

INSTITUTE OF CERTIFIED
PUBLIC ACCOUNTANTS
OF RWANDA

CPA



A2.3

ADVANCED TAXATION

Study Manual

2nd edition February 2020,

INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS OF RWANDA

Advanced Level A2.3 ADVANCED TAXATION

2nd Edition February 2020

This Manual has been fully revised and updated in accordance with the current syllabus/ curriculum. It has been developed in consultation with experienced tutors and lecturers.

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1. A2.3 Advanced Taxation

Aim

The aim of this subject is to ensure that students understand and can apply the principles and practice of taxation and are able to identify and resolve practical taxation problems. Students should be able to interpret and apply relevant law and advice on the most tax efficient structures.

Advanced Taxation as an Integral Part of the Syllabus.

Advanced Taxation develops the students' knowledge and competence in tax acquired in Taxation. There are also linkages to Advanced Financial reporting, Audit Practice and Assurance Services, Strategy & Leadership, Strategic Corporate Finance and Strategic Performance Management.

Learning Outcomes

On successful completion of this subject student should be able to:

- Understand different forms of taxation and tax administration
- Compute tax liabilities for various entities
- Deal with taxation of specialized activities
- Deal with tax investigations
- Provide tax planning advice to different forms of business
- Demonstrate an understanding of customs management and cross
- Boarder taxation regimes
- Understand the various tax systems and policies
- Adopt best practices when dealing with clients.
- Explain the various tax systems and policies

Syllabus:

1. Tax Systems and Policies

- Types of tax systems
- Role of taxation in economic development
- Design of a tax policy
- Criteria for evaluation of a tax system
- Tax reforms and modernization of tax systems

2. Advanced aspects of direct and indirect tax

- Individuals
- Companies/associations
- VAT and excise tax
- Application of relevant case law

3. Taxation of cross border activities

- Distinction between trading in and trading with a country
- Double taxation agreements; theory, design and application
- Regional perspective with reference to the East African Community (EAC) and the Common Market for Eastern and Southern Africa (COMESA)
- Customs valuation
- Most favored nation status
- Withholding tax provisions
- Transfer pricing
- Application of relevant case law

4. Tax Planning

- Tax planning for individuals and companies
- Employment versus self-employment
- Identifying opportunities to alleviate mitigate or defer the impact of direct or indirect taxation
- Remuneration packages
- Corporate structure and dividend
- Transfer of real properties
- Pricing Policy
- Uses of tax incentives
- Disposal of business operations and restructuring of activities
- Lease and purchase decisions
- Forms of business organisations

5. Professional Ethics in Taxation

- Form of tax practice and matters relating thereto
- Obligations to clients
- Confidentiality
- Matters relating to new clients
- Handling of client work
- Charging for services
- Matters giving rise to conflict of interest
- Disclosures in tax returns, computations and correspondence with the Revenue Authority
- Dealing with the Revenue Authority
- Moral and social issues in taxation

6. Tax Investigation

- Tax evasion, tax avoidance and fraud
- Events which may trigger an investigation
- Back duty and in-depth examinations
- Methods of computing omitted and understated income
- VAT refunds, false claims and accountant's certificate
- Capital settlements and ascertainment of income omitted or understated
- Customs and excise investigations
- Negotiation for settlement
- Tax Audit
- Application of relevant case law

2. Emerging trends in Taxation

Tutors will prepare and deliver this topics according to the new current trends at the time of delivery.
(Eg. New investment incentives)

STUDY UNIT

1

ADVANCED ASPECTS OF DIRECT TAX

A. Advanced Taxation of Individual Income

B. Advanced Taxation of Companies/Associations



ADVANCED TAXATION OF INDIVIDUAL INCOME

1.1 PERSONAL INCOME TAX

It involves taxing the individual or personal income of a natural person. An individual may be resident and/or ordinarily in the Rwanda, and his liability to Rwanda income tax will be determined accordingly. A taxpayer's residence and ordinary residence have important consequences in establishing the tax treatment of his Rwanda and overseas income and capital gains.

1.1.1 RESIDENT INDIVIDUAL

According to Article 4 of law number 16 of 2018, an individual is considered to be a resident in Rwanda if he/she fulfils one of the following conditions:

1. He/she has a permanent residence in Rwanda;
2. He/she has a habitual abode in Rwanda;
3. He/she is a Rwandan representing Rwanda abroad.
4. An individual who stays in Rwanda for more than one hundred eighty three (183) days in twelve (12) month period, either continuously or intermittently, is considered to be a resident in Rwanda for the tax period in which the twelve (12) month period has ended.

A person other than an individual is considered as a resident in Rwanda during a tax period if it: is a company or an association established according to Rwandan laws; or has its place of effective management in Rwanda at any time during that tax period; or is a Rwanda government company.

1.1.2 TAX CONSEQUENCES OF RESIDENCE

Generally, a Rwandan resident is liable to Rwanda income tax on his Rwanda and overseas income whereas a non-resident is liable to Rwanda income tax only on income arising in Rwanda. A non-resident is taxed under the personal income tax whereas a non-resident is taxed under withholding tax (15%).

1.1.3 Article 9: Base of Personal Income Tax

The personal income tax shall be levied on an individual's annual income. According to Article 10, each tax period, a resident taxpayer is liable to personal income tax from all domestic and foreign sources in accordance with Articles 4 and 5 of the tax Law. However, a non-resident taxpayer is only liable to personal income tax which has a source in Rwanda. As per Article 11 of the income tax law, the taxable income of an individual derives from the following:

- Employment;
- Business activities;
- Investment;
- Capital gain; use, sale, lease or free transfer of an immovable property allocated to the business;
- Use, sale, lease or free transfer of an immovable property allocated to the business;
- Use, sale, lease or free transfer of movable property allocated to the business.

Taxable income is rounded to the nearest thousand (RWF 1,000) Rwandan francs and taxed following the real profit according to the following as per article 12 of the income tax law

Annual taxable profit (FRW)			Tax rate
From	To		
	0	360,000	0%
	360,001	1,200,000	20%
	1,200,001	More	30%

However, small enterprises must pay a lump sum tax of three percent (3%) on annual turnover. Small enterprises may renounce to the lump sum imposition by opting for the real regime in carrying out accounting in compliance with relevant laws. When they opt for the real regime, they must inform the Tax Administration, and this decision is irrevocable for a period of three (3) years starting from the date the Tax Administration was informed thereof.

1.1.4 Taxation of Micro-enterprises

Micro enterprises are assessed based on their annual turnover and they must pay the flat amount of tax as per the following table:

Annual turnover (RWF)	Annual flat amount of tax due (RWF)
From 2,000,000 to 4,000,000	60,000
From 4,000,001 to 7,000,000	120,000
From 7,000,001 to 10,000,000	210,000
From 10,000,001 to 12,000,000	300,000

However, it is important to note that the tax of 3% and annual flat amount of tax are not applicable to any person who exercises a liberal profession. Without prejudice to the right to be governed by the real profit tax regime, the activities of road transport of persons and goods are imposed at a flat amount of tax determined as below:

1.1.5 INVESTMENT INCOME

Section 4 under article 35 of law 16/2018 of the income tax law defines investment income as any payments in cash or in kind to an individual in the form of financial interest, dividends, proceeds from sale or transfer of shares, royalty, or rent which has not been taxed as business income.

1.1.5.1 CAPITAL GAIN TAX ON SHARES

According to Article 36 of Law 16/2018, capital gain tax is charged on the sale or transfer of shares. The capital gain on sale or transfer of shares is the difference between the acquisition value of shares and their selling or transfer price. Article 37 of the same Law provides that capital gain tax is taxed at a rate of 5%.

Example One

Madam Jane purchased 200,000 shares from Inyane limited at 200RWF per share, a private limited company in 2010. In 2018, Jane sold 50,000 shares to Mark at 300RWF per share. Compute the capital gain and the capital gain tax

Particulars	RWF	RWF
Sales proceeds	50,000 x 300	1,500,000
Cost of the shares sold	50,000 x 200	(1,000,000)
Capital gain		500,000
Capital gain tax	5% x 500,000	25,000

Example Two

Frank owned 1,000,000 shares at NIL limited, a private company. The share was purchased in 2012 at a price of 1,000RWF per share. In 2018, he transferred 200,000 shares to his daughter. The market price of

the shares at the date of the transfer is 1200RWF per share.

Required: Compute his capital gain and the capital gain tax.

Proceeds from the shares transferred	200,000 x 1,200	240,000,000
Cost of the shares transferred	200,000 x 1,000	200,000,000
Capital gain		40,000,000
Capital gain	40,000,000 x 5%	2,000,000

Withholding and Declaration of Capital Gain Tax

According to Article 38 of the Law 16/2018, the capital gain tax on the sale or transfer of shares shall be withheld by the company within which the transaction occurred. The company within which the sale or transfer of shares occurred shall declare and pay the capital gain tax to the Tax Administration within fifteen (15) days following the month in which the sale or transfer of shares occurred. However, Article 39 of the same Law stipulates that capital gain from the sale or transfer of shares on the capital market and capital gain from the sale or transfer of units of the collective investment schemes, is exempted from capital gain tax.

1.1.5.2 FINANCIAL INCOME

According to Article 40 of Law 16/2018, financial income includes:

- Income from loans;
- Income from deposits;
- Income from guarantees;
- Income from government securities: income from bonds, negotiable securities issued by the Government, securities issued by public and private companies, as well as income from cash negotiable securities.

According to Article 60 of Law 16/2018, interest income is subject to a withholding tax of 15% on the value exclusive of VAT. However, the interest income derived from the Treasury bond with a maturity period of three years and above, the withholding tax is 5%.

1.1.5.2.1 EXEMPTED INTEREST INCOME

The following interest income is exempted from the withholding tax.

- Interests on deposits in financial institutions for at least a period of one year;
- interests on loans granted by a foreign development financial institution exempted from income tax under applicable law in the country of origin;
- interests paid by banks operating in Rwanda to banks or other foreign financial institutions;

1.1.5.3 DIVIDEND INCOME

According to Article 41 of Law 16/2018, dividend income includes income from shares in any societies, other similar income that may be generated by all entities that pay corporate income tax, as well as the outstanding balance after the taxation of income from the correction made by the Tax Administration in the transfer pricing. Like interest income, dividend income is also subject to a withholding tax of 15%. However, for shares that are listed at the Rwanda stock exchange and owned by a taxpayer from East Africa, it is subject to a withholding tax of 5%.

1.1.5.4 ROYALTY INCOME

As per Article 42 of Law 16/2018, royalty income includes:

- All payments of any kind received as a prize for the use of, or the right to use, any copyright of literary, craftsmanship or scientific work including cinematograph films, films, or tapes used for radio or television broadcasting;
- Any payment received from using a trademark, design or model, computer application and invention patent;
- The price of using, or of the right to use industrial, commercial or scientific equipment or for using information concerning industrial, commercial or scientific knowledge;
- Payments from natural resource use.

Example One

During the year ended 31/12/2018, John received income from the following assets.

100,000 shares of 250 RWF each in Magendo limited a private company whose shares are not listed at Rwanda stock exchange. During the year ended, John sold 6000 shares at 350RWF each.

Invested 20,000,000RWF in a fixed deposit account in the bank for a period of eight months at an annual interest rate of 9%.

Received 8,000,000RWF from the investment in Government bonds with a maturity period of two years

John has 80,000 shares in KB a listed company at RSE market. At the end of the year, the company declared a dividend of 200RWF per share.

John also owns a fixed deposit account in ACCO bank with a maturity of two years, at the end of the year he received an interest income of 3,000,000RWF

During the year he sold a copy right of his new book at 12,000,000RWF.

He also invested in government securities with a maturity period of 5 years, during the year he received an interest income of 6,000,000RWF

He owns 20,000 shares of 300RWF each in Akandi limited a listed company in Rwanda stock exchange market. During the year he disposed of 12, 000 shares at 400RWF each

He owns shares in Akabanga limited a private company that is listed at RSE. During the year ended, he received a dividend income of 2,500,000RWF

Required:

Compute the relevant withholding taxes.

Income	Workings	Withholding taxes
1. Capital gain	Proceeds from the sale of shares (359 x 6000) 2,100,000 Cost of the shares (200 x 6000) 1,200,000 Capital gain 900,000 Capital gain tax (900,000 x 5%)	45,000
2. Interest income	(20,000,000 x 9%) x 8/12 1,200,000 x 15%	180,000

3.	Interest income	8,000,000 x 100/85 (since maturity is below 3 years the withholding is 15% and it is at the source) 9, 411,765 x 15%	1,411,765
4.	Dividend income	200 x 80,000 = 16,000,000 (since it is a listed company, the WHT is 5%) 5% x 16,000,000	800,000
5.	Interest income	Since the maturity of the deposit is above one year the income is exempted	Exempted
6.	Royalty income	12,000,000 x 15%	1,800,000
7.	Interest income	6000,000 x 100/95 (since it is a long-term government bond the WHT is 5%) 6,315,790 x 5%	315,790
8.	Capital gain	Capital gain on shares that are listed at RSE is exempted	Exempted
9.	Dividend income	2,500,000 x100/95 (since shares are listed at RSE the WHT tax is 5%) 2,631,590 x5%	131,590

Note: when the income are received net, in order to calculate the withholding tax (WHT), there is a need to first gross them before computing the tax.

1.1.5.5 RENTAL INCOME

Article 43 of law 16/2018 states that all revenues derived from rent of machinery and other equipment including agriculture and livestock equipment in Rwanda, are included in taxable income, reduced by:

- Ten percent (10%) of gross revenue as deemed expense
- Depreciation expenses
- Interests paid on loans if the asset was financed by the loan;

Example One

Uwamahoro owns machineries which she rents to various entrepreneurs. During the year ended 31/12/2015, she received a gross income of 34,000,000Rwf. The machineries were purchased at a cost of 45,000,000Rwf of which 20,000,000Rwf was a loan from the bank and she pays an interest rate of 20% annually. Uwamahoro pays a quarterly instalment of 300,000Rwf on the rental income.

Required:

Compute her taxable income

Income from Rent of Machineries			
gross income			34,000,000
less allowable expenses		10% x 34,000,000	-3,400,000
			30,600,000
less depreciation	25% x 45,000,000	11,250,000	
less interest expenses (20% x 20,000,000)		4,000,000	15,250,000
rental income			15,350,000

Tax liability

Tax band	Tax rate	Tax
0 – 360,000	0%	0
360,001 – 1,200,000	20%	168,000
1,200,0001 - 15,350,000	30%	4,245,000
Tax liability		4,413,000
Less quarterly payments	300,000 x 3	900,000
Tax payable		3,513,000

Example Two

Clement owns machineries that he rents to various individuals, during the year ended 31/12/2016, he received a gross rental income of 120,000,000RWF. The machines were purchased in 2015 at 40,000,000RWF. During the purchase, he borrowed 25,000,000RWF from the bank at an annual interest rate of 20%.

Required:

Compute his taxable rental income and the tax payable.

Computation of taxable rental income and tax liability

Gross income			120,000,000
Less allowable expenses	10% x 120,000,000	12,000,000	
Interest expenses	20% x 25,000,000	5,000,000	
Depreciation	W1	7,500,000	(24,500,000)
Taxable income			95,500,000
Tax band	Tax rate	Tax	
0 – 360,000	0%	0	
360,000 – 1,200,000	20%	168,000	
1,200,000 – 95,500,000	30%	28,290,000	
Tax liability		28,458,000	

W1 Depreciation

Period	Depreciation (25%)	ACC. Dep	NBV
1	10,000,000	10,000,000	30,000,000
2	7,500,000	17,500,000	22,500,000

TEST YOUR UNDERSTANDING

Itungo, a resident of Kibeho has many investments ranging from commercial property, shares, bonds and Royalties. During the year ended 31 December, 2016 she provided you with a summary of the following transactions:

Month	Notes	Nature of transaction
February	1	Purchased 31,250 shares from Mandiv Limited Frw 1,250,000.
May		Received payment from copyrights for using literature from one of her books Frw 500,000.
August		Received Frw 4,000,000 from investing in bonds issued by government of Rwanda, through National Bank of Rwanda with maturity of 4 years.
September		Received dividends from Atlas Limited Frw 650,000.
November	2	Received quarterly rent Frw 25,000,000 from her commercial property.

Notes:

Mandiv Limited is listed on the Rwandan Stock Exchange. They declared and paid dividends in July, 2016 at Rwf 10 per share to their shareholders.

The quarterly rent received was from four companies that occupy her commercial property in Kigali.

Required

Advise Itungo on the:

Tax payable on the above transactions.

Tax treatment of the rent received.

Explain the obligations of a withholding tax agent in relation to the tax withheld.

With examples, explain the type of taxpayers who are exempted from withholding tax on importation of goods.

1.6 TAXATION OF EMPLOYMENT INCOME**1.6.1 EMPLOYMENT AND SELF-EMPLOYMENT**

Employment involves a contract of service whereas self-employment involves a contract for services. The distinction between employment and self-employment is decided by looking at all the facts of the engagement.

1.6.1.1 Factors Indicating Employment

- The degree of control exercised over the person doing the work (a high level of control indicates employment)
- Whether the worker must accept further work if offered (if yes, indicates employment)
- Whether the person who has offered work must provide further work (if yes, indicates employment)
- Whether the worker is entitled to employment benefits such as sick pay, holiday pay and pension facilities (entitlement indicates employment)
- Whether the worker works for just one person or organization (such working indicates employment)

1.6.1.2 Factors Indicating Self-Employment

- Whether the worker provides his own equipment (if yes, indicates self-employment)
- Whether the worker hires his own helpers (if yes, indicates self-employment)
- What degree of financial risk the worker takes (if high risk, indicates self-employment)
- What degree of responsibility for investment and management the worker has (if most of responsibility is the worker's, indicates self-employment)
- Whether the worker can profit from sound management (if can do so, indicates self-employment)
- Whether the worker can work when he chooses (if can do so, indicates self-employment)
- Whether the worker works for a number of different persons or organisations (such working indicates self-employment)

1.6.2 EMPLOYMENT INCOME

Section 2 Article 15 of Law 16/2018 provides the following components of employment income. The Article stipulates that employment income includes all payments paid to an employee by his/her employer in cash or in kind in relation to the work performed. Those payments are composed of the following:

1. Wages, salary, leave pay, sick pay and medical allowance, payment in lieu of leave for an employee who stops working before benefiting from his/her annual leave, sitting allowances, commissions, bonuses and gratuity allowances relating to the cost of living, subsistence allowances, housing allowances, and entertainment or travel allowances;
2. Any discharge or reimbursement of expenses incurred by the employee or an associate;
3. Payments to the employee working in exceptional conditions of employment;
4. Payments for redundancy or loss or termination of contract;
5. Pension payments;

Other payments made in respect of previous, current or future employment.

1.6.3 PAYMENTS EXEMPTED FROM EMPLOYMENT INCOME TAX

According to Article 16 of Law 16/2018, the following payments are not included in the calculation of taxable employment income:

- The discharge or reimbursement of expenses incurred by the employee or his/her associate;
- Wholly for business activities of the employer;
- Those that are deducted or would be deductible in calculating the employee's income from all his/her business activities;
- Contributions made by the employer for the employee to the public institution in charge of social security;
- Pension payment from the public institution in charge of social security or from a qualified pension fund;
- Employment income received by an employee who is not a Rwandan citizen from a foreign Government or a non-governmental organization under an agreement signed by the Government of Rwanda, when the income is received for the performance of aid services in Rwanda; employment income received from an employer who is not a resident in Rwanda by a non-resident individual for the performance of services in Rwanda, unless such services are related to a permanent establishment of the employer in Rwanda.

1.6.3 PERSONS EXEMPTED FROM EMPLOYMENT INCOME TAX

Persons are exempted from employment income tax in Rwanda as provided for by international agreements referred to under Article 16 of the income tax Law, due to services rendered in the exercise of their official duties. As per Article 17 of Law 16/2018, the following persons are exempted from employment income tax:

- A foreigner who represents his/her country in Rwanda;
- Any other individual employed in any Embassy, Legation, Consulate or Mission of a foreign state performing State affairs, who is a national of that State and who owns a diplomatic passport;
- A non-citizen individual employed by an international organization that has signed an agreement with the Government of Rwanda in accordance with Rwandan laws.

1.6.4 BENEFITS IN KIND

According to Article 18 of Law 16/2018, benefits in kind received by an employee are included in taxable employment income in consideration of market value as follows:

1.6.4.1 Motor Vehicle

There shall be added to the taxable income an amount meant for the availability and use of a motor vehicle to an employee during a tax period, valued at ten percent (10%) of the employment income excluding benefits in kind.

1.6.4.2 Loan and Salary Advances

There are added to the taxable income, benefits on a loan including advance on a salary exceeding a three (3) months' salary given to an employee valued at a difference between:

The interest on loan, which would have been paid by the employee during the month in which the loan was received, calculated at a rate of interest offered to Rwanda;

And the actual interest paid by the employee in that month;

Example One

Suppose an employer gives a loan of 10,000,000RWF to the employee at an interest rate of 12%, when the interbank interest rate is 15%. The taxable benefit will be $[15\% - 12\%] \times 10,000,000 = 300,000\text{RWF}$

Example Two

John received a salary advance of 8,000,000RWF from his employer which must be paid within one year. The gross salary of John is 1,500,000Rwf per month. John was not charged any interest. The interbank interest rate is 8%. Compute his taxable benefit.

As said above, the three months' salary is exempted $1,500,000 \times 3 = 4,500,000$

The taxable benefit will be $[8,000,000 - 4,500,000] \times 8\% = 280,000$

1.6.4.3 Housing Benefits

There are added to the taxable income an amount meant for use or availability for use of premises including or excluding any household equipment of other contents by an employer for residential occupation by an employee during a tax period, valued at twenty percent (20%) of the employment income excluding benefits in kind. However, a rent of house or motor vehicle directly paid by an employer for an employee is taxed as any allowance referred to in Article 15 of Law 16/2018.

Example Three

Assume the employee in illustration 1 above obtains housing and vehicle use in kind, as well as a loan of 2,400,000RWF free of interest during the month. Also, assume that the BNR interbank rate is 10%. The benefits and the taxable income are determined as follows:

- a) Housing = 20% of 620,000RWF = 124,000RWF
- b) Vehicle use = 10% of 620,000RWF = 62,000RWF
- c) Interest = 10% of 2,400,000 $\times 1/12 = 20,000$
- d) Taxable income = 620,000 + 124,000 + 62,000 + 20,000 = 826,000RWF

1.6.4.4 Domestic Employees

If the employee has domestic employees and those employees are paid by the employer, the salary paid to the domestic employees is considered as a benefit to the employee and therefore should be added to

the employment income of the employee.

1.6.4.5 School Fees

If the employer pays the school fees for the children of the employees, the school fees paid should be considered as a benefit to the employee and added to the employment income.

1.6.4.6 Any Other Benefit/Assistance

Any other benefit which an employee receives because of job or any assistance made to the family member of the employees is considered as a benefit and therefore should be added to the employment income.

Example four

Lwewa is employed by TMK Rwanda limited as the Chief Accountant on the following contractual terms:

- Monthly salary 800,000Rwf
- Communication allowance 100,000Rwf per month
- Overtime allowance 50,000Rwf per month
- A company house where Lwewa contributes 100,000Rwf per month as rent
- A company vehicle which he uses for both private and business
- Two domestic staff paid by the company at 80,000rwf each
- Medical insurance contribution of 80,000rwf per month. The general policy of all employees is 50,000rwf per month paid in RAMA
- During the month of June, he was sent on an official mission in China. The company reimbursed him 5,000,000Rwf spent on the mission
- During the month of November, his wife got an accident the company paid 2,000,000rwf related to the treatment at King Faisal hospital.
- The employer withheld 150,000Rwf per month from Lwera as PAYE
- In addition to employment income, he carries out agriculture and livestock farming. During the year, he received gross income of 20,000,000Rwf.

Required:

Compute his taxable employment income and total income

Compute his tax liability and tax payable

Solution

Computation of Taxable Employment Income of Lwewa for the Year Ended 31/12/2016

	Workings	Amount in RWF	Amount in RWF
Salary	800,000 x 12		9,600,000
Add allowances:			
Communication allowance	100, 000 x 12	1,200,000	
Overtime allowance	50,000 x 12	600,000	1,800,000
Employment income			11,400,000

Add benefits in kind:			
Company house	$11,400,000 \times 20\% - 1,200,000$	1,080,000	
A company car	$11,400,000 \times 10\%$	1,140,000	
Domestic staff	$80,000 \times 2 \times 12$	1,920,000	
Medical contribution	$(80,000 - 50,000) \times 12$	360,000	
Medical expenses for wife		2,000,000	6,500,000
Total employment income			17,900,000
Other incomes			
Agricultural income	$(20,000,000 - 12,000,000)$		8,000,000
Total taxable income			25,900,000
Tax liability			
0 - 360,000	0%		-
360,001 - 1,200,000	20%		168,000
1,200,001 - 25,900,000	30%		7,410,000
Total tax liability			7,578,000
less tax paid at source			
PAYE	$150,000 \times 12$		(1,800,000)
Tax payable			5,778,000

Example five

Umwari is employed by the University of Rwanda as the Director of finance under the following contractual terms:

- Monthly salary 1,800,000RWF
- Transport allowance 200,000RWF per month
- Communication allowances 150,000RWF per month
- University house
- Overtime allowance 300,000RWF per month
- During the month of July 2019, she received a salary advance of 12,000,000RWF for six months. The university charged her an interest rate of 5% per year. The interbank interest rate is 15%.
- During the month of October, Umwari attended a university meeting in Kigali for a period of five days. She used 500,000RWF for accommodations which the university reimbursed her.
- Before joining the University of Rwanda, Umwari was employed by INES-Ruhengeri. She is receiving a pension of 300,000RWF per month from her previous employment
- During the month of April, her husband got an accident the university contributed to Umwari 2,500,000RWF on the cost treating the husband in India.
- The university contributes 150,000RWF for Umwari in the statutory pension fund and 100,000RWF in the private qualified pension fund.
- Umwari contributes 50,000RWF per month in the private qualified pension fund
- The employer withholds 400,000RWF per month as PAYE

Required:

Compute the taxable employment income of Umwari for the year ended 31/12/2019. Show by use of zero the non-allowable income.

Compute her tax liability and tax.

Particulars	Workings	Amount RWF'000'	Amount RWF'000'
Salary	1,800,000 x 12		21,600,000
Add allowances:			
Transport	200,000 x 12	2,400,000	
Over time	300,000 x 12	3,600,000	
Communication	150,000 x 12	1,800,000	
Pension payment	300,000 x 12	3,600,000	11,400,000
Employment income			33,000,000
Add benefits in kind:			
Salary advance	W1	330,000	
Accommodation		0	
Treatment		2,500,000	
Statutory pension	Exempted	0	
Private pension	W3	0	
Personal allowance	50,000 x 12	(600,000)	2,230,000
Taxable employment income			35,300,000
Tax liability			
0 - 360,000	0%		0
360,001 - 1200,000	20%		168,000
1200,001 - 35,300,000	30%		10,230,000
Tax liability			10,398,000
Less PAYE	400,000 x 12		(4,800,000)
Tax payable			5,598,000
W1 Salary advance			
Amount received	21,600,000/12) X 3 = 5,400,000	6,600,000	
Interest	12,000,000 - 5,400,000 6,600,000 x 10% x 6/12	330,000	
W2 Statutory pension allowed contribution	Exempted	0	
amount contributed		1,800,000	
benefits		178,200	
W3 Private pension amount contributed		1,200,000	
rule 10% of 33,000,000 or 1,200,000		1,200,000	
Benefit		0	

TEST YOUR UNDERSTANDING

Kabera is the Quality Assurance Manager with Manzi Construction Company Limited (MCCL). MCCL has its headquarters in Kigali and branches in Kampala, Nairobi and Arusha. Kabera oversees the quality

assurance department and sits at the company headquarters in Kigali. His effective date of appointment was 1 July, 2016. The following is a summary of the remuneration and benefits as per his appointment letter:

1	Basic salary 2,500,000RWF per month payable in arrears at the end of each month.
2	Leave pay 1,500,000RWF when the month leave is taken. Kabera took his leave in June, 2017.
3	Medical allowance 5,000RWF per month.
4	Travel allowance 750,000RWF. During the month of September, 2016, he travelled to Arusha for inspection of completed road projects.
5	He was given a company vehicle, Nissan pickup for both private and official use. The motor vehicle cost the company 37,500,000RWF.
6	In December, 2016 he requested for a salary advance of 8,000,000RWF to enable him start a poultry business, which was approved. The advance was to be recovered by 1 April, 2017 at no interest.
7	In June, 2017 he was paid a bonus of 0.5 % of his annual salary.
8	House servant allowance 75,000RWF. His house servant does general cleaning of his home.
9	The company paid his quarterly rent of 4,000,000RWF at his apartment located at Gasabo.
10	School fee was paid for one of his daughters 125,000RWF under the “support a girl child at school mission” from his church. The church is not part of MCCL
11	Received his yearly subsistence allowance in June, 2017 amounting to 1,235,000RWF.
12	The central bank discount rate was 12.5% in December, 2016 as issued by the National Bank of Rwanda.

Required

Compute Kabera’s chargeable income and tax payable for the year ended 30 June, 2017.

Compute the total amount of contributions that shall be paid to the Rwanda Social Security Board (RSSB) in respect to Kabera’s income.

Explain the tax treatment for the interest free salary advance amounting to 8,000,000RWF repayable by 1 April, 2017.

Test 2

Ntampaka, a water engineer graduate from the University of Rwanda, joined Geo Consult Limited which provides geological services across Rwanda in January, 2016. His employment contract includes the following terms:

(i)	A monthly salary of Frw 1,000,000.
(ii)	A motor vehicle provided by the company for his use since it is a long distance between his home and the office with a market value of Frw 10,000,000.
(iii)	Geo Consult Limited made a monthly retirement contribution on his behalf to Rwanda social security fund of Frw 200,000.
(iv)	Due to his busy work schedule during the year, he did not take his annual leave and as a result he was paid Frw 800,000.
(v)	He went to the field for an urgent official assignment and he paid for his accommodation and lunch amounting to Frw 150,000 which was reimbursed by the company when he returned.

(vi)	The company gave him a plot of land located in Gisagara which was bought in 2012 at Frw 2,000,000 with a current market value of Frw 3,000,000 as a bonus for his exceptional performance.
(vii)	He is entitled to medical allowances and a bonus of Frw 600,000 and Frw 700,000 per annum respectively.
(viii)	The company pays his house keeper a monthly salary of Frw 50,000.
(ix)	Before joining Geo Consult Limited, Ntampaka was formally employed by one of Geo Consult Limited's competitor from where he was head hunted with a promise of Frw 1,200,000 which was paid in March, 2016.

Required

Compute Ntampaka's annual employment income and tax liability for the year ended 31 December, 2016.

Test 3

Mrs. Kagabo Nicholas works with Inzuki SA, a well-known beverage company operating in Rwanda and has provided you with the following information for the year ended 31 December 2013

- Pension from previous employment Frw 20,000 per month.
- Salary Frw 1,200,000 per month.
- Mrs. Kagabo and her husband Mr. Kagabo own a company whose taxable income was agreed at Frw 500,000 after charging husbands salary of Frw 250,000 per month.
- Inzuki SA provided a company house to Mrs. Kagabo in Kabuga, where rent of similar houses was Frw 200,000 per month.
- Mrs. Kagabo works over time and her overtime income averages Frw 100,000 per month.
- Mrs. Kagabo enjoyed medical benefit of Frw 160,000 during the year. She is a senior manager and the company has medical cover for all its employees
- She obtained free consumables from the company as a Christmas gift worth Frw 300,000 during the year.
- Mrs. Kagabo owns rental property at Kagugu estates and receives Frw 500,000 as a rental income per month during the year; she incurred Frw 60,000 in renovation, repairs and painting before letting the property. She had obtained a mortgage loan from BRD amounting to Frw 3,000,000. She paid Frw 900,000 during the year of which Frw 500,000 was principal.
- Mrs. Kagabo owns 20% of the shares of Inzuki SA.

Required

Calculate the taxable income of Mr. and Mrs. Kagabo for the year ended 31 December 2013.

What is the tax payable on income computed in a) above?

5. Chantal, a medical doctor by profession was offered a five-year job contract with Amazing Grace Health Care Ltd (AGHC). The effective date of contract was 1st January, 2016 and it is subjected to renewal upon satisfactory performance for another five-year period. During the year ended 31st December, 2016, Chantal received the following benefits;

(a)	A monthly basic salary Frw 5,000,000.
(b)	Performance bonus Frw 12,000,000 per annum.
(c)	Leave pay of Frw 6,000,000 payable in the last month of the year in the contract.
(d)	Subsistence allowance Frw 700,000 per annum.
(e)	A company car valued at Frw 10,000,000.
(f)	A monthly fuel card Frw 1,200,000

Other relevant information:

1	Chantal travelled to Nairobi for holiday with her family and incurred Frw 900,000. The company refunded her half of the costs incurred.
2	The company paid school fees for her daughter amounting to Frw 1,000,000.
3	Obtained a reimbursement on her medical expenses Frw 600,000.
4	Accommodation at Nyarugenge Frw 2,000,000 per annum.

Required

Compute Chantal's chargeable income and tax payable for the year ended 31st December, 2016.

- Compute the total amount of contributions that shall be paid to the Rwanda Social Security Board (RSSB) in respect to Chantal's income.
- Identify any five taxable payments that are specifically excluded from employment

Test 6

You have been invited by a group of CPA students to discuss the matters listed below:

- A manager who is in full-time employment where he draws 800,000RWF per month. He is housed by the employer in a rented house where rent payable to the landlord is 960,000RWF per annum.
- The manager whose employer makes an annual contribution of Frw 840,000 to registered pension fund.
- The manager is provided with a motor car which had a purchase cost of Frw 12,000,000 and his annual salary is Frw 18,000, 000.
- A high school boy aged 15 years inherits Frw 3,000,000 from his grandfather and wins Frw 1,000,000 in the national lottery.
- A retired civil servant on annual pension of Frw 1,800,000 per annum signed a service contract with effect from 1st January, 2013. The contract was for three years at an annual salary of Frw 4,400,000. The contract was terminated by the employer on 31st December, 2013. The employee was paid compensation amounting to Frw 5,600,000.

Required

In each of the cases, provide explanatory notes and computations for use in your discussions with the students.

Test 7

Mr. Brown is an expert in the mining sector. He obtained a job with Mas Mining Company, Rwanda (MMC) on 1 January, 2016 as a mine supervisor under the following terms and conditions:

- 1 Annual salary 20,000,000RWF.
- 2 Furnished accommodation and a fueled car for private use.
- 3 He has two children attending school. His employer MMC provides an education allowance of 7,200,000RWF per annum paid to him in equal monthly installments.
- 4 The relocation cost was 5,235,000RWF to enable him and his family travel from Italy to Rwanda.
- 5 Subsistence allowance 1,200,000RWF per month.
- 6 Obtained medical reimbursement 1,500,000RWF.

Other income sources:

While in Rwanda, Mr. Brown obtained an online teaching job from India where he was paid 12,000,000RWF annually.

He also obtains 4,500,000RWF from the sale of his online journals in Rwanda annually.

Required

Compute Mr. Brown's chargeable income and tax payable for the year ended 31 December, 2016 including the amounts payable to the National Security Board.

b. Assuming that Mr. Brown did not relocate to Rwanda in order to provide the mine supervision services but only came to Rwanda for a total of 105 days in the year and earned 20,000,000RWF as his salary from MMC, and he did not earn any other allowances and benefits. The company only paid his accommodation costs of Hotel in Kigali. However, he was able to conduct his online teaching job and to sell his online journals while in the country. Advise Mr. Brown of his tax obligations on the income earned while in Rwanda.

Using examples, explain the meaning of foreign tax credit as provided in tax laws/ code.

Explain the circumstances under which a taxpayer, who is an employer and is paying taxes under the pay as you earn system, may be subjected to penalties and fines.

1.6.5 PENSION SCHEME

Pension funds scheme is a scheme established by the government providing benefits for the old, disabled by war or by work; or established by the former employer for employees after long service. Provident fund scheme, on the other hand, is a scheme established by an organisation

Pension Contributions

Where the individual is an employee, his employer may make contributions to his pension scheme as part of his employment benefits package. Such contributions are exempt benefits for the employee.

	Employer	Employee
Pension	3%	3%
Occupation hazards	2%	0
Maternity	0.3%	0.3%
Total	5.3%	3.3%

Tax base = Gross salary – transport allowance + benefits in kind

QUALIFIED PENSION FUND

Qualified pension fund means any fund which fulfils the following:

- one which was established according to Rwanda laws;
- one which is operated for the principal purpose of providing pension payments to residents in the country;

- one which has effective management in Rwanda at any time during the tax period.

1.7 TAXATION OF BUSINESS PROFIT OF INDIVIDUALS

Article 19 section 3 of Law 16/2018 provides guidelines on the computation of business profits. According to Article 19 of Law 16/2018 business profits are determined as the income from all business activities reduced by all business expenses. Business profit also includes proceeds of sale of any business asset and proceeds from asset sharing received during the tax period. Business profits are determined per tax period on the basis of the profit or loss account drawn up in accordance with Generally Accepted Accounting Principles, subject to the provisions of this Law. The Tax Administration may use any other accounting method or other source of information in accordance with the law, to ensure the accuracy of the taxpayer's profit.

1.7.1 TAX EXEMPTION FOR INDIVIDUAL INCOME

However, according to Article 20 of Law 16/2018 there is a tax exemption for income accrued from savings and employees' shares scheme within a company. Income accruing from savings in collective investment schemes and employees' shares scheme within a company are exempted from income tax.

1.7.2 TAX EXEMPTION FOR PROFIT ON AGRICULTURAL AND LIVESTOCK ACTIVITIES

Article 21 of Law 16/2018 also provides that income earned by an agriculturalist or a pastoralist on agricultural or livestock activities is exempt if the turnover from agricultural or livestock activities do not exceed twelve million Rwanda francs (12,000,000RWF) in a tax period. In case the turnover exceeds twelve million Rwandan francs (12,000,000RWF), the latter amount is excluded from the taxable income.

Example

Jaden owns a farm in Bugesera where he practices agriculture and livestock farming. During the year ended 31/12/2018 he received the following incomes

Item	Turnover in amount RWF
Sale of milk	8,120,000
Sale of bananas	5,000,000
Sale of beans	7,500,000
Sale of Irish potato	4,200,000

Required

Compute his taxable income and tax liability

Taxable income $24,820,000 - 12,000,000 = 12,820,000$

Tax Liability since the turnover is below 50,000,000, Jaden can opt to be taxed in the lump sum regime. And since the turnover is above 20,000,000RWF, the tax rate will be 3%

Tax liability $3\% \times 12,820,000 = 384,600$

A taxpayer running a small business as mentioned under item 2° of Article 3, and Paragraph 2 and 3 of Article 12 of the Law 16/2018, may decide to pay a tax on actual profit derived from business activities in accordance with a simplified accounting method to be determined by an Order of the Minister. Such an option may be subject to change after three (3) years.

1.7.2 PROFIT ON ASSETS IN FOREIGN CURRENCY

Article 23 of Law 16/2018 provides that during the conclusion of the tax period, the assets in foreign currency, including claims and debts, are valued at the exchange rate on the last day of the tax period. The profits or loss therein are included in the assessment of business profit for that period

Value of the asset at the end	XXX
Less value of asset at the beginning	(xxx)
Gain/loss on valuation	XXX

1.7.3 COMPUTATION OF TAXABLE PROFITS

Step 1: Profits / loss +- xxx

Step 2: Consider each item of expenses which have been debited and deducted

Allowable - leave

Disallowable - add

Step 3: Consider each item of income which has been credited and deducted

Trading - leave

Non trading - deduct

ii. Consider any item which should be debited but are not and deduct e.g. premium paid on short lease.

iii. Consider any item of income which should be credited and add.

Step 4: Deduct capital allowance on plant and machinery and industrial building.

1.7.4 DEDUCTIONS FROM TAXABLE INCOME/ALLOWABLE EXPENSES

Article 25 of Law 16/2018 provides that in determining profits on business activities, expenses deducted from taxable income must fulfil the following conditions:

They are incurred for the direct purpose of the business and they are directly chargeable to the income;

They correspond to a real expense and can be substantiated with proper purchase receipts;

They lead to a decrease in the net assets of the business;

They are used for activities related to the tax period in which they are incurred.

1.7.5 NON-DEDUCTIBLE EXPENSES FROM TAXABLE INCOME

According to Article 26 of Law 16/2018, the following expenses are not deductible from the taxable business income:

- Dividends declared and profits paid-out to their beneficiaries;
- Reserve allowances, savings and other special-purpose funds, unless otherwise provided for by this Law;
- Fines and similar penalties; donations, save for donations given to non-profit making organisations the value of which does not exceed one percent (1%) of the turnover;
- Income tax paid in accordance with this Law or paid abroad on business profit and recoverable Value Added Tax (VAT);

- Personal consumption expenses;
- Entertainment expenses except for expenses on general sporting activities for employees;
- Twenty per cent (20%) of expenses paid on business overheads as in the case of telephone, water, electricity and fuel whose private and business use cannot be practically separable;
- Management, technical services and royalty fees paid to a non-resident person exceeding two percent (2%) of the turnover of the taxpayer;
- Interest arising from loans between related persons either paid or due on a total loan which is greater than four (4) times the amount of equity. This equity should not include provisions or reserves according to the balance sheet, which is drawn up in accordance with the Generally Accepted Accounting Principles.

The provisions under item 10° of this Article do not apply to commercial banks, financial institutions and insurance companies.

1.7.6 TRADING STOCK VALUE

According to Article 27, 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. However, the work in progress is valued at cost price.

1.7.7 DEPRECIATION

Article 28 of Law 16/2018 provides that, in the determination of business profit, depreciation for business assets is deducted from taxable income.

- Buildings, heavy industrial equipment and machineries are depreciated annually, each on its own, on the basis of the rate of depreciation equivalent to five percent (5%) of the cost of acquisition, construction, refining, rehabilitation or reconstruction.
- Intangible assets including goodwill that is purchased from a third party are depreciated annually, each on its own, on the basis of the rate of depreciation of ten percent (10%) of the cost of acquisition, refining, rehabilitation or reconstruction.
- Information and communication systems whose life is over ten (10) years are depreciated annually on the basis of the rate of depreciation of ten percent (10%) of the cost of acquisition.
- Land, fine arts, antiquities, jewellery and any other assets that are not subject to wear and tear or obsolescence are not depreciated.
- The assets in the following two categories are depreciated in a pooling system on the basis of the following rates:
 - Computers and accessories, information and communication systems whose life is under ten (10) years: fifty percent (50%);
 - Any other business asset: twenty-five percent (25%).

1.7.7.1 Leased Assets

Depreciation of leased assets is allowed to the lessee in case of finance lease and to the lessor in case of operating lease.

1.7.7.2 Depreciation Basis

According to Article 29 of Law 16/2018, the depreciation basis for assets is the acquisition value. However, for the assets depreciated in the pooling system, their depreciation basis is the book value in the balance sheet at the beginning of the tax period:

- Increased by the cost of assets acquired or created and the cost of refining, rehabilitation and reconstruction of the assets in the tax period;
- Decreased by the sale price of assets sold and the compensation received for the loss of assets due to natural calamities or other conversion during the tax period.

Computation of Depreciation

Cost/WDV	XXX
Additional	XX
Less disposal (sales price)	(XX)
Depreciation Basis	XXX
Apply appropriate depreciation rate	X%
Depreciation	XXX

However, if the depreciation basis is less than zero (0), that amount is added to the business profit and the depreciation basis becomes zero (0). If the depreciation basis does not exceed five hundred thousand (500,000) Rwanda francs, the entire depreciation basis is deemed to be a deductible expense.

1.7.8 Training and Research Expenses

According to Article 30 of Law 16/2018, if during a tax period, all training and research expenses incurred by a taxpayer, which promote business activities, are considered as deductible from taxable income in accordance with provisions of Article 25 of the Law, if they have been declared and planned in the activity plan of that tax period. However, expenses on training and research for the promotion of business activities do not concern the purchase of land, houses, buildings and other immovable properties including refining, rehabilitation and reconstruction as well as assets exploration expenses.

1.7.9 Bad Debts

Article 31 of Law 16/2018 provides that in the determination of business profit, a deduction is allowed for bad debts if the following conditions are fulfilled:

- If an amount corresponding to the debt was previously included in the income of the taxpayer;
- If the debt is written off in the books of accounts of the taxpayer;
- If the taxpayer has taken all possible steps in pursuing payment and has shown a court decision declaring the insolvency of his/her debtor.
- However, for an individual whose debt is less than three million Rwandan francs (3,000,000RWF) in addition to the conditions referred to in points 1° and 2° of Paragraph One of this Article, the taxpayer must provide proof that he has taken all reasonable steps over a period of three (3) years to recover the debt.

Notwithstanding the provisions of Paragraph One of this Article, commercial banks and leasing entities duly licensed as such are allowed to deduct from taxable income, any increase of the mandatory reserve for non-performing loans as required by the directives related to management of bank loans and similar institutions of the National Bank of Rwanda. The business profit is increased by the entire amount recovered from bad debts deducted from such reserves

1.8 LOSS CARRIED FORWARD

According to Article 32 of Law 16/2018 if the computation of business profit results in a loss during a tax period, the loss may be deducted from the business profit in the next five (5) tax periods, earlier losses being deducted before later losses. However, the Tax Administration may authorise the taxpayer who so applied for, the loss carried forward of more than five (5) tax periods if s/he fulfils requirements determined by an Order of the Minister.

During a tax period, foreign sourced losses cannot be deducted from either present or future domestic sourced business profits. If during a tax period, the direct and indirect ownership of the share capital or the voting rights of a company, whose shares are not traded on a recognized stock exchange changes more than twenty five per cent (25%) by value or by number, the provisions of Paragraph one of this Article ceases to apply to losses incurred by that company in the tax period and previous tax periods.

The Computation of the Loss

The trade loss for a tax year is the trade loss in the basis period for that tax year. Example: computation of trade loss. Here is an example of a trader with a 31 December year end who has been trading for many years. During the year ended 31/12/2010 the business made a loss of 1,000,000rwf and during the year ended 31/12/2012 he made a loss of 2,500,000rwf.

	2011	2012
Profit/loss	(1,000,000)	2,500,000
Loss relief	1,000,000	(1,000,000)
Taxable profit		1,500,000

Loss relief is given by deducting the loss from total income to calculate net income. Carry forward loss relief and terminal loss relief can only be set against the trading profits of the same trade. Other loss relief may be set against general income (i.e. any component of total income).

Example: Dusabimina is a business lady in Gisenyi for many years. Her profits and losses for three years are as indicated below:

Year	2006	2007	2008
Profit/Loss	(500,000)	200,000	1,000,000
Compute her taxable profits			
Year	2006	2007	2008
Profits/loss	(500,000)	200,000	1,000,000
Loss relief	500,000	(200,000)	(300,000)
Taxable profits	0	0	700,000

The loss in 2006 will be carried forward to 2007. But because the profits in 2007 cannot cover all the loss, the remaining balance will be carried to 2008.

Example: the following information was extracted from the financial statements of highlands limited for the years ended 2013, 2014 and 2015. Show how the losses will be carried forward.

Particulars	2013	2014	2015
Trading Profit/loss	(8,550,000)	3,000,000	6,000,000
Property income	0	1,000,000	1,000,000
Total	(8,550,000)	4,000,000	7,000,000

Solution:

Particulars	2013	2014	2015
Total profits	(8,550,000)	4,000,000	7,000,000
Loss carried forward	4,000,000	(4,000,000)	
Taxable profits	(4,550,000)	0	7,000,000
Loss c/f	4,550,000	0	(4,550,000)
Taxable profits	0	0	2,450,000

TEST YOUR UNDERSTANDING

Joseph is a business man in Kigali city and has been in operation for many years. His profits and losses for the years 2005-2009 is as below:

Year	2005	2006	2007	2008	2009
Profits/loss	(1,000,000)	(500,000)	300,000	(100,000)	1,800,000

Compute his taxable profits.

Mandazi Limited owns a supermarket in Kigali town. The company has been in business for the last four years. In the first two years, the company registered a loss of 2,000,000rwf and 3,000,000rwf respectively. In the third year and fourth year, the company made a profit of 1,500,000rwf, and 3,000,000rwf respectively. Explain his taxable benefits that are provided by the tax laws

Made in Europe, Rwanda limited imports and exports commodities from, and to Europe. The company has been operating since 2010. The following information relates to the company for the last five years

	2010	2011	2012	2013	2014
Profit/loss before tax	(14,205,000)	6,000,000	9,850,000	(8,210,000)	10,000,000
Withholding tax on imports	7,850,000	11,300,000	14,780,000	6,420,100	5,790,000
Installment income tax	2,150,000	1,050,200	3,420,000	1,700,000	2,500,000

Required: Prepare a tax payment plan

1.9 CAPITAL DEDUCTIONS

Capital allowance may be defined as a form of standardized depreciation given under income tax laws on certain specified qualifying capital expenditures. They are granted in place of depreciation charges, which are disallowed by the government to the trader/businessman, over a considerable period of time, in order to encourage automation in the industry.

Capital allowances are allowances granted at approved specified rates on qualifying capital expenditures and rates on assets in use for the purpose of business at the end of the relevant basis period. Accordingly, the qualifying capital expenditure must have been incurred in a basis period that is proceeding the basis period ending in the preceding tax year. The allowance is allowed not as a deduction in computing assessable profit but as a deduction from assessable profits in arriving at chargeable profits.

Capital allowances are available to give tax relief for certain capital expenditure. Capital expenditure on plant and machinery qualifies for capital allowances. Capital Allowance is claimed by the business. These allowances are given against profits and they reduce the taxable profits. There are mainly three types of capital allowance or capital deductions and these include;

- i. Accelerated Depreciation
- ii. Wear and tear
- iii. Balancing allowance/ charge.

1.9.1 ACCELERATED DEPRECIATION

This is granted to provide an incentive to businessmen to invest in capital projects and allowed only once in a year in which the asset is first used.

A registered investor is entitled to a flat accelerated depreciation rate of fifty per cent (50%) for the first year for new or used assets if he/she meets the following criteria:

- 1 Invest in business assets worth at least fifty thousand US dollars (USD 50,000) each;
- 2 Operate in at least one of the sectors below and meet the requirements:
 - a) Export projects;
 - b) Manufacturing;
 - c) Telecommunications;
 - d) Agro processing;
 - e) Education;
 - f) Health;
 - g) Transport excluding passenger vehicles with less than nine (9) people seating capacity;
 - h) Tourism investments worth at least one million eight hundred thousand United States Dollars (USD 1,800,000);
 - i) Construction projects worth at least one million eight hundred thousand United States dollars (USD 1,800,000);
 - j) Any other sectors provided the investment is worth at least one hundred thousand United States dollars (USD 100,000);
 - k) Any other priority sector as may be determined by an Order of the Minister in charge of finance;
- 3 Meet the obligations defined below:
 - a) Keep the assets for at least three (3) years after benefiting from the accelerated depreciation;
 - b) Inform the Commissioner General of the Rwanda Revenue Authority of the disposal of the business assets in case such disposal is made before three (3) years. Where an investor makes the disposal of such assets before the expiration of three (3) years, he/she shall pay the difference from the reduction of corporate income tax caused by the accelerated depreciation as well as any applicable penalties and interests. However, the investor shall not be liable to pay any amount where it is determined that such disposal was the effect of natural calamities, hazards or any other involuntary reason.

If the business asset that is granted an investment allowance is disposed before the end of the period mentioned in point 2, the reduction of income tax caused by the investment allowance, increased by an interest and penalties applicable to taxpayers who do not pay tax on time, starting from when that investment allowance was granted to the time of disposal, must be paid back to the Tax Administration unless such an asset is removed due to natural calamities or other involuntary conversion.

The cost of land is disallowed but expenditure incurred in preparing land for building does qualify. The cost of items which would not be included in a normal commercial lease (such as rental guarantees) also does not qualify. Professional fees, for example architects' fees, incurred in connection with the construction of an industrial building qualify. The cost of repairs to industrial buildings also qualifies, provided that the expenditure is not deductible as a trading expense.

Computation of wear and tear

Written down value (W.D)/cost at the beginning of the year	xxx
Add cost of new machine bought during the year	<u>xxx</u>
Total cost	xxx
Fair amounts realised on disposal of any part of machine	<u>(xxx)</u>
Book value	xxxx
Apply a wear and tear rate (X %)	<u>(X X)</u>
Written down value (WDV)	XXX

Example One

a. Madini enterprises limited is registered under Rwanda's commercial law and received an RDB investment certificate worth 800,000,000RWF. The company is located in Burera district and deals in the mining of Wolfram. The company started its operations on 1/1/2016. In the first year of operation, the company purchased and constructed the following assets.

- i. Heavy Plant and machineries 250,000,000RWF
- ii. Two trucks at 80,000,000RWF each
- iii. Computers 20,000,000RWF
- iv. Software 8,000,000RWF
- v. Furniture 8,500,000RWF
- vi. Building 150,000,000RWF of which 20,000,000RWF is office block the remaining part is factory block

In 2017, the company purchased additional assets which included:

- i. Machineries 85,000,000RWF
- ii. Two four sitter cars for the managers at 14,000,000RWF each
- iii. Extended the factory building at 40,000,000RWF
- iv. Two computer software at 2,000,000RWF each

In 2018, two computers were sold at 2,500,000RWF. And some furniture was disposed of at 4,000,000RWF.

Required

Compute the capital allowances of Madini enterprises for the years ended 31/12/2016, 2017 and 2018.

Computation of Capital Allowance for the Year Ended 31/12/2016/2017/2018

Computation of Capital Allowance for the Year Ended 31/12/2016/2017/2018

	RWF(000)	RWF(000)	RWF(000)	RWF(000)	RWF(000)
	Building	P & M	C & A	Other assets	Cap. Allow
COST 1/1/16	150,000	250,000	28,000	168,500	
Accelerated Dep	50%	50%	50%	50%	
ALLOW.	75,000	125,000	0	80,000	280,000
DEP. VALUE	75,000	125,000	28,000	88,500	
W & T Rate	5%	5%	50%	25%	
W & T	3,750	6,250	14,000	22,125	46,125
Total Cap ALL.					286,125
cost/WDV 2017	75,000	125,000	14,000	66,375	
additional assets	40,000	85,000	4,000	28,000	
Accelerated Dep 2017	0%	50%	0%	0%	
Allowance		42,500	0	0	42,500
Dep. Value	115,000	167,500	18,000	94,375	
W & T	5,750	8,375	9,000	23,584	46,709
Total Cap Allow.					89,209

Cost/ WDV 2018	115,000	167,500	9,000	70,791	
disposal			(2,500)	(4,000)	
Dep Value	115,000	167,500	6,500	66,791	
W & T	5,750	8,375	3,250	16,698	34,073

Note: On other asset the accelerated depreciation is calculated only on the motor vehicle since the value of furniture is below 50,000USD

Note: 1. In the first year, the accelerated depreciation is only calculated on assets whose value exceeds 50,000USD otherwise a normal depreciation of the assets

Note2: In the second year, only one asset qualifies for accelerated depreciation others only calculate a normal depreciation

Note3: WDV/Cost at the end Cost plus new assets minus accumulated depreciation

1.10 ADVANCED ASPECT OF CORPORATE INCOME TAX

As per Article 44 of Law 16/2018, the corporate income tax is levied on business profits received by companies.

1.10.1 SCOPE OF TAX LIABILITY OF CORPORATE INCOME TAX

As per Article 48 of Law 16/2018 all resident entities are liable to corporate income tax on business profit per tax period, whether from domestic or foreign operations. However, dividends paid between resident companies and which have been subject to the withholding tax are not included in corporate taxable income. Non-resident entities shall be liable to corporate income tax on business profit per tax period, which is equivalent to the income tax applicable to resident entities, through their permanent establishments in the country.

1.10.2 CORPORATE INCOME TAX RATE

According to Article 49, the taxable Business profit is rounded down to the nearest one thousand Rwandan Francs (1,000RWF) and taxable at a rate of thirty percent (30%). However, newly listed companies on capital market shall be taxed for a period of five (5) years on the following rates:

- Twenty percent (20%) if those companies sell at least forty percent (40%) of their shares to the public;
- Twenty-five percent (25%) if those companies sell at least thirty percent (30%) of their shares to the public;
- Twenty-eight percent (28%) if those companies sell at least twenty percent (20%) of their shares to the public.

1.10.3 Tax Declaration

As per Article 50 of Law 16/2018 a taxpayer who receives taxable business profit prepares an annual tax declaration in accordance with the procedure determined by the Tax Administration and presents it, at the same time, with the accounting balance sheet, profit and loss statement for the tax period, the annexes thereto, as well as any other relevant document required by the Tax Administration, not later than 31st March of the following tax period The amount of tax to be paid is calculated on the basis of the annual basic declaration, reduced by:

The tax withheld on taxable income; with the exception of the tax withheld on employment income, as well

as on income to which lump sum tax or flat tax rate are applied.

The prepayments made every quarter.

Example

The taxable profit of the company is 30,000,000RWF for the year ended 31/12/2018. During the year, the company made a quarterly prepayment of 2,500,000RWF and had a withholding tax on imports of 2,000,000RWF.

Required

Compute the tax liability and the tax payable.

Solution

Particulars	Amount 'RWF'
Tax liability $30,000,000 \times 30\%$	9,000,000
Less the quarterly prepayments	(2,500,000)
Less withholding on imports	(2,000,000)
Tax payable	4,500,000

The tax is paid to the Tax Administration on the date the tax declaration is submitted which is 31st March after the end of the tax period. If a withheld or prepaid tax exceeds the amount of tax liability calculated on the basis of Paragraph One of this Article, it is considered by the tax administration as liquidation of tax arrears or as the payment of any future tax obligations. Upon a written request by the taxpayer and upon satisfaction that prior tax obligations have been discharged, the Tax Administration returns to the taxpayer the excess amount within thirty (30) days from the date of receipt of the request.

1.10.4 Computation of Corporate Income Taxation

According to Article 51 of Law 16/2018, the corporate income is taxable in the same way as personal income as provided for in the previous Chapter. However, the following companies are taxed as below:

- small business companies pay a lump sum tax of three per cent (3%) of the turnover;
- micro-enterprise companies pay the flat tax whose amount is indicated in accordance with the table referred to under Article 12 of Law 16/2018;

Without prejudice to real profit tax regime, companies operating in the Transport of persons and goods by road pay a flat tax calculated as indicated in chapter three.

1.10.5 Taxation of Income from the Rent of Movable and Immovable Assets

According to Article 52 of Law 16/2018, income from the rent of movable and immovable assets incorporated as assets of entities which are subject to corporate income tax is consolidated in the total taxable income.

1.10.6 Corporate Restructuring

Article 53 defines corporate restructuring as follows:

- A merger of two or more resident companies into a separate company;
- The acquisition or a takeover of fifty percent (50%) or more of shares or voting rights, by number or value in a resident company in exchange for shares of the purchasing company;
- The acquisition of fifty percent (50%) or more of the assets and liabilities of a resident company by another resident company solely in exchange of shares in the purchasing company;

- The acquisition of the entire company's assets so that its existence is replaced by the purchasing company;
- Splitting of a resident company into two or more resident companies.

1.10.7 Taxation of Restructured Companies

- According to Article 54, in case of restructuring of companies, the transferring company is exempted from tax in respect of capital gains and losses realized on restructuring. The receiving company values the assets and liabilities involved at their book value in the hands of the transferring company at the time of restructuring. The receiving company depreciates the business assets according to the rules that would have applied to the transferring company as if the restructuring did not take place.
- In case of restructuring, the receiving company is entitled to carry over the reserves and provisions created by the transferring company, subject to the conditions that would have applied to the transferring company as if the restructuring did not take place. The receiving company assumes the rights and obligations of the transferring company in respect of such reserves and provisions.

1.10.9 Taxation in case of Liquidation

According to Article 55 of Law 16/2018, the liquidation proceeds of a company, after payment of liabilities and distribution of dividends, the remainder, is considered as dividends on shares in the last tax period of the company's existence.

Example

Company X was liquidated on 30/11/2018. The proceeds from the sale of the assets were 250,000,000RWF. The liabilities were 100,000,000RWF and the capital of the shareholders was 80,000,000RWF.

Required

Compute the tax on the liquidation.

Particulars	Amount 'RWF'
Proceeds	250,000,000
Less liabilities	(100,000,000)
Less capital	(80,000,000)
Net liquidation proceeds	70,000,000

The net liquidation proceeds are considered as a dividend and will be taxed at 15%

WHT 15% x 70,000,000 = 10,500,000RWF

1.2.10 TAXATION OF PARTNERSHIPS BUSINESS

Partnerships

A partnership is a group of individuals who are trading together. They will agree amongst themselves how the business should be run and how profits and losses should be shared. Profits from partnership business are taxed at corporate rates like companies (30%). The tax law tax the firm not the partners.

Example 1

Adeline, Nuru and Aisha are in partnership sharing profits and losses in the ratio of 3:2:1 respectively. Their statement of comprehensive income for the year ended 31/12/2017 is as below.

Particulars	Amount 'RWF'	Amount 'RWF'
Sales		120,000,000
Less cost of sales		45,000,000

Gross profits		75,000,000
Other Incomes	Dividend(Net)	15,000,000
		90,000,000
Less expenses		
Salaries:		
Adeline	5,000,000	
Nuru	8,000,000	
Aisha	9,000,000	
Interest in Capital:		
Adeline	2,000,000	
Nuru	1,000,000	
Aisha	3,000,000	
Bad debt	1,500,000	
Electricity	3,000,000	
Audit fee	2,000,000	
Rent	6,000,000	
Legal fee	2,000,000	
Depreciation	3,200,000	
Repair and maintenance	1,200,000	(46,900,000)
Net profit		43,100,000

Additional Information:

1. The repair and maintenance include 500,000RWF for the purchase of computer.
2. The dividend was received from a foreign investment in a Kenyan company net of 15%
3. Of the Bad debt 800,000RWF is still provisional
4. On 1/9/2017 the new profit and loss sharing ratio was 1:1:1
5. Allowable capital allowance is 10,000,000RWF.

Required: Compute the taxable profit of each partner and the tax liability.

Solution

Particulars	Amount 'RWF'	Amount 'RWF'
Net profit		43,100,000
Add back:		
Depreciation	3,200,000	
Interest on capital:		
Adeline	2,000,000	
Nuru	1,000,000	
Aisha	3,000,000	
Provision for bad debt	800,000	
Repair and maintenance	500,000	10,500,000
		53,600,000
Less amount not taxable income		
Dividend Net		(15,000,000)
		38,600,000
Less capital Allowances		(10,000,000)
Taxable partnership profits		28,600,000

Add dividend income gross	(100/85 x 15,000,000)	17,647,058
Total Taxable Income		46,247,058

Tax liability (30% x 46,247,058) = 13,874,117

Net profit (46,247,058 – 13,874,117) = 32,372,941 x 8/12 = 21,581,961

4/12 x 22,472,941 = 10,790,980

Distribution Profit to Each Partner

	Adeline	Nuru	Aisha	Total
	'RWF'	'RWF'	'RWF'	'RWF'
Salary	5,000,000	8,000,000	9,000,000	22,000,000
Capital Interest	1,000,000	2,000,000	3,000,000	6,000,000
Profits to 31/08/2017	8,790,981	5,860,654	2,939,326	17,581,961
Profits from 1/09/2017	2,930,327	2,930,326	2,930,327	8,790,980
Total	15,901,726	15,166,118	16,735,608	54,372,941

Note: The total profit to be shared by the partners in the first period will be 21,581,961 – (8/12 x 6,000,000) and in the second period it will be 8,457,647 – (4/12 x 6,000,000)

1.2.11 TAXATION OF CORPORATIONS

1.2.11.1 Residence of Companies

- A company is of Rwandan resident if it is incorporated in Rwanda or
- if it is incorporated abroad and its central management and control is exercised in Rwanda.
- It has a permanent establishment in Rwanda

1.2.11.2 Taxable Total Profits

- Taxable total profits comprise of the company's income and chargeable gains (total profits) less some losses and gift aid donations. It does not include dividends received from other Rwandan resident companies.

1.2.11.3 Computation of Taxable Profits

Income includes trading income, property income, and income from non-trading loan relationships (interest) and miscellaneous income. A company may have both income and gains. As a general rule income arises from receipts which are expected to recur regularly (such as the profits from a trade) whereas chargeable gains arise on the sale of capital assets which have been owned for several years (such as the sale of a factory used in the trade).

A company may receive income from various sources. All income received must be classified according to the nature of the income as different computational rules apply to different types of income. The main types of income for a company are:

- Profits of a trade
- Profits of a property business
- Investment income
- Miscellaneous income

The computation of chargeable gains for a company is dealt with later in this Text. At the moment, you will be given a figure for chargeable gains in order to compute taxable total profits. Losses are dealt with in detail later in this text, so, at the moment, some losses are given tax relief by being deducted from total profits. A company's taxable total profits are arrived at by aggregating its various sources of income and its chargeable gains and then deducting losses and gift aid donations.

Here is a pro-forma computation.

Particulars	RWF
Computation corporate tax	
Profits from trading	XXX
Less capital allowances	(xxx)
Over sea incomes	XXX
Rental income	XXX
Interest income from non-trading	Xxx
Total profits	XXX
Tax credits (loss)	(xxx)
Taxable profits	Xxx
Corporate tax 30%	(xxx)
Less any relief (withholding, instalment and tax credits)	(XX)
Corporate tax liability	XXX

1.2.11.4 TRADING INCOME

Adjustment of Profits

The adjustment of profits computation for companies broadly follows that for computing business profits subject to income tax. There are, however, some minor differences. The trading income of companies is derived from the profit before taxation figure in the income statement, just as for individuals, adjusted as follows.

	RWF
Profits before taxation	X
Add expenditure not allowed for taxation purposes	X
	X
Less: Incomes not taxable as trading income	X
Expenditure not charged in the accounts but allowable for the purposes of taxation	X
Capital allowances	(X)
Profit adjusted for tax purposes	X
Allowable deductions	

1.2.11.5 Property Business Income

Rental income is deducted in arriving at trading income but brought in again further down in the computation as property business income. The calculation of property rental business income follows income tax principles under article 43 of Law 16/2018. The income tax rules for property businesses were set out earlier in this book.

Gross incomes	XXX
Allowable expenses 10%	(XX)
Depreciation	(XX)
Interest expense	(XX)
Taxable rental income	XXX

Accounting Methods

Debits and credits must be brought into account using the Rwanda generally accepted accounting practice (GAAP) or using the International Accounting Standards (IAS). This will usually be the accruals basis.

1.2.11.6 Miscellaneous Income

Patent royalties received which do not relate to the trade are taxed as miscellaneous income. Patent royalties which relate to the trade are included in trading income normally on an accruals basis.

Example

Made in Rwanda limited operates a general merchandise shop for products that are made in Rwanda. The accountant submitted the following information for the tax assessment purposes:

Particulars	RWF '000'	RWF '000'
Sales		450,000
Cost of sales		(310,000)
Gross profit		140,000
Dividend	10,500	
		150,500
Less operating expenses		
Salaries	40,800	
Rent	25,500	
Electricity	8,000	
Insurance	1,500	
Repair and maintenance	12,800	
Bad debt	4,200	
Office furniture	10,000	
Communication	8,000	
Dividends	25,500	(136,300)
Operating profit		14,200

Addition information:

1. The dividends were received from a local company net of 15% of withholding tax.
2. Salaries amounting to 4,700,000RWF accrued
3. Of the repair and maintenance 8,000,000RWF relates to extension of the building
4. Of the bad debt, 2,500,000RWF is specific
5. Communication expenses relates to the money given to directors for communication. It is difficult to separate the private and business transactions.

Required:

Compute the taxable income and the corporate tax liability

Solution

Computation of Taxable Income and Tax Liability of Made in Rwanda Limited for the Year Ended 31/12/2016

items	Workings	RWF '000'	RWF '000'
Operating profits			14,200
add back non allowable expenses			
repair and maintenance		8,000	
bad debt	(4,200 -2,500)	1,700	
office furniture		10,000	
communication	20% x 8,000	1,600	
dividends		25,500	46,800
			61,000
less un recorded expenses			
accrued salaries			(4,700)
			56,300
less un allowable income			
dividend from local company			(10,500)
Taxable income			45,800
Corporate tax	30% x 45,800		13,740

Example 2

Made in Rwanda limited is a registered company in Rwanda located in Bugesera district. The company operates a number of branches and subsidiaries within and outside Rwanda. During the year ended 31/12/2015, the accountant submitted the following information for tax assessment.

Particulars	RWF '000'	RWF '000'
Sales		460,000
Cost of sales		280,000
Gross profit		180,000
Other incomes		
Dividends	18,900	
Profits	26,750	
Interests	4,500	50,150
		230,150
Operating expenses		
Rent	38,890	
Electricity	8,610	
Donation	5,430	
Salaries and wages	48,600	
Depreciation	14,500	
Bad debt	3,800	
Advertising	13,800	
Directors' allowances	20,700	
Repair and maintenance	15,100	

Income tax	3,780	
VAT	75,600	
Communication	11,400	
Dividends	8,200	
		(268,410)
Operating loss		(38,260)

Additional information

- 10,000,000RWF of the dividend income was received from subsidiaries in Kenya. The dividend was received net of 20%. The remainder was received net from the local companies.
- The profit was received from the branch in Uganda and it was received net of 25% income tax.
- The interest income was received from the long term government bond. The bond has a maturity period of 10 years.
- Rent was paid 1/1/2015 to cover a period up to 30/3/2016.
- The donation was made to charitable recognized organization.
- Salaries amounting to 6,470,000RWF remained outstanding. This amount has not been recognized.

The depreciation expenses relates to the following assets

Assets	Land	Building	Computer and accessories	Furniture and fittings	Motor vehicle
Cost	50,000,000	120,500,000	12,800,000	10,700,000	25,960,000
Acc. Dep		(15,500,000)	(3,800,000)	(1,500,000)	(6,000,000)
WDV 31/12/2014	50,000,000	105,000,000	9,000,000	9,200,000	19,960,000

- Included in the bad debt is the amount of 1,200,000 which is the provision for bad debt which was made during the end of year after failing to meet the customer in his shop.
- Included in the repair in maintenance is an amount of 6,000,000 for the extension of the building. This amount has not been recognized in the cost of assets
- The communication expenses relate to the money loaded on the mobile phones of the directors which money is used for both private and business.

Required

Compute the taxable income, the tax liability and the tax payable.

Solution

Particulars	Workings	RWF '000'	RWF '000'
Operating loss			(38,260)
Add back non allowable expenditure			
Rent	$(38,890/15) \times 3$	7,778	
Donation	$1\% \times 460,000 = 4,600$	830	
	5,430 – 4,600		

Depreciation		14,500	
Bad debt		1,200	
Repair and maintenance		6,000	
Income tax		3,780	
VAT		75,600	
Communication	20% x 11,400	2,280	
Dividends		8,200	120,168
			81,908
Less non allowable income			
Dividends	18,900 – 10,000		(8,900)
			73,008
Less non trading income			
Foreign dividends		10,000	
Foreign profits		26,750	
Interest		4,500	(41,250)
			31,758
Less un recorded expenses			
Salaries and wages			(6,470)
			25,288
Add back allowable business income			
Foreign dividends	10,000 x 100/80	12,500	
Foreign profits	26,750 x 100/75	35,667	
Interest	4,500 x 100/95	4,737	52,904
Business income			78,192
Less capital allowances	N1		(18,115)
Taxable income			60,077
Tax liability	60,077 x 30%		18,023
Less double taxation relief			
Tax on foreign profit	35,667 x 25%	8,916	
Tax on dividend	12,500 x 15%	1,875	
Withholding tax on interest	4,737 x 5%	237	(11,128)
Tax payable			6,895
Total			

N1 Capital Allowances

Assets	Land	Building	Computers and accessories	Furniture and fittings	Motor vehicles	Total
Bal b/d	50,000,000	120,500,000	9,000,000	9,200,000	19,960,000	
Additional		6,000,000				
Total	50,000,000	126,500,000	9,000,000	9,200,000	19,960,000	
Dep rate	0	5%	50%	25%	25%	
Depreciation	0	6,325	4,500	2,300	4,990	18,115

Example Seven

Muvandimwe Ltd is a registered investor in Rwanda. The company is located in Huye and maintains a branch in Burundi (Bujumbura) and other investments within East Africa. The company processes and manufacture iron sheets, iron bars and other hardware materials. In order to raise more capital to finance its operations, the company has just sold 20% of its capital to the general public through Rwanda stock

exchange market. The Accountant has produced the following information for the tax purposes for the year ended 31/12/2017.

Particulars	Notes	RWF '000'	RWF '000'
Sales	1		50,000,000
Cost of sales	2		(24,850,000)
Gross profit			25,150,000
Other incomes			
Profit from the branch	3	650,000	
Dividends	4	8,000	
Interest	5	20,000	678,000
			25,828,000
Operating expenses			
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)
Profit before tax			2,538,000

Notes:

- i. The sales figure is VAT inclusive and during the year, the company exported commodities worth 3,200,000USD. The average exchange rate during the year was 1USD = 720RWF.
- ii. Within the cost of sales, the opening stock is 100,000,000RWF and the closing stock is 620,000,000RWF. Both the closing stock and the opening stock were overvalued by 12%.
- iii. The profit from the branch is net of income tax of 25%
- iv. 30% of the dividends was received from the local companies and the remainder was received from foreign companies and were received net of 20%withholding tax
- v. The company made investment in Rwanda government securities. 50% of the interest income was received from securities with a maturity period which are less than three years; the remainder comes from securities with a maturity period of more than three years.
- vi. Only $\frac{3}{4}$ of the insurance expired
- vii. Included in the directors' remuneration, is 5,000,000RWF for meeting allowances.
- viii. 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	Computer and accessories	Other assets
Cost	450,0000	800,000,000	1,000,000,000	250,000,000	690,000,000
WDV31/12/2016	450,000,000	680,000,000	850,000,000	95,000,000	518,000,000

During the year 2017, the company constructed another factory in Karongi and incurred the following costs

Assets	RWF '000'
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 6,000,000RWF,	320,000,000
Furniture and fittings	28,000,000

- A debtor of 1,680,000RWF 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.
- Included in the advertising expenses, is a cost of 5,000,000RWF for constructing a sign post at the main load showing where the company is located.
- The income tax relates to the unpaid tax of the previous year
- During the year a debtor of 10,000,000RWF that had been written off was recovered
- December salaries amounting to 20,000,000RWF accrued.

Required:

As a tax consultant, advise the company on its taxable income, tax liability and tax payable for the year ended 31/12/2017.

Solution

Computation of Taxable Income and Tax Liability for Muvandimwe Limited for the Year Ended 31/12/2017

Particulars	Workings	RWF '000'	RWF '000'
Profit before tax			2,538,000
Add Back Non-Allowable expenditures			
Depreciation		185,000	
Un expired insurance	N7	200,000	
Meeting allowances		5,000	
Bad debt		3,320	
Advertising		5,000	
Income tax		450,000	848,320
Less VAT	N1	(7,275,661)	
Add VAT		7,000,000	(275,661)
Overvalue of opening stock	N2	10,715	
Overvalued closing stock	N2	(66,429)	(55,714)
Un recorded salaries			(20,000)
Add bad debt recovered			10,000
			3,044,945
Less non allowable income			
Dividend from local companies	N4		(2,400)
			3,042,545
Less no operating income			
Foreign profits		650,000	
Dividends		5,600	
Interests		20,000	(675,600)

Profit from business operations			2,366,945
Add allowable business income			
Foreign profit	N3	866,667	
Foreign dividends	N4	7,000	
Interest income	N5	22,291	895,958
Total business income			3,262,903
Less capital allowances	N9		(1,244,250)
Taxable business income			2,018,653

Tax liability and Tax Payable

Taxable business income	Tax rate		2,018,653
Corporate tax rate (since it sales 20% if its capital)	28%		
	0%		
Applicable corporate tax rate	28%		565,223
Less tax paid at source			
Tax on foreign profit	N10	216,667	
Withholding tax on dividends	N11	1,050	
Withholding tax on interest		2,291	(220,008)
Tax Payable			345,215
Total			

Workings:

N1 VAT on the sales

Exports are zero rated

$$\text{Vatable sales} = 50,000,000 - (3,200,000 \times 720) = 47,696,000$$

$$\text{VAT} = 47,696,000 \times 18/118 = 7,275,661$$

$$\text{Exclusive sales} = 50,000,000 - 7,275,661 = 42,724,339$$

N2 Overvalued closing and opening stock

$$\text{Opening stock} = 100,000 - (100,000 \times 100/112) = 10,715$$

$$\text{Closing stock} = 620,000 - (620,000 \times 100/112) = 66,429$$

N3 profit from the branch

Gross profit from the branch

$$650,000 \times 100/75 = 866,667$$

N4 Dividends income

30% received from local company is not taxable

$$0.3 \times 8,000 = 2,400$$

$$\text{Gross dividends received from the foreign investments} = 5,600 \times 100/80 = 7,000$$

N5 interest income:

50% of the interest income which matures in less than one year is taxed at 15%

The gross interest income received will be $0.5 \times 20,000 \times 100/85 = 11,765$

Securities that matures in more than three years are taxed at 5% the gross income received will be $10,000 \times 100/95 = 10,526$

N7 insurance

$$\frac{3}{4} \times 800,000 = 600,000 \quad 800,000 - 600,000 = 200,000$$

N9 Depreciation and investment Allowances Figures in thousands RWF

Assets	Land	Buildings	Plant and machinery	Computers and accessory	Other assets	Total
COST/WDV	450,000	800,000	1,000,000	95,000	518,000	
Additional assets	200,000	570,000	780,000	85,000	348,000	
Investment allowances (50%)	0	285,000	390,000	42,500	157,000	874,500
Depreciable value	650,000	1,085,000	1,390,000	137,500	709,000	
Depreciation rate	-	5%	5%	50%	25%	
Wear and Tear	0	54,250	69,500	68,750	177,250	369,750
Total capital allowances						1,244,250

N10 Foreign tax on foreign profit: Since the foreign tax rate is less than the local tax rate then, the foreign tax rate is applied (25%).

N11 Withholding tax on foreign dividends: Since the foreign tax is higher than the local tax rate, then the local tax rate is applied on the dividends (15%).

TEST YOUR UNDERSTANDING

Vangado Ltd is a prominent transport company with its office located in the central business district of Rwanda. The following is the statement of profit or loss and other comprehensive income for its operations for the year ended 31 December, 2016.

Particulars	Notes	RWF "000"	RWF"000"
Revenue			600,000
Other Income	5		200,000
Less: operating expenses:			
Salaries & wages		100,000	
Rent		50,000	
Telephone expenses	1	40,000	
Repairs and maintenance	2	200,000	
Directors allowances & expenses		60,000	
Bad debts provision		30,000	
Electricity and water	3	20,000	
Traffic penalties/ fines		10,000	
Depreciation		5,000	
Transport licenses fees		15,000	
Pay as you earn (PAYE)		30,000	
Total operating expenses			560,000
Net profit			240,000

Additional Information:

1. The company's telephone was used for both business and private purposes.
2. The figure for repairs and maintenance includes Frw 50,000 for replacement of company truck engine.
3. During the company's external audit, it was discovered that 50% of the expenses for electricity and water did not have supporting accounting documentation.
4. The company had capital allowances of Frw 4,500 for the period.
5. Other income includes Frw 40,000 relating to foreign exchange gains.

Test Two

Delta Manufacturers Rwanda Ltd (DMRL) is a privately-owned water purifying and bottling company, incorporated in Rwanda. Its head office is located in Kigali city and has branches in Gisenyi, Butare, Byumba and Rwamagana. DMRL is not a registered investor.

The following is DMRL's statement of profit or loss and other comprehensive income for the year ended 31st December, 2015:

	Notes	Frw "000"
Revenue		6,980,187
Cost of sales		(2,920,037)
Gross profit		4,060,150
Other income	1	892,800
Operating income		4,952,950
Operating expenses:		
Staff costs	2	(1,282,946)
Depreciation and amortization	3	(484,976)
Rent		(230,000)
Provision for bad debts	4	
Advertising		(944,500)
Donations	5	(50,000)
Repairs and maintenance	6	(85,000)
Other operating expenses	7	(676,672)
Total operating expenses		(3,807,094)
Profit before tax		1,145,856

Notes:

1. Other income includes:
 - a. Foreign exchange gains Frw 566,725,000.
 - b. Gain on sale of shares held in Bralirwa Ltd, a company listed on the Rwanda Securities Exchange of Frw 126,075,000.
 - c. Interest income on fixed deposit account in the bank Frw 200,000,000.
2. An amount of Frw100,000,000 paid to the directors as their bonus and sitting allowances for the year ended 31 December, 2015 has been included in staff costs.
3. The book value of the depreciable assets owned by the company as at 1 January, 2015 were:

	Frw "00"
Computers and software	350,425
Other assets	2,735,450

4. The cost of the factory building that was constructed in 2010 when the company commenced production was Frw 200,000,000. The company did not purchase any other assets during the year.
5. The company sold packed water to Mr. Karekezi who had a wholesale shop in Remera, Kigali for Frw53,000,000 on credit during the month of February, 2015. Mr. Karekezi travelled to the United States in march, 2015 and had not returned by the end of the year. The wholesale shop has been closed and it is not clear whether he will come back into the country.
6. The donation was made to Vuruga Ltd, one of the customers for the company who is engaged in general trading business.
7. Included in repairs is an amount of Frw 50,000,000 for the reconstruction of the main factory store in Kigali.
8. Other operating expenses include:

	Frw "000"
Fines to Rwanda Environment Management Authority (REMA)	40,000
Mobile telephone expenses (the company is unable to track the business and private use)	35,000
Other expenses (all deductible)	601,672
Total	676,672

9. The company made the quarterly tax payment of Frw 200,000,000 during the year.

Required

Compute the taxable income and the tax liability for Delta Manufacturers Rwanda Ltd for the year ended 31 December, 2015.

Indicate the due date for the payment of the tax.

Test three

Jogo limited is incorporated in Rwanda and acquired an investment certificate of 800,000,000rwf as a manufacturing company. The company is located in Bugesera district. The company started its operation on 01/1/2018. The company operates a number of subsidiaries and branches within and outside the country. In order, to improve on its operations, the company issued 20% of its stock to the general public. Below is the submitted income statement for tax purpose for the year ended 31/12/2015.

Particulars	Notes	Amount (000) RWF	Amount (000) RWF
Sales	1		16,500,000
Cost of goods sold	2		(10,400,000)
Gross profits			6,100,000
Other incomes			
Profits from subsidiaries	3	76,100	
Dividends	4	58,000	
Interest	5	33,700	167,800
			6,267,800
Operating expenses			
Salaries and wages	6	341,500	
Rent	7	258,300	
Insurance		60,500	

Bad debt	8	120,700	
Electricity		85,600	
Repair and maintenance	9	144,000	
Donation	10	104,000	
Depreciation	11	150,000	
Machineries expenses	12	35,800	
Property expenses	13	78,000	
Directors remuneration	14	18,5000	
Transfer to reserves		185,000	
VAT	15	5,000,000	
Accountancy and legal fees	16	8,000,000	
Agricultural expenses	17	15,500	14,763,900
Operating loss			8,496,100

Notes:

1. The sales figure is inclusive of VAT and 50% of the sales revenue is from exports
2. The value of cost of goods sold includes an amount of 185,000,000RWF which the director gave out as bonus to the employees at the end of year party. The market of this stock is 200,000,000RWF.
3. 40% of the profits received is from a local branch where JOGO owns 100% of stock. The remaining 60% is from a foreign subsidiary and it was received net 35% income tax.
4. 60% of the dividend income was received from a local subsidiary, the remainder is from a foreign subsidiary and it was received net of 10% withholding tax.
5. During the period company invested in government securities with a maturity period of 2 year. The interest income was received from those securities
6. 20,000,000Rwf of the salaries and wages accrued there are no records relating to this figure.
7. Rent was paid on 1/1/2015 to cover a period up to 31/3/2016
8. 80% of the bad debt expenses, relates to the provision that was made on 31/12/2015 after failing to trace the customer anywhere.
9. Of the repair and maintenance, 8,000,000Rwf relates to expenses incurred during the partitioning of the offices for the new employees
10. The donation was made to charitable organisation
11. The depreciation expenses, relates to the following assets
12. Building acquired on 1/1/2017 at 120,000,000. This building contains an administration block valued at 45,000,000rwf.
13. Machineries were purchased on 1/1/2017 at 165,800,000Rwf
14. Two heavy trucks at a cost of 50,00,000rwf each a 15 sitter vehicle at 20,000,000rwf, two four sitter vehicles at a cost of 8,000,000rwf each all on 1/1/2017
15. Ten computers at a cost of 1,200,000rwf each a software at 4,000,000 and other computer accessories at 2,000,000rwf. On 1/1/2017
16. Furniture and fittings at 17,500,000rwf on 1/1/2017
17. The company owns machineries which are rented to various individuals the machineries expenses relates to maintenance of these machineries

18. The property expenses relates to the maintenance of the property
19. The directors' remuneration includes 4,000,000rwf for meeting allowances. The remainder are official emoluments of the directors.
20. The VAT for the period was not paid
21. Legal and accountancy fees include; 3,800,000 audit fees, 2,000,000 company registration fees, 1,600,000 for the renewal of lease agreement, and 1,600,000 debt collection fees.
22. The company owns a farm in Bugesera it carries out agricultural activities. The agricultural expenses relates to the farm.
23. Other relevant Information not considered
24. The company owns machineries that it rents to various individuals. The machineries were purchased on 1/1/2015 at a cost of 407,800,000Rwf. During the purchase, the company borrowed 20,000,000RWF from BK and pays an annual interest rate of 15%. During the year, the company received a gross income of 2,000,000,000RWF.
25. The company owns a property in Nyamata. Which it rents to various individuals. During the year, the company received a gross income of 4,500,000,000RWF. The properties are registered under the company's names and were purchased using equity.
26. The company owns a farm in Nyamata where it carries out agricultural and livestock activities. The company received a gross income of 1,500,000,000RWF and incurred expenses of 200,000,000RWF in the maintenance of the farm.
27. The company had 10 hectares of land carrying on florist business. The land was purchased in 2014 at a cost of 50,000,000RWF. During the year ended 31/12/2015, the company disposed of 4 hectares at 25,000,000Rwf and the value of the remaining land is 40,000,000RWF.
28. Debtor of 14,000,000RWF that was written off in full in 2014, appeared and settled his amount in full
29. The company disposed of old furniture at 11,000,000RWF.

Required

Advise the company on the taxable income and the corporate tax payable for the period use zero for the allowable expenses and non-allowable incomes

Test four:

Drop Rwanda limited is a registered company in Rwanda and received a RDB investment certificate 1,000,000,000RWF to operate as a manufacturing company. The company manufactures a number of products which are sold both locally and exported. The company operates a number of subsidiaries and branches both within and outside Rwanda. In order to finance its growth, the company listed 30% of its stock on RSE in 2010. Below is the submitted income statement for the year ended 31/12/2016 tax purposes.

Particulars	Notes	Amount (000) RWF	Amount (000) RWF
Revenues	1		90,000,000
Cost of sales	2		(88,000,000)
Gross profits			2,000,000
Other incomes			
Interest	3	25,000	
Dividends	4	10,000	
Profits	5	54,500	
Agriculture	6	11,000	

Less expenses			
Salaries	7	485,000	
Depreciation	8	120,500	
Electricity		10,200	
Insurance	9	29,600	
Repair and maintenance		80,700	
Donation	10	16,800	
Entertainment	11	20,800	
Interest	12	600,000	
Bad debt	13	65,000	
Research development	14	150,000	
Advertising		289,000	
Sales commission		120,500	
Accountancy and legal	15	20,800	
General expenses	16	60,000	
Fines and penalties		300,000	

Notes:

- 50% of the sales are exports
- The cost of sales was calculated under the following ways

Opening stock		150,000,000
Purchases:		
CIF	65,000,000,000	
Exercise duty	2,500,000,000	
VAT	800,000,000	
Customs duty	200,000,000	
Customs storage	100,000,000	
Transport from Dar - Kgl	320,000,000	
Clearing and forwarding	12,000,000	
Infrastructure tax	2,500,000	
Local purchases	20,000,000,000	88,934,500,000
Closing stock		1,084,500,000
Cost of sales		88,000,000,000

- The interest were received from short term government securities with a maturity period of two years
- 40% of the dividends were received from a local subsidiary and 60% from a foreign subsidiary in Kenya and it was received net 20% withholding tax
- The profits were received from a subsidiary in Uganda and it was received net of 25% income tax
- The company owns a farm in Bugesera. The agriculture income was received from that farm gross

The salary expense is classified as under

Salaries to the employees	300,000,000
Salaries to the directors	100,000,000
Meeting allowances directors	30,000,000
Bonuses to directors	20,000,000

The depreciation was calculated from the following assets

Assets	Land	Buildings	Plant and machinery	Motor vehicle	Comp. & accessories	Furniture & fittings
Cost/WDV (000) RWF 1/1/16	200,000	950,000	800,000	350,000	18,000	30,000
Additions (000) RWF	100,000	400,000	250,000	200,000	20,000	38,000
Note						

The motor vehicles are classified as under

Two trucks which carries 20 tones	130,000,000
One minibus 25 sits	40,000,000
Rav4 new model	30,000,000
Total	200,000,000

7. A third of the insurance expense has not yet expired
8. The donation was made to charitable recognized organization
9. The entertainment expenses are classified as under

Labour day party for the employees	8,400,000
End of year part for the employees	5,000,000
Party for the customers	7,400,000
Total	20,800,000

10. The company's equity capital is 30,000,000,000RWF. The company issued a debt of 150,000,000,000RWF. The interest expense relates to this debt.

11. The bad debt expenses are classified as below:

Customer declared bankrupt by the court	38,000,000
Provision made at the end of the year for a customer who has disappeared for two years	27,000,000
Total	65,000,000

12. The research and development is categorized as below

Market research	50,000,000
Architectural plan for the new building	25,000,000
Training employees on new software	20,000,000
Development of new product	55,000,000
Total	150,000,000

- 13.

14. The accountancy and legal is classified as under

Audit fees	6,400,000
Renewal of finance lease agreement	4,000,000
Revaluation of assets	4,400,000
Debt collection	6,000,000
Total	20,800,000

15. All expenses with no supporting documents were classified as general

Required: Compute the taxable business income, tax liability and tax payable of Drop Rwanda limited for the year ended 31/12/2016.

1.2.12 SPECIAL INCENTIVES FOR REGISTERED INVESTORS IN RWANDA

I. Preferential Corporate Income Tax Rate of Zero Percent (0%)

An international company which has its headquarters or regional office in Rwanda is entitled to a preferential corporate income tax rate of zero percent (0%) if it fulfils the following requirements:

- 1) To invest the equivalent of at least ten million United States Dollars (USD 10,000,000), in both tangible and intangible assets, in Rwanda;
- 2) To provide employment and training to Rwandans;
- 3) To conduct international financial transactions equivalent to at least five million United States Dollars (USD 5,000,000) a year for commercial operations through a licensed commercial bank in Rwanda;
- 4) To be well established in the sector within which it operates;
- 5) To use the equivalent of at least two million United States Dollars (USD 2,000,000) per year in Rwanda;
- 6) To set up actual and effective administration and coordination of operations in Rwanda and perform at least three (3) of the following services in Rwanda:
 - a) Procurement of raw materials, components or finished products;
 - b) Market control and sales promotion planning;
 - c) Information and data management services;
 - d) Treasury management services;
 - e) Research and development work;
 - f) Training and personnel management.

II. Preferential Corporate Income Tax Rate of Fifteen Percent (15%)

A preferential corporate income tax rate of fifteen percent (15%) is accorded to:

A registered investor, exporting at least fifty percent (50%) of turnover of goods and services produced in Rwanda, including business processing outsourcing. This incentive excludes unprocessed minerals, tea and coffee without value addition according to the provisions of this Law.

A registered investor undertaking one of the following operations: energy generation, transmission and distribution from peat, solar, geothermal, hydro, biomass, methane and wind. This incentive excludes an investor having an engineering procurement contract executed on behalf of the Government of Rwanda;

A registered investor in the sector of transport of goods and related activities whose business is operating a fleet of at least five (5) trucks registered in the investor's name, each with a capacity of at least twenty

(20) tons.

A registered investor operating in mass transportation of passengers and goods with a fleet of at least ten (10) buses registered in the investor's name, each with a capacity of at least twenty five (25) seats;

A registered investor in the Information and Communication Technology (ICT) Sector with an investment involving one of the following activities: service, manufacturing or assembly. This incentive excludes ICT retail and wholesale trade as well as ICT repair industries and telecommunications;

A registered investor operating in the following financial services: global business activities, private equity funds, fund management, wealth management; mutual funds, collective investment schemes, captive insurance schemes, venture capital, and asset backed securities. This incentive excludes locally oriented fund and wealth management, retail banking and insurance activities.

An investor registered in building low-cost housing and upon fulfilling the criteria provided under the instructions of the Minister in charge of housing.

III. Corporate Income Tax Holiday of Seven Years

A registered investor investing an equivalent of at least fifty million United States Dollars (USD 50,000,000) and contributing at least thirty percent (30%) of this investment in form of equity in the sectors specified below is entitled to a maximum of seven (7) year corporate income tax holiday. The preferred sectors for investment include:

- 1) Energy projects producing at least twenty five megawatts (25 MW); This incentive excludes an investor having an engineering procurement contract executed on behalf of the Government of Rwanda and fuel produced energy;
- 2) Manufacturing;
- 3) Tourism;
- 4) Health;
- 5) Information and Communication Technology (ICT) Sector with an investment involving manufacturing, assembly and service; This incentive excludes communication, ICT retail and wholesale trade as well as ICT repair companies or enterprises and Telecommunications;
- 6) Export related investment projects;
- 7) An investor registered in another priority economic sector as may be determined by an Order of the Minister in charge of finance.

IV. Corporate Income Tax Holiday of up to Five (5) Years

Microfinance institutions approved by competent authorities will be entitled to a tax holiday of a period of five years (5 years) from the time of their approval. However, this period may be renewed upon fulfilling conditions prescribed in the Order of the Minister in charge of finance.

V. Exemption of Customs Tax for Products Used in Export Processing Zones

A registered investor investing in products used in Export Processing Zones shall be exempted from customs taxes and duties according to the provisions of customs rules and regulations of the East African Community.

VI. Exemption of Capital Gains Tax

A registered investor shall not pay capital gains tax. However, income derived from the sale of a commercial immovable property shall be included in the taxable income of the investor.

VII. Value Added Tax Refund

The refund of the Value Added Tax paid by investors is made within a period not exceeding fifteen (15) days upon receipt of the relevant documents by the tax administration authority.

VIII. Immigration Incentives

A registered investor and his/her dependants shall be issued with a residence permit in accordance with relevant laws.

A registered investor who invests an equivalent of at least two hundred and fifty thousand United States Dollars (USD 250,000) may recruit three (3) foreign employees without necessarily demonstrating that their skills are lacking or insufficient on the labour market in Rwanda.

1.2.13 TAXATION OF PROFITS FROM LONG-TERM CONTRACT

“Long term contract” means a contract for work, manufacture, installation of construction, the performance of related services, which is not completed in the tax period in which work under the contract commenced, or other than a contract estimated to be completed within the twelve months as of the date on which work under the contract commenced. The timing of inclusion in and deduction from business profit relating to a long-term contract is accounted for on the basis of the percentage of the contract completed during any tax period.

Computation of Taxable Profit

The computation of taxable profit for a construction company is the same with other companies in the sense that allowable and non-allowable expenses applicable to the latter also applies to the former. This is more so if the contract work being undertaken by the company is short-term contract and the amount for the contract is payable within a reasonable time frame.

However, where the contract is contrary to the above description or long-term in nature, certificate of work done and the amount payable thereto shall be considered as revenue/turnover for the relevant year of assessment and the expenses to be matched with revenue shall be determined based on the degree of completion or work done which must be in proportion to the revenue realised due to certification.

Capital Allowances

Capital allowances for construction companies are pro-rated according to the degree of work done and according to the number of months in the basis period. However, for the initial allowance, it is given wholly in the year of assessment in which the qualifying expenditure was procured. Any equipment procured for the construction contract but not used within the basis period that covers the year of assessment shall not be considered for any capital allowance for the purpose of taxation for the relevant tax year.

The percentage of completion is determined by comparing the total expenses allocated to the contract and incurred before the end of the tax period with the estimated total contract expenses including any variations of fluctuations or comparing the value of the work certified and the contract price.

$$\text{Percentage of completion} = \frac{\text{expenses of the work certified}}{\text{Estimated contract cost}}$$

A loss in tax period in which a long-term contract is completed may be carried back and offset against previously taxed business profit from that contract to the extent it cannot be absorbed by business profit in the tax period of completion

Example One

On 1/1/2014 Twegerane Limited started the construction of road from Gisenyi to Kigali. The agreed contact price was 30,000,000,000RWF. Twegerane estimated a cost of 27,000,000,000RWF to the complete the road. During the year ended 31/12/2014, the road was only complete up to Mukamira

and the following costs were incurred up to that point: salaries and wages 350,000,000RWF, Materials 4,500,000,000RWF, Administration and General Expenses 800,000,000RWF and other miscellaneous expenses 200,000,000RWF.

Required:

Compute the Taxable income for Twegerane limited for the year ended 31/12/2014.

Differentiate between accounting period and period of accounts

Solution

Computation of Taxable Income for Twegerane Limited for the Accounting Period Ended 31/12/2014

Particulars	Workings	Amount (RWF)	Amount (RWF)
Contract price			30,000,000,000
Estimated cost			27,000,000,000
Costs incurred during the period			
Salaries	350,000,000		
Materials	4,500,000,000		
Administration	800,000,000		
Miscellaneous	200,000,000	5,850,000,000	
Percentage of completion	Cost incurred	5,850,000,000	21.67%
	Estimated cost	27,000,000,000	
Revenues accruing to the period	Percentage of completion x contract price	21.67% x 30,000,000,000	6,501,000,000
Less cost during the period			(5,850,000,000)
Taxable Income for the period			651,000,000
Total			

b). An accounting period is a period under which companies are supposed to declare and submit their accounts for the tax assessment. The period starts from 1 January to 31 December. A period of accounts is a period when companies prepare their accounts. A period of accounts may be more than one year.

Example Two

Starroads Construction Company limited was awarded a contract 800,000,000RWF to construct a road from Gatuna to Kigali on 1/1/2015. The company estimated a cost of 650,000,000RWF to complete the Job. The government withheld 3% on the contract price. By 31/12/2015, the company had reached Gicumbi and had incurred the following costs:

- Salaries and wages 28,800,000RWF
- Purchase of machineries 150,000,000RWF
- Hire or machineries 55,000,000RWF
- Utilities 8,500,000RWF
- Communication 5,800,000RWF
- Fuel 40,000,000RWF
- Raw materials 101,200,000RWF
- Stationaries 2,300,000RWF
- Repair and maintenance 12,100,000RWF
- Allowable capital allowance for tax purpose is 5,950,000RWF

Required:

Compute the taxable incomes of the company for the period ended 31/12/2015 and the tax liability

Solution

Computation of Taxable Income of Starroads Construction Company Limited for the Period Ended 31/12/2015

Particulars	Workings	Amount (000) RWF	Amount (000) RWF
Revenues	62.1% x 800,000		496,800
Less allowable expenses			
Salaries		28,800	
Hire of machineries		55,000	
Communications		5,800	
Purchase of raw materials		101,200	
Repair and maintenance		12,100	
Utilities		8,500	
Capital allowance		5,950	(217,350)
Taxable income			279,450
CIT	30% x 277,050		83,835
Less withholding tax	3% x 800,000 x 62.1%		(14,904)
Tax payable			68,931
Total			

Workings

Percentage of completion = $\frac{\text{actual contract price}}{\text{Estimated costs}} \times 100$

$\frac{403,700}{650,000} = 62.1\%$

Tax treatment of a loss at the end of the contract

The loss can be carried for the future profits for a period of five years

The loss can also be carried back on the profits declared.

Test one

Dorp Construction Company limited entered into a contract with the government of Rwanda to construct a road from Ngororero to Kigali for a contract price of 100,000,000,000RWF. The company's cost accountant estimated a cost of 78,000,000,000RWF to complete the job the company estimated to finish the road in two years. On 1st January 2015, the company started the construction of the road. By 31/12/2015, the company had only reached Muhanga. The following costs had been incurred up to Muhanga.

Items	Costs (RWF)
Purchase of materials	20,500,000,000
Salaries and wages	15,780,000,000
Depreciation of machinery	8,000,000,000
Directors' remuneration	5,000,800,000
Two heavy trucks	600,000,000
Communication	40,000,000

Rent of machinery	850,000,000
Utilities	420,000,000
Fuel	2,500,000,000
Other miscellaneous expenses	1,000,000,000

Required:

Compute the taxable income and the tax liability of the company for the year ended 31/12/2015.

TAXATION OF BANKS AND INSURANCE COMPANIES

• TAXATION OF BANKS

Taxation of the banking sector follows the same tax law as other companies. There is no fundamental difference between the taxation of the banking sector and taxation of other non-financial service companies. The allowable deductions and disallowable deductions are the same. However, in the banking sector, thin capitalization does not apply. Banks are taxed like any other business at a corporate tax rate of 30%. Banks engage in the following activities. What is important is to get used to the terms that are used in insurance and banks.

A bank can be defined as a deposit taking financial institution for purposes of lending and investing. The primary functions of a bank include:

- Safe custody of customer's deposit while allowing for withdrawals;
- Issuing of cheque books to facilitate payment and settlement process;
- Provide personal loans, commercial loans and mortgage loans;
- Issuing of credit cards and processing credit transactions;
- Provide wire transfer of funds and electronic funds transfer between banks;
- Facilitation of standing orders and direct debits to enable automatic payments;
- Provide overdraft to customers on their current account. This involves temporary advancement of Bank's money;
- Provision of internet banking services;
- Guarantee credit worthiness of a customer;
- Accepting of deposits from customers and providing credit facilities to them;
- Provide money and capital markets services such as foreign exchange services and stock brokerage services;
- Other fee generating activities for commissions;
- Trade financing.

The term "commercial bank" is what is commonly referred to as a bank to distinguish it from investment bank. An investment bank is type of financial services entity, which instead of lending money directly to business, helps business to raise money from other firms in the form of a bond and stock.

Income Streams

The main source of income for banks is interest and similar income. As per International Financial Reporting Standards (IFRS), interest revenue is recognised to the extent that it is probable that the economic benefits will flow to the Bank and that the revenue can be reliably measured.

A bank's interest income constitutes interest earned on loans and advances, treasury bills, development bonds and on placements and other bank balances. A key financing cost incurred by the bank is interest paid on saving accounts, term deposit accounts or deposits by other banks.

Interest income or expense is recorded in the income statement by applying the effective interest rate, which is the rate that exactly discounts estimated future cash payments or receipts through the expected life of the financial instrument, to the net carrying amount of the financial asset or liability. The calculation takes into account all contractual terms of the financial instrument and includes any fees or incremental costs that are directly attributable to the instrument and are an integral part of the effective interest rate, but not future credit losses.

In addition to interest, banks also earn fee and commission income from a diverse range of services which it provides to its customers. Fees incomes from services that are provided over a certain period are accrued over that period. Fees and commission income is earned from the following sources

- Local and international cash transfers;
- Credit related fees and commissions;
- Current account ledger fees;
- Commissions on loan service;
- Commissions on guarantees and letters of credit;
- Fees from e-banking transactions;

The above fees are offset against related expenses to determine the net fees and commissions.

Banks also earn other operating income that has tax implications. These include the following:

- Gain on sale of property and equipment;
- Income on foreign exchange transactions;
- Rental income;
- Miscellaneous income.

Expenses

The list below provides a summary of the key expense items for a bank which would be of interest to the tax;

- (i) Interest expense – this relates to interest paid on client deposits or placements with other banks;
- (ii) Provision for bad debts – IFRS 9 requires banks to assess their financial assets at each reporting date to assess whether there is objective evidence that the financial asset is impaired. BNR regulations also require a bank to make a bad debts provision. The provision for bad debts, also known as the provision for impairment, constitutes a significant expense in the bank's books.
- (iii) Staff expenses – staff expenses are disclosed separately in the financial statements;
- (iv) IT and consultancy fees – Banking operations are highly automated and therefore banks make payment of significant amounts for IT and consultancy services. In most instances, the payments are made to non-resident persons resulting in reverse VAT and withholding tax implications;
- (v) Management fees – A number of local banks are part of regional or international banking groups. They may make payments for technical or management services rendered by non-resident related parties. Management fees and other payments made to related parties are normally disclosed in the financial statements;
- (vi) Provisions - In addition to provisions for bad debts, banks also make provisions for expenses such as those arising on litigation. IAS 39 requires that a bank makes a provision for any present legal or constructive obligation arising as a result of past events for which the bank expects to make payment to a third party;
- (vii) Other expenses – The notes to the financial statements will analyse the key expenses in addition to those described above.

TAXATION OF INSURANCE COMPANIES

- **Important Terms in Insurance Companies**

Re-insurance

The term “Reinsurance” is defined by M. Grossmann, in his book *Reinsurance – An Introduction* as the “transfer of part of the hazards or risks that a direct insurer assumes by way of insurance contract or legal provision on behalf of an insured, to a second insurance carrier, the reinsurer, who has no direct contractual relationship with the insured’

The direct insurer needs reinsurance so as:

- ✓ To limit (as much as possible) annual fluctuations in the losses he must bear on his own account;
- ✓ To be protected in case of catastrophe.

The direct insurer cedes part of the premium received from policy holder (the insured), to the reinsurer.

General Insurance

General insurance can be defined as “all types of insurances other than long term business”. The different forms of general insurance are fire, marine, motor, accident and other miscellaneous non-life insurance.

The income of general insurance business is made up of gross premiums received reduced by premiums ceded to reinsurers. Other income sources include commissions earned (for business transferred to the reinsurer), investment income (rent) and other income such as insurance policy fees.

Commission on Reinsurance Ceded

This is the commission received from other insurance companies or reinsurance companies for acting as their agents

Commission on Reinsurance Accepted

This is the commission payable to other insurance or reinsurance companies for acting as our agents which have accepted

Reserves for Unexpired Risks or Unearned Premium

This is the premium received for contracts that have not yet expired as at the year end. This reserve is maintained to cover the occurrence of the risks

Premium

This is the consideration paid by the insured for the cover.

Bonuses

This is the share of profits to the policy holder usually paid on life policies. It includes:

- ✓ Cash bonus: which is bonus paid in cash or cheque.
- ✓ Bonus in reduction of premium: bonus which is not paid to the policy holder that it is used to reduce the premium payable.

- **DETERMINING THE TAXABLE INCOME OF INSURANCE COMPANIES**

1. Life insurance business of an insurance company is treated as a separate business from any other class of the business
2. The gains or the profits of a resident insurance business other than life insurance business consists of:
 - a. Gross premium less any premium returned to the insured and premium paid on reinsurance
 - b. Other incomes including commission or expenses allowances received or receivable from reinsurers and investment income

- c. A reduction in respect of a reserve for unexpired risks at the end of the previous year

Expenses:

- a. Additional reserve deducted in respect of a reserve for unexpired risk at the end of the previous year.
- b. A deduction of claims admitted net of any claim recovered from reinsurance companies
- c. A deduction of agency expenses
- d. Other allowable expenses

The taxable income is arrived at by taking into:

- a. A gross premium
 - b. Commission or expenses allowances received or receivable ie. Commission ceded
 - c. Investment income as a result of investing in general insurance fund
 - d. Bonus received
 - e. Recoverable from reinsurance companies
 - f. Reduction in premium for unexpired risks or unearned premiums provided the provisions are arrived at using actuarial principles
- **Allowable Deductions**
 - a. Claims admitted for the year under consideration
 - b. Agent fees and commission paid
 - c. Other allowable expenses
 - d. Increase in the provision for unexpired risks provided that the provisions is estimated using actuarial principles
 - e. Reinsurance premium paid

Proforma

Taxable income of KB insurance company

Incomes		
Gross premium	XXX	
Less premium returned	(XX)	XXX
Commission on reinsurance ceded		XXX
Recoveries from insurance claims		XXX
Bonus in reduction of premium		XXX
Reduction in expired risks		XXX
Un earned premium		<u>XXX</u>
		XXXX
Deductions allowed		
Claims payable for the year	XXX	
Commission accepted	XXX	
Re insurance premium paid	XXX	
Management expenses	XXX	

Agency fees	XXX	
Increase in provision for unexpired risks	XXX	<u>(XXX)</u>
TRADING INCOME		XXX
Other source of income		
Rental income	XXX	
Dividends	XXX	
Interest	XXX	
Others	XXX	XXX
TAXABLE TRADING INCOME		XXX

Insurance companies are taxed like any other company at corporate of 30%

- **Life Insurance Business**

The income from the life insurance business comprises of:

1. Investment income of the life insurance fund except that part of the life fund which relates to annuity funds less the management expenses including commissions. The investment income is defined as the dividend and interest income but does not include qualifying dividends.
2. The amount of interest received by the company on surrender of policies or on the return of the premiums other than premiums in relation to a registered annuity contract, registered trust scheme or a registered pension fund.

STUDY UNIT

2

ADVANCED ASPECT OF INDIRECT TAX

- **VALUE ADDED TAX (VAT)**
- **CONSUMPTION TAX**

2.0 INTRODUCTION

VAT is the tax charged on turnover at each stage in a production process, but in such a way that the burden is borne by the final consumer. VAT was introduced just before the First World War; there was a gradual improvement in the tax system, which came up with a global taxation system of business with VAT which was the main element. This tax was introduced in Rwanda in January 2001 by the law No. 06/2001.

2.1 EXCLUSIVE AND INCLUSIVE OF VAT

Exclusive of VAT means that VAT is excluded in the price or amount. VAT exclusive on exclusive is equal to the price or amount times the VAT rate. For example, John purchased goods of 10,000,000RWF exclusive of VAT. Compute the amount of VAT.

$$\text{VAT} = 10,000,000 \times 18\% = 1,800,000$$

Inclusive of VAT: under this case, VAT is included in the price. To calculate VAT on inclusive we use a VAT fraction.

$$\text{VAT Fraction} = \frac{\text{VAT Rate}}{\text{VAT rate} + 100} = \frac{18}{118}$$

Mary purchased goods of 10,000,000RWF inclusive of VAT. Compute the VAT

$$\text{VAT} = \frac{18}{118} \times 10,000,000 = 1,525,425$$

2.2 INPUT AND OUTPUT VAT

Input VAT is the VAT on purchases whereas Output VAT is the VAT on the sales. When a taxpayer supplies goods or services to another taxpayer, the supplier of those goods or services will levy VAT. The VAT levied by the supplier is the INPUT TAX of the tax payer who receives those goods or services. On other hand when the vendors in turn supplies goods or services to other tax payers, VAT must be included in the price charged for those goods or services. This is the OUTPUT TAX of the taxpayer. When output tax exceeds input tax, the difference is the VAT payable to Rwanda Revenue Authority.

VAT payable or claimable = output VAT – input VAT

Example

Let us take two businessmen, A and B registered for VAT who trade in sugar. Trader A sells to trader B a bag of sugar at 20,000RWF without VAT and charges him VAT of 18%, which is 3,600RWF. The selling price of trader A is 23,600RWF. Trader B buys sugar at 23,600RWF VAT inclusive. The VAT paid is called input tax. Price without VAT to trader B is 20,000RWF plus his profit margin of 1,000RWF = 21,000RWF. He then charges VAT at 18% to his customer (output tax). Trader B's selling price will be 21,000RWF plus VAT (18%) of 3,780RWF = 24,780RWF.

$$\text{VAT PAYABLE} = \text{OUTPUT TAX} - \text{INPUT TAX}$$

$$3,780\text{RWF} - 3,600\text{RWF}$$

$$= 180\text{RWF}$$

Example 2

Rukundo sells wood to a furniture maker for 100,000RWF VAT, the furniture maker uses this wood to make a table and sells the table to a shop for 150,000RWF VAT. The shop then sells the table to the final consumer for 300,000RWF plus VAT of 18%. Determine the VAT payable to RRA.

Solution

Cost will be 100, 000RWF and 150,000RWF respectively

Input VAT will be $18\% \times 100,000 = 18,000$ and $150,000 \times 18\% = 27,000$

Output VAT will be $18\% \times 100,000$, and $150,000 \times 18\%$ and $300,000 \times 18\%$

VAT Payable RRA will be the value added at each stage

The first stage 18,000 Second stage $(27,000 - 18,000)$ and the third stage it will be $(54,000 - 27,000)$
Total VAT payable will be $18,000 + 9,000 + 27,000 = 54,000$ RWF

2.3 Value of Supply

The value of a supply is the VAT-exclusive price on which VAT is charged. The consideration for a supply is the amount paid in money or money's worth.

Thus with a standard rate of 18%:

Value + VAT = consideration

Example

$100 + 18 = 118$ RWF

The VAT proportion of the consideration is known as the 'VAT fraction'.

VAT Fraction = $\frac{\text{Rate of Tax}}{100 + \text{rate of tax}}$

For example, for standard rated products

VAT fraction = $\frac{18}{100 + 18} = \frac{18}{118}$

If a company sells goods which are inclusive of VAT, then the VAT fraction is used to determine the amount of VAT payable and the exclusive amount.

Examples

1. Ndwyezu sold goods worth 50,000RWF to Mary inclusive of VAT. Determine the amount of VAT payable to RRA.

Solution

Since the amount is inclusive of VAT and VAT is calculated on exclusive amount then a VAT fraction is used to determine the VAT payable

VAT payable will be VAT fraction x the amount inclusive of VAT

$$= \frac{18 \times 50,000}{118} = 7,627$$

Therefore, the amount exclusive of VAT will be determined using the formula for value supply as below:

Value +VAT = consideration

Value + 7,627 = 50,000RWF

Value = 50,000 -7,627 = 42,373RWF

Note: Remember that the amount should be rounded to the nearest thousands therefore 7,627 should be rounded off to 8,000RWF. If you apply a rate of 18% on the VAT exclusive amount you must be able to get the amount of VAT calculated above using the VAT fraction.

- Shumbusho supplied materials to Burlarirwa worth 10,000,000RWF inclusive of VAT. Burlarirwa also supplied the final products to the wholesalers for 20,000,000RWF inclusive of VAT. The wholesaler supplied the goods to the final consumer for 26,000,000RWF inclusive of VAT. Determine the amount of VAT payable to RRA.

Input VAT:

Since the amounts are inclusive of VAT we are using the VAT fraction

$$\frac{18 \times 10,000,000}{118} + \frac{18 \times 20,000,000}{118} = 1,525,424 + 3,050,845$$
$$= 4,576,269$$

Output VAT:

$$\frac{18 \times 10,000,000}{118} + \frac{18 \times 20,000,000}{118} + \frac{18 \times 26,000,000}{118}$$
$$= 1,525,424 + 3,050,845 + 3,966,102 = 8,542,371$$

VAT payable will be Output VAT – Input VAT

$$8,542,371 - 4,576,269 = 3,966,102$$

2.4 Taxable Supplies

VAT is chargeable on taxable supplies made by a taxable person in the course or furtherance of any business carried on by him. Supplies may be of goods or services.

Article 3 defines a **taxable supply** as a supply of goods or services made in the Rwanda, other than an exempt supply.

A taxable supply is either standard-rated or zero-rated. The standard rate is 18%.

Zero-rated supplies are taxable at 0%. A taxable supplier whose outputs are zero-rated but whose inputs are standard-rated will obtain repayments of the VAT paid on purchases.

2.4.1 Zero-rated Goods and Services

The following goods and services shall be zero-rated:

1. Exported goods and services:
 - a) Exported goods bearing stamps recognised by the Commissioner General;
 - b) Transportation services and other related services with regard to export goods referred to in item a) of this Article;
 - c) Transportation services of goods in transit in Rwanda to other countries including related services.
 - d) Aircraft benzene;
 - e) Services rendered abroad;
 - f) Goods used in aircrafts from Rwanda to abroad;
2. Goods sold in shops that are exempted from tax as provided for by the law governing customs;
3. Services rendered to a tourist for which value added tax has been paid;
4. Goods and services intended for special persons:
 - a) Goods and services intended for diplomats accredited to Rwanda that are used in their missions but whose countries should also give the same privileges to the Rwandan diplomats;
 - b) Goods and services intended for international organizations that have signed agreements with Rwanda;
 - c) Goods and services intended for projects funded by partners that have signed agreements with the Government of Rwanda.

2.4.2 An exempt supply is not chargeable to VAT.

A person making exempt supplies is unable to recover VAT on inputs. The exempt supplier thus has to shoulder the burden of VAT. Of course, he may increase his prices to pass on the charge, but he cannot issue a VAT invoice which would enable a taxable customer to obtain a credit for VAT, since no VAT is chargeable on his supplies.

The following goods and services are exempted from value added tax:

1. Services of supplying clean water and ensuring environment treatment for non-profit making purposes and with exception of sewage pumping out services;
2. Goods and services related to health purposes:
 - a) health and medical services;
 - b) Equipment designed for persons with disabilities;
 - c) Goods and drugs appearing on the list provided for by an Order of the Minister.
3. Educational materials and services:
 - a) Educational services provided to students of nursery, primary, secondary and higher institutions of learning;
 - b) Educational services provided by social welfare organizations to students and other youths, meant for promoting the social, intellectual and spiritual development and for non-profit making purposes;
 - c) Educational services provided for vocational institutions;
 - d) Educational materials supplied directly to institutions of learning.
4. Books, newspapers, journals and other electronic equipment used as educational materials.

5. Transportation services:
 - a) Transportation of persons by road in a bus and a coach licensed under the law on vehicles in traffic and which have a seating capacity for fourteen (14) persons or more.
 - b) Transportation of persons by air;
 - c) Transportation of persons or goods by boat;
 - d) Transport of goods by road;
6. Lending, lease and sale:
 - a) Sale or lease of a land property;
 - b) Sale of a whole or part of a building meant for residential purposes;
 - c) Renting of or grant of the right to occupy a house used predominantly as a place of residence of one person and his/her family, if the period of accommodation for a continuous term exceeds ninety (90) days;
7. Financial and insurance services:
 - a) premium charged on life and medical insurance services;
 - b) Fees charged on the operation of current accounts;
 - c) Transfer of shares;
8. Precious metals: sale of gold in bullion form to the National Bank of Rwanda;
9. Any goods or services in the course of burial or cremation of a body, including the provision of any related licence or certificate;
10. Energy supply equipment:
 - a) Energy saving lamps;
 - b) Solar water-heaters;
 - c) Wind energy systems;
 - d) Gas, gas cylinders and related materials;
 - e) Equipment used in the supply of biogas energy;
 - f) Kerosene intended for domestic use, premium and gasoil.
11. Trade union subscriptions;
12. Leasing of exempted goods;
13. All agricultural and livestock products, except processed ones, which are exempted from value added tax. However, milk which is processed in local industries is exempted from this tax;
14. Agricultural input and other agricultural and livestock equipment provided by an Order of the Minister;
15. The following goods and services imported by persons with investment certificate are exempted from value added tax:
 - a) Industrial machinery;
 - b) Raw materials for industries;
 - c) Building and finishing materials imported by an investor fulfilling the requirements determined by an Order of the Minister;
 - d) Refrigerating vehicles, tourist vehicles, ambulances, fire- extinguishing vehicles and hearses;
 - e) Vehicles and movable property and equipment for foreign investors and Rwandans living abroad and their expatriate staff;
 - f) Equipment for tourism and hotel industry and relaxation places appearing on the list determined by an Order of the Minister;

- g) Goods and services meant for free economic zone;
- h) Medical equipment, drugs, agricultural equipment input, livestock and fishing equipment and agricultural input; i) didactical equipment;
- j) Special tourist aeroplanes.

16. Mobile telephones and SIM card;

17. Information, communication and technology equipment appearing on annex of this law.

Example

Uwineza is a registered VAT tax payer in Rwanda. She deals in both exempt and standard taxable supply. Her transactions for the month May 2018 are as shown below.

Items	Purchases inclusive of VAT RWF	Sales inclusive of VAT RWF
Wines	12,450,000	15,600,000
Milk processed in Rwanda	3,800,000	3,790,000
Clothes	7,460,500	9,830,000
Wheel chairs	10,800,000	14,890,000
Tomatoes unprocessed	2,562,000	6,700,600
Tomato source from Kenya	4,120,300	6,950,100
Electricity	2,320,400	
Fuel	3,870,900	
Rent	1,782,300	
Computers	11,456,700	17,850,000
Cooking oil	9,230,600	13,400,500
Total		

Output VAT

Items	Standard Rated	Zero rated	Exempt	Output VAT
Wines	15,600,000			2,379,661
Milk in Rwanda			3,790,000	
Clothes	9,830,000			1,499,492
Wheel chairs	14,890,000			2,271,355
Unprocessed tomatoes			6,700,600	
Tomato source from Kenya	6,950,100			1,060,185
Computers			17,850,000	
Cooking oil	13,400,500			2,044,144
Total sales	45,780,600		43,230,600	9,254,837

Input VAT

Items	Standard Rated	Zero rated	Exempt	Input VAT
Wines	12,450,000			1,899,153
Milk in Rwanda			3,800,000	
Clothes	7,460,500			1,138,042
Wheel chairs	10,800,000		10,800,000	1,647,457
Unprocessed tomatoes			2,562,000	
Tomato source from Kenya	4,120,300			628,520

Electricity	2,320,400			353,959
Fuel			3,870,900	
Rent	1,782,300			271,876
Computers			11,456,700	
Cooking oil	9,230,600			1,408,058
Total purchases	37,364,100		32,489,600	7,347,066

VAT payable/claimable = output VAT – Input VAT = 9,254,837 – 7,347,066 = 1,907,771

Ndimwe is a VAT registered tax payer in Nyarugenge District. His supplies are both exempt and standard rated. His supply for the month of April is as below;

Items	Purchases inclusive	Sales inclusive
Computers	10,000,000	15,800,000
Clothes	25,750,000	32,800,000
Sugar	14,500,000	18,600,000
Unprocessed milk	4,100,000	4,750,000
Telephones	8,200,000	12,620,000
Fridges	28,740,000	30,485,000
Total	91,290,000	115,055,000

Purchases

Item	Exempt	Standard	VAT
Computers	10,000,000		
Clothes		25,750,000	3,927,966
Sugar		14,500,000	2,211,864
Unprocessed milk	4,100,000		
Telephones	8,200,000		
Fridges		28,740,000	4,384,068
total	22,300,000	68,990,000	10,523,898

Sales

Item	Exempt	Standard	VAT
Computers	15,800,000		-
Clothes		32,800,000	5,003,389.83
Sugar		18,600,000	2,837,288.14
unprocessed milk	4,750,000		-
telephones	12,620,000		-
fridges		30,485,000	4,650,254.24
total	33,170,000	81,885,000	12,490,932

3. TEST YOUR UNDERSTANDING

1. Kamanzi Traders Ltd (KTL) operates a grocery shop in Ruhengeri Town. They sell assorted goods ranging from household items, scholastic materials, foods and beverages. They are registered for VAT and have been filling and paying taxes ever since January, 2016.

During January, 2017 they had the following transactions:

1. Sales (VAT Exclusive):	
(i)	Cooking oil 9,000,000RWF
(ii)	School books 1,500,000RWF
(iii)	Tinned milk that was imported from Denmark 1,100,000RWF
(iv)	Energy saving lamps 1,200,000RWF
(v)	Soda 3,800,000RWF
(vi)	Beans 2,200,000RWF
(vii)	Sugar 4,620,000RWF
(viii)	Bananas 120,000RWF

2. Donated sugar worth 100,000RWF to neighbours as part of burial contributions. **Purchases (VAT exclusive & from VAT registered persons where VAT applicable).**

3. Purchases (VAT exclusive & from VAT registered persons where VAT applicable).	
(i)	Two fridge 4,000,000RWF
(ii)	School books worth Frw 2,300,000
(iii)	Soda Frw 4,100,000
(iv)	Bananas Frw 100,000
(v)	Energy saving lamps Frw 2,000,000
(vi)	Sugar Frw 3,000,000
(vii)	Tinned milk from Denmark Frw 2,000,000
(viii)	Beans Frw 3,100,000

Required

Compute the VAT payable or claimable for January, 2017.

2.5 RULES RELATING TO SUPPLY OF GOODS AND SERVICES

The following acts constitute the supply of goods as per the VAT Law.

- i. Sale, exchange, or other transfer of the right to dispose goods by the owner;
- ii. Lease of goods under a leasing agreement;

Any act done but not supply of goods or money is considered as an act of service delivery which include:

- i. The transfer or surrender of any right to any other person;
- ii. Provision of any means for facilitation;
- iii. The toleration of any situation;
- iv. The refraining from doing any act;
- v. The lease of goods under operating leasing agreement

2.6 Taxation Period

The taxation period for the supply of goods and services is the earliest of one of the following:

- i. The date on which the invoice is issued;
- ii. The date on which payment of goods and services, including a partial payment is made. However, this Paragraph does not concern the advance payment made to the constructors who later reimburse it by deducting it from the invoices presented to the client;
- iii. The date on which goods are either removed from the premises of the supplier or when they are given to the recipient;

- iv. The date on which the service is delivered.

In case of electricity, water or any other supplies, goods or services measured by meter or any other calibration, the taxation period shall be the time when the meter or any other calibration reads the number that follows the previous consumption of the supply.

The taxation period to a person who suspends registration of the value added tax occurs immediately before the registration is cancelled.

Taxation of goods or services under Article 4 of this Law used for personal purpose or used as exempted goods and services occurs on the date on which goods or services are consumed.

1.7 Value of Goods and Services

The taxable value of each good or service is determined as follows:

- i. Except where this Law provides otherwise, the taxable value on goods or services is the consideration paid in money by the recipient;
- ii. The taxable value on goods and services is the fair market value, exclusive of the value added tax, if goods or services are supplied for:
 - a) A non-monetary consideration;
 - b) A monetary consideration for one part and non-monetary for the other;
 - c) Consideration that is less than the market value of the goods or services.

1.8 Acquisition of Foreign Services

If a taxpayer gets services from a person who is outside Rwanda, the taxpayer is considered as if he/she has delivered taxable services and has received an output tax from that person residing outside Rwanda. The service delivery is treated as it was made on the date on which the services were performed by the person residing outside Rwanda for a value determined under Article 11 of this Law. The output tax is payable on the date of filing the value added tax declaration for the value added tax period in which those services were performed. The output tax must appear on the receipt that justified the payment to the foreign services provider, and that document is considered to be the value added tax invoice.

Notwithstanding the provisions of Paragraphs One and 2 of Article 11, the recipients of foreign services which are not available in Rwanda are allowed to deduct input tax on output tax. Services are considered not to be available in Rwanda if there is no any person who can deliver identical or similar services on the local market.

Example 1

Shanika is a business woman in Kigali. During the quarter ended 31/5/2018, she hired a foreign consultant to install new business management software; similar consultants who can offer similar services are available in Rwanda. The consultant was paid 10,000,000RWF exclusive of VAT compute the VAT.

Answer

Since similar services can be offered in Rwanda then it is considered as an output VAT

Output VAT = 10,000,000 x 18% = 1,800,000

Example 2

Shamlan is a business man in Kigali during the quarter ended 31/8/2018; he hired a foreign consultant to train the employees on the accounting software for 30,000,000 inclusive of VAT.; No similar service is available in Rwanda.

Required

Compute the VAT

Answer

Since there is no similar service that is available in Rwanda, the VAT is considered an input VAT

Input VAT = $20,000,000 \times 18/118 = 3,050,845$

1.9 RULES RELATING TO IMPORTED GOODS AND SERVICES

1.9.1 Time for Importation of Goods

Importation of goods occurs on the date on which the goods enter Rwandan territory under the Customs legislation.

1.9.2 Basic Value for Taxation of Imported Goods

The basic value of imported goods is the sum of:

- i. The value of the goods for the implementation of customs duty under the customs legislation, whether or not such a duty is payable on such imported goods;
- ii. For matters not specified under the above point:
 - a) The cost of insurance and freight incurred in bringing the goods to Rwanda;
 - b) The cost for services which facilitate the import of goods.
- iii. The amount of customs duty, excise, port charges, or other fiscal charges other than value added tax payable in respect of the import. If goods are re-imported after being exported for repair, renovation or improvement, and the nature of the goods has not changed, the value of the import is the amount of the increase in value of the goods as a result of the repair, renovation or improvement.

Example One

1. Mugisha is a business man in Kigali, during the month of June he imported 30,000Kg of powdered milk from Denmark. The FOB was 30,000USD, marine insurance 4,500USD and transport to Mombasa was 8,000USD. The exchange rate for the period was 1USD = 830RWF.

Tax	Rate
Excise tax	10%
Import duty	25%
VAT	18%

Required

Compute the VAT

$CIF = FOB + I + F$

$CIF = 40,000 + 4,500 + 8000$

$52,500 \times 830 = 43,575,000$

Import duty = $CIF \times \text{rate}$

$= 43,675,000 \times 25\% = 10,918,750$

Excise tax = $(CIF + \text{import duty})$

$(43,675,000 + 10,918,750) 10\%$

5,459,376

Port charges (10RWF per kilogram)

$30,000 \times 10 = 300,000$

VAT = (CIF + import duty + excise tax + port charges) 18%

$(43,675,000 + 10,918,750 + 6,459,376 + 300,000) 18\%$

VAT = 10,809,563

1. TEST YOUR UNDERSTANDING

Mr. Mukunzi, an employee of Toto Kigali Limited was confirmed as a permanent member of staff in May, 2017. In June, 2017 Mukunzi applied for an employer guaranteed car loan from Success Bank Rwanda Limited to enable him import a personal car from Japan for his private use. In July, 2017 Mukunzi placed an order with Kismai Japan Limited for a Toyota Probox, engine capacity 1,300 CC, model 2005. In August, 2017, Kismai sent the following particulars to Mukunzi:

Details	USD
Cost of the vehicle	14,300
Insurance from Japan to the port of Mombasa	1,000
Freight from Japan to Mombasa	1,500

After reviewing the above details, Mukunzi confirmed to Kismai his acceptance of the terms in totality and then effected payment. Kismai delivered the car at the port of Mombasa on 28 September, 2017 and then arranged for its transportation by road to Kampala in accordance with the terms of the agreed contract. On 30 September, 2017, Mukunzi engaged Swift Forwarders Uganda Limited to transport the car from Kampala to Kigali. After payment of the relevant taxes and registration fees on 5 October, 2017, the car was issued with a number plate and a registration certificate by the Rwanda Revenue Authority.

Hint: Import duty rate = 25%, Excise duty rate = 10%, Withholding tax rate = 5% and the exchange rate on 5 October, 2017 was USD 1 = Frw 900.

Required

(a) Compute the customs duties paid to the Rwanda Revenue Authority (RRA) on 5 October, 2017.

2.10 INPUT TAX

2.10.1 Allowance of Input Tax

If all goods or services supplied by a taxpayer during a value added tax period are taxable goods and services, the taxpayer is allowed a credit of the input tax paid in respect of taxable acquisitions or taxable imported goods during the tax period for the purposes of selling or delivering taxable goods and services.

If a taxpayer, purchased in the country or imported taxable goods or services which are directly or indirectly related, on one hand partly to taxable goods or services and partly to exempted goods or services on the other, the sum of the input tax is a portion of the tax paid to the taxable goods or services in relation with his/her taxable business.

No input tax is allowed if goods purchased in the country or taxable imported goods or services are for personal purposes.

Input VAT allowance = Total input x taxable sale

Total sales

Example

Kayishema imported raw materials worth Fwr 200,000,000 exclusive of VAT. The materials were used to manufacture two products that are standard and exempted. The standard goods were sold at Frw180,000,000 exclusive of VAT and exempted were sold at Frw100, 000,000

Required

Compute the VAT payable

Total input VAT = 200,000,000 x 18% = 36,000,000

Allowable input VAT = 36,000,000 x $\frac{180,000,000}{280,000,000}$ = 23,142,857

Output VAT = 180,000,000 x 18% = 32,400,000

VAT payable = 32,400,000 – 23,142,857 = 9,257,143

2. TEST YOUR UNDERSTANDING

Hagenimana is a trader in Musanze. The following are his transaction for the quarter ended 31/8/2018

	FRW
Standard sales	120,000,000
Zero rated sales	200,000,000
Exempted sales	80,000,000
Purchases	220,000,000

The purchases were used to produce all supplies.

Required

Compute the VAT payable or claimable

An input tax is allowed when the taxable goods are acquired or imported. However, if at the time of a value added tax declaration for a tax period in which an input tax would otherwise be allowed under this Law, a taxpayer who does not have the relevant documents for input tax claim, the input tax is not allowed in that period but instead it is allowed in the first value added tax period in which the taxpayer holds such documents provided that they are not exceeding two (2) years after the time of the taxable goods are acquired or imported for which the credit relates.

2.11 Article 84: Value Added Tax violations

A person who does not comply with provisions of Value Added Tax is subject to an administrative fine as follows:

1° an administrative fine of fifty percent (50%) of the amount of value added tax output for the entire period of operation without value added tax registration, where Value Added Tax registration is required;

2° an administrative fine of one hundred percent (100%) of the value added tax indicated in the invoice and payment of that tax as indicated on that invoice, for a person who issued a value added tax invoice when he or she is not registered for value added tax.

A public institution which fails to withhold the value added tax or which withheld value added tax and failed

to pay the tax withheld to the Tax Administration, must pay the Tax not withheld or not paid, fines and default interests as provided for by this Law.

Article 85: Failure to use electronic invoicing system by a person registered for the Value Added Tax

2.11.1 A person registered for the Value Added

Tax who sells goods or services without issuing an electronic invoice is liable to an administrative fine of ten (10) times the value of the evaded Value Added Tax. In case of the fault is repeated, the defaulter is liable to an administrative fine of twenty (20) times the value of the evaded Value Added Tax.

Article 86: Non-compliance with obligations of the user of electronic invoicing system A person who fails to comply with obligations of the user of the electronic invoicing system provided for under Article 18 of this law is liable to an administrative fine of two hundred thousand Rwandan francs (FRW 200,000)

In case of the fault is repeated, the administrative fine is increased to four hundred thousand Rwandan francs (FRW 400,000).

A person registered to the Value Added Tax who carries out a taxable transaction and delivers an electronic invoice with undervalued price or quantity of goods or services is liable to an administrative fine of ten (10) times the value of the evaded value added tax.

In case of the fault is repeated, the administrative fine is increased to twenty (20) times the value of the Value Added Tax evaded.

2.11 VAT Refund

Tax refund is a result of having taxes withheld on earnings that amount to more than what a person owes in income taxes for a calendar year. There are times when a taxpayer pays more than what he/she is required to pay. When tax administration receives excess payment of taxes from any taxpayer, it cross checks the documents of the tax filed and verifies the cause of over payment, and the surplus amount discovered is what is referred to as tax refund.

If during a particular prescribed taxation period, the input tax exceeds the output tax, the Commissioner General shall refund the supplier the due amount to which the supplier stands in credit by reason of the excess, on receipt of the relevant tax return document within thirty (30) days:

- 1) After one day from the expiry of the prescribed period for tax declaration;
- 2) After receipt of proof of the last outstanding tax declaration

Prior to payment, the Commissioner General may order for verification of the claim for refund or deduction submitted to him/ her. In such a case, the period for the response to be communicated shall not exceed three (3) months from the date when the claim was lodged.

2.11.1 For Large Taxpayers

■ When the amount to be refunded is less than Frw200,000, the taxpayer shall deduct that amount during the next filing period;

■ When the requested refund is between frw200,000 and frw2,000,000, as well as the money that was retained in the Office of the treasury, the taxpayer shall be refunded that money by the Rwanda Revenue Authority before any audit is carried out;

■ When a taxpayer requests for refund of more than Frw2,000,000, or between frw200,000 and frw200,000,000 for more than three consecutive times or even suspected of not rightfully demanding for the VAT refund, the RRA carries out an audit to verify the validity of refund request;

■ Prior to the refund, the auditor is required to carry out desk audit without going to the taxpayer's premises.

2.11.2 For Medium Taxpayers

■ When the amount to be refunded is less than Frw100.000, the taxpayer shall deduct that amount during the next filing period;

■ When the amount to be refunded is between frw200.000 and frw1,000,000, as well as the money that was retained by the Office of the treasury, the taxpayer shall be refunded that money by the Rwanda Revenue Authority before any audit is carried out.

2.11.3 For Small Taxpayers

■ When the amount to be refunded is less than Frw50,000, the taxpayer shall deduct that amount during the next filing period;

■ When the amount to be refunded is more than frw50,000 and less than frw500.000, the authority refunds that amount with immediate effect;

■ When a taxpayer requests for refund of more than Frw500,000, for more than three consecutive times, the RRA carries out an audit to verify the validity of refund request; and this is done in a period of three months.

■ When a taxpayer requests for refund of more than Frw 500.000, before that money is refunded, the RRA carries out an audit to verify the validity of refund request. Prior to the audit, the taxpayer is informed in writing of the audit to be done in not less than seven working days.

Privileged and exempted persons such as diplomats, projects funded by international organizations and Non-Governmental Organizations that have a convention with the Government of Rwanda of not paying taxes are refunded the money paid as VAT not less than ten working days after filing the form obtained at RRA offices.

The requirements include an authentic document allowing him/her that exemption or a service card for these Diplomats representing their countries in Rwanda, copies of all invoices and proof of payment for an amount more than Frw100.000.

The Ministerial Order establishes a list of exempted goods and those zero rated in accordance with articles 86 and 87 of law no 6/2001 of 20/1/2001.

When an individual/taxpayer receives a tender from organizations/institutions that are exempted from paying VAT, s/he deducts the VAT as provided for by the law then thereafter files in refund request for VAT from Rwanda Revenue Authority.

2.12 REGISTRATION FOR VAT

A person whose taxable transaction in the preceding calendar year or preceding quarter has reached at least 20,000,0000 (twenty million) or 5,000,000 (five million) RWF, respectively, is required to register with the tax Administration for VAT and must obtain a VAT certificate. The registration must be accomplished within 7 days from the end of that calendar year or quarter.

If the business is newly formed, it may operate up to 3 month without registering for VAT. However, as soon as the taxable transactions reach 5,000,000rwf or more, it must be registered any time before the end of the 3 month period. If a person has different businesses in the same or different locations he shall combine all the activities and register as one single taxable unit.

Example

Ndwayezu commenced business on 1/1/2018. His monthly sales are as below:

Month	Sales
January	1,800,000
February	800,000
March	2,000,000
April	2,500,000
May	2,000,000
June	1,800,000
July	3,000,000
August	4,800,000
September	3,500,000
October	6,850,000
November	2,800,700
December	6,500,000
January	4,650,000
February	1,680,000
March	4,600,800
April	2,804,000
May	3,000,000

When should Ndwayezu register for the VAT?

Quarterly Registration Rule

Month	Monthly sales	Cumulative sales Amount (RWF)
	Amount (RWF)	
January	1,800,000	1,800,000
February	800,000	2,600,000
March	2,000,000	4,600,000
April	2,500,000	2,500,000
May	2,000,000	4,500,000
June	1,800,000	6,300,000

Since Ndwayezu reaches 5,000,000rwf in the second quarter, he must register for VAT in seven days of month July.

Annual Registration Rule

Month	Sales Amount	Cumulative sales
	(RWF)	Amount (RWF)
January	1,800,00	1,800,000
February	800,000	2,600,000
March	2,000,000	4,600,000
April	2,500,000	7,100,000
May	2,000,000	9,100,000
June	1,800,000	10,900,000
July	3,000,000	13,900,000
August	4,800,000	18,700,000
September	3,500,000	22,200,000
October	6,850,000	
November	2,800,700	
December	6,500,000	

Using the annual registration rule, Ndwayezu reaches 20,000,000rwf in the month of September; therefore he must register for VAT in the first seven days of January

3. TEST YOUR UNDERSTANDING

Uwamahoro Ltd (UL) is a tax resident company in Rwanda and engages in the sales of general merchandise. UL has been trading since 2016 but not yet for value Added Tax UL recorded the following sales in 2016.

Period	Sales (Frw)
January	1,200,000
February	800,000
March	1,890,000
April	2,000,000
May	1,500,000
June	2,890,000
July	970,000

In May 2016, UL sold solar water heaters; supplied educational materials directly to learning institutions and sold energy saving lamps to various customers which were all valued at Frw 400,000.

Required

- (i) Determine the period in which Uwamahoro Ltd (UL) met the VAT registration threshold.
- (ii) State when UL was expected to file the first VAT return.
- (iii) State the penalty for non-registration.
- (iv) List three taxable supplies on which input tax is not allowed.

Registration is done in the following:

4. In the name of the sole proprietor
5. In the name of the firm
6. In the name of a company
7. In the name of the organization

The commissioner General, if he sees that it is fit, he may direct that two or more persons be registered and treated as a single entity.

The person who has been registered for VAT is the only one has the right to levy VAT when he sells goods to his customers. Tax payers registered for VAT recovers the tax levied on them and profit more sales compared to those who did not register.

Those who are registered for VAT will be obliged to buy from supplies that are registered.

1.13 Obligations of a VAT Registered Taxpayer

Articles of Rwanda tax law 57-63 specify the rights and obligations of a VAT registered taxpayer and include the following:

1. Must clearly display the VAT registration certificate in a plain view at the entrance of his place of business for his clients to see.
2. Must issue a VAT invoice to his customers every time they purchase goods or services from him.
3. Must file a monthly or quarterly VAT return on the appropriate form (UNG11).

4. Must be available at all times to receive VAT officers and to make available to the officers books of accounts ascertaining to the business.

1.13.1 Other Registration Issues

When determining the value of a person's taxable supplies for the purposes of registration, supplies of goods and services that are *capital assets* of the business are to be disregarded, except for non-zero-rated taxable supplies of interests in land.

When a person is liable to register in respect of a past period, it is his responsibility to pay VAT. If he is unable to collect it from those to whom he made taxable supplies, the VAT burden will fall on him. A person must start keeping VAT records and charging VAT to customers as soon as it is known that he is required to register. However, VAT should not be shown separately on any invoices until the registration number is known. The invoice should show the VAT inclusive price and customers should be informed that VAT invoices will be forwarded once the registration number is known. Formal VAT invoices should then be sent to such customers within 30 days of receiving the registration number.

1.13.2 Deregistration

Every registered taxpayer is de-registered when the commissioner general is satisfied that they ceased to make taxable supplies or is not a person to whom the conditions of registration apply. Any registered person ceasing to be liable for registration notifies the tax administration, within a period of 7 days of the time when he is no longer required to be registered. The tax administration, when satisfied that the person is no longer liable to be registered, may cancel the registration.

A trader may deregister voluntarily if he expects the value of his taxable supplies in the following one year period will not exceed the minimum. Alternatively, a trader who no longer makes taxable supplies may be compulsorily deregistered.

1.1.2 The Consequences of Deregistration

VAT is chargeable on all goods and services at hand on the date of deregistration. On deregistration, VAT is chargeable on all stocks and capital assets in a business on which input tax was claimed, since the registered trader is in effect making a taxable supply to himself as a newly unregistered trader.

1.13.3 Transfer of a Going Concern Business

The transfer of a business as a going concern is outside the scope of VAT. There is no VAT charge if a business (or a separately viable part of it) is sold as a going concern to another taxable person (or a person who immediately becomes a taxable person as a result of the transfer). Such a sale is outside the scope of VAT.

If a transfer of a going concern (TOGC) is from a VAT registered trader to a new owner who is not VAT registered then it is possible to apply to transfer the registration number of the previous owner to the new owner. This would also transfer to the new owner the responsibility for the past VAT history of the old business. So, if the previous owner had committed any VAT misdemeanours the liability for those would transfer to the new owner of the business. As a result of this it may not be wise to apply to transfer the VAT registration number between old and new owners unless of course, it is a situation where there is a very close connection between the two.

If the VAT registration number is not transferred, then the new owner does not have any responsibility for the VAT affairs of the previous owner of the business. This is probably a safer way to structure the transfer of a business.

1.14 Pre-Registration Input Tax

VAT incurred before registration can be treated as input tax and recovered from RRA subject to certain

conditions. If the claim is for input tax suffered on goods purchased prior to registration then the following conditions must be satisfied:

- (a) The goods were acquired for the purpose of the business which either was carried on or was to be carried on by him at the time of supply.
- (b) The goods have not been supplied onwards or consumed before the date of registration (although they may have been used to make other goods which are still held).
- (c) The VAT must have been incurred in the four years prior to the date of registration.

1.14.1 Pre-Registration Services

If the claim is for input tax suffered on the supply of services prior to registration then the following conditions must be satisfied:

- (a) The services were supplied for the purposes of a business which either was carried on or was to be carried on by him at the time of supply.
- (b) The services were supplied within the six months prior to the date of registration.

Input tax attributable to supplies made before registration is not deductible even if the input tax concerned is treated as having been incurred after registration.

1.15 Imports, Exports and Free Zones

VAT is not only a tax on supplies made in Rwanda, it is also a tax on the importation or acquisition of most goods and services.

Imports

When goods and services are imported into Rwanda VAT is due at the same rate as on a supply of those goods in the Rwanda. VAT must be paid when you import the goods and before they are cleared from Customs. If you import services then you must account for VAT as if you supplied the service yourself. However, in the case of imported services you may not reclaim the VAT as input tax.

2.15.1 Exports

If you export goods to a customer outside of Rwanda that supply is normally zero-rated provided that you fulfil certain conditions.

2.15.2 Free Zones

VAT is not due on the importation into a free zone of goods for storage and/or processing. Import VAT is due on goods removed from a free zone into the rest of Rwanda and on goods used or consumed within the free zone. Where goods manufactured in a free zone are removed into Rwanda for use in the owners business, as opposed to being sold or disposed of, VAT is due only on the value of any imported element of the goods.

2.16 Credits and Debits Notes

It is a fact of life that at some stage a customer will return goods or an overcharge or undercharge will be discovered, relating to a supply, on an invoice. To correct such eventualities either a credit note or a debit note will be required to be issued.

To be valid for VAT purposes, a credit or debit note must: - reflect a genuine mistake, overcharge or an agreed reduction in the value of a taxable supply and should be issued as soon as this mistake is discovered. Give value to the customer, i.e. represent a genuine entitlement (or claim) on the part of the customer for the amount overcharged to be either refunded or offset against future supplies is clearly headed.

Credits given for zero rate or exempt supplies included in a credit or debit note must be totalled separately and the note must clearly show that no VAT credit has been allowed for them.

2.16.1 Accounting for Credit Notes and Debit Notes

If you have to make an adjustment for a credit or debit note you must adjust all the records of the taxable supplies made and the output tax to reflect credits or debits you have made. The nature of the adjustments and the reasons for them must be clearly documented. Any VAT adjustment arising from the issue or receipt of credit notes or debit notes must be made for the accounting period in which you enter the adjustment in your business accounts.

In exceptional circumstances, if the VAT credits you allow your customers exceed the output tax you charged on your sales in a VAT period, it is possible that you may have a minus figure in the output tax box of the VAT return. This should be made clear by writing the figure in brackets.

If the standard rate of VAT changes, for any reason, the rate of VAT to be used for the credit note or debit note is the one that was in force at the time of the tax point of the original supply.

2.17 Records and Accounts

You are required by law to keep records and accounts of all taxable goods and services you receive or supply in the course of your business. This includes both standard rated and zero rated supplies. You must also keep records of any exempt supplies that you make. In addition you must keep a summary of your input tax and output tax totals for each monthly tax period.

All these records should be kept up to date and must be in sufficient detail to allow you to calculate correctly the amount of VAT that you have to pay to, or claim from, the RRA.

You do not have to keep these records in a set way but they must be maintained in a way which will allow RRA officers to check easily the figures that you have used to fill in your VAT returns.

2.17 Denial of Input Tax

No input tax is allowed on the following goods:

- 1) Passenger vehicle, or spare parts or repair and maintenance services for such a vehicle, unless the taxpayer's business involves the re-sale or rent of such a vehicle and the vehicle was solely acquired for the purpose of such taxpayer's business.
- 2) Goods acquired or imported for entertainment purposes unless the taxpayer's business involves providing entertainment and the entertainment is provided in the ordinary course of that business and was not entrusted to a partner or employee;
- 3) Goods acquired for accommodation purposes, unless:
 - a) The taxpayer's business involves providing accommodation services and the accommodation is provided in the ordinary course of that business;
 - b) The accommodation was provided to the person who was away from his/her usual residential home for the interest of the business or employer's interests;
- 4) The acquired goods give right to membership or accession for any person to an association of sporting, social, recreational clubs.

Value added tax paid on such business overheads as in the case of telephones and electricity whose use cannot be practically separable from private and business use shall be equal to 40% of the input tax. The Commissioner General shall determine deniable input tax on taxable goods acquired or taxable goods imported as mentioned in Paragraph One of this Article.

2.18 POST-SALE ADJUSTMENTS

Post-Sale Adjustments

The reasons for post-sale adjustments are as follows:

- 1) If taxable goods or services no longer existing;
- 2) If the nature of taxable goods or services is changed or damaged;
- 3) If the consideration of taxable goods or services is changed;
- 4) If goods or part of the goods are returned to the supplier.

2.18.1 Value Added Tax Post-Sale Adjustments

In case post-sale adjustments on taxable goods and services are due to reasons referred to in Article 18 of this Law, which lead to the value added tax paid in respect of the taxable goods or services exceed the value added tax to be duly payable by the supplier, the seller benefits the balance as a deductible input tax. However, if the seller, delivered taxable goods or services to a value added tax non-registered person, the seller shall be allowed to benefit the balance as a deductible input tax only when he/she substantially proves that the balance was repaid to the recipient.

The registered buyer shall consider the additional tax as output tax on taxable goods or services. If adjustments to the taxable goods and services lead to the diminution of the tax to be duly paid against the tax paid by the seller, the registered recipient is requested to pay the value added tax related to the additional value due to the adjustment. The registered recipient shall consider the additional tax as a refundable tax.

2.18.2 Post-Sale Adjustment for Unrecoverable Debts

If a registered tax payer has supplied goods or services for consideration and paid all the tax on those goods and services to the Commissioner General, but has not within twenty (24) months after the delivery of such goods and services received payment in whole or in part from the recipient, the registered supplier is allowed a refund of the tax paid for which he/she did not receive upon fulfilling the following conditions:

- 1) An amount equivalent to the debt previously included in the value of taxable goods or services;
- 2) The debt is written off in the books of accounts of the supplier of goods or services;
- 3) The supplier of goods or services who has taken all possible steps in pursuing payment and has shown convincing evidence that the debtor is insolvent.

1.19 DECLARATION AND PAYMENT OF VALUE ADDED TAX

1.19.1 Value Added Tax Declaration

Within fifteen (15) days after the end of the period of the value added tax, a registered taxpayer must submit value added tax declaration, in accordance with forms and formalities determined by the Commissioner General.

For taxpayers whose annual turnover is equal to or less than two hundred million Rwandan francs (200,000,000 RWF), the value added tax declaration is quarterly and shall be submitted with payment of the tax due within fifteen (15) days after the end of the quarter.

However, taxpayers whose annual turnover is equal to or less than two hundred million Rwandan francs (200,000,000 RWF) who wish may opt for a monthly value added tax declaration.

A registered taxpayer must submit value added tax declaration, whether he/she made sales or not, whether he/she is claiming for refund or whether the difference is zero.

1.19.2 Payment of Value Added Tax

The value added tax payable by a taxpayer for a tax period shall be computed in accordance with Article 21 of this Law and it shall be payable on the date of submission of a value added tax declaration for that taxation period. The value added tax payable by an importer is due and payable when imported goods reach the country.

1.19.3 Collection of Value Added Tax on Imported Goods

Importation of taxable goods is subject to value added tax at the customs point in accordance with the customs legislation.

1.20 Enterprise and Subsidiaries

A taxpayer who manages an enterprise which has subsidiaries is treated as a single enterprise for the purposes of this Law. A person who conducts a business in various subsidiaries of an enterprise is obliged to register the business in his/her name and not in the names of the subsidiaries.

1.21 Currency Conversion

The currency used in implementation of this Law is expressed in Rwandan francs.

If any amount is expressed or paid in a currency other than Rwandan francs:

- 1) In the case of importation of goods, the amount shall be converted into Rwandan francs at the exchange rate applicable under the Customs legislation for the purposes of computing the customs duty payable on the import;
- 2) In any other case, the amount is to be converted into Rwandan francs at the National Bank of Rwanda exchange rate applying between the foreign currency and Rwandan franc on the date on which the amount is given for the purposes of this Law.

If there is no existing applicable exchange rate for a certain currency used by the National Bank of Rwanda, the applicable rate shall be computed on the basis of the National Bank's rate for the U.S. Dollar, and a published cross-rate for that currency in question against the U.S Dollar.

1.22 Foreign Diplomatic Missions in Rwanda and International Agreements

Upon request, and if he/she considers it necessary, the Commissioner General may authorize the refund of part or all of the value added tax incurred on goods acquired or imported by:

- 1) A diplomatic or consular mission, or by a diplomat or consular official who enjoy full or limited immunity, rights, according to the law governing diplomats accredited to Rwanda as well as the law governing trade cooperation between the countries;
- 2) A governmental international organisation or foreign Government to the extent required under an international agreement.

The application for a refund under this article must be made on the approved form and in the manner prescribed by the Commissioner General and be accompanied by supporting documents as the Commissioner General may require. The following are some of such documents:

- 1) Evidence that the value added tax for which the refund is sought was incurred;
- 2) Evidence of the applicant's entitlement to make an application for refund under this Article. In this article, international agreement means an agreement between the Government of Rwanda and a foreign Government or a governmental international organisation for the provision of financial, technical, humanitarian, or administrative assistance to the Government.

1.23 ELECTRONIC BILLING MACHINE (EBM)

An electronic billing machine comprises of two components; there is a certified invoicing system (CIS) and a sales data controller (SDC). Upon the public announcement, every business registered for VAT will have to provide a customer with special receipt issued through electronic billing machine for every good or service.

“**Certified Invoicing System (CIS)**” means an electronic system designated for use in business for efficiency management controls in areas of sales analysis and stock control system which confirms the requirements specified by the Authority

Sales Data Controller (SDC)” means a device connected to CIS used for processing and storing certified receipts;

Machine Registration Code (MRC) means Certified Invoicing System’s unique serial number with designation of its certificate;

Remote audit means a function of SDC to establish two way communications with remote server designated by the Authority in order to transfer required audit information;

Local audit means a function of SDC to provide information from its internal memory to a removable storage media (SD card).

Purposes of EBM

- i. Combating tax evasion
- ii. Combating corruption in the tax system
- iii. Providing a market balance and make equal business opportunities for every entrepreneur.

Sales Data Control (SDC)

Sales Data Controller (SDC) is an electronic device connected to Certified Invoicing System (CIS), designed to receive specific receipt data from CIS, performs data processing and generates response data which is sent back to CIS for further actions. Response data provides authenticity of receipt data. SDC also store receipts to its own.

Certified Invoicing System (CIS)

Certified Invoicing System (CIS) can be any electronic cash register, any terminal with cash register software, any computer using invoicing software, or any other similar system used for registration of outbound transactions.

A CIS cannot operate unless connected to a functional Sales Data Controller unit assigned for the same TIN, which preserves on an irrevocable and secure manner all relevant data of the outbound transactions, uses this data to calculate an algorithm that must be printed on the final receipt, in accordance with **Article 4** of Commissioner General Rules, for the client by the means of CIS printing mechanism.

The data flow between the Certified Invoicing System and the Sales Data Controller will be as follows for each receipt type:

- a. The CIS sends the following receipt data to the SDC at the time when the receipt is being produced:
 - i. Date and time;
 - i. Tax Identification Number;
 - ii. Client’s TIN (optional);
 - iii. Machine registration code (MRC);
 - iv. Receipt number;

- v. Receipt type and transaction type;
 - vi. TAX rates;
 - vii. Total amounts with TAX;
 - viii. TAX amounts.
- b. The SDC receives receipt data from CIS;
- c. The SDC generates the following response data and sends them back to the CIS:
- i. SDC ID;
 - ii. Date and time;
 - iii. Receipt label;
 - iv. Receipt counter per receipt type;
 - v. receipt counter of all receipts;
 - vi. Digital signature (except for the receipt)

Registration as an Electronic Billing Machine User

Any taxpayer informed under Article 9 of this Order shall be required to register with the Authority as a certified electronic billing machine user.

Any taxpayer who is exempted from the obligation under Paragraph One of this Article may voluntarily register or may be required to register with the Authority as a certified electronic billing machine user, based on the level of risk assessment determined by the Commissioner General.

Upon commencement of this Order, only machines for issuing receipts that are found to be compliant with certified electronic billing machine specifications, and have been duly authorized by the Authority are utilised to generate receipts required under Article 7 of this Order.

Receipt Data Requirements

A Certified Invoicing System shall generate receipts which show, among others, the data enumerated in items below as minimum required information:

- 1) Taxpayer's name;
- 2) Taxpayer identification number;
- 3) Address at which the sale takes place;
- 4) Optional tax identification number of the client;
- 5) Receipt type and transaction type;
- 6) Serial number of the receipt, from an uninterrupted ascending number series per receipt type;
- 7) Registered items or services with description, quantity, price, with any other action that may be done, such as cancellations or corrections;
- 8) Total sales amount;
- 9) Tax rates applied;
- 10) The tax added to the sale amount;
- 11) Means of payment;
- 12) SDC information including:
 - a. Date and time stamped by SDC;
 - b. Sequential receipt type number;

- c. Receipt signature;
 - d. SDC identification number;
- 13) Date and time stamped by CIS;
- 14) Machine Registration Code (MRC).

Each receipt shall be formed from a combination of a receipt type and a transaction type, determined by the Commissioner General.

The receipt data requirements referred to in Paragraph One of this Article shall apply to return receipts.

2.23.1 Obligations of a Certified Electronic Billing Machine User

Users of certified electronic billing machines shall be subject to the following obligations:

- 1) To purchase certified set of electronic billing machines from a licensed supplier;
- 2) To install certified electronic billing machines at the sales location;
- 3) To issue receipt generated by certified electronic billing machines to every customer purchasing items or service;
- 4) To ensure that certified electronic billing machines is placed at a place which is accessible and easily seen by customers;
- 5) To ensure that all items or services sold through certified electronic billing machine have clearly defined name and appropriate tax rate.
- 6) To include client's TIN on the receipt upon request from the client who performs the payment prior to start issuing a receipt;
- 7) To put a conspicuous notice containing the following information at a place where the certified electronic billing machine is installed:
 - a. Name of the user, address and the TIN;
 - b. Machine Registration Code;
 - c. SDC Serial Number;
 - d. Statement "In case of machine failure, sales personnel shall issue manual receipts authorized by the Authority";
 - e. Statement "DO NOT PAY IF A RECEIPT IS NOT ISSUED";
- 8) To make certified electronic billing machine available for control with respect to its being intact and the correctness of its operations;
- 9) To perform compulsory technical inspection of certified electronic billing machine with appropriate service point, once such obligation is requested by the Commissioner General;
- 10) To store the copies of certified electronic billing machines journal records within ten (10) years;
- 11) To ensure that the user manual is received at the time of supply by the dealer;
- 12) To ensure that the supplier has registered certified electronic billing machine at the time of supply with the Authority;
- 13) To report change of sales location to the Authority through procedure prescribed by the Commissioner General;
- 14) Not to stop using certified electronic billing machine for more than twelve (12) hours without prior notification to the Authority;
- 15) To report malfunctions of certified electronic billing machine to the Authority within six (6) hours;

- 16 To keep the SDC in Rwanda;
- 17) To preserve the SDC in the event of sale or scrapping of a certified electronic billing machine;
- 18) To preserve the SDC for at least twelve (12) months in a secure manner recommended by manufacturer. This also shall apply to a SDC which has been replaced to be dismantled or has been replaced for some other reason;
- 19) To have a valid purchase contract for the certified electronic billing machines from an authorized supplier;
- 20) Not to start business activity without acquisition of a certified Electronic billing machine with and its installation at sales location;
- 21) To provide accurate information about sales outlet where electronic billing machine shall be operating on the application form for system activation;
- 22) To report to the Authority about electronic billing machine replacement in twelve (12) hours after Electronic billing machine is replaced or moved out from registered sales outlet for any reason;
- 23) To submit request to the Authority for electronic billing machine de-activation in case of cessation of business activity;
- 24) Issue certified receipt printed by Electronic billing machine, regardless if the client requires or rejects to take certified receipt, in case there is at least one electronic billing machine functioning properly at sales location;
- 25) To issue certified refund receipt printed by certified electronic billing machine in case that there is at least one certified electronic billing machine functioning properly at sales location and document refund in accordance with refund procedure specified by Commissioner General's instructions;
- 26) To issue invoices written by hand in two specimens, regardless if the client is requiring or rejecting to take invoice, in case there is no certified electronic billing machine functioning properly at the sales location and at least for ten (10) years and keep second specimen of invoice handwritten together with original certified receipt printed after certified electronic billing machine is recovered;
- 27) To issue certified refund receipts in case of necessary balance correction for previously issued certified receipt due to entry error. Refund receipt in this case shall be in consecutive order from original receipt followed by documented evidence, in accordance with refund procedure specified by Commissioner General's instructions;
- 28) To notify the Authority in writing about termination of certified electronic billing machines operation in twelve (12) hours due to theft or damage by force majeure like flood, fire, earthquake, accident in transportation or similar. This notification shall be accompanied by copy of report from competent authority. If business activity is continuing, a taxpayer shall purchase a new certified electronic billing machine within eight (8) working days;
- 29) To keep the proper functional SDC connected to CIS all the time;
- 30) Not perform operations on certified electronic billing machine applying different tax rates for goods and services other than the ones officially prescribed by the Authority;
- 31) Any other obligation that may be determined by the Commissioner General

2.23.2 Violation of the EBM Law

Failure to use electronic billing machine

Article 24 of Law n° 37/2012 of 9/11/2012 establishing the value added tax as modified and complemented to date is modified and complemented as follows:

“Any person required to use electronic billing machine who sells goods or services without issuing an electronic invoice is liable to an administrative fine of ten (10) times the value of the evaded value added tax.

In case a person repeats the fault specified in Paragraph One of this Article, he/she is liable to an administrative fine of twenty (20) times the value of the evaded value added tax.”

Non-compliance with other obligations of the user of electronic billing machine

Article 24 of Law n° 37/2012 of 9/11/2012 establishing the value added tax as modified and complemented to date is modified and complemented as follows:

“Any person required to use an electronic billing machine complies with other obligations of the user of such a machine provided for by the Ministerial Order on modalities of use of certified electronic billing machine.

Subject to provisions of Article 24 of the Law, any person who fails to comply with the obligations specified in Paragraph One of the Article 24 is liable to an administrative fine of two hundred thousand Rwandan francs (FRW 200,000).

In case a person repeats the fault provided under Paragraph 2 of this Article, he/she is liable to an administrative fine of four hundred thousand Rwandan francs (FRW 400,000).”

Understatement of Tax

“Any person who makes a taxable transaction and delivers an electronic invoice with undervalued price or quantity of goods or services is liable to an administrative fine of ten (10) times the value of the evaded value added tax. In case the person repeats the fault provided under Paragraph 4 of this Article, the fine is increased to twenty (20) times of the value of the value added tax evaded.”

REVIEW QUESTIONS AND ANSWERS

2 Question 1

- a). Define a taxable supply as per the VAT law.
- b). What is the taxation period of the goods and services?
- c). Turikumwe investments limited manufactures and distributes cements. During the month of May 2015, they supplied cement worth 50,000,000RWF inclusive of VAT to Shumbusho, a whole seller located in Nyabugogo. The wholesaler supplied the whole cement to Manzi a retailer in Nyamirambo at 52,000,000RWF exclusive of VAT. The cement was finally supplied to the final consumer at 60,000,000RWF inclusive of VAT.

Required

- i. Determine the amount of output and the Input VAT
- ii. The VAT payable to Rwanda Revenue Authority

Answer

a) A taxable supply is a supply of goods or services in Rwanda, other than an exempt supply. Therefore, a taxable supply is either zero rated supply or standard rated supply.

b). Taxation period is the period on which the supply of goods or service is recognised to have been occurred. The taxation period for the supply of goods and services is the earliest of one of the following:

- i. The date on which the invoice is issued;
- ii. The date on which payment of goods and services, including a partial payment is made.
- iii. The date on which goods are either removed from the premises of the supplier or when they are given to the recipient;
- iv. The date on which the service is delivered.

Particulars	Workings	Amount (RWF)
Output VAT		
Supply by Turikumwe limited	50,000,000 x 18/118	7,627,119

Supply by the whole seller	52,000,000 x 18%	9,360,000
Supply by the retailer	60,000,000 x 18/118	9,152,542
Total output VAT		26,139,661
Input VAT		
Purchase by whole seller	50,000,000 x 18/118	7,627,119
Purchase by retailer	52,000,000 x 18%	9,360,000
Total input VAT		16,987,119
VAT payable	26,139,661 – 16,987,119	9,152,542

3 Question 2

- a) The Government of Rwanda allows tax payers to claim for the Input VAT paid. However, there are circumstances where the input VAT cannot be claimable by the taxpayers. Give four circumstances where the input VAT will be denied.
- b). Nyirarukundo is registered for VAT, and its sales are all standard rated (18%). The following information relates to her VAT return for the quarter ended 31 March 2015:
- Standard rated sales amounted to 120,000,000RWF. She offers her customers a 5% discount for prompt payment.
 - Standard rated purchases and expenses amounted to 35,640,000RWF. This figure includes 480,000 for entertaining customers.
 - On 15 March 2014 she wrote off irrecoverable debts of 2,840,000RWF in respect of invoices due for payment on 10 May 2011.
 - During the month ended 31 March 2015 she received a service from a foreign consultant firm. She paid 3,000,000RWF exclusive of VAT. Similar service can also be provided by consultants in Rwanda but she preferred a foreign firm.
- iv). Unless where indicated, all the figures are inclusive of VAT

Required

- Determine the amount of VAT payable to RRA.
- Give four circumstances under which the tax payer will be penalised for violating the VAT laws.
- Rwanda Revenue Authority introduced the Electronic Billing Machines and every registered tax payer is required to use the Electronic Billing machine. Explain the objectives of introducing the electronic billing machine by RRA.

Answer

- a). Computation of VAT payable

Particulars	Working	Amount (RWF)	Amount (RWF)
Output VAT:			
VAT on sales	$(95\% \times 120,000,000) \times 18/118$	17,389,830	
Less VAT on irrecoverable invoice	$(18/118 \times 2,840,000) \text{ N1}$	(433,220)	
		16,956,610	
Add VAT on foreign service	$(3,000,000 \times 18\%) \text{ N2}$	540,000	
Total output VAT			17,496,610
Input VAT:			
VAT on purchase and expenses	$(35,640,000 - 480,000) \times 18/118$		(5,363,389)
VAT payable			12,133,221
Total marks awarded			

Notes (N)

N1: Since the invoice exceeds 24 months it can be allowed for write off.

N2: Since there are other consultants in Rwanda who can offer the same service. The whole amount will be considered as output VAT.

b) Reasons for denial of Input VAT

- i. **VAT on motor cars** not used wholly for business purposes. VAT on cars is never reclaimable unless the car is acquired new for resale or is acquired for use in or leasing to a taxi business, a self-drive car hire business.
- ii. **VAT on business entertaining** where the cost of the entertaining is not a tax-deductible trading expense. If the items bought are used partly for such entertaining and partly for other purposes, the proportion of the VAT relating to the entertainment is non-deductible.
- iii. VAT on expenses incurred on domestic accommodation for directors.
- iv. VAT on non-business items passed through the business accounts.
- v. VAT which does not relate to the making of supplies by the buyer in the course of a business.

c) Circumstances under a taxpayer will be penalised for violating the VAT laws:

- i). In the event of a taxpayer operating without VAT registration where VAT registration is required;
- ii). In the event of the taxpayer issuing incorrect VAT invoice resulting in a decrease in the amount of VAT payable or in an increase of the VAT input credit;
- iii). In the event the taxpayer fails to issue a VAT invoice where he or she is supposed to issue;
- iv). For issuing of a VAT invoice by a person who is not registered for VAT;
- v). Not paying the VAT on time.

d) Purpose of introducing EBM

- i. It helps in Combating tax evasion
- ii. It helps in Combating corruption in the tax system
- iii. It helps in providing a market balance and make equal business opportunities for every entrepreneur.

4 Question 3

- a. According to article 3 of the VAT law, VAT is charged on a taxable supply. With examples explain the taxable supply for VAT purposes.
- b. Explain four circumstances under which the output VAT may be adjusted
- c. Ndaku is a registered VAT payer. The following transactions took place in his business for the period ended 30/6/2016.
 - i. Purchased items worth 28,800,000RWF inclusive of VAT
 - ii. Paid for electricity 270,500RWF
 - iii. Sold goods worth 30,000,000RWF on credit inclusive of VAT
 - iv. Sold goods worth 12,700,000RWF exclusive of VAT cash
 - v. Purchased home use items worth 6,500,000RWF inclusive of VAT
 - vi. A bad debt of 2,000,000RWF exclusive of VAT was written off. This is after spending one and half years without knowing the whereabouts of the customer.
 - vii. The company outsourced a foreign consultancy to install and train employees on the new business management software. The company paid 14,000,000RWF, exclusive of VAT to the consultants. There are similar companies in Rwanda which can do the same job.
 - viii. The company returned goods to supplier because they were found to be defective. The supplier issued a credit note of 5,000,000RWF inclusive of VAT.

Required

Compute the VAT Payable or claimable

Answer

- a. A **taxable supply** as a supply of goods or services made in Rwanda, other than an exempt supply.

Zero-rated supplies are taxable at 0%. A taxable supplier whose outputs are zero-rated but whose inputs are standard-rated will obtain repayments of the VAT paid on purchases exported goods and services; goods sold in shops that are exempted from tax as provided for by the law governing customs; services rendered to a tourist for which value added tax has been paid;

Standard supply is the supply of goods and service whose inputs and output are taxed at 18%; Example; alcohol, and sugar.

- b. Adjustments of output VAT

- 1° If taxable goods or services no longer existing;
- 2° If the nature of taxable goods or services is changed or damaged;
- 3° If the consideration of taxable goods or services is changed;
- 4° If goods or part of the goods are returned to the supplier.

c) Computation of VAT Payable or Claimable

INPUT VAT		
purchase of items	(28,800,000 x 18%)	5,184,000
electricity	270500 x 18%	48,690
Credit note	5,000,000 x 18%	(900,000)
Total input VAT		4,332,690
Output VAT		
sales	(30,000,000 x 18%)	5,400,000
sales	12,700,000 x 18/118	1,937,288
foreign severance	14,000,000 x 18%	2,520,000
total output VAT		9,857,288
VAT payable		5,524,598

5 Question 4

- a. List four characteristics of VAT
- b. Giving two examples on each, differentiate between zero rated supply, exempt supply and standard rated supply
- c. Kapele is a registered VAT payer. The following transactions took place in his business for the period ended 30/11/2016
 - i. Purchases goods on credit worth 20,000,000Rwf inclusive of VAT
 - ii. Returned goods worth 5,000,000RWF to the supplier because they were defective and the supplier issued a debit note of the same amount
 - iii. Sold goods worth 28,000,000rwf on credit exclusive of VAT
 - iv. After one week the customer realized that his invoice was over estimated by 3,000,000Rwf. He complained to Kapale and he issued a credit note of the same amount
 - v. Kapale wrote off a bad debt of 2,500,000rwf which had stayed for one without any information from the customer

Required

Compute the VAT payable and state when Kapele is supposed to pay the VAT

Answer

- i. VAT is a consumption tax i.e. the consumer of taxable goods or services pays VAT
- ii. VAT is an indirect tax
- iii. VAT is a multi-stage tax of transaction from importer or manufacturer to a wholesaler and finally to the consumer.
- iv. VAT is tax levied on supply of goods made in Rwanda, on the supply of services, and on importation of goods or services
- v. VAT is a tax on the value added to commodity or services. It is imposed on the value added at each stage from the stage of production to retail stage
- vi. VAT is imposed on the value that business firms adds to the goods and services that are purchased from other firms
 - a. Zero rated supply is a supply of goods and service whose input may be taxed at 18% but whose output is taxed at 0%. Examples of zero rated supply include exports, services rendered to a tourist for which value added tax has been paid, goods sold in shops that are exempted from tax as provided for by the law governing customs.

An exempt supply is a supply of goods and services which are not charged for VAT. Example of exempt supply include computers, educational materials and services, books, newspapers, journals and other electronic equipment used as educational materials, transportation services: lending, lease and sale etc.

Standard supply is a supply of goods and services whose inputs and outputs are charged for VAT. Examples of standard supply include supply of electricity, processed food, juice, etc.

Input VAT	Amount RWF	VAT
purchases	20,000,000	3,050,847
Debit Note	5,000,000	762,712
total input VAT		2,288,136
Output VAT		
Sales	28,000,000	5,040,000
credit note	3,000,000	540,000
total output VAT		4,500,000
VAT Payable		2,211,864

6 Question 5

- a. Explain the term tax point of a taxable supply

Answer

Tax point is a point on which the supply of goods or service is recognised to have occurred. The tax point for the supply of goods and services is the earliest of one of the following:

- 1) The date on which the invoice is issued;
- 2) The date on which payment of goods and services, including a partial payment is made.
- 3) The date on which goods are either removed from the premises of the supplier or when they are given to the recipient;
- 4) The date on which the service is delivered.

7 TEST YOUR UNDERSTANDING

8 Test One

- Input VAT can be claimed by a VAT registered tax payer on the purchases made. However, in some cases, RRA may deny a tax payer from claiming the input VAT. Explain four cases where the taxpayer may be denied to claim the input VAT (8 marks)
- Explain the tax point as the VAT law (6 marks)
- Igabe operates a business in Musanze town. She is not registered for VAT. Her sales for the year ended 31/12/2015 are as below:

Month	Sales
January	1,800,000
February	2,000,000
March	980,000
April	2,500,000
May	1,800,000
June	1,250,000
July	5,850,800
August	7,900,000
September	2,640,000
October	4,310,000
November	5,621,000
December	1,652,000

Required

- When should Igabe register for VAT?
- List two cases where Igabe may be allowed to deregister from VAT

9 Test Two

- Muvandimwe is registered taxpayer. During the year he made the following transactions:
 - Purchased goods worth 30,000,000rwf VAT inclusive from a registered tax payer.
 - Sold goods to Rukundo worth 28,000,000rwf inclusive of VAT
 - Hired consultants from UK for 5,000,000rwf exclusive of VAT to prepare a procedure manual, a service which can be accessed in Rwanda.
 - Paid electricity 1,500,000rwf inclusive of VAT, fuel 500,000rwf and audit fees 3,000,000rwf exclusive of VAT
 - Purchased home use items for 12,850,000rwf exclusive of VAT
 - During the year, he made a credit note of 2,890,000rwf to Rukundo for invoiced goods. The amount is exclusive of VAT
 - A bad debt of 1,782,000 which had been previously included in the sales of the previous two was written off

Compute the VAT payable

- Tax payers are allowed a deduction on the output VAT. Explain four circumstances under which the tax payer may be allowed a deduction on the output VAT
- Explain the term taxable supply

Test Three

- Explain the taxable supply as per the VAT law
- Uwase started a business on 1/1/2015 and below are her monthly sales

Month	Sales
January	1,580,000
February	1,000,000
March	2,000,000
April	2,000,000
May	1,500,000
June	2,800,000
July	3,800,000
August	1,500,000
September	5,000,000
October	3,500,000
November	2,100,000
December	6,750,000

- i. Determine when should Uwase register for VAT
- ii. Explain three circumstances where Uwase may apply for deregistration from VAT
- c. Explain for circumstances under which a post-sale adjustments may be allowed for the VAT purposes
- d. During the period a tax payer outsource a foreign service, explain the VAT payment on a foreign service.

10 Test Four

- a. Explain when a tax payer is supposed to register for VAT
- b. The following transaction took place in the business Nyirandi investment limited for the month ended 30/6/2016
 - i. Sales inclusive of VAT 25,000,000rwf
 - ii. The customer returned goods worth 2,000,000rwf and the company issued a credit note for that money
 - iii. The purchases were 30,000,000rwf exclusive of VAT
 - iv. The company realized that the purchases were over invoiced by 4,000,000rwf exclusive of VAT. The company complained to the supplier and the supplier issued a credit note for that amount
 - v. A bad debt of 1,000,000ref that had stayed for 1 year without seeing the customer was written off. This amount had been previously included in the company sales.
- c. Compute the VAT payable by the company
- d. Explain five violations of the VAT law.

Test Five

- a. Kayishema is a registered VAT payer in Kigali. He deals in both exempt and standard rated purchases. The un-distributed purchases are used to manufacture both taxable and exempt sales. It is very hard to directly allocate them to a particular supply. At the end of month of May 2017, he submitted the following transactions for VAT assessment.

Taxable sales	28,000,000	Exclusive
Exempt sales	40,000,000	
Taxable purchases	18,000,000	Inclusive
Exempt purchases	10,000,000	
Un distributed purchases	20,000,000	exclusive

Required: compute the allowed input VAT and the VAT payable.

- b. Explain the VAT implications of the following issues
 - i. Transfer of a VAT registered business
 - ii. Deregistration from VAT

Test Six

- a. Droppex has been in business for 6 years. All its supplies are standard rated. The company's annual turnover is 19,000,000rwf. The company's board meeting discussed to increase the selling price of its products. This will lead to an increase in the annual turnover to 21,620,000rwf. This has created an argument in the board room that if they increase the price automatically they will have to register for VAT. The company's expenses inclusive of VAT are 6,800,000rwf. Determine if it is beneficial for the company to increase its prices.
- b. Akandi limited is a registered VAT tax payer. The following transactions took place for the quarter ended 30/6/2015.
 - i. Sales for the quarter 85,690,000Rwf inclusive of VAT
 - ii. Credit note during the quarter 11,200,000Rwf inclusive of VAT
 - iii. Discount allowed for the period 1,230,000rwf exclusive of VAT
 - iv. Purchases for the quarter 105,500,300rwf inclusive of VAT
 - v. Debit notes during the quarter 16,500,600rwf inclusive of VAT
 - vi. Bad debt written off 1,870,000 inclusive of VAT. The customer was declared bankrupt by the court
 - vii. During the quarter, an input VAT of 3,580,000rwf on imports of 2013 was declared. This was delayed because the company had not yet received the supporting documents.
 - viii. During the quarter the company paid 8,000,000rwf inclusive of VAT to foreign consultant. The same service can be received in Rwanda.

Required: Compute the VAT payable/claimable to RRA.

Test Seven

The following transactions took place in the business of BabG investments limited for the month ended 30/5/2016:

- i. Invoices were issued for sales of 14,780,000Rwf to VAT registered customers. Of this figure, 10,600,000Rwf was in respect of exempt sales and the balance in respect of standard rated sales. The standard rated sales figure is exclusive of VAT.
- ii. Invoices were issued for sales of 87,900,000 to non-VAT registered customers. Of this figure, 55,000,000rwf was in respect of exempt sales and the balance in respect of standard rated sales. The standard rated sales figure is inclusive of VAT
- iii. On 20/5/2015 issued an invoice of 22,600,000rwf to registered tax payer for a consultancy work that will be finished in 20/7/2016.
- iv. A stock of 5,000,000 was in store before BabG registered for VAT 50% was purchased from a VAT registered tax payer
- v. Acquired a foreign service of 8,000,000 inclusive of VAT which not be accessed in Rwanda
- vi. Purchased goods worth 28,650,000 of which 40% are exempt
- vii. Input VAT of 2013 of 4,200,000 received all the necessary supporting documents
- viii. A bad debt of 1,800,000rwf which had stayed for one and half year and were previously included in the company sales was written off.

Required

- a. Explain the VAT issues in each point
- b. Compute the VAT payable

Test Eight

- a) Three traders dealing with standard rated, zero rated and Exempt goods/services for VAT were disagreeing on who among them maximizes profits. The trader dealing in standard rate goods/services argued that he maximizes profits since he claims inputs VAT. The second trader dealing with input tax. The third trader dealing in exempt goods/services argued that “you guys are joking; I don’t pay output VAT at all the supplies I make”.

The following information has been provided to you with respect to the three traders.

	Standard-rated supply	Zero rated supply	Exempt supply
Sales exclusive	10,000,000	10,000,000	10,000,000
Purchases	7,000,000	7,000,000	7,000,000
Expenses	1,000,000	1,000,000	1,000,000

Required

Determine the trader who maximizes the profit.

- b) Mukamana is a registered VAT payer in Rwanda. She imports and exports a variety of commodities within and outside the East African Community. She got registered for VAT on 3/4/2015. On the date of registration, she had a stock worth Frw 8,000,000 with the necessary invoice. During the year ended 31/12/2016, she exported goods worth Frw 5,000,000,000. Mukamana deals in both exempt and standard rated supply. During the month of April 2016, she purchased new software to manage her imports and exports transactions. She could not install the software until August 2016 when she received a foreign consultant to do it since there was no one in Rwanda who could install it. A customer who had stayed in the company’s books without paying for a period of three years was written off.

Required

Discuss the VAT implications of the key issues in the above case.

Test Nine

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

	Notes	MM Ltd	ABC Ltd
Sales (VAT Exclusive):			
Standard Rated	1	520,000,000	520,000,000
Zero Rated		100,000,000	-
Exempt		=	<u>150,000,000</u>
		<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:

1. ABC Ltd made sales of Frw 20,000,000 and later discovered that the customer was most likely not to pay for the goods.
2. 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

- Compute the amount of VAT Payable or Claimable by the two companies.
- Which of the two companies above pays a higher tax and why?
- Explain the consequences for false VAT Claims.
- Advise ABC Ltd on the VAT treatment for goods sold but payments are most likely not to be received.

Test Ten

Virunga Limited has been trading in general merchandise since its inception on 1 January, 2016. The company is not registered for VAT but it trades in both standard and exempt supplies.

(a) The following is a summary of the company's sales made during 2016:

	Standard rated	Exempt	Total
Month	Frw "000"	Frw "000"	Frw "000"
January	800	200	1,000
February	860	250	1,110
March	970	700	1,670
April	1,500	875	2,375
May	1,725	1,002	2,727
June	2,800	1,800	4,600
July	3,500	1,750	5,250
August	4,200	2,500	6,700
September	4,550	2,800	7,350
October	4,900	3,000	7,900
November	5,100	2,800	7,900
December	5,600	3,200	8,800
Total	36,505	20,877	57,382

The amounts were exclusive of VAT where applicable.

The Rwanda Revenue Authority (RRA) officers conducted an audit in January, 2017 and informed the company directors that they were supposed to have registered for VAT. They then compulsorily registered the company for VAT and computed the penalties due. The RRA officers also ordered the company to purchase and start using an Electronic Billing Machine (EBM). The company would like to apply for an exemption to use the EBM, if possible.

Required

- Advise the company on when they were required to register for VAT and the penalties they were liable to pay.
 - Explain to the company the process of obtaining an exemption from using an EBM and whether they qualify for exemption.
- (b) The following purchases and payments were made during the quarter 1 October 31 December, 2016. All transactions were VAT exclusive.

Particulars	Frw "000"
Office furniture	2,000
Motor vehicle for office use	8,000
Fuel for the car	500
Telephone expenses	400
Rent for the shop	1,500
Rent for the Managing Director's residence	3,000
Entertainment goods for clients	450

Required

- (i) Advise Virunga Limited on whether they have an obligation for any VAT during the quarter 1 October - 31 December, 2016.
- (ii) You have been availed with information that the return for the quarter ended 31 December, 2016 was actually filed on 30 March, 2017.
- (iii) Advise the company on the fines and penalties payable.

2.24 CONSUMPTION TAX

“**Tax stamp**” is a sign affixed on a product indicating that the product will be sold and tax collected in Rwanda. Products are regarded as locally manufactured if the manufacturing or processing factory is in the Rwandan territory. Products are regarded as imported if such products require Customs formalities in accordance with the Customs system on the date such products were brought in Rwanda.

Consumption tax is levied on the following products at the corresponding rates:

Products	Tax
Natural fruit or vegetable juices	5%
Juice, Soda and Lemonade	39%
Mineral water	10%
Beer whose local raw material content, excluding water is at least 70% by weight of its constituent	30%
Other Bears	60%
Wine whose local raw material content, excluding water, is at least 70% by weight of its constituents	30%
Other Wine	70%
Brandies, liquors and whisky	70%
Cigarettes	36% of retail price of a pack (of 20 rods) and 130 Frw per pack
Fuel (excluding jet fuel), Gas, oil, fuel	183 Frw/liter on Premium 150 Frw/liter on Gas oil
Lubricants	37%
Vehicles with engine less than 1500cc	5%
Vehicles with engine less than 2500 cc	10%
Vehicles with engine above 2500 cc	15%
Powdered milk	10%
Telephone communication	10%

2.24.1 Taxable Base of the Consumption Tax

Without prejudice to the tax procedure applicable to the quantity of certain products under Article 4 of this Law, the tax base for imported products is calculated according to customs legislation. For products manufactured in Rwanda, the tax base is the selling price of the product. However, the tax base for cigarettes combines the specific base and the retail price.

The selling price referred to under Paragraph one of this Article is the total amount excluding the value added tax, paid or payable by a buyer or a recipient of a taxable product to the producer of the product. If the producer and the buyer or recipient are related, the selling price is the price that the product would reasonably be expected to fetch in an arm's length transaction at that time at the wholesale level

2.24.2 Exemption

The following goods are exempt from the excise duty:

- goods for charitable organizations;
- vehicles assembled in Rwanda;
- one (1) personal vehicle of former diplomats returning from foreign diplomatic missions;
- one (1) vehicle of Rwandan refugees or returnees from a foreign country who fulfil exemption conditions set forth under the Customs Law;
- vehicles of the following categories: minibus and bus that can carry not less than fourteen (14) persons, lorries and single cabin pickups manufactured to carry goods, refrigerating vehicles, tourist vehicles, ambulances and vehicles designed for persons with disabilities;
- products specifically manufactured for export;
- products sold to duty free shops and other specific persons legally determined

2.24.3 Article 7 Time for taxation

The tax is payable when:

- 1° a taxable product is cleared out of the factory, in case of products manufactured in Rwanda;
- 2° a product is under the customs control in case of imported products;
- 3 ° services is sold, for telephone communications

2.24.4 Taxable Value and Time for Tax Imposition

The taxable value on imported products is calculated according to Cost, Insurance and Freight upon arrival in Kigali while on locally manufactured products, it is calculated according to selling price exclusive of taxes.

The tax is payable when:

- 1) The taxable products are cleared out of the factory for consumer use in case of locally manufactured products;
- 2) The taxable products are due for clearing at the customs under the customs system in case of imports.

Taxable export products are exempted from consumption tax. However, the exporter exempted from such a tax is obliged to indicate that he or she has fulfilled all the conditions exporters are required to fulfil.

For imported goods the excise tax = (CIF + import duty) rate

Example

1. Mary imported wines from France and the CIF to Mombasa was 50,000USD. The exchange rate was 1USD = Frw880

Required

Compute the excise tax; assume the import duty of 25%

$$\text{CIF } 50,000 \times 880 = 44,000,000$$

$$\text{Import duty} = 44,000,000 \times 25\% = 11,000,000$$

$$\text{Excise tax} = (44,000,000 + 11,000,000)70\% = 38,500,000$$

2. Akandi limited produced 30,000 boxes of water. The factory price is 2500 per box. Compute the excise tax.

$$\text{The factory value} = 30,000 \times 2500 = 75,000,000$$

$$\text{Excise tax } 75,000,000 \times 10\% = 7,500,000$$

3. Sportsman limited produced 2,000,000 packets of cigarette. The factory price is 700 and the retail price is 1000 per packet. Compute the excise tax.

The excise tax on Cigarette is calculated on the retail price.

Retail value $2,000,000 \times 1000 = 2,000,000,000$

Excise tax = $2,000,000,000 \times 36\% + (2,000,000 \times 130)$
 = 980,000,000

TEST YOUR UNDERSTANDING

1. John imported powered milk from UK

Particulars	USD
FOB	25,000
Insurance	5,000
Freight	7,200
Transport to Kigali	2,000

Note: transport from Mombasa to Kigali is not considered under the CIF

2. Bralirwa produced the following units of beer in the month August

Date	Units	Factory price per unit
5/10/2018	20,000	6,200
18/10/2018	30,000	7,500
26/10/2018	1,500	5,400

Required

Compute the excise tax.

2.24.5 DECLARATION, PAYMENT AND ASSESSMENT OF TAX

For purposes of implementing this law, a month is divided into the following three periods:

1. From 1st to 10th of every month;
2. From 11th to 20th of every month and;
3. from 21st towards the end of the month. A taxpayer is required to file his or her declaration in respect of provisions of paragraph one of this article.

The taxpayer who pays consumption tax is required to deliver to tax administration a declaration sheet and the proofs of how consumption tax was paid in a period not exceeding five (5) days following periods mentioned in article 9 of the tax law. The consumption tax on imports is paid concurrently with custom duties.

In respect of periods prescribed under article 9 of the consumption law, every taxpayer is required to:

1. Keep the books of accounts filed in accordance with national accounting standards;
2. Provide information as the declaration form requires.

An assessment shall be conducted in the manner and in periods prescribed by the Ministerial Order. Such an assessment shall be concluded by an action for recovery of the tax due, interest and fines.

Certain reasons which lead to assessment are as follows:

1. Non conduction of declaration;
2. Returns found to be incorrect, inadequate, or intended to conceal some basic data.

2.24.6 ADMINISTRATION OF CONSUMPTION TAX

An authorised officer has the right to free access to a factory at any time it is operating. He or she has the right to carry out any inspection or verification if considered necessary. Due to such a reason, the authorised officer has prosecution powers during the performance of his or her duties.

Without prejudice to the customs system, all taxable imported products subject to consumption tax, whether by land, water, air or post, must be subject to the control by an authorised officer.

Every authorised officer should be issued with means of identification during his or her duties and shall produce them on demand to any person who requires them. An authorised officer on his or her duties may require the tax payer to give him or her in writing any necessary information.

Where an authorised officer finds that a tax payer conceals certain products in order to evade consumption tax, he or she may seize the products and put them into the custody of the Authority. He or she may also issue a receipt of acknowledgement signed by the owner of the products or his or her representative.

Where the owner of the products seized in accordance with article 16 of this law does not provide information in fifteen (15) days, stating whether he or she complied with the provisions of this law, such products may be sold by public auction. Such a period may be reduced in case it is proved that such products are perishable. In case such products can deteriorate human and other biological health, they shall be immediately destroyed. Such an act shall be at the expense of the owner of the products.

In fulfilment of his or her duties provided for by this law, an authorised officer should be independent. No person shall obstruct or interfere with him or her in his or her duties with an exception of competent authorities. Individuals, government institutions, commercial and business associations are obliged to provide with the authorised officer all the relevant information regarding the implementation of provisions of this law.

Secrets revealed in accordance with provisions of this article or in fulfilment of duties required by this law shall not be disclosed to any person unless the Commissioner General, who if it is in the national interest, upon which he or she shall order it in writing specifying the information to be disclosed and the procedures of its disclosure.

Tax Payer's Rights and Obligations

A taxpayer has a right to self-assessment in accordance with provisions of this law and orders relevant to it. Any disputes related to consumption tax arising between the Authority and the taxpayer shall be submitted to the Commissioner General in order to take action in a period not exceeding thirty (30) days from the day of receipt. The aggrieved tax payer shall have the right, in a period not exceeding ten (10) days, to appeal to Appeals Council established by the Order of the Minister and which shall take action on his or her behalf. The decision of the Appeals Council may be appealed against before a competent Court in a period not exceeding thirty (30) days. Any manufacturer of a product subject to consumption tax is required to keep a register of daily inventory of the products manufactured and a sales register. The sales register shall indicate the price and quantity offered to every customer, his or her names and address.

Every taxpayer is required to keep a register of raw materials, an activity register and a register of inventory of manufactured products. The register of raw materials should record the materials to be used in the manufacturing of taxable products. In the activity register, there should be recorded the information concerning the daily status of every equipment used in the factory or industry.

An authorised officer shall sign in such a register during every his or her visit to the factory or industry.

The register of inventory of the manufactured products indicates the products destroyed, discarded or burnt after being inspected by the authorised officer, the quantity exported, and those sold for consumption, so that at any time, the quantities within the factory can be established and verified.

Any modification to the premises or to the functioning of the factory, any changes and increases, repairs or replacements of one or more equipment or tools shall be notified to the administration of the authority in the month of the last operation.

Any manufacturer of products subject to consumption tax shall own a register indicating, on a daily basis, the following:

1. The date and time of starting and ending work;
2. The type, names and the nature of the equipment used;
3. The type and quantity of the raw materials used and the batch number of production;
4. The quantity of the goods produced.

Any service or activities that are not carried out or that are cancelled shall be notified to the Authority by their provider within a period of ten (10) days.

Some locally manufactured and imported taxable products shall be required to be affixed with a tax stamp. The products to be affixed, the structure of tax stamps, manner and design in which the tax stamps are to be affixed shall be determined by the Order of the Minister.

A tax stamps usage reconciliation statement shall be made by local taxable products manufacturers and taxable product importer. The monthly reconciliation statement shall show a summary of tax stamps indicating the following:

- 1) Stamps in stock at the closure of the month preceding the month in which taxable products are manufactured;
- 2) Stamps received from the Authority;
- 3) Stamps applied to taxable products manufactured in Rwanda or imported into Rwanda as the case may be;
- 4) Stamps spoiled or damaged during the manufacturing process as certified by the Authority staff;
- 5) Stamps unaccounted for in the reconciliation statement;
- 6) Stamps in stock at the end of the month and carried forward for use in the following month.

The reconciliation statement shall be submitted to the Authority within ten (10) days of the end of the month covered by the statement. Tax stamps are exempted from all taxes and duties levied in Rwanda. Locally manufactured products for export are exempt from affixation of tax stamps. However, a written statement thereof shall be made before such products are manufactured or exported.

Obligations that are Peculiar to Oil Products Dealers

Oil products dealers have the following obligations:

- 1) Allow the Authority easy access to all premises and petrol stations for evaluation and inspection purposes;
- 2) Make a declaration to the Authority before any petrol station is started up so that its premises may be inspected first;
- 3) Affix a standards certificate as required by an authorized officer;
- 4) Present any document providing details as to what is required by the Authority's inspection;
- 5) Report beforehand to the Authority and in writing any changes, damage, increase or decrease of tanks and pumps;
- 6) Make a declaration to the Authority as regards any premise used for the sell of oil products;
- 7) Have underground tanks be tested;
- 8) Have pumps be inspected and present their related standards certificate;
- 9) Store and sell oil products that are contained in tested underground tanks or any other tested types of store;
- 10) Have standards certificates for meters of pumps meant for oil products selling;

- 11) Allow easy access for experts or those representing the Agency endowed with expertise in testing whether underground tanks, pumps or meters respect standards;
- 12) Allow easy access to an authorized officer sent by the Commissioner General to carry out relevant inspection in a given petrol station;
- 13) Authorize any qualified person to carry out any activity or check whether legal provisions are respected;
- 14) Any other attribution as may be assigned to by the Minister where necessary and by way of an order. Modalities for carrying out such inspection shall be determined by an Order of the Minister.

2.24.6 PENALTIES

Administrative sanctions for the usage of tax stamps

A domestic manufacturer or importer of products subject to the excise duty who performs one of the following acts:

- 1° failing to keep tax stamp registers, records or any other related documents;
- 2° failing to submit tax stamp reconciliation statements within the prescribed period; is liable to an administrative fine of not less than one million Rwandan francs (FRW1,000,000) and not more than two million Rwandan francs (FRW 2,000,000).

Penalties for the usage of tax stamps

Any domestic manufacturer or importer of products subject to the excise duty who performs one of the following acts:

- 1° failing to affix tax stamps to products;
- 2° affixing tax stamps to products in a manner contrary to rules set forth by the Authority;
- 3° making an overprint or defacing tax stamps affixed to taxable products;
- 4° submitting an incorrect or incomplete tax stamp reconciliation statement;
- 5° using tax stamps on products for which they are not intended;
- 6° selling products subject to the excise duty without tax stamps;

Commits an offence Upon conviction, he or she is liable to imprisonment for a term of not less than six (6) months and not more than one (1) year or to a fine of not less than one million Rwandan francs (FRW 1,000,000) and not more than two million Rwandan francs (FRW 2,000.000)

STUDY UNIT

3

TAXATION OF CROSS BORDER ACTIVITIES

A.	Distinction between trading in and with a country
B.	Double Taxation Agreements
C.	Regional perspective
D.	“Most Favoured Nation”
E.	Withholding Taxes
F.	East African Community
G.	Customs Valuation
H.	Transfer Pricing

A. Distinction between trading in and trading with a country

When an individual, or a business, is trading there are two possibilities:

Either the trade is carried out within their own country:

i.e. both supplier and customer are in the same country – “domestic” trade

Or the trade is carried out with another country:

i.e. the supplier is in one country, and the customer is in another – “international” trade.

When the goods or services are supplied to a customer in another country, the supplier **exports** to that country. When goods or services are bought from a supplier in another country, the customer **imports** from that country.

Both goods and services can be exported and imported. Goods are self-evident – food, minerals, raw materials etc. Examples of the export of services are a designer in country A producing designs for a customer in country B, or an accountant in one country advising a client in another.

Every trading transaction gives rise to tax issues, but the tax issues will differ depending on whether the trade is domestic or international.

A key feature of international trade is import taxes. This is where a country decides to impose import taxes (also known as custom duties) on various products on arrival into a country. The duties will vary depending on the actual product. So, for example, a country which has a vibrant steel business may impose relatively high import duties on steel in order to protect the domestic steel industry from cheap imports.

The duties will also depend on the origin of the imports. Thus imports from Country A may carry higher import duties than those from Country B.

B. Double Taxation Agreements

International Taxation involves taxation which is cross border. It can arise from an individual having taxable income or assets in two countries, or a business operating in two (or more) countries. Due to increased globalisation, the growing level of businesses trading internationally around the globe, and increased personal mobility, international taxation is becoming more and more prevalent. Travel restrictions are less onerous, and it is no longer difficult for people to move from one state to another to carry out businesses or to seek employment opportunities. Capital is more mobile and with advances in e commerce and e banking it moves more swiftly than ever before. Such activities are all likely to attract tax liabilities.

To take a simple example. Joe is a citizen of and lives in Country A. He has a home there, and lives there with his wife and family. Thus, in the normal scheme of things, Joe would be taxed on his income in Country A, in common with all other residents and citizens who live there, and who use the roads, sanitation systems and other public services there.

However Joe is slightly unusual. Every Tuesday morning Joe flies to Country B, works there until Thursday afternoon and then flies home again. He gets paid in Country B.

The dilemma however, is – in what country does the tax liability fall, and how is that decided? And a further issue that may arise is that if an individual or a business is taxed in

Country A **and** in Country B, then that person or entity has effectively been taxed twice on the same income or transaction. If such a situation were to prevail, it could materially inhibit the development of international trade.

So, for example, Country A will argue that Joe is a citizen and a resident, he lives with his wife and family there, and every citizen is expected to make their contribution to the various public services they enjoy. Thus, they will argue, Joe should be taxed on his income in Country A, according to the rules that prevail there.

But Country B will argue that Joe should pay his income tax in their country, because the income originated there, and their rules state that anyone earning an income in their country should be taxed there.

The dilemma for Joe is that he could end up being taxed in both countries on the same income – which is a bit unfair on Joe. The dilemma for both Countries is that they could end up not taxing Joe in either country. And if it is to be only one – which one, and how is that decided?

So a system of double taxation agreements has evolved to deal with this type of situation. The taxpayer does not have to be an individual – it could be a company, or a business operating in both countries.

There are two principal scenarios to be considered:

(A) Where there is a double taxation agreement in place

(B) Where there is not

Scenario (A)

In scenario (A) (where there is a tax treaty, on avoidance of double tax and prevention of fiscal evasion), between Country A and Country B, the treaty generally will specify in a clear wording that the right to tax is with state Country B, because this is the country in which the income arises – i.e. the “source” country. Country A, which taxes on worldwide incomes, i.e. income arising from Country A **and** Country B, will then compute tax payable. Country A will provide credit for the tax paid to Country B i.e. the country where the incomes were sourced. It is thus, through this arrangement that double taxation is avoided.

Scenario (B)

In Scenario (B) (where there is no existing tax treaty on avoidance of double tax and prevention of fiscal evasion) country B will to tax Joe on incomes arising from country B, because that is the source of the incomes. When he goes back to country A, country A may give Joe credit for the tax paid in country B. However, country A may only do this on a unilateral basis, and is not obliged to do so. Thus the certainty created for Joe, and other taxpayers in Scenario a is absent here.

It is desirable, and indeed necessary, in the field of international taxation, that there are rules agreed between different countries as to which tax jurisdiction takes what portion of tax, and why a given tax jurisdiction should forego in whole or in part what it considers to be its revenues. Having such agreements creates taxation certainty for businesses and individuals who operate internationally. Also, such agreements can include provision for cooperation and sharing of information which can assist in tackling tax evasion.

Foreign Tax credit

A tax payer who is a resident of Rwanda is taxed on the income received both in Rwanda and outside

Rwanda. However that tax liability is reduced by the amount of tax paid outside.

Mr. Alex Mugabe works partially in Rwanda and partially in Canada. His family is based in Rwanda. During the year ended 31 December 2016. Mr. Mugabe earned an equivalent of Rwanda francs 3,600,000 from his employment in Canada. He paid an equivalent of Rwandan francs 480,000 as tax on the income.

He also earned Rwanda francs 1,800,000 as consultancy fee in Rwanda in addition to employment income of Rwanda francs 1,200,000 (PAYE-Rwanda francs 400,000). His employer in Rwanda provided his family with accommodation. The monthly rent on the accommodation was Rwanda francs 60,000 per month which was paid by the employer.

Assume that Rwanda has a double taxation agreement with Canada

Required:

Tax liability for Mr. Alex Mugabe for the year ended 31 December 2016

Proposed answer:

Alex Mugabe taxable income

	FRW.
Basic salary	1,200,000
Add housing benefit: 60,000×12	=720,000
	<u>720,000</u>
Taxable employment income	1,920,000
Consultancy fee	<u>1,800,000</u>
Rwandan income	3,720,000
Foreign income (income from Canada)	<u>3,600,000</u>
Total taxable income	7,320,000
Gross tax:	
First	168,000
Excess [7,320,000-1,200,000] ×30%	<u>1,836,000</u>
	2,004,000
Tax liability on Rwandan income	
First	168,000
Excess [3,720,000-1200, 000] ×30%	<u>756,000</u>
	924,000
Tax liability on foreign income	
Gross tax	2,004,000
Tax liability on Rwandan income	<u>(924,000)</u>
	1,080,000
DTR:	
Lower of:	
Tax for foreign income	1,080,000
Actual tax paid	480,000
Thus, DTR	480,000

Tax liability	
Gross tax liability	924,000
DTR	<u>(480,000)</u>
	444,000

Question five

Hellene is resident of Rwanda .during the year ended 31 December 2017.she received the following employment income;

From Rwanda; Frw. 7,200,000

From Zambia; Frw.540, 000 (net of tax Frw.78, 000)

Assume that Rwanda has a double taxation agreement with Zambia

Required:

The double taxation relief due to Hellene for the year ended 31 December 2017.

Proposed answer:**Hellene taxable income**

	FRW.
Rwanda	7,200,000
Zambia	<u>618,000</u>
Total taxable income	7,818,000
Gross tax:	
First	168,000
Excess [1,338,000-1,200,000] ×30%	<u>1,985,400</u>
	2,153,400
Tax liability on Rwandan income	
First	168,000
Excess [7200, 000-1200, 000] ×30%	<u>1800,000</u>
	1,968,000
Tax liability on foreign income	
Gross tax	2,153,400
Tax liability on Rwandan income	<u>(1,968,000)</u>
	185,400
DTR:	
Lower of:	
Tax for foreign income	185,400
Actual tax paid	78,000
Thus, DTR	78,000

Question six

Daniel, a resident of Rwanda earned income from the countries listed below during the year ended 31 December 2015. Income from Rwanda; Frw.1, 765,000

Income from United Kingdom (UK) UK£ 4,800 net of tax deducted amounting to UK£960.

The average exchange rate during the year was 1 UK £=francs 140. A double taxation agreement exists between Rwanda and United Kingdom.

Required:

The double taxation relief (in Rwanda francs) due to Daniel for the year ended 31 December 2015

Proposed answer:

Daniel taxable income

	FRW.
Total taxable income	
Rwandan income	1,765,000
UK 4,800+960×140	<u>806,400</u>
Total taxable income	2,571,400

Gross tax:

First	168,000
Excess [2571400-1200000] ×30%	<u>411,420</u>
	579,420

Tax liability on Rwandan income

First	168,000
Excess [1765000-1200,000] ×30%	<u>169,500</u>
	337,500

Tax liability on foreign income

Gross tax	579,420
Tax liability on Rwandan income	<u>(337,500)</u>
	241,920

DTR:

Lower of:

Tax for foreign income	241, 920
Actual tax paid [960×140]	134,400
Thus, DTR	134,400

Question seven (REINFORCING QUESTION)

Mr.Sylvanus was resident of Rwanda in the year of income 2018.during part of the year, he was in United Kingdom (UK) and earned income amounted amounting to UK £43,500.Taxes paid on UK income amounted to £8,700.His employment income from Rwanda was Frw.950,000(PAYE deducted Frw.184,800).Further ,he had provided consultancy services at a fee of Frw.200,000 (gross).

Other income comprised the following:

1. Rental income of Frw.400, 000 after deducting: cost of furniture Frw.36, 000, estate agents fees before letting Frw.48, 000 and caretakers wages Frw.8, 000 per month.
2. Patent rights where he received gross royalty income of Frw.100, 000. Expenses relating to patent rights were; registration of patent Frw.8, 900 and operating expenses Frw.18, 000.

Assume the applicable exchange rate was Frw.100 to £1. Rwanda has signed a double taxation agreement with UK.

Required:

- i. Double taxation relief (if any) due to Mr.Sylvanus for the year of income 2015.
- ii. Tax payable (or refundable) by Mr.Sylvanus for the year of income 2015.

Various countries have concluded and ratified tax treaties with other countries. Typically these tend to start with a country's major trading partners. Rwanda has signed and ratified tax treaties with Mauritius, South Africa and Belgium. The East African Tax Treaty on Avoidance of Double Tax and Prevention of Fiscal Evasion, is also on the horizon and it is likely that, in time Rwanda will adopt and ratify this. Key to all such treaties is that the business community (and other taxpayers) will be provided with certainty in cross border taxation issues.

A typical Double Taxation Agreement (DTA) will address key issues. Each agreement may differ depending on the prevailing circumstances, and the participating countries. However, a typical DTA would be likely to include provisions for some or all of the following:

PERSONS COVERED

This provision defines who the treaty will apply to, and specifically if it will apply to persons who are residents of either State or both. This is a central concept in all double taxation treaties. Benefits are only extended by one State to "residents" of the other State.

TAXES COVERED

This provision article sets out the taxes to which the treaty will apply. In some cases this may apply only to taxes on income, (personal and corporate); in other cases it may also apply to Capital taxes.

It is very important that there is clarity around precisely what taxes are included in the treaty, and which are not included.

RESIDENT

This provision sets out the rules for determining whether a person is a resident of one State or a resident of the other State for the purposes of the treaty. Only residents of the

Contracting States can claim the benefits of the treaty. A resident of a Contracting State is a person who is subject to comprehensive taxation in that State.

The provision can contain tie-breaker provisions to resolve cases where an individual would be regarded as a resident of both Contracting States.

A treaty will also normally contain a tie-breaker test for corporate entities. Where the entity is a resident of both States it will normally be deemed to be a resident of the State in which it is effectively managed.

D. Most Favoured Nation

Most Favoured Nation (MFN) is a status or level of treatment accorded by one state to another in international trade. This means that the country which is the recipient of this treatment must, nominally, receive equal trade advantages as the "most favoured nation" by the country granting such treatment.

Such advantages would include such things as low tariffs or high import quotas. It effectively means that

a country that has been accorded MFN status may not be treated less advantageously than any other country with MFN status by the country granting MFN status.

MFN status is accorded by members of the World Trade Organization (WTO) to each other. Preferential treatment of developing countries, regional free trade areas and customs unions is permitted by exception.

Some of the benefits conferred by MFN status are:

As a consequence of MFN, smaller countries can participate in the advantages that larger countries often grant to each other. In the absence of an MFN, smaller countries would often not be powerful enough to negotiate such advantages by themselves.

MFN provides domestic benefits: Administration is simplified. By having one set of tariffs for all countries the rules are simplified and made more transparent. It also lessens the frustrating problem of having to establish rules of origin to determine which country a product (that may contain parts from all over the world) must be attributed to for customs purposes.

MFN restrains domestic special interests from obtaining protectionist measures. For example, butter producers in country A may not be able to lobby for high tariffs on butter to prevent cheap imports from developing country B, because, as the higher tariffs would apply to every country, the interests of A's principal ally C might get impaired.

As MFN clauses promote non-discrimination among countries, they also tend to promote the objective of free trade in general.

There is, however, a recognition that the MFN rule should be relaxed to accommodate the needs of developing countries.

The emergence of powerful trade blocs (e.g the EU, or the North American Free trade Agreement (NAFTA) has presented challenges to the MFN concept. In these blocs, tariffs have been lowered or eliminated among the members while maintaining tariff walls between member nations and the rest of the world.

E. WITHHOLDING TAXES

ARTICLE 56: WITHHOLDING TAX ON EMPLOYMENT INCOME

The withholding tax on employment income referred to in Article 15 of this Law shall be paid according to the rates provided below:

Monthly taxable Income (RWF) Tax Rate

30,000 (0%)

30,001 - 100,000 (20%)

100,001 - More (30%)

Notwithstanding Paragraph One of this Article, income from a casual labourer is subject to tax on the special rate of fifteen percent (15%). However, in computing casual labourer's tax, an income not exceeding thirty thousand (30,000 RWF) per month is rated at zero percent (0%)

ARTICLE 57: PERSONS RESPONSIBLE FOR APPLYING A WITHHOLDING TAX ON EMPLOYMENT INCOME

An individual or an entity that pays its employees in cash or in kind is responsible for withholding and paying the withholding tax on employment income referred to in Article 15 of this Law. Employers referred to in Paragraph One of this Article paying the withholding tax on employment income must, within fifteen (15) days following the end of each month or quarter depending on the relevant laws:

- 1) File a tax declaration through procedures specified by the Tax Administration and transmit the tax withheld;

- 2) Transmit to the employee a statement indicating his/her name, the amount and type of income and the amount of tax withheld and paid.

An employer who is not the first employer shall withhold tax at the rate of thirty percent (30%).

ARTICLE 58: TIME PERIOD OVER WHICH THE DECLARATION AND PAYMENT OF THE TAX ON EMPLOYMENT INCOME ARE MADE BY THE EMPLOYEE

Subject to the provisions of Article 57 of this Law, when the employer does not have the responsibility to withhold the tax on employment income in accordance with ratified international agreements, the employee must, within fifteen (15) days following the end of each month, file a tax declaration and pay such a tax through procedures specified by the Tax Administration.

ARTICLE 59: TAX ON SITTING ALLOWANCE

Sitting allowance allocated to the members of the Board of Directors is taxable at a rate of thirty percent (30%).

ARTICLE 60: WITHHOLDING TAX ON PAYMENTS OR OTHER METHODS OF EXTINGUISHING AN OBLIGATION

A withholding tax of fifteen percent (15%) of the total amount excluding Value Added Tax (VAT) where applicable is levied on payments or other methods of extinguishing an obligation made by resident individuals including tax exempt entities, when such payments or other methods of extinguishing an obligation are made to a person not registered in the Rwandan tax administration or to a registered person who does not have recent income tax declaration.

Payments or other methods of extinguishing an obligation subject to the withholding tax of fifteen percent (15%) are related to the following:

- 1) Dividends, except income distributed to the holders of shares or units in collective investment schemes;
- 2) Financial interests except:
 - a. Interests on deposits in financial institutions for at least a period of one year;
 - b. Interests on loans granted by a foreign development financial institution exempted from income tax under applicable law in the country of origin;
 - c. Interests paid by banks operating in Rwanda to banks or other foreign financial institutions;
- 3) Royalties;
- 4) Service fees including management and technical service fees except transport services;
- 5) Performance payments made to a crafts person, a musician, an artist, a player, sports, cultural and leisure activities irrespective of whether paid directly or indirectly;
- 6) Gambling activities;
- 7) Goods sold in Rwanda.

However, money which is recorded in the books of account as a liability of a taxpayer to creditors and which reduces the taxable income is deemed a payment if it has exceeded six (6) months following the tax period.

Paragraphs one and 2 of this Article are also applicable to non-resident persons for such payments on behalf of their permanent establishments.

Subject to the provisions of the previous paragraphs of this Article, a fifteen per cent (15%) tax shall be withheld on dividends attributed to a company registered in Rwanda. However, the withholding tax shall be five percent (5%) if levied on the following interests:

- 1) Dividends and interest on securities listed on capital market when the beneficiary of the dividends or interest is a resident taxpayer of Rwanda or of the East African Community;
- 2) Interests derived from treasury bonds with a maturity of at least three (3) years.

The withholding tax on payments made to a person registered with the Tax Administration but without that person making the previous declaration is deducted from income tax during its declaration and its payment.

ARTICLE 61: WITHHOLDING TAX ON GOODS IMPORTED FOR COMMERCIAL USE

A withholding tax of five percent (5%) of the value of goods imported for commercial use shall be paid at custom on the cost insurance and freight (CIF) value before the goods are released by customs. The withholding tax referred to in Paragraph one of this Article shall be deducted from the income tax when it is declared and paid.

ARTICLE 62: WITHHOLDING TAX ON PUBLIC TENDERS

A withholding tax on public tenders of three percent (3%) of the sum of invoice, excluding the Value Added Tax (VAT), is retained when public tenders are paid. However, a tax of fifteen percent (15%) shall be withheld on public tenders if the recipient is not registered with the Tax Administration or he/she is registered but does not have his/her previous income tax declaration. A withholding tax on payment made to a person registered with the Tax Administration shall be deducted from income tax during the income tax declaration and its payment.

ARTICLE 63: TIME FOR DECLARATION OF WITHHOLDING TAXES

The person who withholds taxes referred to in Articles 59, 60 and 62 of this Law is required to file a tax declaration and make payment in accordance with the procedures prescribed by the Tax Administration within a period of fifteen (15) days after the month in which the taxes were withheld.

ARTICLE 64: PERSONS EXEMPTED FROM WITHHOLDING TAXES

The following taxpayers are exempted from withholding taxes referred to in Articles 59, 60 and 62 of this Law:

- 1) Those whose business profit is exempted from taxation;
- 2) Those who have tax clearance certificate issued by the tax administration.

The Tax Administration may revoke a tax clearance certificate at any time if the conditions required by the tax administration are not fulfilled.

ARTICLE 65: FAILURE TO WITHHOLD TAX

Any person who is required to withhold tax and who fails to do so in accordance with this Law is personally liable to pay to the Tax Administration, the amount of tax which has not been withheld, including penalties and interest on arrears. However, the person who is liable to pay the tax not withheld has the right to appeal for the amount of the tax imposed or to recover any excess amount of tax paid.

ARTICLE 66: RECORDS OF PAYMENTS AND TAX WITHHELD

Any person who pays a withholding tax keeps and makes available to the Tax Administration, for inspection and whenever necessary, records in relation to each tax period showing the following:

- 1) Payments made to taxpayer;
- 2) Amount of tax withheld and paid.

A person who pays withholding tax shall keep the records referred to in Paragraph One of this Article for a period of ten (10) years after the end of the tax period to which the records relate.

The Tax Administration may require a person who pays a withholding tax to provide a copy of records kept in accordance with Paragraph 2 of this Article.

Double taxation agreements

As noted in the table above, a double taxation agreement (DTA) can override the normal 15% rate of WHT. The following rates of WHT apply under existing Rwandan DTAs:

The Tax Administration may require a person who pays a withholding tax to provide a copy of records kept in accordance with Paragraph 2 of this Article.

	Dividend on shares	Interest	Royalty	Technical fees
South Africa	10%	10%	10%	10%
Belgium	10%	10%	10%	10%
Mauritius	10%	10%	10%	12%
Barbados	7.5%	10%	10%	10%
Singapore	7.5%	10%	10%	10%
Jersey	10%	10%	10%	12%

The application of the DTT rates is subject to the recipient of the payments meeting certain conditions. Professional advice should be sought before applying the above rates.

F. EAST AFRICAN CUSTOMS UNION

The main features of a Customs Union include the following:

- 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 among its constituent customs territories;
- iii. Common safety measures for regulating the importation of goods from third parties such as phyto-sanitary requirements and 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 Customs Union i.e. guidelines for entering into preferential trading arrangements such as Free Trade Area's etc. with third parties.

Such main features of the EAC Customs Union are embodied in the Customs Union Protocol and its annexures, Common Customs Law (and regulations) and the Treaty.

- **Objectives of the Customs Union**

The objectives of the Customs Union include:

- (a) Further liberalise intra-regional trade in goods on the basis of mutually beneficial trade arrangements among the Partner States;
- (b) Promote efficiency in production within the Community;
- (c) Enhance domestic, cross border and foreign investment in the Community; and
- (d) Promote economic development and diversification in industrialisation in the Community.

- **Scope of Co-operation in the Customs Union**

The provisions of the Protocol apply to any activity undertaken in co-operation by the Partner States in the field of customs management and trade and include:

- (a) Matters concerning trade liberalisation;
- (b) Trade related aspects including the simplification and harmonisation of trade documentation, customs regulations and procedures with particular reference to such matters as the valuation of goods, tariff classification, the collection of customs duties, temporary admission, warehousing, cross-border trade and export drawbacks;
- (c) Trade remedies and the prevention, investigation and suppression of customs offences;
- (d) National and joint institutional arrangements;
- (e) Training facilities and programmes on customs and trade;
- (f) Production and exchange of customs and trade statistics and information; and
- (g) The promotion of exports.

- **Trade Facilitation**

The Partner States initiate trade facilitation by:

- (a) Reducing the number and volume of documentation required in respect of trade among the Partner States;
- (b) Adopting common standards of trade documentation and procedures within the Community where international requirements do not suit the conditions prevailing among the Partner States;
- (c) Ensuring adequate co-ordination and facilitation of trade and transport activities within the Community;
- (d) Regularly reviewing the procedures adopted in international trade and transport facilitation with a view to simplifying and adopting them for use by the Partner States;
- (e) Collecting and disseminating information on trade and trade documentation;
- (f) Promoting the development and adoption of common solutions to problems in trade facilitation among the Partner States; and
- (g) Establishing joint training programmes on trade.

- **TRADE LIBERALISATION**

- **Internal Tariff**

1. As provided in Article 11 of the Protocol, the Partner States eliminate all internal tariffs and other charges of equivalent effect on trade among them, in accordance with the provisions of Article 14 of the Protocol.
2. The Council may, at any time, decide that any tariff rate should be reduced more rapidly or eliminated earlier than is provided for in accordance with paragraph 1 of Article 11.

- **Common External Tariff**

1. The Partner States hereby establish a three band common external tariff with a minimum rate of 0 per centum, a middle rate of 10 per centum and a maximum rate of 25 per centum in respect of all products imported into the Community.
2. The Partner States hereby undertake to review the maximum rate of the common external tariff after a period of five years from the coming into force of the Customs Union.
3. The Council may review the common external tariff structure and approve measures designed to remedy any adverse effects which any of the Partner States may experience by reason of the

implementation of this part of the Protocol or, in exceptional circumstances, to safeguard Community interests.

4. For purposes of this Article, the Partner States use the Harmonised Customs Commodity Description and Coding System referred to in Article 8 of the Protocol.

- **Non-tariff Barriers**

1. Except as may be provided for or permitted by the Protocol, each of the Partner States agrees to remove, with immediate effect, all the existing non-tariff barriers to the importation into their respective territories of goods originating in the other Partner States and, thereafter, not to impose any new non-tariff barriers.
2. The Partner States formulate a mechanism for identifying and monitoring the removal of non-tariff barriers.

- **TRADE RELATED ASPECTS**

- **Rules of Origin**

For purposes of the Protocol, goods are accepted as eligible for Community 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.

- **National Treatment**

1. The Partner States are not supposed to:
 - (a) Enact legislation or apply administrative measures which directly or indirectly discriminate against the same or like products of other Partner States; or
 - (b) Impose on each other's products any internal taxation of such a nature as to afford indirect protection to other products.
2. No Partner State is supposed to impose, directly or indirectly, on the products of other Partner States any internal taxation of any kind in excess of that imposed, directly or indirectly, on similar domestic products.
3. Where products are exported to the territory of any Partner State, any repayment of internal taxation should not exceed the internal taxation imposed on them, whether directly or indirectly.

- **Anti-dumping Measures**

1. The Partner States recognise that dumping is prohibited if it causes or threatens material injury to an established industry in any of the Partner States, materially retards the establishment of a domestic industry therein or frustrates the benefits expected from the removal or absence of duties and quantitative restrictions of trade between the Partner States.
2. The Secretariat must notify the World Trade Organisation on the anti-dumping measures taken by the Partner States.

Subsidies

1. If a Partner State grants or maintains any subsidy, including any form of income or price support which operates directly or indirectly to distort competition by favouring certain undertakings or the production of certain goods in the Partner State, it notifies the other Partner States in writing.
2. The notification contains the extent and nature of the subsidisation, the estimated effect of the subsidisation, the quantity of the affected product or products exported to the Partner States and the circumstances making the subsidisation necessary.

Countervailing Measures

- (a) The Community may, for the purposes of offsetting the effects of subsidies and subject to regulations made under this Article, levy a countervailing duty on any product of any foreign country imported into the Customs Union.
- (b) The countervailing duty should be equal to the amount of the estimated subsidy determined to have been granted directly or indirectly, on the manufacture, production or export of that product in the country of origin or exportation.

Safeguard Measures

- i. The Partner States agree to apply safeguard measures to situations where there is a sudden surge of a product imported into a Partner State, under conditions which cause or threaten to cause serious injury to domestic producers in the territory of like or directly competing products within the territory.
- ii. (a) During a transitional period of five years, after the coming into force of the Protocol, where a Partner State demonstrates that its economy will suffer serious injury as a result of the imposition of the common external tariff on industrial inputs and raw materials, the Partner State concerned shall, inform the Council and the other Partner States through the Secretary General on the measures it proposes to take.
(b) The Council shall examine the merits of the case and the proposed measures and take appropriate decisions.

• EXPORT PROMOTION SCHEMES

Principles of Export Promotion Schemes

The Partner States agree to support export promotion schemes in the Community for the purposes of accelerating development, promoting and facilitating export oriented investments, producing export competitive goods, developing an enabling environment for export promotion schemes and attracting foreign direct investment.

- (a) The Partner States agree that goods benefiting from export promotion schemes should primarily be for export.
- (b) In the event that such goods are sold in the customs territory such goods attracts full duties, levies and other charges provided in the Common External Tariff.

The sale of goods in the customs territory must be subject to authorisation by a competent authority and such sale has to be limited to 20 per centum of the annual production of a company.

Duty Drawback Schemes

The Partner States agree that, upon exportation to a foreign country, drawback of import duties may be allowed in such amounts and on such conditions as may be prescribed by the competent authority.

Duty drawback is paid:

- (a) Upon submission of an application to the competent authority within such a period from the date of exportation or performance of the conditions on which drawback may be allowed as the competent authority may prescribe; and
- (b) On goods or any material used in the manufacture or processing of such goods may be granted in accordance with and subject to such limitations and conditions as may be prescribed by the competent authority.

Duty and Value Added Tax Remission Schemes

The Partner States agree to support export promotion by facilitating duty and value added tax remission schemes. For purposes of this Article the Partner States may establish duty and value added tax remission

schemes. The implementation of this Article shall be in accordance with the duty and value added tax remission schemes specified in the customs law of the Community.

Manufacturing under Bond Schemes

The Partner States agree to support export promotion by facilitating manufacturing under bond schemes within their respective territories. The procedure for manufacturing under bond allows imported goods to be used in a customs territory for processing or manufacture. Duty and taxes are payable on compensating products at the rate of import duty appropriate to them.

Export Processing Zones

The Partner States agree to support the establishment of export processing zones. Entry into an export processing zone allow total relief from payment of duty on imported goods used directly in the production of goods for export by a person authorised to carry out that activity in the zone.

Other Export Promotion Schemes

The Council may, from time to time, approve the establishment of such other export promotion schemes, as may be deemed necessary.

- ***SPECIAL ECONOMIC ZONES***

Free Ports

The Partner States may provide for the establishment of free ports for the purpose of facilitating and promoting international trade and accelerating development within the Customs Union.

The functions of the free ports include the following:

- (a) Promotion and facilitation of trade in goods imported into free ports;
- (b) Provision of facilities relating to free ports including storage, warehouses and simplified customs procedures; and
- (c) Provision for the establishment of international trade supply chain centres, where persons from within and outside the Community access and harness market opportunities and enhance competitiveness in import and export trade within the global setting.

Goods entering into a Freeport are granted total relief from payment of duty and any other import levies except where the goods are removed from the Freeport for home use.

Other Arrangements

1. The Council may, from time to time, approve the establishment of other special economic arrangements for purposes of the development of the economies of the Partner States.
2. Freeport zones may be established at seaports, river ports, airports and places with similar geographic or economic advantage.

- ***EXEMPTION REGIMES***

Exemption Regimes

1. The Partner States agree to harmonise their exemption regimes in respect of goods that are excluded from payment of import duties.
2. The Partner States hereby agree to adopt a harmonised list on exemption regimes which are specified in the customs law of the Community.

- **RULES OF ORIGIN**

Goods are accepted as originating in a Partner State where they are consigned directly from Partner State to a consignee in another Partner State and where:

- (a) They have been wholly produced as provided for in Rule 5 of these Rules; or
- (b) They have been produced in a Partner State wholly or partially from materials imported from outside the Partner State or of un-determined origin by a process of production which effects a substantial transformation of those materials such that:
 - (i) The C.I.F. value of those materials does not exceed sixty per centum of the total cost of the materials used in the production of the goods;
 - (i) The value added resulting from the process of production accounts for at least thirty five per centum of the ex-factory cost of the goods as specified in the First Schedule to these Rules; and
 - (ii) The goods are classified or become classifiable under a tariff heading other than the tariff heading under which they were imported as specified in the Second Schedule to these Rules.

Goods Wholly Produced in a Partner State

For purposes of these Rules, the following are among the products, which are regarded as wholly produced in a Partner State:

- (a) Mineral products extracted from the ground or sea-bed of the Partner State;
- (b) Vegetable products harvested within the Partner State;
- (c) Live animals born and raised within the Partner State;
- (d) Products obtained from live animals within the Partner State;
- (e) Products obtained by hunting or fishing conducted within the Partner State;
- (f) Products obtained from the sea, rivers or lakes within the Partner States by vessels of that Partner State;
- (g) Products manufactured in a factory of a Partner State exclusively from the products referred to in sub-paragraph (f);
- (h) Used articles fit only for the recovery of materials, provided that such articles have been collected from users within the Partner States;
- (i) Scrap and waste resulting from manufacturing operations within the Partner State; and
- (j) Goods produced within the Partner State exclusively or mainly from the following:
 - (i) Products referred to in sub-paragraphs (a) to (i); and
 - (ii) Materials containing no elements imported from outside the Partner State or which are of undetermined origin.

Electrical power, fuel, plant, machinery and tools used in the production of goods are always regarded as wholly produced within the Partner States when determining the origin of the goods.

Percentage Application of Imported Materials and Value Added Criteria

For purposes of these Rules:

- (a) Any materials which meet the condition specified in these Rules are regarded as containing no elements imported from outside the Partner States;
- (b) The value of any materials which can be identified as having been imported from outside the Partner States is their C.I.F. value accepted by the customs authorities on clearance for home consumption, or on temporary admission at the time of last importation into the Partner State where they were used in a process of production, less the amount of any transport costs incurred in transit through other Partner States;

- (c) Where the value of any materials imported from outside the Partner States cannot be determined in accordance with this Rule, their value is the earliest ascertainable price paid for them in the Partner State where they were used in a process of production; and
- (d) Where the origin of any material cannot be determined, the material shall be deemed to have been imported from outside the Partner States and its value shall be the earliest ascertainable price paid for the material in the Partner State where the material is used in a process of production.

Processes not Conferring Origin

Notwithstanding the provisions of these Rules, the following operations and processes should be considered as insufficient to support a claim that goods originate from a Partner State:

- (a) Packaging, bottling, placing in flasks, bags, cases and boxes, fixing on cards or boards and all other simple packaging operations;
- (b) (i) Simple mixing of ingredients imported from outside a Partner State;
- (ii) Simple assembly of components and parts imported from outside a Partner State to constitute a complete product; and
- (iii) Simple mixing and assembly where the costs of the ingredients, parts and components imported from outside a Partner State used in any processes exceed sixty per centum of the total costs of the ingredients, parts and components used;
- (c) Operations to ensure the preservation of merchandise in good condition during transportation and storage such as ventilating, spreading out, drying, freezing, placing in brine, sulphur dioxide or other aqueous solutions, removal of damaged parts and similar operations;
 - (a) Changes of packing and breaking up or assembly of consignments;
 - (b) Marking, labelling or affixing other like distinguishing signs on products or their packages;
 - (c) simple operations consisting of removal of dust, sifting or screening, sorting, classifying and matching, including the making up of sets of goods, washing, painting and cutting up;
 - (d) A combination of two or more operations referred to in sub-paragraphs (a) to (f) of this Rule; and
 - (e) Slaughter of animals.

Unit of Qualification

In classifying goods under this Rule, each item in a consignment should be considered separately:

- (a) Where the Harmonised Commodity Description and Coding System specifies that a group, set or assembly of articles is to be classified within a single heading, such a group, set or assembly shall be treated as one article;
- (b) Tools, parts and accessories imported with an article, and whose prices are included in the price of tools, parts and
 - i. Accessories which are imported with the article or for which no separate charge is made, shall be considered as forming a whole with the article which the tools, parts and accessories constitute the standard equipment customarily included in the sale of articles of that kind; and
- (a) In cases not within the provisions of sub-paragraphs (a) and (b) of this paragraph, goods shall be treated as a single article where they are so treated for purposes of assessing customs duties on like articles by the importing Partner States.

- **REVIEW QUESTIONS**

1. Define customs administration
2. Explain the objectives of customs administration
3. Explain the importation procedures in Rwanda

4. Define a blue channel
5. Explain the conditions to get a blue channel and the reasons for terminating a blue channel
6. Define a manufacturing under bond and explain the records to be maintained when using this facility
7. Differentiate between inward processing and outward processing and explain the records that must be maintained under both facilities
8. Define the following terms
 - a. Export processing zone
 - b. Free port
 - c. Free zone
 - d. Free port authority
9. Explain the objectives of East African Customs Union
10. Explain the features East African Customs Union
11. Explain the schemes available under EAC to support export
12. Define rule of origin and explain the items that are not considered under the rule of origin
13. Explain the declaration procedures under post office
14. List the items that cannot be warehoused

G. CUSTOMS VALUATION

customs value of imported goods” means the value of goods for the purposes of levying *ad valorem* duties of customs on imported goods;

Key words

identical goods” means goods which are same in all respects, including physical characteristics, quality and reputation. Minor differences in appearance shall not preclude goods otherwise conforming to the definition from being regarded as identical;

“similar goods” means goods which, although not alike in all respects, have like characteristics and like component materials which enable them to perform the same functions and to be commercially interchangeable. The quality of the goods, their reputation and the existence of a trademark are among the factors to be considered in determining whether goods are similar.

“identical goods” and **“similar goods”** do not include, as the case may be, goods which incorporate or reflect engineering, development, artwork, design work, and plans and sketches for which no adjustment has been made under subparagraph (1) (b) (iv) or paragraph

because such elements were undertaken in the Partner States;

“produced” includes grown, manufactured and mined. (2) For the purposes of this Schedule—

(a) goods shall not be regarded as “identical goods” or “similar goods” unless they were produced in the same country as the goods being valued;

(b) goods produced by different persons shall be taken into account only when there are no identical goods or similar goods, as the case may be, produced by the same person as the goods being valued.

(3) For the purpose of this Schedule, persons shall be deemed to be related only if:

- (a) they are officers or directors of one another's businesses;
- (b) they are legally recognised partners in business;
- (b) they have an employer and employee relationship;
- (c) any person directly or indirectly owns, controls or holds five percent or more of the outstanding voting stock or shares of both of them;
- (d) one of them directly or indirectly controls the other;
- (e) both of them are directly or indirectly controlled by a third person;
- (f) together they directly control a third person; or
- (g) they are members of the same family.

(4) A person who associates with another person in business, such that one is the sole agent, distributor or sole concessionaire, however described, of the other shall be deemed to be related for the purposes of this Schedule if they fall within the criteria of sub-paragraph.

2.9.1 Basic Value for Taxation of Imported Goods

The basic value of imported goods is the sum of:

- iv. The value of the goods for the implementation of customs duty under the customs legislation, whether or not such a duty is payable on such imported goods;
- v. For matters not specified under the above point:
 - a) The cost of insurance and freight incurred in bringing the goods to Rwanda;
 - b) The cost for services which facilitate the import of goods.
- vi. The amount of customs duty, excise, port charges, or other fiscal charges other than value added tax payable in respect of the import. If goods are re-imported after being exported for repair, renovation or improvement, and the nature of the goods has not changed, the value of the import is the amount of the increase in value of the goods as a result of the repair, renovation or improvement.

Example

Mugisha is a business man in Kigali, during the month of June he imported 30,000Kg of powdered milk from Denmark. The FOB was 30,000USD, marine insurance 4,500USD and transport to Mombasa was 8,000USD. The exchange rate for the period was 1USD = 830RWF.

Tax	Rate
Excise tax	10%
Import duty	25%
VAT	18%

Required

Compute the VAT

$$\text{CIF} = \text{FOB} + \text{I} + \text{F}$$

$$\text{CIF} = 40,000 + 4,500 + 8000$$

$$52,500 \times 830 = 43,575,000$$

$$\text{Import duty} = \text{CIF} \times \text{rate}$$

$$= 43,675,000 \times 25\% = 10,918,750$$

Excise tax = (CIF + import duty)

$$(43,675,000 + 10,918,750) 10\%$$

5,459,376

Port charges (10RWF per kilogram)

$$30,000 \times 10 = 300,000$$

VAT = (CIF + import duty + excise tax + port charges) 18%

$$(43,675,000 + 10,918,750 + 6,459,376 + 300,000) 18\%$$

VAT = 10,809,563

TEST YOUR UNDERSTANDING

Mr. Mukunzi, an employee of Toto Kigali Limited was confirmed as a permanent member of staff in May, 2017. In June, 2017 Mukunzi applied for an employer guaranteed car loan from Success Bank Rwanda Limited to enable him import a personal car from Japan for his private use. In July, 2017 Mukunzi placed an order with Kismai Japan Limited for a Toyota Probox, engine capacity 1,300 CC, model 2005. In August, 2017, Kismai sent the following particulars to Mukunzi:

Details	USD
Cost of the vehicle	14,300
Insurance from Japan to the port of Mombasa	1,000
Freight from Japan to Mombasa	1,500

After reviewing the above details, Mukunzi confirmed to Kismai his acceptance of the terms in totality and then effected payment. Kismai delivered the car at the port of Mombasa on 28 September, 2017 and then arranged for its transportation by road to Kampala in accordance with the terms of the agreed contract. On 30 September, 2017, Mukunzi engaged Swift Forwarders Uganda Limited to transport the car from Kampala to Kigali. After payment of the relevant taxes and registration fees on 5 October, 2017, the car was issued with a number plate and a registration certificate by the Rwanda Revenue Authority.

Hint: Import duty rate = 25%, Excise duty rate = 10%, Withholding tax rate = 5% and the exchange rate on 5 October, 2017 was USD 1 = Frw 900.

Required

- (a) Compute the customs duties paid to the Rwanda Revenue Authority (RRA) on 5 October, 2017.

Methods of determining the Customs value

1. TRANSACTION VALUE

2. (1) The customs value of imported goods shall be the transaction value, which is the price actually paid or payable for the goods when sold for export to the Partner State adjusted in accordance with the provisions of Paragraph 9, but where—

- (a) there are no restrictions as to the disposition or use of the goods by the buyer other than restrictions which:

- (i) are imposed or required by law or by the public authorities in the Partner State; (ii) limit the geographical area in which the goods may be resold; or
 - (iii) do not substantially affect the value of the goods;
- (b) the sale or price is not subject to some condition or consideration for which a value cannot be determined with respect to the goods being valued;
- (c) no part of the proceeds of any subsequent resale, disposal or use of the goods by the buyer will accrue directly or indirectly to the seller, unless an appropriate adjustment can be made in accordance with the provisions of Paragraph 9; and
- (d) the buyer and seller are not related, or where the buyer and seller are related, that the transaction value is acceptable for customs purposes under the provisions of subparagraph (2).
- (2) (a) In determining whether the transaction value is acceptable for the purposes of subparagraph (1), the fact that the buyer and the seller are related within the meaning of Paragraph (1) shall not in itself be a ground for regarding the transaction value as unacceptable. In such case the circumstances surrounding the sale shall be examined and transaction value shall be accepted provided that the relationship did not influence the price. If, in light of information provided by the importer or otherwise, the proper officer has grounds for considering that the relationship influenced the price, he shall communicate his grounds to the importer and such importer shall be given reasonable opportunity to respond and where the importer so requests, the communication of the grounds shall be in writing;
- (b) In the sale between related persons, the transaction value shall be accepted and the goods valued in accordance with the provisions of subparagraph (1) whenever the importer demonstrates that such value closely approximates to one of the following accruing at or about the same time.
- (i) the transaction value in sales to unrelated buyers of identical or similar goods for export to the Partner State;
 - (ii) the customs value of identical or similar goods as determined under the provisions of Paragraph 6;
 - (iii) the customs value of identical or similar goods as determined under the provisions of Paragraph 7.

Provided that, in applying the provisions under subparagraph (2) (a) and (b) of this Paragraph, due account shall be taken of demonstrated differences in commercial levels, quantity levels, the elements enumerated in paragraph 9 and costs incurred by the seller in sales in which the seller and the buyer are not related that are not incurred by the seller in sales in which the seller and the buyer are related.

The tests set forth in subparagraph (2) (b) are to be used at the initiative of the importer and only for comparison purposes. Substitute values may not be established under the provisions of subparagraph (2) (b).

TRANSACTION VALUE OF IDENTICAL GOODS

3. (1) (a) Where the customs value of the imported goods cannot be determined under the provisions of paragraph 2, the customs value shall be the transaction value of identical goods sold for export to the Partner State and exported at or about the same time as the goods being valued:
- (b) In applying the provisions of this paragraph, the transaction value of identical goods

in a sale at the same commercial level and in substantially the same quantity as the goods being valued shall be used to determine the customs value and where no such sale is found, the transaction value of identical goods sold at the different commercial level or in different quantities, adjusted to take account of differences attributable to commercial level or to quantity, shall be used, provided that such adjustments can be made on the basis of demonstrated evidence which clearly establishes the reasonableness and accuracy of the adjustment, whether the adjustment leads to an increase or decrease in the value;

(2) Where the costs and charges referred to in Paragraph 9 (2) are included in the transaction

value, an adjustment shall be made to take account of significant differences in such costs and charges between the imported goods and the identical goods in question arising from differences in distances and modes of transport.

(3) Where in applying the provisions of this paragraph, more than one transaction value of identical goods is found, the lowest such value shall be used to determine the customs value of the imported goods.

TRANSACTION VALUE OF SIMILAR GOODS

(1) (a) Where the customs value of the imported goods cannot be determined under the provisions of Paragraph 2 and 3, the customs value shall be the transaction value of similar goods sold for export to the Partner State and exported at or about the same time as the goods being valued;

(b) In applying this Paragraph, the transaction value of similar goods in a sale at the same commercial level and in substantially the same quantity as the goods being valued shall be used to determine the customs value. Where no such sale is found, the transaction value of similar goods sold at a different commercial level and/or in different quantities, adjusted to take account of differences attributable to commercial level and/or to quantity, shall be used, provided that such adjustments can be made on the basis of demonstrated evidence which clearly establishes the reasonableness and accuracy of the adjustment, whether the adjustment leads to an increase or a decrease in the value.

(2) Where the costs and charges referred to in subparagraph (2) of Paragraph 9 are included in the transaction value, an adjustment shall be made to take account of significant differences in such costs and charges between the imported goods and the similar goods in question arising from differences in distances and modes of transport.

(3) Where, in applying the provisions of this paragraph, more than one transaction value of similar goods is found, the lowest such value shall be used to determine the customs value of the imported goods.

REVERSAL OF ORDER OF APPLICATION OF DEDUCTIVE VALUE AND COMPUTED VALUES

5. Where the customs value of the imported goods cannot be determined under the provisions of paragraphs 2, 3 and 4, the customs value shall be determined under the provisions of paragraph 6 or, when the customs value cannot be determined under that paragraph, under the provisions of paragraph 7 save that, at the request of the importer, the order of application of paragraphs 6 and 7 shall be reversed.

DEDUCTIVE VALUE

(1) (a) Where the imported goods or identical or similar imported goods are sold in the Partner State in the condition as imported, the customs value of the imported goods under the provisions of this paragraph shall be based on the unit price at which the imported goods or identical or similar imported goods are so sold in the greatest aggregate quantity, at or about the time of the importation of the goods being valued, to persons who are not related to the persons from whom they buy such goods, subject to deductions for the following:

(i) either the commissions usually paid or agreed to be paid or the additions usually made for profit and general expenses in connection with the sales in such country of imported goods of the same class or kind;

(ii) the usual costs of transport and insurance and associated costs incurred within the Partner State;

(iii) where appropriate, the costs and charges referred to in Paragraph 9 (2); and

(iv) the customs duties and other national taxes payable in the Partner State by reason of importation or sale of the goods.

(b) Where neither the imported goods nor identical nor similar imported goods are sold at or about the time of importation of the goods being valued, the customs value shall, subject to the provisions of subparagraph (1) (a), be based on the unit price at which the imported goods or identical or similar imported goods are sold in the Partner State in the condition as imported at the earliest date after the importation of the goods being valued but before the expiration of 90 days after such importation.

(2) Where neither the imported goods nor identical nor similar imported are sold in the Partner State in the condition as imported, then, if the importer so requests, the customs value shall be based on the unit price at which the imported goods, after further processing, are sold in the greatest aggregate quantity to persons in the Partner State who are not related to the persons from whom they buy such goods, due allowance being made for the value added by such processing and the deductions provided for in subparagraph (1) (a).

COMPUTED VALUE

7. (1) The customs value of imported goods under the provisions of this Paragraph shall be based on a computed value which shall consist of the sum of:

(a) the cost or value of materials and fabrication or other processing employed in producing the imported goods;

(b) an amount for profit and general expenses equal to that usually reflected in sales of goods of the same class or kind as the goods being valued which are made by producers in the country of exportation for export to the Partner State;

(c) the cost or value of all other expenses necessary to reflect the costs added under Paragraph 9 (2).

(2) A person who is not resident in the Partner State may be required to, or compelled to produce for examination, or to allow access to, any account or other record for the purposes of determining a computed value. However, information supplied by the producer of the goods for the purposes of determining the customs value under the provisions of this Paragraph may be verified in another country by a proper officer with the agreement of the producer and provided sufficient advance notice is given to the government of the country in question and the latter does not object to the investigation.

FALL BACK VALUE

8. (1) Where the customs value of the imported goods cannot be determined under the provisions of Paragraphs 2, 3, 4, 5, 6 and 7, inclusive, the customs value shall be determined using reasonable means consistent with the principles and general provisions of this Schedule and on the basis of data available in the Partner State.

(2) Customs value shall not be determined under the provisions of this paragraph on the basis of:

- (a) the selling price in the Partner State of goods produced in the Partner State;
- (b) a system which provides for the acceptance for customs purposes of the higher of two alternative values;
- (c) the price of goods on the domestic market of the country of exportation;
- (d) the cost of production other than computed values which have been determined for identical or similar goods in accordance with the provisions of Paragraph 7;
- (e) the price of the goods for export to a country other than the Partner State;
- (f) minimum customs values; or
- (g) arbitrary or fictitious values.

(3) Where the importer so requests, he or she shall be informed in writing of the customs value determined under the provisions of this paragraph and the method used to determine such value.

ADJUSTMENTS TO VALUE

(1) In determining the customs value under the provisions of Paragraph 2, there shall be added to the price actually paid or payable for the imported goods as follows:

- (a) to the extent that they are incurred by the buyer but are not included in the price actually paid or payable for the goods:
 - (i) the commissions and brokerage, except buying commissions;
 - (ii) the cost of containers which are treated as being one for customs purposes with the goods in question;
 - (iii) the cost of packing whether for labour or materials;
- (b) the value, apportioned as appropriate, of the goods and services where supplied directly or indirectly by the buyer free of charge or at reduced cost for use in connection with the production

and sale for export of the imported goods, to the extent that such value has not been included in the price actually paid or payable as follows:

(i) materials, components, parts and similar items incorporated in the imported goods; (ii) tools, dies, moulds and similar items used in the production of the imported goods; (iii) materials consumed in the production of the imported goods;

(iv) engineering, development, artwork, design work, and plans and sketches undertaken elsewhere than in the Partner State and necessary for the production of the imported goods;

(c) royalties and licence fees related to the goods being valued that the buyer must pay, either directly or indirectly, as a condition of sale of the goods being valued, to the extent that such royalties and fees are not included in the price actually paid or payable;

(d) the value of any part of the proceeds of any subsequent resale, disposal or use of the imported goods that accrues directly or indirectly to the seller.

(2) In determining the value for duty purposes of any imported goods, there shall be added to the price actually paid or payable for the goods:-

(a) the cost of transport of the imported goods to the port or place of importation into the Partner State; provided that in case of imports by air no freight costs shall be added to the price paid or payable;

(b) loading, unloading and handling charges associated with the transport of the imported goods to the port or place of importation into the Partner State; and

(c) the cost of insurance.

(3) Additions to the price actually paid or payable shall be made under this paragraph only on the basis of objective and quantifiable data.

(4) Additions shall not be made to the price actually paid or payable in determining the customs value except as provided in this paragraph.

Following this schedule is a Section headed "Interpretative Notes". The student is encouraged to read these notes.

H. TRANSFER PRICING

Transfer pricing refers to the determination of prices charged in transactions between related parties. Such transactions can be sale or purchase of goods, provision of services, borrowing or lending of money, use or transfer of intangibles, etc.

A related party, in relation to a person, means any other person:

(a) Who, directly or indirectly, controls that person;

(b) Who is, directly or indirectly, controlled by that person; or

(c) Where both persons are, directly or indirectly, controlled by a common person. It includes a permanent establishment through which a person carries on its business. In such a situation, the person and its permanent establishment are treated as two separate and distinct persons.

When related parties transact with each other, their pricing may not reflect market conditions due to a lack of independence in their commercial and financial relations. As a result, their profits and tax liabilities may be distorted, especially when they are located in different jurisdictions with different tax rates. This creates concerns that the related parties may not be paying their fair share of tax and are able to derive a tax advantage as a group.

To ensure taxpayers transact with their related parties at pricing that reflects independent pricing, the tax laws apply the internationally endorsed arm's length principle. If taxpayers do not comply with the arm's length principle and have understated their profits, the tax authority will adjust their profits upwards as provided in the Income Tax Law.

Foreign tax authorities will likewise make upward adjustments when they find the transfer pricing of the cross-border related party transactions is not at arm's length. Such transfer pricing adjustments, by tax authorities or the foreign tax authorities, may lead to double taxation. Thus, it is important that taxpayers comply with the arm's length principle when transacting with their related parties and maintain proper transfer pricing documentation to substantiate their pricing.

The arm's length principle

The tax authority endorses the arm's length principle as the standard to guide transfer pricing. The arm's length principle requires a transaction with a related party to be made under comparable conditions and circumstances as a transaction with an independent party. The premise is that where market forces drive the terms and conditions agreed in an independent party transaction, the pricing of the transaction would reflect the true economic value of the contributions made by each party in that transaction. Therefore, if two related parties derive profits at levels above or below the comparable market level solely because of their special relationship, the profits will be deemed as non-arm's length. In such a case, RRA can make necessary adjustments to the taxable profits of the Rwandan taxpayer. This is to reflect the true price that would otherwise be derived on an arm's length basis.

Basis for the arm's length principle

Article 8 of the Rwanda fiscal compilation law stipulates the use of the arm's length principle for related party transactions. The concept or use of the principle is also implied or referred to in various provisions of the tax law.

Reasons for endorsing the arm's length principle

RRA endorses the use of the arm's length principle for two main reasons:

(a) Market forces of supply and demand are the best way to allocate resources and reward effort. To avoid economic distortions that may be created by tax rules, transfer pricing for tax purposes should approximate to market pricing. Applying the arm's length principle would result in related and independent party transactions being treated equally for tax purposes. Hence, it avoids creating tax advantages or disadvantages that would distort the relative competitive positions of either party.

(b) Most tax jurisdictions adopt the arm's length principle. In doing so, taxpayers and tax authorities will have a common basis to deal with related party transactions. This should reduce the incidence of transfer pricing adjustments and improve the resolution of transfer pricing disputes. Consequently, the likelihood of double taxation will be reduced.

Three-step approach to apply the arm's length principle

RRA recommends that taxpayers adopt the following three-step approach to apply the arm's length

principle in their related party transactions:

Step 1 - Conduct comparability analysis

Step 2 - Identify the most appropriate transfer pricing method and tested party

Step 3 - Determine the arm's length results

Step 1 – Conduct comparability analysis

Step 1 is the process of identifying and comparing economically relevant characteristics of the transaction between related parties and those between independent parties to arrive at the characteristics that would have prevailed had the transaction been undertaken between independent parties. This should lead to a finding of:

Related party transactions Independent party transactions (internal comparable)

Independent party transactions (External comparable)

Step 2 – Identify the most appropriate transfer pricing method and tested party

There are five internationally accepted methods for evaluating a taxpayer's transfer prices or margins against a benchmark based on the prices or margins adopted by independent parties in similar transactions. These five methods can be categorised as follows:

Traditional transaction methods	Transactional profits methods
<input type="checkbox"/> CUP method	<input type="checkbox"/> Transactional profit split method
<input type="checkbox"/> Resale price method	<input type="checkbox"/> Transactional net margin method ("TNMM")
<input type="checkbox"/> Cost plus method	

Traditional transaction methods compare the price of related party transactions with that of transactions between independent parties. On the other hand, transactional profits methods compare the profit arising from related party transactions with that generated in independent party transactions.

Controllable uncontrollable price (CUP) method

The CUP method compares the following two prices:

- (a) The price charged for properties or services transferred in a related party transaction; and
- (b) The price charged for properties or services transferred in an independent party transaction in comparable circumstances.

SingCo, a Rwanda company, sells only one type of computer disk drive. The disk drives are sold to two other companies:

- 1) SingCo's overseas subsidiary, Company B, and
- 2) A local unrelated company, Company U.

Under the agreement between SingCo and Company B, SingCo will ship the hard disks to Country B where Company B is located on a CIF basis. On the other hand, Company U takes possession of the hard disks at SingCo's factory.

Transfer price with shipment

RWF 50, 000 without shipment

SingCo

Company B

Company U

Assuming that the volume of SingCo's disk drive sales to both parties, and market and economic conditions are similar in any one particular period, the CUP for the disk drives sold to Company B could be computed as follows:

Price of disk drives sold to Company U (per container of goods) RWF	50,000
Add: Adjustment for insurance and freight RWF	400
Transfer price (per container of goods) based on CUP RWF	50,400

Example 2: CUP method using external CUP

SingCo, a Rwanda company, sells a commodity product to its overseas subsidiary, Company A, which is located in Country A. This commodity product is widely and competitively traded in Country A. Therefore, the price of the commodity at any point in time is easily available.

In this case, the market price would be the CUP to determine if the transfer price between SingCo and Company A is at arm's length. The market price adopted in the above example is commonly termed as "external CUP". Many taxpayers tend to rely on such external data in their attempts to locate comparable independent party transactions.

However, internal comparable transactions (commonly termed as "internal CUP") may have a more direct and closer relationship to the transaction under review as compared to external CUP. As can be seen in the earlier example (Example 1), the internal CUP may arise where the taxpayer buys or sells the particular product, in similar quantities and under similar terms to independent parties in similar markets.

Resale price method

The resale price method is applied where a product that has been purchased from a related party is resold to an independent party. Essentially, it values the functions performed by the "reseller" of a product. In this method, the resale price to the independent party is reduced by a comparable gross margin (the "resale price margin") to arrive at the arm's length price of the product transferred between the related parties. Under arm's length conditions, the resale price margin should allow the reseller to recover its selling and operating costs, and earn a reasonable profit based on its FAR.

Example: Resale price method

SingCo distributes laptop computers in Rwanda for its overseas parent company, PCo. Company C, a Rwanda company unrelated to PCo, has also been appointed by PCo to distribute desktop computers for it in Rwanda. In this example, it is assumed that the laptop and desktop markets are similar in Rwanda. The main difference between the two distributorship agreements is that SingCo performs promotional and marketing functions for PCo whereas Company C does not. The gross profit margin of Company C from the resale of desktops to consumers was found to be 10%.

The arm's length price for the related party transaction is computed as follows:

SingCo's sales of laptop to unrelated parties	RWF 3,500
Less: Arm's length resale price margin based on Company C's transactions (10% x RWF3, 500)	RWF 350

RWF 3,150

Less: Arm's length price for promotional and marketing

functions performed by SingCo for PCo based on transfer pricing analysis RWF 80

Transfer price (based on resale price method) RWF 3,070

The above example is based on an internal comparable. PCo's transactions with Company C, an independent party, are used to benchmark the transactions with SingCo (a related party). If there are no reliable internal comparables, the same analysis above could be undertaken using external comparables i.e. benchmarking the related party transactions between PCo and SingCo against comparable transactions between an independent manufacturer and an independent distributor.

Cost plus method

The cost plus method focuses on the gross mark-up obtained by a supplier who transfers property or provides services to a related purchaser. Essentially, it values the functions performed by the supplier of the property or services. In this method, a comparable gross mark-up is added to the costs incurred by the supplier of goods or services in the related party transaction to arrive at the arm's length price of that transaction.

Type of cost	Examples
Direct costs	<input type="checkbox"/> Cost of raw materials <input type="checkbox"/> Cost of labour
Indirect costs	<input type="checkbox"/> Depreciation <input type="checkbox"/> Repair and maintenance which may be allocated among several products
Operating expenses	<input type="checkbox"/> Marketing <input type="checkbox"/> General and administrative

In applying the cost plus method, direct and indirect costs of producing a product or providing a service are normally used to compute the cost base. Where the independent party adopts a definition of cost base or a method to compute cost that is different from that of the related party, the cost base of the independent party should be adjusted accordingly to ensure comparability.

The cost plus method is most useful where semi-finished goods are sold between related parties or where the related party transaction involves the provision of services. Taxpayers should rely on internal comparables as far as possible. External comparables may be used if no reliable internal comparable transactions exist.

Example: Cost plus method

SingCo is a domestic manufacturer of a specialised drug for its overseas related company, Company D. The MNE group to which SingCo and Company D both belong is the inventor of the drug and the only producer in the world.

Under the agreement, Company D provides all the know-how used in the manufacturing of the drug and undertakes to acquire a fixed output from SingCo every month. Payment is to be made based on the costs incurred by SingCo, along with a mark up to reflect a profit element for SingCo. Based on SingCo's financial statements, the cost incurred to manufacture one unit of the drug is RWF70.

SingCo essentially performs the role of a contract manufacturer. An unrelated Rwanda manufacturing company in the pharmaceutical industry that manufactures a different drug, Company E, has been identified as a potential comparable company. Company E charges an average mark up of 25% for providing similar contract manufacturing services to several other independent companies.

The transfer price for the related party transaction is computed as follows:

Direct and indirect cost incurred by SingCo to manufacture one unit of drug RWF	70.00
Arm's length mark up (25% x RWF70.00) RWF	17.50
Transfer price (based on the cost plus method) RWF	87.50

The above example is based on an external comparable. SingCo's transactions with Company D, a related party, are benchmarked against the transactions between Company E and independent parties. If reliable internal comparables exist, the same analysis should be undertaken using internal comparables. SingCo's related party transactions with Company D are benchmarked against comparable transactions between SingCo and an independent party

Transactional profit split method

The transactional profit split method is based on the concept of splitting the combined profits of a transaction between related parties in a similar way as how independent parties would under comparable circumstances. It is particularly useful where:

- (a) Transactions are so highly inter-related that they cannot be evaluated separately; or
- (b) The parties make unique and valuable contributions to the transaction; or
- (c) The existence of unique intangible assets makes it difficult to find reliable comparables.

Transaction net margin method (TNMM)

The TNMM compares the net profit relative to an appropriate base (such as costs, sales or assets) that is attained by a taxpayer from a related party transaction to that of comparable independent parties. This ratio of net profit and the appropriate base is commonly known as the net profit indicator or profit level indicator.

5.78 Examples of net profit indicators or profit level indicators that may be used in applying the TNMM are as follows:

Net profit/ Profit level indicator	Numerator	Denominator
Operating profit margin	Operating profit	Sales
Full cost mark up	Operating profit	Total costs including all direct, indirect and operating costs
Value-added cost mark up	Operating profit	Operating costs
Return on asset	Operating profit	Operating assets

Related party services

Related party or intra-group services refer to activities that are performed by one or more members of a group of companies or businesses for related parties within the same group. Such services may include

administrative, technical, financial, commercial, management, coordination and control functions.

This section covers the following:

- (a) The “benefits test” which is used to determine whether related party services have been provided;
- (b) Application of the arm’s length principle to determine the arm’s length fee for such services; and
- (c) Administrative practices for routine support services.

Using the “benefits test” to determine the provision of related party services

It is common for a parent company or a designated member within a group to undertake certain activities (e.g. administrative, financial and personnel functions) for the various related parties in the group. To determine whether related party services have been provided, taxpayers can apply the “benefits test” to the facts and circumstances pertaining to their activities. The “benefits test” requires consideration of the following factors:

- (a) Whether activities are performed for another party which receives, or reasonably expects to receive, benefits from such activities. If so, there is a service provided even if the expected benefits do not eventually materialise;
- (b) Whether objectively there is any commercial or practical necessity for the activities to be performed for the service recipient and an independent party would be willing to pay the service provider for the performance of those activities. If not, the benefit is too remote and there is no service provided;
- (c) Whether the benefits have economic or commercial value such that an independent party would expect to pay to receive the benefits or be paid for providing the benefits. If not, there is no service provided; and

Whether the benefits are identifiable and capable of being valued. In other words, the benefits must be sufficiently direct and substantial. Otherwise, there is no service provided.

Application of the arm’s length principle to determine arm’s length fee

Choice of most appropriate transfer pricing method

The following methods are often the most appropriate choices to determine the arm’s length fee for related party services:

- (a) CUP method; or
- (b) Cost plus method; or
- (c) TNMM.

Related party loans

When taxpayers lend money to or borrow money from their related parties, they should adhere to the arm’s length principle when determining the return to be charged for the use of money.

This section provides guidance on:

- (a) The application of the arm's length principle to related party loans; and
- (b) The determination of the arm's length interest.

Application of the arm's length principle to related party loans

A related party loan arises when a taxpayer lends money to or borrows money from a related party. It can be:

Type of loan	Parties to the loan
Related domestic loan	Where a taxpayer in Rwanda lends to or borrows from a related party in Rwanda
Related cross-border loan	Where a taxpayer in Rwanda lends to or borrows from a foreign related party

A loan can be in any form regardless of whether or not it is made through a written agreement. It includes:

- (a) Credit facilities; or
- (b) intercompany credit balances arising from the normal course of sales and provision of services which are left uncollected over a substantial period of time that is beyond what a third party trade creditor would typically allow.

Example:

- Taxpayer A provided a loan to Taxpayer B RWF 100,000
- Interest charged by Taxpayer A in 2014 RWF 100
- Interest expense incurred by Taxpayer A in providing the loan in 2014 RWF 1,000
- Taxpayer A's interest expense claim of RWF1, 000 is limited to RWF100

Test your understanding

- (i) Using examples, explain the meaning of 'transfer pricing' and 'double taxation agreements' as provided in the Rwanda tax laws/ code.
- (ii) Explain any four transfer pricing methods that multinational companies use in order to determine the arms-length price in case of transactions involving related parties.

STUDY UNIT

4

TAX PLANNING

- Nature of the business
- Capital structure
- Lease or purchase
- Form of business
- Tax planning for individuals and companies
- Employment versus self-employment
- indirect taxation
- Remuneration packages
- Corporate structure and dividend
- Transfer of real properties
- Pricing Policy
- Uses of tax incentives
- Disposal of business operations and restructuring of activities
- Lease and purchase decisions

- **DEFINITION**

Arrange financial and tax matters with the purpose of minimizing the tax burden. In other words, it is tax avoidance

Why is it Important to Undertake Tax Planning?

1. Minimize tax liabilities
2. Minimization in tax litigation
3. Healthy growth of the business. Once you pay on time no penalties.
4. Helps in the capital formation
5. Source of working capital.

Main Points of Tax Planning and Management

1. Compliance of tax laws by minimizing tax incidence.
2. Planning location

Example:

VW is establishing a regional office under investment code: CIT =0%.

Special Economic Zone: SEZ:

- CIT 15%
- Free zone
- Export processing zone

Nature of business

- ✓ Investment in commercial property
- ✓ Investment in machinery equipment

Example 1

You have been approached by an investor who is considering two investment opportunities. To either invest in commercial properties or to invest in machine and equipment. Each investment requires an initial capital of 200,000,000RWF; and will generate an annual income of 100,000,000RWF. The investor wants to minimize tax as much as possible; Advice the investor on which option to invest in.

Answer

Option one investment in commercial property

Gross income		100,000,000
Less allowable expenses		(50,000,000)
Taxable income		50,000,000
Tax liability	Rate	Tax
0-180,000	0%	0
180,001-1,000,000	20%	164,000
1,000,001-50,000,000	30%	14,700,000
Tax liability		<u>14,864,000</u>

Option two investment in machinery and equipment

Particular	Working	Amount in RWF
Gross income		100,000,000
Less allowable expenses	10%×100,000,000	(10,000,000)
Less depreciation	25%×200,000,000	(50,000,000)
Taxable income		40,000,000
Tax liability	Rate	Tax
0-360,000	0%	0
360,001-1,200,000	20%	168,000
1,200,001-40,000,000	30%	11,640,000
Tax liability		<u>11,808,000</u>

Example 2

Individual X is considering two investment opportunities which are commercial, agriculture and livestock and wholesale hardware shop. From the forecast, the individual identified that the agriculture and livestock will have an annual turnover of 50,000,000Rwf which is similar to that of the hardware business. An individual wants to minimize the tax. Advise the individual on which decision to take.

Answer

Agriculture and livestock

Particular	working	Amount in Rwf
Gross turnover		50,000,000
Exemption		(12,000,000)
Taxable income		38,000,000
Tax liability	38,000,000×3%	<u>1,140,000</u>

Hardware shop

Gross turnover 50,000,000RWF

Tax liability 3% of 50,000,000Rwf = **1,500,000RWF**

Example 3

Company X is considering two investment opportunities. One is to operate a microfinance and another is to operate a juice processing plant. The forecasted profit for a period of six years for the either investment is as below:

Y1= 8,000,000RWF

Y2= 10,000,000RWF

Y3= 6,000,000RWF

Y4= 2,000,000RWF

Y5= 20,000,000RWF

Y6= 50,000,000RWF

Advise the company on which investment opportunity to take.

Answer

Microfinance for CIT of 5 years is exempted; CIT= 0%

- **FORMS OF BUSINESS ORGANIZATION**

- Sole trade
- Partnership
- companies

Sole Trade

Tax: 360,000 exempt

Tax rates: Certain income is taxed at 20%

Partnership and companies

Taxed as the same way at 30%

Advantages of partnership and companies

- ✓ Loss can be carried forward
- ✓ Discount on listed shares:
 - 40=20%
 - 30=25%
 - 20=28%
- ✓ Preferential CIT 0% and 15%
- ✓ Tax holidays
- ✓ Investment allowance

Example

You have been approached by an investor who is considering to register his business as a company or to operate as an individual business. If he operates as individual business, he expects to earn the following income for the next 5 years' profit. Y1= 2M; Y2=-5M; Y3=10M; Y4=-3M; Y5=2M. dividend income of 2M each year from local company (not listed); he also expects to receive the same income if he operates as a company. Advise the investor on which form of business to register

Answer

Individual Business

	Y1	Y2	Y3	Y4	Y5
Profit	2,000,000	(5,000,000)	10,000,000	(3000,000)	2,000,000
Dividend 2M×100/85	2,300,000	2,300,000	2,300,000	2,300,000	2,300,000
Taxable income	4,300,000	(2,700,000)	12,300,000	(700,000)	4,300,000
Taxable					
0-360,000=0%	0	0	0	0	0
360,001-1,200,000=20%	168,000	-	168,000	-	168,000
1200,000-Above	930,000	-	2,520,000	-	720,000
Tax liability	1,098,000	0	2,688,000	0	888,000
Less withholding tax	(300,000)	(300,000)	(300,000)	(300,000)	(300,000)
Claimable			(300,000)		(300,000)
Tax payable/claimable	<u>798,000</u>	<u>(300,000)</u>	<u>2,088,000</u>	<u>(300,000)</u>	<u>288,000</u>

Total tax= 3,174,000

Exemption= 360,000×3= 1,080,000 (Savings)

Company business

	Y1	Y2	Y3	Y4	Y5
Profit	2,000,000	(5,000,000)	10,000,000	(3000,000)	2,000,000
Dividend not taxable	-	-	-	-	-
Loss	-	5,000,000	(5,000,000)	3,000,000	(3,000,000)
Taxable income	2,000,000	0	5,000,000	0	(1,000,000)
Tax liability at 30%	<u>600,000</u>	<u>0</u>	<u>1,500,000</u>	<u>0</u>	<u>0</u>

Total tax= 2,100,000

Dividend= 2,000,000×5=10,000,000 (Savings)

- **CAPITAL STRUCTURE**

You can finance business using equity and debt

For **equity** dividend is non allowable expenses

For **debt** interest is a tax allowable

Example

You have been approached by an investor who wants to invest in the business. The investor has two options. To either finance a business using equity, that is, through issuing of shares or to issue a debt.

The investment requires an initial capital of 500,000,000RWF. This will require the investor to issue 250,000 shares of 2000RWF each. The dividend per share is 100RWF. The investor can as well raise the required amount by borrowing the money from the bank.

The interest rate on the loan is 15% and the loan must be paid within a period of 5 years making equal payment at the end of each year. The investor forecasted the following profit for the next 3 years: Y1= 50,000,000RWF; Y2= 120,000,000RWF; Y3= 100,000,000RWF.

Required

Advise the investor on how to finance the business if he wants to minimize loses as much as possible.

Solution

Loan= 500,000,000RWF

Interest= 15%

n= 5 years

Annuity= equal payment

$$PVA = PMT \left[\frac{1}{r} - \frac{1}{r(1+r)^n} \right] \left[\frac{1}{r} - \frac{1}{r(1+r)^n} \right]$$

PVA: Present value annuity

PMT: Constant payment

r: interest

$$500,000,000 = PMT \left[\frac{1}{0.15} - \frac{1}{0.15(1+0.15)^5} \right] \left[\frac{1}{0.15} - \frac{1}{0.15(1+0.15)^5} \right]$$

Annuity at the end: ordinary

Annuity at the beginning: due

$$500,000,000 = PMT [6.667 - 3.315]$$

$$\frac{500,000,000}{3.352} = \frac{500,000,000}{3.352} = \frac{3.352 \text{ PMT}}{3.352} \Rightarrow PMT$$

PMT=149,169,677RWF

Year	Constant	Interest	Principal	Balance
0				500,000,000
1	149,157,776	75,000,000	74,157,776	425,842,224
2	149,157,776	63,876,334	85,281,442	340,560,782
3	149,157,776	51,084,117	98,073,659	242,487,123
4	149,157,776	36,373,068	112,784,708	129,702,415
5	149,157,778	19,455,362	129,702,416	0

Option 1 loan

Particulars	Y1 'RWF'	Y2 'RWF'	Y3 'RWF'
PBT	50,000,000	120,000,000	100,000,000
Less interest	(75,000,000)	(63,876,334)	(51,084,117)
P/L	(25,000,000)	56,123,666	48,915,883
Less relief	25,000,000	(25,000,000)	0
Taxable income	0	31,123,666	48,915,883
Tax @ 30%	0	9,337,100	14,674,765
Retained profit	0	21,786,566	34,241,118

Dividend= 250,000×100= 25,000,000

Option 2 shares

particular	Y1 'RWF'	Y2 'RWF'	Y3 'RWF'
PBT	50,000,000	120,000,000	100,000,000
Tax @30%	(15,000,000)	(36,000,000)	(30,000,000)
PAT	35,000,000	84,000,000	70,000,000
Dividend	(25,000,000)	(25,000,000)	(25,000,000)
Retained profit	<u>10,000,000</u>	<u>59,000,000</u>	<u>45,000,000</u>

Conclusion: loan is more beneficial than the lease since it provides the least tax.

Example 2

An individual investor has approached you for advise on how to finance his investment. The investor wants to invest in commercial properties; the investment requires an initial capital of 400,000,000RWF. The investor is considering two financing options which are to either finance using his own savings or to borrow 80% of the required initial investment from the bank. There is a bank that has expressed the willingness to lend him money but at an interest rate of 18% paid in a 5 years' time making equal installments at the end of each year. The forecasted rental income is 10,000,000RWF per month.

Required:

Advise the investor on how to finance the proposed investment.

Solution

$$PVA = PMT \left[\frac{1}{r} - \frac{1}{r(1+r)^n} \right] \left[\frac{1}{r} - \frac{1}{r(1+r)^n} \right]$$

$$\text{Loan} = 400,000,000 \times 80\% = 320,000,000$$

$$r = 18\%$$

$$n = 5 \text{ years}$$

$$320,000,000 = PMT \left[\frac{1}{0.18} - \frac{1}{0.18(1+0.18)^5} \right] \left[\frac{1}{0.18} - \frac{1}{0.18(1+0.18)^5} \right]$$

$$320,000,000 = PMT \left[5.5555556 - \frac{1}{0.18(2.287758)} \right] \left[\frac{1}{0.18(2.287758)} \right]$$

$$320,000,000 = PMT \ 3.127171$$

$$PMT = 102,328,909$$

Loan amortization Schedule

Year	Constant	Interest	Principal	Balance
0				320,000,000
1	102,328,909	57600000	44,728,909	275,271,091
2	102,328,909	49548796	52,780,113	222,490,978
3	102,328,909	40048376	62,280,533	160,210,445
4	102,328,909	28837880	73,491,029	86,719,417
5	102,328,912	15609495	86,719,417	0

Option 1 Loan

	Y1 'RWF'	Y2 'RWF'	Y3 'RWF'	Y4 'RWF'	Y5 'RWF'
PBT	120,000,000	120,000,000	120,000,000	120,000,000	120,000,000
Less interest exp.	(57,600,000)	(49,548,796)	(40,048,376)	(28,837,880)	(15,609,495)
Allowable exp. 30%	(36,000,000)	(36,000,000)	(36,000,000)	(36,000,000)	(36,000,000)
PBT	26,400,000	34,451,204	43,951,624	55,162,120	68,390,505
TAX	(7,784,000) 7,920,000	(10,199,361)	(13,049,487)	(16,412,636)	(20,381,151)
Retained profit	18,616,000	24,251,843	30,902,137	38,749,484	48,009,353

	Y1	Y2	Y3	Y4	Y5
PBT	120,000,000	120,000,000	120,000,000	120,000,000	120,000,000
Less allowable exp.	(60,000,000)	(60,000,000)	60,000,000)	(60,000,000)	(60,000,000)
Profit	60,000,000	60,000,000	60,000,000	60,000,000	60,000,000
Tax	(17,864,000)	(17,864,000)	(17,864,000)	(17,864,000)	(17,864,000)
Retained profit	<u>42,136,000</u>	<u>42,136,000</u>	<u>42,136,000</u>	<u>42,136,000</u>	<u>42,136,000</u>

LEASE OR PURCHASE

Lease or purchase is an agreement between the lessor and lessee where the lessor offers an asset to the lessee and the lessee pays installments.

Type of Lease

- Operating lease
- Financing lease

According to IFRS16, it only recognized one type of lease, which is a finance lease. If a lease does not exceed 12 months it is considered as a normal rent. If it exceeds 12 months it is a financing lease.

Benefits

Operating lease: you recognize a rent as an expense.

Financing lease: lessee recognizes depreciation and interest.

Depreciation of Leased Asset

As per accounting standards, depreciation on the leased asset is calculated on the present value of the lease. By considering the useful life of the asset or the lease term whichever is lower.

PURCHASE

Benefits

- ✓ Depreciation
- ✓ Investment allowance

The higher the cost is better, because we need to minimize the taxable profit.

Example

Company X is considering two options. To either purchase the machine or to lease the machine. If the company is to purchase the machine, it will pay 100,000,000RWF. If it decides to lease, it will pay 12,000,000RWF at the end of each year for period of 10 years. The interest rate on the lease is 10%. The machine has useful life of 20 years after which the scrap value will be zero. The company has made the following forecast of profit for the next 5 years. Y1= 40M; Y2= 65M; Y3= 50M Y4= 70M; Y5= 45M. The company wants to minimize the tax liability as much as possible.

Required

Advise the company on the alternative to take.

$$PMT = 12,000,000RWF$$

$$n = 10 \text{ years}$$

$$r = 10\%$$

$$PVA = PMT \left[\frac{1}{r} - \frac{1}{r(1+r)^n} \right] \left[\frac{1}{r} - \frac{1}{r(1+r)^n} \right]$$

$$12,000,000 = PMT \left[\frac{1}{0.1} - \frac{1}{0.1(1+0.1)^{10}} \right] \left[\frac{1}{0.1} - \frac{1}{0.1(1+0.1)^{10}} \right]$$

$$PVA = 73,734,805$$

This 73M will be the amount of liability in the balance sheet.

Lease amortization

	Beginning balance	Interest	Total	Constant	Ending balance
0					73,734,805
1	73,734,805	7373481	81,108,286	12,000,000	69,108,286
2	69,108,286	6910829	76,019,114	12,000,000	64,019,114
3	64,019,114	6401911	70,421,025	12,000,000	58,421,025
4	58,421,025	5842103	64,263,128	12,000,000	52,263,128
5	52,263,128	5226313	57,489,441	12,000,000	45,489,441
6	45,489,441	4548944	50,038,385	12,000,000	38,038,385
7	38,038,385	3803838	41,842,223	12,000,000	29,842,223
8	29,842,223	2984222	32,826,446	12,000,000	20,826,446
9	20,826,446	2082645	22,909,090	12,000,000	10,909,090
10	10,909,090	1090909	11,999,999	12,000,000	-1

Depreciation

$$PV = 73,734,805$$

$$\text{Depreciation} = \frac{73,734,805 - 0}{10} = 7,373,480$$

NB: Useful life is 20 years and lease term is 10 years whichever is lower.

	Y1	Y2	Y3	Y4	Y5
PBDIT	40,000,000	65,000,000	50,000,000	70,000,000	45,000,000
Interest	7,373,481	6,910,829	6,401,911	5,842,103	5,226,313
Depreciation	7,373,480	7,373,480	7,373,480	7,373,480	7,373,480
PBT	25,253,040	50,715,691	36,224,609	56,784,417	32,400,207
Tax @ 30%	7,575,912	15,214,707	10,867,383	17,035,325	9,720,062
Retained	17,677,128	35,500,984	25,357,226	39,749,092	22,680,145
Total tax Liability	60,413,389				

Option 2: Purchase a machine

Is it industrial machine or other machine? We assume it is a heavy machine (20 years).

Depreciation at 5%; cost 100,000,000

Depreciation= Y1.....Y20= 5,000,000 per year

	Y1	Y2	Y3	Y4	Y5
PBDT	40,000,000	65,000,000	50,000,000	70,000,000	45,000,000
Depreciation	5,000,000	5,000,000	5,000,000	5,000,000	5,000,000
PBT	35,000,000	60,000,000	45,000,000	65,000,000	40,000,000
Tax @ 30%	10,500,000	18,000,000	13,500,000	19,500,000	12,000,000
total tax	73,500,000				

Lease option will be taken

Example 2

Company X is registered investor and received RDB certificate to operate as a manufacturing company. The company is considering two alternatives regarding the need for the moto vehicle to transport its commodities around the country. The company is either to purchase a moto vehicle or lease it from Akagera motors. The cost of moto vehicle is 100,000,000Frw. If the company is to lease, it will pay 25,000,000Rwf at the end of each year for a period of 5 years. The moto vehicle has a useful life of 4 years after which the scrap value will be zero. The interest rate on the lease is 12%. The company has made the following forecast of the profit for the next 3 years. Y1= 60M; Y2= 45M; Y3=30M. Advise the company on the best option it wants to minimize tax liability.

Answer

PMT= 25,000,000

n= 5years

r= 12%

PV= 90,119,405

	Beginning Balance	Interest	Total	Constant	Ending Balance
0					90,119,405
1	90,119,405	10,814,329	100,933,734	25,000,000	75933734
2	75933734	9,112,048	85,045,782	25,000,000	60045782

3	60045782	7,205,494	67,251,275	25,000,000	42251275
4	42251275	5,070,153	47,321,428	25,000,000	22321428
5	22321428	2,678,571	25,000,000	25,000,000	0

Depreciation

Cost: 90,119,405

$$\text{Dep} = \frac{90,119,405 - 0}{4} = 22,529,851$$

NB: Useful life is 4 years and lease term is 5 years whichever is lower.

	Y1	Y2	Y3
PBDIT	60,000,000	45,000,000	30,000,000
Interest	10,814,329	9,112,048	7,205,494
Depreciation	22,529,851	22,529,851	22,529,851
PBT	26,655,820	13,358,101	264,655
Tax @ 30%	7,996,746	4,007,430	79,397
Retained	18,659,074	9,350,671	185,259
Total tax	12,083,573		

Purchase option

Cost= 100,000,000

Rate = 25%

	Cost	Investment Allowance	Depreciation	Book Value
1	100,000,000	50,000,000	12,500,000	37,500,000
2	37,500,000		9,375,000	28,125,000
3	28,125,000		7,031,250	21,093,750
4	21,093,750		5,273,438	15,820,313

	Y1	Y2	Y3
PBDIT	60,000,000	45,000,000	30,000,000
Investment allowance	50,000,000		
Depreciation	12,500,000	9,375,000	7,031,250
PBT	(2,500,000)	35,625,000	22,968,750
Loss relief	2,500,000	(2,500,000)	
Taxable income	-	33,125,000	22,968,750
Tax @ 30%	-	9,937,500	6,890,625
Retained	-	23,187,500	16,078,125
total tax	16,828,125		

Best option is lease

- **BUY OR MAKE**

Buy to purchase

Make

- Invest in asset
 - Depreciation
 - Investment allowance
- Raw material
- Other cost: direct or indirect

The management wants to take decision on the following products:

Products	A	B	C	D
Selling price	50	60	40	25
Variable cost per unit	40	55	50	30

The supplier has the following offers:

	A	B	C	D
He can sell at	35	75	30	25

N.B: when you consider fixed cost, please consider only fixed product cost.

Example

Company A producing 4 products A, B, C and D the selling price of each product is 100; 200; 120 and 80 respectively. The variable cost per unit each product is 150; 130; 70 and 90 respectively. The supplier has offered to supply the same products but at 80; 150; 100 and 120 respectively. The fixed production cost of each product is 10,000; 20,000; 8,000 and 25,000 respectively.

Required:

Should the company make or buy? Number of units: A=1,000; B=1,500; C=800 and D=2000.

Answer

Product	A	B	C	D
Selling price	100	200	120	80
Variable cost /unit	150	130	70	90
Contribution	(50)	70	50	(10)
Units	1,000	1,500	800	2,000
Variable cost/Make	150	130	70	90
Variable cost/Buy	80	150	100	120
	70	(20)	(30)	(30)
Amount saved	70,000	(30,000)	(24,000)	(60,000)
Fixed costs	10,000	20,000	8,000	25,000
Total amount saved	80,000	(10,000)	(16,000)	(35,000)

Option: management buy product A and make product B, C and D.

Example:

Company X has just received an offer from one of its customers. The offer requires the company to supply 10,000 units at a price of 500Frw units. The company is considering two options, that is to either make the product or to purchase the finished product from one reliable supplier. The supplier has offered a price of 250Frw at unit in case of buying, the operating cost is 1000,000Frw in case the company decides to make, it will require the company to invest in a new machine which has a cost of 10,000,000. The company will have to purchase raw material at 100Frw @ unit and to pay operating cost of 1,500,000Frw.

Required: should the company make or buy?

Answer

Option I: Buy

Particular	Working	Amounts (RWF)
Sales	10,000 units @ 500	5,000,000
Less purchase cost	10,000 units @ 250	(2,500,000)
Operating expenses		(1,000,000)
Profit		1,500,000
Tax @ 30%		<u>450,000</u>

Option II: Make

Particular	Working	Amounts (RWF)
Sales	10,000 units @ 500	5,000,000
Raw material	10,000 units @ 100	(1,000,000)
Operating expenses		(1,500,000)
Depreciation	25% of 10,00,000	(2,500,000)
Taxable profit		0
Tax @ 30%		<u>0</u>

Option to make; Tax is zero

• TEST YOUR UNDERSTANDING

Test One

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	2,000,000	8,524,000
Less:			
Marketing and administration expenses	(1,500,000)	(2,000,000)	(1,000,000)
Depreciation	(500,000)	(1,000,000)	(800,000)
Net profit	2,000,000	2,864,000	6,724,000

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:

- (i) Raise the additional Frw 10,000,000 capital by listing shares of the company on the Rwanda Securities Exchange.
- (ii) 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.

Test Two

GCBRL would like to expand their branch network in the country to forty in the next three years commencing in 2018. This will necessitate additional funding of Frw 3,500,000,000. The board of directors has made a decision to apply for an investment license from the Rwanda Development Board with effect from 1 January, 2018. The options that the board of directors is considering in order to raise the additional funding are as below:

- i) Sell 350,000,000 shares at Frw 10 per share to Mr. Smith, a foreign investor, who is a resident of South Africa.
- ii) Borrow USD 4,300,000 (Exchange rate 1 USD = Frw 830) from a venture capital company based in South Africa. The venture capital company has no relationship to the bank and avails loans on a non-discriminatory basis. The loan will carry an interest rate of 10% on reducing balance and will be repayable in equal annual installments in a period of 5 years, the first installment being due on 31 December, 2018.

The company’s projection of the profits before interest and tax and the allowable depreciation allowances (wear and tear) are as below:

	2018	2019	2020
	Frw “million	Frw “million	Frw “million
Profit before interest and tax	9,500	15,000	23,000
Wear and tear allowances	450	1,600	850
Investment allowance	2,300	1,200	

The company expects to make a dividend payment of Frw 2 per share during the period under consideration.

Required:

Advise GCBRL on the best available option of raising additional capital that will lead to a tax advantage on the basis of the information provided.

STUDY UNIT

5

PROFESSIONAL ETHICS IN TAXATION

PROFESSIONAL ETHICS- These are professional standards of personal and business behavior, values and guiding principles established by professional organizations to help guide members in performing their job functions according to ethical principles.

A distinguishing mark of the accountancy profession is its acceptance of the responsibility to act in the public interest.

Acting in the public interest involves having regard to the legitimate interests of clients, government, financial institutions, employers, employees, investors, the business and financial community and others who rely upon the objectivity and integrity of the accounting profession to support the propriety and orderly functioning of commerce. This reliance imposes a public interest responsibility on the profession. Professional accountants shall take into consideration the public interest and reasonable and informed public perception in deciding whether to accept or continue with an engagement or appointment, bearing in mind that the level of the public interest will be greater in larger entities and entities which are in the public eye.

Therefore, a professional accountant's responsibility is not exclusively to satisfy the needs of an individual client or employer. In acting in the public interest, a professional accountant shall observe and comply with the Code of ethics. If a professional accountant is prohibited from complying with certain parts of this Code by law or regulation, the professional accountant shall comply with all other parts of the Code of ethics.

This Code contains the fundamental principles of professional ethics for professional accountants and provides a conceptual framework that professional accountants shall apply to:

1. Identify threats to compliance with the fundamental principles;
2. Evaluate the significance of the threats identified; and
3. Apply safeguards, when necessary, to eliminate the threats or reduce them to an acceptable level. Safeguards are necessary when the professional accountant determines that the threats are not at a level at which a reasonable and informed third party would be likely to conclude, weighing all the specific facts and circumstances available to the professional accountant at that time, that compliance with the fundamental principles is not compromised.

FUNDAMENTAL PRINCIPLES

A professional accountant shall comply with the following fundamental principles:

1. **Professional competence and due care** - To maintain professional knowledge and skill at the level required to ensure that a client or employer receives competent professional services based on current developments in practice, legislation and techniques and act diligently and in accordance with applicable technical and professional standards.
2. **Confidentiality** - To respect the confidentiality of information acquired as a result of professional and business relationships and, therefore, not disclose any such information to third parties without proper and specific authority, unless there is a legal or professional right or duty to disclose, nor use the information for the personal advantage of the professional accountant or third parties.
3. **Professional behavior** - To comply with relevant laws and regulations and avoid any action that discredits the profession.
4. **Integrity** - To be straightforward and honest in all professional and business relationships.
5. **Objectivity** - To not allow bias, conflict of interest or undue influence of others to override professional or business judgments.

CONCEPTUAL FRAMEWORK APPROACH

The circumstances in which professional accountants operate may create specific threats to compliance with the fundamental principles. In addition, the nature of engagements and work assignments may differ

and, consequently, different threats may be created, requiring the application of different safeguards. Therefore, this Code establishes a conceptual framework that requires a professional accountant to identify, evaluate, and address threats to compliance with the fundamental principles. The conceptual framework approach assists professional accountants in complying with the ethical requirements of this Code and meeting their responsibility to act in the public interest.

When a professional accountant identifies threats to compliance with the fundamental principles and, based on an evaluation of those threats, determines that they are not at an acceptable level, the professional accountant shall determine whether appropriate safeguards are available and can be applied to eliminate the threats or reduce them to an acceptable level.

A professional accountant shall take qualitative as well as quantitative factors into account when evaluating the significance of a threat. When applying the conceptual framework, a professional accountant may encounter situations in which threats cannot be eliminated or reduced to an acceptable level, either because the threat is too significant or because appropriate safeguards are not available or cannot be applied. In such situations, the professional accountant shall decline or discontinue the specific professional service involved or, when necessary, resign from the engagement (in the case of a professional accountant in public practice) or the employing organization.

Threats may be created by a broad range of relationships and circumstances. When a relationship or circumstance creates a threat, such a threat could compromise, or could be perceived to compromise, a professional accountant's compliance with the fundamental principles.

Threats fall into one or more of the following categories:

1. SELF-INTEREST THREAT

The threat that a financial or other interest will inappropriately influence the professional accountant's judgment or behavior e.g.

- a. Holding a senior position within a client's organization.
- b. Holding a financial interest in, or receiving a loan or guarantee from the client.
- c. Participating in incentive compensation arrangements offered by the client's organization.
- d. Firm having undue dependence on total fees from a client.
- e. A member of the professional accountant team entering into employment negotiations with the client.
- f. Commercial pressure from outside the employing organization.
- g. A firm being concerned about the possibility of losing a significant client.
- h. A professional accountant discovering a significant error when evaluating the results of a previous professional service performed by a member of the professional accountant's firm.

2. SELF-REVIEW THREAT

The threat that a professional accountant will not appropriately evaluate the results of a previous judgment made or service performed by the professional accountant, or by another individual within the professional accountant's firm or employing organisation, on which the accountant will rely when forming a judgment as part of providing a current service;

3. ADVOCACY THREAT

The threat that a professional accountant will promote a client's or employer's position to the point that the professional accountant's objectivity is compromised;

4. FAMILIARITY THREAT

The threat that due to a long or close relationship with a client or employer, a professional accountant will be too sympathetic to their interests or too accepting of their work e.g.

- a. Being responsible for the employing organization's financial reporting
- b. Long association with business contacts influencing business decisions
- c. Accepting a gift or preferential treatment, unless otherwise trivial and inconsequential.
- d. A member of the engagement team having a close or immediate family member who is an employee of the client who is in a position to exert significant influence over the subject matter of the engagement.

5. INTIMIDATION THREAT

- a. The threat that a professional accountant will be deterred from acting objectively because of actual or perceived pressures, including attempts to exercise undue influence over the professional accountant.
- b. Threat of dismissal or replacement of professional accountant
- c. Dominant personality attempting to influence the decision making process. A professional accountant being informed by a partner of the firm that a planned promotion will not occur unless the accountant agrees with a client's inappropriate tax treatment.
- d. A firm being pressured to reduce inappropriately the extent of work performed in order to reduce fees.

6. THREATS TO PROFESSIONAL COMPETENCE AND DUE CARE.

- a. Insufficient time for properly performing or completing the relevant duties.
- b. Incomplete, restricted or inadequate information for performing duties properly.
- c. Insufficient experience, training and/or education
- d. Inadequate resources for the proper performance of the duties.

THREATS AND SAFEGUARDS

Safeguards are actions or other measures that may eliminate threats or reduce them to an acceptable level. They fall into two broad categories:

1. Safeguards created by the profession, legislation or regulation
2. Safeguards in the work environment.

SAFEGUARDS CREATED BY THE PROFESSION, LEGISLATION OR REGULATION INCLUDE.

1. Educational, training and experience requirements for entry into the profession.
2. Continuing professional development requirements.
3. Corporate governance regulations.
4. Professional standards.
5. Professional or regulatory monitoring and disciplinary procedures.
6. External review by a legally empowered third party of the reports, returns, communications or information produced by a professional accountant.

Certain safeguards may increase the likelihood of identifying or deterring unethical behaviour. Such safeguards, which may be created by the accounting profession, legislation, regulation, or an employing organisation, include:

1. Effective, well-publicized complaint systems operated by the employing organization, the profession or a regulator, which enable colleagues, employers and members of the public to draw attention to unprofessional or unethical behavior.
2. An explicitly stated duty to report breaches of ethical requirements.

SAFEGUARDS IN THE WORK ENVIRONMENT

1. The clients organization's system of corporate oversight
2. The client's organization's ethics and conduct programs.
3. Recruitment procedures in the employing organization emphasizing the importance of employing high caliber competent staff.
4. Strong internal controls
5. Policies and procedures to empower and encourage employees to communicate to senior levels within the clients organisation any ethical issues
6. Consultation with another appropriate professional accountant.
7. Timely communication of the employing client's organisation policies and procedures
8. Leadership that stress the importance of ethical behaviour.

ETHICAL CONFLICT RESOLUTION

A professional accountant may be required to resolve a conflict in complying with the fundamental principles.

When initiating either a formal or informal conflict resolution process, the following factors, either individually or together with other factors, may be relevant to the resolution process:

1. Relevant facts;
2. Relevant parties;

3. Ethical issues involved;
4. Fundamental principles related to the matter in question;
5. Established internal procedures; and
6. Alternative courses of action.

Having considered the relevant factors, a professional accountant shall determine the appropriate course of action, weighing the consequences of each possible course of action. If the matter remains unresolved, the professional accountant may wish to consult with other appropriate persons within the firm or employing organisation for help in obtaining resolution.

Where a matter involves a conflict with, or within, an organisation, a professional accountant shall determine whether to consult with those charged with governance of the organisation, such as the board of directors or the audit committee.

If a significant conflict cannot be resolved, a professional accountant may consider obtaining professional advice from ICPAR or from legal advisors. The professional accountant generally can obtain guidance on ethical issues without breaching the fundamental principle of confidentiality if the matter is discussed with ICPAR ethics helpline or with a legal advisor under the protection of legal privilege. Instances in which the professional accountant may consider obtaining legal advice vary. For example, a professional accountant may have encountered a fraud, the reporting of which could breach the professional accountant's responsibility to respect confidentiality. The professional accountant may consider obtaining legal advice in that instance to determine whether there is a requirement to report.

If, after exhausting all relevant possibilities, the ethical conflict remains unresolved, a professional accountant shall, where possible, refuse to remain associated with the matter creating the conflict. The professional accountant shall determine whether, in the circumstances, it is appropriate to withdraw from the engagement team or specific assignment, or to resign altogether from the engagement, the firm or the employing organisation.

INTEGRITY

The principle of integrity imposes an obligation on all professional accountants to be straightforward and honest in all professional and business relationships. Integrity also implies fair dealing and truthfulness.

A professional accountant shall not knowingly be associated with reports, returns, communications or other information where the professional accountant believes that the information:

1. Contains a materially false or misleading statement;
2. Contains statements or information furnished recklessly; or
3. Omits or obscures information required to be included where such omission or obscurity would be misleading.

When a professional accountant becomes aware that the accountant has been associated with such information, the accountant shall take steps to be disassociated from that information.

OBJECTIVITY

The principle of objectivity imposes an obligation on all professional accountants not to compromise their professional or business judgment because of bias, conflict of interest or the undue influence of others. Objectivity is the state of mind which has regard to all considerations relevant to the task in hand but no other.

PROFESSIONAL COMPETENCE AND DUE CARE

The principle of professional competence and due care imposes the following obligations on all professional accountants:

1. To maintain professional knowledge and skill at the level required to ensure that clients or employers receive competent professional service.
2. To act diligently in accordance with applicable technical and professional standards when providing professional services.

Competent professional service requires the exercise of sound judgment in applying professional knowledge and skill in the performance of such service. Professional competence may be divided into two separate phases:

1. Attainment of professional competence; and
2. Maintenance of professional competence.

The maintenance of professional competence requires a continuing awareness and an understanding of relevant technical, professional and business developments. Continuing professional development enables a professional accountant to develop and maintain the capabilities to perform competently within the professional environment.

Diligence encompasses the responsibility to act in accordance with the requirements of an assignment, carefully, thoroughly and on a timely basis.

A professional accountant shall take reasonable steps to ensure that those working under the professional accountant's authority in a professional capacity have appropriate training and supervision.

CONFIDENTIALITY

The principle of confidentiality is not only to keep information confidential, but also to take all reasonable steps to preserve confidentiality.

The principle of confidentiality imposes an obligation on all professional accountants to refrain from:

1. Disclosing outside the firm or employing organisation confidential information acquired as a result of professional and business relationships without proper and specific authority or unless there is a legal or professional right or duty to disclose; and
2. Using confidential information acquired as a result of professional and business relationships to their personal advantage or the advantage of third parties.

Professional accountants in public practice must not disclose confidential information to a client even though the information is relevant to an engagement for, or would be beneficial to, that client.

A professional accountant shall maintain confidentiality, including in a social environment, being alert to the possibility of inadvertent disclosure, particularly to a close business associate or a close or immediate family member.

A professional accountant shall maintain confidentiality of information disclosed by a prospective client or employer.

This requirement extends not only to clients, past and present, but also to third parties from or about whom information has been received in confidence.

A professional accountant shall maintain confidentiality of information within the firm or employing

organisation.

A professional accountant shall take reasonable steps to ensure that staff under the professional accountant's control and persons from whom advice and assistance is obtained respect the professional accountant's duty of confidentiality.

Member firms shall ensure that all who work on their behalf are trained in, and understand:

1. The importance of confidentiality;
2. The importance of identifying any conflicts of interest and confidentiality issues between clients, or between themselves or the firm and a client, in relation to a current or prospective engagement
3. The procedures the firm has in place for the recognition and consideration of possible conflicts of interest and confidentiality issues.

The professional accountant shall not, however, use or disclose any confidential information either acquired or received as a result of a professional or business relationship.

DISCLOSURE OF CONFIDENTIAL INFORMATION

The following are circumstances where professional accountants are or may be required to disclose confidential information or when such disclosure may be appropriate:

1. Disclosure is permitted by law and is authorized by the client or the employer;
2. Disclosure is required by law, for example:
 - a. Production of documents or other provision of evidence in the course of legal proceedings;
or
 - b. Disclosure to the appropriate public authorities of infringements of the law that come to light.
3. There is a professional duty or right to disclose, when not prohibited by law:
 - a. To comply with the quality review of ICPAR or professional regulator or professional body;
 - b. To respond to an inquiry or investigation by ICPAR or regulatory body;
 - c. To protect the professional interests of a professional accountant in legal proceedings; or
 - d. To comply with technical standards and ethics requirements.

STUDY UNIT

6

TAX AUDIT AND INVESTIGATION

6.1 Tax Audit

6.2 Tax Investigation

6.3 Interest, fines and Penalties

6.1 TAX AUDIT

It is the examination of the taxpayer's record in order to assess the compliance with tax Laws

6.1.2 Conditions in Auditing and Investigation

In case of an audit, the Tax Administration is required to inform in writing, the taxpayer the following:

- i. That he or she will be audited at least seven (7) days before the audit is conducted;
- ii. The place where the audit is to be conducted and the possible duration of the audit;
- iii. Any specific document the tax administration wants to see or any specific information it requires.

In case of audit, the taxpayer is required to work effectively with the tax audit team and to do the following:

- i. To provide the team with suitable premises;
- ii. To give the team books and records

6.1.3 Unique audit principle

The Tax administration audits a taxpayer only once on a type of tax and for a tax period. However, the Tax administration may conduct a new audit only once in case of one of the following circumstances:

- 1 ° Complicity of the taxpayer and the tax auditor to evade taxes or commit any other act intending to non-payment of required tax;
- 2 ° if the first audit was based on forged documents;
- 3 ° if the first audit was issue-oriented and the Tax administration wants to conduct a comprehensive audit,
- 4 ° when the Commissioner General cancels the first audit based on appeal

6.1.4 Use of available information and evidence

6.1.5 The Tax administration uses all available information and evidences, when:

- 1 ° no tax declaration was carried out;
- 2 ° the tax declaration was not certified by a competent person;
- 3 ° the tax declaration was not accompanied by all necessary documents;
- 4 ° the taxpayer was unwilling to cooperate with a tax audit officer or did not provide the explanations requested;
- 5 ° books and records were not filled as prescribed by law;
- 6 ° there are serious indications of tax fraud beyond reasonable doubt; the taxpayer did not provide sufficient information on controlled transactions audit procedure

6.1.6 Tax audit is conducted in one of the following procedures:

- 1° contradictory procedure;
- 2° issue-oriented audit;
- 3° desk audit;
- 4° audit without notice.

6.1.6.1 Contradictory procedure

According to **Article 36** Where the Tax Administration discovers a miscalculation, an omission, an understatement, a misrepresentation of a tax or any other error in the tax declaration or assessment, the Tax Administration sends a draft note for rectification to the taxpayer containing all the elements taken into

6.1.6.2 Issue-oriented audit procedure

The Tax administration may proceed to an issue oriented audit when a comprehensive audit is not necessary.

Disregarding the audit notice period referred to in Article 28 of this Law, in case of an issue-oriented audit, the Tax administration must inform the taxpayer in writing, at least three (3) working days before the audit is conducted

6.1.6.3 Correction of audit procedural errors

In case of error related to tax audit procedure, the Tax Administration is allowed to correct the error only once, as follows:

- 1 ° resumption of the entire audit if the error has a general impact
- 2 ° Correction of the error at the corresponding step if the error only affects one step of the audit.

6.1.7 Time limit of the power to audit

As the **Article 45** the power to audit 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.

6.1.8 Desk Audit

Desk audit is conducted by an auditor in his/her office on any of the following grounds:

- i. Turnover of Value Added Tax is not corresponding to the turnover of income tax without justification;
- ii. Tax declarations are not corresponding to paid taxes;
- iii. The taxpayer deducted from tax base non-deductible expenses;
- iv. One or more invoices were not declared;
- v. Any other situations where the tax administration has sufficient documents that can be used to assess taxes

6.1.9 Other sources of information

In case of audit by the Tax administration, the following must provide all requested information in relation with the taxpayer:

1 ° all public or private institutions;

2 ° other persons in case the Tax administration needs to know the structure and use of taxpayer's property.

The institution or person requested to provide such information must do so within fifteen (15) days, from receipt of the request.

The provisions of Paragraph One of this Article also apply to a person or an institution bound by secrecy

6.1.10 Final note for rectification

Tax Administration issues to the taxpayer the final note for rectification in the following cases:

1 ° after a period of thirty (30) working days, in case of contradictory procedure, without any reaction of the taxpayer to the draft note for rectification;

2 ° after a period of five (5) working days, in case of issue-oriented audit, without any reaction of the taxpayer to the draft note for rectification;

3 ° after the Tax Administration has considered the explanations of the taxpayer on the draft note for rectification.

The final note for rectification provides reasons of rejection of explanations provided by the taxpayer and how the new tax was calculated

6.1.11 Audit without notice

Where there are serious indications of tax evasion, the Tax Administration 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 provisions of Articles 28, 36 and 37 of this Law.

6.1.12 Inadmissibility of documents

Article 43 provides that a taxpayer is not allowed to provide at any stage of appeal, any additional document that was not produced during the audit, unless he or she proves that the document was not produced due to a valid reason.

6.1.13 Correction of audit procedural errors

According to Article 44 In case of error related to tax audit procedure, the Tax Administration is allowed to correct the error only once, as follows:

1 ° resumption of the entire audit if the error has a general impact;

2 ° correction of the error at the corresponding step if the error only affects one step of the audit.

6.1.14 Time limit of the power to audit

The power to audit 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.

6.1.15 New audit based on appeal

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 this Law Amicable settlement and filing a case to the court Article 52: Right to request for amicable settlement

6.2 TAX INVESTIGATION

Is the gathering of admissible evidence to recover tax undercharged where there is suspicion of *tax avoidance* and evasion to enforce criminal aspect of tax Laws

6.2.1 SOME OF CRIMINAL ACTIVITIES

- Deliberately underreporting or omitting income,
- Overstating the amount of deductions
- Keeping two sets of books
- Making false entries in books and records
- Claiming false deductions
- Hiding or transferring assets or income

6.2.2 Article 46: Access to premises for search and seizure

The authorized officer may, without notice, visit or enter business premises of the taxpayer or any other person in search of tax information about the taxpayer. If he or she considers it necessary, the authorized officer may search and seize objects or documents related to the business activities of the taxpayer.

The authorized officer, having a search warrant delivered by the Prosecutor, may also enter the residential premises, search and seize objects or documents related to the business activities of the taxpayer, between six 6:00 am and 6:00 pm.

Before the search, the concerned person is given a copy of the search warrant.

An authorized officer who has a search warrant referred to in Paragraph 2 of this

Article may seek the assistance of the Rwanda National Police or the representatives of decentralized administrative entities of the place of search.

6.2.3 Stages of Tax Investigation

The stages of tax investigation are:

- Surveillance or pre-investigation activities
- Evidential audit or investigation
- Case preparation
- Arraignment
- Termination of investigation.

6.2.4 INCOME RECONSTRUCTION

The Revenue authorities have an array of methods available to reconstruct income if it suspects a taxpayer may have filed a fraudulent return or has not filed one. Courts will allow the use of income reconstruction if

the taxpayer has no records or if the records do not clearly reflect income. If the Revenue authority meets its level of responsibility in presenting the reconstruction, the derived income and tax liability are presumed correct and the taxpayer has the burden of overcoming that presumption.

To rebut (to prove that it is false) the Revenue authority position, the taxpayer need not prove the correct tax due, just that the reconstruction method used was arbitrary, capricious, or erroneous. The taxpayer can do this by showing nontaxable sources for the reconstructed income, such as gifts, inheritances, sale of assets at a loss, or loan proceeds. Depending on the strength of the evidence, the Revenue authority may file civil or criminal charges against the taxpayer.

In addition, the Revenue provides several penalties for underpayment of tax. Forensic accounting is a practice whereby accountants use their business skills to investigate fraud, embezzlement of funds, theft of assets, or perhaps find evidence of hidden assets in divorce cases. One of the most useful tools available for the application of this skill is income reconstruction

6.2.4 AUTHORITY TO RECONSTRUCT INCOME

The power to reconstruct income states that, if the taxpayer does not use a method of accounting that clearly reflects income, the method for computation of taxable income can be determined by Revenue authority. Treasury regulations explain that every taxpayer must maintain accounting records to support the filing of a correct return.

The regulations require accounting records to perform three essential functions:

- Account for inventory,
- Properly classify between expense and capital accounts, and
- With respect to depreciable assets, record additions to those accounts for improvements

The obligation to maintain records is reiterated in Revenue authority, which states that anyone liable for tax must keep records and file returns in accordance with rules and regulations the secretary may prescribe. The only reprieve for the taxpayer has come through the Cohan rule. Deduction of expenses is, however, only half of the equation. Taxpayers are also responsible for the proper inclusion of income items. Calculation of gross income is often accomplished through the use of income reconstruction.

The Revenue authority is not permitted to use income reconstruction in every circumstance. Properly kept records that show actual income cannot be disregarded by the Revenue authority. Several tax court cases have established that mere suspicion that records do not accurately reflect income is not a sufficient reason to use income reconstruction, even if the records are not completely accurate. However, the burden of proof is on the taxpayer to show that the records clearly reflect income. The Revenue authority does not require that a preparer verify information against the taxpayer's actual records. Treasury regulations state that the preparer may "rely in good faith" on information provided by the taxpayer. "The preparer is not required to audit, examine, or review" documents or records, but the preparer must make "reasonable inquiries" if the information seems to be incorrect or incomplete. Income reconstruction can also be used as a verification tool. If the taxpayer uses an unorthodox accounting system, income reconstruction can provide confirmation of taxable income. If records are lost or stolen, income reconstruction may be the fastest method of calculating income.

6.2.5 METHODS OF INCOME RECONSTRUCTION

Income reconstruction methods are divided into two groups: direct and indirect.

Direct methods are used to show a specific taxable transaction was either omitted or reported incorrectly. Indirect methods provide circumstantial evidence about cash flow or accumulation of assets rather than a

specific transaction

6.2.5.1 DIRECT METHODS

When the taxpayer has only a few business transactions or sells to only a few major customers, a direct method may be the most useful. Courthouse records can provide evidence of real estate transactions. Billing invoices from major customers may give an indication that all sales have not been reported. State motor vehicle records can reveal sales or transfers.

Insurance records may show jewelry or art objects sold and removed from policy riders. Instances such as these would be called “specific omissions.” If the Revenue authority establishes that income was omitted from the return, it is up to the taxpayer to prove the income is not taxable.

- A simple bank deposit analysis may reveal deposits with no reported source.
- The deposit analysis may lead to unreported hobby income or sales of securities.
- The taxpayer should be prepared to explain the source of the deposits.
- Loans, gifts, garage sales, inheritances, transfers from other accounts, employee business expense reimbursements, insurance proceeds, nontaxable damages, and savings bonds cashed for education can all explain an unidentified deposit.

6.2.5.2 INDIRECT METHODS

The principal indirect methods are:

1. Net worth method,
2. Sources and applications of funds,
3. Sales markup,
4. Bank deposits,
5. Unit volume computations.

The Revenue authority may use one or more of the above methods to reconstruct income or a different method for each year under examination. The taxpayer has no right to choose the method used.

Net Worth Method

This method is a balance sheet approach to estimating income. The simple premise is that net worth at the beginning of the period plus income equals net worth at the end of the period. The Revenue authority may also add an estimate of nondeductible living expenses, since they are normally paid from taxable income. If the reported income cannot explain the increase in net worth plus living expenses, there must be an undisclosed source of income.

Sources and Applications of Funds

This method is also called the cash expenditures method or the excess expenditures method. Sources and applications are generally useful when the taxpayer spends most of his or her income rather than purchases assets. Deductible expenses that are far out of proportion to reported income are an indication of unreported funds.

The method is easier to use if there is little or no change in net worth and there are only one or two years in question. The Revenue authority still must perform a net worth analysis to establish the taxpayer is not spending out of savings or liquidating investments. As in a net worth case, the Revenue authority must

investigate all reasonable leads and establish a likely source for the unreported income

Percentage Markup

Also called the sales or unit markup method, this method is used only when a business is under examination. The first key to using the markup method is to establish with certainty either the cost of goods sold or some other key expenditure common to the industry. Then use the simple formula from financial accounting: Net sales less cost of goods sold equals gross margin. The second key is to establish an industry-wide percentage for gross margin or the key expenditure.

If invoices from suppliers are available, e.g., \$180,000 and industry gross margin is 70%, the cost of goods sold is 30%. Therefore, sales should be \$600,000 ($\$180,000/30\%$). If the reported sales are significantly less than \$600,000, closer examination is warranted. The industry percentage must be carefully chosen to match the taxpayer's business for type of merchandise, size of business, rural vs. urban location, seasonal variations, and merchandising policies (e.g., high volume, low markup). If the taxpayer's business sells a variety of goods, the product mix must be taken into account.

Bank Deposits

This method is generally used when a business is examined or the Revenue authority suspects the taxpayer operates a business without reporting income. To rely on the bank deposits method, the Revenue authority must-

- establish the taxpayer engaged in an income-producing activity,
- establish the taxpayer made regular periodic deposits into an account, and
- make an adequate investigation to distinguish between taxable and nontaxable deposits.

Even if the Revenue authority makes some classification errors, the court can still accept the overall use of the bank deposits method. The Revenue authority assumes the taxpayer's gross income is the total of the deposits less obvious loan proceeds, transfers, and other nontaxable income. All business expenses, other allowable deductions, and exemptions are subtracted from gross income and the result is taxable income. Checks cleared through the account are the best source of business expenses. When there are cash deposits rather than check deposits, the Revenue authority must establish the taxpayer's beginning cash position to meet its obligation of adequate investigation of nontaxable deposits.

Unit Volume Computation

Unit volume computation can be as simple as the "sheet count" to determine the number of hotel guests. At the other end of the spectrum, the Revenue authority has used the amount of flour purchased and chemical analysis of pizzas to compute the dollar sales that should have been reported by a restaurant owner/operator. The audit training guide for small restaurants tells what kind of pizzas to purchase for analysis, how to obtain a past year's retail prices, how to sample a customer's pizza preferences, and how to use all that information to estimate sales.

BURDEN OF PROOF

When the Revenue authority uses income reconstruction, it is usually attempting to show the taxpayer has intentionally omitted income either by understating income or failing to file a return.

To impose the fraud penalty, the Revenue authority must show the taxpayer knew the contents of the return when it was signed, knew that it was false, and filed the return with the fraudulent intent to evade tax.

The Revenue authority can also impose fraud penalties if the taxpayer failed to file a return

The primary difference between civil and criminal fraud is the issue of willfulness. Both have the presence of specific intent to evade a tax. Civil fraud, however, contains no willful intent. Also, there is a different burden of proof depending on whether the Revenue authority alleges civil or criminal fraud. In a civil case, the court only requires clear and convincing evidence of fraud. In a criminal case, the Revenue authority must prove each element of a crime beyond a reasonable doubt.

Acquittal from a criminal charge carries no weight in a subsequent civil trial, since the burden of proof is less. In addition, a guilty plea in a criminal trial prevents the taxpayer from contesting a charge brought in a civil trial.

Conduct that establishes willfulness includes-

- maintaining a double set of books or records,
- making false entries,
- creating false documents,
- supplying false information to a return preparer,
- destroying records,
- concealing assets or sources of income,
- keeping a safe deposit box under an assumed name,
- claiming to be exempt from taxes, or
- failing to file tax returns.

However, understatement of income does not establish willfulness, unless it is part of a consistent pattern. The court also evaluates the taxpayer's education when determining willfulness. The higher the level of education or sophistication in business dealings, the more willfulness can be attributed to the acts listed above.

When the Revenue authority uses income reconstruction to allege a deficiency and substantive evidence is introduced that shows the taxpayer received unreported income, the determination is presumed to be correct. The taxpayer must then prove the determination is incorrect and provide a nontaxable source for the unreported income

Income Reconstruction Defenses

To prove an error exists in the income reconstruction and contest the deficiency or the amount of a refund, taxpayers have used several tactics.

It is important for the taxpayer to focus on errors made by the Revenue authority in applying the income reconstruction method, not the theory behind the method

All of the court-accepted methods are based on sound accounting principles. While lost or stolen records do not lessen the burden of showing the reconstruction was arbitrary or erroneous, the taxpayer can still be successful. When there are no records because of an innocent loss, the court will accept credible testimony. Testimony as to how the records were lost is important. If testimony can demonstrate the records would have shown the Revenue authority's reconstruction to be arbitrary, capricious, or erroneous, the presumption of correctness may be overcome.

Net Worth Method

A common defense against the net worth method is that the opening net worth is too low. Taxpayers often claim the existence of a cash hoard that was not taken into account by the Revenue authority.

To be successful, the taxpayer must demonstrate a credible source for the cash hoard. Circumstantial

evidence such as regularly conducting business in cash, need for cash on a regular basis, documented distrust of banks, and a large cash expenditure before the examination period, can all lend credence to a cash hoard defense.

In addition, the taxpayer may be able to show there are other assets not included in the beginning net worth, e.g., inventory on consignment, receivables, or assets owned by the taxpayer but held by a third party. The difference between beginning and ending net worth represents income. This income is reduced by the amount of any reported taxable and nontaxable income received by the taxpayer.

The alleged unreported income can be reduced by the amount of any gifts, inheritances, tax exempt interest, capital loss carryovers, and loans not taken into account by the Revenue authority. The taxpayer may also assert the Revenue authority has overestimated personal living expenses or other nondeductible expenses, thereby reducing the amount of income to be explained.

Sources and Applications of Funds

The Revenue authority must establish what funds were available to the taxpayer at the beginning of the year, funds acquired during the year, and then show the expenditures exceed the sum of those funds. As in the net worth method, the Revenue authority must investigate all reasonable leads provided by the taxpayer as to nontaxable sources of funds and establish a likely source for the unreported income. Again, the taxpayer may attempt to prove the beginning funds balance was understated because of a cash hoard or the existence of assets later sold for cash but not included in the analysis by the Revenue authority.

Percentage Markup

This method has several weaknesses because the basis for comparison is an industry average. The taxpayer may claim Revenue authority calculations do not take into account actual breakage, shop lifting, or employee theft. Also, asset size often explains differences in financial ratios.

Location, the age of assets, new competition entering the market, experience of the operator, liberal discount policy, and product mix, can all account for a taxpayer failing to achieve industry profit margins.

Bank Deposits

As with the net worth method, the Revenue authority must determine the taxpayer's beginning position and investigate leads offered by the taxpayer to explain nontaxable sources of cash. The best defense against this method is an alternative nontaxable source of the deposits

Unit Volume Computation

To contest this method, the taxpayer may show that volume assumptions used are not true for the taxpayer's business. The taxpayer may dispute the number of pizzas per bag of flour or drinks per quart of liquor as arbitrary and not realistic given the conditions of the taxpayer's business.

The taxpayer may be able to document two-for-one marketing plans or losses due to poor employee training and high turnover to dispute the calculation of units sold.

Sale of inventory in bulk for catering or to other businesses or abnormal employee theft or breakage can explain lower than average unit volume sales.

Determination of Income through Back-duty cases

The taxpayer can declare income acceptable to the department supported by accounts and other relevant documentation. A capital statement may be prepared as sufficient estimation of growth in assets and

therefore estimate income for such taxpayer if there are no reliable records/accounts. A capital statement consists of details of assets and liabilities as at a given date or period. This would show changes in total worth of a taxpayer between two or more periods. The capital statement also considers capital losses or gains, living expenses, income tax paid etc

Steps

Add all assets of taxpayer both tangible and intangible for a given period.

Deduct all liabilities both personal and business used to finance the assets. Net result will be Net Assets for the period.

Calculate the growth or loss in Net assets for each time period by taking the Net Assets of the period and comparing it with the Net Assets of the previous period. This represents additional assets that the taxpayer acquired or disposed in the time period.

Deduct any non-taxable income that was used to finance the above growth in Net assets – e.g. income or assets from a legacy or inheritances, capital gains, gifts, money from friends and relatives. If looking for only the undeclared business profits taxable, then deduct any non-trading business income from growth in Net Assets. The net figure would represent Net Business savings.

Add to the balance (4) living expenses such as water & electricity, income tax paid, interest on loans, premium on various types of insurance, rents and rates as supported by bills or invoices. Add also personal expenses such as food, services, clothing, toiletries, medical expenses, house servant, holidays, amusements, private motor vehicle running and maintenance costs, donations and any cash stolen from house or shop etc.

If capital assets are sold at a loss, add the loss. If sold at a profit, deduct the profit. Deduct any income declared during the year – balance is undeclared income.

The increase in capital is adjusted for the following items

Deduct

Legacies, gifts not taxable, income already taxed at source and not subject to further taxation, relief and allowances, windfall gains, inherited wealth/property, life policies matured/surrendered.

Add

Taxes paid, gifts or donations made, non-allowable losses e.g. loss on sale of investments/assets, personal expenditures, unexplained payments.

Example one

Charles Muhire has been operating a large scale sole proprietorship business the year 2008.

He has however not been maintaining a complete set of books of account for the business.

The revenue authority has issued Charles Muhire with estimated assessments for years 2016 and 2017 showing taxable income of Frw.250, 000,000 and Frw.31, 000,000 respectively

Charles Muhire has approached you for advice on the estimated assessments and whether he should pay the tax thereon. He has provided you with the following information on his financial position for the last three years

Year ended

PARTICLUARS	31 December 2015	31 December 2016	31 December 2017
	Frw.000	Frw.000	Frw.000
Leased property	48,200	59,300	38,250
Plant and machinery	32,000	33,900	36,420
Motor vehicles:			
-Commercial	420,000	450,350	516,000
-Private	150,000	132,000	112,500
Inventory in trade	10,580	7,340	5,620
Trade receivables	4,545	3,820	2,670
Residential house	108,000	100,300	92,800
Furniture	10,780	10,472	12,628
Trade payables	5,200	5,480	6,228
Bank loan	210,800	210,520	210,240
Loan from relative	1,200	960	840
Bank account	(18,480)	110,880	55,440
Mortgage loan	4,600	4,280	3,800

Additional information:

1. During the year ended 31 December 2017, furniture was disposed at a gain of Frw.800,000
2. Personal expenses were Frw.46,820,000 and Frw.68,980,000 for years 2016 and 2017 respectively.
3. Interest on the mortgage was at a rate of 15% per annum on reducing balance basis. Maximum mortgage interest allowed is 150,000
4. Ignore capital allowances.

Required: Using suitable computations, advise Charles Muhire on whether to pay tax on the estimated assessments.

Proposed answer:

CHARLES MUHIRE, CAPITAL STATEMENT FOR THE YEARS ENDED 31 December 2015-2017.

ASSETS	31 December 2015	31 December 2016	31 December 2017
	Frw.000	Frw.000	Frw.000
Leased property	48,200	59,300	38,250
Plant and machinery	32,000	33,900	36,420
Motor vehicles:			
-Commercial	420,000	450,350	516,000
-Private	150,000	132,000	112,500
Inventory in trade	10,580	7,340	5,620
Trade receivables	4,545	3,820	2,670
Residential house	108,000	100,300	92,800
Furniture	10,780	10,472	12,628
Bank account	-	110,880	55,440
TOTAL ASSETS	784,105	908,362	872,328
Trade payables	5,200	5,480	6,228
Bank loan	210,800	210,520	210,240
Loan from relative	1,200	960	840
Bank overdraft	18,480	-	
Mortgage loan	4,600	4,280	3,800
TOTAL LIABILITIES	240,280	221,240	221,108
NET ASSETS	543,825	687,122	651,220
Increase/decrease in net assets		143,297	(35,902)
Personal expenses		46,820	68,980
Mortgage interest (maximum 150,000)		(150)	(150)
Gain on sale of furniture			(800)
TAXABLE INCOME		189,967	32,128

Advice:

Based on the computations above [189967+32,128=222,095,000], Charles Muhire should not pay tax based on the estimated assessments [250,000,000+31,000,000=281,000,000] because it is higher [281,000,000>222,095,000].

Question two / chapter four income reconstruction

Amos, a businessman, is facing a tax investigation by the revenue authority which suspects that he has been under –declaring income for the four years from years 2011 to 2014.

You are the head of a team from the revenue authority conducting an investigation on Amos. He has submitted to your team records of his private and business assets and liabilities from 1 January 2011 to 31

December 2014 as shown below:

PARTICLUARS	1 January 2011	31 December 2011	31 December 2012	31 December 2013	31 December 2014
	Frw.000	Frw.000	Frw.000	Frw.000	Frw.000
Factory premises	48,000	54,000	56,000	52,000	54,000
Plant and machinery	24,000	25,000	38,000	34,000	36,000
Motor vehicles (Commercial)	12,000	14,000	14,000	15,000	20,000
Inventory	4,600	5,200	9,000	10,000	8,000
Trade receivables	3,950	4,540	3,640	3,530	3,980
Private residence	8,240	14,600	14,600	14,600	14,600
Trade payables	7,280	8,640	9,420	8,360	7,890
Bank loan	10,900	10,000	9,870	7,640	9,840
Loan from a friend	800	700	600	870	640
Mortgage loan	3,780	3,780	3,780	3,780	3,780
Cash balance	3,400	5,400	3,600	3,760	4,670

Additional information:

1. The cash balance on 31 December 2012 included Frw.600, 000 inherited from a relative on 30 August 2012.
2. His living expenses for each of the four years were as follows:

Year ended 31 December

PARTICLUARS	2011	2012	2013	2014
Living expenses (Frw.)	85,000	140,000	90,000	165,000

3. Ignore capital allowances.

Required:

Taxable income of Amos for each of the four years ended 31 December 2011, 2012, 2013 and 2014.

Proposed answer:

AMOS, CAPITAL STATEMENT FOR THE YEARS ENDED 31 December 2011-2017.

ASSETS	1 January 2011	31 December 2011	31 December 2012	31 December 2013	31 December 2014
	Frw.000	Frw.000	Frw.000	Frw.000	Frw.000
Factory premises	48,000	54,000	56,000	52,000	54,000
Plant and machinery	24,000	25,000	38,000	34,000	36,000
Motor vehicles					
(Commercial)	12,000	14,000	14,000	15,000	20,000
Inventory	4,600	5,200	9,000	10,000	8,000
Trade receivables	3,950	4,540	3,640	3,530	3,980
Private residence	8,240	14,600	14,600	14,600	14,600
Cash Balance	3,400	5,400	3,600	3,760	4,670
TOTAL ASSETS	104,190	122,740	138,840	132,890	141,250
Trade payables	7,280	8,640	9,420	8,360	7,890
Bank loan	10,900	10,000	9,870	7,640	9,840
Loan from a friend	800	700	600	870	640
Mortgage loan	3,780	3,780	3,780	3,780	3,780
TOTAL LIABILITIES	22,760	23,120	23,670	20,650	22,150
NET ASSETS	81,430	99,620	115,170	112,240	119,100
Increase/decrease in net assets		18,190	15,550	(2,930)	6,860
Living expenses		85	140	90	165
Inheritance			(600)		
Mortgage interest		(150)	(150)	(150)	(150)
TAXABLE INCOME		18,125	14940	(2,990)	6,875

Question three (REINFORCING QUESTION) / chapter four income reconstruction

Mr. David is a businessman with interests in the manufacturing sector. He is facing a back duty investigation by the revenue authority which suspects that he has been under-declaring income four years from 2013 to year 2016.

You are the head of the team from the revenue authority conducting this investigation. David has submitted to you records of his private and business assets and liabilities from 1 January 2013 to 31 December 2016 as shown below:

PARTICLUARS	1 January 2013	31 December 2013	31 December 2014	31 December 2015	31 December 2016
	Frw.000	Frw.000	Frw.000	Frw.000	Frw.000
Factory buildings	36,000	48,000	48,000	52,000	54,000
Plant and machinery	24,000	28,000	36,000	36,000	38,000
Commercial vehicles	9,000	12,000	12,000	15,000	18,000
Stock in trade	3,600	4,200	8,000	9,000	7,000
Trade debtors	2,960	3,540	2,640	2,530	2,980
Private residence	9,240	13,600	13,600	13,600	13,600
Trade creditors	7,280	8,640	9,420	8,360	7,890
Bank loan	10,900	10,000	9,870	7,640	9,840
Loan from uncle	800	700	600	870	640
Mortgage loan	3,780	3,780	3,780	3,780	3,780
Bank balance	3,400	5,400	3,600	3,760	4,670

Additional information:

1. There were no disposals of fixed assets during the period under investigation.
2. The bank balance on 31 December 2014 included Frw.400, 000 inherited from a relative on October 2014.
3. His living expenses for each of the four years were as follows:

Year ended 31 December

PARTICLUARS	2013	2014	2015	2016
Living expenses (Frw.)	70,000	120,000	90,000	150,000

4. Interest on mortgage is at a rate of 15% per annum.

Required:

The taxable income of Mr. David for each of the four years ended 31 December 2013,2014,2015,2016.

6.3 INTEREST, FINES AND PENALTIES

6.3.1 Interest paid by Tax administration

If the taxpayer is discharged from tax, interest or penalties by an administrative or judicial decision, or if no refund of excess taxes paid is done in the time prescribed by this Law, the Tax Administration must pay interest on the due refund.

6.3.2 Administrative fine for non-declaration and non-payment of tax on time

If a taxpayer has neither declared nor paid tax in the required time limits provided by law, he or she pays the tax he or she did not declare and pay and is liable to an administrative fine as follows:

- 1 ° twenty percent (20%) of due tax, when the taxpayer exceeds the time limit for declaration and payment for a period not exceeding thirty (30) days;
- 2 ° forty percent (40%) of tax the taxpayer should have declared and paid, if he or she pays within a period ranging from thirty-one (31) to sixty (60) days from the time limit for the payment;
- 3 ° sixty percent (60%) of due tax, if the taxpayer exceeds the time limit for declaration and payment by more than sixty (60) days.

6.3.3 Late payment of tax

The taxpayer who has declared due tax in the required time limits provided by law but did not pay that tax in such time limits, pays the principal tax and an administrative fine as follows:

- 1 ° ten percent (10%) of due principal tax, when the taxpayer exceeds the time limit for payment for a period not exceeding thirty (30) days from the fixed date of payment;
- 2 ° twenty percent (20%) of the principal tax due, when the taxpayer exceeds the time limit for the payment of a period ranging from thirty-one (31) to sixty (60) days from the fixed date of payment;
- 3 ° thirty percent (30%) of due principal tax, when the taxpayer exceeds the time limit for payment by more than sixty (60) days from the fixed date of payment;

The taxpayer is not subject to the administrative fine referred to in item One of Paragraph 2 of this Article if the Administrative fine for understatement of tax levied after audit or investigation

6.3.4 Understatement of tax

If an audit or investigation shows that there is the understatement of the amount on a tax declaration is at least ten percent (10%) but doesn't exceed twenty percent (20%) of the tax liability, the taxpayer must pay the nonpaid tax and also be subject to an administrative fine of ten percent (10%) of the amount of the understatement. The administrative fine referred to in

Paragraph one of this Article doubles if the understatement rate exceeds twenty percent (20%) of the principal tax liability the taxpayer ought to have paid.

6.3.5 Late payment before notice assessment

However, if a taxpayer voluntarily declares and pays the due tax after required time limits but before he or she is notified of imminent audit, is liable to an administrative fine as follows:

- 1 ° twenty percent (20%) of due tax, when the taxpayer exceeds the time limit for declaration and payment for a period not exceeding thirty (30) days;

2 ° thirty percent (30%) of tax the taxpayer should have declared and paid, if he or she pays within a period ranging from thirty-one (31) to sixty (60) days from the time limit for the payment;

3 ° forty percent (40%) of due tax, if the taxpayer exceeds the time limit for declaration and payment by more than sixty (60) days.

However, a taxpayer who rectifies his or her tax declaration and pays relevant tax before he or she is notified of imminent audit of his or her tax is not subject to the administrative fine referred to in this Article. Administrative fine for nondeclaration and non-payment of the tax levied after audit or investigation

If an audit or investigation shows that a taxpayer has neither declared nor paid tax in the required time, the taxpayer is liable to an administrative fine equivalent to sixty percent (60%) of due principal tax.

Article 81: Failure to comply with modalities and conditions for the use of electronic invoicing system
Except for taxpayers registered for the value added tax, any person who is required to issue an invoice generated by an electronic invoicing system recognized by the Tax administration who fails to do so is liable to an administrative fine of two (2) times the value of the transaction.

Any value addition tax unregistered person who carries out a taxable transaction and delivers an electronic invoice with undervalued price or quantity of goods or services is liable to an administrative fine of two (2)

Failure to provide information

A taxpayer who fails to provide information, or who provides incomplete, incorrect or misleading information, in relation to audited transactions, is subject to an administrative fine equivalent to five percent (5%) of the value of the transaction under audit. Special administrative fine related to the Value Added Tax

STUDY UNIT

7

TAXES AND FEES OF DECENTRALIZED ENTITIES

The Rwandan tax structure is categorised into two that is, the decentralised tax structure and the centralised tax structure. The centralised tax structure is the one that is collected by the central government whereas the decentralised tax structure is the one that is collected by the

Sources of Revenue and Property of Decentralized Entities

The revenue and property of decentralized entities come from the following sources:

- i. Taxes and fees paid in accordance with the decentralised tax structure;
- ii. Funds obtained from issuance of certificates and their extension by decentralized entities;
- iii. Profits from investment of decentralized entities and interests from their own shares and income-generating activities;
- iv. Administrative fines;
- v. Loans;
- vi. Government subsidies;
- vii. Donations and bequests;
- viii. Fees from partners;
- ix. Fees from the value of immovable property sold by auction;
- x. Funds obtained from rent and sale of land of decentralized entities;
- xi. All other fees and administrative fines that can be collected by decentralized entities according to any other Rwandan law.

Types of Taxes to be paid to Decentralized Entities

Taxes to be paid to decentralized entities include the following:

- i. Immovable property tax;
- ii. Trading licence tax;
- iii. Rental income tax.

IMMOVABLE PROPERTY TAX

According to Article 6 of Law 75/2018, the immovable property tax is assessed and paid by the owner, the usufructuary or any other person considered being the owner. The owner who lives abroad can have a proxy in Rwanda. Such a proxy must fulfil the tax liability that this Law requires from the owner. Misrepresentation is considered as if it is done by the owner. The tax liability on immovable property is not terminated or deferred by the disappearance of an owner of immovable property, or if the owner has disappeared without leaving behind a proxy or other person to manage the immovable property on his or her behalf.

Commencement of the Tax Liability for the Usufructuary

Article 7 of Law 75/2018 stipulates that the tax liability for the usufructuary runs from the date of commencement of the usufruct.

Co-ownership of Immovable Property

According to Article 8 of Law 75/2018, if immovable property is owned by more than one (1) co-owner, the

co-owners appoint and authorize one of them or any other person to represent them collectively as a group of taxpayers. If co-owners of immovable property did not appoint a co-owner or a proxy to represent them collectively as a group of taxpayers, the tax obligations related to the immovable property are settled in accordance with laws regulating co-owned property.

Persons Considered being Owners of Property

According to Article 9 of Law 44/2018, the following persons are considered to be owners of property:

- i. The holder of immovable property where the property title deed has not yet been transferred in his/her own name;
- ii. A person who occupies or who has used the immovable property for a period of at least two (2) years as if he/she is the owner as long as the identity of the legally recognized owner of such property is not known;
- iii. A proxy who represents an owner of property who lives abroad;
- iv. A usufructuary; an administrator of an abandoned property.

Change of Ownership of Property

Article 10 of Law 75/2018 stipulates that in case there is a transfer of ownership of an immovable property for any reason within the tax period, the acquirer of immovable property is liable for tax from the date of the transfer. If the former owner of the immovable property fails to meet his/her tax obligations, he/she is liable for payment of the fines and late payment interests in accordance with the provisions of the decentralised tax Law

Immovable Property Tax Base

According to Article 11 of Law 75 2018, the immovable property tax is levied on the market value of a building and surface of a plot of land. If the immovable property consists of a plot of land that is not built, the tax on immovable property is calculated on each square meter of the whole surface of the plot of land. Where the immovable property consists of a plot of land, a building and its improvements, the tax on immovable property for a plot of land is calculated separately in accordance with the provisions of Paragraph 2 of Article 11, while the tax on the building and its improvements is based on the market value.

Immovable Property Exempted from Immovable Property Tax

The following immovable properties are exempted from the immovable property tax as per Article 12 of Law 75/2018

- i. One building whose owner intends for occupancy for dwelling purposes and its annex buildings located in a residential plot for one family. That building remains considered as his/her dwelling even when he/she does not occupy it for various reasons;
- ii. Immovable property determined by the District Council and donated to vulnerable groups;
- iii. Immovable property belonging to the State, Province, decentralized entities as well as public institutions except if they are used for profit-making activities or for leasing;
- iv. Immovable property belonging to foreign diplomatic missions in Rwanda if their countries do not levy tax on immovable property of Rwanda's diplomatic missions;
- v. Land used for agricultural and livestock activities whose area is equal to or less than two hectares (2ha);

- vi. Land reserved for construction of houses in rural areas but where no basic infrastructure has been erected.

The exemption referred to under item 1 of Paragraph One of this Article equally applies to each individually owned portion of a condominium. All owners in condominium are commonly liable for the tax on commonly owned portions of plots of land on which a condominium is built. However, commonly owned portions of the building are totally exempted from the tax.

Period of Immovable Property Valuation

As per Article 13 of Law 75/2018, the date of valuation of immovable property is 1st January of the first taxable year. The value of immovable property is determined for a cyclical period of five (5) years. This means that every 5 years the property is revalued. It includes the market value of the building and the plot of land. For the five (5) years assessment cycle to enable the taxpayer to assess the market value of the immovable property, the following must be taken into account:

- i. In the beginning of the second assessment cycle which commences after five (5) years and in the beginning of every next assessment cycle, a general revision of market value takes place;
- ii. A global fluctuation of the market value between two (2) general revisions is not a reason for a new assessment of immovable property.

However, the value of immovable property can be reviewed before the end of the assessment cycle due to increase or decrease of its value.

Methodology of Valuation of Immovable Property

Article 14 of Law 75/2018 provides the following methods for evaluating the market value of the immovable property.

- i. If the immovable property was valued within the previous five (5) years and no major changes in the buildings and structures, leading to an increase or decrease of the immovable property value by more than twenty percent (20%), have occurred, this value is regarded as the market value. In this case, the taxpayer must provide the certificate of valuation to the tax administration for verification purposes;
- ii. If the immovable property was bought within the previous five (5) years in the free market and no major changes in the buildings and structures, leading to an increase or decrease of the immovable property value by more than twenty percent (20%) have occurred, the purchase price is regarded as the market value. In this case, the taxpayer must provide the acquisition contract for verification purposes to the tax administration;
- iii. If the taxpayer's self-assessment on value of property is believed to be under valued, the tax administration will proceed to a counter-valuation. If the value difference between the taxpayer's self-assessment and the tax administration's counter-valuation is more than twenty percent (20%), the value from counter-valuation will be regarded as the final market value. Otherwise, the taxpayer's self-assessment value applies. The taxable value should be rounded up to the next full one thousand (FRW 1,000) in Rwandan francs.

Example

John owns a property in Gikondo valued at 100,000,000 RWF during the year ended 31/12/2017, he extended his building by

- a. 10,000,000

- b. 30,000,000

In each of the above cases show the tax base of the asset

- a. Appreciation of the asset $10,000,000/100,000,000 = 10\%$ since the increase in the value of the asset is below 20%, the tax base will remain the same.
- b. Appreciation $30,000,000/100,000,000 = 30\%$ since the appreciation in the value of the asset is above 20%, the new tax base of the asset will be $100,000,000 + 30,000,000 = 130,000,000$

Tax Rate on Buildings

According to Article 16 of Law 75/2018, the tax rate on buildings is determined as follows:

- i. One per cent (1%) of the market value of a residential building;
- ii. Zero point five per cent (0.5%) of the market value of the building for commercial buildings;
- iii. Zero point one per cent (0.1%) of the market value of industrial buildings, buildings belonging to small and medium enterprises and those intended for other activities not specified in this Article.

Application of Tax Rate on Buildings

According to Article 17 of Law 75/2018, except for the tax rate of zero point one per cent (0.1%), the tax rates prescribed by Article 16 of this Law are applied progressively as follows:

1. For residential buildings a progressive rate is applied as follows:
 - a. Zero point two five percent (0.25%) from the first year after the commencement of this Law;
 - b. Zero point five percent (0.50%) from the second year after the commencement of this Law;
 - c. Zero point seven five percent (0.75%) from the third year after the commencement of this Law
 - d. One percent (1%) from the fourth year after the commencement of this Law;
2. For commercial buildings a progressive rate is applied as follows:
 - a. Zero point two percent (0.2%) of the market value of the building is applied in the first year of the commencement of this Law;
 - b. Zero point three percent (0.3%) during the second year of the commencement of this Law;
 - c. Zero point four per cent (0.4%) during the third year of the commencement of this Law;
 - d. Zero point five percent (0.5%) during the fourth year of the commencement of this Law.

Residential apartments having a minimum of four floors, including basement floors, benefit from reduction of tax rates, equivalent to fifty percent (50%) of the ordinary rate.

Example:

Ndamaje owns the following properties in Muhanga valued on 1/1/2019

Particular	Market value
Residential building occupied by the owner and his family	200,000,000
Apartment with two floors	450,000,000
Apartments with five floors	800,000,000
Commercial building	500,000,000

Solution

Particular	Market value	Working	Tax
Residential building occupied by the owner and his family	200,000,000		Exempted
Apartment with two floors	450,000,000	0.25% x 450,000,000	1,125,000
Apartments with five floors	800,000,000	0.25% x 50% x 800,000,000	1,000,000
Commercial building	500,000,000	0.2% x 500,000,000	1,000,000
Total tax			3,125,000

Tax Rate on Plots of Land

Article 18 of Law 75/2018, provides that the tax rate on plot of land varies between zero (0) and three hundred Rwandan francs (FRW 300) per square meter. The tax rate determined by the District Council per square meter of land in accordance with the provisions of Article 18 of this Law is increased by fifty percent (50%) applicable to land in excess to standard size of plot of land meant for construction of buildings this is per Article 19 of the Law 75/2018. Any undeveloped plot of land is subject to additional tax of one hundred percent (100%) to the tax rate referred to in Article 18 of this Law.

Example

Hagama owns a property which is located on 500m²: the district council approved a tax of 250RWF per square meter. Required: compute property tax

Since the standard plot is 300m², the first 300m², will be taxed at 250RWF, the excess to 200m², the tax will be increased by 50%.

Workings	Tax RWF
300 x 250	75,000
200 x (250 + (250 x 50%))	75,000

Tax Declaration on Immovable Property by the Taxpayer

According to Article 21 of Law 75/2018, the taxpayer must file the declaration to the tax administrator not later than 31st December of the year that corresponds to the first tax period. The taxpayer files to the tax administration his/her declaration of the immovable property tax determined in accordance with provisions of the Order of the Minister in charge of taxes. A new declaration of immovable property tax is filed by not later than 31st December of the last year of each tax assessment cycle.

Declaration of Appreciation and Depreciation

If, due to changes to immovable property, the value of that property increases or decreases by more than twenty percent (20%) within an assessment cycle, the taxpayer submits within a period of one (1) month, a new tax declaration to the tax administration with all changes thereof and the value of the immovable property.

Review and Re-Assessment of Tax by the Tax Administration

Tax Administration reviews the tax declaration on immovable property within a period of six (6) months starting from 1st January of the year following the year for which the tax declaration was made. If the tax declaration on immovable property was filed late, the six (6) months period starts from the date on which the tax administration received the declaration. The review of the tax declaration on immovable property is based on the nature and general state of the immovable property, its location and its actual use.

Tax Assessment Notice

The tax assessment notice of the tax administration to be addressed to a failing tax declarant contains at least the following details:

- i. Tax base calculation outline;
- ii. Calculation of the value of the concerned immovable property;
- iii. Calculation of the tax;
- iv. Names of the owner, his/her proxy or usufructuary;
- v. Address of the owner, the proxy or the usufructuary;
- vi. The due date for tax payment;
- vii. Mode of payment;
- viii. Consequences of late payment or non-payment of tax;
- ix. A reference to the taxpayer's right to complain and appeal.

Waiver of Tax Liability

According to Article 31 of the Law 75/2018, the concerned District Council can only waive the due immovable property tax in the following cases:

- a. The taxpayer has provided a written statement of an inventory of his property justifying that he/she is totally indebted so as a public auction of his/her remaining property would yield no result;
- b. The taxpayer proves that he/she is not able to pay immovable property tax. The taxpayer applying for waiver of immovable property tax liability must write to the tax administration. When the request is found valid, the tax administration makes a report to the executive committee of the competent decentralized entity which also submits it to the District Council for decision. The waiver of immovable property tax liability cannot be granted to a taxpayer who understated or evaded taxes.

Late Submission or Incomplete or Misleading Tax Declaration

Apart from collecting the actual amount of the tax due, the decentralized entity shall levy a fine not exceeding 40% of the tax due where:

1. The fixed asset tax declaration form is not submitted;
2. The fixed asset tax declaration form is submitted late;
3. The fixed asset tax declaration form contains incorrect or fraudulent information with intent to evade tax.
4. The fixed asset tax declaration form is substantially incomplete;

Valuation of Fixed Asset

As mentioned in Article 6 of the Rwanda Tax Law, the fixed asset tax base is the market value of such fixed asset. If the fixed asset constitutes a parcel of land that is not built, the market value constitutes as per square meter value times the size of that parcel of land. Where the fixed asset consists of a parcel of land and a building and improvements, the aggregate value of the land, the building and improvements constitute the market value of such fixed asset.

Where a parcel of land, building, improvement and usufruct have been purchased, the purchase price shall be taken as the tax base, unless it is patently clear that the purchase price is below the market value. The taxable value should be rounded up to the next full one thousand Rwandan francs.

Example 1

OneFrank is located in Musanze town. He owns the properties below which are used for commercial purposes; the residential property which he dwells with his family, and a commercial building. The market value of the residential building is RWF 130, 000,000 and the market value of the commercial building is RWF 250, 000,000.

Solution

Since the residential house is dwelled by the owner, it is exempted from the property tax.

The commercial building will be taxed in the following ways

	1 st year (0.2%)	2 nd year (0.3%)	3 rd year (0.4%)	4 th year (0.5%)
Property tax	$0.2\% \times 250,000,000$ = 500,000	$0.3\% \times 250,000,000$ = 750,000	$0.4\% \times 250,000,000$ = 1,000,000	$0.5\% \times 250,000,000$ = 1,250,000,000

Example 2

Uwamariya owns the following properties

Residential house 1 occupied by the owner	200,000,000
Residential house 2 rented	100,000,000
Total	300,000,000

Required: Compute her property tax

The residential house occupied by the owner is exempted from the property tax and the one which is rented is taxed under the property tax law.

Computation of property tax

	1 st year (0.25%)	2 nd year (0.5%)	3 rd year (0.75%)	4 th year (1%)
Property tax	$100,000,000 \times 0.25\%$ = 250,000	$100,000,000 \times 0.5\%$ = 500,000	$100,000,000 \times 0.75\% =$ 750,000	$100,000,000 \times 1\%$ = 1,000,000

TRADING LICENSE TAX

The trading license tax is paid by any person who commences a profit-oriented activity in Rwanda.

Tax Year

The tax year starts on January 1st and ends on December 31st of that same year. If taxable activities start in January, the trading license tax must be paid for a whole year. If such activities start after January, the taxpayer must pay trading license tax equivalent to the remaining months including the one in which the activities started. As regards to persons conducting seasonal or periodic activities, the trading license tax must be paid for a whole year, even though the taxable activities do not occur throughout the whole year.

Tax Exemption

The Government entities are exempted from trading license tax.

Tax Declaration

Not later than 31st March of the tax year, every taxpayer must file an official tax declaration to the decentralized entity where his/her activities are undertaken. If a taxpayer operates branch offices, tax declaration shall be required for the head office as well as for each branch. When several activities are carried out by the same company or a natural person in the same premises, only one trading license tax certificate shall be required.

The tax declaration shall show details of the taxable activities including the self-assessed tax due. The tax declaration must be personally signed by the person who will receive the trading certificate. In case of a corporate entity, the tax declaration shall be signed by its properly authorized representative.

The trading license tax shall be calculated on the basis of the following tables:

All value added tax registered tax payers

Turnover in RWF	Tax in RWF
40,000,000	60,000
40,000,001 – 60,000,000	90,000
60,000,001 – 150,000,000	150,000
150,000,000 and above	250,000

Other profit-oriented activities

Type of the activities	Rural Areas	Towns	City of Kigali
A) Vendors without shops, small scale technicians who do not use machines	4,000	6,000	8,000
B) Transport of people and goods on motorcycles	8,000	8,000	8,000
Traders and technicians who use machines	20,000	30,000	40,000
All other vehicles besides bicycles	40,000 on each vehicle	40,000 on each vehicle	40,000 on each vehicle
Transport activities by motor boat	20,000 on each boat	20,000 on each boat	20,000 on each boat
Other profit-oriented activities	20,000	30,000	40,000

RENTAL INCOME TAX

Payment of Rental Income Tax

Rental income tax is charged on income generated by individuals from rented fixed assets located in Rwanda. The natural person who receives such an income is the taxpayer. The income taxable year for calculating the tax starts on January 1st and ends on December 31st of the previous year which shall be the income taxable year.

Taxable Income

Rental income tax is charged to the following:

1. Income from rented buildings in all or part;
2. Income from rented improvements in whole or in part;
3. Any other activity to which rental income may be accrued

Tax Computation Method

The taxable income is obtained by deducting from the gross rental income fifty percent (50 %) considered as the expenses incurred by the taxpayer on maintenance and upkeep of the rented property. When the taxpayer produces the proof of bank interest payments on a loan for the construction or purchase of a rented property, the taxable income shall be determined by deducting from gross rental income thirty percent (50 %) considered as the expenses incurred plus actual bank interest paid from the beginning of the rental period.

Tax Rate

The rental income tax is calculated as follows:

1. The bracket part of annual income generated through rental of a building from Rwf 1 to Rwf 180,000 shall be taxed at zero percent (0 %);
2. The bracket part of annual income generated through rental of a building from Rwf 180,001 to Rwf 1,000,000 shall be taxed at twenty percent (20 %);
3. The bracket part of the annual income generated through rental of a building above Rwf 1,000,000 shall be taxed at thirty percent (30 %).

Example 1

Habineza owns two properties in Nyenyeri which he rents to various business men. In Property one he receives a monthly rent of 800,000Rwf and in Property two he receives a monthly rent of 1,200,000Rwf. Property two was constructed using a loan of 15,000,000 Rwf from the bank at an interest rate of 16% per annum.

Required:

- a). Calculate His taxable rental income
- b). Determine His Tax liability and the Tax Payable.

Computation of Rental income for Habineza for the Year Ended 31/12/2014

Property One:

Particulars	Workings	Amount (RWF)	Amount (RWF)
Property One			
Gross Rent	800,000 x 12	9,600,000	
Less Allowable expense	50% x 9,600,000	(4,800,000)	
Taxable Rental Income			4,800,000
Property Two:			

Gross Rent	1,200,000 x 12	14,400,000	
Less Allowable expenses	14,400,000 x 50%	(7,200,000)	
		7,200,000	
Less interest expenses	16% x 15,000,000	(2,400,000)	4,800,000
Total income			9,600,000
Tax liability	Tax rate	Tax	
0 – 180,000	0%	0	
180,000 – 1,000,000	20%	164,000	
1,000,000 – 9,600,000	30%	2,580,000	
Total liability		2,744,000	

Example 2

Uwimana owns two properties in Gikondo. The first property was constructed in 2010 at a cost 150,000,000Rwf. During the construction, she borrowed 50,000,000Rwf from the bank and she pays an interest rate of 15%. The property was occupied from 1/1/2015 to 31/12/2015. The second property was constructed in 2014 at a cost of 125,000,000Rwf using her own money. The property was occupied from 1/5/2015 to 31/12/2015. Each property is rented at 3,500,000rwf per month. Uwimana incurred the following expenses on the two properties during the year.

- i. Salaries of the manager 4,800,000Rwf
- ii. Electricity 2,500,000Rwf
- iii. Painting 4,500,000Rwf
- iv. Water 1,200,000Rwf
- v. Depreciation 10,500,000 RWF
- vi. Security personal 5,000,000RWF

Required

Compute the taxable rental income and the tax liability for the year ended 31/12/2015

a. Computation of Rental Income and Tax of Uwimana for the Year Ended 31/12/2015

Items	Workings	Amount RWF	Amount RWF
Property one:			
Gross income	3,500,000 x 12		42,000,000
Less allowable expenses	50% x 42,000,000	21,000,000	
Less interest	50,000,000 x 15%	7,500,000	(28,500,000)
Taxable income			13,500,000
Property Two:			
Gross income	8 x 3,500,000	28,000,000	
Less allowable expenses	50% x 28,000,000	14,000,000	
Taxable income			14,000,000
Total taxable income			27,500,000
Tax liability	Rate		Tax

0 - 180,000	0%		0
180,001 – 1,000,000	20%		164,000
1,000,001 – 27,500,000	30%		7,950,000
Tax liability			8,114,000

Example 3

Nina is a resident of Rwanda. He owns two commercial properties in Gikondo which she rents to various individuals. Each property is rented at 1,200,000Rwf per month. All properties received tenants the whole year. In the construction of the first property, Nina borrowed 20,000,000Rwf from KCB and she pays annual interest rate of 18%. Compute her rental income and the rental tax liability.

Computation of Rental Income and Tax of Nina for the Year Ended 31/12/2016

Property One:	WORKINGS	AMOUNT RWF
Gross income	12 x 1,200,000	14,400,000
less allowable expenses	50% x 14,400,000	(7,200,000)
less interest expenses	18% x 20,000,000	(3,600,000)
taxable rental income		3,600,000
Property Two:		
Gross income	12 x 1,200,000	14,400,000
less allowable expenses	50% x 14,400,000	(7,200,000)
taxable rental income		7,200,000
Total taxable rental income		10,800,000
Tax Liability	rate	
0 - 180,000	0%	-
180,001 - 1,000,000	20%	164,000
1,000,001 – 10,800,000	30%	2,940,000
Tax Liability		3,104,000

Tax Declaration

Any person who earns an income referred to in Article 52 of Law 75/2018 of Rwanda tax Law must, on or before January 31st each year, file an official tax declaration as provided for by laws.

TEST YOUR UNDERSTANDING

1. Explain the term trade license tax and who is liable to pay the tax.
2. Mr. Makuza Emmanuel owns the following fixed assets in Kigali City, Nyarugenge District and their values as at 1st January, 2016 were:

Asset	Value (RWF)
A commercial building that houses 10 shops	400,000,000
A residential house	200,000,000

Required: Calculate the total asset tax payable by Mr. Makuza for the year ended 31st December, 2016 and indicate the due dates for payment.

3. James also has rental properties in the same district from which he earns a monthly gross income of RWF 5,000,000. These rentals were constructed using a bank loan of RWF 150,000,000 for which he paid interest of RWF 8,000,000 during the year ended 31 December, 2016. However, he could only provide supporting documents for the interest paid of RWF 7,000,000 to Rwanda Revenue Authority.

Required

- (i) Compute James' rental income and tax liability for the year ended 31 December, 2016.
 - (ii) Advise him on when he is required to file his return and the likely penalty that he would pay if the tax per return is paid 3 months late assuming tax payable is RWF7,000,000.
4. Nsengiyumva Damian, a resident in Rwanda, owns rental apartment in Nyarutarama, Kigali. He completed the construction of the apartments in December, 2014 and the first occupants entered the apartments in January, 2015. The total cost of construction of the apartments was RWF1.2 billion. Part of the construction costs was funded by mortgage loan from bank of Kigali of RWF 500,000,000 repayable in 15 years at an interest rate of 15% per annum. There is sufficient documentation to support the interest paid during the year. The rental income earned for the year ended 31st December, 2015 was RWF 185,250,000. The expenses incurred during the year were:

	RWF "000"
Cleaning and garbage disposal	8,000
Security services	52,000
Other general maintenance expenses	<u>70,000</u>
Total	<u>130,000</u>

Required

Compute the taxable rental income and tax payable by Nsengiyumva Damian for the year ended 31st December, 2015 and state the due date of payment.

5. Nsengiyumva Damian was not in position to pay the rental tax due in time because of unforeseen circumstances. He was advised that it is possible to defer the tax payment without incurring any fines. Explain the circumstances under which he differs the payment of the rental tax
6. Maniriho owns the following properties in Musanze town.

Particular	Market value RWF
Residential property where he stays with the family	100,000,000
Commercial building	340,000,000
Residential apartments with five floors	624,000,000
Residential apartment with two floors	270,000,000
Commercial building is located on 600M ²	
Five floors apartment is located on 400M ²	
Two floor apartment is located on 1000M ²	

The district council approved a tax of 200RWF per square metre. Due to many commitments, Maniriho was unable to declare and pay the property tax on time; he was late for two months.

Required: Compute the property taxes due and the penalties due.

