MACHAKOS UNIVERSITY

University Examinations for 2016/2017 Academic Year

SCHOOL OF BUSINESS AND ECONOMICS

DEPARMENT OF BANKING, ACCOUNTING & FINANCE

FOURTH YEAR FIRST SEMESTER EXAMINATION FOR BACHELOR OF COMMERCE

BAC 400: TAX LAW AND PRACTICE

DATE: 27/7/2017 **TIME: 8:30 – 10:30 AM**

INSTRUCTIONS:

i. Answer question one and any other two questions.
ii. Marks allocated for each question are shown at the end of the question.
iii. Show your working where necessary.

1. (a) Outline FOUR benefits of an effective tax policy to an economy. (6 marks)

   (b) The following information was extracted from the records of Pesa Limited for the year ended 31 December 2016.

- Gross profit for the year Sh.3, 600,000
- Raw materials in respect of imported products intended for export to another country Sh. 644,000. This amount was inclusive of import duty at a rate of 15% which was refunded by the revenue authority. Value added tax is at a rate of 16% on value for duty.
- Investment deduction and other capital allowances Sh. 1,800,000.
- Other expenses Sh. 840,000.
- Ordinary share capital Sh. 2,000,000. The par value per share was sh.10. The company had paid an interim dividend of sh. 0.8 per share and the directors proposed a final dividend of sh. 4.20 per share which was approved at the general meeting.
- Dividends received from other companies Sh.600, 000.
- Corporation tax rate is 30%

Required:

Dividend Tax Account showing the compensating tax payable for the year ended 31 December 2016. (8 marks)

(c) Assume that you have been requested to make a presentation in a tax seminar, on the measures that should be put in place to curb the problem of tax evasion in your country.

Required:

Discuss FOUR measures of overcoming the problem of tax evasion that you would include in your presentation. (6 marks)

(d) The following transactions were reported by Abdi Wholesalers for the three months' period ended 31 December 2016.

	Sh.
Sales at standard rate	9,600,000
Sales at Zero rate	3,200,000
Computer purchases	2,400,000
Computer servicing costs	800,000
Export Sales	840,000
Exempt sales	4,800,000
Purchases at standard rate	5,000,000
Purchases at zero rate	1,000,000
Wages paid	4,000,000
Consultancy fees paid	900,000
Telephones and electricity expense	200,000
Rent expense	1,600,000

Amounts are stated exclusive of VAT at the rate of 16% where applicable.

Required:
Total VAT payable (or refundable) for the three months ended 31 December 2016 ignore restrictions on input tax deductible). (10 marks)

2. Heshima limited commenced operations on 1 January 2016 after incurring the following expenditure.

	Sh. "000"
Factory building	4,500
Processing Machinery	1,200
Furniture & Fittings	320
Boilers	920
Staff quarters	780
Heavy duty fork lift	720
Staff canteen	540
Saloon car	2,500
Delivery van	2,800
Godowns	860

Tractor	3,200
Lorry (3.5 tonnes)	2,400
Computers	450
Staff clinic	810

Additional information:
Factory building includes the cost of a showroom Sh. 500,000 and a retail shop Sh. 400,000.
A perimeter wall was constructed at a cost of Sh.827,000 and put into use on 1 April 2016.
The godown and staff quarters were constructed at a cost of Sh. 860,000 and Sh. 780,000 respectively and put into use on 1 October 2016.
On October 2016, the following assets were acquired:

	Sh. "000"
Conveyor belts	350
Workshop machine	330
Water pump	480
Trailer for tractor	248
Laptop computer	150

In the year ended 31 December 2016, the followig assets were disposed off:

	Sh. "000"
Furniture	280
Computers	720

The saloon car was traded in during the year with another vehicle costing Sh. 3,000,000. The trade in value was Sh. 800,000.
The income statement extract for the company for the year ended 31 December 2016 disclosed the following information.

	Sh. "000"	Sh. "000"
Sales		68,000
Cost of sales		(36,000)
Gross Profit		32,000
Selling expenses	4,800	
Salaries & Wages	1,940	
Depreciation	3,200	
Provision for bad debts	1,600	
Electricity & Water	640	
Rent & Rates	560	
Printing & Stationery	720	(13,460)
Net Profit		18,540

Required:

Compute for Heshima Limited for the year ended 31 December 2016;

a) Capital allowances
b) Adjusted taxable profit (20 marks)

3. (a) Discuss FIVE sources of revenue for a county government in Kenya. (10 marks)

(b) One of the facilitators in an East African Community tax seminar commented that "There are diverse factors that influence taxable capacity (or tax income) in various countries". Justify the facilitator's comment by discussing FIVE factors that influence the taxable capacity of a country. (10 marks)

4. (a) Linda insurance company Limited provides motor vehicle and fire insurance covers to its policy holders. The following information was extracted from the financial records of the company for the year ended 31 December 2016.

	Motor Vehicle Insurance	Fire Insurance
	Sh. "000"	Sh. "000"
Gross premium received	84,000	18,360
Re-insurance ceded	31,480	8,400
Unearned premium: 1 January 2016	9,240	2,830
31 Dec 2016	5,400	1,820
Claims paid	2,720	1,420
Claims outstanding: 1 January 2016	3,980	4,680
31 Dec 2016	3,540	14,280
Depreciation	820	940
Gain on sale of fixed assets	84	36
Agency expenses	526	180
Commission received	320	1,780
Telephone & Postage	1,538	1,630
Management expenses	3,400	1,820
Bad debts	900	360
Advertising	860	800

Additional information:

i) Bad debts for the motor vehicle insurance included Sh. 300,000 relating to general provisions for bad debts.

ii) The agency expenses for fire insurance business included;
- Commission paid on sale of equipment Sh. 80,000
- Commission paid on sale of fixed assets Sh. 6,000

iii) Capital allowance for the year ended 31 December 2016 were agreed with the tax authority at Sh. 2,400,000.

Required:

i) The taxable profit /Loss for Linda insurance company for the year ended 31 December 2016.
ii) Tax payable (if any) by the company for the year ended 31 December 2016. (14 marks)

(b) Explain the following terms as used in Taxation.
   i) Tax evasion
   ii) Tax avoidance
   iii) Tax investigation (6 marks)

5. (a) The following information relates to Akiba Savings and Credit Co-operative Society for the year ended 31 December 2016.

Income Statement for the year ended 31 December 2016

	Sh. "000"	Sh. "000"
Income:		
Interest from members' loans		9,600
Interest from fixed deposit accounts		2,400
Interest from government infrastructure bonds		3,600
Other investment income		1,500
Rental income		3,200
Interest from Front Office Saving Activity (FOSA)		1,000
Dividends from Supa Co-operative Society		800
Gross income		22,100
Expenditure:		
Administrative expenses	5,600	
Capital allowances	1,400	
Operating expenses	3,000	10,000
Surplus		12,100

Additional information:

i) The society paid dividends and bonuses to members amounting to sh 6.5 million for the year ended 31 December 2014.

ii) Administrative expenses included:

Salaries to officers directly involved in the processing of members' loans sh.1,400,000

- Salary to the caretaker of rental property sh.200,000
- Purchase of computer software sh. 400,000

iii) Operating expenses included depreciation of sh. 84,000 and non-performing loans to members of sh. 120,000 which were written off.

iv) Other investment income includes income from saving account of sh. 500,000.

Required:

i. Adjusted taxable profit or loss for the year ended 31 December 2016.
   Hint: You may start with the reported surplus.

ii. Tax liability (if any) due for the year ended 31 December 2016. (12 marks)

(b) Explain FOUR benefits that accrue to a country that uses Integrated Tax Management System. (8 marks)