

2804/305

TAXATION

November 2018

Time: 3 hours



THE KENYA NATIONAL EXAMINATIONS COUNCIL

DIPLOMA IN ACCOUNTANCY

TAXATION

3 hours

INSTRUCTIONS TO CANDIDATES

*This paper consists of **SIX** questions.*

*Answer any **FIVE** questions in the answer booklet provided.*

All questions carry equal marks.

Maximum marks for each part of a question are indicated.

Show all your working.

Candidates should answer the questions in English.

This paper consists of 7 printed pages.

Candidates should check the question paper to ascertain that all the pages are printed as indicated and that no questions are missing.

1 • (a) Explain **four** conditions to be met by a tax payer for an objection to be valid.

(8 marks)

(b) Mwalulu Limited operates a supermarket in Nairobi. The following income statement relates to business for the year ended 31 December 2017.

	Ksh	Ksh
Sales		8,560,000
Profit on sale of machinery		710,000
Dividends received		540,000
Discounts received		<u>340,000</u>
		10,150,000
Expenses		
Cost of sales	5,327,000	
Depreciation	430,000	
Legal fees	320,000	
Purchase of furniture	200,000	
Purchase of computers	120,000	
Professional fees	290,000	
Director's remuneration	400,000	
Rent and rates	450,000	
Donations	180,000	
Subscriptions	250,000	<u>7,967,000</u>
Net profit		<u><u>2,183,000</u></u>

Additional information:

- Legal fees include Ksh 130,000 for defending a directors against corruption.
- Professional fees include Ksh 90,000 paid to a tax consultant.
- Donations include Ksh 100,000 paid to a political party and Ksh 80,000 paid to children's home.
- Subscriptions comprises of Ksh 130,000 paid to a trade association and Ksh 120,000 to a non-governmental organisation.
- Capital allowances were agreed at Ksh 395,000 with the commissioner of Domestic Taxes.

(i) Prepare a statement of adjusted taxable profits for the year ended 31 December 2017.

(ii) Calculate the tax payable (if any) for the year ended 31 December 2017.

(12 marks)

2. (a) Explain **four** circumstances under which a manufacturer may shift the burden of a tax to the final consumer. (8 marks)

- (b) Tamu and Kali are in partnership sharing profits and losses in the ratio 3:2 respectively. The income statement for the year ended 31 December 2017 was as follows :

	Ksh	Ksh
Sales		4,350,000
Less: Cost of sales		
Opening inventory	830,000	
Purchases	<u>3,400,000</u>	
	4,230,000	
Less closing inventory	<u>(1,890,000)</u>	<u>(2,340,00)</u>
Gross profit		2,010,000
Farming income		<u>750,000</u>
		2,760,000
Operating expenses		
Salaries and wages	600,000	
Water and electricity	85,000	
Loss on sale of furniture	196,000	
Depreciation	215,000	
Rent and rates	200,000	
Interest expense	380,000	
Loan repayment	320,000	
Professional fees	250,000	
Purchases of computers	270,000	
Bad debts	110,000	
Insurance	<u>230,000</u>	<u>(2,916,000)</u>
Net loss		<u>(156,000)</u>

Additional information:

- Salaries and wages include Ksh 120,000 and Ksh 180,000 paid to Tamu and Kali for the year respectively.
- The interest expense includes interest on capital to partners of Ksh 170,000. The interest on capital to partners is shared on their profit sharing ratio.
- Professional fees include Ksh 70,000 paid to Tamu for his services as an auditor.
- Insurance of Ksh 60,000 relates to Tamu's life insurance.
- Drawings made by Tamu and Kali during the year amounted to Ksh 80,000 and Ksh 100,000 respectively. The drawings has been included in the cost of sales.
- The agreed capital allowances with the commissioner of Domestic Taxes was Ksh 290,000.

(12 marks)

Prepare:

- (i) A statement of taxable profits for the year ended 31 December 2017.
- (ii) A schedule showing the allocation of partners' taxable income for the year of income 2017.
- (iii) Kali intends to file his returns for the year of income 2017 with an estimated taxable income of Ksh 524,000. Using the results (ii) advise him in his tax position.

3. (a) Explain **two** advantages in each of the following:

- (i) Direct tax. (4 marks)
- (ii) Withholding tax. (4 marks)

(b) Mr. Mwanza was employed as an accountant of Pendo Company with effect from 1 January 2017. The following information relates to his income for the year of income 2017.

- Basic salary Ksh 120,000 per month (PAYE Ksh 29,000 per month)
- He stays in a company house, whose market rental rate is Ksh 25,000 per month but he pays a nominal rent of Ksh 2,500 per month.
- He was provided with a company car of 2000 CC whose initial cost was Ksh 1,400,000
- Insurance premiums paid for his life by the employer amounted to Ksh 240,000 for that year.
- Income from his retail business amounted to Ksh 450,000 for that year.

Calculate the:

- (i) Taxable income for the year of income 2017.
- (ii) Tax payable.

(12 marks)

4. (a) Explain **four** offences that may be committed by a tax payer. (8 marks)

(b) Mrs. Okello has been operating business without proper accounting records for the last four years. The following information relates to the business for the year ending 31 December;

	2014	2015	2016	2017
	Ksh '000	Ksh '000	Ksh '000	Ksh '000
Assets:				
Land	2,300	2,300	2,300	3,400
Buildings	1,800	2,600	2,600	3300
Motor vehicles	1,200	1,200	400	400
Furniture	1300	600	800	800
Inventories	780	800	870	900
Trade receivables	1,300	1,400	1,000	980
Bank	-	650	700	500
Liabilities:				
Accounts payable	560	700	930	910
Bank loan	1,700	1,100	1,100	1,100

Additional information:

- The total assets and liabilities as at 31 December 2013 were ksh 4,350,000 and Ksh 1,700,000 respectively.
- Estimated living expenses were Ksh 275,000 in 2014 and increased by 25% every subsequent year.
- Furniture with a book value of Ksh 900,000 was sold for Ksh 750,000 in 2014.
- A motor vehicle with book value of Ksh 800,000 was sold in 2015 for Ksh 1,150,000.
- Interest charged on the loan is to be ignored.

Calculate the income chargeable to tax for the years 2014,2015,2016 and 2017.

(12 marks)

5. (a) Explain five ways in which Value Added Tax (VAT) satisfies the principles of a good tax system. (10 marks)

- (b) The following are the purchases and sales of Mako Traders for the months of April to September 2017.

	Purchases	Sales
	Ksh	Ksh
April	1,900,000	3,360,000
May	2,100,000	2,850,000
June	1,850,000	4,400,000
July	2,000,000	2,700,000
August	2,300,000	3,900,000
September	1,870,000	2,800,000

Additional information:

- (i) 50% of the June 2017 and August 2017 Sales were exported to Tanzania.
- (ii) Issued credit notes to debtors amounted to Ksh 700,000 in July 2017.
- (iii) Received credit note for Ksh 950,000 from Perna suppliers in September 2017.
- (iv) Transactions are exclusive of VAT at the rate of 16%.

Prepare a VAT account for each of the months showing the VAT payable or refundable. (10 marks)

6. (a) Explain the tax treatment of the following:

- (i) Loose tools. (2 marks)
- (ii) Amount paid on passages. (6 marks)

- (b) Mr. Komeni is a commercial farmer in Nakuru Country. On 30 June 2017, he completed building a farm house at the cost of Ksh 2,100,000 and occupied it immediately. Additional expenditure incurred during the year 2017 was as follows:

	Ksh
Tractor	2,000,000
Milking machinery	500,000
Irrigation system	350,000
Cattle dip	840,000
Labour quarters	1,880,000
Chicken pen	100,000
Motor van	1,400,000
Sewerage system	90,000
Farm implements	60,000
Computers	180,000

Calculate the capital allowances due to Mr. Komeni for the year of income 2017.

(12 marks)

RATE OF TAX (including wife's employment, self employment and professional income rate of tax).
Year of income 2017.

Annual taxable pay	Monthly taxable pay	
On the first Kshs 134,164	On the first Ksh 11,180 10%
On the next Ksh 126,403	On the next Ksh 10,534 15%
On the next Ksh 126,403	On the next Ksh 10,534 20%
On the next Ksh 126,403	On the next Ksh 10,534 25%
On all income over Ksh 513,403	On all income over Ksh 42,781 30%

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

Prescribed benefits rates of motor vehicles provided by employer

			Monthly Annual rates (Ksh) rates (Ksh)			
Capital allowances			(i) Saloons, Hatch Backs and Estates			
Wear and tear allowance:			Up to	1200 cc	3,600	43,200
Class I	37.5%		1201	- 1500 cc	4,200	50,400
Class II	30%		1501	- 1750 cc	5,800	69,600
Class III	25%		1751	- 2000 cc	7,200	86,400
Class IV	12.5%		2001	- 3000 cc	8,600	103,200
Industrial building allowance:			Over	3000 cc	14,400	172,800
Industrial buildings	10%		(ii) Pick-ups, Panel Van (uncovered)			
Hotels	4.0%					
Farm works allowance	33.3%		Upto	1750 cc	3,600	43,200
Investment deduction allowance:			Over	1750 cc	4,200	50,400
2003 -	70%		(iii) Land Rovers/Cruisers		7,200	86,400
2004 -	100%		OR 2% of the initial capital cost of the vehicle for each month, whichever is higher.			
2005 - 2010	100%					
Shipping investment deduction 40%						
Mining allowances						
Year 1	-	40%				
Year 2-7 -	10%					

Commissioner's prescribed benefit rates

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

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