CERTIFIED ACCOUNTING TECHNICIAN (CAT)

STAGE 3 EXAMINATION

S3.3 TAX

PILOT PAPER

ANSWERS

Section A – Answer Grid

1. C
2. B
3. B
4. C
5. D
6. E
7. C
8. A
9. B
10. B

Section A – Suggested solutions

Marking scheme

	Marks
2 marks for each correct answer	2
Total marks for this section	100

1. C An individual is treated as a Rwandan resident for a tax year if they have either a permanent residence or a habitual abode in Rwanda, or there is a period of 12 months ending in that tax year, during which the individual has been present in Rwanda at midnight for at least 183 days. During 2018 and 2019, Josie only spends five months in Rwanda, and does not have a Rwandan permanent residence or habitual abode.

   Ending during the tax period to 31 December 2020, there is a period of 12 months (the 12 months to 30 April 2020) where Josie has been present in Rwanda for at least 183 days (1 May 2019–15 July 2019 and 1 January 2020–30 April 2020). So although Josie does not have a permanent residence or habitual abode in Rwanda until she purchases her apartment in 2021, she will be treated as a Rwanda resident for the tax period to 31 December 2020.

   (LO 1.1.2)

2. B The assets must be retained by the business for at least three years and the business must apply for and hold a valid investment certificate specifying the incentives to which they are entitled. The assets do not have to be brand new, so statement (i) is not a valid condition, and the minimum expenditure per asset is US$50,000, not RWF50,000, so statement (ii) is also incorrect. The correct answer is therefore B (only statements (iii) and (iv) are correct).

   (LO 1.3.1)

3. B As these are amounts owed to Ubukungu Ltd, any reduction in the rate of RWF per unit of foreign currency will result in an exchange loss, and conversely any increase in the RWF rate per unit of foreign currency will increase the amount of RWF received by Ubukungu when the debtor pays.

   Customer 1: foreign exchange loss of RWF(1170 – 1200) = RWF(30) × 50,000 = RWF(1,500,000).

   Customer 2: foreign exchange gain of (912 – 890) = RWF22 × 20,000 = RWF440,000.

   Exchange gains and losses are included in taxable income for a tax period. The net figure is a deductible loss of RWF(1,060,000).

   If you chose Option A, you have misunderstood the movements (classed gains as losses, and *vice versa*). Option C assumes that the Customer 2 foreign exchange gain is a loss, and Option D only taxes the gain on Customer 2, and does not relieve the loss on Customer 1.

(LO 1.3.2)

4. C Cissy's debt is an allowable expense, because the following conditions are met:

- Thomas has recorded the income in his accounts and has written off the debt.
- The debt is less than RWF2,500,000, and Thomas has taken steps to recover the debt for at least three years.

Increases in bad debt provisions are never an allowable expense, so this must be added back. The debt from Antonio PLC will not be allowable until Antonio PLC is declared insolvent, as it is for an amount of more than RWF2,500,000. This must therefore also be disallowed, and the total amount added back is (RWF500,000 + RWF4,000,000) = RWF4,500,000.

(LO 1.3.2)

5. D Troy Ltd is thinly capitalised, as its total debt (RWF140,000,000) is more than four times its equity share capital (RWF30,000,000), Therefore, interest on the amount of debt that exceeds four times share capital is disallowed under the thin capitalisation rules. The excessive loan from Helen Ltd is RWF20,000,000 (RWF140,000,000 – (4 × RWF30,000,000)), and so the interest disallowed due to the thin capitalisation rules will be RWF2,000,000 (RWF20,000,000 × 10%).

However, Helen Ltd is also charging Troy Ltd a higher than market interest rate on the loan. The difference between the interest rate charged (10%) and the market rate (7%) must be disallowed for the balance of the loan: RWF60,000,000 × (10 – 7)% = RWF1,800,000. The total amount disallowed is therefore RWF3,800,000.

Option A only takes into account the thin capitalisation. Option B disallows all interest, including that paid under normal commercial terms to a bank, and Option C only takes account of the transfer pricing restriction so disallows the interest that is in excess of a market rate (10% – 7%) on the whole loan.

(LO 1.3.2)

6. E The correct answer is 50% of gross rents, with no deduction for actual expenses:

50% × ((RWF250,000 × 12) + (RWF600,000 × 2)) = RWF2,100,000

If you chose Option A, you deducted actual expenses rather than the deemed 50% of rent. Option B deducts both the actual expenses and the deemed 50% of rents. Option C correctly deducts the deemed expenses, but assumes that Property 2 was rented for a whole year (ie 4 quarters not 2), and Option D is the full rent received by Robert in the year.

(LO 1.4.2)

7. C The taxpayer in statement (ii) is large, and so fixed fines are usually RWF500,000. Statement (i) is incorrect, as this taxpayer's turnover is in excess of RWF20,000,000 and so a fixed fine would be RWF300,000. Penalties may be waived in certain circumstances, for example, if a business is insolvent or due to *force majeure*, but not merely for cash flow difficulties. Therefore statement (iii) is also incorrect.

(LO 3.1.2)

8. A Only the car park creation is capital expenditure that must be disallowed. Paying royalties to the owner of a patent is a ongoing, revenue expense. The tools cost less than RWF500,000, although capital in nature did not need to be added back. Replacing broken window panes is a repair, and therefore revenue in nature.

(LO 4.1.2)

9. B The assets qualify for the following tax depreciation:

		Rate	*Tax depreciation*
	RWF'000		RWF'000
Goodwill	20,000	10%	2,000
Office Premises	50,000	5%	2,500
Computer equipment (expected life 5 years)	10,000	50%	5,000
Motor vehicles	30,000	25%	7,500
Stock and other current assets	90,000	Nil	0
Total	200,000		17,000

Answer A treats the computers as if they have a life of over 10 years, and so only received 10% depreciation. Answer C awards pooled asset depreciation to stock and other current assets (they do not qualify for tax depreciation at all). Answer D uses the net book values in the sole trader's books, rather than the price paid by Environ Ltd.

(LO 4.1.3)

10. B The expenses can be analysed as follows:

(i) Motor costs have some private use, so a deemed private proportion of 20% is assumed. Therefore disallow RWF160,000.

(ii) Client entertaining, including paying for accommodation (irrespective of the type of event) is always disallowed. Add back RWF200,000.

(iii) Staff training is allowable.

(iv) Charitable donations are disallowed to the extent they exceed 1% of turnover.
RWF550,000 – (1% × 40,000,000) = RWF150,000 disallowed.

Total disallowed = RWF(160,000 + 200,000 + 150,000) = RWF510,000.

Option A allows the entertaining. Option C disallows the whole donation, rather than just the excess over 1% of turnover. Option D disallows everything except staff training.

(LO 4.2.1)

Section B – Suggested solutions

11.

Marking scheme

	Marks
Offer 1 – PAYE calculation (W1)	1
Offer 1 – RSSB calculation (W2)	1
Offer 1 – spendable pay	1
Offer 2 – PAYE calculation (W3)	2
Offer 2 – RSSB calculation (W2)	1½
Offer 2 – spendable pay	2
Recommendation	1½
Total marks for this section	**10**

Detailed solution

Offer 1

	RWF'000
Gross salary	15,000
Personal income tax (PAYE) (W1)	(4,758)
Employee RSSB contributions (W2)	(544.5)
Bicycle maintenance costs	(62)
Annual after-tax spendable income	**9,635.5**

Workings

1

	RWF'000
Salary	15,000
Pension contributions (10% × 15,000)	1,500
Gross taxable pay	16,500
Personal income tax (PAYE):	
360,000 × 0%	0
840,000 × 20%	168
15,300,000 × 30%	4,590
Total	**4,758**

2

	RWF'000
Pay liable to RSSB contributions	16,500
Pension at 3%	495
Maternity at 0.3%	49.5
Total employee RSSB	**544.5**

Offer 2

	RWF'000
Gross salary	20,000
Personal income tax (PAYE) (W3)	(6,048)

Employee RSSB contributions (W4)	(2,160)
Personal pension contributions – amount paid	(1,500)
Fuel costs	(1,400)
Annual after-tax spendable income	**8,892**

3

	RWF'000
Salary	20,000
Car benefit (10% × 20,000,000)	2,000
Pension contributions of RWF 1,500,000: capped at the lower of:	
• 10% of salary = RWF 2,000,000	
• 1,200,000	(1,200)
Gross taxable pay	20,800
Personal income tax (PAYE):	
360,000 × 0%	0
840,000 × 20%	168
19,600,000 × 30%	5,880
Total	**6,048**

4

	RWF'000
Pay liable to RSSB (excluding car allowance)	20,000
Pension at 3%	600
Maternity at 0.3%	60
Medical (compulsory as public body) at 7.5%	1,500
Total employee RSSB	**2,160**

Recommendation: Offer 1 gives the higher after-tax spendable income by (RWF9,635,500 – RWF8,892,000) = RWF743,500 per year. However, other factors may be important, such as promotion opportunities in either role, the additional benefits provided by the medical element of RSSB contributions from Offer 2, or the lower commuting time if she accepts Offer 1.

(LO 1.2.2, 1.2.4, 2.1.1, 2.2.2, 2.3.1)

12.

Marking scheme

	Marks
Head office	½
Nyamata factory	½
Fixed machinery balancing allowance	1
Industrial equipment	1
Kinazi factory	1½
Kinazi machinery	1½
Computer equipment pool	1
Other business assets pool	½
Car (private use)	1
Capital gain tax	1½
Total marks for this section	**10**

Detailed solution

Tax depreciation and investment allowance: non-pooled assets

	Notes/ workings	*Cost*	*TWDV b/f*	*Tax*	*TWDV*

				depreciation	*c/f*
		RWF'000	RWF'000	RWF'000	
Head office	1	150,000	120,000	7,500	112,500
Nyamata factory	2	270,000	189,000	189,000	0
Fixed machinery (Nyamata factory)	3	35,000	24,500	2,500	0
Heavy industrial equipment	4	20,000	18,000	1,000	17,000
Kinazi factory	5	450,000		236,250	213,750
Kinazi machinery	6	50,000		26,250	23,750
Total tax depreciation and investment allowance				462,500	

Notes

1 5% straight-line on cost. 5% × 150,000 = 7,500

2 Remaining balance written off on disposal

3 Balancing allowance of (RWF24,500 – 22,000) = 2,500

4 5% straight-line on cost. Relocation of machinery is a revenue expense, given tax relief in the year of expenditure and not part of cost for tax depreciation.

5 50% investment allowance = RWF225,000,000, plus 5% of the remaining cost (225,000,000 × 5% = 11,250,000). Total tax relief is therefore RWF236,250,000.

6 50% investment allowance = RWF25,000,000, plus 5% of the remaining cost (25,000,000 × 5% = 1,250,000). Total tax relief is therefore RWF26,250,000.

Pooled assets:

	Computer equipment pool	*Other business assets pool*	*Car (private use)*	*Tax depreciation claimed*
	RWF'000	RWF'000	RWF'000	RWF'000
TWDV b/f	2,500	5,000	0	
Acquisitions			18,500	
Disposals	(200)			
Balance to depreciate	2,300	5,000	18,500	
Tax depreciation (50%/25%)	(1,150)	(1,250)		2,400
(25%)			(4,625) × 80%	3,700
TWDV c/f	1,150	3,750	13,875	
Total tax depreciation (pooled assets)				6,100

Capital gains tax on building disposal:

	RWF'000
Proceeds	320,000

Less: disposal costs (1%)	(3,200)
Less: unrelieved tax base	(189,000)
Capital gain	127,800
Capital gains tax (30%)	38,340

(LO 1.1.3, 3.2.3, 4.2.2, 4.2.3)

Section C – Suggested solutions

13.

Marking scheme

			Marks
(a)	Reason registration is necessary	1	
	Deadline	1	
			2
(b)	How taxable income calculated under real regime	1	
	Verifying income is correct	1	
	General rules for deducting expenses	2	
	Minibus	1	
	Fuel, maintenance and insurance	½	
	Website costs	1	
	Advertising and launch party (½ each)	1	
	Equipment purchases	1	
	Clothing	½	
	Food	1	
	Insurance and wages (½ each)	1	
	PIT computation	1½	
	Due date and why no IQPs	1½	
			14
(c)	Partnership is corporate structure with shareholders	1	
	CIT due, remaining profit retained or distributed as dividends	1	
	Taxation of dividend on James	1	
	Taxation of dividend on wife	1	
			4
	Total marks for this section		**20**

Detailed solution

(a) Registration with the Rwanda Revenue Authority (RRA) is compulsory for taxpayers who set up a business or a company. Prior to starting your business, your tax would have been payable by your employer via PAYE, and therefore you would not have needed to declare your income separately to the RRA. Your clients pay you without deducting PAYE, and therefore you must declare your taxable profits via a self-assessment form and pay your personal income tax (PIT) every tax year. The deadline for registering with the RRA is seven days after commencement of the business, which means that you should have registered by 8 February 2019.

(LO 1.1.2)

(b) Under the 'real regime', PIT is payable on taxable profits. This means your accrued (earned) income, minus any deductible expenses incurred and tax depreciation on capital items. I can confirm that your level of sales makes the use of the real regime compulsory.

In order to calculate taxable profit, I will need to know whether the income of RWF75,000,000 you mentioned includes any debtors as at 31 December 2019 – these must be included in taxable income.

The general rules for deducting expenses from income are:

- They must be incurred for the purpose of the business and be directly attributable to the income generated.
- They must be a real expense and be substantiated with an invoice or receipt.
- They represent a decrease in the net assets of the business – which means they must be revenue, rather than capital, in nature, and be an expense for which the cash has already been paid or will be paid in a future period.

There are, however, some specific rules meaning that certain expenses are not deductible, even if they meet the above criteria.

In terms of the expenses you have incurred, taking each in turn:

1. The minibus is a capital item (as it will be used in the business for more than a year), and therefore will not be immediately deductible from taxable income. However, it will qualify for tax depreciation in the 'other business assets' pool at a rate of 25% per year on a reducing balance basis – this means that the residual balance of expenditure is multiplied by 25% each tax period. Tax depreciation is reduced by 20% if there is any private use of the minibus – please let me know if this is the case.
2. Fuel, maintenance and insurance are all deductible expenses provided the use of the minibus is wholly for business purposes.
3. Website creation costs are an intangible asset – again this is capital expenditure, and will qualify for tax depreciation; however, intangible assets are given relief at 10% of cost every year. Ongoing internet service costs, and website updates, are deductible expenses.
4. Advertising is deductible in full.
5. A launch party would be considered client entertaining, and does not qualify for tax relief.
6. Equipment purchases, if they cost less than RWF500,000, are deductible immediately. If they cost over RWF500,000, they will qualify for 25% per year tax depreciation (as per the minibus in (1)).
7. Your clothing is personal and not business expenditure, therefore is not deductible.

8. Food for yourself is personal expenditure, so does not qualify for relief. However, providing food to your clients on their hiking trips is part of the service they are paying for, and so will qualify for relief.

9. Business liability insurance is a normal revenue expense and meets the deductibility criteria, so is deductible.

10. Wages paid to family members are deductible provided they represent a real business expense.

If after applying these rules, your taxable profit for the tax year to 31 December 2019 is RWF30,000,000, the personal income tax thereon will be RWF8,808,000, calculated as follows:

	RWF'000
360,000 × 0%	0
840,000 × 20%	168,000
28,800,000 × 30%	8,640,000
	8,808,000

The PIT liability will be due three months after the end of the tax period – so before 31 March 2020. No instalment quarterly prepayments will be required for 2019, because you did not have any tax payable to the RRA (other than PAYE paid by your employer) in the tax year to 31 December 2018.

(LO 1.3.2, 3.2.1, 3.2.6, 3.2.7)

(c) If you decide to form a partnership with your wife, you will need to set up a company to run your business. You and your wife will be shareholders in the company, and can split the proportions of shares owned however you like.

The company will then pay corporate income tax on its profits at 30%, and any remaining profits can either be retained in the company, or can be paid to you and your wife as dividends.

Further withholding tax at 15% may apply to these dividends if either of you are not registered with the tax administration (which will probably be the case for your wife). If you are registered (which will apply to you because of your sole trade business, as per (a) above), the dividends must be reported on your PIT return for the tax year; however, the dividend income will be identified as exempt from personal income tax on you, as the income from which the dividend was paid has already suffered corporate income tax.

(LO 3.2.5, 4.1.5, 4.1.6)

14.

Marking scheme

		Marks
(a)	Definition of a PE	2
	Exception for independent agents	1
	Application to scenario – freelance agents	1
	Application to scenario – rented office	1

			5
(b)	Independent agents not liable to CIT on FL	1	
	PE profits liable to CIT	1	
	Only Rwandan income taxable	1	
	Income and expenses	1	
	Tax depreciation and tax rate	1	
			5
(c)	Import WHT explanation and application to FRL	2	
	Calculation	1	
	Deduction from CIT if PE	1	
	Exemption with *quitus fiscal*	1	
	Circumstances where WHT arises	1	
	Application to FRL	1	
	DTA explanation	1	
	Calculation of WHT	1	
	Due date	1	
			10
	Total marks for this section		**20**

Detailed solution

(a) A permanent establishment (PE) is a fixed place of business through which the business of an enterprise is wholly or partly carried on. For example, a place of management, a branch or a place for the provision of services; including consulting services, carried on by a person, with the support of employees or other personnel or for more than 90 days in a 12-month period.

However a company is not treated as having a PE in Rwanda merely because it carries on business in that state through an agent of an independent status, provided that they are acting in the ordinary course of their business.

Therefore, the proposed freelance agents would probably not be treated as PEs, if they are considered to be independent.

The lease of premises and staffing with employees would be considered a 'fixed place of business' and therefore be treated as a PE.

(LO 1.1.2)

(b) The agency structure, provided the agents are not considered to be PEs, will not result in a liability to corporate income tax (CIT) for FL. Each agent will instead be liable to personal income tax (PIT) on their commissions earned.

A Rwandan permanent establishment is liable to CIT on any profits generated in Rwanda. Taxable profit would be calculated in the same way as for a Rwandan company, except that only Rwandan profits are taxable. FL would therefore have to identify from its profit and loss account all income and expenses of the Rwandan branch, and qualifying assets owned by the Rwandan branch would qualify for tax depreciation. The net amount of profit after tax depreciation would suffer CIT at 30%.

(LO 1.6.2)

(c) Imports of goods

When goods are imported into Rwanda by FL (operating through an agent or PE) or FRL, for commercial use (ie onward sale to customers), they are held at customs until the importer collects them. The importer of the goods retains (and pays to the tax administration) withholding tax of 5% on such purchases. The rate is applied to the cost of the goods, including insurance and transportation costs.

Based on the import of 1,000 units of furniture, import WHT would be:

1000 × RWF(180,000 + 80,000 + 60,000) × 110% × 5% = RWF17,600,000

If the seller of the goods (FL) is liable to Rwandan tax on this sale, which would be the case for FL if the business was carried on through a Rwandan PE, it is deductible from their income tax due.

Import withholding tax can be avoided if FL has a tax clearance certificate issued by the Commissioner General of the Rwanda Revenue Authority (*quitus fiscal*). A taxpayer can apply for a tax clearance certificate if they are registered with the RRA and have no unpaid tax arrears with the RRA. Each certificate lasts for one year.

Payment of interest, technical fees and dividends

Withholding tax is applicable to financial interest and dividends, usually at a rate of 15%, where:

- The payer is Rwandan resident; and
- The recipient is either not Rwandan resident or is not registered with the RRA or registered but does not file tax returns.

This would apply to the relationship between FRL (a Rwandan resident company) and its parent company FL (which is resident in South Africa).

However, because there is a Double Taxation Agreement between Rwanda and South Africa, the rate of withholding tax is reduced from 15% to 10% on all of these types of payments.

Hence, WHT on the loan notes would be:

10% × (150,000,000 × 8%) = RWF1,200,000 pa

Due date

The due date for WHT is the 15th of the month following the relevant payment that attracts WHT.

(LO 1.5.1, 1.5.3, 1.5.4)

15.

Marking scheme

			Marks
(a)	CIT computation (½ per line, 1 for interest)	4	
	IQPs amount	½	
	IQP dates (½ each)	1½	
	Balancing payment amount	1	
	Due date for declaration and balance of CIT	1	
			8
(b)	Fixed penalty – December 2017	½	
	Fixed penalty – December 2018	1	
	Late filing and payment penalties	1½	
	Calculations of penalties for December 2017	1½	
	Calculations of penalties for December 2018	1½	
			6
(c)	Tax fraud	1	
	Understatement of tax penalties	2	
	Late payment of tax penalty	½	
	Administrative fine and prosecution of directors	1	
	Non-monetary measures (½ mark per measure)	1½	
			6
	Total marks for this section		**20**

Detailed solution

(a) Corporation tax for the year ended 30 June 2019

		RWF'000
Trading income		750,000
Tax depreciation		(50,000)
Interest income	85,000 × 100/85	100,000
Capital gain		30,000
Total taxable profits		830,000
CIT at 30%		249,000
Less withholding tax	100,000 × 15%	(15,000)
CIT payable		234,000

Note. Dividends from Rwandan companies are not liable to CIT on Kamena Ltd.

Schedule of due dates and amounts of CIT payable:

	Working	
	RWF'000	RWF'000
31 December 2018	25% × 180,000	45,000
31 March 2019	25% × 180,000	45,000

30 June 2019	25% × 180,000	45,000
30 September 2019	234,000 – (3 × 45,000)	99,000

The due date for the declaration of CIT is 30 September 2019 (three months after the end of the tax period).

(LO 3.3.3, 4.2.4, 4.2.5, 4.2.6, 4.2.7)

(b) **Fixed penalties**

Charlotte will be liable to a fixed penalty for failure to submit a declaration for each of the relevant years.

For the year ended 31 December 2017, her turnover was less than RWF20,000,000, and this was her first such violation, so her fixed penalty will be RWF100,000.

For the year ended 31 December 2018, her turnover was again less than RWF20,000,000, so the normal penalty would be RWF100,000; however, this is her second identical offence in a five-year period, so the penalty is doubled to RWF200,000.

Penalties for late filing and late payment

Because Charlotte has neither filed her declarations nor paid her tax on time for these tax periods, she is liable to further penalties:

- 70% of the outstanding tax, consisting of a 60% administrative fine and 10% late payment penalty
- 1.5% interest per month or part month

Year ended 31 December 2017

The filing and payment of tax for the period to 31 December 2017 was due on 31 March 2018. The tax paid should have been (using turnover tax at 3% × 18,000,000) RWF540,000.

The penalties will therefore be 70% × 540,000 = RWF378,000

Interest for 18 months (1/4/18 – 30/9/19) = 1.5% × 540,000 × 18 = RWF145,800

Year ended 31 December 2018

The flat tax regime will apply here, and tax due is RWF210,000. This was due by 31 March 2019.

Penalty at 70% = RWF147,000

Interest at 1.5% for 6 months = RWF18,900

(LO 3.1.2)

(c) If the directors of Gucenga Ltd have falsified invoices in order to reduce their taxable profits and pay less corporate income tax, this is deliberate underpayment of tax (tax fraud). This would seem to be the case given the directors' response to my queries and the evidence gathered.

Gucenga Ltd may be liable to the following monetary sanctions:

Understatement of tax penalties – these depend on the amount of understatement as a proportion of the correct tax liability and can be between 5% and 50% of the underpaid amount. Based on my estimated correct tax liability of RWF110,000,000, there is an understatement of RWF35,000,000, and this is 31.8% of the correct liability. The penalty percentage would be 20% of the correct tax due, or RWF22,000,000.

Late payment of tax penalties at 10% plus 1.5% per month, on the difference between the paid tax and the correct amount.

Administrative fine of 100% of the evaded tax. In addition to the above, assuming the directors have voluntarily evaded the tax, the tax administration could refer the case to the prosecution service. In case of conviction, they could be sentenced for a period between six months and two years.

Other non-monetary measures that can be applied are:

- Closure of the business for 30 days
- Withdrawal of a trade licence
- Denial of tax clearance certificate
- 100% tax audits
- 'Naming and shaming' in newspapers
- Seizure of property

(LO 1.6.1, 3.1.2)