# CPA II

# PUBLIC FINANCE AND TAXATION

## Revision Kit

# Acknowledgment

We gratefully acknowledge permission to quote from the past examination papers of the following bodies: Kenya Accountants and Secretaries National Examination Board (KASNEB); Chartered Institute of Management Accountants (CIMA); Chartered Association of Certified Accountants (ACCA).

# Contents

# Part I: Introduction

This revision kit addresses needs of students preparing to sit ATC Level II examination for Taxation.

The kit is divided into THREE main parts:

**PART I: INTRODUCTION**

Approach to Examinations
Syllabus
Topical guide to ATC past paper questions

**Part II: REVISION QUESTIONS AND ANSWERS**

Past paper questions with model answers

**Part III: Comprehensive MOCK examinations papers with sample answers**

To make effective use of this kit, candidates are advised to:

Read widely so as to have adequate background information relating to the issues raised in the revision questions.
Do the MOCK papers in Part III under exam conditions and then check the solutions provided to assess their success in tackling the questions.

This kit should be useful in enabling any student preparing for examinations in Taxation 1 to pass with good grades in the exams.

# Approach To Examinations

The Revision Kit lays emphasis on exam technique and preparation for students sitting the Taxation examination. It is hoped that in dealing with examination style questions the student who will have covered this syllabus content by referring to the study pack and other texts, is well prepared to meet the challenges in the real examination. This kit is therefore meant to supplement texts available and the study pack and consists of a number of the KASNEB (Kenya Accountants and Secretaries National Examination Board) questions with suggested solutions. You will notice that questions are normally structured and rather than attempt to arrange questions in syllabus topic order, the set out is by paper from June 2003 to December 2013. Note that suggested solutions do not represent the view of the Kenya Accountants and Secretaries National Examination Board.

# Syllabus

## OBJECTIVE

To equip the candidate with through knowledge on the theory of public and the principles, law and practice of taxation in Kenya.

## SPECIFIC OBJECTIVES

A candidate who passes this subject should be able to:

Understanding the theory underlying the process of taxation
Appreciate the structure and legal framework governing Kenyan tax system
Apply principles and concepts of taxation
Compute tax of persons and institutions
Understand the way in which taxation is administered in Kenya
Appreciate current developments concerning taxation in Kenya

## CONTENT

### 4.1 Theory of Taxation

Why governments levy taxes
Principles of an optimal tax system
Classification of taxes
Incidence of tax
Taxable capacity
Budget surpluses and deficits and calculations
Budgetary objectives
Fiscal policy issues

### 4.2 Taxation of the Income of Persons and Institutions

Taxable incomes
Non- taxable income
Specified sources
Allowable and non – allowable deductions
Taxable and non – taxable persons and institutions
Tax deficits
Tax rates; individuals, companies, withholding taxes
Individuals: sources of income, tax at source, personal reliefs, tax payable
Partnerships: drawings, adjustments, distribution of income, tax payable
Corporative bodies: taxable, tax payable
Co-operative societies
Clubs and other non-profit making organizations

### Capital Deduction

Investment deductions: ordinary manufacture, manufacture under bond, shipping investment deductions Industrial building deductions
Wear and tear allowances
Farm works deductions
Other deductions

**Administration of Taxes**

- Kenya Revenue Authority and its departments
- Kenya Income Tax Act, Finance Bills and Finance Acts and their provisions
- P.A.Y.E. and other statutory deductions
- Identification of new taxpayers through: PIN, investigators, public media and business registrars
- Assessments; self – assessments, Additional assessments, estimated assessments
- Instalment tax
- Tax returns
- Notices
- Objections, appeals and relief of mistake
- Appellant bodies
- Collection, recovery and re – payment of VAT Tax
- Offences and penalties and interest

**Administration of Value Added Tax**

Introduction and development of VAT in Kenya
VAT Act Cap. (476)
Taxation of goods and services
Registration of taxable persons
Accounting for VAT
Remission, rebate and refund of VAT Tax
Offence and penalties
Privileges and rights of a VAT registered person
Appeals and objections requirements

**Customs and Excise Tax**

Imports, exports and excise duties
Prohibitions and restriction measures
Bond securities

**Other Revenue Sources**

Miscellaneous revenue sources: road licences, inspection charge, trade licences, airport taxes, cesses, stamp duties, royalties, property rates, Local Authority services, petroleum levy
New taxes, levies and charges

# Part II: Revision Questions and Answers

## QUESTIONS - PAST PAPERS

**JUNE 2003**

**Answer ALL questions. Marks allocated to each questions are shown at the end of the question. Show ALL your workings. Any assumptions made must be stated.**

**QUESTION ONE**

(a) (i) Distinguish between a direct and indirect tax. ( 4 marks)

(ii) Is Value Added Tax (VAT) a direct or indirect tax? Explain ( 2 marks)

(b) What are the rules governing the payment of VAT? Specify the additional tax that may arise from failure to comply with those rules. ( 6 marks)

(c) (i) Mr. Mali Mingi is a hardware merchant. He purchases cement from Athi Cement Ltd. which he then sells to his customers. Both Mali Mingi and Athi Cement Ltd. require a profit margin of 20% on cost. Cement attracts 18% VAT. If the cost of production by Athi Cement Ltd. is Sh.220 per bag of 50Kg. At what price should Mali Mingi sell a bag of cement including VAT? ( 5 marks)

(ii) What VAT is payable to the Collector of VAT by Mr. Mali Mingi per 50 Kilogramme bag? ( 3 marks)

**(Total: 20 marks)**

**QUESTION TWO**

(a) Many farmers in the rural areas are unaware of the benefits accorded to them in form of capital allowances under the Income Tax Act. Write a brief summary on capital allowances which may be available to the farmer. ( 6 marks)

(b) On 1 January 2003, Pesa Limited brought into full operation its Limuru Factory of producing bottle tops. The following expenditure had been incurred up to that date.

| | **Sh.** |
|---|---|
| Factory building | |
| (including store and showroom of Sh.600,000 and 800,000 respectively) | 5,600,000 |
| New machinery installed: Fixed | 8,000,000 |
| Moveable | 2,000,000 |
| Delivery trucks (6980cc each) | 4,800,000 |
| Office furniture | 1,600,000 |
| Computers | 2,400,000 |
| Workers" canteen | 800,000 |

In 2005, additional machinery worth Sh.1,200,000 was purchased and installed in the store at a cost of Sh.320,000. It was brought to use on 1 January 2005 to produce can tops. A saloon car worth sh.600,000 was also purchased.

**Required:**

Compute the capital allowances due to the company in 2003, 2004 and 2005.

**(Total: 22 marks)**

**QUESTION THREE**

(a) Explain clearly the nature of a public good with specific reference to provision of education in Kenya today and the role taxes play under such circumstances. (10 marks)

(b) What is the principle of cost sharing and to what extent does it influence the level of taxation? ( 8 marks)

**(Total: 18 marks)**

**QUESTION FOUR**

(a) List and explain any three deductions that may be available against gains or profits from employment. ( 3 marks)

(b) Mr. Matata has approached you with a view to obtaining help in determining his taxable income for 2005. He has supplied the following information:

1. 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.

2. Wife"s Income

His wife was employed by Mafuta Ltd. as the Finance Director. Her salary was sh.52,000 p.m. Additional benefits include:

Company car 1800 cc.

House at New Muthaiga (market value of rent Sh.20,000 per month) Staff gifts of oil products worth Sh.1000 p.m

3. Capital Gains

In the course of the year, the Matatas sold one plot they owned in Nairobi for Sh.1,200,000. This represented a gain of Sh.600,000 which they used to take a holiday to Mombasa.

4. 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 |

5. 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.

6. Utajiri Limited insures all its sales against default from customers. The cost of the insurance was Sh.10,000 which represents 0.001 percent of sales. The company also paid sh.20,000 to cover the life of Matata and his household items.

7. 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. (15 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)

**(Total: 22 marks)**

## QUESTION FIVE

Mr. Hesabu has recently opened all Income Tax Consultancy office in Nairobi. He has been approached by his clients on the following matters.

(i) M/S Watu, Wote, Wao are three partners operating WWW Enterprises. In 2005, they made profits of Sh.180,000. They share profits in the ratio 3:3:4. Wao had overdrawn on his account and was charged Sh.30,000 interest. Watu and Wote received interest of Sh.25,000 each from the partnership. The interest account is included in the above profits. Mr. Wote wishes to know how much tax he would pay. He has no other source of income. ( 6 marks)

(ii) Live Well Foundation is a Non-Governmental Organisation formed for the purposes of addressing people"s spiritual needs. It will derive its income from donations of all kinds, charitable walks and sale of religious literature. They wish to know if they will be required to pay any tax. ( 4 marks)

(iii) Mrs. Mjini is a happily married housewife residing in Kilimani Estate, Nairobi. Since her compound is big she engages in backyard gardening during her spare time and she derives a lot of satisfaction from it. She also maintains very accurate records of the performance of her garden. Details for the three years ending 31 December 2005 are as follows:

| | |
|---|---|
| Year ended 31 December 2003 Profit | Sh.20,000 |
| Year ended 31 December 2004 Loss | Sh.40,000 |
| Year ended 31 December 2005 Profit | Sh.50,000 |

Garden produce consumed by Mrs., Mjini"s family during the year of income 2005 was sh.60,000 (not included in the above results).
She wishes to know how much tax she should pay from this activity in 2005. ( 4 marks)

(iv) New Plastic Limited, manufacturers of plastic products wishes to sponsor research into plants that may produce plastics related materials. They have set aside Sh.20,000,000 which will be awarded to the Department of Biochemistry, Ubora Science University. They wish to know if there is any tax advantage which may arise. ( 4 marks)

**Required:**

As Mr. Hesabu"s tax manager, write a memorandum on each of the points for his consideration.

**(Total: 18 marks)**

**DECEMBER 2003**

**Answer ALL questions. Marks allocated to each questions are shown at the end of the question. Show ALL your workings. Any assumptions made must be stated.**

**QUESTION ONE**

(a) (i)Specify the rules relating to payment of Income tax under the Pay As You earn rules. ( 5 marks)

(ii) What are the consequences of failure to deduct and pay tax under PAYE? ( 3 marks)

(b) Mr. Manubhai works as a sales manager with Kenya Bats Limited. The following are his employment details for the year ended 31 December 2005. The company pays him a salary of Sh.90,000 per month. He is a member of the company"s pension scheme which is registered with the Commissioner for Income Tax. He contributes five percent of his salary and company contributes ten per cent.

He has a co-operative loan which he repays at the rate of sh.9,967 per month.

The company bought for him a car on loan and repays Sh.10,160 per month towards the loan. Drought levy has been agreed at Sh.1,438 per month.

Mr. Manubhai lives in Nairobi and is married with two children. His Payroll Number is FD0095/12.

Statutory deductions are: NSSF Sh.200 per month
NHIF Sh.320 per month.

**Required:**

(i) A well laid out statement in respect of the month of December 2005 showing the income tax and other deductions; and net pay for Mr. Manubhai. ( 8 marks)

(ii) Would you agree that current income tax rules regarding payment of tax discriminate against employees when compared to companies? Explain. ( 4 marks)

**QUESTION TWO**

You are provided with the following details:

1. Installing a system of ventilation in the factory.
2. Legal expenses incurred when acquiring a new building
3. Giving the factory a fresh cost of plant
4. Replacing 200 tiles on a roof damaged by wind
5. Expenditure incurred in demolishing part of a wall to make room for a recently purchased machine.

**Required:**

(a) 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 2005.

| | Building | Class I | Class II | Class III | Class IV |
|---|---|---|---|---|---|
| 1. | **Sh.** | **Sh.** | **Sh.** | **Sh.** | **Sh.** |
| | 1,400,000 | 460,000 | 610,000 | 800,000 | 6,200,000 |

2. The industrial building had been constructed sometimes back in 2000 at a cost of Sh.1,600,000. 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 60% as the rate of investment deductions. For year 2000.

**Required:**

(i) Capital allowances for Timexa Limited for year of Income 2005. (15 marks)
(ii) Comment on the error resulting from non-claim of investment deduction. ( 4 marks)
**(Total: 24 marks)**

## QUESTION THREE

(a) Explain the role and functions of a Value Added Tax tribunal. ( 4 marks)

(b) The following purchases and sales were made by Pepo Limited (VAT No. !00012Y) during the first two weeks of January 2006. Prices shown are inclusive of VAT at the standard rate of 16 percent.

| | | PURCHASES | | SALES | |
|---|---|---|---|---|---|
| | | Unit | Price per Unit Sh. | Unit | Price per Unit Sh. |
| January | 1 | 100 | 1,400 | 10 | 1,800 |
| | 2 | | | 20 | 1,800 |
| | 5 | | | 50 | 1,800 |
| | 7 | 75 | 1,600 | | |
| | 10 | | | 20 | 1,800 |
| | 12 | - | | 50 | 2,000 |
| | | 175 | | 150 | |

There were no opening stocks at the beginning of the month.
The physical inventory confirmed that there were 25 units in stock as at 31 January 2006.

**Required:**

(i) The VAT account for Pepo Limited. ( 8 marks)
(ii) What are the requirements with respect to any sales made by Pepo Limited? ( 5 marks)
(iii) Specify when and how VAT computed under (i) is payable. ( 3 marks)
**(Total: 20 marks)**

## QUESTION FOUR

(a) It is common in Kenya to have individuals who cannot distinguish between taxes and charges. Explain the difference between a tax and National social Security Fund deductions. ( 6 marks)

(b) Specify the basic rules in Income Tax with regards to payment of pension from a registered scheme to:

(i) The pensioner, (3 marks)
(ii) The widow or widower of a pensioner. (4 marks)

(c) Specify the main rules relating to a registered pension fund. (5 marks)

## QUESTION FIVE

Leo, Kesho and Kutwa trade in electrical goods and as partners in Leo Unincorporated. They share profits and losses equally. The following details in the draft accounts regarding their profit and loss status as at 31 December 2005 have been provided:

| | Debits | | Credits |
|---|---|---|---|
| | **Sh.** | | **Sh.** |
| Office expenses | 408,000 | Gross profit | 2,600,000 |
| General expenses | 188,000 | Interest earned | 240,000 |
| Salaries and wages | 560,000 | Discounts received | 160,000 |
| Show room expenses | 234,000 | Other receipts | 300,000 |
| Rents, rates and taxes | 300,000 | Rent income | 264,000 |
| Printing and stationery | 128,000 | Capital gain on shares. | 200,000 |
| Instalment tax paid | 90,000 | | |
| Advertising | 146,000 | | |
| Legal charges | 164,000 | | |
| Interest on capital | 420,000 | | |
| Depreciation | 184,000 | | |
| Bad debts | 136,000 | | |
| Commission to partners | 160,000 | | |
| Donation for poverty | 200,000 | | |
| Property taxes | 24,000 | | |
| Electricity expenses | 92,000 | | |
| General reserve | 240,000 | | |

The partners provided additional information as follows:

1. Closing stock had been understated by Sh.30,000 as at 31 December 2004.
2. Leo was paid Sh.100,000 as salary (included in salaries and wages) and PAYE Sh.31,000 was paid on it.
3. The firm was fined Sh.30,000 for breach of regulations. This is included in legal charges.
4. Interest on capital was Sh.160,000 to Leo, Sh.120,000 to Kesho and sh.140,000 to Kutwa.
5. Commission to partners include sh.90,000 to Leo and the balance to Kutwa.
6. Capital allowances had been agreed at sh.1,800,000 with the tax authorities.

**Required:**

(a) Compute the total income (loss) from the partnership business. ( 9 marks)
(b) Show allocation of profit/loss among partners. ( 4 marks)
(c) How is the profit/loss of each partner to be treated for tax purposes? ( 2 marks)
(d) Specify five matters you are likely to question on the above accounts and state why. ( 5 marks)

**(Total: 20 marks)**

## JUNE 2004

**Answer ALL questions. Marks allocated to each questions are shown at the end of the question. Show ALL your workings. Any assumptions made must be stated.**

## QUESTION ONE

Mrs. Mary Meno is a professional dentist who practices in Nairobi. She has provided you with the details on her clinic for the year ended 31 December 2005:

| | **Sh.** | |
|---|---|---|
| Gross Professional fees received | 1,000,000 | |
| Subscriptions to professional association and publications | 20,000 | |
| Subscriptions to a wildlife magazine | 2,000 | |
| Donations to a children"s home | 10,000 | |
| Debt collection expenses (dental patients) | 6,000 | |
| Wages for dental assistant | 120,000 | |
| Replacement of surgical instruments | 40,000 | |
| Rent for the clinic premises | 140,000 | |
| Electricity and water – clinic | 40,000 | |
| Other clinic expenses | 70,000 | |
| Hire of car for use in practice | 50,000 | |
| Uniforms for staff | 5,000 | |
| Payment of school fees for own children | 40,000 | |
| Contribution to provident fund – self | 60,000 | |
| Payment of life insurance premium – self | 20,000 | |
| Terminal benefits paid to retired receptionist | 50,000 | |
| Depreciation on furniture – clinic | 12,000 | |
| Rents received from sub-rentals | 14,000 | |
| Rent collection expenses(sub-tenants) | 2,000 | |
| Wages paid to cleaners and watchman – clinic | 50,000 | |
| Furniture bought for clinic 1 January 2005 | 64,000 | |
| Tarmacking of Drive-way personal residence | 80,000 | |
| Additional servant quarters – personal residence | 140,000 | |
| Dividend income net of withholding tax | 34,000 | |
| Interest income from commercial bank – gross | 24,000 | |
| Directors fees received (deductions at source SSh.3,0000 | 120,000 | Net |

**Required:**

(a) Calculate the taxable income of Mrs. Mary Meno for the year ended 31 December 2005. (12 marks)
(b) Tax payable by Mrs. Mary Meno. ( 6 marks)
(c) Indicate when the tax, if any, is payable to the Income Tax department. ( 2 marks)

**(Total: 20 marks)**

## QUESTION TWO

You have been invited by a group of ATC I and CPS I students to discuss the matters listed below:

**Required:**

In each of the cases provide explanatory notes and computations for use in your discussions with students.

(a) (i) A manager who is on full-time employment where he draws sh.80,000 per month. He is housed by the employer in a rented house where rent payable to the landlord is Sh.720,000 per annum. ( 4 marks)

(ii) The manager makes an annual contribution of Sh.84,000 to a registered pension fund. ( 3 marks)

(iii) The manager is provided with a motor car whose purchase cost was Sh.1,200,000. ( 3 marks)

(b) A high school boy aged 15 years inherits Sh.300,000 from his grandfather and wins Sh.100,000 in the national lottery. ( 4 marks)

(c) A retired civil servant on an annual pension of Sh.180,000 per annum signed a service contract with effect from 1 January 2005. The contract was for three years at an annual salary of Sh.440,000. The contract was terminated by the employer on 31 December 2005. The employee was paid compensation amounting to Sh.560,000. ( 6 marks)

**(Total: 20 marks)**

## QUESTION THREE

(a) Give a brief definition of value added tax (VAT). ( 2 marks)
(b) Explain in numbered paragraph the case for and against VAT in your country. ( 8 marks)
(c) Saika Co. Ltd. a manufacturer, purchases raw materials at Sh.1,000,000. The company then incurs conversion costs which are estimated at 40% of material cost. The profit mark-up is 20% of total cost. The completed product is sold to Chemuka Wholesalers who then incur conversion costs of 50% on cost. The wholesalers mark-up is 10% on cost. The wholesaler sells the product to a retailer, who has no conversion costs but sells at a profit of 30%.

**Required:**

Assuming VAT is charged at 15% on all products, compute the total VAT payable. (10 marks)

**(Total: 20 marks)**

## QUESTION FOUR

(a) What is meant by the term qualifying expenditure? ( 2 marks)
(b) Name and briefly explain items which may be included in the qualifying expenditure for the purposes of investment deductions. ( 8 marks)
(c) Kalamuka Maize Millers Limited purchased a building on 1 January 2005, for Sh.4,000,000. It was brought into use on the same day. The sellers construction cost comprised:

| | Sh. |
|---|---|
| Land | 200,000 |
| Architects fees | 40,000 |
| Leveling land | 60,000 |
| Construction (including offices sh.160,000) | 1,700,000 |
| | 2,000,000 |

B.B. Ltd. purchased the whole of the Kalamuka Maize Millers Ltd. on 31 December 2005 and continued with the same business of milling maize. The following amounts were paid for assets purchased.

| | Sh. |
|---|---|
| Goodwill | 10,000 |
| Land and buildings | 4,000,000 |
| Milling machines | 1,800,000 |
| Tractor and lorry | 1,600,000 |
| Motor vehicle | 1,200,000 |

B.B Ltd. Incurred the following additional costs:

| | Sh. |
|---|---|
| Extension to building | 800,000 |
| Security wall | 100,000 |
| Additional boiler | 1,000,000 |
| New sorter and conveyor – fixed to fabric of building | 1,200,000 |
| Fixtures and fittings. | 600,000 |

B.B Ltd. sold some surplus assets as follows:

| Date | **Particulars** | **Sh.** |
|---|---|---|
| 1-7-2006 | Milling machines | 200,000 |
| 1-9-2006 | Damaged fixtures and fittings | 8,000 |
| 1-9-2006 | Lorry | 180,000 |

B.B. Ltd"s financial year ended on 30 September 2006.

**Required:**

The capital deductions claimable for the year ended 31 December 2006. (10 marks)

**(Total: 20 marks)**

## QUESTION FIVE

Write explanatory notes on the taxes listed below and in each case indicate whether the tax complies with the main principles of a good tax system.

(a) Presumptive tax on agricultural produce. (5 marks)
(b) Cess on agricultural produce. (5 marks)
(c) Trade licence chargeable to professionals. (5 marks)
(d) Stamp duties on transfer of properties. (5 marks)

**(Total: 20 marks)**

**DECEMBER 2004**

**Answer ALL questions. Marks allocated to each questions are shown at the end of the question. Show ALL your workings. Any assumptions made must be stated.**

**QUESTION ONE**

(a) Distinguish between tax evasion and tax avoidance. ( 5 marks)

(b) The recent debate relating to importation of goods through the port of Mombasa has had one of its issues the amount of tax assessed. Specify and explain clearly at least three ways in which the Government may lose tax revenue on imports. ( 6 marks)

(c) Suggest three possible ways in which the Government may prevent loss of tax revenue from imports. ( 6 marks)

(d) Should citizens feel obliged to pay tax? Explain. ( 3 marks)

**(Total: 20 marks)**

**QUESTION TWO**

Mr. Ole Mboga is married to Pesa Mboga. Ole Mboga is a registered engineer and he is the proprietor of Leta Engineering Services a firm of consulting engineers. He is nevertheless fully occupied as an employee of Zeta Construction Limited. His company is therefore managed by his wife who draws Sh.50,000 per month as salary. PAYE of Sh.20,000 per month is deducted and remitted to the Commissioner.

Zeta Construction Ltd. provided the following emoluments to Mr. Ole Mboga for the year ended 31 December 2005:

1. Salary of Sh.150,000 per month (PAYE deducted and paid to the Commissioner Sh.62,000 per month).

2. Housing – Free housing is provided, with water and electricity. He pays a nominal sh.10,000 per month. Water consumed was for Sh.4,800 and electricity consumed was for Sh.18,000 during the year.

3. 1,000 ordinary shares for past years of service. Last valuation of shares was at sh.50 each. The issued share capital is now 25,000 shares. The company paid a dividend of Sh.10 per share on 31 December 2005.

4. Company car of 2000 cc.

5. Leave pay equal to one month"s salary.

6. Life insurance premium per each household member of Sh.10,000 per annum. This covers himself, wife and son.

7. Pension at 10% per month. He contributes 5% towards the same scheme. The scheme is registered.

Leta Engineering Services made an assessed loss of Sh.400,000 for the year of income 2005.

Mr. Ole Mboga owns property which he bought many years

ago. Rent income account for the year 2005 is as follows:

| | Sh. | Sh. |
|---|---|---|
| Gross rent | | 300,000 |
| Less: | | |
| Loan repayment | 150,000 | |

| | | |
|---|---|---|
| Interest on loan | 125,000 | |
| Fencing | 30,000 | |
| Caretaker wages | 55,000 | |
| Insurance, rent and rates | 25,000 | |
| Replaced broken doors | 85,000 | 470,000 |
| Loss to be carried forward | | 170,000 |

**Required:**

(a) Taxable income of Mr. Ole Mboga for the year of income 2005. (12 marks)

(b) Tax payable by Mr. Ole Mboga for the year of income 2005. ( 5 marks)

(c) Mr. Ole Mboga is being invited by Tana Ranching Company Limited to be their manager and reside at the farm. What will be the tax implications of this? Explain but do not compute if he takes up the offer and every thing remains unchanged other than the residence. ( 3 marks)

**(Total: 20 marks)**

## QUESTION THREE

The trial balance of Kitu and Watu, trading as partners and sharing profits in the ratio 2:3 as at 31 December 2005 is as follows:

| | Sh. | Sh. |
|---|---|---|
| Capital: | | 3,600,000 |
| Kitu | | 5,221,000 |
| Watu | | |
| Factory building | 5,000,000 | |
| Furniture at cost | 750,000 | |
| Factory equipment at cost | 2,000,000 | |
| Director"s car at cost | 1,000,000 | |
| Provision for depreciation | | 710,000 |
| Depreciation expense | 115,000 | |
| Debtors and prepayments | 1,050,000 | |
| Stocks as at 31 December 2005 | 1,042,000 | |
| Creditors and accruals | | 853,000 |
| Balance at bank | 720,000 | |
| Gross profit on trading | | 4,165,000 |
| Rent and rates | 300,000 | |
| Office salaries | 826,000 | |
| Partners salaries | 600,000 | |
| Advertising costs | 210,000 | |
| Transport costs | 236,000 | |
| Deposit on new equipment | 100,000 | |
| Short term investment | 600,000 | |
| | 14,549,000 | 14,549,000 |

The following additional information is provided:

1. Rent and rates are for fifteen months to 31 March 2006

2. The partners have contracted to purchase new equipment for the factory at a cost of Sh.500,000. A debt of Sh.100,000 was paid during December 2005 and the remainder will be paid during January 2006 when … is expected.

3. The factory building has been revalued from Sh.4,000,000

4. The partnership started operating on 1 January 2005

5. Partnership salaries are taken equally

6. Interest on capital is to be provided at 10% on balance given.

**Required:**

(a) Taxable partnership profit for the year of income 2005. (15 marks)
(b) Show the allocation between partners. ( 5 marks)
All computations and support notes must be provided. **(Total: 20 marks)**

## QUESTION FOUR

The directors of Totale engineering Company Limited presented the following Profit and Loss for the year ended 31 December 2005:

| | Sh. |
|---|---|
| Revenues | |
| Sales | 30,780,000 |
| Interest on Government Securities (Gross) | 50,000 |
| | 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 | 80,000 |
| Audit fees | 70,000 |
| Depreciation | 3,017,000 |
| Provision for doubtful debts | 104,000 |
| Debenture interest | 600,000 |
| Interim dividend | 400,000 |
| Proposed dividend | 731,300 |
| | 32,892,300 |
| Net Loss | 2,062,300 |

The following additional information is provided:

(c) Purchase returns and sales returns were Sh.500,000 and Sh.700,000 respectively. These were left out while preparing the trial balance.

(d) 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.

(e) Trade expenses include an amount of Sh.60,000 travel expenses to Korea for the Director as part of the National Chamber of Commerce Trade and Industry promotion tour.

(f) Repairs to machinery include small loose tools written off by Sh.10,000

5. Bad debts which are specifically bad are Sh.74,000

6. Capital allowances have been agreed at Sh.2,000,000.

**Required:**

(a) Taxable profits for the year of income 2005. (10 marks)
(b) Tax payable if any for 2005. Comment on the results. ( 4 marks)
(c) The company intends to give the Director a company car in 2006. What are the tax implications? ( 3 marks)
(d) Comment on the tax implication of the action of the "consultant" with respect to the VAT claims. ( 3 marks)

**(Total: 20 marks)**

**QUESTION FIVE**

(a) Write brief notes on the following:

(i) Stamp duty; ( 6 marks)
(ii) Tax matters relating to Export Processing Zones. ( 6 marks)

(b) Jenga Engineers and Associates is a firm of engineers and designers. In the year of income 2005 they earned professional fee of Sh.7,500,000 before VAT. Their accounts show the following expenses:

| | **Sh.** |
|---|---|
| Medical services | 180,000 |
| Accountancy and audit | 225,000 |
| Legal services | 300,000 |
| Design materials | 1,600,000 |
| Salaries and wages | 2,410,000 |
| Depreciation | 985,000 |

**Required:**

(i) Value Added Tax Account for the year of income 2005. ( 6 marks)
(ii) Comment on payment of VAT computed above. ( 2 marks)

**(Total: 20 marks)**

## JUNE 2005

**Answer ALL questions. Marks allocated to each questions are shown at the end of the question. Show ALL your workings. Any assumptions made must be stated.**

### QUESTION ONE

(a) A person who is registered for VAT must maintain certain records to satisfy the VAT regulations. Give ten examples of such records that must be kept. (10 marks)

(b) Discuss three practical problems experienced by a Kenyan in complying with the VAT Act. Suggest ways in which these problems can be overcome. (6 marks)

(c) The value for VAT of a supply is the consideration paid. Indicate the value for VAT under the ` following circumstances:

The price of a radio cassette was Sh.17,500. A cash discount of 10% was given to the customer.
Ushonaji Architects provided a free service to a community based project. The value of the service was Sh.125,000.
Dubai Kenya Ltd. imported electricals valued for Sh.2,000,000. A duty of 25% was charged by customs department.
Kupenda Company Ltd. sold furniture by instalments. The first instalment of Sh.5,000 was received immediately. The sales price of the furniture is Sh.20,000 and the remaining balance is to be paid in three equal monthly instalments. (4 marks)

**(Total: 20 marks)**

### QUESTION TWO

(a) Miss Nyakio"s contract of employment for five years was terminated on 31 December 2005 after ithad run for three years. Compensation for Sh.300,000 was paid. Her salary at the date of termination was Sh.90,000 per year. If the contract had run its full term, a total of Sh.180,000 would have been paid as salary for both 2006 and 2007.

**Required:**

What income is assessable on Miss Nyakio, and in which years?
Assume that Nyakio"s contract was not specific, what income is assessable on Miss Nyakio and inwhich years?
Assume Miss Nyakio was a director in the company paying her compensation. Her shareholding in the company was 5% of the share capital. Explain. What will be the tax treatment in (i) and (ii) above? (12 marks)

(b) State and explain from tax perspective whether each of the following items are capital or revenue.

- Legal and professional fees on computerization.
- Structural alterations to premises to maintain existing rent.
- Legal costs and stamp duty for acquisition of lease of business premises
- Expenditure on advertising to promote sale of goods or services provided by a business income tax
- Reserves and provisions. (3 marks)

(c) Give five examples of non-taxable income. (5 marks)

**(Total: 20 marks)**

### QUESTION THREE

(a) With reference to wear and tear allowances, what is meant by the "pooling method"? ( 2 marks)

(b) The following information is given to you from the books of Kilimo Holdings Ltd., a farming and manufacturing company as at 31 December 2005:

| | **Sh.** |
|---|---|
| Written down values as at 31 December 2005 | |
| Motor vehicles | 655,000 |
| Tractors | 2,755,000 |
| Plant and machinery | 530,000 |
| Furniture and fittings | 225,000 |
| Combine harvester | 1,012,500 |
| Spares for tractors | 510,000 |
| Land rovers | 1,135,000 |
| Office curtains | 22,000 |
| Computers | 77,000 |
| Fax machine | 40,000 |
| Telephones | 80,000 |
| Farm works (original cost Sh.21,000) | 7,000 |
| Industrial building (original cost net of investment deduction Sh.1,000,000) | 950,000 |

| Additions in 2006: | Sh. | | Sh. |
|---|---|---|---|
| Library books | 25,000 | Saloon car | 1,500,000 |
| Loose tools | 10,000 | Pick-up | 850,000 |
| Engine head for trailer | 500,000 | Farmhouse | 200,000 |
| New building | 750,000 | | |
| Old machinery installed in new building | 350,000 | | |

| Disposals in 2006: | Sh. |
|---|---|
| Saloon car (cost in 2003 – Sh.150,000) | 250,000 |
| Furniture | 25,000 |
| Computers | 80,000 |
| Tractor | 75,000 |

**Required:**

Compute total capital allowances for the year 2006. State why you have not used any information and why you think it is not relevant. (14 marks)

Show balances carried forward to 2007. (2 marks)

Comment on the tax treatment of class II balance. (2 marks)

**(Total: 20 marks)**

## QUESTION FOUR

Kenwide Enterprises Ltd. is a distributor of wines and spirits. The profit and loss account for the year ended 31 December 2005 is as follows:

| | **Sh.** | | **Sh.** |
|---|---|---|---|
| Purchases | 1,000,000 | Sales | 3,655,000 |
| Staff wages | 850,000 | Discounts | 355,000 |
| Rent and rates | 92,500 | Provision for bad and doubtful | 35,500 |
| Distribution and office expenses | 445,500 | debts | 65,500 |
| Traveling | 256,000 | Profit on sale of assets | 170,000 |
| Repairs and maintenance | 85,600 | Insurance recovery | |
| Discount | 156,000 | | |
| Bad debts | 122,100 | | |

| | | |
|---|---|---|
| Subscription | 25,000 | |
| Bank charges & interest | 24,000 | |
| Loss on sale of assets | 35,500 | |
| Legal fees | 95,000 | |
| Audit fees | 41,500 | |
| Depreciation | 126,000 | |
| Gross profit | 917,300 | |
| | 4,282,000 | 4,282,000 |

**Notes:**

1. 10% of rent and rates relate to directors.

2. Distribution and office expenses includes the following expenses:

| | Sh. |
|---|---|
| Directors personal expenses | 31,550 |
| Contribution to a sports club – employees use it | 30,000 |
| Donations | 22,000 |
| Loss on staff canteen | 12,000 |

3. Repairs and maintenance include extension to an office block 40,000

4. Subscriptions are to trade associates.

5. Travelling expenses include business trip to Dubai to attend a trade exhibition. 56,000

6. Legal charges include the following:

| | |
|---|---|
| Acquisition of copyrights | 25,000 |
| Debt collection | 21,000 |
| Renewal of lease for 99 years | 18,000 |
| Fines and defence of legal suits | 11,000 |
| Employment contract | 5,000 |

7. Insurance recovery is in connection with stolen stock in the previous year.

8. Bad debts provision is reduced in general provision.

**Required:**

(a) Prepare a tax computation. (14 marks)
(b) Compute the tax liability and indicate the due date. ( 2 marks)
(c) Compute the instalment tax payable in 2006 and indicate the respective due date(s). ( 4 marks)
**(Total: 20 marks)**

## QUESTION FIVE

With reference to Income Tax, write short notes on the following:

(a) Self assessment; ( 4 marks)
(b) Notice of Objection; ( 4 marks)
(c) NSSF; ( 4 marks)
(d) PIN advantages; ( 4 marks)
(e) Valuation of housing for employees. ( 4 marks)
**(Total: 20 marks)**

## DECEMBER 2005

**Answer ALL questions. Marks allocated to each questions are shown at the end of the question. Show ALL your workings. Any assumptions made must be stated.**

## QUESTION ONE

Write short notes on the following:

(a) Industrial Building – "Hotel" ( 4 marks)
(b) Exempt Dividend Income. ( 4 marks)
(c) Non-Resident Individual ( 4 marks)
(d) Memorandum of Appeal & Statement of Facts. ( 4 marks)

**(Total: 16 marks)**

## QUESTION TWO

(a) Write brief notes on the tax aspects of the following:

(i) Royalties ( 3 marks)
(ii) Import Declaration Form ( 3 marks)
(iii) Valuation Roll of Local Authorities. ( 3 marks)

(b) Sponex Limited deals in a wide variety of low-price sports goods. Shown below is a list of transactions for the month of June 2006.

June 2Purchased goods on credit from Marun Shoes of Sh.96,000

June 3 Paid freight charges of Sh.2,450 on the shipment of goods purchased from Manrun Shoes

June 4 Upon unpacking the goods from Manrun Shoes, discovered that some of the shoes were the wrong style. Returned those shoes which cost Sh.4,000 to Manrun Shoes and received full credit.

June 9Sales made on account to Ripa Sports for Sh.141,000

June 11 Paid Sh.2,200 freight charges on the shipment to Ripa Sports. June 12 Paid Marun Shoes in full

June 16 Made credit sales to Holiday Sports for Sh.27,550 June 19 Received payment in full from Ripa Sports.

June 21Holiday Sports returned goods worth Sh.6,500

All transactions were subject to Value Added Tax where applicable. The rate of VAT is 15%.

**Required:**

(a) Sportex Limited Value Added Tax Account for June 2006 ( 8 marks)
(b) If the amount calculated above is not paid on time, what penalties will be imposed? ( 3 marks)

**(Total: 20 marks)**

## QUESTION THREE

(a) Distinguish between sole proprietorship and limited liability forms of business in relation to:

Income Tax
PAYE for the owners of business
Service charge for the owners and the business. ( 8 marks)

(b) A Nairobi businessman is contemplating investing in a business worth Sh.5,000,000 but has not made up his mind on which form of ownership he will assume. The business is expected to produce a profit of Sh.2,000,000 before tax and his drawings/salary averaging 10% on investment.

**Required:**

Advice the businessman on the tax implications of operating the business as a company and a sole proprietorship using the above information. (12 marks)

**(Total: 20 marks)**

## QUESTION FOUR

(a) Now that there is self assessment under the Income Tax Act, does the Commissioner of Income Tax have to issue any assessment? Explain. ( 3 marks)

(b) Does an individual person have to raise an objection for tax assessed under the Income Tax Act now that there is self assessment? Explain. ( 3 marks)

(c) Mr. Banu Shah provided the following information for the year ended 31 December 2005:

- He was employed as a full time director of Letex Limited at a salary of Sh.80,000 per month(PAYE Sh.31,200 per month was deducted).
- Free goods worth Sh.30,000 were received from the company in the year for personal use.
- He enjoyed free medical treatment under a medical scheme operated by the company which wasassessed at Sh.50,000 in the year.
- Mr. B Shah and his wife operate a company fully owned by them whose taxable income has beenagreed at Sh.200,000 after charging wife"s salary of Sh.120,000 (PAYE sh.22,000).
- Letex Limited provided him with free housing from 1 August 2005 prior to which he lived in hisown house.

His wife also works as a nurse in a private hospital and earned Sh.20,000 per month (PAYE Sh.4,000).

Rent from property owned was Sh.30,000 per month from August 2005. Repair and painting of Sh.11,500 before letting. The house had a mortgage of Sh.2,000,000 and Sh.600,000 was paid of which Sh.330,000 was capital

**Required:**

(i) Total taxable income of Mr. Banu Shah for 2005. ( 9 marks)
(ii) Tax payable/repayable on the income computed above. ( 3 marks)
(ii) Comment on the importance of P9 A in Income Tax Returns. ( 2 marks)

**(Total: 20 marks)**

## QUESTION FIVE

Rai, Sai and Tai are former school mates who were doing business together. The business is not registered but they registered themselves as equals in it. They keep proper books of account and have been able to provide the following profit and loss account for the year ended 31 December 2005.

Profit and Loss Account

| | Sh. | | Sh. |
|---|---|---|---|
| Establishment expenses | 800,000 | Gross profit | 1,908,000 |
| Rent of business premises owned by | | Sundry receipts | 80,000 |
| all of them jointly | 180,000 | Interest Income | 72,000 |
| Interest expense | 80,000 | Profit on sale of shares | 200,000 |
| Stationery and printing | 120,000 | Gross income from farming | 340,000 |
| Light and heating | 40,000 | Lottery winnings | 800,000 |
| General farm expenses | 294,000 | Dividend (Gross) | 120,000 |
| Repair of premises | 40,000 | | |
| Depreciation | 300,000 | | |
| Interest on partner"s capital: | | | |
| Rai | 80,000 | | |
| Tai | 120,000 | | |
| Salary to Sai | 160,000 | | |
| Commission to partners: | | | |
| Rai | 96,000 | | |
| Sai | 96,000 | | |
| Tai | 96,000 | | |
| Bad debts | 240,000 | | |
| Gifts, present and charity | 40,000 | | |
| Donation to child welfare | 200,000 | | |
| Interest on loan taken to pay | | | |
| Income tax | 20,000 | | |
| Legal charges | 120,000 | | |
| Net profit | 398,000 | | |
| | 3,520,000 | | 3,520,000 |

Additional information:

1. Capital allowances have been agreed as follows: Wear and Tear allowances sh.180,000; Farm works deductions sh.120,000.
2. The partners had borrowed Sh.400,000 with a hope of investing it on fixed securities to earn more income interest rates nevertheless declined. Interest expense of Sh.80,000 and interest income of Sh.72,000 relate to the loan.
3. Legal charges include Sh.40,000 paid to finish a case in the customs department.
4. In 2005, the partners brought forward losses amounting to Sh.800,000 from this business.

**Required:**

(a) Compute taxable income derived from the partnership (16 marks)
(b) Show allocation among partners. (3 marks)
(c) Comment on the results of (a) above. (5 marks)

**(Total: 24 marks)**

**JUNE 2006**

**Answer ALL questions. Marks allocated to each questions are shown at the end of the question. Show ALL your workings. Any assumptions made must be stated.**

**QUESTION ONE**

Mr. Kiplimo is finalizing his tax affairs for the year of income 2005. He and his wife had the following income and transactions for 2005:

1. Mr. Kiplimo"s income:
   He has paid Sh.52,000 Value Added Tax on all his purchases for the year
   He was an employee of Bomet Tea Limited and was paid an annual salary of Sh.600,000 (P.A.Y.E deducted was Sh.142,500).
   Pension contribution to a registered scheme were Sh.100,000 by his employer and Sh.50,000 from his pay.
   Dividend received was Sh.40,000 gross. (Withholding tax was deducted as appropriate). Gross interest received was sh.18,000 of which Sh.10,000 was from Post Office Savings Bank.

2. Mr. Kplimo"s expenses for the year:
   Personal accident insurance premium of Sh.9,000 paid to American Life Insurance Company
   Life insurance premium on self life of Sh.15,000 paid to world Life Union Insurance of the United Kingdom.
   Alimony to his first wife of Sh.6,000 per month
   Mortgage interest of Sh.62,000 on his house where he stays with his wife and children. The mortgage is from Savings and Loan Kenya Limited.

3. Mrs. Kiplimo"s income:
   She was an employee of Macadamia Limited who paid her a salary of Sh.25,000 per month. P.A.Y.E of Sh.7,800 was deducted per month from her salary.
   She made a profit of Sh.900,000 from the sale of a plot in Nairobi inherited from her father.
   She used the money to start a private clinic. She is a registered clinical officer. In the year of income 1997, she made an assessed loss of Sh.240,000.

**Required:**

(a) What is a registered pension scheme and what are its implications? ( 5 marks)
(b) Compute the income chargeable to tax of Mr. Kiplimo for the year 2005. ( 8 marks)
(c) Calculate the tax payable (repayable) by him for 2005. ( 4 marks)
(d) Identify and comment on any information you have not used in calculations in (b) and (c) above. ( 5 marks)

**(Total: 22 marks)**

**QUESTION TWO**

(a) Explain any FOUR effects of Value Added Tax on business. ( 8 marks)

(b) Specify the rules relating to appeal against the Commissioner"s decision under the Value Added Tax Act. ( 4 marks)

(c) A company had VAT due amounting to Sh.300,000. It was late in making the payment for six weeks. What late payment penalty will be charged? ( 4 marks)

(d) Inland Limited imported goods whose landed value is Sh.400,000. The duty chargeable on them is at the rate of 35%. There is to be made a provision for transport to the interior amounting to Sh.50,000. A commission is to be paid of 2% dutable value. Value Added Tax is charged on those goods at 16%. Determine the amount of VAT payable. ( 4 marks)

**(Total: 20 marks)**

## QUESTION THREE

With reference to Pay As You Earn (PAYE) system:

(a) Write explanatory notes on the following:

(i) Taxation of pension income for a retired employee; ( 4 marks)

(ii) Allowable deductions for contributions to a registered pension scheme; ( 2 marks)

(iii) Procedure for the end of year Return; ( 6 marks)

(b) Give a list of statutory deductions. ( 4 marks)

(c) Give a list of three omissions which amount to failure to comply with PAYE regulations and indicate the penalty there on. ( 4 marks)

**(Total: 20 marks)**

## QUESTION FOUR

The following balances are extracted from the books of Wendani Limited for the year ended 30 April 2006.

| | Sh. |
|---|---|
| Share capital: | |
| 3,000,000 ordinary shares (fully paid) | 3,000,000 |
| 800 8% redeemable preference shares | 80,000 |
| Share premium account | 50,000 |
| General reserves | 200,000 |
| Preference share redemption | 96,000 |
| Block capital (at cost less depreciation) | 1,910,000 |
| Net profit for the year (before tax) | 842,000 |
| Debtors (unsecured, considered good) | 60,000 |
| Creditors | 50,000 |
| Profit and Loss Account (Cr 1 May 2005) | 20,000 |
| Interim dividend | 150,000 |
| Unpaid dividend | 18,000 |
| Other current assets | 1,150,000 |
| Investments | 390,000 |
| Preliminary expenses | 12,000 |
| Income tax paid, under dispute for the year ended 30 April 2005 | 200,000 |
| Advance payment of income tax | 440,000 |

You are provided with the following additional information:

1. Market value of the investment is Sh.355,000. Investment which cost Sh.40,000 had been sold in the year and realized a profit of Sh.12,500 which is included in the above profits.

2. The disputed income tax of the year ended 30 April 2005 is per revised assessment. Original self-assessment indicated an amount of Sh.96,000 which had been paid.

3. Preference shares are redeemable on 1 April 2007, at a premium of 20% but no entries were recorded in the books for giving effect thereto except for the payment standing to the debit of preference share redemption account.

4. Preliminary expenses represent the balance after amortisation. The original amount incurred to pay wages before commencement of business was Sh.20,000 and is being amortised over 5 years. The amortisation charge is debited to the profit and loss account.

5. Other current assets include stocks of Sh.90,000 which had been written down by 10% as provision for future plans decline. The amount was debited to the profit and loss account.

**Required:**

(a) Comment on reasons why a tax payer may appeal to the Local Committee. (4 marks)
(b) How does each of the five issues above affect the tax position of Wendani Limited? (10 marks)
(c) Compute revised taxable profits of Wendani Limited for the year ended 30 April 2006 and show tax payable. (5 marks)
(d) Is it prudent to raise an objection on revised assessment? Explain. (3 marks)

## QUESTION FIVE

(a) Define the term capital allowances. (4 marks)

(b) Cindera Enterprises is a partnership manufacturing timber pallets. The partners are L, M and N. The business has an account in the balance sheet entitled "Property". The account had been used to record a variety of expenditures. At the end of the year, the property account contained the following entries:

| | Sh. | Sh. |
|---|---|---|
| **Debit entries:** | | |
| Purchase by cash of building site | | 2,000,000 |
| Cost of removing old building from site to build factory | | 80,000 |
| Paid contract price for new factory building completed on 1 January 2005 | | 5,600,000 |
| Insurance, inspection fees and other costs directly related to construction of new building. | | 180,000 |
| New machinery brought to use on 1 January 2005 | | 4,000,000 |
| Cost of fixing machinery and testing | | 400,000 |
| | | 12,260,000 |
| **Credit entries:** | | |
| Proceeds from sale of salvaged material from demolition of old building | 30,000 | |
| Depreciation for the year completed at 4% of Sh.12,260,000 | 490,000 | |
| Total credits | | 520,400 |
| Balance in property account as at 31 December 2005 | | 11,739,600 |

**Required:**
(i) Determine the correct balance for each account. (4 marks)
(ii) Show the capital allowances due to the partnership in 2005. (9 marks)
(iii) If the profits, before capital allowances and salaries, made by the partnership was sh.2,860,000, show its allocation among partners if each receives a salary of Sh.120,000 per annum. The adjusted profit is after adjusting for these salaries. (3 marks)

**(Total: 20 marks)**

**TAXATION 1 (Principles and Concepts)**

**NOVEMBER 2006**

**Answer ALL questions. Marks allocated to each questions are shown at the end of the question. Show ALL your workings. Any assumptions made must be stated.**

## QUESTION ONE

Richex Limited has provided the following profit and loss account for the year ended 31 December 2005:

Profit and Loss Account for the year ended
**31 December 2005**

| | Sh. | | Sh. |
|---|---|---|---|
| Opening stock | 524,000 | Sales | 10,584,000 |
| Purchases | 4,692,000 | Closing stock | 761,000 |
| Manufacturing expenses | 2,563,000 | | |
| Salaries and wages | 252,000 | | |
| Supplies consumed | 466,000 | | |
| General expenses | 85,000 | | |
| Interest on loan | 364,000 | | |
| Commission and brokerage | 90,000 | | |
| Director"s fees | 55,000 | | |
| Auditor"s fees | 70,000 | | |
| Taxes | 43,000 | | |
| Bad debts reserve | 296,000 | | |
| Depreciation | 648,000 | | |
| Managing directors remuneration | 126,000 | | |
| Reserves | 750,000 | | |
| Provision for dividends | 300,000 | | |
| Profit for the year | 21,000 | | |
| | 11,345,000 | | 11,345,000 |

The following additional information is provided:

1. Salaries and wages include Sh.20,000 contributed by the company to unregistered pension scheme.
2. 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.
3. Taxes represent VAT paid.
4. Bad debts (specific) are Sh.180,000.
5. The fixed asset schedule is as follows:

| Asset | Year | Cost Sh. | |
|---|---|---|---|
| – Factory building | 2000 | 4,000,000 | |
| – Additional plant building | 2005 | 2,000,000 | - brought to use 1 July 2005 |
| – Machinery | 2000 | 4,800,000 | |
| – New machinery | 2005 | 6,000,000 | - fixed in new building |
| – Computers | 2004 | 1,000,000 | |
| – Other machinery and furniture | 2000 | 640,000 | |

- Year 2000 I.D rate = 60%

**Required:**

(a) Compute the capital allowances due to the company. (8 marks)

(b) Show the adjusted profit (loss) for tax purposes for the year 2005. (7 marks)

(c) State if any tax is payable. (1 mark)

(d) State the intervals relating to payment of tax instalments. ( 4 marks)
**(Total: 20 marks)**

## QUESTION TWO

(a) Mr. Shoma has two offers for employment in two engineering firms. The details of the two offers are as follows:

| | Firm A | Firm B |
|---|---|---|
| | **Sh.** | **Sh.** |
| Basic pay per month | 45,000 | 41,000 |
| Benefits: | | |
| Housing (market rent) p.m. | 50,000 | 60,000 |
| Car 1600cc (cost) | 600,000 | 600,000 |

Pension scheme which is registered by commissioner of income tax both employer and employee contribute 5% of the basic salary for pension scheme.

**Required:**

What offer would you recommend to Mr. Shoma? Explain the reasons for your recommendation. (16 marks)

(b) What is the tax treatment of school fees? ( 4 marks)
**(Total: 20 marks)**

## QUESTION THREE

(a) Distinguish between farm works deductions and capital deductions. ( 5 marks)

(b) John Moturi, a farmer, constructed a farmhouse on 2 January 2005 for Sh.6,000,000 and incurred the following additional expenditure:

| | | **Sh.** |
|---|---|---|
| 2.1.2005 | Cattle dip | 1,000,000 |
| 30.6.2005 | Irrigation system | 1,500,000 |
| 30.9.2005 | Labour quarters | 2,400,000 |
| 30.10.2005 | Milking machinery | 1,120,000 |

John Moturi sold the farm on 2.1.2006 to his brother, Peter Muturi, who is also a farmer. Their sale agreement contained the following particulars:

| | **Sh.** |
|---|---|
| Cattle dip | 1,200,000 |
| Farmhouse | 6,700,000 |
| Irrigation system | 1,200,000 |
| Milking machinery | 980,000 |
| Labour quarters | 2,800,000 |

**Required:**

Calculate the capital deductions due to John Moturi and Peter Muturi for the years 2005, 2006 and 2007. (15 marks)
**(Total: 20 marks)**

## QUESTION FOUR

(i) State the benefits of value added tax (VAT) in the context of the principles of a good tax system. (10 marks)

(ii) Given below were the purchases and sales made by Tough Limited during the month of December 2005. The prices were inclusive of VAT at the standard rate of 17 percent.

| | | |
|---|---|---|
| December | 1 | Purchased 400 units at Sh.5,600 per unit |
| | | Sold 40 units at sh.7,200 per unit |
| | 5 | Sold 80 units at Sh.7,200 per unit |
| | 10 | Sold 200 units at Sh.7,200 per unit |
| | 20 | Purchased 300 units at Sh.6,400 per unit |
| | 25 | Sold 80 units at sh.7,200 per unit |
| | 31 | Sold 200 units at Sh.8,000 per unit |

There was no inventory at the beginning of the month but 100 units were in stock at the end of the month.

**Required:**

(a) The VAT account for the month of December 2005. ( 8 marks)
(b) On what date is VAT due payable? ( 2 marks)
**(Total: 20 marks)**

## QUESTION FIVE

Explain the meaning of the following terms as appearing in the respective tax legislation:

(a) Excise duty; ( 2 marks)
(b) Local committee; ( 2 marks)
(c) Designated primary society; ( 2 marks)
(d) Bonded warehouse; ( 2 marks)
(e) Taxable person; ( 2 marks)
(f) Zero-rated; ( 2 marks)
(g) Non-resident; ( 2 marks)
(h) Exempt income; ( 2 marks)
(i) Registered home ownership savings plan; ( 2 marks)
(j) Commercial vehicle ( 2 marks)
**(Total: 20 marks)**

**TAXATION 1 (Principles and Concepts)**

**MAY 2007**

## QUESTION ONE

(a) State and briefly explain four factors which influence the taxable capacity in a country. ( 6 marks)

(b) "Governments in developing countries tend to overtax individuals in formal employment".

(I) Using suitable explain why Governments find it convenient to continually raise higher taxes on earnings from formal employment. ( 6 marks)

(ii) Suggest and explain one proposal on how the Government can be able to generate tax revenue from the informal sector. ( 2 marks)

(c) Normally in Kenya a trader is required to pay for a variety of licences in order to conduct trade.

(i) Do you consider a licence to be a tax? Explain. ( 1 mark)
(ii) Specify four of such licences. ( 4 marks)

(iii) In Kenya there is a proposal for the Government to issue a single licence to a trader in preference to the practice of issuing a variety of licences. Would you support this proposal? Why ( 1 mark)

**(Total: 20 marks)**

## QUESTION TWO

Mrs. S. Nkuraru is the owner of a supermarket in Nairobi East. Her accounts clerk has submitted to you the following trading profit and loss account for the year ended 31 December 2005:

| | Sh. | | Sh. |
|---|---|---|---|
| Opening stock | 8,640,000 | Closing Stock | 1,004,000 |
| Purchases | 96,000,000 | Sales | 110,000,000 |
| Salaries and wages | 1,500,000 | Proceeds from sale of land allocated to her by the Government | 500,000 |
| Donations to Kenya Chamber of Commerce | 100,000 | Gain on sale of shares | 200,000 |
| Redundancy payments | 600,000 | Gain on sale of residential plot | 400,000 |
| Contributions to registered pension fund | 100,000 | General bad debts recovery | 36,000 |
| Rent, rates and taxes | 110,400 | Dividends (Net) | 43,200 |
| Insurance | 14,880 | | |
| Legal and professional fees | 109,200 | | |
| Depreciation | 363,840 | | |
| Advertising | 166,800 | | |
| Value Added Tax | 247,200 | | |
| Customs duty – 2005 | 700,000 | | |
| Income tax for 2004 | 312,000 | | |
| Medical expenses – Mrs. S. Nkuraru | 28,800 | | |
| Interest on bank overdraft | 49,920 | | |
| Purchase of equipment | 25,200 | | |
| Christmas gifts to customers | 20,160 | | |
| General bad debts | 55,200 | | |
| Household expenses | 100,800 | | |
| Stationery and postage | 33,120 | | |
| Net profit | 2,905,680 | | |
| | 112,183,200 | | 112,183,200 |

The following additional information is provided:

1. Rent, rates and taxes include sh.20,400 being customs duty for the purchase of equipment.
2. Sales include a sum of Sh.120,000 representing the value of goods withdrawn for use by Mrs. S. Nkuraru and her children. These goods had been purchased at a cost of Sh.96,000.
3. Opening stock as well as the closing stock are consistently overvalued by 20% above cost price.
4. The legal and professional fees are analysed below:

| | Sh. |
|---|---|
| Appeal to local committee against tax assessment | 24,000 |
| Renewal for 5 year lease | 25,200 |
| Defending a suit for breach of trade agreement | 36,000 |
| Court fines | 20,400 |
| Miscellaneous (allowable) | 3,600 |
| | 109,200 |

5. Wear and tear allowances were agreed at Sh.259,200.
6. Included in advertising expenses is a sign board erected at the road junction leading to the supermarket at a cost of Sh.24,000.

**Required:**

(a) Mrs. S. Nkuraru"s chargeable profit for the year of income 2005. (14 marks)
(b) The tax payable on chargeable profit and state when it is payable. ( 4 marks)
(c) State the tax position if the tax payable is not paid on the due date. ( 2 marks)

**(Total: 20 marks)**

## QUESTION THREE

Professor Ujuzi, a Kenyan, came back to Kenya from USA on 1 August 2005 to take up an appointment as a managing director of Good Metal Limited after a 15 year absence from Kenya. The letter of offer sent to him from the Good Metal Limited indicated that he would:

1. receive a monthly basic salary of Sh.200,000.

2. be provided with a company car for his own personal use of 2,000cc rating. The company had bought the car for sh.2,000,000.

3. be provided with school fee support for his two children in America. The company is to spend sh.300,000 per annum for this purpose.

4. have his baggage moved from America to Kenya by Express Cargo who were paid Sh.1,500,000 to move the four containers of personal effects and the air tickets for Professor Ujuzi, his wife and children.

5. buy 10 per cent of the share capital of the company at US$50,000 (Sh.3,000,000). For the year ended 31 December 1998, the company paid him Sh.400,000 (gross) as dividends. Withholding tax for the dividends were paid by the company.

6. be covered by the company on his life with Fedlife, an American Insurance Company based in New York. Premium of Sh.60,000 was to be paid for a sum insured on death of Sh.6,000,000.

Upon arrival in Kenya on 1 August 2005, Professor Ujuzi purchased a house in Runda Estate using a loan from Housing finance Company of Kenya. The loan advanced was for Sh.2,000,000 at 25 per cent interest rate. All instalments in the year were paid. He lived in the house from 1 August 2005 to 31 December 2005. The wife did not like the house and on 31 December 2005, they sold the house and made a gain of Sh.400,000.

The wife, Mrs Ujuzi enrolled for the external degree programme at the University of Nairobi. While there, she was requested to teach American English. The University paid her a honoraria of Sh.2,000 per hour for 60 hours. She did not receive the money in cash but the amount was used to offset her fees as an external student.

**Required:**

(a) (i)Comment briefly on the tax implications of Professor Ujuzi"s return to Kenya, using the Income Tax Act, the Customs and Excise Act. ( 4 marks)

(ii) According to the Customs and Excise Act, are the personal effects chargeable to tax? ( 1 mark)

(b) Analyse the income tax effects of each item in Professor Ujuzi"s employment contract. ( 6 marks)

(c) Determine the taxable income of Professor and Mrs Ujuzi for the year of income 1998. ( 7 marks)

(d) Calculate the tax payable by Professor Ujuzi and Mrs. Ujuzi. ( 2 marks)
**(Total: 20 marks)**

## QUESTION FOUR

Kamene, Mutinda and Mwende have been trading in partnership as Meka Associates making water tanks for the last 5 years. They share profits and losses in the ratio 2:2:1 respectively.

For the year ended 31 December 2005, Meka Associates made a profit adjusted for income tax purposes of Sh.60,498,500 before capital allowances.
On 31 December 2004, Meka Associates acquired in whole the business of Nithi Brothers, a tea processing firm. Information given below relates to the business when it was owned by Nithi Brothers.

Nithi Brothers had purchased a building on 1 January 2004 for Sh.42,000,000 (including land valued at Sh.6,000,000). It was brought into use on the same day. The sellers construction costs comprised:

| | Sh. | Sh. |
|---|---|---|
| Land | | 4,000,000 |
| Construction costs: | | |
| Factory | 30,800,000 | |
| Offices | 3,200,000 | 34,000,000 |
| Levelling land | | 1,200,000 |
| Architects fees | | 800,000 |

Meka Associates continued with the same business of processing raw tea. The following amounts were paid for assets purchased from Nithi Brothers:

| | Sh. |
|---|---|
| Motor vehicle | 4,000,000 |
| Goodwill | 200,000 |
| Land and buildings | 80,000,000 |
| Milling machines | 36,000,000 |
| Tractor and lorry | 32,000,000 |

Meka Associates incurred the following additional costs:

| | **Sh.** |
|---|---|
| Extension to building | 16,000,000 |
| Security wall | 2,000,000 |
| Fixtures and fittings | 12,000,000 |
| Installed machinery | 24,000,000 |
| Additional boiler | 20,000,000 |
| Volvo – saloon | 2,000,000 |
| Nissan urvan | 3,000,000 |

The following transactions took place in 2005:

| | |
|---|---|
| 1.8.2005 | Sold milling machines for Sh.4,000,000 and one faulty photocopier for sh.80,000 |
| 1.10.2005 | Sold damaged fixture and fittings for 160,000 and disposed of a lorry for Sh.3,600,000 |
| 3.10.2005 | Disposed of the motor vehicle for Sh.3,000,000 |

The terms of the partnership agreement were as follows:

1. Kamene and Mutinda to receive salaries of Sh.480,000 each per annum.
2. Interest of Sh.2,000,000 and Sh.1,320,000 to be paid to Kamene and Mutinda respectively on their fixed capital accounts.
3. Mwende was to draw a salary of Sh.2,400,000 per annum.
4. The remaining profits or losses to be shared according to the existing profit/loss sharing ratio.

The following additional information is provided:

Kamene and Mutinda are married while Mwende is unmarried. Kamene has a mortgage for a residential house and paid interest amounting to Sh.600,000 during the year 2005 to Savings and Loan (K) Ltd. Mutinda received Sh.400,000 as interest on Sh.4,000,000, city council stocks which he has held for many years. The partners had no other income.

**Required:**

(a) The capital allowances due to Meka Associates in 2005. (10 marks)
(b) Allocation of partnership profits/losses for 2005. ( 8 marks)
(c) Taxable income for each partner. ( 4 marks)
**(Total: 22 marks)**

## QUESTION FIVE

(a) What are the partners responsibility with respect to the following VAT matters?

(i) Exempt supplies in relation to their business. ( 2 marks)
(ii) Zero rated supplies in relation to their business. ( 2 marks)

(b) Discuss the tax implications of the following independent transactions:

(i) 16% VAT paid on a new factory building constructed on behalf of Wema Ltd.
VAT of Sh.60,000 due on the invoice to Disaster Limited which has remained unsettled by them for 6 months.
Transfer of a building worth Sh.5,000,000 from a father to a daughter for a nominal sum of Sh.1,000,000 in an urban area.
Custom bond executed by Watu Insurance Company on behalf of Barm Limited for sugar worth Sh.100 million which was not re-exported as promised. (12 marks)
**(Total: 18 marks)**

**TAXATION 1 (Principles and Concepts)**

**NOVEMBER 2007**

**Answer ALL questions. Marks allocated to each questions are shown at the end of the question. Show ALL your workings. Any assumptions made must be stated.**

## QUESTION ONE

(a) What does the term employer include for PAYE purposes? ( 4 marks)

(b) J. Selina is an accountant with Kamau Enterprises Ltd. Details of employment income for the year ended 31 December 2005 are as follows:

Salary per month – Sh.250,000 (PAYE of Sh.84,600 per month).
She contributes 5% of her monthly salary to the company"s pension scheme which is registered with the Commissioner of Income Tax.
She is provided with a company house.

The financial controller has informed you that Kamau Enterprises Ltd. has leased the house which J. Selina is occupying at the monthly rent of Sh.50,000

**Required:**

(i) Compute chargeable income for J. Selina in 2005. ( 6 marks)
(ii) Compute J. Selina"s 2005 tax liability. ( 6 marks)
(iii) Would the chargeable income and the tax liability in (i) and (ii) above change if the house that J. Selina occupies was rented from her? Explain. Calculations are not required). ( 4 marks)

**(Total: 20 marks)**

## QUESTION TWO

(a) What is instalment tax and when is it payable? ( 6 marks)
(b) Who is a „whole time service director" as defined by Income Tax Act (cap 470)? ( 2 marks)
(c) Millers is a manufacturing company located in the Nairobi industrial area. The following profit and loss account was prepared from its books for the year ended 31 December 2005:

| | Notes | Sh. |
|---|---|---|
| Gross profit | | 1,864,000 |
| Investment income | [1] | 284,636 |
| Profit on sale of shares | | 216,324 |
| | | 2,364,960 |
| Directors remuneration | [2] | 1,020,000 |
| Interest | [3] | 273,600 |
| Audit fees and expenses | [4] | 216,000 |
| Bad debts | [5] | 158,400 |
| Depreciation | | 344,760 |
| Miscellaneous expenses | [6] | 133,600 |
| Net profit | | 218,600 |
| | | 2,364,960 |

**Notes:**

1. **Investment income:**

| | Sh. |
|---|---|
| Dividends from Kenya Commercial Bank (Net) | 72,000 |
| Interest on fixed deposit account – NBK (Net) | 58,760 |
| Interest on Treasury Bills | 93,876 |
| Dividends from subsidiary company | 60,000 |
| | 284,636 |

2. **Directors remuneration:**

| | Sh. |
|---|---|
| Directors fees | 240,000 |
| Travelling expenses – directors | 400,000 |
| Payment to pension scheme | 160,000 |
| Ex-director compensation for wrongful termination of contract | 220,000 |
| | 1,020,000 |

3. **Interest expenses:**

| | Sh. |
|---|---|
| Interest on bank overdraft | 151,200 |
| Interest on loan from a foreign bank | 50,400 |
| Interest on loan to purchase investment shares | 72,000 |
| | 273,600 |

4. **Audit fees and expenses:**

| | Sh. |
|---|---|
| Audit fees | 68,000 |
| Tax appeal against assessment | 32,000 |
| Book-keeping fees | 48,000 |
| Audit expense paid in relation to a discontinued business line | 68,000 |
| | 268,000 |

5. **Bad debts:**

| | Sh. |
|---|---|
| Embezzlement by accountant | 21,600 |
| Received from insurance | (12,000) |
| Bad debts written off | 28,800 |
| General provision | 120,000 |
| | 158,400 |

6. **Miscellaneous expenses:**

| | Sh. |
|---|---|
| Acquisition of 100 year lease on business premises | 28,000 |
| Directors Christmas party | 24,000 |
| Kenya National Chamber of Commerce subscription | 30,000 |
| ASK show contribution | 10,000 |
| Thomas Barnado"s Home contributions | 41,600 |
| | 133,600 |

**Required**

The profit chargeable to tax for year of income 2005. (12 marks)

**(Total: 20 marks)**

## QUESTION THREE

(a) Explain the meaning of the following terms and state their effects on taxable income.

| | |
|---|---|
| Trading receipts. | ( 2 marks) |
| Balancing charge. | ( 2 marks) |
| Trading loss | ( 2 marks) |
| Balancing deduction. | ( 2 marks) |

(b) The Meru Forest Tree Fellers Ltd. commenced business on 1 January 2005.

The following fixed assets of the company which it acquired prior to the commencement of the business were stated at their written down values as at 1 January 2005:

| | **Sh.** |
|---|---|
| Milling machine | 3,440,000 |
| Fork lifts | 1,720,000 |
| Tractors | 7,800,000 |
| Lorries – 200 tones | 2,400,000 |
| Packaging machine | 3,500,000 |
| Crushing machine | 3,680,000 |
| Conveyor and sorter | 6,240,000 |
| Two pick-ups | 1,800,000 |
| One lorry | 2,400,000 |
| Saloon cars | 780,000 |
| Furniture and fittings | 544,000 |
| Land | 20,000,000 |

The building in which the processing was to be carried out was constructed in 2003 but was first used for manufacture in 2005.

The building cost sh.13,600,000 in 2003 and the estimated value in January 2005 was sh.11,400,000.

In 2005 the company bought the following assets:

| | **Sh.** |
|---|---|
| Toyota-saloon car | 2,700,000 |
| Lorry | 5,200,000 |
| Tractor | 3,540,000 |
| Furniture | 280,000 |
| Land | 6,240,000 |
| Pick-up | 4,000,000 |
| Computers | 50,000 |
| Computer scanner | 400,000 |
| Printers | 200,000 |
| Milling machine | 5,550,000 |

The following assets were also disposed of in 2005:

| | **Sh.** |
|---|---|
| Forklift | 480,000 |
| Saloon car | 920,000 |
| Printer | 50,000 |
| Land | 2,240,000 |
| Packaging machine | 4,500,000 |

A tractor was damaged through a road accident during the year and the insurance company paid Sh.3,200,000 as compensation.

**Required:**

Capital allowances for the company for 2005. (12 marks)

**(Total: 20 marks)**

## QUESTION FOUR

(a) Write short notes on VAT tribunal. (5 marks)
(b) To what extent are the partners responsible in respect to payments of VAT. (3 marks)
(c) You are provided with the following transactions for Juice Processors Ltd. for the six months period ended 31.10.2005:

1. Sales for May was sh.300,000. the sales increased by 5% in June and by 10% in each of the following months.

2. Purchases for fruits were constant at Sh.120,000 per month. The purchases were made direct from farmers.

3. The company is registered for VAT and the VAT paid in July to November was Sh.145,000 after claiming input tax of sh.5,000 that is each month.

**Required:**

(i) Using the information provided, confirm the correctness of VAT paid. (10 marks)
(ii) What are your recommendations to the management on VAT compliance? ( 2 marks)

**(Total: 20 marks)**

## QUESTION FIVE

Gatwiri, Kiende and Kanyiri are partners, operating a supermarket in Meru town. They share profits and losses in the ratio 2:2:1 respectively. During the year ended 31 December 2005, the partners reported a loss of Sh.4,425,000 after deducting the following:

| | Sh. |
|---|---|
| Interest on capital: | |
| Gatwiri | 232,000 |
| Kiende | 232,000 |
| Kanyiri | 348,000 |
| Salaries to partners: | |
| Gatwiri | 400,000 |
| Kiende | 420,000 |
| Kanyiri | 576,000 |
| Motor vehicle running expenses | 304,000 |
| Repairs and maintenance | 96,000 |
| Office expenses | 240,000 |
| Goodwill | 400,000 |
| Loss on investment | 600,000 |
| Postage and telephone | 170,000 |
| Water and electricity | 136,000 |
| Subscriptions to Kenya National chamber of Commerce | 128,000 |
| Salaries and wages | 712,000 |
| Donations | 300,000 |
| Bad debts written off | 346,000 |
| Rent, rates and licences | 160,000 |
| Professional fees | 960,000 |

| | |
|---|---|
| Depreciation | 1,760,000 |
| Purchase of lorry | 1,331,000 |
| Dividend receive (Net) | 264,000 |
| Insurance recovery on motor vehicle | 520,000 |



**Notes:**

1. Offices included cost of office cabinet of Sh.110,000.
2. Travelling expenses amount to Sh.12,000 per month related to personal use.

3. **Provision for bad and doubtful debts account**

| | Sh. | | Sh. |
|---|---|---|---|
| Bad debts | 246,000 | General b/f) | 330,000 |
| Specific (c/f) | 192,000 | Specific (b/f) | 152,000 |
| General (c/f) | 390,000 | Profit and loss account | 346,000 |
| | 828,000 | | 828,000 |

4. Kiende had taken goods worth Sh.70,000 for her own use.
5. Wear and tear allowances agreed with the commissioner amounted to Sh.706,000.
6. Included in repairs and maintenance is Sh.80,000 paid for office partitions in 2005.

**Required:**

The taxable profit (loss) from the partnership business and show the distribution among the partners as at 31 December 2005 and tax payable thereon. **(20 marks)**

**TAXATION 1 (Principles and Concepts)**
**MAY 2008**

**Answer ALL questions. Marks allocated to each questions are shown at the end of the question. Show ALL your workings. Any assumptions made must be stated.**

## QUESTION ONE

Mr. John Kiogora is employed by Meru Distributors Ltd. During the year of income 2005, he presented to you the following information:

1. Mr. Kiogora owns 10,000 ordinary shares of Sh.50 each in Benki Ltd. During the year of income, he received a dividend of Sh.2 per share.

2. His employment earnings include:

   Salary sh.60,000 per month (P.A.Y.E Sh.16,000 per month)
   He received an end of the year bonus payable to executive staff: sh.20,000
   He used his own car to travel during the course of duty and the following costs were met by the employer:

   Petrol paid for by Mr Kiogora and reimbursed by his employer in full Sh.12,000.
   Maintenance and repair costs Sh.14,000.
   Road licence and insurance sh.28,000.

   Mr. Kiogora spent Sh.17,000 on entertainment of customers which was fully reimbursed by the employer.
   Mr. Kiogora is housed by his employer, in a house where the employer pays Sh.5,000 per month. His employer pays on his behalf life insurance premium at sh.2,000 per month.
   The employer paid Sh.2,000 per month for Mr. Kiogora"s approved pension scheme.

3. Interest received by Mr. Kiogora during the year was as follows:

| | |
|---|---|
| Post Office Savings Bank | Sh.12,000 |
| Fixed Deposit Account: Euro Bank | Sh. 2,250 |
| Savings Account: National Bank | Sh. 8,400 |

4. Mr. Kiogora paid interest of Sh.20,000 per month, on a loan from HFCK for the purchase of his residence.

5. Rental income:

| | | Sh. | Sh. |
|---|---|---|---|
| | Gross rent | | 43,000 |
| Less: | Mortgage interest: | 8,000 | |
| | Cost of building extension | 120,000 | |
| | Painting extension | 10,000 | 138,000 |
| Net loss on rent | | | 95,000 |

6. Mrs. Mary Kiogora earned the following income for the year of income 2005:

   Salary: Malima Manufacturers sh.72,000 per month (P.A.Y.E. Sh.25,000 per month) Free lunches by his employer Sh.2,400 per month
   Part-time business Sh.10,000 per month.

**Required:**

(a) Calculate the total taxable and tax payable income for Mr. Kiogora for the year of income 2005. (13 marks)

(b) State the tax position of Mrs. Kiogora. ( 2 marks)

(c) Comment on any information that you did not use in computation of Mr. Kiogora"s taxable income. ( 5 marks)

**(Total: 20 marks)**



## QUESTION TWO

Mr. S. Shah owns a coffee processing factory in Kiambu. The following particulars relate to assets of the factory in 2005.

1. 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.
2. Purchased three micro computers at a total cost of Sh.300,000.
3. Other assets of the factory were as follows:

| | WDV **1.1.2005** **Sh.** | Additions **Sh.** | Disposals **Sh.** |
|---|---|---|---|
| Office furniture | 3,300,000 | 1,900,000 | 700,000 |
| Computers | 200,000 | - | 80,000 |
| Tractors | 12,000,000 | - | 2,500,000 |
| Lorries (1 ton) | 2,500,000 | 3,000,000 | 500,000 |
| Processing machines | 4,800,000 | 2,400,000 | 1,800,000 |
| Saloon cars | 3,200,000 | 4,000,000 | 200,000 |
| Buildings | 5,000,000 | - | - |
| Land | 7,500,000 | 2,000,000 | 4,000,000 |

4. The old buildings were inherited from Shah"s father 5 years ago when new and were valued atSh.50,000,000.

5. A farm house was constructed in 2005 at a cost of Sh.600,000. a cattle dip and milking machinery costing Sh.120,000 and sh.220,000 respectively were constructed and purchased during 2005.

6. The saloon cars (two) disposed of in June 2005 were purchased in 2003 at a cost of Sh.250,000 each. Another saloon car was purchased during 2005.

7. Goodwill and patents carried forward from 2003 were valued at Sh.1,400,000 on 31 December 2005.

**Required:**

(a) Capital deductions for Mr. S. Shah for the year of income 2005. (20 marks)

(b) Comment on any information you have not used in (a) above. (3 marks)

**(Total: 23 marks)**

## QUESTION THREE

A, K and M are in a partnership of selling imported clothes, handbags and shoes. They have provided the following information for the year of income 2005:

| | | Sh. |
|---|---|---|
| Net loss after deducting the following: | | (1,080,000) |
| Rent | | 180,000 |
| Legal costs | | 75,000 |
| Salaries and wages | | 300,000 |
| Donations: Turkana Food Relief Fund | | 50,000 |
| Electricity and water | | 35,000 |
| Repairs to business premises | | 65,000 |
| Stationery | | 12,000 |
| Vehicle expenses | | 90,000 |
| Audit and accountancy | | 24,000 |
| Advertising | | 65,000 |
| Depreciation: | Car | 10,000 |
| | Building | 33,000 |
| Salaries: | K | 240,000 |
| | M | 240,000 |
| | A | 360,000 |
| Interest on capital | K | 80,000 |
| | M | 80,000 |
| | A | 120,000 |
| Bad debts | | 40,000 |
| Loss on sale of shares | | 8,000 |
| Political party membership: K | | 6,000 |
| Withdrawals by M | | 5,000 |
| Dresses taken by A for her own use | | 12,000 |
| School fees paid for A"s children | | 55,000 |

**Additional information:**

1. Wear and tear deductions were estimated at Sh.16,000.
2. Fifty per cent of vehicle expenses was for personal use.
3. Salaries and wages include Sh.30,000 paid to A"s daughter for assisting in the business during the school holidays.
4. Rent analysis:

| | |
|---|---|
| Payment for Partners residence | Sh. 80,000 |
| Business | Sh.100,000 |

5. Legal costs included a payment of Sh.15,000 paid to an arbitrator to settle a personal dispute between K and M.
6. Bad debt analysis:

| | Sh. |
|---|---|
| General provision | 10,000 |
| Specific provision | 12,000 |
| Written-off | 8,000 |
| A"s son (defaulter) | 10,000 |
| | 40,000 |

7. Advertising:

| | Sh. |
|---|---|
| Advertising campaign | 28,000 |
| Cost of new sign board | 5,000 |
| Sale of clothes | 9,000 |
| A"s birthday expenses | 23,000 |
| | 65,000 |

8. Other incomes (included in trading profit)

| | Sh. |
|---|---|
| Dividends from shares KCB Ltd. | 19,000 |
| Rental income: sub-letting business premises | 22,000 |
| Gain on sale of furniture | 13,000 |
| | 54,000 |

**Required:**

(a) Taxable income (loss) for the partnership business and distribution among the partners for 2005 if they share profits and losses in the ratio 2:1:1. (18 marks)

(b) Determine the taxable income of each partner. ( 3 marks)

**(Total: 21 marks)**

## QUESTION FOUR

(a) With examples distinguish between:

(i) specific customs duty from advalorem import customs duty. ( 4 marks)

(ii) discriminatory policy from non-discriminatory policy as used in custom duties. ( 4 marks)

(b) The following transactions related to the business of Mr. Mark Makenzie for the year of income 2005:

| | **Sh.** |
|---|---|
| Wages | 1,350,000 |
| Purchases (zero rate) | 150,000 |
| Purchases (standard rate – 16%) | 900,000 |
| Purchased car from Japan | 700,000 |
| Sales at standard rate (16%) | 2,400,000 |
| Sales at zero rate | 600,000 |
| Exempt sales | 900,000 |

**Required:**

Calculate the VAT payable by Mr. Mark Mackenzie for the year of income 2005. ( 8 marks)

(c) You are provided with the following accounts for Mrs. Moraa. Her accountant ahs calculated VAT and transferred to the ledger accounts as given below:

Purchases Account

| | **Sh.** | | |
|---|---|---|---|
| Bank | 350,000 | | |

Bank Account

| | **Sh.** | | **Sh.** |
|---|---|---|---|
| Sales account | 700,000 | Purchases account | 1,050,000 |
| VAT | 105,000 | VAT account | 140,000 |

Sales Account

| | | | **Sh.** |
|---|---|---|---|
| | | Bank account | 700,000 |

Bank Account

| | **Sh.** | | **Sh.** |
|---|---|---|---|
| Bank | 70,000 | Bank | 105,000 |
| Balance c/d | 35,000 | | |
| | 105,000 | | 105,000 |
| | | Balance b/d | 35,000 |

**Required:**

Comment on the accuracy of the above entries clearly stating the possible errors made by the accountant. ( 3 marks)

**(Total: 19 marks)**

## QUESTION FIVE

(a) State the tax position where a taxpayer undertakes transactions aimed at avoiding liability to tax. ( 3 marks)

(b) Explain the tax treatment of the following:

Income and expenditure after cessation of business. ( 3 marks)
Accounting periods not coinciding with the year of income. ( 3 marks)
Offences by corporate bodies. ( 3 marks)
Service of notices. ( 2 marks)
Interest on under estimated tax. ( 2 marks)

**(Total: 17 marks)**

## TAXATION I

## DECEMBER 2008

**Answer ALL questions. Marks allocated to each questions are shown at the end of the question. Show ALL your workings. Any assumptions made must be stated.**

### QUESTION ONE

(a) Explain the tax position of the income of a deceased person. ( 2 marks)

(b) What is „set-off" tax? ( 2 marks)

(c) Mrs. Ongera works with Anga Ltd. and has provided you with the following information for the year ended 31 December 2005.

Pension from previous employment Sh.20,000 per month.

Salary sh.120,000 per month (P.A.Y.E Sh.42,000 per month)

Mrs. Ongera and her husband own a company whose taxable income was agreed at Sh.500,000 after charging husband"s salary of sh.250,000 per month (P.A.Y.E sh.60,000 per month).

Anga Ltd. provided a company house to Mrs. Ongera in South B where rent of similar houses was Sh.20,000 per month.

Mrs. Ongera works over-time and her over-time income averages Sh.10,000 per month.

Mrs. Ongera enjoyed medical benefit of Sh.160,000 during the year. She is a senior manager and the company has medical cover for all its employees.

She obtained free consumables from the company as a Christmas gift worth Sh.30,000 during the year.

Mrs. Ongera owns rental property at Komarock Estate and receives Sh.50,000 as rental income per month. During the year, She incurred Sh.60,000 in renovations, repairs and painting before letting the property. She had obtained a mortgage loan from Housing Finance Company amounting to sh.3,000,000. She paid sh.900,000 during the year of which sh.500,000 was principal.

Mrs. Ongera owns 20% of the shares of Anga Ltd.

**Required:**

(i) The taxable income for Mr and Mrs Ongera for the year of income 2005. (10 marks)

(ii) Tax payable on the income computed above. (4 marks)

(iii) Mrs. Ongera did not fill her sell assessment return form for 2005. State the penalties due, if any. (2 marks)

**(Total: 20 marks)**

### QUESTION TWO

(a) Explain the tax treatment of a farmhouse for purposes of capital deductions. ( 2 marks)

(b) Sweet Tooth, a grape farmer completed construction of a farmhouse on 2 January 2005 for Sh.12,000,000. Additional expenditure incurred on the same date was as follows:

| | Sh. |
|---|---|
| Milking machinery | 2,240,000 |
| Irrigation system | 3,000,000 |

| | |
|---|---|
| Labour quarters | 4,800,000 |
| Cattle dip | 2,000,000 |
| Sewerage system | 1,200,000 |
| Digging terraces | 500,000 |
| Farm implements | 600,000 |

On 6 April 2005, Sweet Tooth incurred an additional sh.3,500,000 as expenditure for uprooting old plants and planting others. The uprooted plants were infected by pests. The cost of treating the soil before replacing the old plants amounted to Sh.200,000.

Sweet Tooth sold his farm to Toothache on 1 May 2006 for the following amounts:

| | Sh. |
|---|---|
| Milking machinery | 1,960,000 |
| Irrigation system | 2,400,000 |
| Labour quarters | 5,600,000 |
| Farm house | 13,400,000 |
| Cattle dip | 2,400,000 |
| Sewerage system | 1,600,000 |

The farm implements were considered to be of marginal value and were given to Toothache free of charge. An expert valuer however estimated their value at Sh.50,000. Terraces which had cost sh.500,000 to dig were destroyed by heavy rains and therefore their value was reduced to zero.

**Required:**

- Calculate the framework deductions due to Sweet Tooth and toothache for the years 2005 and 2006. (14 marks)
- Comment on the treatment of the cost incurred to replace the old plants and the cost of treating the soil. ( 2 marks)
- Comment on any other information not used above. ( 2 marks)

**(Total: 20 marks)**

## QUESTION THREE

K. Kinyenje Co. Ltd is a manufacturing cum wholesale business. The accountant of the company has provided you with the following profit and loss account for the year of income 2005.

| | **Sh.** | | **Sh.** |
|---|---|---|---|
| Opening stock | 1,048,000 | Sales | 31,752,000 |
| Purchases | 14,076,000 | Closing stock | 2,283,000 |
| Depreciation | 2,052,000 | Profit on sale of shares ex-dividend | 760,000 |
| Directors remuneration | 543,000 | Bad debts recovered (specific) | 120,000 |
| Salaries and wages | 756,000 | | |
| General expenses | 255,000 | | |
| Auditor"s fees | 210,000 | | |
| Reserves | 2,250,000 | | |
| Bad debts reserve | 888,000 | | |
| Taxes | 129,000 | | |
| Interest on loan | 1,038,000 | | |
| Manufacturing expenses | 7,689,000 | | |
| Supplies used | 1,338,000 | | |
| Commissions paid | 270,000 | | |
| Provision for dividends | 900,000 | | |
| Audit fees – for tax appeal | 100,000 | | |
| Preliminary expenses | 700,000 | | |
| Fire insurance | 122,000 | | |

| | | |
|---|---|---|
| Rental loss | 10,000 | |
| Net profit | 541,000 | |
| | 34,915,000 | 34,915,000 |

Additional information provided is as follows:

1. Stock of goods both at the beginning and at the end of the year were overstated by 20%.
2. Rental loss analysis:

| | Sh. | Sh. |
|---|---|---|
| Gross rent | | 820,000 |
| Less: Sweepers wages | 60,000 | |
| Extension (servants quarter) | 400,000 | |
| Painting | 80,000 | |
| Mortgage interest | 170,000 | |
| Land rates and rent | 20,000 | |
| Stone wall fencing | 100,000 | 830,000 |
| Loss | | (10,000) |

3. Preliminary expenses relate to company formation.
4. Bad debts (specific) are Sh.540,000.
5. Taxes represent VAT paid
6. General expenses include Sh.45,000 for donations and Sh.30,000 contributions to a trade union.
7. The company owned the following fixed assets purchased during the years indicated:

| | Year | Cost Sh. |
|---|---|---|
| Machinery (old) fixed in old building | 2004 | 14,400,000 |
| Computers | 2005 | 3,000,000 |
| Furniture and fittings | 2004 | 1,920,000 |
| New machinery fixed in building | 2005 | 18,000,000 |
| Factory building | 2004 | 12,000,000 |
| Extension to factory building (Brought to use on 1 August 2005) | 2005 | 6,000,000 |

**Required:**

(a) The adjusted income/loss for K. Kinyenje Co. Ltd. for the year of income 2005. (17 marks)
(b) The tax payable (if any), indicating when it is due. ( 3 marks)
**(Total: 20 marks)**

**QUESTION FOUR**

(a) Explain the VAT position on imported goods and warehoused goods. ( 4 marks)

(b) On 31 March 2006, VG Company had VAT due amounting to Sh.120,000 relating to sales for the month of March 2006. The company made the payment on 30 May. State the penalty chargeable for the late payment and the total amount to be paid by the company. ( 5 marks)

(c) On 10 July 2005, Dubai Merchants imported goods valued at sh.1,200,000. The customs duty chargeable on these goods was at 35%, clearing charges paid amounted to Sh.20,000 and transport from Mombasa to Nairobi amounted to Sh.70,000. A commission on the dutable value of the goods was paid at 5%.

**Required:**

(i) Determine the amount of VAT payable on the goods. ( 8 marks)
(ii) If the goods were sold on arrival in Nairobi at a mark-up of 20%,

determine the selling price. ( 5 marks)

**(Total: 20 marks)**

## QUESTION FIVE

(a) Briefly explain the position regarding hotel accommodation tax? ( 4 marks)

(b) State and briefly explain the factors that influence tax shifting. ( 6 marks)

(c) Explain the tax position on "recovery of tax from persons intending to leave Kenya or who have left Kenya" ( 3 marks)

(d) Time limit to making tax assessments. ( 7 marks)

**(Total: 20 marks)**

**TAXATION I**

**MAY 2009**

**Answer ALL questions. Marks allocated to each questions are shown at the end of the question. Show ALL your workings. Any assumptions made must be stated.**

## QUESTION ONE

Write short notes on the following:

(a) Taxable turnover in relation to VAT; ( 6 marks)
(b) Deregistration for VAT; ( 2 marks)
(c) Assessment for VAT; ( 3 marks)
(d) Appeals under VAT Act; ( 3 marks)
(e) Tax invoice; ( 3 marks)
(f) Rules regarding payment of VAT. ( 3 marks)

**(Total: 20 marks)**

## QUESTION TWO

The partners of Mehta Brothers reported a loss of Sh.250,000 for the year ended 31 August 2005 after deducting the following expenses:

| | **Sh.** |
|---|---|
| Salaries and wages | 450,000 |
| Partners drawings | 360,000 |
| Loss on sale of investment | 15,000 |
| Professional fees | 120,000 |
| Travelling expenses | 650,000 |
| Purchases | 5,250,000 |
| Repairs and maintenance | 320,000 |
| Depreciation | 650,000 |
| Rent and rates | 240,000 |
| Telephone | 60,000 |
| Postage and stationery | 175,000 |
| Bank charges and interest | 24,000 |
| Salaries to partners: | |
| S. Mehta | 50,000 |
| M. Mehta | 50,000 |
| N. Mehta | 100,000 |
| Donations | 20,000 |
| Purchase of computer | 200,000 |
| Bad debts written off | 65,000 |
| Interest on capital: | |
| S. Mehta | 20,000 |
| M. Mehta | 20,000 |

**Notes:**

1. Agreed written down values of the assets as at 31 August 2005. Class I – Sh.1,250,000; Class III – Sh.250,000; Class IV – Sh.375,000.
2. The partners share profits and losses equally after salaries and interest.
3. The wife of S. Mehta is a full time employee of the company and was paid a salary of Sh.120,000 during the year.
4. The partners have no other source of income other than from the partnership.

**Required:**

(a) Calculate the taxable profit (loss) of the partnership for the year ended 31 August 2005 and taxable income of each partner. (13 marks)

(b) The partners self-assessment returns and the partnership self-assessment are to be submitted to the Tax Department by 31 December 2005. What advice would you give the partners on filing tax returns? ( 4 marks)

(c) State the tax position of S Mehta and wife, if the wife runs a part time curio shop where she earns Sh.40,000 per month and incurs an expenditure of Sh.10,000 in the same month. ( 3 marks)

**(Total: 20 marks)**

## QUESTION THREE

Mrs. Jinny Ondemo is a professional medical doctor, practicing in Nairobi. Given below are the financial details of her clinic for the year ended 31 December 2005.

| | **Sh.** |
|---|---|
| Gross professional fees received | 3,000,000 |
| Directors fees received(deductions at source) | 360,000 |
| Interest income from AB Bank Ltd. – Gross | 72,000 |
| Dividend income (net) | 102,000 |
| Subscriptions to professional association and publications | 60,000 |
| Donations to destitute children"s home | 30,000 |
| Subscriptions to a Wildlife Magazine | 6,000 |
| Debt collection (patients) expenses | 18,000 |
| Wages for clinic assistant | 360,000 |
| Replacement of clinic instruments | 120,000 |
| Rent for the clinic premises | 420,000 |
| Electricity and water – clinic | 120,000 |
| General expenses – clinic | 210,000 |
| Car hire expenses – for use in practice | 150,000 |
| Uniforms for staff | 115,000 |
| Payment of school fees for own children | 120,000 |
| Contribution to Registered Provident Fund-self | 180,000 |
| Payment of life insurance premium-self | 60,000 |
| Terminal benefits paid to retired receptionist | 150,000 |
| Depreciation on furniture – clinic | 36,000 |
| Rents received from sub-rentals | 42,000 |
| Rent collection expenses | 6,000 |
| Wages paid to cleaners and watchman – clinic | 150,000 |
| Tarmacking of drive-way-personal residence | 240,000 |
| Additional servant quarters – personal residence. | 420,000 |

**Required:**

(a) Taxable income of Mrs. Jinny Ondemo for the year ended 31 December 2005. (10 marks)
(b) Tax payable by Mrs. J. Ondemo. ( 3 marks)
(c) Indicate the date when the tax, if any, is payable to the Income Tax Department. ( 2 marks)
(d) What is the tax position on a wife"s income? ( 5 marks)

**(Total: 20 marks)**

## QUESTION FOUR

The Gitoro Food Processing Industries Ltd. commenced business on 1 January 2005 and the following are the fixed assets of the company which it acquired prior to the commencement of the business:

| | Sh. |
|---|---|
| Conveyer and sorter (installed in the buildings) | 3,120,000 |
| Packaging machine | 2,625,000 |
| Milling machine | 2,580,000 |
| Crashing machine | 2,760,000 |
| Fork lifts | 1,290,000 |
| Farm tractors | 5,850,000 |
| Lorry | 1,800,000 |
| Saloon car | 585,000 |
| Delivery van | 1,350,000 |
| Furniture, fittings and partitions | 408,000 |
| Land at cost | 15,000,000 |

The building in use was constructed at a cost of Sh. 10,200,000 but its value after construction was estimated at Sh.12,600,000 by a professional valuer. In year 2006, the company bought the following assets:

| | Sh. |
|---|---|
| Tractor | 2,655,000 |
| Lorry | 3,900,000 |
| Toyota-Land-Cruiser | 2,025,000 |
| Furniture | 210,000 |
| Partitions | 408,000 |
| Land | 4,680,000 |
| 3 computers | 450,000 |

The following assets were disposed off in Year 2006:

| | |
|---|---|
| Forklift | 360,000 |
| Saloon car | 690,000 |

**Required:**

(a) Compute the capital allowances for the company for the years 2005 and 2006. (18 marks)
(b) Comment on any information not used in (a) above. ( 2 marks)
**(Total: 20 marks)**

## QUESTION FIVE

(a) Name and briefly explain four major principles of a good tax system. (16 marks)
(b) Write brief notes on housing benefit. (4 marks)
**(Total: 20 marks)**

## TAXATION I
## DECEMBER 2009

**Answer ALL questions. Marks allocated to each questions are shown at the end of the question. Show ALL your workings. Any assumptions made must be stated.**

## QUESTION ONE

(a) Explain the meaning of the following terms as used in respective tax legislation:

| | |
|---|---|
| Bond security | ( 2 marks) |
| Single business permit | ( 2 marks) |
| Customs bonded warehouse | ( 2 marks) |
| Stamp duty | ( 2 marks) |
| Tax free remuneration | ( 2 marks) |

(b) Ukulima Savings and Co-operative Society Ltd. has presented you with the following income and expenditure account for the year ended 31 December 2005:

| | Sh. | Sh. |
|---|---|---|
| Income | | 2,252,500 |
| Rental income | | 424,000 |
| Investment income – dividends | | 5,750,500 |
| Interest from loans to members | | 747,300 |
| Interest from Savings and Loans Kenya Ltd. | | 9,174,300 |
| Expenses | | |
| Traveling | 443,875 | |
| Printing and stationery | 236,910 | |
| Legal expenses | 132,500 | |
| Medical expenses for staff | 271,625 | |
| Salaries and wages | 4,253,350 | |
| General office expenses | 100,000 | 5,438,260 |
| Net income | | 3,736,040 |

**Required:**

(i) The taxable income for the year and tax payable. ( 8 marks)
(ii) Comment on any information not used in (i) above. ( 2 marks)
**(Total: 20 marks)**

## QUESTION TWO

Mr. Kipkoech, a wealthy farmer from Uasin Gishu District has presented you with the following profit and loss account for the year of income 2005.

| | Sh. | Sh. |
|---|---|---|
| Income | | 800,000 |
| Disposal of entire poultry stock | | 3,000,000 |
| Sale of other livestock and produce | | 1,500,000 |
| Sale of all standing timber | | 175,000 |
| Dividends from Uasin Dairy Society (net) | | 80,000 |
| Interest from Co-operative Bank (net) | | 5,555,000 |

| | Sh. | Sh. |
|---|---|---|
| Expenditure | | |
| Clearing bush land for planting coffee | 250,000 | |
| Capital works to prevent soil erosion | 240,000 | |

| | | |
|---|---|---|
| Purchase of pigs to replace the poultry | 575,000 | |
| Wages of labourers | 465,000 | |
| Wages of housegirl | 60,000 | |
| Purchase of seeds and fertilizers | 590,000 | |
| Rent of shed to store harvested crop | 135,000 | |
| Motor vehicle expenses | 96,000 | |
| Repairs to fence, dips and dairy shed | 88,000 | |
| Subscriptions to Usasin gishu sports Club | 60,000 | |
| Interest paid to bank on loan to finance planting | 84,000 | |
| Hailstorm damage to pyrethrum crop (insured) | 240,000 | |
| Insurance premiums against crop damage | 80,000 | |
| Depreciation: | | |
| Dairy machines | 120,000 | |
| Tractors and lorries | 420,000 | |
| Salary of Mrs. Kipkoech | 144,000 | |
| Hire of pick-up for farm deliveries | 68,000 | |
| School fees for son | 120,000 | |
| Life insurance premium for Mr. Kipkoech | 40,000 | 3,875,000 |
| Net profit before tax. | | 1,680,000 |

Mr. Kipkoech has provided the following additional information:

1. During the year he sold all his poultry on changing over to pig-farming.
2. He disposed of all his standing timber during the year.
3. Farm produce consumed by his family amounted to sh.110,000 during the year.
4. He received a salary from the local co-operative society for work as a management chairman, amounting to Sh.15,000 per month.
5. His wife works in the farm as a manager. She is paid Sh.12,000 per month. The family lives in the farmhouse.
6. The record of fixed assets is as follows:

| | Original cost | Year of purchase |
|---|---|---|
| Farmworks | Sh. | |
| Farmhouse | 2,000,000 | 1988 |
| Dairy building | 400,000 | 1999 |
| Fences, dips and dams | 800,000 | 1998 |
| Planted wind breaks | 120,000 | 2000 |
| Labour quarters | 360,000 | 1998 |
| Machinery | | |
| Tractor | 850,000 | 1999 |
| 10 ton lorry | 2,500,000 | 1999 |
| Dairy machinery | 960,000 | 2000 |
| Others | | |
| Standing timber | 800,000 | 1995 |
| Farm land | 7,200,000 | 1995 |

**Required:**

(a) The adjusted taxable farming income for Mr. Kipkoech. (18 marks)

(b) Mr. Kipkoech"s tax liability for the year 2005. ( 2 marks)

**(Total: 20 marks)**

## QUESTION THREE

Mr. Lewis Duncan is a director of Lewin Ltd., a manufacturing company in which he owns 20% of the issued and fully paid up capital. He earns a fixed salary of Sh.1,500,000 per month. For the year commencing 1 January 2006, the board of directors evaluated him and considered various additional means of remunerating him given his excellent performance. The chairman of the board has written to you seek your opinion on the proposals before any of them can be adopted.

1. Giving him a housing loan of Sh.1,000,000 at an interest rate of 5% per annum repayable over a ten year period. Interest for the year will be computed on the loan balance due on 31 December each year. Mr. Duncan would be required to occupy his own house from the date of receiving the loan from the company. He is currently housed by the company.

2. Issuing him 1,000 redeemable preference shares of sh.10 par value for free in recognition of his dedicated and loyal service to the company. The market price of these shares is currently estimated at sh.50 each.

3. Providing him with a fully maintained company car of 2000 cc which was bought in the year 2000 for Sh.600,000 instead of the current mileage allowance of Sh.6,000 per month.

4. Increasing the company"s contribution to the unregistered Executive Provident Fund from 5% to10% of his basic salary per annum.

5. Paying his medical bills and those of his family directly to the doctor instead of the current system where he has to pay the doctor and then claim a reimbursement from the company. He is also entitled to claim a maximum of Sh.30,000 per annum. His normal medical bills are approximately Sh.40,000 per annum. The company has a medical scheme for directors and executive staff.

**Required:**

(a) Discuss the above proposals with regard to their income tax implications. (18 marks)
(b) Advise the board on the best alternative to ensure Mr. Lewis Duncan stays motivated to work. ( 2 marks)

## QUESTION FOUR

Omondi, Onyango and Kimani are partners operating a wholesale shop in Kisumu. They share profits and losses in the ratio 2:2:1 respectively. During the year ended 31 December 2005, the partners reported a loss of Sh.10,325,000 after deducting the following:

| | | Sh. |
|---|---|---|
| Interest on capital: | Omondi | 406,000 |
| | Onyango | 406,000 |
| | Kimani | 609,000 |
| Motor vehicle running expenses | | 532,000 |
| Office expenses | | 420,000 |
| Goodwill | | 700,000 |
| Repairs and maintenance | | 168,000 |
| Loss on investment | | 55,000 |
| Postage and telephone | | 297,500 |
| Water and electricity | | 238,000 |
| Salaries and wages | | 1,246,000 |
| Donations to charitable institutions | | 525,000 |
| Subscriptions to KNCCI (Trade Association) | | 224,000 |
| Bad debts expense | | 605,500 |
| Rent, rates and licences | | 280,000 |
| Professional fees | | 760,000 |
| Depreciation | | 960,000 |
| Purchase of lorry | | 2,329,250 |
| Salary to partners | Omondi | 700,000 |
| | Onyango | 735,000 |
| | Kimani | 1,008,000 |

**Additional information:**

1. Office expenses included cost of office cabinet of Sh.192,500.
2. The partnership received dividends amounting to Sh.462,000 (net) from various stocks held in different companies. This was excluded from the above computation.
3. The partnership received Sh.910,000 being insurance recovery for stocks which were destroyed by fire in 2004. This was omitted in arriving at the reported loss above.
4. Motor vehicle running expenses included Sh.21,000 per month related to personal travel by the partners.
5. Provision for bad and doubtful debts account for the year was as follows:

| | **Sh.** | | **Sh.** |
|---|---|---|---|
| Bad debts written off | 430,500 | General brought forward | 577,500 |
| Specific carried forward | 336,000 | Specific brought forward | 266,000 |
| General carried forward | 682,500 | Profit and loss account | 605,500 |
| | 1,449,000 | | 1,449,000 |

6. Omondi had taken goods worth Sh.122,500 for his own use. This was not recorded in the books of account.
7. Included in repairs and maintenance is Sh.140,000 paid for office partitions during the year.
8. The partners had other incomes as follows:

| | **Omondi** | Onyango | **Kimani** |
|---|---|---|---|
| | **Sh.** | **Sh.** | **Sh.** |
| Rent (net) | 200,000 | - | 350,000 |
| Farming income | - | 750,000 | (745,000) |
| Interest (net) | 191,250 | 81,600 | - |
| | 391,230 | 831,600 | (495,000) |

9. Capital allowances have been agreed with the Commissioner at Sh.906,000.

**Required:**

(a) The taxable profit/(loss) for the partnership business for the year 2005. ( 8 marks)
(b) Show the allocation of the profit/(loss) among the partners. ( 6 marks)
(c) Compute tax payable by each partner. ( 6 marks)

## QUESTION FIVE

(a) Recently, traders opposed a move by Kenya Revenue Authority requiring them to keep stock records on a daily basis arguing that it would result in increased cost of compliance. However, upon review of the VAT Act, one realizes that record keeping in general has all along been part of the VAT regulations.

List down ten examples of records that must be kept for purposes of accounting for VAT. (10 marks)

(b) Under the VAT regulations, taxable value of supplies is the price at which the goods are provided.

**Required:**

Calculate the value for VAT and the amount of VAT under each of the following circumstances:

(i) Kucheza Limited imported computers valued at Sh.1,500,000. A duty of 20% was charged by the customs department. ( 2 marks)

(ii) ART (K) Ltd. sold a fridge by hire purchase. The cash price was Sh.96,000 while the hire purchase price was Sh.165,000 with a 20% down payment plus 20 monthly instalments of Sh.6,600. ( 2 marks)

(iii) The price of a motor car was Sh.2,500,000. A cash discount of 20% was allowed to Peter when he bought the vehicle. ( 2 marks)

(iv) Ernest and Kamau, a professional accounting firm provided free accountancy and auditing services to the bomb blast project. This project, a charitable undertaking, was initiated to help victims of the 1998 bomb blast. The value of the services provided is estimated at Sh.2,400,000. ( 2 marks)

(v) ABC Ltd. purchased goods worth Sh.1,200,000 from Colour Packaging Ltd. This excluded cost of packaging and transportation charged by Colour Packaging Ltd. amounting to Sh.96,000. ( 2 marks)

**(Total: 20 marks)**

**TAXATION I**
**MAY 2010**

**Answer ALL questions. Marks allocated to each questions are shown at the end of the question. Show ALL your workings. Any assumptions made must be stated.**

## QUESTION ONE

(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. (15 marks)

**(Total: 20 marks)**

## QUESTION TWO

(a) Explain the reasons why, for a particular year of income, the total income received is usually different from total taxable income. ( 4 marks)

(b) Mr. Somji Patel is a mechanical engineer by profession. He has provided you with the following details of his income for the year 2005.

1.

| | **Sh.** | **Sh.** |
|---|---|---|
| Practice fees | | 2,820,000 |
| Less expenditure: | | |
| Salary to support staff | 216,000 | |
| Salary to self | 1,560,000 | |
| Interest on bank loan | 135,000 | |
| Repayment of bank loan | 480,000 | |
| Stationery and postage | 84,000 | |
| Rent | 408,000 | |
| Traveling expenses | 72,000 | |
| Subscription to the Engineers Institute | 10,000 | |
| Single business permit | 20,000 | 2,985,000 |
| Practice loss | | (165,000) |

PAYED on salary to self of Sh.444,600 has been paid to the Income Tax Department.

2. Mr. Somji Patel previously worked for KK Engineers until 31 December 2004 when he proceeded on terminal leave for six months ending 30 June 2005. During the period of terminal leave, the company paid him a salary of sh.120,000 per month and provided him with a free house. The company recovered a nominal 5% of his basic salary towards his housing. The house has a market rental value of Sh.30,000 per month. PAYE of Sh.34,000 was deducted from his salary and paid to the Income Tax Department every month.

3. KK Engineers provides a generous pension scheme and Mr. Patel retired on 30 June 2005 with a pension of Sh.18,000 per month. PAYE of sh.2,500 is deducted from the pension every month.

4. Mr. Somji Patel owned 30,000 shares of Barclays Bank of Kenya Ltd. The Company paid him a dividend of Sh.150,000 (net) in 2005.

5. In July 2005, he obtained a loan from Kenya Building Society and purchased a house at a cost of Sh.2,400,000 in Buruburu which he occupied immediately. By the end of the year 2005, he had paid mortgage interest amounting to Sh.180,000.

6. Mrs. Patel is a nurse at Tender Care hospital earning a salary o Sh.30,000 per month. (PAYE of Sh.4,860 per month was deducted).

**Required:**

(i) Compute Mr. Patel"s taxable income of the year 2005. ( 8 marks)
(ii) Compute the income tax payable for the year 2005. ( 4 marks)
(iii) when is the tax you have computed in (ii) above payable? ( 1 mark)
(iv) Comment on any information you have not used or any assumptions you have made. ( 3 marks)

**(Total: 20 marks)**

**QUESTION THREE**

(a) State and explain the VAT position on:

(i) Security on property for unpaid tax. ( 4 marks)
(ii) Relief because of doubt or difficulty in recovery of VAT. ( 2 marks)

(b) Lusweti Kamau operates an electronics shop along Luthuli Avenue in Nairobi. He undertook the following transactions for the month of March 2006:

| | |
|---|---|
| 1 March 2006 | Purchased 10 cameras for a total of Sh.500,000 |
| 4 March 2006 | Purchased flashbulbs for a total of Sh.200,000 |
| 4 March 2006 | Purchased 5 slide projectors for a total of sh.1,000,000 |
| 5 March 2006 | Sold 5 cameras each at 25% above cost price. |
| 6 March 2006 | Purchased 200 wrist-watches at Sh.1,500 each. |
| 8 March 2006 | Sold 2 slide projectors for a total of Sh.500,000. |
| 9 March 2006 | Sold flashbulbs that cost sh.100,000 for Sh.150,000. |
| 12 March 2006 | Purchased 50 stop watches for a total of Sh.50,000 |
| 15 March 2006 | Purchased 100 alarm clocks at a total value of sh.80,000 |
| 18 March 2006 | Sold the remaining 5 cameras each at 25% above cost price. |
| 20 march 2006 | Sold 3 slide projectors for a total of sh.750,000. |
| 22 March 2006 | Sold 100 wrist-watches at sh.2,000 per watch. |
| 25 March 2006 | Sold 70 alarm clocks each at 30% above cost. |
| 27 March 2006 | Sold 500 stop watches for a total of Sh.75,000. |

**Required:**

(i) Given that the prices are inclusive of VAT, calculate Mr. Lusweti Kamau"s:
Input Tax. ( 5 marks)
Output Tax. ( 5 marks)

(ii) Prepare the VAT account for Mr. Lusweti Kamau clearly showing the VAT (refundable). ( 2 marks)
(iii) State when the above tax is due, and the penalties payable if the tax is not paid on the due date. ( 2 marks)

**(Total: 20 marks)**

**QUESTON FOUR**

(a) Write brief notes on the following:
(i) Taxation of companies operating in export processing zones. ( 3 marks)
(ii) Taxation of members" clubs. ( 3 marks)

(b) flora Ltd. has been in the flower business for many years. The company"s profit and loss account for the year ended 31 December 2005 is as follows:

| | Sh. | Sh. |
|---|---|---|
| Sales | | 29,489,600 |
| Less: Cost of sales | | 20,902,400 |
| Gross profit | | 8,587,200 |
| **Less expenses:** | | |
| Salaries and wages | 4,543,200 | |
| Shop expenses (rent, rates, lighting and telephone | 1,708,800 | |
| Printing and stationery | 89,600 | |
| Motor vehicle expenses | 332,000 | |
| Depreciation – motor vehicle | 96,000 | |
| Legal expenses | 99,200 | |
| Redundancy payments to retrenchment staff | 46,400 | |
| Sundry expenses (all allowable) | 144,800 | |
| Bad and doubtful debts | 44,800 | |
| Loss on sale of motor van | 36,000 | 7,140,800 |
| | | 1,446,400 |
| Dividend received from XYZ Ltd. | | 102,400 |
| Net profit | | 1,548,800 |

**Additional information:**

1. Capital allowances have been agreed with the Commissioner of Income Tax at Sh.84,000.

2. The Ledger account for bad and doubtful debts for the year is as follows:

Bad and doubtful debts

| | Sh. | | Sh. |
|---|---|---|---|
| Debts written off: | | Balances brought forward: | |
| Customers | 31,200 | General provision | 14,400 |
| Staff | 1,600 | Specific provision | 21,600 |
| Balances carried forward: | | Bad debts recovered | |
| General provision | 24,000 | (previously allowed) | 4,000 |
| Specific provision | 84,800 | Profit and loss account | 44,800 |
| | 84,800 | | 84,800 |

3. Legal expenses consist of:

| | Sh. |
|---|---|
| Advice on staff service contracts | 23,200 |
| Tax appeals | 38,400 |
| Debt collection | 37,600 |
| | 99,200 |

**Required:**

Compute the adjusted taxable profit or loss for Flora Limited for the year 2005. (8 marks)
Calculate the tax payable thereon. (2 marks)
If Flora Limited paid instalment tax by the due dates, when is the final tax for 2005 payable? ( 2 marks)

Assume that the management of Flora Limited neither paid the tax in (iii) above on the due date nor submitted the self assessment return as required. What are the consequences of this action? ( 2 marks)

**(Total: 20 marks)**

## QUESTION FIVE

Simon and Peter have been trading as partners under the name Simope Enterprises, sharing profits and losses equally. They manufacture motor vehicle accessories for local and overseas markets.

They have provided you with the following information in relation to their trading results for the year ended 31 December 2005.

1. They reported a net profit of sh.7,000,000 after charging the following expenses:

| | **Sh.** |
|---|---|
| Salaries and wages | 640,000 |
| Repairs and maintenance | 325,000 |
| Bad debts written-off | 120,000 |
| Office expenses | 605,000 |
| Staff welfare costs | 72,000 |
| Partners" salaries | |
| Simon | 750,000 |
| Peter | 900,000 |
| Travelling expenses | 120,000 |
| Interest on capital | |
| Simon | 200,000 |
| Peter | 160,000 |
| Depreciation | 265,000 |
| Interest on bank overdraft | 96,000 |

2. Dividends were received from the following companies:

| | | **Sh.** |
|---|---|---|
| BAT Ltd. | - | 285,000 |
| Barclays Bank Ltd. | - | 120,000 |
| Firestone Ltd. | - | 60,000 |

3. Details of assets are as follows:

As at 1 January 2005, the written down values of assets brought forward for income tax purposes were as follows:

| Factory building | Class I | Class II | Class III | Class IV |
|---|---|---|---|---|
| **Sh.** | **Sh.** | **Sh.** | **Sh.** | **Sh.** |
| 18,000,000 | 1,093,750 | 3,125,000 | 2,187,500 | 2,980,000 |

Additions during the year:

| | **Sh.** |
|---|---|
| Machinery | 500,000 |
| Fax machine | 45,000 |
| Photocopier | 180,000 |
| Computers | 250,000 |
| Saloon car | 1,150,000 |
| Factory building | 2,400,000 |

Disposals during the year:

| | Class I | Class II | Class III | Class IV |
|---|---|---|---|---|
| | **Sh.** | **Sh.** | **Sh.** | **Sh.** |
| Cost | 650,000 | 175,000 | 300,000 | 400,000 |
| Net book value | 200,000 | 40,000 | 75,000 | 150,000 |
| Sale proceeds | 760,000 | 96,000 | 250,000 | 100,000 |

The old factory building was constructed in 2000 and put into use with effect from 1 January 2001. the additional building was brought into use from 1 July 2005.

**Required:**

(a) Capital allowances due to Simope Enterprises for the year 2005. (10 marks)

(b) Taxable profit (or loss) for the partnership and show its division among the partners. ( 5 marks)

(c) Tax payable by each partner ( 4 marks)

Comment on any information you have not used. ( 1 mark)

**(Total: 20 marks)**

## TAXATION I
## DECEMBER 2010

**Answer ALL questions. Marks allocated to each questions are shown at the end of the question. Show ALL your workings. Any assumptions made must be stated.**

## QUESTION ONE

(a) Differentiate between the low interest benefit tax and the fringe benefits tax. ( 4 marks)

(b) with reference to the provisions of the Income Tax Act, identify four methods which the Commissioner of Income Tax is empowered to use in order to collect overdue tax from a taxpayer. ( 4 marks)

(c) With the introduction of the self-assessment system in 1992, the Commissioner of Income Tax does not raise assessments or send notices to taxpayers except in two circumstances.

Explain these two circumstances. ( 4 marks)

(d) List six matters that are contained in a notice of assessment. ( 6 marks)

(e) What is "stamp duty"? ( 2 marks)

**(Total: 20 marks)**

## QUESTION TWO

Mobile Options Ltd. is a distributor of mobile phones and accessories. The profit and loss account for the year ended 31 December 2005 is as follows:

| | Sh. | | Sh. |
|---|---|---|---|
| Purchases | 12,000,000 | Sales | 18,000,000 |
| Salaries and wages | 2,000,000 | Discounts | 400,000 |
| Rent and rates | 125,000 | Insurance recovery | 180,000 |
| Distribution and office expenses | 480,000 | Profit on sale of assets | 240,000 |
| Traveling and subsistence | 336,000 | Provision for bad debts | 80,000 |
| Subscriptions | 50,000 | | |
| Licences and permits | 200,000 | | |
| Legal fees | 436,000 | | |
| Depreciation | 670,000 | | |
| Audit fees | 130,000 | | |
| Loss on sale of assets | 240,000 | | |
| Bank charges and interest | 96,000 | | |
| Bad debts | 415,000 | | |
| Discounts | 336,000 | | |
| Repairs and maintenance | 705,000 | | |
| Net profit | 681,000 | | |
| | 18,900,000 | | 18,900,000 |

**Notes:**

1. Distribution and office expenses include the following:

| | Sh. |
|---|---|
| Subscriptions to Wananchi sports Club for employees" benefit | 180,000 |
| Directors" personal expenses | 96,000 |
| Donations to charity | 50,000 |

2. 15% of rent and rates relate to payments in connection with directors" private residences.

3. Insurance recovery is in connection with mobile phones stolen while on transit to a client.
4. Bad debts provision represents a reduction in the general provision for bad debts.
5. Legal fees include the following:

| | Sh. |
|---|---|
| Debt collection | 80,000 |
| Employment contracts | 60,000 |
| Acquisition of trade mark | 120,000 |
| Renewal of lease – 50 years | 60,000 |
| Legal suit in relation to counterfeit Handsets found in the company"s warehouse | 116,000 |
| | 436,000 |

6. Subscriptions are to the Mobile Phone Dealers Association.
7. Licences and permits represents sh.150,000 paid to the Communications Commission of Kenya (CCK) and Sh.50,000 relates to the single business permit paid to the Nairobi city Council.
8. Repairs and maintenance include an extension to the warehouse at a cost of Sh.450,000.
9. Travelling expenses include sh.240,000 incurred by the sales manager when he traveled to South Africa to attend a mobile phones and accessories trade fair.
10. Capital allowances have been agreed with the Commissioner of Income Tax at Sh.860,000.

**Required:**

(a) Compute Mobile Options Ltd."s taxable profit or loss for the year ended 31 December 2005. (12 marks)

(b) Compute the tax payable thereon. ( 2 marks)

(c) Assuming that Mobile Options Ltd."s tax liability for the year ended 31 December 2004 wassh.800,000, indicate the due dates for the tax you have computed in (b) above showing the amounts payable. ( 4 marks)

(d) Compute the penalties payable by Mobile Options Ltd. if the company paid the tax of Sh.800,000 in (c) above on 30 November 2005. ( 2 marks)

**(Total: 20 marks)**

## QUESTION THREE

(a) Mr. Hassan Ali"s contract of employment with Kenwide Ltd. which was to run for five years wasterminated on 31 December 2005 after the contract had run for three years. A compensation of sh.960,000 which had been stipulated in his contract was paid. His salary, as at the date of termination was sh.30,000 per month.

**Required:**

(i) Compute the income assessable on Mr. Hassan ali and indicate the year(s) to which the income relates. ( 2 marks)

(ii) Assuming that Mr. Hassan Ali"s contract did not provide for payment of compensation nor the contract period, what income would be assessable on him and in which years? ( 2 marks)

(iii) Compute the tax payable by Mr. Hassan Ali in (i) above. ( 4 marks)

(iv) When is the tax you have computed in (iii) above payable? ( 2 marks)

(b) (i) Recently Kusoma Institute underwent a PAYE audit by the Kenya Revenue Authority (KRA) auditors after which penalties amounting to sh.1,000,000 were levied.
Explain the circumstances that might have triggered the PAYE audit at Kusoma Institute. ( 5 marks)

(ii) The income of educational institutions is exempt from tax. What would be the tax implications of a proposal to pay school fees for the children of junior staff who qualify for university admission? ( 2 marks)

(iii) List three "unique" disallowable expenses against partnership income. ( 3 marks)

**(Total: 20 marks)**

## QUESTION FOUR

You are provided with the following information concerning Bimak Ltd., a company that makes its accounts to 31 December every year.

The company bought an industrial building from Mr. Kujenga at a cost of Sh.20,000,000 in 2002. Mr. Kujenga had constructed the building in 2001 at a cost of Sh.16,600,000 which included the cost of land amounting to Sh.4,000,000, a canteen for workers for Sh.2,400,000, showroom costing Sh.600,000 and offices costing Sh.1,500,000. The building however, had not been put into any use in 2002.

In the same year, Bimak Ltd. made the following additions to the building:

A warehouse at a cost of Sh.3,600,000
Labour quarters costing sh.2,400,000
Extension to the factory building to accommodate machines at a cost of Sh.4,200,000.

Before commencing manufacturing on 1 July 2003, Bimak Ltd. acquired the following additional assets:

| | | |
|---|---|---|
| Processing machinery | - | Sh.5,200,000 |
| Labour Cruiser | - | Sh.1,200,000 |
| A three ton lorry | - | Sh.2,600,000 |
| A tractor | - | Sh.3,600,000 |
| Furniture and fittings | - | Sh.1,200,000 |

Bimak Ltd. converted one of the director"s Mercedez Benz vehicles into company"s use. It was valued at Sh.1,500,000 and was used entirely for the company"s business.

| | | |
|---|---|---|
| Computers | - | Sh.1,600,000 |
| Photocopier | - | Sh. 240,000 |
| Saloon car | - | Sh.1,200,000 |

In the year 2004, Bimak Ltd continued expanding and acquired/constructed the following:

Additional processing machinery - Sh.2,400,000
An additional factory extension was constructed at a cost of sh.4,600,000 which included an administrative office costing Sh.1,000,000. These were brought into use with effect from 1 September 2004.
A fire exit was also constructed at a cost of Sh.900,000 and brought into use on 1 July 2004.

The management disposed of the following assets in the year 2000:

Processing machinery Sh.1,200,000
One of the computers purchased in 2003 for sh.120,000 was traded in with another one valued at Sh.300,000. The trade-in-value was sh.150,000.
The Mercedez Benz was disposed of at Sh.600,000.

In the year 2005, Bimak Ltd. decided to strengthen the security at the factory by building a stone perimeter fence at a cost of Sh.1,800,000. This was brought into use with effect from 1 June 2005. The company bought a Range Rover for the Chief Executive at a cost of Sh.2,400,000.

**Required:**

(a) Bimak Ltd."s capital allowances for each of the years ended 31 December 2003, 2004 and 2005. (16 marks)

(b) Obtain the written down values of the assets as at 31 December 2001. ( 4 marks)

**(Total: 20 marks)**

## QUESTION FIVE

(a) With reference to the tax legislation in your country, write brief notes on the following:

(i) Import declaration form. ( 3 marks)
(ii) Reverse charge. ( 3 marks)
(iii) Refund of duty paid on imported goods. ( 3 marks)

(b) ABC Ltd imported goods from Dubai whose landed value was Sh.2,450,000. Duty is chargeable on them at the rate of 20%. Other charges include a provision for transport to the company premises amounting to Sh.110,000 and a commission of 5% of dutable value to the clearing agent. VAT was charged on the goods at the standard rate (16%).

**Required:**

Determine the amount of VAT payable. ( 3 marks)

(c) Akuru and Associates is a firm of Certified Public Accountants. During the month of December 2005, the firm provided accountancy, audit and tax consultancy services to XYZ Ltd. and charged the following fees:

| | | Sh. |
|---|---|---|
| Accountancy | - | 120,000 |
| Audit | - | 240,000 |
| Tax consultancy | - | 180,000 |

VAT was charged at the rate of 16%.

**Required:**

(i) Prepare a tax invoice as per the requirements of the VAT Act and regulations for XYZ Ltd. (5 marks)

(ii) Prepare a VAT account for Akuru and Associates, assuming that they did not perform any other professional assignments in December 2005. However, they bought stationery worth Sh.75,520, inclusive of VAT and paid an electricity bill which included Sh.7,210 VAT. (3 marks)

**(Total: 20 marks)**

**TAXATION 1**
**JUNE 2011**

**QUESTION ONE**

(a) Briefly explain the rationale behind the "benefit theory" of taxation. ( 4 marks)

(b) What problems are experienced in attempting to achieve justice in taxation? Support your answer with the four main theories which explain why it is difficult to exercise justice in taxation. (12 marks)

(c) Giving appropriate examples, differentiate between customs duty and excise duty. ( 4 marks)
**(Total: 20 marks)**

**QUESTION TWO**

Andrew Ndwiga practices mixed farming and closes his books on 31 December every year. He has provided the following income and expenses summary for the year ended 31 December 2005:

| | |
|---|---|
| **Income:** | **Sh.** |
| Sale of milk to Maziwa Dairies | 547,500 |
| Sale of vegetables | 365,000 |
| Sale of broilers to Chicken World Ltd. | 2,575,000 |
| Sale of sheep and heifers | 380,000 |
| Sale of firewood | 165,000 |
| Total income | 4,032,500 |
| | |
| **Expenses:** | |
| Fertilizers | 90,000 |
| Pesticides | 55,000 |
| Seeds | 36,000 |
| Planting of tea seedlings | 111,000 |
| Motor vehicle expenses (Pick-up) | 180,000 |
| Insurance for farm works | 69,000 |
| Agricultural shows for employees | 133,000 |
| Salaries and wages for employees | 420,000 |
| Vaccines for livestock | 88,000 |
| Electricity and water | 66,000 |
| Purchase of chicks | 585,000 |
| Animal feeds | 675,000 |
| Wood shavings and saw dust (for poultry) | 24,000 |
| Construction of water storage tank | 235,000 |
| Construction of chicken sheds | 900,000 |
| Loan repayment – Wakulima Farmers SACCO Ltd. | 312,000 |
| Interest on loan – Wakulima Farmers SACCO Ltd. | 106,800 |
| Repairs on dairy sheds and fences | 156,000 |
| Subscriptions to Starehe sports Club | 60,000 |
| Value of goats killed by a leopard | 110,000 |
| Wages for Ndwiga"s housegirl | 33,600 |
| Ndwiga"s personal accident insurance cover | 23,000 |
| Bad debt written off – Shambani Stores Ltd. (in receivership) | 77,500 |
| School fees for Mr. Ndwiga"s children | 300,000 |
| Depreciation – motor vehicles | 85,500 |
| Total expenses | 4,931,400 |
| Net loss | (898,900) |

**Additional information:**

1. Insurance for farm works includes cover for Ndwiga"s household items amounting to sh.19,000.
2. Mr. Ndwiga received sh.25,000 dividend, net of withholding tax from Majani Ltd.
3. Farm produce consumed by Mr. Ndwiga"s family was valued at Sh.265,000.
4. Mr. Ndwiga received Sh.135,000 from the local farmers" co-operative society as consultancy fees. The farmers" co-operative society uses his farm as a demonstration farm for training other farmers.
5. Salaries and wages include sh.100,000 paid to Ndwiga"s wife.
6. Capital allowances for the year ended 31 December 2005 have been agreed with the Commissioner of Income Tax at Sh.196,400.

**Required:**

(a) Mr. Ndwiga"s taxable income for the year ended 31 December 2005. (16 marks)
(b) Tax payable on taxable income computed in (a) above. ( 4 marks)

**(Total: 20 marks)**

**QUESTION THREE**

(a) Explain the basic principles followed in the taxation of the income of cooperative societies. ( 4 marks)

(b) With reference to the provisions of the VAT Act, write brief notes on the following:

(i) Bad debt relief. ( 2 marks)
(ii) Deregistration of taxable persons ( 2 marks)
(iii) Goods in stock ( 2 marks)

(c) The following information relates to the transactions of Communication Solutions Ltd. for the month of September 2005. The company is registered for VAT.

| | |
|---|---|
| 2 September | Purchased goods worth sh.2,400,000 from Japan. Customs duty was paid at 5%. |
| 2 September | Sold goods to Mobile Connections Ltd. for Sh.960,000 on credit. Goods worth sh.60,000 were found to be defective and were returned. |
| 5 September | Purchased office furniture for Sh.640,000. One desk worth sh.80,000 was defective and was retuned to the seller. |
| 9 September | Purchased office furniture for Sh.4,500,000 on credit from a manufacturing company. Goods worth sh.500,000 were damaged in transit and were thus not saleable. It cost the company sh.240,000 to transport the goods. |
| 10 September | Sold goods for cash worth Sh.960,000 |
| 12 September | Exported goods worth sh.2,400,000 |
| 16 September | Imported goods worth sh.1,500,000 from India. Customs duty was paid at 5% |
| 20 September | Sold goods worth sh.218,000 to XYZ Ltd. |
| 25 September | Exported goods worth Sh.2,600,000 to Kimbo ltd. |
| 30 September | Paid the following expenses for the month of September: |

Sales and wages – Sh.1,400,000
Electricity - Sh.48,000
Telephone - Sh.36,000
Water - Sh.10,000

**Note: Where applicable, prices are quoted inclusive of VAT.**

**Required:**

The VAT payable (or refundable) for the month of September 2005. (10 marks)

**(Total: 20 marks)**

## QUESTION FOUR

(a) Using two examples in each case, differentiate between allowable and non-allowable expenses under the Income Tax Act. ( 4 marks)

(b) The directors of PQR Limited have presented you with the following profit and loss account for the year ended 31 December 2005:

| | Sh. | Sh. |
|---|---|---|
| Gross profit | | 29,826,000 |
| Less: Operating expenses | | |
| Salaries and wages | 8,000,000 | |
| Reserves for contingencies | 1,580,000 | |
| Hire purchase interest | 413,000 | |
| Laundry expenses | 434,000 | |
| Legal and professional fees | 400,000 | |
| Depreciation | 2,450,000 | |
| Dividends paid | 1,600,000 | |
| Repairs and maintenance | 872,000 | |
| Insurance premiums | 320,000 | |
| VAT paid | 168,000 | |
| Bad and doubtful debts | 228,000 | |
| Advertising | 1,200,000 | |
| Bank charges | 170,000 | |
| Water and electricity | 1,200,000 | |
| Rent and rates | 3,020,000 | |
| Subscriptions and donations | 371,000 | |
| Telephone and postage | 1,204,000 | |
| Sundry expenses | 600,000 | |
| Motor vehicle running expenses | 2,300,000 | 26,530,000 |
| Net profit | | 3,296,000 |

**Additional information:**

1. Salaries and wages include Sh.66,000 paid to the Income Tax Department as penalties and interest on delayed submission of PAYE deductions.

2. Hire purchase interest relates to loans obtained to purchase a delivery van sh.146,000 and the Chairman"s personal car Sh.267,000.

3. The company directors and senior managers are given free laundry services at the company"s laundry. The cost of cleaning their personal clothing for the year ended 31 December 2005 was sh.133,000.

4. Legal and professional expenses include sh.146,000 incurred while defending the Managing Director in a private suit against him.

5. Repairs and maintenance include the cost of acquiring a second hand laundry machine for sh.167,000.

6. Bad and doubtful debts are made up of a 10% general provision against the debtors balance as at 31 December 2005 and a full provision of Sh.93,000 owed by Orient Finance Ltd. that has been placed under receivership. The debtors balance as at 31 December 2005 was Sh.1,350,000.

7. Subscriptions and donations comprise:

| | Sh. |
|---|---|
| Subscription to Rhino golf Club for the Managing Director | 260,000 |
| Subscription to the Chamber of Manufacturing and Commerce | 63,500 |
| Donation of books to the Watoto School for the Handicapped | 35,000 |
| Annual subscription for Finance Manager paid to the Institute of Certified Public Accountants of Kenya | 12,500 |

8. Sundry expenses include sh.263,000 paid to Health Africa for the Managing Director"s medical cover. He is the only one in the company covered by the medical scheme.

9. Wear and tear allowances for the year ended 31 December 2005 have been agreed at Sh.4,320,000.

**Required:**

(i) PQR Ltd."s adjusted profit (or loss) for tax purposes for the year ended 31 December 2005. (14 marks)

(ii) Corporation tax (if any) payable by PQR Ltd. for the year ended 31 December 2005. ( 2 marks)

**(Total: 20 marks)**

## QUESTION FIVE

On 1 January 2003, Patel Manufacturers Limited commenced business at Eldoret Municipality with the following assets:

| | **Sh.** |
|---|---|
| Goodwill | 600,000 |
| Land | 24,000,000 |
| Buildings (industrial) | 51,000,000 |
| Plant fixed to the buildings | 7,200,000 |
| Heavy duty fork lifts | 4,950,000 |
| Three transit goods prime movers | 5,910,000 |
| Mitsubishi Pajero vehicle for use by the Managing Director | 3,960,000 |
| Peugeot 504 pick-up | 1,750,000 |
| Security wall | 1,200,000 |
| Workers quarters | 18,000,000 |
| Boilers | 6,000,000 |
| Furniture and fittings | 3,600,000 |
| Milling machines | 37,500,000 |

**Additional information:**

1. The following assets were acquired in the year ended 31 December 2004:

| | **Sh.** |
|---|---|
| V W Passat car for the Finance Manager | 2,200,000 |
| Toyota Hilux Pick-up | 2,300,000 |
| One tractor | 3,200,000 |
| Executive desks for departmental heads | 900,000 |

2. In the year ended 31 December 2004, the following assets were sold:

| | Sales proceeds (Sh.) |
|---|---|
| One fork lift | 1,200,000 |
| One transit goods prime mover | 1,500,000 |
| Furniture | 600,000 |
| Milling machines | 8,000,000 |

3. In the year ended 31 December 2005, the following assets were acquired or constructed:

| | Sh. |
|---|---|
| Land | 6,000,000 |
| Buildings extensions | 12,000,000 |
| Additional conveyor fixed to the building | 1,000,000 |
| Staff bus | 5,500,000 |
| Drilled borehole | 1,900,000 |
| Computers | 3,600,000 |

**Required:**

Capital allowances for the years ended 31 December 2003, 2004 and 2005. (20 marks)

**TAXATION 1**
**DECEMBER 2011**

**Answer ALL questions. Marks allocated to each questions are shown at the end of the question. Show ALL your workings. Any assumptions made must be stated.**

## QUESTION ONE

(a) Distinguish between the tax treatment of rent income on resident and non-resident individuals. ( 4 marks)

(b) With reference to the Customs and Excise Act (Cap.472), write short notes on the following:

(i) Import declaration form. ( 4 marks)

(ii) Clean report of findings. ( 2 marks)

(iii) Four categories of goods liable to forfeiture to the Customs Department. ( 4 marks)

(iv) Four privileged persons or institutions exempted from pre-shipment inspection of imports. ( 4 marks)

(c) Identify and briefly explain the operation of any two instruments of fiscal policy. ( 4 marks)

**(Total: 20 marks)**

## QUESTION TWO

(a) Explain the tax treatment of compensation received for loss of office. ( 6 marks)

(b) Mr. Charles Kivuna worked for Maua Limited, a company in the horticultural sector, as the General Manager on a five year contract commencing 1 January 2002. His contractual salary per annum was Sh.800,000. The contract provided for compensation in case of contract termination before its expiry of Sh.3,000,000. The contract was terminated on 1 January 2005 and he received the compensation on that date. On 3 January 2005, he secured employment with Charter Bank Limited. The following information is relevant for his year of income ended 31 December 2005:

1. His basic salary was Sh.90,000 per month (PAYE Sh.12,000).

2. He was entitled to reimbursement of medical expenses incurred on self and family subject to a maximum of 10% of basic pay. He spent Sh.135,000 on medical costs for the year. The medical scheme covers senior managers only.

3. He obtained a mortgage for Maendeleo Finance Ltd. on 1 July 2005 for Sh.3,500,000 at an interest rate of 10% per annum to purchase a residential house. The house was furnished by his employer at a cost of Sh.60,000. An alarm system was also installed in the house by the employer at a cost of Sh.10,000.

4. He was sponsored for a seminar on banking by the employer at Sh.120,000. 5% of this cost was for private entertainment.

5. He received 1,000 ordinary shares of Charter Bank Ltd. as a performance bonus on 31 December 2005. Each of these shares had a par value of Sh.10 but at the time of their issue to Mr. Kivuna, their market price was Sh.8 each.

6. On 1 September 2005, he obtained a sh.600,000 loan from his employer. The interest payable on this loan was at the rate of 2% per annum.

7. He contributes 5% of his basic pay to a registered pension scheme while the employer contributes an equal amount for him.

8. He employed a night watchman on 1 August 2005 at a salary of Sh.3,000 per month. Charter Bank Ltd. pay half the salary.

9. He received a gross dividend of Sh.8,000 from Akiba Ltd. on 31 October 2005.

10. During the year, he paid a total of Sh.35,000 as fees for his children studying in public schools.

11. He won a defamation case against a local newspaper and was awarded Sh.300,000. The amount was paid on 15 November 2005.

12. His other incomes (or losses) for the year ended 31 December 2005 included:
Net income from rent Sh.1,000,000
Profit from retail business Sh.320,000
Loss from farming business Sh.600,000

**Required**

(i) Compute the fringe benefit tax payable. Assume a prescribed interest rate of 12% per annum. ( 2 marks)

(ii) Compute the total taxable income for Mr. Kivuna for the year ended 31 December 2005. (10 marks)

(iii) Compute the tax payable on the taxable income in (ii) above. ( 2 marks)

**(Total: 20 marks)**

## QUESTION THREE

(a) Write short notes on the taxation of:

(i) Petroleum companies and their sub-contractors. ( 4 marks)
(ii) Enterprises situated in export processing zones (EPZs). ( 4 marks)

(b) Cheruiyot and Maina are partners in business trading as Chemaina Enterprises. They operate in the dairy industry and share profits and losses equally. The following trial balance was extracted from the books of the partnership as at 31 December 2005.

| | Sh. | Sh. |
|---|---|---|
| Capital introduced (1 January 2005): | | |
| Cheruiyot | | 4,320,000 |
| Maina | | 6,265,200 |
| Debtors and prepayments | 1,260,000 | |
| Stocks (31 December 2002) | 1,250,400 | |
| Cash in hand and at bank | 864,000 | |
| Creditors and accruals | | 1,737,600 |
| Farm works (cost) | 6,000,000 | |
| Furniture (cost) | 900,000 | |
| Dairy equipment (cost) | 2,400,000 | |
| Motor car (saloon) | 1,200,000 | |
| Provision for depreciation | | 138,000 |
| Depreciation charge for the year | 138,000 | |
| Gross profit on trading | 360,000 | 4,998,000 |
| Rent and rates | 991,200 | |

| | | |
|---|---|---|
| Salaries and wages partners" salaries | 720,000 | |
| Advertising expenses | 252,000 | |
| Transport costs | 283,200 | |
| Deposit paid on new dairy equipment | 120,000 | |
| Fixed deposit account | 720,000 | |
| | 17,458,800 | 17,458,800 |

**Additional information:**

Rent and rates were for the eighteen months to 30 June 2006.
partners salaries were shared equally between the partners.
interest on capital is provided at 15% on the balances at the beginning of the year. the partnership commenced operations on 1 January 2005.
the partners contracted to acquire new dairy equipment form Farm Machines Ltd. at a cost of Sh.600,000. A deposit of Sh.120,000 was paid in December 2005. The balance was paid in March 2006 when the equipment was delivered.
the farm works were revalued at Sh.4,800,000 on 31 December 2005.

**Required:**

(i) Taxable income for the partnership for the year ended 31 December 2005. ( 8 marks)
(ii) The allocation of profits (or losses) to the partners. ( 4 marks)
**(Total: 20 marks)**

**QUESTION FOUR**

(a) List five costs that would qualify for mining allowance under the Income Tax Act (Cap. 470). ( 4 marks)

(b) Christopher Nabutola established a flour milling plant in Nakuru on 1 January 2004. During the two years ended 31 December 2004 and 2005, the following transactions took place:

| | |
|---|---|
| **2004** | |
| 1 January | He leased a factory at Sh.30,000 per month. The construction cost to the lessor was Sh.4,700,000. |
| 1 January | He imported second-hand machinery at a cost of Sh.2,250,000. |
| 30 April | He sold for Sh.500,000 machinery with an original cost of Sh.680,000. |
| 1 June | He bought one car for Sh.300,000 for use in the business. During the year, the car clocked 20,000 kilometres out of which 5,000 kilometres were in respect of private business. |
| 15 July | He bought a lorry (4 tonnes) and a pick up for Sh.800,000 and Sh.200,000 respectively. |
| 2 August | He purchased an adjacent plot for Sh.600,000 and started construction on the site. |
| **2005** | |
| 1 January | He completed factory construction at a cost of Sh.3,000,000 excluding the cost of the plot. He shifted from the leased factory effective from this date. |
| 1 January | He installed new and second-hand machinery costing Sh.800,000 and Sh.600,000 respectively. This machinery was imported and was in addition to that acquired on 1 January 2004. |
| 12 February | He purchased an old tractor for Sh.900,000. |
| 3 June | He replaced the car purchased on 1 June 2004. He paid sh.200,000 after obtaining a trade-in allowance of Sh.150,000 for the old car. His private mileage in the use of the new car was 30% of his annual mileage. |

**Required:**

Compute the capital allowances due to Mr. Nabutola for the two years ended 31 December 2004 and 2005.
(15 marks)
**(Total: 20 marks)**

## QUESTION FIVE

(a) Mr. Wafula is a trader whose business turnover averages Sh.300,000 per month. He approaches you for advice on whether he should register for VAT.

Explain to him the minimum turnover levels required for traders to register for VAT.
( 4 marks)

(b) List any four grounds of appeal to a VAT tribunal. ( 4 marks)

(c) Identify any four details to be found in a tax invoice. ( 4 marks)

(d) The following are the sales and purchases of Jasho Limited, a supplier of vatable goods for the six-month period ended 31 December 2005.

| | | Sales | |
|---|---|---|---|
| | Standard | **Zero-rate** | Exempt |
| | **Sh.** | **Sh.** | **Sh.** |
| July | 1,200,000 | 300,000 | 160,000 |
| August | 1,000,000 | 250,000 | 100,000 |
| September | 800,000 | 160,000 | 90,000 |
| October | 1,400,000 | 400,000 | 135,000 |
| November | 600,000 | 100,000 | 80,000 |
| December | 1,600,000 | 380,000 | 170,000 |
| | 6,600,000 | 1,590,000 | 735,000 |

| | Purchases (Standard) |
|---|---|
| | **Sh.** |
| July | 900,000 |
| August | 750,000 |
| September | 350,000 |
| October | 1,100,000 |
| November | 400,000 |
| December | 1,200,000 |
| | 4,700,000 |

All the purchases and sales above are VAT exclusive.

**Required:**

(i) Determine the total input tax deductible for the six-month period ended 31 December 2005.
( 6 marks)

(ii) Determine the total VAT payable or refundable for the period to 31 December 2005.
( 2 marks)
**(Total: 20 marks)**

## TAXATION 1

## MAY 2012

### QUESTION ONE

(a) Write brief notes on each of the following matters:

(i) Taxation of pension income (3 marks)

(ii) Penalties for submitting fraudulent tax returns (3 marks)

(iii) Computation and treatment of capital deductions in respect of mining operations. (4 marks)

(b) (i) Define the term "tax avoidance." (2 marks)

(ii) Identify two ways in which an individual or institution could engage in the practice of "tax avoidance." (2 marks)

(c) Explain the concept of the "incidence of a tax" clearly outlining its importance to policy makers. (6 marks)

**(Total: 20 marks)**

### QUESTION TWO

(a) In the context of the administration and recovery of income tax, write brief explanatory notes on the following:

(i) Taxation at source (2 marks)

(ii) Taxation of wife"s employment income (2 marks)

(iii) Back duty (2 marks)

(b) Mr. Mbotela is employed by Jamii Bank Ltd. as an accountant. He has presented the following details to be used in the computation of his taxable income for the year ended 31 December 2005:

1. He received a basic salary of Sh. 60,000 per month (PAYE Sh. 7,000). He also received an overtime allowance equivalent to 10% of his monthly pay.
2. His employer paid his hospital bills averaging Sh. 4,000 per month.
3. His employer provided him with the following
   - A car which was acquired at a cost of Sh. 300,000. This car has an engine capacity of 2000c.c.
   - A house. The employer deducted Sh. 2,500 from Mr. Mbotela"s salary every month to cover rent for the house.
   - A gardener and a night watchman.
4. He contributes Sh. 8,000 per month to a registered pension scheme while the employer contributes an equal amount.
5. For the year ended 31 December 2005, the employer provided Mr. Mbotela with tea and snacks valued at Sh. 3,000.
6. Mr. Mbotela attended a one-day seminar and received Sh. 2,500 from his employer as allowances. He donated 10% of this amount to a local childrens" home.
7. He was nominated the employee of the year on 31 December 2005. This award carried a cash gift of Sh. 45,000.
8. Mr. Mbotela operates a savings account with Post Bank Ltd. During the year ended 31 December 2005, the bank credited his account with Sh. 2,000 being interest on the balance in his account.
9. In the month of November 2005, he received compensation from an insurance company amounting to Sh. 80,000. This was in relation to household furniture destroyed by fire.
10. On 5 November 2005, he started offering part-time tax consultancy services. He made a profit of Sh. 70,000 from the consultancy before deducting operating expenses of Sh. 18,000 and Sh. 4,000 relating to the acquisition of furniture.
11. His wife, Mrs. Mbotela, operates a grocery. She made a net-profit of Sh. 50,000 after deducting the following:

| | Sh. |
|---|---|
| Rent of stall | 10,000 |
| Hire of van | 22,000 |
| School fees for children | 108,000 |
| Advertisement expenses | 6,000 |

**Required:**

(i) Mr. Mbotela"s taxable income for the year ended 31 December 2005 (10 marks)

(ii) Tax payable on the taxable income computed in (i) above. (4 marks)

**(Total: 20 marks)**

## QUESTION THREE

(a) The taxation of co-operative societies in Kenya is significantly different from that of companies registered under the Companies Act (Cap. 486).

Briefly explain four main differences. (4 marks)

(b) Kufika Limited is a company involved in the processing, packaging and distribution of coffee. The following is its profit and loss account for the year ended 31 December 2005;

| | Sh. | Sh. |
|---|---|---|
| Profit from operations | 30,000,000 | |
| Investment income (gross) | 850,000 | |
| Gain on sale of motor vehicle | 600,000 | |
| | | 31,450,000 |
| Directors remuneration | 3,000,000 | |
| Interest expense | 400,000 | |
| Audit fees and expenses | 390,000 | |
| Bad debts | 300,000 | |
| Depreciation of fixed assets | 500,000 | |
| Miscellaneous expenses | 250,000 | |
| | | (4,840,000) |
| Net profit | | 26,610,000 |

Additional information:

1. The following is the breakdown of the investment income:

| | Sh. |
|---|---|
| Dividends from Unga Processors Ltd. | 80,000 |
| Interest on deposits in commercial banks | 400,000 |
| Interest on Treasury Bills | 200,000 |
| Dividends from a company incorporated in Uganda | 170,000 |
| | 850,000 |

2. Directors" remuneration is analysed below:

| | Sh. |
|---|---|
| Directors" fees | 400,000 |
| Travel expenses (private) | 600,000 |
| Contributions to pension scheme | 580,000 |
| Compensation for termination of a director"s contract | 1,420,000 |
| | 3,000,000 |

3. Interest expense comprised the following:

| | **Sh.** |
|---|---|
| Interest on bank overdraft | 160,000 |
| Interest on loan from a foreign bank | 200,000 |
| Interest on loan to purchase machinery | 40,000 |
| | 400,000 |

4. Audit fees and expenses were made up of the following:

| | Sh. |
|---|---|
| Appeal against tax assessment | 250,000 |
| Audit fees | 140,000 |
| | 390,000 |

5. Bad debts were made up of the following:

| | Sh. |
|---|---|
| Embezzlement by staff | 180,000 |
| Bad debts written off | 50,000 |
| General provisions | 70,000 |
| | 300,000 |

6. The details of the fixed assets are provided below:
   - The written down values of the various classes of assets as at 1 January 2005 were as follows:

| **Class I** | **Class II** | **Class III** | **Class IV** |
|---|---|---|---|
| **Sh.** | **Sh.** | **Sh.** | **Sh.** |
| 600,000 | 1,280,000 | 1,700,000 | 2,200,000 |

   - Construction of the factory building at a cost of Sh. 2,500,000 was completed on 1 January 2004.
   - Additions of assets during the year ended 31 December 2005 were as follows:

| | **Sh.** |
|---|---|
| Processing machinery | 300,000 |
| Fax machine | 25,000 |
| Telephone set | 15,000 |
| Computers | 70,000 |
| Saloon car | 1,200,000 |
| Factory extension (completed 1 July 2005) | 1,800,000 |

   - Disposal proceeds of assets during the year ended 31 December 2005 were:

| | **Sh.** |
|---|---|
| Class I | 90,000 |
| Class II | 230,000 |
| Class III | 175,000 |
| Class IV | 420,000 |

7. Miscellaneous expenses comprised the following:

| | **Sh.** |
|---|---|
| Contribution to children"s home | 75,000 |
| Staff Christmas party | 30,000 |
| Rent of exhibition stall | 60,000 |
| Subscription to National Chamber of Commerce | 85,000 |
| | 250,000 |

Required:

(i) Capital allowances due to Kufika Limited for the year ended 31 December 2005. (8 marks)
(ii) Kufika Limited"s taxable profit (or loss) for the year ended 31 December 2005. (6 marks)
(iii) Tax payable (if any), on the taxable profit computed in (ii) above. (2 marks)

**(Total: 20 marks)**

## QUESTION FOUR

(a) Identify any four instruments on which stamp duty is chargeable. (4 marks)

(b) Write brief explanatory notes on the following miscellaneous sources of government revenue.
  (i) Motor vehicle licences (2 marks)
  (ii) Training levies (2 marks)

(c) Maina, Njoka and Otieno are in partnership sharing profits and losses in the ratio of 3:1:1 respectively. For the year ended 31 December 2005, they presented the following trading and profit and loss account.

| | **Sh.** | **Sh.** |
|---|---|---|
| Sales | | 13,000,000 |
| **Cost of sales:** | | |
| Opening stock | 2,200,000 | |
| Purchases | 4,000,000 | |
| Closing stock | (800,000) | (5,400,000) |
| Gross profit | | 7,600,000 |
| Other operating income | | 400,000 |
| | | 8,000,000 |
| **Expenses:** | | |
| Salaries and wages | 2,500,000 | |
| Rent | 40,000 | |
| Advertisement | 120,000 | |
| Transport | 60,000 | |
| Depreciation | 75,000 | |
| Interest on partners" capitals | 450,000 | |
| Commissions paid to partners | 90,000 | |
| Printing and stationery | 144,000 | |
| Repairs and maintenance | 380,000 | |
| Postage and telephone | 17,000 | |
| Legal fees | 23,000 | |
| Insurance | 110,000 | |
| Gifts | 4,000 | |
| Net profit | | (4,013,000) |
| | | 3,987,000 |

**Additional information:**

1. Opening stock and closing stock have each been understated by 10%
2. Other operating income includes Sh. 50,000 related to gain on sale of furniture.
3. Salaries and wages include salaries to Maina, Njoka and Otieno of Sh. 300,000, Sh. 250,000 and Sh. 50,000 respectively for the year ended 31 December 2005.
4. Transport costs include Sh. 18,000 paid to Otieno on account of a private trip.
5. Interest on partners" capitals and commissions paid to partners are to be apportioned equally to the partners.
6. The gifts were given to the staff of the firm during the end of year party.
7. Capital allowances due to the firm for the year ended 31 December 2005 were agreed at Sh. 120,000.

**Required:**

(i) The partnership"s adjusted profit (or loss) for tax purposes for the year ended 31 December 2005. (8 marks)

(ii) Distribution of the taxable profit (or loss) between the partners as at 31 December 2005. (4 marks)

**(Total: 20 marks)**

## QUESTION FIVE

(a) In the context of the Customs and Excise Act (Cap. 472) what is meant by the term "dumping"? (4 marks)

(b) Identify the measures that a government may put in place to discourage dumping. (4 marks)

(c) Outline four circumstances under which duty paid on imported goods may be refunded. (4 marks)

(d) The following transactions relate to Mapato Limited, a VAT registered company, for the month of June 2005

1 June: Brought forward merchandise purchased in the previous month for Sh. 200,000.
3 June Purchased vatable merchandise at Sh. 80,000
4 June: Sold zero-rated merchandise for Sh. 60,000
6 June: Purchased merchandise from a trader at Sh. 100,000. This trader was not registered for VAT purposes.
7 June: Merchandise worth Sh. 16,000 was returned to supplier.
9 June: Merchandise sold on 4 June for Sh. 25,000 was returned by customers.
12 June: Sold merchandise for Sh. 360,000.
19 June: A customer who had purchased merchandise on 12 June for 18,000 was declared bankrupt before paying the amount due from him.
25 June: Purchases merchandise as follows:

- From suppliers registered for VAT purposes - Sh. 80,000
- From suppliers not registered for VAT purposes - Sh. 40,000

27 June: Sold merchandise as follows:

- To customers registered for VAT purposes – Sh. 160,000
- To customers not registered for VAT purposes – Sh. 122,000

Required:
VAT account for the month ended 30 June 2005. (8 marks) (Where applicable, transactions are inclusive of VAT at the standard rate).

**(Total: 20 marks)**

## TAXATION 1

**NOVEMBER 2012** **Time Allowed: 3 hours**

### QUESTION ONE

(a) The Minister for Finance, through the budget speech of June 2004, issued an amnesty to tax defaulters in Kenya. This amnesty expires on 31 December 2004.

**Required:**

(i) Define the term „tax amnesty." (2 marks)

(ii) Explain two advantages of a tax amnesty from the viewpoints of:

- The Kenya Revenue Authority (4 marks)
- The tax payer (4 marks)

(b) Highlight three key features of each of the following taxes;

(i) Motor vehicle advance tax (3 marks)

(ii) Fringe benefit tax (3 marks)

(c) With reference to the Customs and Excise Act (Cap. 472), outline four circumstances under which the Commissioner may grant a refund for import duty paid. (4 marks)

**(Total: 20 marks)**

### QUESTION TWO

(a) Briefly explain the responsibility of partners with respect to:

(i) Filing of the partnership tax returns. (2 marks)

(ii) Penalties for late payment of tax (2 marks)

(b) Mwanzo, Bidii and Faulu have been partners in a firm dealing with the importation and sale of second hand clothes. They shared profits and losses is the ratio of 3:2:1 respectively upto 30 September 2005, when the firm was dissolved. During the nine months to 30 September 2005, the firm presented the following income statement:

**Mwanzo, Bidii and Faulu Partnership**
**Income Statement for the nine months ended 30 September 2005**

| | Sh. „000" | Sh. „000" |
|---|---|---|
| Gross profit | | 18,000 |
| Deduct: | | |
| Rent and rates | 1,600 | |
| Salaries: Staff | 780 | |
| Mwanzo | 1,500 | |
| Bidii | 1,200 | |
| Faulu | 900 | |
| Depreciation | 400 | |
| Balancing deduction | 100 | |
| Advertising (neon sign) | 250 | |
| Interest on capital: | | |
| Mwanzo | 600 | |
| Bidii | 400 | |
| Faulu | 200 | |
| Commission paid to Faulu | 80 | |
| Water and electricity | 300 | |
| Insurance | 190 | (8,500) |
| Net profit | | 9,500 |

On 1 October 2005, Bidii was employed as a sales manager by Mavazi Limited. The terms of his employment provided for the following:

1. An annual salary of Sh. 960,000 (PAYE Sh. 144,000 per annum).
2. His monthly allowances were specified as follows:

| | Sh. |
|---|---|
| Entertainment | 18,000 |
| Travelling (on business) | 24,000 |
| House | 30,000 |

3. A medical scheme exists for senior managers only. It is operated on a reimbursement basis. In the three months ended 31 December 2005, Bidii claimed Sh. 120,000 for medical expenses paid.
4. He was entitled to a Christmas bonus of 5% of his annual salary, paid pro rata to months of service.
5. He contributed 10% of his monthly basic salary to a registered provident fund.

Required:

(i) Compute the taxable profit or loss of the partnership for the period ended 30 September 2005. (6 marks)

(ii) Allocate this profit or loss among the partners. (2 marks)

(iii) Determine Bidii"s taxable income for the year ended 31 December 2005 and his tax liability. (8 marks)

**(Total: 20 marks)**

## QUESTION THREE

(a) With reference to the VAT Act (Cap. 476), define the following terms:

(i) Time of supply (2 marks)
(ii) Minimum turnover (2 marks)
(iii) Tax invoice (2 marks)
(iv) VAT tribunal (2 marks)

(b) Kikomatt Supermarket Limited registered for VAT on 15 December 2005. On that date, it had goods in stock for sale valued at Sh. 96,000 and for which input tax had been paid. These goods were subsequently sold in March 2006.

During the four months ended 30 April 2006, the supermarket completed the following transactions:

| **Month** | **Purchases** | **Sales** |
|---|---|---|
| | **Sh.** | **Sh.** |
| January | 2,450,000 | 3,200,000 |
| February | 2,870,000 | 3,460,000 |
| March | 3,250,000 | 2,940,000 |
| April | 3,120,000 | 3,500,000 |

The purchases and sales are inclusive of VAT, at the standard rate, where applicable.

**Additional information:**

1. 10% of the monthly purchases and sales relate to exempt goods.
2. 20% of the monthly sales represent goods exported to Uganda.
3. Credit notes amounting to Sh. 25,000 were issued to customers in March 2006.
4. VAT on monthly electricity consumption was Sh. 2,000.

**Required:**

The VAT account for the four month period ended 30 April 2006. (12 marks)

**(Total: 20 marks)**

## QUESTION FOUR

Chai Limited was incorporated on 31 December 2004 to process and package tea for sale within Kenya. On 2 January 2005, the company purchased the following movable assets and buildings from Mwisho Limited, an existing company in the same business.

| Asset | Tax written down value Sh. „000" | Selling price to Chai Limited Sh. „000" |
|---|---|---|
| Machinery | 18,000 | 10,000 |
| Standby generator | 200 | 250 |
| Computers | 750 | 400 |
| Printers | 90 | 110 |
| Loose tools (original cost Sh. 150,000) | 100 | 70 |
| Delivery vans (3 tonnes each) | 7,200 | 8,000 |
| Mobile phones | 150 | 80 |
| Office furniture | 1,400 | 1,000 |
| Weighing scales | 30 | 28 |

| Nature of building | Construction date | Construction cost Sh. „000" | Selling price to Chai Limited Sh. „000" |
|---|---|---|---|
| Factory | 1 January 1998 | 40,000 | 48,000 |
| Office complex | 1 January 1998 | 22,000 | 26,000 |
| Warehouse A | 1 July 1999 | 2,000 | 1,800 |
| Warehouse B | 1 January 2000 | 1,700 | 2,400 |
| Staff quarters | 1 August 2001 | 3,600 | 4,000 |
| Staff Canteen | 1 December 2001 | 900 | 750 |

The following additional transactions occurred in the year ended 31 December 2005:

(iv) On 1 March, one of the delivery vans purchased from Mwisho Limited for Sh. 1.2 million was sold for Sh. 700,000.

(v) As the number of employees increased. Warehouse B was converted into an office with effect from 1 April. The cost of partitioning the warehouse amounted to Sh. 150,000.

(vi) Additional staff quarters were constructed at a cost of Sh. 800,000 and utilized from 1 July.

(vii) On 1 October, a machine was imported at a cost of Sh. 450,000 and the following costs subsequently incurred on it:

| | Sh. |
|---|---|
| Import duty | 100,000 |
| Carriage inwards | 40,000 |
| Repairs in transit | 18,000 |
| Installation costs | 5,600 |
| Annual insurance | 12,000 |

5. One of the computers valued at Sh. 18,000 was traded in on 2 November for a new one costing Sh. 50,000. The balance was settled in cash.
6. The company reported a profit before capital allowances of Sh. 26 million for the year ended 31 December 2005. This was after deducting depreciation of Sh. 2 million.

**Required:**

(a) Determine the capital allowances due to Chai Limited for the year ended 31 December 2005. (16 marks)

(b) Compute the company"s taxable profit or loss and the tax payable (if any) for the year ended 31 December 2005. (4 marks)

**(Total: 20 marks)**

## QUESTION FIVE

(a) Mr. Allan Muvozi is a Ugandan businessman wishing to invest in Kenya. He has approached you for professional advice on the tax implications of various forms of business.

**Required:**
Explain to him four tax advantages enjoyed by a sole proprietorship over a company. (8 marks)

(b) Mr. John Mpole accepted voluntary retirement from the Civil Service on 1 January 2006. He received a golden handshake of Sh. 2 million. He is now considering six possible investments as listed below:

1. Purchase ordinary shares in Kenya Airways Limited.
2. Purchase ordinary shares in Uganda Breweries Limited.
3. Open a fixed deposit account with Kenya Commercial Bank Limited.
4. Purchase government Treasury bills.
5. Open a savings account with Kenya Post Office Savings Bank Limited.
6. Subscribe for debentures in National Bank of Tanzania Limited.

**Required:**
For each of the investments above, advise Mr. Mpole on the income tax consequences. (6 marks)

(c) List and briefly explain three ways in which a government can reduce its budget deficit. (6 marks)

**(Total: 20 marks)**

# MAY 2013

## QUESTION ONE

(a)

(i) Cess – a charge on agricultural income especially cashcrops for maintenance and repair of roads which access those agricultural locations.

(ii) Property rates – rates charged local authority on land and building owned by individuals and body corporates. The local authority charge such rates on property located within its jurisdiction. Valuation of property is necessary for purpose of imposing property rates.

(iii) Stamp duty – duty charged by the government in respect of some documents specified under stamp duties act. Such documents must be stamped and duty paid for them to be legal in executing transactions. The instruments are written documents for transactions such as:

- Transfer of property
- Mortgage of property
- Hire purchase agreements
- Lease agreements
- Insurance policies.
- Memorandums and articles of association
- Marketable securities etc.

(b) Refer to solution of Q1 (b) Dec 2005.

(c) Mr. Ombaka taxable income.

| | Kshs. | Kshs. |
|---|---|---|
| Salary 45,000 x 12 | | 540,000 |
| Bonus | | 90,000 |
| Car: Higher of 24% x 600,000 or Kshs. 86,400 (on 2000cc) | | 144,000 |
| Pensionable pay before H.B. | | 774,000 |
| Add: H. Benefit = 15% x 774,000 | | 116,100 |
| Less rent paid 3000 p.m x 12 | | (36,000) |
| Pensionable pay | | 854,100 |
| Less pension contribution: lower of: | | |
| (i) Actual amount | 240,000 | |
| (ii) Maxi. Limit | 210,000 | |
| (iii) 30% x 854,100 | 256,230 | (210,000) |
| | | 597,870 |
| Pension income (20,000 – 15,000 exempt) x 12 | | 60,000 |
| Farming income | | |
| Gross income | 160,000 | |
| Less allowables – labour costs | (60,000) | |
| Miscellaneous | (20,000) | |
| WTA on pick-up = 25% x 400,000 | (100,000) | |
| Net loss c/f | (20,000) | |
| Total taxable income | | 657,870 |

* Staff meal of Kshs. 24,000 p.a. a tax free benefit as long as it does not exceed Kshs. 36,000 p.a. (w.e.f 1/1/2006)

(ii) Tax liability on Kshs. 657,870

| | | |
|---|---|---|
| $1^{st}$ 466,704 = (121,968 @ 10%) + 114,912 @ (15% + 20% + 25%) | = | 81,144 |
| Surplus = (657,870 – 466,704) @ 30% | = | 57,350 |

| | |
|---|---|
| Gross tax | 138,494 |
| Less p/relief | (13,944) |
| PAYE deducted 3000 p.m. x 12 | (36,000) |
| Net tax | 88,550 |

## QUESTION TWO

(a) Forward shifting – shifting the tax imposed on one party to consumers through increase in selling price.
- Backward shifting–tax is shifted to the suppliers through reduction in buying price.

(b) (i)Income tax – this cannot be shifted since it is a form of direct tax. The impact and incidence are on the same person. E.g. employees cannot shift PAYE to another party.

(ii) Custom duties: - if the imparted good is for personal consumption e.g. imparted vehicle for personal use, the duty cannot be shifted. However, if it"s for resale, the duty is shifted to the buyer since the sell mark-ups the cost inclusive of duty paid.

(c) Advantages of progressive taxes

Progressive taxes is where the tax rate rises as taxable income increases (the higher the taxable income, the higher the rate).

Advantages
- Equitable–higher income is subject to more tax.
- Productive–yields more revenue to the government compared to proportional tax.
- Economical–collection cost does not increase with increase in tax rate.
- Equal sacrifice–the marginal utility of money decreases with every increase in income hence forhigher income individuals to make equal sacrifice, they pay higher taxes.
- Equalities in wealth distributions–the rich with less disposable income will forgo their luxuriesand the poor will benefit more from the more tax charged on the rich.

(d) Goods liable to forfeiture (goods confiscated by the government) – Prohibited goods
- Uncustomed goods
- Restricted goods (goods subject to conditions of importation or exportation.
- Goods imported or exported contained in a package of which the entry, application of shipmentor application to unload does not correspond with the goods.
- Goods imported or exported concealed in a manner or packaged in a manner appearing to beintended to deceive an officer.

## QUESTION THREE

(a) Conditions to be granted IDBM
- Manufacture goods for exports only (not for local sales)
- Manufacture period not less than 3 years.
- First qualify for I.D under ordinary manufacture.
- If manufacture for export only ceases before the lapse of 3 years, the IDBMgranted shall be withdrawn and treated as a taxable income in the year of withdrawal but the investor shall be granted I.B.D and W.T.A as applicable on the withdrawn IDBm.

(b) (i)Investment deduction

Year 2003 I.D. @ 70% (Kshs „000")

Q. Cost of building = 200 + 320 + 8,000 – 900 = 7,620.

| Asset | Q. Cost | I.D. @ 70% | Residual for IBD |
|---|---|---|---|
| Building | 7,620 | 5,334 | 2,286 |
| Sewerage | 240 | 168 | 72 |
| Power transfer | 800 | 560 | 240 |
| P. machine | 1,900 | 1,330 | 570 |

| | | | |
|---|---|---|---|
| Water pump | 150 | 105 | 45 |
| Total | | 7,497 | |

2004 @ 100%

| | | |
|---|---|---|
| Processing machine (cash) | 250 | 250 |
| Total I.D. | | 250 |

(ii) Industrial Building Deduction IBD.

**2003:**

| Building | Q. Cost | Residual b/f | IBD @ 2.5% x $\frac{6}{12}$ | Residual c/f |
|---|---|---|---|---|
| Building | 2,286,000 | - | 28,575 | 2,257,475 |
| F. Building | 72,000 | - | 900 | 71,100 |
| Sewerage | 240,000 | - | 3,000 | 237,000 |
| Power transformer | 600,000 | - | 7,500 | 592,500 |
| Bridge | | | 39,975 | |

**2004:**

| | | | | |
|---|---|---|---|---|
| F. Building | 2,286,000 | 2,257,475 | 57,150 | 2,200,325 |
| Sewerage | 72,000 | 71,100 | 1,800 | 69,300 |
| Power transformer | 240,000 | 237,000 | 6,000 | 231,000 |
| Bridge | 600,000 | 592,500 | 15,000 | 577,500 |
| | | | 79,950 | |

(iii) Wear and Tear Allowance (Kshs. „000")

| **2003** | | | | |
|---|---|---|---|---|
| Class | I @ 37.5% | II @ 30% | III @ 25% | IV @ 12.5% |
| | | | | |
| WDV 1/1/2003 | - | - | - | - |
| Others net of I.D. (Notes) | - | - | - | 615 |
| Forklift and Tractor | 2,600 | - | - | - |
| Saloon cars | - | - | 2000R | - |
| Computer and scanners | - | 280 | - | - |
| WTA furniture & fixtures | - | - | - | 120 |
| Pick-ups | - | - | 1,500 | - |
| | 2,600 | 2,800 | 3,500 | 735 |
| WTA – (2003) | (975) | (840) | (875) | (92) |
| WDV 31/12/2003 | 1,625 | 1,960 | 2,625 | 643 |

2004:

| Class | I @ 37.5 | II @ 30% | III @ 25% | IV @ 12.5% |
|---|---|---|---|---|
| WDV 1/1/2004 | 1,625 | 1960 | 2625 | 643 |
| Add office curtains | - | - | - | 160 |
| Fax machines | - | 100 | - | - |
| Disposal-car (w1) | - | - | (500) | - |
| | 1,625 | 2,060 | 2,125 | 803 |
| | (609.4) | (618) | (531) | (100.4) |
| WDV 31/12/2004 | 1,015.6 | 1,442 | 1,594 | 702.6 |

Note 1 = Cost of processing machine and water pump net of I.D = 570 + 45 = 615.

$W_1 = \frac{\text{disposal value}}{\text{Cost}} \times \text{restricted Q. cost}$

$= \frac{900,000}{1,800,000} \times 1,000,000 = \underline{\underline{500,000}}$

## QUESTION FOUR

(a) Importance of tax invoice

- Indicates the value, quantity and price of supply.
- Help in determining the tax point.
- Indicates all vital details of supplier such as VAT number, PIN etc.
- Used in claiming input VAT.
- Used in claiming bad debt relief.

(b) Tax Invoice

P. Kamau
P.O. Box 9999-0066
Nairobi, Kenya
Tel: ________________________

VAT Reg. No: 00987763R
S. No: 16345
Date of invoice: 20/1/2006
Date of supply: 20/1/2006

To: L. Omondi
VAT Reg. No. = 00120365R

| Qty | Description | Value | VAT rate | VAT (Kshs) | Total (Kshs) |
|---|---|---|---|---|---|
| 2 | Radio | 15,000 | 16% | 2,400 | 17,400 |
| 1 | Television set | 30,000 | 16% | 4,800 | 34,800 |
| 1 | Fridge | 40,000 | 16% | 6,400 | 46,400 |
| | | | | | |
| | | | | | |
| | | | | | |

Paid: cheque No: 014632 Signed ________________________________

Amount: 98,600 Stamp ________________________________

(c) (i)January VAT was due by 20th February 2004. The penalties are (i) failure to file VAT return = Sh. 10,000 no VAT was payable since input VAT > output VAT but return should nevertheless be filed. i.e. 48,000 output – 150,000 input = 102,000 refund.

(ii) February: refund = 0 – 219,480 = 219,480. Should file VAT return by 20th March otherwise a Sh. 10,000 is imposed.

(iii) March: VAT due = 497,940 – 167,640 = 330,300 payable. Payable by 20th April otherwise penalty would be as follows:
* Late filing penalty: Higher of 10,000 or 5% x 330,300 = 16,515.
* Late interest penalty = 2% p.m x 330,300 = 6,606.
Total penalty = 16,515 + 6,606 = 23,121

(iv) April: VAT due = 308,940 – 274,380 = 34,560 by 20th May. Penalties due.

| | | |
|---|---|---|
| * Failure to file return = 10,000 or 5% x 34,560 | = | 10,000 |
| * Interest penalty = 2% x 34,560 | = | 691.2 |
| Total penalty | | 10,691.2 |

(v) Mwajuma should notify the commissioner of the omission of not deducting the input VAT.

## QUESTION FIVE

(a) (i)Dividend Income

- If from, outside Kenya, it"s tax exempt.
- If received from another company in which the receiving company controls 12.5% or more, it"s tax exempt.
- If controlling is less than 12.5%, 5% W/T is final.
- If it"s investment income of an insurance company from it"s life insurance fund, it"s tax exempt.

(ii) Interest

- From outside Kenya, it"s tax exempt.
- If qualifying interest, gross it up and aggregate with other incomes and tax @ 30%.
- Enjoy a tax credit of 15% of gross against corporate tax liability.

(iii) Rent:

Determine net rent income, aggregate it with other incomes and tax @ 30% corporate tax rate.

(b) (i)MALI LTD ADJUSTED INCOME

| | | (Kshs. „000") |
|---|---|---|
| Reported net profit | | 4,200 |
| Add back | | |
| Bad debts – employee loan | 15 | |
| Legal expenses – manager | 20 | |
| Insurance premium – penalty | 24 | |
| Rent expenses – stamp duty | 6 | |
| Depreciation | 25 | |
| Purchase of furniture | 26 | 116 |
| Less | | |
| Capital allowances | 75 | |
| Dividend and interest (200 + 4) | 204 | |
| VAT refund | 12 | |
| Gain on sale of M. Vehicle | 14 | (305) |
| Adjusted taxable income | | 4,011 |

(ii) Tax payable = 30% x 4,011,000 = 1,203,300

# DECEMBER 2013

## QUESTION ONE

(a) (i)Charitable trusts are exempted from taxation under the following conditions:
- They are public in character serving a section of the public or the whole public.
- They are for relief of distress or poverty in Kenya.
- They are for advancement of religion or education.
- Their incomes are expended in Kenya for charitable purposes and for benefit of Kenyan citizens.

(ii) Amateur Sport Associations
The income (apart from their investment income) is exempt from taxation if:
- The members are amateurs.
- The aim of the association is foster and control outdoor sports.
- It"s by-laws provide that should a member turn professional, he ceases to be a memberof the association.

(b) The areas to pay attention in auditing of PAYE are:
- Has the employer all the cash and non-cash benefits or emoluments into payroll.
- Was the correct amount of PAYE deducted?
- Was all the PAYE deducted remitted to the tax authorities.
- Were the payroll records correctly transferred to tax deduction cards.
- Have all the tax deductions correctly completed in all respects?

(c) Refer to solution of Q5 (c) Dec 2000.

(d) Permanent establishment
- This, in relation to any person (individual or body corporate) means a fixed place of business inwhich a company carries on business.
- For the purposes of this definition, a building site or a construction site or assembly projectwhich has existed for six months or more shall be deemed to be a fixed place of business.

## QUESTION TWO

(a) The qualifying expenditures for mining investment deduction (M.I.D) are:
- Cost of buildings, machineries and other assets that would have little or no value if the mine ceased to operate.
- Cost of acquisition of rights over the minefield and minerals excluding cost of land.
- Cost of prospecting, exploring and searching the mine.
- Any intangible drilling costs.
- Cost of development, administration and management during prospecting, explorations and during the period prior to the commencement of mining operations.

(b) (i)Investment deduction (Kshs. „000") year 2003 @ 70%.

| **Asset** | **Q. Cost** | **I.D @ 70%** | **Residual for IBD & WTA** |
|---|---|---|---|
| F. Building | 5,200 | 3,640 | 1,560 |
| Processing machine | 1,940 | 1,358 | 582 |
| Conveyor Belt | 120 | 84 | 36 |
| | | 5,082 | |

| **2004** | **Q. Cost** | **I.D. @ 100%** | **Residual** |
|---|---|---|---|
| F. Building | 2,000 | 2,000 | - |
| P. Machine | 640 | 640 | - |
| Parking Bay | 560 | 560 | - |
| Sewerage systems | 700 | 700 | - |
| | | 3,900 | |

(ii) Industrial Building Deduction (IBD)

**Year 2003:** **Kshs. „000"**

| Building | Q. Cost | Residual b/f | IBD @ 2.5% | Residual c/f |
|---|---|---|---|---|
| F. Building | 1,560 | - | 39 | 1,521 |
| Godown at cost | 960 | 864(W1) | 24 | 840 |
| | | | 63 | |

**Year 2004:**

| | | | | |
|---|---|---|---|---|
| F. Building | 1,560 | 1,521 | 39 | 1,482 |
| Godown | 960 | 840 | 24 | 816 |
| Borehole* | 600 | - | 5* (W2) | 595 |
| | | | 68 | |

*W1 = 960 – (960 x 2.5%p.a x 4 yrs) = 964

W2 = $600 \text{ x } 2.5\% \text{ p.a. x } \frac{4}{12} = 5$

Borehole qualify for IBD.

(iii) Loose tools

Year 2003:

Diminution = $33\frac{1}{3}$% x 30,000 = 10,000

Year 2004:

Diminution = $33\frac{1}{3}$% x 30,000 = 10,000

(iv) Wear and Tear Allowance (WTA) (Kshs. „000")

| **Class** | **I @ 37.5** | **II @ 30%** | **III @ 25%** | **IV @ 12.5%** |
|---|---|---|---|---|
| WDV 1.1.2003 | NIL | NIL | NIL | NIL |
| Add: P. Machine net of I.D. | - | - | - | 582 |
| Coveyor Belt | - | - | - | 36 |
| Lorry and Tractor | 3,300 | - | - | - |
| Computers | - | 600 | - | - |
| Motor car (non-commercial) | - | - | 1000$^{R}$ | - |
| Fax machine | - | 90 | - | - |
| Trailer (detachable) | - | - | - | 200 |

| | | | | |
|---|---|---|---|---|
| Pick-up van (commercial) | - | - | 1,200 | - |
| | 3,300 | 690 | 2,200 | 818 |
| W.T.A | (1,237.5) | (207) | (550) | (102.3) |
| WDV 31/12/2003 | 2,062.5 | 483 | 1,650 | 715.7 |
| **Year 2004:** | | | | |
| WDV 1/1/2004 | 2,062.5 | 483 | 1,650 | 715.7 |
| Additions | - | - | - | - |
| Disposals m. vehicle ($W_1$) | - | - | (342.9) | - |
| | 2,062.5 | 483 | 1,307.1 | 715.7 |
| | (773.4) | (145) | (326.8) | (89.5) |
| | 1,289.1 | 338 | 980.3 | 626.2 |

## QUESTION THREE

(i) Hotel and restaurant services
- Taxed V.A.T at a lower special rate of 14%
- V.A.T paid by hotel owner.

(ii) Transportation of raw material
- Exempt from V.A.T.

(iii) Medical services
- Exempt from VAT

(iv) Mobile phone airtime
- Subject to VAT at 16% standard rate.
- Paid by service provider. It"s passed to the consumer through higher charges.

(b) Since prices are inclusive of VAT, the input or output VAT would be determined as follows:

$$\frac{16\%}{116\%} \text{ x price inclusive of V.A.T}$$

| Month | | Input VAT | | Output VAT |
|---|---|---|---|---|
| January | Purchases | 206,897 | Sales | 303,448 |
| February | Purchases | 248,276 | Sales | 372,414 |
| March | Purchases | 234,483 | Sales | 275,862 |
| April | Purchases | 206,897 | Sales | 124,138 |
| May | Purchases | 55,172 | Sales | 82,759 |
| June | Purchases | 275,862 | Sales | 358,621 |
| Bad debt relief | | 27,586 | Return out | 20,690 |
| V.A.T payable | | 27,586 | | |
| | | 282,759 | | |
| | | 1,537,932 | | 1,537,932 |

## QUESTION FOUR

(a) Refer to solution of question 5 (a) (ii) May 1996

(b) Refer to solution of question 5 (e) may 1997

(c) Mr. J. Barasa

| | Kshs. p.a. |
|---|---|
| Salary 60,000 p.m x 12 | 720,000 |
| Furniture 12% x 300,000 | 36,000 |
| Free lunch 3,600 x 12 = 43,200 > 24,000 | 43,200 |
| Car: higher of 24% x 800,000 x 25% or 69,600 x 25% (1500cc benefit) | 48,000 |
| Tuition fees | 65,000 |
| Gardener 4000 p.m x 12 | 48,000 |
| Watchman 4000 p.m. x 12 | 48,000 |
| Entertainment allowance 10,000 p.m. x 12 | 120,000 |
| Leave allowance 5% x 720,000 | 36,000 |
| | 1,164,200 |
| Add: housing benefit = 15% x 1,164,200 | 174,630 |
| Total pensionable pay | 1,338,830 |
| Less: pension contribution: lower of (i) 30% x 1,338,830 = 401,649 | |
| (ii) Set max. limit = 210,000 | |
| (iii) Actual 20,000 x 12 = 240,000 | (240,000) |
| | 1,128,830 |
| Business income (not at arm"s length) | |
| Kiosk profits 120,000 | |
| Add back wife"s salary 60,000 | 180,000 |
| Taxable income | 1,308,830 |

**QUESTION FIVE**

(a) Resident tax payer

| | | | |
|---|---|---|---|
| (i) | Management fees | = | No: W/T |
| (ii) | Royalties | = | 5% W/T of gross income |
| (iii) | Insurance commission | = | 10% W/T on gross paid to agencies or 5% W/T on gross paid to brokers. |
| (iv) | Rent | = | No W/T |

(b) MAPATO LTD

| | Shs. | Shs. |
|---|---|---|
| Reported Net profits | | 218,600 |
| Add back disallowable expenses | | |
| Depreciation | 344,760 | |
| Travelling expenses – directory | 400,000 | |
| Pension scheme (unregistered) | 160,000 | |
| Compensation | 220,000 | |
| Interest on loan to purchase shares | 72,000 | |
| Audit fees – tax appeal | 32,000 | |
| - discontinued business | 68,000 | |
| Bad debts – general provision | 120,000 | |
| Miscellaneous | | |
| 100 year lease | 28,000 | |
| X- mass party | 24,000 | |
| Ask show | 10,000 | |
| Donations | 41,600 | 1,329,920 |
| | | 1,548,520 |
| Add insurance compensation (embezzlement) | | 12,000 |
| Less: investment income (all non-business income) | | (284,636) |
| Adjusted taxable income | | 1,275,884 |

**NB**: Embezzlement of staff of Sh. 21,600 is treated as allowable expense but compensation as taxableincome. This is the practice for strictly cash and stock embezzlement or loss.

# ANSWERS - PAST PAPERS

## SUGGESTED SOLUTIONS TO THE PAST PAPER QUESTIONS
## JUNE 2003-DECEMBER 2013

## MODEL ANSWERS TO THE PAST ATC PAPERS

### JUNE 2003

### QUESTION ONE

(a) (i)A direct tax is one whose impact as well as incidence falls on one and the same person while an indirect tax has its impact on one person and incidence is partly or wholly on another person.

Examples of a direct tax include income tax, wealth tax, gift tax, inheritance tax and corporation tax. Examples of indirect tax include Value Added Tax (VAT), Sales tax, Customs and excise duties.

Note that impact of tax in the case of direct tax is on the person on whom it is legally imposed and the same person pays the tax. In indirect taxation, however, the tax is legally imposed on one person and through tax shifting, it is paid by another person.

Direct tax has income as the base while indirect tax is based on expenditure/consumption.

(ii) Value Added Tax (VAT) is a multi-stage indirect tax based on the expenditures of individuals as well as legal persons and services on taxable goods and services charged and collected by traders/businessmen acting as agents to the taxing authority. Registered persons are required to charge output VAT on Sales made of taxable goods and services and to recover input VAT charged on purchases they made such that the final consumer bears the final burden of the tax.

(b) The VAT tax period is one month, hence VAT collected for any particular month must be remitted to the VAT department using form VAT 3 by the 20th day of the following month using a bankers cheque addressed to the commissioner VAT or by cash. Where the 20th day of the following month falls on a public holiday or a weekend, then VAT payable must be paid by the last working day before that weekend or holiday. Note that failure to submit a return attracts a default penalty of Ksh.10,000 and additional interest of 2% per month compounded. Failure to pay the tax attracts Ksh.15,000 penalty.

(c) (i)**Mr. Mali Mingi**
**Selling Price for a bag of cement**

| | **Ksh.** |
|---|---|
| Cost of cement production to Athi Cement Ltd. | 220 |
| Profit margin cost @ 20% | 44 |
| V.A.T exclusive price by Athi Cement Ltd. | 264 |
| Profit margin for Mali Mingi @ 20% | 52.8 |
| VAT exclusive price by Mali Mingi | 316.8 |
| VAT thereon @ 16% | 50.688 |
| Total price VAT inclusive | 367,488 |

(ii) **VAT Payable by Mali Mingi**

| | | |
|---|---|---|
| VAT Payable | = | Output tax less input tax |
| | = | 50.688 – (16% x 264) |
| | = | 8.448 |

**QUESTION TWO**

(a) The following capital allowances may be available to the farmer:

1. Farm works allowances
2. Wear and tear allowances
3. Investment deduction and industrial building deduction

(1) Farm works allowances are granted where a farmer incurs capital expenditure on construction of farm works on a farm for the better performance of farm activities. Farm works include farm houses, labour quarters, fences, dips, drains, water and electricity supply works other than machinery, fish pond, coffee factory, house stable, cowshed, windbreaks, roads, stores, irrigation network, etc. The rate of farm works deduction with effect from 1.1.1985 is 33½%. In the case of farmhouse, only one third of the initial cost of the farmhouse qualities for farm works deduction.

(2) Wear and tear allowances will be granted where during a year of income machinery owned by a farmer is used by the farmer for the purpose of farming activity. Note that machinery which qualify for wear and tear are classified into four pools with rates as follows:-

| | |
|---|---|
| Class I | @ 37.5% |
| Class II | @ 30% |
| Class III | @ 25% |
| Class IV | @ 12.5% |

(3) Investment deduction and industrial building deductions may be claimed on industrial building and machinery in the case of manufacture.

(b) **Pesa Ltd.**

**Capital Allowances Due in 2003, 2004 and 2005.**

Year 2003:

(i) **Investment Deduction**

| **Asset** | **Cost** | **Investment Deduction @ 70% Sh. „000"** | **Residue for IBD and WTA** |
|---|---|---|---|
| Factory building | 4,800 | 3,360 | 1,440 |
| New machinery: | | | |
| Fixed | 8,000 | 5,600 | 2,400 |
| Moveable | 2,000 | 1,400 | 600 |
| TOTAL | I.D | 10,360 | |

(ii) **Industrial Building Deduction**

Residue after investment deduction is claimable on straight line basis over a forty year period.

| **Building** | **Q. Cost** | **Residual b/f** | **IBD @ 2.5%** | **Residual c/f** |
|---|---|---|---|---|
| Factory net of I.D. | 1,440 | - | 36 | 1,404 |
| Store | 600 | - | 15 | 585 |
| Workers Canteen | 800 | - | 20 | 780 |
| | | | 71 | |

(iii) **Wear and Tear Allowance**

| Class | I @ 37.5% | II @ 30% | IV @ 12.5% |
|---|---|---|---|
| WDV 1/1/2003 | NIL | NIL | NIL |
| Additions: | | | |
| Machines net of I.D. | | | 7000 |
| Delivery trucks (6980 c.c. each) | 4,800 | - | - |
| Office furniture | - | - | 1,600 |
| Computers | - | 2,400 | - |
| | 4,800 | 2,400 | 8,600 |
| WTA | (1,800) | (720) | (1,075) |
| WDV 31/12/2003 | 3,000 | 1,680 | 7,525 |

**Summary of Capital Allowances Year 2003**

| | |
|---|---|
| I.D | 10,360,000 |
| I.B.D | 71,000 |
| WTA | |
| Class I | 1,800 |
| Class II | 720 |
| Class IV | 1,075,000 |
| Total Capital Allowance | 11,506,000 |

**Year 2004**

(i) I.D = NIL

(ii) I.B.D = Sh.71,000 (straight line allowance over 40 years)

(iii) Wear and Tear allowance

| Class | I @ 37.5% | II @ 30% | IV @ 12.5% |
|---|---|---|---|
| WDV 1/1/2004 | 3,000 | 1,680 | 7,525 |
| | 3,000 | 1,680 | 7,525 |
| WTA | (1,125) | (504) | (941) |
| WDV 31/12/2004 | 1,875 | 1,176 | 6,584 |

**Summary year 2004**

| | |
|---|---|
| I.B.D | 71,000 |
| WTA | |
| Class I | 1,125,000 |
| Class II | 504,000 |
| Class IV | 941,000 |
| Total Capital Allowance | 1,884,000 |

**Year 2005**

(i) **Investment deduction**

Qualifying cost = 1,200 + 320 = 1520
I.D = 100% x 1,520,000 = 1,520,000

(ii) **Industrial Building Deduction**

Straight line allowance = Sh. 71,000

(iii) **Wear and Tear Allowance**

| Class | I @ 37.5% | II @ 30% | III @ 25% | IV @ 12.5% |
|---|---|---|---|---|
| WDV 1/1/2005 | 1,875 | 1,176 | - | 6,584 |
| Additions: Saloon | - | - | 600 | - |
| | 1,875 | 1,176 | 600 | 6,584 |
| WTA | (703.125) | (352.8) | (150) | (823) |
| WDV 31/12/2005 | 1,171.875 | 823.2 | 450 | 5,761 |

**Summary of Capital Allowance Year 2005**

| | |
|---|---|
| ID | 1,520,000 |
| I.B.D | 71,000 |
| WTA | |
| Class I | 703,125 |
| Class II | 352,800 |
| Class III | 150,000 |
| Class IV | 823,000 |
| Total Capital Allowance | 3,619,925 |

**Notes:**

1. Delivery trucks have been assumed to be heavy and 3 tons and above hence treated as class I items.
2. Investment deduction rate for year 2004 of 100% of qualifying cost is used.
3. Store automatically qualify for IBD.

$$\% \text{ of showroom} = \frac{800}{5,600 - 600} = \frac{800}{5,000} \text{x}100 = 16\% > 10\%$$ hence can"t qualify for I.D.

## QUESTION THREE

(a) A public good is one used by the public, i.e. some members of society cannot be prevented from its consumption. An example would be provision of Education in Kenya. Generally speaking Education is **indivisible**, it cannot be **priced** in the market in order to deprive some members of the society from its use or benefits.

An individual cannot refuse the benefit of education or street lighting. Since the **exclusive principlecannot be applied** to the indivisible goods or services, this creates a problem of raising thenecessary finances. Some individuals may argue that if they didn"t pay for education, the supply of education service would still be there. Voluntary payment would be lower (problem of free-riders).

Consequently, provision of such public good/services will be made through compulsory contributions by the members of society for example through taxation. The decisions regarding whether or not education service be provided in Kenya or where or not Kenyans require such good cannot be left to the market forces of demand and supply. Society has to decide the way in which these decisions will be taken and financed and such decisions need not be unanimous.

Government decides whether or not education is necessary and be provided to Kenyan society and how finances have to be raised. Note that education services in Kenya are also provided by the private sector where individuals decide whether or not to pay for such service provided by private institutions.

Government may introduce cost sharing in addition to taxation to ensure that education services are provided to all.

(b) The principle of cost sharing refers to the requirement for the members of society to share in/or supplement the total cost of provision of public goods and services by Government. This is usually in appreciation of the following facts:

1. That there is an ever-increasing requirement for Government to provide goods and services which continually puts greater pressure on limited resources available to the state.

2. That members of society view projects for provision of public goods and services as their own such that they cultivate sense of ownership and accountability.

3. That whereas public goods are for benefit of all, it would be fair to introduce the element of a charge on or contribution by those directly benefiting from such projects rather than entirely depend on taxation of all.

4. Cost sharing may affect level of taxation such that rather than raise taxes to generate extra funds cost showing is used to target persons directly benefiting from the individual project/service or good. This can only apply where society has enough disposable income left in their hands after taxation. In a situation of general poverty and increasing pressure on Government to provide essential services and goods cost showing would be minimal and as such taxation would still be high or public debt would increase.

**QUESTION FOUR**

(a) Deductions that may be available against gains or profits from employment are:

- Mortgage interest (owner occupied interest) paid on loan to buy or improve a residential house up to a maximum Ksh.100,000 from year 2001. Note that where the mortgage interest paid is less than the maximum, the actual interest paid is claimed. Where actual mortgage interest is higher than maximum only maximum allowable can be claimed. W.e.f 1/1/2006, the maximum allowable interest is Sh. 150,000 p.a (12,500 p.m)
- Actual amount contributed by an employee to a registered pension or provident fund which shall be the lower of (i) Actual contribution or Sh. 240,000 or 30% of pensionable income.
- Contribution to a registered Home Ownership Savings Plan up to Ksh.48,000 p.a., that is Ksh.4,000 p.m.
- N.S.S.F of Kshs 200 p.m (Kshs 2,400 p.a)
- Subscriptions to professional associations such as LSK, IATCK etc.

(b) (i)**Mr. Matata**

**Total Income Chargeable to Tax and Tax Thereon**

| | SH."000" |
|---|---|
| Self: | |
| Employment income:- | |
| Salary (Sh."000" 40 x 12 months) | 480 |
| Bonus (2% x 10 million) | 200 |
| Insurance cover for life and household items | 20 |
| Other incomes:- Business income | |
| Sh."000" 60 less 40 b/fwd | 20 |

| | |
|---|---|
| Taxable income | - |
| | 720,000 |
| Wife: | |
| Employment incomes: | 624 |
| Salary (Sh."000" 52 x 12 months) | 86.4 |
| Company car 1,800 c.c | 12 |
| Staff gifts of oil products (Sh."000" 20 x 12 months) | 240 |
| Chargeable income | 962.4 |

**Tax Liability**

Husband on Kshs. 720,000

| | |
|---|---|
| 1st 121,968 @ 10% | 12,196.8 |
| Next 114,912 @ 15% | 17,236.8 |
| Next 114,912 @ 20% | 22,982.4 |
| Next 114,912 @ 25% | 28,728.0 |
| 466,704 | 81,144.0 |
| Surplus (720,000 – 466,704) @ 30% | 75,988.8 |
| Gross tax | 157,132.8 |
| Less p/relief | (13,944.0) |
| Less PAYE deducted | (130,000.0) |
| Net tax | 13,188.8 |

OR

| | | |
|---|---|---|
| (121,968 @ 10%) + (114,912 @ 60%) | = | 81,144.0 |
| (720,000 – 466,704) @ 30% | = | 75,988.8 |
| Gross tax | | 157,132.8 |
| Less: p/relief + PAYE | | (143,944.0) |
| Net tax | | 13,188.8 |

Wife on Kshs. 962,400

| | |
|---|---|
| 1st Kshs. 466,704 = (121,968 @ 10%) + (114,912 (15% + 20% +25%) = | |
| (121,968 @ 10%) + (114,912 @ 60%) = | 81,144.0 |
| Surplus (962,400 – 466,704) @ 30% | 148,704.8 |
| Gross tax | 229,852.8 |
| Less: personal relief | (13,944.0) |
| PAYE deducted | (180,000.0) |
| Net tax | 35,908.8 |

(ii) **Information not used in (i) above:**

- Capital gains arising from sale of a plot in Nairobi of Sh.600,000 is not taxable since the law relating to capital gains tax is currently suspended in Kenya.
- Insurance by Utajiri Limited of sales does not affect computation of taxable income of Mr. Matata. Dividends from the three companies is taxed at source at 5% final tax.
- Interest income on Housing development bonds from HFCK is not taxed further since it is below the first Ksh.300,000 p.a. Post office savings bank interest is tax exempt. Kenya Commercial Bank and Treasury bonds interest suffer withholding tax as final taxation5%.

(iii) Mr. Matata is not to blame for failure of the company to pay his PAYE since the deduction from his pay was properly effected and shown in the monthly pay slip. It is the company"s (employer) responsibility to deduct and remit PAYE to the taxing authority failure to which they will pay a penalty of 25% of unpaid tax or Ksh.10,000 whichever is higher.

## QUESTION FIVE

DATE: 1/1

MEMO FROM: TAX MANAGER
TO: MR. HESABU – TAX CONSULTANT AND DIRECTOR
REF: TAX CONSIDERATIONS ON POINTS RAISED BY CLIENTS

(i) Mr. Wote"s taxable income is arrived at as follows:

| | |
|---|---|
| Partnership profits reported | 180,000 |
| Add back interest to Watu and Wote (Sh.25,000 x 2) | 50,000 |
| Adjusted Partnership profit | 230,000 |

Distributed as follows:

| Partner | WATU | WOTE | WAD | TOTAL |
|---|---|---|---|---|
| | SH."000" | SH."000" | SH."000" | SH."000" |
| Interest on Capital | 25 | 25 | - | 50 |
| Balance of profits | 54 | 54 | 72 | 180 |
| | 79 | 79 | 72 | 230 |

Therefore Mr. Wote"s taxable income in equivalent to KShs. 79,000

(ii) Live Well Foundation being a Non-Governmental organization formed to address people"s spiritual needs is of a Public character and sources of its income include donations, charitable walks and sale or religious literature and where such income is entirely expended in Kenya for the same purpose, no tax liability arises.

(iii) Liability to tax on farm income to wife rests with the husband. Secondly where farming is established to be hobby farming then profits will not be chargeable to tax. We are told that family consumption is Sh.60,000 for the year and that she derives a lot of satisfaction from this activity. This may be an indicator to hobby farming. However if 25% or less of the farm produce is consumed then profits are taxable. For year 2005 taxable farm profit would be computed as follows:

| | |
|---|---|
| Profit year 2005 | Sh. 50,000 |
| Add: Own Consumption | Sh. 60,000 |
| | Sh.110,000 |
| Less loss b/fwd (40,000 loss – 20,000 profit) | Sh.(20,000) |
| Taxable farm income | Sh. 90,000 |

Taxable farming income of Ksh.90,000 will be added to the husbands income and total assessed to tax on him.

(iv) By sponsoring research into plants to produce plastic related materials which they manufacture, New plastic Limited will be allowed to deduct the contribution against taxable income of such year of income. This reduces taxable income and tax liability. Section 15(i) (ii) (iv) states: „a sum paid to a university, college, research institute research mentioned in sub-paragraph (iii):" as deductible against taxable income.

Signed
TAX MANAGER

DECEMBER 2003

**QUESTION ONE**

(a) (i)"Pay as You earn" is deductible from weekly wages, month salaries, annual salaries, bonuses, commissions, directors fees (whether the director is resident or non-resident) pensions paid to pensioners who reside in Kenya, where the amount from registered pension funds Kshs. 150,000 p.a. and any other income from an office or employment. W.e.f 1/7/2004, this amount has been increased to Kshs. 180,000 p.a.

It is the employer"s statutory duty to deduct income tax from the pay of his employees whether or not he has been specifically told to do so by the Department.

The law requires an employer to remit the income tax deducted from his employee"s pay before the tenth day of the month following the deduction.

If the total amount of tax deducted, from all employees in any month is less than hundred shillings or when no tax has been deducted, the employer must complete the relevant portions of the top copy of a credit slip and send it direct to his Income Tax office before the tenth day of the following month.

Where total amount of tax deducted is less than Ksh.100, it should be carried forward to later months until it exceeds Ksh.100 or until December, whichever is the earlier, and then paid-in.

(ii) If any employer fails to comply with the provisions of Section 37 and with the provisions of any rules made under Section 130 which deals with the payment over of tax deducted and the accounting for it to the commissioner, the commissioner may, by order, impose a penalty equal to twenty five per cent of the amount of tax involved or tenthousand shillings whichever is greater, and the provisions of the Act relating to the collection and recovery of the tax shall apply to the collection and recovery of any tax payable and such penalty as if it were tax due by the employer.

(a) **MR. MANUBHAI PAYROLL NO. FD0095/12**

(ii) **INCOME TAX, OTHER DEDUCTIONS AND NET PAY**

| | Sh. "000" |
|---|---|
| Income: | |
| Salary (Sh.90,000 x 12) | 1,080 |
| Low interest benefit – taxed on employer (F.B.T) | - |
| Deductible contribution to registered pension scheme | |
| 5% x 1080 | (54) |
| Less NSSF contribution Sh.200 p.m x 12 | (2.4) |
| Tax thereon on Ksh.1,023,600 | 1,023.6 |
| 1st 466,704 = (121,968 @ 10%) + 114,912 (15% + 20% + 25%) = | 81,144 |
| Surplus (1,023,600 – 466,704) @ 30% = | 1,670,688 |
| Gross tax | 248,212.8 |
| Less personal relief | (13,944.0) |
| Net tax | 234,268.8 |
| | |
| Net Pay | |
| Income | 1,080,000 |
| Deductions: | |
| PAYE | (248,213) |
| Personal relief | (13,944) |
| NSSF | (2,400) |

| | |
|---|---|
| Co-operative loan (Sh. 9,967 x 12) | (119,604) |
| Car loan repayment (Sh.10,160 x 12) | (121,920) |
| Pension contribution (5% x 1,080) | (54,000) |
| | 547,807 |

**Note:**

1. Contribution by the employer on behalf of Mr. Manubhai to pension scheme is a non-taxable benefit.
2. Drought levy is no longer applicable.

(ii) Payment of tax is a requirement for all persons liable to tax whether individuals or bodies corporate. The difference arising is that individuals are taxed on total taxable income at the individual rate of tax (Graduated Scale rates) while companies are taxed at a flat corporate tax rate. For both persons expenses are allowable against income where such expense is wholly and exclusively incurred to generate income. Expenses to be matched against employment income are rare and tax is payable on a monthly basis compared to instalment and self assessment tax payments the case of companies which is required by 4$^{th}$, 6$^{th}$, 9$^{th}$ and 12$^{th}$ months during the year and by end of the fourth month after year end respectively. The highest tax bracket in the case of employment income is 30% which is similar to the corporate tax rate. Personal relief is granted to individuals and not to bodies corporate.

## QUESTION TWO

(a) 1.Cost of installing a ventilation system in the factory:

This is a capital expenditure (not allowable) since such installation would occur before the building is put into use and is thus capitalized.

2. Legal expenses incurred when acquiring a new building.

This is a capital expenditure. Such expenses are capitalized and disallowable since they are not incurred in generating taxable business income.

3. Giving the factory a new fresh coat of paint.

This is revenue expense since it is basically a maintenance cost used on a factory already existing and used in generating taxable income.

4. Replacing 200 tiles on a roof damaged by wind

This is allowable expense since tiles are replaced with tiles. If tiles are replaced with other roofing materials, the cost is treated as capital in nature hence disallowable.

5. Demolition cost to accommodate a new machine

This is a capital expenditure and should be capitalized as part of the qualifying cost of the machine. It is incurred before the machine is put into use. It is disallowable expense.

(b) Capital allowances

(i) <u>Corrected written value for industrial building: </u>The

I.D. for year 2000 would have been as follows:

| **Asset** | **Q. Cost** | **I.D @ 60%** | **Residual for IBD and WTA** |
|---|---|---|---|
| Building | 1,600 | 960 | 540 |
| Machinery | 2,000 | 1,200 | 800 |

Therefore I.B.D p.a. $= \frac{540,000}{40yrs} =$ 13,500 p.a.

Written down value as at 1/1/2005 472,500
= 540,000 – (13,500 x 5 yrs)

(ii) Wear and Tear on the machines over five years

| Machines | IV @ 12.5% Sh."000" |
|---|---|
| Cost net of I.D. | 800 |
| WTA yr 2000 | (100) |
| WDV 31/12/2000 | 700 |
| WTA Yr. 2001 | (88) |
| WDV 31/12/2001 | 612 |
| WTA Yr. 2002 | (77) |
| WDV 31/12/2002 | 535 |
| WTAX Yr. 2003 | (67) |
| WDV 31/12/2003 | 468 |
| WTA Yr. 2004 | (59) |
| WDV 1/1/2005 | 409 |

Total WTA over the five years to 31/12/2004 = 391

Incorrect written down value for the machines for manufacture

| Machines | Shs. „000" IV @ 12.5% |
|---|---|
| Cost | 2,000 |
| WTA yr 2000 | (250) |
| WDV 31/12/2000 | 1,750 |
| WTA Yr. 2001 | (21,875) |
| WDV 31/12/2001 | 1,531,25 |
| WTA Yr. 2002 | (191.406) |
| WDV 31/12/2002 | 1,339,844 |
| WTAX Yr. 2003 | (167,480) |
| WDV 31/12/2003 | 1,172,364 |
| WTA Yr. 2004 | (146,545) |
| WDV 31/12/2004 | 1,025,819 |

Therefore correct written down value class IV = Sh. "000" 6,200 + 409 – 1,026 = 5,583

**CAPITAL ALLOWANCES YR. 2005**

(i) **Industrial Building Deduction**

As shown in working No.(i) above = Sh. 13,500

(ii) **Wear and Tear Allowances**

| Class | I @ 37.5% | II @ 30% | III @ 25% | IV @ 12.5% |
|---|---|---|---|---|
| WDV 1/1/2005 | 460,000 | 610,000 | 800,000 | 5,583,000 |
| Additions: | | | | |
| Computers | - | 390,000 | - | - |
| Stamping machine | - | 800,000 | - | - |
| Disposals – car | - | - | - | - |
| Computers | - | (1,220,000) | - | - |
| | 460,000 | 580,000 | 800,000 | 5,583,000 |
| WTA – 2005 | (172,500) | (174,000) | (200,000) | (697,875) |
| WDV 31/12/2005 | 287,500 | 406,000 | 600,000 | 4,885,125 |

**Notes:**

Written down values provided for class IV of Wear and Tear as well as for industrial building are incorrect due to non-claim of investment deduction.

Patents and land costs do not attract capital allowances.

Class three balance is a trading receipt which is taxable in the year.

(ii) Non-claim of investment deduction resulted in erroneous computation of industrial building allowances and wear and tear allowances class IV for the building and machinery for manufacture from year 2000 to year 2004. Investment deduction may be claimable where the commissioner is not yet time barred to do so. In this particular case seven years have not elapsed hence there is chance to claim relief of error. Under section 90 of cap 470.

## QUESTION THREE

(a) The role of a value added tax tribunal is that of an appeals body for the purpose of hearing and deciding on appeals where a taxpayer is dissatisfied with the ruling by the commissioner for value added tax.

The appeals Tribunal has powers of a subordinate court of the first class to summon witnesses, to take evidence upon oath or affirmation and to call for the production of books and other documents.

(b) (i)**PEPO LTD VAT NO. A00012Y**
**VAT ACCOUNT JANUARY 2006**

| | Sh. | | Sh. |
|---|---|---|---|
| June 1 Purchases | | June 1 | |
| (100 units x 1,400 x $\frac{16}{116}$ | 19,310 | (10 units x 1,800 x $\frac{16}{116}$ ) | 24,838 |
| June 7 purchases | | June 2 Sales | |
| (75 units x 1,600 x $\frac{16}{116}$ | 16,552 | 20 units x 1,800 x $\frac{16}{116}$ | 4,966 |
| | | June 5 sales | |
| | | 50 units x 1,800 x $\frac{16}{116}$ | 12,414 |
| | | June 10 sales | |
| | | (20 units x 1,800 x $\frac{16}{116}$ ) | 4,966 |
| | | June 12 sales | |
| VAT Payable | 2,760 | (50 units x 2,000 x $\frac{16}{116}$ ) | 13,793 |

| | |
|---|---|
| 38,622 | 38,622 |

(ii) **Requirements with respect of any sales made**

To issue/furnish the purchaser with a tax invoice at the time of supply or within fourteen (14) days of the completion of that supply. To record all sales made in the sales journal and account and the value added tax element reflected in the value added tax income. Other records include credit and debit notes, customs entries, ledgers, copy of tax invoice, etc. To charge VAT at the right rate on the sale made.

(iii) VAT 3 Return form is a payment return. The return and a bankers cheque are required to be submitted to the Commissioner VAT not later than the 20th day of the month following the month in which the sale took place. Where the 20th day for submission of returns falls on a public holiday, a Saturday or a Sunday, then the return and payment must be submitted on the last working day prior to that day. Payment returns should be submitted to any of the commercial banks or Central Bank nearest to your business.

## QUESTION FOUR

(a) A tax is a compulsory contribution by persons liable to pay tax to the state to defray the expenses incurred in the common interest of all, without reference to special benefits conferred. By compulsory we mean any person who refuses to pay a tax is liable to punishment. Tax revenue is used for the benefit of all and there is no direct „Quid Pro Quo" payment. The National social Security Fund is a government fund which was established by the National social Security Fund Act 1965 for the benefit of workers. It is a compulsory savings scheme into which the employer pays a statutory contribution for every employee who is a member of this fund. The scheme is applicable to those employers having five or more employees. The average rate of contribution is 10% of a worker"s wages half of which is paid by the employer an half by the worker.

The following benefits are provided under this scheme:

- Age benefits–paid to a member at age of sixty or when he retires from paid employment,whichever is later.
- Withdrawal Benefit–paid to a member who is at least fifty-five years of age and has not engagedin paid employment during the previous three months.
- Invalidity Benefit–Paid to a member who is permanently incapable of work because of physicalor mental disability.
- Survivors Benefit–Paid to the dependants of deceased member
- Immigration Grants–Paid to a member who is permanently emigrating from Kenya.

(b) (i) Payment of pension from a registered scheme to a pensioner will be based on the following rules:

the first Ksh.150,000 received by a resident individual in a year of income in respect of pensions or retirement annuities is exempted and is not chargeable to tax Sec 58 (4). (Shs. 180,000 p.a. w.e.f 1/7/2004).

Lump sum payment of first Ksh.480,000 is exempted from income tax upon maturity of employment.

(i) Payment to widow or widower of a pensioner will be treated as follows:

- the first Ksh.1,400,000 of such a lump sum payment will be consolidated income not chargeable to tax as income of the beneficiary.

(c) The following are the main rules relating to a registered Pension scheme – Sec.22:

(i) Deduction in respect of contributions of an employee in a year shall be limited to the lesser of:-

the sum of the contributions made by the employee to registered funds in the year, or thirty per cent of the employee‟s pensionable income in the year, or two hundred and ten thousand shillings per year or seventeenthousand five hundred shillings per month of service. (240,000 w.e.f 1/1/2006).

(ii) the deduction in respect of the contributions made by an employer in a year under defined contribution provisions of registered funds shall be limited to the sum of the deductible contributions of the employer in the year.

(iii) the deduction in respect of the contributions made by an employer in a year under defined benefit provisions of registered funds shall be limited to the amount by which the lesser of -

the sum of the contributions made by the employer and by the employee in the year to registered funds in respect of members of the defined benefit registered funds of the employer, or

thirty per cent of the sum of the pensionable incomes from the employer in the year of members of defined benefit registered funds of the employer; or

two hundred and ten thousand shillings per annum times the number of full-year members of defined benefit registered funds of the employer, exceeds the sum of -

(i) the deductible contributions made in the eyar to the registered funds of the employer by the members of registered funds of the employer, and

(ii) the amounts deducted by the employer for the year for contributions made under defined contribution provisions of registered funds under subsection (2) in respect of the members of the defined benefit registered funds.

(iii) Pension funds in respect of an employee may be transferred to another registered fund or registered individual retirement fund and not be treated as a withdrawal under Sec.3 (2) ©.

(iv) Where registered fund is wound up, any surplus funds therein shall be deemed to be the funds of the employer and shall be immediately withdrawn by the employer unless the trust deed in respect of such registered fund specifies the contrary.

Other rules:

- Funds must be registered
- contribution cannot be withdrawn before 5 years have expired neither can contributions be used as security.

## QUESTION FIVE

**a)**

| | | |
|---|---|---|
| Net Profit – (General Reserve) | | 240,000 |
| Add back disallowable expenses | | |
| Understated closing stock | 30,000 | |
| Salary to Leo | 100,000 | |
| Legal expenses – fines | 30,000 | |
| Interest on capital (160+120+140) | 420,000 | |
| Commission to partners | 160,000 | |
| Instalment tax paid | 90,000 | |
| Depreciation | 184,000 | |
| Donation | 200,000 | |
| Property taxes | 92,000 | 1,306,000 |
| | | 1,546,000 |
| Less non-business income/allowable expenses | | |
| Capital allowances | 180,000 | |
| Interest earned | 240,000 | |
| Rent income | 264,000 | |
| Capital gains | 200,000 | (884,000) |
| Business Loss | | 662,000 |

b) Allocation of profits

| Partner | Leo | Kesho | Kutwa |
|---|---|---|---|
| Ratio | ⅓ | ⅓ | ⅓ |
| Salary | 100,000 | - | - |
| Commission | 90,000 | - | 70,000 |
| Interest on capital | 160,000 | 120,000 | 140,000 |
| Share of loss | (6,000) | (6,000) | (6,000) |
| | 344,000 | 114,000 | 204,000 |
| Add share of rent income | 88,000 | 88,000 | 88,000 |
| Total income | 432,000 | 202,000 | 292,000 |

(c) The profit of each partner will be aggregated with other incomes from other sources and taxed on graduated scale according to PAYE system.

(d) Five issues that would require further enquiry are:-

1) Method of valuation of stock
2) Bad debts – Are they general or specific and what is the provision for the current year.
3) What constitute "other receipts" and is it business or private income?
4) Breakdown of general expenses to determine the allowable and disallowable expenses.
5) What assets are granted capital allowances? To what extent are they used for business and private purposes.
6) Interest earned – what is on bank deposit, drawings by partners, loans to 3rd parties etc.

**JUNE 2004**
**QUESTION ONE**

(a) Mrs. Neno taxable income

| | | Sh. | Sh. |
|---|---|---|---|
| Gross professional fees received | | | 1,000,000 |
| Less allowable expenses received | | | |
| Subscriptions to professional association | | 20,000 | |
| Debt collection expenses (dental patients) | | 6,000 | |
| Wages for dental assistant | | 120,000 | |
| Rent for clinic premises | | 140,000 | |
| Water and electricity | | 40,000 | |
| Other clinic expenses | | 70,000 | |
| Hire of car for use | | 50,000 | |
| Uniforms for staff | | 5,000 | |
| Contributions to provident fund (Note 1) | | 60,000 | |
| Wages to cleaners and watchman | | 50,000 | |
| WTA on furniture 64,000 x 12.5% | | 8,000 | |
| Diminution on surgical instruments (Note 2) | | 13,333 | (582,333) |
| Professional taxable income | | | 417,667 |
| Add rent income | 14,000 | | |
| Less rent collection expenses | (2,000) | | 12,000 |
| Director"s fees received (gross) (120,000 + 3,000) | | | 123,000 |
| Total taxable income | | | 552,667 |

**Note 1** - Assumed that the provident fund was registered hence her contribution would beallowable.

**Note 2** - Cost of surgical instruments treated as cost of tools and implements for practicehence enjoy diminution at a rate of 33⅓ % p.a. on cost.

(b) Tax payable on Ksh.552,667

| | |
|---|---|
| First Ksh.121,968 @ 10% | 12,196.8 |
| Next Ksh.114,912 @ (15% + 20% + 25%) | 68,947.2 |
| Surplus (552,667 – 466,704) @ 30% | 25,788.9 |
| Gross tax liability | 106,932.9 |
| Less personal relief | (13,944.0) |
| Less withholding tax on director"s fees | (3,000.0) |
| Net tax liability | 89,988.9 |

(c) Mrs. Neno shall file a self-assessment return. She should pay self-assessed tax by end of the fourth month after the accounting year i.e 30$^{th}$ April 20066. She should file the self-assessment return by 30$^{th}$ June 2006 (end of the 6$^{th}$ month after the end of accounting year.)

**QUESTION TWO**

(a) (i) the manager draws a salary of more than Ksh.50,000 per month (i.e more than sh.600,000 p.a) and therefore Housing benefit is to be computed using the normal 15% of gains from employment and the figure obtained compared with the actual rent paid to the landlord of sh.720,000 p.a. or Sh.60,000 that is 15% x 80,000 x 12 months = sh.144,000 compared to Sh.720,000 p.a. therefore housing benefit would be Sh.720,000 p.a.

(ii) Contributions by an employee to a registered pension fund will be deductible against income up to the lesser of 30% of pensionable pay, i.e. 30% x 80,000 x 12 months = Sh.288,000 p.a. or actual contributionofSh.84,000 p.a. or set limit (year 2001) of Sh.210,000 p.a. Therefore Sh.84,000 p.a. would be deductible against income before tax.

Note: w.e.f 1/1/2006, the set limit has been increased to Sh. 240,000.

(iii) Provision of a company car gives rise to a car benefit equal to the higher of c.c. rating and 2% per month multiplied by initial cost of car. In this case the c.c. rating is not revealed but 2% x 12 months x Sh.1,200,000 would give a taxable benefit of Sh.288,000 p.a.

(b) A high school boy inheriting Sh.300,000 from his grandfather would not pay tax on the amount since there is presently no inheritance tax in Kenya. However stamp duty is chargeable on such transfer. Winning sh.100,000 in the National lottery is non-taxable income regarded as a windfall gain.

(c) Compensation received for termination of a contract of employment or services is taxable income. In this case the taxable amount will be at the annual rate of earning immediately before termination multiplied by the years outstanding i.e.

| | |
|---|---|
| Contract term | 3 years |
| Unexpired term | 2 years |
| Total compensation | Sh.560,000 |

Therefore taxable amount will be:

| **Year** | **Taxable amount** **Sh."000"** |
|---|---|
| 2006 | 440 |
| 2007 | 120 |
| Total | 560 |

This treatment arises due to the fact that the contract was for specified term.

## QUESTION THREE

(a) VAT is a multi-stage indirect tax imposed at every point of sale on value added to goods and services. The tax paid on expenditure is called the input tax and tax charged on income is called output tax.

(b) The case for VAT in Kenya is:

- Easy to administer since the seller of good or service becomes the collection agent.
- It allows for the canon of productivity since more goods and services can be subject to VAT to increase revenue to the government.
- It is difficult to evade since it is charged on selling price.
- It does not have a cascading effect i.e no tax is charged on tax.

The case against VAT

- It is complicated for most traders and requires many records to be maintained.
- If charged on basic commodities, hence it falls heavily on the poor and may not be equitable.
- Not convenient for most taxpayers e.g it has to be paid by 20th day of the following month even where the trader made a credit sale and has not received cash.
- It could have inflationary effects since it will lead to increase in commodity prices.

(c) Assuming the buying price was exclusive of VAT, then
input tax for Salka = 16% x 1,000,000 = 160,000

**SAIKA Ltd.**

| | |
|---|---|
| Buying price exclusive of VAT | 1,000,000 |
| Add conversion cost @ 40% | 400,000 |
| | 1,400,000 |
| Add 20% mark-up | 280,000 |
| Selling price exclusive of VAT | 1,680,000 |
| Add 16% output VAT | 268,800 |
| Selling price inclusive of VAT | 1,948,800 |

VAT paid by Saika = 268,800 – 160,000 = 108,800

Chemuka Ltd.

| | | |
|---|---|---|
| Buying price exclusive of VAT | | 1,680,000 |
| Add conversion cost @ 50% | | 840,000 |
| | | 2,520,000 |
| Add 10% mark-up | | 252,000 |
| Selling price exclusive of VAT | | 2,772,000 |
| Add 16% output VAT | | 443,520 |
| Selling price inclusive of VAT | | 3,215,520 |
| Output VAT charged | 443,520 | |
| Less input VAT paid | 268,800 | |
| VAT payable by Chemuka | 174,720 | |

Retailer

| | |
|---|---|
| Buying price inclusive of VAT | 3,215,520 |
| Buying price exclusive of VAT | 2,772,000 |
| Input VAT paid | 443,520 |
| Buying price exclusive of VAT | 2,772,000 |
| Add 50% mark-up | 1,386,000 |
| Selling price exclusive of VAT | 4,158,000 |
| Add 16% output VAT | 665,280 |
| Selling price inclusive of VAT | 4,823,280 |

VAT payable= 665,280 – 443,520 = 221,760

## QUESITON FOUR

(a) Qualifying expenditure – the cost of the asset (used for generating taxable income) which should qualify for a capital allowance/deduction

(b) The items to be included as qualifying expenditure include:

- Buying price of the asset
- Any customs duty and Vat paid on the asset
- Installation costs
- Insurance on transit and transport costs before the asset is brought into use
- Cost of demolition of a building to accommodate the asset
- Any repair cost incurred before the asset is brought into use

- As a rule, any incidental cost incurred before the asset is brought into use is a qualifying expenditure.

(d) Kalamuka qualifying cost of Sh.4 M would be broken down as follows:

| Construction cost | | Apportioned to buying price | | |
|---|---|---|---|---|
| Land | 200 | 200/2.000 x 4,000 | = | 400 |
| Fees | 40 | 40/2,000 x 4,000 | = | 80 |
| Leveling | 60 | 60/2,000 x 4,000 | = | 120 |
| Construction | 1,540 | 1540/2,000 x 4,000 | = | 3,080 |
| Office | 160 | 160/2,000 x 4,000 | = | 320 |
| | 2,000 | | | 4,000 |

Land does not qualify for any capital allowance hence qualifying cost = 4,000 – 400 = 3,600

Office cost qualify for capital allowance since its cost is less than 10% i.e $\frac{320}{3,600}$x100 = 8.9%

Kalamuka will claim capital allowances as follows:

**I.B.D claimed in 2004**

| Item | Qualifying cost | Residual b/f | I.B.D @ 2.5% | Residual c/f |
|---|---|---|---|---|
| Building | 1,080 | - | 27 | 1,053 |

BB Ltd will inherit the residual of 1,053,000 for the remaining 39 years.

**Capital allowances for 2005**

1. **Investment deductions Sh."000"**

| Item | Qualifying cost | I.D @ 100% | Residual for WTA & IBD |
|---|---|---|---|
| Building extension | 100 | 100 | - |
| Boiler | 1,000 | 1000 | - |
| New sorter | 1,200 | 1,200 | - |
| | | 2,300 | |

2. **IBD Sh."000"**

| Item | Qualifying cost | Residual b/f | IBD @ 2.5% | Residual c/f |
|---|---|---|---|---|
| Old building | 1,030 | 1,053 | 27.00 | 1,026.00 |
| Security wall | 100 | - | 2.50 | 97.50 |
| | | - | 29.50 | |

3. **WTA**

| Class | I @ 37.5% | III @ 25% | IV @ 12.5% |
|---|---|---|---|
| Milling machines | - | - | 1,800,000 |
| Tractor | 1,600,000 | - | - |
| Motor vehicle | - | 1,200,000 | - |
| Furniture | - | - | 600,000 |
| Less disposals – lorry | (180,000) | - | - |
| Milling machine | - | - | (200,000) |
| Damaged fixtures and fittings | - | - | (8,000) |
| | 1,420,000 | 1,200,000 | 2,192,000 |
| WTA | (532,500) | (300,000) | (274,000) |

| | | | |
|---|---|---|---|
| WDV 31/12/2005 | 887,500 | 900,000 | 1,918,000 |

**Summary of 2005 capital allowances**

| | |
|---|---|
| I.D | 2,300,000 |
| I.B.D | 29,500 |
| WTA (532,500 + 300,000 + 274,000) | 1,106,500 |
| Total | 3,436,000 |

## QUESTION FIVE

(a) **Presumptive Tax on Agricultural Produce**

- This tax was levied on the value of gross sales of specified agricultural produce. Introduced in 1989 was charged at rate of 5% and collected by the authorized agents specified in the 19$^{th}$ sechdule of the Act. These agents are required to remit this tax to the commissioner in 30 days of making such deductions.
- This tax is charged under the provisions of Section 17 (a) of the Income tax Act and based on the presumption that farmers who grow certain crops or produce derive gains and profits chargeable to tax under Section 3 (2) (a).
- The rate was later reduced to 2% which was final tax in the case of individual farmers only. Presumptive tax which was suspended from 1$^{st}$ January, 1999 was reintroduced with effect from 1$^{st}$ January 2000 and lasted till June 2000 when it was again suspended.
- The tax complies with principles of a good tax in that gains to farmers are also brought to taxation in line with canon of equality/equity or fairness.
- It is convenient and economical since it is collected by authorized agents appointed by Government and that it is based on gross sales made. It is certain since it is collectable at points of sales of agricultural produce affected.

(b) **Cess on Agricultural Produce**

Is a levy imposed by Rural local authorities on traders of the main commodities found in such local authority such as Agricultural produce, building materials, e.g. Sand, Stones, Quarry chips. The purpose of the levy is to maintain roads and essential facilities provided by such local authority.

(c) **Trade Licence Chargeable to Professionals**

Trade licences fees are charged in accordance with provisions of Trading Licenses Act (Cap 497). These are licenses on annual basis to grant the permission to conduct professional work for a gain. This charge ensures that the right persons get the authorization to conduct professional work and protects such professionals from non-qualified persons who may wish to join the trade. It is convenient and economical since the licenses will normally be issued by the local authority concerned as a Government body. It may not be productive given few number of professionals require such permit per year but satisfies principle of equity or fairness as professionals desiring to practice are also brought into the tax net.

(d) **Stamp Duties on Transfer of Premises**

Stamp duties are charges by Government in respect of some documents which are specified in the Stamp Duties Act. Stamp duties are charged in Kenya in accordance with the provision of Stamp Duties Act Cap 480. instrument must be stamped where property transfers are effected.

Conveyance or transfer duty is charged on every instrument or court order in respect of the transfer of any property as a result of sale. Stamp duty on transfers of premises is equitable/fair since the property owners contribute tax, it is convenient since it is only applicable upon such transfer.

## DECEMBER 2004

## QUESTION ONE

(a) Tax evasion is an illegal means employed by a taxpayer in order to reduce his tax liability. This may be carried out by fraudulent or false tax, smuggling, hiding or non-declaration of incomes, claiming expenses or relief one is not entitled to, etc. The Tax Act usually states the penalties to be applied in case of evasion of tax.

Tax avoidance on the other hand is where a taxpayer uses methods to reduce tax liability but within the law. This could be done by studying the Tax Act and detecting loopholes in it to be exploited to the full advantage of the taxpayer. For example a taxpayer could operate business as a company or sole proprietorship or partnership whichever gives the best advantage. Pressure groups could be formed to influence legislation in taxpayers favour. Note that tax avoidance (tax planning) may or may not lead to loss of revenue to the government and is not punishable.

(b) Three ways in which the government may lose tax revenue on imports are:-

1. Collusion
2. Use of wrong rates or valuations for goods
3. Conversion of goods on transit for local use.

Collusion may take place between customs officials and taxpayers in order to escape or pay less tax. Wrong rate or valuations may result due to improper import declaration procedures, poor inspection procedures. Goods destined for other countries which are on transit to such countries may be converted and sold in the country so that no duty is paid on them.

(c) To prevent or curb loss of revenue on imports, Mombasa port should seal loopholes by:-

1. Ensuring that import declaration procedures as well as pre-shipment inspections be improved and tightened. Offshore inspections and proper classifications of goods imported be done.

2. Goods in transit must reach countries of destination and not converted into use in the country by ensuring that bond charges are imported to be refunded on proving that such goods have reached destination. This could also call for liaison with the authorities of the country of destination of the goods in question.

3. Collusion between customs officers and taxpayers should be strictly policed and that heavy penalty be imposed on offenders.

(d) It is the obligation of persons liable to tax to pay tax. In the case of the citizens it is hoped that being patriotic and knowing the need for the Government to raise finances to carry out functions for the common good of all and that Government is by the people, of the people and for the people, they should feel obligated to pay taxes. However, the obligation to pay taxes can be strengthened only where citizens clearly reap expected benefits.

## QUESTION TWO

(a) Mr. Ole Mboga taxable income for 2005

| | |
|---|---|
| **<u>Employment Income</u>** | |
| Salary 150,000 p.m x 12 | 1,800,000 |
| Water benefit (fixed benefit by CIT = amount paid) | 4,800 |
| Electricity (fixed benefit = Amount paid) | 18,000 |
| Shares 1000 shares c Sh.50 | 50,000 |
| Company car: benefit on 2000cc | 86,400 |

| | | | |
|---|---|---|---|
| Leave pay (1 month salary) | | | 150,000 |
| Insurance premium 10,000 x 3 members | | | 30,000 |
| Pensionable pay before housing benefit | | | 2,139,200 |
| Add housing benefit = 15% x 2,139,200 | = 320,880 | | |
| Less rent paid = 10,000 p.m x 12 | =(120,000) | | |
| Total employment income | | | 200,880 |
| Less allowable expense | | | 2,340,080 |
| Pension contribution 5%x 1,800,000 | | | (90,000) |
| Employment income | | | 2,250,080 |

**Business Income**

| | | | |
|---|---|---|---|
| Wife"s salary from Leta Ltd. 50,000 p.m x 12 (Note 1) | | 600,000 | 600,000 |
| Rent income | | | |
| Gross rent income | | 300,000 | |
| Less allowable expenses only | | | |
| Interest on loan | 125,000 | | |
| Care taken wages | 55,000 | | |
| Insurance rent and rates | 25,000 | | |
| Replaced broken doors (Note 2) | 85,000 | (290,000) | 10,000 |
| Total taxable income | | | 2,860,080 |

**Note 1 :** The wife is not at arm"s length since Leta Ltd (company) is owned by Mr. Mboga. Therefore the income shall be assessed on the husband.

**Note 2 :** It is assumed that the door was replaced with a similar one in terms of material e.gmetallic door replaced with metallic door hence cost is allowable. However, if a wooden door is replaced with metallic door, the cost is not allowable.

Dividend income on shares suffers 5% final withholding tax.

(b) Tax payable on Ksh.2,860,080

| | |
|---|---|
| (121,968 x 10%) + 114,912 x (15% + 20% + 25%) | 81,144 |
| (2,860,080 – 466,704) x 30% | 717,989 |
| | 799,133 |
| Less PAYE | |
| Mr. Mboga 62,000 x 12 | (799,133) |
| Mrs. Mboga 20,000 x 12 | (240,000) |
| Personal relief | (13,944) |
| Net tax liability (refund) | 198,811 |

(c) If Mr. Mboga was to reside within the firm, the housing benefit shall be equal to 10% of pensionable pay (for agriculture employees) and not 15% of pensionable pay.

## QUESTION THREE

(a) Charitable Trust are exempted from taxation if:

- One public in character for a small section or the public in general (not discriminative)
- for enhancement of education or religion
- for purpose of eradication of poverty and disease
- no profit sharing
- income generated is expended in Kenya for benefit of Kenyan citizens
- registered as a charitable trust

Watu clinic does not qualify as a charitable trust hence not exempted from tax.

(b) Income statement

| | | | |
|---|---|---|---|
| Net profit (income – expenditure) | | 3,741 | |
| Add back disallowable expenses | 5.0 | | |
| Salaries – partners | 12.0 | | |
| Interest – partners | 15 | | |
| Life cover for partners | 67.2 | | |
| 40% M.V expenses | 200 | 922.2 | 4,663.2 |
| Depreciation | | | |
| Less: non-business income | | | |
| Expenses | | 3,600 | |
| Donation and grants | | 140 | |
| Goodwill | | 96 | |
| Capital allowances | | 50 | |
| Dividends | | 12 | 3,898 |
| Int. on deposits | | | 765.2 |
| Adjusted partnership profits | 9/12 x 765.2 = 573.9 | | |
| Profits for 9 months = | | | |

(c) 9 months to 30/9/2005

| | H. Kutibu | Mrs. W Kutibu | F. Nafuu | Mganga | Total |
|---|---|---|---|---|---|
| | 40% | 20% | 40% | | |
| Interest x 9/12 | 15 | 5.25 | 15 | - | 35.25 |
| Salaries x 9/12 | 180 | - | 180 | - | 360 |
| Profits x 9/12 | 71.46 | 35.73 | 71.46 | - | 173.65 |
| | 266.46 | 40.98 | 266.46 | - | 573.9 |

| | | | | | |
|---|---|---|---|---|---|
| 3 months from | 1 :10 :2005 | 31/12/2005 | | | |
| | 40% | 10% | 40% | 10% | Total |
| Int. 3/12 | 5 | 1.75 | 5 | 3.0 | 14.75 |
| Salaries x 3/12 | 60 | - | 60 | 30 | 150 |
| Profits x 3/12 | 10.62 | 2.655 | 10.62 | 2.655 | 26.550 |
| | 75.62 | 4.405 | 75.62 | 35.655 | 191.3 |
| Add for 9 | 266.46 | 40.90 | 266.46 | - | 565.2 |
| months above | 342.08 | 45.385 | 342.08 | 35.655 | 765.2 |

(d) -Combine Kutibu"s p/ship income and tax on husband
-For Nafuu and Mganga, aggregate with other incomes and taxed on graduated scale.

(e) Dr. (Mrs) Kutibu would be assessed separately on her Sh.240,000 salary as follows:

| | |
|---|---|
| 121,968 @ 10% | = 12,196.8 |
| 114,912 @ 15% | = 17,236.8 |
| 236,880 | |
| | = 624.0 |
| | 30,057.6 |
| (240,000 – 236,880) @ 20% | |
| Gross liability | 30,057.6 |
| Less personal relief | (13,944.0) |
| PAYE | (97,200) |
| Tax refund | (81,086.4) |

The refund would be used to offset the husbands tax liability as follows:

| | |
|---|---|
| Partnership income | 342,080 |
| Add: Wife"s partnership income | 45,385 |
| | 387,465 |

| | |
|---|---|
| Tax liability | |
| Sh. 121,968 @ 10% | = 12,196.8 |
| Sh. 114,912 @ (15% + 20%) | = 40,219.0 |
| (Sh.387,465 – 351,792) @ 25% | 8,918 |
| | 61,334 |
| Less personal relief | (13,944) |
| Wife"s refund | (78,960) |
| Tax refund | (31,570) |

## QUESTION THREE

| | | | |
|---|---|---|---|
| (a) | Gross Profit | | 4,165,000 |
| | Less allowable expenses only | | |
| | Rent and rates (W1) | 240,000 | |
| | Office salaries | 826,000 | |
| | Advertising costs | 210,000 | |
| | Transport costs | 236,000 | |
| | Capital allowances (W2) | 5,500,000 | 5,549,500 |
| | Net loss | | (2,847,000) |

W1 Rent and rate = $300,000 - \left(\frac{300,000}{15} x3months \mid prepaid\right)$

= 240,000

W2 Capital allowances

(i) Investment deduction (Kshs. 000)

| Item | Q.Cost | I.D @ 100% | Residual for WTA & IBD |
|---|---|---|---|
| Factory building | 5,000 | 5,000 | - |
| | | 5,000 | |

(ii) WTA

| Class | III @ 25% | IV @ 12.5% |
|---|---|---|
| Directors car | 1,000,000r | - |
| Equipment net of ID | - | 2,000,000 |
| | 1,000,000 | 2,000,000 |
| WTA for 2005 | (250,000) | (250,000) |
| WDV 31/12/2005 | 750,000 | 1,750,000 |

Summary of capital allowances:

| | |
|---|---|
| ID | 5,000,000 |
| WTA (250,000 + 250,000) | 500,000 |
| | 5,500,000 |

**NB:** The new equipment will enjoy capital allowances in 2006.

(b)

| | Kitu | Watu | Total |
|---|---|---|---|
| Ratio | 2 | 3 | 5 |
| Salary 600,000 ÷ 2 | 300,000 | 300,000 | 600,000 |
| Interest on capital @10% | 360,000 | 522,100 | 582,100 |
| Share of loss | (2,008,360)) | (2,417,460) | (4,029,100) |
| | 1,348,360 | (1,595,360) | (2,847,000) |

## QUESTION FOUR

(a) **TOTAL ENGINEERING COMPANY LIMITED**
**TAXABLE INCOME FOR YEAR OF INCOME 2005**

| | SH."000" | SH."000" |
|---|---|---|
| Sales | 30,780 | |
| Less sales returns | (700) | 30,080 |
| Purchases plus carriage inwards | 24,370 | |
| Less returns outwards | (500) | 23,870 |
| Gross profit | | 6,210 |
| Less allowable expenses | | |
| Trade expenses | 100 | |
| Wages less amount paid to consult (2320 – 300) | 2,020 | |
| Rent | 300 | |
| Insurance | 190 | |
| Repairs to Building and Machinery (Sh."000" 300 + 46) | 346 | |
| Loose tools w/o | 10 | |
| Advertising | 254 | |
| Legal charges | 80 | |
| Audit fees | 70 | |
| Bad debts – specific | 74 | |
| Debenture interest | 600 | 4,044 |
| | | 2,166 |
| Less capital allowance | | 2,000 |
| Adjusted business income | | 166 |

(b) **Tax Payable**

Corporation tax @ 30% (Sh.166,000 x 30%) = Sh.49,800. Tax thereof is expected to be paid first during the year as tax instalments by $20^{th}$ of $4^{th}$ , (30/4/2006) $6^{th}$, $9^{th}$ and $12^{th}$ months. Any balance of tax is payable by end of $4^{th}$ month after year-end.

(c) Giving the director a company car would give rise to a taxable employment benefit (car benefit) to the director and taxable benefit will be computed as the higher of c.c. rating for the car and 2% per month multiplied by initial cost of the car. On the side of the company maintenance costs for the car will be an allowable expense.

(d) The claim by the consultant with respect to the VAT promising to find a way of getting tax due (VAT) written off amounts to tax evasion which is penalized under the VAT Act, i.e failure to pay tax on time will attract Ksh.10,000 penalty plus 2% per month interest compounded. Any falsehood would attract a fine of up to Ksh.500,000 or up to 3 years imprisonment.

## QUESTION FIVE

(a) (i)**Stamp Duty**

Stamp duty is a charge by the Government in respect of some documents specified in the Stamp Duties Act. The stamp duties law is enforced to raise revenue by requiring certain documents to be stamped. The instruments include those for securing the payment of money, the performance of some obligation, transfer of property, mortgage of property, etc. The instruments requiring stamping includes agreements such as Hire Purchase agreement, partnership deeds, bills of exchange, memorandum of associations, articles of association and capital of companies, conveyances on sales or title deeds, lease agreement, marketable deed, affidavit or statutory declaration, awards, bill of lading, delivery order, instrument of divorce, letter of allotment of shares, etc.

(ii) **Matters Relating to Export Processing Zones**

- An E.P.Z is an area within a country which is free of duty or government red tape. An EPZ enterprise will be exempted from paying any corporation tax for a period of 10 years commencing with the year in which production, sales or receipts from its activities commence.
- After the first 10 years an E.P.Z enterprise will be subject to corporate tax at the rate of 25% for a period of 10 years commencing immediately thereafter.
- Exports are zero rated for VAT purposes.
- 100% I.D on building and machinery used to manufacture exports.

(b) Payment by an E.P.Z enterprise to non-resident person shall be deemed to be exempted from tax. Resident employees and directors of an E.P.Z enterprise are liable to tax and deduction of PAYE. The E.P.Z is required to comply with the rules and regulations concerning the deduction of tax from their employment income.

(i) **JENGA ENGINEERS AND ASSOCIATES**
**VALUE ADDED TAX ACCOUNT FOR YEAR 2006**

| **INPUT TAX** | | **OUTPUT TAX** | |
|---|---|---|---|
| Accountancy & Audit | | Professional fees | |
| (2,250 x 16%) | 360 | (Sh.7,500,000 x 16%) | 1,200,000 |
| Legal Services | | | |
| (300,000 x 16%) | 48,000 | | |
| Design materials | | | |
| (1,600,000 x 16%) | 256,000 | | |
| VAT payable | 895,640 | | |
| | 1,200,000 | | 1,200,000 |

**Notes:**

1. Medical services are exempt hence do not attract VAT.

2. Salaries and wages and depreciation are not services provided for VAT purposes hence not taxable.

(ii) VAT on professional fees must have been accounted for on a monthly basis and payable in each following month, i.e the month following the month in which services were rendered. VAT is payable by bankers cheque addressed to Commissioner VAT by 20$^{th}$ of following month. Form VAT 3 is used to account for VAT payable monthly.

## JUNE 2005

## QUESTION ONE

(a) Ten of the records a person registered for VAT must maintain are:

- Tax invoices on sales and purchases
- A record of all the taxable goods and services received or supplied by the firm including zero rated supplies.
- Separate record of any exempt supplies made.
- Summary of total input and output tax for each calendar month i.e VAT account
- Copies of all invoices issued, in serial number order
- Copies of all credit and debit notes issued in chronological
- All purchase invoices, customs entries, receipts for payment of customs duty or tax and credit and debit notes received.
- Details of goods manufactured and delivered from the factory of the taxable person
- Other business records namely – orders and delivery books, relevant business correspondence, appointment and job books, purchase and sale books, cash books, petty cash vouchers, annual accounts, import and export documents, pay in slips, record of daily takings.
- Details of cash or other discounts, whether supply is for cash or credit, etc.

(b) Practical problems experienced under VAT include:

- Complexity of interpretation of the VAT Act and regulations stemming from it. This can be overcome through regular training seminars conducted by the VAT department for the benefit of tax payers, easy to read and understand literature through the Department"s taxpayers education programme as well as continuous press bulletins.
- Cash flow problem could arise especially because the taxpayer is required to account for excess VAT charged on earnings basis even where the customer has not yet paid him (credit sales). This could be overcome if the taxpayer could be allowed to account for VAT when the credit period allowed to the customers is over.
- Compliance problems of elaborate and costly accounts to be maintained, filling of returns on a monthly basis. This could be overcome by simplifying as to reduce record keeping and extending time for payment rather than on monthly basis.

(c) **Value for VAT**

| | | Sh. |
|---|---|---|
| (i) | Radio Cassette price | 17,500 |
| | Less Cash discount @ 10% | 1,750 |
| | Value for VAT | 15,750 |
| | VAT thereon @ 16% (15,750 x 16%) | 2,520 |
| | Total price (VAT inclusive) | 18,270 |
| (ii) | Uchoraji architects services (value for VAT) | 125,000 |
| | Therefore VAT thereon @ 16% (16% x 125,000) | 20,000 |
| | Total price (VAT inclusive) | 145,000 |
| (iii) | Dubai Kenya Ltd. value for duty | 2,000,000 |
| | Plus duty @ 25% | 500,000 |
| | Value for VAT | 2,500,000 |
| | VAT thereon @ 16% (16% x 2,500,000) | 400,000 |
| | Total price (VAT inclusive) | 2,900,000 |
| (iv) | Kopesha Company Limited sale price of furniture | 20,000 |
| | VAT thereon @ 16% (16% x 20,000) | 3,200 |
| | Total price (VAT inclusive) | 23,200 |

## QUESTION TWO

(a) (i)**MISS NYAKIO**

**ASSESSABLE INCOME AND YEARS**

| | |
|---|---|
| Contract term | 5 years |
| Unexpired term | 2 years |
| Compensation | Sh.300,000 |

Therefore assessable income at rate of remuneration immediately before termination:

| YEAR | ASSESSABLE AMOUNT SH."000" |
|---|---|
| 2006 | 150,000 |
| 2007 | 150,000 |
| | 300,000 |

The total compensation is wholly taxable (w.e.f 1/1/2005) and will be spread evenly forward over the remaining contract period.

(ii) Assuming Nyakio"s contract to be unspecified:

Income assessable depend on whether or not there is a provision that compensation would be paid

(a) **Contract unspecified but provides for compensation**

Assessable income will be at rate of remuneration immediately before termination as follows:

| YEAR | ASSESSABLE INCOME SH."000" |
|---|---|
| 1997 | 90 |
| 1998 | 90 |
| 1999 | 90 |
| 2000 | 30 |
| Total assessable | 300 |

(b) **Contract unspecified but does not provide for compensation**

Income assessable at rate of remuneration immediately before termination but is not to exceed three years remuneration, i.e.

| YEAR | ASSESSABLE INCOME SH."000" |
|---|---|
| 1997 | 100 |
| 1998 | 100 |
| 1999 | 100 |
| Total assessable | 300 |

w.e.f 1.1.2005, compensation from termination of employment contract is taxable in full regardless of the nature of the contract of employment.

(iii) Where shareholding is more than 5% the director is other than full-time hence the total amount would be assessable however, Miss Nyakio is a full time director and therefore the assessment would be as in a(i)– (ii) above as applicable.

(b) **Items whether capital or revenue**

- Legal and professional fees on computerization is capital expenditure forming part of total computerization cost.
- Structural alterations to premises to maintain rent is tax allowable even though capital in nature.
- Legal costs and stamp duty for acquisition of lease of business premises is regarded as tax allowable (revenue) so long as such lease is not for more than or capable of extension beyond 99 years.
- Expenditure on advertising to promote sale of goods, services provided by the business is revenue in nature and tax allowable.
- Income tax is revenue item to the state but not tax allowable to firms/taxable persons.
- Reserves and provisions may be capital or revenue but are generally disallowable for tax purposes since these are not incurred. However in the case of specific provisions for bad debts, it would be tax deductible.

(c) **Five examples of non-taxable income**

- Casino and betting winnings.
- Donations received
- Gifts from friends
- Dowry received.

## QUESTION THREE

(a) The pooling method refers to the classification of plant and machinery in four respective classes each reflecting a rate of wear and tear for assets in that class for the purpose of determining or calculating wear and tear allowance on a reducing method basis.

(b) **KILIMO HOLDINGS LTD CAPITAL ALLOWANCES FOR 2006**

(i) **Investment deduction**

| ASSET | QUALIFYING COST SH. | I.D @ 100% | RESIDUE FOR IBD AND W.T.A |
|---|---|---|---|
| New building | 750,000 | 750,000 | - |
| Old machinery | 350,000 | 350,000 | - |
| | | 1,100,000 | |

(ii) **Industrial Building Deduction**

| ASSET | QUALIFYING COST SH. | RESIDUE B/FWD SH. | I.B.D @ 2½% SH. | RESIDUE C/FWD SH. |
|---|---|---|---|---|
| Industrial building | 1,000,000 | 950,000 | 25,000 | 925,000 |
| | | | 25,000 | |

(iii) **Wear and Tear Allowance**

| CLASS | I @ 37½% SH.000 | II @ 30% SH.000 | III @ 25% SH.000 | IV @ 12½% SH.000 |
|---|---|---|---|---|
| WDV AS AT 1/1/2006 | | | | |
| Motor vehicles | | | 655 | |
| Tractors | 2,755 | | | |

| | | | | |
|---|---|---|---|---|
| Plant and Machinery | | | | 530 |
| Furniture and fittings | | | | 225 |
| Combine harvester | 1,012 | | | |
| Land rovers | | | 1,135 | |
| Computers | | 77 | | |
| Fax machine | | 40 | | |
| Telephones | | 80 | | |
| Additions: | | | | |
| Office curtains | | | | 22 |
| Engine head for trailer | 500 | | | |
| Saloon car | | | $100^R$ | |
| Pick-up | | | 850 | |
| Disposals: | | | | |
| Saloon car | | | (166.667) | |
| Furniture | | | | (25) |
| Computers | | (80) | | |
| Tractor | (75) | - | - | - |
| | 4,192 | 117 | 2,573.333 | 752 |
| WTA | (1,572) | 3501 | (643.333) | (94) |
| WDV 31/12/1996 | 2,620 | 8109 | 1,930 | 658 |

(iv) **Farm Works Deduction**

| | | |
|---|---|---|
| (a) | New Farmhouse 1/1/2006 | 200,000 |
| | FWD = 33⅓% X 200,000 | 66,667 |
| (b) | Farm works WDV b/fwd 1.1.96 | 7,000 |
| | Year 2006 FWD (33⅓ % x 21,000) | (7,000) |
| | Bal. C/fwd | NIL |

(v) Dimunition on loose tools - 33⅓% x 10,000 = 3333 p.a for 3 years

Summary of Capital Allowances

| | Sh. |
|---|---|
| Dimunition | 3,333 |
| I.D | 1,100,000 |
| I.B.D | 25,000 |
| WTA | |
| Class I | 1,572,000 |
| Class II | 35,100 |
| Class III | 643,333 |
| Class IV | 94,000 |
| FWD | 73,667 |
| Total Capital allowances | 3,546,433 |

**Note:**

1) Spares for tractors are not plant and machinery and are expensed upon issue for repairs.
2) W.e.f 1.1.1996 investment in purchase and installation of machinery whether new or old will qualify for investment deduction.
3) Library books do not qualify as machinery

## QUESTION FOUR

(a) **KENWIDE ENTERPRISES LTD.**
**TAX COMPUTATION YEAR 2005**

| | Sh.000 | **Sh.000** |
|---|---|---|
| Adjusted profit: | | |
| Profit reported | | 917.3 |
| Add disallowable expenditure: | | |
| Rent and rate for directors (10% x 92,500) | 9.25 | |
| Distribution and office expenses | | |
| Directors personal expenses. | 32.55 | |
| Contribution to Sports Club | 30 | |
| Donations | 22 | |
| Loss on staff canteen | 12 | |
| Repairs and maintenance – extension to office block | 40 | |
| Loss on sale of assets | 35.5 | |
| Legal fees: | | |
| Acquisition of copyrights | 25 | |
| Renewal of a lease for 99 years | 18 | |
| Fines and defence of legal suits | 11 | |
| Depreciation | 126 | 360.3 |
| | | 1,287.6 |
| Less non-taxable income: | | |
| Provision for bad and doubtful debts reduction | 35.5 | |
| Profit on sale of assets | 66.5 | (102) |
| | | 1,185.6 |

(b) **Tax Liability & Due Date**

Taxable income Sh.1,185,600
Tax thereon @ 30 Sh.355,680
Due date for outstanding tax after instalments is by 4th month after year end, i.e. 30th April 2006 in this case.

(c) **Instalment tax payable in 2006 and due dates**

Estimate tax for 2006 = (Sh.355,680 x 110%) = Sh.391,248
Instalments payable as follows:

| DATE | BY 20TH APRIL 2006 | 20TH JUNE 2006 | 20TH SEPT 2006 | 20TH DEC 2006 |
|---|---|---|---|---|
| INSTALMENT | 97812 | 97,812 | 97812 | 97,812 |

NB: each instalment = 25% x 391,248 = 97,812

## QUESTION FIVE

(a) **Self-Assessment**

For accounting year-ended 31.12.1992 and after, a taxpayer will determine the tax liability on the basis of the final return and such bill is referred to as self-assessment and the final return itself referred to as self-assessment return. Self-assessment return may be submitted along with payment of self-assessment tax but submission of return may be delayed up to end of sixth month after year-end.

(b) **Notice of Objection**

A taxpayer who disputes or who does not agree with an assessment for any year of income has a right to lodge an objection against such an assessment by the C.I.T. Such objection is referred to as "notice of objection". For such objection to be valid it must:

- be in writing;
- state the grounds of objection;
- with effect from 1/1/2005 made within 30 days after date of service of assessment;
- return of income and support schedules must be submitted before appeal is accepted.

(c) **N.S.S.F**

Is National Social Security Fund which was established by the Nation Social Security Fund Act of 1965 for the benefit of workers. It is a compulsory savings scheme into which the employer pays a statutory contribution for every employee who is a member of this fund. The scheme is applicable to those employers having five or more employees. The average rate of contribution is 10% of the workers wage, half of which is paid by the employer and half by the worker concerned. The following benefits are provided under the scheme:-

(i) <u>Age Benefits:</u>
Paid to a member of age sixty or when he retires from paid employment whichever is later.

(ii) <u>Withdrawal Benefit</u>
Paid to a member who is at least fifty-five years of age and has not engaged in paid employment during the previous three months.

(iii) <u>Invalidity Benefit</u>
Paid to a member who is permanently incapable of work because of physical or mental disability.

(iv) <u>Survivors Benefit</u>
Paid to the dependants of deceased member.

(v) <u>Emigration Grants</u>
Paid to a member who is permanently emigrating from Kenya.

(d) **PIN Advantages**

PIN is personal identification number for taxpayer. PIN has the following advantages:

1. Identifies eligible taxpayers
2. Assists the Government in identifying known taxpayers who were suppressing their income to evade tax.
3. It is a deterrent to tax evaders
4. Assists in ensuring the national tax burden is distributed as fairly as possible.

(e) **Valuation of Housing for Employees**

A housing benefit arises where an employee is housed by the employer. The employer may own the house or lease it from third parties. To determine the amount of housing benefit, the employees may be classified into five groups.

**(i) Ordinary Employee**
The housing benefit shall be 15% of his gains from employment (i.e. monthly cash pay plus benefits), excluding the value of those premises, minus rent charged to the employee; subject

to the limit of the rent paid by the employer if that is paid under an agreement made at arms length with a third party.

**(ii) Agricultural Employees**

Including a whole time service director on a farm housing benefit shall be 10% of gains or profits from employment minus amount of rent charged to the employee.

**(iii) Director Other Than Whole Time Service Director**

Housing benefit is computed as 15% of his total income excluding value of those premises, minus amount of rent charged to such director, provided that-

If employer pays rent under an agreement not made at arms length with a third party; the value of the quarters shall be, the fair market rental value of the premises in that year or rent paid by the employer, whichever is higher, OR

Where the premises are owned by the employer, the fair market rental value in that year is to be taken.

**(iv) Accommodation And Meals Provided**

If an employee is accommodated within the employer‟s premises and is also provided meals, the value of benefit shall be 10 percent of gains from employment for accommodation and another 10 percent representing meals making a total charge of 20%. This will normally apply in the case of hotel employees.

## DECEMBER 2005
## QUESTION ONE

(a) **Industrial Building – "Hotel"**

This is a hotel building or part of a hotel building which the Commissioner of Income Tax has certified to be an industrial building, including any building directly related to the operations of the hotel such as kitchens, staff quarters and entertainment and sporting facilities.

(b) **Exempt dividend income**

Dividends from without Kenya
Dividends received by a company which owns 12½% or more of the voting power of the paying company.
Dividends received by an exempt person, e.g registered pension and provident funds.

(c) **Non-Resident Individual**

Is an individual person who has a permanent home in Kenya and was not present in Kenya for any period during the year of income under consideration; or he has no permanent home in Kenya and was not present in Kenya for a period or periods amounting in aggregate to 183 days or more during the year of income under consideration; or he has no permanent home in Kenya and was present in Kenya for any period during the year under consideration and in each of the two preceding years for periods not averaging more than 122 days for the three years.

(d) **Memorandum of Appeal & Statement of Facts**

These are the most important documents (Memorandum of appeal and statements of facts) which must be submitted to the clerk of the Local Committee. Memorandum of appeal is a document stating the grounds/reasons for the appeal. The original and 9 other copies for the members of the Local Committee. A statement of facts, on the other hand, is a document which gives a sequence of events on the assessment before appeal to the local committee, i.e. dates assessment was issued and objected to, confirmed, etc.

## QUESTION TWO

(a) (i)**Royalties – Tax Aspects**

Royalties are gains or profits from a right granted to another person for use of one"s property. Royalties could be paid on copyrights, patents, trademarks, etc. In the case of resident individual person royalty income is added to the persons other income for taxation at the individual scale rates. Royalties payable to non-residents will be subject to withholding tax at the rate of 20%. Specific rates are available for countries with which Kenya has double tax treaties.

**Important Declaration Form**

An import declaration form is a form filled by persons intending to import goods into the country wherein the nature, quantities of the goods imported and country of origin of goods. This facilitates inspection and authorization of such importation. The importer forwards the completed import declaration form with copies or supplier"s invoices to the respective inspection company.

(i) **Valuation Role of Local authorities**

Valuation Role of local authorities is categorization of properties (land and buildings) within the local authority for the purpose of charging appropriate rates of tax/charges.

(b) **SPORTEX LIMITED**

(i) **Value Added Tax For June 2006**

| | Sh. | | Sh. |
|---|---|---|---|
| June 2 Purchases (Sh.96,000 x 16/116) | 13,241.4 | June 4 Returns out (Sh.4,000 x 16%) | 640 |
| June 11 Freight (Sh.2,200 x 16/116) | 303.4 | June 9 Sales (Sh.141,000 x 16/116) | 19,448.3 |
| June 21 Returns in (Sh.6,500 x 16%) | 1,040 | June 16 Credit sales (Sh.27,550 x 16/116) | 3,800 |
| VAT payable | 9,303.5 | | |
| | 23,888.3 | | 23,888.3 |

(c) If amount of VAT payable as calculated above is not paid on time then a penalty higher of Ksh.10,000 or 5% of VAT due is imposed plus interest at rate of 2% per month compounded.

## QUESTION THREE

(a) **Distinction**

| | REFERENCE | SOLE PROPRIETORSHIP | **LIMITED LIABILITY COMPANY** |
|---|---|---|---|
| 1. | Income Tax | Income tax is computed on all profits and other incomes using the graduated scale rates | Profits of the company shall be subjected to corporation taxation at corporation tax rate of 30% |
| 2. | PAYE on owners of business | Applicable to income from employment and is a set-off tax against gross tax liability to arrive at net tax liability | Directors/shareholders in receipt of employment income will pay PAYE tax as individuals and not the company. Salaries or fees to directors are allowable to the company against its profits. |
| 3. | Service Charge for the owners and the business | Service charge was payable by the self-employed persons and those employed. This has been scrapped. | Service charge was payable by legal persons as well. This has been scrapped. |

| **Sole proprietorship** | | **Ltd. Company** | |
|---|---|---|---|
| Profits before salary/drawings | 2,000 | | 2,000 |
| Less drawings/salary (not allowable) | - | 10% x 5m | (500) |
| Taxable income | 2,000 | | 1,500 |
| Tax liability on Kshs. 2,000,000 | | Tax at 30% | (150) |
| 1st 466,704 = 121,968 @ 10% + 114,912 (15% + 20% + 25%) | 81,144 | | 1,350 |
| Surplus (2,000,000 – 466,704) @ 30% | 459,989 | Distributable statutory retention @ 60% | (810) |
| Gross tax | 541,133 | Dividends | 540 |
| Less p/relief | (13,944) | W/T @ 5% | 27 |
| Net tax | 527,189 | Total tax = 150,000 + 27,000 = | 177,000 |

## QUESTION FOUR

(a) Section 52(b) of the Income Tax Act requires that every individual chargeable to tax with effect from the year of income 1992 shall furnish to the Commissioner a return of income including a self assessment of his tax from all sources not later than the last day of the sixth month after year end. However, the commissioner may, where he considers appropriate send to any person to whom Section 52(b) applies in respect of any year of income, a form or forms to enable that person to furnish the required return. The C.I.T may raise an assessment where taxpayers fails to do so or when the commissioner considers that assessment raised by the taxpayer is not correct. Estimates, additional assessments may be raised by the commissioner including reverse charges (back duty) wherever applicable.

(b) An individual person assess his own income in self-assessment thus he can only raise an objection for tax assessed where the C.I.T intervenes in the following instances:

Estimates assessment raised by the C.I.T where the C.I.T does not agree with assessment by the taxpayer or no accounts were submitted along with self-assessment forms.

Additional assessment has been raised by the C.I.T where the taxpayer had under assessed.

**MR. BANU SHAH**
**TOTAL TAXABLE INCOME 2005**

**(i) Employment Income**

| | Kshs. | Kshs. P.a. |
|---|---|---|
| Salary 80,000 p.m. x 12 | | 960,000 |
| Free goods (more than 24,000 p.a.) | | 30,000 |
| | | 990,000 |
| Add: H. Benefit 15% x 990,000 x $\frac{5}{12}$ | | 61,875 |
| Total pensionable pay | | 1,051,875 |
| Less: mortgage interest: lower of | | |
| (i) actual $\frac{7}{12}$ x 270,000 = 157,500 | | |
| (ii) set limit 100,000 p.a. x $\frac{7}{12}$ = 58,333 | | (58,333) |
| | | 993,542 |
| Wife‟s income not at arm‟s length | | |
| Wife‟s salary | | 120,000 |
| Rent income | | |
| Gross 30,000 p.m x 5 | 150,000 | |
| Less repair and painting | (11,500) | |
| Interest 270,000 x $\frac{5}{12}$ | (112,500) | 26,000 |
| Total taxable income | | 1,139,542 |

Wife‟s income at arm‟s length

| | |
|---|---|
| Salary from hospital = 20,000 p.m x 12 = | 240,000 |

(ii) Tax liability: Mr. Shah on Kshs. 1,139,542.

| | |
|---|---|
| 1st 466,704 = (121,968 @ 10%) + 114,912 (15% + 20% + 25%) = | 81,144 |
| Next (1,139,542 – 466,704) @ 30% | 204,851 |
| Gross tax | 282,995 |
| Less: PAYE – husband 31,200 p.m. x 12 | (374,400) |
| - wife | (22,000) |
| - personal relief | (13,944) |
| Tax refund | (127,349) |

Wife on Kshs. 240,000

| | | |
|---|---|---|
| 1st 121,968 @ 10% | 12,196.8 | 12,196.8 |
| Next 114,912 @ 15% | 17,236.8 | 17,236.8 |
| 236,880 | 624.0 | 624.0 |
| Surplus (240,000 – 236,880) @ 20% | | |
| Gross | | 30,057.6 |
| Less: p/relief | | (13,944.0) |
| PAYE 4000 x 12 | | (48,000.0) |
| Tax refund | | (31,886.4) |

Notes:

1. Free goods of Sh.30,000 to Banu Shah of exceed maximum non-taxable allowable amount of Sh. 24,000 per annum in each case, therefore taxable.
2. The medical scheme operated by the company is assumed to cover all employees therefore not taxable on Mr. Banu Shah.
3. Mrs. Shah"s employment income is not at arms length since she and the husband own the company employing her. It is therefore assessed on the husband.
4. Assuming mortgage was from approved institution, he will enjoy owner occupied mortgage interest for first 7 months to the launch of actual and set limit.
5. The house occupied for 7 months becomes a commercial property and interest allowable is the actual amount.

(iii) P9A is a Pay As You Earn tax deduction card that is maintained for each employee showing monthly gross pay, benefits, deductions allowed, PAYE deducted, personal relief and net pay.

## QUESTION FIVE

(a) **RAI, SAI AND TAI**
**TAXABLE INCOME DERIVED FROMPARTNERSHIP**

| | Sh."000" | Sh."000" | Sh."000" |
|---|---|---|---|
| Net profit as per accounts | | | 398 |
| Add back disallowable expenses | | | |
| Depreciation | | 300 | |
| Interest on Partners Capitals: | | | |
| Rai | | 80 | |
| Sai | | 120 | |
| Salary to Sai | | | |
| Commission to Partners: | | | |
| Rai | | 160 | |
| Sai | | 96 | |
| Tai | | 96 | |
| Gifts, presents and charity | | 40 | |
| Donations to child welfare | | 200 | |
| Interest on loan to pay income tax | | 20 | |
| Legal charges | | 40 | 1,248 |
| | | | 1,646 |

| | | | |
|---|---|---|---|
| Deduct non-taxable income, non-business income, etc | | | |
| Profit on sale of shares | | 200 | |
| Lottery winnings | | 340 | |
| Dividends (withholding tax is final tax) | | 120 | |
| Farming income gross | | 340 | |
| Capital allowance – wear & tear | | 180 | (1,180) |
| Adjusted business profit for year | | | 466 |
| Other incomes: | | | |
| Gross farming income | 340 | | |
| Less farm works income | (120) | | 220 |
| Taxable income derived from partnership | | | 686 |

**Notes:**

1. Interest expense Sh.80,000 is assumed wholly and exclusively incurred for business hence allowable.

2. Legal charges of Sh.40,000 to finish a case in Customs Department is disallowable as the case is assumed to be a result of failure to comply with regulations of the customs department.

3. Profit on sale of shares is non-taxable as this is a capital gain. The law relating to capital gains is presently suspended.

(b) **Allocation to Partners**

| | RAI SH."000" | SAI SH."000" | TAI SH."000" | TOTAL SH."000" |
|---|---|---|---|---|
| Salary | - | 160 | - | 160 |
| Commission | | | | |
| Interest on capital | 96 | 96 | 96 | 288 |
| Share of business loss | (60.666) | (60.667) | (60.667) | (182) |
| | 115.334 | 155.333 | 155.33 | 466 |
| Business loss b/fwd | (266.666) | (266.667) | (266.667) | (800) |
| Business loss c/fwd | (151.322) | (71.334) | (111.334) | |
| Other incomes | | | | |
| Farming income | 71.333 | 72.334 | 72.334 | 220 |
| Taxable income | 71.333 | 72.334 | 72.334 | |

(c) The adjusted profit from business is Sh.686,000 against which loss from business b/fwd is set-off for each partner giving rise to further loss c/fwd. However farming income is taxable on each partner"s share.

## JUNE 2006
## QUESTION ONE

(a) **REGISTERED PENSION SCHEME AND IMPLICATIONS**

Registered Pension Scheme is a retirement benefit scheme registered under rule 4 of the Income Tax Act and the following are the main rules relating to a registered Pension Scheme – Sec.22:

(i) Deduction in respect of contributions of an employee in a year shall be limited to the lesser of:
The sum of the contributions made by the employee to registered funds in the year or,
Thirty percent of the employee"s pensionable income in the year, or
Two hundred and ten thousand per year or seventeen thousand five hundred shillings per month of the funds.

(ii) The deduction in respect of the contributions made by an employer in a year under defined contribution provisions of registered funds shall be limited to the sum of the deductible contributions of the employer in the year under defined contribution provisions of registered funds on behalf of the funds.

(iii) The deduction in respect of the contributions made by an employer in a year under defined benefit provisions of registered funds shall be limited to the amount by which the lesser of -

The sum of the contributions made by the employer and by the employee in the year to registered funds in respect of members of the defined benefit registered funds of the employer, or

Thirty per cent of the sum of the pensionable incomes from the employer in the year of members of defined benefit registered funds of the employer; or

Two hundred and ten thousand shillings per annum times the number of full-year members of defined benefit registered funds of the employer, exceeds the sum of -

The deductible contributions made in the year to the registered funds of the employer by the members of registered funds of the employer, and

The amounts deducted by the employer for the year for contributions made under defined contribution provisions of registered funds under subsection (2) in respect of the members of the defined benefit registered funds.

(iv) Pension funds in respect of an employee may be transferred to another registered fund or registered individual retirement fund and not be treated as a withdrawal under Sec.3 (2)(c)

(v) Where registered fund is wound up, any surplus funds therein shall be deemed to be the funds of the employer and shall be immediately withdrawn by the employer unless the trust deed in respect of such registered fund specifies the contrary.

Other rules:
- Funds must be registered
- Contribution cannot be withdrawn before 5 years have expired neither can contributions be used as security.

(i) Payment of pension from a registered scheme to a pensioner will be based on the following rules:
(a) The first Ksh.180,000 received by a resident individual in a year of income in respect of pensions or retirement annuities is exempted and is not chargeable to tax Sec 58(4).
(b) Lump sum payment of first Ksh.480,000 is exempted from income tax upon maturity of employment.

(i) The amount withdrawn on termination of employment is exempted from tax to a limit based on the lesser of:

The first Ksh. 48,000 per full year of service with the employer for first 10 years.
The first Ksh. 480,000 for period of service is more than 10 years.

(ii) Payment to widow or widower of a pensioner will be treated as follows:

- the first Ksh.1,400,000 of such a lump sum payment will be considered as income not chargeable to tax as income of the beneficiary.

(b) **MR. KIPLIMO**

**INCOME CHARGEABLE TO TAX YEAR 2001**

| | | |
|---|---|---|
| Self | | |
| Employment income – salary | 600,000 | |
| Less pension contribution the lesser of: | | |
| 30% x 600,000 = 180 | | |
| or Actual contribution 50 | (50,000) | |
| or set limit (Yr.2001) 210 | | |
| Owner occupied | | |
| Mortgage interest | | |
| Lower of: Actual interest 62,000 | (62,000) | 488,000 |
| Set limit 100,000 | | |
| **Wife"s income** | | |
| Employment income – salary | | |
| (Sh.25,000 x 12 months) | 300,000 | |
| Clinical loss (registered clinical officer) | (240,000) | |
| Total income chargeable to tax | | 60,000 |

(c) **TAX PAYABLE**

Chargeable income split as follows:

| | MR. KIPLIMO | | WIFE |
|---|---|---|---|
| | SH.488,000 | | SH.60,000 |
| Tax thereon | | | |
| (121,968 @ 10%) + (114,912 x 60%) | 81,144 | | |
| (488,000 – 466,704) @ 30% | 6,389 | | |
| | 87,533 | Sh.60,000 x 10% | 6,000 |
| Less: PAYE | (142,500) | Less: PAYE = | (93,600) |
| Personal relief | (13,944) | Personal relief | (13,944) |
| Net tax liability (refund) | (68,911) | Tax refund | (101,544) |

(d) (i) Value Added Tax on his purchases is not deductible against incomes provided hence ignored.

(ii) Pension contribution by the employer on behalf of Mr. Kiplimo is a non-taxable benefit for Mr. Kiplimo.

(iii) Dividend received suffers 5%withholding tax as final tax – assumed qualifying type.

(iv) Post office savings bank interest is tax exempt. Balance of interest assumed to originate from qualifying sources hence W/T final tax.

(v) Personal expenses such as personal accident policy premium, life insurance premium, alimony to first wife is not tax allowable.

## QUESTION TWO

(a) **FOUR EFFECTS OF VALUE ADDED TAX ON BUSINESS**

- VAT increases prices of goods or services hence may reduce sales and profitability

- VAT calls upon a registered person (trader) to maintain expensive elaborate records in addition to penalties, where VAT is not paid on time or a return has not been submitted, etc.

- In the case of credit sales the trader will be required to finance VAT whether customers have paid or not and in the case of capital assets input tax is not recoverable but is capitalized.

- VAT may create market imperfections because not all traders dealing in same supplies are required to charge VAT.

(b) If the Commissioner of VAT makes a decision which still leaves the trader aggrieved, such a trader can appeal to the VAT appeals Tribunal within thirty days for an independent decision. However, such a person must pay to the commissioner the assessed tax not in dispute or such part thereof as the commissioner may require before the appeal is registered. It further aggrieved by the rulings of the tribunal he can seek redress from the High Court on payment of full amount of the tax disputed.

(c) Where VAT is not paid on time then there will be:-

2% per month interest on Cumulative basis on tax due. In this case one month has elapsed hence penalty would be: (Sh.300,000 x 2%) = Sh.6,000
In addition, failure to submit the return along with payment attracts Ksh.10,000 penalty or 5% of VAT due whichever is higher.

(d) **INLAND CO. LTD**

VAT PAYABLE

| | Sh. |
|---|---|
| Goods landed value | 400,000 |
| Duty thereon @ 35% | 140,000 |
| Value for duty plus duty | 540,000 |
| Commission on dutable value @ 2% x 400,000 | 8,000 |
| Transport | 50,000 |
| Value for VAT | 598,000 |
| VAT thereof @ 16% | 95,680 |
| Total price | 693,680 |

## QUESTION THREE

(a) (i)**TAXATIONOF PENSION INCOME FOR A RETIRED EMPLOYEE**

- Pension payment to retired employee may be a one-time lump sum regular payments for a specified period of a combination of the above. The following shall apply:

- The first Ksh.480,000 computed as a lump sum from registered pension is tax exempt; any amount in excess is taxable.

- Where contributions to a pension fund was for less than 10 years, then the exempt lump sum amount shall be Ksh.48,000 for year of pensionable service.

- Total pensions received by a resident from un-registered pension fund, where such contributions were not deducted for tax are tax-exempt.

- From 1/7/2004 pensions and retirement annuities up to Ksh.180,000 per annum (periodic payment) in total received by a resident individual is tax exempt.

(ii) **ALLOWABLE DEDUCTIONS FOR CONTRIBUTIONS TO A REGISTERED PENSION SCHEME**

- An employee can claim relief in respect of his annual contribution to a registered retirement benefit scheme, limited to the lesser of:

- 30% of pensionable pay or;
- Actual contribution made to the scheme or;
- Set limit of Ksh.210,000 p.a. (Sh. 240,000 w.e.f 1/1/2006)

- Note that pensionable income means employment income cash pay including non-cash benefits.

(iii) **PROCEDURE FOR END OF YEAR RETURN**

At the end of the year employers should fully complete the questionnaire on every tax deduction card showing:

Dates of commencement and leaving employment
Names and address of old and/or new employer
Details of benefits provided, if any, at the back of the tax deduction cards
The amounts and details of any pay from which tax was deducted which relates to an earlier period of e.g. gratuities, bonuses, compensation for loss of office, etc. Details of rent paid by employee towards housing.

Employees should also give details of normal monthly PAYE remittances, separately from other payments made at the Pay-Master General relating to tax on lump sum payments, audit tax, interest and penalty. Dates on which the relevant payments were made to the bank must also be shown.

In addition employers are required to show total tax paid in respect of: tax on lump sum payments, tax determined through PAYE Audit, Interest and penalty. Details of fringe benefits and tax paid thereon should not be reflected on the employee"s tax deduction card. Employers should submit form P10B showing names of employees involved, loan amounts, rate of interest charged by employer, taxable fringe benefit values and amount of tax paid.

(b) **STATUTORY DEDUCTIONS**

PAYE tax
National Social Security Fund (NSSF)
National Hospital Insurance Fund (NHIF)

(c) **OMISSIONS CONSTITUTING PAYE OFFENCES**

1. Failure to deduct tax
2. Failure to remit PAYE deducted
3. Failure to remit PAYE deducted by due date
4. Failure to submit end year PAYE returns to the commissioner.

The general penalty for not observing PAYE rules is a fine not exceeding ten thousand shillings and/or imprisonment of up to six months. Where the employer fails to deduct tax from employees pay he will be liable to pay the outstanding tax as though it were due from him. Late payment of tax generally attracts a penalty of 20% plus interest at 2% per month simple interest.

## QUESTION FOUR

(a) A taxpayer may appeal to Local Committee for the following reasons:

1. The Commissioner of Income Tax has confirmed an assessment following an objection to it by the taxpayer.
2. The Commissioner has rejected a late objection.
3. The Commissioner has amended the assessment to the best of his knowledge not acceptable by the taxpayer (non-agreed assessment).

(b) **WENDANI LTD.**
**TAX POSITION REGARDING ISSUES RAISED**

1. Profit realized on sale of investment which had cost Sh.40,000 amounting to Sh.12,500 is a capital gain. The law relating to capital gains is currently suspended hence the gain is not taxable and since included in profits, it must be deducted before tax.

2. The disputed income tax for year ended 30 April 2005 is per revised assessment by the CIT. Wendani Ltd if aggrieved by the CIT decision/assessment have a right to lodge an objection with the commissioner in writing within 30 days from date of service of the revised assessment stating clearly the grounds to the objection. Wendani has further right to Local Committee if the commissioner"s response to the objection is not satisfactory.

3. Preference shares redemption at premium of 20% is non-taxable capital gain and since it was not reflected in the books as income no adjustment is required.

4. Payment of wages before commencement now being amortised over 5 years is allowable deduction since it is an expense which would ordinarily be allowable upon commencement as revenue in nature.

5. Writing down of stocks to cater for future price decline is not allowable and since already deducted, the amount of Ksh.10,000 must be added to net profit for the tax purposes.

(c) **WENDANI LTD**

**REVISED TAXABLE PROFIT AND TAX PAYABLE YEAR 2006**

| | | |
|---|---|---|
| Net profit for the year | | 842,000 |
| Add: | | |
| Gain on sale of shares | 12,500 | |
| Stocks written down | 10,000 | 22,500 |
| Revised profits | | 864,500 |
| | | |
| Tax thereof @ 30% x 864,500 | | 259,350 |

(d) A taxpayer must carry out cost/benefit analysis before raising objection against revised assessment. In addition he must be able to furnish evidence to provide that he has been unduly over assessed. It would be wise for the taxpayer to enlist services of a qualified accountant or agent for this purpose.

## QUESTION FIVE

(a) Capital allowances is a term that may be defined as tax relief in respect of certain types of capital expenditure by granting specific deductions in respect thereof as per section 15(2) such as deductions in respect to capital expenditure on industrial buildings; capital expenditure of machinery; mining operations; capital expenditure on agricultural land; investment deductions, etc.

(b) **CINDERA ENTERPRISES**

CORRECT BALANCE FOR EACH ACCOUNT

(i) LAND AND BUILDING ACCOUNT

| | Sh.000 | | Sh.000 |
|---|---|---|---|
| Cash purchase – Land | 2,000 | Proceeds from salvaged | |
| Old building demolition cost | 80 | material | 30 |
| Cost of new building | 5,600 | | |
| Other direct costs of building | 180 | Balance c/fwd | 7,830 |
| | 7,860 | | 7,860 |

(ii) MACHINERY ACCOUNT

| | Sh.000 | | Sh.000 |
|---|---|---|---|
| Cost of machinery | 4,000 | | |
| Installation and testing | 400 | Balance c/fwd | 4,400 |
| | 4,400 | | 4,400 |

(iii) DEPRECIATION EXPENSE ACCOUNT

| | Sh. | | Sh. |
|---|---|---|---|
| Machinery (Sh.4,400 x 4%) | 176 | | |
| Building (Sh.5,830 x 4%) | 233.2 | P & L A/c | 409.2 |
| | 409,2 | | 409.2 |

(b) **CAPITAL ALLOWANCES DUE TO THE PARTNERSHIP**

(a) **INVESTMENT DEDUCTION**

| ASSET | QUALIFYING COST SH."000" | I.D @ 100% SH."000" | RESIDUE SH."000" |
|---|---|---|---|
| Factory | 5,830 | 5,830 | - |
| Machinery | 4,400 | 4,400 | - |
| Total I.D | | 10,230 | |

NB:No IBD and WTA since with 100% I.D, there is zero residual for IBD and WTA.

(iii)

| | |
|---|---|
| Profit before capital allowances | 2,860,000 |
| Less: capital allowances | (10,230,000) |
| Adjusted loss | (7,370,000) |

**ALLOCATION TO PARTNERS**

**Kshs. „000"**

| Partner | L | M | N | Total |
|---|---|---|---|---|
| Salary | 120 | 120 | 120 | 360 |
| Profit (loss) share equally | (2,576.6) | (2,576.6) | (2,576.6) | (7,730) |
| Partnership loss | (2,456.6) | (2,456.6) | (2,456.6) | (7,370) |

## NOVEMBER 2006

## QUESTION ONE

(a) RICHEX LTD
CAPITAL ALLOWANCES DUE

(i) I.D for year 2005 (Kshs. 000)

| Asset | Q. Cost | I.D @ 100% | Residual for IBD and WTA |
|---|---|---|---|
| Additional plant | 2,000 | 2,000 | - |
| New machinery | 6,000 | 6,000 | - |
| | 8,000 | 8,000 | |

(ii) IBD
Cost of year 2000 Factory Building net of I.D.
4,000 – (60% x 4,000) = 1,600
IBD Q. Cost = 1,600
Residual as at 31/12/2004 = 1,600 – (1,600 x 2.5% x 5 yrs) = 1,400
Year 2005 IBD

| Building | Q.C. | Balance b/f | IBD @ 2.5% | Balance c/f |
|---|---|---|---|---|
| F. Building (year 2000) | 1,600 | 1,400 | 40 | 1,360 |
| | | | 40 | |

(iii) W.T.A
Cost of year 2000 machine net of I.D. = 4,800 – (4,800 x 60%) = 1,920.

| Class | (ii) @ 30% | | IV @ 12.5% |
|---|---|---|---|
| Machine net of I.D. (year 2000) + others | - | (1920 + 640) | 2,560 |
| WTA – year 2000 | - | | (320) |
| WDV – 31.12.2000 | - | | 2,240 |
| WTA – year 2001 | - | | (280) |
| WDV – 31.12.2002 | - | | 1,960 |
| WTA – year 2003 | - | | (245) |
| WDV – 31.12.2003 | - | | 1,715 |
| Add computers (year 2004) | 1,000 | | - |
| | 1,000 | | 1,715 |
| WTA – year 2004 | (300) | | (215) |
| WDV – 31.12.2004 | 700 | | 1500 |
| WTA – year 2005 | (210) | | (188) |
| WDV – 31.12.2005 | 490 | | 1,312 |

| Summary | Kshs. „000" |
|---|---|
| I.D. | 8,000 |
| IBD | 40 |
| WTA 210 + 188 | 398 |
| Total capital allowances | 8,438 |

(b) ADJUSTED PROFIT (LOSS) FOR TAX PURPOSES YEAR 2005

| | SH.000 | **SH.000** |
|---|---|---|
| Profit for the year as per P & L a/c | | 21 |
| Add disallowable expense | | |
| Salaries & wages | | |
| – contribution to unregistered pension scheme | 20 | |
| General expenses – donation | 15 | |
| Taxes – VAT | 43 | |
| Bad debt reserve – General reserve (276 – 180) | 116 | |
| Reserves | 750 | |
| Provision for dividends | 300 | 1,244 |
| | | 1,265 |
| Less capital allowances | | (8,438) |
| Adjusted loss | | (7,173) |

(c) No tax is payable since loss is reported for tax purposes. The loss is c/fwd.

(d) Intervals for payment of tax instalments are as

follows: Due date during year under consideration

| | 20th of 4th month | 20th of 6th month | 20th of 9th month | 20th of 12th month |
|---|---|---|---|---|
| For taxpayers other than Agricultural taxpayers | 25% | 25% | 25% | 25% |
| Agricultural taxpayers | NIL | NIL | 75% | 25% |

**Notes:**

1. In computing industrial building deduction on factory building it is necessary to first establish qualifying cost residue as at 1/1/2005

2. Contributions to business pressure group has been allowed since it is to protect traders of same king.

3. Contributions by the employer to unregistered schemes is not allowable.

## QUESTION TWO

(a) RECOMMENDATON ON JOB OFFERS

WORKINGS

| Offer | A | | B |
|---|---|---|---|
| Salary 45,000 x 12 | 540,000 | (41,000 x 12) | 492,000 |
| Car benefit: Higher of | | | |
| (i) Amount on 1600cc = 69,600 | | | |
| (ii) 24% x 600,000 = 144,000 | 144,000 | | 144,000 |
| | 684,000 | | 636,000 |
| Add: Housing benefit: Higher of | | | |
| (i) 15% x 684,000 = 102,600 | | | |
| (ii) 50,000 p.m. x 12 = 600,000 | 600,000 | | - |
| (i) 15% x 636,000 = 95,400 | - | | |
| (ii) 60,000 p.m. x 12 = 720,000 | - | | 720,000 |
| Pensionable pay | 1,284,000 | | 1,356,000 |
| Less pension contribution: lower of | | | |
| (i) 30% x 1,284,000 = 385,200 | | | |
| (ii) Actual 5% x 540,000 = 27,000 | | | |
| (iii) Set limit of = 210,000 | (27,000) | | - |
| (i) 30% x 1,350,000 = 405,000 | | | |
| (ii) Actual 5% x 492,000 = 24,600 | | | |
| (iii) Set limit = 210,000 | - | | (24,600) |
| Taxable income | 1,257,000 | | 1,331,400 |
| | | | |
| Tax liability | | | |
| 121,968 @ 10% | 12,196.8 | | 12,196.8 |
| 114,912 (15% + 20% + 25%) | 68,947.2 | | 68,947.2 |
| (1,257,000 – 466,704) @ 30% | 237,089.0 | | - |
| (1,331,400 – 466,704) @ 30% | - | | 259,409.0 |
| Gross tax | 318,233.0 | | 340,553.0 |
| Less: personal relief | (13,944) | | (13,944) |
| | 304,289 | | 326,609 |

Take offer A because of lower tax

| | | | |
|---|---|---|---|
| Offer A | Take home | = | 540,000 – 304,289 = 235,711 |
| Offer B | Take home | = | 492,000 – 326,609 = 165,391 |

(b) According to Sec. 16(2) (a)(iv), no deduction shall be allowed in respect of educational fees of employees dependants or relatives. Where school fees for dependants/relatives have been paid by employer and taxed on employer, the benefit is NOT taxed on the employee.

## QUESTION THREE

(a) Strictly speaking, it is not possible to distinguish between farm works deductions and capital deduction. Farm works deductions are, to all intents and purposes, capital deductions. Capital deductions are unique as they relate to farm works. Other capital deductions mainly relate to manufacture.

(b) JOHN MOTURI

**Farm-works deductions**

| Expenditure | Total cost Sh."000" | 2005 Sh.000 | 2006 Sh.000 | 2007 Sh.000 |
|---|---|---|---|---|
| Farmhouse (1/3.6M) | 2,000 | 667.667 | 667.667 | 667.667 |
| Cattle dip | 1,000 | 333.333 | 333.333 | 333.333 |
| Irrigation systems | 1,500 | 500.000 | 500.000 | 500.000 |
| Labour quarters | 2,400 | 800.000 | 800.000 | 800.000 |
| Milking machinery (give wear and tear) | NIL | NIL | NIL | NIL |

When a farmer takes over works (in this case Peter Muturi) from another farmer (John Moturi) will continue to claim the remaining deductions regardless of the price paid for the farm works.

Where farm works are transferred during the year, the deductions for that year in respect of the transferred farm works will be apportioned to the farmer on a time basis.

**Wear and Tear Allowances**

| | Class IV **12½%** **sh."000"** |
|---|---|
| Written down value 1.1.2005 | Nil |
| Additions in the year | 1,120 |
| | 1,120 |
| Wear and tear | (140) |
| WDV at 31.12.2005 | 980 |
| Wear and tear 2006 | (123) |
| WDV – 31.12.2006 | 857 |
| WTA | 107 |
| WDV 31.12.2007 | 750 |

**Summary (John Moturi)**

| | 2005 Sh.000 | 2006 Sh.000 | 2007 Sh.000 |
|---|---|---|---|
| Farm works | 2,300 | 2,300 | - |
| Wear and tear | 140 | - | - |
| | 2,440 | 2,300 | - |

**Summary of (Peter Muturi)**

| | 2005 Sh.000 | 2006 Sh.000 | 2007 Sh.000 |
|---|---|---|---|
| Farm works | - | 2,300 | 2,300 |
| Wear and tear | - | 123 | 107 |
| | - | 2,423 | 2,407 |

**QUESTION FOUR**

(i) Benefits of VAT in the context of a good tax system

- VAT is usually collected by the government through VAT registered traders. The government does not pay the traders to collect VAT on its behalf. Given the wide scope of

VAT, each and every person in the economy is affected. The government is able to reach every person who suffers VAT though a relatively small proportion of the entire population that comprises VAT traders.

- VAT is equitable the overall liability is determined by a person"s expenditure/consumption. Those with a higher expenditure (and therefore more able to pay tax) end up contributing similarly high proportion of VAT collected.

- VAT is also equitable where it does not apply, (either through zero rating or exemption) to basic necessities such as foods, medicine, healthcare, agricultural inputs, education, etc. Lower income groups spend a high proportion of their incomes on such goods. Consequently, only a small proportion of their expenditure is affected by VAT.

- VAT is based on consumption in the domestic economy. Its wide scope where accompanied by little leakage results in high revenue yields.

- VAT is an indirect tax. It is based on a person"s expenditure and not income. This minimizes the disincentives associated with direct taxation. Its indirect nature means most people who suffer VAT may not know about it or may not be able to quantify how much is paid. For this reason there is less likelihood of resentment. Resentment of taxation usually leads to high tax evasion.

- The wide scope of VAT accompanied with minimal expenditure does not distort the working of the market mechanism. In other words, VAT ensures neutrality as consumers in the economy cannot switch their preferences/consumption to avoid taxation.

(ii) **TOUGHT LIMITED**

(a) VAT Account for the month of December 2005

| | | Shs. | | | Shs. |
|---|---|---|---|---|---|
| Dec | Purchases | | Dec | Sales | |
| 1st | 16/116(400)(5,600) | 308,966 | 1st | 16/116(40)(7,200) | |
| 20th | Purchases 16/116(300)(6,400) | 264,828 | 5th | Sales 16/116(80)(7,200) | 79,448 |
| | | | 10th | Sales 16/116(200)(7,200) | 198,621 |
| | | | 25th | Sales 16/116(80)(7,200) | 79,448 |
| 31st | Net VAT payable | 43,137 | 31st | Sales 16/116(200)(8,000) | 220,690 |
| | | 616,931 | | | 616,931 |

## QUESTION FIVE

(a) **EXCISE DUTY**

The Customs and Excise Act does not expressly define excise duty. However, it refers to duty levied on the local manufacture or importation of excisable goods which are usually luxurious items such as cigarettes, wines, electronic sets, etc.

(b) **LOCAL COMMITTEE**

Is an appeal body charged with hearing and deciding on disputes between taxpayers and the commissioners of income tax.

(c) **DESIGNATED PRIMARY SOCIETY**

Means a co-operative society registered under the Co-operative societies Act, Section 19 A (7).

(d) **BONDED WAREHOUSE**

Is a warehouse licensed by the commissioner of customs and excise for storage of goods prior to entry for home use or re-exportation or awaiting payment of duty.

(e) **TAXABLE PERSONS**

Section 2 of VAT Act – Any person liable to apply for registration under the sixteenth schedule but does not include an export processing zone enterprise.

(f) **ZERO RATED**

Section 8 of Vat Act gives zero-rated supplies as those business transactions on which VAT is charged at zero rate.

(g) **NON-RESIDENT**

Is a person/company that does not fit into the definition of a resident as specified in Section 2(1) of the Income Tax Act.

(h) **EXEMPT INCOME**

Is income not subject to tax such as interest earned on tax reserve certificates.

(i) **REGISTERED HOME OWNERSHIP SAVINGS PLAN**

Is a savings plan established by an approved institution and registered with the commissioner in a prescribed manner – Section 2 (1).

(j) **COMMERCIAL VEHICLE**

Is a road vehicle which the commissioner is satisfied that it is manufactured for carriage of goods and so used in connection with business; or a motor or minibus as per Traffic Act, or used for carriage of members of public for hire or reward.

## JUNE 2007

## QUESTION ONE

(a) Taxable capacity of the people refers to the extent of their ability to pay tax. Four factors affecting/influencing taxable capacity in a country are:

**Number of inhabitants:**

The larger the number the greater is the taxable capacity of the community to contribute towards the expenses of the Government.

Distribution of wealth:

Where wealth is more equally distributed, the taxable capacity will be correspondingly reduced. If accumulations of wealth in a few hands then the Government has to tax the rich highly to help the poor.

**Method of taxation:**

A tax system composed of various types; direct and indirect will ensure a larger yield.

**Purpose of taxation:**

If the purpose of taxation is to promote welfare of the people, they will be more willing to pay tax for popular causes. If tax revenue is used to finance war, maintenance of armed forces, a costly civic service them taxable capacity will reduce.

**Others: Psychology of taxpayers, stability of incomes, rate of inflation etc.**

(b) (i)Formal employment has the following characteristics that make it convenient to raise taxes:

- Income in formal employment is certain since those in employment are expected to be in work over a long period of time before retirement.
- Collection of such tax is less costly since employers are agents to the Government who charge, collect and remit tax to the state without payment.
- Elasticity of demand for income in formal employment is inelastic in face of rise in tax since incomes informal employment tends to be higher than would be the case in informal sector.
- It is not easy to evade taxes on formal employment.
- The tax authority does not have sufficient capacity to enforce/collect tax from informal sectors.

(ii) One-way the Government can be able to generate tax revenue from informal sector is designating areas of informal sector operations so as to make easy registrations and collection of tax/charges from such operators.

**Others:**

- Introducing indirect tax on items used by informal sector operations.
- Introduce direct tax on informal operations.

(c) (i) A licence is not strictly a tax but authorization for one to conduct a particular business or a line of business.

(ii) For such licences include:

Trade licence – for authority to conduct business

Driving licence – authorizes one to drive an automobile
Import/export licences – authorizes one to import or export
Practice licence – authorizes one to practice in a particular profession as a professional.

**Others:**

- Transport licensing board permit
- Liquor licences, etc.

(iii) Issuing a single licence to a trader rather than a variety of licences would reduce costs involved in acquiring a number of licences from different points hence convenient to trader. However this would not check abuses by traders wishing to carry out trade in various trade activities requiring proof of eligibility. It would also reduce revenue collection by the government.

**QUESTION TWO**

(a) MRS. NKURARU
CHARGEABLE PROFIT FOR 2005

| | Sh."000" | **Sh."000"** |
|---|---|---|
| Net profit as per account | | 2,905.68 |
| Add disallowable expenses | | |
| Over valuation of opening stock (20/120 x 8,640) | 1,439.999 | |
| Rent, rates and taxes – customs on equipment to capitalize | 20.4 | |
| Legal and professional fees: | | |
| Tax appeal | 24 | |
| Breach of trade agreement | 36 | |
| Court fines | 20.4 | |
| Depreciation | 363.84 | |
| Advertising – sign board (capital) | 24 | |
| Value added tax | 247.2 | |
| Customs duty for 2005 | 700 | |
| Income tax for 2004 | 312 | |
| Medical expenses Mrs. Nkuraru (private) | 28.8 | |
| Purchase of equipment | 25.2 | |
| General bad debts | 55.2 | |
| Household expenses | 100.8 | 3,397.889 |
| | | 6,303.519 |
| Less non-taxable income, capital allowances, etc | | |
| Over valuation of closing stock (20/120 x 1,004) | 167.333 | |
| Unrealised profit on drawings (Sh.000, 120-96) | 24 | |
| Proceeds from sale of land | 500 | |
| Gain on sale of shares | 200 | |
| Gain on sale of residential plot | 400 | |
| General bad debt recovery | 36 | |
| Dividends (net) assumed qualifying type | 43.2 | |
| Wear & Tear allowances | 259.2 | 1,629.733 |
| Chargeable profit | | 4,673.786 |

(b) Tax payable

| | |
|---|---|
| Ksh.121,968 @ 10% | 12,196.8 |
| Ksh.114,912 @ (15% + 20% + 25%) | 68,947.2 |
| (Ksh.4,673,786 – 466,704) @ 30% | 1,262,125.0 |
| Gross tax liability | 1,343,269.0 |
| Less personal relief | (13,944.0) |
| Net tax liability | 1,329,325.0 |

Tax is payable through self assessment on or by end of the 4th month after accounting year i.e 30th April 2006.

## QUESTION THREE

(a) (i) Having taken up appointment as managing director of Good Metal Limited from 1st August 2005, Prof. Ujuzi becomes resident individual for year 2005; (i.e. from 1st August – 31 December 2005) since he has a permanent home in Kenya. His salary and benefits will be taxed on him as a resident and will be entitled to 5 months personal relief. He will also be entitled to mortgage interest to the lower of (Sh.2,000,000 x 25% x 5/12) Sh.208,333 or set limit of Ksh.100,000 p.a x 5/12 = Ksh.41,667 (allowable amount)

(ii) He will be exempted from customs duty on personal belongings as returning resident subject to nature and quantities of items involved.

(b) For income tax purposes the following would be the implications of his employment contract:-Monthly salary of Sh.200,000 is employment income and chargeable to income tax.

School fees of Sh.300,000 will be taxable on him unless Good Metal Limited treat this expense as disallowable (taxed on the employer).

Provision of a car of 2,000 c.c rating gives rise to taxable car benefit equal to the higher of c.c. rating of Sh.(36,000 x 5/12) = 15,000 p.a. or 2% per month multiplied by cost of car, i.e. (Sh.2,000,000 x 2% x 5months) = Sh.200,000. Therefore taxable car benefit will be Sh.200,000 for the year.

Baggage and air travel costs are not taxable benefit on Prof. Ujuzi who is coming to Kenya having been appointed outside Kenya on a first appointment in Kenya; Sec.5(4)(a).

Dividend is not employment income and is taxed at source. However tax paid on dividend by the employer on his behalf is taxable income on him and will be added to his income and taxed as such. Premium paid on his behalf by employer is a taxable benefit on him.

(c) PROFESSOR UJUZI
TAXABLE INCOME YEAR 2005

| | Ksh. p.a. |
|---|---|
| Employment income: salary (Sh.200,000 x 5 months) | 100,000 |
| <u>Benefits:</u> | |
| Company car take the higher of 2000 c.c rating | |
| (Sh.36,000 x 5/12) = Sh."000" 15 | 200,000 |
| or 2% x 2,000,000 x 5 months) = Sh.000 200 | |
| Dividend tax paid at source by employer | 20,000 |
| Premium on life paid for by employer | 60,000 |
| Less interest on owner occupied property – the lesser of actual | |
| Sh.208,333 or max. 41,667 for 5 months | (41,667) |
| Taxable income | <u>1,238,333</u> |

**Tax liability**

| | |
|---|---|
| (Ksh.121,968 @ 10%) + (114,912 @ 60%) | 81,144 |
| (Ksh.1,238,333 – 466,704) @ 30% | <u>231,489</u> |
| Gross tax liability | 312,633 |
| Less personal relief 1,162 p.m x 5 | <u>(5,810)</u> |
| Net tax liability | <u>306,823</u> |

**Notes:**

1. Honoraria to wife is not strictly employment income neither is it business and therefore not taxable on her.

2. Personal relief to Prof. Ujuzi is for 5 months only of employment during the year.

## QUESTION FOUR

(a) **MEKA ASSOCIATES**
**CAPITAL ALLOWANCES YEAR 2005**

(I) **INVESTMENT DEDUCTION**

| ASSET | QUALIFYING COST SH."000" | I.D @ 100% SH."000" | RESIDUE FOR IBD & WTA SH."000" |
|---|---|---|---|
| Building extension | 16,000 | 16,000 | - |
| Security wall | 2,000 | 2,000 | - |
| Machinery | 24,000 | 24,000 | - |
| Boiler | 20,000 | 20,000 | |
| | | 62,000 | |

Note that Nithi Brothers had claimed I.D on factory building and machinery.

(ii) **INDUSTRIAL BUILDING DEDUCTION**

| NATURE OF BUILDING | QUALIFYING COST SH."000" | RESIDUE B/FWD SH."000" | IBD @ 2½% SH."000" | RESIDUE C/FWD SH."000" |
|---|---|---|---|---|
| Factory building (2004) | 14,400 | 14,040 | 360 | 13,680 |
| | | | 360 | |

(iii) **WEAR & TEAR ALLOWANCES**

| CLASS | I @ 37½% SH."000" | II @ 30% SH"000" | III @ 25% SH."000" | IV @ 12½% SH."000" |
|---|---|---|---|---|
| WDV as at 1/1/2005 | Nil | Nil | Nil | NIL |
| Additions | | | | |
| Fixtures & fittings | - | - | - | 12,000 |
| Volvo – saloon | - | - | 1,000R | - |
| Nissan Urvan | - | - | 3,000 | - |
| Milling machines | - | - | - | 36,000 |
| Tractor & lorry | 32,000 | - | - | - |
| Motor vehicle | - | - | 1,000R | - |
| Disposals: | | | | |
| Milling machines | - | - | - | (4,000) |
| Fixtures and fittings | - | - | - | (160) |
| Lorry | (3,600) | - | - | - |
| Motor vehicle | - | - | (750)R | - |
| Photocopier | - | (80) | - | - |
| | 28,400 | (80)T.R | 4,250 | 43,840 |
| WTA | (10,650) | - | (1,062.5) | (5,480) |
| Trading receipt | - | 80 | - | - |
| WDV 31/12/2005 | 17,750 | Nil | 3,187.5 | 38,360 |

Total WTA = 17,192.5

**SUMMARY OF CAPITAL ALLOWANCE**

| | |
|---|---|
| INVESTMENT DEDUCTION | 62,000,000 |
| INDUSTRIAL BUILDING | 360,000 |
| WEAR & TEAR ALLOWANCE | 17,192,500 |
| TOTAL CAPITAL ALLOWANCES | 61,372,500 |

MEKA ASSOCIATES
COMPUTATION OF TAXABLE INCOME

| | Sh."000" |
|---|---|
| Net profit as per accounts | 60,498,500 |
| Less capital allowances | (80,552,500) |
| Add trading receipt | 80,000 |
| | (19,974,000) |

(b) **ALLOCATION TO PARTNERS**

| **PARTNERS** | KAMENE SH."000" | MUTINDA SH"000" | MWENDE SH."000" | TOTAL SH."000" |
|---|---|---|---|---|
| Salaries | 480 | 480 | 2,400 | 3,360 |
| Interest | 2,000 | 1,320 | - | 3,320 |
| Share of loss | (10,661.6) | (10,661.6) | (5,330.8) | (26,654) |
| Net profit share | (8,181.6) | (8,861.6) | 2,930.8 | (19,974) |

(c) **TAXABLE INCOME FOR EACH PARTNER**

| | KAMENE SH."000" | MUTINDA SH"000" | MWENDE SH."000" |
|---|---|---|---|
| Net profit from partnership | (8,181.6) | (8,861.6) | 2,930.8 |
| Less mortgage interest (maximum) | (100.0) | - | - |
| Interest on city council | (8,281.6) | - | - |
| Chargeable income | | (8,861.6) | 2930.8 |

**Notes:**

1. Interest on city council stocks suffers withholding tax as final tax.
2. W.e.f 1 January 1995 any civil works or related structure to an industrial building is taken as part of the building and will qualify for investment deduction.

**QUESTION FIVE**

(a) (i)**Exempt supplies:**
Partners need not register for VAT and consequently cannot claim input tax suffered on purchases.

(ii) **Zero Rate Supplies:**
Partners need to register for VAT, to charge VAT but at zero rate can claim input tax suffered on purchases.

(iii) **Non-Remittances of VAT:**
The following actions, penalties are available to the commissioner:

(a) Seizing goods of taxable person in question
(b) Collecting the money from debtors of the taxpayer out of sums due to the taxable person.

(c) Property of the taxable person can be distained.
(d) Taxpayer could be sued for the amount in a court of law
(e) Late payment penalty of Ksh.15,000 and interest charge of 2% per month.

(b) (i) The VAT suffered on new building constructed on behalf of Wema Ltd. is capital in nature and therefore not deductible as input tax rather it is included in total factory building cost for the purpose of claiming capital allowances.

(ii) VAT is payable on total invoices amount by $20^{th}$ of the following month whether sales were on cash or credit basis.

(iii) Stamp duty is payable on such transfer based on market value of building i.e. Sh.5,000,000 x 4% = Sh.200,000.

(iv) Since goods have not been re-exported as required then the customs department will require the Watu Insurance Company to pay up the sum guaranteed. The customs bond is a guarantee of performance by the insurance company, however the Insurance Company may then recover the amount from Barm Limited.

## NOVEMBER 2007
## QUESTION ONE

(a) Employer for PAYE purposes includes:

- Any person having contract of payment of remuneration.
- Any agent or manager or other representative in Kenya of any employer who is outside Kenya.
- Any paying officer of the government or public authority
- Any institution or insurance company or other body of pension paying pensions.
- A manager of a branch or firm as well as the main employer.

(b) **J SELINA**

(i) **2005 TAX COMPUTATIONS**

| | Sh. |
|---|---|
| Salary (250,000 x 12) | 3,000,000 |
| Housing benefit (50,000 x 12)<br>Lower of 15% of 3,000,000 | 600,000 |
| | 3,600,000 |
| Less: | |
| Contributions to pension scheme<br>Actual contributions<br>(5% x 3,000,000) = 150,000 < 210,000 | (150,000) |
| Taxable income | 3,450,000 |

(ii) Tax liability on Ksh.3,450,000

| | Sh. |
|---|---|
| 1st Ksh.121,968 @ 10% | 12,196.8 |
| Ksh.114,912 @ (15% + 20% + 25%) | 68,947.2 |
| (Ksh.3,450,000 – 466,704) @ 30% | 894,989.0 |
| | 976,133.0 |
| Less: | |
| Personal relief | (13,944.0) |
| PAYE | (1,015,200.0) |
| Tax Refund | (53,011.0) |

(iii) Tax liability and taxable income

- This would remain as above

- J Selina would be assessed on the 50,000 per month as house allowance since there is no housing benefit in this case. Housing benefit is equal to house allowance.

## QUESTION TWO

(a) - Payment of Income tax due for the year within the accounting period in full or instalments. Four equal instalments are made during the year of income based on 110% of last years tax liability. Instalment tax is not payable where:

- emoluments have been subjected to PAYE deductions
- tax due for any corporate taxpayer is not more than Sh.40,000 p.a.

Instalment tax is payable on the following dates:

20th of the 4th month

20th day of the 6th month

20th day of the 9th month

20th day of the 12th month

Agricultural income:

20th day of the 9th month

20th day of the 12th month..

Balance of tax due is payable at end of the 4th month of the year following the accounting date of the year of income.

(b) WTSD – a director of a company who is required to devote substantially the whole of his time to the service of that company in a managed or technical capacity and does not control directly or indirectly more than 5% of the company"s share capital.

(c) Net profit

| | | |
|---|---|---|
| Net Profit | | 218,600 |
| Add: | | |
| Interest – investment shares | 72,000 | |
| Audit – Appeal | 32,000 | |
| Business line | 68,000 | |
| General provision of bad debt | 120,000 | |
| Directors Christmas party | 24,000 | |
| Depreciation | 344,760 | |
| Miscellaneous expenses | | |
| 100 year lease | 28,000 | |
| Donations | 41,600 | 730,360 |
| Grossed-up | | 948,960 |
| Deduct: | | |
| Dividends | 72,000 | |
| Interest FD | 58,760 | |
| Interest TD | 93,876 | |
| Dividends – SC | 60,000 | |
| Profit on sale of shares | 216,324 | (500,960) |
| Business Income | | 448,000 |

Summary of chargeable income

| | |
|---|---|
| | Sh. |
| Business | 448,000 |
| Gross interest – FD 58,760 ÷ 0.89 | 69,129 |
| - Treasury bills | 93,876 |
| | 611,005 |

## QUESTION THREE

(a) (i) Trading receipt in confirming business where the disposal value trading receipt class of WTA more than/exceeds the written down value in that class. The excess of the disposal value over WDV is taxable.

(ii) Balancing Charge – arises where in closing down business the disposal value of a class is more than/the WDV in that class, it is chargeable to tax as taxable income.

(iii) Trading Loss: This arises in a confirming business where the disposal in a particular class of WTA is less than the WDV. Trading loss is deductible.

(iv) Balancing Deduction: In a class of down business where the disposal value of a particular class less than the WDV of that class for taxing deduction is deductible.

(b) Investment Deductions

| | | Sh „000" |
|---|---|---|
| Milling machine | 5,550,000 x 100% = | 5,550 |
| Building (milling) | 13,600,000 x 100% = | 13,600 |
| | | 19,150 |

No residual for IBD and WTA.

Wear & Tear Schedule

| **Class** | **I** | **II** | **III** | **IV** |
|---|---|---|---|---|
| WDV 1.1.2005 | - | - | - | 3,440,000 |
| Milling machine | - | - | - | |
| Fork lifts | 1,720,000 | - | - | |
| Tractors | 7,800,000 | - | - | |
| Lorries | 2,400,000 | - | - | |
| Packaging Machine | - | - | - | 3,500,000 |
| Crushing machine | - | - | - | 3,680,000 |
| C & Sorter | - | - | - | 6,240,000 |
| Pick-ups | - | - | 1,800,000 | |
| Lorry | 2,400,000 | - | - | |
| Saloons | - | - | 780,000 | |
| Furniture & Fixtures | - | - | - | 544,000 |
| | 14,320,000 | | 2,580,000 | 17,404,000 |
| Additional: | | | | |
| Toyota | - | - | 1,000,000[R] | - |
| Lorry | 5,200,000 | - | - | - |
| Tractor | 3,540,000 | - | - | - |
| Furniture | - | - | - | 280,000 |
| Pick-up | - | - | 4,000,000 | - |
| Computers | - | 50,000 | - | - |
| Computer scanners | - | 400,000 | - | - |
| Printers | - | 200,000 | - | - |
| | 23,060,000 | 650,000 | 7,580,000 | 19,300,000 |
| Disposals | | | | |
| Forklift | (480,000) | - | - | - |
| Saloon car | - | - | (920,000) | - |
| Printer | - | (50,000) | - | - |
| Packaging machine | - | - | - | (4,500,000) |
| Tractor | (3,200,000) | - | - | - |
| | 19,380,000 | 600,000 | 6,660,000 | 13,184,000 |
| Wear and tear allowance | (7,267,500) | (180,000) | (1,665,000) | (1,648,000) |
| WDV @ 31/12/2005 | 12,112,500 | 420,000 | 4,995 | 11,536,000 |

**Summary**

| | |
|---|---|
| Investment allowance | 19,150,000 |
| Wear and tear allowance: | |
| Class I (37½%) | |
| Class II (30%) | 7,267,500 |
| Class III (25%) | 180,000 |
| Class IV (12½%) | 1,665,000 |
| | 1,648,000 |
| | 29,910,500 |

**QUESTION FOUR**

(iii) **VAT Tribunal**

Appointed by the Minister of Finance to arbitrate disputes between commissioner of VAT and registered pensions for VAT
Composed of a chairman and two other members from the general public
The Minister prescribes the manner in which an appeal may be made
The tribunal may confirm, reduce, increase or nullify the tax assessed as it thinks fit.

Any person aggrieved by the decision made by the VAT tribunal may make an appeal to the high court.

**Requirements for Appeal**

- Within 30 days
- Submit all outstanding returns
- Pay all tax not in dispute
- Deposit 50% of tax in dispute if dispute in assessment relates to:

* failure to
  - * failure to submit returns
  - * non-registration
  - * late registration

(b) All partners are jointly and severely liable for all the payment of VAT i.e

* Submitting the VAT return by the 20th of the month after the supply and remit only VAT due.

(c) May - Output tax – 300,000
June - Sales for June – 1.05 x 300,000 = 315,000

| | **June** | **July** | **August** | **Sept.** | **Oct.** | **Total** |
|---|---|---|---|---|---|---|
| Sales | 315,000 | 346,500 | 381,150 | 419,265 | 461,191 | |
| VAT – Output tax @ 16% | 50,400 | 55,440 | 60,984 | 67,082 | 73,791 | 307,691 |

VAT payable in July

| | |
|---|---|
| For period of July to November | 307,691 |
| VAT actually paid | (145,000) |
| Underpayment | 162,691 |

* Input tax is not deductible.

**(ii) Recommendations**

- Use of the right VAT rate
- Incorrect claim of input tax should be discouraged.
- Maintain accurate VAT records.

## QUESTION FIVE

**Gatwiri, Kiende & Kanyiri Partnership**
**2005 Tax Computations**

| | | |
|---|---|---|
| Reported Loss | | (4,425,000) |
| Add back | | |
| Interest on capital | | |
| Gatwiri | 232,500 | |
| Kiende | 232,000 | |
| Kanyiri | 348,000 | |
| Salaries to partners | | |
| Gatwiri | 400,000 | |
| Kiende | 420,000 | |
| Kanyiri | 576,000 | |
| Office expenses – cabinet | 110,000 | |
| Travelling expenses (12,000 x 12) | 144,000 | |
| Increase in general provision for bad debts | 60,000 | |
| Drawings – Kiende | 70,000 | |
| Office partitions | 80,000 | |
| Goodwill | 400,000 | |
| Loss on investment | 600,000 | |
| Donations | 300,000 | |
| Depreciations | 1,760,000 | |
| Purchase of lorry | 1,331,000 | 7,063,000 |
| | | 2,638,000 |
| Deduct: | | |
| Wear & Tear allowance | (706,000) | |
| Dividends received | (264,000) | |
| Insurance recovery on Motor vehicle | (520,000) | (1,490,000) |
| Taxable partnership profit/(loss) | | 1,148,000 |

Allocation to Partners

| | Gatwiri | **Kiende** | **Kanyiri** | **Total** |
|---|---|---|---|---|
| Interest on capitals | 232,000 | 232,000 | 348,000 | 812,000 |
| Salaries to partners | 400,000 | 420,000 | 576,000 | 1,396,000 |
| Share of loss | (424,000) | (424,000) | (212,000) | (1,060,000) |
| | 208,000 | 228,000 | 712,000 | 1,148,000 |

**MAY 2008**
**QUESTION ONE**

(a) **MR. KIOGORA**
**TOTAL TAXABLE AND TAX PAYABLE YEAR 2001**

| **Self** | | Sh.p.a. | Sh. |
|---|---|---|---|
| Employment income | | | |
| Earnings (Sh.16,000 x 12 months) | | 720,000 | |
| End year bonus | | 20,000 | |
| Road licence and insurance (private expenses) | | 28,000 | |
| Maintenance and repair (private expenses) | | 14,000 | |
| Insurance premium by employer | | 24,000 | 806,000 |
| House benefit – rent paid (5,000 x 12 months) or 15% x 806,000 (Higher of two) | | | 120,900 |
| **Other Incomes:** | | | |
| Rental income: Gross | 43,000 | | |
| Less mortgage interest | 8,000 | | |
| Total taxable income | | | 35,000 |
| | | | 961,900 |
| **Wife"s Income:** | | | |
| Salary (Sh.72,000 x 12 months) | | 864,000 | |
| Free lunches (Sh.2,400 x 12 months) | | 28,800 | |
| Part time Business (Sh.10,000 x 12 months) | | 120,000 | |
| Total taxable income | | | 1,012,000 |

Taxable income split as follows:

| MR. KIOGORA | | MRS KIOGORA |
|---|---|---|
| Kshs. 961,900 | | Kshs. 1,012,800 |
| Tax thereon | | |
| (121,968 x 10%) + (114,912 x 60%) | 81,144 | 81,144 |
| (961,900 – 466,704) @ 30% | 148,559 (1,012,000 – 466,704) | 163,589 |
| Gross tax liability | 229,703 | 244,733 |
| Less: Tax at source (PAYE) | (192,000) | (300,000) |
| - Personal relief | (13,944) | (13,944) |
| Net tax liability (refund) | 23,759 | (69,211) |

Therefore net tax refund to couple = (69,211) + 23,759 = (45,452)

(b) **Tax Position of Mrs. Kiogora**

- She has the option to file her own self-assessment return with respect to her employment and business income at arms length.
- Her employment and business income qualify for separate taxation.
- A tax refund is due to her for the year of income.

(c) **Information Not Used in the Computation Above**

- Mr. Kiogora is denied owner occupied interest deduction since it appears he does not live in his house.
- In arriving at taxable rental income cost of building extension and painting extension are capital in nature hence not deductible against gross rent.

- Entertainment and petrol re-imbursements are not taxable employment benefits (they are business expenses).
- Contribution by the employer on behalf of Mr. Kiogora to approved pension scheme is not taxable.
- Interest from Post Office Savings Bank is tax exempt
- Interest from Euro and National Bank are qualifying and W/T @ 15% is final.

## QUESTION TWO

MR S SHAH
CAPITAL DEDUCTIONS YEAR 2005

(a) (i)**Investment Deduction**

| ASSET | QUALIFYING COST SH."000" | I.D @ 100% SH."000" | RESIDUE SH."000" |
|---|---|---|---|
| New building | 1,750 | 1,750 | - |
| Processing machines | 2,400 | 2,400 | - |
| | | 4,150 | |

**Industrial Building Deduction**

| NATURE OF BUILDING RESIDUE | QUALIFYING COST | RESIDUE B/FWD | I.B.D @ 2½% | C/FWD |
|---|---|---|---|---|
| Old Building | 6,250 | 5,000 | 156.25 | 4,843.75 |
| Total I.B.D | | | 156.25 | |

## WEAR AND TEAR ALLOWANCE

| Class | I @ 37½% Sh."000" | II @ 30% | III @ 25% Sh."000" | IV @ 12½% Sh."000" | Sh."000" |
|---|---|---|---|---|---|
| WDV 1/1/2005: | - | - | - | - | - |
| Office furniture | | | | | 3,300 |
| Computers | | 200 | | | |
| Tractors | 12,000 | | | | |
| Lorries (1 ton) | | | 2,500 | | |
| Processing machine | | | | | 4,800 |
| Saloon cars | | | 3,200 | | |
| <u>Additions</u> | | | | | |
| Office furniture | | | | | 1,900 |
| Lorries (1 ton) | | | 3,000 | 3,000 | |
| Saloon cars | | | 1,000^R | | |
| Micro computers | | 300 | | | |
| Milking machinery | | | | | 220 |
| <u>Disposals</u> | | | | | |
| Office furniture | | | | | (700) |
| Computers | | | (80) | | |
| Tractors | (2,500) | | | | |
| Lorries (1 ton) | | | | (500) | |
| Processing machines | | | | | (1,800) |

| | | | | |
|---|---|---|---|---|
| Saloon car | - | - | (200) | - |
| | 9,500 | 420 | 9,000 | 7,720 |
| WDV 31/12/2005 | (3,562.5) | (126) | (2,250) | (965) |
| Total WTA | 5,937.5 | 294 | 6,750 | 6,755 |

**Farmworks Deduction**

| ASSET | QUALIFYING COST SH."000" | FWD @ 33⅓ % P.A. FOR 3 YRS SH."000" |
|---|---|---|
| Farm house (⅓ x 600) | 600 | 200,000 |
| Cattle dip | 120 | 40,000 |
| | | 240,000 |

**SUMMARY OF CAPITAL DEDUCTIONS**

| | |
|---|---|
| Investment Deduction | 4,150,000 |
| Industrial Building Deduction | 156,250 |
| Wear & Tear Allowance | 6,903,500 |
| Farmworks Deduction | 240,000 |
| | 11,449,750 |

(b) **Information not use in (a) above**

1. Cost of land does not qualify for any capital allowance
2. Cost of two cars disposed off was not used since on acquisition the cars cost was restricted.
3. Building inherited was valued at Sh.50 million and this valuation figure is irrelevant for industrial building deduction computation.
4. Goodwill and patents do not attract capital allowance hence ignored.

**QUESTION THREE**

A, K & M PARTNERSHIP

(a) TAXABLE INCOME (LOSS) YEAR 2005

| | SH."000" | SH."000" |
|---|---|---|
| NET LOSS REPORTED | | (1,080) |
| Add disallowable expenses: | | |
| Rent – for partners residence | 80 | |
| Legal costs – personal dispute resolution | 15 | |
| Salaries and wages – A"s daughter | 30 | |
| Donations – Turkana Food relief fund | 50 | |
| Motor vehicle expenses – personal use | 45 | |
| Advertising | | |
| New sign board | 5 | |
| A"s birthday expenses | 23 | |
| Depreciation – car & building | 43 | |
| Salaries | | |
| K | 240 | |
| M | 240 | |
| A | 360 | |
| Interest on capital | | |
| K | 80 | |
| M | 80 | |
| A | 120 | |
| Bad debts: | | |

| | | |
|---|---|---|
| General provision | 10 | |
| A"s son (defaulter) | 10 | |
| Loss on sale of shares | 8 | |
| Political membership – K | 6 | |
| Withdrawals by M | 5 | |
| Dresses taken by A for her own use | 12 | |
| School fees paid for A"s children. | 55 | 1,517 |
| | | 437 |
| **Deduct non taxable income; income taxed separately:** | 19 | |
| Dividends from KCB shares | 22 | |
| Rental income | 13 | |
| Gain on sale of furniture | 16 | (70) |
| Wear and tear deductions | | 367 |
| Adjusted partnership profit | | |

**DISTRIBUTION AMONG PARTNERS**

| | A | K | M | Total |
|---|---|---|---|---|
| Salaries | 240,000 | 240,000 | 360,000 | 840,000 |
| Interest on capital | 80,000 | 80,000 | 120,000 | 280,000 |
| Share of loss | (376,500) | (188,250) | (188,250) | (753,000) |
| Net profit or loss share | - | - | - | - |
| | 56,500 | 131,730 | 291,750 | 367,000 |

(b) TAXABLE INCOME OF EACH PARTNER

| | A | K | M |
|---|---|---|---|
| Partnership profit(loss) | 56,500 | 131,750 | 291,700 |
| Add rental income | 11,000 | 5,500 | 5,500 |
| Taxable income | 11,000 | 137,250 | 297,250 |

## QUESTION FOUR

(a) (i) Specific import customs duty refers to customs duty charge based on units of imported item i.e change per unit e.g on each unit of vehicle. While advalorem import customs duty is duty levy based on value of item imported for example jewellery, medication, liquors, etc.

(ii) Discriminatory policy is an international trade policy where a country charges different duties according to the source (country of origin) of the same kind of commodity. Non-discriminatory policy refers to the charging of similar rates of customers duty on similar goods from different countries.

(b) MR MARK MACKENZIE
VAT PAYABLE FOR YEAR 2005

| INPUT TAX | SH."000" |
|---|---|
| Purchases at zero rate | 0 |
| Purchases at standard rate (Sh.900,000 x 16%) | 144 |
| Purchases – car (input tax capitalized) | - |
| Total | 144 |
| | |
| OUTPUT TAX | |
| Sales at standard rate (Sh.2,400,000 x 16%) | 384 |
| Sales at zero rate | 0 |
| Exempt sales | 360 |

Compute Claimable Input tax

Claimable input tax = $\frac{\text{Taxable supplies}}{\text{Total supplies}}$ x total input tax

$$= \frac{\text{Sh.}2{,}400{,}000 + 600{,}000}{2{,}400{,}000 + 600{,}000 + 900{,}000} \times 144{,}000$$

= Sh.110,769

Therefore VAT payable = Output tax less claimable input tax
= 384,000 – 110,769
= 273,231

(c) **Comments on Accuracy of Entries and Possible Errors**

1. Sales account entry posted on wrong side (debited) rather than credited
2. VAT received in Bank a/c of Sh.105,000 correctly posted.
3. VAT paid through Bank of Sh.140,000 is not posted to the VAT a/c.

**QUESTION FIVE**

(d) **Tax Position on Tax Avoidance**

Tax avoidance is the arrangement of taxpayer"s affairs in such a manner that tax liability is reduced without breaking the law. Tax avoidance is therefore legal method of reducing tax liability. However, where the commissioner is satisfied that the main objective of a given transaction was to avoid tax then he may direct that tax arising thereof be paid. This will also arise in areas of shortfall distributions of dividends by a company Sec.23 and 24 of Income Tax Act.

(e) (i)**Income and Expenditure After Cessation of Business**

The income or expenditure received or paid by a person after the cessation of his business is considered taxable income or allowable expenditure of the person for the year of income that the income of expenditure is received or paid, as the case may be. If the payment is not exhaustively set off in the year of income in which it is paid, the difference is deducted from taxable income for the year of income in which the business ceased.

(ii) **Accounting Periods Not Coinciding with Year of Income**

Section 27 deals with accounting periods not coinciding with the year of income. The legal position is as follows: subject to such adjustments as the commissioner may deem necessary, such accounting periods is to be taken as the year of income:

In the case of accompany for all chargeable income

In the case of an individual for all chargeable income except employment income. Where a person makes up the accounts of his business for a period longer or shorter than twelve months, the commissioner may subject to such adjustments as he may consider necessary treat the income of any such accounting period as income of the year of income in which the accounting period ends and tax is charged accordingly.

In the case of a partnership which makes up the accounts of its business to an accounting date other than 31st December in any year, the accounting date of the partners of the partnership in respect of income of the business is considered to be that of the partnership, but the income from employment or services rendered elsewhere will fall within the normal year of income in which it was earned.

(iii) **Offences By Corporate Bodies**

Where, under the Act, any offence has been committed by any body corporate, then everyone who, at the time the offence was committed was a director, general manager, secretary or other similar officer, is also guilty of the offence, unless he proves that the offence was committed without his consent or knowledge and that he took reasonable precautions to prevent the commission of the offence, as he should have taken having regard to his company – (S.116)

(iv) **Service of Notices – S.128)**

The Commissioner is necessarily empowered to determine the form of any notice, return of income, or any other document required for the purposes of the Act shall take and once he has specified the form of any such document, that is the form it must take. Notice given by the commissioner under this Act may be signed by any officer authorized to do so, and any notice purporting to be signed by the commissioner, is assumed, unless proved otherwise, to have been signed by the authorized officer. Any document which has the name, or title of the commissioner, or of the authorized officer who issued it, printed, stamped, or written thereon, is sufficiently authorized.

(v) **Interest On Underestimated Tax**

If a person files a provisional return/instalment return of income and later when he files self-assessment return, the tax assessed on the self assessment/final return turns out to be greater than instalment assessment by more than 10%, he will be liable for an interest at the rate of 2% per month on the difference i.e. 2% p.m. (understated tax + 20% penalty).

**DECEMBER 2008**
**QUESTION ONE**

(a) **Tax position of the income of a deceased person**

Income accrued to or received prior to date of death of a deceased person which would have been assessed on him for a year of income shall be assessed and tax charged on his executors or administrators for that year of income.

Income received by executors or administrators which would have been taxable on the deceased person is assessable and charged on them.

Where income relating to the deceased is distributed by executors and administrators before a change in tax rate, they shall not be liable to any increase in tax resulting from the change in tax rate.

(b) **Set-off tax**

Tax already paid by way of PAYE instalment tax systems, withholding tax (if not final tax), refunds claimable from tax authorities, shall be deducted from tax charged on the tax payer for the year of income in respect of which it was deducted.

(c) (i)Mr. And Mrs. Ongera
Taxable Income
Year of Income 2005

| | Sh. | Sh. |
|---|---|---|
| Salary (120,000 x 12) | | 1,440,000 |
| Overtime (10,000 x 12) | | 120,000 |
| Christmas gifts | | 30,000 |
| Pension Income (240,000 – 180,000) | | 60,000 |
| Rent income: Gross 50,000 x 12) | 600,000 | |
| Less interest | (400,000) | 200,000 |
| | | 1,850,000 |
| Add housing benefit: 15% x 1,850,000 | 277,500 | |
| Or 20,000 x 12 | 240,000 | 277,500 |
| | | 2,127,500 |
| Add husbands income = 250,000 p.a x 12 | | 3,000,000 |
| | | 5,127,500 |

Mrs. Ongera owns 20% of the shares of Anga Ltd. Thus she is other director and housing benefit is based on 15% of the total income.

(ii) Tax liability on Ksh. 5,127,500

| | Sh. | Sh. |
|---|---|---|
| Ksh.121,968 @ 10% | | 12,196.8 |
| Ksh.114,912 @ (15% + 20% + 25%) | | 68,947.2 |
| Ksh.(5,127,500 – 466,704) @ 30% | | 1,398,239.0 |
| Less PAYE: | | 1,479,383.0 |
| Husband | 504,000 | |
| Wife | 720,000 | |
| Personal relief | 13,944 | (1,237,944.0) |
| Net tax liability | | 241,439.0 |

(iii) Penalties for failure to fill self assessment return

Penalty of 5% of tax payable subject to Sh. 10,000 minimum. Late payment interest of 2% p.m of tax liability unpaid plus 20% late payment penalty..

## QUESTION TWO

(a)
- A farmhouse qualifies for a capital deduction called farm works deduction (FWD) at 33⅓ % of cost on straight line basis.
- If the farm house is occupied by the owner of the farm then only ⅓ of the cost will qualify for FWD. Therefore, FWD will be ⅓ of ⅓ of the qualifying cost.
- If the farm house is occupied by a director of the farm or other employees, then the total cost qualifies for FWD i.e FWD = ⅓ or 33⅓ % of cost.

(b) (i) (1) **2005 Farm works deductions**

**Sweet Tooth**

| Item | Qualifying Cost |
|---|---|
| Irrigation System | 3,000,000 |
| Labour Quarters | 4,800,000 |
| Cattle Dip | 2,000,000 |
| Sewerage | 1,200,000 |
| Farm house (⅓ x 12,000,000) | 4,000,000 |
| | 15,000,000 |

Farm works: 2005 = ⅓ x 15,000,000 = 5,000,000 p.a. for 3 years.

(2) Wear and Tear Allowance

| Class | IV @ 12.5% |
|---|---|
| Machinery | 2,240,000 |
| WTA 2005 | (280,000) |
| WDV 1/1/2006 | 1,960,000 |
| WTA 2006 | (245,000) |
| WDV 1/1/2007 | 1,715,000 |

(3) Diminution in value of implements

Diminution = ⅓ x 600,000 = 200,000 p.a for 3 years

Summary

| | **Sweet tooth 2005** | **Tooth Ace 2006** |
|---|---|---|
| Farm works deductions | 5,000,000 | 5,000,000 |
| Wear and Tear allowance | 280,000 | 245,000 |
| Diminution | 200,000 | 200,000 |
| | 5,480,000 | 5,445,000 |

(ii) Cost of Sh.3,500,000 of replacing plants regarded as a capital expenditure but is allowable against farming income for the year of income.

Cost of treating soil also allowable against farming income for 2006.

(iii) Purchase price of assets by Tooth-ache is ignored since for farm works deduction, the written-down values of the assets are the ones that enjoy capital deductions when the assets are sold to another person.

Expenditure in relation to prevention of soil erosion is an allowable deduction (terraces).

## QUESTION THREE

(a) Kinyenje Limited
Adjusted Taxable Profit
Year of Income 2005

| | Sh. | Sh. |
|---|---|---|
| Net profit (reported) | | 541,000 |
| Add back | | |
| Depreciation | 2,052,000 | |
| Reserves | 2,250,000 | |
| Taxes | 129,000 | |
| Provision for dividends | 900,000 | |
| Audit Fees – Tax | 100,000 | |
| Opening Stock Overstatement | 174,667 | |
| Rental loss: Extension | 400,000 | |
| Rental loss | (10,000) | |
| Preliminary expenses | 700,000 | |
| Stone wall fencing | 100,000 | |
| Bad debts – non specific | 348,000 | |
| Donations | 45,000 | 7,188,667 |
| | | 7,729,667 |
| Less: Overstatement | | |
| Closing stock | 380,000 | |
| Profit sale of shares | 760,000 | |
| Capital Deductions | 25,110,000 | (26,250,000) |
| Adjusted Net loss | | (18,520,333) |

Overstatements

| | | |
|---|---|---|
| Stock: | Opening 120% $X_1$ = 1,048,000 $X_1$ = 873,333 | 174,667 |
| | Closing 120% $X_2$ = 1,902,500 $X_2$ = 1,902,500 | 380,500 |

2005(1) Investment deduction

**Kshs. „000"**

| | Q. Cost | ID (100%) | Residual for WTA and IBD |
|---|---|---|---|
| Extension | 6,000 | 6,000 | - |
| New Machinery | 18,000 | 18,000 | - |
| | | 24,000 | |

2004

| | Q. Cost | ID (100%) | Residual for WTA and IBD |
|---|---|---|---|
| Factory Building | 12,000 | 12,000 | - |
| Old machinery | 14,400 | 14,400 | - |
| | | 26,400 | |

(2) Industrial Building Deduction (IBD) – no IBD since there was nil residual after I.D in year 2004 and 2005.

(3) Wear and Tear Allowance

**Kshs. „000"**

| **2004** | **Class** | **II @ #0%** | **IV @ 12.5%** |
|---|---|---|---|
| | Furniture | - | 1,920 |
| | WTA 2004 | - | 1,920 |
| | WDV 31/12/2004 | - | (240) |
| | | | 1,680 |
| 2005 | WDV 1/1/2005 | - | 1,680 |
| | Computers | 3,000 | - |
| | WTA – 2005 | 3,000 | 1,680 |
| | WDV 31/12/2005 | (900) | (210) |
| | | 2,100 | 1,470 |

**Summary**

**Kshs. „000"**

| | **2004** | **2005** |
|---|---|---|
| ID | 26,400 | 24,000 |
| WTA | 240 | 1,110 |
| | 26,640 | 25,110 |

(b) **Tax Payable**

No tax is payable during the current year since the company made a loss. Any amounts paid via the instalment tax system using prior year income or current year estimates is claimable from income tax.

## QUESTION FOUR

(a) VAT position on imported goods and warehouse goods: Imported

Goods – VAT value is the value for goods plus the duty.

Warehoused goods = VAT value is the cost plus the duty at the time of release from the warehouse.

(b) Unpaid VAT = 120,000
Number of months delayed = 2
Interest penalty @ 2% p.m compounded

| | | |
|---|---|---|
| $120{,}000(1.02)^2$ - 120,000 | = | 4,848 |
| Penalty for failure to file return | = | 10,000 |
| VAT payable | = | 120,000 |
| Total amount payable | | 134,848 |

(c) (i)

| | |
|---|---|
| Value of Imports | 1,200,000 |
| Duty: 35% x 1,200,000 | 420,000 |
| Clearing charges | 20,000 |
| Transport | 70,000 |
| Commission (5/100 x 1,200,000) | 60,000 |
| | 1,770,000 |
| VAT 16% x 1,770,000 | 283,200 |
| Value of Goods | 2,053,200 |

(ii) Selling value

| | |
|---|---|
| Value of goods before VAT | 1,770,000 |
| Add 20% mark-up | 354,000 |
| Selling price excluding VAT | 2,124,000 |
| Add 16% VAT | 339,840 |
| Inclusive of VAT | 2,463,840 |

## QUESTION FIVE

(a) **Hotel accommodation tax:**

Tax charged in accordance with provisions of Hotel Accommodation Tax Act
Guest of hotels and clubs charged accommodation tax of 12.5% (full board or 17.5% (bed and breakfast) plus hotel training levy of 2% based on the hotel or club charges.

(b) **Factors that influence tax shifting:**

- Type of tax – direct tax cannot be shifted but indirect tax can.
- Objects of a tax – e.g. income tax can not be shifted.
- Price elasticity of supply and demand
- Availability of substitutes – goods without substitutes means consumer bear the tax.
- Geographical coverage of the tax – can consumers move to other areas to avoid tax.
- rate of tax – higher tax rates means people try to shift tax.
- Profitability of business – If businesses are making losses there is the likelihood of shifting the whole tax to consumers.
- Government fiscal policy – price control means no tax shifting.

(c) Recovery of tax from persons intending to leave on having left Kenya.

- Commissioner is required to issue estimated assessment as quickly as possible and according to the best of his judgement, to persons who are about to leave Kenya.

(d) -The CIT can issue an assessment when:

- The taxpayer has failed to file tax returns
- The CIT believes that the taxpayer was under assessed hence issue additional assessment.
- Where the CIT discovers a fraud in tax returns filed by the taxpayer in earlier years.
- In case of discovery of fraud the CIT can issue an assessment regardless of how many years have lapsed since the fraudulent returns were filed.
- For any other type of assessment, the CIT can issue it before the lapse of 7 years from the year of income to which the assessment relates.

**MAY 2009**
**QUESTION ONE**

(a) **Taxable turnover**

If a business is making taxable supplies, the value of these supplies is called taxable turnover. All goods are taxable except those listed in the second schedule of VAT Act as exempt.

Taxable services are listed in the third schedule of VAT Act. All other services are exempt. If a business supplies taxable goods or services and the turnover is above Sh.3 million p.a. then the person is taxable and should register for VAT. The above limits are not applicable if:

- One is a supplier of designated jewellery
- One is a supplier of pre-recorded cassettes
- One is a saw miller
- One sells 4 or more motor vehicles in a year.
- One is a supplier of accountancy services
- One is an auctioneer
- One is a lawyer
- One is a supplier of motor vehicle spare parts accessories and electrical appliances.

(b) **Deregistration for VAT:**

A registered person can apply for deregistration for VAT if:
- He/she ceases to make taxable supplies.
- The value of taxable supplies in any 12 months does not exceed Sh.2.0 million.
- The business is liquidated.
- The business is sold as a going concern.

(c) **Assessment for VAT**

The commissioner of VAT may issue an assessment if:

- The taxpayer fails to keep proper books of accounts, records or documents.
- Fails to make a return
- Fails to apply for registration

(d) **Appeals**

An appeal is made to the tribunal under the following conditions:

- If a taxpayer is aggrieved by the commissioner"s decision.

The appeal should be made within 30 days from the date of the assessment provided the taxpayer has fulfilled the following conditions:

- Made all VAT returns
- Paid all the tax shown on the returns not in dispute
- Pay 50% of tax in dispute
- Tribunals decision is final and conclusive.

(e) **Tax Invoices**

Whenever a taxpayer supplies goods or services, the registered person must furnish the purchaser with a Tax Invoice on his sales, in order that they (the customers) may claim relief on the tax they pay.

It should show – Pin No., VAT registration number, value of taxable supplies, amount of VAT etc. It should be issued within 14 days of making taxable supply.

(f) Rules:

Payable on or before 20th of following month Submitted with a return
Penalty 2% of VAT payable + Ksh.10,000

## QUESTION TWO

**(a)** MEHTA BROTHERS
TAXABLE PROFIT (LOSS) FOR THE YEAR ENDED 31.8.2005

| | Sh. | Sh. |
|---|---|---|
| Loss for the period | | (250,000) |
| Add: | | |
| Non-allowable expenses | | |
| Partners drawings | 360,000 | |
| Loss on sale of investment | 15,000 | |
| Depreciation | 650,000 | |
| Partners salaries | 200,000 | |
| Donations | 20,000 | |
| Purchase of computer | 200,000 | |
| Interest on capital | 40,000 | |
| Wife"s salary | 120,000 | 1,605,000 |
| Less: | | |
| Total | | 1,355,000 |
| Wear and Tear Allowance | | (638,125) |
| Taxable profit | | 596,875 |

WEAR AND TEAR COMPUTATION

| | Class I 37.5% | Class II 30% | Class III 25% | Class IV 12.5% | Total |
|---|---|---|---|---|---|
| WDV 1.9.2004 | 1,250,000 | - | 250,000 | 375,000 | 1,875,000 |
| Additions (computers) | - | 200,000 | - | - | 200,000 |
| | 1,250,000 | 200,000 | 250,000 | 375,000 | 2,075,000 |
| Wear & Tear Allo. | 468,750 | 60,000 | 62,500 | 46,875 | 638,125 |
| WDV 31.8.2005 | 781,250 | 140,000 | 187,500 | 328,125 | 1,436,875 |

Distribution of Profits

| | S. MEHTA | M. MEHTA | N. MEHTA | TOTAL |
|---|---|---|---|---|
| Salaries | 50,000 | 50,000 | 100,000 | 200,000 |
| Interest | 20,000 | 20,000 | - | 40,000 |
| Balance | 118,958 | 118,598 | 118,959 | 356,875 |
| Taxable Profit | 188,958 | 188,598 | 218,959 | 596,875 |
| Wife"s salary from the partnership (note) | 120,000 | - | - | - |
| Taxable income | 308,958 | 188,598 | 218,958 | 716,514 |

(b) The self-assessment returns for sole proprietors, individuals and partnership are due by 30 April of the following year i.e. 30/4/2006.

- The tax law was amended in 1998 to have 31 December as the year end for all unincorporated businesses. The management of Mehta Brothers do not seem to know this and should do the following to correct this situation.

- Prepare accounts for 4 months to 31 December 2005 or apportion the income for the four months from the 12 months accounts for the year ended 31st December 2004 so as to bring to charge income for the period ended 31 December 2004.

Prepare accounts for 12 months to 31st December 2004 and use them to file self assessment returns for both years and for the partners for 2004 year of income.

The returns and tax will be due by 30th April 2006.

(g) Tax position on S. Mehta and wife

- If the curio is the wife"s business, the income is earned at arm"s length and the net of Sh. 30,000 x 12 = 360,000 would be taxed on the wife.
- She would enjoy a personal relief of Sh. 13,944 p.a.
- Mr. Mehta would be taxed separately on the partnership income of Kshs. 308,958 and enjoy a personal relief of Kshs. 13,944 p.a.

## QUESTION THREE

(a) Mrs. Jinny Ondemo
Practice Income Year
of Income 2000

| | | | |
|---|---|---|---|
| Professional fees received | | | 3,000,000 |
| Director"s fees received | | | 360,000 |
| | | | 3,360,000 |
| Less Expenses | | | |
| Professional subscriptions | | 60,000 | |
| Debt Collection expense | | 18,000 | |
| Wages – Clinic | | 360,000 | |
| Rent for clinic premises | | 420,000 | |
| Electricity and water – clinic | | 120,000 | |
| General expenses | | 210,000 | |
| Car hire expenses | | 150,000 | |
| Uniform for staff | | 115,000 | |
| Contribution to Registered provident fund | | 180,000 | |
| Terminal benefits – receptionist | | 150,000 | |
| Wages to cleaners and watchmen | | 150,000 | |
| Wear and tear (120,000 x 12.5%) | | 15,000 | (1,948,000) |
| | | | 1,412,000 |
| Rental income | | | |
| Sub-rentals | 42,000 | | |
| Less collection expense | (6,000) | | 36,000 |
| Taxable income | | | 1,448,000 |

(b) **Tax liability**

| | |
|---|---|
| Ksh. 121,968 @ 10% | 12,196.8 |
| Ksh. 114,912 @ (15% + 20% + 25%) | 68,947.2 |
| Ksh. (1,448,000 – 466,704) @ 30% | 294,389.0 |
| Less personal relief | 375,533.0 |
| Net tax liability | (13,944.0)) |
| | 361,589.0 |

(c) Tax should be paid through self-assessment by 30th April 2006. The return should be filed by 30th June 2006.

(d) Wife"s income is deemed to be the income of the husband.

However, employment income, professional and self employment are assessed separated on the wife unless:

- Husband or wife or both own more than 12½% of the voting power of the company
- Wife is an employee of a settlement/trust created by the husband
- Wife is employed by a firm where the husband is a partner.

## QUESTION FOUR

(a) Gitoro Food Processing Industries Ltd.
Investment Deductions year 2005

| | Qualifying Costs Sh. | ID @ 100% Shs. | Balance/residual |
|---|---|---|---|
| Factory building | 10,200,000 | 10,200,000 | - |
| Machinery installed | 11,085,000 | 11,085,000 | - |
| | 21,285,000 | 21,285,000 | - |

**GITORO FOOD PROCESSING INDUSTRIES LIMITED**
**CAPITAL ALLOWANCES**
**YEARS ENDED 31ST DECEMBER 2005 AND 2006**

1. INVESTMENT DEDUCTION

| Item | Qualifying Costs | ID @ 100% | Residue for WTA & IBD |
|---|---|---|---|
| 2005 | Sh. | Sh. | Sh. |
| Conveyer and sorter | 3,120,000 | 3,120,000 | - |
| Packaging machine | 2,625,000 | 2,625,000 | - |
| Milling machine | 2,580,000 | 2,580,000 | - |
| Crashing machine | 2,760,000 | 2,760,000 | - |
| Building | 10,200,000 | 10,200,000 | - |
| | | 21,285,000 | |

2. WEAR AND TEAR ALLOWANCE

| | **Class I @ 37.5%** | **Class II @ 30%** | **Class III @ 25%** | **Class IV 12.5%** |
|---|---|---|---|---|
| 2005 | | | | |
| W.D.U 1/1/2005 | - | - | - | - |
| Additions: | | | | |
| Forklift | | 1,290,000 | | - |
| Tractor | | 5,850,000 | | - |
| Lorry | 1,800,000 | | | |
| Saloon cars | | | 585,000 | 4,080,000 |
| Delivery van | | | 1,350,000 | 4,080,000 |
| Furniture and partitions | | | | |
| | 8,940,000 | | 1,935,000 | (510,000) |
| 2005 WTA | (3,352,500) | | (483,750) | |
| WDV 31/12/2005 | 5,587,500 | | 1,451,250 | 3,570,000 |
| | | | | |
| Year 2006 | **Class I** | **Class II** | **Class III** | **Class IV** |
| WDV as at 1.1.2006 | 5,587,500 | - | 1,451,250 | 3,570,000 |
| Add: | | | | |
| Tractor | 2,655,000 | - | - | - |
| Lorry | 3,900,000 | - | - | - |
| Toyota | - | - | 1,000,000[R] | - |
| Furniture and partitions | - | - | - | 894,000 |
| Computers | - | 450,000 | - | - |
| Disposals: | | | | |
| Forklift | (360,000) | - | - | - |
| Saloon car | - | - | (690,000) | - |
| | 11,782,500 | 450,000 | 1,761,250 | 4,464,000 |
| Less WTA | (4,418,438) | (135,000) | (440,313) | (558,000) |
| WDV 31/12/2006 | 7,364,062 | 315,000 | 1,320,937 | 3,906,000 |

(b) (i) Land at cost Sh.15,000,000 and disposed. Sh.4,290,000
– Do not qualify for any deductions

(ii) Professional valuation of the building at Ksh.12,600,000 does not qualify for industrial building deductions. Construction costs qualify.

## QUESTION FIVE

(a) (i) Economical:

Low cost of collection to the tax body
Low compliance costs by the taxpayer.

(ii) Equity

Horizontal equity: People with the same economic position should pay equal amount of tax.

Vertical equity: Consideration is taken as to whether tax payable should be proportional to income i.e progressive or regressive.

(iii) Certainty

Clear to taxpayer what his liability actually is and how it arises
To the tax body it is guaranteed of the amount of revenue its going to collect

(iv) Convenience

Taxpayer should pay when he has the ability to pay There is no administrative difficulties when collecting tax

(b) **Notes on Housing Benefit (HB)**

- It is a taxable benefit on the employee where the employer provides accommodation
- For agricultural employees, HB is equal to 10% of pensionable pay
- For directors other than whole time service directors HB is the higher of:

- 15% of total income from all sources or
- fair market rental value or
- actual rent paid by employer.

- For employees provided with accommodation and meals, HB is equal to 10% of pensionable pay.
- For ordinary employees and whole time service directors, HB is the higher of:

- 15% of pensionable pay or
- fair market rental value or
- actual rent paid

\- In all the above cases, HB is reduced by amount of rent contributed by the employee.

**DECEMBER 2009**
**QUESTION ONE**

(a) (i)Bond security:

- This is where a personal taxpayer delivers a document as prove of legal ownership of an asset and enters into a binding agreement to fulfill his obligations with regard to compliance and payment of tax.

- If the person fails to fulfill the conditions he loses the asset.

(ii) Single business permit:

- This is a license granted by local authorities to businesses operating within their jurisdiction.

- It replaces the local authority service charge and other licenses that were issued by different Government departments.

(iii) Customs bonded warehouse:

This is a place/store licensed by the commissioner for customs and excise for deposit of dutiable goods for which duty has not yet been paid. It helps in reducing clogging of goods at the port and also facilitates smooth handling of transit goods.

(iv) Stamp duty:

- This is chargeable in respect of certain legal documents such as partnership deeds, hire purchase agreements, lease agreements, mortgages, etc. as specified in the Stamp Duties Act (Cap.480). Any legal instruments which have not been duly stamped are inadmissible as evidence in any civil proceedings and may not be registered or legally enforced as evidence of ownership.

-Duty is payable within 30 days of the execution of the instrument.

(b) (i)Ukulima Sacco

Taxable Income for the year 2005

| | Sh. |
|---|---|
| Rental Income (70% of 2,252,500) | 1,576,750 |
| Dividend Income (85% of 424,000) | 360,400 |
| Interest Income (85% of 747,300) | 635,205 |
| Taxable income | 2,572,355 |

Tax payable

30% of 2,572,355 = Sh. 771,706.50

(ii) Information not used

Interest from loans to members – This is not taxable Expenses

– These are ignored since income is assessed gross.

## QUESTION TWO

**(a)** MR. KIPKOECH
COMPUTATION OF TAXABLE INCOME 2000

| | **Sh.** | **Sh.** |
|---|---|---|
| Net profit as per accounts | | 1,680,000 |
| Add back: | | |
| Wages of house girl | | |
| Subscriptions to U.G.S.C | 60,000 | |
| Depreciation: | 60,000 | |
| Dairy machine | 120,000 | |
| Tractors and lories | 420,000 | |
| Salary to wife | 144,000 | |
| School fees for son | 120,000 | |
| Life insurance – self | 40,000 | |
| Hail damage to pyrethrum | 240,000 | 1,314,000 |
| Produce consumed by family | 110,000 | 2,994,000 |
| Less: | | |
| Farm work deductions (W-1) | 742,222 | |
| Wear and tear (W 2) | 905,156 | |
| Interest from co-operative bank | 80,000 | |
| Dividends from co-operative society | 175,000 | |
| Taxable farming income | | (1,902,378) |
| | | 1,091,622 |

**Workings**

W1 Farm work deductions

| | **Sh.** |
|---|---|
| Farm house (⅓ of 2M) | 666,667 |
| Dairy building | 400,000 |
| Fences, dips and dams | 800,000 |
| Labour quarters | 360,000 |
| | 2,226,667 |

Farm work deductions: ⅓ of 2,226,667 = 742,222

**W2 Wear and Tear**

| **Class** | **Sh.** **I @ 37.5%** | **Sh.** **IV @ 12.5%** | |
|---|---|---|---|
| Tractor | 850,000 | | |
| Lorry | 2,500,000 | | |
| | 3,350,000 | | |
| Wear and Tear 2004 | 1,256,250 | | |
| WDV 31/12/2004 | 2,093,750 | | |
| Additions | | | |
| Dairy machines | - | 960,000 | |
| | 2,093,750 | 960,000 | |
| Wear and Tear: 2005 | (785,156) | (120,000) | 905,156 |
| WDV 31/12/2005 | 1,308,594 | 840,000 | |

(b) Mr. Kipkoech"s Tax Liability

| | |
|---|---|
| Farming income | 1,091,622 |
| Employment | 180,000 |
| Dividend | 205,882 |
| | 1,477,504 |
| | |
| Sh.121,968 @ 10% | 12,196.8 |
| Sh.114,912 @ (15% + 20% + 25%) | 68,947.2 |
| Sh.(1,477,504 – 466,704) @ 30% | 303,240.0 |
| Less Personal relief | (13,944.0) |
| W/T on non-qualifying dividend | |
| = 15% x 205,882 | (30,882.0) |
| Net tax liability | 339,558.0 |

**QUESTION THREE**

(a) (i)House loan:

- The loan would be subject to fringe benefit tax which is payable by the employer at the corporate rate of tax. 1,000,000 x (15%, - 5%) x 30% = 30,000
- It is computed on the difference between the interest rate charged and the market interest rate.
- For Duncan the loan is not taxable on him.
- Mr. Duncan will also benefit by the savings he will make on the housing benefit which he is currently paying tax on. The benefit is material because it is based on his global income.

(ii) Share issue:

- There will be no tax benefit for Mr. Duncan since he will be taxed on the value of shares when ownership passes. Benefit 1000 x 50 = 50,000
- In the long run he will be entitled to dividends for which WHT will be deducted @ 5% and is final tax.
- On the employer there are no tax implications.

(iii) Company car:

- There will be no advantage for Duncan since his tax liability will increase if he is given a company car. Currently he is being taxed on the Sh.6,000 mileage allowance. However, if given the car this taxable benefit will double to Sh.12,000 per month.

- On the company there are no major tax implications. However, the company can claim wear and tear allowance on the vehicle and repair and maintenance of the car.

(iv) Increase pension contributions:

- Since the provident fund is not registered there will be no immediate benefit for Mr. Duncan. However, in the long term his savings into the pension scheme will double and increase his tax liability.

- On the company the amount will not be allowable for tax purposes.

(v) Medical bills:

- Whichever way this does not change Mr. Duncan"s taxable income, unless the company intends to pay the full bill for Duncan which means he benefits by a furthur Sh.10,000 tax free.

- On the company given that the scheme is for senior employees only the amounts paid are not allowable for tax purposes.

(b) Preferred alternative:

- From the above it appears that giving Mr. Duncan a loan of Sh.1,000,000 to purchase a house is the most beneficial taxwise. This is because he will not only get an additional tax-free benefit but also reduce his taxes as a result of discontinuing the house benefit.

- However on the part of the company providing a house loan will result into higher taxes as a result of the fringe benefits tax.

## QUESTION FOUR

(a) OMONDI, ONYANG AND KIMANI
COMPUTATION OF TAXABLE PROFITS

| | Sh. | Sh. |
|---|---|---|
| Accounting loss | | (10,325,000) |
| Add back | | |
| Interest on capital | | |
| Insurance recovery | 910,000 | |
| Omondi | 406,000 | |
| Onyango | 406,000 | |
| Kimani | 609,000 | |
| Office expenses – cabinet | 192,500 | |
| Goodwill | 700,000 | |
| Salary to partners: | | |
| Omondi | 700,000 | |
| Onyango | 735,000 | |
| Kimani | 1,008,000 | |
| Motor vehicle expenses | 252,000 | |
| Office partitions | 140,000 | |
| Omondi – Goods for own use | 122,500 | |
| Depreciation | 960,000 | |
| Purchase of lorry | 2,329,250 | |
| Donations | 525,000 | |
| Increase in general profit | 105,000 | |
| Loss on investment | 55,000 | 10,155,250 |
| | | (169,750) |
| Less: | | |
| Capital deductions | | 906,000 |
| Taxable loss | | (1,075,750) |
| Add: | | |
| Insurance recovery | | 910,000 |
| Loss | | (1,075,750) |

(b) Allocation among partners:

| | Omondi Sh. | Onyango Sh. | Kimani Sh. | Total Sh. |
|---|---|---|---|---|
| Interest on capital | 406,000 | 406,000 | 609,000 | 1,421,000 |
| Salaries | 700,000 | 735,000 | 1,008,000 | 2,443,000 |
| Share of loss | (1,975,900) | (1,975,900) | (987,950) | (4,939,750) |
| Taxable profit/loss | (869,900) | (834,900) | 629,050 | 1,075,750 |

(c) Tax payable by each partner:

| | Omondi Sh. | Onyango Sh. | Kimani Sh. |
|---|---|---|---|
| Partnership income | (loss) | (loss) | 629,050 |
| Rental Income | 200,000 | - | 350,000 |
| Farming income | - | 750,000 | - |
| Taxable income | 200,000 | 750,000 | 979,050 |

Omondi on Ksh.200,000

| | |
|---|---|
| 1st Ksh.121,968 @ 10% | 12,196.8 |
| Next (200,000 – 121,968) @ 15% | 11,704.8 |
| | 23,901.6 |
| Less personal relief | (13,944.0) |
| Net liability | 9,957.6 |

Onyango on Ksh.750,000

| | |
|---|---|
| KSh.121,968 @ 10% | 12,196.8 |
| Ksh.114,912 @ (15% + 20% + 25%) | 68,947.2 |
| Ksh.(750,000 – 466,704) @ 30% | 84,989.0 |
| | 166,133.0 |
| Less personal relief | (13,944.0) |
| Net tax liability | 152,189.0 |

Kimani on Ksh.979,050

| | |
|---|---|
| Ksh. (121,968 @ 10%) + (Sh.114,912 @ (15% + 20% + 25%)] | 81,144 |
| (Sh.979,050 – 466,704) @ 30% | 153,704 |
| | 234,848 |
| Less personal relief | (13,944.0) |
| Net tax liability | 220,904.0 |

## QUESTION FIVE

(a) Ten VAT records:

- Copies of all VAT invoices issued in serial number order
- Copies of all debit and credit notes issued in chronological order.
- All purchase invoices, copies of customs entries, receipts for payment of duty or tax.
- Details of goods manufactured and delivered from the factory
- Orders and delivery notes
- Copies of customer entries.
- Annual accounts e.g. P & L a/c

- Purchase and sales books
- Bank statements and pay-in-slips
- Import and export documents
- Cash books, petty cash vouchers and other books of accounts
- Relevant business correspondence
- Records in the computers
- Totals of output and input tax in each period.

(b) (i)**Input Tax:**

| | | Cost | **VAT (16%)** |
|---|---|---|---|
| 1.3 | Cameras | 500,000 | 68,966 |
| 4.3 | Bulbs | 200,000 | 27,586 |
| 4.3 | Slide Projectors | 1,000,000 | 137,931 |
| 6.3 | W. Watches | 300,000 | 41,379 |
| 12.3 | S. Watches | 50,000 | 6,897 |
| 15.3 | Alarm clocks | 80,000 | 11,035 |
| | | | 293,794 |

**Output Tax:**

| | | Cost | **VAT (16%)** |
|---|---|---|---|
| 5.3 | Cameras | 312,500 | 43,103 |
| 8.3 | Projectors | 500,000 | 68,966 |
| 9.3 | Bulbs | 150,000 | 20,690 |
| 18.3 | Cameras | 312,500 | 43,103 |
| 20.3 | Projectors | 750,000 | 103,448 |
| 22.3 | W. watches | 200,000 | 27,586 |
| 25.3 | Alarm clocks | 72,800 | 10,041 |
| 27.3 | S. Watches | 75,000 | 10,345 |
| | | | 327,282 |

(ii) **VAT Account**

| | **Sh.** | | **Sh.** |
|---|---|---|---|
| Bank | 293,794 | Bank | 327,282 |
| Balance c/d | 33,488 | | - |
| | 327,282 | | 327,282 |
| VAT payable is Sh. | 33,488 | | |

(iii) Tax is due by 20 April 2002

Penalty for non-payment: Sh.10,000 plus 2% per month. Interest compounded on tax outstanding.

**MAY 2010**

## QUESTION ONE

(a) (i)**Direct Tax:**

- Impact and incidence is on the same person e.g. PAYE, imports or exports, corporate tax etc.
- Tend to be elastic

(ii) **Indirect Tax:**

- Impact and incidence falls on different persons.
- Tend to be inelastic since these taxes are imposed mainly on the necessities examples are VAT, custom duty etc.

(b) **Objectives of raising taxes**

- Pension of social and merit goods and services by the government such as roads, health, education etc.
- Efficient allocation of resources e.g. tax the rich more and use taxes to alleviate poverty among low income groups.
- To achieve monetary policies e.g. control rate of inflation by increasing taxes, and thus reducing disposable income available on individuals.
- Protect local industries e.g. raise the customs duty on imports to discourage consumption of import and encourage consumption of local goods and production.
- Creation of employment e.g. government could impose more taxes to reduce investment in private sector ("crowding out" effects) and invest more in public sector to create employment opportunities.

## QUESTION TWO

(a) Why accounting income is different from taxable income.

- Some income of capital nature e.g. capital gain is not taxable but it is part of accounting profits.
- Accounting profits are determined after deducting depreciation but from taxable income, we deduct capital allowances.
- Some accounting expenses are not allowable for tax purposes e.g. general provision for bad debts, capital loss, some legal fees etc.
- Released and unrealized profits – for tax purposes, we recognize realized foreign exchange gains/losses but accounting profits recognize both realized and unrealized gains (losses).

(b) (i)Mr. Somji Patel

| | | | |
|---|---|---|---|
| **Practice Income** | | | |
| Practice loss | (165,000) | | |
| Add back: | | | |
| Salary to self | 1,560,000 | | |
| Loan repayment | 480,000 | | 1,875,000 |
| **Employment Income** | | | |
| Salary 120,000 p.m x 6 | | 720,000 | |
| Housing benefit (30,000 x 6) or (15% x 720,000 x $\frac{6}{12}$) | | 180,000 | |
| | | (36,000) | 864,000 |
| Less rent paid 5% x 720,000 | | | |
| Less owner occupied mortgage interest lower of: | | | |
| (i) 180,000 x 6/12 = 90,000 | | | (50,000) |
| (ii) 100,000 x 6/12 = 50,000 | | | 18,000 |

| | |
|---|---|
| Pension income [18,000 p.m – 15,000 (exempt)]x6 | 2,707,000 |

Mrs. Patel Income:

30,000 p.m x 12 = Sh.360,000 p.a.

(ii) **Tax payable**

| | |
|---|---|
| Sh. 121,968 x 10% | 12,196.8 |
| Sh. 114,912 (0.15 + 0.2 + 0.25) | 68,947.2 |
| Sh. (2,707,000 – 466,704) | 672,089.0 |
| | 753,233.0 |
| Less: personal Relief | (13,944.0) |
| PAYE: | |
| On self salary | (444,600) |
| On employment | (204,000) |
| Pension (2,500 p.m. x 6) | (15,000) |
| Net tax liability | 75,689.0 |

(iii) -The tax is payable by 30 April 2006
- Paid by instalments through current year of income

(iv) Information Unused:

- The cost of house Sh.2,400,000
- Dividends from Barclays Bank – Withholding tax is final tax
- Mortgage interest – Sh.180,000 – maximum deductive is Sh.100,000
- Wife"s salary – Assumed wife opted to file her own return.

## QUESTION THREE

(a) (i)

- Commissioner may by notice in writing to inform that person of his intention to apply to the Registrar of Lands or buildings to be the subject of security for tax of an amount specified in the notice.

- If a person fails to pay the whole of the amount specified in the notice within 30 days from the date of service of the notice, the commissioner may by notice in writing direct the Registrar of Lands that the land and buildings, to the extent of the interest there in must be the subject of security, for the tax of specified amount and the Registrar shall, without fee, register the direction as if it were an instrument of mortgage over, or charge on, as the case may be.

- Commissioner will write to the Registrar of lands to cancel the directive upon payment of the whole of the amount of tax secured.

Commissioner has right to sell property if VAT is not paid.

(ii) **Where the commissioner has reasons to belief that there is:**

- Uncertainty as to any question of law or fact
- Bankruptcy or insanity of the debtors.
- Impossibility due to undue difficulty or expense in recovery of tax.

## QUESTION FOUR

(a) (i)**Taxation of Export Processing Zones (EPZ)**

- 100% investment deduction on plant and machinery
- Exempted from Corporation tax for the first ten years
- Pay tax at a lower rate of 25% for the next 10 years
- Zero-rated for purposes of the VAT Act.
- Refund of import duty on imported raw materials to manufacture exports.

(ii) **Members clubs**

- Provided ¾ or more of club income (i.e. entrance fees and subscriptions) comes from members, the club income will not be taxable.
- This excludes investment income such as dividends, interest and rent.
- They pay tax at corporate tax rate.

(b) (i)**Flora Ltd**

Taxable Profit for 2005

| | Sh. | Sh. |
|---|---|---|
| Net Profit | | 1,548,800 |
| Add back: | | |
| Loss on sale of pick-up | 36,000 | |
| Legal expenses – Tax appeals | 38,400 | |
| Bad and doubtful debts | 11,200 | |
| Depreciation | 96,000 | 181,600 |
| | | 1,730,400 |
| Less: | | |
| Dividends | 102,400 | |
| Capital allowances | 84,000 | (186,400) |
| Adjusted profit | | 1,544,000 |

(ii) **Tax Payable:**

30% of 1,544,000 = Sh.463,200

(iii) **Final tax payable by 30 April 2006 (end of 4th month after year end).**

(iv) **Failure to submit S.A.R.**

- A late filing penalty of 5% of tax due subject to Kshs. 10,000 minimum.

**Failure to pay tax:**

- Late penalty of 20% of tax due
- Late payment interest of 2% per month
- Interest based on tax due plus, penalty.

## QUESTION FIVE

(a) **Simope Enterprises:**

(i) Capital Allowances

Sh."000"

| **Investment Deduction** | **Q. Cost** | **I.D @ 100%** | **Residual** |
|---|---|---|---|
| Additional factory building | 2,400 | 2,400 | - |
| Machinery | 500 | 500 | - |
| | | 2,900 | |

(ii) Industrial Building Deduction: (Kshs. „000")

- Lifespan of building 40 years
- Balance – 36 years.
- Therefore Q. Cost for IBD = $\frac{18M}{36yrs} x40yrs=20M$
- Balance b/f = 20m - $\frac{20m}{40yrs}$x4=18M

| Building | Q. Cost | Bal b/f | IBD @ 2.5% | Bal c/f |
|---|---|---|---|---|
| Old F. Building | 20,000 | 18,000 | 500 | 17,500 |
| | | | 500 | |

(iii) Wear and Tear Schedule

| | Class I Sh. | Class II Sh. | Class III Sh. | Class IV Sh. |
|---|---|---|---|---|
| WDV 1.1.2005 | 1,093,750 | 3,125,000 | 2,187,500 | 2,980,000 |
| Additions: | | | | |
| Fax machine | - | 45,000 | - | - |
| Photocopier | - | 180,000 | - | - |
| Computer | - | 250,000 | - | - |
| Daewoo Car | - | - | 1,000,000 | - |
| | 1,093,750 | 3,600,000 | 3,187,500 | 2,980,000 |
| Disposals: | (760,000) | (96,000) | (250,000) | (100,000) |
| | 333,750 | 3,504,000 | 2,937,500 | 2,880,000 |
| Wear & Tear | 125,156 | 1,051,200 | 734,375 | (360,000) |
| WDV 31.12.2005 | 208,594 | 2,452,800 | 2,203,125 | 2,520,000 |

**Summary:**

| | | Sh. |
|---|---|---|
| Investment Deduction | - | 2,900,000 |
| IBD | - | 500,000 |
| Wear and Tear: | | |
| Class I | - | 125,156 |
| Class II | - | 1,051,200 |
| Class III | - | 734,375 |
| Class IV | - | 360,000 |
| | | 5,670,731 |

(b) **Computation of Taxable Profit/Loss:**

| | | Sh. |
|---|---|---|
| Net profit | | 7,000,000 |
| Add: | | 518,000 |
| Partners salaries | 1,650,000 | |
| Interest on capital | 360,000 | |
| Depreciation | 265,000 | 2,275,000 |
| | | 9,275,000 |
| Less: | | |
| Capital allowances | | (5,670,731) |
| Profit | | 3,604,269 |

**Division among partners:**

| | Simon | Peter | Total |
|---|---|---|---|
| | **Sh.** | **Sh.** | **Sh.** |
| Salary | 750,000 | 900,000 | 1,650,000 |
| Interest on capital | 200,000 | 160,000 | 360,000 |
| Share of profit (loss) | 797,134.5 | 797,134.5 | 1,594,269(Bal) |
| | 1,747,134.5 | 1,857,134.5 | 3,604,269 |

(c) **Tax Payable:**

| | Simon | Peter |
|---|---|---|
| Sh.121,968 @ 10% | 12,196.8 | 12,196.8 |
| Sh.114,912 @ (15% + 20% + 25%) | 68,947.2 | 68,947.2 |
| Surplus (1,747,134.5 – 466,704) @ 30% | 384,129.0 | 417,129.0 |
| | 465,273.0 | 498,273.0 |
| Less personal relief | (13,944.0) | (13,944.0) |
| Net tax liability | 451,329.0 | 484,329.0 |

(d) **Information not used:**

- Dividends received – WHT is final tax
- Cost and Net book value of disposed assets – Disposal proceeds used.

TAXATION
DECEMBER 2010

QUESTION ONE

(a) **Low interest benefit tax and the fringe benefits tax**

Low interest benefit results from the charging of a low rate of interest on an employment benefit as compared to the commissioner"s prescribed marked rate of interest. The employment benefit applicable is normally staff loan(s) advanced to staff at a concessionary rate(s) of interest.

The difference between the commissioner"s prescribed market rate (currently 15%) and theconcessionary rate of interest charged to staff by the employer constitutes a taxable benefit for all loans given before 12 June 1998. The benefit is taxable on the employee based on the ruling PAYE rates.

**Fringe benefits tax (FBT)**

Fringe benefits tax is applicable to all employment benefits (loans) given to employees or their relatives on or after 12 June 1998 at concessionary rates of interest. It is based on the 91 days average treasury bill rates. The average rate is computed and issued by the Kenya Revenue Authority through the press.

The tax is payable by the employer at the average treasury bill rate less the interest rate charged to the employees. The tax is based on the ruling corporate tax rate which is currently 30%.

FBT is submitted together with PAYE before 10$^{th}$ of the following month together with PAYE.

(b) **Four methods the Commissioner of Income Tax is empowered to use in collecting overdue tax**

- Commissioner of Income Tax can use for the recovery of the tax through a court of law.
- Commissioner of Income Tax can collect the tax through authorized agents under Section 96
- Can collect under Section 102 by distress i.e. can seize property
- Commissioner of Income Tax under Section 103 can attach property of a tax payer as security for unpaid tax.

(c) **Three circumstances under which CIT can send notices or raise assessments:**

- A person has not submitted a return of income and the CIT considers that the person has income chargeable to tax for that years
- CIT considers that a person has been assessed or has assessed himself at a less amount in relation to income or tax payable.
- Where CIT issues an agreed amended assessment but later discovers unassessed income.

(d) **Matters that are contained in a notice of assessment**

- Notice to the taxpayer that he has been assessed under the Income Tax Act (ITA)
- Information to the taxpayer that he has a right to object to the notice of assessment
- Amount of tax assessed or loss to be carried forward
- Amount of relief available (in case of individual)
- Any amount of tax paid at source
- Personal identification number (PIN)
- Interest and penalties where applicable
- Amount of tax payable, due date, or where tax is overpaid amount of refund
- Name/and address of taxpayer

(e) **Stamp duty**

Stamp duty is charged on a large number of legal documents and agreements e.g cheques, bonds, marketable securities etc.
Payable within 30 days after transaction.

## QUESTION TWO

(a) Mobile Options Ltd.
Computation of Taxable Profit for the year ended 31 December 2005

| | **Sh.** | **Sh.** |
|---|---|---|
| Net profit as per a/cs | | 681,000 |
| Add back: | | |
| Donations | 50,000 | |
| Director expenses | 96,000 | |
| Rent and rates | 18,750 | |
| Depreciation | 670,000 | |
| Legal fees – criminal | 116,000 | |
| Trade mark | 120,000 | |
| Repairs and maintenance | 450,000 | 1,760,750 |
| Loss on sale of assets | 240,000 | 1,820,750 |
| Adjusted profit | | 2,441,750 |
| Less: | | |
| Capital allowances | 860,000 | |
| Profit on sale of assets | 240,000 | |
| Provision for bad debts | 80,000 | (1,180,000) |
| Taxable profit | | 1,261,750 |

(b) **Tax payable thereon:**

30% of 1,261,730 - Sh.378,525

(c) **Due dates**

| Date | Description | **Sh.** |
|---|---|---|
| 20th April 2005 | 1st instalment | 220,000 |
| 20th June 2005 | 2nd instalment | 220,000 |
| 20th September 2005 | 3rd instalment | 220,000 |
| 20th December 2005 | 4th instalment | 220,000 |
| 30th April 2006 | Final tax refundable | (501,475) |
| | | 378,525 |

(d) Penalty P = 20%(A-B) 110%: A = Actual tax
B = Estimated tax

## QUESTION THREE

(a) (i)**Income assessable on Mr. Hassan Ali**

Annual salary – Sh.30,000 x 12 = Sh.360,000

Income assessed as follows:

| | | |
|---|---|---|
| Year 2006 | - | Sh.480,000 |
| Year 2007 | - | Sh.480,000 |
| | | Sh.960,000 |

(ii) Year 2006 - Sh.360,000
Year 2007 - Sh.360,000
Year 2008 - Sh.240,000
- Sh.960,000

(iii)

- Rate of tax should be the last known rates in this case year 2005. For each of the 2 years, he would be taxed on Kshs. 480,000 as follows:

| | Shs. |
|---|---|
| 1st Kshs. 466,704 = (121,968 @ 10%) + 114,912 @ (15% + 20% + 25%) = | 81,144 |
| Surplus (480,000 – 466,704) @ 30% | 3,989 |
| Gross tax | 85,133 |
| Less p/relief | (13,944) |
| Net tax | 71,189 |

Total = 71,189 p.a. x 2 yrs = 142,372

(iv) The tax is payable together with normal PAYE (but shown separately) by 9th of January 2006.

(b) (i)**Circumstances that may trigger off a PAYE Audit**

- PAYE not paid on time
- Salaries and wages figure as per annual accounts is high compared to that reflected in PAYE returns.
- Major month to month variances on PAYE payments
- Third party information/complaints
- Newspaper/Media reports
- Non-compliance detected during a normal tax audit
- Failure to submit PAYE Returns
- Failure to keep proper records.

(ii) **Taxation of School fees**

Since Kusoma Institute is tax exempt,, school fees will be taxed on the employees concerned as a benefit.

(iii) **Unique disallowable partnership expenses**
- Remuneration/salary paid to partners
- Interest on capital paid to partners
- Drawings by partners
- Commission paid to partners

## QUESTION FOUR

(a) Bimak Ltd
Capital Deductions (using year 2004 rates)
Investment Deductions Schedule

| Year | Asset | Q.Cost | I.D @ 100% | Residue |
|---|---|---|---|---|
| | | Sh. | Sh. | Sh. |
| 2003 | Factory building | 8,100,000 | 8,100,000 | - |
| 2003 | Factory extension | 4,200,000 | 4,200,000 | - |
| 2003 | Processing machine | 5,200,000 | 5,200,000 | - |

| | | | | |
|---|---|---|---|---|
| | | | 17,500,000 | |
| 2004 | Processing machine | 2,400,000 | 2,400,000 | - |
| 2004 | Factory extension | 3,600,000 | 3,600,000 | - |
| | | | 6,000,000 | |

**Industrial Building Deduction Schedule**

| Year | Building | Q. Cost Sh. | Bal b/d Sh. | IBD @ 25% Sh. | **Bal C/d Sh.** |
|---|---|---|---|---|---|
| 2003 | Workers canteen | 2,400,000 | - | 30,000 | 2,370,000 |
| | Warehouse | 3,600,000 | - | 45,000 | 3,555,000 |
| | Labour quarters | 2,400,000 | - | 30,000 | 2,370,000 |
| | NB: I.B.D for 6 months only | | | 105,000 | |
| 2004 | Workers canteen | 2,400,000 | 2,370,000 | 60,000 | 2,310,000 |
| | Warehouse | 3,600,000 | 3,555,000 | 90,000 | 3,465,000 |
| | Labour quarters | 2,400,000 | 2,370,000 | 60,000 | 2,310,000 |
| | Fire exit | 900,000 | - | 11,250 | 888,750 |
| | 6 months IBD | | | 221,250 | |
| | Factory extension | | | 322,500 | |
| | | *1,080,000 x 2.5% x 3/12 | | 9,000 | |

| Year | Building | Q. Cost Sh. | Bal b/d Sh. | IBD @ 25% Sh. | **Bal C/d Sh.** |
|---|---|---|---|---|---|
| 2005 | Workers canteen | 2,400,000 | 2,310,000 | 60,000 | 2,250,000 |
| | Warehouse | 3,600,000 | 3,465,000 | 90,000 | 3,375,000 |
| | Labour quarters | 2,400,000 | 2,310,000 | 60,000 | 2,250,000 |
| | Fire exit | 900,000 | 888,750 | 22,500 | 866,250 |
| | Security fence | 1,800,000 | | 26,250 | 1,773,750 |
| | | | | 258,750 | |

**Wear and Tear Schedule**

| Class | I | **II** | **III** | **IV** |
|---|---|---|---|---|
| Land cruiser | - | - | 1,000,000R | - |
| Lorry | 2,600,000 | - | - | - |
| Tractor | 3,600,000 | - | - | - |
| Furniture and fittings | - | - | - | 1,200,000 |
| M. Benz and saloon car @ Sh.1MR | - | - | 2,000,000R | - |
| Computer and photocopier | - | 1,840,000 | - | - |
| | 6,200,000 | 1,840,000 | 3,000,000 | 1,200,000 |
| WTA for 2003 | (2,325,000) | (552,000) | ( 750,000) | (150,000) |
| WDV 1.1.2004 | 3,875,000 | 1,288,000 | 2,250,000 | 1,050,000 |
| Computer | - | 300,000 | - | - |
| | 3,875,000 | 1,588,000 | 2,250,000 | 1,050,000 |
| Disposals: | | | | |
| Processing machine | - | - | - | (1,200,000) |
| Computer | - | (150,000) | - | - |
| M. Benz | - | - | (400,000) | - |
| | 3,875,000 | 1,438,000 | 1,850,000 | 150,000 |
| WTA for year 2004 | (1,453,125) | (431,400) | (462,500) | NIL |

| | | | | |
|---|---|---|---|---|
| WDV 1.1.2005 | 2,421,825 | 1,006,600 | 1,387,500 | NIL |
| Additions – Range rover | - | - | 1,000,000[R] | - |
| | 2,421,825 | 1,006,600 | 2,387,500 | NIL |
| WTA for year 2005 | (908,184) | (301,800) | (596,875)) | NIL |
| WDV 31/12/2005 | 1,513,641 | 704,200 | 1,790,625 | NIL |

NB: The Shs. 150,000 in class IV is a trading receipt.

## QUESTION FIVE

(a) (i)**Import declaration for**

- Import declaration form is a form supplied by the customs department for the importer to fill in order to ensure that:

- He declares/shows the goods he is importing, and that
- He indicates the correct value of the goods he is importing
- Show country of origin and destination
- Name/address of importer and exporter

(ii) **Reverse charge**

This refers to VAT charged on imported services. The VAT in this cse is paid by the person importing the service since the provider of the service is outside the scope of VAT. The importer of the service also claims the tax paid as input tax.

(iii) **Refund of duty paid on imported goods**

The commissioner of customs and excise may refund duty paid on imported goods under the following circumstances:

Where goods are returned to seller
Re-assessment leads to lower duty
Where goods are lost or destroyed in an accident while under customs control
Where goods are used in production of exports or specified duty exempt goods.

(b) **Amount of VAT payable**

| | **Sh.** |
|---|---|
| Landed value | 2,450,000 |
| Duty 20% | 490,000 |
| | 2,940,000 |
| VAT 16% | 470,400 |
| | 3,410,400 |

(c) (i)VAT Invoice

Akuru & Associates
Akuru House, 4th Floor
Waiyaki Way
P O Box 000 Nairobi

| | | | |
|---|---|---|---|
| To: | ABC Ltd. | INVOICE NO. 101 | |
| | P O Box 20 | Date: 31st December 2005 | |
| | NAIROBI | LPO No.1089 | |

| Quantity | Description | Rate | **Sh.** | **Cts.** |
|---|---|---|---|---|
| 1 | Accountancy services | 120,000 | 120,000 | 00 |
| 1 | Audit fees for 2005 | 240,000 | 240,000 | 00 |
| 1 | Tax consultancy | 180,000 | 180,000 | 00 |
| | | | 540,000 | 00 |
| | VAT @ 16% | | 86,400 | 00 |
| E&OE | | Total | 626,400 | 00 |

VAT REG. NO.0099888A PIN NO. P120099978X

(ii)

**VAT A/C**

| | Sh. | | Sh. |
|---|---|---|---|
| Input tax | 18,730 | Output tax | 86,400 |
| VAT payable | 67,670 | | |
| | 86,400 | | 86,400 |

## TAXATION

## JUNE 2011

## QUESTION ONE

(a) **Benefit Theory:**

Maintains that justice in taxation is secured by taking each citizen in proportion to the benefits he derives from the activity of the state.

(b) **Problems in achieving justice**

Recommendations:

- Distribution of taxation can be considered and treated as payment for public services and a payment equal to the cost of the services rendered.
- People can pay tax in proportion to benefits derived from the state activity.
- Sacrifice by the tax-payer should be taken into account.

**Problems experienced:**

(i) Cost theory:- method of specific payment for public services does not result in justice in the distribution of the burdens of taxation.

Citizen normally not at liberty to reuse the services of the state and by refusing is not able to escape the necessity of paying taxes.

(ii) Benefit theory:- weak and the poorer people receive great benefits from the government in the form of free education, but they are least able to bear the burden of taxation.

Impossible to determine the proportion of the general benefits of government expenditure that accrue to particular individuals.

(iii) Equal sacrifice theory:- not feasible to levy heavy taxes on the rich and to leave the general public free as such tax would discourage savings and investment.

(iv) Ability theory:- difficult to measure ability to pay. Property may not be a good indicator of ability to pay.

Expenditure incurred may not necessarily be an indication of ability to pay because amount of expenditure could be due to number of dependants.

(c) Customs duty is the tax paid on goods imported through the ports of Kenya. The goods subjected to customs duty are specified in the first schedule of the Customs and Excise Act (Cap.472)

Examples of such goods include:

- Machinery
- Motor vehicles
- Electronics
- Textiles
- Food commodities, etc.

Excise duty is the tax imposed on goods manufactured locally and are specified in the fifth schedule of the Customs and Excise Act (cap.472). Examples of such goods include:

Beer
Cigarettes
Shoes

Textiles
Sodas, etc

## QUESTION TWO

(a) **Mr. Ndwiga"s taxable income for the year ended 31 December 2005**

| | Note | Sh. |
|---|---|---|
| Net loss before tax per the accounts | | (898,900) |
| Add back: | | |
| Water storage tank construction | 1 | 235,000 |
| Chicken sheds construction | 1 | 900,000 |
| Loan repayment – Wakulima Farmers SACCO | 2 | 312,000 |
| Subscription to Starehe Sports Club | 3 | 60,000 |
| Wages for house girl | 3 | 33,600 |
| Personal accident insurance | 3 | 23,000 |
| School fees for children | 4 | 300,000 |
| Depreciation – motor vehicles | 5 | 85,500 |
| Insurance for household items | 3 | 19,000 |
| Drawings by wife | 3 | 100,000 |
| | | 1,169,200 |
| Less: Wear and tear allowances | 5 | (196,400) |
| | | 972,800 |
| Add: | | |
| Produce consumed by family | | 265,000 |
| Consultancy fees | | 135,000 |
| Taxable income | | 1,372,800 |

**Notes:**

1. These are items of capital nature that will be subjected to capital allowances.
2. This is a capital item not chargeable to income.
3. These items do not contribute to the generation of the farming income for Mr. Ndwiga
4. This can either be on the farming income or on Mr. Ndwiga. It is being taxed on the farming income.
5. Depreciation is not an allowable expense – instead wear and tear allowance is allowed.
6. Dividends received net of tax are not subjected to further taxation – the withholding tax deducted at source is a final tax in itself.

(b) Tax payable on taxable income computed in (a) above:

| Sh. | | | | Sh. |
|---|---|---|---|---|
| 121,968 | X | 10% | | 12,196.8 |
| 114,912 | X | 15% | | - |
| 114,912 | X | 20% | (114,912 x 60%) | 68,947.2 |
| 114,912 | X | 25% | | 271,829.0 |
| (1,372,800 – 466,704) | X | 30% | | 352,973.0 |
| Less: Personal relief | | | | (13,944.0) |
| | | | | 339,029.0 |

## QUESTION THREE

(a) **Basic principles of taxing co-operatives**

- Taxed on incomes from independent activities e.g. rent
- The basic notion underlying the new code of taxation is that a co-operative society is a body
- Corporate having its own existence, separate from that of its members. A co-operative society is, therefore, deemed to have its own income, regardless of the consideration that some of that income

may be derived from transactions with its own members. The current law sanctions the deduction from the income of the co-operative society appropriations to profit made by it from its members.

- Corporate rate = 30%
- Tax on gross investment income
- A different basis of taxation has been laid down for credit and savings societies. These societies will be liable to tax generally on only their gross investment income, that is on interest and dividends derived from normal investment of surpluses.
- Expenses not from incomes deducted.
- Interest income deducted from members loans not taxable

(b) **Brief notes**

(i) Bad debts relief

- This is applicable where a registered person has supplied goods or services and has accounted for and paid tax on that supply but has not received any payment from the person liable to pay the tax.

- The registered person may apply for refund or remission of tax after a period of three years from the date of that supply or where the person has become legally insolvent.

(ii) De-registration of taxable persons

- De-registration applies when:

- A registered person ceases to make taxable supplies.
- The value of taxable goods or services being supplied in any period of twelve months falls below Sh.2 million and is not expected to increase.
- Incapacitation
- Insolvency
- Death
- Change in business name

(iii) Goods in stock

- A registered person is entitled to claim relief from any tax paid on goods in stock prior to registration.
- The claim for relief must be made within 30 days of registration.
- The goods must have been purchased within the 12 months preceding registration.

(c) **VAT payable**
**Input tax**

| Date | **Value (Sh.)** | **VAT (Sh.)** |
|---|---|---|
| 2/9 | 2,520,000 | 453,600 |
| 9/9 | 4,000,000 | 610,169 |
| 5/9 | 60,000 | 85,424 |
| 16/9 | 1,575,000 | 283,500 |
| 30/9 | 48,000 | 7,322 |
| 30/9 | 36,000 | 5,492 |
| | | 1,445,507 |

Output

| Date | **Value (Sh.)** | **VAT (Sh.)** |
|---|---|---|
| 2/9 | 900,000 | 137,288 |
| 10/9 | 960,000 | 146,441 |

| | | |
|---|---|---|
| 20/9 | 218,000 | 33,254 |
| 12/9 | 2,400,000 | - |
| 25/9 | 2,600,000 | - |
| | | 316,983 |

VAT refundable = 316,983
= Sh.1,128,524

## QUESTION FOUR

(a) Allowable expenses are expenses that are deductible from a person"s taxable income as specified by the Income Tax Act. Examples of such expenses include:

- Wear and tear allowance
- Salaries and wages
- Repairs and maintenance, etc
- Specific bad debt provision

Non-allowable expenses are expenses that are not deductible from the taxable income as specified in the Income Tax Act. These are expenses that do not help in the generation of income. Such expenses include:

(b) (i)PQR Limited

Adjusted profit or loss for the year ended 31 December 2005

| | Sh. |
|---|---|
| Net profit per the accounts | 3,296,000 |
| Add back: | |
| ATCK | 125,000 |
| Reserve for contingencies | 1,580,000 |
| Depreciation | 2,450,000 |
| Dividends paid | 1,600,000 |
| VAT paid | 168,000 |
| Tax penalties and interest | 66,000 |
| Hire purchase interest for chairman | 267,000 |
| Personal laundry | 133,000 |
| Personal legal expenses | 146,000 |
| Second hand laundry machine | 167,000 |
| General bad debts (100% x 1,350,000) | 135,000 |
| Subscription – Rhino gold Club | 260,000 |
| Donation – Watoto School for the Handicapped | 35,000 |
| MD"s medical cover | 263,000 |
| | 10,578,000 |
| Less: Wear and tear | (4,320,000) |
| Taxable income | 6,258,500 |

(ii) Tax payable = Sh.6,258,000 x 30% = Sh.1,877,550

## QUESTION FIVE

Capital Allowances for year 2003, 2004 and 2005

1. **Investment deduction (Sh. "000")**

| | Asset | Q. Cost | I.D @ 70% | Residual for WTA & IBD |
|---|---|---|---|---|
| **Year 2003:** | Security wall | 1,200 | 8,400 | 360 |
| | Building | 51,000 | 35,700 | 15,300 |
| | Plant fixed | 7,200 | 5,040 | 2,160 |
| | Boilers | 6,000 | 4,200 | 1,800 |
| | Milling machine | 37,500 | 26,250 | 11,250 |
| | | | 69,230 | |
| Year 2005 | | | 100% | - |
| | Building | 12,000 | 12,000 | - |
| | Conveyor | 1,000 | 1,000 | |
| | | | 13,000 | |

2. **Industrial Building Deduction (IBD)**

| | Building | Q. Cost | Bal b/f | IBD @ 2.5% | Balance c/f |
|---|---|---|---|---|---|
| 2003: | Security wall | 360 | - | 9.0 | 351.0 |
| | Building | 15,300 | - | 382.5 | 14,917.5 |
| | Workers canteen | 18,000 | - | 450 | 17,550.0 |
| | | | | 841.5 | |
| 2004: | Security wall | 360 | | 9.0 | 342 |
| | Building | 15,300 | | 382.5 | 14,535 |
| | Canteen | 18,000 | | 450.0 | 17,100 |
| | | | | 841.5 | |
| 2005: | Security wall | 360 | | 9.0 | 333 |
| | Building | 15,300 | | 382.5 | 14,152.5 |
| | Canteen | 18,000 | | 450.0 | 16,650.0 |
| | Borehole | 1,900 | | 47.5 | 1,852.5 |
| | | | | 889.0 | |

3. Wear and Tear Allowance

| Class | I | II | III | IV |
|---|---|---|---|---|
| Year 2003: Additions | 37.5% | 30% | 25% | 12.5% |
| HD fork lifts | 4,950 | - | - | - |
| Prime movers | 5,910 | - | - | - |
| Others net of I.D (notes) | - | - | - | 15,210 |
| Pajero | - | - | 1,000[R] | - |
| Peugeot | - | - | 1,750 | - |
| Furniture and fittings | - | - | - | 3,600 |
| | 10,860 | - | 2,750 | 18,810 |
| WTA for year 2003 | (4,073) | - | (688) | (2,351) |
| WDV 31/12/2003 | 6,787 | - | 2,062 | 16,459 |
| Year 2004 WDV 1/1/2004 | 6,787 | - | 2,062 | 16,459 |
| Add: VW Passat | - | - | 1,000[R] | - |
| Toyota pick-up | - | - | - | - |
| Tractor | 2,300 | - | - | - |
| Desks | - | - | - | 900 |
| Less disposals – fork lift | (1,200) | - | - | - |
| Prime mover | (1,500) | - | - | - |
| Furniture | - | - | - | (600) |
| Milling machines | - | - | - | (8,000) |

| | | | | |
|---|---|---|---|---|
| | | | 5,362 | (8,759) |
| Less year 2004 WTA | (2,733) | - | (1,341) | (1,095) |
| WDV 31/12/2004 | 4,554 | - | 4,021 | 7,664 |
| Year 2005: WDV 1/1/2005 | 4,554 | - | 4,021 | 7664 |
| Add conveyor | - | - | - | - |
| Staff bus | - | - | 5,500 | - |
| Computers | - | 3,600 | - | - |
| | 4,554 | 3,600 | 9,521 | 7,664 |
| WTA for year 2005 | (1,708) | (1,080) | (2,380) | (958) |
| WDV 31/12/2005 | 2,846 | 2,520 | 7,141 | 6,706 |

– Note 1 → 2,160 + 1,800 + 11,250 = 15,210.

**TAXATION 1**
**DECEMBER 2011**

**QUESTION ONE**

(a) - Rent income received by resident individuals is taxed at the graduated scale rate. It is added to other incomes for the year. Expenses incurred in earning the rent income are tax deductible.

Rent income received by non-resident individuals is taxed at a withholding tax rate of 30% which is final tax. No expenses are tax deductible i.e it is taxed gross.

(b) (i)Important declaration form.

A document issued by the Ministry of Finance
It is filled by importers of goods to Kenya
It contains the description of goods, quality, values and their country of origin.
Importer forwards the completed form with a copy of the supplier"s invoice to the respective inspection company
The company is then issued with a serial number

(ii) Clean report of findings

A document issued to the importer after the goods are subjected to pre-shipment inspection. The inspection is carried out in the country of origin before shipment
It shows the dutable value of goods and the custom coding
It is issued by the inspection company after satisfactory inspection of the subject goods and receipt of final documents
It authorizes the goods to be imported.

(iii) Goods liable to forfeiture

Prohibited goods e.g fire arms, false money, distilled beverages harmful to health, obscene prints etc.
Restricted goods i.e those goods where the conditions for their import are not met. Uncustomed goods i.e those goods where customs duty has not been paid.
Goods which are imported, or exported or contained in a package of which the entry does not correspond with the goods.
Goods which are imported, or exported concealed in a manner appearing to be intended to deceive an officer of customs.

(iv) Privileged persons and institutions

The President
Armed Forces
Commonwealth
Diplomatic staff
Aid Agencies
British Council
Charitable Institutions
Religious bodies
Disabled persons
East African Development Bank Hospitals
Public education institutions

(c) Fiscal policies can be defined as those policies that the Government uses/implements to achieve certain economic objectives or reduce undesirable effects on the economy, on national income, on production or on employment. The policies are also concerned with the determination and timing of Government revenue and expenditure to ensure economic growth. In this regard Lord Keynes defined a fiscal policy as any policy that uses public finance and subsequently causes development within the economy. Thus, fiscal policies could be said to be a combination of those deliberate changes in Government revenue and expenditure programmes to bring about economic development.

The main objectives of fiscal policies in a developing country like Kenya may include:

- Increasing the level of employment
- Encouragement of flow of investment into the desirable areas of the society e.g agriculture.
- Attract foreign and local investments e.g. through tax incentives
- Promote import substitution
- Promote accountability in public finance and resources (good governance of public institutions)
- Achievement of desirable price levels
- Achievement of desirable wealth distribution
- Achievement of desirable level of development.

The three main instruments of fiscal policy are:

- Public revenue
- Public expenditure
- Public debt

## QUESTION TWO

(a) The tax treatment of compensation received for loss of office:

(i) Where the compensation is for specified terms, income assessable is not to exceed the amount which would have been received in respect of the unexpired period of the contract.
The amount is to be spread evenly over that period at equal amounts per annum and assessed accordingly. The compensation should be exhausted.

Where the contract is for an unspecified term and provides for terminal payments, the compensation is to be spread forward and assessed at the rate of employee‟s remuneration per annum immediately before termination until compensation is exhausted.

Where the contract is for an unspecified term and does not provide for a terminal payment, the compensation is to be spread forward over 3 years equally and tax wholly.

(b) (i)The fringe benefit tax payable

(Prescribed rate – Rate charged) x Loan Amount x Corporate tax rate

= (12% - 2%) x 600,000 x 30%
= 18,000 x 4/12 = Sh.6,000

(ii) **Mr. Charles Kivuna**
**Taxable Income**
**Year ended 31 December 2005**

| | | |
|---|---|---|
| Employment | | Sh. |
| Basic pay (90,000 x 2) | | 1,080,000 |
| Medical benefits (10% x 1,080,000) | | 108,000 |
| Furniture | | 60,000 |
| Alarm system | | 10,000 |
| Entertainment (5% x 120,000) | | 6,000 |
| Bonus shares (1000 shares x Sh. 8) | | 8,000 |
| Watchman (3000 x ½ x 5 months) | | 7,500 |
| | | 1,279,500 |
| Pension | | |
| Actual | 54,000 | |
| 30% x 1,279,500 | 283,850 | |
| Limit | 210,000 | (54,000) |
| | | 1,225,500 |
| Other Income | | |
| Compensation for loss of office | | 1,500,000 |
| Rent income | | 1,000,000 |
| Business income | | 320,000 |
| | | 4,045,500 |
| Mortgage interest relief | | |
| Actual: 10% x 3,500,000 x 6/12 = 175,000 | | |
| Maximum: 100,000 x 6/12 = 50,000 | | (50,000) |
| Taxable income | | 3,995,500 |

(iii) Tax payable on the taxable income in (ii) above.

**Mr. Kivuna**
**Tax Liability**

| | |
|---|---|
| 1st 466,704 = (121,968 @ 10%) + [114,912 @ (15% + 20% + 25%)] | 81,144 |
| Surplus (3,995,500 – 466,704) @ 30% | 1,058,639 |
| Gross tax | 1,139,783 |
| Less: PAYE 12,000 p.m. x 12 | (144,000) |
| p/relief | (13,944) |
| Net tax | 981,839 |

## QUESTION THREE

(a) (i)Taxation of petroleum companies and their sub-contractors.

- Favourable rates of tax on management or professional fees and interest paid to non-residents by such companies.
- Generous terms with regard to allowable deductions for tax purposes.
- Non-resident contractors will be deemed to have made a taxable profit of 15% of the sum paid to them by a petroleum company (exclusive of certain defined expenses, and the tax on this is deducted when payment is made.
- The firms are taxed at 30% corporate tax rate.

(ii) Enterprises situated in export processing zones (EPZs)

- For the first 10 years, from the date of commencement of business:

(a) Payments to the EPZ will be subject to withholding tax at non-resident rate
(b) Payment by the EPZ to non-resident persons will be exempt from tax
(c) The EPZ will be exempt from corporate tax.

- For the period of 10 years commencing immediately after its initial 10 year commencing immediately after its initial 10 year period the EPZ will be subject to corporation tax at the rate of 25%.

- Thereafter 20 year, CT is 30%.

- Employees and directors of EPZ if resident are liable to tax and deduction of PAYE in the normal way.

- Exports are zero rated for V.A.T purposes.

- Investment allowance is granted at 100% on cost of qualifying building and machinery.

(b) **Chemaina Enterprises**
**Taxable income for year 2005**

| | Sh. | Sh. |
|---|---|---|
| Gross profit on trading | | 4,998,000 |
| Rent and rates (360,000 x 12/18) | 240,000 | |
| Salaries and wages | 991,200 | |
| Advertising | 252,000 | |
| Transport costs | 283,200 | |
| Capital allowances (ii + iii) | 2,662,500 | 4,428,900 |
| Taxable partnership income | | 569,100 |

**Workings**

(i) Rent + rates = Ksh.360,000 for 18 months

For 1 year $\frac{360,000}{18} x12 = 240,000$

(ii) Farm works deduction

⅓ of qualifying cost or ⅓ x 6,000,000 = 2,000,000

(iii) Wear and tear deduction

| | Class III @ 25% | Class IV @ 12.5% |
|---|---|---|
| Furniture | | 900,000 |
| Dairy equipment | | 2,400,000 |
| Director"s car (restricted amount) | 1,000,000 | - |
| | 1,000,000 | 3,300,000 |
| Wear and Tear deduction | 250,000 | 412,500 |
| | 2,662,500 | |

Total C. Allowances = 2,000,000 FWD + 250,000 + 412,500 = 2,662,500

**Allocation between partners**

| | Cheruiyot Ksh. | Maina Ksh. | Total Ksh. |
|---|---|---|---|
| Salary | 360,000 | 360,000 | 720,000 |
| Interest on capital @ 15% | 648,000 | 939,780 | 1,587,780 |
| Share of loss | (869,340) | (869,340) | (1,738,680) |
| Taxable income | 138,660 | 430,440 | 569,100 |

## QUESTION FOUR

(a) Costs qualifying for mining allowance

- Costs incurred in searching for, discovery, testing and winning access to minerals.
- Expenses incurred in obtaining acquisition rights over the mineral and deposits, but not the cost of land.
- The cost of buildings or civil works which would have little or not value if the mines ceased to be worked on.
- Cost of mining machinery which would be rendered valueless after mining.
- Cost of development general administration and management prior to the commencement of production or during the period of non-production.

(b) Capital allowances
Year 2004
**Investment Deduction**

| Asset | Q. Cost | ID 100% | Residue |
|---|---|---|---|
| Second hand Machinery | 2,250,000 | 2,250,000 | - |
| | | 2,250,000 | |

**Wear and Tear Allowance**

| | Class I 37.5% | Class II 30% | Class III 25% |
|---|---|---|---|
| Motor car: (75% x 300) | | | 300,000 |
| Lorry | 800,000 | | |
| Pick-up | | | 200,000 |
| Qualifying | | | |
| Cost | 800,000 | | 500,000 |
| WTA | (300,000) | | 125,000 |
| WDV | 500,000 | | 375,000 |

**Year 2005**

i) **Investment Deduction**

| Asset | Q. Cost | ID 100% | Residue |
|---|---|---|---|
| Factory | 3,000,000 | 3,000,000 | - |
| New machinery | 800,000 | 800,000 | - |
| Second hand Machinery | 600,000 | 600,000 | - |
| | 4,400,000 | 4,400,000 | - |

ii) **Wear and Tear Allowance**

| | Class I 37.5% | Class II 30% | Class III 25% |
|---|---|---|---|
| WDV b/f | 500,000 | | 375,000 |
| Tractor | 900,000 | | |
| Car (75% x 350,000) | - | | 350,000 |
| | 1,400,000 | | 725,000 |
| Disposal: (75% x 150,000) | - | | (150,000) |
| | 1,400,000 | | 575,000 |
| WTA | (525,000) | | (143,750) |
| | 875,000 | | 431,250 |

**QUESTION FIVE**

(a) Minimum vatable turnover as per year 2005 budget is Ksh.3,000,000 p.a.

(b) Grounds of appeal to VAT Tribunal

- Compulsory registration of a trader by the Commissioner
- Commissioner"s requirement for a security
- VAT penalties objected to
- VAT amount or rate used
- Commissioner"s failure to refund VAT
- De-registration of a trader without his consent

(c) Four details found in a tax invoice

- Name of the supplier
- Name of the buyer
- Address of supplier
- Serial number of the invoice
- Date of the invoice
- Date of supply if different from date of invoice
- PIN of supplier
- VAT registration number of supplier.
- Description of goods supplied in terms quantity,
- Value of goods exclusive VAT
- Discount if any
- VAT rate
- VAT amount
- Total value of supply inclusive VAT

(d) Input/output VAT 16% rate x value exclusive of VAT.

(i)

| Month | Output VAT | Input VAT |
|---|---|---|
| July | 16% x 1,200,000 = 192,000 | 16% x 900,000 = 144,000 |
| Aug | 16% x 1,000,000 = 160,000 | 16% x 750,000 = 120,000 |
| Sep | 16% x 800,000 = 128,000 | 16% x 350,000 = 56,000 |
| Oct | 16% x 1,400,000 = 224,000 | 16% x 1,100,000 = 176,000 |
| Nov | 16% x 600,000 = 96,000 | 16% x 400,000 = 64,000 |
| Dec | 16% x 1,600,000 = <u>256,000</u> | 16% x 1,200,000 = <u>192,000</u> |
| | <u>1,056,000</u> | <u>752,000</u> |

$$\text{Deductible input VAT} = \frac{\text{Taxable supplies}}{\text{Total supplies}} \times \text{input VAT}$$

$$= \frac{6{,}600{,}000 + 1{,}590{,}000}{6{,}600{,}000 + 1{,}590{,}000 + 735{,}000} \times 752{,}000$$

$$= \frac{8{,}190{,}000}{8{,}925{,}000} \times 752{,}000 = 690{,}071$$

(ii) VAT payable = Output VAT – Restricted input VAT
= 1,056,000 – 690,071 = <u>365,929</u>

## TAXATION

**MAY 2012**

**QUESTION ONE**

(a) (i) **Taxation of Pension Income**

- In case of period income, the first Ksh.180,000 p.a. (15,000 p.m) is tax exempt if from registered pension schemes only.
- In case of lumpsum income, the first Ksh.48,000 p.a for each year of service up to a maximum of Ksh.480,000 is tax exempt where the income is from registered pension and provident funds.
- The first Ksh.1,400,000 withdrawn by dependants of a deceased person is tax exempt.

(ii) **Submission of Fraudulent Returns**

The penalties shall be:

- a fine not exceeding Ksh.200,000 and
- additional tax equal to 200% of tax evaded/concealed and/or
- 2 year imprisonment.

(iii) Annual allowances are given on capital expenditure incurred in the mining of specific minerals as follows:

- 1$^{st}$ year – 40% of total capital expenditure
- year 2 – 7 – 10% p.a of total capital expenditure.

No balancing allowance or loss arises from disposal of assets.

(b) (i)

- Tax avoidance is arrangement of taxpayers affairs to reduce tax liability without resulting to tax evasion.
- The taxpayer will utilize loopholes in tax legislations. It is legal exercise that cannot result in penalties.

(ii) Taxpayers can engage in tax avoidance through tax planning activities such as:

- buying assets to enjoy capital allowances instead of leasing
- engaging in exporting business where exports are zero rated instead of domestic sales
- use of debt capital where interest is tax allowable instead of equity capital
- decision as to whether to operate as a partnership, sole proprietorship or limited company.
- Being granted low interest loan to purchase a house (employer pays Fringe Benefit Tax) instead of being granted a house (taxable housing benefit)

(c) **Incidence of Tax**

- Implies the final resting place of tax burden. Once tax is imposed on one party, it can be shifted forward i.e. to the consumer through wholly or partial increase in selling price or backward (through partial or wholly reduction in cost of inputs).

-This concept is important to policy makers in the following ways:

(i) It identifies which section of society can best bear the money tax burden
(ii) To evaluate whether tax system conforms to canon of equality.
(iii) It will affect elasticity of demand and supply of some commodities which will affect production and employment levels.
(iv) Formulation of tax policies i.e direct or indirect taxes

## QUESTION TWO

(a) (i) **Taxation at Source**

- This is where tax is withheld and the recipient only receives the income net of tax e.g. Pay As You Earn (PAYE) deducted from employment income, withholding tax on qualifying dividends and interest income etc.

- The person withholding the tax is a tax agent who will remit the tax withheld to the government by 20th day of the following month (10th day for PAYE)

(ii) Taxation of wife"s employment income

- Employment income of wife is laxed on graduated scale and is assessable on the wife if it is at arm"s length i.e. it is not derived from:
  - A partnership in which the husband is a partner
  - A trust created by the husband
  - A company in which the wife and/or husband hold 12.5% or more of voting power
  - Where wife is employee of the husband.

- If employment income is at arm"s length, the wife will enjoy personal relief.

(iii) **Back duty**

- This is tax in arrears which was not paid by a taxpayer by reason of:

  (b) non-payment of tax
  (c) non or under-declaration of taxable income
  (d) backdating of salary increment or gratuity received in lumpsum for services rendered in the past.

(b) **Employment Income – Mr. Mbotela**

(i)

| | | |
|---|---|---|
| Salary 60,000 x 12 | | 720,000 |
| Overtime 10% x 720,000 | | 72,000 |
| Medical bills | | 48,000 |
| Car benefit: Higher of: | | |
| (i) 2% x 300,000 x 12 = | 72,000 | 86,400 |
| (ii) Fixed benefit on 2000cc = | 86,400 | |
| Gardener – fixed benefit | | 21,600 |
| Seminar allowance | | 2,500 |
| Cash gift | | 45,000 |
| Pensionable pay before housing benefit | | 995,500 |
| Housing benefit 15% x 99,300 | 149,325 | |
| Less rent paid 2500 x 12 | (30,000) | 119,325 |
| Total pensionable pay | | 1,114,825 |
| Less pension contribution – lower of: | | |
| (i) 30% x 1,111,950 = | 333,585 | |
| (ii) Actual amount 8000 x 12 = | 96,000 | |
| (iii) Set limit = | 210,000 | (96,000) |
| | | 1,018,825 |
| **Business Income** | | |
| Consultancy profits | 70,000 | |
| Less operating expenses | (18,000) | |
| Less WTA on furniture 12.5% x 4,000 | (500) | 51,500 |
| | | 1,070,325 |
| **Mrs. Mbotela** | | |
| Net profit | | |
| Add back | 50,000 | |
| School fees for children | 108,800 | 158,000 |

**Notes:**

- Tax and snacks not taxable since the value is less than Sh.24,000 p.a.
- Assumed medical scheme is discriminatory hence medical benefit taxable.
- Interest from POSB is tax exempt
- Insurance compensation not taxable

(ii) Tax liability – Mr. Mbotela on Ksh.1,015,950

| | |
|---|---|
| 1st Ksh.121,968 @ 10% | 12,196.8 |
| Next Ksh.114,912 @ (15% + 20% + 25%) | 68,947.2 |
| Surplus (1,070,325 – 466,704) @ 30% | 181,086.3 |
| | 262,230.3 |
| Less: Personal relief | (13,944.0) |
| PAYE 7000 x 12 | (84,000.0) |
| | 167,286.3 |
| Mrs. Mbotela on Ksh.158,000 | |
| 1st KSh.121,968 @ 10% | 12,196.8 |
| Surplus (158,000 – 121,968) @ 15% | 5,404.8 |
| | 17,601.6 |
| Less: Personal relief | (13,944.0) |
| Net tax liability | 3,657.6 |

## QUESTION THREE

(a) Differences between taxation of co-operative societies and companies:

- Dividends to the extent of 80% are allowable expenses for primary co-operative (100% for secondary co-operative) societies which is not the case for companies.
- The societies cannot carry losses forward to be offset against future income but companies can.
- SACCO"s are taxed on selected incomes i.e. 85% of gross non-qualifying dividends and 70%of gross rent income but companies pay tax on all business incomes.
- Co-operative Societies are not expected to pay instalment tax but companies must pay.
- Expenses incurred in generating income of a company are allowable but no expenses are allowable in determining taxable income of a SACCO.

(b) (i)**Using year 2005:**

| **Asset** | **Q. Cost** | **Investment deduction I.D @ 100%** | **Residual for IBD & WTA** |
|---|---|---|---|
| F. Building | 2,500,000 | 2,500,000 | - |
| p. Machine | 300,000 | 300,000 | - |
| F. Extension | 1,800,000 | 1,800,000 | - |
| | | 4,600,000 | |

| **Class** | **I @ 37.5%** | **II @ 30%** | **III @ 25%** | **IV @ 12.5%** |
|---|---|---|---|---|
| WDV 1.1.2003 | 600,000 | 1,280,000 | 1,700,000 | 2,200,000 |
| Add: Fax machine | - | 25,000 | - | - |
| Telephone set | - | 15,000 | - | - |
| Computers | - | 70,000 | - | - |
| Saloon car | - | - | 1,000,000R | - |
| Less: Disposals | (90,000) | (230,000) | (175,000) | (420,000) |
| | 510,000 | 1,160,000 | 2,525,000 | 1,780,000 |
| WTA | (191,250) | (348,000) | (631,250) | (222,500) |
| WDV 31/12/2003 | 318,750 | 812,000 | 1,893,730 | 1,557,500 |

(ii) **Adjusted Taxable Profits**

| | | **Sh."000"** |
|---|---|---|
| Reported net profits | | 26,100 |
| Add back disallowable expenses | | |
| Directors remuneration – private travel | 600 | |
| Audit fees – tax appeal | 250 | |
| Bad debt – General provisions | 70 | |
| embezzlement | 180 | |
| Miscellaneous expenses – contributions | 75 | |
| Staff Xmas party | 30 | |
| Depreciation | 500 | 1,705 |
| | | 28,315 |
| Less: Investment income | 850 | |
| Gain on sale of motor vehicle | 600 | |
| Capital Allowance - ID | 4,600 | |
| Total WTA | 1,393 | (7,443) |
| Net taxable income | | 20,873 |

**Notes:**

1. Embezzlement by staff would be treated as allowable expenses on condition that if insurance compensation is received, it would be treated as taxable income.
2. Interest on loan borrowed to purchase machine is tax allowable.

(iii) Tax payable = 20,872,000 x 30% = 6,261,600

## QUESTION FOUR

(a) Instruments on which stamp duty is changeable:

- Increase of share capital – 1%
- Transfer of securities of unquoted firms
- Transfer of immovable property within and outside a municipality – 4% and 2% respectively
- Lease agreement of 1 – 2 years – 1% of annual rent
- Primary debenture/mortgage – 0.5%
- Insurance policies
- Hire purchase agreements
- Agreements such as partnership deeds.

(b) (i)Motor vehicle licences
- A fee is charged on road and driving licences
- The fees is based on the period (4 months or 12 months) and engine size of the vehicle determined by cylinder capacity (CC)

(ii) Training Level
This is charged on the guests of hotels and clubs at 2% based on the hotel and club charges.

(c) (i)

| | | |
|---|---|---|
| Reported net profits | | 3,987,000 |
| Add back: Understated closing stock = $\frac{800,000}{90\%} - 800,000$ | | 88,889 |
| Transport costs – private | | 18,000 |
| Gifts to staff | | 4,000 |
| Partner salaries 300 + 250 + 50 | | 600,000 |
| Depreciation | | 73,000 |
| Interest on capital | | 450,000 |
| Commission paid to partners | | 90,000 |
| | | 5,268,889 |
| Less: Overstated closing stock $\frac{2,200,000}{90\%} - 2,200,000$ | 244,444 | |
| Capital allowances | 120,000 | |
| Other incomes | 50,000 | (414,444) |
| Adjusted business income | | 4,854,445 |

(iii) **Distribution of profits**

| Partner | **Maina** | **Njoka** | **Otieno** | **Total** |
|---|---|---|---|---|
| Salaries | 300,000 | 250,000 | 50,000 | 600,000 |
| Interest on capital | 150,000 | 150,000 | 150,000 | 450,000 |
| Commission | 30,000 | 30,000 | 30,000 | 90,000 |
| Profit share 3:1:1 | 2,228,667 | 742,889 | 742,889 | 3,714,445 |
| | 2,708,667 | 1,122,889 | 922,889 | 4,854,445 |

## QUESTION FIVE

(a) - Dumping means importing goods into Kenyan Market and selling them at a price below the fair market price of the same goods in the country from which goods were imported.

- It does not necessarily mean sub-standard goods.

- It also applies to selling of imported goods at a price below the fair market value of the same goods in the country from which were first imported, then exported to another country before being exported to Kenyan.

(b) The measures to eliminate dumping are:

- high, anti-dumping duty.
- Imposition of a quota on the quantity of goods that can be imported from a given country or foreign institution.
- Pre-shipment inspection of goods
- Adequate documentation of all imports.

(c) Import duty may be refunded if:

- It was paid in error (over-paid)
- Goods are returned to the seller
- Goods are destroyed or damaged while under customs control
- If goods are used to manufacture exports.

(d) **VAT A/c**

| **Input VAT** | | **Output VAT** | |
|---|---|---|---|
| 3/6 Purchases 16/110 x 80,000 | 11,035 | 4/6 Sales 60,000 x 0% | 0 |
| 9/6 Return in @ 0% | 0 | 7/6 Return out 16/116 x 16000 | 2,207 |
| 19/6 Bad debt relief 16/116 x 18000 | 2,483 | 12/6 Sales 16/116 x 360,000 | 49,655 |
| 25/6 Purchases 16/116 x 80,000 | 11,035 | 27/6 sales 16/116 x 16,000 | 22,069 |
| VAT Payable | 66,206 | sales 16/116 x 122,000 | 16,828 |
| | 90,759 | | 90,759 |

**NB:**
- VAT on merchandise b/f was accounted for in the previous month
- No input VAT is charged by unregistered suppliers but on supplying goods, the seller should charge VAT whether the buyer is registered or not.

## NOVEMBER 2012
## TAX I

### QUESTION ONE

(a) (i)Tax amnesty - "forgiveness" of tax liability and or penalties associated with past tax that was evaded. The tax amnesty with 31st Dec 2004 was on interest, fines and penalties on tax evaded in the past. The taxpayer has to disclose and pay such evaded tax only

- The amnesty was in respect of fines, interest and penalties associated with the following types of taxes evaded

  - Income tax for year 2003 and prior years
  - Customs duty on imported goods before 11/6/2004
  - Excise duty on goods manufactured and/or sold before 30/4/2004
  - A VAT on goods and services supplied before 11/6/2004

(ii) Advantages of tax amnesty to

(a) KRA
- Increased tax revenue to government
- Higher level of compliance in future
- More people are brought into the tax net

(b) Tax payer
- No prosecution or indepth investigation for past tax evasion
- No payment of penalties, interest and fines
- Higher tax compliance in future

(b) Features of

(i) Motor vehicle advance tax (section 12 A of Cap 470)

- Paid by owners of commercial vehicles and public service vehicles P.S.V - Paid in advance at the beginning of the year
- Based on number of passengers or weight of luggage - Can be offset against tax liability of the business

(ii) Fringe benefit tax (FBT)

- Payable together with P.A.Y.E on monthly basis
- Based on corporate tax rate of 30%
- Based on fringe benefit resulting from granting of low interest rate loan to the employee by employer below market interest

$$\text{FBT} = \begin{pmatrix} \text{Market interest} - \text{Low interest} \\ \text{rate} \qquad\qquad \text{rate} \end{pmatrix} \text{Amount of loan x 30\%}$$

-Paid by the employer will effect from 11th June 1998

(c) Refund of import duty paid

- Where goods are returned to seller
- Where duty was paid in error i.e. over paid
- Where goods are lost or destroyed while under customs control

- Where goods are used in production of exports members of diplomatic missions, Armed forces, NGO"s etc

## QUESTION TWO

(a) (i)The partners have the responsibility of filing the partnership business returns by the end of the 4th month after the end of the calendar year i.e. 30th April. The returns will form the basis of determining how profit was shared and the taxable income from partnership business

(ii) Late payment of tax will attract the following penalties

- Late payment penalty of 20% of unpaid tax
- 2% p.m interest penalty on unpaid tax plus penalty

(b) (i)Adjusted partnership income for a months net profits

| | |
|---|---|
| Net profits | 9,500,000 |
| Add back | |
| Partners salaried 1500 + 1200 + 900 | 3,600,000 |
| Depreciation | 400,000 |
| Advertising - -neon sign | 250,000 |
| Interest on capital 600 + 400 + 200 | 1,200,000 |
| Commission to Faulu | 80,000 |
| Adjusted partnership income | 15,030,000 |

(ii) Allocation of profits

Sh „000"

| Partner | M | B | F | Total |
|---|---|---|---|---|
| Salary | 1,500 | 1,200 | 900 | 3,600 |
| Interest | 600 | 400 | 200 | 1,200 |
| Commissions | - | - | 80 | 80 |
| Profit share 3:2:1 | 5,075 | 3,383.3 | 1,691.7 | 10,150 |
| | 7,175 | 4,983.3 | 2,871.7 | 15,030 |

(iii) Bidii"s income

| | | |
|---|---|---|
| Employment income – 3 months | | **Ksh** |
| Salary 960 000 | | |
| Allowances-entertainment 18 000 x 3/12 | | 240,000 |
| House 30 000 x 3 | | 54,000 |
| Medical (discriminating) | | 90,000 |
| Bonus 5% x 240 000 | | 120,000 |
| Pensionable pay | | 12,000 |
| | | 516,000 |
| Less contributions to registered fund | | |
| Lower of (1) 30% x 516,000 = | | |
| (2) Set limit = 210 000 x3/12 = | 154,800 | |
| (3) Actual amount = 10% x 240 000 | 52,500 | |
| Income from employment | 24,000 | (24,000) |
| Income from P/ship business | | 492,000 |
| Total taxable income | | 4,983,000 |
| **Total liability** | | 5,475,000 |

| | |
|---|---|
| 1st Ksh. 121,968 @ 10% | 12,196.8 |
| Next Ksh. 114,912 @ (15% + 20% + 25%) | 68,947.2 |
| Surplus Ksh. (5,475,000 – 466,704) @ 30% | 1,502,489.0 |
| Gross tax liability | 1,583,633.0 |
| Less personal relief | (13,944.0) |
| PAYE 144,000 x 3/12 | (36,000.0) |
| Net tax liability | 1,533,689.0 |

## QUESTION THREE

(a) (i)The time for supply for VAT purposes shall be earliest of the time when

- goods are supplied or services rendered or
- an invoice is issued in respect of the supply or
- payment is received for all or part of the supply or
- certificate is issued by an architect, surveyor or any person acting in a supervisory capacity in respect of the service

(ii) Minimum Turnover

Compulsory registration for VAT applies to any person who in the course of business supplied or expect to supply taxable goods or services or both, the values of which in any of the following periods exceeds the value shown

| | |
|---|---|
| 12 months | Ksh. 3,000,000 |
| 9 months | Ksh. 2,400,000 |
| 6 months | Ksh. 1,800,000 |
| 3 months | Ksh. 1,200,000 |

(iii) Tax invoice

- A registered person who makes taxable supply shall issue a tax invoice at the time of supply or within 14 days of the completion of that supply.

- For cash sale, a tax invoice must be issued immediately

- A simplified tax invoice should show the following

  - Date of invoice

- Brief description of supply made
- Name address, PIN and VAT registration number of the supplier
- Serial number of the invoice
- Total amount charged inclusive of VAT
- Explicit statement that the price is inclusive of VAT

**IV VAT Tribunal**

- Established by minister of Finance to arbitrate tax disputes between commissioner of VAT and person registered for VAT
- Consists of chairman and two other members of the general public
- The minister prescribes the manner in which an appeal is made to the tribunal. The tribunal can confirm, reduce, nullify or increase the tax assessed
- A tax payer aggrieved by the decision of the Tribunal can appeal to the high court

**4 Months VAT A/C**

| | Input VAT | | Output VAT |
|---|---|---|---|
| VAT bills 2,000 x 4 | 8,000 | January | |
| January | | Exports 3,200,000 x 20% x 0% | 0 |
| 90% x 2,450,000 x $\frac{16}{116}$ | 304,138 | Std sales 3,200,000 x 70% x $\frac{16}{116}$ | 308,965 |
| February | | February | |
| 90% x 2,870,000 x $\frac{16}{116}$ | 356,276 | Exports 3,460,000 x 20% x 0% | 0 |
| March | | Std sales 3,460,000 x 70% x $\frac{16}{116}$ | 334,009 |
| 90% x 3,250,000 x $\frac{16}{116}$ | 403,448 | March | |
| | | Exports 2,940,000 x 20% x 0% | 0 |
| April | | | |
| 90% x 3,120,000 x $\frac{16}{116}$ | 387,310 | Std sales 2,940,000 x 70% x $\frac{16}{116}$ | 283,862 |
| Return inwards $\frac{16}{116}$ x 25,000 | 3,448 | April | |
| | | Exports 3,500,000 x 20% x 0% | 0 |
| | | Std sales 3,500,000 x 70% x $\frac{16}{116}$ | 337,931 |
| | | VAT refund | 197,793 |
| | | | 1,462,620 |

**QUESTION FOUR**

(a) For the purpose of computing capital allowances on purchased item Chai Ltd will

(i) Inherit residual/ WDV of the Buildings and loose tools

(ii) Use the Buying price for the rest of the assets

**CAPITAL ALLOWANCES**

(i) Diminution in value of loose tools @ 331/3% p.a

| **Year** | **Diminution** |
|---|---|
| 2004 | 150,000 x 1/3 = 5,000 (enjoyed by Mwisho Ltd) |
| 2005 | 150,000 x 1/3 = 50,000 |
| 2006 | 150,000 x 1/3 = 50,000 |

(ii) Investment deduction

Qualifying cost of machine = 450,000 + 100,000 + 40,000 + 18,000 + 5,600 = 613,600

| Asset | Q.Cost | I.D@ 100% | residual |
|---|---|---|---|
| Machinery | 613,600 | 613,600 | --- |
| | | 613,600 | |

The factory building is assumed to have enjoyed 100% I.D in 1996

(iii) Industrial building deduction

IBD Residual as at 2/1/2005

| Building | Cost | Years in existence | IBD@ 2.5% | Residual |
|---|---|---|---|---|
| Warehouse A | 2,000,000 | 5.5 yrs | 275,000 | 1,725,000 |
| Warehouse B | 1,700,000 | 5.5 yrs | 212,500 | 1,487,500 |
| Staff quarters | 3,600,000 | 3.41667 yrs | 307,500 | 3,292,500 |
| Staff canteen | 900,000 | 3.08333 yrs | 69,375 | 830,625 |

**YEAR 2005 IBD**

| Building | Q Cost | Residual b/f | IBD@ 2.5% | Residual c/f |
|---|---|---|---|---|
| Warehouse A | 2,000,000 | 1,725,000 | 50,000 | 1,675,000 |
| Warehouse B | 1,700,000 | 1,487,500 | 10,625 | - |
| Old Staff quarters | 3,600,000 | 3,292,500 | 90,000 | 3,202,500 |
| Staff canteen | 900,000 | 83,625 | 22,500 | 808,125 |
| New Staff quarters | 800,000 | - | 10,000 | 790,000 |
| | | Total IBD | 183,125 | |

Warehouse B was used for only 3 months hence IBD

= 1,700,000 x 2.5% x 3/12 = 10,625

New staff quarters were utilized for 6 months hence IBD

= 800,000 x 2.5% x 6/12 = 10,000

Office Building dies not qualify for IBD

(iv) Wear and Tear allowance (WTA) Sh „000"

| Class | I @ 37.5% | II @ 30% | IV @ 12.5% |
|---|---|---|---|
| Machinery + generator | - | - | 10,250 |
| Computers + printers + mobiles | - | 590 | - |
| Delivery vans | 8,000 | - | - |
| Furniture + weighing scale | - | - | 1,028 |
| Add: partitions – warehouse B | - | - | 150 |
| Computers | - | 50 | - |
| Less: delivery van | (700) | - | - |
| Computer | - | (18) | - |
| | 7,300 | 622 | 11,428 |
| WTA | (2,737.5 | (186.6) | (1,428.5 |
| WDV | 4,562.5 | 435.4 | 9,999.5 |

Total WTA = 4,352,600

(b)

| | | |
|---|---|---|
| Profits | | 26,000,000 |
| Add back depreciation | | 2,000,000 |
| | | 28,000,000 |
| Less capital allowances | | |
| Diminution | 50,000 | |
| Investment deduction | 613,600 | |
| I.B.D | 183,125 | |
| W.T.A | 4,352,600 | (5,199,325) |
| Adjusted taxable profits | | 22,800,675 |
| Tax liability = 30% x 22 800 675 | | 6,840,202.5 |

## QUESTION FIVE

(a) Four tax advantages enjoyed by a sole proprietorship over a company

- Income taxed on individual and not business
- Income taxed on graduated scale such that the lower the income, the lower the tax unlike a constant corporate tax rate for a company.
- The individual shall be granted a personal and insurance relief (if he takes a life or education policy) which are not available to a company
- The withholding tax on incomes such as qualifying dividends and interest are final for individuals.

(b) (1)Purchase ordinary shares in Kenya Airways Ltd

- The dividends received will suffer a 5% final withholding tax while any capital gains realised on disposal of shares is tax exempt

(2) Purchase ordinary shares in Uganda Breweries Ltd

- The dividend income receivable or even capital gains realizable are tax exempt since they are derived from outside Kenya

(3) Open a fixed deposit Account with KCB Ltd.

- The interest income is subject to a 15% final withholding tax

(4) Purchase Government Treasury bills

- These are considered as riskless investments but the interest income is subject to a 15% final withholding tax

(5) Savings account with POSB Ltd

- The interest income earned on deposit with post office savings bank is tax exempt according to the first schedule of cap 470 (income tax Act)

(6) Subscribe for debentures in national Bank of Tanzania Ltd

- Interest income is tax exempt in Kenya since it is derived from outside Kenya

(c) The government can reduce its budget deficit by

(1) Internal borrowing through the issue of Treasury bills and bonds

(2) External borrowing from IMF and world bank

(3) Enhance tax revenue collection through administrative efficiency and bringing more people into the tax net

(4) Sale of national assets e.g. privatization of parastatals to eliminate their financing thus reducing government expenditure.

TAX I

# MAY 2013

## QUESTION ONE

(a)

(iv) Cess – a charge on agricultural income especially cashcrops for maintenance and repair of roads which access those agricultural locations.

(v) Property rates – rates charged local authority on land and building owned by individuals and body corporates. The local authority charge such rates on property located within its jurisdiction. Valuation of property is necessary for purpose of imposing property rates.

(vi) Stamp duty – duty charged by the government in respect of some documents specified under stamp duties act. Such documents must be stamped and duty paid for them to be legal in executing transactions. The instruments are written documents for transactions such as:
- Transfer of property
- Mortgage of property
- Hire purchase agreements
- Lease agreements
- Insurance policies.
- Memorandums and articles of association
- Marketable securities etc.

(d) Refer to solution of Q1 (b) Dec 2005.

(e) Mr. Ombaka taxable income.

| | Kshs. | Kshs. |
|---|---|---|
| Salary 45,000 x 12 | | 540,000 |
| Bonus | | 90,000 |
| Car: Higher of 24% x 600,000 or Kshs. 86,400 (on 2000cc) | | 144,000 |
| Pensionable pay before H.B. | | 774,000 |
| Add: H. Benefit = 15% x 774,000 | | 116,100 |
| Less rent paid 3000 p.m x 12 | | (36,000) |
| Pensionable pay | | 854,100 |
| Less pension contribution: lower of: | | |
| (i) Actual amount | 240,000 | |
| (ii) Maxi. Limit | 210,000 | |
| (iii) 30% x 854,100 | 256,230 | (210,000) |
| | | 597,870 |
| Pension income (20,000 – 15,000 exempt) x 12 | | 60,000 |
| Farming income | | |
| Gross income | 160,000 | |
| Less allowables – labour costs | (60,000) | |
| Miscellaneous | (20,000) | |
| WTA on pick-up = 25% x 400,000 | (100,000) | |
| Net loss c/f | (20,000) | |
| Total taxable income | | 657,870 |

* Staff meal of Kshs. 24,000 p.a. a tax free benefit as long as it does not exceed Kshs. 36,000 p.a. (w.e.f 1/1/2006)

(ii) Tax liability on Kshs. 657,870

| | | |
|---|---|---|
| 1st 466,704 = (121,968 @ 10%) + 114,912 @ (15% + 20% + 25%) | = | 81,144 |
| Surplus = (657,870 – 466,704) @ 30% | = | 57,350 |
| Gross tax | | 138,494 |

| | |
|---|---|
| Less p/relief | (13,944) |
| PAYE deducted 3000 p.m. x 12 | (36,000) |
| Net tax | 88,550 |

**QUESTION TWO**

(a) Forward shifting – shifting the tax imposed on one party to consumers through increase in selling price.
- Backward shifting–tax is shifted to the suppliers through reduction in buying price.

(b) (i)Income tax – this cannot be shifted since it is a form of direct tax. The impact and incidence are on the same person. E.g. employees cannot shift PAYE to another party.

(iii) Custom duties: - if the imparted good is for personal consumption e.g. imparted vehicle for personal use, the duty cannot be shifted. However, if it"s for resale, the duty is shifted to the buyer since the sell mark-ups the cost inclusive of duty paid.

(c) Advantages of progressive taxes

Progressive taxes is where the tax rate rises as taxable income increases (the higher the taxable income, the higher the rate).

Advantages
- Equitable–higher income is subject to more tax.
- Productive–yields more revenue to the government compared to proportional tax.
- Economical–collection cost does not increase with increase in tax rate.
- Equal sacrifice–the marginal utility of money decreases with every increase in income hence forhigher income individuals to make equal sacrifice, they pay higher taxes.
- Equalities in wealth distributions–the rich with less disposable income will forgo their luxuriesand the poor will benefit more from the more tax charged on the rich.

(d) Goods liable to forfeiture (goods confiscated by the government) – Prohibited goods
- Uncustomed goods
- Restricted goods (goods subject to conditions of importation or exportation.
- Goods imported or exported contained in a package of which the entry, application of shipmentor application to unload does not correspond with the goods.
- Goods imported or exported concealed in a manner or packaged in a manner appearing to beintended to deceive an officer.

**QUESTION THREE**

(a) Conditions to be granted IDBM
- Manufacture goods for exports only (not for local sales)
- Manufacture period not less than 3 years.
- First qualify for I.D under ordinary manufacture.
- If manufacture for export only ceases before the lapse of 3 years, the IDBMgranted shall be withdrawn and treated as a taxable income in the year of withdrawal but the investor shall be granted I.B.D and W.T.A as applicable on the withdrawn IDBm.

(b) (i)Investment deduction

Year 2003 I.D. @ 70% (Kshs „000")

Q. Cost of building = 200 + 320 + 8,000 – 900 = 7,620.

| Asset | Q. Cost | I.D. @ 70% | Residual for IBD |
|---|---|---|---|
| Building | 7,620 | 5,334 | 2,286 |
| Sewerage | 240 | 168 | 72 |
| Power transfer | 800 | 560 | 240 |
| P. machine | 1,900 | 1,330 | 570 |
| Water pump | 150 | 105 | 45 |

| | | |
|---|---|---|
| Total | | 7,497 |

2004 @ 100%

| | | |
|---|---|---|
| Processing machine (cash) | 250 | 250 |
| Total I.D. | | 250 |

(ii) Industrial Building Deduction IBD.

**2003:**

| Building | Q. Cost | Residual b/f | IBD @ 2.5% x $\frac{6}{12}$ | Residual c/f |
|---|---|---|---|---|
| Building | 2,286,000 | - | 28,575 | 2,257,475 |
| F. Building | 72,000 | - | 900 | 71,100 |
| Sewerage | 240,000 | - | 3,000 | 237,000 |
| Power transformer | 600,000 | - | 7,500 | 592,500 |
| Bridge | | | 39,975 | |

**2004:**

| | | | | |
|---|---|---|---|---|
| F. Building | 2,286,000 | 2,257,475 | 57,150 | 2,200,325 |
| Sewerage | 72,000 | 71,100 | 1,800 | 69,300 |
| Power transformer | 240,000 | 237,000 | 6,000 | 231,000 |
| Bridge | 600,000 | 592,500 | 15,000 | 577,500 |
| | | | 79,950 | |

(iii) Wear and Tear Allowance (Kshs. „000")

| **2003** | | | | |
|---|---|---|---|---|
| Class | I @ 37.5% | II @ 30% | III @ 25% | IV @ 12.5% |
| | | | | |
| WDV 1/1/2003 | - | - | - | - |
| Others net of I.D. (Notes) | - | - | - | 615 |
| Forklift and Tractor | 2,600 | - | - | - |
| Saloon cars | - | - | 2000R | - |
| Computer and scanners | - | 280 | - | - |
| WTA furniture & fixtures | - | - | - | 120 |
| Pick-ups | - | - | 1,500 | - |
| | 2,600 | 2,800 | 3,500 | 735 |
| WTA – (2003) | (975) | (840) | (875) | (92) |
| WDV 31/12/2003 | 1,625 | 1,960 | 2,625 | 643 |

2004:

| Class | I @ 37.5 | II @ 30% | III @ 25% | IV @ 12.5% |
|---|---|---|---|---|
| WDV 1/1/2004 | 1,625 | 1960 | 2625 | 643 |
| Add office curtains | - | - | - | 160 |
| Fax machines | - | 100 | - | - |
| Disposal-car ($w_1$) | - | - | (500) | - |
| | 1,625 | 2,060 | 2,125 | 803 |
| | (609.4) | (618) | (531) | (100.4) |
| WDV 31/12/2004 | 1,015.6 | 1,442 | 1,594 | 702.6 |

Note 1 = Cost of processing machine and water pump net of I.D = 570 + 45 = 615.

$W_1$ = disposal value x restricted Q. cost

$$= \frac{\overset{\text{Cost}}{900{,}000}}{1{,}800{,}000} \times 1{,}000{,}000 = \underline{\underline{500{,}000}}$$

**QUESTION FOUR**

(a) Importance of tax invoice

- Indicates the value, quantity and price of supply.
- Help in determining the tax point.
- Indicates all vital details of supplier such as VAT number, PIN etc.
- Used in claiming input VAT.
- Used in claiming bad debt relief.

(b) Tax Invoice

P. Kamau
P.O. Box 9999-0066
Nairobi, Kenya
Tel: ______________________

VAT Reg. No: 00987763R
S. No: 16345
Date of invoice: 20/1/2006
Date of supply: 20/1/2006

To: L. Omondi
VAT Reg. No. = 00120365R

| Qty | Description | Value | VAT rate | VAT (Kshs) | Total (Kshs) |
|---|---|---|---|---|---|
| 2 | Radio | 15,000 | 16% | 2,400 | 17,400 |
| 1 | Television set | 30,000 | 16% | 4,800 | 34,800 |
| 1 | Fridge | 40,000 | 16% | 6,400 | 46,400 |
| | | | | | |
| | | | | | |
| | | | | | |

Paid: cheque No: 014632 Signed ______________________________

Amount: 98,600 Stamp ______________________________

(c) (i)January VAT was due by 20th February 2004. The penalties are (i) failure to file VAT return = Sh. 10,000 no VAT was payable since input VAT > output VAT but return should nevertheless be filed. i.e. 48,000 output – 150,000 input = 102,000 refund.

(vi) February: refund = 0 – 219,480 = 219,480. Should file VAT return by 20th March otherwise a Sh. 10,000 is imposed.

(vii) March: VAT due = 497,940 – 167,640 = 330,300 payable. Payable by 20th April otherwise penalty would be as follows:
* Late filing penalty: Higher of 10,000 or 5% x 330,300 = 16,515.
* Late interest penalty = 2% p.m x 330,300 = 6,606.
Total penalty = 16,515 + 6,606 = 23,121

(viii) April: VAT due = 308,940 – 274,380 = 34,560 by 20th May. Penalties due.

| | | |
|---|---|---|
| * Failure to file return = 10,000 or 5% x 34,560 | = | 10,000 |
| * Interest penalty = 2% x 34,560 | = | 691.2 |
| Total penalty | | 10,691.2 |

(ix) Mwajuma should notify the commissioner of the omission of not deducting the input VAT.

**QUESTION FIVE**

(a) (i)Dividend Income

- If from, outside Kenya, it"s tax exempt.
- If received from another company in which the receiving company controls 12.5% or more, it"s tax exempt.
- If controlling is less than 12.5%, 5% W/T is final.
- If it"s investment income of an insurance company from it"s life insurance fund, it"s tax exempt.

(iv) Interest
- From outside Kenya, it"s tax exempt.
- If qualifying interest, gross it up and aggregate with other incomes and tax @ 30%.
- Enjoy a tax credit of 15% of gross against corporate tax liability.

(v) Rent:

Determine net rent income, aggregate it with other incomes and tax @ 30% corporate tax rate.

(b) (i)MALI LTD ADJUSTED INCOME

| | | (Kshs. „000") |
|---|---|---|
| Reported net profit | | 4,200 |
| Add back | | |
| Bad debts – employee loan | 15 | |
| Legal expenses – manager | 20 | |
| Insurance premium – penalty | 24 | |
| Rent expenses – stamp duty | 6 | |
| Depreciation | 25 | |
| Purchase of furniture | 26 | 116 |
| Less | | |
| Capital allowances | 75 | |
| Dividend and interest (200 + 4) | 204 | |
| VAT refund | 12 | |
| Gain on sale of M. Vehicle | 14 | (305) |
| Adjusted taxable income | | 4,011 |

(ii) Tax payable = 30% x 4,011,000 = 1,203,300

**TAXATION**

# DECEMBER 2013

### QUESTION ONE

(a) (i)Charitable trusts are exempted from taxation under the following conditions:

- They are public in character serving a section of the public or the whole public.
- They are for relief of distress or poverty in Kenya.
- They are for advancement of religion or education.
- Their incomes are expended in Kenya for charitable purposes and for benefit of Kenyan citizens.

(iii) Amateur Sport Associations

The income (apart from their investment income) is exempt from taxation if:

- The members are amateurs.
- The aim of the association is foster and control outdoor sports.
- It"s by-laws provide that should a member turn professional, he ceases to be a member of the association.

(b) The areas to pay attention in auditing of PAYE are:

- Has the employer all the cash and non-cash benefits or emoluments into payroll.
- Was the correct amount of PAYE deducted?
- Was all the PAYE deducted remitted to the tax authorities.
- Were the payroll records correctly transferred to tax deduction cards.
- Have all the tax deductions correctly completed in all respects?

(c) Refer to solution of Q5 (c) Dec 2000.

(d) Permanent establishment

- This, in relation to any person (individual or body corporate) means a fixed place of business inwhich a company carries on business.
- For the purposes of this definition, a building site or a construction site or assembly projectwhich has existed for six months or more shall be deemed to be a fixed place of business.

### QUESTION TWO

(a) The qualifying expenditures for mining investment deduction (M.I.D) are:

- Cost of buildings, machineries and other assets that would have little or no value if the mine ceased to operate.
- Cost of acquisition of rights over the minefield and minerals excluding cost of land.
- Cost of prospecting, exploring and searching the mine.
- Any intangible drilling costs.
- Cost of development, administration and management during prospecting, explorations and during the period prior to the commencement of mining operations.

(b) (i)Investment deduction (Kshs. „000") year 2003 @ 70%.

| Asset | Q. Cost | I.D @ 70% | Residual for IBD & WTA |
|---|---|---|---|
| F. Building | 5,200 | 3,640 | 1,560 |
| Processing machine | 1,940 | 1,358 | 582 |
| Conveyor Belt | 120 | 84 | 36 |
| | | 5,082 | |

| 2004 | Q. Cost | I.D. @ 100% | Residual |
|---|---|---|---|
| F. Building | 2,000 | 2,000 | - |
| P. Machine | 640 | 640 | - |
| Parking Bay | 560 | 560 | - |
| Sewerage systems | 700 | 700 | - |
| | | 3,900 | |

(ii) Industrial Building Deduction (IBD)

**Year 2003:** **Kshs. „000"**

| Building | Q. Cost | Residual b/f | IBD @ 2.5% | Residual c/f |
|---|---|---|---|---|
| F. Building | 1,560 | - | 39 | 1,521 |
| Godown at cost | 960 | 864(W1) | 24 | 840 |
| | | | 63 | |

**Year 2004:**

| | | | | |
|---|---|---|---|---|
| F. Building | 1,560 | 1,521 | 39 | 1,482 |
| Godown | 960 | 840 | 24 | 816 |
| Borehole* | 600 | - | 5* (W2) | 595 |
| | | | 68 | |

*$W_1$ = 960 – (960 x 2.5%p.a x 4 yrs) = 964

$W_2$ = 600 x 2.5% p.a. x $\frac{4}{12}$ = 5

Borehole qualify for IBD.

(iii) Loose tools

Year 2003:

Diminution = $33\frac{1}{3}$% x 30,000 = 10,000

Year 2004:

Diminution = $33\frac{1}{3}$% x 30,000 = 10,000

(viii) Wear and Tear Allowance (WTA) (Kshs. „000")

| Class | I @ 37.5 | II @ 30% | III @ 25% | IV @ 12.5% |
|---|---|---|---|---|
| WDV 1.1.2003 | NIL | NIL | NIL | NIL |
| Add: P. Machine net of I.D. | - | - | - | 582 |
| Coveyor Belt | - | - | - | 36 |
| Lorry and Tractor | 3,300 | - | - | - |
| Computers | - | 600 | - | - |
| Motor car (non-commercial) | - | - | $1000^{R}$ | - |
| Fax machine | - | 90 | - | - |
| Trailer (detachable) | - | - | - | 200 |

| | | | | |
|---|---|---|---|---|
| Pick-up van (commercial) | - | - | 1,200 | - |
| | 3,300 | 690 | 2,200 | 818 |
| W.T.A | (1,237.5) | (207) | (550) | (102.3) |
| WDV 31/12/2003 | 2,062.5 | 483 | 1,650 | 715.7 |
| **Year 2004:** | | | | |
| WDV 1/1/2004 | 2,062.5 | 483 | 1,650 | 715.7 |
| Additions | - | - | - | - |
| Disposals m. vehicle ($W_1$) | - | - | (342.9) | - |
| | 2,062.5 | 483 | 1,307.1 | 715.7 |
| | (773.4) | (145) | (326.8) | (89.5) |
| | 1,289.1 | 338 | 980.3 | 626.2 |

## QUESTION THREE

(v) Hotel and restaurant services
- Taxed V.A.T at a lower special rate of 14%
- V.A.T paid by hotel owner.

(vi) Transportation of raw material
- Exempt from V.A.T.

(vii) Medical services
- Exempt from VAT

(viii) Mobile phone airtime
- Subject to VAT at 16% standard rate.
- Paid by service provider. It"s passed to the consumer through higher charges.

(b) Since prices are inclusive of VAT, the input or output VAT would be determined as follows:

$$\frac{16\%}{116\%} \text{ x price inclusive of V.A.T}$$

| Month | | Input VAT | | Output VAT |
|---|---|---|---|---|
| January | Purchases | 206,897 | Sales | 303,448 |
| February | Purchases | 248,276 | Sales | 372,414 |
| March | Purchases | 234,483 | Sales | 275,862 |
| April | Purchases | 206,897 | Sales | 124,138 |
| May | Purchases | 55,172 | Sales | 82,759 |
| June | Purchases | 275,862 | Sales | 358,621 |
| Bad debt relief | | 27,586 | Return out | 20,690 |
| V.A.T payable | | 27,586 | | |
| | | 282,759 | | |
| | | 1,537,932 | | 1,537,932 |

## QUESTION FOUR

(a) Refer to solution of question 5 (a) (ii) May 1996

(b) Refer to solution of question 5 (e) may 1997

(c) Mr. J. Barasa

| | **Kshs. p.a.** |
|---|---|
| Salary 60,000 p.m x 12 | 720,000 |
| Furniture 12% x 300,000 | 36,000 |
| Free lunch 3,600 x 12 = 43,200 > 24,000 | 43,200 |
| Car: higher of 24% x 800,000 x 25% or 69,600 x 25% (1500cc benefit) | 48,000 |
| Tuition fees | 65,000 |
| Gardener 4000 p.m x 12 | 48,000 |
| Watchman 4000 p.m. x 12 | 48,000 |
| Entertainment allowance 10,000 p.m. x 12 | 120,000 |
| Leave allowance 5% x 720,000 | 36,000 |
| | 1,164,200 |
| Add: housing benefit = 15% x 1,164,200 | 174,630 |
| Total pensionable pay | 1,338,830 |
| Less: pension contribution: lower of (i) 30% x 1,338,830 = 401,649 | |
| (ii) Set max. limit = 210,000 | |
| (iii) Actual 20,000 x 12 = 240,000 | (240,000) |
| | 1,128,830 |
| Business income (not at arm"s length) | |
| Kiosk profits 120,000 | |
| Add back wife"s salary 60,000 | 180,000 |
| Taxable income | 1,308,830 |

## QUESTION FIVE

(a) Resident tax payer

| | | | |
|---|---|---|---|
| (i) | Management fees | = | No: W/T |
| (ii) | Royalties | = | 5% W/T of gross income |
| (iii) | Insurance commission | = | 10% W/T on gross paid to agencies or 5% W/T on gross paid to brokers. |
| (iv) | Rent | = | No W/T |

(b) MAPATO LTD

| | **Shs.** | **Shs.** |
|---|---|---|
| Reported Net profits | | 218,600 |
| Add back disallowable expenses | | |
| Depreciation | 344,760 | |
| Travelling expenses – directory | 400,000 | |
| Pension scheme (unregistered) | 160,000 | |
| Compensation | 220,000 | |
| Interest on loan to purchase shares | 72,000 | |
| Audit fees – tax appeal | 32,000 | |
| - discontinued business | 68,000 | |
| Bad debts – general provision | 120,000 | |
| Miscellaneous | | |
| 100 year lease | 28,000 | |
| X- mass party | 24,000 | |
| Ask show | 10,000 | |
| Donations | 41,600 | 1,329,920 |
| | | 1,548,520 |
| Add insurance compensation (embezzlement) | | 12,000 |
| Less: investment income (all non-business income) | | (284,636) |
| Adjusted taxable income | | 1,275,884 |

**NB**: Embezzlement of staff of Sh. 21,600 is treated as allowable expense but compensation as taxableincome. This is the practice for strictly cash and stock embezzlement or loss.

# TAXATION I

**RATES OF TAX** (Including wife"s employment, self employment and professional income rates of tax).
YEAR OF INCOME 2005

**Taxable Employment Benefits - Year 2005**

| Monthly taxable pay (shillings) | | | Annual taxable pay (shillings) | | | Rates of tax % in each shilling |
|---|---|---|---|---|---|---|
| 1 | - | 10,164 | 1 | - | 121,968 | 10% |
| 10,165 | - | 19,740 | 121,969 | - | 236,880 | 15% |
| 19,741 | - | 29,316 | 236,881 | - | 351,792 | 20% |
| 29,317 | - | 38,892 | 351,793 | - | 466,704 | 25% |
| Excess over | - | 38,892 | Excess over | - | 466,704 | 30% |

**Personal relief Shs. 1,162 per month (Shs. 13,944 per annum)**

**Capital allowances:**

**Wear and tear allowances**

| | |
|---|---|
| Class I | 37.5% |
| Class II | 30% |
| Class III | 25% |
| Class IV | 12.5% |

**Industrial building allowance:**

| | |
|---|---|
| Industrial buildings | 2.5% |
| Hotels | 4.0% |

**Farm works allowance** 33.3%

**Investment deduction allowance:**

| | | |
|---|---|---|
| 2003 | - | 70% |
| 2004 | - | 100% |
| 2005 | - | 100% |

**Shipping investment deduction 40%**

**Mining allowance:**

| | |
|---|---|
| Year 1 | 40% |
| Year 2 - 7 | 10% |

**Prescribed benefit rates of motor vehicles provided by employer**

| | | | | Monthly rates (Sh.) | Annual rates (Sh.) |
|---|---|---|---|---|---|
| (i) | Saloon, Hatch Backs and Estates | | | | |
| | Upto | - | 1200 cc | 3,600 | 43,200 |
| | 1201 | - | 1500 cc | 4,200 | 50,400 |
| | 1501 | - | 1750 cc | 5,800 | 69,600 |
| | 1751 | - | 2000 cc | 7,200 | 86,400 |
| | 2001 | - | 3000 cc | 8,600 | 103,200 |
| | Over | - | 3000 cc | 14,400 | 172,800 |
| (ii) | Pick-ups, Panel Van (Unconverted) | | | | |
| | Upto | | 1750 cc | 3,600 | 43,200 |
| | Over | | 1750 cc | 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, whichever is higher.

## Commissioner"s prescribed benefit rates

| | Services | Monthly rates Sh. | Annual rates 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 2005 Tax rates to be used for year 2006 Exam.

# Part III: Comprehensive Mock Examinations

## QUESTIONS - MOCKS

The following are three MOCK papers that address the major areas of the syllabus. It is recommended that candidates attempt the questions in Ian examination condition and then revise their answers using the suggested answers that follow.

**Instructions:**
Answer FIVE questions. Note that marks allocated to each part of the question are shown at the end of the question.

Questions in this part are selected from across the topics in the entire syllabus. It will be important for the candidate to try and relate the questions to the appropriate topic or sub-topic of the syllabus.

Each question carries a total of 20 marks.

Time Allowed: 3 hours

# MOCK 1
# ATC PART I
# TAXATON I

**Time Allowed: 3 hours**

**Answer FIVE questions. Marks allocated to each question are shown at the end of the question.**

## QUESTION ONE

(a) State and explain any four deductions that may be available against gains or profits from employment. (2 marks)

(b) You have been approached by Mr. Kujua to help him determine his taxable income for the year ended 31 December 2005. He provided you with the following information:

1. Employment income:

   He is employed by Nyorosha Ltd. where he earns a salary of Sh.75,000 per month. Other benefits from employment include the following:

   Company car of 1850cc which was bought in the year 2004 for Sh.850,000
   Housed in Furaha Estate. The house has a market rental value of Sh.35,000 per month
   Annual performance bonus of one month"s salary if he is rated more than 80% in the company"s annual performance review. In the year 2005, he was rated 85%.
   A watchman and a house girl who are paid by the company Sh.5,000 each per month.

2. Business income:

   He runs an internet café in Furaha shoping Centre. It generated sh.725,000 in the year 2005. However, in the year 2004, it had made a loss of sh.300,000.

3. Wife"s income:

   His wife is employed by Sukari Ranch Ltd. where she draws a salary of sh.45,000 per month. In addition, she is given five litres of milk per day to take home. The market price of the milk is sh.30 per litre. PAYE of sh.98,400 was deducted and paid to the Income Tax Department for the year 2005.

4. In the course of the year, Mr. Kujua sold his personal saloon car for Sh.620,000. This represented a gain of sh.200,000 which he used to travel to Dubai for a holiday.

5. Through the advice of his Personal Financial advisor, he had obtained the following investment income in the year:

| | Sh. |
|---|---|
| Dividends | |
| Castle Breweries Ltd. | 240,000 |
| South Africa Creameries Ltd. (A South African Company) | 360,000 |
| | |
| Interest | |
| HFCK Ltd. – Housing development bonds | 120,000 |
| Treasury bills | 420,000 |
| Akiba Bank fixed deposit | 96,000 |
| Loan to a friend | 200,000 |

**Required:**

(i) Total income chargeable to tax for Mr. Kujua for the year 2005. (10 marks)

(ii) Tax payable and its due date. ( 5 marks)
(iii) Comment on any information not used. ( 3 marks)
**(Total: 20 marks)**

## QUESTION TWO

(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 eight items that are prohibited for input tax deduction. ( 4 marks)

(b) State the circumstances under which a registered person can qualify for bad debt relief as per the VAT regulations. ( 2 marks)

(c) Bloggs Boots (K) Ltd. is a leading manufacturer of a wide range of goods which are either consumed locally or exported. During the month of September 2005, the following transactions took place:

September

2: Paid sh.960,000 to Dr. Greg William, an American, who had come to design the company"s website.

4: Received architect"s certificates amounting to sh.3,200,000 for the construction of anextension to the factory building which had been completed. Out of this amount, sh.1,000,000 represents retention money.

5: Purchased goods on credit from KLM Ltd. worth Sh.1,360,000.

6: Purchased stationery for use in the business on credit from Text Book Centre worth Sh.500,540.

6: Sold goods worth Sh.2,650,000 on credit to Options (K) Ltd.

7: Sold goods to Zim Bank (K) Ltd. for Sh. 1,970,200

9: Paid Maersk shipping Line sh.350,000 for transporting goods purchased by Zim Bank (K) Ltd.

11: Options (K) Ltd returned goods worth Sh.300,000 due to some major defects.

11: Sold goods worth Sh.865,000 on credit to Homa Bay Wholesalers.

12: Returned defective office stationery, which had cost Sh.50,800 to Text Book Centre.

14: Sold goods for Sh.1,220,000 to Rwanda Miners Ltd. a company based in Rwanda.

16: Goods worth Sh.200,000 were stolen while in transit to Rwanda.

18: Granted Sh.20,000 allowance to Rwanda Miner Ltd. for some minor defects on some items.

18: Agreed to cancel the account received from Zim Bank (K) Ltd. in exchange for services rendered by them to the company in the Coast Province.

20: Sold goods for cash amounting to Sh.2,734,000.

23: Homa Bay Wholesalers was declared insolvent by the High court and a winding up order issued.

30: Telephone and electricity bills for the month were received. The VAT on the telephone and electricity bills was Sh.300,000 and Sh.17,500 respectively.

**Required:**

(i) The VAT account for Bloggs Boots (K) Ltd. for the month of September 2005 (where applicable prices and payments made are VAT inclusive. ( 9 marks)

(ii) Amount of VAT payable and when it is due. ( 2 marks)

(iii) Briefly describe the procedure for payment of VAT on an imported service. ( 2 marks)

(iv) Comment on any information not used in (i) above. ( 1 mark)

**(Total: 20 marks)**

## QUESTION THREE

"In my judgement, not every payment made to an employee is necessarily made to him as a profit arising from his employment. Indeed, in my judgement, the authorities show that to be a profit arising from employment the payment must be in reference to the services the employee renders by virtue of his office, and it must be something in the nature of a reward for services past, present or future". Justice Upjohn in Hochstrasser v–Mayes (1960) 38 TC 673.

**Required:**

In the light of the above judgement and the relevant provisions of Income Tax Act (Cap 470) of the laws of Kenya, explain the tax benefits arising out of the use of the following in the design of an "Executive Remuneration Package".

(i) Expense reimbursement. ( 4 marks)
(ii) Benefits in kind ( 4 marks)
(iii) Pension entitlement ( 4 marks)
(iv) Bonus Schemes ( 4 marks)
(v) Share Purchase arrangements for employees. ( 4 marks)

**(Total: 20 marks)**

## QUESTION FOUR

Ahmed, Benji and Chepkonga run a private school as partners sharing profit and losses in the ratio 3:2:1. During the year ended 31 December 2005 the trading results showed a loss of Sh.2,160,000 after charging/crediting:

| | Sh. |
|---|---|
| Depreciation | 780,000 |
| Legal, insurance and audit expenses | 150,000 |
| Rent, rates and taxes | 90,000 |
| Sub-letting rent received | 36,000 |
| Dividends received (net) | 102,000 |
| Bad debts | 120,000 |
| Donations | 90,000 |
| Salaries and wages | 324,000 |
| Subscriptions | 54,000 |
| Telephone and postage | 60,000 |
| Electricity and water | 48,000 |
| Goodwill written off | 108,000 |
| Salary to Ahmed | 288,000 |
| Salary to Benji | 216,000 |
| Salary to Chepkonga | 144,000 |

| | |
|---|---|
| Stationery and office expenses | 108,000 |
| Repairs and renewals | 36,000 |
| Interest on capital accounts: | |
| Ahmed | 144,000 |
| Benji | 96,000 |
| Chepkonga | 48,000 |
| School bus running expenses | 132,000 |
| Loss on sale of investment | 270,000 |

**Notes:**

(i) Legal, insurance and audit expenses are analysed as follows:

| | Sh. |
|---|---|
| - Partnership deed | 12,000 |
| - Recovery of trade debt | 18,000 |
| - Insurance | 78,000 |
| - Audit fees | 42,000 |
| | 150,000 |

(ii) Sub-letting rent was for part of the premises let to the shopkeeper who runs the school canteen.
(iii) Donations were made during a Harambee function to raise funds for a local dispensary.
(iv) Bad debts are analysed as follows:

| | Sh. | | Sh. |
|---|---|---|---|
| Bad debts | 36,000 | B/F – Specific | 60,000 |
| C/f: - Specific | 138,000 | - General | 180,000 |
| - General | 186,000 | P & L Account | 120,000 |
| | 360,000 | | 360,000 |

(v) As at 1 January 2005, the Written Down Values (WDV) were:

| Class I | Class III |
|---|---|
| **Sh.** | **Sh.** |
| 270,000 | 336,000 |

(vi) All the partners are married.

**Required:**

Calculate taxable income (loss) for each of the partners as at 31 December 2005.

## QUESTION FIVE

(a) List thee circumstances under which:

(i) The income of a taxable person is assessed on another person. ( 3 marks)

(ii) A married woman living with her husband may be called upon to bear the burden of tax. ( 3 marks)

(b) Briefly describe the treatment of the following classes of taxpayers with regard to Pay As You Earn (PAYE):

(i) Casual workers. ( 2 marks)
(ii) Taxpayers with multiple sources of income ( 2 marks)

(c) What circumstances may trigger a Pay As You Earn (PAYE) audit? ( 5 marks)

(d) What tax set-offs are available to an individual taxpayer which may reduce the gross tax liability? ( 5 marks)

**(Total: 20 marks)**

**MOCK 2**
**QUESTION ONE**

Miss Jane Kambo is the owner of a wholesale shop in Kariobangi. Her accounts clerk has submitted to you the following profit and loss account for the year ended 31 December 2005:

| | Sh. | | Sh. |
|---|---|---|---|
| Opening stock | 2,160,000 | Closing stock | 276,000 |
| Purchases | 24,000,000 | Sales | 27,600,000 |
| Salaries and wages | 750,000 | Gain on sale of a residential plot | 150,000 |
| Rent, rates and taxes | 27,600 | General bad debts recovery | 9,000 |
| Insurance | 3,720 | Dividends (gross) | 10,800 |
| Legal and professional fees | 27,300 | | |
| Depreciation | 90,960 | | |
| Advertising | 41,700 | | |
| Value added tax | 61,800 | | |
| Income tax for 2004 | 78,000 | | |
| Medical expenses for Miss Kambo | 7,200 | | |
| Interest on bank overdraft | 12,480 | | |
| Purchase of equipment | 6,300 | | |
| Christmas gifts to customers | 5,040 | | |
| General bad debts | 13,800 | | |
| Household expenses | 25,200 | | |
| Stationery and postage | 8,280 | | |
| Net profit | 726,420 | | |
| | 28,045,800 | | 28,045,800 |

**Notes:**

(ii) Opening stock as well as the closing stock are consistently overvalued by 10% above cost price.

(iii) Sales include a sum of Sh.30,000 representing the value of goods withdrawn for use by Miss Kambo and her children. These goods had been purchased at a cost of Sh.24,000.

(iv) Rent, rates and taxes include Sh.5,100 for customs duty for purchase of equipment.

(v) Analysis of legal and professional fees:

| | Sh. |
|---|---|
| Renewal of five years lease | 6,300 |
| Appeal to local committee against tax assessment | 6,000 |
| Defending a suit for alleged breach of a trading agreement | 9,000 |
| Court fines | 5,100 |
| Miscellaneous and allowable | 900 |
| | 27,300 |

(v) Wear and tear allowances had been agreed with the Commissioner of Income Tax at Sh.64,800.

(vi) Advertising expenses include Sh.6,000 spent on erecting a sign board at the road junction lead to the shop.

**Required:**

Compute Miss Kambo"s chargeable profit for the year of income 2005. (20 marks)

## QUESTION TWO

Dr. H. Kutibu, Dr.(Mrs.) W. Kutibu and Dr. F. Nafuu operate Watu Clinic in Nairobi in line with their desired mission of providing health services to the people. Dr. H. Kutibu and Dr. F. Nafuu spend all their time at the clinic. Dr.(Mrs) Kutibu, who is an eye specialist, only spends two days at the clinic since she works at the nearby Government hospital and also attends to their two children. Profit and losses are shared in the ratio of 40% to Dr. H. Kutibu, 20% to Dr.(Mrs.) W. Kutibu and 40% to Dr. F Nafuu after charging partners salaries and interest.

In comparison with other clinics, Watu Clinic charges minimal fee. The clinic relies very much on donors goodwill. The profit and loss account of the clinic for income 2005 is provided below:

| **Income** | **Shs.** |
|---|---|
| Professional fees | 6,400,000 |
| Donations and grants | 3,600,000 |
| Dividends (Gross) | 50,000 |
| Interest from bank deposits | 12,000 |
| Receipts from Jumbo sale | 38,000 |
| Goodwill from incoming partner | 140,000 |
| **Expenditure** | |
| Purchase of pharmaceutical products | 3,120,000 |
| Salaries and wages | 2,560,000 |
| Rents, rates and service charge | 82,000 |
| Repairs and maintenance | 35,000 |
| Interest paid (Note 5) | 250,000 |
| Insurance | 55,000 |
| Motor car expenses | 168,000 |
| Depreciation of assets | 200,000 |
| Jumbo sale costs | 8,900 |
| Medicine to the people programme | 20,100 |

**Additional information:**

1. Donations and grants were received as follows:

| | |
|---|---|
| Overseas | 3,175,000 |
| Local | 425,000 |
| | 3,600,000 |

2. Receipts from Jumbo sale represents amount received from the local community in support of the clinic.

3. On 1 October 2005, Dr. M. Mganga was admitted into partnership to deal with the ever increasing eye problems. He was given 10% share of the profit, reducing that of Dr.(Mrs.) W. Kutibu to 10%. The amount of Sh.140,000 goodwill represents his purchase of future profits.

4. Salaries and wages include that of:

| | Shs. |
|---|---|
| Dr. H. Kutibu | 240,000 |
| Dr. F. Nafuu | 240,000 |
| Dr. M. Mganga | 30,000 |

5. Interest paid includes:

| | Shs. |
|---|---|
| Bank overdraft | 40,000 |
| Dr. H. Kutibu | 30,000 |
| Dr. F. Nafuu | 20,000 |
| Dr.(Mrs.) W. Kutibu | 7,000 |
| Dr. M. Mganga | 3,000 |
| Mortgage account for: | |
| Dr.(Mrs.) W. Kutibu | 80,000 |

| | |
|---|---|
| Loan to the clinic | 80,000 |
| | 50,000 |

6. Insurance includes:

| | Shs. |
|---|---|
| Professional indemnity | 36,000 |
| Life cover for partners | 15,000 |
| Clinic"s property | 4,000 |
| | 55,000 |

7. 40% of the motorcar expenses are personal to partners.

8. Capital allowances have been agreed at Sh.96,000.

**Required:**

a) The partners are of the view that due to their very useful community service, they should be exempt from income tax. Explain under what conditions this is possible. (3 marks)

b) Compute the adjusted clinic income for the year of income 2005. (9 marks)

c) Show allocation of taxable income among the four partners. Assume income accrued evenly throughout the year. (3 marks)

d) Explain how the income allocated under part (c) above will be taxed. (2 marks)

e) If Dr.(Mrs.) W. Kutibu"s income from her other job was Sh.240,000 per annum; P.A.Y.E. Sh.97,200 and the family has no other income, show tax payable by Dr.(Mrs.) W. Kutibu. (3 marks)

**(Total: 20 marks)**

## QUESTION THREE

Mr. Joab is a director of Fofo Limited. During the year 2003, the company allowed him to purchase 40,000 shares based on his enormous contribution to the company. The company"s share capital is 300,000 shares.

During the year of income 2005, Mr. Joab had the following income:

1. Employment income
   Salary per annum Sh.805,000 (PAYE sh.185,000)
   Bonus from current employment Sh.265,000 (PAYE Sh.45,000)
   Pension contribution paid by employer to a registered scheme Sh.48,000
   Unapproved scheme Sh.55,000
   Life insurance premium paid by the employer Sh.68,000.

   He was provided with a cook during the year. The salary of the cook per month was sh.2,000. the employer had provided him with a car which was bought for Sh.2,500,000. Its capacity was 1750cc. At the beginning of January 2005, the employer rented for him a house at a monthly rent of Sh.20,000. He is charged 5% of his monthly salary as part of rent contribution.

2. Dividend income

| | | |
|---|---|---|
| - | Kenya Commercial Bank | Sh.485,000 (net) |
| - | Home based Co-operative society involved in weaving | Sh. 45,000 (net) |

3. Interest

| | | |
|---|---|---|
| - | Post office savings bank | Sh. 850,000 |
| - | A housing finance company | Sh.1,300,000 |

| | | | |
|---|---|---|---|
| | - A commercial bank | Sh. | 24,000 |
| 4. | Pension receipt from previous employer | Sh. | 360,000 |
| 5. | Lottery and sweepstake | Sh. | 15,000 |

6. Mr. Joab"s wife was paid sh.360,000 as salary (PAYE Sh.85,000) and sh.48,000 as sick leave pay in theyear 2005. Mrs Joab owns 28% of the shares in Alex Ltd. where she is in employment. Due to her being sick, her colleagues contributed Sh.800,000 at the end of 2004 which she used to cover medical expenses. The employer contributed sh.250,000 as part of medical expenses. Only directors have a medical scheme in Alex Ltd. Before Mrs. Joab got married on 1 January 2005, she used to operate a retail shop where she had an accumulated loss of Sh.48,000. In 2005, the retail shop made an additional loss amounting to Sh.22,000.

**Required:**

(a) Determine Mr. Joab"s taxable income and tax liability for 2005. (15 marks)
(b) Comment on any information not used in answering part (a) above. ( 5 marks)
**(Total: 20 marks)**

**QUESTION FOUR**

(a) What are the capital expenditure implications of taxation in relation to capital allowances available to a hotel owner? Discuss.

(b) Wageni Tourist Hotel Ltd. Is a five star hotel located in Mombasa. The following information related to the year ended 30 September 2005:
As at 1 October 2004 the written down values of assets brought forward for Income Tax purposes areas follows:

1. As at 1 October 2004 the written down values of assets brought forward for Income Tax purses are as follows:

| Hotel building | Class I | Class II | Class III | Class IV |
|---|---|---|---|---|
| Sh. | Sh. | Sh. | Sh. | Sh. |
| 10,000,000 | 875,000 | 2,500,000 | 1,750,000 | 3,725,000 |

2. Disposals during the year.

| | Class I | Class II | Class III | Class IV |
|---|---|---|---|---|
| | Sh. | Sh. | Sh. | Sh. |
| Cost | 750,000 | 250,000 | 250,000 | 300,000 |
| Net book value | 325,000 | 75,000 | 90,000 | 100,000 |
| Sale proceeds | 900,000 | 125,000 | 200,000 | 90,000 |

Class III disposal is a private vehicle which was purchased in 2003.

3. Additions during the year:

| | Sh. |
|---|---|
| Computers | 350,000 |
| Fax machine | 40,000 |
| Photocopier | 160,000 |
| Beds | 500,000 |
| Mercedes benz car | 1,250,000 |
| Hotel building | 5,000,000 |

(b) A saloon car which cost Sh. 250,000 in 2003 was traded in for a new car costing Sh. 400,000. The old car was valued at Sh. 200,000 and the company paid a balance of Sh. 200,000. The net book value of the car was Sh. 90,000.
The old hotel building was constructed in 2000 and put into use in the same year.

**Required:**

(i) Calculate the capital allowances due to the company for 2005. (10 marks)
(ii) Show the written down values of all the assets as at 30 September 2005. ( 4 marks)
Comment on class I balances. **(Total: 20 marks)**

## QUESTION FIVE

Mr. M. Muriungi is a wholesaler. He sometimes deals with imported goods. Given below are details of his business transactions for the months of November and December 2005 and January to March 2006:

| | |
|---|---|
| 1.11.2005 | Imported 10 radios and 2 tape recorders worth Sh.150,000 and Sh.100,000 respectively. |
| 6.11.2005 | Imported 10 TVs for Sh.500,000 |
| 10.11.2005 | Sold 5 radios for Sh.150,000 |
| 16.11.2005 | Sold 2 tape recorder for Sh.200,000 |
| 30.11.2005 | Fire destroyed the whole of his remaining stock |
| 5.12.2005 | Imported motor-car spare parts worth Sh.1,500,000 |
| 11.12.2005 | Sold spare parts worth Sh.800,000 |
| 20.12.2005 | Thieves broke into his shop and stole the remaining stock |
| 2.1.2006 | Imported 20 cars at a total cost of Sh.30,000,000. |
| 5.1.2006 | Sold 2 cars for Sh.4,000,000 |
| 15.1.2006 | Imported 4 motorbikes at a total cost of Sh.1,000,000 |
| 31.1.2006 | Sold 3 motorbikes for Sh.900,000 |
| 10.2.2006 | 1 car was stolen at gunpoint |
| 20.2.2006 | Imported clothes for himself and his family worth 500,000 |
| 28.2.2006 | Sold the remaining motorbike for Sh.350,000 |
| 1.3.2006 | Sold 10 cars to a local motorcar dealer for Sh.20,000,000 |
| 5.3.2006 | Insurance claim received amounting to Sh.1,000,000 in relation to radios and TVs destroyed by fire since they were insured. |
| 15.3.2006 | Received Sh.600,000 from insurance company being compensation for the stolen spare parts for the motor vehicles. |
| 30.3.2006 | Sold 5 cars to a local institution for a total of Sh.10,000,000. |

**Note:**

1. All purchases and sales are inclusive of VAT at 16%

2. Mr. Muriungi had not paid any VAT pertaining to the above transactions although he was registered for VAT.

**Required:**

a) The VAT payable or refundable for each month, clearly indicating when due. (12 marks)

b) The penalties (where applicable) relating to the above transactions. (4 marks)

c) State and explain the VAT position on recoveries from insurance. (1 mark)

d) State the customs duty position of the above transactions. (3 marks)
**(Total: 20 marks)**

## MOCK 3

## QUESTION ONE

(a) Explain the meaning of the term "Residence" when applied to a company under Kenya Income Tax Act. (5 marks)

(b) Chumex Limited makes its accounts to 31 December of each year and ahs prepared the following profit and loss account for 2005:

| | Notes | Sh. | | Notes | Sh. |
|---|---|---|---|---|---|
| General administrative expenses | | 40,000 | Gross profit b/d | | 200,000 |
| Repairs and renewals | (i) | 12,000 | Bad debts previously written off | | 1,000 |
| Depreciation | | 10,000 | | | |
| Subscriptions and donations | (ii) | 2,000 | Dividends (Gross) | (vii) | 5,000 |
| Bad debts | (iii) | 8,000 | POSB interest | | 6,000 |
| Directors" fees and expenses | | 5,000 | Gain on sale of plant and machinery | | 10,000 |
| Patents written-off | | 2,500 | | | |
| Preliminary expenses | (iv) | 3,000 | Tax refunded | | 20,000 |
| Retirement benefits | (v) | 50,000 | | | |
| Rent, rates and insurances | | 30,000 | | | |
| Legal and accountancy | (vi) | 41,500 | | | |
| Interest on overdue tax | | 2,500 | | | |
| Interest in lieu of dividends | | 5,000 | | | |
| Net profit before taxation | | 30,500 | | | |
| | | 242,000 | | | 242,000 |

**Notes**

(i) Repairs and renewals: Sh.
- Redecoration of an existing business 3,000
- Renovation to new building 5,000
- Partition and carpeting offices 4,000
- 12,000

(ii) Subscriptions and donations Sh.
- National Chamber of Commerce and industry 1,000
- NE Refugee Fund 1,000
- 2,000

(iv) Bad debts:
This is on account of a previous company employee who cannot now be traced.

(iv) Preliminary expenses: Sh.
- Legal fee on issue of shares on stock exchange 2,000
- Payment for stationery before commencement of business 1,000
- 3,000

(v) Retirement benefits: Sh.
- NSSF Contribution 5,000
- Registered Pension Scheme for senior management 40,000
- Gifts to retiring staff 5,000
- 50,000

(vi) Legal and Accountancy: Sh.
- Staff service agreement 2,000

| | |
|---|---|
| Audit fees | 30,000 |
| Legal fee for lease (non-renewable) | 4,000 |
| Legal fee – Plot acquisition | 5,500 |
| | 41,500 |

(vii) Dividends:
These were from a subsidiary company where Chumex owns 60% of the shares.

(viii) Capital Allowances for 2005 have been agreed at Sh.30,000

**Required:**

(a) Compute Corporation tax liability for 2005.

(b) State the dates when such tax should be paid. (15 marks)
**(Total: 20 marks)**

## QUESTION TWO

Mrs. Mary Mwongozo and her husband Mr. John Mwongozo had the following income for 2005:

**Mrs. Mary Mwongozo:**

Salary Sh.90,000 per month

Life insurance paid by employer for her Sh.3,000 per month

Pension contributions paid by employer:
Approved scheme Sh.56,000
Unapproved scheme Sh.120,000

Entertainment allowance paid by employer Sh.48,000 per annum

Bonus paid for excellent performance Sh.50,000 per annum

Day and night watchman per month sh.1,000 per watchman

The company provided her with a car. The cost of the car was Sh.2,000,000. The car was of 1976cc. She incurred the following costs during the year in the course of duty and the amounts were refunded to her by the employer:

Maintenance and repairs Sh.12,000
Petrol sh.27,000
Insurance: Sh.25,000
Alarm system sh.15,000

Interest :Treasury bills: Sh.500,000
Fixed deposit – commercial bank Sh.105,000

City Council rates sh.1,600

Mortgage interest paid: sh.175,000 per year

Pension from previous employment Sh.450,000 computed in lumpsum

Key money from a tenant of one rented house sh.26,000

She is housed by her employer who pays rent amounting to Sh.45,000 to a landlord per month.

Mr. John Mwongozo

He works in Tanzania and his income in Kenya shillings for 2005 was as follows:

Salary Shs. 34,000 per month (PAYE sh.15,000 per month)

| | | |
|---|---|---|
| Interest: | Fixed deposit account bank | Sh.33,000 |
| Mortgage interest on loan | | Sh.80,000 |

Hardship allowance: Sh.290,000

Business income – Tanzania sh.500,000

Dividends from Tanzanian company Sh.35,000

Free lunches sh.20,000 paid for by his employer. Mwangaza Trading Company based in Tanzania.

**Required:**

(a) The total chargeable income for Mr. and Mrs. Mwongozo (12 marks)
(b) Comment on any information not used above. (5 marks)

(c) PAYE was not deducted from the income of Mrs. Mwongozo. Are Mr. And Mrs. Mwongozo to blame for failure of the employer to deduct and pay PAYE? Explain. (3 marks)
**(Total: 20 marks)**

**QUESTION THREE**

(a) The Managing director of Athi Production Limited has passed to you a copy of the company"s capital budgets for the year ended 31 December 2005:

You have extracted the following items of capital expenditure from these budgets:

New plant and machinery for fixed in factory extension - £24,000 Extension to existing factory building £136,000
New sports pavilion for staff welfare and recreation £144,000 A patent from another company for special tools for £36,000 A new factory which will cost £640,000 made up from:

| | £ |
|---|---|
| Land | 140,000 |
| Site clearance | 70,000 |
| Construction materials | 230,000 |
| Architects fees | 60,000 |
| Labour costs | 140,000 |

A new extruding machine for £100,000 of which £20,000 will be paid as deposit and balance over the next five years with interest at 10% p.a., fixed in new factory.
A fleet of seven identical new cars for sales representatives £147,000. A new Volvo for the managing director £105,000
To spend £70,000 on pure scientific research.
To purchase old factory building for £127,000 which originally cost the first owner £26,000 when constructed in January 1962.
Computerize the system of the company £90,000

**Required:**

A statement showing the capital allowances available in respect of the accounting period ended 31 December 2005, assuming all items are purchased according to the budget. (12 marks)

(b) The company made a profit of £1,000,000 before allowances and other allowable expenditure in (a) above. The directors do not intend to distribute a dividend.

(i) Determine the taxable profit for the year. ( 4 marks)

(ii) Provide a rationale to the Commissioner of Income Tax why the company should not be penalized for non-distribution of dividend, indicating clearly under what conditions such penalty arises.
( 4 marks)
**(Total: 20 marks)**

## QUESTION FOUR

Nairobi Rural Tea Limited has presented the following information relating to its affairs for the year ended 31 December 2005:

| | |
|---|---|
| **Income:** | Sh. |
| Sale of proceed tea | 60,000,000 |
| Sale of surplus furniture | 600,000 |
| Year end bonus from KTDA | 6,000,000 |
| | 66,600,000 |
| Expenses | |
| Purchases | 28,000,000 |
| Wages to staff (net of PAYE) | 19,700,000 |
| NASSF | 2,800,000 |
| PAYE | 1,100,000 |
| Electricity | 420,000 |
| Staff uniforms | 110,000 |
| Repairs and renewals | 205,000 |
| Insurances | 96,000 |
| Legal expenses | 72,000 |
| Motor vehicle expenses | 160,000 |
| Cost of construction of gabions | 128,000 |
| Depreciation | 5,250,000 |
| Tax penalties | 41,000 |
| Efficiency tracking computers | 184,000 |
| Dividends | 200,000 |
| | 57,466,000 |

**Additional information:**

1. The company incurred the following capital expenditure for which it claims deductions under the second schedule. All the capital items were in use with effect from 1 January 2005.

| | Sh. |
|---|---|
| Agricultural land for planting tea bushes | 4,000,000 |
| Irrigation plant | 1,800,000 |
| Nursery shed for transplanting seedlings | 840,000 |
| Labour lines for tea pickers | 2,400,000 |
| Land for Tea Factory | 2,500,000 |
| Factory building (including office block costing Sh.1,000,000) | 15,000,000 |
| Dehydrating plant (new) | 3,600,000 |
| Conveyor belt fixed to the dehydrating plant | 1,200,00 |

| | |
|---|---|
| Grading machine (new) and fixed | 2,800,000 |
| Movable weighting scale | 200,000 |
| Mobile fork lift (20 tons) | 600,000 |
| Lorries for transporting Tea to Factory | 5,400,000 |
| 4 Toyota cars for managers | 3,200,000 |
| Furniture and fittings | 1,000,000 |

2. The furniture sold was part of the furniture bought under (1) above.

3. Repairs and renewals include purchase of loose tools worth Sh.35,000.

4. Legal expenses include an amount of Sh.40,000 paid to a lawyer to facilitate "passing" of the tea during tasting.

5. Motor vehicle expenses include sh.92,000 incurred on petrol for saloon cars.

6. Gabions were constructed by Waterways on contract to prevent flooding of the tea plantation during rainy seasons.

7. Tax penalties resulted from breach of VAT regulations

**Required:**

(a) Capital allowances due to the company in 2005. (12 marks)

(b) Adjusted profit or loss for the year of income 2005. ( 8 marks)
**(Total: 20 marks)**

## QUESTION FIVE

Comment briefly on the following matters of taxation:

(a) Presumptive income.
(b) Reverse charge
(c) Insurance reliefs
(d) Taxation of Export Processing Zones Enterprises. (Total: 20 marks)

## MOCK 4
## QUESTION ONE

Prof. Mohamed Omar, a registered architect, is the proprietor of Omar Architects. Since he is a full time employee of TRD Ltd., Omar Architects is managed by his wife, Mrs. Zahra Omar who draws a monthly salary of Sh.87,500 (PAYE deducted per month – Sh.20,000).

TRD Ltd. provided the following emoluments to Prof. Omar for the year ended 31 December 2005:

1. Basic salary of sh.450,000 per month (PAYE deducted was Sh.85,000 per month).

2. Free housing was provided with water, electricity and telephone with effect from September 2005. Prior to this, he was living in his own house. He paid a nominal rent of Sh.10,000 per month towards rent. Water consumed was for Sh.14,400, telephone was Sh.15,000 and electricity was sh.18,000 during the year. The market rental value for the house is estimated at Sh.150,000 per month.

3. In December 2005, the Board of TRD Ltd. issued him 2,000 ordinary shares for his good performance during the year. The last valuation of the shares was at Sh.50 each. TRD Ltd."s issued share capital is now 25,000 shares. The company paid a dividend of Sh.10 per shares on 30 December 2005.

4. Company car of 2000cc which cost Sh.950,000 in 2004

5. Leave pay equal to one month"s basic salary.

6. Life insurance premium per each household member of Sh.10,000 per annum. This covers himself, wife and son.

7. Pension contribution at 5% of basic salary per month to the company"s registered pension scheme. He contributes a similar amount.

8. During the year, the company paid school fees for his son amounting to Sh.95,000. The amount was disallowed for tax purposes on TRD Ltd.

9. TRD Ltd. operates a medical cover for all staff with AAR. In the year 2005, the amount paid for Prof. Omar"s cover amounted to Sh.45,000.

Prof. Omar"s other incomes were as follows:

Omar Architects made a loss of Sh.700,000 for the year 2005.
During the year, he received pension amounting to Sh.280,000 from his previous employer. He has been receiving this annually since 2002.

Amounts received for rented personal property was Sh.100,000 per month from September 2005. Repairs and painting cost sh.25,600 before letting. The house was later furnished at a cost of Sh.600,000 in October 2005. The house had a mortgage of Sh.2,000,000 and Sh.600,000 was paid during the year, out of which Sh.330,000 was capital.

Mrs. Zahra Omar had previously been working for World Vision, an International NGO, on contract since January 2004. However, on 31 December 2005, her five year contract was terminated and a compensation of Sh.1,200,000 was paid. Before termination her remuneration was Sh.360,000 per annum. She used the proceeds to purchase a plot in Nairobi, which she sold in November 2005 and made a profit of sh.600,000. The balance of the amount was used to set up a small business whose accounts reflected the following:

| | Sh. | Sh. |
|---|---|---|
| Gross profit | | 3,000,000 |
| Less: expenses | | |
| Staff salaries | 480,000 | |
| Salary to self | 600,000 | |
| Partitions | 200,000 | |
| Computers | 1,200,000 | |
| Insurance, rent and rates | 180,000 | |
| General expenses | 220,000 | |
| Interest on loan | 365,000 | 3,245,000 |
| Net loss for the year | | 245,000 |

**Required:**

(a) Taxable income of Prof. Omar for the year of income 2005. (12 marks)
(b) Tax payable by Prof. Omar for year of income 2005. (3 marks)
(c) Show how the compensation paid to Mrs. Zalma Omar will be assessed. (3 marks)
(d) Comment on any information not used above. (2 marks)

**(Total: 20 marks)**

**QUESTION TWO**

a) Write brief notes on specified sources of To what extent do the rules on specified sources income. to insurance companies? apply (5 marks)

b) Wananchi General Insurance Limited provided the following details with respect to the activities for the year ended 31 December 2005:

| | Shs. |
|---|---|
| Claims paid | 4,800,000 |
| Claims outstanding on 1 January 2005 | 400,000 |
| Claims intimated and accepted but not paid on 31 December 2005 | 700,000 |
| Premiums received | 12,000,000 |
| Re-insurance premium paid | 1,200,000 |
| Commission paid | 2,000,000 |
| Commission on re-insurance ceded | 80,000 |
| Commission on re-insurance | 40,000 |
| Repair of rented premises | 150,000 |
| Fees paid to investment managers | 600,000 |
| Expenses of management | 3,020,000 |
| Provision for unexpired risk on 1 January 2005 | 4,000,000 |
| Bonus utilized in reduction of premium | 120,000 |
| Re-insurance recoveries of claims | 80,000 |
| Medical expenses regarding claims | 50,000 |
| Loss on sale of motor car | 35,000 |
| Bad debts – specific | 25,000 |
| Tax credit for double taxation | 45,000 |
| Interest received (Gross) | 2,600,000 |
| Dividend received (Gross) | 4,500,000 |
| Provision for unexpired risk – 31 December 2005 | 4,677,200 |
| Legal expenses regarding claims | 400,000 |
| Profit on sale of investments | 2,350,000 |
| Rent income on property | 750,000 |
| Depreciation | 1,200,000 |

Wear and tear allowances have been agreed at Sh.800,000.

**Required**

a) With specific reference to the provisions of the Income Tax Act, compute the taxable income on Wananchi General Insurance Limited for 2005. (12 marks)

b) Comment on any losses, gains or specified sources of income which you have ascertained in (a) above. (3 marks)

## QUESTION THREE

(a) Suggested three possible ways in which the government may prevent loss of tax revenue from imports. (6 marks)

(b) You have recently received a request from the management of a newly registered business for your help with matters concerning VAT. The following is the extract of the letter:

i) We understand that some business must register for VAT while others need not register. Could you please advise us on the position regarding VAT registration?

ii) How should VAT on our income and expenditure be reflected in our operating budgets and monthly management accounts?

iii) When and how is the amount of VAT to be accounted for to the Commissioner of VAT?

**Required:**

Respond to the above queries. ( 8 marks)

(c) A manufacturer sells his manufactures goods to a wholesaler who incurs an additional 25% in storage and transport costs. The wholesalers mark-up is 20% on cost goods. The wholesaler bought the goods for Sh. 2,000 inclusive of VAT.

**Required:**

Calculate the amount of VAT payable to the commission by the wholesaler. ( 6 marks)

**(Total: 20 marks)**

## QUESTION FOUR

The following trial balance was extracted from the books of Leta Limited at 31 December 2005.

| | Sh. | Sh. |
|---|---|---|
| Share capital | | 2,000,000 |
| Share premium | | 1,000,000 |
| 12% Debentures | | 2,250,000 |
| Fixed assets at cost: | | |
| Factory buildings | 4,350,000 | |
| Machinery and equipment (fixed) | 600,000 | |
| Motor lorries | 2,250,000 | |
| Provisions for depreciation to 31 December 2005: | | |
| Factory buildings | | 360,000 |
| Machinery and equipment | | 300,000 |
| Motor lorries | | 1,070,000 |
| Goodwill (net) | 240,000 | |
| Sales | | 7,916,000 |
| Discounts allowed | 142,000 | |
| Discounts received | | 98,000 |
| Bank account | 356,000 | |
| Purchases | 4,582,000 | |
| Debtors and creditors | 525,000 | 314,000 |
| Provision for doubtful debts 31 December 2005 | | 530,000 |

| | | |
|---|---|---|
| Bad debts | 45,000 | |
| Depreciation expenses | 570,000 | |
| Wages and salaries | 684,000 | |
| Goodwill amortisation expense | 6,000 | |
| Administrative expense | 328,000 | |
| Research and development expenditure | 96,000 | |
| Debenture interest paid | 135,000 | |
| Director"s remuneration | 400,000 | |
| Instalment tax paid | 330,000 | |
| Retained profit | | 935,000 |
| Stocks at 1 January 2005 | 1,134,000 | |
| | 16,773,000 | 16,773,000 |

**Notes:**

1. Accrued expenses not included for wages and administrative expenses are sh.15,000 and Sh.9,000 respectively.
2. Stock held at 31 December 2005 was as follows:

| | Cost Sh. | Net Realisable value Sh. |
|---|---|---|
| Ziga | 563,000 | 468,000 |
| Zepa | 362,000 | 267,000 |
| Zela | 478,000 | 586,000 |

3. The factory was brought to use on 1 January 2005. The directors were not aware of the need to claim capital allowances and none has been made to date. A tax of Sh.420,000 was paid for the year of income 2004 upon final assessment.
4. Half years debenture interest is still outstanding.
5. Research and development expenditure is to be written off.

**Required:**

(a) Explain what happens if an error from previous tax returns is observed by a tax payer. ( 4 marks)
(b) Compute the taxable profit (loss) of Leta Limited for the year of income 2005 (16 marks)
(c) Show the tax account for Leta Limited as at 31 December 2005. ( 2 marks)

**(Total: 22 marks)**

## QUESTION FIVE

A, B and C are in partnership since January 2003. On 1 January 2005, they decided to diversify by converting their premises to a tea processing factory.

The following are the written down values as at 1 January 2005 of the assets taken over by the new business from previous operations.

| | Sh. |
|---|---|
| Milling machines | 2,000,000 |
| Farm house | 300,000 |
| Labour quarters | 400,000 |
| Land and buildings | 6,000,000 |
| Goodwill | 500,000 |
| Tractor | 5,000,000 |
| Lorries (2 tons) | 3,500,000 |
| Saloon cars | 3,600,000 |
| Computer system | 250,000 |
| Free machinery (non-processing) | 800,000 |

| | |
|---|---|
| Worker"s canteen | 150,000 |
| Sewerage system | 40,000 |
| Wind vane | 60,000 |

Included in the land and building is a building constructed in 2003 at Sh.3,500,000 which was converted to a factory on 1 January 2005.

During 2005 the partnership purchased an aircraft at a cost of Sh.24,500,000 for transporting processed tea. The company traded in 3 saloon cars purchased in 2004 at Sh.450,000 each. The saloon cars had been purchased in 2003 at sh.750,000 each. Three new cars for the partners (one for each partner) were bought at Sh.1,200,000 each in 2005. Security systems were fixed in the new saloon cars at a total cost of sh.200,000 to comply with insurance regulations. The milling machines were installed in the building in January 2005 and processing started on the same date.

Additional assets purchased during the year included:

| | **Sh.** |
|---|---|
| Extension to building | 2,400,000 |
| Furniture and equipment | 800,000 |
| Processing machines (donated by a Japanese Agency) | 1,200,000 |

The following additional information is provided:

1. One car was involved in an accident in 2005 and the insurance company paid compensation amounting to Sh.190,000. This car had cost Sh.300,000 in 2004.

2. The partnership made a net profit of Sh.19,800,000 after charging:

| | | |
|---|---|---|
| Partners" salaries: | A | Sh.500,000 |
| | B | Sh.250,000 |
| | C | Sh.250,000 |

3. The partners kept ten cows. They obtained milk value at Sh.230,000 during the year.
4. No interest on capital was paid to the partners.

**Required:**

(a) The capital deductions due to the partnership for 2005. (15 marks)

(b) The taxable income of the partnership and the distribution of the profit (loss) among the partners if their profit sharing ratio is 3:2:1 ( 3 marks)

(c) Comment on any information not used above and any assumptions made. ( 2 marks)

**(Total: 20 marks)**

## QUESTION SIX

Write short notes on the following:

(i) Instalment Tax. (5 marks)
(ii) Appeals to Income Tax Tribunal (5 marks)
(iii) Regressive taxes. (5 marks)
(iv) Government Budget Deficit. (5 marks)

**(Total: 20 marks)**

## MOCK 5

### QUESTION ONE

FK Insurance Brokers Limited was incorporated on 1 July 2004. The Managing Director has kept all his transaction vouchers in good order and also maintains proper registers for the premiums received, premiums paid, commissions received, etc. He has approached you to advise him on the tax payable for the eighteen months ended on 31 December 2005. From your detailed enquiry you have obtained the following information:

| | Sh. |
|---|---|
| Premiums received from clients | 30,000,000 |
| Premiums paid to insurance companies | 25,000,000 |
| Commissions received (Net) | 8,500,000 |
| Rent paid | 422,440 |
| Salaries and wages | 979,980 |
| Subscriptions to the Insurance Institute | 6,500 |
| Withholding Tax Paid | 1,500,000 |
| Instalment Tax paid in September 2005 | 1,125,000 |
| Donations | 50,000 |
| Annual charges by Commissioner of Insurance | 15,000 |
| Bank charges | 3,336 |
| Bank interest earned | 8,972 |
| Income from Bearer and Treasury Bonds | 965,000 |
| Depreciation | 223,500 |
| Office stationery | 123,400 |
| Office maintenance | 97,000 |
| Equipment purchases | 92,000 |
| Auditors remuneration | 100,000 |
| Directors fees | 108,000 |
| Entertainment | 180,000 |
| Business travel | |
| Provision for bad debts: | 68,000 |
| Specific | 45,000 |
| General | 50,000 |
| Architects fees on office partitioning | 55,000 |

**NB:** Wear and Tear allowances as agreed with the Commissioner for Income Tax (for 2005) 232,500

**Required:**

(a) Compute the Profit chargeable to Income Tax for the 18 months ended 31 December 2005. (12 marks)

(b) Show tax payable and the dates payable. ( 4 marks)

(c) Explain why you may not have used all the information provided to you. ( 4 marks)

**(Total: 20 marks)**

### QUESTION TWO

Mrs. Carol Wasike is a practicing accountant working under the style and name of Wasike and Associates. Her firm is registered for Value Added Tax (VAT). During the month of September 2005, she undertook and completed the following assignments:

| | | |
|---|---|---|
| 2 September | - | Tax consultancy work for ABC Ltd. her fees were sh.240,000 inclusive of VAT. |
| 4 September | - | Audit for Rwandacell, a company based in Rwanda. Her fees amounted to Sh.840,000 exclusive of VAT. |
| 10 September | - | Management consultancy services for Kikwetu Ltd. she billed them for sh.360,000 inclusive of VAT. |
| 15 September | - | Her firm was appointed by XYZ Ltd. to undertake a review of the internal control systems of the company. Her fees were Sh.1,200,000 exclusive of VAT. |
| 17 September | - | The firm conducted the audit of Kikwetu Ltd. for the year ended 31 December 2000. Charges were Sh.480,000 inclusive of VAT. |
| 18 September | - | The firm was appointed by Stima Ltd to conduct a survey on power consumption at a fee of Sh.2,400,000 (exclusive of VAT). |
| 19 September | - | Her firm audited the accounts of Miracle Ministries, a church where she serves as a volunteer auditor. She estimated that her fees would have been Sh.720,000 exclusive of VAT. |
| 21 September | - | The firm bill Kikwetu Limited Sh.136,000 (inclusive of VAT) for debt collection services. |
| 22 September | - | The firm undertook a financial consultancy assignment for Worldnet South Africa, a company based in South Africa. The fees were Sh.420,000 exclusive of VAT. |
| 24 September | - | Conducted audit of Lengo Ltd. at a fee of Sh.180,000 inclusive of VAT. |
| 26 September | - | Provided accountancy services to Rehema Children"s Home on a volunteer basis. The estimated value of the services was Sh.90,000 inclusive of VAT. |
| 30 September | - | Performed audit services for Ujamaa County Council. The fees earned were Sh.860,000 exclusive of VAT. |

During the month of September 2005, the firm paid for the following services:

| | |
|---|---|
| Electricity | Sh.42,500 |
| Water | Sh.2,400 |
| Rent | Sh.120,000 |
| Garbage collection | Sh.36,000 |
| Stationery | Sh.960,000 |
| Computer repairs and maintenance | Sh.240,000 |
| Telephone | Sh.330,000 |

(where applicable, the above payments were VAT inclusive)

**Required:**

(a) Prepare a VAT Account for Wasike and Associates for the month of September 2005. (14 marks)

(b) The VAT you have computed in (a) above, was paid on 22 October 2005 since 20 October was on a Saturday. The VAT return was also submitted on the same day. How much additional tax would be payable, if any? ( 2 marks)

(c) Kikwetu Limited was the subject of a creditors voluntary winding up and the appropriate resolution was passed on 1 April 2005. By that time the company paid Wasike and Associates only Sh.240,000 for services rendered. Assuming that all the conditions for the refund of bad debt relief are met, calculate the amount of VAT bad debt relief. (4 marks)

**(Total: 20 marks)**

## QUESTION THREE

The following figures represent the projected Government revenue and budgeted expenditure for the year 2004/2005 for Kenya.

| Projected Government Revenue | Sh."000,000" |
|---|---|
| Tax revenue | |
| Income tax | 55,079 |
| VAT | 32,907 |
| Import duty | 23,932 |
| Excise duty | 29,091 |
| Non-tax income | 19,002 |
| | 160,011 |
| Budgeted expenditure | |
| Salaries and wages | 56,411 |
| Debt services | 58,577 |
| Operations and maintenance | 38,859 |
| Development expenditure | 17,430 |
| Other expenditure | 8,898 |
| Total expenditure | 180,175 |

**Required:**

(a) Comment on the relationship between projected revenue and budgeted expenditure as shown by the above figures. (3 marks)

(b) Explain briefly four additional sources of funds in the Government other than the ones tabulated above. For each source, show clearly the constraints involved in it as a source of funds. (6 marks)

(c) What are the economic consequences of increasing the Value Added Tax rate to raise additional revenue for the Government? (5 marks)

(d) Many of the big businesses in Kenya pay all the four types of taxes shown in the table. The Minister for Finance is moving towards creating a "one tax point" system for businesses. Specify the major advantages likely to be provided by this system. (4 marks)

**(Total: 18 marks)**

## QUESTION FOUR

(a) Many flower growers and exporters are unaware of the benefits accruing from registering for VAT and claiming capital allowances available to them under the Income Tax Act. Write brief notes on the benefits arising in the two areas. (5 marks)

(b) You have been approached by the director of Flower Export Ltd. to help them do their tax returns for 2005. The following information is available.

Written down values at 31 December 2004 per self-assessment return submitted are as follows:

| | **Sh.** |
|---|---|
| Motor vehicles: | |
| Lories | 250,000 |
| Tractors | 375,000 |
| Pick-up and saloons | 1,250,000 |
| Farm house (constructed in 2003) | 300,000 |
| Computers | 750,000 |
| Plant | 475,000 |
| Equipment | 275,000 |
| Furniture | 725,000 |

2. During the year the company purchased and sold the following:

Mercedex Benz for use by the director costing Sh.2,500,000.
Security systems were fixed into company"s lorries to comply with the insurance requirements. The cost to the company was sh.250,000.
The company traded-in four Nissan Sunny cars which were purchased in 2003. The trade-in value of each of the cars was Kshs. 150,000 (Net book value Shs. 100,000).
Four new cars were bought at Sh.500,000 each.
The vehicles are used by the senior officers of the company and their rating is 1300cc.
Equipment worth Sh.1,650,000 was acquired while carpet worth Sh.450,000 was disposed of, furniture with net book value of Sh.460,000 was disposed of.
Computers worth Sh.1,250,000 were acquired for purposes of speeding up computerization of the company"s operations.

The company"s adjusted profit before wear and tear allowances is Sh.1,599,000.

**Required:**

(ii) Compute the capital allowances for Flower Export Ltd. as at 31 December 2005 and calculate the tax liability. (13 marks)

(ii) Comment on the motor vehicle benefit available to senior officers who are provided with motor vehicles. (2 marks)

**(Total: 20 marks)**

**QUESTION FIVE**

(a) List thee circumstances under which:

(i) The income of a taxable person is assessed on another person. (3 marks)

(ii) A married woman living with her husband may be called upon to bear the burden of tax. (3 marks)

(b) Briefly describe the treatment of the following classes of taxpayers with regard to Pay As You Earn (PAYE):

(i) Casual workers. (2 marks)
(ii) Taxpayers with multiple sources of income (2 marks)

(c) What circumstances may trigger a Pay As You Earn (PAYE) audit? (5 marks)

(d) What tax set-offs are available to an individual taxpayer which may reduce the gross tax liability? (5 marks)

**(Total: 20 marks)**

# ANSWERS - MOCKS

## SUGGESTED ANSWERS TO MOCK EXAMS

## SOLUTIONS FOR MOCK 1

### QUESTION ONE

(a) -NSSF contribution

- Owner occupied mortgage interest up to Sh.100,000 p.a.
- Contributions to have ownership savings plans up to Sh.48,000 p.a.
- Contributions by an employee to a registered pension and provident fund
- … of cost of tools and implements provided by architects, mechanics, engineers etc. in performance of employment services.
- Traveling expenses incurred in performance of duty.

(b) (i)Employment income

| | | |
|---|---|---|
| Salary (75,000 p.m x 12) | | 900,000 |
| Company car: Higher of fixed benefit on 1850cc | 86,400 | |
| or 2% p.m x 85,000 x 12 | 204,000 | 204,000 |
| Performance bonus (monthly salary) | | 75,000 |
| Watchman: Higher of actual amount paid 5,000 x 12 | 60,000 | |
| Fixed benefit by C.I.T | 14,400 | 60,000 |
| House girl: Higher of actual amount paid 5,000 x 12 | 60,000 | |
| Fixed benefit by C.I.T | 14,400 | 60,000 |
| | | 1,299,000 |
| Add housing benefit: higher of actual rent paid | 420,000 | |
| 35,000 x 12 or 15% x 1,299,000 | 194,850 | 420.000 |
| | | 1,719,000 |
| **Business Income** | | |
| Profits for year 2001 | 725,000 | |
| Less loss b/f | (300,000) | 425,000 |
| Interest income – loan to a friend | | 200,000 |
| | | 2,344,000 |

**Wife"s income**

| | |
|---|---|
| Salary 45,000 x 12 | 540,000 |
| Milk benefit 5 litres x 30/= x 365 | 54,750 |
| | 594,750 |

(b) (ii) Tax liability

**Mr. Kujua on Kshs. 23,440,000**

| | |
|---|---|
| (121,968 @ 10%) + [114,912 (15% + 20% + 25%)] = | 81,144 |
| (2,344,000 – 466,704) @ 30% = | 563,189 |
| Gross tax | 644,333 |
| Less: p/relief | (13,944) |
| Net tax | 630,389 |

**Mrs. Kujua on Kshs. 594,750**

| | |
|---|---|
| (121,968 @ 10%) + 114,912 @ 60%) = | 81,144 |
| (594,750 – 466,704) = | 38,414 |
| Gross tax | 119,558 |
| Less: personal relief | (13,944) |
| PAYE deducted | (98,400) |
| Net tax | 7,214 |

Mr. And Mrs. Kujua shall file a self assessment return since they have more than one source of income. The tax is due and payable by the last day of the 4th after the accounting year i.e 30th April 2006. The self assessment return should be filed by end of the 6th month after the accounting year i.e. 30th June 2006.

(iii) Information not used:

- Interest from HFCK, Treasury Bills and Akiba bank is subject to W/T which if final.
- Dividends from Castle Breweries Ltd – W/T is final
- Dividends from a South African Co. – tax exempt.

**QUESTION TWO**

(a) Non-deductible items

- Entertainment services
- Restaurant services
- Staff welfare costs
- Household or domestic electrical appliances
- All motor vehicles (other than passenger cars and minibus) bodies, pars and service for repair and maintenance of such vehicles.
- All fuels and oils for use in motor vehicles and such other bodies.
- Furniture, fittings and ornaments or decorative items in buildings other than items permanently attached to the buildings.
- Passenger cars and mini-buses, parts and service for the repair and maintenance of such vehicles and the leasing and hiring of such vehicles.

(b) Bad debt relief.

Where the buyer (debtor) has become legally insolvent.
When the debt of a registered person (for which tax has been paid) remains unpaid for a 3 year period from date of supply.

VAT Account (Using 16% VAT rate)

| | | | | | |
|---|---|---|---|---|---|
| 2/9 | Reverse charge (website) | 132,414 | 6/9 | Options (K) Ltd | 365,517 |
| 4/9 | Factory building | 441,379 | 7/9 | Zim Bank | 246,897 |
| 5/9 | KLM Ltd | 187,586 | 11/9 | Homa Bay W/S | 119,310 |
| 6/9 | Textbook Centre | 69,040 | 12/9 | Return outwards | 7,007 |

| | | | | | | |
|---|---|---|---|---|---|---|
| 9/9 | Transport | 48,276 | 20/9 | Cash sales | 377,103 |
| 11/9 | Return inwards | 41,379 | | VAT refund | 217,947 |
| 18/9 | Services from Zim bank | 246,897 | | | |
| 23/9 | Bad debt – Homa Bay | 119,310 | | | |
| 30/9 | w/s | 30,000 | | | |
| | Telephone VAT | 17,500 | | | |
| | Electricity | 1,333,781 | | | 1,333,781 |

**Note:**

(i) Any input tax incurred in construction of a factory building is deductible against the output tax as the factory is not sold before the lapse of five years from the date it was first put into use.

(ii) The VAT refund is due on 20th October 2000. However, this being a public holiday, its due on or before the last working day before 20th October.

(iii) VAT on imported services

- This VAT is called reverse charge and is due and payable at the time the service is received or when payment is made for all or part of the service by importer.
- The VAT is declared through form VAT 7 and payment is made to the designate banks using form VAT 28.
- The VAT is allowable as a deduction against the output tax.

(iv) Information not used

- Sales to Rwanda Miners Ltd – zero rated.
- Sh.20,000 allowance to Rwanda Miners Ltd. – Zero rated hence no effect on VAT computation.
- Stolen goods on transit – no VAT is charged since its on zero rate export

**QUESTION THREE**

(i) Expense Reimbursement

Reimbursement of personal expenses constitutes a taxable benefit. The assessed benefit will be equivalent to the cost of the employer. Consequently, this scheme does not have any benefits if the reimbursement is for personal expenses. The reimbursement of expenses incurred in the course of carrying out the business of the employer does not constitute a taxable benefit. Here, it is assumed the reimbursement is for the actual cost incurred by the employee. If the amount reimbursed exceeds the cost to the employee, the difference will be subject to tax.

The personal expenses reimbursed will be tax deductible by the employer if the employee has been taxed. Reimbursement of business expenses is tax deductible if the employee has been taxed. Reimbursement of business expenses is tax deductible if the expenditure is incurred wholly and exclusively for the purpose of the business.

(ii) Benefits in Kind

Benefits in kind are taxable, unless the aggregate value does not exceed Ksh.24,000 p.a. This amount is not significant enough to be included in an "Executive Remuneration Package". Other benefits not subject to tax include:

Medical services to full time employees;
Employer"s contribution to a pension or provident fund (whether registered or not);

Education fees of an employee"s dependents, where treated as a non-deductible expense by theemployer;
Passages between Kenya and any place outside Kenya for expatriates.

(iii) Pension Entitlement

Contributions by an employer to a pension or provident fund, whether registered or not are not taxable on the employees. However, the employer is not allowed to deduct contributions to non-registered schemes. The employees can benefit from these schemes but may not be tax efficient because the employer will be taxed on the contributions.

(iv) Bonus Schemes

Bonuses constitute cash payments to employees. All cash payments received as a gain or profit from employment are taxable in full. This item will not be tax effective to be included in a remuneration package.

(v) Share Purchase Arrangements

(a) The granting of bonus share for better performance by the firm is a benefit in kind received for employment services rendered thus a taxable benefit.
where the shares are given free, the taxable benefit is based on the prevailing market price per share (MPS). Where the shares are issued at price lower than the market price per share, the taxable benefit shall be (MPS – issue price) number of shares issued.
Where the difference between MPS and issue price is 5% or less of the MPS, the benefit is not taxable example.

| Assume | 1 | 2 |
|---|---|---|
| MPS | Sh.100 | Sh.100 |
| Issue price to employee | Sh. 96 | Sh. 91 |
| Different/discount | Sh. 4 | Sh. 91 |
| % of MPS | $\frac{4}{100} \times 100 = 4\%$ | $\frac{9}{100} \times 100 = 9\%$ |

Where the shares are redeemable, the taxable benefit shall be the higher of the difference between: issue price and nominal value; or
issue price and redemption value.

## QUESTION FOUR

| | | |
|---|---|---|
| Partnership loss | | (2,160,000) |
| Add back disallowable expenses | | |
| Partnership deed | 12,000 | |
| Bad debts – general provision (186,000 – 180,000) | 6,000 | |
| Depreciation | 780,000 | |
| Donations | 90,000 | |
| Subscriptions | 54,000 | |
| Goodwill written off | 108,000 | |
| Salary to partners (288 + 216 + 144) | 648,000 | |
| Interest on capital (144 + 96 + 48) | 288,000 | |
| Loss on sale of investment | 270,000 | 2,256,000 |
| | | 96,000 |
| Less: | | |
| Wear and Tear allowance (W1) | 165,000 | |
| Dividend received | 102,000 | |
| Sub-letting rent income | 36,000 | (303,000) |
| Adjusted partnership business income(loss) | | (207,000) |

Work 1 - WTA

| Class | II @ 30% | III @ 25% | Total |
|---|---|---|---|
| WDV 1/1/90 | 270,000 | 336,000 | |
| Less 1990 WTA | (81,000) | (84,000) | 165,000 |
| WDV 31/12/90 | 189,000 | 252,000 | |

Profit Distribution Schedule

| | Ahmed | Benji | Chepkonga | Total |
|---|---|---|---|---|
| Ratios | 3 | 2 | 1 | 6 |
| Salaries | 288,000 | 216,000 | 144,000 | 648,000 |
| Interest on capital | 144,000 | 96,000 | 48,000 | 288,000 |
| Share of loss | (571,500) | (381,000) | (190,500) | (1,143,000) |
| Partnership loss | (139,500) | (69,000) | 1,500 | (207,000) |
| Rent income | 18,000 | 12,000 | 6,000 | |
| Total taxable income | 18,000 | 12,000 | 7,500 | |

**Note:**

The loss from partnership business will be carried forward to be offset against future partnership profits. The loss cannot be offset against rent income since it is a specified source of income.

## QUESTION FIVE

(a) (i)The income of a taxable person is assessed on another person in case of a:

- Deceased person income assed on executors or administrators
- Incapacitated persons and minors – income assessed on guardian or trustee.
- Married women – income not earned at arms length assessed on the husband
- Non-resident ship – owners – income assed on the captain of the ship

(ii) Payment of tax by a married woman living with the husband.

- Where the husband has been declared bankrupt
- Where the husband is of unsound mind
- Where the husband does not have distrainable goods
- Where the husband does not have any taxable income (wife is the sole bread winner)
- The husband is untraceable or has gone underground.

(b) (i) Casual workers – casual workers who are engaged by the employer for periods less than one month are not taxable. However, if the casual worker is employed regularly he will be taxed.

(ii) Multiple sources of income
These are taxed on all incomes but granted personal relief only by the "main employer"

(c) Circumstances that trigger off PAYE Audit

- Salaries and wages figure per the audited accounts is higher or lower than the amounts reflected in the PAYE returns.
- PAYE is usually not paid on time
- Material fluctuations over the months on PAYE payments
- Third party information or complaints
- Non-compliance noted/detected during a normal tax examination be it VAT or Corporate tax examination.

- Off-late KRA is offering rewards to anybody who divulges information that leads to a tax recovery by authorized persons only.
- Newspaper reports
- Court cases
- Construction sites sign boards – This affects mainly contractors and professionals in the construction industry.
- Information emanating from related companies audited
- Cessation of business on a large part of a business
- Higher salaries awarded to middle level managers compared to those awarded to their seniors.

(d) Tax set-offs available to an individual tax payer to reduce gross tax liabilities are:

- PAYE deducted at source
- Double taxation relief
- Personal relief
- Any installment tax paid
- Withholding tax on non-qualifying dividends and royalties income
- Tax refunds of previous years of income.

## MOCK II
## QUESTION ONE

Miss Jane Kambo Adjusted Profits

| | | |
|---|---|---|
| Net profits as per the accounts | | 726,420 |
| Add back: | | |
| Overstated opening stock (W1) | 196,364 | |
| Customs duty for equipment | 5,100 | |
| Legal and professional fees: | | |
| Local committee appeal | 6,000 | |
| Court fines | 5,100 | |
| Breach of agreement | 9,000 | |
| Advertising – sing board | 6,000 | |
| Depreciation | 90,960 | |
| VAT | 61,800 | |
| Income Tax | 78,000 | |
| Medical expenses | 7,200 | |
| Purchase of equipment | 6,300 | |
| Christmas gifts | 5,040 | |
| General bad debts | 13,800 | |
| Household expenses | 25,200 | 515,864 |
| Less: | | |
| Overstated closing stock (W2) | 25,091 | |
| Capital allowances – WTA | 64,800 | |
| Drawings at selling price | 30,000 | |
| Gain on sale of plot | 150,000 | |
| Gross dividends | 10,800 | (280,691) |
| Adjusted trading income | | 961,593 |

**Note:**

Drawings are deducted at selling price to reduce Sh.6000 and then Sh.24,000 cost. W1 and W2 – the cost given is equal to 110%

W1= $2,160,000 - \left(\frac{2,160,000}{110\%} x100\right) = 196,364$

W2= $276,000 - \left(\frac{276,000}{110\%} x100\right) = 25,091$

## QUESTION TWO

(a) Charitable Trust are exempted from taxation if:

- One public in character serving a small section or the public in general (not discriminative)
- for enhancement of education or religion
- for purpose of eradication of poverty and disease
- no profit sharing
- income generated is expended in Kenya for benefit of Kenyan citizens
- registered as a charitable trust

Watu clinic does not qualify as a charitable trust hence not exempted from tax.

(b) Income statement

| | | | |
|---|---|---|---|
| Net profit (income – expenditure) | | 3,741 | |
| Add back disallowable expenses | 5.0 | | |
| Salaries – partners | 12.0 | | |
| Interest – partners | 15 | | |
| Life cover for partners | 67.2 | | |
| 40% M.V expenses | 200 | 922.2 | 4,663.2 |
| Depreciation | | | |
| Less: non-… income & all. | | | |
| Expenses | | 3,600 | |
| Donation and grants | | 140 | |
| Goodwill | | 96 | |
| Capital allowances | | 50 | |
| Dividends | | 12 | 3,898 |
| Int. on deposits | | | 765.2 |
| Adjusted partnership profits | 9/12 x 765.2 = | | |
| Profits for 9 months = | 573.9 | | |

(c) 9 months to 30/9/2005

| | H. Kutibu | Mrs. W Kutibu | F. Nafuu | Mganga | Total |
|---|---|---|---|---|---|
| | 40% | 20% | 40% | | |
| Interest x 9/12 | 15 | 5.25 | 15 | - | 35.25 |
| Salaries x 9/12 | 180 | - | 180 | - | 360 |
| Profits x 9/12 | 71.46 | 35.73 | 71.46 | - | 173.65 |
| | 266.46 | 40.98 | 266.46 | - | 573.9 |

| | | | | | |
|---|---|---|---|---|---|
| 3 months from | 1 :10 :2005 | 31/12/2005 | | | |
| | 40% | 10% | 40% | 10% | Total |
| Int. 3/12 | 5 | 1.75 | 5 | 3.0 | 14.75 |
| Salaries x 3/12 | 60 | - | 60 | 30 | 150 |
| Profits x 3/12 | 10.62 | 2.655 | 10.62 | 2.655 | 26.550 |
| | 75.62 | 4.405 | 75.62 | 35.655 | 191.3 |
| Add for 9 | 266.46 | 40.90 | 266.46 | - | 565.2 |
| months above | 342.08 | 45.385 | 342.08 | 35.655 | 765.2 |

(d) -Combine Kutibu"s p/ship income and tax on husband
-For Nafuu and Mganga, aggregate with other incomes and taxed on graduated scale.

(e) Dr. (Mrs) Kutibu would be assessed separately on her Sh.240,000 salary as follows:

| | |
|---|---|
| 121,968 @ 10% | = 12,196.8 |
| 114,912 @ 15% | = 17,236.8 |
| 236,880 | 29,433.6 |
| (240,000 – 236,880) @ 20% | = 624.0 |
| Gross liability | 30,057.6 |
| Less personal relief | (13,944.0) |
| PAYE | (97,200.0) |
| Tax refund | (81,086.4) |

The refund would be used to offset the husbands tax liability as follows:

| | |
|---|---|
| Partnership income | 342,080 |
| Add: Wife"s partnership income | 45,385 |
| | 387,465 |

| | |
|---|---|
| Tax liability | |
| Sh.121,968 @ 10% | = 12,196.8 |
| Sh.114,912 @ (15% + 20%) | = 40,219.2 |
| (Sh.387,465 – 351,792) @ 25% | 8,918.0 |
| Gross tax | 61,334.0 |
| Less personal relief | (13,944.0) |
| Wife"s refund | (81,086.4) |
| Tax refund | (33,696.6) |

**QUESTION THREE**

(a) Joab Income Tax Computation

| | | |
|---|---|---|
| Employment | Ksh. P.a. | |
| Salary | 805,000 | |
| Bonus | 265,000 | |
| Employer Contribution to pension approved | - | |
| Employer contribution to pension unapproved | - | |
| Life insurance premium | 68,000 | |
| House servant – higher of | | |
| (i) Fixed benefit of Sh.18,000 | 24,000 | |
| (ii) Actual salary 2000 p.m x 12 = 24,000 | | |
| Motor car: Higher of: | | |
| (i) Fixed benefit on 1750 cc = 69,600 | 600,000 | |
| (ii) 2% p.m x 2,500,000 x 12 = 600,000 | | |
| Other incomes | | |
| Dividend from society (W1) | 52,940 | |
| Interest on HFCK | 1,000,000 | 2,814,940 |
| H. Benefit = 20,000 x 12 or 15% x 2,814,940 = | | 422,241 |
| Wife"s income | | |
| Salary | 360,000 | |
| Sick leave | 48,000 | |
| Employer contribution to medical | 250,000 | 658,000 |
| Taxable income | | 3,895,181 |
| Less: rent paid = 5% x 805,000 | | (40,250) |
| Taxable income | | 3,854,931 |

| | |
|---|---|
| Tax on 3,854,931 | |
| 1st 466,704 = (121,968 @ 10%) + 114,912 (15% + 20% + 25%) = | 81,144 |
| Surplus = (3,854,931 – 466,704) @ 30% = | 1,016,468 |
| Gross tax | 1,097,612 |
| Less: p/relief – husband only | (13,944) |
| PAYE: husband | (185,000) |
| wife | (85,000) |
| W/T on non-qualifying dividends | |
| 15% x 52,940 | (7,941) |
| Net tax | 805,727 |

**Notes:**

1. Dividend from home-based co-op society is non-qualifying dividends hence W/T is 15%. The gross income =

$$\frac{45,000}{00.85} = 52,94$$

2. Mr. Joab is not a whole time service director. His housing benefit is based on total income from all sources. He owns 13.3% $\frac{40,000}{300,000}$ which is greater than 12.5% of shares of the firm. The wife holds 28% of shares of Atex hence her income is assessed on husbands income.

3. Interest from HFCK – the 1st Sh.300,000 suffers 10% W/T which is final and any surplus is taxed on graduated scale.

(b) (i) The loss from retail shop of 22,000 + 48,000 = 70,000 will be carried forward to be offset against income from same source.
(ii) Interest from POSB - exempt
(iii) Interest from bank – W/T is final
(iv) Lottery and sweepstake – non-taxable income
(v) Pension contribution to approved and unapproved schemes – non-taxable benefit.
(vi) Dividend from KCB – 5% W/T final
(vii) Pension from previous employer – the 1st lumpsum income of Ksh.480,000.

## QUESTION FOUR

(a) - The capital expenditure implication for a hotel owner is that he will enjoy all capital allowances as deductible expenses leading to reduction in taxable profits and tax liability.

- The capital allowances include:
- Investment deduction on hotel building certified as industrial building
- Industrial building deduction on cost of hotel building net of investment deduction
- Wear and tear allowance on computers, washing machines, lawn mowers, furniture, beds, carpets etc.
- Diminution in value of utensils and other kitchen wares.

(b) (i) and (ii)

(i) Industrial building deduction (IBD) show

Residual value of hotel building after 5 years of usage is Sh.10 million. It still has 20 years remaining.

Qualifying cost in 2000 = 25/20 x 10 million = 12.5 million.

**Note:**

Hotel building are granted IBD @ 4% p.a. (over 25 year life).

| | |
|---|---|
| IBD – old hotel 12,500 x 4% = | 500 |

(ii) Investment deduction @ 100%
New hotel = 100% x 5,000,000 = 5,000,000
There is no residual for IBD

(iii) Wear and Tear Allowance

| Class | I @ 37.5% Sh."000" | II @ 30% Sh."000" | III @ 25% Sh."000" | IV @ 12.5% Sh."000" |
|---|---|---|---|---|
| WDV 1/10/2004 | 875 | 2,500 | 1,750 | 3,725 |
| Add computers and fax | - | 390 | - | - |
| Photocopier | - | 160 | - | - |
| Beds | - | - | - | 500 |
| Mercedes Benz | - | - | 1,000R | - |
| Traded in car | - | - | 400 | - |
| Disposals | (900) | (125) | (200) | (90) |
| | (25) | 2,925 | 2,950 | 4,125 |
| Trading receipt | 25 | - | - | - |
| WTA | - | (878) | (738) | (516.9) |
| WDV 30/9/2005 | NIL | 2,047 | 2,212 | 3,618.1 |

* Disposal Value

Disposal Value x Restricted qualifying cost in 2003. Cost

The Q. cost was less than Kshs. 1,000,000 restricted Q. C hence no restriction on disposal.

Class one results in a trading receipt of Sh.25,000 which is a taxable income.

## QUESTION FIVE

(a) Use 16% VAT Rate

Nov. 2000 VAT A/c

| Input tax | | | Output Tax |
|---|---|---|---|
| 1/11 Radios | 20,690 | 10/11 Radios | 20,590 |
| Recorders | 12,793 | 16/11 Recorders | 27,586 |
| 6/11 T.Vs | 68,966 | VAT refund | 55,173 |
| | 103,449 | | 103,449 |

Dec. 2000 VAT A/c

| Input tax | | Output Tax | |
|---|---|---|---|
| 5/11 Spare parts | 206,897 | 11/12 Spare parts | 110,345 |
| | | VAT refund | 96,552 |
| | 206,897 | | 206,897 |

Jan 2001 VAT A/c

| Input tax | | Output Tax | |
|---|---|---|---|
| 2/1 Cars | 4,137,793 | 5/1 Cars | 511,724 |
| 15/1 Motor bikes | 137,931 | 31/1 Motor bikes | 124,138 |
| | | VAT refund | 3,639,862 |
| | 4,275,724 | | 4,275,724 |

Feb 2001 VAT A/c

| Input tax | | | Output Tax |
|---|---|---|---|
| VAT payable | 20,690 | 28/1 Motor bikes | 20,690 |
| | 20,690 | | 20,690 |

March 2001 VAT A/c

| | Input tax | | Output Tax |
|---|---|---|---|

| | | | |
|---|---|---|---|
| VAT payable | 1,600,000 | 5/3 Insurance claim | 137,931 |
| | | 15/3 insurance claim | 82,759 |
| | | 30/3 Cars | 1,379,310 |
| | 1,600,000 | | 1,600,000 |

**Note:**

VAT for imported personal clothes cannot be offset against business output VAT.

(b) The penalties are:

Failure to file VAT return = Sh.10,000
Failure to pay VAT on due date = 2% p.m compounded interest on unpaid VAT

(c) Recoveries from insurance are treated as taxable supplies hence output tax shall be charged accordingly.

(d) If customs duty was imposed, then VAT should be charged after duty has been included in lauding price of goods e.g

| | |
|---|---|
| Assume lauding price of imports = | 500,000 |
| + 20% customs duty | 100,000 |
| Value for VAT | 600,000 |
| Add 16% input tax | 96,000 |
| Import price inclusive of VAT | 696,000 |

## MOCK 3

### QUESTION ONE

(a) When applied to a company, "Residence" means:

- a body corporate incorporate under the laws of Kenya e.g. Companies Act Cap.486.
- a company whose management and control are exercised in Kenya.
- A company or body corporate which has been declared as a "resident" by Minister for Finance through a Kenya Gazette notice.

(b) Adjusted taxable income for year ending 2005:

| | | |
|---|---|---|
| Net profits as per the accounts | | 30,500 |
| Add back disallowable expenses | | |
| Partition and carpeting offices (Note 1) | 4,000 | |
| Subscriptions and donations (Note 2) | 1,000 | |
| Bad debts (Note 3) | 8,000 | |
| Gifts to retiring staff | 5,000 | |
| Legal fees – plot acquisition | 5,500 | |
| Depreciation | 10,000 | |
| Patents written off | 2,500 | |
| Interest on overdue tax | 2,500 | |
| Interest in lieu of dividends | 5,000 | (43,500) |
| | | 74,000 |
| Less capital allowances | | (30,000) |
| Net taxable income | | 44,000 |

Corporate tax liability = 44,000 x 30% = 13,200

The tax should be paid in instalments during the year of income 2005 as follows:

| | | |
|---|---|---|
| 1st Instalment | 20th April 2005 | 25% of tax due |
| 2nd instalment | 20th June 2005 | 25% of tax due |
| 3rd instalment | 20th September 2005 | 25% of tax due |
| 4th instalment | 20th December 2005 | 25% of tax due |
| 5th and final instalment | 30th April 2006 | |

**Note:**

Tax due = 110% of 2004 tax liability
Final instalment = 2005 tax liability – Total tax paid over the 4 instalments.

### QUESTION TWO

(a) Mrs. Mwongozo

| | |
|---|---|
| Salary | 1,080,000 |
| Life insurance by employer | 36,000 |
| Pension Contributions by employer to: | |
| Approved scheme | - |
| Unproved scheme | - |
| Entertainment allowance | 50,000 |
| Bonus for excellent performance | 50,000 |
| Day and night watchman | |
| Higher of [Actual amount paid 1,000 x 12 x 2 = 48,000; Fixed amount Sh.14,400 x 2 = 28,800] | 48,000 |

| | | | |
|---|---|---|---|
| Car benefit | | | |
| Higher of | 2% x 2,000,000 x 12 | = 480,000 | |
| | Fixed benefit on 1876cc | = 86,400 | 480,000 |
| Pensionable income before housing benefit | | | 1,742,000 |
| Add Housing benefit | | | |
| Higher of | Actual amount paid sh.45,000 x 12 = 540,000 | | |
| | 15% x 1,742,000 | | 540,000 |
| Pension income | | | |
| Lump sum 450,000 – 360,000 (non-taxable) | | | 90,000 |
| Total taxable income | | | 2,372,000 |

Mr. Mwongozo

| | |
|---|---|
| Salary Sh.34,000 x 12 | 408,000 |
| Hardship allowance | 290,000 |
| Free lunches | 20,000 |
| Key money (net income) | 26,000 |
| | 744,000 |

(b) Information not used:

- Cost reimbursed by employer are mere reimbursements, which are not taxable.
- Contributions to approve and unapproved scheme by employer is not a taxable benefit on employee.
- Interest income for Mr. And Mrs. Mwongozo is subject to 15% W/T which is final.
- Business income from Tanzania and dividends income from Tanzania are not taxable in Kenya.
- City Council rates is private expenses and does not affect income.
- Mortgage interest paid is not allowable since Mrs. Mwongo did not occupy her house during the years she was housed by the employer.

(c) Mr. And Mrs. Mwongozo do not have the responsibility to deduct and pay PAYE. This responsibility rests on the employer. If the employer does not deduct PAYE, he shall be liable to a fine of 25% of tax due subject to a minimum of sh.10,000.

## QUESTION THREE

(a) Kaka & Yao

| | | | |
|---|---|---|---|
| Sales | Cash | 6,400 | |
| | Credit | 5,460 | |
| | Banked | 200,000 | 211,860 |
| | Cost of sales | | |
| | Cash purchases | 2,500 | |
| | Credit purchases | 3,800 | |
| | Banked Purchases | 150,000 | |
| | Less closing stock | (9,200) | |
| | Drawings | (2,260) | 154,840 |
| | Gross profit | | 57,020 |
| | Wages | 170,000 | |
| | Rent & rates –100 | 3,400 | |
| | Light & Heat + 1280 | 1,400 | |
| | Petrol | 2,000 | |
| | Maintenance | 1,000 | |
| | Advert | 900 | |
| | W.T.A. 25% x 119,00 | 29,730 | 55,450 |

1,570 x ½ = 785 each

(b). Date of payment 30.4.2005 20% penalty
2% interest

Penalty 120,000 x 20% = 24,000
Interest 2% x (120,000 + 24,00)

(c). They should do the following
(i). Prepare all the accounts and tax returns
(ii). File the returns and pay all tax due
(ii). Lodge an objective with the C.I.T which should be:

In writing
State the grounds of objectives
Supported by all relevant accounts
Made within 60 days or receiving the notice of assessment.

**QUESTION FOUR**

(a) Capital allowances

1.

| | Investment Qualifying Cost | Allowance I.D @ 100% | Residual for IBD and WTA |
|---|---|---|---|
| Factory building | 15,000 | 15,000 | - |
| Dehydrating plant | 3,600 | 3,600 | - |
| Conveyor belt | 1,200 | 1,200 | - |
| Grading machine | 2,800 | 2,800 | - |
| | | 22,600 | |

2. Diminution in value of loose tools

Diminution = 33⅓ % x 35,000 = 11,667 p.a. for 3 years

3. Farm works deductions Sh."000"

| Farm work | Q. Cost | FWD @ 33⅓ % p.a. for 3 years |
|---|---|---|
| Nursery shed | 840 | 280 |
| Labour Lines | 2,400 | 800 |
| | | 1,080 |

4. W.T.A sh."000"

| | I | II | III | IV |
|---|---|---|---|---|

| | | | | |
|---|---|---|---|---|
| Additions: Irrigation plant | - | - | - | 1,800 |
| computers | - | 184 | - | - |
| Weighing scale | - | - | - | 200 |
| Fork lift | 600 | - | - | - |
| Lorries for transport | 5,400 | - | - | - |
| 4 Toyota cars | - | - | 3,200 | - |
| furniture and fittings | - | - | - | 1,000 |
| disposals – furniture | - | - | - | (600) |
| | 6,000 | 184 | 3,200 | 2,400 |
| WTA for 2005 | (2,250) | (55.2) | (500) | (300) |
| WDV 31/12/2005 | 3,750 | 128.8 | 2,400 | 2,100 |

Total WTA = 3105.2

**Note:**

- Cost of constructing gabions is an allowable capital expenditure.
- Land does not qualify for any capital deductions.

(b) Adjusted income Sh."000"

| | | |
|---|---|---|
| Gross income | | 66,600 |
| Less gross expenditure | | (57,466) |
| Net profits | | 9,134 |
| Add back: | | |
| Cost of loose tools | 35 | |
| Legal expenses | 40 | |
| Tax penalties | 41 | |
| Depreciation | 4,250 | |
| Computers | 184 | |
| Dividends | 200 | 4,750 |
| | | 13,884.000 |
| Less capital allowances: | | |
| ID | 22,600 | |
| Diminution | 11.667 | |
| FWD | 1,080.0 | |
| WTA | 3,105.2 | |
| Sale of surplus furniture | 600.0 | |
| Adjusted Loss | | (27,396.867) |
| | | 13,512.867 |

**Note**

: Gross salaries and wages are allowable i.e. net wages + NSSF + PAYE = Gross wages.

## QUESTION FIVE

(a) Presumptive income

- This is farming income derived from certain agricultural produce such as coffee, cotton, pyrethrum, tea, maize, wheat, cashew nuts etc.
- Where a farmer derives such presumptive income, he has 2 options of paying tax.
- Pay the presumptive income tax at 2% of gross income (before deducting any allowable expense) which is final tax or
- Determine the net taxable income (gross income – allowable expenses) and pay tax on graduated scale.

(b) Reverse charge

- This is VAT payable on imported services
- The Kenyan importer would pay VAT on such services
- The reverse charge is input tax deductible against the firms output tax
- It is payable using form VAT 4

(c) Insurance relief

With effect from 1st January 2003, the Minister for Finance reintroduced the insurance relief to be offset against gross tax liability of individuals.
The relief shall be the lower of:

Set limit of Ksh.36,000 p.a (3,000 p.m) 15% of premium paid

For an individual to qualify for this relief he must have:

Taken a life or education policy with a maturity period of not less than 10 years The policy must have been taken after 1/1/2003.

(d) Taxation of EPZ enterprises

- EPZ enterprises enjoy the following tax incentives:

- A 10 year tax holiday
- A 25% corporate tax rate between years 11 – 20
- A 100% investment deduction on building and machine used to manufacture exports
- Exports are zero rated hence they can claim a refund of input VAT paid.
- Refund or customs duty paid on imported raw material to manufacture exports.

## MOCK 4
## QUESTION ONE

(a) Prof. Mohammed Omar
Computation of taxable income for 2005

| | | |
|---|---|---|
| Employment income | Ksh. | |
| Salary 450,000 x 12 | 5,400,000 | |
| Benefits: | | |
| Housing (150,000 – 10,000) x 4 | 560,000 | |
| Electricity | 6,000 | |
| Water | 4,800 | |
| Telephone | 1,200 | |
| Ordinary shares | 100,000 | |
| Company car | 228,000 | |
| Leave pay | 450,000 | |
| Life insurance | 30,000 | |
| | | 6,780,000 |
| Other incomes | | |
| Pension (280,000 – 180,000) | | 100,000 |
| Rent income | | |
| Gross 100,000 x 4 | 400,000 | |
| Less repairs and painting | (25,600) | |
| WTA on furniture | | |
| 12.5% x 600,000 x 4/12 | (25,000) | |
| interest 270,000 x 4/12 | (90,000) | |
| | | 259,400 |
| Wife"s income from Omar Architects | | |
| Loss reported | (700,000) | |
| Add back wife"s salary | 1,050,000 | |
| | | 350,000 |
| Less owner occupied mortgage interest (8 months) | | |
| Amount = 8/12 x 100,000 | | (66,667) |
| Pension contribution 5% x 5,400,000 (actual) or Sh. 210,000 (lower) | | (210,000) |
| Net taxable income | | 7,122,733 |

Mrs. Zachra"s income at arm"s length

| | | | |
|---|---|---|---|
| Compensation for Yr 2000 | | | 360,000 |
| Business income Gross | | 3,000,000 | |
| Less: | | | |
| Salaries | 480,000 | | |
| Insurance, rent & rates | 180,000 | | |
| General expenses | 220,000 | | |
| Interest on loans | 365,000 | | |
| WTA – Partition 12.5 x 200,000 | 25,000 | | |
| Computers 30% x 1,200,000 | 360,000 | 1,630,000 | 1,370,000 |
| | | | 1,730,000 |

(c) Mr. Omar Tax Liability

| | |
|---|---|
| [Sh.121,968 @ 10% + Sh.114,912 @ (15% + 20% + 25%)] | 81,144 |
| (Sh.7,122,733 – 466,704) @ 30% | 1,996,809 |
| | 2,077,953 |
| Less PAYE | |
| Omar 85,000 x 12 | (1,020,000) |
| Zahra 20,000 x 12 | (240,000) |
| Personal relief | (13,944) |
| Net tax liability | (804,009) |

(c) Taxation of compensation to Zahra

This will be taxed for the unexpired period of contract by being spread equally over the 3 years unexpired.

Year 2006 - Sh .400,000

Year 2007 - Sh. 400,000

Year 2008 - Sh. 400,000

The rates to be used are the last known rates by the date of payment.

(d) Information not used

- Company dividend payment – withholding tax is final tax.
- Medical cover – not taxable because it is not discriminatory
- School fees – not taxable on Prof. Omar.
- Gain from plot – not taxable, capital gains tax suspended.

## QUESTION TWO

(a) Income is currently classified into the following sources:

- Employment and professional income
- Business income
- Farming income
- Gains or rights arising from use or occupation of property
- Investment income
- Unspecific sources
- Pension and provident funds

Exceptions from unspecified sources computation

- Banks
- Insurance companies
- Financial institutions other than banks
- Housing financial institutions
- Companies quoted in the NSE
- Oil companies
- Large multi-national companies (manufacturing)

**NB:**

The above exceptions do not cover farming income.

(b) WANANCHI GENERAL INCOME LTD 2005 INCOME COMPUTATION

| INCOME | SHS. | SHS. | SHS. |
|---|---|---|---|
| Premium received | | 12,000,000 | |
| Communication on reinsurance | | 80,000 | |
| Bonus utilized to reduce premium | | 120,000 | |
| Re-insurance recoveries of claims | | 80,000 | |
| | | | 12,280,000 |
| Less allowable expenses | | | |
| Claims: Brought forward | (400,000) | | |
| For the year | 4,800,000 | | |
| Carried forward | 700,000 | 5,100,000 | |
| Re-insurance premium paid | | 1,200,000 | |
| Commission on re-insurance accepted | | 2,000,000 | |
| Management expenses | | 40,000 | |
| Provision unexpired risk | 4,667,200 | 3,020,000 | |
| Closing | | | |
| Opening | (4,000,000) | 677,200 | |
| Medical expenses | | 50,000 | |
| Bad debts – specific | | 25,000 | |
| Legal expenses regarding claims | | 400,000 | |
| Wear and tear allowance | | 800,000 | |
| | | | (13,312,200) |
| Adjusted business income/(loss) | | | (1,032,200) |
| Rental Income: gross | | 750,000 | |
| Less expenses | | (150,000) | 600,000 |
| Interest income | | | 2,600,000 |
| Investment income | | 2,350,000 | |
| Less inv. Managers fees | | (600,000) | 1,750,000 |
| Total Taxable Income | | | 3,917,800 |

(ii) The loses from one source can be offset against the income from other sources.

## QUESTION THREE

(a) The Government can prevent loss of revenue from imports in the following ways:

- Correct valuation of imports such that there is no undervaluation.
- Impose stiff penalties on customs duty defaulters
- Adequate documentation using import declaration forms, importers code number, PIN, clean report of findings etc.
- Destruction of counterfeit goods which could be of low value compared to the original goods.
- Tightening controls at the point of entry and eradicate corruption among customs officers.

(b) (i)The following should register for VAT:

- Manufacturers whose annual turnover exceeds Sh.3 million.
- Hotel and restaurant owners
- Saw millers
- Motor vehicle dealers who sells four or more vehicles in any one year.
- Suppliers of designated goods such as jewellery, timber, motor vehicle spare parts, domestic electronic and electrical appliances etc.

-Suppliers of accountancy services such as auditing, book keeping etc.

(ii) Accounting for VAT:

- The VAT paid on expenditure should be accounted for as <u>input</u> tax while VAT charged on supply of goods and services should be accounted for as <u>output</u> tax.

(iii) How and when to account for VAT:

- The amount of VAT payable to the commissioner of VAT is equal to output tax minus input tax.

- This VAT is payable on or by 20th day of the month after the month of transaction. If the 20th day falls on a weekend or public holiday, Vat is payable on the last working or business days of the week before 20th.

(c) Assuming the buying price was inclusive of VAT at 16%, the:

Buying rice = Sh.2000

$$\text{B.P exclusive of VAT} = \frac{100}{116} x2000 = 1,724$$

$$\text{Input tax} = \frac{16}{116} x2000 = 276$$

| | | |
|---|---|---|
| Buying price exclusive of VAT | 1,724 | |
| Add conversion cost @ 25% | 431 | |
| | | 2,155 |
| Add 20% mark-up | | 431 |
| Selling price exclusive of VAT | | 2,586 |
| Add 16% output VAT | | 414 |
| Selling price inclusive of VAT | | 3,000 |

VAT payable = 414 – 276 = <u>138</u>

**QUESTION FOUR**

(a) Refer to Sec. 90 of Income Tax Act.

(b) Adjusted taxable income for Leta Ltd.

| | | Sh. | Sh. |
|---|---|---|---|
| Sales | | | 7,916,000 |
| **Less Cost of Sales** | | | |
| Opening Stock | | 1,134,000 | |
| Add Purchases | | 4,582,000 | |
| Less closing stock (W1) | | (1,213,000) | (4,503,000) |
| Gross profit | | | 3,413,000 |
| Add discounts received | | | 98,000 |
| | | | 3,511,000 |
| **Less allowable expenses only** | | | |
| Wages and salaries | 684,000 | | |
| Add accruals | 15,000 | 699,000 | |
| Administration expenses | 328,000 | | |
| Add accruals | 9,000 | 337,000 | |
| Debenture interest | 135,000 | | |
| Add accruals | 135,000 | 270,000 | |
| Research and development | | 96,000 | |
| Discount allowed | | 142,000 | |

| | | |
|---|---|---|
| Bad debts | 45,000 | |
| Directors remuneration | 400,000 | |
| Capital allowances | | |
| IBD (W2) | 32,625 | |
| WTA (W3) | 547,032 | (2,568,657) |
| Adjusted taxable income | | 942,343 |

W1 - The stocks are valued at the lower of cost a net realizable value i.e.

| | |
|---|---|
| Ziga | 468,000 |
| Zepa | 267,000 |
| Zela | 478,000 |
| | 1,213,000 |

W2 - ID on factory Building = 70% x 4,350,000 = 3,045,000
ID on machinery and equipment = 70% x 600,000 = 420,000
Residual for IBD – factory 4,350,000 x 30% = 1,305,000
Residual for WTA – M & E 600,000 x 30% = 180,000
IBD (2004) 1,305,000 x 2.5% p.a = 32,625
IBD (2005) 1,305,000 x 2.5% p.a = 32,625

W3 - W.T.A

| **Class** | **1 @ 37.5%** | **IV @ 12.5%** | **Total** |
|---|---|---|---|
| Motor lorries | 2,250,000 | - | |
| Machine & equipment | - | 180,000 | |
| | 2,250,000 | 180,000 | |
| | (843,750) | (22,500) | 866,250 |
| W.T.A 2004 | 1,406,250 | 157,500 | |
| | (527,344) | (19,688) | 547,032 |
| W.T.A 2005 | 878,906 | 137,812 | |

The I.D, IBD and W.T.A for 2004 would be claimed in 2004 since they were incurred in generation of 2004 income. The 2004 final assessment has an error and require adjustment with respect to the 2004 unclaimed capital deductions.

## QUESTION FIVE

(a) 1. Investment Deduction

| Nature of Asset | Quantity Cost | ID @ 100% | Residual WTA and IBD |
|---|---|---|---|
| Extension | 2,400,000 | 2,400,000 | - |
| Processing Machinery (donated) | 1,200,000 | 1,200,000 | - |
| | | 3,600,000 | |

2. Industrial building allowance/deduction (IBA/D)

| Nature of Building | Q. Cost | Residual b/f | IBD @ 2.5% | Residual c/f |
|---|---|---|---|---|
| 1997 building | 3,500,000 | *3,325,000 | 87,500 | 3,237,500 |
| | | | 87,500 | |

$$*\text{Residual b/f} = 3{,}500{,}000 - \frac{(3{,}500{,}000)\,2\ years}{40\ years} = 3{,}325{,}000$$

The building has already been used for 2 years (2004 and 2004). It can"t qualify for ID since its not new.

3. Farmworks deductions

| Farmwork | Residual/WDV | FWD p.a. |
|---|---|---|
| Farmhouse | 300,000 | 300,000 |
| Labour quarters | 400,000 | 400,000 |
| Workers canteen | 150,000 | 150,000 |
| Sewerage system | 40,000 | 40,000 |
| Wind vane | 60,000 | 60,000 |
| | | 950,000 |

The farmworks were already used for 2 years as at 1st January 2005. Therefore, farmworks deduction had already been granted for those two years and the residual (WDV is the FWD for the 3rd last year. FWD is granted at 33% of qualifying cost or over a 3 year period on straight line basis.

4. Wear and Tear allowances

| Class | I @ 37.5% | II @ 30% | III @ 25% | IV @ 12.5% |
|---|---|---|---|---|
| WDV 1.1.99 – Milling | | | | |
| Machines & Free machinery | - | - | - | 2,800,000 |
| Tractor | 5,000,000 | - | - | - |
| Lorries & Saloon cars | - | - | 7,100,000 | - |
| Computer system | - | 250,000 | - | - |
| Additions | | | | |
| Furniture | - | - | - | 800,000 |
| Aircraft | - | - | 24,500,000 | - |
| 3 new cars | - | - | 3,000,000R | - |
| Security systems | - | - | - | 200,000 |
| Disposals: | | - | - | |
| 3 traded-in cars (W1) | - | - | (900,000) | - |
| Insurance compensation | - | - | (190,000) | - |
| | 5,000,000 | 250,000 | 33,510,000 | 3,800,000 |
| | (1,875,000) | (75,000) | (8,377,500) | (475,000) |
| | 3,125,000 | 175,000 | 25,132,500 | 3,325,000 |

Total WTA 10,802,500

**Working:**

Restricted disposal value = Sales proceeds x restricted Q.C. in the year of purchase (2003) Cost

$$= \left(\frac{450{,}000}{750{,}000} x500{,}000\right) x3vehicles = 900{,}000$$

The sale proceeds is equal to the trade-in value of Sh.450,000 for each vehicle.

The disposal value for the car involved in an accident is the insurance compensation of Sh.190,000. However this is not restricted because the qualifying cost of the vehicle (Sh.300,000) in 2004 was less than the restricted qualifying cost of Sh.1,000,000.

(b) Adjusted Partnership Income

| | | |
|---|---|---|
| Net profits | 19,800,000 | |
| Add back salaries to partners | 1,000,000 | |
| Milk drawings | 230,000 | |
| | 20,030,000 | |
| Less capital allowances | | |
| Investment deduction | 3,600,000 | |
| IBD | 87,500 | |
| FWD | 950,000 | |
| WTA | 10,802,500 | (15,440,000) |
| | | 4,590,000 |

| Partner | A | B | C | Total |
|---|---|---|---|---|
| Salaries | 500,000 | 250,000 | 250,000 | 1,000,000 |
| Profit share | 1,795,000 | 1,196,667 | 598,333 | 3,590,000 |
| (3:2:1) | 2,295,000 | 1,446,667 | 848,333 | 4,590,000 |

(c) Comment:

- Land does not qualify for any capital deduction
- Goodwill is an intangible asset and does not qualify for any capital deduction
- Cost of vehicles involved in an accident not relevant in the above computation.

## QUESTION SIX

(a) Instalment tax

This is tax payable by all body corporates and individuals whose employment income exceeds ⅓ of total taxable income.
The tax is paid in advance (before end of accounting year) as follows:

| | | |
|---|---|---|
| 1st instalment | = | 25% of tax due - by 20th day of the 4th month |
| 2nd instalment | = | 25% of tax due – by 20th of 6 th months |
| 3rd instalment | = | 25% of tax due – by 20th day of 9th month |
| 4th instalment | = | 25% of tax due – by 20th day of 12th month |

The tax due is usually equal to 110% of last years tax liability.

(b) Appeals to income tax tribunal

A tribunal is an appeal body consisting of chairman and four other members, appointed by Minister of Finance for a two year period.
The tribunal hears appeals in respect of:

Shortfall distribution of dividends (Section 23 of Cap.470) e.g a firm must pay at least 40% of profits as dividends otherwise there will be shortfall distribution.

Transactions designed to avoid tax liability e.g inter-group transactions not made at arm"s length and intended to understate taxable income and tax liability.

(c) Regressive Taxes

- This is the opposite of progressive tax. The tax burden falls more heavily on the poor than on the rich especially when tax is imposed on basic commodities commonly consumed by the poor.
- It thus means that as income increases, the tax rate decreases and vice versa.

- This is a very unjust tax and no civilized government could impose such taxes.

(d) Government budget deficit

A budget is a statement showing revenue and expenditure of the Government for one particular year. A budget deficit arises when the Government expenditure exceeds the revenue.
When revenue exceeds expenditure, we would have budget surplus.

## MOCK 5

## QUESTION ONE

(a) Tax income for 18 months

| | | |
|---|---|---|
| Premiums received | | 30,000,000 |
| Less premiums paid | | (25,000,000) |
| Gross income | | 5,000,000 |
| Add other incomes | | |
| Commissions received | | 8,500,000 |
| Less allowable expenses only | | 13,500,000 |
| WTA | | |
| Rent paid | 232,500 | |
| Salaries and wages | 422,400 | |
| Subscriptions | 979,980 | |
| Charges by Commissioner of Insurance | 6,500 | |
| Bank charges | 15,000 | |
| Office stationery | 3,336 | |
| Office maintenance | 123,400 | |
| Auditor remuneration | 97,000 | |
| Directors fees | 100,000 | |
| Business fees | 108,000 | |
| Business travel | 68,000 | |
| Specific debt provisions | 45,000 | (2,201,116) |
| | | 11,298,884 |
| Add other incomes | | |
| Bank interest income gross (W1) | 10,555 | |
| Income from Treasury Bonds (W2) | 1,135,294 | 1,145,849 |
| | | 12,444,733 |

W1 and W2

It is assumed that the interest income is net of 15% withholding tax i.e it is 85% of gross. Therefore, gross income = $\frac{8972}{0.85}$=10,555 and $\frac{965,000}{0.85}$=1,135,294 respectively

(b) Tax liability

30% x 12,444,733 = 3,733,420

Less W/T on interest

| | |
|---|---|
| 15% x 10,555 | (1,583) |
| 15% x 1,135,234 | (170,285) |
| Net tax liability | 3,561,552 |

Assuming the firm"s financial year runs from 1st July through 30th June, then tax liability for the first yearwould be $\frac{12}{18}$x3,561,552=2,374,368

This would be payable by instalments as follows:

1st instalment – by 20th October 2005

2nd instalment – by 20th December 2005

3rd instalment – by 20th March 2006

4th instalment – by 20th June 2006

(c) Why all information was not used:

- W/T and isntalment taxes are not allowable expenses
- Donations are non-business expenses hence disallowable
- Depreciation is ignored and capital allowances taken instead as allowable.
- Equipment purchases is a capital expenditure which is disallowable
- General bad debts provisions are disallowable.

## QUESTION TWO

(a) Wasike and Associates
VAT Account for September 2005

Using 16% VAT rate

| Item | Sh. | Date | Output | Sh. |
|---|---|---|---|---|
| Electricity | 5,862 | 2/9 | « | 33,104 |
| Garbage collection | 4,996 | 10/9 | « | 49,655 |
| Stationery | 132,427 | 15/9 | « | 192,000 |
| Computer repair | 33,107 | 17/9 | « | 66,208 |
| Telephone | 45,517 | 18/9 | « | 384,000 |
| VAT payable | 811,889 | 19/9 | « | 115,200 |
| | | 21/9 | « | 18,759 |
| | | 24/9 | « | 24,828 |
| | | 26/9 | « | 12,414 |
| | | 30/9 | « | 137,600 |
| | 1,033,768 | | | 1,033,768 |

**Note :**

VAT on commercial rent was introduced with effect from 1 September 2005 but withdrawn on December 2005.
Candidates should be able to distinguish when a service is zero rated.

(b) Additional tax payable;

| | | | |
|---|---|---|---|
| - | Failure to submit return | - | Sh.10,000 |
| - | 2% of 811,882 (interest) | - | Sh.17,238 |
| | | | Sh.27,248 |

(c) Bad debt relief

| | Sh. | VST |
|---|---|---|
| September 10 | 360,000 | 49,655 |
| September 17 | 480,000 | 66,208 |
| September 21 | 136,000 | 18,759 |
| | 976,000 | 134,622 |
| | | |
| | 976,000 | 134,622 |
| | (240,000) | |
| | 736,000 | |

VAT relating to debt still owing:

$$\frac{sh.736,000}{976,000} = 134,622$$

= Sh.101,518 (Bad debt relief)

## QUESTION THREE

| | | |
|---|---|---|
| (a) | Projected Revenue | 160,011 |
| | Budgeted expenditure | 180,175 |
| | Budgeted deficit | 20,164 |

There is a projected budget deficit of Sh.20,164 million. This means that deficit financing will become necessary.

(b) Additional source of funds.

(i) Internal borrowing.
Constraints
- inflationary when funds repaid
- amount to be borrowed restricted to a percentage of GDP
- interest rates required to attract funds too high.

(ii) External borrowing
Constraints
- Country already in critical external destination situation
- numerous conditions given
- loss of national pride

(iii) Aid/Grants
Constraints
- Humiliating to the nation
- Not guaranteed as based on goodwill
- Impose conditions
- May not be sufficient

(iv) Printing money
Inflationary
Not allowed under IMF agreements
Illusionary

(v) Sale of national assets e.g. privatization.

## QUESTION FOUR

(a) The flower growers and exporters could benefit as follows:

- Exports are zero rated for VAT purposes and thus can claim a refund for input tax
- Exemptions from import duty on machinery, materials and other intermediate inputs
- They can claim the following capital allowances:-

Farmworks deductions
Diminution in value of farm tools and implements
Wear and Tear allowances on furniture, computers, tractors etc
I.B.D on storage facilities/buildings

(b) (i)Capital allowances

(I) Farmworks deduction

| Farmwork | Q-Cost (2003) | 2003 | 2004 | 2005 |
|---|---|---|---|---|
| Farm house | 900,000 | 300,000 | 900,000 | 900,000 |
| FWD | 900,000 | (300,000) | (300,000) | (300,000) |
| Residual | NIL | NIL | NIL | NIL |

The FWD is equal to the residual/WDV as at 31st December 2004

(2) Wear and Tear Allowances (using year 2004 rates)

| Class | I @ 37.5% | II @ 30% | III @ 25% | IV @ 12.5% |
|---|---|---|---|---|
| WDV Lorries & Tractors | 625,000 | - | - | - |
| Pick-ups & saloons | - | - | 1,250,000 | - |
| Computers | - | 750,000 | - | - |
| Plant, equipment & Furniture | - | - | - | 1,475,000 |
| Additions: M. Benz | - | - | 1,000,000R | - |
| Security systems | - | - | - | 250,000 |
| 4 new cars @ 500,000 | - | - | 2,000,000 | - |
| Equipment | - | - | - | 1,650,000 |
| Computers | - | 1,250,000 | - | - |
| Disposals: carpets | - | - | - | (450,000) |
| Furniture | - | - | - | (460,000) |
| 4 traded in cars (W1) | - | - | (600,000) | - |
| | 625,000 | 2,000,000 | 3,650,000 | 2,465,000 |
| W.T.A | (234,375) | (600,000) | (912,500) | (308,125) |
| | 390,625 | 1,400,000 | 2,737,500 | 2,156,875 |

Total WTA = 2,055,000

| | |
|---|---|
| Reported profits | 1,599,000 |
| Less: | |
| Farmwork deduction | (300,000) |
| W.T.A | 2,055,000) |
| Adjusted loss | (756,000) |

(b) The motor vehicle benefit would be taxable on the directors at the higher or

2% p.m x 500,000 x 12 = Sh.120,000
or fixed benefit on 1300cc = Sh.50,000

## QUESTION FIVE

(a) (i)The income of a taxable person is assessed on another person incase of a:

- Deceased person income assed on executors or administrators
- Incapacitated persons and minors – income assessed on guardian or trustee.
- Married women – income not earned at arms length assessed on the husband
- Non-resident ship – owners – income assed on the captain of the ship

(ii) Payment of tax by a married woman living with the husband.

- Where the husband has been declared bankrupt
- Where the husband is of unsound mind
- Where the husband does not have distrainable goods
- Where the husband does not have any taxable income (wife is the sole bread winner)

- The husband is untraceable or has gone underground.

(b) (i) Casual workers – casual workers who are engaged by the employer for periods less than one month are not taxable. However, if the casual worker is employed regularly he will be taxed.

(ii) Multiple sources of income
These are taxed on all incomes but granted personal relief only by the "main employer"

(c) Circumstances that trigger off PAYE Audit

- Salaries and wages figure per the audited accounts is higher or lower than the amounts reflected in the PAYE returns.
- PAYE is usually not paid on time
- Material fluctuations over the months on PAYE payments
- Third party information or complaints
- Non-compliance noted/detected during a normal tax examination be it VAT or Corporate tax examination.
- Off-late KRA is offering rewards to anybody who divulges information that leads to a tax recovery by authorized persons only.
- Newspaper reports
- Court cases
- Construction sites sign boards – This affects mainly contractors and professionals in the construction industry.
- Information emanating from related companies audited
- Cessation of business on a large part of a business
- Higher salaries awarded to middle level managers compared to those awarded to their seniors.

(d) Tax set-offs available to an individual tax payer to reduce gross tax liabilities are:

- PAYE deducted at source
- Double taxation relief
- Personal relief
- Any installment tax paid
- Withholding tax on non-qualifying dividends and royalties income
- Tax refunds of previous years of income.