

**INSTRUCTIONS: Answer question one and any other two questions**

**QUESTION ONE**

- a) Explain the meaning of the following terms as appearing in the respective tax legislation.
- i) Excise duty
  - ii) Taxable person
  - iii) Non-resident
  - iv) Zero-rated
  - v) Exempt income (5marks)
- b) Discuss any five canons of an optimum tax system (5 marks)
- c) Specify the rules relating to payment of Income tax under the Pay As You Earn (PAYE). (5 marks)
- d) Outline the consequences to the employer of failure to deduct and pay tax under PAYE (5 marks)
- e) Mr. Wambugu works as a sales manager with Kenya Bats Limited. The following are his employment details for the year ended 31 December 2019. The company pays him a salary of Sh.120,000 per month. He is a member of the company's pension scheme which is registered with the Commissioner for Income Tax. He contributes seven percent of his salary and company contributes fourteen per cent. The company bought for him a car on loan and repays Sh.20,160 per month towards the loan. Statutory deductions are: NSSF Sh.2,000 per month  
NHIF Sh.1,320 per month.

**Required:**

A well laid out statement in respect of the month of December 2019 showing the income tax and other deductions; and net pay for Mr. Wambugu after deducting tax. (10 marks)

**QUESTION TWO**

- a) You are provided with the following details:
- Installing a system of ventilation in the factory.
  - Legal expenses incurred when acquiring a new building
  - Giving the factory a fresh coat of paint
  - Replacing 200 tiles on a roof damaged by wind
  - Expenditure incurred in demolishing part of a wall to make room for a recently purchased machine.
- Required:** From an Income Tax perspective indicate for each of the above items whether it is capital or revenue expenditure. Explain. (5 marks)
- b) Timexa Limited provided the following details with respect to its fixed assets for the year of income 2018.

- |    |                 |            |            |            |            |
|----|-----------------|------------|------------|------------|------------|
| 1. | <b>Building</b> | Class I    | Class II   | Class III  | Class IV   |
|    | <b>Sh.</b>      | <b>Sh.</b> | <b>Sh.</b> | <b>Sh.</b> | <b>Sh.</b> |
|    | 1,400,000       | 460,000    | 610,000    | 800,000    | 6,200,000  |
2. The industrial building had been constructed sometimes back in 2017 at a cost of Sh.2,600,000. Fixed machines were Sh.2,000,000. Due to an oversight, no investment deduction was claimed.
3. During the year the following assets were purchased:
- |   |                  |            |
|---|------------------|------------|
| - | Patents          | Sh.200,000 |
| - | Computers        | Sh.390,000 |
| - | Stamping machine | Sh.800,000 |
| - | Land             | Sh.530,000 |
4. A car for use by the directors was involved in an accident and written off. No recoveries were made.
5. In December, all computers were sold as one lot for Sh.1,220,000.
6. Assume 100% as the rate of investment deductions. For year 2017.
- Required:** Capital allowances for Timexa Limited for year of Income 2018. (15 marks)

### QUESTION THREE

- a) Explain any five roles of a Value Added Tax tribunal. (5 marks)
- b) The management of Maendeleo Ltd., a registered supplier of vatable goods presented the following information relating to the company's transactions for the six months ended 30 June 2019.

	<b>Purchases</b>	<b>Sales</b>
	<b>Sh</b>	<b>Sh</b>
January	1,500,000	2,200,000
February	1,800,000	2,700,000
March	1,700,000	2,000,000
April	1,500,000	900,000
May	400,000	600,000
June	2,000,000	2,600,000

The amounts stated above were inclusive of VAT at a rate of 16%.

**Additional information:**

1. All purchases were made on cash basis while all sales were on credit basis. The cash due on credit sales was received in the month following the month of sale.
2. Ten per cent of the purchases made by the company in the month of April were returned to the suppliers in the same month.
3. Included in the sales for the month of May was Sh.200,000 for which the debtor defaulted and was subsequently declared bankrupt on 30 June 2019.

**Required**

Determine the VAT payable or refundable for each of the six months from January to June 2019 (15 marks)

### QUESTION FOUR

- a) Explain the concept of elasticity with respect to:
- (i) Direct Tax (2 marks)
  - (ii) Indirect Tax. (3 marks)
- b) Name five objectives of raising taxes and explain how they are achieved by the government. (5 marks)

- c) Alex Wachira is employed by Zintac Ltd. as a salesman. He provided the following information relating to his income and that of his wife for the year ended 31 December 2019:
1. His monthly basic salary is Sh. 60,000 (PAYE Sh. 15,000 per month).
  2. He is also entitled to a commission based on 5% of all extra sales he makes above Sh. 200,000 per month. His sales for the months of March, June, August and October 2019 amounted to 250,000, Sh.300,000, Sh.220,000 and Sh.215,000 respectively.
  3. He lives in a company house and pays a nominal rent of Sh. 8,000 per month. The market rental value of the house is Sh. 45,000 per month.
  4. The company reimburses him for all out-of- pocket expenses incurred on the official use of his car. In the year 2019, the amount reimbursed was Sh. 90,000, he had purchased the car in the year 2018 at cost of Sh. 800,000. The car has an engine capacity of 1600cc.
  5. The education fees for his two children amounting to Sh. 200,000 was paid by the company during the year. This amount was charged to the company's income statement.
  6. He earned a net interest income of Sh. 150,000 during the year from his investments in housing development bonds.
  7. He is contemplating purchasing a house for his residence in the near future. In the year 2019, he invested Sh. 100,000 in a registered home ownership savings plan and earned an interest income of Sh. 10,000.
  8. He has a life insurance policy for self and family for which he pays a total premium of Sh.45,000 per annum.
  9. He has a farm which generated a surplus of Sh. 120,000 during the year. A tax of Sh. 15,000 had been deducted under presumptive tax regulations.
  10. His wife has invested in the shares of a quoted company. She received a dividend of Sh. 12,000 (net) from the shares in the year 2019.
- Required:** Compute the total taxable income of Alex Kipkoech for the year ended 31 December 2019. (10 marks)

### QUESTION FIVE

The directors of Totale engineering Company Limited presented the following Profit and Loss for the year ended 31 December 2018:

	<b>Sh.</b>
Revenues	
Sales	30,780,000
Interest on Government Securities (Gross)	<u>50,000</u>
	30,830,000
<b>Expenses:</b>	
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	80,000
Audit fees	70,000
Depreciation	3,017,000
Provision for doubtful debts	

Debenture interest	104,000
Interim dividend	600,000
Proposed dividend	400,000
	<u>731,300</u>
Net Loss	<u>32,892,300</u>
	2,062,300

The following additional information is provided:

1. Wages include Sh.25,000 per month paid to a “consultant” who helps the company whenever there is a problem with the VAT department.
2. Trade expenses include an amount of Sh.60,000 travel expenses to Korea for the Director for personal issues.
3. Bad debts which are specifically bad are Sh.74,000
4. Capital allowances have been agreed at Sh.2,000,000.

**Required:**

- a) Taxable profits for the year of income 2018. (10 marks)
- b) Tax payable if any for 2018. Comment on the results. (5 marks)
- c) The company intends to give the Director a company car in 2019. What are the tax implications? (5 marks)