CERTIFIED PUBLIC ACCOUNTANT

FOUNDATION LEVEL 2 EXAMINATIONS

F2.4: TAXATION

DATE: MONDAY, 25 JULY 2022

MARKING GUIDES AND MODEL ANSWERS

QUESTION ONE

Marking Guide

Question	Description	Marks	Total Marks
a	Comment on Inputs tax	1.5	
	Comment on Exports	0.5	
	Comment on a credit note	2	
	Comment on purchase of passenger vehicle	1	
	Comment on the liability to report an output	1.5	
	Comment on entertainment	1.5	
	Comment on residential rent	1	
	Comment on hotel bills	1	
	Total		**10**
b	Input disallowed (out of date purchase Invoices)	0.5	
	Advance receipts/payments	1	
	Repairs to a company passenger vehicle	0.5	
	Denied input tax (Gym Equipment)	0.5	
	Credit note included in outputs	0.5	
	Credit note should be in inputs	1	
	Residential rent	1	
	Total		**5**
c	0.5 Marks each criterion for a supply of goods or services occurs	2	
	1 Mark on each circumstance or rules of determining taxation period	3	
	Total		**5**
	Total Marks		**20**

Model Answer

a) Commentary on value added tax (VAT) status:

(i) Inputs can only be claimed within two years of the date of the invoice. The VAT return is for the period ended 31 July 2021 and so the latest invoice that can be claimed in this tax period is July 2019, anything prior to that date is out of time and will be disallowed.
(ii) Exports should be reported as this is required in the VAT return. However, they are zero-rated and so their omission does not have any VAT effect.
(iii) A credit note issued by the company should be an input adjustment and not an output adjustment. It should increase inputs rather than increasing outputs. It is simply supposed to reduce the output VAT and take note that it should be in inputs. Otherwise, in output it has to be negative.
(iv)Purchase of passenger vehicle, costs incurred on spare parts or repair and maintenance services for such a vehicle are a denied/blocked input VAT.
(v) The liability to report an output - which is the tax point, also known as the taxation period - is triggered by the earlier of raising an invoice or the receipt of cash. The receipt should therefore be included in outputs.
(vi) Entertainment is specifically a prohibited (blocked) input and that includes any recreational expenses. The gym equipment is therefore a denied input.
(vii). Residential rent is an exempt supply and should be reported as such but it does not attract VAT.
(viii) All hotel bills incurred for business purposes are claimed for VAT purposes.

b) Restatement of the VAT returns

Details	**FRW**	**FRW**
Excess of output originally reported		500,000
Add:		
Input disallowed (out of date purchase Invoices)	1,700,000	
Advance receipts/payments	1,300,000	
Repairs to a company passenger vehicle	900,000	
Denied input tax (Gym Equipment)	230,000	
		4,630,000
Less:		
Credit note included in outputs	480,000	
Credit note should be in inputs	480,000	
Residential rent	750,000	
		(1,710,000)
Restated excess of outputs over inputs		**2,920,000**

c) Circumstances or rules of determining Taxation periods.

(1) A supply of goods or services occurs

(i) On the earliest of the following:

a. the date on which the invoice is issued;
b. the date on which payment of goods and services, including a partial payment is made. However, this provision does not concern the advance payment made to the constructors who later reimburse it by deducting it from the invoices presented to the client;
c. the date on which goods are either removed from the premises of the supplier or when they are given to the recipient;
d. the date on which the service is delivered.

(2) Where supplies are made on a continuous basis e.g., electricity, water or any other supplies, goods or services measured by meter or any other calibration, the taxation period is the time of the meter reading or any other calibration reads.

(3) In case of a person who deregisters from Value added tax the taxation period occurs immediately before the registration is cancelled.

(4) In case of goods used for personal purpose or used as exempted goods and services, the taxation period occurs on the date on which goods or services are consumed.

QUESTION TWO

Marking Guide

Question	Description	Marks	Total Marks
a.i)	Rents received	0.5	
	Less: insurance paid	0.5	
	Less: rates paid	0.5	
	Less: repairs and maintenance	0.5	
	Less: capital allowances [5% x 72,000,000]	1	
	Total		**3**
a.ii)	Net sales	0.5	
	Net purchases	0.5	
	Less: obsolescence	1	
	Wages	0.5	
	Rent of shop	0.5	
	Purchase of truck		
	Purchase of Passenger Motor car	0.5	
	Purchase of furniture and fittings		
	Personal drawings	0.5	
	Other business expenses	0.5	
	Contribution to personal pension scheme	0.5	
	Children's school fees	0.5	
	Interest on business bank loan	0.5	
	Interest on late payment of VAT	0.5	
	Capital allowance on truck	1	
	Capital allowance passenger motor car	1	
	Capital allowance on furniture	0.5	
	Total		**9**
a.iii)	Chargeable income from rents	0.5	
	Chargeable income from business	0.5	
	Add:		
	Add: Car benefit (10% X (personal expenses)	1	
	Total		**2**
b. i)	Award 0.5 Marks for correct date of PAYE payment	0.5	
	Award 1.5 Marks for detailed fines and penalties	1.5	
	Total		**2**
b. ii)	Award 2 Marks for explained employer's responsibility	2	
	Total		**2**
b. iii)	Award 0.5 Mark for director's fees, dividend and 1 Mark for Interest income treatment	2	
	Total		**2**
	Total Marks		**20**

Model Answer

a) Bob Mugisha

(i) Calculation of chargeable income from rent

Details	FRW	FRW
Rents received		23,200,000
Less: insurance paid	(2,736,200)	
Less: property tax paid	(590,370)	
Less: repairs and maintenance	(2,500,000)	
Less: Capital allowances [5% x 72,000,000]	(3,600,000)	
		(9,426,570)
Chargeable income from rents		**13,773,430**

(ii) Chargeable income from Kigali Creations

Details	Notes	FRW	FRW	FRW
Net sales				63,200,000
Net purchases			37,220,000	
Closing stock		7,400,000		
Less: obsolescence	Note 1	(1,100,000)	(6,300,000)	(30,920,000)
				32,280,000
Expenses				
Wages			4,800,000	
Rent of shop			1,200,000	
Purchase of truck	Note 2		0	
Purchase of Passenger Motor car	Note 2		0	
Purchase of furniture and fittings	Note 2		0	
Personal drawings	Note 3		0	
Other business expenses			820,000	
Contribution to personal pension scheme	Note 3		0	
Children's school fees	Note 3		0	
Interest on business bank loan			5,800,000	
Interest on late payment of VAT	Note 4		0	
Capital allowance on truck	25% x 35,000,000		8,750,000	
Capital allowance passenger motor car	25% x 20,000,000		5,000,000	
Capital allowance on furniture	25% x 3,800,000		950,000	
				(27,320,000)
Chargeable income from business				**4,960,000**

Notes

1. A taxpayer is entitled to reduce his closing stock by the amount of any obsolescent stock. Article 27 of the income tax Act provides that the trading stock is valued at the lower price between the cost price and the market price on the last day of the tax period.
2. Capital expenditure is non-deductible instead is should be granted capital allowances.
3. Personal expenditure is specifically not deductible for tax purposes (Article 26 (6))
4. Interest, fines and penalties are specifically not deductible for tax purposes (Article 26(3))

iii) Calculation of the taxable income

Details	**FRW**
Chargeable income from rents	13,773,430
Chargeable income from business	5,980,000
	19,753,430
Add:	
Add: car benefit (10% X (personal expenses) **Note 1**	444,000
Taxable income	20,197,430

Note 1: Car benefit is determined as 10% to the total remuneration of the taxable person. In this case the total remuneration is the drawings, schools' fees, and contribution to the personal pension schemes. It is the contributions to a state pension scheme e.g. RSSB is not considered as a benefit. That is FRW 2,400,000+FRW 240,000+FRW 1,800,000= FRW 4,440,000

b) Frederick Gasana

(i) When should PAYE be paid and fines for failure to pay PAYE?

- Generally, PAYE must be paid by the 15th following the month the deductions were made. However, Frederick could opt to register for the quarterly scheme if the employer's turnover is less than FRW 200,000,000

- Failure to remit PAYE will attract fines and penalties
- Interest of 1.5% per month the payment is outstanding.
- Administrative fines for non-payment:
- Less than 30 days late- 20% of the liability
- 31- 60 days late 40% and
- More than 60 days late 60%

and

- Fixed administrative penalty FRW 100,000 for individuals

ii) Responsibilities of and employer

An employer making a payment for services rendered by an employee under a contract of employment or service, is required to deduct income tax in the form of Pay As You Earn (PAYE) from such payment and remit it to the Commissioner General at the Rwanda Revenue Authority.

Failure to deduct PAYE renders an employer liable for payment of the amount not deducted plus fines and interest. The employer, however, may recover this amount from the employee as a debt but only the principal tax can be recovered from the employee

(ii) Implication of other income.

- **Directors' fees:** Director's fees are usually taxed at source - by way of withholding tax at the rate of 30% -by the company paying the fees. This is a final tax and therefore there would be no further payment or disclosure expected from Frederick seeing that he received the fees net of taxes.

- **Dividends:** Dividends are taxed at source by way of withholding tax at the rate of 15% or 5% if the shares are listed on to RSE. The withholding tax is a final tax and therefore there are no further compliance obligations expected from Frederick seeing that he receives the dividends net of tax.

- **Interest on fixed term deposits:** The interest earned on fixed term deposits that have a maturity date of more than a year are specifically exempted from withholding tax. Therefore, Frederick will not have any further tax obligations on this income.

QUESTION THREE

Marking Guide

Question	Description	Marks	Total Marks
a	Award 0.5 Marks for each tax applicable on importation of goods	3	
	Total		**3**
b	Import duty	1	
	Consumption tax	2	
	VAT	2	
	WHT	1	
	IDL	1	
	QIF	1	
	AU Levy	1	
	Total		**9**
c	Award 0.5 Marks for each feature of East African Customs Union	4	
	Total		**4**
d	Award 2 Marks for EAC rules of Origin explanation ,2 Marks for correct criteria	4	
	Total		**4**
	Total Marks		**20**

Model Answer

a) Import taxes

Rwanda is a member of the East African Community (EAC) and therefore the country's customs tax regime is governed by the East African Community Customs Management Act ("EACCMA") and the Common External Tariff (CET).

Generally, the taxes applicable on importation of goods are:

a) Import duty ranging from **0% to 25%**;
b) Value added tax (VAT) of **18%**;
c) Consumption tax/Excise duty ranging from **5% to 150%**;
d) Withholding tax (WHT) of **5%**;
e) Infrastructure Development levy (IDL) of **1.5%**;
f) Quality Inspection Fees (QIF) of **0.2%**
g) African Union fees of **0.2%**

b) Computation of import taxes

In computing import taxes, the following order is adopted by the customs department:

- Import duty is levied on the CIF value
- Consumption tax is levied on the CIF value + import duty
- VAT is levied on CIF value + import duty + consumption tax
- WHT is levied on CIF value
- IDL is levied on CIF value
- QIF is levied on CIF value
- AU fess is levied on CIF value

Below is computation of the import taxes applicable on imported goods with CIF value equivalent to FRW 100,000.

I have assumed a 25% import duty and 5% consumption tax is applicable on the imported goods.

Details	**Duty/Tax calculation**	**FRW**
Import duty	(100,000*25%)	25,000
Consumption tax	(100,000+25,000) *5%	6,250
VAT	(100,000+25,000+6,250) *18%	23,625
WHT	(100,000*5%)	5,000
IDL	(100,000*1.5%)	1,500
QIF	(100,000*0.2%)	200
AU Levy	(100,000*0.2%)	200
Total tax on goods imported		**61,775**

c) **The main features of the East African Customs Union include the following:**

According to the EAC Customs Union Protocol and its annexures, Common Customs Law (and regulations) and the Treaty, the main features of the EAC Customs Union are:

(i) A common set of import duty rates applied on goods from third countries (Common External Tariff, CET).

(ii) Duty-free and quota-free movement of tradable goods within the customs territories.

(iii)Common safety measures for regulating the importation of goods from third parties e.g., food standards.

(iv)A common set of customs rules and procedures including documentation.

(v) A common coding and description of tradable goods (Common Tariff Nomenclature, CTN).

(vi)A common valuation method for tradable goods for tax (duty) purposes (Common Valuation system).

(vii) A structure for collective administration of the Customs Union.

(viii) A common trade policy that guides the trading relationships with third countries/trading blocs outside the EAC Customs Union i.e., guidelines for entering into preferential trading arrangements such as Free Trade Area's etc. with third parties.

d) **Explaining the EAC rules of Origin**

- For purposes of the East African Custom's protocol, goods are accepted as eligible for EAC tariff treatment if they originate in the Partner States;
- Goods are considered to originate in the Partner States if they meet the criteria set out in the Rules of Origin. For the purposes of implementing these Rules, the EAC Partner States are considered as one territory.

Origin Criteria

Goods are accepted as originating in a Partner State if the goods are

a. Wholly produced in the Partner State; or
b. produced in the Partner State incorporating materials which have not been wholly obtained there, provided that such materials have undergone sufficient working or processing in the Partner State.

QUESTION FOUR

Marking Guide

Question	Description	Marks	Total Marks
a	Award 2 Marks for each explained role of taxation	10	
	Total		**10**
b.i)	Award 1 Mark for the definition of tax incidence	1	
b.ii)	Award 1 Mark for final effect of tax on each 4 examples	4	
	Total		**5**
c	Award 1 Mark of the definition of taxable capacity and its each determinant	5	
	Total		**5**
	Total Marks		**20**

Model Answer

a) The role of taxation in achieving budgetary objectives

The primary purpose of taxation is to raise revenue to meet huge public expenditure. Most governmental activities must be financed by taxation. But it is not the only goal. In other words, taxation policy has some non-revenue objectives that are aligned to government budgetary objectives. Such objective could include (i) reallocation of resources, (ii) reducing inequalities in income and wealth, (iii) Economic stability (iv) Economic growth (v) reduce regional disparities, etc. Therefore, in a modern world, taxation is used as an instrument of economic policy.

Below is a detailed analyzing of the role of taxation in achieving the above budgetary objectives:

1. Economic development: One of the important objectives of taxation is economic development. Economic development of any country is largely conditioned by the growth of capital formation. It is said that capital formation is key to economic development. To overcome the scarcity of capital, governments mobilize resources so that a rapid capital accumulation takes place. To step up both public and private investment, government rely on tax revenues.

One of the important elements of economic development is the raising of savings- income ratio which can be effectively raised through taxation policy.

2. Full employment: Since the level of employment depends on effective demand, a country desirous of achieving the goal of full employment must cut down the rate of taxes. Consequently, disposable income will rise and, hence, demand for goods and services will rise. Increased demand will stimulate investment leading to a rise in income and employment through the multiplier mechanism.

3. Price Stability: Taxation can be used to ensure price stability—a short run objective of taxation. Taxes are regarded as an effective means of controlling inflation. By raising the rate of direct taxes, private spending can be controlled. Naturally, the pressure on the commodity market is reduced.

But indirect taxes imposed on commodities fuel inflationary tendencies. High commodity prices, on the one hand, discourage consumption and, on the other hand, encourage saving. Opposite effect will occur when taxes are lowered down during deflation.

4. **Control of Cyclical Fluctuations:** Control of cyclical fluctuations—periods of boom and depression—is another objective of taxation. During depression, taxes are lowered down while during boom taxes are increased so that cyclical fluctuations are tamed.

5. **Reduction of Balance of payment difficulties**: Taxes like custom duties are also used to control imports of certain goods with the objective of reducing the intensity of balance of payments difficulties and encouraging domestic production of import substitutes.

6. Non-Revenue Objective: Finally, taxation help in the reduction of inequalities in income and wealth. This can be done by taxing the rich at higher rate than the poor or by introducing a system of progressive taxation.

b) Tax incidence

(i) What is tax incidence

This is the division of tax payment between the buyer and seller used to analyse who between the buyer and seller is really paying the tax.

(ii) Suppose the tax levied on buyers was removed and is now levied on sellers in equal amounts by the government. This change in tax policy means that now the sellers have to pay the tax. But the actual burden of tax is independent of the fact on whom tax is imposed. The elasticity of supply and demand determines the tax burden.

1. The price that buyers have to pay to the sellers after tax is the same in both the cases where a buyer pays the tax and where a seller pays the tax. The increase in price after tax depends on the tax burden shared by the producers and consumers.

2. The out-of-pocket expense of buyers, the amount paid in tax is again determined by the actual burden of tax which remains the same irrespective of whether the buyer pays the tax or sellers pay it.

3. The price received by sellers is the after-tax amount they get, which remains the same in both cases where the buyer pays the tax and the seller pays the tax determined by the tax incidence on buyers and sellers.

4. The quantity of the good sold falls in both the cases where the buyers pay the tax and where the sellers pay the tax by the same amount.

Thus, it can be concluded that the final effect of tax on market price, quantity, the price paid by buyers, and the price received by sellers remains the same regardless of who pays the tax

d) Taxable capacity and Factors that determine the taxable capacity of a country

Taxable capacity: It refers to the maximum tax which might be collected from a taxpayer or a group of taxpayers.

Determinants of Taxable Capacity

The taxable capacity of a country is determined by a number of factors. The main factors are:

1. **Size of income and wealth**: generally, the larger wealth and income of the country, greater is its taxable capacity. Hence rich nations have a higher taxable capacity than poor nations.

2. **Stability and Growth of income:** basically, if the economy operates smoothly and progresses well, and ensures a stable and growing income, the taxable capacity of the community will be higher. But if there are fluctuations with serious ups and downs, and especially during a depression, taxable capacity will obviously be lower.

3. **Standard of living of the people:** the standard of living determines the consumption pattern and habit of the community. A community accustomed to greater needs as satisfaction on account of living, cannot bear great sacrifice in paying taxes, hence its taxable capacity will be less. But if the standard of living is low, there is a greater surplus available for taxation, so that taxable capacity will be high.

4. **Price level:** if the price level is reasonably low and stable, a high income means greater taxable capacity. But, if prices are rising fast, a very high income may also pose a low capacity in real terms.

5. **Characteristics of the tax system:** a multiple tax system has a greater advantage of enlarging the overall taxable capacity than a single tax system.

6. **Nature and purpose public expenditure:** public expenditure is largely for developmental schemes the productivity power of the country is very essential for improving taxable capacity enlarges. Further taxation intended for financing capital formation is therefore quite justified as it raises the taxable capacity in effect.

7. **Political condition:** Generally, when people appreciate the government, they will be willing to undergo many hardships and bear heavier taxes to in order to enable the government to undertake welfare measures beneficial to the common people, hence the taxable potential automatically expands.

QUEST ION FIVE.

Marking Guide

Question	Description	Marks	Total Marks
(a)	Award 1 Mark for each 5 explained type of audit. Award 0.5 Marks for non-explained type of audit.	5	
	Total		5
(b)	Award 2 Marks for statutory audit limitation time limit	2	
	Total		2
(c)	Award 1 Mark for each reason for new audit	3	
	Total		3
(d)	Award 1 Mark for each point for burden of proof lies with the taxpayer	3	
	Award 1 Mark for each point for burden of proof lies with tax Administration	4	
	Total		7
(e)	Award 1.5 Marks for any tax recovery procedures	3	
	Total		3
	Total Marks		**20**

Model Answer

(a) Audit procedures

The RRA could conduct any of the following tax audit

i) **Comprehensive Audit:** This is a regular routine audit conducted by the Rwanda Revenue Authority (RRA) that covers all domestic tax heads. The Tax administration informs the taxpayer in writing, at least seven (7) working days before conducting the audit. It is the most common audit amongst the other audits

ii) **Issue-oriented audit procedure:** The RRA may proceed to an issue-oriented audit when a comprehensive audit is not necessary. For an issue-oriented audit the RRA must inform the taxpayer in writing, at least three (3) working days before the audit is conducted.

iii) **Desk Audit:** Desk audits are regular validations audits conducted by RRA's officers – at their desks, as the name suggests - on any of the following grounds:
a. Turnover of Value Added Tax is not corresponding to the turnover of income tax without justification;
b. Tax declarations are not corresponding to paid taxes;
c. The taxpayer deducted from tax base non-deductible expenses;
d. One or more invoices were not declared;
e. Any other situations where the tax administration has enough documents that can be used to assess taxes**.**

iv) **Contradictory procedure:** This is where the RRA discovers a miscalculation, an omission, an understatement, a misrepresentation of a tax or any other error in the tax declaration or assessment, the RRA sends a draft note for rectification to the taxpayer containing all the elements considered under this procedure.

v) **Audit without notice:** Where there are serious indications of tax evasion, the RRA may conduct an audit without notice. In such a case a notice of assessment or a notification of fine is issued to the taxpayer disregarding any notification requirement.

b) Statutory audit limitation and we it varies

The power for RRA to audit a taxpayer is limited to a period of five (5) years, starting from 1st January following the concerned tax period. However, if it is established that the taxpayer has concealed information with intent to evade tax, the power to audit lapses after ten (10) years, the same time allowed to keep records by the Companies law.

c) Why a new audit may be conducted by Rwanda Revenue Authority

After consideration of the appeal, the Commissioner General may cancel the audit conducted and decide that a new audit be conducted, if there are faults committed by the taxpayer which were not disclosed by the audit and which resulted into reduction of the tax. The new audit is conducted in accordance with the provisions of the Amicable settlement law.

e) Burden of Proof

The burden of proof lies with the taxpayer when:

(i) The RRA conducts a tax assessment without notice;
(ii) The taxpayer starts an appeal procedure to correct an unintentional error in tax declaration;
(iii) The taxpayer wants to disprove the content of an affidavit.

The burden of proof lies with the Tax Administration when:

(i) Rectifying tax declaration of the taxpayer;
(ii) Indicating the method of proof based on signs and indications of prosperity;
(iii) Applying for permission from provincial or City of Kigali Prosecutor to ask questions from a person bound by professional secrecy;
(iv) Applying to the Provincial or City of Kigali Prosecutor for search warrant.

f) Tax recovery

(i) Seizure or Attachment of the Taxpayer's Property

- When tax is not paid within fifteen (15) days as provided by the tax law, the RRA may attach any movable or immovable property of the taxpayer, whether held by the taxpayer or any other person.
- The seized property is sold under a public auction eight (8) days after the taxpayer is notified of the affidavit.
- If the RRA has serious indications that a supplier is selling taxable goods and such goods have previously not been charged with value added tax, the RRA can seize those goods.
- The seizure and selling of the attached goods take place according to the law on civil and commercial procedures. In the field of taxation, the bailiffs of the RRA have the same competence as Private court bailiffs.

(ii) Third Parties Garnishment

- If a tax is not paid within fifteen (15) days as provided for by the tax law, the RRA may require any person who is a debtor of the taxpayer to pay to the RRA the amount due to the taxpayer against the taxpayer's tax liability.

- In case the RRA assumes that a person is a debtor of a taxpayer, it is required to:

i) Send a notification to that person;
ii) Ask the debtor to give a clear explanation of the debt due to the taxpayer;
iii) Inform the debtor that he or she is required to pay to RRA in accordance with the terms and conditions of the contract with the taxpayer or with respect to obligations of the taxpayer;
iv) Send copies of all the letters to the taxpayer he or she sent to the debtor.

- The debtor has the obligation within a period of fifteen (15) days from the time of receipt of the note from the RRA to:

(i) Give written explanations to the RRA of the amount due or;
(ii) Notify the RRA in writing that he or she owed no debt to the taxpayer by the time when the RRA notified him or her;
(iii)Pay the debt which is equivalent to the tax in accordance with the contract with the taxpayer or with respect to obligations to the taxpayer.

- If the debtor does not comply with the conditions mentioned in the law, he or she is assumed as liable to debt of the RRA the amount equal to tax liability. However, on the other hand if the debtor complies with the conditions provided for in the law, he or she is discharged of the debt liability to the taxpayer for the amount paid to the RRA.

QUESTION SIX

Marking Guide

Question	Description	Marks	Total Marks
(a)	Award 2 Marks for each definition clearly showing the difference between tax avoidance and evasion	4	
	Total		**4**
(b)	Award 1 Mark for each scenario. Students must provide adequate explanations for each answer in order for them to earn the full 1 mark	6	
	Total		**6**
(c)	Capital Gains tax 5% of the gain	1	
	Since Quantum is a listed on the RSE, so the WHT reduces from 15% to 5%	1	
	Capital Gains on Shares that are listed at RSE is exempt	1	
	Since the company is listed the dividend is taxed at 5%	1	
	Tax on interest (15%)	1	
	Since the maturity of the fixed deposit is above one year, the Interest is exempt	1	
	Since Maturity is below 3 Years the withholding tax is 15%	1	
	Since it is a long-term Government bond with WHT is 5%	1	
	Royalty income withholding tax rate at 15%	1	
	WHT is 30% of the income since the Local University is considered a second employer	1	
	Total		**10**
	Total Marks		**20**

Model Answer

a)

Tax evasion

Tax evasion means a method of evading tax liability by dishonest means like suppression, conscious violation of rules, inflation of expenses etc. In other words, tax evasion involves use of unfair means to avoid paying taxes. It is illegal. Tax evasion generally begins after the liability of tax has arisen.

Tax avoidance

Tax avoidance means planning for minimization of tax burden according to the provisions of the tax laws and within legal framework, though it defeats the basic intention of legislature. In other words, tax avoidance takes into account various lacunas of law and the taxpayer takes advance of these loopholes. It is not illegal**.** Tax avoidance begins before the actual liability of tax has arisen.

b)

1. It is neither a tax avoidance nor tax evasion. It is the intention of the law to exempt taxpayers from withholding tax interest earned on Fixed Term deposit that are more than one year – in order to encourage savings. So, this action could fall under the purview of tax planning.

2. It is an unlawful act to treat a personal expenditure as business expenditure which is disallowed under the law. Rutabingwa is resorting to unfair means to claim deduction by falsification of records. Therefore, it is tax evasion and illegal.

3. It is a case of tax evasion as the air-conditioner fitted at residential place is a personal capital expenditure, which would not be allowed a justifiable capital expense on the company. The wrong treatment unjustifiably increases the amount of depreciation and consequently reduces profit unlawfully.

4. This neither tax avoidance nor tax evasion. It is tax management because maintaining register of withholding tax payments helps the company in complying with the obligations under the income tax law.

5. Net effect of transaction is reduction of tax liability of the company by improper means. The company is liable to tax at the rate of 30% whereas Nshuti would only be liable to tax rates provided for Micro enterprises since his income does not exceed threshold of lump sum tax limit of FRW12,00,000. Micro enterprises tax rates are significantly lower than the rate under the real regime. Therefore, the issuance of credit notes to reduce the liability of company amounts to tax evasion**.**

6. Premium paid on medical insurance policy of employee is specifically allowed as deduction under the Income tax Act. Therefore, FRW2,000,000 paid by BMK Supermarket, as premium on medical insurance policy of the company's employees, is neither tax avoidance nor tax evasion - it is an act of Tax Planning as it is the intention of the law and practice to exempt such premiums to encourage medical insurance coverage for the citizens.

c) Withholding tax on other sources of income are calculated as below:

Income	Workings	Income FRW	Withholding tax FRW
Investment in Equities			
Capital Gains	Proceeds from sale of shares (150 X 26,000)	3,900,000	
	Cost of the shares (90 X 26,000)	2,340,000	
	Gain on Disposal of shares	1,560,000	
	Capital Gains tax 5% of the gain		78,000
Dividend Income	FRW120 x 160,000	19,200,000	
	Since Quantum is a listed on the RSE, so the WHT reduces from 15% to 5%		960,000
Capital Gains	Capital Gains on Shares that are listed at RSE is exempt		Exempt
Dividend Income	Dividends Received	4,500,000	
	Gross up the amount received	*100/95	
	Gross Dividends	4,736,842	
	Since the company is listed the dividend is taxed at 5%	5%	236,842
Investment in Fixed Deposits			
Interest income	Loan	15,000,000	
	Interest Rate	9%	
	Interest income	1,350,000	
	Interest income for the period 8/12	900,000	
	Tax on interest (15%)		135,000
Interest income	Interest Earned	3,000,000	
	Since the maturity of the Fixed deposit is above one year, the Interest is exempt		Exempt
Investment in Government Security			
Interest income	Interest earned	8,000,000	
	Gross up the amount received	*100/85	
	Gross Interest Income	9,411,765	
	Since Maturity is below 3 years the withholding tax is 15%.		1,411,765
Interest income	6000,000 x 100/95 (since it is a long-term	6,000,000	
	government bond the WHT is 5%)	*100/95	

Income	Workings	Income	Withholding tax
		FRW	FRW
	Gross Interest Income	6,315,789	
	Since it is a long-term Government bond with WHT is 5%		315,789.47
Income from other assets and vocations			
Royalty income	Income	22,000,000	
	Withholding tax rate is 15%	15%	3,300,000
Lecturing fees	Income from second employer	5,000,000	
	WHT is 30% of the income since the Local University is considered a second employer	30%	1,500,000

QUESTION SEVEN

Marking Guide

Question	Description	Marks	Total Marks
a.i)	Amount Wagered	0.5	
	Less: Winning Pay-outs	0.5	
	Gaming tax (13%)	1	
	Total		**2**
a.ii)	Amounts awarded by the operator	0.5	
	Amount Wagered	0.5	
	Withholding tax (15%)	2	
	Total		**3**
a.iii)	Gross gaming Revenue	1	
	Gaming tax	1	
	Salaries and benefits	0.5	
	Allowable general expenses	0.5	
	Interest	0.5	
	Allowable tax depreciation	1.5	
	Total		5
(b)	Award 0.5 Marks on each principle of taxation	5	
	Total		**5**
(c)	Award 1 Mark on 5 explained advantages of direct taxes	5	
	Total		**5**
	Total Marks		**20**

Model Answer

a)

i) Gaming tax

Details	FRW
Amount Wagered	850,450,000
Less: Winning Payouts	570,500,450
Gross gaming revenue	279,949,550
Gaming tax (13%)	**36,393,442**

ii) Tax due on Teta's winning

Details	FRW
Amounts awarded by the operator	2,000,000
Amount Wagered	500,000
Winnings	1,500,000
Withholding tax (15%)	**225,000**

The due date for paying withholding tax is 15 days following the month in which the winning where made. Therefore, the due date would be 15 August 2021.

iii) Total taxable income of Betting House Limited

Details	FRW
Amount Wagered	850,450,000
Winning Payouts	(570,500,450)
Gross gaming Revenue	279,949,550
Less:	
Gaming tax	(36,393,442)
Salaries and benefits	(30,000,000)
Allowable general expenses	(20,000,000)
Interest	(60,000,000)
Allowable tax depreciation	(90,000,000)
Taxable income	**43,556,109**

Due date for paying of Corporate Income Tax is three (3) following the end of company's year-end. Therefore, the due date is 31 September 2021.

b) List and discuss ten principles of taxation.

1. The Principle of Legality: The principle of legality in tax matters provides the basis for the safeguarding of taxpayer's rights because it means that the public authorities cannot act in an arbitrary fashion. This principle is enshrined in the constitutions of many countries.

2. The Principle of Equality: The principle of equality as far as tax is concerned has a role to play in the essential characteristics of the law and, in particular, defines that taxation must be applied impersonally to all individuals regardless of their status or background.

3. **The Principle of Freedom:** The principle of tax freedom relates not only to personal freedom but also to the freedom of trade and industry. The essential principle of freedom is at the heart of a number of the procedures of tax law, even though in some cases it appears to go against personal or corporate freedom. Indeed, the variety of the taxes that exist means that the taxpayer, individual or corporate, often has a choice as to the actual taxation that they pay dependent on the particular course of action that they adopt.

4. **Principle of efficiency:** An efficient tax system raises the revenue needed at the lowest possible cost to the taxpayer. Efficient taxes systems raise revenue without negative distortions such as reducing work-incentives for individuals and investment incentives for companies.

5. **Principle of Equity and the Benefit:** Taxes should be fair and based on people's ability to pay. The benefits principle requires that people should pay taxes according to the benefit (utility) they derive from consuming government goods and services.

6. **Principle of certainty:** The certainty principle is very important in tax affairs. Taxpayers should be able to anticipate the possible amount of their tax obligations and plan for payment of them in due course. For this reason, tax rates should be relatively stable from year to year and should not be subject to sudden fluctuations. This allows people to undertake their own financial planning knowing the basic tax liabilities they are likely face in the coming year.

7. **Principle of Adequacy:** Taxes should be just enough to generate the revenue required for provision of essential public services.

8. **Principle of Broad Based:** Taxes should be spread over as wide a section of the population as possible, or over a wide section of sectors of the economy, in order to minimize the individual tax burden.

9. **Principle of Compatibility:** Taxes should be coordinated to ensure tax neutrality and the overall objectives of good governance.

10. **Principle of Convenience:** Taxes should be enforced in a manner that facilitates voluntary compliance to the maximum extent possible.

11. **Principle of Neutrality:** Taxes should not favor any one group or sector over another and should not be designed to unfairly interfere with or influence individual decision-making (unless this is for social reason).

12. **Predictability principle:** The method of collection of taxes should facilitate the certainty and regularity of recovery.

13. **Restricted exemptions principle:** Tax exemptions must only be for specific purposes (such as to encourage investment) and for a limited period.

14. **Principle of Simplicity:** Tax assessment and determination should be easy to understand by an average taxpayer.

15. **The principle of an optimal tax:** Optimal tax theory, also known as "optimal taxation", is the study and implementation of how best to design a tax system by minimizing its distortion and inefficiency with the aim of increasing set revenues.

c) List and discuss five advantages of direct taxes

First a Direct tax is a tax imposed on the person who also bears the burden of the tax. Such taxes include payroll taxes or corporate income tax.

The advantages of direct taxes are:

1. **Income equality:** Direct taxes are more effective in lessening the inequality of income and wealth than indirect taxes. These taxes can be used to reduce income and wealth inequalities and thereby various social evils can be mitigated.

2. **Ability to pay:** It is claimed that direct taxes are intimately related to the ability-to-pay. This is judged directly, since direct taxes can be chosen and their rate-schedules determined in such a way as to secure the maximum possible closeness to the ability to pay and the least aggregate sacrifice. In these taxes we can determine the degree of progression that we want and thus bring about adequate social and economic justice.

3. **Revenue elasticity:** As income of the community goes up, so does the tax yield from direct taxes. However, this claim can be made for indirect taxes as well.

4. **Civic responsibility:** Direct taxes encourage the spirit of civic responsibility amongst taxpayers. They try to be more vigilant about how much tax revenue is being raised and to what uses it is being put.

5. **Utility maximization and resource allocation:** Economically, indifference curves analysis reveals that direct tax is preferable over indirect tax because it leaves the consumer on a higher indifference curve. Thus, direct taxes do not cause at all distortion in the resource allocation of the economy and they leave the taxpayer better off than do the indirect taxes.

END OF MARKING GUIDE AND MODEL ANSWERS