



The Co-operative University of Kenya

END OF SEMESTER EXAMINATION – DECEMBER 2016

**EXAMINATION FOR THE BACHELOR OF COMMERCE
(BCOM YR III SEM I)**

UNIT CODE: HBA 2302

UNIT TITLE: ADVANCED TAXATION

DATE: 13TH DECEMBER, 2016

TIME: 2:00 PM – 4:00 PM

INSTRUCTIONS:

- Answer question **ONE (compulsory)** and any other **TWO** questions

QUESTION ONE

- (a) Outline the tax implications of lease hire arrangements (5 Marks)
(b) Explain any FIVE modes of tax avoidance (10 Marks)
(c) Explain the significance of the concept of residence to a resident individual (4 Marks)
(d) Explain the tax effects of shortfall distribution of company profits (5 Marks)
(e) The following information relates to Jaribu SACCO for the year 2015

JARIBU SACCO

Income statement for the year ended 31.12.2015

	Shs '000'	Shs '000'
INCOME		
Interest from members loans		6,000
Interest from KCB (net)		255
Rental income		2,500
Dividends from XYZ Ltd (Gross)		300
Dividends from Wamanchi Co-op Society Ltd (net)		800
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		9855
EXPENSES		
Salaries and wages	2,450	
Donations	300	
Depreciation	600	
Travel and entertainment	80	
AGM and training	35	
Insurance	100	
Rent	200	
Interest	140	
Repairs and maintenance	120	
General expenses	50	
Bad debts written off	25	
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Surplus income		4,100
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		5,755

Required:

Compute the taxable surplus and tax liability

(6 Marks)

QUESTION TWO

The following is the summarised statement of financial position of Faraja Ltd as at 31st December 2015

	Shs	Shs
Non-current assets:		
Factory building (net book value)	5,680,000	
Processing machinery (net book value)	2,420,000	
Motor vehicles (net book value)	1,500,000	
Furniture and fittings (net book value)	840,000	
Office equipment (net book value)	670,000	11,110,000
Current Assets:		
Stock	1,240,000	
Trade debtors	760,000	
Prepaid insurance	360,000	
Bank balance	540,000	
	540,000	2,900,000
		14,010,000
Financed By:		
Share capital (Ordinary shares of Shs 20 each)	9,000,000	
10% debenture stock	2,400,000	
15% bank loan	1,500,000	
	1,500,000	12,900,000
Current liabilities:		
Creditors	1,000,000	
Accrued general expenses	110,000	
		1,110,000
Total capital liabilities		14,010,000

Additional information:

- All the non-current assets were acquired on 1 January 2014. When the company commenced operations. The net book value of these assets as at 1 January 2015 was the same as their written down values for capital allowance purposes
- Included in the processing machinery are machinery with a net book value of Shs 420,000 as at January 2014. This machinery are used in designing a moulding products during the manufacturing process
- Office equipment as at 1 January 2015 comprised the following assets at net book value:

	Shs
Computers	240,000
Telephone switchboard	96,000
Fax machines	120,000
Neon sign	36,000
Other office equipment	178,000

- One of the motor vehicles purchased on 1 January 2014 was a saloon car acquired at a cost of Shs 1,200,000
- The reported profit of the company for the year ended 31st December 2015 was Shs 1,840,000 before accounting for capital allowances due for the year and interest expenses. The reported profit was based on cash sales
- The following transactions included in the bank statement for the year had also not been accounted for in arriving at the reported profit:

	Shs
Receipts from trade debtors	2,800,000
Payment to trade creditors	1,400,000
Refund from trade creditors for purchase returned	360,000
General expenses	346,400
Insurance	550,800
Cash sales deposited directly to bank account	140,000

Insurance paid includes a pre-payment of Shs 50,800 for year 2016

7. There were no closing balances of trade debtors and creditors as at 31st December 2015. All payments from or to trade debtors and creditors were made through the bank account

Required:

For the year ended 31st December, 2015, determine for Faraja Ltd:

- a) Capital Allowances (12 Marks)
 b) Adjusted taxable profit or loss (8 Marks)

QUESTION THREE

- (a) The management of Shamrock Bank Ltd has sought your professional guidance in determining the Bank's tax liability for the year ended 31st December 2015. The income statement of Shamrock Bank Ltd for the year ended 31st December 2015 is given below

	Kshs '000'	Kshs '000'
Income		
Interest on loans and advances to customers		540,800
Interest on government securities		120,650
Interest on placement with other banks and institutions		40,650
Fees and commissions income		39,360
Rental Income		2,190
Income from foreign exchange dealings		31,980
Gain on disposal of property and equipment		12,300
Other operating income		42,950
Total Income		<u>830,830</u>
Expenses		
Salaries and employee benefits		360,400
Occupancy expenses		20,350
Deposit protection fund contributions		12,360
Depreciation expense		43,700
Interest on customer' deposits		202,450
Interest on deposit from other banks and institutions		80,200
Director's emoluments		
Fees	11,200	
Other operating income	<u>3,600</u>	14,800
Auditors' remuneration:		
Current year	2,100	
Under provision for the year (2014)	<u>300</u>	2,400
Operating lease rental		16,300
Loss on disposal of equipment		7,250
Other administrative expenses		20,620
Provision for bad and doubtful debts		80,500

Provision for interest suspense	20,950
Total expenses	<u>882,280</u>
Loss for the year	51,450

Additional Information

1. Salaries and employee benefits comprise:

	Shs '000'
Leave benefits	720
Pension contributions	1,460
Termination costs	2,860
Provision for staff leave accruals	<u>4,920</u>
	9,960

2. Included in the directors' "other" emoluments are:

	Shs '000'
School fees for the chairman's children	1,200
Entertainment allowance (used in clients)	1,800
Travelling costs for a newly recruited expatriate director	600

3. The movement in provisions for bad and doubtful debts during the year was as follows:

	Specific Provisions Shs '000'	General Provisions Shs '000'	Total Shs '000'
At 1 January 2007	650,300	630	631,130
Charge for the year	83,800	15,300	99,100
Released during the year	<u>(18,600)</u>	-	<u>(18,600)</u>
At 31 December 2007	<u>695,700</u>	<u>15,930</u>	<u>711,630</u>

4. Provision for interest suspense represents non-performing loans and advances on which interest has been suspended. The management has confirmed that the loans and advances are fully secured.
5. Capital allowances for the year ended 31st December 2015 amounted to Shs 18,900,000
6. Lease rental charges relate to office equipment leased from AB office solutions for use in the entire bank network.

Required:

- i. Taxable income of Shamrock Bank Ltd for the year ended 31st December 2015 (16 Marks)
- ii. Tax payable (if any), on the taxable computed in a (i) above
- b) Given the Shamrock Bank Ltd's taxable income for the year ended 31st December 2015, was assessed at Shs 2,400,000, show how the tax computed in (a) ii. Above is to be paid (4 Marks)

QUESTION FOUR

- (a)
- i. Distinguish between the taxation of trade association and club (4 Marks)
- ii. Briefly discuss the taxation of amateur sporting associations (4 marks)
- iii. List EIGHT allowable expenditure of a petroleum company while arriving at the taxable profit (4 Marks)
- iv. List the applicable tax exemptions to venture capital enterprises (2 Marks)

(b) Chris Ouma, a married Kenyan resident, had income of Kshs 360,000 for year of income 2015 and also received income from Zambia net of tax Kshs 180,000. The tax deducted in Zambia was Kshs 60,000. Kenya has a double taxation relief treaty with Zambia.

Required:

- i. The double tax relief in Kenya (4 Marks)
- ii. The tax payable by Ouma in Kenya (2 Marks)

QUESTION FIVE

(a) Afro Insurance Ltd. Underwrites three classes of insurance. The management has provided you with the details below on their operations for the year ended 31st December 2007:

Class of insurance	Fire	Motor vehicle	Theft
	Shs '000'	Shs '000'	Shs '000'
Gross premium written	23,088	24,664	9,780
Reinsurance ceded	14,747	15,007	4,822
Unearned premium brought forward	4,205	6,293	1,466
Unearned premium carried forward	2,035	9,259	688
Claims paid	2,216	5,538	1,215
Claims outstanding brought forward	2,781	10,325	4,532
Claims outstanding carried forward	2,755	9,416	8,755
Legal expenses on claims	645	420	125
Depreciation	60	125	65
Gain on sale of motor vehicles previously written off	-	50	-
Specific bad debts	80	35	62
Management expenses	1,606	2,350	876
Commissions (net)	255	1,546	890

Additional information

1. Wear and tear deductions have been agreed with the Income Tax department at Shs 454,000
2. The company invested surplus funds and earned investment income as follows:

	Shs
Interest from Treasury bills (net)	2,040,000
Interest from fixed deposit in local bank (net)	762,450
Gross dividends from Zim-Re Zimbabwe (a foreign company)	450,000
Dividends from KELP Ltd	912,000

3. The company paid Shs 745,000 to ABC Investment Management Services, their fund managers for professional services for the year ended 31st December 2007.
4. The company owns Afro House which houses its offices. Part of the office space is rented out to other tenants. In the year to 31 December 2007, the Company received Shs 2,200,000 net rental income from their estate agents. Property management fees amounting to Shs 2,400,000 for the year to 31st December 2007 had been deducted
5. Afro Insurance Ltd owns 80% of the ordinary shares in KELP Ltd. A locally incorporated company.

Required:

- a) Compute the taxable profit or loss for Afro Insurance Ltd. For the year ended 31 December 2007. (17 Marks)
- b) Compute the tax payable in a) above. (3 Marks)