CERTIFIED PUBLIC ACCOUNTANT

ADVANCED LEVEL 2 EXAMINATIONS

A2.3 ADVANCED TAXATION

DATE: MONDAY 25, NOVEMBER 2024

MARKING GUIDE AND MODEL ANSWERS

SECTION A

QUESTION ONE
Marking Guide:

		Marks
A	1.5 Marks for each valid point, maximum 06 marks	6.0
B	01 Mark for highlighting the tax treatment for each option	4.0
	02 Marks for a correct calculation for each option	8.0
	01 Marks for correct advice on both benefits, maximum 02 marks	2.0
C		
(i)		
Net Accounting profit		0.5
Deduct the following:		
	Sale of old shelves	1.0
	Purchases relating to 2023	1.0
	Bad debts provision	1.0
	Actual bonus payout in 2023	1.0
	Actual audit fees paid	1.0
	Capital allowance	1.0
Add the following:		
	Purchase iPads for the clients	1.0
	Bonus provision	0.5
	General Manager's farewell	0.5
	Launch of new shop	0.5
	Sample products at launch	0.5
	Penalty on overdraft	0.5
	Interest on overdue invoices	0.5
	Accrual for audit fees	1.0
	Legal fees for drunk driving	0.5
	Bad debts - specific provision	1.0
	Golf tournament membership	0.5
	Provision for replacement of broken glass window	0.5
	Provision for untaken leave days	0.5
	Gifts to customers	0.5
	Investigation to acquire new company	1.0
	Income tax paid	0.5
	Depreciation and amortization	0.5
	20% disallowable for airtime and data	1.0
C		
(ii)	02 Marks for correct explanation	2.0
Total marks for Question One		***40.0***

Model Answers:

(a) Generally, faith-based organizations may not pay taxes based on the nature of their activities but there are some specific caveats and statutory requirements to be met.

Tax implications

1. Churches will be exempted from tax as per article 46 of the income tax law of 2018 relating to entities which are exempted from CIT.
2. In case of a surplus, Rwanda Revenue Authority will tax the church organization as this is considered as profit.
3. Churches should prepare and submit to the Tax Administration their financial statements not later than 31 March following the tax period.

Advice to the pastor

1. His church should comply with local taxes like property taxes
2. His church must deduct and remit taxes on payments to suppliers or employees where applicable (Withholding taxes)

(b)(i)

1) Accommodation Option 1:

Providing a fully furnished company owned house with the Managing Director is a typical benefit in kind and will attract more tax payable by the Managing Director, see calculations below;

Accommodation option 1	**RWF**	**RWF**
Basic annual salary		84,000,000
House benefit in Kind value (20%)		16,800,000
Total taxable income		**100,800,000**
Calculation of taxable income;		
Calculation tax on benefit in kind;		
(0 to 360,000), taxable at 0%	-	
(360,010 to 1,200,000), taxable at 20%	168,000	
above 1,200,000 is taxable at 30%	29,880,000	
Total Pay as You Earn on House Benefit		**30,048,000**

2) Accommodation Option 2:

Renting a house for the managing director is a taxable benefit that should be added on basic income, consequently increasing the tax paid by the employee, see illustration below.

Accommodation option 2	**RWF**	**RWF**
Basic annual salary		84,000,000
Taxable benefit for house rent		9,600,000
		93,600,000
Calculation of taxable income;		
(0 to 360,000), taxable at 0%	-	
(360,000 to 1,200,000), taxable at 20%	168,000	
above 1,200,000 is taxable at 30%	27,720,000	
Total Pay as You Earn on house benefit		**27,888,000**

3) Car option 1:

Providing a fueled company car to an employee is a benefit in kind and valued at 10% of the total employee salary for tax purposes. See below illustration

Car option 1	**FRW**	**FRW**
Basic annual salary		84,000,000
Car benefit in Kind value (10%)		8,400,000
Taxable income		**92,400,000**
Calculation tax on benefit in kind;		
(0 to 360,000), taxable at 0%	-	
(360,010 to 1,200,000), taxable at 20%	168,000	
above 1,200,000 is taxable at 30%	27,360,000	
Total Pay as You Earn on car benefit		**27,528,000**

4) Car option 2:

Rent of vehicle for the employee is like renting a house, the entire rent amount is added to the basic salary and taxed to increase the tax payable by the beneficiary employee. See the illustration below.

Car option 2	**FRW**	**FRW**
Basic annual salary		84,000,000
Taxable benefit for car rent		10,200,000
Taxable income		**94,200,000**

Calculation of taxable income;		
(0 to 360,000), taxable at 0%	-	
(360,000 to 1,200,000), taxable at 20%	168,000	
above 1,200,000 is taxable at 30%	27,900,000	
Total Pay as You Earn on car benefit		**28,068,000**

(b) (ii): Comparison between the different options.

- **Accommodation:** Option two (renting a furnished apartment for RWF 800,000) is a better option as it attracts less tax for the Managing Director than option one benefit in Kind.
- **Car benefit:** Option one of car benefit in kind is a better option for the Managing Director as it has the lower tax payable compared to option two.

(c)**(i)**

Computation of Taxable income for Taifa Limited for the tax period 2023

		RWF '000	RWF '000
Net Accounting profit			106,787
Deduct the following:			
	Sale of old shelves	22,000	
	Purchases relating to 2023 (8,900*100/118)	7,542	
	Bad debts provision	Allowed	
	Actual bonus payout in 2023	38,500	
	Actual audit fees paid	Allowed	
	Capital allowance granted	32,000	
			100,042
			6,745
Add back the following:			
	Purchase iPads for the clients	10,000	
	Bonus provision	40,000	
	General Manager's farewell	2,000	
	Launch of new shop	Allowed	
	Sample products at launch	Allowed	
	Penalty on overdraft	500	
	Interest on overdue invoices	2,500	
	Accrual for audit fees	Allowed	
	Legal fees for drunk driving	2,625	
	Bad debts - specific provision	520	
	Golf tournament membership	2,500	
	Provision for replacement of broken glass window	5,650	
	Litigation Provision	900	

	Provision for untaken leave days	9,720	
	Gifts to customers	3,500	
	Investigation to acquire new company	Allowed	
	Income tax paid	31,078	
	Depreciation and amortization	46,260	
	20% disallowable for airtime and data	7,807	
			165,560
	Adjusted Taxable income		**172,305**

Assumption:

1. We assumed that the interest from the bank was received as gross.
2. We assumed that the office stationaries from miscellaneous were used for the period.

(c)(ii)

The quarterly prepayments are considered as an advance payment and is offset against current tax period income tax payable. For this particular case, the gross income tax amount on the above calculated taxable income would be reduced by the total FRW 25 million quarterly prepayments and the company would pay only the net amount.

SECTION B

QUESTION TWO

Marking Guide

Descriptions	**Marks**
Award 2 Marks for explanation of tax implication of the company liquidation	2
Award 3 Mark for computation of the tax payable	3
b	
Award 2 Marks for explanation on loss carry forward	2
Award 1 Marks for capital gain treatment	1
Award 2 Marks for capital restructuring explanation	2
c	
Award 2 on Decentralized tax explanation	2
Award 1 Mark for tax implication on sale of residential building	1
Award 2 Marks for tax implication on sale of commercial building	2
d	
Award 2.5 Marks for explanation of employment	2.5
Award 2.5 Marks for explanation of self-employment	2.5
Total Marks	**20**

Model Answers

a) Taxation implications in case of company liquidation.

For the purpose of liquidation of a company, after payment of liabilities and distribution of dividends, the remainder, shall be considered as dividends on shares in the last tax period of the company's existence.

The following is the computation of the tax payable

Descriptions	**FRW million**
Proceeds from sale	265,500
Less total liability	-41,375
Less shareholders' equity	-62,970
Remaining	152,155
WHT of 15%	**22,823**

b) The following are the tax implications for the issuing 50% of the shares.

i) Loss carry forward.

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 accumulated losses from previous period will be disregarded.

ii) Corporate restructuring (Assumed there was an exchange of share in the purchasing company)

1. Companies are subject to restructuring as follows:
2. A merger of two or more resident companies into a separate company.
3. 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.
4. 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.
5. The acquisition of the entire company's assets so that its existence is replaced by the purchasing company.
6. Splitting of a resident company into two or more resident companies.

Based on the above transactions the transaction will be qualified as corporate restructuring hence taxed in the following ways:

1. In case of restructuring of companies, the transferring company is exempt from tax in respect of capital gains and losses realized on restructuring.

1. 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.
2. 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.
3. 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.
4. The receiving company assumes the rights and obligations of the transferring company in respect of such reserves and provisions.

iii)The share bought will attract dividends at the end of the tax period, this payment will attract withholding tax of 15%.

c) Tax implications on the sale of residential and commercial properties.

i) Residential buildings are exempted if they are for dwellings, for the purpose of this question, the residential building is for business purpose and will be subjected to the 0.5% tax applicable on the market value. In addition to that it will pay tax land based on the covered square meter and tax rate approved by the district council. Commercial buildings are taxed at 0.3% tax applicable on the market value. In addition to that it will pay tax on land based on the covered square meter and tax rate approved by the district council. **N.B I applied for the tax rates for the period of 2020.**

By selling residential and commercial properties,

The proceeds from the sale of a whole or part of a building meant for residential purposes will be exempted from VAT, however the sale of commercial building will attract VAT at 18% i.e. (18%*350,875,000) = FRW 63,157,500 payable to the tax administration.

ii) 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.

Factors Indicating Employment

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

Factors Indicating Self-Employment

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

QUESTION THREE

Marking Guide

Descriptions	Marks
Award 1 Mark for loan amortization comp for each period max 5	5
Award 2 Marks for computation of tax payable using debts	2
Award 2 Marks for computation of tax payable using Equity	2
Award 1 Mark for Best option	1
Award 1 Mark for each factor of ethical conflict max 5	5
Award 1 mark for each solution of ethical conflict	5
Total Marks	**20**

Model Answers

a) Computation of the loan amortization

Loan amount: FRW 3,500,000,000
Interest rate: 10%
Loan Period: 5 years
Payment: annuity with equal payment
Payment (PMT)= FRW 923,291,183
Repayment schedule

Year	Constant	Interest	Principal	Balance
0	0	0	-	3,500,000,000
1	923,291,183	350,000,000	573,291,183	2,926,708,817
2	923,291,183	292,670,882	630,620,301	2,296,088,516
3	923,291,183	229,608,852	693,682,331	1,602,406,184
4	923,291,183	160,240,618	763,050,565	839,355,620
5	923,291,183	83,935,562	839,355,620	0

Particular	2018	2019	2020	Total
	FRW Million	**FRW Million**	**FRW Million**	
PBIT	12,500	22,000	32,000	66,500
Wear and tear allowance	500	1,200	950	2,650
Investment allowance	2,300	1,500	-	3,800
Interest expenses	350	293	230	872
Taxable Income	9,350	19,007	30,820	59,178
Tax 30%	**2,805**	**5,702**	**9,246**	**17,753**
PAT	6,545	13,305	21,574	41,424

Computation of the tax payable by using Equity

Descriptions	1st FRW million	2nd year FRW million	3rd year FRW million	Total
Income	12500	22,000	32,000	66,500
Less:				
Financial interest	-	-	-	-
Wear and tear	-500	- 1,200	- 950	- 2,650
Investment allowances	-2300	- 1,500	-	- 3,800
Taxable profit	9,700	19,300	31,050	60,050
Tax 30%	2,910	5,790	9,315	18,015

Conclusion: The best option is 2 of taking the loan

B.

A conflict of interest for a professional accountant arises when their personal or financial interests' conflict with their professional duties and responsibilities. Here are some common situations where conflicts of interest can occur between accountants:

1. **Financial Interests (Self Interest)**: When an accountant or their immediate family members have a financial interest in a client's business or investment decisions, it can create a conflict of interest. For example, owning shares in a company that the accountant audits or provides financial advice too.
2. **Employment or Consulting Relationships (Self review)**: If an accountant holds a position as a director, officer, or consultant for a client, it may compromise their objectivity and independence when performing audit or advisory services for that client.
3. **Gifts, Entertainment, or Hospitality**: Accepting significant gifts, entertainment, or hospitality from clients or vendors can influence the accountant's judgment and compromise their impartiality.
4. **Personal Relationships (Familiarity)**: Personal relationships with clients or individuals within client organizations can create biases or perceptions of bias, affecting the accountant's ability to act objectively.
5. **Pressure from Superiors or Employers**: Accountants working in firms may face pressure from senior management or partners to prioritize the firm's financial interests over those of clients, potentially compromising their professional judgment.

6. **Regulatory or Legal Compliance**: Failure to comply with regulatory or legal requirements, such as independence rules set by accounting bodies or government regulations, can lead to conflicts of interest.
7. **Advocacy Threat**:
   Promoting a client's position or interests, which might compromise objectivity (e.g., defending a client in a tax dispute while auditing their accounts).

Resolving conflicts of interest is essential for professional accountants to uphold ethical standards and maintain trust with clients, employers, and the public. Here are ethical solutions that accountants should apply to effectively manage and resolve conflicts of interest:

1. **Disclosure and Transparency**: The first step is to disclose the conflict of interest to relevant parties, such as clients, employers, or professional colleagues. Transparency about potential conflicts helps to maintain trust and allows others to assess the situation objectively.
2. **Recusal or Withdrawal**: If the conflict cannot be managed through disclosure alone, the accountant should consider recusing themselves from the situation or withdrawing from the engagement entirely. This ensures that their objectivity and independence are not compromised.
3. **Establishing Independence**: Professional accountants must maintain independence in fact and appearance. This involves avoiding situations where their judgment or actions could be perceived as biased or influenced by personal interests.
4. **Ethical Decision Making**: Accountants should adhere to ethical decision-making frameworks provided by their professional codes of conduct or ethical guidelines. This includes considering the impact of their decisions on stakeholders and maintaining integrity in all professional activities.
5. **Seeking Guidance**: When facing complex conflicts of interest, accountants should seek guidance from appropriate sources, such as their firm's ethics committee, professional bodies, or legal advisors. Consulting with others can provide clarity on the best course of action.
6. **Avoiding Conflicting Roles**: Accountants should avoid taking on roles or responsibilities that could create conflicts of interest in the first place. This includes refraining from financial investments or business relationships that could impair their objectivity when serving clients.
7. **Continuing Professional Education**: Staying informed about ethical standards and regulations through continuing education is crucial for accountants. This helps them recognize and effectively manage conflicts of interest as they arise in their professional practice.
8. **Documentation and Record-Keeping**: It's important to maintain clear documentation of decisions made regarding conflicts of interest. This includes documenting disclosures, actions taken to manage conflicts, and any approvals obtained from relevant parties.

QUESTION FOUR

Marking Guide

		Marks
A	**1. Test Thin capitalization possibility on Loan**	
	Total Loan balance at year end @ closing exchange rate	0.5
	Maximum Loan on which interest is allowable (4 x paid up capital, excluding retained earning & reserves)	1.0
	Loan on which Interest is disallowed	1.0
	2. Determine Interest allowable / disallowable	
	Total Interest paid	0.5
	Interest allowable (1,500 million x4/8,750 million) x 350 million	1.0
	Interest disallowable under Thin Capitalization	1.0
	3. Determine Foreign exchange Loss allowable / not allowable	
	Total foreign exchange Loss incurred	0.5
	Foreign exchange loss allowable (1,500 million x4/8,750 million) x 75 million	1.0
	Foreign exchange Loss disallowable on thin capitalization	1.0
	Total finance cost on Loan that is disallowable	0.5
	01 marks for an introduction of the Memo	1.0
	02 merks for the proper problem analysis including withholding tax on interest payment	2.0
	award 02 for the Memo structure	*1.0*
B	Award 03 marks for Rental income tax computation, evenly spread	*3.0*
	Award 03 marks for tax computation on machinery and heavy equipment rental, evenly spread	*3.0*
	award 02 marks for a proper conclusion from the computations	*2.0*
	Total Marks for Question Four	***20.0***

Model Answers

A.

MEMO:

To: Chief Financial Officer

From: Tax Manager

SUBJECT: Tax implications resulting from thin capitalization on Loan status with Chale Ltd

INTRODUCTION:

In response to your request for me to provide a summary of the tax implications of the Loan status with Chale Ltd, I have summarized the tax implications below and shown you comprehensively with aid of detailed computation in the annexture below this Memo on the next page.

ISSUES:

Ingaju Ltd is a subsidiary of Chale Ltd, which makes it a related party. Per Rwandan tax laws, Loan between related parties is subject to thin capitalization. Essentially, Interest on the Loan in excess of 4 times equity is disallowed for Income tax purposes.

For our case in particular, up to FRW 2.75 billion Loan is in excess of 4 times paid up capital, please note that here paid-up capital excludes retained earnings and reserves. So, per calculation above, The Finance cost (Interest on Loan plus foreign exchange Loss incurred on Loan repayment) would be disallowed for Income tax purposes.

A total of FRW 110 million and FRW 23.57 million Interest and foreign exchange Loss respectively shall be disallowed for Income tax purposes.

In addition, The Upon Interest payment there would be a 15% withholding tax chargeable. The above thin capitalization rules do not apply to the withholding tax, it is chargeable on all interest paid.

CONCLUSION:

With the above summary and detailed calculations thereof, I believe it will aid your comprehension of the current Loan status.

Yours faithfully,

Tax Manager.

Detailed computation of tax Implication and Thin capitalization.

1. Test Thin capitalization possibility on Loan	**FRW '000**
Total Loan balance at year end closing exchange rate	8,750,000
Maximum Loan on which interest is allowable (4 x paid up capital, excluding retained earning & reserves)	6,000,000
Loan on which Interest is disallowed	*2,750,000*
2. Determine Interest allowable / disallowable	
Total Interest paid	350,000
Interest allowable (1,500 million x4/8,750 million) x 350 million	240,000
Interest disallowable under Thin Capitalization	*110,000*
3. Determine Foreign exchange Loss allowable / not allowable	
Total foreign exchange Loss incurred	75,000
Foreign exchange loss allowable (1,500 million x4/8,750 million) x 75 million	51,429
Foreign exchange Loss disallowable on thin capitalization	*23,571*
Total finance cost on Loan that is disallowable	***133,571***

B. Computation of tax payable on the two investment options

Option 1: Investing in rental Property	**FRW '000**
Gross annual Income	420,000
Less costs:	
50% deemed expenses	(210,000)
Interest on Loan (35%*500m*15%)	(26,250)
Taxable rental Income	***183,750***
Rental Income tax calculation:	
0-180,000 @0%	-
180,001 to 1,000,000 @20%	164
>1,000,000 @30%	54,825
Total rental income tax	***54,989***

Option 2: Investing in Machines & Equipment	**FRW ‘000**
Gross annual Income	384,000
Less costs:	
10% Deemed expenses	(38,400)
Interest on Loan (35%*500m*15%)	(26,250)
Depreciation (25%) of total cost	(125,000)
Taxable Income	***194,350***
Tax calculation:	
0 to 360,000 @0%	-
360,001 to 1,200,000 @20%	168
>1,200,000 @30%	57,945
Total tax payable	***58,113***

Conclusion:

Based on the above calculations I have done, there are two fascinating outcomes;

- Investment in Machinery brings in less income but higher tax liability, mainly due to the tax brackets, rates and most importantly the allowable deductions.
- Investment in Residential houses on the other hand brings more income compared to the Equipment and Machinery Investment but has a lower tax liability. The allowable expenses here are a bit higher fixed at 50% of the annual income.

From purely a tax point of view, Dr Yvan Shema would have a better investment in Residential houses than in Equipment and Heavy Machinery. He can earn more and pay less on taxes, obviously there are other factors to consider beyond tax, but my assignment is limited to tax implication.

QUESTION FIVE

(a)

Marking guide

i) 1 mark for each point explained up to 4 marks

ii) 1 mark for each point explained up to 3 marks

iii)1 mark for each point up to 3 marks

Total Marks 10

Model answers

(i) Belgium, Because Mr. Eliott will not having a permanent home, center of vital interest, habitual place of residence and nationality as well in Rwanda

(ii) If Mr. Eliott is considered as resident in Rwanda, his tax regime will fall under real tax regime of PIT and taxed at the tax rate band of individuals.

(iii) The income earned from abroad will not be taxed in Rwanda because as per article 16 of income tax law regarding to payments exempted from employment income tax states that 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 is exempted.

(b)

Marking Guide

VAT account			
Input VAT	Marks	Output VAT	Marks
Import (W1)	-	Sales of shoes	0.5
Sales of shoes to Govt institution	0.5	Sales of shoes to Govt institution	0.5
Purchase of shoes from RMC	0.5		
Electricity	0.5	Export	0.5
Purchase of shoes from BMB	0.5	Bad debt recovery	0.5
Shoes returned to RMC	0.5	Sales return	0.5
Staff telephone cost	0.5	Bad debt written off	0.5
office rent	0.5	VAT Reverse	0.5
Consultant	0.5	Consultant	0.5
Security guard (450,000-90,000)	0.5		

GHF			Marks
Import duty@25%			0.5
Excise duty @10%			0.5
Port charge			0.5

Model answers

VAT account			
Input VAT	FRW	Output VAT	FRW
Import (W1)	9,969,750	Sales of shoes	3,050,847
Sales of shoes to Govt institution	7,627,119	Sales of shoes to Govt institution	7,627,119
Purchase of shoes from RMC	2,700,000		
Electricity	457,627	Export	Zero rated
Purchase of shoes from BMB	4,500,000	Bad debt recovery	900,000
Shoes returned to RMC	(720,000)	Sales return	(1,440,000)
Staff telephone cost	540,000	Sales Transport	Exempted
Repair and maintenance	Exempted	Bad debt written off	(1,080,000)
office rent	762,712	VAT Reverse	1,800,000
Fuel of cars used in transport	Exempted		
office computers	Exempted		
Consultant	2,700,000	Consultant	2,700,000
Security guard (450,000-90,000)	360,000		
	28,897,208		**13,557,966**
VAT Refundable	**15,339,242**		

Working 1

GHF			
Imported Material	$20,000	Exchanged at FRW 1050 per $1	21,000,000
Transport	$8000	Exchanged at FRW 1050 per $1	8,400,000
Insurance	$ 6000	Exchanged at FRW 1050 per $1	6,300,000
CIF			**35,700,000**
Import duty@25%			8,925,000
			44,625,000
Excise duty @10%			4,462,500
			49,087,500
Port charge			6,300,000
			55,387,500
VAT@18%			**9,969,750**

End of marking guide and model answers