



UNIVERSITY OF EMBU

2017/2018 ACADEMIC YEAR

TRIMESTER EXAMINATIONS

**SECOND YEAR EXAMINATION FOR THE DEGREE OF
BACHELOR OF COMMERCE**

DAC 202 PRINCIPLES OF TAXATION

DATE: AUGUST 3, 2018

TIME: 8:30-10:30AM

INSTRUCTIONS:

Answer Question ONE and ANY Other TWO Questions.

QUESTION ONE (30 MARKS)

- a) Distinguish between the following set of terms as used in taxation
- i) Impact and incidence of tax (2 marks)
 - ii) Tax avoidance and Tax evasion (2 marks)
 - iii) Forward shifting and backward shifting (2 marks)
- b) Explain the four canons of taxation put forward by Adam Smith (6 marks)
- c) Highlight the reasons behind the inability of Kenya Revenue Authority (KRA) to meet tax collection targets (6 marks)
- d) Explain ways through which the commissioner for income tax may collect overdue tax (6 marks)
- e) Lawrence Kamau operates an electronics shop along Murang'a town. He undertook the following transactions for the month of March 2016:
- 1-Mar-16 Purchased 10 cameras for a total of Sh.500,000
 - 4-Mar-16 Purchased flashbulbs for a total of Sh.200,000
 - 4-Mar-16 Purchased 5 slide projectors for a total of sh.1,000,000
 - 5-Mar-16 Sold 5 cameras each at 25% above cost price.
 - 6-Mar-16 Purchased 200 wrist-watches at Sh.1,500 each.

- 8-Mar-16 Sold 2 slide projectors for a total of Sh.500,000.
- 9-Mar-16 Sold flashbulbs that cost sh.100,000 for Sh.150,000.
- 12-Mar-16 Purchased 50 flash discs for a total of Sh.50,000
- 15-Mar-16 Purchased 100 phones at a total value of sh.800,000
- 18-Mar-16 Sold the remaining 5 cameras each at 25% above cost price.
- 20-Mar-16 Sold 3 slide projectors for a total of sh.750,000.
- 22-Mar-16 Sold 100 wrist-watches at sh.2,000 per watch.
- 25-Mar-16 Sold 70 phones each at 30% above cost.
- 27-Mar-16 Sold 50 flash discs for a total of Sh.75,000.

Required: Prepare the VAT account clearly showing the VAT payable (refundable). (6 marks)

QUESTION TWO (20 MARKS)

Mr. Mambo is employed by Jiinue Bank Ltd. as a chief accountant. He has presented the following details to be used in the computation of his taxable income for the year ended 31 December 2017 :

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. 400,000 per month. The banks had a scheme that covered senior employees only
3. His employer provided him with the following
 - A car which was acquired at a cost of Sh. 1,200,000. This car has an engine capacity of 2000c.c.
 - A house whose market value is sh.15,000 per month The employer deducted Sh5000 from Mr. Mambo's salary every month to cover rent for the house.
 - A gardener and a night watchman who were paid sh.8,000 and Sh.9000 per month respectively
4. He contributes Sh. 8,000 per month to a registered pension scheme while the employer contributes an equal amount.
5. He worked away from his work station for 5 days and was paid sh.4,000 daily subsistence allowance.
6. The employer paid his life insurance premium for the year amounting to sh.100,000
7. For the year ended 31 December 2017, the employer provided Mr. Mambo with tea and snacks valued at Sh. 3,000.

8. Mr. Mambo attended a one-day seminar and received Sh. 25,000 from his employer as allowances. He donated 10% of this amount to a local childrens' home.
9. He was nominated the employee of the year on 31 December 2017. This award carried a cash gift of Sh. 45,000.
10. Mr. Mambo operates a savings account with Post Bank Ltd. During the year ended 31 December 2017, the bank credited his account with Sh. 2,000 being interest on the balance in his account.
11. In the month of November 2017, he received compensation from an insurance company amounting to Sh. 80,000. This was in relation to household furniture destroyed by fire.
12. On 5 November 2017, 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

Required:

- a) Mr. Mambo's taxable income for the year ended 31 December 2017 (14 marks)
- b) Tax payable on the taxable income computed in (i) above. (3 marks)
- c) Comment on information not included in the above computations (3 marks)

QUESTION THREE (20 MARKS)

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 2017, 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	<u>(800,000)</u>	<u>(5,400,000)</u>
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	(4,013,000)
Net profit		<u>3,987,000</u>

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 2017 .
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 2017 were agreed at Sh. 120,000.

Required:

- i) The partnership's adjusted profit (or loss) for tax purposes for the year ended 31 December 2017 (12 marks)
- ii) Distribution of the taxable profit (or loss) between the partners as at 31 December 2017 (8 marks)

QUESTION FOUR (20 MARKS)

- a) Explain the meaning of the term residence in relation to an individual (4 marks)
- b) Indicate whether the following individuals who have no permanent home in Kenya are considered as resident or non-resident for the ended 31st December 2017 for income tax purposes. (6 marks)

Name	Year	Number of days present
1. Mr Lewis	2017	189days
	2016	48days
	2015	NIL

- | | | |
|---------------|------|----------|
| 2. Mr Brooke | 2017 | 105 days |
| | 2016 | 145 days |
| | 2015 | 146 days |
| 3. Mrs. Walia | 2017 | 72 days |
| | 2016 | 115days |
| | 2015 | 177 days |

- c) State and explain any five factors that are likely to influence taxable capacity in a country
(10 marks)

QUESTION FIVE (20 MARKS)

- a) Explain the allowable deductions from employment income (10 marks)
- b) Describe the tax treatment of the following
- i) Employee Share Ownership Plan (ESOP) (3 marks)
 - ii) Passages (3 marks)
 - iii) Meals provided by the employer (4 marks)

RATES OF TAX

RATES OF TAX (Including wife's employment, self-employment and professional income rates of tax).

Year of income 2016.

Monthly taxable pay (Sh.)	Annual taxable pay (Sh.)	Rate of tax % in each Sh.
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 Sh.1,162 per month (Sh.13,944 per annum)

Prescribed benefit rates of motor vehicles provided by employer

	Monthly rates (Sh.)	Annual rates (Sh.)
Capital allowance:		
Wear and tear allowance:		
Class I 37.5%	(i) Saloons, Hatch Backs and Estates Up to 1200 cc 3,600	43,200
Class II 30%	1201 - 1500 cc 4,200	50,400
Class III 25%	1501 - 1750 cc 5,800	69,600
Class IV 12.5%	1751 - 2000 cc 7,200	86,400
Software 20%	2001 - 3000 cc 8,600	103,200
	Over 3000 cc 14,400	172,800

Industrial building allowance:
Up to 2009 2.5%
From 1 January 2010 10%
Hotels 10%
Hostels/Educational/Film producers buildings 100%

From 1 January 2010 -
Commercial building:
(Shop, office or show room) 25%

Farm works allowance 100%

Investment deduction allowance 100%

Shipping investment deduction 100%
(Ships over 125 tonnes)

Extraction expenditure:
Written off over 5 years (20%)

Commissioner's prescribed benefit rates

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

NB. With effect from 1st January 2017, the personal relief increased from ksh 13,944 Per Annum to **ksh 15,360**. The Tax Bands were expanded by 10% as follows:-

On the first shs. 134,16410%
On the next shs.126,40315%
On the next shs.126,40320%
On the next sh.126,40325%
On all income over shs.513,373.....30%

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