

## TAXATION – BLOCK REVISION MOCK 5

### QUESTION ONE

- (a) A person who is registered for VAT must maintain certain records to satisfy the VAT regulations. Give ten examples of such records that must be kept.  
(10 marks)
- (b) Discuss three practical problems experienced by a Kenyan in complying with the VAT Act. Suggest ways in which these problems can be overcome.  
(6 marks)
- (c) The value for VAT of a supply is the consideration paid. Indicate the value for VAT under the following circumstances:

The price of a radio cassette was Sh.17,500. A cash discount of 10% was given to the customer.

Ushonaji Architects provided a free service to a community based project. The value of the service was Sh.125,000.

Dubai Kenya Ltd. imported electricals valued for Sh.2,000,000. A duty of 25% was charged by customs department.

Kupenda Company Ltd. sold furniture by instalments. The first instalment of Sh.5,000 was received immediately. The sales price of the furniture is Sh.20,000 and the remaining balance is to be paid in three equal monthly instalments.

(4 marks)

**(Total: 20 marks)**

### QUESTION TWO

- (a) Miss Nyakio's contract of employment for five years was terminated on 31 December 2005 after it had run for three years. Compensation for Sh.300,000 was paid. Her salary at the date of termination was Sh.90,000 per year. If the contract had run its full term, a total of Sh.180,000 would have been paid as salary for both 2006 and 2007.

#### **Required:**

What income is assessable on Miss Nyakio, and in which years?

Assume that Nyakio's contract was not specific, what income is assessable on Miss Nyakio and in which years?

Assume Miss Nyakio was a director in the company paying her compensation. Her shareholding in the company was 5% of the share capital. What will be the tax treatment in (i) and (ii) above?

Explain.

12 marks)

(b) State and explain from tax perspective whether each of the following items are capital or revenue.

- Legal and professional fees on computerization.
- Structural alterations to premises to maintain existing rent.
- Legal costs and stamp duty for acquisition of lease of business premises
- Expenditure on advertising to promote sale of goods or services provided by a business income tax
- Reserves and provisions. (3 marks)

(c) Give five examples of non-taxable income. (5 marks)

**(Total: 20 marks)**

### QUESTION THREE

(a) With reference to wear and tear allowances, what is meant by the “pooling method”? ( 2 marks)

(b) The following information is given to you from the books of Kilimo Holdings Ltd., a farming and manufacturing company as at 31 December 2005:

	<b>Sh.</b>
Written down values as at 31 December 2005	
Motor vehicles	655,000
Tractors	2,755,000
Plant and machinery	530,000
Furniture and fittings	225,000
Combine harvester	1,012,500
Spares for tractors	510,000
Land rovers	1,135,000
Office curtains	22,000
Computers	77,000
Fax machine	40,000
Telephones	80,000
Farm works (original cost Sh.21,000)	7,000
Industrial building (original cost net of investment deduction Sh.1,000,000)	950,000

Additions in 2006:	Sh.		Sh.
Library books	25,000	Saloon car	1,500,000
Loose tools	10,000	Pick-up	850,000

Engine head for trailer	500,000 750,000	Farmhouse	200,000
New building			
Old machinery installed in new building	350,000		
Disposals in 2006:			Sh.
Saloon car (cost in 2003 – Sh.150,000)			250,000
Furniture			25,000
Computers			80,000
Tractor			75,000

**Required:**

Compute total capital allowances for the year 2006. State why you have not used any information and why you think it is not relevant.  
(14 marks)

Show balances carried forward to 2007. (2 marks)

Comment on the tax treatment of class II balance.  
(2 marks)

**(Total: 20 marks)**

**QUESTION FOUR**

Kenwide Enterprises Ltd. is a distributor of wines and spirits. The profit and loss account for the year ended 31 December 2005 is as follows:

	Sh.		Sh.
Purchases	1,000,000	Sales	3,655,000
Staff wages	850,000	Discounts	355,000
Rent and rates	92,500	Provision for bad and doubtful debts	35,500
Distribution and office expenses	445,500	Profit on sale of assets	65,500
Traveling	256,000	Insurance recovery	170,000
Repairs and maintenance	85,600		
Discount	156,000		
Bad debts	122,100		
Subscription	25,000		
Bank charges & interest	24,000		
	35,500		

Loss on sale of assets	95,000	
Legal fees	41,500	
Audit fees	126,000	
Depreciation	<u>917,300</u>	
Gross profit	<u>4,282,000</u>	<u>4,282,000</u>

**Notes:**

- 10% of rent and rates relate to directors.
- Distribution and office expenses includes the following Sh.
 

expenses:	31,550
Directors personal expenses	30,000
Contribution to a sports club – employees use it	22,000
Donations	12,000
Loss on staff canteen	
- Repairs and maintenance include extension to an office block 40,000
- Subscriptions are to trade associates.
- Travelling expenses include business trip to Dubai to attend a trade exhibition. 56,000
- Legal charges include the following:
 

Acquisition of copyrights	25,000
Debt collection	21,000
Renewal of lease for 99 years	18,000
Fines and defence of legal suits	11,000
Employment contract	5,000
- Insurance recovery is in connection with stolen stock in the previous year.
- Bad debts provision is reduced in general provision.

**Required:**

- (a) Prepare a tax computation. (14 marks)

- (b) Compute the tax liability and indicate the due date. ( 2 marks)  
(c) Compute the instalment tax payable in 2006 and indicate the respective due date(s). ( 4 marks)

**(Total: 20 marks)**

### **QUESTION FIVE**

With reference to Income Tax, write short notes on the following:

- (a) Self assessment; ( 4 marks)  
(b) Notice of Objection; ( 4 marks)  
(c) NSSF; ( 4 marks)  
(d) PIN advantages; ( 4 marks)  
(e) Valuation of housing for employees. ( 4 marks)

**(Total: 20 marks)**

# SUGGESTED ANSWERS

## QUESTION ONE

(a) Ten of the records a person registered for VAT must maintain are:

- Tax invoices on sales and purchases
- A record of all the taxable goods and services received or supplied by the firm including zero rated supplies.
- Separate record of any exempt supplies made.
- Summary of total input and output tax for each calendar month i.e VAT account
- Copies of all invoices issued, in serial number order
- Copies of all credit and debit notes issued in chronological
- All purchase invoices, customs entries, receipts for payment of customs duty or tax and credit and debit notes received.
- Details of goods manufactured and delivered from the factory of the taxable person
- Other business records namely – orders and delivery books, relevant business correspondence, appointment and job books, purchase and sale books, cash books, petty cash vouchers, annual accounts, import and export documents, pay in slips, record of daily takings.
- Details of cash or other discounts, whether supply is for cash or credit, etc.

(b) Practical problems experienced under VAT include:

- Complexity of interpretation of the VAT Act and regulations stemming from it. This can be overcome through regular training seminars conducted by the VAT department for the benefit of tax payers, easy to read and understand literature through the Department's taxpayers education programme as well as continuous press bulletins.
- Cash flow problem could arise especially because the taxpayer is required to account for excess VAT charged on earnings basis even where the customer has not yet paid him (credit sales). This could be overcome if the taxpayer could be allowed to account for VAT when the credit period allowed to the customers is over.
- Compliance problems of elaborate and costly accounts to be maintained, filling of returns on a monthly basis. This could be overcome by simplifying as to reduce record keeping and extending time for payment rather than on monthly basis.

(c) **Value for VAT**

	Sh.
(i) Radio Cassette price	17,500
Less Cash discount @ 10%	<u>1,750</u>
Value for VAT	15,750
VAT thereon @ 16% (15,750 x 16%)	<u>2,520</u>
Total price (VAT inclusive)	<u>18,270</u>
(ii) Uchoraji architects services (value for VAT)	125,000
	<u>20,000</u>
Therefore VAT thereon @ 16% (16% x 125,000)	<u>145,000</u>
Total price (VAT inclusive)	
(iii) Dubai Kenya Ltd. value for duty	2,000,000
Plus duty @ 25%	<u>500,000</u>
Value for VAT	2,500,000
VAT thereon @ 16% (16% x 2,500,000)	<u>400,000</u>
Total price (VAT inclusive)	<u>2,900,000</u>
(iv) Kopesha Company Limited sale price of furniture	20,000
	<u>3,200</u>
VAT thereon @ 16% (16% x 20,000)	<u>23,200</u>
Total price (VAT inclusive)	

**QUESTION TWO**

(a) (i) **MISS NYAKIO**

**ASSESSABLE INCOME AND YEARS**

Contract term	5 years
Unexpired term	2 years
Compensation	Sh.300,000

Therefore assessable income at rate of remuneration immediately before termination:

YEAR	ASSESSABLE AMOUNT SH.'000'
2006	150,000
2007	<u>150,000</u>
	<u>300,000</u>

The total compensation is wholly taxable (w.e.f 1/1/2005) and will be spread evenly forward over the remaining contract period.

(ii) Assuming Nyakio's contract to be unspecified:

Income assessable depend on whether or not there is a provision that compensation would be paid

(a) **Contract unspecified but provides for compensation**

Assessable income will be at rate of remuneration immediately before termination as follows:

YEAR	ASSESSABLE INCOME SH.'000'
1997	90
1998	90
1999	90
2000	<u>30</u>
Total assessable	<u>300</u>

(b) **Contract unspecified but does not provide for compensation**

Income assessable at rate of remuneration immediately before termination but is not to exceed three years remuneration, i.e.

YEAR	ASSESSABLE INCOME SH.'000'
1997	100
1998	100
1999	<u>100</u>
Total assessable	<u>300</u>

w.e.f 1.1.2005, compensation from termination of employment contract is taxable in full regardless of the nature of the contract of employment.

(iii) Where shareholding is more than 5% the director is other than full-time hence the total amount would be assessable however, Miss Nyakio is a full time director and therefore the assessment would be as in a(i) – (ii) above as applicable.

(b) **Items whether capital or revenue**

- Legal and professional fees on computerization is capital expenditure forming part of total computerization cost.
- Structural alterations to premises to maintain rent is tax allowable even though capital in nature.
- Legal costs and stamp duty for acquisition of lease of business premises is regarded as tax allowable (revenue) so long as such lease is not for more than or capable of extension beyond 99 years.
- Expenditure on advertising to promote sale of goods, services provided by the business is revenue in nature and tax allowable.
- Income tax is revenue item to the state but not tax allowable to firms/taxable persons.
- Reserves and provisions may be capital or revenue but are generally disallowable for tax purposes since these are not incurred. However in the case of specific provisions for bad debts, it would be tax deductible.

(c) **Five examples of non-taxable income**

- Casino and betting winnings.
- Donations received
- Gifts from friends
- Dowry received.

**QUESTION THREE**

- (a) The pooling method refers to the classification of plant and machinery in four respective classes each reflecting a rate of wear and tear for assets in that class for the purpose of determining or calculating wear and tear allowance on a reducing method basis.

(b) **KILIMO HOLDINGS LTD  
CAPITAL ALLOWANCES FOR 2006**

(i) **Investment deduction**

ASSET	QUALIFYING COST SH.	I.D @ 100%	RESIDUE FOR IBD AND W.T.A
New building	750,000	750,000	-
Old machinery	350,000	<u>350,000</u>	-
		1,100,000	

(ii) **Industrial Building Deduction**

ASSET	QUALIFYING COST SH.	RESIDUE B/FWD SH.	I.B.D @ 2½% SH.	RESIDUE C/FWD SH.
Industrial building	1,000,000	950,000	<u>25,000</u> <u>25,000</u>	925,000

(iii) **Wear and Tear Allowance**

CLASS	I @ 37½% SH.000	II @ 30% SH.000	III @ 25% SH.000	IV @ 12½% SH.000
WDV AS AT 1/1/2006				
Motor vehicles			655	
Tractors	2,755			
Plant and Machinery				530
Furniture and fittings				225
Combine harvester	1,012			
Land rovers			1,135	
Computers		77		
Fax machine		40		
Telephones		80		
<u>Additions:</u>				
Office curtains				22
Engine head for trailer	500			
Saloon car			100 <sup>R</sup>	
Pick-up			850	
<u>Disposals:</u>				
Saloon car			(166.667)	
Furniture				(25)
Computers		(80)		
Tractor	(75)	<u>-</u>	<u>-</u>	<u>-</u>
	4,192	117	2,573.333	752
WTA	<u>(1,572)</u>	<u>3501</u>	<u>(643.333)</u>	<u>(94)</u>
WDV 31/12/1996	<u>2,620</u>	<u>8109</u>	<u>1,930</u>	<u>658</u>

(iv) **Farm Works Deduction**

(a)	New Farmhouse 1/1/2006	200,000
	FWD = $33\frac{1}{3}\%$ X 200,000	66,667
(b)	Farm works WDV b/fwd 1.1.96	7,000
	Year 2006 FWD ( $33\frac{1}{3}\%$ x 21,000)	(7,000)
	Bal. C/fwd	<u>NIL</u>

(v) Diminution on loose tools -  $33\frac{1}{3}\%$  x 10,000 = 3333 p.a for 3 years

Summary of Capital Allowances

	Sh.
Diminution	3,333
I.D	1,100,000
I.B.D	25,000
WTA	
Class I	1,572,000
Class II	35,100
Class III	643,333
Class IV	94,000
FWD	<u>73,667</u>
Total Capital allowances	<u>3,546,433</u>

**Note:**

- 1) Spares for tractors are not plant and machinery and are expensed upon issue for repairs.
- 2) W.e.f 1.1.1996 investment in purchase and installation of machinery whether new or old will qualify for investment deduction.
- 3) Library books do not qualify as machinery

**QUESTION FOUR**

(a) **KENWIDE ENTERPRISES LTD.  
TAX COMPUTATION YEAR 2005**

Adjusted profit: Sh.000 Sh.000

Profit reported		917.3
<u>Add disallowable expenditure:</u>		
Rent and rate for directors (10% x 92,500)	9.25	
Distribution and office expenses		
Directors personal expenses.	32.55	
Contribution to Sports Club	30	
Donations	22	
Loss on staff canteen	12	
Repairs and maintenance – extension to office block	40	
	35.5	
Loss on sale of assets		
Legal fees:	25	
Acquisition of copyrights	18	
Renewal of a lease for 99 years	<u>11</u>	
Fines and defence of legal suits	<u>126</u>	<u>360.3</u>
Depreciation		1,287.6
Less non-taxable income:	35.5	
Provision for bad and doubtful debts reduction	<u>66.5</u>	<u>(102)</u>
Profit on sale of assets		<u>1,185.6</u>

(b) **Tax Liability & Due Date**

Taxable income Sh.1,185,600

Tax thereon @ 30 Sh.355,680

Due date for outstanding tax after instalments is by 4<sup>th</sup> month after year end, i.e. 30<sup>th</sup> April 2006 in this case.

(c) **Instalment tax payable in 2006 and due dates**

Estimate tax for 2006 = (Sh.355,680 x 110%) = Sh.391,248

Instalments payable as follows:

DATE	BY	20 <sup>TH</sup>	20 <sup>TH</sup>	JUNE	20 <sup>TH</sup>	SEPT	20 <sup>TH</sup>	DEC
	APRIL	2006	2006		2006		2006	
INSTALMENT	97812		97,812		97812		97,812	

NB: each instalment = 25% x 391,248 = 97,812

## QUESTION FIVE

(a) **Self-Assessment**

For accounting year-ended 31.12.1992 and after, a taxpayer will determine the tax liability on the basis of the final return and such bill is referred to as self-assessment and the final return itself referred to as self-assessment return. Self-assessment return may be submitted along with payment of self-assessment tax but submission of return may be delayed up to end of sixth month after year-end.

(b) **Notice of Objection**

A taxpayer who disputes or who does not agree with an assessment for any year of income has a right to lodge an objection against such an assessment by the C.I.T. Such objection is referred to as “notice of objection”. For such objection to be valid it must:

- be in writing;
- state the grounds of objection;
- with effect from 1/1/2005 made within 30 days after date of service of assessment;
- return of income and support schedules must be submitted before appeal is accepted.

(c) **N.S.S.F**

Is National Social Security Fund which was established by the Nation Social Security Fund Act of 1965 for the benefit of workers. It is a compulsory savings scheme into which the employer pays a statutory contribution for every employee who is a member of this fund. The scheme is applicable to those employers having five or more employees. The average rate of contribution is 10% of the workers wage, half of which is paid by the employer and half by the worker concerned. The following benefits are provided under the scheme:-

(i) Age Benefits:

Paid to a member of age sixty or when he retires from paid employment whichever is later.

(ii) Withdrawal Benefit

Paid to a member who is at least fifty-five years of age and has not engaged in paid employment during the previous three months.

- (iii) Invalidity Benefit  
Paid to a member who is permanently incapable of work because of physical or mental disability.
- (iv) Survivors Benefit  
Paid to the dependants of deceased member.
- (v) Emigration Grants  
Paid to a member who is permanently emigrating from Kenya.

(d) **PIN Advantages**

PIN is personal identification number for taxpayer. PIN has the following advantages:

1. Identifies eligible taxpayers
2. Assists the Government in identifying known taxpayers who were suppressing their income to evade tax.
3. It is a deterrent to tax evaders
4. Assists in ensuring the national tax burden is distributed as fairly as possible.

(e) **Valuation of Housing for Employees**

A housing benefit arises where an employee is housed by the employer. The employer may own the house or lease it from third parties. To determine the amount of housing benefit, the employees may be classified into five groups.

(i) **Ordinary Employee**

The housing benefit shall be 15% of his gains from employment (i.e. monthly cash pay plus benefits), excluding the value of those premises, minus rent charged to the employee; subject to the limit of the rent paid by the employer if that is paid under an agreement made at arms length with a third party.

(ii) **Agricultural Employees**

Including a whole time service director on a farm housing benefit shall be 10% of gains or profits from employment minus amount of rent charged to the employee.

(iii) **Director Other Than Whole Time Service Director**

Housing benefit is computed as 15% of his total income excluding value of those premises, minus amount of rent charged to such director, provided that-

If employer pays rent under an agreement not made at arms length with a third party; the value of the quarters shall be, the fair market rental value of the premises in that year or rent paid by the employer, whichever is higher, OR

Where the premises are owned by the employer, the fair market rental value in that year is to be taken.

**(iv) Accommodation And Meals Provided**

If an employee is accommodated within the employer's premises and is also provided meals, the value of benefit shall be 10 percent of gains from employment for accommodation and another 10 percent representing meals making a total charge of 20%. This will normally apply in the case of hotel employees.