
**CERTIFIED PUBLIC ACCOUNTANT
ADVANCED LEVEL 2 EXAMINATIONS**

A2.3: ADVANCED TAXATION

DATE: MONDAY, 26 APRIL 2021

INSTRUCTIONS:

1. **Time Allowed: 3 hours 45 minutes** (15 minutes reading and 3 hours 30 minutes writing).
2. This examination has **two** sections; **A & B**.
3. Section **A** has **one** Compulsory Question while section **B** has Four optional questions to choose any three
4. In summary attempt **Four** questions.
5. Marks allocated to each question are shown at the end of the question.
6. Show all your workings where necessary.

SECTION A

QUESTION ONE

Alpha Ltd is a multinational enterprise incorporated in Rwanda in 2018 and started its operations in January 2019. It was registered with Rwanda Development Board and obtained its investment certificate. Alpha Ltd deals in the manufacturing of textiles. Its main plant is located in Kigali Economic zone. Alpha Ltd has branches upcountry, and out of the country, and has made different investments on the African continent. The management submitted to the tax Administration the following trading and profit or loss account for the year ended 31st December 2019.

Particulars	Frw "000"	Frw "000"
Business sales		10,500,000
Less cost of sales:		
Opening stock	3,600	
Purchases	8,500,000	
Goods available for sale	8,503,600	
Closing stock	<u>(2,400,000)</u>	<u>6,103,600</u>
Gross profit		<u>4,396,400</u>
Other incomes		
Gain on sale of motor vehicle		3,200
Interest on savings		7,300
Dividends received		165,000
Profit received		658,500
VAT refund		100,000
Exchange gain		2,600
Total Incomes		5,333,000
Expenses		
Salaries and wages	590,000	
Staff meals	300,700	
Management and technical fees	508,450	
Research and development	165,000	
Advertisement and marketing	70,050	
Trainings and capacity building	35,000	
Repair and maintenance	276,500	
Loan interests	876,000	
Legal expenses	68,400	
Travelling and communication	47,200	
Donations	350,950	
Bad debts	105,000	
Good will	2,500	
Depreciation	900,000	
VAT declared and paid	4,000,000	
WHT on public tenders	245,000	
Total Expenses		(8,540,750)
Net profit for the year		<u>(3,207,750)</u>

Additional information:

- i) The closing stock was valued at cost plus mark-up of 5%
- ii) Dividends were received from an investment made in Mauritius net of tax. Rwanda has a DTA (Double Tax Agreement) with Mauritius to tax dividends paid out at withholding tax rate of 10%.
- iii) Profit received was from ASA (Alpha South Africa) Ltd, its branch operating in South Africa. The income tax rate in South Africa is 28%.
- iv) Included in salaries and wages are Board of Directors' sitting allowances amounting to Frw 63,000,000 and penalties for delay in the declaration and payment of PAYE for permanent staff amounting to Frw 28,000,000.
- v) Staff meals included the following:

Staff meals	Frw "000"
Staff party	175,000
Staff water and tea at offices	125,700
Total	300,700

- vi) It was discovered that a prepayment of house rent for the CEO amounting to Frw 500,000 per month for two years ending in December 2020 was omitted in the books of accounts.
- vii) It is the company's policy to account for provision for bad and doubtful debts at a rate of 1% of the turnover. This provision was included in bad debts.
- viii) Legal expenses included factory insurance policy of Frw 9,600,000 for two years expiring on 31/12/2020.
- ix) Repair and maintenance included an amount equivalent to Frw 70,000,000, which was the purchase of new machinery in the public auction. This expense was not capitalized.
- x) Travelling and communication expenses related to the car fuel and telephones whose private and business use cannot be practically separated.
- xi) Management and technical fees were paid to a non-resident person.
- xii) Depreciation was calculated on the following assets:

Assets	Land	Buildings	Plant and Machineries	Motor vehicles	IT systems & software	Computers & accessories	Furniture and fittings	Total
	Frw "000"	Frw "000"	Frw "000"	Frw "000"	Frw "000"	Frw "000"	Frw "000"	Frw "000"
Cost 01/01/2019	168,000	3,500,000	3,657,000	124,000	1,275,000	56,000	92,000	8,872,000

Required:

- a) As a tax auditor from the tax administration, compute Alpha Ltd capital allowance for the year ended 31st December 2019. (9 Marks)
- b) Compute Alpha Ltd taxable income, total tax to be paid and tax payable for the year ended 31st December 2019. (25Marks)
- c) Explain the term Tax haven as used in taxation. (2 Marks)
- d) The following relates to Quincaillerie Narumugabo Ltd. It has been operating in Kigali city since 2007.

Particulars	Frw "000"
Fixed assets	98,700,000
Stock	5,645,000
Shareholders 'equity	62,970,000
Total liabilities	41,375,000
Net Assets	21,595,000

Additional information:

- i) Due to unforeseeable circumstances, the company was liquidated in July 2019.
- ii) The sale of its assets and remaining stock was Frw 138,000,000

Required:

Compute the tax liability on liquidation.

(4 Marks)

(Total:40 Marks)

SECTION B

QUESTION TWO

Brexel XL Hotel is a five-star hotel registered as a large taxpayer in Rwanda Revenue Authority. The following relates to its accounts as of May 2019.

Sales	Frw "000"
Room accommodation	376,000
sale of Food in restaurant	549,800
Sale of drinks in bar	163,800
Conferences room accommodation	276,300
Sales in the shop	15,620
Gym subscriptions	47,856
Sauna & massage	4,850
Hairdressing saloon	5,700
Total sales	1,439,926

Expenses	Frw "000"
Food	83,200
Beer, Fanta and liquors	158,400
Electricity	59,430
Water bill	48,600
Gaz	11,300
staff salaries	158,000
Gym trainer	4,600
articles in the shop	89,400
Hair saloon materials	2,700
Fuel	5,700
Imports of kitchen appliances	289,000
Computers	64,000
Software for accounting and stock management	278,000
Spare parts for car maintenance	2,400
Total purchases	1,254,730

Additional information:

- i) Where applicable, all the figures are VAT inclusive.
- ii) Food was purchased from the farmers in Western province. Only 2/3 was manufactured food and was supplied by recognized supermarkets from Kigali City.
- iii) Included in sales of food and drinks were 5% relating to tips provided by customers to hotel waiters.
- iv) Sales in the shops were related to Made in Rwanda handcraft articles.
- v) The hotel found defected vatable goods among the received supplies. These goods were returned to the supplier who issued a debit note of Frw 1,600,000.
- vi) The spare parts purchased were used to repair the Hotel Minibus. This car is used for transportation of the hotel staff who work during the night shifts.

vii) During the month, the hotel wrote off bad debts amounting to Frw 58,000,000. This debt was due in 2017. The hotel has taken all possible steps in pursuing payment; however, the debtor has been declared bankrupt.

Required:

- a) **Compute the VAT payable for Brexel XL Hotel for the period ending 31st May 2019.** (17.5 Marks)
- b) **Brexel XL failed to submit VAT declaration and payment on time for a period of one month. Compute applicable tax penalties.** (2.5 Marks)
- (Total:20 Marks)**

QUESTION THREE

- a) **Explain the main features of a customs union.** (4 Marks)
- b) International Accounting standards (IAS 24) related party disclosures, states that if an entity has had related party transactions during the periods covered by the financial statements, it shall disclose the nature of the related party relationship as well as information about those transactions and outstanding balances, including commitments necessary for users to understand the potential effect of the relationship on the financial statements. The necessity of disclosing related party transaction information is because this has a big impact not only on the reported income but also on the tax to be paid by the entity.

Required:

- In the context of Rwandan Income tax law, briefly explain the term related party.** (2 Marks)
- c) The OECD transfer pricing guidelines and other countries legislations details transfer pricing methods that can be used to establish whether the conditions imposed in controlled transactions are consistent with the arm's length principle.

Required:

- i) **Briefly discuss the concept of transfer pricing and transfer mispricing. And explain what would motivate international companies to engage in transfer mispricing.** (6 Marks)
- ii) **Outline the most used transfer pricing methods.** (2 Marks)

- d) B & G Corporation Ltd is a Chinese controlled subsidiary company established in Rwanda since 2017. It deals in the road construction and maintenance. The information below was extracted from its Balance Sheet for the year ended 31st December 2019.

Assets	Frw "000"
Non-current assets	6,987,560
Current assets	4,689,432
Total assets	11,676,992
Equity & Liabilities	
Shareholders' equity	1,405,000
Net profit for the year	128,560
Loss carried forward from previous period	(400,000)
Long-term loan (interest 10% p.a.)	10,543,432
Total equity & liabilities	11,676,992

Required:

- i) B & G Corporation Ltd was in dispute with Rwanda revenue authority on the argument that B & G Corporation Ltd is thinly capitalized. **With reference to Income tax law no. 16 of 13/04/2018 establishing taxes on income, Advise B & G Corporation Ltd on thin capitalization.**
(3 Marks)
- ii) **Compute B & G Corporation Ltd deductible and non-deductible interests, and tax shield for the year 2019.**
(3 Marks)
(Total:20 Marks)

QUESTION FOUR

Giramata Promesse is employed as a permanent staff of Rwanda Agricultural Board since 2019. Her contract terms are as follows:

- Monthly basic salary Frw 2,500,000.
- Monthly transport allowance Frw 100,000.
- Cash allowances Frw 200,000 per month.
- Communication allowances Frw 50,000 per month.
- Medical insurance contribution Frw 187,000.
- Pension contribution Frw 198,0000.
- Employers' contribution to qualified pension fund Frw 120,000.
- Mission allowance Frw 13,000,000.
- She was entitled to a leave pay equivalent to her basic salary in September 2019.
- She received Frw 980,000 annual interest on her savings account.
- Giramata Promesse has a second employment contract to provide teaching services during the weekend at the University of Applied Sciences in Musanze. She gets monthly payment of Frw 600,000 net of taxes.
- Giramata Promesse was provided with an advance salary of Frw 15,000,000 on 1st March 2019 at an annual interest rate of 5%. The bank interest rate is 17%. The loan should be repaid in one year.
- Giramata Promesse had a farm located in Eastern province. During the year, she received Frw 36,000,000 on her agricultural livestock.
- Monthly PAYE withheld and paid by the first employer was amounting to 600,000.

Required:

Compute Giramata Promesse’s annual employment income, tax liability and tax payable if any.

(20 Marks)

(Total:20 Marks)

QUESTION FIVE

Double taxation, a phrase used in taxation and which is considered to be the central problem of international taxation and its treatment causes much complexity of international taxation and the primary concern of taxpayers dealing with cross-border trade.

In this context, Multinational Enterprises’ desire to minimise the tax payable and avoid double taxation, conflict with tax authority’s concerns to protect their right to tax and to ensure taxpayers make fair tax contributions to their countries.

Required:

a) With tangible examples on each of these concepts, describe the concept of double taxation and double non-taxation. (8 Marks)

b) The following relates to SKYS & Partners Group Ltd income for the period ended December 2019.

Particulars	Frw "000"
Local Profit Before Tax	100,000
Gross foreign income	50,000
Gross Profit Before Tax	150,000
Local tax on local income @ 30%	30,000
Foreign tax @ 15%	7,500

Required:

- i) Compute SKYS & Partners Group Ltd effective tax rate.** (4 Marks)
- ii) Provide two main aims of tax treaties and state at least four countries with which Rwanda has signed such agreements.** (4 Marks)
- iii) “If you fail to plan, then you are planning to fail” said Benjamin Franklin long time ago. Based on Benjamin Franklin’s quote, discuss the necessity for a taxpayer to undertake tax planning.** (4 Marks)

(Total:20 Marks)