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**University Examinations 2015/2016**

SECOND YEAR, SECOND SEMESTER EXAMINATION FOR THE DEGREE OF BACHELOR OF COMMERCE

AND

SECOND YEAR, FIRST SEMESTER EXAMINATION FOR THE DEGREE OF BACHELOR OF CO-OPERATIVE MANAGEMENT

**BFC3276: INTRODUCTION TO TAXATION**

**DATE: NOVEMBER 2015 TIME: 2 HOURS**

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

**QUESTION ONE (30 MARKS)**

1. Explain the meaning of the term “Residence” when applied to a company under Kenya Income Tax Act. CAP 470 (5 Marks)
2. Explain the main canons of taxation as outlined by economist Adams Smith (10 Marks)
3. Achievers Limited makes its accounts to 31st December of each year and has prepared the following profit and loss account or 2014:

**Dr Cr**

**Shs. Shs.**

General administrative expenses 40,000 Gross profit b/d 200,000

Repairs and renewals 12,000 Bad debts previously

Depreciation 10,000 written off 1,000

Subscriptions and donations 2,000 Dividends (Gross) 5,000

Bad debts 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 3,000 Tax refunded 20,000

Retirement benefits 50,000

Rent, rates and insurances 30,000

Legal and accountancy 41,500

Interest on overdue tax 2,500

Interest in lieu of dividends 30,500

Net profit before taxation 242,000 242,000

**Notes**

1. **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

1. **Subscriptions and donations** **Sh.**

National Chamber of Commerce and industry 1,000

NE Refuge Fund 1,000

 2,000

1. **Bad debts:**

This is on account of a previous company employee who cannot now be traced

1. Preliminary expenses: **Sh.**

Legal fee on issue of shares on stock exchange 2,000

Payment for stationery before commencement of business 2,000

 3,000

1. **Retirement:** Sh.

NSSF Contribution 5,000

Registered Pension Scheme for senior management 40, 000

Gifts to retiring staff 5,000

 50,000

1. 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 41,500

1. Dividends:

These wee from a subsidiary company where Chumex own 60% of the shares

1. Capital Allowances for 2005 have been agreed at Sh.30,000

**Required:**

1. Compute Corporation tax liability for 2005.
2. State the dates when such tax should be paid (15 Marks)

**QUESTION TWO (20 MARKS)**

Mrs. Mary Kawira and her husband Mr. John Kawira had the following income for 2015:

**Mrs. Mary Kawira:**

Salary Sh.90, 000 per month

Life insurance paid by employer for her Sh.3, 000 per month

Pension contributions paid by employer:

Approval 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 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 lump sum

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 Kawira**

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 Sh.33, 000

Mortgage interest on loan Sh.80, 000

Hardship allowance; Sh.290, 000

Business income – Tanzania Sh.500, 000

Dividends from Tanzania company Sh.35, 000

Free lunches sh.20, 000 paid for by his employer. Mwangaza Trading Company based in Tanzania.

**Required:**

1. The total chargeable income for Mr. and Mrs. Kawira (12 Marks)
2. Comment on any information not used above. (5 Marks)
3. PAYE was not deducted from the income of Mrs. Kawira. Are Mr. and Mrs. Kawira to blame for failure of the employer to deduct and pay PAYE? Explain (3 Marks)

**QUESTION THREE (20 MARKS)**

1. The Managing director of MUST Limited has passed to you a copy of the company’s capital budget for the year ended 31st December 2014:

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

 Anew 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 2002.

Computerize the system of the company £90, 000

**Required:**

1. A statement showing the capital allowances available in respect of the accounting period ended 31st December 2015, assuming all items are purchased according to the budget. (12 Marks)
2. Explain the following terms as used in the second schedule (Capital deductions)) of the income tax ACT CAP 470 (8 Marks)
* Balancing charge
* Trading receipt
* Balance allowance
* Trading loss

**QUESTION FOUR (20MARKS)**

Explain the following matters of taxation:

1. Presumptive income. (5 Marks)
2. Reverse charge (5 Marks)
3. Insurance relief (5 Marks)
4. Taxation of Export Processing Zone Enterprises (5 Marks)

**QUESTION FIVE (20 MARKS)**

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 tapes 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 tapes 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 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 a 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:**

1. The VAT payable or refundable for each month, clearly indication when due. (15Marks)
2. The penalties (where applicable) relating to the above transactions (4 Marks)
3. State and explain the VAT position on recoveries from insurance (1 Marks)