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**University Examinations 2015/2016**

THIRD YEAR, FIRST SEMESTER EXAMINATION FOR THE DEGREE OF BACHELOR OF COMMERCE

**BFC 3276: ADVANCED TAXATION**

**DATE: NOVEMBER 2015 TIME: 2 HOURS**

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

**QUESTION ONE (30 MARKS)**

1. With an aid of a decided case explain the term manufacturing (3 Marks)
2. The income tax ACT CAP 470 does not define the term plant and machinery. Explain the literal interpretation of the term using decided cases (7 Marks)
3. Chai Limited was incorporated on 31st December 2013 to process and package tea for sale within Kenya. On 2nd January 2014, the company purchased the following movable assets and building from Mwisho Limited, an existing company in the same business.

**Asset Tax written down value Selling price to Chai Limited**

 **Sh.’000’ Sh.’000’**

Machinery 18,000 10,000

Standby generator 200 250

Computers 750 400

Printers 90 110

Loose tools (original cost Sh. 100 70

150,000) 7,200 8,000

Delivery vans (3 tonnes each) 150 80

Mobile phones 1,400 1,000

Office furniture 30 28

Weighing scales

**Nature of building Construction date Construction cost Selling price to Chai Limited**

 **Sh.’000’ Sh.’000’**

Factory 1 January 2008 40,000 48,000

Office complex 1 January 2008 22,000 10,000

Warehouse A 1 July 2009 2,000 1,800

Warehouse B 1 January 2010 1,700 2,400

Staff quarters 1 August 2011 3,600 4,000

Staff Canteen 1 December 2011 900 750

The following additional transactions occurred in the year ended 31 December 2014:

1. On 1 March, one of the delivery vans purchased from Mwisho Limited for Sh.1.2 million was sold for Sh.700, 000.
2. As the number of employees increased. Warehouse B was converted into an office with effect from 1 April. The cost of partitioning the warehouse amounted to Sh. 150,000.
3. Additional staff quarters were constructed at a cost of Sh. 800,000 and utilized from 1 July.
4. On 1 October, a machine was imported at a cost of Sh. 450,000 and the following costs subsequently incurred on it:

Sh.

Import duty 100,000

Carriage inwards 40,000

Repairs in transit 18,000

Installation costs 5,600

Annual insurance 12,000

1. One of the computers valued at Sh. 18,000 was traded in on 2 November for a new one costing Sh. 50,000. The balance was settled in cash.
2. The company reported a profit before capital allowances of Sh. 26 million for the year ended 31 December 2005. This was after deducting deduction depreciation of Sh. 2million.

**Required:**

1. Determine the capital allowances due to Chai Limited for the year ended 31 December 2014.

 (16 Marks)

1. Compute the company’s taxable profit or loss and the tax payable (if any) for the year ended 31 December 2015. (4 Marks)

**QUESTION TWO (20 MARKS)**

Mr. A. Kirianki started a retail business on 1 January 2002. He has not been filing income tax returns for the six years to 31 December 2007.

An investigation of his affairs revealed the following:

1. The balance sheet of the retail business as at 31 December 2006 was as shown below:

**Fixed asset: Sh.000 Sh.000**

-Premises 2,000

-Furniture and fittings 1,000

Motor vehicle 500

 35,000

**Current asset:**

-Stock 250

-Debtor 160

-Bank balance 81

Cash in hand 9 500

 4,000

**Total assets**

Capita: 1 January 2006 3,000

Net profit for the year 300

 1,300

Drawing (500) 2,000

Mortgages loan 1,000

Creditors 200

Total capital and liabilities 4,000

1. He constructed an extension to the premises in year 2006 at a cost of Sh. 625,000.
2. The following account balances were outstanding in the respective year shown below:

**2003 2004 2005 2006 2007**

**Sh. Sh. Sh. Sh. Sh.**

Trade debtors 173,000 190,000 208,000 232,500 253,000

Bank balance 109,000 194,000 281,000 409,500 (32,000)

Trade creditors 230,000 241,000 253,000 272,000 291,500

Cash in hand 10,000 10,000 10,000 10,000 10,000

Stock 255,000 302,500 332,500 366,000 402,500

1. He withdrew goods worth Sh. 5,000 per annum from the business for his personal use.
2. The principal repayment on each mortgage loan amounted to Sh. 250,000 annum from 31 December 2003. The mortgage interest paid in each of the four years ended 31 December 2003, 2004, 2005 and 2006 amounted to Sh. 100,000sh. 75,000, sh. and 25,000 respectively.
3. His wife opened a saving account in a commercial bank in year 2003. The balances in this account after crediting the carried were as follows:

**2003 2004 2005 2006 2007**

**Sh. Sh. Sh. Sh. Sh.**

Saving account 300,000 900,000 100,000 725,000 750,000

Interest earned 25,000 75,000 90,000 70,000 60,000

1. His living expenses and water and tear allowances were agreed with the authorities as follows:

**2003 2004 2005 2006 2007**

**Sh. Sh. Sh. Sh. Sh.**

Living expenses 300,000 400,000 450,000 500,000 600,000

Wear and tear 155,500 130,500 109,000 73,000 157,000

**Required:**

Compute the annual taxable income of Mr. A. Kirianki from year 2003 to 2007.

**QUESTION THREE (20 MARKS)**

Waweru, Mbogo and Shano are in partnership sharing profits and losses in the ration of 3:1:1 respectively. For the year ended 31 December 2014, they presented the following trading and profit and loss account.

  **Sh, Sh.**

Sales 13,000,000

**Cost of sales:**

Opening stock 2, 200, 000

Purchases 4,000,000

Closing stock (800, 0000) (5,400,000)

Gross profit 7,600,000

Other operating income

**Expenses:** 400,000

 8,000,000

Salaries and wages 2,500,000

Rent 40,000

Advertisement 120,000

Transport 60,000

Depreciation 75,000

Interest on partner’s capital 450,000

Commissions paid to partners 90,000

Printing and stationery 144,000

Repairs and maintenance 380,000

Postage and telephone 17,000

Legal fees 23,000

Insurance 110,000

Gifts

Net profit 4,000

 (4,013,000)

 3,987,000

**Additional information:**

1. Opening stock and closing stock have each been understated by 10%
2. Other operating income includes Sh. 50,000 related to gain on sale of furniture.
3. Salaries and wages include salaries to Maina, Njoka and Otieno of Sh. 300,000, Sh. 250,000 and Sh. 50,000 respectively for the year ended 30 December 2014.
4. Transport costs include Sh. 18,000 paid to Otieno on account of a private trip.
5. Interest on partners’ capitals and commissions paid to partners are to be apportioned equally to the partners.
6. The gifts were given to the staff of the firm during the end of year party.
7. Capital allowances due to the firm for the year ended 31 December 2014 were agreed at Sh. 120,000.

**Required:**

1. The partnership’s adjusted profit (or loss) for tax purposes for the year ended 31 December 2014. (12 Marks)
2. Distribution of the taxable profit (or loss) between the partners as at 31 December 2014.(8 Marks)

**QUESTION FOUR (20 MARKS)**

1. Britain Insurance Company Ltd provides motor vehicles and fire insurance covers to its policy holders.

The following was extracted from the financial records of the company for the year ended 31 December 2014.

 **Motor**

**Vehicle Five**

 **Insurance Insurance**

 **Ksh.000 Ksh.000**

Gross premiums 56,000 12,640

Unearned premiums 1 January 8,240 2,360

 31 December 2014 4,630 1,070

Claims outstanding 1 January 2014 3,950 4,820

 31 December 3,680 10,340

Depreciation 700 860

Reinsurance ceded 22,400 5,200

Gain on sale of equipment 64 -

Agency expenses 480 170

Commission received 300 1,690

Telephone & postage 1,460 1,580

Management expenses 3,475 1,875

Bad debts (specific) 600 230

Advertising 846 802

**Additional information:**

1. The agency expenses for motor vehicle insurance include:

 **Ksh.**

1. Commission paid on sale of investments 120,000
2. Commission paid on purchase of equipment 80,000
3. Capital allowances have been agreed with the tax authorities at Ksh. 6,000,000 for the year ended 31 December 2014

**Required:**

Compute the income tax or loss for Britam Insurance Company Ltd for the year ended 31 December 2014. (20 Marks)