



TECHNICAL UNIVERSITY OF MOMBASA

SCHOOL OF BUSINESS
DEPARTMENT OF ACCOUNTING & FINANCE
UNIVERSITY EXAMINATION FOR:
BACHELOR OF COMMERCE III
BACHELOR OF IN BUSINESS ADMINISTRATION III
BAC 4305: TAXATION 11
END OF SEMESTER EXAMINATION
SERIES: AUGUST, 2019
TIME: 2 HOURS
DATE: AUGUST, 2019

Instructions to Candidates

You should have the following for this examination
-Answer Booklet, examination pass and student ID

This paper consists of **FIVE** questions. Attempt question ONE (Compulsory) and any other TWO questions.

Do not write on the question paper.

QUESTION ONE

- (a) Section 24 (1) of the Income Tax Act (Cap 470) requires companies to adequately distribute their profits as divided within twelve months after the end of the accounting period.

Required:

Outline the circumstances under which a company may apply for exemption from the shortfall distribution requirements. **(5 Marks)**

- (b) Discuss six documents required when filing capital gain tax returns. **(6 Marks)**
- (c) Tumtec Ltd commenced its water purification operations on 2 January 2018 after incurring the following capital expenditure:

	<i>Sh.</i>
Factory building	12,000,000
Computers	380,000
Processing machine	6,000,000
Drainage system	480,000
Tractors	5,600,000

Lorry (10 tonnes)	8,000,000
3 saloon cars (Sh. 2,500,000)	7,500,000
Furniture and fittings	820,000
Motor cycles	250,000
Staff clinic	860,000

Additional information:

1. Factory building includes a warehouse costing Sh. 2,000,000 and a showroom costing Sh. 2,500,000.
2. A perimeter wall was constructed at a cost of Sh. 3,000,000 during the year.
3. The staff quarters and staff canteen were constructed at a cost of Sh. 1,500,000 and Sh. 860,000 respectively and were both put into use from 1 October 2018.
4. During the year, one of the saloon cars was sold for Sh. 800,000.
5. During the year, the following additional assets were acquired:

	<i>Sh.</i>
Wheel barrows	36,000
Weighing machine	163,000
Fax machine	145,000
Laptop computer	120,000

6. An extract of the income statement for the year ended 31 December 2018 was as follows:

	Sh. "000"	Sh. "000"
Gross profit		48,000
Less:		
General expenses	3,900	
Directors fees	7,200	
Depreciation	10,400	
Salaries and wages	4,600	
Donation to a political party	820	
Interest expenses	6,200	
Dividend paid	4,605	
Repair and maintenance	6,250	(43,975)
Net profit for the year		<u>4,025</u>

General expenses included Sh. 1,200,000 being payment of penalties due to non-compliance with manufacturing regulations.

Required:

- i) Capital allowances due to Tumtec Ltd for the year ended 31 December 2018 **(10 Marks)**
- ii) Taxable profit (if any) for the year ended 31 December 2018 **(9 Marks)**

Question Two

- (a) Back duty investigation refers to the assessment and collection of tax in arrears relating to the past years.

Required:

Discuss any **FIVE** sources of Information for back duty investigations

(10 Marks)

- (b) Mr. Dalali owns several rental houses located in upmarket areas. Commencing 1 January 2018, he rented out fifteen of his houses at a monthly rent of Sh. 80,000 each. The tenants were acquired to pay a two months deposit before occupying the houses.

The following expenses were incurred by Mr. Dalali in January 2018:

- Legal fees for drawing rental agreements – Sh. 5,000 per agreement.
- Furnishing of the houses – Sh. 400,000 per house
- Valuation fees for five houses – Sh. 64,000
- Insurance premium for the fifteen houses for the period 1 January 2018 to 31 December 2018 – Sh. 196,000.

Mr. Dalali provided the following additional information for the year ended 31 December 2018:

1. The rent for each month was collected by an estate agent on behalf of the landlord. The estate agent charged a fee equivalent to 5% of the rent collected.
2. Interest charged on a loan used to develop the five houses amounted to Sh. 720,000 during the year.
3. Land rates paid for the year 2018 amounted to Sh. 138,000.
4. He employed two caretakers to serve the fifteen houses at a monthly salary of Sh. 12,000 each with effect from 1 March 2018.
5. The fifteen houses were served by five watchmen who were each paid Sh. 15,000 per month with effect from 1 February 2018.
6. Repairs and maintenance costs during the year amounted to Sh. 85,000.
7. The cost garbage collection per house was Sh. 500 for each month that the house was occupied. The rental agreement provided that the landlord was responsible for paying this amount to the garbage collection company.
8. In June 2018, the landlord spent Sh. 48,000 in erecting a signboard at a junction leading to the houses.
9. In December 2018, one of the tenants was declared bankrupt by a court of law. The tenant had not paid rent for the months of November and December 2018. The landlord sent a notice to the tenant to vacate the house by the end of December 2018 and recovered the rental arrears from the two months deposit earlier paid by the tenant.

Required:

Taxable rental income (if any) of Mr. Dalali for the year ended 31 December 2018.

(10 Marks)

Question Three

The following is the income statement of Bahati Co-operative Society, **AN APEX SOCIETY**, for the year ended 31st Dec 2018.

INCOME STATEMENT			
Dr(Ksh)		Cr(Ksh)	
Salaries/ Wages	1,200,000	Gross profit b/d	10,000,000
Directors fees	200,000	Sale of N.C asset	1,500,000
Rent/rates	80,000	Bad debts	
Travelling/Entertainment	20,000	recovered	200,000
Donations	80,000	(previously w/off)	1,000,000
Repairs/maintenance	1,000,000	Income tax refund	200,000
Bad debts reserves	600,000	Release of liability	
General expenses	1,500,000		
Income tax paid	400,000		
Net profit c/d	7,820,000		
	12,900,000		12,900,000

Additional information;

- Included in director's fees is 60,000 paid to the director's daughter studying in USA.
- Repairs and maintenance include depreciation of Ksh 400,000.
- General expenses include cost of delivery van purchased at Ksh 900,000
- The cooperative society would like to shs 6,500,000 as dividends and bonuses.
- Assume this cooperative society is a primary society
- Dividends and bonuses paid during the year amounted to Sh. 9,000,000

Required:

Compute taxable income and tax liability for Bahati Cooperative Society.

(20 Marks)

Question Four

Blasio and Mbalanya have been trading in partnership sharing profit and losses in the proportion of three fifths and two-fifths. They have prepared the accounts for 2018 as follows:

	Sh.
Interest on Capital Blasio	20,000
Interest on Capital Mbalanya	10,000
Goodwill written off	4,000
Bad debts	20,000
Audit, insurance and legal expenses	20,000
Motor vehicle expenses	30,000
Depreciation	60,000
Special expenses	8,000
Withholding tax on dividends	3,000
Partnership salaries (Mbalanya)	60,000
Loss on sale of investments	10,000
Repairs and renewals	6,000
Salaries and wages	100,000
Light, Water and Electricity	20,000

Net profit	<u>32,000</u>
	<u>403,000</u>
Gross profit from trading	380,000
Dividend received (Net)	17,000
Sub-letting rent income	<u>6,000</u>
	<u>403,000</u>

NOTES:

(i) Bad debts:

The bad debts account is as follows:	Sh.	Sh.
Bad debts written off		10,000
Reserves carried down:		
General	80,000	
Specific	22,000	<u>102,000</u>
		<u>112,000</u>
Balances b/d	Sh.	Sh.
General	60,000	
Specific	30,000	90,000
P & L Account		20,000
Debts recovered		<u>2,000</u>
		<u>112,000</u>

(ii) Audit, Insurance and Legal:

	Sh.
Audit expenses	10,000
Partner's insurance	2,000
Legal fees – Debt collection	500
Legal fees for making partnership deed	<u>7,500</u>
	<u>20,000</u>

(iii) Special expenses:

	Sh.
Penalty for breach of sales tax regulations	4,000
Redundancy pay to employee	3,000
Christmas gifts to partner's wives	<u>1,000</u>
	<u>8,000</u>

(iv) Withholding tax on dividend:

Dividends were received net of tax.

(v) Loss on Sale of Investments:

The shares in a quoted company were disposed of by sale during the year. They had cost Sh.60,000 and were disposed of for Sh.50,000. There were no other incidental expenses.

(vi) Repairs and renewals:

	Sh.
Office partitions	2,000
Office carpet	1,500
Replacement of adding machine	1,000
General repairs	<u>1,500</u>
	<u>6,000</u>

(vii) Wear and tear schedule:	Class III	Class IV
	Sh.	Sh.
Written down value	90,000	56,000

One third of the motor vehicle expenses is used on private motoring by partners.

Required:

- (a) Calculate the adjusted profit for tax purposes for each partner. **(15 Marks)**
- (b) Tax payable by Mbalanya **(5 Marks)**

Question Five

- (a) Tax planning is defined as the methods used by a tax payer to reduce his burden of taxes in a legal manner. Discuss five strategies that can be used to achieve tax planning goals. **(10 Marks)**
- a) Msambweni Merchant Ltd, is registered for value added tax (VAT) purpose. During the month of July 2019, the company made the following transactions.

- July 1: Sold goods to Karisa Ltd for Sh. 300,000 on credit
- July 2: Purchased goods on credit from Chengo Traders for Sh. 150,000
- July 3 : Keita Ltd returned goods valued at Sh. 45,000 and received a credit note
- July 4: Exported goods to Mapenzi Ltd, a company based in Tanzania for Sh. 225,000
- July 5: Purchased goods for Sh. 600,000 from Mboze Ltd on credit
- July6: Imported goods from Viatu exclusive of import duty and VAT for Sh.675,000
- July 7: Received debit note from Chengo Ltd worth Sh. 36,000
- July 8: Bought spare parts for repair of motor vehicle for use in business for Sh. 90,000
- July 9: Sold goods to Juma on credit amounting to Sh. 600,000
- July 15: Sold goods to various customers on cash for Sh. 150,000
- July 20: Paid the following expenses:

	Sh.
Catering	51,000
Stationery	63,000
Electricity bills	18,000
Audit fee	45,000

- July 25: Received cash Sh.255,000 from Karisa Ltd, in full statement of debt
- July30 : Closing inventory was valued at Sh. 560,000

All transactions are stated inclusive of VAT at the rate of 16% where applicable unless otherwise stated. Import duty was agreed to be 25% of the value of the goods imported.

Required:

- A value added tax (VAT) account for the month of July 2019. **(10 Marks)**

RATES OF TAX (Including wife's employment and professional income rates of tax)
year of income 2018.

Monthly taxable pay (Sh.)	Annual taxable pay (Sh.)	Rate of tax % in each Sh.
0 - 12,298	1 - 147,580	10%
12,298 - 23,885	147,580 - 286,623	15%
23,885 - 35,472	286,623 - 425,666	20%
35,472 - 47,059	425,666 - 564,709	25%
Excess over 47,059	Excess over - 564,709	30%

Personal relief Sh. 1,408 per month (Sh. 16,896 per annum)

Prescribed benefit rates of motor vehicles provided by employer

		Monthly rates (Sh.)	Annual rates (Sh.)
Capital allowance:	(i) Saloons, Hatch Backs and Estates		
Wear and tear allowance:	Upto 1200cc	3,600	43,200
Class I 37.5%	1201 1500cc	4,200	50,400
Class II 30%	1501 1750cc	5,800	69,600
Class III 25%	1751 2000cc	7,200	86,400
Class IV 12.5%	2001 3000cc	8,600	103,200
Software(straight-line) 20%	Over 3000cc	14,400	172,800
Telecommunication equipment (straight-line) 20%			
Loose tools and implements (straight-line) 33.3%			

Industrial building allowance:

Upto 2009	2.5%
From 1 January 2010	10%
Hotels	10%
Hostels/Education buildings	50%
From 1 January 2010 – Commercial building:	
Shop, office or show room)	25%

Farm works allowance 100%

Investment deduction allowance 100%

(ii) Pick-ups, Panel Vans (unconverted)			
Upto 1750cc	3,600	43,200	
Over 1750cc	4,200	50,400	
(iii) land Rovers/Cruisers	7,200	86,400	

Shipping investment deduction 40%

Mining allowance:

Year 1	-	40%
Years 2 – 7	-	10%

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