INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS OF RWANDA

Driving Sustainable Performance

Associate of IFAC

CERTIFIED PUBLIC ACCOUNTANT

ADVANCED LEVEL 1 EXAMINATIONS

A2.3: ADVANCED TAXATION

MONDAY: 1 DECEMBER 2014

INSTRUCTIONS:

1. **Time Allowed: 3 hours 45 minutes** (15 minutes reading and 3 hours 30 minutes writing).
2. This examination has two sections; A & B.
3. Section A has one Compulsory Question while section B has four optional questions to choose any three.
4. In summary attempt three questions.
5. Marks allocated to each question are shown at the end of the question.
6. Show all your workings

TAX RATES AND ALLOWANCES:

The following rates of tax and allowances are to be used when answering the questions

Personal Income Tax Rates

Monthly Taxable Income		**Tax Rate**
From	**To**	
0	Rwf30,000	0%
30,001	Rwf100,000	20%
100,001	and above	30%

Individual's housing benefit: 20% of the employment income excluding benefits in kind

Individual's Car benefit: 10% of the employment income excluding benefits in Kind

National Social Security Contribution

Employer's contribution	3%
Employee's contribution	5%

Corporate Income Tax Rate 30%

Capital gains tax

Net aggregate gains are taxable at the company rate of tax

Value Added Tax Rate 18%

Annual tax depreciation allowances

Depreciable assets	**Rate**
Land, fine arts, antiquities, jewellery and any other assets that are not subject to wear and tear or obsolescence.	0%
The cost of acquisition or construction and the cost of refining, rehabilitation, reconstruction of buildings, equipment and heavy machinery fixed in walls	5%
The cost of acquisition or development and the cost of improvement, rehabilitation, and re-construction of intangible assets including goodwill that is purchased from a third party	10%
Computers and accessories, information and communication systems, software products and data equipment	50%
All other assets (the tax depreciation is granted on reducing balance basis).	25%
Investment Allowance	**Rate**
Investment within Kigali	40%
Investment within priority sectors, or registered business located outside Kigali.	50%

SECTION A

This section has one compulsory question to be attempted.

QUESTION ONE

Taxation is essential for sustainable development; it supports the basic function of a sustainable state and sets the context for economic growth. It is also essential for responsive government. Yet Rwanda foregoes a significant (and unknown) amount of tax each year amounting to what are in effect hidden expenditures. Rwanda is the most generous of the EAC countries in providing tax incentives for FDI and domestic investment, foregoing about a quarter of its potential revenue each year in tax incentives from businesses alone, 14 per cent of its potential budget. The revenue foregone would be sufficient to more than double spending on health or nearly double that on education.

Tax exemptions and concessions given to business in Rwanda are seen as an integral element of government policies for developing an economy led by the private sector, part of a package of policy measures to attract local and foreign direct investment, but the amount 'spent' is not considered as part of the budget expenditure. There has been no systematic monitoring and evaluation of the extent to which they are working and the government has not systematically discussed the recommendations of external experts recommending that they be reviewed.

The main purpose of this analysis is to raise the issue of tax incentives and exemptions. Are they too generous for a country like Rwanda that is struggling to raise money to fund its development strategy? Are they targeted at the right groups? Are they achieving the government's objectives for them? Would the money be better spent on other policy priorities like education or health? Why are the amounts foregone not made publically available? Why is there no monitoring and evaluation of their effectiveness and why has there been no cost benefit analysis of tax incentives for attract investment? Should the amount foregone be considered as part of the Government's budget so that it becomes transparent expenditure?

As a member of the East African Community, the government is committed to removing or at least harmonising 'harmful taxes'. The expert review of taxes undertaken for the EAC concluded that there was a need to review all tax exemptions and concessions in member states, to harmonise them and to remove a number. There was a danger, the report warned, of a 'race to the bottom'.

Rwanda has in place a complex system of tax incentives and exemptions and there is evidence of a significant increase in private sector investment following the introduction of the revised tax code in 2005. This has resulted in the creation of new jobs. Exports have increased and there is some evidence of a beginning of export diversification into areas prioritised by the government as well as an increase in revenues from tourism. However, the government remains dependent on ODA for about half its budget.

Exempting a range of essential goods and services from VAT (a regressive tax) benefits everyone and especially the poor. The exemption of agricultural inputs from VAT is also of benefit to a large percentage of the Rwandan population, and by keeping prices lower than they would otherwise be, supports the government's efforts to get farmers to use more agricultural inputs to improve production and reduce poverty. Tax exempt status for registered NGOs and religious organisations is a way for the government to raise support for public funds and social goods that are of benefit to society generally or to specific groups. Often the services provided by these organisations would be provided by government if they were not provided by the NGOs. Nevertheless VAT exemption and zero rating is still tax foregone and there needs to be explicit criteria for determining what goods and services are exempt or zero rated.

The exemption of a proportion of income from taxation so that the poor are exempt from paying tax is also a widespread practice. However, exempting the first 12 million of turnover from taxation for farmers may be considered over-generous. Non-farm small enterprises have to start paying tax when their turnover exceeds 1.4 million Frw and a proportion with incomes below this threshold pay local taxes from which farmers are also exempt. The same arguments for bringing farmers into the tax net applies as for other small businesses, developing a culture of tax compliance and holding government to account for the expenditure of public (tax payers) money.

More controversial are the tax incentives and exemptions given to businesses. These include businesses registered with the RDB as investors. The main beneficiaries are big businesses, many of which are foreign owned although domestically owned businesses can benefit from some of the incentives and exemptions. The largest amount is exemptions on imported goods amounting to 84 per cent of the total while only 0.17 per cent is for employing Rwandans. The latter is generally regarded as a preferable type of incentive as it rewards output. Our analysis of the costs and benefits of providing tax incentives for businesses including attracting FDI and domestic investment is inconclusive, but there is a growing consensus that tax incentives may not work, or to the extent they do they have to be used selectively and for a limited time. The government needs to balance supporting investment by providing a competitive tax environment and ensuring that investors pay an appropriate share of the fiscal revenue. There is a need to protect the tax base against sophisticated tax planning, that is, businesses avoiding taxation by taking advantage of incentives and then moving when they are no longer entitled to them. It should also be noted that once they are introduced, it is difficult to remove tax incentives.

Whether tax incentives and exemptions work or not, there is a need for transparency, public scrutiny and dialogue, equity and bargaining are essential to building a culture of tax compliance. Accountability of government to citizens is essential and taxation encourages citizens to make claims on governments and hold them accountable for public expenditure.

The report recommends that the government:

1. Develops an efficient and effective personal and corporate tax system that is transparent and fair to all;

2. Publishes comprehensive information on all tax exemptions in an annex to the annual budget giving details of the amount of revenue foregone due to tax incentives and exemptions;

3. Put in place mechanisms to monitor and evaluate tax incentives;

4. Carries out a cost-benefit analysis of tax incentives for business

5. Reviews the tax incentives that it offers and the list of goods that are exempt from VAT;

6. Works with the other members of the EAC to harmonize taxes including tax incentives and exemptions.

Required:

a) Explain and support with appropriate examples the following statement

"Whether tax incentives and exemptions work or not, there is a need for transparency, public scrutiny and dialogue, equity and bargaining are essential to building a culture of tax compliance. Accountability of government to citizens is essential and taxation encourages citizens to make claims on governments and hold them accountable for public expenditure". **(12 Marks)**

b) Explain "race to the bottom" and secondly identify major economic issues. **(4 Marks)**

c) What are the major issues related to fiscal policy that is raised in the above case? **(12 Marks)**

d) As a policy maker if you are asked to devise FDI friendly soft tax policy what will you do to help in corporate sector development in developing countries. **(12 Marks)**

(Total 40 Marks)

SECTION B

Attempt any three of the four questions in this section.

QUESTION TWO

You are the Senior Tax Auditor of KAM Associates, a firm of Accountants specialized in tax and accounting services. The following information relates to one of your client Place Ltd for the year ended 30 June 2014:

The reported profit before tax=Frw 126,280,000

This reported profit excludes the profit of Frw 35,560,000 earned by PT Ltd, the subsidiary of Place Ltd operating in DR of Congo.

The above profit of PT Ltd was before deducting corporate tax at a rate of 25%. There is no double taxation agreement between Rwanda and DR of Congo.

The reported profit from Place Ltd included Frw 3,000,000 paid to Property Ltd for assets revaluation an

Place Ltd had paid quarterly prepayments of Frw 10,000,000

25% of Place Ltd's shares are traded on Rwanda Stock exchange.

Required:

Write a draft report to the Tax Manager of KAM Associates clarifying:

a) The tax implications of the above transactions **(12 Marks)**

b) The Corporate tax payable by Place Ltd for the year ended 30 June 2014 **(4 Marks)**

c) Tax considerations to be made before opening a new subsidiary overseas **(4 Marks)**

(Total 20 Marks)

QUESTION THREE

Madam Alice a Certified Public Accountant (CPA) owns a tax advisory business in Kigali, she has been approached by her clients on the following matters:

(i) Man made money Ltd is a business which deals in brokerage services which involves various travels. One of the Director is provided with a house for accommodation and a luxurious car of which he uses company travels and as well as his personal activities. The car maintenance and fuel is fully maintained by the company. The director is given presents by the company whenever he holds events at home like birthday parties, marriages etc for himself and family and the presents are in form of cash and quantities. **(3 Marks)**

(ii) XYZ Ltd is an importing company of whose incomes are 50,000,000 Frw and 49,500,000 Frw and its profits before tax are 13,500,000 Frw and 11,200,000 Frw for the years 2012 and 2013 respectively. The company has been making various donations to various entities (trading and non trading). It had donated 700,000 Frw and 320,000 Frw to Amahoro as a Corporate Social Responsibility. Amahoro is a Non-Governmental Organisation formed for the purposes of reconciliation, healing and create a better community. **(6 Marks)**

(iii) Bailey is a not for profit organization registered in UK. Since January 2014, it started operating in Rwanda through financial support into different sectors. To achieve this, local and international consultants were recruited and they are all paid annual fees of USD 500,000 (Assume a rate of USD/Frw of 705). The fees paid to local consultants are 40 % of the total fees while the remaining part was paid to international consultants. As Bailey does not have a registered office in Rwanda, they don't know the tax implications of the fees paid to local and international consultants. **(5 Marks)**

(iv) ABC company ltd deals in construction business of which it has been making losses since it started with an effort to break even. The management also maintains very accurate records of the performance for the business.

Details for 6 years ending 31 December 2013 are as follows:

Year	Loss "Frw"
2008	300,000,000
2009	230,000,000
2010	80,000,000
2011	75,000,000
2012	18,000,000
2013	8,000,000

Required:

Assume that you are the tax associate to Alice's business, write a memorandum on each of the points for her consideration considering 31st march 2015 as the last date of CIT declaration for the year 2014 where necessary. **(6 Marks)**

(Total 20 Marks)

QUESTION FOUR

Beauty Cosmetics Ltd ('the company') is a Rwandan resident company. As at 1 January 2013, it has a paid up capital of 200 million, its year end is 31 December. The company is listed at the Rwanda Stock Exchange since 2012 and 28% of its shares are traded at the stock market. The company deals in ladies cosmetic products manufactured in Kenya under license from England. The profit and loss account for the year ended 31December 2013 was as follows:

	Note	Frw "000"	Frw "000"
Sales			363,613
Less: Cost of sales			(254,529)
Gross profit			109,084
Add: Other income			
Dividend	1	5	
Interest	2	34	
Rent	3	90	
Insurance recovery	4	53	182
			109,266
Less: Expenses			
Salaries and wages	5	950	
Interest	6	763	
Entertainment	7	661	
Depreciation		609	
Repair and maintenance	8	360	
Bad and doubtful debts	9	1,432	
Advertisement	10	900	
Professional fees	11	57	
Promotion expenses	12	32	
Insurance	13	108	
Foreign exchange loss	14	14	
Donation	15	110	(5,996)
Profit before taxation			**103,270**

Notes:

1) **Dividend**

The company received dividend from an investment in a local company listed in the Rwanda Stock exchange. Withholding tax of 15% has been deducted at source.

2) **Interest**

Frw 4,000 interest on a fixed deposit placed with Bank of Kigali, as security for supply of goods, was remitted to the company. The Frw 30,000 interest balance consists of late payment charges received from customers. VAT and WHT were considered in computation.

3) **Rent**

The company owns a property, a hostels building in Kigali bought for investment purposes. The unadjusted rental for the year ended 31December 2013 is Frw 90,000.

4) **Insurance recovery**

The company received a payment of Frw 17,000 for goods shipped from England which were lost, and a sum of Frw 36,000 for a endowment policy on the director of the company who was dead in a car accident.

5) **Salaries and wages**

Includes a gross remuneration totaling of Frw 240,000 paid to two employees as vacation and severance pay. No statutory dues were charged.

6) **Interest**

Interest charges are as follows:

a) Interest on the borrowing to finance the investment in shares of Frw 3,000 listed company from which a dividend of Frw 5,000 was received during the year.

b) Interest on borrowing for working capital purposes was Frw 696,000

c) Interest on late payment charges for goods received was Frw 64,000

7) **Entertainment**

The entertainment expense includes the following:

a) Frw 50,000 on the company's annual dinner.

b) Frw 180,000 for disbursement of the marketing team's entertainment expenses; and

c) Frw 79,000 for the company's family day held on 15 December 2013 in Gisenyi Beach Hotel .

8) **Repair and maintenance**

The company spent Frw 45,000 to make repair and maintenance of a vehicle under an operating lease agreement. The balance of the expenses relates to renovation of the office and storage building.

9) **Bad and doubtful debts**

The bad and doubtful debts accounts in respect of trading debts are made up of the following movements during the year:

(i) Bad debts written off Frw 177,000 as recommended by the commercial court.

(ii) General bad debts provision Frw 987,000

(iii) Specific debts provision Frw 268,000

10) **Advertisement**

During the year, the company constructed and commissioned several large billboards across the country costing Frw 800,000. The balance of the Frw 100,000 refers to advertising the company's products in foreign newspapers and radio stations.

11) Professional fees

a) Legal fee of Frw 7,000 was incurred for terminating the supply contract with a dealer before the expiry of the contract.

b) Frw 47,000 was incurred on legal action taken to recover trading debts from various dealers.

c) Frw 3,000 was incurred as penalties to draw up the contract for the motor vehicle leasing arrangements.

13) Promotion expenses

The company paid Frw 32,000 to three local celebrities to promote the company's product at several super-markets and shopping complexes in the country during selected festive seasons but a half of the expenses had no supporting documents.

14) Insurance

a) During the year, the company purchased a 12 years endowment policy on the life of the sales manager (who is also the director of the company) and paid a premium of Frw 2,000 for the first year. Under the policy, the company is the beneficiary and would receive Frw 120,000 at the end of 12 years or upon the death of the sales manager, whichever is earlier.

b) The company also purchased another term life policy on the life of the managing director for an annual premium of Frw 3,000.

c) Shipping insurance includes Frw 5,000 paid to a local insurance company for the import of goods from England.

d) The balance of the insurance charges refers to policies on the company's stocks, plant and machinery.

15) Foreign exchange loss

It is composed of the following:

- Unrealized loss on import of trading stocks Frw 3,000
- Realised loss on import of trading stocks Frw 11,000

16) Donation

a) The company contributed Frw 105,000 being expenditure on the provision of library facilities to the science faculty of a private local university. It included books, tapes, discs, and other related materials on cosmetics and the science of beauty.

b) A sum of Frw 5,000 was donated to an approved charitable foundation.

Required:

i) Based on the information given, compute the income tax and withholding tax paid and advise the management of Beauty Cosmetics Ltd on each tax adjustment for the year of assessment 2013.

ii) Explain why the Beauty Cosmetic Ltd a dealer of Kenyan company producing women cosmetic products under license from England is or not a permanent establishment in Rwanda. **(20 Marks)**

QUESTION FIVE

Kamuhanda Ltd is a manufacturing company involved in the production of plastic products (WFP), with its headquarters located in Muhanga District, Southern Province. It has a related company in Kenya (Maya Ltd) and some of the raw materials used to produce the final product by Kamuhanda Ltd are bought from Maya Ltd at a cost of Frw 30 per unit. There has been a disagreement between the Tax Auditors of Rwanda Revenue Authority (RRA) and the Management of Kamuhanda Ltd, that the cost of the raw materials is an arm's length price.

Required:

a) Discuss at least two methods RRA Tax Auditors could use to determine arm's length unit cost of raw materials. **(10 Marks)**

b) Based on your discussions in a) above, propose two alternative costs of raw materials **(N.B: Include any assumption made)** **(10 Marks)**

(Total 20 Marks)

End of question paper