



**Strathmore**  
UNIVERSITY

**STRATHMORE BUSINESS SCHOOL  
BACHELOR OF COMMERCE  
END OF SEMESTER EXAMINATION  
BFS 2103: TAXATION IN BUSINESS**

**DATE:** Fri, 2<sup>nd</sup> Aug 2024

**TIME:** 15:30 – 17:30

**Instructions**

- This examination consists of **FIVE** questions.
- Answer **Question ONE (COMPULSORY)** and any other **TWO** questions.

**Year of income 2023.**

**Assume the following rates of tax applied throughout the year of income 2023:**

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%
32,334 - 500,000	388,001 - 6,000,000	30%
500,001 - 800,000	6,000,001 - 9,600,000	32.5%
Excess over 800,000	Excess over 9,600,000	35%

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

Investment allowance:  Capital expenditure incurred on:	Rate of investment allowance	Residual value (25% per year on equal instalments)	Prescribed benefit rates of motor vehicles provided by employer (i) Saloons, Hatch Backs and Estates	
			Monthly rates (Sh.)	Annual rates (Sh.)
(a) Buildings: • Hotel building • Building used for manufacture • Hospital buildings • Petroleum or gas storage facilities • Educational/hostels building • Commercial building	50% in the first year of use 50% in the first year of use 50% in the first year of use 50% in the first year of use 10% per year on straight line basis 10% per year on straight line basis	25% 25% 25% 25%	Up to 1200 cc 1201 - 1500 cc 1501 - 1750 cc 1751 - 2000 cc 2001 - 3000 cc Over - 3000 cc	3,600 4,200 5,800 7,200 8,600 4,400
(b) Machinery: • Machinery used for manufacture • Hospital equipment • Ships or aircraft • Motor vehicles and heavy earth moving equipment • Computer software, calculators, copiers and duplicating machines • Furniture and fittings • Telecommunication equipment • Film equipment by a local producer • Machinery used to undertake operations under prospecting rights and exploration under mining rights • Other machinery	50% in the first year of use 50% in the first year of use 50% in the first year of use 25% per year on straight line basis 25% per year on straight line basis 10% per year on straight line basis 10% per year on straight line basis 25% per year on straight line basis 50% in the first year of use 10% per year on straight line basis	25% 25% 25% 25% 25% 25% 25%	(ii) Pick-ups, Panel Vans (unconverted) Up to - 1750 cc Over - 1750 cc  (iii) Land Rovers/Cruisers	3,600 4,200 7,200
(c) Purchase/acquisition of right to use fibre optic cable by telecommunication operation	10% per year on straight line basis			
(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
<b>Agriculture employees: Reduced rates of benefits</b>		
(i) Water	200	2,400
(ii) Electricity	900	10,800

**QUESTION ONE****(30 Marks)**

Kiwanda limited presented the following income statement for the year ended 31 December 2023

	Sh`000	Sh`000
Gross Profit		1,800,000
Other Incomes		
Discount received		120,000
Profit on sale of machinery		150,000
Investment Income		200,000
		<b>2,270,000</b>
Less Expenses		
Depreciation	140,000	
Wages and salaries	800,000	
Rent and rates	480,000	
Legal and professional fees	360,000	
Interest charges	250,000	
Motor expenses	210,000	
Allowance for bad debts	180,000	
Stationery	140,000	
VAT paid	220,000	<b>(2,780,000)</b>
Net Loss		<b>(510,000)</b>

Additional information

1. Legal and professional fees comprise:

	Sh`000
Audit and accountancy fees	160,000
Legal fees to defend a director against fraud	80,000
Legal fees for debt collection	74,000
Conveyance fees	46,000
	<b>360,000</b>

2. Interest charges comprises:

	Sh`000
Bank overdraft interest	60,000
Interest on late VAT payments	100,000
Interest on loan to purchase shares	90,000
	<b>250,000</b>

3. Motor expenses comprise:

	Sh`000
Running expenses for the delivery Van	20,000
Parking Fines	10,000
Replacement of engine in Director`s Car	180,000
	<b>210,000</b>

**Required:**

- Compute the adjusted taxable profit for Kiwanda Limited for year ended 31 December 2023. **(9 Marks)**
- Taxable payable for the year ended 31 December 2023. **(2 Marks)**
- No one has yet come up with a better set of criteria for judging a tax than the canons of taxation first proposed by Adam Smith more than two hundred years ago.

**Required:** Identify and explain any **three** cannons of an optimal tax system as postulated by Adam Smith. **(3 Marks)**

d) Income Tax Act has defined business to include any trade, profession or vocation, and every manufacture, adventure, and concern in trade. Identify and explain any **three** examples of taxable incomes and three examples of allowable expenses. **(6 Marks)**

e) In Kenya, the concepts of citizenship and residency are distinct for tax purposes, and they determine an individual's tax obligations in the country.

**Required:** Clearly distinguish between citizenship and residency for tax purposes. **(5 Marks)**

f) Export Processing Zones (EPZs) are designated geographical area within Kenya that offers special incentives and facilities to encourage investment and promote exports.

**Required:** Discuss the tax incentives relating to Export Processing Zones. **(5 Marks)**

**QUESTION TWO**

**(20 Marks)**

a) Masewax Enterprises has provided the following information. In the year of income 2023 they earned professional fee of Sh.7,500,000 before VAT. Their accounts show the following expenses:

	<b>Sh.</b>
Medical services	180,000
Accountancy and audit	225,000
Legal services	300,000
Design materials	1,600,000
Salaries and wages	2,410,000
Depreciation	985,000

**Required:**

(i) Value Added Tax Account for the year of income 2023. **(5 marks)**

(ii) Comment on payment of VAT computed above. **(2 marks)**

b) Matrix Ltd. is a distributor of wines and spirits. The profit and loss account for the year ended 31 December 2023 is as follows:

	<b>Sh.</b>		<b>Sh.</b>
Purchases	1,000,000	Sales	3,655,000
Staff wages	850,000	Discounts	355,000
Rent and rates	92,500	Provision for bad and doubtful debts	35,500
Distribution and office expenses	445,500	Profit on sale of assets	65,500
Traveling	256,000	Insurance recovery	170,000
Repairs and maintenance	85,600		
Discount	156,000		
Bad debts	122,100		
Subscription	25,000		
Bank charges & interest	24,000		
Loss on sale of assets	35,500		
Legal fees	95,000		
Audit fees	41,500		
Depreciation	126,000		
Gross profit	<u>917,300</u>		
	<u>4,282,000</u>		<u>4,282,000</u>

### Additional information

1.	10% of rent and rates relate to directors.	
2.	Distribution and office expenses includes the following expenses: Directors personal expenses Contribution to a sports club – employees use it Donations Loss on staff canteen	Sh. 31,550 30,000 22,000 12,000
3.	Repairs and maintenance include extension to an office block	40,000
4.	Subscriptions are to trade associates.	
5.	Travelling expenses include business trip to Dubai to attend a trade exhibition.	56,000
6.	Legal charges include the following: Acquisition of copyrights Debt collection Renewal of lease for 99 years Fines and defence of legal suits Employment contract	25,000 21,000 18,000 11,000 5,000
7.	Insurance recovery is in connection with stolen stock in the previous year.	
8.	Bad debts provision is reduced in general provision.	

**Required:** Compute taxable income of Matrix Limited for year ended 31 December 2023.

**(13 marks)**

### QUESTION THREE

**(20 Marks)**

- a) Thomas Nuti is a general manager with Judixo Enterprises. He has provided you with the following information on his income for the year ended 31 December 2023.
1. He is paid a basic salary of Sh.75,000 per month (PAYE Sh.15,000 per month).
  2. He is housed by the employer in a house leased at Sh 30,000 per month. The house was furnished by the employer at a cost of Sh 200,000. His private telephone charges averaging Sh1,800 per month are also paid by the employer.
  3. He is a member of a golf club where the employer contributes Sh 5,000 per month for him.
  4. He holds a life assurance policy with Maisha Assurance Company Ltd. The employer paid the premiums on the policy for year 2019 amounting to Sh 48,000
  5. He separated with his wife on 1 October 2023. With effect from 31 October 2019, he has been paying alimony of sh20,000 per month to his wife as required by a court order.
  6. He is provided with a motor vehicle (2000cc) by the employer which was purchased on 1 January 2019 at a cost of Sh1,500,000.
  7. He contributed Sh 25,000 per month towards a registered pension scheme.
  8. On 1 December 2023, his monthly salary was increased by ten per cent backdated to 1 July 2023.

**Required:**

- (i) Taxable income of Mr. Thomas Nuti the year ended 31 December 2023.

**(13 marks)**

- (ii) Tax liability from the income computed in (i) above

**(6 marks)**

- (iii) Comment on the information not considered for the above tax computation **(1 mark)**

**QUESTION FOUR (20 Marks)**

- a) Tax shifting, the process by which taxes are passed on from one party to another, can be influenced by various factors.  
**Required:** State and explain any four factors affecting tax shifting. **(8 Marks)**
- b) Mr. Wako, who is a resident in Kenya earned the following incomes in the year ended 31 December 2023
- i. Salary Ksh. 50,000 per month.
  - ii. Travel allowances Ksh. 12,000 per month.
  - iii. Car allowance Ksh. 10,000 per month.
  - iv. He lived a company house and paid a rent of Ksh. 8,000 per month to the employer.
  - v. Received a dividend of Ksh. 20,000 from Polytex Limited.
  - vi. Received net interest of Ksh. 50,000 from Kenya Commercial Bank Limited.
  - vii. He received net interest of Ksh. 680,000 from Housing Finance Corporation of Kenya.

**Required:** Calculate the taxable Income and the tax therefore for Mr. Wako for the year of income 2023. **(12 Marks)**

**QUESTION FIVE (20 Marks)**

- a) In accordance with tax amendment law number two of 2020:
- i. Distinguish between a building used for manufacture and a commercial building **(2 Marks)**
  - ii. Define a machinery used for manufacture and provide three examples of the ancillary purposes in which it can be used **(4 Marks)**
- b) Mimi, Sisi and Wewe are partners trading in a firm sharing profit and loss in the ratio 4:3:3. On 1 January 2023, Wao was admitted as a partner. The profit and loss sharing ratio was revised 2:1:1:1 for Mimi, Sisi, Wewe and Wao respectively with effect from 1 January 2023. He contributed KES 500,000 as his share of capital and goodwill. The income statement of the firm for the year ended 31.12.2023 showed a loss of sh. 600,000 before adjusting the following.

Details		KES
Interest on capital Mimi		160,000
Sisi		120,000
Wewe		120,000
Wao		120,000
Commission Mimi		40,000
Sisi		100,000
Salaries to partners Mimi		20,000
Wewe		40,000
Wao		40,000

Note: Assume that all revenues and expenses accrued evenly throughout the year unless otherwise stated.

**Required:**

- i) Prepare statement of taxable profit for the year of income 2023 **(10 Marks)**
- ii) Show the allocation of taxable profit for the year of income 2023 **(4 Marks)**