



# MACHAKOS UNIVERSITY

University Examinations for 2020/2021 Academic Year

SCHOOL OF BUSINESS AND ECONOMICS

DEPARTMENT OF ACCOUNTING BANKING AND FINANCE

THIRD YEAR SPECIAL/ SUPPLEMENTARY EXAMINATION FOR

BACHELOR OF COMMERCE

BAC 304: FUNDAMENTALS OF TAXATION

DATE: 24/3/2021

TIME: 8.30-10.30 AM

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## INSTRUCTIONS:

*Answer question one and any other two questions.*

### QUESTION ONE (30 MARKS)

- a) Explain the characteristics of public goods.
- b) Explain the meaning of the following terms as used in V.A.T(Value Added Tax):
  - i. Value added
  - ii. Output Tax
  - iii. Input Tax.
  - iv. Taxable Person
  - v. Exempt goods and Services.

- c) John earned the following incomes in the year 2003:

Basic salary ksh.30,000 per month, Medical allowance Ksh. 25,000 per month, House allowance ksh.15,000 per month. He was provided with a car of an engine capacity of 1700cc, which had cost ksh.2,500,000. He made a pension contribution of 10% of his basic salary to a pension scheme that was not registered. His Employer contributed a similar amount. He paid insurance premium of ksh.20,000 per month towards his life insurance policy. He had a house mortgage and paid an interest of ksh.25,000 per month.

### Required:

- i. Calculate his taxable income for the year of income.
- ii. Calculate the tax payable by John for that year.

## QUESTION TWO (20 MARKS)

- a) Briefly explain any one theory of taxation.
- b) Explain the rationale for taxation in a country.
- c) Explain the canons of a good tax system.

## QUESTION THREE (20 MARKS)

- a) Explain any 5 deductions against business income.
- b) Mutua carried on a business and made a Net profit of ksh. 40,000. His expenses were as follows:

Salaries	ksh. 200,000
Stationery	ksh. 100,000
Electricity	ksh. 50,000
Bad debts written off	Ksh. 80,000
Donations	Ksh. 50,000
Purchase of a computer	Ksh. 30,000
Purchase of a car	Ksh. 250,000
School fees for children	Ksh.120,000

The provision for bad debts comprised of 60% specific. Gain on sale of a fixed asset ksh.25,000. He paid a salary to himself of ksh.100,000 in the year and wife Ksh.35,000. He purchased office furniture of ksh.100,000.

**Required:** Calculate the adjusted taxable profit.

## QUESTION FOUR (20 MARKS)

- a) A, B and C are in partnership sharing profits and losses in the ratio of 3:2:1 respectively. In a certain year of income, the partnership business made a profit of ksh. 200,000. This was after charging the following expenses:

i.	Salaries to	A	20,000
		B	30,000
ii.	Commission to	C	50,000
iii.	Interest on capital	A	20,000
		B	40,000
		C	20,000
iv.	Interest on drawings	A	5,000
		B	10,000
		C	15,000
v.	School fees for their children	A	4,000
		B	5,000
		C	7,000

The business had made late tax returns and was fined Ksh.10,000 which they paid accordingly. They had also assisted a friend of them with Ksh.15,000 to take care of a medical bill.

**Required:** calculate the adjusted partnership profit or loss.

- b) Explain the treatment of the following with regard to taxation of partnerships:
- i. Salaries to partners
  - ii. Salaries to partners' wives.
  - iii. Interest on drawings.
  - iv. Interest on partners' capitals
  - v. Bonus paid to partners.

**QUESTION FIVE (20 MARKS)**

- a) Distinguish between depreciation and capital deductions.
- b) Explain 2 deductions allowed against the tax payable by an individual.
- c) Explain the difference between medical allowance and medical benefit.
- d) Differentiate between zero rated goods and Exempt goods with examples where necessary.
- e) Give four examples of VAT records.
- f) Give Four examples of privileged bodies and institutions with zero rated status on imports and purchases.