

CHUKA



UNIVERSITY

UNIVERSITY SUPPLEMENTARY/SPECIAL EXAMINATIONS.

EXAMINATION FOR THE AWARD OF DIPLOMA IN PROCUREMENT AND
BUSINESS MANAGEMENT

DIAC 0225: TAXATION

STREAMS: DIP

TIME: 2 HOURS

DAY/DATE: MONDAY 23/07/2018

8.30 A.M - 10.30 A.M

INSTRUCTIONS:

- Answer **Question ONE** and other **TWO Questions**
- Do not write anything on the Question paper.

QUESTION ONE

- (a) Explain the meaning of the term taxes and give reasons why government levies taxes to its citizens. [10 Marks]
- (b) Explain the advantages of value added tax (VAT) over pay as you earn (PAYE). [6 Marks]
- (c) Highlight any five principles of a good tax system. [6 Marks]
- (d) Distinguish between the following terms as used in taxation;
- (i) Tax impact and tax incidence. [2 Marks]
 - (ii) Forward shifting and backward shifting. [2 Marks]
 - (iii) Tax avoidance and tax evasion. [2 Marks]
- (e) The second schedule of Income Tax Act grants allowances with respect to capital expenditure. State any three examples of such allowances. [3 Marks]

QUESTION TWO

Derrick Odhiambo, a procurement manager at ABC Ltd provided the following information in relation to his employment and personal incomes for the year ended 3/12/2017.

1. Basic salary Kshs.130,000 per month.

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2. House allowance Kshs.50,000 per month
3. Travelling allowance of Kshs.30,000 per month in which he used Kshs.240,000 during the year for official duties and the rest for personal use.
4. Contribution for retirement fund are paid by the employer and himself at Kshs.15,000 and Kshs.5,000 per month respectively. The fund is registered with the commissioner of KRA.
5. He is provided with a house which the employer hired him. He pays a house rent of Kshs.2,000 per year per month.
6. He received a loan from the company of Kshs.500,000 at 8% interest rate per annum. The current market rate is 20%.
7. He is provided with a company car whose engine capacity is 2700cc.
8. He went to Ethiopia to visit his personal friend and purchased shoes worth Kshs.5000 for his wife and engineer labcoat for Kshs.10,000.
9. The employer paid telephone bills of Kshs.100,000 during the year on his behalf.

Required:

- (a) Calculate the taxable income of Mr. Odhiambo for the year ended 31/12/2017. [15 Marks]
- (b) Compute his tax liability. [5 Marks]

QUESTION THREE

John and James are in a partnership trade. They share profits in the ratio of 3:2 respectively. They have presented the income statement of 31st December 2016.

Income	Kshs.	Kshs.
Sales revenue	6,880,000	
Proceed on sale of asset	200,000	
Refund by VAT	40,000	
Interest on post offices savings account	10,000	
Dividends (net)	<u>50,000</u>	<u>7,180,000</u>
Expenses		
Cost of sales	1,500,000	
NHIF	100,000	
NSSF	150,000	
Motor vehicle maintenance	100,000	
Salaries to partners	900,000	
Household expenses (John)	96,000	
Advertising	160,000	
Insurance premiums	130,000	

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Interest on loans	200,000	
Subscriptions to trade associations	50,000	
Donations	20,000	
Legal expenses	100,000	
Income tax	250,000	
General expenses	100,000	
Bad debts	70,000	
Water and electricity	90,000	
Depreciation	<u>21,000</u>	<u>(4,957,000)</u>
Net profit		<u><u>2,223,000</u></u>

Additional information

1. Included in the sales revenue were goods valued at Kshs.200,000 consumed by partners. The goods had a cost of Kshs.100,000 which was included in the cost of sales.
2. Insurance premiums include Kshs.70,000 incurred on life insurance policy of James.
3. Bad debts comprise increase in general provisions Kshs.20,000 and increase in specific provisions of Kshs.45,000.
4. Interest on loans and general expenses relate to mortgage acquired by John for purchase of residential house.
5. Salaries to partners; John Kshs.500,000 and James Kshs.400,000.
6. NSSF and NHIF relate to the employees of the firm.

Required:

- (i) Adjusted partnership profit or loss for the year ended 31/12/2016. [15 Marks]
- (ii) The allocation of the profit or loss between the partners and the tax payable by each partner. [5 Marks]

QUESTION FOUR

- (i) Explain other ways in which government can raise its revenue apart from taxes. [8 Marks]
 - (ii) Explain your understanding of the term payment in lieu of leave. [2 Marks]
- (b) XYZ Ltd started operations in 2015. The written down values as at 1/1/2015 were:-
- Class I; Kshs.1,600,000
 - Class II; Kshs.1,200,000
 - Class III; Kshs.2,000,000
 - Class IV; Kshs.1,000,000

During the year, the company acquired the following;

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1. January 2015, lorry of 2.9 tonnes for Kshs.800,000, a tractor of Kshs.500,000 and a lorry 3.8 tonnes second hand for Kshs.900,000.
2. In June 2015, the proprietor converted own vehicle NZE into company use valued at Kshs.840,000.
3. In July 2015, a computer which was purchased in 2011 at Kshs.180,000 was traded in with a modern type of computer valued at Kshs.270,000. The traded in value of the old computer was Kshs.100,000.
4. In August 2015, the company purchased a Toyota Prado for Kshs.1,200,000 which was used for tax purpose during the year.
5. September 2015, the proprietor purchased a bicycle for business use by his wife at Kshs.8,000 and Toyota Vitz for Kshs.480,000 which was used by the secretary.

Required:

Compute the actual wear and tear allowance for the year 2015.

[10 Marks]

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