



MACHAKOS UNIVERSITY

University Examinations for 2019/2020 Academic Year

SCHOOL OF BUSINESS AND ECONOMICS

DEPARTMENT OF ACCOUNTING BANKING AND FINANCE

THIRD YEAR SECOND SEMESTER EXAMINATION FOR

BACHELOR OF COMMERCE

BAC 304: FUNDAMENTALS OF TAXATION

DATE:16/11/2020

TIME: 2:00 – 4:00 PM

INSTRUCTIONS:

Answer Question One and Any Other Two Questions.

QUESTION ONE (COMPULSORY) (30 MARKS)

a) The following information relates to the transactions of communication solutions ltd for the month of September 2017. The company is registered for VAT.

September 2 purchased goods worth sh.2,400,000 from Japan. Customs duty was paid at 5%.

September 2 sold goods to mobile connections ltd for sh.960,000 on credit. Goods worth sh.60,000 were found to be defective and were returned.

September 5 purchased office furniture for sh.640,000. One desk worth sh.80,000 was defective and was returned to the seller.

September 9 purchased goods worth 4,500,000 on credit from a manufacturing company. Goods worth sh.500,000 were damaged in transit and were thus not salable. it cost the company sh.240,000 to transport the goods.

September 10 sold goods for cash worth sh.960,000

September 12 exported goods worth sh.2,400,000

September 16 imported goods worth 1,500,000 from india. Customs duty was paid at 5% .

September 20 sold goods worth sh.218,000 to XYZ ltd.

September 25 Exported goods worth sh.2,600,000 to kimbo ltd.

September 30 paid the following expenses for the month of September.

Salaries and wages sh.1,400,000

Electricity sh.48,000

Telephone sh.36,000

Water sh.10,000.

Note: where applicable prices are quoted inclusive of VAT.

Required:

- The VAT payable (or refundable) for the month of September 2017. (10 marks)
- b) Explain the meaning of tax evasion and give reasons as to the causes of tax evasion. (6 marks)
- c) Explain the features of a tax policy for a developing country. (4 marks)
- d) Explain the objectives of the fiscal policy. (4 marks)
- e) Explain the advantages of progressive taxes and its disadvantages. (6 marks)

QUESTION TWO (20 MARKS)

- a) Explain the meaning of taxable capacity, distinguishing between absolute taxable capacity and relative capacity.
- b) What are the factors which govern taxable capacity?

QUESTION THREE (20 MARKS)

Mrs Kamau is the owner of a supermarket in Nairobi East. Her accounts clerk has submitted to you the following trading profit and loss account for the year ended 31 December 2017.

Shs Shs

| | | | |
|-----------------------------|------------|----------------------------------|-----------|
| Opening stock | 8640,000 | Closing stock | 1,004,000 |
| Purchases | 96,000,000 | Proceeds from sale of land | |
| | | Allocated to her by government | 500,000 |
| Donations to Kenya Chamber | | | |
| Of commerce | 100,000 | Gain on salary shares | 200,000 |
| Redundancy payments | 600,000 | Gain on sale of residential plot | 400,000 |
| Contributions to registered | | | |
| Pension fund | 100,000 | general bad debt recovery | 36,000 |
| Rent, rates and taxes | 110,400 | dividends (net) | 43,200 |
| Insurance | 14,880 | | |
| Legal and professional fees | 109,200 | | |

| | | |
|------------------------------|-----------|--------------------|
| Depreciation | 363,840 | |
| Advertising | 116,800 | |
| Value added tax | 247,200 | |
| Customs duty-2017 | 700,000 | |
| Income tax for 2015 | 312,000 | |
| Medical expenses (mrskamau) | 28,800 | |
| Interest on bank overdraft | 49,920 | |
| Purchase of equipment | 25,200 | |
| Christmas gifts to customers | 20,160 | |
| General bad debts | 55,200 | |
| Household expenses | 100,800 | |
| Stationery and postage | 33,120 | |
| Net profit | 2,905,680 | |
| <u>112,183,200</u> | | <u>112,183,200</u> |

The following additional information is also provided

- i) Rent, rates and taxes includes sh.20,400 being customs duty for the purchase of equipment.
- ii) Sales include a sum of sh. 120,000 representing the value of goods withdrawn for use by mrskamau and her children. These goods had been purchased at a cost of sh.96,000

Required:

- a) Mrs. Kamau's chargeable profit for the year of income 2017 (16 marks)
- b) The tax payable on the profit. (4 marks)

QUESTION FOUR (20 MARKS)

Rai, Sai and Tai are former school mates who are doing business together. The business is not registered but they regard themselves as equals in it. They keep proper books of accounts and have been able to provide the following profit and loss account for the year ended 31 December 2016.

Profit and loss account

Shs shs

| | | | |
|--|---------|---------------------------|-----------|
| Establishment expenses | 800,000 | Gross profit | 1,908,000 |
| Rent of business premises (jointly owned by them) | 180,000 | Sundry receipts | 80,000 |
| Interest expense | 80,000 | interest income | 72,000 |
| Stationery and printing | 120,000 | profit on sale of shares | 200,000 |
| Lighting and heating | 40,000 | gross income from farming | 340,000 |
| General farm expenses | 294,000 | lottery winnings | 800,000 |
| Repair of premises | 40,000 | | |
| Depreciation | 300,000 | | |
| Interest on capital | | | |
| Rai | 80,000 | | |
| Tai | 120,000 | | |
| Salary to Sai | 160,000 | | |
| Commission to partners | | | |
| Rai | 96,000 | | |
| Sai | 96,000 | | |
| Tai | 96,000 | | |
| Bad debts | 240,000 | | |
| Gift, presents and charity | 40,000 | | |
| Donations | 200,000 | | |
| Interest on loan taken | | | |
| To pay- income tax | 20,000 | | |
| -legal charges | 120,000 | | |
| Net profit | 398,000 | | |
| <u>3,520,000</u> | | <u>3,520,000</u> | |

Additional information

capital allowances have been agreed as follows:

1. wear and tear sh.180,000
2. farm works deductions sh.120,000
3. the partners had borrowed sh.400,000 with a hope of investing it in fixed securities to earn more income. The interest rates nevertheless declined. Interest expenses of sh.80,000 and interest income of sh.72,000 relate to this loan.
4. legal charges include sh.40,000 paid to finish a case in the customs department.
5. The partners had brought forward losses amounting to sh.800,000 from, the previous year.

Required:

- a) Taxable income from the partnership. (16 marks)
- b) Show allocation among the partners. (4 marks)

QUESTION FIVE (20 MARKS)

- a) Outline the offenses and penalties under P.A.Y.E. (5 marks)
- b) Explain the meaning of income from rent and state the deductions allowed against rental income. (7 marks)
- c) Peter earned the following incomes in the year 2017.

Basic salary sh.20,000 per month

Medical allowance sh.10,000 per month

Travelling allowance sh.15,000 per month.

He contributed 10% of his basic pay to a registered pension fund. He was provided with a car which had cost sh.1,000,000. He was provided with a house by his employer.

Required: calculate his taxable income for the year 2017. (8 marks)