1. Answer question **ONE** and any other **THREE** questions
2. Do not forget to write your registration number

This paper consists of 6 printed pages. Please turn over.

**QUESTION ONE**

a) According to income tax act 470 section 15 explain how interest on mortgage and contribution to Home ownership savings plan are treated for tax purpose  (4marks)

b) Discuss the significance of residence to an individual tax payer  (4marks)

c) Mr Barasa is employed as a sales manager in Turbo ltd. The following details relates to his employment income for the year ending 31st Dec 2018:

1. Basic salary sh60,000 per month (PAYE sh9,000)

2. He received the following benefits from the employer:

   ✓ A fully furnished house(cost of the furniture sh300,000)

   ✓ Free lunch valued at sh3800 per month

   ✓ A company car 1500cc whose cost is sh800,000 as at January 2017

   ✓ The school fees for his son was paid by the employer amounting to sh65000 per term in the year 2018.

   ✓ A watchman and gardener were both paid by the employer sh10,000 each as from June 2018 respectively.

   ✓ Daily entertainment allowance of sh5000 during a four days seminar at Nakuru County.

   ✓ Annual leave allowance which was calculated at 8% of his basic pay.

3. He contribute sh20,000 per month to a registered pension scheme with employer contributing the same amount.

4. His wife operates a shop which is registered in their joint names. She reported a profit of sh1200,000 for the year ending 31st Dec 2018 after deducting her annual salary 600,000 and rent of sh800,000.

**Required:**
i. Determine the taxable income of Mr Barasa for the year ending 31st Dec 2018 (12 marks)

ii. Tax payable if any on the above income (5 marks)

QUESTION TWO

a) Discuss four ways which a company could avoid tax (4 marks)

b) Fanikiwa Limited presented the following income statement as at 31st Dec 2018

Sales 64,000,000
Opening stock  6,000,000
Purchases 20,000,000
Less Closing stock 13,000,000

Gross profit 52,000,000

General expenses 6,000,000
Raw materials consumed 18,000,000
Salaries and wages 4,000,000
Office expenses 7,600,000
Directors fee 2,000,000
Auditors fees 400,000
Tax consultancy fee 80,000
Depreciation 1,500,000
Selling price 3,000,000
Interest on borrowed loan 250,000  
Provision for taxation 1,600,000  
Preliminary expenses 540,000  
Proposed final dividends 1,300,000  
Legal fee 800,000  
Transfer to reserve account 2,200,000  

**Net profit** 1,830,000

**Additional information**

1. Preliminary expenses were incurred on 1st January 2016 and relate to company formation  
2. Legal expenses include  
   - Settling a dispute with a customer 120,000  
   - Protection of the company’s title deed 60,000  
   - Cost for a breach of law 42,000  
   - Cost of a income tax appeal 18,000  
   - Registration of a trade mark 12,000  
   - Cost of raising a loan 10,000  
   - Interest charged on hire purchase agreement 24,000

**Required**

i. Adjusted taxable profit of loss for Fanikiwa limited for the year 31st Dec 2018  
   **(10marks)**

ii. Tax payable if any for the ending 31st Dec 2018  
   **(1mark)**

**QUESTION THREE**

a) Discuss five reasons why a tax payers evade taxes  
   **(5 marks)**

b) Biashara limited commenced operation on 1st January 2017 after incurring the following on assets.  
   Processing machinery 1,800,000
Factory building 4,800,000
Trailer for tractor 400,000
Parking bay 800,000
Saloon car 2,400,000
Computer 900,000
Tractor 1,500,000
Furniture 460,000

During the year ending 31st Dec 2018 the following transaction took place
a. The saloon car was disposed at sh 2000,000
b. All assets in class II were disposed at sh900,000
  c. Laptops were purchased and carpet at sh300,000 and sh120,000 respectively
  d. Factory extension was constructed at cost of 1,500,000 and put on use on 1st oct 2018.

Required

Capital allowance due to Biashara ltd for the years ending 31st December 2017 and 2018

(10marks)

QUESTION FOUR

a) Name interest incomes which are not taxable in Kenya
   (5marks)

b) List five circumstance under which a tax payer might receive an additional assessment from revenue authority
   (5marks)

c) Maridadi Traders ltd deals in variety of taxable and non-taxable supplies. During the month of December 2018, The company recorded the following transactions:

December 2: Purchased goods on credit from BB Ltd for ksh 150,000 at standard rate.
December 8: Received credit note from BB Ltd for ksh 30,000
December 10: Sold computer spare parts to the ministry of finance for ksh 200,000
December 18: Exported goods to for 80,000 to Malawi
December 21: Supplied standard rated goods for ksh 1380,000 to webu ltd on credit
December 22: Exempted supplies amounted to ksh 60,000
December 24: Paid electricity ksh 48,000
December 24: Paid water ksh 10,000
December 28: Paid ksh 80,000 for auditing services offered by Bepo certified public accountants.
December 30: Purchased goods at a standard rate for ksh 400,000

The above transactions were reported as exclusive of vat at the rate of 16% where applicable.

Required:
The vat account to show tax payable or refundable for the month of December 2018
QUESTION FIVE

a) Name and explain the principles of good tax system as advocated by Adam Smith.

(4marks)

b) Kaka, Mambo and Korir are in partnership operating a hardware shop as Kamako Enterprises and share profits or losses equally. The following is the income statement of the partnership business for the year ending 31 December 2017.

<table>
<thead>
<tr>
<th>Income</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Gross profit</td>
<td>8,000,000</td>
</tr>
<tr>
<td>Farming income</td>
<td>400,000</td>
</tr>
<tr>
<td>Rental income</td>
<td>200,000</td>
</tr>
<tr>
<td>Foreign exchange gain</td>
<td>123,000</td>
</tr>
</tbody>
</table>
| Discount received               | 36,000   | **8,759,000**

<table>
<thead>
<tr>
<th>Expenditures</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Lorry 4 tonnes</td>
<td>2,800,000</td>
</tr>
<tr>
<td>General expenses</td>
<td>2,000,000</td>
</tr>
<tr>
<td>Legal fee</td>
<td>480,000</td>
</tr>
<tr>
<td>Interest on loan</td>
<td>460,000</td>
</tr>
<tr>
<td>Loss on sale of motor car</td>
<td>74,000</td>
</tr>
<tr>
<td>Stamp duty</td>
<td>10,000</td>
</tr>
<tr>
<td>Bad debts written off</td>
<td>56,000</td>
</tr>
<tr>
<td>Mortgage interest</td>
<td>230,000</td>
</tr>
<tr>
<td>Drawings by partners</td>
<td>640,000</td>
</tr>
<tr>
<td>Photocopier purchased</td>
<td>42,000</td>
</tr>
<tr>
<td>Salaries and wages</td>
<td>3,000,000</td>
</tr>
<tr>
<td>Debt collection fee</td>
<td>7,200</td>
</tr>
</tbody>
</table>
| Vat paid                        | 48,000   | **(9,847,200)**

Net loss reported **(1,088,200)**

Additional information

1. **General Expenses includes**
   - Depreciation                    240,000
   - Cash embezzled by cashier      560,000
   - Staff Christmas party         300,000
   - Pension for retired staffs     600,000
   - School fees partners children 240,000

2. **Interest on loan includes**
   - Interest on partners’ capital (equally paid) 300,000
   - Interest on a bank loan        60,000

3. **Drawing by partners were as follows**
Kaka 200,000
Mambo 300,000
Korir 140,000

4. Legal fee

Parking fee 14,000
Drafting of tender document 86,000
Signing lease agreement 99 years 40,000
Defending partner dispute 80,000
Defending partner of tax dispute 30,000

5. Mortgage interest relate to a partner residential home

6. Salaries and wages include partners as follows

<table>
<thead>
<tr>
<th>Partner</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Kaka</td>
<td>360,000</td>
</tr>
<tr>
<td>Mambo</td>
<td>240,000</td>
</tr>
<tr>
<td>Korir</td>
<td>500,000</td>
</tr>
</tbody>
</table>

7. Interest on drawings is to be calculated at the rate of 10% and distributed to partners equally.

Required

i. Adjusted taxable profit or loss of the partnership for the year ending 31st Dec 2017

(8Marks)

ii. A schedule showing the taxable income for each partner as at 31st Dec 2017  (3Marks)

--------------------------------------------------------------------------------------------------

BCM 3206: Taxation

Page 7