# KENYATTA UNIVERSITY

## UNIVERSITY EXAMINATIONS 2017/2018

## FIRST SEMESTER EXAMINATION FOR THE DEGREE OF BACHELOR OF COMMERCE

## BAC 400: TAX LAWS AND PRACTICE

**DATE: WEDNESDAY 29TH NOVEMBER 2017** **TIME: 11.00 A.M. – 1.00 P.M.**

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**INSTRUCTIONS:**

**Answer ALL the Questions**

**Question one**

PeaceInsurance Ltd. deals in both general and life business. The company has provided you with the following income statement for the business for the year ended 31 December 2016:

| Income | notes | Shs.000 |
|---|---|---|
| Loss from insurance business | 1 | (36,000) |
| Investment income | 2 | 517,500 |
| Net premiums earned | | 1,463,700 |
| Rental income | 3 | 237,360 |
| | | **2,182,560** |
| **Expenses** | | |
| Provision for staff leave accruals | | 37,500 |
| Provision for business expansion to Rwanda | | 240,000 |
| Agency expenses | | 69,000 |
| Bad debts (specific) | | 36,900 |
| Management expenses | | 264,000 |
| Donations to IDP housing fund | | 33,000 |
| Advertisement expenses | | 6,900 |
| Legal expenses | 4 | 140,355 |
| Loss on disposal of property | | 24,150 |
| Net claims | | 69,000 |
| Goodwill amortization | | 6,150 |
| NSSF contributions | | 675 |
| Stamp duty paid | | 690 |
| General expenses | 5 | 134,430 |
| Depreciation | | 16,470 |
| Provision for doubtful debts | 6 | 305,850 |
| Commission paid to 'facilitate' transfer at lands office | | 4,650 |
| | | **1,389,720** |
| **Net income** | | **792,840** |

**Notes**

1. **Life insurance business**

   The company uses the income and expense method to account for the income from the life business. The following information is provided for the year ended 31 December 2016:

| | Shs.000 | |
|---|---|---|
| Investment income | 282,000 | |
| Management expenses | 318,000 | |
| Net loss | | 36,000 |

On the advice of their actuary the company transferred Shs.50million from the life fund to the income statement

2. **Investment Income:**

| | | | Shs.000 |
|---|---|---|---|
| Dividend received from companies quoted on the NSE | | | 240,000 |
| Capital gains on sale of shares quoted on the NSE | | 75,000 | |
| Interest on Treasury bonds | 165,000 | | |
| Dividend from Rwandacell Ltd (Rwanda) | | 37,500 | |
| 517,500 | | | |

3. **Rental Income:**

| | | Shs.000 | Shs.000 |
|---|---|---|---|
| Rent received | | | 246,000 |
| Expenses: | | | |
| Agency collection expenses | 1,125 | | |
| Garbage disposal expenses | 450 | | |
| Purchase of garden furniture | 750 | | |
| Land rates | 315 | | |
| Purchase of power back up system | 6,000 | 8,640 | |
| **Net rent received** | | | **237,360** |

4. **Legal expenses:**

| | | | | shs000 |
|---|---|---|---|---|
| Legal fees for breach of contract | | | 3,600 | |
| Drafting of tender documents | | 54,000 | | |
| Expenses relating to claims | 75,210 | | | |
| Parking fines paid to city council | | 45 | | |
| Employee service contracts | 7,500 | | | |
| **140,355** | | | | |

5. **General expenses:**

| | Shs.000 |
|---|---|
| Purchase of a Jaguar for sales manager | 9,600 |
| Purchase of a shredder | 450 |
| Harambee contributions for an employee | 3,600 |
| Purchase of furniture and fittings | 36,780 |
| General office expenses | 84,000 |
| | **134,430** |

6. **The movement in provisions for bad & doubtful debts during the year was as follows:-**

| | Shs000 Specific | Shs000 General |
|---|---|---|
| 1st Jan.2016 | 1,891,500 | 52,200 |
| Charge for the year | 251,400 | 110,250 |
| Released during the | (55,800) | - |
| **At 31.Dec 2016** | **2,087,100** | **54,150** |

7. **Written down value of assets at 1 January 2016**

| | | Shs.000 |
|---|---|---|
| Furniture and fittings | | 50,400 |
| Motor vehicles | 10,750 | |

**Shs.000**

| | | |
|---|---|---|
| Office equipment | 85,150 | |
| Computers | 123,500 | |
| Insurance software (cost) | | 105,000 |
| *(Purchased in the year 2014)* | | |

8. To solve the water shortage problem at its headquarters in Nairobi the company sunk a borehole at a cost of shs15million on 1 July 2016 and it was put into use immediately.

**Required:**

a. Taxable profit or loss for PeaceInsurance Ltd. for the year ended 31 December 2016 [21marks]

b. One of the sources of revenue losses for Kenya is through tax incentives. Discuss the pros and cons of using tax incentives for a developing country like Kenya. [9marks]

**[Total 30marks]**

**Question two**

**a.** Discuss Two advantages and Two disadvantages of the Value Added Tax [4marks]

b. Shah has been operating a wholesale business in Nairobi. The following details related to the business for the month of August2017:

| | **Shs.** |
|---|---|
| Imported goods for resale | 1,750,000 |
| Telephone and Email expenses | 84,000 |
| Audit fees paid | 1,120,000 |
| Purchases at zero rate | 870,000 |
| Sales at standard rate | 5,350,000 |
| Purchases at standard rate | 1,640,000 |
| Photocopying costs | 180,000 |
| Purchases at zero rate rate | 550,000 |
| Water bill paid | 12,500 |
| Salaries and wages | 3,750,000 |

**Additional Information:**

- Shah paid imports duties of 25% on the resale value of the goods above. The firm also incurred transport costs of Shs.50,000 and repackaging costs of Shs.20,000 on the imported goods for resale. Theses goods were later sold during the month at a mark-up cost of 25%. These sales have not been included in the sales above.
- 5% of standard rate purchases were made from suppliers who were not registered for VAT
- Goods at standard rate valued at Shs.600,000 were returned during the month to the wholesaler.
- One of the debtors of the business was declared bankrupt and the business wrote off Shs.500,000 which was outstanding from the debtor at the end of the month.
- Shah donated goods worth shs.90,000 to Imani Home. These goods were not included in any of the sales above.

**Required:**

The VAT payable (or refundable) by the business for the month of August2017

**Note:** The amounts above are stated exclusive of VAT at the rate of 16% where appropriate

[6marks].

**[Total 10marks]**

**Question three**

You are a tax consultant and one of your clients, Mr.Kioko who works for Umeme Ltd has received an additional assessment from the Commissioner for Domestic Taxes for the year ended 31 December 2016. The Commissioner is satisfied with the taxes paid by Kioko on employment income however he based the additional assessment on the non-inclusion of the following incomes in Mr.Kioko's income tax return:

1. **Investment Income**
   Interest on loan to his friends law firm Shs.45,000(gross)
   Dividends from companies quoted on the NSE Shs.75,000(net)
2. Mr.Kioko is a board member of a local Polytechnic. During the year 2016, he earned a total income of Kshs.500,000 from board meetings. No taxes were deducted by the polytechnic.
3. **Rental income**
   Mr.Kioko owns several rental properties where he receives an annual gross rental income of shs.14million. You have established that the rent is collected by an agent and Mr.Kioko pays the agent a commission of 2.5% of gross rent collected. He also incurred the following expenses during the year:

| | **Shs** |
|---|---|
| Garbage collection expenses | 120,000 |
| Land rates and rent | 385,000 |
| Mortgage payments: Interest | 1,600,000 |
| :Principal | 250,000 |
| Installation of water tanks for all the houses | 500,000 |
| Salary of the Gardener | 580,000 |
| Purchase of flower pots and garden furniture | 230,000 |
| **Total expenses** | **3,665,000** |

In addition Mr.Kioko informs you that he incurred legal expenses of shs.85,000 in evicting a tenant who had rent arrears.

4. **Business income**

Mr. Kioko owns a hair and beauty salon which is run and managed by his wife. In the year 2015 when the salon was started it made a loss of shs.750,000.The salon generated a net profit of shs.2,648,700 in the year 2016 determined as follows:

| | | |
|---|---|---|
| **Turnover** | | **5,800,000** |
| **Expenses** | | |
| Purchase of Dryers and Furniture | 800,000 | |
| Payments of commissions to employees | 1,400,000 | |
| Salaries to non-commision employees | 360,000 | |
| Payments for utilities | 89,000 | |
| Free haircuts to street boys | 2,300 | |
| Purchase of TVs for reception area | 500,000 | **3,151,300** |
| | | **2,648,700** |

**Required:**

Write a memorandum of appeal on behalf of Mr.Kioko justifying the taxable income in each case and determine his tax liability. **[10marks]**

**Question four**

a. Briefly explain the meaning of an in-depth examination in taxation[2 marks]

b. Mumo and Mutuma are in partnership trading as Matu Enterprises and sharing profits and losses in the ratio of 2:3 respectively. The partnership has however not been maintaining proper books of accounts and the organization has been selected for an in-depth examination by KRA. The partners have provided KRA with the following information for the year ended 31 December 2016:

1. The firm's assets and liabilities as at 1 January 2016 comprised:

| | Shs |
|---|---|
| Furniture and fittings (written down value) | 2,975,000 |
| Motor Vehicles (written down value) | 4,200,000 |
| Stock (cost) | 3,158,750 |
| Trade debtors | 9,450,000 |
| Trade creditors | 5,460,000 |
| Bank balance | 12,075,000 |

2. The following transactions were reflected in the bank statement of the partnership for the year ended 31 December 2016:

| | Debit | Credit | Balance |
|---|---|---|---|
| | Shs. | Shs. | Shs. |
| Balance brought forward (1 January 2016) | | | 12,075,000 |
| Rental Income | | 8,050,000 | 20,125,000 |
| Legal expenses | 2,275,000 | | 17,850,000 |
| Payment to trade creditors | 4,410,000 | | 13,440,000 |
| Insurance | 1,575,000 | | 11,865,000 |
| Ledger fees | 1,043,000 | | 10,822,000 |
| Farming revenue | | 47,460,000 | 58,282,000 |
| Advertisement | 6,125,000 | | 52,157,000 |
| Salaries and wages | 20,160,000 | | 31,997,000 |
| Sale of surplus company assets | | 18,480,000 | 50,477,000 |
| NSSF payments | 463,400 | | 50,013,600 |
| Drawings by partners | 1,907,500 | | 48,106,100 |
| Motor car running expenses | 1,916,250 | | 46,189,850 |
| Sales assistant's wages | 808,500 | | 45,381,350 |
| Utility expenses | 1,251,250 | | 44,130,100 |
| Sundry expenses | 365,750 | | 43,764,350 |
| Purchase of I-pads | 1,732,500 | | 42,031,850 |
| Cash purchases | 24,255,000 | | 17,776,850 |
| Cash received from debtors | | 13,590,500 | 31,367,350 |
| Cash sales | | 57,750,000 | 89,117,350 |

3. The cash sales deposited are after deducting shs.45,000 per month taken as imprest by each partner in order to pay for goods drawn from the firm. No entries have been made to record the imprest or drawings of goods.
4. Trade debtors and creditors balances as at 31 December 2015 were shs.3,760,000 and shs.1,800,000 respectively.
5. Salaries and wages includes salaries paid to Mutumaduring the year amounting to shs.175,000p.m.
6. Advertising expenses includes shs.850,000 used to mount a neon sign advertisement.
7. The closing stock amounting to shs3,150,000 at 31 December 2016 was undervalued by 25%.
8. Five per cent of the trade debtors outstanding as at 1 January 2016 were uncollectible during the year and were written off.
9. On 2nd November 2016 the partners installed security cameras at the business premises at a cost of shs.1.5million. They paid using a cheque which has not been presented to the bank for payment.
10. As a tax expert, the partners have offered to pay you shs.370,000 to help them prepare adequate accounts for tax purposes.

**Required:**

Adjusted partnership profit or loss for the year ended 31 December 2016. [18marks]

**[Total 20marks]**