CERTIFIED PUBLIC ACCOUNTANT

ADVANCED LEVEL 2 EXAMINATIONS

A2.3: ADVANCED TAXATION

DATE: MONDAY 21, AUGUST 2023

MARKING GUIDE AND MODEL ANSWERS

SECTION A

QUESTION ONE

Marking Guide

Question	Description	Marks	Total Marks
(a)	**Statement of adjusted taxable profit or loss**		
	Operating income	1	
	Add non-allowable deductions		
	House keepers' salary	1	
	Interest expenses	1	
	Provision for bad debts	1	
	Depreciation	1	
	Tax paid	1	
	WHT tax	1	
	Transfer to reserves	1	
	Repair and maintenance	1	
	Donation	1	
	Training fees	1	
	Communication	1	
	Less non-allowable income:		
	Dividends from a local company	0.5	
	Income from agricultural activities	1	
	Add foreign dividends	1	
	Add local dividend gross up	1	
	Less capital allowance	1	
	Adjusted taxable income	1	
	Total		**17.5**
	Well calculated Capital allowance and wear and tear on:		
	Land	1	
	Building	1	
	Motor vehicle	1	
	Furniture and fittings	1	
	Computer & accessories	1	
	Software	1	
	Total		**6**
(b)	**Computation of tax to be paid**		
	360,001 - 1,200,000	0.5	
	Above 1,200,000	0.5	
	Less withholding tax on imports	0.5	
	Less double taxation relief:		
	Withholding tax on local dividends	1	

Question	Description	Marks	Total Marks
	Withholding tax on foreign dividends	1	
	Total		**3.5**
(c)	Award 0.5 marks on each tax liability computed for every year. **(Maximum 13 marks).**	13	
	Total		**13**
	Total Marks		**40**

Model Answers

a) Computation of adjusted taxable profit or loss of Muthoni for the year ended 31/12/2021

Description	**Workings**	**Amount FRW "000"**	**Amount FRW "000"**
Operating income			22,010
Add non-allowable deductions			
House keepers' salary		32,000	
Interest expenses		30,000	
Provision for bad debts		21,000	
Depreciation		94,000	
Tax paid	Allowed	-	
WHT tax		55,000	
Transfer to reserves		690,500	
Repair and maintenance		20,000	
Donation	91,762 - (1% * 8,342,009)	8,342	
Training fees		2,000	
Communication	5,200+(96,000-5,200) *20%	23,360	976,202
			998,212
Less non-allowable income:			
Dividends from a local company	Not taxable	168,000	
Income from agricultural activities	Exempted	11,500	(179,500)
			818,712
Add foreign dividends	(124,000/90*100)	137,778	137,778
Add local dividends	(168000*100/85)	197,647	1,154,137
Less capital allowance	W 1		(786,850)

Description	Workings	Amount FRW "000"	Amount FRW "000"
Adjusted taxable income			367,287

Working 1:

<u>Computation of Capital allowance and wear and tear</u>

Assets	Land	Building	Motor vehicle	Furniture and fittings	Computer & accessories	Software	Capital allowances
Cost	85,000	960,000	140,000	122,000	45,000	132,000	
Rate	0%	50%	50%	50%	50%	50%	
Capital allowance		480,000	70,000	61,000	-	66,000	677,000
Dep Value		960,000	70,000	61,000	45,000	66,000	
W & T rate	0%	5%	25%	25%	50%	10%	
W & T	0	48,000	17,500	15,250	22,500	6,600	109,850
Total allowance	0	528,000	87,500	76,250	22,500	72,600	786,850
WDV 31/12/2021	**85,000**	**960,000**	**52,500**	**45,750**	**22,500**	**59,400**	

b) Computation of the tax liability of Muthoni for the year ended 31/12/2021

Computation of tax to be paid	**Workings**	**FRW "000"**
0 - 360,000	0%	0
360,001 - 1,200,000	(1,200,000-360,000) *20%	168
Above 1,200,000	(367,287-1,200) * 30%	109,826
Tax for the year		109,994
Less withholding tax on imports		(55,000)
<u>Less double taxation relief:</u>		
Withholding tax on foreign dividends	(137,778/100*10)	(13,778)
Withholding tax on local dividends	(197,647*15/100)	(29,647)
Tax to be claimed		**(11,569)**

c) Advice on which sector Mutoni Merci may invest in;

Before go into details for the incentive attached to each sector Mutoni the best investment is looking to invest in as tax is concerned is the one which minimize the tax liability or provide the high tax saving through the tax incentives. So let us see in detail the tax incentive attached to each sector to arrive on the final conclusion;

For Mining sector

The law stated that a registered investors holding a valid exploration license are entitled to carry forward losses for a period of ten (10) years from the first year of making the loss, by deducting losses in the order in which they incurred.

For construction Sector and for manufacturing sector

Both construction and manufacturing sector are entitled to carry forward the loss within the period of 5 years but in case for construction, the taxpayer engaged in long term contract for constructing like the road, the law stated that a loss in a tax period in which a long-term contract is completed may be carried back and offset against previously taxed business profit from that contract to the extent it cannot be absorbed by business profit in the tax period of completion.

By calculating the tax to be paid within the investment period between 2 options, below is the advice for each:

Option 1

Total Tax that will be paid under mining sector is calculated as follows:

Years	Profit or loss	Loss to be Carried forward	Net profit or loss	Tax @ 30%
	FRW Million	FRW Million	FRW Million	FRW Million
1	(800)	-	(800)	0
2	50	(800)	(750)	0
3	100	(750)	(650)	0
4	150	(650)	(500)	0
5	160	(500)	(340)	0
6	180	(340)	(160)	0
7	70	(160)	(90)	0
8	60	(90)	(30)	0
Total Tax after 8 years				**0**

Total Tax that will be paid under manufacturing sector is calculated as follows:

Years	Profit or loss	Loss to be Carried forward	Net profit or loss	Tax @ 30%
	FRW Million	FRW Million	FRW Million	FRW Million
1	(800)	-	(800)	0
2	50	(800)	(750)	0
3	100	(750)	(650)	0
4	150	(650)	(500)	0
5	160	(500)	(340)	0

6	180	(340)	(160)	0
7	70	0	70	21
8	60	0	60	18
Total Tax after 8 years				**39**

Under option 1, the best investment that will minimize the tax liability is Mining sector because more period of 10 years to carry forward the loss.

Option 2

Total Tax that will be paid under manufacturing sector is calculated as follows:

Years	Profit or loss	Loss to be Carried forward	Net profit or loss	Tax @ 30%
	FRW Million	FRW Million	FRW Million	FRW Million
1	20	-	20	6
2	50	-	50	15
3	100	-	100	30
4	130	-	130	39
5	(290)	-	(290)	0
Total Tax after 5 years				**90**

Total Tax that will be paid under construction sector is calculated as follows:

Years	Profit or loss	Loss to be Carried forward	Net profit or loss	Tax @ 30%
	FRW Million	FRW Million	FRW Million	FRW Million
1	20	-	20	6
2	50	-	50	15
3	100	-	100	30
4	130	-	130	39
5	(290)	(-290+20+50+100+120)	(290)	(87)
Total Tax after 5 years (Balance)				**3**

Under option 2, the best investment that will minimize the tax liability is construction sector because of carrying back the loss incurred in the last year.

SECTION B

QUESTION TWO

Marking Guide

		Maximum marks
A.	02 Marks for each well explained point	6.0
B	02 Marks for each well explained point	4.0
	Sub-total for these sections	*10.0*
	Recommended split of marks	
C	Gross employment income	1.0
	Add: housing benefit (2M*12)	1.0
	Consultancy Income	1.0
	Foreign income (from South Africa) converted at rate of 68	1.0
	Calculation of Gross tax liability	1.0
	Calculation of tax liability on Rwanda sourced income	1.0
	Calculation of tax liability on foreign income	1.0
	Calculation of double tax relief	2.0
	Calculation pf net tax liability after offsetting DTR	1.0
	Sun-total for this section	*10.0*
	Total Marks for Question Two	***20.0***

Model Answers

a. Memo

To: Board of Management of Vatex LLC

From: CPA Graduate

Subject: Tax Implications of proposed investment in Dizo Ltd

I have made a careful evaluation of the proposed investment approach, informed by Rwanda relevant tax code, I would like to draw your attention to the following for your further steps and decision.

1. **Thin Capitalization:** The proposed Investment would create Thin Capitalization for the Rwandan company Dizo Ltd, which needs to be carefully looked at. Article 26 (10) of law no. 16/2018 stipulates that interest paid on loans and advances from related entities is not deductible to the extent that the total amount of the loan for which interest is paid exceeds four (4) times the amount of equity during the tax period. With a 65% majority shareholding, I recommend a maximum debt: equity ratio of 4:1.
2. **Withholding tax on interest**: Interest paid to Vatex LLC shall be subject to 15% withholding tax per Rwandan tax code. There are some exceptions like Interest on loans from foreign

development financial institutions are exempted from this tax and interest on loans from local banks. Since Vatex is a foreign company, not primarily in business of lending the withholding tax shall be applied on interest.

3. **Interest allowed for CIT**: In line with thin capitalization, Interest on loan is only allowable for income tax purposes up to a cap of loan not exceeding 4 times equity. For this particular scenario, only interest on loan of up to FRW 3.6 billion (4x850 Million equity) shall be allowed for income tax, the interest on the rest of the loan (FRW 5.3 billion – 3.6 billion) is disallowed for income tax purposes.

b. Advise to Mr Jacques Mulisa:

- **Domestic & foreign income both taxable**: Mr Mulisa is a Rwandan resident, essentially the Rwandan tax law requires Rwandan residents to pay tax on both their domestic and foreign income. In this regard Mr Mulisa is accountable for tax on his income at home and also on his income from Egyptian subsidiary, however there are other applicable tax credits explained below.
- **Foreign tax credit**: Article 7 of law n. 16/2018 stipulates that if in a tax period a resident in Rwanda generates income from taxable activities performed abroad, the income tax payable on such foreign sourced income is reduced by amount of foreign tax payable on such income, as long as there's appropriate evidence. However, such reduction cannot exceed tax payable in Rwanda on income from abroad. So Mr Mulisa's total income tax shall be reduced by tax paid in Egypt, as long as the above conditions are fulfilled. In addition, Mr Mulisa must look if Rwanda and Egypt signed a Double Taxation Agreement (DTA) to be allowed this foreign tax credit.

c.

Francis Ngabo tax computation		
for the year 2021	**FRW '000**	**FRW '000**
Gross employment income	120,000	
Add: housing benefit (2M*12)	24,000	
Total taxable employment income		**144,000**
Add: Consultancy Income		62,000
Total Rwandan Income		**206,000**
Add: Foreign income (from South Africa) converted at 68		204,000
Total taxable income		**410,000**
Gross tax calculation:		
First 360,000	-	
(360,001 to 1,200000), taxed at 20%	168	
Above 1,200,000, taxed t 30%	122,640	
Total tax liability		***122,808***
Tax liability on Rwandan income calculation;		
Fist	168	
Excess of 1,200,000 at 30%	61,440	

Total tax liability on Rwandan Income		**61,608**
Tax Liability on Foreign income (Gross tax - Rwanda income tax)		61,200
Double Tax Relief (DTR):		
Lower of;		
Foreign tax income	61,200	
Actual tax paid (Converted at 68)	51,000	
Hence, DTR		51,000
Net tax Liability calculation:		
Gross tax liability	122,808	
Less: DTR	(51,000)	
Less PAYE	(36,000)	
Net Tax Liability		***35,808***

QUESTION THREE

Marking guide:

		Maximum marks
A.	02 marks for at least two (2) valid well explained points	4.0
	01 mark for citing the relevant applicable tax law & convincing conclusion	1.0
	Sub-total for these sections	*5.0*
B	Maximum of 03 marks for each of the five (5) scenarios well explained, a well explained answer should comprise of; i) 0.5 marks for a clear introduction to the topic, citing relevant tax law applicable ii) 02 marks for a customized explanation / analysis in line with the case study provided iii) 0.5 marks for a valid conclusion	15.0
	Sun-total for this section	*15.0*
	Total Marks for Question Three	***20.0***

Model Answers

A. Advise to the CEO of GenMotors

Article 2 of Law No. 02/2015 sets out different goods, services and entities that are zero rated and some exempt from Value added tax. In the following paragraphs, I am summarizing specific Vehicle models that GenMotors can consider prioritizing if they want to take advantage of available VAT incentives;

- **Buses:** Article stipulates that transportation of persons by road in vehicles which have a seating capacity of fourteen (14) persons or more is exempted from VAT. In contrast, Vehicles with less than 14 sitting capacity don't qualify for this benefit.
- **Trucks**: In the same article, transportation of goods by road is exempted from VAT. Since GenMotors manufactures trucks as well, having a large fleet of trucks would be beneficial, Rwanda currently has most of trucks so old that's even an additional advantage to GenMotors to consider.
- **Nature of business:** There is an exception on vehicles with less than 14 seating capacity, if these vehicles are for tourist purposes. Gen motors can consider using their various range of VIP SUVs and go into tourism business to take advantage of this incentive.

B. Advise to H manufacturers Ltd;

Introduction: A sale (tax point) is a point on which the supply of goods or service is recognised to have occurred. The tax point for the supply of goods and services is the earliest of one of the following:

- The date on which the invoice is issued;
- The date on which payment of goods and services, including a partial payment is made.
- The date on which goods are either removed from the premises of the supplier or when they are given to the recipient;
- The date on which the service is delivered

i. VAT law requires the A local recipient of services from a foreign supplier is required to account for a VAT reverse charge at 18% of the value of the services procured. The VAT Act further provides that the recipient may not reclaim the corresponding input VAT unless the services so procured are not available in the local market. In addition, being a non-resident, the company needs to account for withholding tax of 15% on the payment of the EUR 40,000. I understand the CFO is certain there are no local suppliers available here, but that decision / judgement is not in hands of the company to make. The Company should write to RRA, through relevant ministry in charge, and only until RRA approves in writing the company should account for relevant taxes I mentioned above.

ii. This pertains to the outsourcing of services, and it's essential to invoice for the full amount. The service provider incurs expenses to ensure the delivery of the required service like any other business, but the HR Company should issue an invoice to HM which includes a 18% VAT charge on the total amount.

iii. There are two main considerations when it comes to supplies to Government institutions; 1) The Government Institution holds VAT from source and pays it directly to RRA, 2) The Public institution withholds 3% on amount payable to the supplier, unless the supplier holds a valid tax clearance certificate. In HM's case, both sales the company should invoice with VAT but does not have to pay it since the public institution holds it from the source. However, the first sale will suffer from 3% withholding tax since the company did not have a valid tax clearance certificate, the second sale shall not suffer the withholding tax as HM has applied the tax clearance certificate.

iv. If a taxpayer, purchased in the country or imported taxable goods or services which are directly or indirectly related, on one hand partly to taxable goods or services and partly to exempted goods or services on the other, the sum of the input tax is a portion of the tax paid to the taxable goods or services in relation with his/her taxable business. In HM's case, I have summarized this in calculation below;

Standard formula: ***Allowable Input VAT = Total Input VAT x (Taxable sales / Total sales)***

	FRW
Total Input vat (345m*18%)	**62,100,000**
Output VAT;	
Standard sales (305M*18%)	54,900,000
Zero rated sales (55M*0%)	-
Exempted sales (100M)	(N/A)
Total Output VAT	**54,900,000**
Allowable Input VAT = 62.1M x (305M+55M)/460M	48,600,000
Net VAT payable / (claimable)	***6,300,000***

Therefore, HM may have incurred 62.1M input VAT, but can only claim 48.6M.

v. The VAT law has a specific provision on what is called the Blocked supplies (No input VAT deductible). One of them is importation of passenger vehicles and spare parts or repair and maintenance services for these vehicles (unless the taxpayer is involved in resale or leasing of such vehicles and they were acquired for this purpose. HM being a manufacturing company and not necessarily using these vehicles in daily business operations to generate income, the company cannot claim import VAT paid on these vehicles. It is good that the beneficiaries are paying a benefit in kind in the payroll.

QUESTION FOUR

Marking Guide

		Maximum marks
A.	02 marks for a well detailed answer for each of the points (i to iv)	8.0
	A well detailed answer should show proper understanding of tax implication on the said topic and linking it to Rwanda context	-
	Sub-total for these sections	*8.0*
B	01 mark can be awarded for showing understanding that the company is liable for 'some' tax fines and penalties regardless the approach to use	1.0
	02 marks for clearly clarifying on the benefit of voluntary declaration of taxes Vs. waiting for RRA notification of audit / investigation	2.0
	01 mark for a valid conclusion and recommendation	1.0
	Sun-total for this section	*4.0*
C (i)	03 Marks evenly distributed for a well detailed calculation of administrative fines and late payment interest	3.0
(ii)	02 Marks for the right recommendation to the client to do self / voluntary declaration	2.0
	03 Marks evenly distributed for a well detailed calculation of administrative fines and late payment interest	*3.0*
	Sun-total for this section	*8.0*
	Total Marks for Question Three	***20.0***

Model Answers

a.

i. **Taxation and Unemployment**: In times of unemployment, taxes can be reduced, most especially corporate taxes. This leaves companies with more earnings after tax, which can be used to grow business operations, hence creating more employment. The Government can also advance tax credits attached the number of employees, in Rwanda there are some CIT tax credits attached to employing Rwandans.

ii. **Taxation and Inflation:** The Government can increase or decrease tax rates to manage inflation levels. During times of high inflation there is a lot of money in circulation & people have more money in hand, The Government can increase tax to reduce purchasing power, hence reduce cash in circulation and eventually help to control Inflation.
The reverse is true when the inflation is very low and demand is sluggish, the government can decrease taxes hence increasing purchasing power and increasing cash in circulation.

iii. Income Gap: Huge income gap happens when the rich get richer and the poor get poorer. The Government can use taxation to try and minimize this gap, by taxing the rich more and the poor less, and instead using tax monies from the rich to extend essential facilities to the poor can eventually partially mitigate this problem.

iv. Consumption Behaviour: Taxation is one of the most effective ways to influence consumption behaviours, by taxing certain goods and services more or less consumption is shifted to and the reverse is true. For Instance, The Government of Rwanda does not impose tax on agricultural products because Agriculture is essential to Rwanda economy and consumption of agricultural produce should be promoted. However, certain goods and services are so essential that even when taxes are increased consumption still remains high.

b. Advise to the CFO:

The CFO's statement contains inaccuracies. The tax procedures law delineates various fines and penalties depending on the specific wrongful act committed.

Article 76: Late Payment Interest

Article 76 (Interests for late payment) provides that if the taxpayer fails to pay tax within the period provided for by this Law, he or she must pay late payment interest on the amount of principal tax. The interest rate is fixed at one point five percent (1.5%). Interests for late payment are calculated on a monthly basis, non-compounding, counting from the first day after the tax should have been paid until the day of payment inclusive. Interest for late payment applies to both non-filers (those who declares on time but fail to pay) and non payers (those who declare on time but fail to pay on time).

Article 77: Wrongful acts punished with fixed administrative fine.

Article 77 provides the fixed administrative fines for taxpayers who fail to submit their tax declarations on time. In our case, this provision specifically target those who do not adhere to the deadline for tax declaration.

Article 78: Administrative fine for non-declaration and non-payment of tax on time

Article 78 addresses administrative fines for taxpayers who neither declare nor pay their taxes within the legally mandated time limits. It's noteworthy that taxpayers who declare their taxes within the specified time limits but fail to make timely payments are subject to a reduced fine, amounting to half of the penalty imposed on non-filers.

c.

i) November PAYE	**FRW '000**
Principal PAYE payable:	
Gross pay	135,000
Add: Benefit in kind taxable	4,000
Total Taxable income	*139,000*
PAYE Payable;	
(0-30,000), 0%	-
(30,001-100,000), 20%	14
(100,000 and above), 30%	41,670
Total PAYE	*41,684*
Calculation of Fines & Penalties;	
Days defaulted;	
From	16-Dec-2022
To	19-Jan-2023
Days defaulted	***34***
Administration fine (31-60 days)	20%
*Late payment fine (20%*41,684)*	*8,337*
Late payment interest (1.5% x 2 months)	1,251
Total PAYE payable including late payment penalty	***51,272***

ii) December: Soon or later RRA shall initiate their tax investigation / audit notice. This will help to minimize tax accruing penalties significantly. For example, when RRA conducts an audit, there will be understatement fines, which could be much higher, plus monthly interest keeps accumulating at 1.5% non-compounding every month of delay.

If the company does a voluntary declaration, below will be the computation of fines and penalties.

December PAYE	**FRW '000**
Principal PAYE payable:	
Gross pay	142,000
Add: Benefit in kind taxable	4,200
Add: 13th check once off payment	142,000
Total Taxable income	*288,200*

PAYE Payable;	
(0-30,000), 0%	-
(30,001-100,000), 20%	14
(100,000 and above), 30%	86,430
Total PAYE	*86,444*
Calculation of Fines & Penalties;	
Days defaulted;	
From	16-Jan-2023
To	19-Jan-2023
Days defaulted	***3***
Administration fine (< 30 days)	20%
*Late payment fine (20%*86,444)*	*17,289*
Late payment interest (1.5% per month x 1 month)	1,297
Fixed fines	300
Total PAYE payable including late payment penalty	***105,330***

QUESTION FIVE

Marking Guide

		Maximum marks
A	05 marks for 5 well explained points	5.0
	Sub-total for these sections	*5.0*
B (i)	03 marks for a clear distinction between the 2 concepts and linking 'doing business in Rwanda' with permanent establishment	3.0
(ii)	04 marks for 4 well explained points explaining a controlled transaction	4.0
	Sun-total for this section	*7.0*
C (i)	02 marks for clear explanation of the part constituting a permanent establishment	2.0
	02 marks for clear explanation of the part not constituting a permanent establishment	2.0
	01 mark for bringing out the concept of double taxation treaty and double taxation relief provision	1.0
(ii)	03 marks for a comprehensive explanation with evidence linking to the law, how the scenario provided does not constitute a permanent establishment.	3.0
	Sun-total for this section	*8.0*
	Total Marks for Question Three	***20.0***

Model Answers

a) Advantages of double taxation agreements:

- Double taxation agreements create more certainty in fiscal policies of concerned countries which eventually encourages investments and inter-trade between the countries.
- Double taxation agreements enhance the co-operation between tax authorities of contracting countries, which comes with a lot of mutually benefiting strategies.
- They help to curb the problems of unfair and discriminatory taxation of certain foreigners who are working in another country, which in the end encourages more exchange of skills.
- Double tax agreements help countries easily prevent international tax evasion and unjustified avoidance of obvious taxes payable in-home countries.
- Double taxation agreements promote Foreign Direct Investments (FDI) in contracting countries, for instance investors from Angola shall not hesitate to invest in Rwanda since they are assured there won't be any unfair or double taxation of their income.

b)

i. Doing business in Rwanda essentially refers to having permanent establishment in Rwanda, in this case income derived from taxable activities in Rwanda is taxable. Doing business with Rwanda on the other hand does not necessitate presence in Rwanda, hence no obligation to pay tax from resulting income from 'doing business with Rwanda'.

ii. **Controlled transaction:** A transaction can be considered to be a controlled transaction when;

- One of the parties to the parties to the transaction has physical presence in Rwanda and taxable in Rwanda while the other party to the transaction is outside Rwanda and not taxable in Rwanda.
- A resident company in Rwanda transacts with a non-resident related party, as long as the transaction relates to a permanent establishment of the Rwanda based entity.
- A Rwandan tax resident entity / person engages in a business transaction with another person in a country whose tax administration grants preferential tax treatment, whether the transacting entities are related or not.
- A non-resident person, residing in a country where tax administration does provide beneficial tax regime, does business with a non-resident in Rwanda that results in a permanent establishment, whether such persons are related or not.

c)

i.

- Manufacture of plastic pipes is done outside Rwanda and corresponding money paid to the Rwandan firm, this does not fulfil the requirements of permanent establishment, and hence Metis is not tax liable in Rwanda for the $100 Million.
- The Rwanda office manage land preparation, pipes installation constitutes a permanent establishment. So, the income generated from Rwanda in this regard is taxable per Rwanda tax laws and Metis's subsidiary is expected to account for all corresponding taxes in Rwanda as a permanent establishment.
- However, if there was a double taxation agreement between Rwanda and Greece, Metis would seek appropriate tax reliefs the manufacture and installation works done both at home country and in Rwanda.

ii. Per article 6 of the Rwanda income tax law, Charles Obi does not meet the requirements of qualifying to be a permanent establishment; no physical place of work, branch, factory / workshop, site for construction… as specified in the law.

Also, he is serving Ugandan clients, a non-resident living in Rwanda, generating income from a non-resident entity is not liable for tax in Rwanda.

END OF MARKING GUIDE AND MODEL ANSWERS