

CHUKA



UNIVERSITY

UNIVERSITY EXAMINATIONS

EXAMINATION FOR THE AWARD OF DEGREE OF BACHELOR OF COMMERCE

BCOM 412: TAX MANAGEMENT

STREAMS:Y4S1

TIME: 2 HOURS

DAY/DATE: MONDAY 20/09/2021

2.30 P.M – 4.30 P.M

INSTRUCTIONS

■ Answer question one and any other two questions

QUESTION ONE

- (a) Differentiate between tax audit and tax investigations. [4 marks]
- (b) ABC limited is considering the best source of finance for the new company. They desire to raise requirement of ksh 10 billion. They have approached you as consultant to give them advice on how to source the additional ksh 5 billion that they require. The consultant has assembled his analysis into two mutually exclusive financing sources based on their request as follows;

Optional A (Equity only)

	Ksh '000'
Base capital Equity	5,000,000
Additional capital -all equity	<u>5,000,000</u>
Total	<u>10,000,000</u>

Optional -B (Debt only)

	Ksh '000'
Base capital Equity	5,000,000
Additional capital long term debt	<u>5,000,000</u>
	<u>10,000,000</u>

It is assumed that both the additional equity and additional debt will require an annual payment of ksh 400 Million and ksh 500 million for dividend and interest respectively every year. Assume that the profit before interest and taxes that the company would post each year is ksh 10 billion. The corporate tax rate is 30%.

Required :

Suggest, from a tax planning perspective, the best source of additional financing that the consultant should recommend. [10 marks]

(c) The following statement of financial performance was prepared by the management of Kebro limited for the year ended 31 December 2018.

	Ksh	Ksh
Sales (gross)		25,000,000
Rental income		5,000,000
Profit on sale of shares		60,000
Dividend income (net)		1,000,000
Interest income (net)		2,000,000
Insurance claim received		400,000
Miscellaneous income (taxable)		200,000
Closing stock		1,800,000
Opening stock	1,400,000	
Purchase	12,000,000	
Salaries and wages	3,500,000	
Depreciation	1,500,000	
Water and electricity	600	
Interest expense	2,500,000	
Rent, rate and taxes paid	1,000,000	
Donations to new political party	140,000	
Loss of stock through theft	1,100,000	
Legal expenses	600,000	
Repairs and maintenance cost	1,900,000	
Bad debt	1,300,000	
Proposed dividend	1,100,000	
Redundancy payments	1,900,000	
Promotion expense	700,000	
Net profit	<u>4,220,000</u>	
	<u>35,460,000</u>	<u>35,460,000</u>

Additional information

1. Legal expense comprised

Drawing of leases (50 years)	140,000
Conveyance on purchase of land	100,000
Settling customers disputes	60,000
Issuance of debentures	<u>300,000</u>
	<u>600,000</u>

2. Bad debts were specific ksh 800,000

3. Repairs and maintenance included ksh 300,000 incurred on renovation of a warehouse.

4. Dividend income was received from the following investments.

Share in area ltd	800,000
Share in Timau Commercial bank ltd	<u>200,000</u>
	<u>1,000,000</u>

5. Interest income arose from deposits held with various financial institution.

6. Insurance compensation received related to stock lost through theft.
7. Capital allowances were agreed with tax authorities at ksh 1,600,000 for the year ended 31st December 2018.

Required :

Adjustable tax profit or loss of Kenbro ltd for the year ended 31st December 2018. [10 marks]

QUESTION TWO

- (a) Briefly explain two instances in which a business may apply the concept of tax planning. [4 marks]
- (b) Explain the term ‘thin capitalization’. [4 marks]
- (c) Explain briefly the meaning of ‘goods subject to customs control’ under the customs and excise Act (cap 472) . [4 marks]
- (d) Mr. Kingei is a Kenyan resident who works un United States (USA) . In the year 2019 his income in Kenya was ksh 3,700,000 p.a and his net income in USA was ksh 700,000 (\$7,000). The tax deductible was ksh 200,000. Kenya has a double taxation relief treaty with USA.

Required :

- (i) The double taxation relief in Kenya. [6 marks]
- (ii) The tax payable by Mr. Kingei in Kenya. [6 marks]

QUESTION THREE

- (a) Briefly explain the concept of “Back duty” and why its necessary. [3 marks]
- (b) Kalee imported a pick up motor vehicle from Japan for use in business. The cost details of the motor vehicle were as follows:

Purchase cost	ksh 710,000
Customs duty	ksh 72,000
Excise duty	ksh 144,000
Logistics costs	ksh 205,000
Insurance cost	ksh 187,000

Additional information

45% of the logistics cost related to freight for the vehicle and the balance was a clearing agent’s fee.

35% of the insurance costs was for insurance in transit and the rest was for third party insurance.

Required :

Value of motor vehicle imported. [7 marks]

- (c) In the year of income 2019, Mr. Kamau earned an equivalent of ksh 5 million from employment in Canada where he paid tax equivalent to ksh 400,000. He earned ksh 2 million in consultancy fee in Kenya and employment income of ksh 900,000 (PAYE ksh 220,000) . His Kenyan employer provided his family with accommodation where rent

paid is ksh 85,000 per month. He is married to 2 wives and has 10 children. The wives don't earn any income.

Required :

- (i) Double taxation relief [5 marks]
- (ii) Tax liability for Mr. Kamau for the year of income 2019. [5 marks]

QUESTION FOUR

- (a) How can the following arrange their affairs within the current legal environment so as to minimize their tax burden. (Base your argument on the tax provisions)
 - (i) Employed persons [5 marks]
 - (ii) Sole traders [5 marks]
 - (iii) Corporations [5 marks]
 - (iv) Cooperatives [5 marks]
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