



**STRATHMORE BUSINESS SCHOOL
BACHELOR OF FINANCIAL SERVICES
SPECIAL EXAMINATION
BFS 2103: TAXATION IN BUSINESS**

DATE: Tue 23rd April 2024

TIME: 10:30 – 12:30

Instructions

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

QUESTION ONE

(30 MARKS)

- a) Taxation is based on the principle of "*quid pro quo*" i.e. no direct benefit in return for the tax paid.
Required: Describe **three** characteristics Tax **(3 Marks)**
- b) Taxation is part of a broader discussion on public finance while public finance is the section of economic theory that deals with public expenditure and revenue.
Required: Identify and explain **four** sources of government revenue. **(4 Marks)**
- c) 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** canons of an optimal tax system as postulated by Adam Smith. **(3 Marks)**
- d) Mr. Phyllis is a non-whole time service director of Komatsu Ltd a company incorporated in Kenya. He has approached you to help in filing his tax return for the year of income 2023. 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.2000,000 as at date of acquisition on 1 January 2019. 50% of the car was used for official duty.
 4. On 1 January 2023, 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.2000,000 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: Calculate Income assessable to tax Mr. Phyllis for the year of income 2023. **(10 Marks)**

- e) VAT has become a significant source of revenue for the Kenyan government, contributing to funding public services and development initiatives. However, like any tax system, it continues to evolve in response to changing economic conditions, fiscal priorities, and policy objectives.
Required: State and explain **four** obligations of a registered person for value added tax (VAT) purposes. **(4 Marks)**
- f) 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)**

QUESTION TWO (15 MARKS)

- a. In Kenya, Value Added Tax (VAT) and customs duty are two distinct forms of taxation that serve different purposes and apply to different types of transactions.
Required; Describe the distinguishing characteristics of VAT and customs duty **(6 Marks)**
- b. 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 **(4 Marks)**
- c. Tax avoidance refers to legal methods used by individuals or businesses to minimize their tax liabilities within the boundaries of the law. In Kenya, like in many other countries, there are several tax avoidance strategies employed by taxpayers.
Required: Describe **five** tax avoidance measures that a business entity may execute. **(5 Marks)**

QUESTION THREE (15 MARKS)

Lavish, Kwisha and Kent trade in electrical goods and as partners in Lavish Unincorporated. They share profits and losses equally. The following details in the draft accounts regarding their profit and loss status as at 31 December 2023 have been provided:

	Debits Sh.		Credits Sh.
Office expenses	408,000	Gross profit	2,600,000
General expenses	188,000	Interest earned	240,000
Salaries and wages	560,000	Discounts received	160,000
Show room expenses	234,000	Other receipts	300,000
Rents, rates and taxes	300,000	Rent income	264,000
Printing and stationery	128,000	Capital gain on shares.	200,000

Instalment tax paid	90,000		
Advertising	146,000		
Legal charges	164,000		
Interest on capital	420,000		
Depreciation	184,000		
Bad debts	136,000		
Commission to partners	160,000		
Donation for poverty	200,000		
Property taxes	24,000		
Electricity expenses	92,000		
General reserve	240,000		

The partners provided additional information as follows:

1. Closing stock had been understated by Sh.30,000 as at 31 December 2022.
2. Lavish was paid Sh.100,000 as salary (included in salaries and wages) and PAYE Sh.31,000 was paid on it.
3. The firm was fined Sh.30,000 for breach of regulations. This is included in legal charges.
4. Interest on capital was Sh.160,000 to Lavish, Sh.120,000 to Kwisha and sh.140,000 to Kent.
5. Commission to partners include sh.90,000 to Lavish and the balance to Kent.
6. Investment allowances had been agreed at sh.1,800,000 with the tax authorities.

Required:

- (a) Compute the total income (loss) from the partnership business. **(9 marks)**
- (b) Show allocation of profit/loss among partners. **(4 marks)**
- (c) How is the profit/loss of each partner to be treated for tax purposes? **(2 marks)**

QUESTION FOUR

(15 MARKS)

a) 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. **(6 marks)**

b) Joramex Engineers and Associates is a firm of engineers and designers. In the year of income 2023 they earned professional fee of Sh.7,500,000 before VAT. Their accounts show the following expenses:

	Sh.
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. **(6 marks)**
- (ii) Comment on payment of VAT computed above. **(3 marks)**

QUESTION FIVE**(15 MARKS)**

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

	Sh.		Sh.
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	170,000
Traveling	256,000	Insurance recovery	
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>

Notes:

1.	10% of rent and rates relate to directors.	
2.	Distribution and office expenses includes the following expenses:	Sh.
	Directors personal expenses	31,550
	Contribution to a sports club – employees use it	30,000
	Donations	22,000
	Loss on staff canteen	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	25,000
	Debt collection	21,000
	Renewal of lease for 99 years	18,000
	Fines and defence of legal suits	11,000
	Employment contract	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 Kenwide for year ended 31 December 2023

(15 marks)

Tax Band	Rate of Tax
On the first Kshs 24,000 per month or Kshs 288,000 per annum	10%
On the next Kshs 8,333 per month or Kshs 100,000 per annum	25%
On all income amount in excess of Kshs 32,333 per month or Kshs 388,000 per annum	30%
Personal Relief	
The applicable monthly personal relief is Kshs 2,400 per month or Kshs 28,800 annually	