



OFFICE OF THE DEPUTY PRINCIPAL

ACADEMICS, RESEARCH AND STUDENTS' AFFAIRS

UNIVERSITY EXAMINATIONS

2019 /2020 ACADEMIC YEAR

4TH YEAR 1ST SEMESTER REGULAR EXAMINATION

**FOR THE DEGREE OF BACHELOR OF BUSINESS
MANAGEMENT**

COURSE CODE: BBM 401

COURSE TITLE: TAXATION II

DATE: Thursday 11th March 2021

TIME: 2.00-5.00 PM

INSTRUCTION TO CANDIDATES

- SEE INSIDE

PLEASE TURN OVER

RATE OF TAX (including wife's employment, self employment and professional income rates of tax)

	Annual	Monthly	Rates
On the first	Ksh. 147,580	Ksh. 12,298	@ 10%
On the next	Ksh. 139,043	Ksh. 11,587	@ 15%
On the next	Ksh. 139,043	Ksh. 11,587	@ 20%
On the next	Ksh. 139,043	Ksh. 11,587	@ 25%
On all income over	Ksh. 564, 709	Ksh. 47,059	@ 30%

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

Prescribed benefits rates of motor vehicles provided by employer

			Monthly rates (Sh.)	Annual rates (Sh.)
Capital Allowances:	(i)	Saloons, Hatch backs and estates		
Wear and tear allowance:				
Class I	37.5%	Up to 1200 cc	3,600	43,200
Class II	30%	1201 1500 cc	4,200	50,400
Class III	25%	1501 1750 cc	5,800	69,600
Class IV	12.5%	1751 2000 cc	7,200	86,400
Industrial Building Allowance:		2001 3000 cc	8,600	103,200
Up to 2009	2.5%	Over 3000 cc	14,400	172,800
From January 2010	10%			
Hostels	10.0%			
Hostels/Education Buildings	50.0%			
Farm allowance:	100%			
Investment deduction	100%	Pick-up, panel van (Unconverted)		
		Up to 1750 cc	3,600	43,200
		Over 1750 cc	4,200	50,400
		Land Rovers/Cruisers	7,200	86,400
Shipping investment deduction	100%			
	%			
Extraction expenditure				
Written over 5 years (20%)				
Commissioner's prescribed benefit rates				
Services			Monthly rates Sh.	Annual rates Sh.
(i) Electricity (Communal or from generator)			1,500	18,000
(ii) Water (Communal or from borehole)			500	6,000
Agricultural employees: Reduced rates of benefits				
(i) Water			200	2,400
(ii) Electricity			900	10,800

INSTRUCTIONS ANSWER QUESTION ONE AND ANY OTHER TWO QUESTIONS**QUESTION ONE COMPULSORY (30 MARKS)**

- a) Explain Tax matters relating to Export Processing Zones. (4 marks)
- b) Mbale Ltd. has not paid tax for a number of years. As a tax consultant, advise the Finance Manager of Mbale Ltd. on four actions that the revenue authority could take against the company for recovery of overdue tax.(8 marks)
- c) Mr. S. Kibesa, a single man has recently received a Preliminary Enquiry Form from the Income Tax Department. He is required to show income chargeable to tax for the years of income 2016 to 2020 inclusive. Your discussion with him yields the following information:

Using savings from employment and a winning from Kenya Charity Sweepstake he built a shop in 2013 at a cost of sh.800,000. Furniture and stock-in-trade were purchased the following year when he started as a general merchant. He has not kept proper books of account for his business and has not paid any income tax since he became a general merchant. From his explanations and the scanty records available, you have been able to reconstruct the following:

	2013	2014	2015	2016	2017	2018	2019	2020
	Sh.	Sh.	Sh.	Sh.	Sh.	Sh.	Sh.	Sh.
Assets	'000'	'000'	'000'	'000'	'000'	'000'	'000'	'000'
Building	800	800	800	800	800	800	800	800
Furniture	-	100	100	150	150	200	200	200
Freehold land	-	-	-	-	-	300	300	300
Commercial motor vehicle	-	-	-	-	-	250	250	250
Stock-in-trade	-	100	100	120	120	150	200	200
Debtors	-	-	-	-	-	50	60	80
Cash in bank	150	50	20	8	8	20	10	10
Total Assets	950	1050	1020	1150	1078	1770	1820	1840
Liabilities								
Trade creditors	-	25	10	5	5	80	85	90
Loan from a friend	-	-	-	-	-	200	200	80
Total liabilities	-	25	10	5	5	280	285	170
Living expenses (estimates)	-	100	125	150	150	200	200	200

No interest has been charged on the loan from the friend, also there has been no sales of fixed assets, there has been no other investment.

Required:

- Calculate the income chargeable to income tax for each year of income. (15 marks)
- State briefly what further information the Income Tax Department may require to satisfy itself that the chargeable income you have calculated reflects the true and correct income of the tax payer for each year of income. (3 marks)

QUESTION TWO (20 MARKS)

The management of ABC Bank Ltd. has sought your professional guidance in determining the Bank's tax liability for the year ended 31 December 2020. The income statement of ABC Bank Ltd. for the year ended 31 December 2020 is given below:

Income	Sh. 000	Sh. 000
Interest on loans and advances to customers		540,800
Interest on government securities		120,600
Interest on placements with other banks and institutions		40,650
Fees and commissions income		39,360
Rental income		2,190
Income from foreign exchange dealings		31,980
Gain on disposal of property and equipment		12,300
Other operating income		<u>42,950</u>
Total income		<u>830,830</u>
Expenses:		360,400
Salaries and employee benefits		20,350
Occupancy expenses		12,360
Deposit protection fund contributions		43,700
Depreciation expense		202,450
Interest on customers' deposits		80,200
Interest on deposits from other Banks and institutions		
Director's emoluments:		
Fees	11,200	
Other	<u>3,600</u>	14,800
Auditors' remuneration:		
Current year	2,100	
Under provision for the previous year (2019)	<u>300</u>	2,400
Operating lease rental		16,300
Loss on disposal of equipment		7,250
Other administrative expenses		20,620
Provision for bad and doubtful debts		80,500
Provision for interest suspense		<u>20,950</u>
Total expenses		<u>882,280</u>
Loss for the year		<u>(51,450)</u>

Additional information:

1. Salaries and employee benefits comprise:

	Sh. 000
Leave benefits	720
Pension contributions	1,460
Termination costs	2,860
Provision for staff leave accruals	4,920
	9,960

2. Included in the Directors' "other" emoluments are:

	Sh. '000'
School fees for the Chairman's children	1,200
Entertainment allowance (used on clients)	1,800
Travelling costs for a newly recruited expatriate director	600

3. Provision for interest suspense represents non-performing loans and advances on which interest has been suspended. The management has confirmed that the loans and advances are fully secured.
4. Capital allowances for the year ended 31 December 2020 amounted to Sh. 18,900,000.
5. Lease rental charges relate to office equipment leased from AB office solutions for use in the entire bank network.

Required:

- (a) (i) Taxable income of ABC bank Ltd. for the year ended 31 December 2020. (11 marks)
(ii) Tax payable (if any), on the taxable income computed in (i) above. (2 marks)
- (b) Given the ABC Bank Ltd's taxable income for the year ended 31 December 2019, was assessed at Sh. 2,400,000, show how the tax computed in (a) (ii) above is to be paid, inclusive of the due dates. (5 marks)
- (c) Explain the implication of Income Tax Act – section 15(7) (e) (specified sources of income) on ABC Bank Ltd's income. (2 mark)

QUESTION THREE (20 MARKS)

- a) State the key provisions of section 19 of the Income Tax Act (Cap.470) relating to the taxation of savings and credit cooperative societies (SACCOS). (6 marks)
- b) ABC ltd reported taxable income of sh. 2 million before tax for the year ending 31st December 2020. The profit was from the core business activity, the management distributed sh. 160,000 as dividend to shareholders determine the short fall tax payable and interest payable if any if all issues are completed by February 2021. (6 marks)
- c) Makazi Savings and Credit Cooperative Society (Sacco) Ltd. reported the following incomes and expenditure for the year ended 31 December 2020:

Income:	Sh.
Interest on loans to members	1,500,000
Interest on savings accounts	30,000
Interest on fixed deposit accounts	400,000
Other investment income	12,000
Rental income	<u>600,000</u>
Total income	<u>2,242,000</u>

Expenditure	Sh.
Administration expenses	<u>300,000</u>
Surplus	<u>1,942,000</u>

Required:

The taxable profit of Makazi Sacco Ltd. for the year ended 31 December 2020. (8 Marks)

QUESTION FOUR (20 MARKS)

The following is the income statement for XYZ ltd a manufacturing company for the year ended 31st December 2020.

Item	Sh.	Sh.
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Gross profit		5,760,000
Foreign exchange gain		72,000
Dividends from ukulima cooperative (net)		34,000
Dividends from subsidiary company		122,000
		5,990,000
Less expenses		
Directors emoluments	3,240,000	
Provision for depreciation	125,000	
Office furniture	180,000	
Computer software	45,000	
Donations	12,750	
Legal expenses	324,000	
Dividend paid	60,000	
Corporation tax	187,500	
Salaries and wages	337,000	4,511,250
Net profit		1,478,750

Additional information

- The company operates in a factory building whose construction cost at the time of first operation on 1st January 2016 was 2,400,000. The cost of construction of building is included in the directors emoluments
- On 1 July 2020 the company acquired portable packaging machinery at a cost of sh. 210,000 computers sh. 120,000, and weighing scale machine sh.48,000
- On 1st October 2020 the company put into use a staff canteen constructed at a cost of 390,000 and godown at a cost of 300,000
- Legal expenses include
 - Costs of disposal of banned packaging material sh 13,500
 - Negotiating loan agreement sh.18,000
 - Processing legal documents for new factory plant sh, 9,900
 - Defending a law suit for defending a director of the company for his private business sh. 47,000
 - Preparing patent documents for registration sh,26,400
- Gross profit was overstated by 20% and directors allowance include management fees of sh.247,500 from a director of one of the subsidiaries.
- Interest on loan of sh. 48,000 from head office was included in directors emoluments. The interest was received from a thinly capitalised company

Required

- Statement of adjusted profit or loss for the year ended 31st December 2020.(12 marks)
- Tax liability if any for the year ended 31st December 2020 (2 marks)
- Comment on the payment of tax for the year ended 31st December 2020 assuming that tax had been paid in the year 2020 based on previous tax sh,1,200,000 (4 marks)
- Explain the meaning of thinly capitalised company (2 marks)

QUESTION FIVE (20 MARKS)

- Explain Tax matters relating to special economic zone.(5 marks)

- b) Wananchi General Insurance Limited provided the following details with respect to the activities for the year ended 31 December 2020:

	Sh.
Claims paid	4,800,000
Claims outstanding on 1 January 2020	400,000
Claims intimated and accepted, but not paid on 31 December 2020	700,000
Premiums received	12,000,000
Re-insurance premium paid	1,200,000
Commission paid	2,000,000
Commission on re-insurance ceded	80,000
Commission on re-insurance accepted	40,000
Repair of rented premises	150,000
Fees paid to investment managers	600,000
Expenses of management	3,020,000
Provision for unexpired risk on 1 January 2020	4,000,000
Bonus utilized in reduction of premium	120,000
Re-insurance recoveries of claims	80,000
Medical expenses regarding claims	50,000
Loss on sale of motor car	35,000
Bad debts – specific	25,000
Tax credit for double taxation	45,000
Interest received (Gross)	2,600,000
Dividend received (Gross)	4,500,000
Provision for unexpired risk – 31 December 2020	4,677,200
Legal expenses regarding claims	400,000
Profit on sale of investments	2,350,000
Rent income on property	750,000
Depreciation	1,200,000

Wear and tear allowances have been agreed at Sh.800,000.

Required:

- (i) With specific reference to the provisions of the Income Tax Act, compute the taxable income of Wananchi General Insurance Limited for 2020. (12 marks)
- (ii) Comment on any losses, gains or specified sources of income which you have ascertained in (i) above. (3 marks)
