

BUSINESS INCOME

This is one of the specified sources of income as per section 3 subsection 2 of the income tax act.

Sec 3 sub sec 2 describes the following as the specified sources of income.

1. Employment income
2. Business income for whichever period the business is carried on.
3. Investment income i.e. dividends, interest and capital gains
4. Income earned from rights granted for the use or occupation of immovable property i.e. rent and royalties.
5. Farming or agricultural income.
6. Income from previous employment.

When determining whether a business is carried on for tax purpose. The following factors should be considered:

- i) The profit motive. This must be the main objective rather than incidental objective for the existence of the business.
- ii) Nature of assets acquired and the quantities involved.
- iii) Method of financing. When the proceeds from sales are used to finance to acquire more goods for resell, it is an indication that a business is being carried on.
- iv) The method used to generate sales.
- v) The mode of acquisition of assets e.g. when inherited assets are sold, it doesn't indicate that a business is carried on.

Taxable Business Income

- i) Insurance compensation for the loss of trading inventory or loss of revenue items.
- ii) Realized foreign exchange gains.
- iii) Balancing charge and trading receipts for wear and tear purpose.
- iv) Bad debts recovered which were previously written off and allowed.
- v) Reduction in specific provision for bad and doubtful debts.
- vi) A gain arising from buying and selling.

Non Taxable Business Income

- i) Income from foreign investments.

- ii) Reduction in general provision for bad and doubtful debts.
- iii) Additional capital introduced.
- iv) Inheritance and dowry on individuals.
- v) Insurance compensation for non-current assets.
- vi) Interest from government infrastructural bond with maturity period of more than 2 years.
- vii) Gain on disposal of assets.
- viii) Unrealized foreign exchange gains.
- ix) Interest income from post bank.

Allowable Expenses

They are expenses which are wholly and exclusively incurred in the production of income.

They include:

1. Trade bad debts and increase in specific provision or allowance for doubtful debts.
2. Capital allowances e.g. wear and tear allowances, investment allowance, and industrial building allowance
3. Legal cost in connection with acquisition of a lease of not more than 99 years.
4. Subscription to a trade association.
5. Expenses of capital or revenue in nature on scientific research related to the business.
6. Interest on loans for developing the business.
7. Advertisement expenses.
8. Loss brought forward from the previous years with a limit of 4 years.
9. Legal fees paid on listing of securities to a security's exchange registered in Kenya.
10. The cost of preparing land for farming i.e. both revenue and capital expense.
11. Any cost incurred in the prevention soil erosion.

Non-allowable Expenses

The guiding principle is the expenses which are not wholly and exclusively incurred in the production of income.

They include:

- i) Any capital expenditure on acquisition of non-current assets.
- ii) Depreciation amortization and impairment loss.
- iii) Personal and household expenses.
- iv) Income tax and all the expenses related to the payment of taxes.
- v) Increase in general provision for bad and doubtful debts.
- vi) Legal fees and other professional fees of capital in nature, in relation to borrowing, valuation of property, preparation of partnership deed and MOA.
- vii) Capital repairs including cost of extension and replacement.
- viii) Loss on disposal of non-current assets.
- ix) Other expenses which overtime are regarded as non-business expenses e.g. donations, penalties, fines etc.

However, donations are allowable where:

- a) They are to a charitable institution.
- b) There is evidence that the donation was made.
- c) The donor doesn't expect to benefit either indirectly or directly from the donation.

Taxation of Sole Proprietorship

Sole proprietorship doesn't have separate taxable capacity.

The profits are taxed on the owner using the graduated scale rates of tax.

Salary to the owner and any drawings are not allowable.

Taxation of partnership

The profits from a partnership are taxed on the partners; the partners share the profit as per the profit sharing ratios after adjusting from the following:

Allocation schedule

	X	Y	Total
Salaries bonus			
Commission	Xx	Xx	Xxx
Interest on capital	Xx	Xx	Xxx
Interest on drawings	(xx)	(xx)	(xxx)
Profit share	Xx	Xx	Xxx
Adjusted taxable profit	Xx	Xx	xxx
<u>Other incomes</u>			
Farming	Xx	Xx	
Employment	Xx	Xx	
Total taxable income	xx	xx	

Any form of remuneration to the partners, interest on capital and drawing is not allowable.

Interest on drawings and capital introduced is not taxable.

Taxation of Corporations

Corporations are taxed at corporation's tax rate of 30% for residents and 37.5% for non-residence.

Salaries of the directors are allowable expenses.

Transactions between the business and the shareholders are considered to be business transactions for tax purpose.

Income from other sources is added to the taxable profit and taxed as an aggregate.

XYZ	
Computation of taxable profit	
Year of income 2018	
Reported profit (Net profit)	Xx
Addback: non-allowable deductions	Xx
: omitted incomes	Xx
: understand incomes	Xx
Less: Omitted allowable expenses	(xx)
: Non-taxable incomes	(xx)
: understated expenses	(xx)
: overstated incomes	(xx)
: income from specified sources	(xx)
Adjustable taxable profit	xx

XYZ	
Computation of taxable profit	
Sales	Xx
Less cost of sales	<u>(xx)</u>
Gross profit	Xx
Add other incomes	Xx
Less allowable expenses	<u>(xx)</u>
Taxable profit	xx