

THE COOPERATIVE UNIVERSITY OF KENYA
FINAL EXAMINATION
2018/2019 ACADEMIC YEAR
YEAR TWO SEMESTER TWO EXAMINATION
FOR THE DEGREE OF BACHELOR OF COOPERATIVE BUSINESS

HCOB 2303 : TAXATION I

DATE: APRIL 2019

TIME 2 HOURS

INSTRUCTIONS:

ANSWER QUESTION ONE AND ANY OTHER TWO QUESTIONS.

Question 1

(a) The following information relates to Mr. Tom and his wife for the year ended 31 December 2018:

1. He was employed by LT Ltd as a manager on the following terms:
 - Basic pay per annum Sh. 1,800,000 (annual PAYE Sh. 500,000)
 - Annual bonus of Sh. 50,000
 - Monthly commission equal to 2% of monthly basic pay
 - Annual medical allowance (non-discriminatory scheme) of Sh. 360,000 paid on reimbursement basis. During the year, he was reimbursed Sh. 240,000 for medical cost incurred on self and family
 - Free lunch valued at Sh.70,000 per annum
2. He obtained a loan from the employer amounting to Sh. 800,000 on 1st December 2018. The interest on the loan was specified by the employer as 5% per annum. Assume a prescribed interest rate of 8% per annum for the month of December 2018
3. He paid life premium amounting to Sh.144,000 during the year for policies on self and family
4. His wife is employed by MN Ltd as a financial analyst at a basic salary Sh.120,000 per month. Mr. Tom owns 25% of the ordinary share capital of MN Ltd.
5. The following additional income accrued to his wife during the year:
 - She earned a profit of Sh.800,000 from a supermarket business registered by her name but managed by her daughter. This profit was after deducting Sh.240,000 paid as salary to the daughter during the year. The daughter was below eighteen years of age as at 31 December 2018
 - She owns residential houses inherited from her father. The rental income received for the year amounted to Sh.960,000.

Required:

Compute the taxable income and tax liability of Mr. Tom and his wife for the year ended 31 December 2018

- | | |
|---|-------------------------|
| (b) Describe the canons of taxation and expenditure | (14 Marks) |
| (c) Distinguish between balancing charge and balancing deduction | (4 marks) |
| (d) Describe the benefits of tax residence status | (4 marks) |
| (e) Explain the implications of VAT zero rating and VAT exempt status | (4 marks) |
| | (Total 30 marks) |

Question 2

TX company reported a net profit of Sh. 7,855,500 for the year ended 31 December 2018. This profit was after debiting and crediting the following items.

	Sh.
Opening stock	1,950,000
Purchases	18,900,600
Salaries and wages	6,750,000
Lease amortization	375,000
Gross sales	42,000,000
Rental income	10,500,000
Electricity and water expense	2,400,000
Interest expense	4,500,000
Rent, rates and taxes	1,800,000
Donations to a political party	240,000
Closing stock	2,550,000
Profit on sale of shares	100,500
Impairment of assets	528,000
Depreciation	1,353,000
Cost of stolen stock	1,800,000
Legal expenses	1,200,000
Dividend income (gross)	1,800,000
Interest income (net)	3,150,000
Repairs and maintenance	2,970,750
Bad debts	2,031,000
Proposed dividend	1,800,000
Redundancy payments to employees	3,270,900
Insurance compensation received	750,000
Business promotion cost	1,440,750
Miscellaneous income (not taxable)	315,000

Additional information:

1. Legal expenses were incurred in relation to:

	Sh.
Drafting of a lease agreement (100 years)	180,000
Settling customer disputes	120,000
Conveyance fee on purchase of land	300,000
Issue of debentures	<u>600,000</u>
	<u>1,200,000</u>

2. Bad debts were analyzed as follows:

Bad debts account		
	Sh.	Sh.
Bad debts written off	381,000	
<u>Balance carried down:</u>		<u>Balance brought forward:</u>
General provision	7,200,000	General provision 6,750,000
Specific provision	2,700,000	Specific provision 1,500,000
		Profit loss account 2,031,000
	10,281,000	10,281,000

3. Included in repairs and maintenance was Sh. 300,000 incurred on renovation of a factory building.

4. Capital allowances for the year ended 31 December 2011 were agreed with tax authorities at Sh. 2,730,000.

5. Dividend income received was analyzed as follows:

	Sh.
Dividend from a subsidiary company	600,000
Dividend from shares held in a commercial bank	<u>1,200,000</u>
	<u>1,800,000</u>

6. Interest income comprised of:

	Sh.
Interest from an account with foreign bank	1,350,000
Interest from Treasury bills	<u>1,800,000</u>
	<u>3,150,000</u>

7. Insurance compensation received was in relation to the debtors who had defaulted on payment.

Required:

(i) Taxable profit or loss of TX Ltd for the year ended 31 December 2018

(18 marks)

(ii) Tax liability (if any) due from the company for the year ended 31 December 2011.

(2marks)

Question 3

You have been approached by the directors of FD Ltd to help them do their income tax returns for 2011. The following information is available. Written down values at 1 January 2011 per self assessment return submitted are as follows:

	Sh..
Motor vehicle - Lorries	250,000
- Tractors	375,000
- Pick-up and saloons	1,250,000
Farm House (constructed in 2011)	300,000
Computers	750,000
Plant	475,000
Equipment	275,000
Furniture	725,000

During the year the company purchased and sold the following:

1. Mercedes Benz for use by the director costing Sh. 2,500,000
2. Security systems were fixed into company's Lorries to comply with the insurance requirements. The cost to the company was Sh 250,000.
3. The company traded – in four Nissan Sunny cars which were purchased in 2009. The trade-in value of each of the cars was Sh..1, 800,000(Net book value of Sh. 1,600,000).
4. Four new cars were bought at Sh..2, 500,000 each. The vehicles are used by the senior officers of the company and their rating is 1300cc.
5. Equipment worth Sh. 1,650,000 was acquired while carpet worth Sh. 450,000 was disposed off and furniture with net book value of Sh. 460,000 was disposed of.
6. Computers worth Sh. 1,250,000 were acquired for purposes of speeding up computerization of the company's operations.
7. The company's adjusted profit before wear and tear allowances is Sh 1,599,000.

Required:

Compute the capital allowances for Flower Export Ltd as at 31 December 2011. **(20 Marks)**

Question 4

Mr. TM is a marketing executive and during the month ended 31 December 2018, the firm undertook the following transactions:

April:

- 1: Provided marketing consultancy services to a client and invoiced Sh. 60,000 excluding VAT.
- 2: Provided marketing consultancy services assignment for Jakumu Traders and raised an invoice of Sh. 96,000 inclusive of VAT.
- 6: Provided marketing consultancy services to a client at an agreed fee of Sh. 70,000 exclusive of VAT.
- 8: Provided marketing consultancy services to a client at an agreed fee of Sh. 100,000 exclusive of VAT.
- 15: Provided marketing consultancy services to a client and invoiced Sh. 69,000 inclusive of VAT for debt collection services rendered.
- 20: Provided management consultancy services to a home of orphans on a voluntary basis. The value of the services was Sh. 23,200 exclusive of VAT.
- 24: Undertook marketing consultancy work and raised an invoice of Sh.150,000 exclusive of VAT.
- 30: Provided marketing consultancy services to a client and raised an invoice of Sh. 116,000 inclusive of VAT.
- 31: Received goods worth Sh. 60,000 from a client in full settlement of the amount billed for services rendered on 15 December.

Additional Information:

The following expenses were paid by the firm during the month:

	Sh.
Salaries and wages	800,000
Electricity	5,600
Telephone	8,400
Water	5,200

Fuel	16,000
Garbage collection	720
Computer repairs and maintenance	2,800
Rent	12,000

The above expenses are stated as VAT exclusive where applicable.

Required:

VAT account in the books of TM for the month of December 2018

(20 Marks)

Question 5

Ronald, Martin and Nathan have been trading in partnership sharing profits and losses in the ratio of 2:2:1 respectively. They have presented the following profit and loss account of the firm for the year ended 31 December 2018:

	Sh.000	Sh.000
Gross profit		24,800
Investment income (gross)		450
Miscellaneous income		315
Deduct:		
Depreciation		(110)
Office expenses		(1,568)
Legal fees		(360)
Sundry		(630)
Trade expenses		(380)
Partners' salaries, interest on Capital and drawings		(13,350)
Net profit		9,167

Additional information

1. Investment income comprises:	sh.000
Interest on bank deposits	210
Dividend on shares in quoted companies	130
Interest charged on partners' drawings:	
Ronald	50
Martin	40
Nathan	20
2. Miscellaneous income comprises:	Sh.000
Gain on sale of furniture and fittings	195
Insurance recoveries for stolen stock	120
3. Office expenses comprise:	Sh.000
Advertisements on billboards	250
Rent	800
General expenses (allowable)	518
4. Legal fees include sh.150,000 incurred on a successful defense of a partner in a private legal suit.	
5. Sundry expenses comprise:	Sh.000
Donations to orphanage	420
Debt recovery charges	90

Vehicle maintenance costs	120
6. Trade expenses comprise:	Sh.000
Subscriptions to a trade association	150
Value Added Tax (VAT) paid	170
Repairs to building	60

7. Partners' salaries, interest on capital and drawings are analysed below:

	Ronald	Martin	Nathan	Total
	Sh.000	Sh.000	Sh.000	Sh.000
Salaries	4,000	4,500	3,700	12,200
Interest on capital	200	300	330	830
Drawings	60	100	160	320
	4,260	4,900	4,190	13,350

8. Capital allowances for the year ended 31 December 2011 were agreed with the tax authority at sh.480,000.

Required:

- Adjusted partnership profit or loss for the year ended 31 December 2011 (12 Marks)
- Distribution of the adjusted profit or loss amongst the partners (4 Marks)
- The tax liability for each of the partners for the year ended 31 December 2011(4 Marks)

(Total: 20 Marks)