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**MASINDE MULIRO UNIVERSITY OF SCIENCE AND
TECHNOLOGY**

(MMUST)

MAIN/BUNGOMA/WEBUYE/ CAMPUS

UNIVERSITY EXAMINATIONS

2022/2023 ACADEMIC YEAR

FORTH YEAR SECOND SEMESTER EXAMINATIONS

FOR THE DEGREE

OF

BACHELOR OF COMMERCE

COURSE CODE: BCA 422

COURSE TITLE: TAXATION THEORY AND PRACTICE

DATE: Thursday 13th April 2023

TIME: 3.00-6.00 pm

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 8 Printed Pages. Please Turn Over. 

RATE OF TAX (including wife's employment, self-employment and professional income rates of tax).
Year of income 2021.

Assume that the following rates of tax applied throughout the year of income 2021:

Monthly taxable pay (Sh.)	Annual taxable pay (Sh.)	Rate of tax % in each Sh.
1 - 24,000	1 - 288,000	10%
24,0001 - 32,333	288,001 - 388,000	25%
Excess over - 32,333	Excess over - 388,000	30%

Personal relief Sh. 2,400 per month (Sh. 28,800 per annum).

Investment allowance :	Rate of investment allowance	Residual value (per year on reducing balance)	Prescribed benefit rates of motor vehicles provided by employer (i)Saloons, Hatch Backs and Estates
Capital expenditure incurred on:			Monthly Annual rates rates Up to 1200cc 3,600 43,200
(a) Buildings:			
• Hotel building	50% in the first year of use	25%	1201 - 1500cc 4,200 50,400
• Building used for manufacture	50% in the first year of use	25%	1501 - 1750cc 5,800 69,600
• Hospital building	50% in the first year of use	25%	1751 - 2000cc 7,200 86,400
• Petroleum or gas storage facilities	50% in the first year of use	25%	2001 - 3000cc 86,400 103,200
• Educational/hostels building	10% per year on reducing balance		Over - 3000cc 14,400 172,800
• Commercial building	10% per year on reducing balance		
(b) Machinery:			(ii)Pick- ups, Panel Vans (unconverted)
• Machinery used for manufacture	50% in the first year of use	25%	Up to - 1750cc 3,600 43,200
• Hospital equipment	50% in the first year of use	25%	Over - 1750cc 4,200 50,400
• Ships or aircraft	50% in the first year of use	25%	
• Motor vehicles and heavy earth moving equipment	25% per year on reducing balance		
• Furniture and fittings			
• Telecommunication equipment	10% per year on reducing balance		
• Film equipment by a local producer	10% per year on reducing balance		
• Machinery used to undertake operations under prospecting rights and exploration under mining rights	25% per year on reducing balance	25%	
• Other machinery	50% in the first year of use		
	10% per year on reducing balance		
(c) Purchase/acquisition of right to use fiber optic cable by telecommunication operation	10% per year on reducing balance		(iii)Land Rovers/Cruisers 7,200 86,400
(d) Farm works	50% in the first year of use	25%	

Commissioner's prescribed benefit rates: Services	Monthly rates (Sh.)	Annual rates (Sh.)
(i) Electricity (commercial or from a generator)	1,500	18,000
(ii) Water (Communal or from a borehole)	500	6,000

Agriculture employees: Reduced rates of benefits

(i) Water	200	2,400
(ii) Electricity	900	10,800

QUESTION ONE (30 MARKS)

a) Briefly explain any four characteristics of tax that distinguish it from any other payment made to the state. **(4 Marks)**

(b) Taxable capacity is the capacity of individuals to pay tax to the government. It is the maximum tax that can be collected from an individual without producing undesirable effects. Explain any five factors that influence taxable capacity of a nation like Kenya **(5 Marks)**

(c) KRA has made major strides to increase the overall taxable capacity of the country. In light of this explain any 5 recent initiatives KRA has undertaken to widen Tax base **(5 Marks)**

(d) Josphat Makale works for Geosat solutions LTD as a technical director. During the year ended 31st Dec 2022, he received the following incomes and emoluments.

1. Basic salary of 120,000 p.m. (Inclusive of PAYE 42,000 p.m.)
2. He was provided with a 2200 cc Land rover which had cost the company 4.6 m in the year 2014.
3. In the month of Dec 2022, he received a sitting allowance of 280,000.
4. He is a member of a registered retirement benefit scheme of which he makes monthly contribution of 30,000.
5. He was housed by the company in a rented house with water, telephone and electricity. The house had a market rental value of 64,000 p.m. and he paid a nominal rent of 25,000 p.m.
6. During the year, the company paid school fees for his son amounting to 280,000. This amount was disallowed for tax purposes on Geosat Solution LTD.
7. Geosat Solution Ltd operates a medical scheme for all staff with Afia Insurance Ltd in the year 2021, the amount paid for Moses Bundi cover amounted to 320,000.
8. The company paid his monthly electricity, water and telephone bills averaging to 18,000, 12,500 and 16,000 respectively.
9. He earned interest income of 180,000 during the year from his investment in housing development bond.
10. The company paid 240,000 to cover for josphat Makale family life insurance premiums during the year, the insurance policy covered Josphat Makale, his wife and son.
11. In Dec 2022 Josphat Makale received an entertainment allowance of 120,000. Half of this amount was spent on entertaining business customers.
12. Josphat Makale received a net rental income of 1.5 M from his commercial rental premises during the year. This was after deducting the following expenses.

Caretaker's wages 200,000

Purchase of a water tank 150,000

Required

- a) Taxable income of Josphat Makale for the year of income ended 31st Dec 2022
- b) Tax liability (if any) from the income computed in (a) above. **(16 Marks)**

QUESTION TWO (20 MARKS)

- a. Abula and Bajo have been trading in partnership sharing profit and losses in the proportion of three fifths and two fifths. They have prepared the accounts for 2022 as follows:

	Shs
Interest on capital A	20 000
Interest on capital B	10 000
Goodwill written off	4 000
Bad debts	20 000
Audit, insurance and legal expenses	20 000
Motor vehicle expenses	30 000
Depreciation	60 000
Special expenses	8 000
Withholding tax on dividends	3 000
Partnership salaries (Bajo)	60 000
Loss on sale of investments	10 000
Repairs and renewals	6 000
Salaries and wages	100 000
Light, water and electricity	20 000
Net profit	<u>32 000</u>
	<u>403 000</u>
Gross profit from trading	380 000
Dividends received(net)	17 000
Sub-letting rent income	<u>6 000</u>
	<u>403 000</u>

Notes:

- i. Bad debts:

The debts account is as follows:

	Shs	Shs
Bad debts written off		10 000
Reserves carried down:		
General	80 000	
Specific	22 000	
		<u>102 000</u>
		<u>112 000</u>
Balances b/d :		
General	60 000	
Specific	30 000	
P&L account		20 000
Debts recovered		<u>2 000</u>
		<u>112 000</u>

- ii. Audit, insurance and legal:

	Sh
Audit expenses	10 000

Partner's insurance	2 000
Legal fees-debt collection	500
Legal fees for making partnership deed	<u>7 500</u>
	<u>20 000</u>

iii. Special expenses:

	Sh
Penalty for breach of V.A.T tax regulations	4 000
Redundancy pay to employee	3 000
Christmas gift to partner's wives	<u>1 000</u>
	<u>8 000</u>

iv. Withholding tax on dividend:

Dividends were received net of tax

v. Loss on sale of investments:

The shares in a quoted company were disposed of by sale during the year. They had cost Sh 60 000 and were disposed of for Sh 50 000. There were no other incidental costs

vi. Repairs and renewals:

	Sh
Office partitions	2 000
Office carpet	1 500
Replacement of adding machine	1 000
General repairs	<u>1 500</u>
	<u>6 000</u>

vii. Wear and tear schedule:

	Class III	Class V
	Shs	Shs
Written down value	90 000	56 000

One third of motor vehicle expenses is used on private motoring by partners

Required: calculate the adjusted profit for tax purposes for each partner (14 Marks)

b. Identify any three tax incentives offered to investors in Special Economic Zones in Kenya (6 Marks)

QUESTION THREE(20 MARKS)

(a) Waitiki Ltd presented the following income statement for the year ended 31st December 2022:

	<u>Sh 000</u>	<u>Sh 000</u>
Gross profit		36 000
Specific bad debts recovered		1200
Gain on sale of shares		200
Dividend from Bridge company		8 500
Interest on Post bank account		1 300
Proceeds on sale of machinery		<u>60</u>
Total revenue		47 260
<u>Expenses</u>		
Legal and accountancy fee	24 000	
Salaries to staff	1 405	

Donations	120	
Patents	60	
Repairs and maintenance	1 420	
Interest on loan	14	
Directors fee	2 450	
General bad debt	160	
Partitions (of office)	64	
Depreciation	180	
Purchase of machinery	128	
Advertising	1 360	
Purchase of library books	148	
Stamp duty on transfer of land	360	
Electricity expense	171	34 080
Net profit		13 180
Additional information		
1. Legal fee include:		Sh 000
Defense of company driver on traffic offence		36
Income tax appeal		18
Lease agreement (55 years)		46
Staff contract agreement		600
2. Repairs and maintenance include:		
Replacement of car engine		75
Painting of new factory building		24
Carpeting of manager's office		42
Conversion of garage into office		84
3. Electricity bill include Sh 20,000 incurred on additional deposit as required by Power co.		
4. Bad debt recovered include sh 640,000 relating to bad debts not previously allowed as an expense		
5. Capital allowances for the year were agreed with the tax authority at sh 250,000		
6. Donations were to a harambee to offset school fees for one of the director's sons		
7. The company owns 25% of share capital in bridge ltd		

Required: Compute taxable profit/loss and tax liability for Waitiki Ltd. **(14 Marks)**

(b) Comment on whether the following individuals and companies were residents of Kenya for tax purposes for the year ended 31st December 2022. Justify your comment in each case.

- i Mr. Charles Owini has a permanent home in Kenya. He works for a Company based in the United Kingdom(UK) where he lives. He came to Kenya for a one month holiday on 1st December 2022 but had not returned to the UK by 31st December 2022. **(2 Marks)**
- ii MapatoLtd is registered in South Africa where its headquarters are based. The Company opened a branch in Kenya on 1st March 2022. **(2Marks)**
- iii)Mrs. Frida Aloo, a Kenyan citizen, is married to a citizen of Canada. She was employed in Kenya until 31st August 2022 when she resigned to join her husband in Canada **(2 Marks)**

QUESTION FOUR(20 MARKS)

(a) Chemtech ltd commenced operations on 1st January 2022 after incurring the following expenses

	Shs
Revenues:	
Sales	30 780 000
Interest on government securities (Gross)	<u>50 000</u>
	30 830 000
Expenses:	
Purchases	24 000 000
Wages	2 320 000
Carriage inwards	370 000
Rent	300 000
Insurance	190 000
Trade expenses	100 000
Repairs:	
- Building	300 000
- Machinery	56 000
Advertising	254 000
Legal charges	100 000
Audit fees	80 000
Depreciation	3 017 000
Provision for doubtful debts	104 000
Debenture interest	600 000
Interim dividend	400 000
Proposed dividend	<u>731 000</u>
	<u>32 892 300</u>
Net loss	<u>2 062 300</u>

The following additional information is provided

1. Purchases returns and sales returns were Sh 500 000 and Sh 700 000 respectively. These were left out while preparing trial balance
2. Wages include Sh 25 000 per month paid to a “consultant” who helps the company whenever there is a problem with the VAT department. VAT of Sh 560 000 remains unpaid and the “consultant” promises to find a way of getting it written off. Full PAYE is deducted from his salary
3. Trade expenses include amount of Sh 60 000 travel expenses to Korea for the Director as part of the National Chamber of Commerce and Industry promotion tour
4. Repairs to machinery include small loose tools written off by Shs 100 000
5. Bad debts which are specifically bad are Sh 74 000
6. Capital allowances have been agreed at Sh 2 000 000

Required: Taxable profits for the year of income 2022 and tax payable if any (14 Marks)

- b) Explain three benefits of value added tax (VAT) in the context of the principles of a good tax system. (6 Marks)

	Cost Sh.
Factory building	3,600,000
Processing machinery	1,200,000
Furniture	320,000
Fittings	920,000
Staff quarters	780,000
Heavy duty forklift	720,000
Staff canteen	2,500,000
Saloon car	2,500,000
Delivery van	2,800,000
Godown	860,000
Tractor	3,200,000
Lorry 3.5 tonnes	2,400,000
Computers	450,000
Staff clinic	810,000

Additional information

1. Perimeter wall was constructed at a cost of 827,000 and put into use on 1st April 2022
2. The go-down and staff quarters was constructed at a cost of 860,000 and 780,000 respectively and put in to use on 1st October 2022
3. On 1st October the following assets were acquired in sh.
 - Conveyer belts 350,000
 - Workshop machinery 330,000
 - Water pump 480,000
 - Trailer for tractor 248,000
 - Laptop computer 150,000
4. During the year the following assets were disposed of.in sh.
 - Furniture 280,000
 - Computers 720,000
5. The saloon car was traded in during the year with another vehicle costing sh. 3,000,000 the trade in value was 1,800,000

Required; Compute capital allowances for Chemtech ltd for the year ended 31st December 2022
(12 Marks)

(b) Propose four ways through which taxpayers could engage in tax avoidance (4 Marks)

(c) Outline four circumstances upon which the commissioner of domestic tax may accept a late notice of objection from a tax payer (4 Marks)

QUESTION FIVE (20 MARKS)

- a. The directors of Tatu Ltd presented the following profit and loss account for the year ended 31 December 2022