2804/305
TAXATION
July 2022
Time: 3 hours

THE KENYA NATIONAL EXAMINATIONS COUNCIL

DIPLOMA IN ACCOUNTANCY

TAXATION

3 hours

INSTRUCTIONS TO CANDIDATES

*This paper consists of **SIX** questions.*
*Answer any **FIVE** questions in the answer booklet provided.*
All questions carry equal marks.
Maximum marks for each part of a question are indicated.
Show all your working.
Candidates should answer the questions in English.

This paper consists of 7 printed pages.

Candidates should check the question paper to ascertain that both pages are printed as indicated and that no questions are missing.

© 2022 The Kenya National Examinations Council

CamScanner

1. (a) Highlight **four** disadvantages of levying indirect taxes in an economy. (8 marks)

(b) Duke and Duncan are partners operating as Dudu Traders. The following is the income statement of the business for the year ended 21 December, 2021:

	Ksh.	Ksh.
Gross profit		3,710,000
Insurance compensation		429,000
Discounts received		235,000
Specific bad debts recovered		180,000
Lottery winnings		230,000
		4,784,000
Less expenses:		
Salary and wages	1,600,000	
Discounts allowed	375,000	
Rent	431,000	
Office furniture	350,000	
Drawings: - Duke	120,000	
- Duncan	80,000	
Repairs and maintenance	174,000	
Motor van	490,000	
Advertising	50,000	
Fine for lack of business licence	290,000	
Water and electricity	130,000	
Duncan's household expenses	150,000	
Interest on loan	260,000	
Harambee contributions	170,000	
Loss on sale of computers	75,000	4,745,000
Net profit		39,000

Additional information:

I. salary and wages include Ksh. 440,000 paid to each partner as salary;
II. rent includes Ksh. 80,000 paid for Duncan's private residence;
III. interest on loan include Ksh. 60,000 paid for Duke's personal loan;
IV. the partners share profits and losses equally.

Prepare:

(i) the partnership's adjusted income statement for taxation for the year of income 2021.

(ii) a schedule showing the allocation of the taxable profits to each partners. (12 marks)

CamScanner

2. (a) Explain **four** factors that may influence the amount of tax revenue collected by the government. (8 marks)

(b) The following information relates to Mr. Lucigi, an employee of Utubora Limited for the year of income 2021.

I. Basic salary - Ksh. 105,000 per month, (PAYE Ksh. 18,500 per month)

II. He received the following benefits from employment:
- House allowance Ksh. 13,500 per month.
- Travelling allowance Ksh. 3,000 per month.
- A company car of 1800 cc that had cost the company Ksh. 2,300,000 on 1 January 2021.
- Medical benefit amounting to Ksh. 1,800,000 per annum. The company has a medical scheme for all employees.
- Company shares valued Ksh. 300,000 for which he paid Ksh. 100,000
- He consumed meals amounting to Ksh. 8,000.

III. He obtained a loan of Ksh. 4,500,000 from the company at an interest rate of 4% per annum. The market rate of interest was 13.5% per annum.

IV. His wife operates a shop from which she made a profit of Ksh. 2,141,500 after deducting the following expenses:
- Salaries and wages of Ksh. 310,000 including her salary of Ksh 180,000
- Partitions to the shop - Ksh 34,000
- Loan interest - Ksh. 15,300
- Water and electricity - Ksh. 9,500

Determine:

(i) Lucigi's taxable income.

(ii) tax payable. (12 marks)

3. (a) Explain ways in which Pay As You Earn (P.A.Y.E) satisfies the principles of a good tax system. (8 marks)

(b) Achiro Enterprises is registered for V.A.T purposes. The following transactions took place during the month of December 2021.

Month December	Purchases Kshs.	Month December	Sales Kshs.
5	2,260,000	7	1,330,000
12	4,320,000	20	3,600,000
26	3,520,000	24	3,810,000
28	2,130,000	30	2,870,000

CS CamScanner

Additional information:

(i) 8% of sales relate to exempt goods.

(ii) purchases of Ksh. 300,000 on 12th December 2021 were from sellers not registered for V.A.T purposes.

(iii) On 7 December 2021, goods worth Ksh. 410,000 were sold on credit to a customer who was declared bankrupt.

(iv) Received credit notes from suppliers as follows:
- Ksh. 250,000 from registered suppliers
- Ksh. 180,000 from unregistered suppliers

(v) Credit notes amounting to Ksh. 120,000 were issued to customers during the month.
- the sales and purchases are inclusive of V.A.T at the standard rate of 16%

Prepare a Value Added Tax (V.A.T) Account. (12 marks)

4. (a) Explain **four** ways in which the Kenya Revenue Authority (KRA) may reduce tax default by tax payers. (8 marks)

(b) The following information relates to the assets and liabilities of Upeo Limited for the year of income 2021.

I. Written down value as at 1 January, 2021

Class I	Class II	Class III	Class IV
(Ksh.)	(Ksh.)	(Ksh.)	(Ksh.)
5,390,000	370,000	2,916,000	1,580,000

additions during the year:	Ksh.
Forklifts	1,720,000
Machinery	2,385,000
Furniture	345,000
Computers	460,000
Lorry	2,450,000
Saloon car	2,710,000
Factory buildings	2,469,000
Staff quarters	1,150,000
Warehouse	670,000
Canteen	365,000

CamScanner

Disposals during the year:

	Ksh.
Printing machine	190,000
Machinery	530,000
Tractor	1,100,000

Compute the capital allowances due to Upeo Limited for the year of income, 2021. (12 marks)

5. (a) Explain **four** ways in which taxation may affect the operations of a public limited company. (8 marks)

(b) The following is an income statement of Tapo Limited for the year ended 31 December 2021.

	Ksh.	Ksh.
Gross income		13,560,000
Investment income		1,300,000
Dividend income		2,500,000
Bad debts recovery - specific		420,000
Discounts received		230,000
Foreign exchange gains		180,000
		18,190,000
Expenses		
Salaries and wages	4,800,000	
Purchase of computers	680,000	
Insurance premiums	350,000	
Depreciation	490,000	
Donations	770,000	
Rent and rates	1,200,000	
Audit fee	860,000	
Loan repayment	370,000	
Director's remuneration	1,750,000	
Furniture	560,000	
Bad debts written off	340,000	
Discounts allowed	170,000	
School fees paid	350,000	
Bank charges	110,000	12,800,000
Net profit		5,390,000

CamScanner

Additional information:

I. Donations include subscriptions to employees' social welfare club amounting to Ksh. 230,000.
II. Rent and rates include a fine of Ksh. 200,000 on overdue rates.
III. Audit fees include Ksh. 270,000 paid to a private auditor hired by one of the managers who was under investigation.
IV. Directors' remuneration include a retirement fee of Ksh. 250,000 for one of the directors.
V. Sixty percent of the bad debts written off were specific.
VI. School fees was for some of the employees' children. This had been deducted from the employees' income.
VIII. Capital allowance were agreed with the commissioner of Domestic Taxes at Ksh. 526,300.

(i) Prepare a statement showing the taxable income for the year of income 2021.

(ii) Determine the corporation tax due.

(12 marks)

6. (a) Explain **four** benefits of taxation in an economy. (8 marks)

(b) Mr. Mapoa has been operating a business without maintaining proper books of account. The following information relates to his assets and liabilities for the last four years:

	2017	2018	2019	2020
	Ksh'000'	Ksh'000'	Ksh'000'	Ksh'000'
Assets				
Land	1,500	1,500	2,600	2,600
Building	2,700	2,700	2,700	4,000
Motor vehicle	3,300	2,100	2,100	3,600
Inventory	1,400	1,200	800	530
Trade receivables	2,500	2,800	1,670	710
Bank	1,200	1,550	510	870
Cash	750	750	860	860
Trade payables	820	1,630	1,800	900
Bank loan	2,700	1,900	1,100	750

Additional information:

(i) He contributes Ksh. 150,000 per year towards a savings plan.
(ii) He withdrew Ksh. 250,000 in 2017 towards meeting his personal expenses. This has been increasing at 10% per annum in the subsequent years.
(iii) During the year 2018, he sold a motor vehicle that had cost Ksh. 1,200,000 for Ksh. 725,000.
(iv) Furniture that had cost Ksh. 1,040,000 was sold for Ksh. 680,000 in the year 2019.

Prepare a statement showing income chargeable to tax for each of the years of income 2017, 2018, 2019 and 2020. (20 marks)

Year of income 2021

Monthly taxable pay (Sh.)		Annual taxable pay (Sh.)		Rate of tax % in each Sh.
1	- 12,298	1	- 147,580	10%
12,299	- 23,885	147,581	- 286,623	15%
23,886	- 35,472	286,624	- 425,666	20%
35,473	- 47,059	425,667	- 564,709	25%
Excess over	- 47,059	Excess over	- 564,709	30%

Personal relief Sh.1,408 per month (Sh.16,896 per annum).

Prescribed benefit rates of motor vehicles provided by employer

			Monthly rates (Sh.)	Annual rates (Sh.)
(i) Saloons, Hatch Backs and Estates				
	Up to	1200 cc	3,600	43,200
	1201	1500 cc	4.200	50,400
	1501	1750 cc	5,800	69,600
	1751	2000 cc	7,200	86,400
	2001	3000 cc	8,600	103,200
	Over	3000 cc	14.400	172.800
(ii) Pick-ups, Panel Vans (unconverted)				
	Up to	1750 cc	3,600	43.200
	Over	1750 cc	4,200	50,400
(iii) Land Rovers/Cruisers			7,200	86,400

Capital allowance:

Wear and tear allowance:

Class I	37.5%
Class II	30%
Class III	25%
Class IV	12.5%
Software	20%

Industrial building allowance:

Up to 2009	2.5%
From 1 January 2010	10%
Hotels	10%
Hostels/Education/Film producers buildings	100%
From 1 January 2010 - Commercial building: (Shop, office or show room)	25%

Farm works allowance	100%
Investment deduction allowance	100%
Shipping investment deduction (**Ships over 125 tonnes**)	100%

Extraction expenditure:

Written off over 5 years (20%)

Commissioner's prescribed benefit rates

Services	Monthly rates Sh.	Annual rates Sh.
(i) Electricity (Communal or from a generator)	1,500	18,000
(ii) Water (Communal or from a borehole)	500	6,000
Agriculture employees: Reduced rates of benefits		
(i) Water	200	2,400
(ii) Electricity	900	10,800

THIS IS THE LAST PRINTED PAGE.