

CHUKA



UNIVERSITY

UNIVERSITY EXAMINATIONS

THIRD YEAR EXAMINATIONS FOR THE AWARD OF DEGREE  
OF BACHELOR OF COMMERCE

BCOM 315: TAX LAW AND PRACTICE

STREAMS: BCOM

TIME: 2 HOURS

DAY/DATE: WEDNESDAY 08/8/2018

2.30 P.M. – 4.30 P.M.

INSTRUCTIONS: Attempt question ONE and any other TWO questions

QUESTION ONE

- (a) Briefly describe what 'tax' is and outline its features [4 marks]
- (b) Peter Mule works for Supreme Ltd as a finance manager. You have been provided with the following details relating to his income for the year ended 31<sup>st</sup> December 2017.
1. Basic salary sh. 120,000 per month (PAYE sh. 32, 000 per month)
  2. During the year he was provided with a saloon car of 3,000 cc rating by the company.  
The car was purchased for sh. 1.8 million
  3. The company has a registered pension scheme for its employees whereby it contributes 15% of each employee's basic pay. Peter contributed 5% of his basic salary towards the scheme
  4. He was enrolled to a medical scheme with Uzima insurance limited for sh. 48,000 annually. The medical scheme catered for senior managers only
  5. The company provided Peter with a fully furnished residential house where the value of the furniture amounted to sh 260,000. The market rental value of the house was 45,000 per month
  6. The employer paid the following bills for Peter Mule during the year:  
Electricity 180,000

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|-----------|--------|
| Telephone | 96,000 |
| Water     | 42,000 |
- Peter is a member of a home ownership saving plan where he contributed sh. 12,000 per month towards the plan
  - Peter received an entertainment allowance of sh. 220,000 during the year. Half of his amount was spent on entertaining his family and the balance was utilized in entertaining customers
  - He was provided with a gardener and a security guard who are on the company's payroll and receives sh. 18,000 and sh. 22,000 per month respectively.
  - Peter has a life insurance policy and contributes a monthly premium of sh, 15, 000 per month

### Required:

- Taxable income for Peter Mule for the year ended 31 December 2017 [14 marks]
  - Tax liability (if any) Peter Mule's for the taxable income [4 marks]
- (b) Describe the characteristics of excisable goods and services [4 marks]
- (c) Daniel Maina received a net rental income of sh. 1,800,000 from his commercial rental premises during the year ended 2017. This was after deducting the following expenses

	Sh.
Caretaker's wages	620,000
Building an extension	840,000
Interest on mortgage	120,000
Fixing metallic doors	320,000

### Required:

- Taxable rental income [4 marks]

## QUESTION TWO

- Explain any five canons that are considered when designing the tax systems of an economy. [5 marks]
- Ruth and Grace are in a partnership operating a hardware shop as 'Ruga' enterprises and sharing profit and losses equally. The following is the income statement of the partnership business for the year ended 31 December 2017

Sh. Sh.

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Sales		9,280,000
Less expenses:		
Cost of goods sold	4,000,000	
Purchase of computers	160,000	
Salaries and wages	360,000	
General expenses	720,000	
Legal expenses	940,000	
Repairs and maintenance	25,000	
Interest on partners capital	450,000	
Ruth's mortgage interest	65,000	
Donations to Tennis club	35,000	
Commission to Grace	<u>21,000</u>	
		<u>(6,776,000)</u>
Profit for the period		<u>2,504,000</u>

### Additional information:

1. Salaries to partners and interest on partners capital is to be shared according to the profit and loss sharing ratio
2. Salaries and wages include salaries to employees of sh. 160,000 while the balance was paid to partners
3. Legal expenses include:

Drafting a partnership deed	42,000
Negotiating a bank loan	30,000
Defending the business against breach of contract	38,000

### Required:

- (i) Adjusted taxable profit and loss for the partnership for the year ended 31 December 2017 [10 marks]
- (ii) A schedule showing distribution of partners taxable income for the year ended 31 December 2017 [5 marks]

### QUESTION THREE

- (a) In a tax seminar, one of the facilitators noted that, 'raising revenue is not the only purpose for which taxes are levied'. With reference to the above statement and using practical illustrations, explain five other purposes of levying taxes. [10 marks]
- (b) Fedha Traders provided the following summary of transactions for the month of July 2018.

Item	Sh.
Sales	6,960,000
Purchases	4,408,000
Credit notes issued to customers	62,640,

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Debit note received from suppliers for goods under invoiced 17,400

### Additional information:

1. Sales include good exported to Uganda amounting to sh. 232, 000 and exempt supplies of sh. 406,000
2. Purchases at standard rate could not be directly identified from exempt supplies and therefore the business restricted deductible input tax
3. All transactions are inclusive of value added tax (VAT) at the rate of 16% where applicable. Calculate for Fedha traders for the month of July 2018
  - (i) Deductible input [8 marks]
  - (ii) VAT payables (or refundable) [2 marks]

### QUESTION FOUR

- (a) Outline any six (6) expenses that are specifically allowable deduction against taxable income by the Income Tax Act [6 marks]
- (b) Bright Industries Limited, a manufacturer of leather products was established and commenced its operations on January 2016 after incurring the following capital expenditure:

Nature of expenditure	Sh.
Factory building	6,800,000
Drainage system	320,000
Saloon car	2,800,000
Office furniture	120,000
Tractor	5,800,000
Fax machine	150,000
Staff Canteen	700,000
Generator	350,000
Delivery van	190,000
Computers	660,000

### Additional information:

1. The company acquired processing machinery from Japan at a cost of sh. 5,600,000 and was installed in the factory building on 1 February 2016.
2. A godown was constructed and utilized with effect from 1 October 2016. The total construction cost was sh. 960,000
3. The saloon car was disposed off for sh. 1.6 million November 2016.
4. On 1 January 2017, the company acquired the following assets:

Nature of asset	Sh.
Air filters	360,000

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Trailer for the tractor	1,200,000
Two delivery vans	5,600,000

5. A sports pavilion and labour quarters were constructed at a cost of sh. 780000 and sh 1,200,000 respectively. Both were utilized with effect from 1 April 2017.
6. During the year ended 31 December 2017, computers and office furniture valued at sh 360,000 and sh 64,000 respectively were disposed off.

**Required:**

Capital allowances due to Bright Industries limited for each of the two years ended 31 December 2016 and 2017 [14 marks]

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