



# KENYATTA UNIVERSITY

## UNIVERSITY EXAMINATIONS 2017/2018

### SECOND SEMESTER EXAMINATION FOR THE DEGREE OF BACHELOR OF COMMERCE

#### BAC 304: FUNDAMENTALS OF TAXATION

DATE: Tuesday 24<sup>th</sup> July 2018

TIME: 8.00a.m -10.00a.m

**INSTRUCTIONS:** Answer all questions.

#### Question one

(a) Discuss four arguments in favour of progressive taxes in a developing country like Kenya. [4marks]

(b) Almasi is an employee of Jenga Ltd. He has provided the following details relating to all his incomes for the year ended 31<sup>st</sup> December 2017:

#### Employment income:

1. Monthly basic salary of shs.300,000 (PAYE tax shs.84,000) and annual leave allowance of 50% of one month's basic salary.
2. On December 15<sup>th</sup> 2017, he received an end of year bonus of shs.450,000 from his employer.
3. He is housed by the employer in a leased house where Jenga Ltd pays rent on a quarterly basis of shs.300,000 per quarter.
4. He uses a company car (2000cc) which was purchased in 2015 at a cost of shs.2.8million. Depreciation on motor vehicles is at the rate of 20% per annum on cost for insurance purposes.
5. He has a life assurance policy where the company paid premiums of shs.250,000 per annum on his behalf.
6. Almasi is a member of the company's contributory pension scheme which is registered with KRA. He contributes shs.11,000 per month and the employer contributes an equal amount towards the pension scheme.
7. In August, Almasi was reimbursed shs.310,000 in relation to medical expenses for his children during the year. The medical scheme covers senior employees only.
8. He is a member of a house ownership savings plan where he contributes shs.30,000 per month. He intends to build his own house in 3 years' time.

#### Other incomes:

	Shs.
Interest from Treasury Bills	350,000(net)
Interest from 30year Treasury Infrastructure Bond	180,000(net)
Dividends from Hekima Cooperative society	49,000 (net)
Net Farming income (excluding family consumption of Farm produce worth shs.50,000)	180,000
Net professional loss during the year (part-time consultancy)	<u>(360,000)</u>

Required:

Compute for Mr. Almasi for the year ended 31 December 2017:

- i. Taxable income [12marks]
- ii. Tax liability [2marks]
- iii. Comment on any information not used in your calculations in b (i) and (ii) above [2marks]

[Total 20marks]

**Question two**

- (a) Highlight five factors that influence the extent of forward shifting of indirect taxes [5marks]

Waridi Manufacturing Ltd commenced operations on 1 July 2016 after incurring the following expenditures:

ITEM	Shs.
Factory building	8,500,000
Processing machinery	15,000,000
Generator	600,000
Workshop machinery	1,250,000
Computers	9,200,000
1 Pickup vehicle	1,640,000
Go-down	9,000,000
Saloon Car	3,000,000
Photocopier	750,000
Tractor	2,300,000

Additional information:

1. Factory building includes the cost of fire outlet Shs.450,000 and a retail shop Shs.780,000.
2. A perimeter wall was constructed at a cost of shs1.5million and put into use on 1 October 2016.
3. The go-down was put into use on 1 September 2016 after installation of a ventilation system and elevators at a cost of Shs 960,000 and Shs.1,450,000 respectively.
4. On 1 January 2017 the following assets were acquired:

ITEM	Shs.
Conveyor belts	1,680,000
Surveillance cameras	2,100,000
Accounting software	2,690,000
Television set-reception area	230,000
2 additional pickups	4,800,000
Office furniture	1,500,000

5. The saloon car was involved in an accident in September 2017. The company received Shs3million as compensation for the loss in the same year. Those funds were used to buy a Mercedes Benz for the production manager at a cost of Shs.4.5million.
6. Two computers valued at shs.800,000 were disposed at a cost of shs.750,000 in 2017 and a new advanced computer purchased in the same year to aid in production at a cost of shs2.5million.
7. The company sunk a borehole at a cost of shs.1.3million which was put to use on 1 November 2017.

Required:

- (b) Capital allowances due to the company for the years of income ended 31 December 2016 and 2017.

[15marks]

[Total 20marks]

**Question three**

Carol, Lucy and Wambui are in partnership trading as Divas enterprises and sharing profits and losses in the ratio of 2:2:1 respectively. The following income statement was prepared by the partnership for the year ended 31 December 2017:

Income	Shs
Gross profit	18,000,000
Farming income	4,000,000
Rental income	7,500,000
Dividends from Hekima Cooperative Society	250,000
Foreign Exchange gains	375,000
Interest from NIC bank	580,000
<b>Total Income</b>	<b>30,705,000</b>
<b>Expenditure</b>	
General expenses	3,750,000
Legal fees	575,000
Interest on bank loans	1,890,000
Loss on sale of furniture	350,000
Drawings by partners	1,280,000
Bank charges	160,000
Repairs	184,000
Advertisement	136,000
General provision for bad debts	120,000
Loan repayment	248,000
Interest on capital	682,800
Salaries	4,200,000
<b>Total expenditures</b>	<b>13,575,800</b>
<b>Reported profit</b>	<b>17,129,200</b>

**Additional information:**

1. Advertisement includes a neon sign valued at Shs.50,000
2. Interest on capital is in the profit sharing proportion.
3. Legal fees include shs.54,000 to purchase a lap top for the business
4. Drawings by partners were as follows:

	Shs.
Carol	400,000
Lucy	600,000
Wambui	280,000
<b>Total</b>	<b>1,280,000</b>

5. Salaries include salaries paid to the partners as follows:

	Shs.
Carol	720,000
Lucy	480,000
Wambui	1,020,000
<b>Total</b>	<b>2,220,000</b>

**Required:**

- i. The taxable income or loss of the Partnership
- ii. Total taxable income or loss for each partner

[16marks]

[4marks]

[Total 20marks]

**Question four**

A tax payer who is not satisfied with KRA's decision regarding his objection has a right to appeal to the local committee.

- (a) In relation to the above statement. Highlight four instances when a tax payer can appeal to the local committee. [4marks]
- (b) The Kenya Revenue Authority [KRA] recently launched an online based integrated tax management system. Highlight three benefits that may accrue from using an I-tax system to
- i. KRA [3marks]
  - ii. Tax payers [3marks]

[Total 10marks]