
CERTIFIED PUBLIC ACCOUNTANT(CPA)

ADVANCED LEVEL 2 EXAMINATIONS

A2.3: ADVANCED TAXATION

MONDAY: 4 JUNE 2018

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.

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QUESTION ONE

East Africa Safari (Rwanda) Limited (EASRL) is a private company incorporated in Rwanda that is engaged in the transportation of passengers from both within and outside Rwanda. The shareholders of the company are East Africa Safari Limited (EASL), a company incorporated in Kenya and Mr. Kayibanda Jean, a Rwandese national who owns a permanent residence in Kigali.

EASL owns 90% of the ordinary share capital of EASRL while the remaining 10% are owned by Mr. Kayibanda. The share capital of the company is Frw 800,000,000.

EASRL started operations in Rwanda on 1 January 2016, after obtaining an investment license from the Rwanda Development Board as a registered investor. The company's office is located in the Nyabugogo suburb of Kigali. The company started the business with ten (10) buses with a seating capacity of 60 each. The buses ply the Kigali - Nairobi route via Kampala on a daily basis.

The following is EASRL's statement of profit or loss and other comprehensive income for the year ended 31 December 2017.

	Notes	Frw '000'
Revenue		19,450,500
Direct costs		(10,300,620)
Gross profit		9,149,880
Other income	1	<u>500,000</u>
		9,649,880
Operating expenses	2	(2,657,890)
Administrative expenses	3	(5,229,890)
Other operating expenses	4	<u>(387,350)</u>
Operating profit		1,374,750
Finance costs	5	<u>(150,000)</u>
Profit before tax		<u><u>1,224,750</u></u>

Notes:

1. Other income
This is an amount of interest earned on Rwanda government securities with a security of 5 years. The interest is reported gross of tax.

2. Operating expenses include the following;

	Notes	Frw '000'
Office rent		51,800
Office water and electricity	6	35,400
Professional fees	7	1,000,000
Repairs and maintenance		950,560
Internet and communication		620,130
		2,657,890

3. Administrative expenses include the following;

	Notes	Frw '000'
Salaries and wages		2,764,203
Bad debts	8	725,320
Auditor's remuneration		452,000
Depreciation of vehicles and other property		526,780
Directors' sitting allowances		56,000
Staff welfare	9	705,587
		5,229,890

4. Other operating expenses include the following;

	Notes	Frw '000'
Donations	10	127,500
Penalties	11	7,200
Security expenses		65,000
Other deductible expenses		187,650
		387,350

5. Finance costs

Frw 50,000,000 was interest paid on loan that was used to purchase land for the managing director. Frw 100,000,000 was paid in respect of a business loan and bank overdraft.

6. Water and electricity

The managing director lives on the second floor of the office block but it is not easy to estimate the amount of water and electricity used by the residence and the office

7. Professional fees

The professional fees were paid to the EASL for the provision of specialized staff to help in organizing and branding the office.

8. Bad debts

Included is a provision for bad debts of Frw 325,320,000 in respect of a debtor that has migrated to Burundi. No follow up on the debtor has been done yet.

9. Staff welfare

Included in the amount is Frw 120,000,000 which was attributed to Entertainment costs.

10. Donations

Included in the donations is Frw 122,500,000 that the company paid to Ruhengeri Traders Limited, a customer as contribution for construction of a new warehouse. The remaining amount was paid to a charitable organization.

11. Penalties

The penalties relate to violation of traffic rules by the company drivers.

12. Information relating to property, plant and equipment

Tax written down values as at 1 January 2017

	Frw '000'
Computers and accessories, information and communication systems, software products and data equipment	1,250
Other business assets	450,000

Additions:

The company bought the following assets;

- Five 30 seater buses at Frw 40,000,000 each.
- 5 desktop computers at Frw 500,000 each.
- Constructed a passenger waiting lobby at Frw 150,000,000.
- Furniture and fittings Frw 20,000,000.

Disposals:

- Sold 2 scrapped buses that were involved in accident at Frw 25,000,000 each.

13. The company had a tax loss brought forward from 2016 of Frw 920,534,000.

14. The company did not make any quarterly payment of tax during the year but made the declaration for 2017 as well as paying the tax due on 30 April 2018. The company had not applied to extend the date for making the declaration.

REQUIRED:

- (a) Advise EASRL on their taxable income and corporate tax payable for the year ended 31 December, 2017.

(21 Marks)

- (b) Advise EASRL on any penalties, fines and interest due (if any) on its compliance with declaration and payment of tax for the year 2017.

(5 Marks)

- (c) EASL had commissioned a feasibility study in the wider East African region in December 2017 as to whether it would be viable to carry on with the transportation of goods in addition to the transportation of passengers. The consultants confirmed in a January 2018 report that there are opportunities for expanding the transport business to transport goods from Mombasa to Uganda, Rwanda, Burundi and the Democratic Republic of Congo.

The company however would need to raise additional capital to the tune of Frw 1,200,000,000.

Following the recommendations of the report, the Directors made a decision to relocate the head office of EASL from Nairobi to Kigali. They also decided to list additional shares of

Frw 1,200,000,000 of EASRL on the Rwanda Securities exchange in order to raise the additional funds to enable them purchase heavy trucks that are able to carry cargo of 30 tons each. They floated the shares on 1 March 2018 and raised Frw 900,000,000 from 1,000 residents of Rwanda that subscribed. The additional Frw that was not subscribed was taken up by EASL. This reduced the shareholding of EASL in EASRL from 90% to 55%. They have initially bought five trucks of 30 tons each at Frw 100,000,000 each and started transporting cargo in April 2018.

The alternative option that had been available to the company was to maintain the Head office in Kenya and finance the expansion by having EASRL borrow Frw 1,200,000,000 from a development bank in Kenya at an interest rate of 15% per annum to be repaid in equal installment in 10 years. The amount raised from the loan would be used to purchase five trucks of 30 tons each at Frw 100,000,000 and to facilitate the working capital. Shs. 200,000,000 would be paid to EASL in Kenya for arranging and guaranteeing the loan.

The company has projected, in both scenarios, a profit before tax of Frw 520,000,000 and to make a dividend payment of 20% of the profits after tax at the end of 2018.

REQUIRED:

Advise the EASL on whether they have made the right decision by relocating the Head office to Rwanda.

(14 Marks)
(Total 40 Marks)

QUESTION TWO

Giant Stores Limited (GSL) is one of the leading supermarkets in Byumba town. They sell household items, scholastic materials, construction materials and electronic supplies. The company is registered for VAT and has been compliant in terms of tax declaration and payment.

GSL has a contract with three secondary schools to supply them with scholastic material for the year 2018. The sales of school books and newspapers were exclusively sold to the three schools during the quarter ended March 2018.

Below is a summary of the sales and purchases made for the months of January, February and March, 2018.

Item sold	Frw '000'	Item purchased	Frw '000'
School books	87,000	Newspapers	15,000
Fresh fruits	60,000	Plastic cups, chairs & buckets	86,400
Cement	90,060	School books	140,700
Laptops	57,800	Fresh fruits	55,160
Newspapers	5,000	Cement	171,600
Plastic cups, chairs & buckets	<u>38,700</u>	Laptops	<u>76,500</u>
Total	<u>338,560</u>	Total	<u>545,360</u>

Other relevant information:

- (a) The sales are VAT Exclusive and Purchases are VAT Inclusive where applicable.
- (b) GSL provided you with information relating to debit notes and credit notes for January 2018. Debit notes amount to Frw 10,000,000 and Credit notes Frw 6,500,000.
- (c) GSL donated cement valued at Frw 2,500,000 to one of the local orphanages to enable them construct a building.

REQUIRED:

- (i) Compute GSL's VAT payable or claimable for the quarter ended 31 March, 2018 and advise the company, in detail, on the tax implications of the result. **(13 Marks)**
- (ii) A Revenue Authority officer on a routine check on the company's records included in his report that the company was not compliant with the requirements of the use of Electronic Billing Machine (EBM). The tax accountant in his defense explained to the managing director that it is not easy to use the EBM.

REQUIRED:

Explain to the managing director any 6 (six) challenges one may encounter in using the EBM and the penalties (if any) of tampering with information from the EBM?

(7 Marks)
(Total 20 Marks)

QUESTION THREE

- (a) Gisenyi Breweries Ltd manufactures light beer from imported malt. The beer is consumed both locally in Rwanda and some exported to the neighboring countries of Uganda, Democratic Republic of Congo and Burundi. During the month of March 2018, the Board of Directors made a decision to purchase a new motor vehicle for the exclusive use of the Managing Director.

After thorough market research, a motor vehicle befitting the status of the Managing Director was identified from Jimex Global Car Suppliers, a supplier in Japan. The company made a decision to import the motor vehicle as per the specifications below;

Vehicle model	Toyota Land cruiser Prado
Year of Manufacture	2017
Engine Capacity	2.7 L(2,694cc) Diesel
Price on Commercial invoice - Free on Board (FOB) Tokyo Japan	US\$ 40,000

The company wired the quoted amount in the commercial invoice direct to the supplier in Japan and then contracted High Sea Transport Company Limited to transport the motor vehicle up to Gisenyi in Rwanda for a contract amount of US\$ 8,500.

High Sea Transport Company Limited provided the details of their costs to the company which was broken down as below;

- Storage charges at the Yokohama Harbour before loading on the ship US\$ 700
- Shipping charges from Yokohama to the port of Mombasa in Kenya US\$ 3,860
- Marine insurance on board the ship US\$ 600
- Transport from Mombasa to Katuna Boarder post US\$ 2,300
- Transport from the boarder at Katuna to Gisenyi US\$ 1,040

The following information is also available

1. Exchange rate of the US\$ 1= Frw 864
2. Tax rates

	Rate %
Import duty	25
Excise duty	15
Infrastructure development	1.5
Withholding tax	5

3. The registration fees is Frw 250,000

REQUIRED:

Advise Gisenyi Breweries Ltd on all the taxes payable on the registration of the imported motor vehicle in the month of March, 2018

(11 Marks)

- (b) During the month of March 2018, Gisenyi Breweries Limited supplied the following beer to its distributors out of its factory warehouse.

Date	Number of crates	Ex-factory price
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		Frw '000'
5 March, 2018	5,000	75,000
15 March, 2018	8,000	120,000
25 March, 2018	5,600	84,000

The declaration and payment of the consumption tax due on the supplies made on 5 and on 15 March, 2018 were made on time but the declaration and payment of the consumption tax due on the supplies made on 25 March, 2018 were not made until the 20 April, 2018.

REQUIRED:

- (i) Advise Gisenyi Breweries Limited on the due dates for declaration and payment of consumption tax. **(3 Marks)**
- (ii) Advise the company on the consumption tax payable for the month of March 2018 as well as the penalties due (if any). **(6 Marks)**

(Total 20 Marks)

QUESTION FOUR

Miss Giramata is a professional lawyer who has worked in the public and private sector for the last 10 years. She was recently offered a job by Charitas International, a local NGO registered in Kigali and given an opportunity to choose between working as a full time lawyer or as a consultant. The details of the contract under the two options for the year ended 31st December 2017 are as follows;

Contract 1-Working as a full time lawyer

- (i) Basic salary Frw 30,000,000 per year
- (ii) Subsistence Allowance Frw 8,000,000 per year
- (iii) Leave pay Frw 10% of basic salary
- (iv) Housing Allowance Frw 6,000,000
- (v) Motor vehicle –Available for use all the time for both official and private work
- (vi) Meals and refreshment Frw 1,000,000
- (vii) Over time allowances Frw 1,800,000
- (viii) She will be required to work 5 times a week for eight hours per day.

Contract 2-Working as a consultant

- (i) Consultancy fees Frw 48,000,000 per year
- (ii) Transport reimbursement Frw 3,000,000 per year
- (iii) She will be required to avail legal advice and invoice the Charitas International for the services provided

REQUIRED:

- (a) Advise Giramata on the option that offers the most tax efficient benefits. **(14 Marks)**
- (b) Advice Charitas International on their tax obligations regarding the income paid to Giramata either as a full time lawyer or as a consultant. **(6 Marks)**

(Total 20 Marks)

QUESTION FIVE

Atlas Technologies International (ATI) is a Dubai based company that owns 99% of shares in Atlas Technologies-Rwanda Limited (ATR). They deal in the supply of telephone software, computers and automatic teller machines (ATMs) that are supplied by ATI. The total equity of the company is comprised of the following;

	Frw '000'
Share capital	100,000,000
Share premium	200,000,000
Profit and Loss reserve	45,000,000
Revaluation reserve	35,000,000
Total	380,000,000

During the year ended 31 December, 2017 ATR obtained a FRW 500,000,000 loan from ATI at interest of 10% per annum, repayable in 5 years.

During the year ended 31 December, 2017 ATR engaged the services of Kamanzi Tax Associates(KTA) to review the company's transactions with the aim of ensuring compliance with Rwanda tax laws and regulations.

ATR did not disclose to KTA that there were some services that ATR provides to ATI within Rwanda that were not disclosed in the accounts. They also did not inform KTA that they keep two sets of accounts, one for the purpose of disclosure to the revenue authority and the other for the majority shareholder in Dubai.

KTA also did not disclose that the manager responsible for ATR account is a wife of the Commissioner General of the revenue authority. ATR only discovered this when they had paid a visit to the commissioner general at his home in Kigali. The meeting had been arranged by ATR without the knowledge of KTA but the intention was to talk about a tax matter that was of concern to the major shareholder in Dubai which had come to the attention of the revenue authority after they carried out an audit.

REQUIRED:

- (a) With reference to the ethical principles that govern the relationship between client and tax consultant discuss the problems that are likely to arise from the relationship between ATR and KTA. **(10 Marks)**
- (b) It has been found out that the price at which ATI provides software to ATR is on the average less by 20% to the price that other competing companies in Rwanda supply the same software. This has led to ATR becoming a monopoly on the market due to their low cost of installing software. At the same time, the company makes losses because of the amount of management charge that is paid to the main shareholder and who is the parent company in Dubai. The revenue authority has made an assertion that the transactions between ATI and ATR are not at “arm’s length”.

REQUIRED:

Explain what you understand by the term “arm’s length price” and what is its importance with regard to transactions involving third parties?

- (c) Comment on the tax implications, if any, of the interest payable by ATR to ATI. **(4 Marks)**
- (6 Marks)**
- (Total 20 Marks)**

