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**CERTIFIED PUBLIC ACCOUNTANT**

**ADVANCED LEVEL 2 EXAMINATIONS**

**A2.3: ADVANCED TAXATION**

**MONDAY: 3 DECEMBER 2018**

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**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.

## SECTION A (COMPULSORY)

### QUESTION ONE

Subirwa Rwanda Limited (SRL), a private resident company, is a manufacturer and distributor of fast moving consumer goods based in the Kigali Special Economic Zone. Their products include bar soap, detergent powder, bath soap, petroleum skin jelly, hair products and skin lotions.

The company serves consumers in Rwanda, Burundi, Democratic Republic of Congo, Uganda, Tanzania and Kenya.

SRL is a subsidiary of Subirwa Kenya Limited (SKL) which holds 100% shares in SRL and is a registered investor. SKL is located in Mombasa, Kenya

SRL's statement of profit or loss and other comprehensive income for the year ended 31 December, 2017 is as follows:

Particulars	Note	RWF '000'	RWF '000'
Revenue	1		19,350,000
Cost of sales	2		(7,820,000)
Gross profit			11,530,000
Less:			
Selling and distribution expenses	3	1,200,000	
Marketing expenses	4	1,030,500	
Administrative expenses	5	2,740,900	
Finance costs	6	1,000,000	(5,971,400)
Profit before tax			<u>5,558,600</u>

1. The revenue is comprised of the following amounts:

	Note	RWF '000'
Domestic sales		14,560,000
Export sales	(i)	3,220,170
Profit on disposal of assets		369,830
Interest earned on bank account		<u>1,200,000</u>
		<u>19,350,000</u>

(i) Tax of US\$ 10 million was paid on the profit made from the sales in Uganda and KShs 60,000 on the profit on sales made in Kenya, through the branch offices. The sales are included in the export sales in the revenue. Tax credit certificates from the revenue authorities of both countries have been obtained. The corporate tax rate in both countries is 30%.

The exchange rate of the Rwanda Francs to the Uganda shillings and Kenya shillings was 4 and 0.12 respectively.

2. Cost of sales are comprised of the following amounts:

	Note	RWF '000'
Raw materials and consumables		2,865,300
Depreciation of plant and machinery		1,256,790
Technical fees to SKL	(ii)	1,000,000
Direct salaries and wages		1,350,000
Electricity and water costs		521,400
Destruction of expired raw materials	(iii)	<u>826,510</u>
		<u>7,820,000</u>

- (i) The fees were paid to SKL, the parent company for work done by the engineers who came to Rwanda for three months to ensure that the necessary standards of the products were maintained.
- (ii) The amount included the cost of the materials written off of RWF 590 million and RWF 230,510,000 was a payment made to a waste disposal company to destroy the materials. RWF 6 million was paid to Rwanda Environment Management Authority (REMA) as a fine for allowing waste material flow into the local river before the material was destroyed.

3. Selling and distribution expenses include the following:

	Note	RWF'000'
Transport costs		542,600
Bad debts written off	(iv)	380,000
Commissions to sales staff	(v)	52,000
Packaging costs		<u>225,400</u>
		<u>1,200,000</u>

- (iv) Included in the bad debts written off is an amount of RWF 80 million that was owed to Magana Limited, a company that has since been liquidated. RWF 300 million relates to a provision for doubtful debt due to a fire that broke out at the warehouse of Sabula Ltd, one of the company's biggest distributors, three months ago. No formal process has been entered into with the company on whether there will be any recovery. The warehouse was not insured.

- (v) The commissions paid to the sales staff were not included in their employment income.

4. Marketing expenses include the following:

	Note	RWF'000'
Advertising	(vi)	60,000
Donations	(vii)	35,000
Entertainment costs (both staff and clients)		56,900
Branding costs		500,600
Sponsorship	(viii)	<u>378,000</u>
		<u>1,030,500</u>

- (vi) Included in advertising expenses is RWF 10 million that was used to put up advertising billboards in Kigali city.
- (vii) Donations of RWF 5 million was donated to a community school run by Huye Development Association a registered charitable organization, while RWF 30 million was made to Lumbuye Limited, a distributor of SRL in Burundi. Lumbuye Limited had requested for the donation in order to build a church in Burundi.
- (viii) Sponsorship includes an amount of RWF 35 million that was given to a local political party and the remaining amount is for sponsoring a local football club.

5. Administrative expenses include the following:

	Note	RWF'000'
Salaries and wages		1,250,000
Depreciation of equipment		432,000
Telephone expenses	(ix)	45,000
Professional fees	(x)	500,000
Amortization of intangible asset		335,600
General office expenses		28,280
Repairs and maintenance	(xi)	<u>150,000</u>
		<u>2,740,900</u>

- (ix) All the telephone expenses are for business and there is sufficient support for the expense.
- (x) The professional fees were paid to Perfect Body Limited a company based in South Africa. The company provided services related to market research on the consumption of the products. The research was conducted in Uganda and Kenya for a period of two months but the payment was made to South Africa.
- (xi) Included in repairs was an amount of RWF 50 million which was used to completely overhaul a machine and its function was renewed.

7. Finance costs

	Note	RWF '000'
Interest expense	(xii)	840,000
Foreign exchange loss		<u>160,000</u>
		<u>1,000,000</u>

- (xii) Interest was paid on the loan that was given to the company by SKL. SRL received a loan of RWF 8,400,000,000 in 2016 at an interest rate of 10% per annum. The loan was to assist the company construct a new factory and to expand business into the East African region. SRL is expected to repay the loan after five years although the interest is payable at the end of each year. The total share capital of SRL comprises of 2,000,000 shares of RWF 500 each.

8. Information relating to property, plant and machinery of the company:

The factory building was bought at RWF 2,200,000,000 and was first used with effect from 1 January, 2014. The value of the land was estimated to be RWF 200 million at the time.

The written down values of the assets as at 1 January, 2017 were:

	RWF '000'
Computers and accessories, information and communication systems, software products and data equipment	162,500
Other business assets	10,881,250

The following assets were purchased during the year:

	RWF '000'
Machinery ( not fixed to the walls)	5,102,000
20 computers	82,000
10 Distribution trucks each at RWF 60,000,000	600,000

The old manufacturing machinery which was replaced during the year was sold as scrap for RWF 150 million. The machinery had cost RWF 1,800,000,000 when first used on 1 January, 2014. None of the machinery was fixed to the walls and they were all treated as light machines.

9. The company's tax payable for the year 2016 was RWF 320 million. The quarterly tax declaration and payment for the year 2017 were made to the revenue authority in time but the final declaration was made on 1 May, 2018, on which date the tax was also paid. SRL had not requested for extension of time to file the declaration. SRL had been notified by the Commissioner General to be a large taxpayer and this is the first time they have not made the declaration in the time required.

Note: You are required to use the law on income taxes applicable for the year of income.

**REQUIRED:**

- (a) Advise SRL on the taxable income and the corporate tax payable for the year ended 31 December, 2017. **(28 Marks)**
- (b) Advise the company on any fines or penalties due, if any. **(2 Marks)**
- (c) Comment on the tax treatment of the following items and compute the taxes payable, if any.
- (i) Technical fees paid to SKL – the parent company resident in Kenya. **(3 Marks)**
- (ii) Professional fees paid to Perfect Body Limited a company resident in South Africa. **(3 Marks)**
- (d) SKL is considering restructuring their investment and is considering leaving the Rwanda market to concentrate on opening a new market in South Sudan. SKL has approached two companies, Soapings Limited based in South Africa and Giggings Limited, based in Dubai, with a proposal to sell them their entire shareholding in SRL and the current loan at a cost of USD 15 million. This transaction will be concluded by the end of January 2019 but all the negotiations will be

done in Kenya. SKL has engaged the services of an accountant who has estimated the value of the SRL at RWF 800 per share. The exchange rate of the RWF to the USD in January 2019 is expected to be 860.

**REQUIRED:**

Advise the management of SRL on whether the transaction will have any tax consequences for their operations in Rwanda.

**(4 Marks)**  
**(Total 40 Marks)**

## SECTION B (CHOOSE ANY THREE QUESTIONS)

### QUESTION TWO

Safi Bakery Limited (SBL) bakes bread and cakes that are supplied to major supermarkets around Huye town. They have also expanded their business to engage in events management where they provide chairs, tables and tents for various ceremonies. They are duly registered for all taxes and have been compliant in terms of tax declaration and payment. During the period February to April, 2018 they purchased and sold the following items:

	February	March	April
Items purchased:	RWF '000'	RWF '000'	RWF '000'
Cooking oil	24,500	13,500	1,850
Salt	11,500	2,400	750
Baking flour	12,800	11,521	18,000
Packaging materials	36,450	12,670	20,500
Tyres for delivery van	1,200	-	-
Salary and wages	25,500	25,500	25,500
Repair of chairs, tables and tents	1,250	200	680
Maintenance of baking machinery	1,500	245	
Paintings	16,780	-	-
Wheat flour	20,500	28,800	30,000
Firewood	20,500	18,400	19,500
Fresh milk	6,500	12,430	8,500
Total	<u>178,980</u>	<u>125,666</u>	<u>125,280</u>
Items sold:			
Bread	22,500	18,350	25,250
Cakes	20,500	16,780	26,780
Supply of chairs, tables and tents	<u>26,500</u>	<u>18,150</u>	<u>19,650</u>
Total	<u>69,500</u>	<u>53,280</u>	<u>71,680</u>

Notes:

- Purchases and sales are all VAT exclusive.
- Included within the February sales were cakes worth RWF 50,000 that Safi took for home consumption with her family.
- Baking powder worth RWF 1,250,000 expired and was therefore destroyed in the month of April, 2018.
- The electronic billing machine was faulty in the month of March 2018 and took three days to repair. Therefore sales with respect to bread worth RWF 1,200,000 were not included in the summary above.

**REQUIRED:**

- (a) Advise SBL on the VAT payable or claimable for the period February to April, 2018.  
(12 Marks)
- (b) From your answer above, advise SBL its rights from the Rwanda Revenue Authority.  
(4 Marks)
- (c) During the month of March, 2018 SBL's electronic billing machine broke down. The management of SBL is seeking guidance on the best way this problem would have been handled.

**REQUIRED:**

Advise SBL on the ethical ways she could have handled the above problem.

(4 Marks)  
(Total 20 Marks)

**QUESTION THREE**

Dr. Ganza is a medical doctor who is employed in two organizations namely, Lifelink Hospital-Kigali and Kigali School of Nursing. At Lifelink Hospital, he works as a senior specialist while at Kigali school of nursing, he works as a lecturer. A summary of his allowances and benefits for the year ended 31 December, 2017 are as follows:

Employment at Lifelink Hospital-Kigali.

1. Works from Monday to Friday, 8:00 am to 5:00 pm.
2. Basic salary RWF 26,500,000 per annum.
3. Is entitled to 2.5 days of leave per month worked or a payment in lieu of leave that accrues at rate of RWF 800,000 per month. He took leave only in December 2017.
4. Was availed a company car for both official and private use. The car (a Toyota Prado) was purchased for RWF 80,500,000 on 1 January, 2017. The company gives him fuel valued at RWF 2,500,000 per year.
5. Received RWF 10,000,000 to cater for half of the school fees for his two children.
6. Is provided with meals while on duty. Annually, the hospital spends RWF 850,000 on his meals.
7. Is given housing allowance RWF 8,510,000 annually.
8. Is entitled to travelling allowance RWF 6,500,000 per annum. However, he did not travel during the year.
9. Over time allowance earned throughout the year was RWF 8,000,000.
10. Education allowance to help him purchase educational materials for career growth RWF 800,000 per year.

Employment at Kigali school of nursing.

1. Lectures over the weekends i.e. Saturday and Sunday from 9:00am to 12:00 noon.
2. Basic pay RWF 3,000,000 per weekend.
3. Examination invigilation allowances RWF 1,500,000 per year.
4. Transport refund RWF 1,050,000 for invigilation of examinations.
5. Moderation of examinations RWF 500,000 per year.



**REQUIRED:**

- (a) Advise Dr. Ganza on his employment income and tax payable for the year ended 31 December, 2017.  
**(12 Marks)**
- (b) Explain to Dr. Ganza why some allowances and benefits were not included in ascertaining tax under employment income.  
**(4 Marks)**
- (c) Explain any **four** differences between contract of service (employee) and contract for service (consultant).  
**(4 Marks)**

**(Total 20 Marks)**

## QUESTION FOUR

- (a) Smuggling goods into Rwanda from the neighboring countries has significantly increased despite intensive efforts to curb the vice. Several researchers have observed that many tones of minerals are smuggled into Rwanda, all of which are suspected to have been smuggled through the Congolese border.

### REQUIRED:

Explain any **four** problems associated with smuggling to the economy. **(8 Marks)**

- (b) Mr. Mukajanga, a businessman dealing in the sale of building materials in Uganda and Kenya intends to expand his business into Rwanda. However, he was advised that for him to successfully operate his business, he has to register his business with the office of the Registrar General and get a trading license. He intends to import and sale building material within Rwanda. He has further been told that the building materials will have to go through levels of verification before they can be cleared.

Mr. Mukajanga intends to import floor tiles from India, with the following details:

- Cost price \$ 312,500 as per the commercial invoices.
- The floor tiles weigh 16 tonnes
- Port handling and clearing charges at Mombasa \$ 1,000.
- Marine insurance on board the ship \$ 2,000.
- Transport from Mombasa to Katuna boarder RWF 925,000.
- Transport from Katuna boarder to Gasabo RWF 362,500.
- Exchange rate \$1: RWF 870.

### REQUIRED:

Advise Mr. Mukajanga on the:

- (i) Customs declaration and clearance process that his products will undergo before they are cleared for sale on the local market. **(5 Marks)**
- (ii) Taxes payable in case he imports the floor tiles from India to Rwanda. **(7 Marks)**

**(Total 20 Marks)**

## QUESTION FIVE

Mr. Smith Brown is a resident of the United Kingdom (UK). He visited Rwanda for one month in January 2018 to track mountain Gorillas in Volcanoes National Park. Mr. Smith fell in love with the country and after meeting with an official of the Rwanda Development Board, he made a decision to invest in the country. On 30 January, 2018 he decided to invest in Tourist Lodges Limited (TLL), a private company which has greatly invested in tourism and operates hotels in various parts of the country. He bought 1,000,000 shares at RWF 1,000 each before leaving the country.

He had earlier on 20 January, 2018 bought a three storied commercial building in Gisenyi from Mr. Bizimungu, a Rwandan citizen who normally lives in the UK. He paid USD 300,000 for the building which had been vacant and dilapidated about 2 years. He then engaged a property company in Rwanda to renovate the building for USD 100,000 and it was ready for occupation by 31 March, 2018. He obtained tenants for the fifteen shop units from 1 April, 2018. Each tenant agreed to pay RWF 300,000 per month. He opened a savings account in a local commercial bank in Gisenyi where the tenants will be required to deposit the rent at the beginning of each month. The savings account will attract interest at a rate of 12% per annum, posted on a quarterly basis. He will not withdraw any money from this account until after three years. The bank credits interest to personal accounts quarterly.

Expected gross interest by end of June, September and December 2018 is as below:

	RWF '000'
June	405
September	810
December	1,050

On 30 September, 2018 TLL paid dividends of RWF 100 per share but the company indicated that they may not pay dividends for the next two years since the company will be constructing another hotel in Akagera National park. This decision made Mr. Smith reconsider his investment in TLL. He had realised that there are many individuals in the United Kingdom that are interested in investing in Rwanda. He sold 500,000 of his shares to Mr. John Jones, a resident of the UK for RWF 750,000,000 on 30 October, 2018.

Mr. Smith's year ends on 31 December every year and the exchange rate of the USD to the RWF should be taken as 860.

### REQUIRED:

- Advise Mr. Smith on the tax implications of the above transactions.  
(10 Marks)
  - Compute Mr. Smith's taxes payable on the above transactions, if any, and when the taxes will be payable.  
(10 Marks)
- (Total 20 Marks)**