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

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

**MONDAY: 05 JUNE 2017**

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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 (4) questions to choose any three(3).**
- 4. Marks allocated to each question are shown at the end of the question.**
- 5. Show all your workings.**
- 6. Any assumptions made must be clearly and concisely stated.**
- 7. All iCPAR Examination rules and regulations apply.**

## 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	3.3%
Employer's contribution	5.3%

**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 is a compulsory question*

#### QUESTION ONE

Real Manufacturers Rwanda Ltd (RMRL), a Rwanda resident company manufactures various concrete building products. The main factory is located in Gisenyi in the Western Province of Rwanda. The company manufactures bricks, roofing tiles and paving blocks using special technology developed in South Africa by Real Manufacturers International Ltd, a company incorporated in South Africa. RMRL is a subsidiary of Real Manufacturers International Ltd (RMIL) which holds 100% shares in RMRL. RMRL has an investment license issued by the Rwanda Development Board. RMRL is therefore a registered investor. Rwanda and South Africa have an agreement for the avoidance of double taxation (DTA) in either country that became effective on 3 August, 2010.

The sand that is used as the major raw material is supplied by Majambere Ltd, a company incorporated in Rwanda and located in Gisenyi. All the sand is mined within Rwanda. However, to ensure the maintenance of the required standard per the patent, the other raw materials including cement, gypsum and ash fly are imported from South Africa and supplied by RMIL, the parent company. The patent for the concrete products is held by RMIL and is registered in South Africa. RMRL pays a royalty fee to RMIL for the permission to manufacture the concrete products in Rwanda. The company also pays technical fees to RMIL for the service the company provides in form of seconding engineers and supervisors to RMRL. The following is RMRL's statement of profit or loss and other comprehensive income for the year ended 31 December, 2016.

	Notes	Frw “000”	Frw “000”
Turnover			10,000,000
Interest Income			<u>277,500</u>
			10,277,500
<b>Expenses:</b>			
Manufacturing	<b>1</b>	5,555,000	
Selling and distribution	<b>2</b>	1,590,000	
Administrative	<b>3</b>	685,000	
Finance	<b>4</b>	40,500	
Other operating expenses	<b>5</b>	<u>500,000</u>	<u>(8,370,500)</u>
<b>Profit before tax</b>			<b><u>1,907,000</u></b>

#### Notes:

1. Included in the manufacturing expenses:

	Frw “000”
Depreciation of plant and machinery	1,625,000
Raw material costs	1,000,000
Salaries and wages	1,250,000
Royalty payment to RMIL	625,000
Technical fees (paid to RMIL)	250,000
Electricity and water	<u>800,000</u>
<b>Total</b>	<b><u>5,550,000</u></b>

## 2. Included in selling and distribution expenses:

	Frw “000”
Advertising	500,000
Transport	390,000
Bad debts written off (i)	100,000
Donations (ii)	180,000
Entertainment ( prospective customers)	40,000
Branding	380,000
<b>Total</b>	<b><u>1,590,000</u></b>

### (i) Bad debts written off:

Frw 80,000,000 has been written off in the books of accounts and the company has gone through the court process to recover the money. The case in court was decided against the company and there is no hope of ever recovering the money. The remaining Frw 20,000,000 represents the amounts that are doubtful but no measures have been taken to recover the outstanding amount yet.

### (ii) Donations:

Frw 130,000,000 was donated to Gisenyi Development Association a registered charitable organization, while Frw 50,000,000 was made to Manzi Ltd, a trading company that deals with building materials.

## 3. Administrative expenses comprised of:

	Frw “000”
Salaries and wages	225,000
Directors’ bonus and allowances	125,000
Fines paid to the local authority	5,000
Telephone expenses (iii)	12,000
Office supplies	30,000
Motor running costs	120,000
Auditors fees	20,000
Other professional fees	148,000
<b>Total</b>	<b><u>685,000</u></b>

(iii) The company mainly uses mobile phones. The expenses related to the subscription and airtime loaded on the staff phones on a weekly basis. The company does not have a system to allow staff account for the time spent on private and official calls.

## 4. Finance costs included:

(a) Interest paid on the loan that was given to the company by RMIL. RMRL got a loan of Frw 125,000,000 at an interest rate of 10% per annum. The interest for the year 2016 of Frw 12,500,000 is included in the finance costs. The total share capital of RMRL comprises of 100,000 shares of Frw 250 per share.



- (b) The remaining amount of Frw 28,000,000 relates to interest paid to commercial banks in Rwanda in relation to the loans obtained. The amount borrowed was used for business purposes.

5. Other operating expenses represent an amount that was paid to Worldwide Researchers Ltd (WWRL), a company incorporated in France that was engaged to carry out research on the effectiveness and suitability of the building products in Rwanda. The researchers conducted their work in Rwanda but the money was paid to France.

#### Additional Information:

##### 1. Information relating to fixed assets:

- (a) The cost of constructing the factory building was Frw 500,000,000 and was first used with effect from 1 January, 2014. An extension to the factory was constructed for Frw 200,000,000 and put to use commencing on 1 January, 2016.
- (b) The written down values of the assets as at 1 January, 2016 were:

	Frw “000”
Computers and accessories, information and communication systems, software products and data equipment	62,500
Other business assets	2,881,250

- (c) Additions during the year:

	Frw “000”
Machinery ( not fixed to the walls)	102,000
Computers	10,000
3 Distribution trucks each at Frw 50,500,000	151,500
One 5-seater salon car (for the Finance Director)	20,000

- (d) Disposals during the year:

Two delivery trucks that were purchased for Frw 40,000,000 each on 1 January, 2015 were sold for Frw 35,000,000 each on 30 June, 2016. This was because they were found unsuitable for the purpose they had been purchased.

2. The company paid the quarterly tax prepayment for 2016 of Frw 720,000,000. The balance of tax payable for 2015 and 2016 were all paid in time.
3. The company employs an average of 180 Rwandans in addition to other staff from Uganda, the Democratic Republic of Congo and South Africa.

#### REQUIRED:

- (a) Advise RMRL on the taxable income and the corporate tax payable for the year ended 31 December, 2016. **(26 Marks)**
- (b) Comment on implications of the DTA between Rwanda and South Africa on the withholding tax obligations of the company and compute the withholding tax that was paid to the revenue authority, given that the company was compliant with all their withholding tax obligations during the year 2016. **(7 Marks)**

- (c) The Rwanda Revenue Authority (RRA) has raised concern with the profit being declared by RPRL for tax purposes. This is because RMRL and RMIL are related parties and yet there is considerable trading between the two entities. The management of RMRL has approached you as a tax consultant to attend a meeting with them and RRA to explain the transactions.

**REQUIRED:**

- (i) Explain the term “**Arm’s length price**” with reference to the transfer pricing rules. **(1 Mark)**

- (ii) Briefly explain any three methods recommended under the transfer pricing rules that the company may use in order to determine the arm’s length price. **(6 Marks)**

**(Total 40 Marks)**

**SECTION (B)**

*This section has four (4) questions to attempt any three (3)*

**QUESTION TWO**

You have been provided with a summary of transactions for two companies, MM Ltd and ABC Ltd. Both companies are registered for VAT.

	Note	MM Ltd	ABC Ltd
Sales ( VAT Exclusive):			
Standard Rated	1	520,000,000	520,000,000
Zero Rated		100,000,000	—
Exempt		—	150,000,000
		<u>620,000,000</u>	<u>670,000,000</u>
Purchases & Expenses (VAT Inclusive where applicable):			
Purchases			
Standard Rated		430,000,000	411,000,000
Zero Rated		80,000,000	—
Exempt		—	120,000
Expenses	2	<u>80,000,000</u>	<u>87,000,000</u>
		<u>590,000,000</u>	<u>498,120,000</u>

**Notes:**

- ABC Ltd made sales of Frw 20,000,000 and later discovered that the customer was most likely not to pay for the goods.
- The detailed review of the expenses reveals that MM Ltd engaged services of non registered taxpayers. However, ABC Ltd deals with only registered taxpayers.

**REQUIRED:**

- (a) Compute the amount of VAT Payable or Claimable by the two companies. **(10 Marks)**
- (b) Which of the two companies above pays a higher tax and why? **(2 Marks)**
- (c) Explain the consequences for false VAT Claims. **(3 Marks)**
- (d) Advise ABC Ltd on the VAT treatment for goods sold but payments are most likely not to be received. **(5 Marks)**

**(Total 20 Marks)**

### QUESTION THREE

Mabonga Construction Ltd, a company incorporated in Rwanda, has been in the construction business since 1 January, 2010. Their main operational area is Kigali. The company's authorized share capital is 200,000 shares of Frw 50,000 per share. All shares are fully paid.

The company has been concentrating on the construction of high cost residential apartments. However, during the board meeting held on 5 January, 2017, the directors passed a board resolution to invest in the low cost housing area, with effect from 1 January, 2017, since the demand for low cost houses is on the increase. This will require the company to mobilise additional capital of Frw 10,000,000,000. They, therefore, signed a resolution to increase the authorised share capital to 400,000 shares of Frw 50,000 each. The directors have also made a resolution to apply for registration as an investor.

Below is the summary of projected financial position for the next two years:

	Actual 2016	Projected 2017	Projection 2018
	Frw "000"	Frw "000"	Frw "000"
Revenue	12,000,000	20,736,000	24,883,200
Cost of sales	(8,000,000)	(14,872,000)	(16,359,200)
Gross profit	4,000,000	5,864,000	8,524,000
<b>Less:</b>			
Marketing and administration expenses	(1,500,000)	(2,000,000)	(1,000,000)
Depreciation	(500,000)	(1,000,000)	(800,000)
<b>Net profit</b>	<b><u>2,000,000</u></b>	<b><u>2,864,000</u></b>	<b><u>6,724,000</u></b>

The company does not own any building and the Net book value of the assets as at 31 December, 2016 was Frw 3,500,000,000, of which Frw 400,000,000 related to computers. The company intends to spend Frw 4,000,000,000 on acquiring assets other than computers in 2017.

The company will pay dividends of Frw 2,000 per share per year. There are two options that the company has considered for raising the additional capital:

- Raise the additional Frw 10,000,000 capital by listing shares of the company on the Rwanda Securities Exchange.
- Borrow Frw 10,000,000 on mortgage terms from a bank in Rwanda at an interest rate of 15% over a period of 15 years.

The company directors of Mabonga Construction Ltd have approached you as their tax consultant to examine the options and advise them on the most tax efficient way to raise more capital.

#### REQUIRED:

Evaluate the tax implications of each of the above mentioned two options and advise the company on the most advantageous method for raising additional capital. **(Total 20 Marks)**

### QUESTION FOUR

Ms. Kamikazi Jeannete has just completed her Certified Public Accountants of Rwanda exams and has two job offers for Senior Accountant position, one with the Gahii Hospital in Muhanga district and the other with Mountain View Lodge in Musanze district. Both contracts are for a three-year period commencing 1 January, 2017 renewable only once.



Below are the detailed terms of the contracts:

<b>Contract 1 - Gahii Hospital:</b>	
(i)	A monthly basic salary of Frw 4 million.
(ii)	A house in the hospital premises where she will not have to pay any rent.
(iii)	The hospital will pay her annual subscription fees to iCPAR of Frw 125,000.
(iv)	The hospital will contribute 10% of her basic salary towards the National Retirement fund every month. In addition, she will contribute a further 15% of her basic salary per month to a qualified pension fund run by the hospital.
(v)	A car whenever she will be travelling on the hospital business like attending meetings and going to the bank. However, whenever she uses the hospital vehicle for private purposes Frw 30 per kilometer travelled will be deducted from her salary at the end of the month in which the vehicle is used.

<b>Contract 2 - Mountain View Lodge:</b>	
(i)	A monthly salary Frw 4 million.
(ii)	A monthly medical allowance Frw 125,000.
(iii)	A housing allowance Frw 500,000 per month
(iv)	The lodge will pay her annual subscription fees to iCPAR of Frw 125,000.
(v)	The lodge will contribute 10% of her basic salary towards her National Retirement fund every month. In addition, she will contribute a further 10% of her basic salary per month to a qualified pension fund run by the lodge.
(vi)	A monthly electricity and water bills to a maximum of Frw 500,000.
(vii)	A company car to use for both business and private purposes.

**NB:**

Ms. Kamikazi has grown and lived in Kigali City and she would like to be advised on the best employment package she should agree to.

**REQUIRED:**

- (a) Advise Ms. Kamikazi on the contract that offers the most tax efficient salary. **(16 Marks)**
  - (b) Explain to Ms. Kamikazi what constitutes exempt employment income. **(4 Marks)**
- (Total 20 Marks)**

**QUESTION FIVE**

- (a) Mr. Rutagarama Vincent owns a shop that deals in general merchandise in Byumba town, Northern Province. His average turnover is Frw 150,000,000 and he is a registered taxpayer for both direct taxes and VAT. On 30 April, 2017, Mr. Rutagarama received a telephone call from the revenue office that the revenue officers will be coming to his shop on 2 May, 2017 to conduct an audit. They specifically informed him that they have information from a reliable source that he had been under declaring his sales especially in 2016. They would like to examine his Electronic Billing Machine (EBM), sales records and other financial information that he keeps and they therefore requested him to prepare his information.

Mr. Rutagarama has called you as a tax consultant to help him arrange the books the revenue officers have requested for and to advise him on whether he should accept the audit or not. He has never been audited in the five years that he has carried on business and he has been filing both the income tax declaration and VAT return in time.



## REQUIRED:

Advise Mr. Rutagarama on the procedure that is provided under the law for tax audits. **(6 Marks)**

- (b) Mr. Rutagarama has requested you to help him arrange his records before the revenue officers come in to audit. During your discussions with him, you have found out that he has a bank account which he jointly owns with his wife but he does not bank all the money he receives from sales. He also sometimes picks some items from the shop for his own use. He has provided you with his summarized profit statement as below:

	<b>Frw “000”</b>
Revenue	152,000
Less: purchases	(117,952)
Gross profit	34,048
Less expenses	(13,710)
<b>Profit before tax</b>	<b><u>20,338</u></b>

The details of his other transactions that you have gathered are the following:

- (i) At 1 January, 2016 the balance of cash at the shop was Frw 1,450,560 and the balance on the bank account was Frw 35,076,960.
- (ii) From his records, you have also established that he had the following balances at the beginning of the year:
  - Receivables Frw 14,500,000
  - Payables Frw 7,520,000
  - Inventories Frw 28,900,000
- (iii) During the year, he invested Frw 50,000,000 in shares at the Rwanda Securities Exchange. He has not yet received any dividends.
- (iv) He withdraws cash of Frw 260,000 per week for living expenses from the business. In addition, he has also withdrawn from the bank Frw 6,000,000 for private purposes. No business expense was paid out of private sources.
- (v) Items taken from the shop for private use at his home have not been paid for out of his drawing, but are estimated to have been of a total cost price of Frw 4,000,000.
- (vi) He rents his shop for Frw 6,000,000 per annum and lives in a flat above the shop. The residential proportion is estimated to be approximately one third ( $\frac{1}{3}$ ) of the total area. The rent paid is included in the expenses in the income statement.
- (vii) At 31 December, 2016 the balance of cash at the shop was Frw 2,850,000 and the balance on the bank account was Frw 5,802,240. In addition, the balances on other assets were:

- Receivables Frw 18,200,000
- Payables Frw 6,250,000
- Inventories Frw 26,700,000

**REQUIRED:**

- (a) Establish whether the income statement that Mr. Rutagarama has given you can be relied on by reconciling the opening and closing cash and bank balances.
- (b) Determine Mr. Rutagarama's taxable income. **(9 Marks)**

**(5 Marks)**

**(Total 20 Marks)**

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**End of question paper**





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