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**University Examinations 2016/2017**

THIRD YEAR FIRST SEMESTER EXAMINATION FOR THE DEGREE OF BACHELOR

OF COMMERCE AND CO-OPERATIVE MANAGEMENT

**BFC3326: ADVANCED TAXATION**

**DATE: DECEMBER 2016 TIME: 2HOURS**

**INSTRUCTIONS:** *Answer question* ***one*** *and any other* ***two*** *questions*

**QUESTION ONE (30 MARKS)**

1. With an aid of decided cases, explain the term plant and machinery (4 marks)
2. With reference to wear and tear allowances, what is meant by the”pooling system”?

(2 marks)

1. Explain the difference between trading receipt and balancing charge (4 marks)
2. The following information is provided to you from the books of Nakuru Holdings Ltd, a farming and manufacturing company as at 31 December 2015

**Sh.**

Written down values as at 31 December 2014

Motor vehicles 655,000

Tractors 2,755,000

Plant and machinery 530,000

Furniture and fittings 225,000

Combine harvester 1,012,500

Spares for tractors 510,000

Land rovers 1,135,000

Office curtains 22,000

Computers 77,000

Fax machine 40,000

Telephones 80,000

Industrial building (original cost net of investment deduction

Sh.1, 000,000) 950,000

Additions in 2015: sh. Shs.

Library books 25,000 saloon car 1,500,000

Loose tools 10,000 pick-up 850,000

Engine head for farmhouse 200,000

Trailer 500,000

New building 750,000

Old machinery

installed in new

buildings 350,000

disposal in 2015: sh.

Saloon car (cost in 2009-sh. 1,500,000) 250,000

Furniture 25,000

Computers 80,000

Tractor 75,000

**Required:**

1. Compute total capital allowances for the year 2015. State why you have not used any of the information and why you think it is not relevant (18marks)
2. Comment on the tax treatment of class II balance (2 marks)

**QUESTION TWO (20 MARKS)**

1. Meru options ltd is a distributor of mobile phones and accessories. The profit and loss account for the year ended 31 December 2015 is as follows:

Sh. Sh.

Purchases 11,500,000 sales 18,000,000

Salaries and wages 2,000,000 ` discounts 400,000

Rent and rates 125,000 Insurance recovery 180,000

Distribution and office 480,000 profit on sale of assets 240,000

Expenses 336,000 provision for bad debts 80,000

Traveling and subsistence 50,000

Subscriptions 200,000

Licenses and permits 436,000

Legal fees 670,000

Depreciation 130,000

Audit fees 240,000

Loss on sale of assets 96,000

Bank charges and interest 415,000

Bad debts 336,000

Discounts 705,000

Repairs and maintenance 500,000

Net profit 681,000

18,900,000 18,900,000

**Notes:**

1. Distribution and office expenses include the following:

Sh.

Subscription to Wananchi sports club for employees’ benefit 180,000

Directors personal expense 96,000

Donations to charity 50,000

1. 15% of rent and rates relate to payments in connection with directors’ private residences
2. Insurance recovery is in connection with mobile phones stolen while on transit to a client.
3. Bad debts provision represents a reduction in the general provision for bad debts
4. Legal fees include the following:

Sh.

Debt collection 80,000

Employment contracts 60,000

Acquisition of trade mark 120,000

Renewal of lease – 50 years 60,000

Legal suit in relation to counterfeit

Handsets found in the company’s 116,000

Warehouse 436,000

1. Subscriptions are to the Meru Phone Dealers Association.
2. Licences and permits represents sh. 150,000 paid to the communications commission of Kenya (CCK) and sh. 50,000 relates to the single business permit paid to the Nairobi city council.
3. Repairs and maintenance include an extension to the warehouse at a cost of sh. 450,000
4. Travelling expenses include sh. 240,000 incurred by the sales manger when he traveled to South Africa to attend a mobile phones and accessories trade fair.
5. Capital allowances have been agreed with the commissioner of income tax at sh. 860,000.

**Required:**

1. Compute Meru Options ltd’s taxable profit or loss for the year ended 31 December (12 marks)
2. Compute the tax payable thereon (2 marks)
3. Assuming that Meru options ltd’s tax liability for the year ended 31 December 2004 was sh.80,000 indicate the due dates for the tax you have computed in (b) above showing the amounts payable (4 marks)
4. Compute the penalties payable by Meru Options ltd if the company paid the tax of sh. 80,000 in (c) above on 30 November 2015 (2 marks)

**QUESTION THREE (20 MARKS)**

1. With the aid of decided cases, explain the main avenues of tax planning (10 marks)
2. Discuss the anti avoidance tax provisions as contained in the income tax Act CAP 470

(10 marks)

**QUESTION FOUR (20 MARKS)**

Mrs. Murungi has not been keeping proper books of account since she started her business. She has been able to provide you with the following information relating to the five years 2011 to 2015

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
|  | 2011  Sh. | 2012  Sh. | 2013  Sh. | 2014  Sh. | 2015  Sh. |
| Assets |  |  |  |  |  |
| Inherited house(leasehold) | 2,000,000 | 2,000,000 | 2,000,000 | 2,000,000 | 2,000,000 |
| Investment  (treasury bills) | - | - | 400,000 | 200,000 | - |
| Motor cars | ? | ? | ? | ? | ? |
| Furniture and  Fittings | 490,000 | 450,000 | 500,000 | 500,000 | 500,000 |
| Computers | 150,000 | 150,000 | 150,000 | 30,000 | 400,000 |
| Stocks | - | 250,000 | ? | 300,000 | 400,000 |
| Business bank account | 340,000 | 300,000 | 290,000 | 250,000 | 200,000 |
| Personal savings  Account | 50,000 | 100,000 | 150,000 | 190,000 | 220,000 |
| Debtors | 650,000 | 555,000 | 4,015,000 | 4,570,000 | 5,300,000 |
| Cash | ? | ? | ? | ? | ? |
|  | 3,030,000 | 3,250,000 | 3,490,000 | 3,830,000 | 3,730,000 |
| Liabilities |  |  |  |  |  |
| Mortgaged house | - | - | 3,500,000 | 4,000,000 | 5,000,000 |
| Trade creditors | 150,000 | 105,000 | 135,000 | 140,000 | 90,000 |
| Bank overdraft | - | - | - | - | - |
| Loan from brother | 500,000 | 450,000 | 380,000 | 280,000 | - |

Additional information:

1. Mrs. Muriungi did not employ the services of a value to estimate for her the value of the house, thus no records were maintained in relation to the house.
2. Two saloon cars were donated to her by her friend who left Kenya to go back to her country. The cars were bought in 2009 at a cost of sh. 500,000 each
3. In 2011, she mad drawings amounting to sh. 20,000 per month. The drawing increased by 20% per year in subsequent years
4. The amount indicated in the statement relating to the bank accounts are the balances with the banks at year end. The banks consistently paid interest at a rate of 7% from 2011 to 2015
5. Parts of investments were sold in 2012 and a loss of sh. 60,000 was incurred in June 2010. The balance was sold at a gain of sh. 70,000
6. Furniture and fittings and computers have been consistently carried at cost in the books
7. Inventory was destroyed by fire in 2012 and no records could be traced to give an indication of the value
8. All cash was deposited with business bank at year end thus no balance was recorded in each of the years. In 2011 the cashier defrauded the business of sh. 80,000 and in 2012 he again defrauded the business of sh.60,000. None of these sums were recorded. Insurance compensated the cash loss for account. No compensation was paid in relation to the incurred in 2011

**Required:**

1. Use the above information to estimate the taxable income for each of the four years 2012 to 2015 inclusive. (14marks)
2. State and justify any other information that may be required (6marks)

**QUESTION FIVE (20 MARKS)**

1. Explain the main allowed deductions available for petroleum companies in Kenya

(5marks)

1. Explain the main provisions regarding the taxation of the following special businesses as outlined by the income tax Act CAP 470
2. Amateur sporting clubs
3. Consolidated financial statements
4. Trade associations
5. Companies under liquidation
6. Collective investment schemes (5marks)
7. Mrs. Karanja is a Kenyan resident. In 2015 she earned income of shs 240,000 in Kenya and taxable income from Canada shs 120,000. Tax deducted in Canada was shs.40,000. Kenya has a double taxation treaty with Canada

Required:

1. Double taxation relief due to Mrs Karanja in Kenya (6marks)
2. Her total tax liability for the year of income 2015 (4 marks)