



DEDAN KIMATHI UNIVERSITY OF TECHNOLOGY
UNIVERSITY EXAMINATIONS 2021/2022 ACADEMIC YEAR
SECOND YEAR SECOND SEMESTER EXAMINATION FOR THE DEGREE OF
BACHELOR OF SCIENCE IN BUSINESS INFORMATION TECHNOLOGY

BCM 2203: INTRODUCTION TO TAXATION

DATE: 6TH APRIL 2022

TIME: 8:30-10:30AM

INSTRUCTIONS: Answer question one and any other two questions

QUESTION ONE

- a) Consider the following situation;
- i. Mr. Ambrose Kwame is a Tanzanian. He has been carrying out business in three different countries in the last five years. His transactions in Kenya are of high economic value. Explain to him, with reference to provisions of the Income tax Act section 2(1), who a resident person is for purposes of taxation. (5 marks)
 - ii. Advise Mr. Ambrose Kwame on how he can benefit from being a resident person with reference to tax laws in Kenya. (4 marks)
- b) Dividend income is classified as a taxable income in Kenya. Identify THREE dividend incomes which are fully exempted from taxation. (3 Marks)
- c) Identify THREE differences between fringe benefit tax and low interest benefits tax. (3 marks)
- d) Miss June Kanene, an employee of Kwetu Ltd had the following income s in the year 2019:
- i. Salary sh. 75,000 per month (PAYE 15,000)
 - ii. She was provided with the accommodation at Solian Estate which she contributed 4% of her basic salary. The house was furnished by the employer at a cost of sh. 200,000
 - iii. A company car of 2,100 cc was provided which had cost the company 1.2 million
 - iv. She was also provided with a gardener and a watchman who were paid sh. 4,000 each by the employer.
 - v. During the year, the company paid hospital bills on her behalf of sh. 120,000. She paid the remaining 70,000. The company had a medical scheme for junior staff only.
 - vi. The company contributed sh. 120,000 to a registered retirement scheme. She contributed sh. 120,000 to the same scheme.
 - vii. She had taken an insurance cover for which she paid insurance premiums of sh. 46,000 during the year.

- viii. The employer had paid school fees of sh. 130,000 for her children studying in a private school. The amount was treated as a non-allowable deduction in the company's financial statements.

Required:

- i) Explain the meaning of set offs as used in taxation (5 marks)
ii) Compute Miss June Kanene's taxable income for the year (10 marks)

QUESTION TWO

- a) Discuss two advantages and two disadvantages of Value Added Tax (4 marks)
b) Distinguish the following;
i. Zero rated supplies
ii. Standard rated supplies
iii. Exempt supplies (6 marks)
c) Shem has been operating a wholesale business in Nairobi. The following details related to the business for the month of August 2019

	Ksh
Imported goods for resale	1,750,000
Telephone and email expenses	84,000
Audit fees paid	1,120,000
Purchases at zero rate	870,000
Sales at standard rate	5,350,000
Photocopying costs	180,000
Purchases at zero rate	550,000
Water bill paid	12,500
Salaries and wages	3,750,000

Additional information;

- i. Shem paid import duties of 25% on the resale value of the goods above. The firm also incurred transport costs of Ksh 50,000 and repackaging costs of Ksh 20,000 on the imported goods resale. These goods were later sold during the month at a markup cost of 25%. These sales have not been included in the sales above.
ii. 5% of standard rate purchases were made from suppliers who were not registered for VAT.
iii. Goods at standard rate valued at Ksh 600,000 were returned during the month to the wholesaler
iv. One of the debtors of the business was declared bankrupt and the business wrote off Ksh 500,000 which was outstanding from the debtor at the end of the month
v. Shem donated goods worth Ksh 90,000 to Imani Home. These goods were not included in any of the sales above.

Required; The VAT payable/refundable by the business for the month of August 2019.

Note; The amounts above are stated exclusive of VAT at the rate of 16% where appropriate

(10 marks)

QUESTION THREE

You are a tax consultant and one of your clients, Mr. Kioko who works for Umeme Ltd has received an additional assessment from the Commissioner for Domestic Taxes for the year ended 31 December 2021.

The Commissioner is satisfied with the taxes paid by Kioko on employment income however he based the additional assessment on the non-inclusion of the following income in Mr. Kioko's income tax return.

1. Investment Income

Interest on loan to his friend's law firm Ksh 45,000 (gross)

Dividends from companies quoted on the NSE Ksh 75,000 (net)

2. Mr. Kioko is a board member of a local polytechnic. During the year 2021 he earned a total income of Ksh 500,000 from the board meetings. No taxes were deducted by the polytechnic.

3. Rental income

Mr. Kioko owns several rental properties where he receives an annual gross rental income of Ksh 14 million. You have established that the rent is collected by an agent and Mr. Kioko pays the agent a commission of 2.5% of the gross rent collected. He also incurred the following expenses during the year;

	Ksh
Garbage collection expenses	120,000
Land rates and rent	385,000
Mortgage payments; Interest	1,600,000
Principal	250,000
Installation of water tanks for all the houses	500,000
Salary of the Gardener	580,000
Purchase of flower pots and garden furniture	230,000
Total expenses	3,665,000

In addition Mr. Kioko informs you that he incurred legal expenses of Ksh 85,000 in evicting a tenant who had rent arrears.

4. Mr. Kioko owns a hair and beauty salon which is run and managed by his wife. In the year 2019 when the salon was started it made a loss of Ksh 750,000. The salon generated a net profit of Ksh 2,648,700 in the year 2021 determined as follows;

	Ksh	Ksh
Turnover		5,800,000
<u>Expenses;</u>		
Purchase of dryers and furniture	800,000	
Payments of commissions to employees	1,400,000	
Salaries to non-commission employees	360,000	
Payments for utilities	89,000	
Free haircuts to street boys	2,300	
Purchase of TVs for reception area	500,000	(3,151,300)
		2,648,700

Required;

Write a memorandum of appeal on behalf of Mr. Kioko justifying the taxable income in each case and determine his tax liability. (20 marks)

QUESTION FOUR

- a) Briefly explain the meaning of capital allowance in taxation (2 marks)
 b) Identify the four categories of capital allowances in Kenya (4 marks)

c) Hakim Ltd. is a manufacturing company operating in Mombasa. The following information was obtained from the books of the company for the year ended 31 December 2019.

- i. Profits for the year before capital allowances amounted to Shs3,206,000
- ii. Written down values of assets for capital allowance purposes as at 1 January 2019 were as follows.

	Sh.
Computers	390,000
Plant and machinery	3,640,000
Tractors	940,000
Furniture and fittings	120,000
Motor vehicles	740,000

- iii. The parking bay constructed on 1 January 2015, and put into use on 1 January 2016 had a written down value of Shs. 1,655,000 as at 1 January 2016.
- iv. The following were constructed or acquired during the year.

Asset	Cost (sh).
Staff canteen	784,000
Security wall	160,000
Showroom	348,000
Computer and peripherals	96,000
Motor vehicles	2,000,000
Lorry (3 tonnes)	1,290,000
Office cabinets	84,000
Conveyor belts	180,000
Processing machinery	680,000

- v. The company constructed a go down at a cost of Shs 560,000 which was put into use on 1st September 2019.

Required: Capital allowances due to the company and the taxable income for the year ended 31 December 2019. **(14 marks)**

QUESTION FIVE

Mumo, Maina and Mutuma are in partnership trading as Matu Enterprises. Their business income statement for the year 2021, has the following results:

	Sh	Sh
Revenue		208,000,000
Other income		<u>400,000</u>
Total Income		208,400,000
Less: Operating Expenses		
Depreciation allowance	10,800,000	
Fuel and Oils	90,000,000	
Spares, repairs & maintenance	14,000,000	
Licenses	300,000	

Interest	5,600,000	
Salaries and wages	26,000,000	
Stationery	800,000	
Tyres and tubes	55,500,000	
Miscellaneous expenses	<u>8,000,000</u>	<u>211,000,000</u>
Net loss for the year		<u><u>2,600,000</u></u>

Additional information is given as follows:

(i) The partners equally spent 20% of fuel and oils used for office vehicles for private purposes.

(ii) Analysis of salaries and wages:

Drivers	shs. 10,000,000
Maina	shs. 8,000,000
Mumo	shs. 4,000,000
Mutuma	shs. 4,000,000

(iii) Analysis of miscellaneous expenses:

Office cleaning	shs. 350,000
Weigh bridge fines	shs. 3,500,000
Total tax paid by partners'	shs. 3,300,000
Office electricity	shs. 250,000
Tip to Police to allow speeding car	shs. 600,000

(iv) The Partners share profits/losses equally

(v) Other Income: This represents interest on drawings paid by Mutuma

(vi) Interest analysis: Interest on bank overdraft shs. 5,000,000
Interest on loan paid to Bush shs. 600,000

(vii) Maina's personal account showed shs. 2,000,000/=, 3,000,000/= and 5,000,000/= as income received from Royalty, Dividend and Realization/capital gain respectively. A non-resident corporation paid dividend, realization is part payment of sale of a building for shs. 20,000,000/=. The building that costed shs. 4,000,000/= in year 2018 and used for residence was sold to Mr. John in 2021.

(viii) The capital allowances for the year were as follows;

Class	I	II
Value	2,000,000/=	950,000/=

Required: (i) Determine the partnership profits/losses (15 marks)
(ii) Determine the partners' taxable income (5 marks)

RATES OF TAX (including wife's employment, self-employment and professional income rates of tax). **Year of income 2018-2019**

Annual taxable pay (shillings)	Monthly pay (shillings)	Rates of tax % in each shilling
On the first 147,180	12,265	10%
On the next 139,043	11,586.92	15%
On the next 139,043	11,586.92	20%
On the next 139,043	11,586.92	25%
Excess over 564,709	47,059.08	30%

Personal relief Sh.16,896 per annum)

Prescribed benefit of motor vehicles provided by employer

		Monthly Rates (Sh.)	Annual Rates (Sh.)
Capital allowances:			
Wear and tear allowances:			
Class I	37.5%		
Class II	30%	(i)	Saloons Hatch Backs and Estates
Class III	25%		
Class IV	12.5%		
Software	20%		
Telecommunication	20%		
Industrial building allowances:			
Industrial building	10%	Upto 1200cc	3,600 43,200
Hotels	10%	1201 - 1500cc	4,200 50,400
Commercial	25%	1501 - 1750cc	5,800 69,600
Hostels	50%	1751 - 2000cc	7,200 86,400
		2001 - 3000cc	14,400 172,800
Farm works allowances	100%		
Investment deduction allowance:			
2011 -	100%	(ii)	Pick-ups, panel vans (Unconverted)
Shipping investment allowances 40%			
Mining allowance:			
Year 1	40%	Upto 1750cc	3,600 43,200
Year 2-7	10%	Over 1750cc	4,200 50,400
		(iii)	Land Rovers/Cruisers 7,200 86,400
			OR 2% of the initial capital cost of the

Vehicle for each month.

Commissioner's prescribed benefit rates

	Monthly rates Sh.	Annual rates Sh.
Services		
(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 (Land line and mobile)	30% of bills	

Agriculture employees: reduced rates of benefits

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

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.