CERTIFIED PUBLIC ACCOUNTANT

ADVANCED LEVEL 2 EXAMINATIONS

A2.3 ADVANCED TAXATION

DATE: MONDAY 24, APRIL 2023

MARKING GUIDES AND MODEL ANSWERS

SECTION A

QUESTION ONE

Marking Guide

		Maximum Marks
(a)	01 mark for showing understanding of Thin Capitalization	1.0
	01 Mark for highlighting Rwanda tax law treatment of this	1.0
	01 mark for assessing the tax exposure on the $10M Loan proposal	1.0
	01 Mark for advising CFO to stick to max. 4:1 debt: Equity ratio	1.0
	Sub-total for this section	*4.0*
(b)	Profit / (Loss) per accounts	1.0
	Additions:	
	Accounting depreciation	1.0
	Insurance prepayment	1.5
	Prepaid Airport parking cost	1.5
	Pension (Employees' liability)	1.5
	Bonus provision	1.0
	Best performers payment	1.0
	Bad debt written by the company	1.0
	Fuel reimbursement (Personal use)	1.5
	IFRS 16: Amortization	1.0
	AFRRS 16: Finance cost	1.0
	technical support fees	1.0
	Deductions:	
	Tax depreciation	1.0
	Profit on disposal of Fixed assets	1.0
	Release of Bonus Provisions (2020)	2.0
	Actual rent expense	1.0
	Tax losses brought forward (b/f)	1.0
	CIT rate	
	CIT payable (N/A, company has a 7 years tax holiday)	1.0
	W1:	
	Additions qualifying for Accelerated depreciation	1.0
	Additions not qualifying for Accelerated depreciation	1.0
	Proceeds from disposal of fixed assets	1.0
	Initial allowance (50% for assets of $50k and above)	1.0
	Tear & Wear allowance rate	1.0
	Tear & Wear allowance -Amount	1.0
	Total tax depreciation allowances	1.0

	W2: Management, Loyalty & Technical fees	1.0
	W3: Prior year losses (RWF '000)	1.0
	Sun-total for this section	*30.0*
(c)	02 marks for each comprehensive explanation of the tax treatment, citing relevant tax provisions and advising on the right treatment	6.0
	Sub-total for this section	*6.0*
	Total Marks for Question One	***40.0***

Model Answers

(a)Advise to the CFO regarding $10 Million Loan

Generally, interest on Loans is allowable expense for Income tax purposes provided the loan was acquired and used solely for business purposes.

Rwanda tax law puts some restrictions on interest on loans and advances from related entities, this is called 'Thin Capitalization'.

Article 26 (10) of law no. 16/2018 stipulates that interest paid on loans and advances from related entities is not deductible to the extent that the total amount of the loan for which interest is paid exceeds four (4) times the amount of equity during the tax period.

Currently with the equity of RWF 38.9M there is no exposure in this regard. The $10M interest bearing loan would not be thinly capitalized.

However, while making future loan decisions, the company should bear in mind that the maximum recommended debt to equity ratio is 4:1.

(b) Income Tax Computation for the tax period ending 31 December 2021.

Description	**Workings**	**RWF '000**	**RWF '000**
Profit / (Loss) per accounts			22,386,486
Additions:			
Accounting depreciation		7,973,827	
Insurance prepayment	(99M/12*8)	66,000	
Prepaid Airport parking cost	(75M/3*1)	25,000	
Pension (Employees' liability)	(3.3% x Gross pay	83,249	
Bonus provision		247,442	
Best performers payment		6,000	
Bad debt written by the company		65,000	
Fuel reimbursement (Personal use)	20%	20,000	
IFRS 16: Amortization		79,000	
IFRS 16: Finance cost		69,727	
Technical support fees	W2	58,100	
Total additions (Disallowable expenses)			**8,693,346**

Deductions:			
Tax depreciation	W1	7,953,502	
Profit on disposal of Fixed assets		2,875,764	
Release of Bonus Provisions (2020)		205,000	
Actual rent expense	(14m/1.18*100*10)	118,644	
Total deductions			**11,152,909**
Adjusted taxable profit			**19,926,922**
Tax losses brought forward (b/f)	W3		(13,032,178)
Net Taxable profit			***6,894,744***
CIT rate			30%
CIT payable (N/A) due to tax holiday of 7 years			-

W1: Tax Depreciation (05 Marks)	**Computers**	**Other Assets**	**Total**
Opening TWDV	345,605	33,738,060	34,083,665
Additions qualifying for Accelerated depreciation	62,000	-	62,000
Additions not qualifying for Accelerated depreciation	6,610	1,293,750	1,300,360
Proceeds from disposal of fixed assets	-	(4,108,234)	(4,108,234)
Sub-total	**414,215**	**30,923,577**	**31,337,792**
Initial allowance (50% for assets of $50k and above)	(31,000)	-	(31,000)
Sub-total	**383,215**	**30,923,577**	**31,306,792**
Tear & Wear allowance rate	50%	25%	
Tear & Wear allowance -Amount	(191,608)	(7,730,894)	(7,922,502)
Closing TWDV	**191,608**	**23,192,683**	**23,384,290**
Total tax depreciation allowances	***(222,608)***	***(7,730,894)***	***(7,953,502)***
W2: Management, Loyalty & Technical fees (01 Mark)			

	RWF '000		
Amount expensed	905,000		
Amount allowable (Caped at 2% of Income)	(846,900)		
Disallowed	**58,100**		
W3: Prior year losses (RWF '000)	**Annual**	**Cumulated**	
Year 1: 2018	(5,115,271)	(5,115,271)	
Year 2: 2019	(4,622,914)	(9,738,185)	
Year 3: 2020	(3,293,993)	(13,032,178)	

(c) MEMO
FROM: CPA FINALIST STUDENT

TO: TWAGIYE MOBILITY CFO

TOPIC: Explanation for Key Adjustments in CIT computation on some topics:

Area	**Explanation**
IFRS 16 Adjustment	The Interest on Lease Liability and Amortization of Right to use asset was disallowed and we allowed the actual rent per lease agreement. As much as article 19 of law no.16/2018 allows for taxable business profit to be determined in accordance with IFRS, you will note that IFRS 16 does not correspond to a real expense that can be substantiated with proper receipts.
Release of provisions	An amount of RWF 205 million for bonus provision was deducted from taxable income (refer to computation above) in determination of taxable profit. Based on information shared, we understand that; - The amount was taxed in prior year - The cost was actualized in current year - The corresponding taxes were dully paid (PAYE.) Based on this, it fulfils the requirements of article 25 of Rwanda income tax law to be allowed for tax purposes.

SECTION B

QUESTION TWO

Marking Guide

Question	Details	Marks	Total Marks
(a)	Award 2 marks of a well computed CIF value	2	
	Award 0.5 marks on well computed import duty	0.5	
	Award 2 mark on well computed excise tax	1	
	Award 2.5 marks on well computed VAT	2.5	
	Award 0.5 marks on well computed withholding tax	0.5	
	Award 0.5 marks on a well computed IDL tax	0.5	
	Award 0.5 marks on a well computed AUL tax	0.5	
	Award 2.5 marks on Total cost computed that will be recognized in the P/L Statement	2.5	
	Reasons why VAT and WHT were not included in the total cost of P/L Statement	2	
	Total		**12**
(b) (i)	04 marks for a good illustration of Leasehold Improvement, comprehensive understanding that it is a capital expenditure and correct proposal of tax treatment	4	
(b) (ii)	Maximum 04 marks for a well detailed explanation of IFRS 16 adjustment, disallowable based on specific tax law requirement and bringing out the right treatment	4	
	Total		**8**
	Total Marks		**20**

Model Answers

a) Computation of Taxes payables at Customs

Description	Workings	FRW "000"
CIF	FOB+I+F	
	(59,000+8,000+12,000) *950	75,050,000
Import duty	CIF *rate	
	75,050,000*25%	18,762,500
Excise tax	(CIF + import duty+ Handling Fees) *rate	
	(75,050,000+18,762,500) *10%	9,381,250
VAT	(CIF +import duty + excise tax + port charges) 18%	
	(75,050,000+18,762,500+9,381,250+(80,000*10) *18%)	18,718,875
WHT	CIF *rate	

	75,050,000*5%	3,752,500
IDL	CIF *Rate	
	(75,050,000*1.5%)	1,125,750
AUL	CIF*Rate	
	(75,050,000*0.2%)	150,100

Total cost that will be recognized in the P/L statement (CIF+ Import duty+ Excise duty + IDL+ AUL)	**104,469,600**

The reasons why VAT and WHT were not included in the total cost that will be recognized in the P/L Statement of Mountain Gorilla Ltd is because; VAT of FRW 18,718,875 will be claimed back in domestic VAT declarations (as Mountain Gorilla Ltd is not the final consumer), and the WHT 5% of FRW 3,752,500 will be claimed back in domestic Income Tax declarations.

(b)

i. ***Lease hold Improvement:***

The expenditure on the building, the improvement it makes of the asset's functionality and the duration if the contract (4 years) qualifies this to be a capital expenditure per IFRS requirements.

Since tax laws of Rwanda allow for accounting to base on IFRS rules, this should be capitalized and not expensed upfront.

The company shall then gradually depreciate the 'Leasehold Improvement' over its useful life, in this case falls under 'Other assets and expense the corresponding tax tear and wear.

Therefor the CFO's statement is not correct, the expensed amount shall be 'added back' to increase taxable profit and only recognize corresponding tear and wear.

ii. ***IFRS 16 Adjustment:***

Ideally based on article 19 of law No. 16/2018 depreciation and interest on loans are allowable tax expenses, based on this alone you could argue that the current treatment is ok.

However, the same law stipulates the specific conditions that must be fulfilled for an expense to qualify as a tax expense (refer to article 25 of the same law).

IFRS 16 amortization of Right to use asset and interest expenses on Lease Liability do not constitute a real tax expense and cannot be supported with relevant receipts.

Therefore, both shall be added as disallowed (FRW 95 million + FRW 73 million) and actual rent expense of FRW 180 million annual cost shall be allowed and deducted to reduce taxable profit.

Finally, the prepayment aspect should not create confusion, we do not expense prepaid services, hence any payment made crossing into 2022 shall also be disallowed.

QUESTION THREE

Marking Guide

Question	Description	Marks	Total Marks
(a)	**July 2021 VAT computation**		
	Output VAT		
	Standard sales	1	
	Credit notes (for supplier, a credit = a reduction of the accounts receivable)	1	
	Input VAT		
	Standard rated purchases	1	
	Imports of raw materials-from 4 lines in Working	4	
	Less return outwards	1	
	Add understated returns outwards	1	
	Less purchases without fiscal invoices	1	
	Office electricity bills	1	
	Office telephone bills	1	
	VAT liability for July 2021	1	
	Add non-declaration penalty		
	Add late payment penalty (16,790*20%)	1	
	Total VAT payable for July 2021		
	June 2021 VAT computation		
	Non-declaration penalty	1	
	Explanation: Though the company did not had sales in June 2021, but it had the obligation to declare whether sales were made or not. The reason why it is charged fixed penalties for non-declaration.	1	
	Total		**16**
b	Award 0.5 on the correct answer to each available option for communication between RRA and taxpayers. (Maximum 2 Marks)		**2**
c	Award 0.5 marks on explanation that a taxpayer is only audited once. Maximum 0.5 marks	0.5	
	Award 0.5 marks on two circumstances that allow RRA to conduct a new tax audit. Maximum 1 mark.	1	

Question	Description	Marks	Total Marks
	Award 0.5 marks to the explanation that Mercure international company can be audited again. Maximum 0.5 marks	0.5	
	Total		2
	Total Marks		**20**

Model Answers

a) Computation of VAT position for Mercure International Company.

Computation of VAT for Mercure International Company for the Month of June & July 2021

July 2021 VAT computation			
Output VAT	**Description**	**Workings**	**Amount "000" FRW**
	Standard sales	799,000,000*18/100	143,820
	Credit notes (for supplier, a credit = a reduction of the accounts receivable)	46,000* 18/100	8,280
	Total Output VAT		135,540
Input VAT	**Description**	**Workings**	**Amount "000" FRW**
	Standard rated purchases	421,095*18/100	75,797
	Imports of raw materials	W1	42,219
	Less return outwards	17,620* 18/100	3,172
	Add understated returns outwards	9,000* 18/100	1,620
	Less purchases without fiscal invoices	7,500*18/100	1,350
	Office electricity bills	2,200*18/100	396
	Office telephone bills	3,000*18/100	540
	Total inputs VAT		118,751
VAT liability for July 2021	(135,540 - 118,751)		16,790
Add non-declaration penalty			300
Add late payment penalty (16,790*20%)			3,358
Total VAT payable for July 2021			20,447

June 2021 VAT computation			
Non-declaration penalty			300,000
Note 1. Though the company did not had sales in June 2021, but it had the obligation to declare whether sales were made or not. The reason why it is charged fixed penalties for non-declaration.			

Working 1:

Description	**Workings**	**FRW "000"**
CIF Kigali		152,400
Understatement insurance and freight		16,000
		168,400
Import duty	CIF *rate	
	168,400,000*25%	42,100
Excise tax	(CIF + import duty) *rate	
	168,400,000+42,100,000*10%	21,050
VAT on imports	(CIF +import duty + excise tax + port charges) 18%	
	(168,400,000+41,100,000+21,050,000+3,000,000) *18%	42,219

b) A communication between the Tax administration and the taxpayer is delivered through any of the following means:

- A registered letter,
- A written act or communication delivered with acknowledgement of receipt.
- An official notification by the court bailiff;
- Electronic message sent to the email address given by the receiver,

c) With reference to Mercure International Company's audit case, explain the concept of the 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:
- Complicity of the taxpayer and the tax auditor to evade taxes or commit any other act intending to non-payment of required tax.
- If the first audit was based on forged documents.
- If the first audit was issue-oriented and the Tax administration wants to conduct a comprehensive audit,
- When the Commissioner General cancels the first audit based on appeal.
- For the case of Mercure International Company, RRA conducted an issue-oriented tax audit because it was only looking for VAT only for the month of June to July 2021. The tax

administration has the right to conduct a comprehensive audit which can include the reviewed taxes.

QUESTION FOUR

Marking Guide

	Marks
(a) Good presentation of PVA	
Award 2 Marks for computation of Constant Payment, Award 2 Marks for correct computation of Interest, Award 2 Marks for Correct Computation of Principal, Award 2 Mark for Correct Computation of Balance. Max 8 Marks	8
Good presentation of loan option	
PBT	1.5
Less interest	1.5
P/L	1.5
Less relief	1.5
Taxable income	1.5
Tax @ 30%	1.5
Retained profit	DNA
(b) Award 1 Mark for each scenario of registration. Max 3 Marks	3
Total Marks	**20**

Model Answers

a) **Advise on how to finance the business**

Loan = FRW 1,000,000,000

Interest (r) = 10%

Period (n) = 5 years

PVA=A*3.7907868

A=Constant payment

1,000,000,000= A*3.7907868

A=1,000,000,000/3.7907868 = 263,797,481

Year	Constant-FRW	Interest-FRW	Principal-FRW	Balance-FRW
0				1,000,000,000
1	263,797,481	100,000,000	163,797,481	836,202,519
2	263,797,481	83,620,252	180,177,229	656,025,290
3	263,797,481	65,602,529	198,194,952	457,830,339
4	263,797,481	45,783,034	218,014,447	239,815,892

Year	Constant-FRW	Interest-FRW	Principal-FRW	Balance-FRW
5	263,797,481	23,981,589	239,815,892	0

Option 1: Loan

Particulars	Y1-FRW	Y2-FRW	Y3-FRW
PBT	100,000,000	240,000,000	200,000,000
Less interest	(100,000,000)	(83,620,252)	(65,602,529)
P/L	0	156,379,748	134,397,471
Less relief	0	0	0
Taxable income	0	156,379,748	134,397,471
Tax @ 30%	0	46,913,924	40,319,241
Retained profit	**0**	**109,465,824**	**94,078,230**

Option 2: Equity

Dividend=500,000 x 200 = 100,000,000

particular	Y1	Y2	Y3
PBT	100,000,000	240,000,000	200,000,000
Tax @30%	30,000,000	72,000,000	60,000,000
PAT	70,000,000	168,000,000	140,000,000
Dividend	100,000,000	100,000,000	100,000,000
Retained profit	**(30,000,000)**	**68,000,000**	**40,000,000**

Conclusion: The loan is beneficial as it provides less taxes and higher retained profits

b) Advise on the company registration.

A person who sets up a business must register with the Register General. A person who carries out any taxable activity whose turnover is equivalent to twenty million Rwandan Francs (FRW 20,000,000) in the previous fiscal year, or five million Rwandan Francs (FRW 5,000,000) in the preceding calendar quarter is required to register for Value Added Tax within a period not exceeding seven (7) days from the end of the concerned year or quarter.

A person who is not required to register for Value Added Tax may voluntarily register with the Tax administration for Value Added Tax.

QUESTION FIVE

Marking Guide

Question five	Details	Marks	Total Marks
(a)	Award 1 Mark for stating Trading licence tax, Award 1 Mark for explaining exemption on Trading license tax, Award 1 Mark for stating public cleaning fees, and award 1 Mark on explanation.		**4**
(b) (i)	06 marks for relevant workings, evenly distributed	6	**6**
(b) (ii)	05 marks for correct determination of taxable income and 03 marks for calculation of tax liability	8	
	Tax penalty for non-declaration (Explanation)	2	
	Total		**10**
	Total Marks		**20**

Model Answers

a) Taxes and fees applicable to Venus Ltd are as follows:

- Trading licence tax: Venus Ltd is qualified to register for trading license tax, however because he is a newly registered medium taxpayer, he will start to pay the trading licence tax after two years.
- Venus Ltd is also required to declare and pay Public Cleaning fees of FRW 10,000 per month, because its offices are located in Kigali City.

(b) (i) Calculation of Capital gains tax:

The standard formula for determining capital gains as base for calculation of capital gains tax is getting the difference between proceeds from sale of shares and the cost of the shares, but for this question we have to separate calculation for the cost of shares as it is not straight.

Step 1: Calculate the presale shares and cost				
When	**Particulars**	**Shares**	**Share Price (FRW)**	**Total (FRW)**
April 2021	Purchase of shares	200,000	375	75,000,000
June 2021	Purchase of shares	185,000	250	46,250,000
		385,000		**121,250,000**
November 2021	Sale of shares	300,000		
Number shares remaining after sale		**85,000**		
Step 2: Calculate the cost of the Shares to be sold				
Cost = (sale proceeds)/(Sale proceeds + value of shares remaining)* Cost of shares pre-sale				
Value of remaining shares is 85,000 shares * selling price (123,000,000/300,000)				
Value of remaining shares =		34,850,000		
Cost of shares sold = (123,000,000)/(123,000,000+34,850,000)*121,250,000				

Cost of shares sold =		94,480,519		
Calculation of capital gains and capital gains tax				
Particulars		**FRW**	**FRW**	
Proceeds from sale of shares			123,000,000	
Cost of net shares realized (refer to step 2)		94,480,519		
Add: Broker fees (1% of 123m)		1,230,000		
Total cost			95,710,519	
Net capital gains			**27,289,481**	
Capital gains tax @ 5%			**1,364,474**	

(b) (ii) Rental income tax

	FRW '000	**FRW '000**
Gross Income (100m*3)		300,000
Deductions:		
Allowable expenses (10%)	30,000	
Depreciation (25% of cost)	112,500	
Finance cost (Interest) (15%*300m)	45,000	
		(187,500)
Net taxable rental income		**112,500**
Tax Liability calculation:		
Tax band	**Tax rate**	**Tax amount (FRW '000)**
(0 to 360,000)	0%	-
(360,001-1,200,000)	20%	168
(Above 1,200,000)	30%	33,390
Total tax liability		***33,558***
Less Tax paid as at 28th February 2022		***(10,000)***
Net tax liability (To be paid not later than 31st March 2022)		***23,558***

No penalty and interest to be payable by Mrs Tengera because as per Article 43 of law nº 016/2018 of 13/04/2018 establishing taxes on income, all revenues derived from rent of machinery and other equipment including agriculture and livestock equipment in Rwanda, are included in taxable income and reduced by allowable expenses and for this case the deadline of 31st January 2022 is not applicable as the rental income received by Mrs Tengere is a Personal Income to be treated under Personal Income Tax (PIT) and for PIT, the deadline for declaration and payment is 31st March 2022. So even if she declared and paid on 28th February 2022 the lesser amount, she still has until 31st March to pay all due amount.

END OF MARKING GUIDES AND MODEL ANSWERS