employer reimbursed him for all out of pocket expenses incurred on the official use of his personal car.
 - vii. In the year 2017, the amount reimbursed amounted to Sh. 180,000. He had purchased the car in the year 2015 at a cost of Sh. 900,000. The car had an engine capacity of 1600 cc.
 - viii. He contributed Sh. 28,000 per month to a registered pension scheme. The employer contributed Sh. 18,000 per month for him to the same scheme.
 - ix. He received entertainment allowance amounting to Sh. 40,000. He utilized the amount in celebrating his birthday together with his family.
 - x. He received a year-end bonus payable to executive staff of Sh. 80,000
 - xi. The employer provided him with electricity, water, telephone and a cook at a cost of Sh. 15,000, Sh. 9,000, Sh.60,000 and Sh. 18,000 per month respectively.
 - xii. During the year Umeshi Osodo was declared the best employee and the employer paid him a reward of Sh. 100,000.
 - xiii. He received medical benefits amounting to Sh. 420,000 from the employer. The company has a medical scheme for all staff members.

Required:

Compute the following for the year ended 31 December 2017:

- I. Taxable income for Umeshi Osodo. (8 marks)
- II. Tax liability (if any) on the income in (b)(i) above. (4 marks)

QUESTION THREE (20 MARKS)

General expenses include:

Directors' Christmas party	36,000
Increase in general provision for bad and doubtful debts	14,000
Defending a company driver in a traffic offence	10,000

Subscriptions paid include:

Donations to a children's home	8,000
Donations to a registered political party	4,600
Membership fees to the National Agricultural Society	4,400

Professional fees include:

Architect's fees on proposed farm work	48,400
Farm valuation fees	27,400
Valuation of farm machinery for disposal purposes	24,600

Farm works acquired on 1 January 2017 comprised:

Livestock trough	90,000
Granary	20,000
Farmhouse	480,000
Labour line	240,000

Required:

- I. A statement of adjusted taxable profit (or loss) for the year ended 31 December 2017. (9 marks)
- II. Tax payable (if any) by the company. (3 marks)

QUESTION FOUR (20 MARKS)

Jawabu Ltd. commenced its operations on 1 January 2016 after obtaining a licence to manufacture leather bags for export. The following information relates to the company's operations for the financial years ended 31 December 2016 and 2017:

- i. The company incurred the following expenditure prior to the commencement of its operations

Acquisition of land	15,000,000
Demolition of old buildings	800,000
Staff canteen	1,500,000
Factory building construction	14,000,000
Labour quarters	1,200,000
Stone perimeter wall	2,500,000

- ii. On 5 January 2016, the following assets were acquired:

Conveyor belts	72,000
Imported processing machinery (including import duty Sh. 200,000)	2,600,000
Cash registers	120,000
Fax machines	200,000
Delivery vans	1,500,000
Computers	320,000

- iii. A borehole was drilled at a cost of Sh.680,000 and utilized with effect from 1 October 2016.
- iv. The factory building constructed comprised of a warehouse costing Sh.6,000,000, administration block costing Sh. 1,500,000 and a showroom costing sh. 2,200,000

- a) Indicate whether the following individuals who have no permanent home in the country are considered as resident or non-resident for the year ended 31st December 2017 for income tax purposes. Show your working where applicable.

Name	Year	No of days present in kenya
Mrs omondi	2017	72
	2016	115
	2015	177
Mr. Kamau	2017	105
	2016	145
	2015	146
Mr Mbithi	2017	189
	2016	48
	2015	Nil
Mr Wafula	2017	Nil
	2016	224
	2015	188

- b) Rift Valley Ltd. is in the business of farming. The following income statement was obtained from the books of the company for the year ended 31 December 2017:

Income:	Sh.	Sh.
Sale of horticultural products	3,600,000	
Sale of livestock	2,840,960	
Gain on sale of shares	14,180	
Foreign exchange gain	36,400	6,491,540
Expenditure:		
Insecticides	250,000	
Veterinary services	284,600	
Purchase of fertilizer	562,000	
Packaging materials	246,400	
Professional fees	274,000	
Subscriptions paid	34,240	
Repairs and maintenance	580,000	
Motor vehicle running. Costs	624,900	
Interest on loan	249,400	
Salaries and wages	1,490,400	
General expenses	145,700	(145,700)
Net profit		1,749,900

Additional information:

Repairs and maintenance include:

	Sh
Freight charges on machinery	98,000
Provision for fencing expenditure	120,000
Purchase of furniture	78,000

- v. On 2 January 2017, the company acquired the following additional assets:

Air filters	420,000
Heating plant	380,000
Photocopier	140,000
Pick-up	1,200, 000
Factory machinery	750,000
Lorry (10 tonnes)	4,500, 000
Office cabinets	120, 000
Computer software	160, 000
Silencers (fitted on factory building)	180, 000

- vi. A loading bay and an extension to the factory building were constructed and utilized with effect from 2 January 2017. The loading bay cost Sh. 2,400,000 while the factory extension cost Sh.3,500,000.
- vii. On 1 July 2017, Jawabu Ltd. ceased to manufacture bags for export and started selling its bags in the local market. On the same date the company disposed of the following assets:

Asset	Cash proceeds Sh
Computers	220,000
Heating plant	130,000
Fax machine	100,000

Required:

Capital allowances due to Jawabu Ltd.

- For the year ended 31 December 2016 (8 marks)
- For the year ended 31 December 2017 (12 marks)

QUESTION FIVE (20 MARKS)

- Outline four offences under the value added tax (VAT) Act.
- Beta Supermarket Ltd. is registered for VAT. During the month of January 2018, the supermarket had the following transactions:

January

- Sold goods on credit to Mwamba Enterprises for Sh. 400,000.
- Purchased goods on credit from Hekima Traders for Sh. 200,000
- Paid for catering expenses Sh. 68,000 by cash
- Mwamba Enterprises returned goods valued at Sh.60, 000, and received a credit note.
- Exported goods to Uzalendo Ltd., a company based in Rwanda for Sh. 300,000
- Purchased stationery for Sh. 84,000 on credit from Smart Books Bookshop.
- Purchased goods for Shs 800,000 from Uchumi Enterprises on credit
- Imported goods from Canada for Sh. 900,000 exclusive of import duty of 25% and value added tax at 16%.
- Received a debit note of Sh. 48,000 from Uchumi Enterprises
- Paid electricity bills amounting to Sh. 24,000 by cheque
- Engaged an auditor and paid him Sh. 60,000 for auditing the supermarket's inventory.
- Sold goods worth Sh. 1,400,000 to the Ministry of Youth and Sports
- Bought spare parts for repair of motor vehicles for Sh. 120,000
- Sold goods on credit to Jawabu Enterprises for Sh. 800,000
- Made cash sales of Sh. 200,000 and banked the cash on the same day

The above transactions are stated inclusive of VAT at the rate of 16% where applicable and unless otherwise stated.

Required:

A value added tax (VAT) account for the month of January 2017.