PUBLIC FINANCE AND TAXATION

PART I

SECTION 2

CPA
CCP
CIFA
CS

STUDY TEXT

KASNEB JULY 2018 SYLLABUS

Revised on: January 2019
CONTENT

1. Introductions to public financial management
   - Nature and Scope of Public Finance
   - General overview of public financial management as envisaged by the constitution
   - Responsibility of National and County Treasuries
   - Overview of the public financial management Act
   - Financial regulations
   - Treasury circulars; meaning and application
   - Process of developing county government finance bills
   - Role of budget officers in budget preparation and execution
   - Responsibilities of the national and county treasuries in relation to budget preparation
   - Budget process for both national, county and public entities

2. Establishment of public funds in the public sector
   - Provision of establishing public funds
   - Rationale of creation of public funds
   - The consolidated fund
   - The establishment and administration of contingency funds
   - The establishment and administration of equalization funds
   - County revenue sources

4. Supply chain management in public entities
   - Definition and terminologies
   - General overview of Public Procurement and Disposal (PPD) Act
   - Procurement guidelines as envisaged by PPD Act
   - Committees responsible for procurement
   - Procurement process by National, County and other Public entities
   - Tendering process and selection of suppliers in public sector
   - Concept of E-procurement

5. Oversight function in public finance management
   - The role of National Assembly
   - The role of senate
   - The role of county assembly
   - The role of auditor general
   - The role of Internal Audit
   - Role of controller of budget in relation to disbursement of public funds as envisaged by the constitution and PFM Act, 2012
6. Introduction to taxation
- History of taxation
- Principles of an optimal tax system
- Single versus multiple tax systems
- Classification of taxes and tax rates
- Impact incidence and tax shifting, Lax shifting theories
- Taxable capacity
- Budgetary and fiscal policy tools: General definition of budgets terms, budget surplus and deficits
- Role of budget officers in budget preparation and execution
- Responsibilities of the national and county treasury in relation to budget preparation
- Budget process for both national, county and Public entities
- Revenue Authority — History, structure and mandate

7. Taxation of income of persons Taxable and non taxable persons
- Sources of taxable incomes
- Employment income:
  - Taxable and non taxable benefits
  - Allowable and non allowable deductions
  - Tax credits (Withholding tax, personal and insurance relief etc)
  - Pension Income
- Business income:
  - Sole proprietorship
  - Partnerships (excluding conversions)
  - incorporated entities (excluding specialised institutions)
  - Turnover tax
- Income from use of property- rent and royalties
- Farming income
- Investment income
- Capital gains tax

8. Capital deductions
- Rationale for capital deductions
- Investment deductions: ordinary manufacturers
- Industrial building deductions
- Wear and tear allowances
- Farm works deductions
- Mining allowance
- Shipping investment deduction
- Other deductions

9. **Administration of income tax**
- Overview of the income tax act
- Identification of new tax payers
- Assessments and returns
- Operations of PAYE systems: Preparation of PAYE returns, categories of employees
- Notices, objections, appeals and relief of mistake A
- Appellant bodies
- Collection, recovery and refund of taxes
- Offences, fines, penalties and interest
- Application of ICT in taxation: iTaxi Simba system

10. **Administration of value added tax**
- Introduction and development of VAT
- Registration and deregistration of businesses for VAT
- Taxable and non taxable supplies Privileged persons and institutions
- VAT rates
- VAT records
- Value for VAT, tax point
- Accounting for VAT
- VAT returns
- Remission, rebate and refund of VAT
- Rights and obligations of VAT registered person
- Offences fines, penalties and interest
- Enforcement
- Objection and appeals: Requirements and procedure
- Challenges in administration of VAT

11. **Customs taxes and excise taxes**
- Customs procedure
- import and export duties
- Prohibitions and restriction measures
- Transit goods and bond securities
- Excisable goods and services
- Purposes of customs and excise duties
- Goods subject to customs control
- Import declaration form, pre-shipment inspection, clean report of findings
- Other revenue sources

6.12 **Emerging issues and trends**
<table>
<thead>
<tr>
<th>TOPIC</th>
<th>PAGE</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Topic 1:</strong> Introduction to public financial management</td>
<td>6</td>
</tr>
<tr>
<td><strong>Topic 2:</strong> Establishment of public funds in the public sector</td>
<td>52</td>
</tr>
<tr>
<td><strong>Topic 3:</strong> Supply chain management in public entities</td>
<td>62</td>
</tr>
<tr>
<td><strong>Topic 4:</strong> Oversight function in public finance management</td>
<td>77</td>
</tr>
<tr>
<td><strong>Topic 5:</strong> Introduction to taxation</td>
<td>90</td>
</tr>
<tr>
<td><strong>Topic 6:</strong> Taxation of income of persons</td>
<td>127</td>
</tr>
<tr>
<td><strong>Topic 7:</strong> Capital deductions</td>
<td>210</td>
</tr>
<tr>
<td><strong>Topic 8:</strong> Administration of income tax</td>
<td>255</td>
</tr>
<tr>
<td><strong>Topic 9:</strong> Administration of value added</td>
<td>273</td>
</tr>
<tr>
<td><strong>Topic 10:</strong> Customs taxes and excise taxes</td>
<td>300</td>
</tr>
</tbody>
</table>
TOPIC 1

INTRODUCTIONS TO PUBLIC FINANCIAL MANAGEMENT

NATURE AND SCOPE OF PUBLIC FINANCE

Meaning of Public Finance

Public finance is related to the financing of the state activities and a narrow definition of the public finance would try to say that public finance is a subject which discusses the financial operation of the fiscal or of the public treasury.

Nature of Public Finance

Public finance has been held as a science which deals with the income and expenditure of the government’s finance. It has been held as a study of principles underlying the spending and raising of funds by the public authorities. The various theories which form the basis of the collection; maintenance and expenditure of the public income constitute the subject and matter of finance.

Scope of Public Finance

The scope of public finance is not just to study the composition of public revenue and public expenditure. It covers a full discussion of the influence of government fiscal operations on the level of overall activity, employment, prices and growth process of the economic system as a whole.

According to Musgrave, the scope of public finance embraces the following three functions of the government’s budgetary policy confined to the fiscal department the:

- allocation branch,
- distribution branch, and
- stabilization branch.

These refer to three objectives of budget policy, i.e., the use of fiscal instruments to secure:

- Adjustments in the allocation of resources
- Adjustments in the distribution of income and wealth, and
- Economic stabilization.
Public finance is composed of the following constituents public:

- Expenditure
- Revenue
- Debt
- (Financial) administration

Private finance is the study of the income, debt and expenditure of the individual or a private company or business venture or an association. It includes the study of their own view regarding earning expenditure and borrowing.

Similarities and Differences between Public Finance and Private Finance

Despite the differences in scope and nature of the public finance and private finance, following are similarities.

Similarities

I. Based on Similar Theories
The basis of public as well as private finance is the same. Both seek the help of various principles of economics in determining various interrelated problems. For example, a person wants to secure maximum utility on count of minimum expenditure and government too wants to secure public utility by spending the least possible amount of public money.

II. Both Face the Problem of Scarcity
Limitation of the resources is the problem before private as well as public finance. Individuals’ resources are limited up to this earnings; past savings and ancestral property similar governments’ resources also depend on taxable capacity of the individuals earnings of the various corporations etc. None of the two is capable of extending its expenditure beyond a certain limit; hence non can afford to go to the infinity in the use of finance.

III. Both Require Efficient Administration
Private as well as public finance require efficient administration to look after the various acts of extravagance. In the event of the failure of an efficient administration both might be compelled to face ‘dire-consequence’ in their financial field, individual never wants any kind of wastage or misuse of his income, so the government if it is alive to the sense of duty.

IV. Both Borrow and Must Repay
To run the administration of finance sometimes money in hand fails to fulfill the requirements especially in the times of emergency, governments borrow money from individuals and also
borrow from different sources like relatives, banks, at the same it is obligatory for both the public finance as well as the private finance to repay the debt. The point here is that none can live without repaying the amount.

V. Both are Based on Rationality of Thought
When an individual spends some money he makes it certain in his mind that money is spent in the best way. He applies his rational faculties. In the same way any irrational step taken by the government may bring wastage and misuse of finance. This irrationality lead them to damages while rationality to prosperity and achievement of goals.

Differences between Public Finance and Private Finance

i. Individual determines his expenditure on the basis of his income but government determines its income on the basis of its expenditure. As far as an individual is concerned he determines his expenditure on the basis of the income, in the sense that he cannot think of spending more than his income. He distributes the amount of income to be spent on various subjects with income at his finger tips. The position is quite contrary in the case of government. The government first decides the amount of expenditures to be done during a period of time, and then frames scheme to secure money to meet the expenditure. Government has the power to increase its income be internal borrowings but this is not possible for an individual.

ii. Government’s source of income is more flexible in comparison to private source. Government has legal power to extend the sources of its income according to the needs of the time. Government has the control over the whole national property but individual has to rely upon his own individual standing. Moreover, government can take the help of the foreignment and this is not possible for a person to secure such supports. The last resort available to the government is the printing of new currency notes to increase its income. But an individual will be definitely but behind the bars for such an office.

iii. It is easy for an individual to base his expenditure on the law of equal marginal utility, but far difficult for governments. Individual is free to measure his expenditure in the sense of utility and spends his money on the certain weighted subjects. These subjects may not be of social need or may not add anything to social advantage. Such expenditures are very prominent in the democratic countries for example building of hospitals, roads, parks.

iv. Private finance is narrow and short lived in comparison to public finance. Private finance faces suspension with the end of the individual’s life or with the closure of the particular business enterprise. But governments are more tenable. It is well said in this context is that ‘king may come and king may go but government is eternal.’ Governments keep on moving form generation to generation interlinking past from present with an eye on future.
v. Public finance is subject to public censor but not the private finance. A complete secrecy may be maintained by an individual regarding his income and savings. But the government records are furnished to let the people see through the desirability of the expenditure. Public is entitled to know, criticize and the press is free to comment on the public finance outlays, its drawbacks and failures.

vi. There are pre-determined policies behind public expenditure but not so in the case of private expenditure. Public expenditure is done to achieve the goals which are predetermined in their nature.

vii. There is difference in the budgeting process of the public finance and the private finance. The budget of the government is subject to the approval of the parliament of the concerned country. It is now a well established principal no taxation without representation and no tax shall be without the due/process of law. Unless the demand gets approval of the parliament of the executive cannot spend even a single penny. But individual is his own master and he need not ask for parliamentary approval for spending his bricks.

viii. Governments’ accounts are audited by constitutional authorities but private finance has its own arrangement. An individual can audit his accounts without performing formalities about it. But there is procedural necessity in the case of public finance. The budget is to be prepared in the prescribed manner and to be presented according to the settled norms.

ix. A private individual can face the crises of being bankrupt but no government can be bankrupt. An individual may ‘run-riot’ his money and thus may become an insolvent, but the question of the government being bankrupt is impracticable. It is funny to talk of the bankruptcy of the government; since all the currencies are printed and circulated by it.

Functions of Modern Government

We should know the role of the government to enable us to appreciate the importance of government sector. Government of a modern state generally undertakes the following functions:

1. Security - Both external and internal involving outlay for military, police and other protective services.
2. Justice or settlement of disputes
3. The regulation and control of economy – including the services such as coinage,
   a. weights and measures, the business practices, operation of public sector
   b. undertakings
4. Of social and cultural welfare through education, social relief, social insurance, health and other activities.
5. Conservation of natural resources.
6. Promotion of the unity of the state by control of transportation and communication.
7. Administration and financial system, government revenue expenditure and fiscal control.
8. Education and employment.
9. Housing.
11. Upliftment of weaver sections of the society.
12. Restore social justice in the society.

Functions of modern governments are broadening due to socio-political reasons. Therefore, to discharge these increasing functions, the government has to increase its expenditure. To meet out the enormous amount of expenditure it has to mobilize funds with the help of public finance policy. Hence public finance has developed into an important branch of economics.

**Scope of Public Finance**

Public finance deals with the income and expenditure pattern of the Government. Hence the substances concerned with these activities become its subject matter. The subject matter of the public finance is classified under five broad categories of which the first two are discussed. They are,

1. Public Revenue
2. Public Expenditure
3. Public Debt
4. Financial Administration
5. Economic Stabilization

**Public Revenue**

Under this category, the sources of the public revenue, principles of taxation, effects of taxes on the economy, methods of raising revenue and the like are dealt with. Public revenue is the means for public expenditure. Various sources of public revenue are:

A. **Tax Revenue, and**
B. **Non-tax Revenue**

**A. Tax Revenue**

Taxes are compulsory payments to government without expectation of direct return or benefit to tax payers. It imposes a personal obligation on the taxpayer. Taxes received from the taxpayers, may not be incurred for their benefit alone. Tax revenue is one of the most important sources of revenue.
This is a SAMPLE (Few pages extracted from the complete notes: Page numbers reflects the original pages on the complete notes).

It’s meant to show you the topics covered in the notes.

Download more at our websites:

www.someakenya.co.ke
or
www.someakenya.com

To get the complete notes either in softcopy form or in Hardcopy (printed & Binded) form, contact us:

Call/text/whatsApp 0707 737 890

Email:
someakenya@gmail.com
info@someakenya.co.ke
info@someakenya.com

Get news and updates about kasneb by liking our page
www.fb.com/studycpa

Or following us on twitter www.twitter.com/someakenya

Pass on first attempt
“Buy quality notes and avoid refers/retakes which costs more money and time”

Sample/preview is NOT FOR SALE
TOPIC 2

ESTABLISHMENT OF PUBLIC FUNDS IN THE PUBLIC SECTOR

PROVISIONS OF ESTABLISHING PUBLIC FUNDS

This is the main fund to which all revenue due to the national government is channeled.

It is the principal fund to which public debt is charged.

It is the revenue fund from which the national government draws its current and development expenditure, constitutional offices such as the President and the Deputy President, Judges, Commissions and parliament are examples of public offices that draw their remunerations and benefits from the consolidated fund.

Political Parties Fund

This is a national Revenue Fund to be shared between registered political parties.

Political parties must fulfill strict terms and conditions of registration and party strength in relation to representation in national assembly.

The fund is set at 0.3 percent of national revenue.

RATIONALE OF CREATION OF PUBLIC FUNDS INTRODUCTION

The structure of Public Funds closely follows the devolution model. This means that public funds have both a national and county component.

The PFM Act 2011 and the contingencies and emergency fund Act 2011 provide the structure of

National revenue
- Parliamentary fund
- Political fund
- Equalization fund
- Consolidated fund
- Judiciary fund
**County revenue**
- Contingencies fund
- Revenue fund
- Emergency fund

The PFM Act 2012 Section 24(4) states that the cabinet secretary may establish a national government public fund with the approval of the national assembly.

Section 116 of the PFM Act 2012 empowers the county’s executive committee member for finance to establish other public funds with the approval of the county executive committee and county assembly.

A county Executive Committee may establish a county government emergency fund under section 110(1) of the PFM Act 2012 which will consist of money appropriated to the fund by the county assembly.

**County Revenue Fund**
- This is the main repository of all funds raised by or allocated to a county.
- It is established for each county and administered in accordance with Article 207 of the Constitution.

**CONSOLIDATED FUND**

There is established Consolidated Fund into which all monies raised or received by or on behalf of the national government, except money that—

a) is reasonably excluded from the Fund by an Act of Parliament and payable into another public fund established for a specific purpose; or

b) May, under an Act of Parliament, be retained by the State organ that received it for the purpose of defraying the expenses of the State organ.

Money may be withdrawn from the Consolidated Fund only—

a) in accordance with an appropriation by an Act of Parliament;

b) in accordance with the constitution

c) As a charge against the Fund as authorised by this Constitution or an Act of Parliament.

Money is not withdrawn from any national public fund other than the Consolidated Fund, unless the withdrawal of the money has been authorised by an Act of Parliament.

Money is not withdrawn from the Consolidated Fund unless the Controller of Budget approves the withdrawal.
This is a **SAMPLE** (Few pages extracted from the complete notes: Page numbers reflects the original pages on the complete notes).

It’s meant to show you the topics covered in the notes.

**Download more at our websites:**

www.someakenya.co.ke  
or  
www.someakenya.com

To get the **complete** notes either in **softcopy** form or in **Hardcopy** (printed & Binded) form, contact us:

**Call/text/whatsapp**  **0707 737 890**

**Email:**  
*someakenya@gmail.com*  
*info@someakenya.co.ke*  
*info@someakenya.com*

**Get news and updates about kasneb by liking our page**  
www.fb.com/studycpa

Or following us on twitter [www.twitter.com/someakenya](https://twitter.com/someakenya)

**Pass on first attempt**  
“Buy quality notes and avoid refers/retakes which costs more money and time”

**Sample/preview is NOT FOR SALE**
TOPIC 3

SUPPLY CHAIN MANAGEMENT IN PUBLIC ENTITIES

DEFINITIONS AND TERMINOLOGIES

Asset - means movable and immovable property, tangible and intangible “Authority” means the public procurement regulatory authority

Citizen Contractor - a person or a firm wholly owned and controlled by persons who are citizens of Kenya.

Common-user items - goods, works or services that are usable by procuring entities across the board irrespective of type or

Complex and specialized contracts - means contracts that include procurement where the terms and conditions of an agreement are different from standard commercial terms and conditions.

Contract administration - means management of terms of procurement or asset disposal contracts made with contractors

Design competition - a procurement procedure for obtaining competitive tenders for services which are creative in nature and which require that part of the services be carried out part of the tender to facilitate evaluation of the tenders.

Disadvantaged group - means persons denied by mainstream society access to resources and tools that are useful for their survival

Disposal - means the divestitures of public assets

Electronic reverse action - means an online real-time purchasing technique utilized by the procuring entity to select the successful submission which involves the presentation by tenderers, suppliers or contractors of successfully lowered bids during a scheduled period of time and the automatic evaluation of bids.

E-procurement - means the process of procurement using electronic medium such as the internet or other information and communication technologies.

Fiscal agency - means a person or an organization or trust company, that on behalf of the government of Kenya in performing various financial duties including assistance in the arrangement for issuance of international sovereign bonds, redemption of bonds or coupons,
handle tax issues, replace lost or damaged securities.

**Prequalification Procedure** - means a procedure by which candidates are invited to demonstrate their qualifications prior to and as a condition for being invited to tender or submit proposals.

**Procurement** - means the acquisition by purchase, rental, lease, hire purchase, licence, tenancy, franchise or by any other contractual means of any type of works “Public money” includes monetary resources appropriated to procuring entities through the budgetary process

**Supply chain management** - means the design, planning, execution, control and monitoring of supply chain activities

**Tender security** - a guarantee required from tenderers by the procuring entity and provided to the procuring entity to secure the fulfillment of any obligation in the tender process “Urgent need” means the need for goods, works or services in circumstances where there is an imminent or actual threat to public health, welfare, safety or of damage to property “Fraudulent practices” a misrepresentation of fact in order to influence a procurement or disposal process.

**Works** - means a combination of goods and services

**GENERAL OVERVIEW OF PUBLIC PROCUREMENT AND DISPOSAL (PPD) ACT**

- Public Procurement and Disposal (PPD) Act established the procurement methods, advertising methods, rules and time limits, the contents of tender documents and technical specifications, tender evaluations and award criteria, procedures for submission, receipt and opening of tenders, complaint system structure and sequence.
- The PDD Act regulations cover procurement of goods, services and works using public funds.
- Standard tender documents are developed for goods, works and services.
- The legal framework is complemented with a series of standard tender documents (STDs) covering procurement of goods, services and works.
- The responsibility for updating the standard tender documents is assigned to the Public Procurement Oversight Authority (PPOA).
- The purpose of PPD Act is to establish procedures for procurement and the disposal of unserviceable, obsolete or surplus stores and equipment by public entities to:
  - maximize economy and efficiency
  - Promote competition and ensure that competitors are treated fairly.
  - promote the integrity and fairness of the procedures
  - increase transparency and accountability in the procedures
  - increase public confidence in the procures
This is a SAMPLE (Few pages extracted from the complete notes: Page numbers reflects the original pages on the complete notes).

It’s meant to show you the topics covered in the notes.

Download more at our websites:

www.someakenya.co.ke
or
www.someakenya.com

To get the complete notes either in softcopy form or in Hardcopy (printed & Binded) form, contact us:

Call/text/whatsapp 0707 737 890

Email:
someakenya@gmail.com
info@someakenya.co.ke
info@someakenya.com

Get news and updates about kasneb by liking our page
www.fb.com/studycpa

Or following us on twitter www.twitter.com/someakenya

Pass on first attempt
“Buy quality notes and avoid refers/retakes which costs more money and time”

Sample/preview is NOT FOR SALE
TOPIC 4

OVERSIGHT FUNCTION IN PUBLIC FINANCE MANAGEMENT

ROLE OF NATIONAL ASSEMBLY

National assembly has established budget committee in public finance matters meant to oversee public finance management.

The committee is established to deal with budgetary matters and has responsibility for the following matters, in addition to the functions set out in the Standing Orders—

a) discuss and review the Budget Policy Statement and budget estimates and make recommendations to the National Assembly;
b) provide general direction on budgetary matters;
c) monitor all budgetary matters falling within the competence of the National Assembly under this Act and report on those matters to the National Assembly;
d) monitor adherence by Parliament, the Judiciary and the national government and its entities to the principles of public finance and others set out in the Constitution, and to the fiscal responsibility principles of this Act;
e) review the Division of Revenue Bill presented to Parliament and ensure that it reflects the principles of the Constitution;
f) examine financial statements and other documents submitted to the National Assembly and make recommendations to the National Assembly for improving the management of Kenya's public finances;
g) make recommendations to the National Assembly on "money Bills", after taking into account the views of the Cabinet Secretary; and
h) table in the National Assembly a report containing the views of the Cabinet Secretary;
i) Introduce the Appropriations Bill in the National Assembly.
This is a SAMPLE (Few pages extracted from the complete notes: Page numbers reflects the original pages on the complete notes).

It’s meant to show you the topics covered in the notes.

Download more at our websites:

www.someakenya.co.ke
or
www.someakenya.com

To get the complete notes either in softcopy form or in Hardcopy (printed & Binded) form, contact us:

Call/text/WhatsApp 0707 737 890

Email:
someakenya@gmail.com
info@someakenya.co.ke
info@someakenya.com

Get news and updates about kasneb by liking our page
www.fb.com/studycpa

Or following us on twitter www.twitter.com/someakenya

Pass on first attempt
“Buy quality notes and avoid refers/retakes which costs more money and time”

Sample/preview is NOT FOR SALE
TOPIC 5

INRODUCTION TO TAXATION

HISTORY AND PURPOSE OF TAXATION

Before 1897, Kenya was made up of multifarious tribal-based societies each with its own geographical and sociological background. These societies were communist/socialist in the sense that property was communally owned by all the members of a particular social setup. Upon amassing wealth in form of harvests, part of it was required to be submitted to the community leaders in form of tithe. This “tithe” was to be used in future to assist those who didn’t have enough property to sustain them or even to assist those who were hit by calamities. In a sense, this was a form of taxation because the percentage that was submitted to the community leaders was used to help others in future.

The principles and systems of taxation that existed in most African Kingdoms during this period were therefore informal. It was only upon the influx of foreigners that some form of formal taxation started. The Arabs who entered Kenya in the seventh century for example taxed the coastal region on the basis of Islamic Law. Islamic law upholds the right of leaders to tax their subjects within bearable limits and therefore taxation is not forbidden. Capitation of such tax was done by charging a fixed amount for each and every slave that was to be exported from the Sultanate of Oman. Custom duties were also charged on other exports like ivory, cloves and beads.

The Portuguese arrived at the Kenyan coast and were now taking over from the Arabs. The first recorded treaty that involved a form of taxation in this period was in 1502. The then Sultan Ibrahim of Malindi was held against his wishes and forced to accept defeat. While being held hostage during negotiations on Vasco da Gamma’s boat, a treaty of surrender was signed with Portugal for an annual tribute of 1,500 meticals of gold.

However, the Portuguese were violent and thus this led to a complete failure to use equity in the creation and levy of taxes there were riots (you thought riots started the other day?) were punctuated with civil disobedience and widespread cases of tax evasion and avoidance.

By the end of the rule of the Arabs and Portuguese along the East coast of Africa the existing balance of taxation that was inherited by the British included a capitation tax payable per head of slave exported and customs revenue shared equally between the Arabs and Portuguese. The tax base was, however, limited to traders only.
Exit Portuguese and Arabs, Enter The British

Next were the British who ruled what is presently Kenya and Uganda together to form British East Africa Protectorate. British colonial tax policy developed mostly on the grounds that Britain needed to support its own economy by creating foreign markets and sources of raw materials for its industries, thus obtain maximum gains with minimum input. This was done by initially through the Chartered company concept. However, later in order to encourage rule from within the territory to make it viable after the accidental discovery of arable land in Kenya.

British Taxes

Hut and Poll Tax: The 1901 Hut Tax Regulation imposed a tax of one rupee, payable in kind or through labour, upon every native hut in British East Africa. Hut tax or poll tax was increased to 5 rupees in 1915 and again in 1920 to 8 Rupees.

Land Tax: The levying of a graduated land tax on individual holdings was introduced by the British as a sound basis for land policy in East Africa. The protectorate government in East Africa argued in early 1908 for preserving the means of obtaining some share of any future appreciation in the value of the land, particularly because much of the land acquired by settlers was not being developed.

Graduated Personal Tax: The Graduated Personal Tax was introduced in 1933. The Act was modeled on the Colonial Income Tax Ordinance which itself was a ‘simplified synthesis’ of the United Kingdom Income Tax Act of 1920. Now graduated taxes on global income would have been considered revolutionary because non-Africans were liable to a flat poll rate and an Educational Tax. This tax was applied for the first time in 1934 at rates graduated according to the taxpayer’s income with certain amendments.

Income tax: It was first introduced in Kenya in 1921, and in 1954, the rates of personal income tax were set at 20 shillings for anyone earning less than £60, for earnings between £60-120 charge of 40 shillings and for earnings over £120 a charge of 60 Shillings. In 1956, a Commission of Enquiry into the Administration of Income was established and was chaired by Sir Erick Coates.

Kenya’s taxation system and policy after independence

The first post-independence strategy on matters taxation and policy was set out in Kenya’s earliest planning document entitled Sessional Paper No. 10 of 1965 on African Socialism and its Application to planning in Kenya. The main purpose of the paper was to guarantee all citizens equal political and economic rights. The paper stated that the economic approach of the government was to ensure Africanisation of the economy and also the public service16. The
government would concentrate investment in places where it was likely to maximize returns which would subsequently be distributed to the rest of the country. The paper laid down the foundation for the country’s fiscal policy framework. By the year 1972, the economy of the country expanded and this saw the introduction of Sales Tax in 1973 which, coupled with the first oil crisis of 1973, led to an economic shock and an increasing debt problem. The resultant fiscal reforms included 20% withholding tax on nonresident entrepreneurs, capital allowance restricted to rural investment, a new tax on the sale of property, taxes on shares, the sale of land and a custom tariff of 10% on a range of previously duty-free goods.

Kenya later came up with its own income tax department as a department of treasury and also came up with its own income tax legislation known as the Income tax Act which commenced on 1st January 1974 and it was codified as Chapter 470 of the laws of Kenya. The preamble to this Act reads as follows, “An Act of Parliament to make provision for the charge, assessment and collection of income tax: for the ascertainment of the income to be charged; for the administrative and general provisions relating thereto; and for matters incidental to and connected with the foregoing”. The preamble gives us the scheme or the various components with which this law has dealt with.

PURPOSE OF TAXATION

1. **Raising public revenue** to meet public expenditure for a common cause.
2. **Protection of the health of citizens.** Heavy taxes are imposed on goods that are considered to be harmful to the health of citizens if consumed in large quantities such as beer and cigarettes.
3. **Protection of local industries.** Heavy taxes are imposed on imported goods which are substandard or goods that are available locally in plenty.
4. **Encourage exportation** and hence the generation of foreign currency e.g. Exports are zero rated for VAT purposes, i.e. VAT paid on purchases used for processing exports is refundable.
   - **Export processing zones (EPZ).** These are designated areas where the industries located are granted attractive tax incentives in exchange of exporting manufactured goods e.g.
     - Corporation tax is not payable during the first ten years of operation.
     - Corporation tax is payable at a rate of 25% from the 11th to 20th year of operation.
     - Capital expenditure or machinery and factory building is deductible at 100% cost known as investment deduction.
   - **Manufacturers under bond (MUB).** These are manufacturers that are licensed by the customs department to manufacture for export purposes for at least three years. Such manufacturers are granted 100% investment deduction on capital expenditure incurred on machinery and factory buildings.
5. **To encourage savings for retirement.**
• As a contributor: contributions to a registered pension scheme are exempted from tax up to a maximum of Sh. **240,000** p.a. (20,000 per month)

**TYPES OF TAXES**

- **Income tax**
  This is the tax imposed on income derived by individuals, (i.e. Pay as You Earn) and businesses (i.e. Corporation Tax).

- **Value Added Tax (VAT)**
  This is the tax imposed on goods and services supplied in Kenya and goods and services imported into Kenya.

- **Excise duty**
  This is tax imposed on locally manufactured goods such as textiles, shoes, wines, and spirits.

- **Custom duty**
  This is tax imposed on imported goods such as machinery, cars, Electronics e.t.c.

**TAXES CHARGED ON SPECIFIC ITEMS**

1. **Petroleum levy**
   This is the tax that is imposed on the prices of petroleum products. The revenue collected is used to maintain roads in the country.

2. **Airport tax**
   This is the tax imposed on air tickets through various airlines. The amounts collected are used to improve or maintain airport facilities such as the run-ways.

3. **Stamp duty**
   It is imposed by the government on the transfer of properties and on certain instruments or legal documents. The purpose of stamp duty is to ensure that the transactions are legalised.

4. **Catering levy**
   This is a tax imposed by the government on services and food supplied in certain hotels. The amounts collected from catering levy are used to improve tourism industry e.g. maintaining of institutions offering courses in hospitality such as Utalii College.

**TAXES BY LOCAL AUTHORITIES**

1. **Rates**
   These are charged by local authorities on property owners e.g. land and buildings within the local authority.

2. **Cess**
This is a SAMPLE (Few pages extracted from the complete notes: Page numbers reflects the original pages on the complete notes).

It’s meant to show you the topics covered in the notes.

Download more at our websites:

www.someakenya.co.ke
or
www.someakenya.com

To get the complete notes either in softcopy form or in Hardcopy (printed & Binded) form, contact us:

Call/text/whatsApp 0707 737 890

Email:

someakenya@gmail.com
info@someakenya.co.ke
info@someakenya.com

Get news and updates about kasneb by liking our page

www.fb.com/studycpa

Or following us on twitter www.twitter.com/someakenya

Pass on first attempt

“Buy quality notes and avoid refers/retakes which costs more money and time”

Sample/preview is NOT FOR SALE
TOPIC 6

TAXATION OF INCOME OF PERSONS

INTRODUCTION

Income tax is charged under the income tax Act (Cap 470) which contains rules and regulations relating to the following:
- Ascertainment of income
- Assessment of tax
- Collection of tax
- Entitlement of personal relief

S.3 (1) of the income tax act states that:
“Subject to, and in accordance with this Act, a tax to be known as income tax shall be charged for each year of income upon all the income of a person, whether resident or non-resident, which accrued in or was derived from Kenya.”

S.3 (2) of the income tax act states
‘Subject to this act, income upon which tax is chargeable is income in respect of
  a. Gains or profits from
     i) A business for whatever period of time carried on
     ii) Employment or service rendered
     iii) A right granted to another person for use or occupation of property
  b. Dividends or Interest
  c. Pension income or withdrawal from a registered provident and provident fund.
  d. Any withdrawal from a registered Home Ownership Saving Plan
  e. Any deemed income
  f. Gains from transfer of property

The income tax Act (Cap 470) was enacted in 1973, and its date of commencement was January 1974. It replaced the East Africa Income Tax Management Act, which had served the countries of the East Africa Community, and which became outdated following the break up of the community. Income tax is charged for each year of income on all income of a person, whether resident or non-resident, which accrues in or is derived from Kenya.
Year of income and accounting year

Year of Income is a period of 12 months commencing 1 January and ending on 31 December in each year. It is the same as calendar year.
Income tax is charged for each year of income.
The year of income should be distinguished from the accounting year. There is a date to which accounts of a business are prepared each year, and this date would indicate the accounting year end. The accounting year ending on 31 December would coincide with the year of income.
Other accounting year-ends would however fall in a given year of income and the profit or loss per the accounts would be for that year of income. For example, an accounting date ended 31 May 2015 would fall to be treated as the year of Income 2015.

TAXABLE AND NON TAXABLE PERSONS

A person whose income is taxed is either:
   a) An individual i.e. a natural person; or
   b) A legal person e.g. a company. The company here includes a Trust, Co-operative Society, Estate, Club, Trade Association etc.

A taxable person does not include a partnership. A partnership is not taxed on its income but the partners are taxed on their share of profit or loss from the partnership. However, under Turnover Tax ((TOT), a taxable person has been defined to include a partnership.

Resident and non-resident persons
There are conditions for being a resident in case of an individual and also in case of a body of persons.

a) Resident in relation to an individual means that the individual:
   i) Has a permanent home in Kenya and was present in Kenya for any period during the year of income under consideration; or
   ii) Has no permanent home on Kenya but was present in Kenya for a period or periods amounting in total to 183 days or more during the year of income under consideration; or
   iii) Has no permanent home in Kenya but was present in Kenya for any period during the year of income under consideration and in the two preceding years of income for periods averaging more than 122 days for the three years.
Residence in relation to a company
A company is considered to be a resident in any year of income if:
1. It is incorporated in Kenya under the laws of Kenya.
2. Management and control of the affairs of the company was exercised in Kenya during the year of income under consideration.
3. The company has been declared by the Minister for finance to be a resident for any year of income through a notice in the Kenya gazette.

The significance of the concept of residence
The importance of residence is shown in the differences in the tax treatment of income derived by residents and non-residents e.g.

<table>
<thead>
<tr>
<th>Resident</th>
<th>Non-resident</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Employment income arising in Kenya and other sources outside Kenya are taxable.</td>
<td>• Employment income arising only From Kenya is taxable.</td>
</tr>
<tr>
<td>• In case of individuals personal relief is granted as a deduction against tax liability.</td>
<td>• Individuals cannot claim personal relief as a deduction from tax liability.</td>
</tr>
<tr>
<td>• Pension Income - The first Sh.600,000 received in lump sum is tax exempt. In case of Periodic payment, the first Sh.300, 000 p.a. is tax exempt.</td>
<td>• The gross pension income received for services rendered in Kenya is subject to withholding tax of 5% as the final tax.</td>
</tr>
<tr>
<td>• Rental Income - The income from property less allowable expenses is taxed using the graduated scale for individuals or corporation tax for a company.</td>
<td>• The gross rental income is subject to withholding tax of 30% as the final tax.</td>
</tr>
</tbody>
</table>
| • Royalty Income –  
  • Gross royalties are subject to withholding of 5%. | • Gross royalties are subject to withholding tax at the rate of 20% as the final tax. |
| • Gross royalties net of allowable expenses are taxed using the corporation tax for a company. |  |
| • In case of companies, profits are taxed at the rate of 30%. | • In case of companies the profits are taxed at the rate of 37.5%. |
SOURCES OF TAXABLE INCOME

Tax treatment of residents and non-residents

(i) Residents and non-residents of Kenya are taxable only on income derive from Kenya. In general income earned outside Kenya even if remitted into Kenya is not taxable.

(ii) There is the exception in respect of residents who with regard to employment income are taxable on all such income derived from services rendered in or outside Kenya.

(iii) Where a non-resident company has a permanent establishment in Kenya (e.g. a branch or office) its treatment for tax purposes is the same as for a resident company. But its tax rate is for the non-resident rate. A non-resident without a permanent establishment in Kenya, is subjected to withholding tax on all income derived from Kenya.

(iv) Where a Kenyan business is carried on partly in Kenya and partly in a foreign country all income is chargeable to tax irrespective of whether or not it has been derived from Kenya.

(v) Where a non-resident is involved in carrying on business within Kenya of manufacturing, growing, mining or harvesting for delivery or use in his business outside Kenya then the gains and profits of that business are income derive from Kenya and is taxable at full open market value of the goods in question.

(vi) A bank operated in Kenya by a non-resident owner which holds some of its deposits derive from Kenya outside Kenya, should account for the income from such deposits to tax in Kenya as such income is considered to be derived from Kenya.

Taxable income is classified according to specified sources.
The income tax Act lays down six categories of income or specified sources of income as follows:

- Gains from employment for services rendered.
- Profit from business such as trade, manufacture, vacation, adventure e.t.c
- Gains from the rights granted for use or occupation of property e.g. rental income or royalty income.
- Profits from farming or commercial agricultural activities e.g. horticulture
- Investment income such as dividends and interest income.
- Any other source of income that is chargeable to tax or unspecified sources e.g. pension income, insurance annuities e.t.c.

From 1 January 1979, losses incurred in any specified source may only be offset against income from the same source in the following or future years. From 1 January 2010 this will be for the subsequent four years unless an extension application is made and approved by the minister.

Note:

i) The circumstances involving a transaction are very important such as purchase, quantity and the price offered. This determines the intention of a person.
This is a SAMPLE (Few pages extracted from the complete notes: Page numbers reflects the original pages on the complete notes).

It’s meant to show you the topics covered in the notes.

Download more at our websites:

www.someakenya.co.ke
or
www.someakenya.com

To get the complete notes either in softcopy form or in Hardcopy (printed & Binded) form, contact us:

Call/text/WhatsApp 0707 737 890

Email:

someakenya@gmail.com
info@someakenya.co.ke
info@someakenya.com

Get news and updates about kasneb by liking our page
www.fb.com/studycpa

Or following us on twitter www.twitter.com/someakenya

Pass on first attempt
“Buy quality notes and avoid refers/retakes which costs more money and time”

Sample/preview is NOT FOR SALE
TOPIC 7

CAPITAL DEDUCTIONS

INTRODUCTION

Key terms

**Investment deduction:** Is a capital deduction given on cost of buildings and machinery which are used for manufacture, on cost of a ship, and on cost of a hotel building. The investment deduction on buildings and machinery is intended to encourage new investments in the manufacturing sector. The investment deduction is deducted in the income tax computation, or in arriving at the taxable income/loss.

**Industrial Building allowance:** This is a capital deduction or allowance given in respect of capital expenditure on an industrial building. The amount of industrial building allowance is deducted in the income tax computation or in arriving at the taxable income/loss for year or period.

**Wear and Tear allowance:** The wear and tear deduction is a capital deduction on machinery used for business. The deduction is made against income.

**Farm works deduction:** This is a capital deduction granted only in respect of capital expenditure on agricultural land. The farm works deduction is deducted in the income tax computation.

The deductions or allowances are at standard rates for all taxpayers depending on the nature of the capital expenditure incurred.

Section 16 of the income tax expressly provides that in calculating the gains or profits of a person no deductions can be made for expenditure of a capital nature. The same principle is applied in disallowing capital losses, exhaustion of capital e.g. depreciation of fixed assets.

- Capital Allowances are allowable deductions granted on the capital expenditure incurred to acquire assets that are utilized in the business to generate taxable income.
- Capital allowances are granted for the following reasons:
  - To encourage new industrial enterprises;
  - To allow such deductions as may just and reasonable as representing the diminution in value of fixed assets during a particular year.
  - To encourage exportation.
- Capital allowances include the following:
  (i) Investment deduction (ID)
  (ii) Industrial building deduction (IBD)
  (iii) Framework deductions (FWD)
  (iv) Diminution in value of loose tools and implements

**The capital deductions are important because:**

a) Some offer incentives to business by allowing capital expenditure otherwise not claimable.
b) Some act as standard depreciation for income tax purpose. The depreciation and similar charges are not allowable expenses against taxable income.

These are referred to as deductions (allowances) under the Second Schedule to the Income Tax Act.

The manner of calculating and computing the various capital deductions or allowances is given below.

The wear and tear deduction is a capital deduction on machinery used for business. The deduction is made against income. As we shall see later, the deduction is made in the income tax computation (or in arriving at the taxable income or loss for the year) after disallowing any depreciation and similar charges against taxable income.

As noted earlier any capital loss, diminution, exhaustion of capital, such as depreciation, amortisation, loss on sale of assets, obsolescence, provision for replacement, are not allowable expenditure against income.

But the Income Tax Act recognises the loss of value of assets used in business through usage, passage of time or obsolescence and so grants the wear tear allowance.

As per paragraph 7 of the Second Schedule to the Income Tax Act ... —where during a year of income machinery owned by a person is used by the person for the purpose of his business, there shall be made in computing the person’s gains or profits ... a deduction ... referred to as a ‘wear and tear deduction’.l

**It should be noted that machinery qualifies for wear and tear deduction where:**

  i. Owned by a person, and
  ii. Used by the person for business anytime during the year of income.
INVESTMENT DEDUCTION (ID)

This is a claim granted in the year the asset is first used on the capital expenditure incurred on factory buildings and machinery as an incentive to encourage investments in the manufacturing sector.

Investment deduction is granted to encourage:

- The development of industries in normal manufacture, tourism and shipping.
- Exportation to earn foreign exchange e.g. in the case of Export Processing Zones enterprises.
- To encourage foreign investment in Kenya

The qualifying capital expenditure for purposes of investment deduction includes:

1. Construction of a factory building.
2. Installation of new or imported second hand processing machinery.
3. Construction of a hotel building certified to be an industrial building.
4. Purchase of machinery utilized for ancillary purpose such as:
   - Generation, transformation and distribution of electricity.
   - Machinery for clean up and disposal of effluent and other waste products.
   - Machinery for the reduction of environmental damage
   - Machinery for water supply and disposal
5. From 1 January 1995, specified civil works are eligible for investment deductions.
   Civil works includes:
   a. Roads parking areas.
   b. Railway lines and related structures.
   c. Water, industrial effluent and sewerage works.
   d. Communication and electrical posts and pylons and other electrical supply works.
   e. Security walls and fencing.
6. From 1 July 1999, workshop machinery for the maintenance of machinery used for manufacturing.
7. From 1 January 2010, purchase of filming equipment by a local film producer.

Rates of ID are:

<table>
<thead>
<tr>
<th>Year</th>
<th>Nairobi &amp; Mombasa</th>
<th>Elsewhere</th>
</tr>
</thead>
<tbody>
<tr>
<td>1988</td>
<td>10%</td>
<td>60%</td>
</tr>
<tr>
<td>1989</td>
<td>25%</td>
<td>75%</td>
</tr>
<tr>
<td>1990-94</td>
<td>35%</td>
<td>85%</td>
</tr>
<tr>
<td>1995-00</td>
<td>60%</td>
<td>60%</td>
</tr>
<tr>
<td>2001</td>
<td>100%</td>
<td>100%</td>
</tr>
<tr>
<td>2002</td>
<td>85%</td>
<td>85%</td>
</tr>
<tr>
<td>2003</td>
<td>70%</td>
<td>70%</td>
</tr>
</tbody>
</table>
Notes
(i) With effect from 1st January 2010, Investment Deduction is granted at the rate of 150% on capital expenditure incurred in an investment within satellite towns adjoining Nairobi, Mombasa, and Kisumu provided that the value of investment is Sh. 200M or more.
(ii) An industrial building that qualifies for ID must be new i.e. it must not have been used before for any other purpose.
(iii) When non-qualifying expenditure is included in the cost of an industrial building that qualifies for investment deduction, such expenditure shall also qualify for ID if the proportion to the total cost is 10% or less.
Example of non qualifying expenditure and administration offices, showrooms, retail shops and residential areas not meant for workers.

Question:
BB Ltd constructed a factory building at a total cost of Sh.10m. The cost of construction comprised:

<table>
<thead>
<tr>
<th>Description</th>
<th>Cost</th>
</tr>
</thead>
<tbody>
<tr>
<td>Land</td>
<td>2,000</td>
</tr>
<tr>
<td>Office</td>
<td>600</td>
</tr>
<tr>
<td>Show room</td>
<td>300</td>
</tr>
<tr>
<td>Factory</td>
<td>7,100</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>10,000</strong></td>
</tr>
</tbody>
</table>

Answer:
Non qualifying cost X 100
Total cost

\[
\frac{600 + 300}{600 + 300 + 7100} \times 100 = 11.25\%
\]

Qualifying cost is only the factory cost of Sh. 7,100,000
Cost of office and show room will not qualify for ID.

INVESTMENT DEDUCTION FOR BONDED MANUFACTURERS (IDBM)

This is an additional incentive that was granted to manufacturers to encourage manufacture for export purposes. IDBM was introduced in Kenya in 1988. Capital expenditure that qualified for IDBM had to fulfill the following specific conditions.

1. The expenditure must qualify for ordinary ID.
This is a SAMPLE (Few pages extracted from the complete notes: Page numbers reflects the original pages on the complete notes).

It’s meant to show you the topics covered in the notes.

Download more at our websites:

www.someakenya.co.ke
or
www.someakenya.com

To get the complete notes either in softcopy form or in Hardcopy (printed & Binded) form, contact us:

Call/text/whatsApp 0707 737 890

Email:
someakenya@gmail.com
info@someakenya.co.ke
info@someakenya.com

Get news and updates about kasneb by liking our page
www.fb.com/studycpa

Or following us on twitter www.twitter.com/someakenya

Pass on first attempt
“Buy quality notes and avoid refers/retakes which costs more money and time”

Sample/preview is NOT FOR SALE
TOPIC 8

ADMINISTRATION OF INCOME TAX

OVERVIEW OF INCOME TAX ACT

Income tax in Kenya is charged under the income tax Cap 470. The Act contains provisions relating to:

- Ascertainment of income.
- Assessment of tax.
- Collection of tax
- Entitlement to personal relief

The income tax Act Cap 470 was enacted on 20 December 1973 to replace the former East Africa income tax management Act. It contains:

- 14 parts
- 133 sections
- 13 schedules
- 8 subsidiary legislation

IDENTIFICATION OF NEW TAX PAYERS

The finance Act 1992 introduced the thirteenth Schedule to the income tax Act which took effect from 1st January 1993. A personal identification number (PIN) shall be required for tax purposes for any of the following transactions:

<table>
<thead>
<tr>
<th>Institution</th>
<th>Purpose of transaction</th>
</tr>
</thead>
<tbody>
<tr>
<td>Commissioner of lands</td>
<td>Registration of title and stamping of instruments</td>
</tr>
<tr>
<td>Local Authorities</td>
<td>Approval of plans and payment of water deposits</td>
</tr>
<tr>
<td>Registrar of motor vehicles</td>
<td>Registration of motor vehicles and transfer of motor vehicles, licensing under traffic act</td>
</tr>
<tr>
<td>Registrar of Business Names</td>
<td>New registrations</td>
</tr>
<tr>
<td>Registrar of Companies</td>
<td>New registrations</td>
</tr>
<tr>
<td>Insurance companies</td>
<td>Underwriting of policies</td>
</tr>
<tr>
<td>Ministry of Commerce</td>
<td>Importing licenses or trade licensing</td>
</tr>
<tr>
<td>Commissioner of VAT</td>
<td>Applying for registration</td>
</tr>
<tr>
<td>Kenya Power</td>
<td>Payment of deposit for power connection</td>
</tr>
</tbody>
</table>
TAX ASSESSMENT: SELF-ASSESSMENT, ADDITIONAL ASSESSMENTS AND ESTIMATED ASSESSMENTS

ASSESSMENT

- Assessment means computation of tax liability on any income derived in a particular year.
- In case a person has submitted a self assessment return to the tax authority, the commissioner may:
  - Accept the assessment return and consider the amount declared in the return as the correct self assessment, in which case no further notification will be given.
  - If the commissioner has reasonable cause to believe that the self assessment return is not true or correct, he may determine according to the best of his judgment the amount of income of that person and prepare an assessment on that basis.
- In case a person has not submitted a self assessment return for any year and the commissioner considers that he has income chargeable to tax, he may determine the amount of income of that person to the best of his judgment and prepare an assessment on that basis.

The time limits for making assessments.

- An assessment may be made at any time by the commissioner for any year of income before the expiry of 7 years. However, incase fraud or willful negligence has been committed, an assessment may be made at any time.
- In case of an assessment upon the executors or administrators of the estate of a deceased person, an assessment must be made before the expiry of 3 years after the year in which the person died.

REMITTANCE OF TAX: INSTALLMENT TAX, FINAL TAX

- Payment of installment tax serves as an assessment to installment tax. The tax is payable not later than the 20th day of the month of the current accounting year. The commissioner may issue an installment tax assessment in the event of failure to pay tax in time; tax assessed is payable within 30 days of service of the assessment.
- The amount of the installment tax payable is the lesser of:
  - The tax payable by the person on his total income for the year:
  - The tax assessed, or in the absence of an assessment, estimated as assessable for the proceeding year of income, multiplied by 110%.
Installment tax is not payable in the case of an individual to the extent the total liability to tax for a year of income does not exceed Sh. 40,000.

Installment tax is payable in four equal installments after the commencement of the accounting period on the 20\textsuperscript{th} day of the fourth, sixth, ninth and twelfth month.

For agricultural enterprises installment tax is payable on the 20\textsuperscript{th} day of the ninth month while the second installment is due on the 20\textsuperscript{th} day of the twelfth month.

Adjustment to installment tax payable is required where there are changes in the length of a company’s accounting period, where companies have merged or have been acquired or where substantial transfer of assets between companies have taken place.

**TURNOVER TAX**

Turnover tax with effect from 1 January 2007 for businesses with a turnover of less then Sh. 5 Million p.a. the applicable rate is 3\% of the gross receipt of the business. Turnover shall not apply to:

- Employment income.
- Exempt incomes.
- Incomes subject to final withholding tax.
- Business incomes below Sh.500,000.

Turnover tax is charged at the rate of 3\% on gross sales per annum. No expenditure or capital allowance shall be granted against turnover tax.

For income tax purpose, turnover tax is a final tax.

For turnover tax purposes, the tax period means every 3 calendar months commencing 1st of January of every year that is, turnover tax payers shall submit a quarterly return. Payment shall be made on or before the 20th day of the month immediately following the end of the quarter.

For turnover tax purposes, registered tax payer shall maintain the following records:

- Cashbook
- Sales receipts and invoices (daily sales summary)
- Purchase invoices
- Bank statements

Benefits of Turnover tax

- It simplifies tax procedures.
- It simplifies tax computation.
- Makes filing of returns easier.
- Simplifies record keeping
- Reduces cost of compliance
This is a SAMPLE (Few pages extracted from the complete notes: Page numbers reflects the original pages on the complete notes).

It’s meant to show you the topics covered in the notes.

Download more at our websites:

www.someakenya.co.ke
or
www.someakenya.com

To get the complete notes either in softcopy form or in Hardcopy (printed & Bound) form, contact us:

Call/text/whatsapp 0707 737 890

Email:

someakenya@gmail.com
info@someakenya.co.ke
info@someakenya.com

Get news and updates about kasneb by liking our page

www.fb.com/studycpa

Or following us on twitter www.twitter.com/someakenya

Pass on first attempt
“Buy quality notes and avoid refers/retakes which costs more money and time”

Sample/preview is NOT FOR SALE
TOPIC 9

ADMINISTRATION OF VALUE ADDED TAX

INTRODUCTION AND DEVELOPMENT OF VAT

VAT is a tax on expenditure that is collected by suppliers of goods and services and passed on to the government.

VAT is charged on the supply of goods and services in Kenya by a taxable person in the cause of or in furtherance of any business carried on by that person and on the importation of goods and services into Kenya.

VAT was introduced in Kenya 1990 to replace sales tax. The decision to replace sales tax with VAT was as a result of the perceived deficiencies in the sales tax system which includes:

- The sales tax system was a single stage system- sales tax was levied only once at the manufacture level. However, in a country where tax evasion is widespread, a single stage tax system will result in a higher loss of revenue than would normally be the case if the system was multi stage.
- Where the inputs for manufacturing were subject to sales tax, the imposition of sales tax on the finished product will result in the imposition of tax on another tax i.e. cascading effect.
- The sales tax system had a limited scope - sales tax was levied only on certain specific manufactured Goods. Services were not within the scope of tax. Therefore sales tax had a narrow tax base as compared to VAT, with the result that the revenue yield was comparatively low.
- VAT is an indirect tax, It is essentially a tax on the domestic expenditure or consumption. Under VAT, it the end user or consumer that ultimately bears the tax burden.
- VAT is charged on each transaction in the production and distribution chain.

QUESTION:
A manufacturer purchased raw materials at sh. 1 m on which VAT was charged at 16%. At each stage of the production and distribution chain conversion cost of 25% was incurred and a markup of 30% included to determine the selling price. Calculate the total VAT collected for the government.
ANSWER:

<table>
<thead>
<tr>
<th></th>
<th>Value Sh.000</th>
<th>VAT Sh.000</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Supplier</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Cost of materials</td>
<td>1,000</td>
<td></td>
</tr>
<tr>
<td>VAT @ 16%</td>
<td>160</td>
<td>160</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>1,160</strong></td>
<td></td>
</tr>
<tr>
<td><strong>Manufacturer</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Purchase of materials</td>
<td>1,000</td>
<td></td>
</tr>
<tr>
<td>Conversion cost @ 25%</td>
<td>250</td>
<td></td>
</tr>
<tr>
<td>Mark-up @ 30%</td>
<td>375</td>
<td></td>
</tr>
<tr>
<td>Selling price</td>
<td>1,625</td>
<td></td>
</tr>
<tr>
<td>VAT @ 16%</td>
<td>260</td>
<td>260</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>1,885</strong></td>
<td></td>
</tr>
<tr>
<td>Less input VAT</td>
<td></td>
<td><strong>160</strong></td>
</tr>
<tr>
<td></td>
<td></td>
<td><strong>100</strong></td>
</tr>
<tr>
<td><strong>Wholesaler</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Purchase of product</td>
<td>1,625</td>
<td></td>
</tr>
<tr>
<td>Additional cost @ 25%</td>
<td>406.25</td>
<td>2,031.25</td>
</tr>
<tr>
<td>Mark-up @ 30%</td>
<td>609.375</td>
<td></td>
</tr>
<tr>
<td>Wholesale price</td>
<td>2,640.625</td>
<td></td>
</tr>
<tr>
<td>VAT @ 16%</td>
<td>422.5</td>
<td>422.5</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>3,063.125</strong></td>
<td></td>
</tr>
<tr>
<td>Less input VAT</td>
<td></td>
<td><strong>260</strong></td>
</tr>
<tr>
<td></td>
<td></td>
<td><strong>162.5</strong></td>
</tr>
<tr>
<td><strong>Retailer</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Purchase of product</td>
<td>2,640.625</td>
<td></td>
</tr>
<tr>
<td>Additional cost @ 25%</td>
<td>660.156</td>
<td>3,300.181</td>
</tr>
<tr>
<td>Mark-up @ 30%</td>
<td>990.234</td>
<td></td>
</tr>
<tr>
<td>Retail price</td>
<td>4,291.015</td>
<td></td>
</tr>
<tr>
<td>VAT @ 16%</td>
<td>686.562</td>
<td>686.562</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>4,977.577</strong></td>
<td></td>
</tr>
<tr>
<td>Less input VAT</td>
<td></td>
<td><strong>422.5</strong></td>
</tr>
<tr>
<td></td>
<td></td>
<td><strong>264.0</strong></td>
</tr>
</tbody>
</table>
Total VAT collected for Cost

<p>| | |</p>
<table>
<thead>
<tr>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Supplier</td>
<td>160</td>
</tr>
<tr>
<td>Manufacturer</td>
<td>100</td>
</tr>
<tr>
<td>Wholesaler</td>
<td>162.562</td>
</tr>
<tr>
<td>Retailer</td>
<td>264</td>
</tr>
<tr>
<td></td>
<td><strong>686.562</strong></td>
</tr>
</tbody>
</table>

NB

- The illustration above demonstrates that it is the end user or consumer to bears the burden of tax. The participants in the production and distribution chain are simply the collection agents of the government.
- It also shows that incase there is tax evasion, the loss of revenue by the government is minimized.

REGISTRATION AND DE-REGISTRATION OF TAXABLE PERSONS

REGISTRATION FOR VAT

- Registration, de-registration and changes affecting registration are dealt with in the sixth schedule of the VAT Act.
- Compulsory registration applies to any person who in the course of his business has supplied taxable goods or taxable services or expects to supply taxable goods or taxable services, or both, the value of which is Sh. 5,000,000 or more in a period of twelve months.
- Any person who meets the above conditions is a taxable person and should, within thirty days of becoming a taxable person, apply for registration.
- Voluntary registration is permissible under the law, but is granted at the discretion of the commissioner.
- Where a person qualifies for registration, a registration certificate shall be issued within ten working days after receipt of the application by the commissioner.
- Where an application for registration is made within 30 days of becoming a taxable person, the effective date for registration is deemed to be the 30th day from the date the person became a taxable person. However, the commissioner has the discretion to vary the effective date, and in practice, the date of receipt of the certificate applies.
- Every registered person is required to display the registration certificate in a clearly visible place in his business premises. Where a person has more than one place of business, certified copies (by the commissioner) must be displayed in each of those places.
This is a SAMPLE (Few pages extracted from the complete notes: Page numbers reflects the original pages on the complete notes).

It’s meant to show you the topics covered in the notes.

Download more at our websites:

www.someakenya.co.ke

or

www.someakenya.com

To get the complete notes either in softcopy form or in Hardcopy (printed & Binded) form, contact us:

Call/text/whatsapp 0707 737 890

Email:

someakenya@gmail.com
info@someakenya.co.ke
info@someakenya.com

Get news and updates about kasneb by liking our page

www.fb.com/studycpa

Or following us on twitter www.twitter.com/someakenya

Pass on first attempt

“Buy quality notes and avoid refers/retakes which costs more money and time”

Sample/preview is NOT FOR SALE
TOPIC 10

CUSTOMS TAXES AND EXCISE TAXES

CUSTOMS PROCEDURE

INTRODUCTION

Customs and Excise duties are charged under the custom and excise Act cap 472. The custom department is charged with the responsibility of controlling imports and exports, enforcing prohibitions and restrictions and collecting revenue on both imports and excisable goods.

- On arrival cargo from an aircraft, vehicle or vessel which unloaded must be declared to customs in a prescribed form within 21 days. The goods should be entered either for home consumption, transit, transshipment, warehousing or to an export processing zone.
- Where there is insufficient information, the declaration maybe made on provisional status subject to approval by the proper officer. Where provisional entry has been allowed, the proper officer will require the owner to deposit an amount estimated as the duty payable.
- Where goods have not been entered for clearance within 21 days, they will be deemed as deposited in a customs warehouse where rent will be charged at the prescribed rates. Where goods are not removed from the customs warehouse within the notice period granted by customs, they may be sold by public auction to recover customs duty and warehouse rent payable on them.

TAX POWERS AND RIGHT TO REVENUE

POWERS OF THE COMMISSIONER OF CUSTOMS AND EXCISE

1. S. 9 of customs and excise Act states that the commissioner can appoint and fix the limits in the Kenya gazette of:
   - Ports
   - Customs airport
   - Customs areas
   - Entrances and exits
   - Routes in Kenya over which goods in transit can be conveyed
   - Bonding stations i.e. area appointed by the commissioner for air crafts and vessels arriving or departing from a port may be kept.
   - Places of loading and unloading of goods within a port.
   - Places of examination of goods.
• Places for landing and embarkation of persons.

2. Provision of suitable accommodation for offices
3. Power to permit roads, area, place, boarding station, route entrance and exit etc to be used on a temporary basis if so appointed
4. Power to disclose information to a person in the service of the government in the revenue department for official duties.
5. Power to compound an offence by agreement
6. Power to revoke a license issued to manufacture excisable goods
7. Power to furnish to a competent authority any information, certificate or official import document etc of goods in or from a foreign country
8. Power to require information from importers concerning dumping of goods

POWERS OF THE OFFICERS

To prevent smuggling and evasion of duty the Act gives the following powers to officers:
1. Power to require vessels to board failure to which the master of the ship or vessel is liable to a fine of sh. 100,000 and seizure of the vessel.
2. Power to require a vessel to depart from the Kenyan port within 12 hours, failure to which a maximum fine of Sh.100,000 is imposed and the vessel is liable to forfeiture.
3. Power to patrol freely and move the vessels i.e. He can take the aircraft of vessel to a place convenient for investigation of smuggling or evasion without any legal liability to the office.
4. Power to board a vessel and make a search. If the master of the ship refuses he is liable to;
   a) A fine not exceeding Sh. 500,000 or
   b) 3 years imprisonment
   c) Forfeiture of goods
5. Power to require persons entering or leaving Kenya to answer questions concerning their luggage.
6. Power to search persons where he has reasonable grounds to believe that the person has excisable goods or uncustomed goods. However, a female office can only search a female person
7. Power to seal and search premises. They can sea, lock or secure:
   a) Buildings, rooms or receptacle of a plant
   b) Excisable goods or material in a factory
   c) Aircraft, vessels, vehicles or container
8. Power to have a search warrant issued by the magistrates to enable the officer to enter day and night premises to seize and carry away uncustomed goods, plant or documents
IMPORTS AND EXPORT DUTIES

DUTY

- Duty is defined to include:
  - Customs duty, excise duty, levy, cess, imposition of tax, surtax
  - Imposed on goods by the commissioner

CUSTOMS DUTY

- This is the duty or tax paid on goods imported through any port of Kenya or goods imported and which are specified in the first schedule of the Customs and Excise Act
- Goods subject to customs duty include:
  - Machinery
  - Textiles
  - Electronics
  - Vehicles
  - Food commodities

- The **purposes of customs duty** are:
  - To **raise revenue** for the government.
  - To **protect local industries** e.g. impose high customs duty to discourage consumption of imports.
  - To **prevent dumping of goods** into the Kenyan Market e.g. impose high anti-dumping duty
  - To **discourage production of harmful goods** e.g. excise duty imposed on manufacture of beer and cigarettes.

EXPORT DUTY

- This is **tax** that is **imposed on goods which are exported to foreign countries**. The main purposes of excise duties are:
  - To **raise revenue** for the government.
  - To **discourage the exportation of certain goods** e.g. scrap metal, hides and skins.
  - To **encourage the use of materials locally** e.g. scrap metal.
This is a SAMPLE (Few pages extracted from the complete notes: Page numbers reflects the original pages on the complete notes).

It’s meant to show you the topics covered in the notes.

Download more at our websites:

www.someakenya.co.ke
or
www.someakenya.com

To get the complete notes either in softcopy form or in Hardcopy (printed & Binded) form, contact us:

Call/text/whatsApp 0707 737 890

Email:

someakenya@gmail.com
info@someakenya.co.ke
info@someakenya.com

Get news and updates about kasneb by liking our page
www.fb.com/studycpa

Or following us on twitter www.twitter.com/someakenya

Pass on first attempt
“Buy quality notes and avoid refers/retakes which costs more money and time”

Sample/preview is NOT FOR SALE