



STRATHMORE UNIVERSITY BUSINESS SCHOOL
BACHELOR OF FINANCIAL SERVICES
END OF SEMESTER EXAMINATION
BFS 2103: TAXATION IN BUSINESS

Date: Wednesday 2nd August 2023

Time: 2 Hours

Instructions

1. This examination consists of **FIVE** questions.
2. Answer **Question ONE (COMPULSORY)** and any other **TWO** questions.
3. Use the following table for prescribed information.

Year of Income 2022.		
Monthly taxable pay (Sh.)	Annual taxable pay (Sh.)	Rate of tax % in each Sh.
1 - 24,000	1 - 288,000	10%
24,001 - 32,333	288,001 - 388,000	25%
Excess over - 32,333	Excess over - 388,000	30%

Personal relief Sh.2,400 per month (Sh.28,800 per annum).

Investment allowance:	Rate of investment allowance	Residual value (25% per year on equal instalments)	Prescribed benefit rates of motor vehicles provided by employer		
Capital expenditure incurred on:			(i) Saloons, Hatch Backs and Estates		
				Monthly rates (Sh.)	Annual rates (Sh.)
(a) Buildings:			Up to 1200 cc	3,600	43,200
• Hotel building	50% in the first year of use	25%	1201 - 1500 cc	4,200	50,400
• Building used for manufacture	50% in the first year of use	25%	1501 - 1750 cc	5,800	69,600
• Hospital buildings	50% in the first year of use	25%	1751 - 2000 cc	7,200	86,400
• Petroleum or gas storage facilities	50% in the first year of use	25%	2001 - 3000 cc	8,600	103,200
• Educational/hostels building	10% per year on straight line basis		Over - 3000 cc	14,400	172,800
• Commercial building	10% per year on straight line basis				
(b) Machinery:			(ii) Pick-ups, Panel Vans (unconverted)		
• Machinery used for manufacture	50% in the first year of use	25%	Up to - 1750 cc	3,600	43,200
• Hospital equipment	50% in the first year of use	25%	Over - 1750 cc	4,200	50,400
• Ships or aircraft	50% in the first year of use	25%			
• Motor vehicles and heavy earth moving equipment	25% per year on straight line basis				
• Computer software, calculators, copiers and duplicating machines	25% per year on straight line basis				
• Furniture and fittings	10% per year on straight line basis				
• Telecommunication equipment	10% per year on straight line basis				
• Film equipment by a local producer	25% per year on straight line basis				
• Machinery used to undertake operations under prospecting rights and exploration under mining rights	50% in the first year of use	25%			
• Other machinery	10% per year on straight line basis				
(c) Purchase/acquisition of right to use fibre optic cable by telecommunication operation	10% per year on straight line basis		(iii) Land Rovers/Cruisers 7,200 86,400		
(d) Farm works	50% in the first year of use	25%			

Commissioner's prescribed benefit rates:		
Services	Monthly rates (Sh.)	Annual rates (Sh.)
(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

QUESTION ONE

(TOTAL 30 MARKS)

- a) Mr. Felix Oketch is a non-whole time service director of Oxyfarm Ltd a company incorporated in Kenya. He has approached you to help in filing his tax return for the year of income 2022. The following are the details he provided relating to his income during the year:
1. Basic Salary per month Sh. 143,000 (PAYE Sh. 37,200)

2. He is a member of registered pension scheme where he contributed Sh.35,000 per month. The employer contributed similar amount.
3. He was provided with a company car of 3500cc whose cost was Sh.2,000,000 as at date of acquisition on 1 January 2019.50% of the car was used for official duty.
4. On 1 January 2022, he moved to his own house which was acquired through a 10% mortgage loan of Sh.6000,000. The company furnished the house for him at a cost of Sh.300,000.
5. The company gave him a 10% loan of Sh.2,000,000 to assist in offsetting the mortgage loan. The average market rates of interest were 15%.
6. The company paid his monthly mobile phone bill of Sh.10,000.
7. He was provided with a watchman paid by the company at Sh. 50,000 per annum while the average market rate was Sh.60,000 per annum. The company paid his gardener and cook Sh.100,000 each per annum.
8. His other incomes for the year included:
 - a. Livestock farming profit Sh.350,000
 - b. Poultry Farming profit Sh.200,000.

Required:

- i. Income assessable to tax for Mr. Felix Oketch for the year of income 2022. **(10 Marks)**
 - ii. Total tax Liability due from Mr. Felix Oketch for year of income 2021. **(5 Marks)**
- b)** Mr. Mwakazi received net interest income from housing bond investment of Ksh. 900,000 for the year of income 2022.
- i. Determine the qualifying interest amount. **(1 Mark)**
 - ii. Determine the non-qualifying interest amount. **(1 Mark)**
 - iii. Determine the tax credit. **(1 Mark)**
- c)** Distinguish the following terms:
- i. Direct money burden and direct real burden of tax **(2 Marks)**
 - ii. Direct tax and indirect tax **(2 Marks)**
- d)** Summarise four obligations of a registered person for value added tax (VAT) purposes **(4 Marks)**
- e)** Using an example for each case, distinguish between customs duty and excise duty **(4 Marks)**

QUESTION TWO

(TOTAL 20 MARKS)

- a) Dividend income from investment in equity instruments can be qualifying, non-qualifying or exempt from taxation. Identify three examples of dividend income exempted from taxation. **(3 Marks)**
- b) Income Tax Act has defined business to include any trade, profession or vocation, and every manufacture, adventure, and concern in trade. Identify two examples of taxable incomes and two examples of allowable expenses. **(4 Marks)**
- c) Distinguish between zero rated supplies and Exempt supplies **(3 Marks)**
- d) The following information was extracted from the books of Detroy Traders, a registered business for Value Added Tax (VAT) purposes, for the month of August 2022:

Details	KES
Export sales	150,000
Imported goods for resale (dutiable value)	900,000
Telephone expenses	72,000
Audit fees	180,000
Purchases at zero rate	240,000
Exempted sales	184,000
Sales at standard rate	3,500,000
Purchase at standard rate	1,480,000

Note: Transactions are stated as exclusive of VAT where appropriate. The rate of VAT is 16%.

Additional Information for the month of August 2022:

1. Detroy Traders received debit notes and credit notes of Sh. 400,000 and Sh. 200,000 respectively for standard rated supplies
2. The imported goods for resale were subject to customs duty at the rate of 30%. These goods were subsequently transported to the business premises at a cost of Sh. 40,000 and repackaged at a cost of Sh. 10,000. The goods were then sold at a mark-up of 20% (the sales proceeds on these goods were not included in the reported sales at standard rate).
3. A debtor for goods sold at standard rate for Sh. 120,000 was declared bankrupt.

Required:

The amount of VAT payable (if any) by Detroy Traders for the month of August 2022 **(10 Marks)**

QUESTION THREE (TOTAL 20 MARKS)

- a) Xylox Ltd commenced manufacturing operations on 1 January 2022 after incurring the following capital expenditure

	Date of first use	Costs Kshs
Factory buildings	1 January 2022	21,500,000
Processing Machinery	1 January 2022	18,500,000
Furniture and fittings	1 January 2020	9,500,000 Written down value
Photocopier Machine	1 January 2022	60,000
Computers	1 January 2022	150,000
Forklift	1 January 2018	200,000 Written down value
Scanners	1 January 2022	45,000
Industrial Effluent treatment plant	1 January 2022	2,500,000
Tractors	1 January 2022	3,000,000
Godown	1 January 2022	800,000

Required:

Compute Investment allowance due for year ended 31 December 2022 **(10 Marks)**

- b) The Commissioner shall issue a number, to be known as a personal identification number (“PIN”), to a person registered for the purposes of a tax law and that person shall use the PIN as may be required under the Act. **Required:** Identify four transactions for which personal identification number is required **(4 Marks)**
- c) PAYE is a method of deducting income tax from salaries and wages. **Required:** Identify three circumstances under which a commissioner may impose a penalty to an employer. **(3 Marks)**
- d) Dividends are subject to withholding tax which might be final tax or not final tax. **Required:** Identify three transactions that are deemed a payment of dividend **(3 Marks)**

QUESTION FOUR (TOTAL 20 MARKS)

- a) An optimal (good) tax system must help achieve increased economic growth, maintain economic stability and increased distribution of income. It is a system that should exhibit or satisfy most if not all the principles of good tax system. **Required:** Describe FOUR main canons of a good tax system that were advanced by Mr. Adam Smith **(4 Marks)**
- b) State and briefly explain three factors that influence tax shifting. **(6 Marks)**
- c) The terms "tax avoidance" and "tax evasion" are often used interchangeably, but they are very different concepts. Basically, tax avoidance is legal, while tax evasion is not. **Required:** Identify two ways in which an individual or institution could engage in the practice of “tax avoidance.” **(4 Marks)**

- d) An amount received as compensation for the termination of a contract of employment or service, whether or not provision is made in the contract for the payment is taxable. **Required:** Explain the tax treatment of compensation received for loss of office as per the Income Tax Act in Kenya. **(6 Marks)**

QUESTION FIVE

(TOTAL 20 MARKS)

Max Wicky and Sly are running partnership business in Madaraka as Mwakazi Enterprises. They share profits and losses in the ratio of 3:1:1 for Max, Wicky and Sly respectively. The following summary of the bank statements for the year ended 31st December 2022 has been presented to you. For the year ended 31 December 2022, they presented the following profit and loss account.

	Sh.	Sh.
Sales		13,000,000
Less: 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
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	
Discount allowed	10,000	
Gifts	4,000	<u>(4,023,000)</u>
Net profit		<u>3,977,000</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 Max, Wicky and Sly of Sh. 300,000, Sh. 250,000 and Sh. 50,000 respectively for the year ended 31 December 2022.
4. Printing & stationery prepaid and Insurance were Sh.10,000 and Sh.3000 respectively
5. Transport costs include Sh. 18,000 paid to Otieno on account of a private trip.
6. Interest on partners' capitals and commissions paid to partners are to be apportioned equally to the partners.
7. The gifts were given to the staff of the firm during the end of year party.
8. Investment allowances due to the firm for the year ended 31 December 2022 were agreed at Sh. 120,000.

Required:

- i) The partnership's profit (or loss) for tax purposes for the year ended 31 December 2022 **(15 Marks)**
- ii) Distribution of the taxable profit (or loss) as at 31 December 2022 **(5 Marks)**