

## **CERTIFIED PUBLIC ACCOUNTANT ADVANCED LEVEL 2 EXAMINATIONS**

### **A2.3: ADVANCED TAXATION**

**MONDAY: 30 NOVEMBER 2015**

#### **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 four 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		
From	To	Tax Rate
0	Frw 30,000	0%
30,001	Frw 100,000	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

Employees contribution	3%
Employer'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 reconstruction 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*

### QUESTION ONE

Muvandimwe Ltd is registered in Rwanda, located in Huye with a branch in Burundi (Bujumbura) and other investments within East Africa. The company processes and manufactures iron sheets, iron bars and other hardware materials. In order to raise more capital to finance its operations, the company sold 20% of its capital to the general public through Rwanda stock exchange. The Accountant has produced the following information for tax purposes for the year ended 31/12/2014.

Particulars	Notes	Frw('000)	Frw('000)
Sales	1		50,000,000
Cost of sales	2		(24,850,000)
<b>Gross profit</b>			<b>25,150,000</b>
<b>Other incomes</b>			
Profit from the branch	3	650,000	
Dividends	4	8,000	
Interest	5	20,000	678,000
<b>Total incomes</b>			<b>25,828,000</b>
<b>Operating expenses</b>			
Salaries and wages	6	6,000,000	
Electricity		8,000,000	
Insurance	7	800,000	
Directors' remunerations	8	650,000	
Depreciation	9	185,000	
Bad debt	10	5,000	
Communication		100,000	
Advertising	11	100,000	
VAT		7,000,000	
Income tax	12	450,000	(23,290,000)
<b>Profit before tax</b>			<b>2,538,000</b>

Additional information:

- The sales figure is VAT inclusive and during the year, the company exported commodities worth USD 3,200,000. The average exchange rate during the year was 1USD = 720Frw.
- Within the cost of sales the opening stock was Frw 100,000,000 while the closing stock was Frw 620,000,000. Both were overvalued by 12%.
- The profit from the branch is net of income tax of 25%.
- 30% of the dividends was received from the local companies the remainder being received from foreign companies and all were net of 20% withholding tax.
- The company made investment in Rwanda government securities. 50% of the interest income was received from securities with a maturity period of less than three years; the remainder is from securities with a maturity period of more than three years.
- The company employs 600 employees. Two hundred (200) are part time employees and the four hundred (400) are permanent employees and receive an annual salary of Frw 800,000 each.
- Only  $\frac{3}{4}$  of the insurance is expired.



8. Included in the directors' remuneration, is Frw 5,000,000 for meeting allowances.
9. The depreciation expense was calculated on the following assets: (the value of the assets at the beginning of the period.)

Assets	Land	Buildings	Plant and machinery	Computers	Motor vehicles	Furniture & fittings
Cost	450,000	800,000,000	1,000,000,000	250,000,000	640,000,000	50,000,000
WDV	450,000,000	680,000,000	850,000,000	95,000,000	480,000,000	38,000,000

During the year 2014, the company constructed another factory in Karongi and incurred the following costs:

Assets	Frw
Land	200,000,000
Factory building	570,000,000
Plant and machinery	780,000,000
Computers and accessories	85,000,000
Motor vehicle three heavy trucks and one small car for the manger. The cost of the small car is Frw 6,000,000,	320,000,000
Furniture and fittings	28,000,000

- 10 A debtor owing Frw 1,680,000 was declared bankrupt by the court, the remainder of the bad debt is a provision that was made at the end of the year after failing to trace the customers.
- 11 Included in the advertising expenses, is Frw 5,000,000 for construction of a sign post at the main road.
- 12 The income tax relates to the unpaid tax of the previous year
- 13 During the year a debtor owing Frw 10,000,000 previously written off was recovered.
- 14 December salaries amounting to Frw 20,000,000 were accrued.

#### REQUIRED:

- a) The taxable income for the year ended 31/12/2014 (35 Marks)
  - b) Tax liability and tax payable (5 Marks)
- (Total 40 Marks)**

### SECTION B

**This section has four questions to attempt any three**

#### QUESTION TWO

Rwanda's economy is facing a dilemma of mobilizing resources in the coming years as funding options continue to dwindle. Donor aid uncertainty and insufficient domestic revenue against the backdrop of depreciating local currency, lower global growth and depressed commodity prices for its major exports including minerals, and agricultural produce means that the government must adjust its spending plans to available resources, a move which might see it reduce spending. There is a risk that if government cuts its expenditure it might undermine its growth prospects.

The country is in “stormy weather”. The Government still has room for improvement in prioritization of its expenditure; there is no luxury of increasing Government expenditure as has been done in the past 15 years.

Rwanda’s economic growth over the past decade was largely fuelled by increased public expenditure estimated at approximately 18-20% every year, Beginning this year public spending is expected to remain constant. Rwanda’s total budget for fiscal year 2015/16 is projected at \$2.4 billion, reflecting an increase of \$8.26 million, compared with the 2014/15 revised budget of \$2.46 billion. Donor funding is expected to decline to 5.7 per cent of the gross domestic product (GDP) in 2015/2016 from 7.3% of GDP in 2014/15 as development partners opt to channel funds directly to specific projects and to non-governmental organizations.

According to the IMF’s latest economic outlook for sub-Saharan Africa released in October 2015, growth in the region has weakened markedly, and is now expected at 3.4 % this year and 4.4% in 2016, from 5% in 2014. Any measures taken to absorb the shocks could have an effect on demand. Any reduction in GDP is likely to have an effect on consumption but it is a short term measure.

Rwanda’s economic growth is expected to fall to 6.5% 2015 from 6.9% registered last year, according to IMF figures largely driven by a less favorable external environment including a sharp decline in the prices of their main commodity exports.

Statistics from the National Bank of Rwanda show that in the first half of 2015, the country’s exports decreased by 6.2 % in value to \$275.28 million from \$293.61 million in the first half of 2014 as a result of poor performance in the mining sector, the value of whose exports dropped by 31.3 % mainly due to falling international prices. Government cannot absorb all the shocks without increasing domestic funding, especially increasing domestic fiscal revenue.

## **REQUIRED:**

Assume you are a Senior Tax Manager of an Auditing and Accounting firm in Rwanda and you have been approached by the Minister of Finance and Economic Planning to advise on how government can increase domestic financing ratio to GDP. Write a report to the Minister of Finance and Economic Planning showing how domestic tax collection can be improved as a source of domestic financing. In the report, highlight the challenges that tax administration may face in tax collection. **(Total 20 Marks)**

## **QUESTION THREE**

Samson Mende is an American national working with American Research Holdings Inc. (ARH). ARH primary objective is to conduct research on causes of conflicts in African countries. ARH is not a tax resident in Rwanda and does not want to create or trigger any Permanent Establishment (PE) in Rwanda in the near future. ARH has signed a contract for two years with the Government of Rwanda to conduct a research on what caused Genocide in Rwanda in 1994. ARH is planning to send Samson Mende to Rwanda to conduct this research. Samson plans to recruit a local researcher from the University of Rwanda (UR) who will be assisting him in interpreting data from Kinyarwanda to English. The local researcher is on UR payroll and earns Frw 1,800,000 as gross pay per month.

Samson Mende will remain on AHR's payroll and his salary will be paid in California, his home town. He will get remunerated as follows:

- Basic annual salary USD 18,000
- Monthly transport allowance USD 200

The company will pay his return air ticket of USD 1,000 so that he can come and commence work. In addition, he will be paid a return ticket of USD 1,000 per annum to enable him visit his family in California. ARH will be pay a hardship allowance of USD150 per month because America considers Rwanda a risky country to work in.

He will be given domestic travel allowance of USD 100 per month to enable him travel to all districts of Rwanda to collect data. This money will cover travel and accommodation and food out of Kigali. He will account for this money by producing receipts of expenditure.

In addition, ARH will rent a house in Kigali worth USD 1,000 per month. This will be paid to the land lord's bank account held in the bank of Kigali. Samson will get a bonus of USD 3,000 each year and will be paid in December each year. Samson will be paid education allowance of USD 4,000 per annum for his children who are studying at Harvard University. He will be paid medical allowance of USD 1,000 per annum and this will be paid to the Rwanda Insurance Company-Radiant Insurance Company.

He will be paid other monthly allowances in Rwanda totalling to Frw 700,000. In addition, he will be provided with a security guard from KK Security and a cook and these will be paid USD 200 per month each. His research assistant from UR will be paid by ARH in Rwandan Francs. He will be paid Frw 1,200, 000 per month. Apply exchange rate of 1USD=Frw 750

**REQUIRED:**

- a) What is a Permanent Establishment (PE) in accordance with the tax laws of Rwanda? **(2 Marks)**
- b) Discuss two ways in which income tax for Samson Mende can be accounted for in Rwanda without creating a PE for ARH Limited **(8 Marks)**
- c) Compute monthly PAYE and RSSB Contribution for Samson. **(6 Marks)**
- d) Compute PAYE for the UR researcher on earnings from ARH Limited **(4 Marks)**

**(Total 20 Marks)**



## QUESTION FOUR

Rwanda Revenue Authority (RRA) has been focusing on increasing collections either from customs duties or domestic taxes. Specifically, efforts have been put on arrears recovery and fighting transfer pricing effects.

Whereas this campaign has had a significant impact on the overall RRA's collections and Rwandese economy in general, this has not been without challenges.

### REQUIRED:

Assume you have been hired as consultant by RRA, prepare a Memo to the Department in charge of tax investigation and revenue recovery which addresses the following:

- Four challenges that RRA officers encounters in tax investigation and arrears recovery; **(4 Marks)**
- Ethical behavior RRA officers should have to overcome the above mentioned challenges. **(4 Marks)**
- Challenges associated with transfer pricing and how they can be mitigated. **(12 Marks)**

**(Total 20 Marks)**

## QUESTION FIVE

The Coffeehouse Association (the association) is made up of members who are operators of coffeehouses in Karongi District. The association was formed in 1971 to safeguard and promote the business of its members. For the year ended 31 December 2014, the association prepared the following accounts:

Particulars	Frw('000)	Frw('000)
<b>Income</b>		
Memberships' subscription		118,300
Seminar fees		59,150
Kinyarwanda dance		35,000
Dividend (Net)		8,000
Fixed deposit interest (Net)		<u>1,400</u>
<b>Total income</b>		<b>221,850</b>
<b>Less: Expenses</b>		
Salary and wages	60,480	
Rental of seminar hall	5,000	
Kinyarwanda dance expenses	14,700	
Speaker fees	10,080	
Employee's Provident Fund	7,862	
Stationery	6,048	
Utility expenses	5,040	
Painting of premises	2,590	
Donation and contributions	2,016	
Assessment	1,210	
Quit rent	403	<u>(115,429)</u>
<b>Surplus</b>		<b>106,421</b>

**Additional information:**

1. The association is entitled to capital allowance on its common assets amounting to Frw 1,200,000 for the year of assessment 2014.
2. During the year, the association donated Frw 975,000 to an approved institution
3. Dividend is received from a local listed company and is net of 15% withholding tax.
4. The fixed deposit interest is derived from deposits with a local bank.
5. The quarterly prepayments paid equal to Frw 46,500,000 up December 2014.
6. Seminars were conducted by the association to update members on the current issues in the coffeehouse business. Prominent business leaders were invited to speak at these seminars.
7. The Kinyarwanda Dance was a cultural affair designed to collect funds for the association's activities.

**REQUIRED:**

- a) Income tax payable by the Coffeehouse Association for the year of 2014 and the income tax paid for the previous year. (15 Marks)
  - b) Discuss the tax treatment of thin capitalization in accordance with law no 16/2005 on direct tax on income as amended and complemented to date. (5 Marks)
- (Total 20 Marks)

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**End of question paper**