

# CPA

**Certified Public Accountant Examination**

**Stage: Foundation 2.4**

**Subject Title: Taxation**

**Examination Format Revision Pack**



INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS OF RWANDA  
Driving Sustainable Performance

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# **F2.4 TAXATION**

## **FOUNDATION 2**

### **EXAMINATION FORMAT REVISION QUESTIONS & SOLUTIONS**

**Notes:**

You are required to answer a total of **five** questions. Questions 1 ,2 ,3 and 4 are compulsory. You are also required to answer **either** Question 5 or 6.

(If you provide answers to both Questions 5 and 6, you must draw a clearly distinguishable line through the answer not to be marked. Otherwise, only the first answer to hand for Questions 5 or 6 will be marked).

**TIME ALLOWED:**

3 hours, plus 10 minutes to read the paper.

**INSTRUCTIONS:**

During the reading time you may write notes on the examination paper but you may not commence writing in your answer book. **Please read each Question carefully.**

Marks for each question are shown. The pass mark required is 50% in total over the whole paper.

**Start your answer to each question on a new page.**

You are reminded to pay particular attention to your communication skills and care must be taken regarding the format and literacy of the solutions. The marking system will take into account the content of your answers and the extent to which answers are supported with relevant legislation, case law or examples where appropriate.

List on the cover of each answer booklet, in the space provided, the number of each question(s) attempted.

**Question 1.**

- (a) Who is liable to personal Income Tax?
- (b) Calculate the Income tax liability on the following:-

Sehuku Venuste receives a wage of RWF 400,000 per month, and benefits from his employer a house living and transportation. Which category of tax must he pay? Specify the tax base, the taxable amount, the rate of imposition and finally the tax due.

- (c) Discuss the warning letter and seizure in the procedures of recovery of taxes
- (d) What types of tax are there?

**25 Marks**

**Question 2.**

- (a) What are the Penalties and Interest if a taxpayer fails to pay tax?
- (b) Explain the meaning “Long Term Contract” and the rules that apply to such contracts
- (c) A contract between the Ministry of Health and COTO LTD Company for construction of a hospital for 100 million RWF. This construction is estimated to be completed in 3 years and for 80 million RWF (estimated expenses).

Implementation plan:

The Ministry of Health and COTO Ltd Company agreed on the following:-

- For the 1<sup>st</sup> year: the construction company will finish 20% of the work
- For the second year: 50% of the work will be completed
- For the 3<sup>rd</sup> year 30% will be completed

Calculate the tax to be paid for the 3 years.

**20 Marks**

**Question 3.**

(a)

Ms Sylvia has placed her 10,000,000 RWF to her Zigama CSS savings account for profits to the year rate of 10%, from 01/09/2011 until 31/12/2011. Which category of tax must she pay? Specify the tax base, the taxable amount, the rate of imposition and finally the tax due.

(b)

Define the concept of Depreciation

(c)

Discuss the taxable operations under VAT in Rwanda

**20 Marks**

**Question 4.**

**(a)**

Mr Kanamugire Anastase imports from Brazil 5,000 bags (50kg each) of sugar at a price of 10US\$ per sack CIF. Calculate the vat payable?

**(b)**

Discuss the free movement of goods under the Common Market per Article 39 (East African Community Customs Union).

**(c )**

Discuss the concept of training, education and research expenses as deductible charges under Rwandan Income Tax Law.

**20 Marks**

**Question 5.**

The Safintra Limited Company produces iron sheets to be sold to the wholesalers. During a fiscal year 2011, the company produced and sold to the wholesalers at 460,000 RWF VAT excluded.

The wholesalers sold the iron sheets to the semi wholesalers at the price of 600,000 RWF VAT excluded who sold the products to the retailers at 750,000 RWF VAT excluded. At the last stage the retailers sold the iron sheets products to the builder who is the last consumer at a price of 800,000 RWF VAT excluded.

Calculate the total VAT payable to the Rwandan Revenue Authority using the VAT rate in Rwandan law.

**15 Marks**

**OR**

**Question 6.**

What obligations are imposed on a person who is or should be registered for VAT?

**15 Marks**

## **Solution 1**

### **(a)**

Residence can be defined as the place where by someone lives. For tax purposes, residence varies considerably from state to state. For individuals, physical presence in a state is an important factor. Some states also determine residence of an individual by reference to a variety of other factors, such as the ownership of a home or availability of accommodation, family, and financial interests.

An individual is taxable in Rwanda only if he/she has a tax residence there. According to article 3 of the Law N° 16/2005 OF 18/08/2005 2005 On Direct Taxes on Income (DTI) have tax residence in Rwanda:

- The taxpayers who have in Rwanda a permanent residence or;
- The taxpayers who have a principal residence in Rwanda;
- Diplomatic agents or consular Rwandan accredited abroad.

An individual who stays in Rwanda for more than 183 days in any 12-month period, either continuously or intermittently, is resident in Rwanda for the tax period in which the 12 month period ends.

If during a tax period, a resident in Rwanda generates income derived from taxable activities performed abroad; the income tax payable by that resident in respect of that income is reduced by the amount of foreign tax payable on such income in accordance with articles 3° and 4° of the Law N° 16/2005 OF 18/08/2005 2005 On Direct Taxes on Income. The amount of foreign tax payable shall be substantiated by appropriate evidence such as tax declaration, a withholding tax certificate or any other similar acceptable document.

The reduction of the income tax provided for by the Rwandan legislation does not exceed the tax payable in Rwanda on income from abroad<sup>1</sup>.

A resident taxpayer is liable to income tax per the tax period from all domestic source and foreign sources in accordance with articles 3 and 4 of the said law.

A nonresident taxpayer is only liable to income tax which has a source in Rwanda<sup>2</sup>.

The incomes which are regarded as Rwandan source are enumerated in the article 4 Law N° 16/2005 OF 18/08/2005 2005 On Direct Taxes on Income as follows:

- Income generated from services performed in Rwanda, including income generated from employment;
- Income generated by a crafts person, musician or a player from his or her performances in Rwanda;
- Income generated from activities carried on by a non-resident through a permanent establishment in Rwanda;

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<sup>1</sup> Article 6: of Tax Law n°16/2005 of 18/08/2005; related on Foreign tax credit

<sup>2</sup> Article 6: of Tax Law n°16/2005 of 18/08/2005; related on obligations

- Income generated from sale of movable assets owned by a permanent establishment in Rwanda;
- Income generated from the following assets in Rwanda:
  - immovable assets and accessories thereto;
  - livestock and inventory generated from agriculture and forestry;
  - usufruct and other rights derived from an immovable asset if such an asset is in Rwanda;
  - income generated from sale of assets from immovable assets and accessories, livestock and inventory from agriculture and forestry and all usufructs and rights in relation with an immovable asset or its accessory.
  - dividends distributed by a resident company;
  - profit shares distributed by a resident partnership;
  - interest paid by the Central Government, District, a resident of Rwanda or by a permanent establishment that a non-resident maintains in Rwanda;
  - license fees including lease payments and royalties or artistic fee paid by a resident, or paid by a permanent establishment owned by a non-resident in Rwanda;
  - income generated from any other activities carried on in Rwanda.

According to article 6 of the DTI, if during the fiscal year, a resident perceives an income of the taxable activities carried on abroad, (according to the provisions of articles 3 and 4 of the DTI) the payable tax by this resident under this income is tiny room of the amount of the payable foreign tax on this income. However, this tax cut could not be higher than the tax which would have been taken in Rwanda with the title of the income of foreign source. In other words, the foreign tax credit will be granted only to the amount of the Rwandan tax corresponding.

However, a problem remains: if the taxpayer systematically chooses to pay the tax in order to profit abroad from the tax credit in Rwanda, it will have always a loss of earnings for the Rwandan finance public. The only remedy for this situation will be to conclude from preventive conventions of double taxation.

(b)

**Category of tax:** Income tax on employment

**Tax base:** Salary + Expenses in kind

**Taxable amount:** - Living house: = 80,000 Rwf

- Transport : =40,000 Rwf

**Total taxable amount:** 400,000 Frw +80,000 Rfw + 40,000 Rfw= **520,000 Rwf.**

**Rate:** 0%, 20%, 30%.

**Tax due:**

- 0 Rwf 30,000 Rwf 0%
- 30,001 Rwf 100,000 Rwf is 20%

=14,000 Rwf

- 100,001 Rwf 520,000 Rwf 30%

520,000 RWF -100,000 Frw= **420,000 RWF**

= 126,000 Rwf

Total amount per month: 0 Rwf +14,000 Rwf +126,000 Rwf= **140,000 Rwf**

**Total amount per year: 140,000 Rwf x 12= 1, 680, 000 Rwf.**

(c )

- **Warning letter:** When a tax is not paid on time according to paragraph 2, article 18 of the tax law procedures, the article 46 of the same law provides that the Tax Administration sends a warning letter to the taxpayer, indicating the amount of tax, interest and penalties to be paid and the legal action that will follow if the tax, interest and penalties are not paid within fifteen (15) days from the delivery of the warning letter. The 15-day period may be disregarded in case the possibilities for effective tax collection are in jeopardy. When taxes were not paid within a period of ten (10) years counting from the time it was due, the tax cannot be paid. Such a period can be stopped through procedures determined by the Civil code and by the arrangement of payment the debtor has made with the Tax Administration and after. If the period for taxation is postponed, after 10-year period following the latest postponement notice of taxation period prescription, another 10-year period of stopping may also be postponed in the same manner, if in that period the case of the disputed tax was not filed in the court.
- **Seizure of taxpayer's property**

As provides by article 48 of the law on tax procedures, when the tax is not paid within fifteen (15) days as mentioned in article 46 of this law, the Tax Administration may attach



any movable or immovable property of the taxpayer, whether held by the taxpayer or any other person. The seized property is sold under a public auction after eight (8) days the taxpayer is notified of the affidavit.

If the Tax Administration has serious indications that a supplier is selling taxable goods and such goods have previously not been charged with value added tax, the Tax Administration can seize those goods. If the supplier cannot provide evidence of compliance with the provisions of the value added tax law within fifteen (15) days, the Tax Administration can sell these goods at a public auction.

The seizure and selling of the attached goods takes place according to the law on civil and commercial procedures. In the field of taxation, the bailiffs of the Tax Administration have the same competence as Private court bailiffs.

**(d)**

There are 2 types of tax – Direct Taxation and Indirect Taxation

Direct – paid directly to the RRA out of earnings. Income tax on earned income or dividends. Indirect – paid at the time of sale to the next in the chain. The final consumer pays the tax to the seller/supplier/producer and so on down the line.

Excise duty is added to the cost paid by the wholesaler/agent and the producer/importer pays the duty to the RRA. The final consumer pays the tax in the end but this is really to refund the person who sold him/her the good.

VAT – value added tax. Each person in the chain pays VAT to the RRA which is calculated as a % of the value he adds to the processes he employs. He hands to the RRA the VAT he adds to his invoice less the VAT on any allowable invoices which he has had to pay in the making or acquiring of the good.

The final consumer pays an invoice which includes the vat in total and so the tax is effectively levied on the total consumer, but the RRA collects portions of the final tax in elements along the line.

## **Solution 2**

(a)

### **Interest**

A taxpayer who fails to pay tax within the due date is required to pay interest on the amount of tax. Interest is calculated on a monthly basis at the inter-bank offered rate of the National Bank of Rwanda plus 2 (two) percentage points. For example, if the inter-bank rate is 9%, interest is imposed at 11% annually.

### **Penalties**

With regard to PAYE tax, a taxpayer is subject to penalty and fine when failing to:

- a) file a tax declaration on time;
- b) file a withholding declaration on time;
- c) withhold tax;
- d) reply to an information request of the Tax Administration;
- e) cooperate with a tax audit;
- f) communicate the capacity or appointment as described by Article 7 §2 of the Law on Tax Procedures;
- g) register as described by Article 10 of the Law on Tax Procedures; or
- h) Comply with Articles 12, or 13, of the Law on Tax Procedures.

(b)

### ***Long-term contract***

Within the meaning of the law, a long-term contract is a contract of manufacture, installation, construction or provision of services relating to these activities, which is not finished during the fiscal year during which it started. And this, with exclusion of the contracts whose completion is envisaged in the twelve (12) months which follows their beginning (art.20 DIT).

For these contracts, the following **rules must apply**:

- The benefit of businesses (constituted of the remuneration of labour) is not taxed during the fiscal year during which work ends. It is taxed at the end of each intermediate fiscal year;
- This intermediate benefit is given according to the percentage of the activities carried out during the intermediate exercise;
- The percentage of realization is determined by comparison of the total of the expenditure related with the contract and incurred before the end of the fiscal year with the estimated total of the expenditure on all the duration of the contract, including the possible variations and fluctuations;

- If a loss is incurred during the fiscal year for which the long-term contract is completed, this loss will be charged to the benefit of a former fiscal year. In other words, the taxpayer will be given a tax credit (or refunding of tax) pursuant to the system of *the carry back* (see infra).

(c)

The tax to be paid is calculated in accordance with what is stipulated in the article 20 paragraph 2 & 3 mentioned above.

✓ 1<sup>st</sup> year

Income = 20% x 100 M RwF = 20 M RwF

Expense = 20% x 80 M RwF = 16 M RwF

Profit = 20 M RwF - 16 M RwF = 4 M RwF

**Since it is a company, then the tax to pay equals to 30% x 4 M RwF = 1,200,000 RwF**

✓ 2<sup>nd</sup> year

Income = 50% x 100 M RwF = 50 M RwF

Expense = 50% x 80 M RwF = 40 M RwF

Profit = 50 M RwF - 40 M RwF = 10 M RwF

**Since it is a company, then tax to pay equals to 30% x 10 M RwF = 3,000,000 RwF**

✓ 3<sup>rd</sup> year

Income = 30% x 100 M RwF = 30 M RwF

Expense = 30% x 80 M RwF = 24 M RwF

Profit = 30 M RwF - 24 M RwF = 6 M RwF

**Since it is a company, then tax to pay equals to 30% x 6 M RwF = 1,800,000 RwF**

Article 20 paragraph 4 of the law n° 16/2005 of 18/08/2005 on direct taxes on income deals with a loss in tax period in which a long-term contract is completed may be carried back and offset against previously taxed business profit from that contract to the extent it cannot be absorbed by business profit in the tax period of completion.

### **Solution 3**

**(a)**

**Category of tax:** Income tax on investment.

**Tax base:** Interests

**Taxable amount:** =1,000,000 Rwf

**Rate:** 15%

**Tax due:** = 150,000 Rwf.

**(b)**

Depreciation means a decrease in value due to wear and tear, decay, decline in price, etc. Such a decrease as allowed in computing the value of property for tax purpose.

It can also mean a decrease in the purchasing or exchange value of money. It can also refer to a lowering in estimation.

In accounting, the depreciation is the reduction in value of a fixed asset due to use, obsolescence. It is the amount deducted from gross profit to allow for such reduction in Value.

**(c )**

The following operations are subjected to the Rwandan VAT when they are localized in Rwanda (Article 2 LVAT). They are the supplies of goods, the provisions of services and the imports.

- **Supply of goods**

By supply of goods, the law aims at the setting of a good at the disposal of its purchaser by a taxable person his partner or his agent, for a counterpart. This counterpart is defined by the law as being the rising its equivalent or silver total actually paid or payable in order to acquire the good (Article 85.6 LVAT).

The supply of goods is thus a transfer of property (*usus, fructus, abusus*) even if the effective delivery of the good will be operated only later (ex: contract of lease back by which an owner sells a good for then taking it in hiring) or although the payment of the counterpart is not directly carried out (ex: hire-purchase).

Also, the concept of goods is defined like any personal property or real like any article considered as good under the terms of Law VAT other than the money (art 85.8 LVAT). For purposes of the application of the VAT, immaterial goods like gas, the air or electricity can be compared to movable property.

- **Provisions of services**

The provisions of services are all the operations which do not require a transfer of property but which is made or achieved for a counterpart, including the lease, the hiring, the transfer or the abandonment of straight or interest. It should nevertheless be specified that the provisions of services made by an employed person or a government official, are not taxable operations with the VAT.

- **Importation**

The importation can be a supply of goods or a provision of services according to cases'. The importation is supply of goods that this one made enter to Rwanda of the goods starting from a country or a foreign place. It is about a provision of services if this one is carried out under one of these two (2) conditions (Article 85.10 of the LVAT):

- The service provider is a non-resident;

The person receiving benefits of the services is a resident in an ordinary situation of businesses carried out outside Rwanda but the recipient of the service having to prof

## Solution 4

(a)

Article 12 (1) the law stipulates that “Goods or services shall be deemed as taxable supplies when the supply of the same is made by a taxable person, a partner or agent, for consideration, under the conditions set forth in article 4 and 9 of this law.

The taxable value of imported goods shall be determined as for a duty of customs, but shall be taken to include the amount of any duty or other import duties payable otherwise than under this Law in respect of the importation (**Article 18**).

Mr KANAMUGIRE Anastase imports from Brasil 5,000 bags (50 kg each) of sugar at a price of 10 US\$ per sac CIF

**The VAT payable is calculated as follows:**

Total CIF value:  $5,000 \times 10 \text{ US\$} = 50,000 \text{ US\$} \sim 30,000,000 \text{ RWF}$  if we consider  $1 \text{ US\$} = 600 \text{ RWF}$

- i. Customs Duties (CD) =  $30,000,000 \text{ RWF} \times 25\% = 7,500,000$  if we consider the rate for rice as equals to 25% ;
- ii. Storage fees in MAGERWA (10 RWF/100 Kgs) =  $(50,000 \times 50 \text{ kg}) \times 10/100$   
 $= 250,000 \text{ RWF}$
- iii. Rwanda Bureau of Standards Fees =  $\text{CIF} \times 1/1000 = 30,000,000 \text{ RWF} \times 1/1000 = 30,000 \text{ RWF}$

Since there are no other fees paid for the importation, the VAT payable to Customs will be:

VAT:  $(\text{CIF} + \text{CD} + \text{Storage fees} + \text{RBS Fees}) \times 18\% = (30,000,000 + 7,500,000 + 250,000 + 30,000) \times 18\% = 37,780,000 \times 18\% = \mathbf{6,800,400 \text{ RWF}}$

**VAT payable at the Customs Department is 6,800,400 RWF**

(b)

### **Free movement of goods under the Common Market**

The Common Market Protocol stipulates that “The free movement of goods between the Partner States shall be governed by the Customs Law of the Community as specified in Article 39 of the Protocol on the Establishment of the East African Community Customs Union”.

On 1st July, 2009, Rwanda commenced the implementation of the EAC Customs Union and started levying zero percent import duty tariff on goods originating from the Partner States,

applying the Common External Tariff and the East African Customs Management Act and Regulations.

“Implementation of the Customs Union is progressive and a case in point is the internal tariff elimination on intra regional trade which took 5 years that is to say, from 1st January 2005 to 31st December 2009,”.

Removal of VAT, Consumption tax (excise duty) and Withholding tax will be effected upon realization of a fully fledged customs union which is yet to materialize. The following will be envisaged under a fully fledged Customs Union:

- Shifting of borders between Partner States to the peripheral;
- Collection of duties and taxes at the point of entry into the Customs Union Territory;
- Agreeing on the revenue sharing mechanism;
- Establishment of a regional authority to administer the Customs Union
- Elimination of rules of origin on intra regional trade. In a fully fledged Customs Union, goods from Nairobi to Kigali will not attract any duties and taxes will be considered just as goods coming from Huye, Southern Province or Musanze, Northern Province.

**(c)**

Article 27 of the law on income tax states that all Training and Research expenses incurred and declared as agreed by a taxpayer and declared and earlier agreed and which promote activities during a tax period are considered as deductible from taxable profits in accordance with provisions of Article 21 of this law.

Expenses on training, research and on promotion of activities as applied in the said Article do not concern the purchase of land, of houses, of buildings and other immovable properties including refining, rehabilitation and reconstruction as well as exploration expenses and other assets”.

However, the provision of the law, goes further to state that such training and research activities are those that promote business activities in the tax period.

The other issue which we do not find necessary to discuss here is the nature of training vis-à-vis the business that is covered under the above article.

This training and research should be in line with the nature of business carried out; such that a law firm may not claim a deductible expense, for a research carried out on mining, while

arguably, a law firm can be allowed a deduction for training of an accountant, if such training is intended to facilitate the attorneys in that firm to carry out their business. Needless to mention is that the principle of deductibility, benefits only businesses that keep book of accounts, and which do not fall under the lump sum regime.

- ***Educational expenses***

Educational expenses paid directly on behalf of an employee, or reimbursed to an employee, can be deducted by the company if the expenses are ordinary and necessary to maintain or improve the employee's skills for the business, or if incurred by the employee pursuant to a written educational assistance program. Any educational expenses that are deductible only as part of an educational assistance program (because they aren't related to the employee's job duties) are limited to a maximum of \$5,250 per employee per year, and must be part of a qualified, written plan that does not discriminate in favour of highly compensated employees.

- ***Research and Development.***

Research and development costs are costs incurred in the business to learn information about the development or improvement of a product. Product is broadly defined to include formulas, inventions, patents, process, techniques, and similar property. Research and development costs do not include the cost of quality control testing, consumer surveys, advertising or the cost of purchasing someone else's process or patent.

One can deduct the costs of research and development in the year that she/he pays or incur the expenses by taking the full deduction for such costs in the first year that you incur the expenses. If she/he don't make the election to take the full deduction in the first year, then she/he must treat the expense as a capital expense related to the product or process, and amortize the deduction over the anticipated life of the product or process.



**Solution 5.**

	Taxable base	VAT paid	VAT received	Recoverable VAT	VAT to pay
Nyirangarama SA	460,000	-	82,800	-	82,800
Wholesalers	600,000	82,800	108,000	82,800	25,200
Semi Wholesalers	750,000	108,000	135,000	108,000	27,000
Retailers	800,000	135,000	144,000	135,000	9,000
Consumers	-	144,000	-	-	-
<b>TOTAL VAT</b>					<b>144,000</b>

## **Solution 6**

In Rwandan Law a person includes individuals and entities such as limited companies or partnerships.

Any person (or business) whose turnover exceeds or is expected to exceed 20,000,000 RWF in a year or 5,000,000 RWF in a quarter must within 7 days of the end of the relevant period register with the tax authority.

The business registered for VAT must issue invoices in a prescribed format and on such an invoice there must be:

1. The Name of the Taxpayer, client and the name of the Business
2. The TIN, Taxpayer's Identification Number and that of the purchaser if applicable
3. No. and date of VAT certificate
4. Description of goods sold or service rendered
5. Value of taxable goods or services
6. Date the invoice was issued
7. The serial number of the VAT invoice

The return shall be lodged together with any tax due within fifteen days after the end of the prescribed accounting period to which it relates or within such other time as the Commissioner General may determine by notice.