



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 II
END OF SEMESTER EXAMINATION
SERIES: DECEMBER, 2024
TIME: 2HOURS
DATE: DECEMBER, 2024

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) Give a critical analysis of the benefit theory of taxation (5 marks)
b) FKM Ltd. Is a manufacturing firm which has been in operation since 2005. The capital deduction schedule shows that the written down values as at 31st December 2022 were as follows:-

Written down values

Sh.

Plant and machinery	5,261,500
Motor lorry and tractor	72,760
Delivery vans and pick-up (less than 3 tones)	2,025,000
Furniture and fittings	600,000

During the year ended 31st December 2023, FKM Ltd acquired the following assets:

Cost

	Sh.
Furniture and fittings	1,600,000
Pick-ups (less than 3 tons)	8,000,000
Lorries	3,600,000

The following items were disposed of during the year:

	Written down value	Sold for
	Sh.	Sh.
Machinery	1,000,000	900,000
Delivery van (less than 3 tons)	250,000	270,000
Tractor	30,000	20,000

Required:

Calculate Investment allowances to be claimed under the second schedule of the Income Tax Act for the year ended 31 December 2023 and shown the written down values of the assets as at that date. **(15 marks)**

(c) Triplecom Insurance Company Ltd. is a resident company carrying on both general and life assurance businesses. The following information relates to the insurance company's business for the year ended 31 December 2023:

	General Insurance	
	Sh. "000"	
Profit on sale of investments	14,200	-
Premium received in the year	15,450	
Commission ceded	8,000	
Premium returned	374	
Recovery from reinsurance company	1,200	
Premiums paid to reinsurance company	7,680	
Commission expenses	1,050	
Management expenses	2,034	
Travelling expenses	1,200	
Marketing expenses	314	
Fees paid to investment managers	900	
Legal expenses relating to claims	740	
General expenses	8,490	
Bad and doubtful debts	468	
Claims paid in the year	9,800	

Additional information:

1. Claims outstanding for general business were as follows:
 - As at 1 January 2023 Sh.6,640,000.
 - As at 31 December 2023 Sh.7,000,000.
2. General expenses under general insurance include cost of computers Sh.800,00 and cost of saloon car sh.3,260,000.
3. Reserves for unexpired risks for general insurance were as follows:
 - As at 1 January 2023 Sh.3,240,000.
 - As at 31 December 2023 Sh.6,200,000.
4. Other income received by Triplecom Insurance Company Ltd. comprised:
 - Interest from fixed deposit account Sh.780,000.
 - Dividend received from qualifying company Sh.3,000,000 (net).
 - The company owns the building which houses its offices. Part of the office space is rented out to other tenants. In the year to 31 December 2020, the company received Sh.2,800,000 net rental income from their estate agents. Property management fees amounting to Sh.3,200,000 for the year to 31 December 2020 had not been deducted.

Required:

The taxable income or loss for Triplecom Insurance Company Ltd. for the year ended 31 December 2023.

(10 Marks)

Question Two

Linda Obari has been operating a retail business since year 2016. She has not been maintaining proper books of account over the years and is therefore under investigation by the revenue authority.

The following details were obtained from her business records:

	31 December 2019	31 December 2020	31 December 2021	31 December 2022	31 December 2023
	Sh.	Sh.	Sh.	Sh.	Sh.
Equipment	2,345,670	2,391,840	2,395,350	2,210,000	2,285,000
Investment in shares	30,000	150,000	270,000	320,000	325,000

Bank balance	3,000	4,500	6,000	7,000	7,500
Inventory	-	303,000	540,000	620,000	685,000
Debtors	-	180,000	450,000	720,000	830,000
Building	_____	<u>2,050,000</u>	<u>2,050,000</u>	<u>2,050,000</u>	<u>2,050,000</u>
	=				
	<u>2,648,670</u>	<u>5,079,340</u>	<u>5,711,350</u>	<u>5,927,000</u>	<u>6,182,500</u>
Financed by:					
Capital	2,648,670	2,844,340	3,254,350	3,239,000	3,263,500
Bank loan	-	1,425,000	1,566,000	1,716,000	1,866,000
Creditors	-	810,000	891,000	972,000	1,053,000
	<u>2,648,670</u>	<u>5,079,340</u>	<u>5,711,350</u>	<u>5,927,000</u>	<u>6,182,500</u>

Additional information:

1. Personal expenses:

	31 December 2020 Sh.	31 December 2021 Sh.	31 December 2022 Sh.	31 December 2023 Sh.
Repairs of house	172,000	-	180,000	-
House manager salary	259,000	302,000	344,000	358,000
Cash withdrawn from bank account	192,000	220,000	300,000	340,000
School fees	228,000	-	-	-
House expenses	163,000	331,600	356,000	382,000

2. Non-business income:

	31 December 2020 Sh.	31 December 2021 Sh.	31 December 2022 Sh.	31 December 2023 Sh.
Rental income	182,000	166,560	120,000	218,000
Interest from bank deposits	2,750	14,970	20,000	22,000

3. For the year ended 31 December 2020, salaries paid to Linda Obari's husband by the business amounted to Sh.312,000 and this was increased every year by 15%.

4. She received Sh.360,000 in cash as inheritance in the year 2019 from her late father.

Required:

- Compute Linda Obari's correct taxable income or loss for the years ended 31 December 2020 to 2023. **(15 Marks)**
- Describe the factors that a revenue authority considers in ascertaining the adequacy of living expenses under back duty investigations. **(5 Marks)**

Question Three

Ochieng, Mutua and Odongo are partners in an engineering firm. They share profits and losses equally. For the year ended 31 December 2023, you have been provided with the following summary of receipts and expenditures:

	Sh.		Sh.
Salaries and wages	10,000,000	Professional fees	35,000,000
Audit and accountancy fees	430,000	Capital introduced: Mutua	6,000,000
Legal fees	160,000	Odongo	4,000,000
Rent and rates	180,000		
Water and electricity	96,000		
Telephone and postage	240,000		
Subscriptions to the Engineering Association	60,000		
Subscriptions to Starehe Sports Club	400,000		
Instalment tax paid	1,000,000		
Donations to women's group	50,000		
Interest on overdraft	136,000		
VAT paid	6,000,000		
Office expenses	240,000		
Sundry expenses	300,000		
Purchase of design materials	2,000,000		
Drawings: Ochieng	2,000,000		
Mutua	3,000,000		
Odongo	500,000		
Interest on capital: Ochieng	170,000		
Mutua	60,000		
Odongo	20,000		
Net Profit	<u>17,958,000</u>		
	<u>45,000,000</u>		<u>45,000,000</u>

Additional information:

- Salaries and wages include salaries paid to the partners as follows:

Ochieng	Sh.1,440,000
Mutua	Sh.1,200,000
Odongo	Sh. 960,000
- Legal fees include Sh.100,000 for conducting a VAT appeal.
- Telephone and postage includes Sh.60,000 paid for Mr. Ochieng's house telephone.
- Credit notes issued to clients and not included in the accounts amount to Sh.950,000.
- Agreed capital allowances for the year ended 31 December 2018 amount to Sh.4,000,000.

Required:

- Adjusted profit and loss account for the partnership for the year 2023. (12 marks)
- Allocation of the profit to the partners (4 marks)

(c) Tax payable by each Ochieng'.

(4 marks)

(Total: 20 marks)

Question Four

(a) With regards to capital gain tax, discuss SEVEN transactions that are exempted from capital gain tax. **(7 Marks)**

(b) Matatu SACCO presented the following income statement for the year ended 31st Dec 2018

	<u>Ksh</u>
Interest on member's loan	1,700,000
Interest from commercial banks	400,000
Interest from treasury bills (T-bills)	180,000
Dividends from Bidii (K) Ltd	42,000
Rental income	<u>440,000</u>
Gross income	2,762,000
<u>Less: expenses</u>	
Admin expenses	235,000
Depreciation	130,000
Purchase of furniture for rentals/property	180,000
Printing and stationery	19,000
Caretaker's wages	12,000
Mortgage interest for rental property	20,000
Miscellaneous expenses	16,000
	<u>(612,000)</u>
	<u>2,150,000</u>

The SACCO intends to distribute Ksh 400,000 as dividend and bonuses to members for the year. All investment incomes have been stated gross of withholding tax.

Required:

(c) Determine tax liability for Matatu SACCO **(13 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.

(5 Marks)

(b) Mr. Joe Kamuzu is a practicing accountant operating under the name Kamuzu and Associates. His firm is registered for value added tax (VAT). During the month of March 2024, he undertook and completed the following assignments"

March 2: Tax consultancy work for Base Ltd., at a fee of Sh.240,000.

March 4: Audit for Mwanza Ltd., a company based in Tanzania for Sh.840,000.

March 10: Management consultancy services for Zeal Ltd., for a fee of Sh.360,000.

March 15: The firm was engaged by ABC Ltd., to undertake a review of the internal control

systems of the company. His fees were Sh.1,200,000.

March 17: The firm provided audit services to Afro Ltd. for the year ended 30 June 2015 at Sh.480,000.

March 18: Conducted a survey on power consumption for Mwema Enterprises Ltd., at a fee of Sh.2,400,000.

March 19: His firm audited the accounts of Soul Harvester Ministries, a church where he serves as a volunteer auditor. He estimated that his fees would have been Shs.720,000.

March 2024: The firm billed Afro Ltd. Sh.136,000 for debt collection services.

March 21: The firm undertook a financial consultancy assignment for World Net South Africa, a company based in South Africa. The fees were Sh.420,000.

March 23: Conducted audit of Matuu Ltd., at a fee of Sh.180,000.

March 27: Provided accountancy services to Githiga Children's home on a voluntary basis. The estimated value of the services was Sh.90,000.

March 30: Performed audit services for Mengo County Council. The fees earned was Sh.860,000.

During the month of March 2024, the firm paid for the following expenses:

	Sh.
Electricity	42,500
Water	42,000
Rent	120,000
Garbage collection	36,000
Stationery	960,000
Catering services	48,000
Computer repair	240,000
Telephone	330,400

All transactions are inclusive of VAT at a rate of 16% where applicable.

Required:

A VAT account for Kamuzu and Associates for the month of March 2024.

(15 marks)

RATES OF TAX (For employment income including wife's employment, self-employment and professional income). Year of income 2023.

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

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

Monthly taxable pay		Annual taxable pay		Rate of tax
(Sh.)		(Sh.)		% 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%

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	4,400	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		(ii) Land Rovers/Cruisers			
• Computer software, calculators, copiers and duplicating machines	25% per year on straight line basis				7,200	86,400
• 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					
(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