

KABARAK



UNIVERSITY

**UNIVERSITY EXAMINATIONS
2009/2010 ACADEMIC YEAR**

**FOR THE DEGREE OF BACHELOR OF
COMMERCE**

COURSE CODE: ACCT: 322

COURSE TITLE: TAXATION II

STREAM: Y3S2

DAY: THURSDAY

TIME: 9:00 – 11:00 A.M.

DATE: 25 /03/2010

INSTRUCTIONS:

1. This paper comprise of four questions
2. Question one is compulsory
3. You are required to answer any other two questions
4. Marks for each question are indicated at the end of every question
5. You are required to use taxation rates for the year 2009 unless otherwise instructed

PLEASE TURNOVER

QUESTION ONE

- 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. (3marks)
- (c) Kabu (K) Ltd is a leading manufacturer of a wide range of goods which are either consumed locally or exported. During the month of September 2009, the following transactions took place:

September 2: paid Sh.960,000 to Dr. Kip Kaput, an American citizen of Kenyan origin, who had come to design the company's website.

4. paid Sh.3, 200,000 for the construction of an extension to the factory building which had been completed. Out of this amount, Sh.1, 000,000 represents purchase of land.
5. Purchased goods on credit from town C. .Ltd worth Sh.1, 360,000.
6. Purchased stationery for use in the business on credit from Ereto Book shop worth Sh.500, 540.
6. Sold goods worth Sh.2, 650,000 on credit to Mwakenya Ltd.
7. Sold goods to Kipsyot Ltd for Sh.1, 790,200.
- 9 Paid Tango Shipping Line Sh.350, 000 for transporting goods purchased by Town C. Ltd.
- 10 Mwakenya Ltd returned goods worth Sh.300,000 due to some major defects.
- 11 Sold goods worth Sh.865,000 on credit to Amagopo Wholesalers.
12. Returned defective office stationery, which had cost Sh.50,800 to Ereto Book shop
14. Sold goods for Sh.1, 220,000 to Sotafic Miners Ltd a company based in South Africa.
- 16 Goods worth Sh.200, 000 were stolen while in transit to South Africa.
- 18 Granted Sh.20,000 allowance to Sotafic Miners Ltd for some minor defects on some items.
- 18 Agreed to cancel the account receivable from Kipsyot Ltd in exchange for services rendered by them to the company in the Coast Province.

Required:

- (i) The VAT account for Kabu (K) Ltd for the month of September 2005 (where applicable prices and payments made are VAT inclusive). (15 marks)
- (ii) Amount of VAT payable and when it is due. (4 marks)
- (iii) Briefly describe the procedure for payment of VAT on an imported service. (3 marks)

(iv) Comment on any information not used in (I) above.

(1 mark)

(Total: 30 marks)

QUESTION TWO

(a) Ojwang Kimondo and sons Ltd. commenced manufacturing operations on 1 January 2006. The management of the company has prepared the following financial statements for the year ended 31 December 2009:

Balance sheet as at 31 December 2009:

	Sh.	Sh.
Non-current assets:		
Factory building		8,600,000
Motor vehicles		2,500,000
Machinery		5,400,000
Computers		900,000
Furniture and fittings		<u>360,000</u>
		<u>17,760,000</u>
Current assets:		
Stock	840,000	
Trade debtors	360,000	
Cash at bank	<u>780,000</u>	<u>1,980,000</u>
	<u>19,740,000</u>	
Financed by:		
Ordinary share capital of Sh.20 each		10,000,000
Profit and loss account		1,500,000
Loan		2,500,000
10% debenture stock (issued 1 January 2003)		3,000,000
Current liabilities		
Trade creditors	2,000,000	
Bank overdraft	740,000	<u>2,740,000</u>
		19,740,000

Profit and loss account for the year ended 31 December 2009:

	Sh.	Sh.
Gross sales		
Less expense		12,000,000
Repairs and maintenance	364,000	
Administration expenses	321,000	
Depreciation	425,000	
Subscriptions to the chamber of Commerce	100,000	
Hire purchase interest	36,000	

Annual lease payment for a 99 year lease	<u>87,000</u>	<u>1,333,000</u>
Reported profit		<u>10,667,000</u>

Additional information:

1. Non-current assets are stated net of depreciation including for year 2009. \It is the policy of the company to charge depreciation at 20% per annum on a straight line method
2. The company had not claimed allowances since it commenced operations.
3. The company has not claimed capital allowances since it commenced operations.
4. The company's reported taxable profits for the year ended 31 December 200, 2007 and 2008 were Shs.8,00,000 and Shs.6,400,000 shs.5,600,000 respectively.
5. Factory building includes an extension to the factory constructed at a cost of sh.1,600,000 which was put into use on 1 January 2006.
6. Machinery includes; a generator and conveyor belts bought for Sh.1,400,000 and Sh.800,000 respectively. These were put in use on 1 January 2006.
7. Motor vehicles include a forklift purchased in year 2007 at Sh1,160,000.
8. A saloon car purchased in years 2008 at Sh.12,000,000 was disposed of during the year 2009 for Sh.6000,000 no adjustments have been made to record this disposal.
9. The loan was received on 1 January 2008 and is subject to interest at the rate of 8% per annum.

Required:

(I) Capital allowances due to Ojwang Kimono and sons Ltd. for each of the three years ended 31 December 2003, 2004 and 2005. (10 marks)

(ii) Adjusted taxable profit or loss for the company in each of the three years above. (4 marks)

(Total: 20 marks)

QUESTION THREE

- a. Clearly explain the implication of non-deductible expenses as far as capital assets are concerned. (2 marks)
- b. Explain the following terms as used for taxation purposes so as to clearly distinguish them:
 1. capital allowance
 2. Manufacture under bond
 3. Export processing zone (EPZ)
 4. Industrial buildings
 5. Hotel building (5 marks)
- c. comment on the following issues as far as capital allowances are concerned.
 - i. Munyua who recently won in a rotary competition wants to invest in manufacturing.

- ii. He has acquired an old building which he intends to convert to a factory which will manufacture cotton thread for the purpose of the local market. He expects to extensively refurbish and renovate the building so as to accommodate the second hand machinery which he intends to import from India. Some of the machines will be permanently fixed to the fabric of the building while some will be independent and motorized. (5 marks)
- iii. 2. Mr. Kiprop Kimenju wants to start a business. His main concern is taxation. He has heard of VAT as a very annoying tax. He can either start a jewelery shop, an electronic shop, a motor spares shop, a posho mill or a fabricating workshop. He expects to generate turnovers of 2, 3, 5 and 10 millions in the next four years.
(5 marks)
- iv. 3. Omolo Obama Washington is an enterprising young Kenyan. He has an innovative new machine which he believes will course a revolution in the cremation industry. By subjecting the bodies to a chemical process, he can convert bodies to a clean pack of storable energy with very minimal solid matter. He intends to claim investment allowance.
(3 marks)

QUESTION FOUR

- a) Explain the following terms so as to distinguish them
- (i) Back duty:
- (ii) Interest on tax arrears (2 marks)
- b) Mr. Kamone Kiprotich, a retail trader, does not maintain proper books of account. You are provided with the following information:
1. His profit for the years ended 31 December 2004 to 2009 were as follows:

Year	Profit (Sh.)
2004	735,000
2005	740,000
2006	787,000
2007	1,375,000
2008	1,214,000
2009	926,000

2. The creditors, debtors, cash and stock as at 31 December 2004 and 31 December 2009 were as follows:

	31 December 2004	31 December 2009
	<i>Sh.</i>	<i>Sh.</i>
Creditors	732,000	840,000
Debtors	145,000	592,000

Cash	947,000	1,945,000
Stock	542,000	674,000

3. Mr. Kamone Kiprotich owed his brother Sh.40,000 on 31 December 2003. This was repaid on 15 February 2007. Kamone Kiprotich lent his brother Sh.300,000 on 1 January 2009.

4. Over the years, Mr. Kamone Kiprotich has purchased the following assets:

Year	Item	Amount (Sh)
2003	House	2,000,000
2008	Car	450,000
2009	Sh. 1,000,000 26% Treasury bond	1,050,000

5. In 2007, Sh.300,000 in cash was stolen from his house.

His living expenses are estimated as follows:

2004 Sh.500,000; 2005 Sh.550,000; 2006 Sh.650,000; 2007, 2008 and 2009 Sh.700,000 per annum.

He received a legacy of Sh.125,000 in August 2001 from the estate of his father.

Required:

- a) A statement showing the growth of capital between 2000 and 2005 for tax purposes.
- b) Comment on the tax treatment of such increase in capital on Mr. Kamone Kiprotich's tax liability.

(18 marks)

QUESTION FIVE

Your brother a doctor by profession intends to set up a business for his wife and sister who will operate the business on equal terms as partners. He has requested you to advise him on the tax matters involved. He has particularly requested you to explain to him on the following matters: 1) VAT on imports and exports 2) capital allowances on saloon cars 3) investment allowances 4) industrial building allowances 6) shipping investment allowances 7) export processing zone capital allowances 8) capital allowances available on computers and related machineries 9) the meaning of manufacturing under bond and 10) taxation of partnerships.

(20 marks)