

**CTO – Taxation Operations**

**T160**

**Thursday, 29/11/2018**

**08:30 – 11:30 AM**

WORKFORCE DEVELOPMENT AUTHORITY



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**ADVANCED LEVEL NATIONAL EXAMINATIONS, 2018,  
TECHNICAL AND PROFESSIONAL STUDIES**

**EXAM TITLE: TAXATION OPERATIONS**

**OPTION: CUSTOMS AND TAX OPERATIONS (CTO)**

**DURATION: 3 hours**

**INSTRUCTIONS**

The paper is composed of **three (3) main Sections** as follows:

**Section I:** Attempt **all the thirteen (13)** questions. **55 marks**

**Section II:** Attempt **any three (3)** out of five questions. **30 marks**

**Section II:** Attempt **any one (1)** out of three questions. **15 marks**

**Note:**

***Every candidate is required to carefully comply with the above instructions. Penalty measures will be applied on their strict consideration.***

**Section I. Attempt all the Thirteen (13) questions**

**55 marks**

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- (01)** Taxes have existed virtually as long as there have been organized governments. In the biblical concept, a tithe (one tenth) of the crops used to be set aside for the purposes of redistribution and support the priesthood. In the middle ages, individuals provided services directly to the minor lords. These were all taxes, only that they were not monitored.

Write down at least two clear statements on the meaning of taxation?

**(3 marks)**

**Answers:**

It is a compulsory payment to the government for the payment or provision of voluntary consumption of goods and services.

Taxation is a legally compulsory transfer of money from the public to the government mainly as a source of government revenue.

It is a leakage from the circular flow of income into public sector excluding loans or any other direct payment for publicly produced goods and services up to the cost of producing item. No direct connection between benefit received and the payment.

Taxation as “ a practice of imposing tax or an assessment of tax, where a tax is a charge or contribution required from persons or groups within the domain of a government for the support of the government.”

- (02)** Taxes can be categorized as Progressive, Regressive, and Proportional.

Differentiate those categories.

**(3 marks)**

**Answers:**

**A progressive tax:** is a popular form of taxation which levies taxes according to the individual's household income. In the sense it levies higher taxes to wealthier individuals and considerably lower tax to low income individual. Most believe that this is the best taxation since it lessens the tax burden to low income families. The lower class individuals are shielded from higher tax burdens.

**Regressive tax:** is just the opposite of the progressive tax. As the income of the individual increases, the rate of the tax goes on diminishing. Regressive taxes encourage saving and investment. When high-income earners pay less tax, they have more discretionary funds to use for investment and savings.

**Proportional Taxes:** Incomes are taxed at single uniform rate, no matter whether the income is high or low.

**(03)** What is meant by taxing authority, taxpayer and tax? **(3 marks)**

**Answers:**

Taxing authority refers to the authority with the power to impose tax e.g. the central government or a local government. (1mark)

In Rwanda, the central government imposes tax through Rwanda Revenue Authority. Districts also have the power to impose the decentralized taxes (patent, property taxes). (1mark)

Taxpayer is the person or entity that pays tax e.g. individuals, companies, businesses and other organisations. (0.5mark)

Tax is a compulsory contribution by a tax payer to the government through the revenue authority without involving equal and opposite return.(0.5mark)

**(04)** Taxes are normally classified as either direct or indirect.

**a)** What mean direct Taxes and indirect Taxes?

**b)** Give two examples to each

**(4 marks)**

**Answers:**

**a) Direct taxes** are those that affect the individual or firm directly through a reduction from his/her/its earnings. (1mark)

**Indirect taxes** are those that are paid to government by an intermediary then passed on to the consumer by including the tax in the final price. (1mark)

Indirect taxes are taxes on out lays or consumption as opposed to taxes on incomes or earnings.

Indirect taxes can be avoided an entity.

b) Example of Direct taxes, Individual income taxes and Taxes on payroll and labour (1mark)

Example of Indirect taxes, General sales, turnover or VAT and Import duties or Export duties (1mark)

**(05)** Explain the following characteristics of a good tax system: The canon of certainty and the canon of productivity. **(4 marks)**

**Answers:**

**The canon of certainty:**

- According to Smith, there should be certainty in taxation because uncertainty breeds corruption.

- The canon of certainty means that “the tax which an individual is bound to pay ought to be certain and not arbitrary”. 1mark
- The time of payment, the manner of payment, the quantity to be paid ought to be clear and plain to the contributor and to every other person. This canon requires that there should be no element of arbitrariness in a tax. It should be clear to every taxpayer as to what, when and where the tax is to be paid, nothing should be left to the discretion of the tax department.  
1mark

**The canon of productivity**

According to this canon, the tax should be productive in the sense that it should bring large revenues which should be adequate for the government but it doesn't mean that in its efforts to raise more revenues the government should tax people heavily. 1mark

Further, this canon implies that one tax which brings large revenue is better than a number of taxes which bring small revenue. 1mark

**(06)** Rwanda government after recognizing that many African countries have adopted VAT system as a foundation for their economic growth, it introduced VAT in its taxation system in order to pursue the tax reforms by establishing a fair and suitable tax system.

- a) What is VAT?
- b) Indicate the merits of VAT system.

**(4 marks)**

**Answers:**

a) A value-added tax, (VAT) is a type of tax that is assessed incrementally, based on the increase in value of a product or service at each stage of production or distribution (1mark)

A *value-added tax (VAT)* is a consumption *tax* placed on a product whenever value is added at each stage of the supply chain, from production to the point of sale (1mark)

b) Broaden the tax base: VAT is a multistage tax for all registered suppliers. This concept of broadening the tax base aims at having more people and more products/ services to pay and have each contributing less.

**Self-policing mechanism:** the purchase of one taxpayer is the sale of another one hence, the tax involved is the input for the last and output for the first taxpayer (0.5mark)

**Avoid cascading effect:** this is a situation whereby a tax is imposed to another  
(0.5mark)

**Export promotion:** exported products are zero-rated. Since all the VAT inputs on exports are refunded, our exports will be competitive on international market.  
(0.5mark)

**Cash flows:** through refund mechanisms, traders acquire cash for running their business (0.5mark)

**(07)** Certain taxes which were formerly collected by the Central government have been transferred to Local Governments. They include:

- a) The property tax
- b) The rental income tax

Briefly explain these types of tax.

**(4 marks)**

**Answers:**

**Property Tax**

Property tax is a tax levied on immovable property: parcels of land, buildings and improvements. Currently, the property tax is the single most important local tax in developing countries. 2marks

**Rental Income Tax**

Rental Income Tax is a tax for individual persons, who earn income from rented immovable properties located in Rwanda. Currently, this type of tax is a potential source of revenue for urban authorities where the demand for accommodation and commercial activities will always be higher than supply. 2marks

**(08)** Taxes have different Objectives, briefly explain five.

**(5 marks)**

**Answers:**

- Raising Revenue
- Encouraging domestic industries
- Stimulating Investment
- Promoting Economic Growth
- Ensuring Price Stability

**(09)** Explain the characteristics of a Tax.

**(4 marks)**

**Answers:**

- Compulsory payments to the government from the citizen.
- Imposes a personal obligation
- Absence of direct benefit or quid pro quo between the State and people

It is payments for meeting the expenses in the common interest of all citizens

The governments have to provide public utility goods

Certain taxes are imposed on specific objectives

There is no tax without representation

**(10)** Differentiate tax incidence from tax impact.

**(4 marks)**

**Answers:**

**Tax incidence**

The incidence of the tax is the final resting place i.e, burden of paying tax. This is the person who bears the burden of paying tax. He/she suffers the economic liabilities of tax. 2marks

**Tax impact.**

The impact of tax is the person on whom tax is imposed on by the government at the first instance. This is the person who is legally liable to pay the tax. He therefore suffers the legal liability. If the government imposes a tax on a person, he/she can transfer the burden to someone else. This is called **tax shifting**.

2marks

**(11)** Tax is the citizen's compulsory and non-refundable contribution to financing government's activities towards the general social welfare in the country".

Some taxpayers tend to believe that tax is an unfair payment such that compliance is only due to fear of legal consequences and not a motivation for business growth and development? Is it this a good way of perceiving tax?

Justify your answer.

**(6 marks)**

**Answers:**

No. This is the wrong way of perceiving tax. 2marks

As mentioned in the statement, tax is the citizen's contribution to financing government's activities aimed at ensuring the general social welfare in the country (building roads, schools, electricity infrastructure, catering for national security...).

2marks

Therefore, tax comes to finance the process of putting in place necessary conditions for economic growth and stability. Paying tax would better be understood as a motivation towards the country's self-reliance rather than being an unfair burden to tax payers. 2marks

**(12)** When taxpayers are not conversant with the tax systems, they can engage in tax offences.

Do you agree with the above statement? Explain different forms of tax offences that are common worldwide? **(6 marks)**

**Answers:**

Yes. 1mark

Taxpayers tend to not comply with tax payment obligation. In case, something is not clearly flowing in terms of what to pay and how, they tend to take advantage by either minimizing the tax to pay or simply by not paying any taxes. 1mark

Tax offences that are known include tax avoidance, tax evasion and tax fraud. 1mark

Tax evasion is an economic crime whereby the taxpayer deliberately tries to avoid paying taxes by either not declaring his true situation of his total income or by claiming higher expenses to offset against his earnings by claiming allowances or relief to which he is not entitled. It is the intentional and fraudulent underpayment or non-payment of taxes. It is paying less than the legally due tax liability by using illegal methods. Tax evasion is a criminal offence. 1mark

Tax avoidance is where the taxpayer carries out his or her business in such a way that he will be required to pay less tax by exploiting the loopholes in the tax law/system. Tax avoidance is not a criminal offence. 1mark

Tax fraud may be considered as a form of deliberate evasion of tax which is generally punishable by law. The term includes situations in which deliberately false statements are submitted, fake documents are produced, etc. Sanctions may include civil or criminal penalties. 1mark

**(13)** Explain what you understand by decentralized taxes in Rwanda. **(5 marks)**

**Answers:**

The Government of Rwanda has embarked since 2000, on decentralization process as an instrument of people's empowerment, a platform for sustainable democratization, a structural arrangement for mobilization for economic development energies, initiatives and resources and as a means for reconciliation, social integration and well-being.

Certain taxes which were formerly collected by the Central government have been transferred to Local Governments. They include:

- The property tax 0.5mark
- The trading license tax 0.5mark
- The rental income tax 0.5mark

#### **Property Tax**

Property tax is a tax levied on immovable property: parcels of land, buildings and improvements. Currently, the property tax is the single most important local tax in developing countries. 1mark

#### **Rental Income Tax**

Rental Income Tax is a tax for individual persons, who earn income from rented immovable properties located in Rwanda. Currently, this type of tax is a potential source of revenue for urban authorities where the demand for accommodation and commercial activities will always be higher than supply. 1mark

#### **Trading License Tax**

Trading license Tax is a tax paid every year by the individuals who has decided to undertake any profit-oriented activity in Rwanda. Legally registered organizations or companies which are liable to the corporate tax should also pay the trading license tax annually. 1mark

The basic trading license is fixed each year by the Council of the District or Town where taxpayers are based. Trading license tax is paid according to type of business activity and area, but for VAT registered taxpayers, trading license will be paid according to their annual turnover and the basis will be the turnover realized during the previous tax year revised by RRA. 0.5mark

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### **Section II. Choose and Answer any THREE (3) questions                      30 marks**

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- (14) Calculate the income tax payable by a resident individual whose annual income is Frw 45,000,000. The employee is provided with furnished accommodation and a fuelled car for private use. The employee has two children attending school. The employer provides an education allowance of Frw 7,200,000 a year, paid monthly. **(10 marks)**



**Answers:**

Cash benefits	Frw	Marks
Basic salary	45,000,000	1
Housing allowance 20%	9,000,000	2
Transport allowance 10%	4,500,000	2
Benefits in kind		
Education allowance	7,200,000	1
Total taxable income	65,700,000	2
PAYE = (65,700,000 - 1,200,000) *30% +168,000	19,518,000	2
		10

- (15) Mr Innocent whose gross salary was Frw 450,000 per month received a loan of 15,000,000 from his employer free of interest on 1<sup>st</sup> January 2018 payable in 15 years. While computing his salary for January 2018, the accountant remembered that he should charge interest income tax to Innocent. The BNR interbank interest rate was 12% per annum. As an accountant assistant, you are requested to compute tax on the loan.

Required:

- how much is taxable income from the loan;
- How much is that tax?

**(10 marks)**

Answers:

- Taxable income for this loan is the interest Innocent would pay for January 2018 if the interbank interest rate is applied, this is Frw 15,000,000 \*12%\*1/12

$$\frac{15,000,000 \times 0.12 \times 1}{12} = \text{Frw } 150,000 \text{ (5 marks)}$$

- Hence his monthly gross salary is above Frw 100,000, the tax on interest income will be 30% = (150,000\* 30%) = Frw 45,000 (5 marks)

- (16) (a) What is the difference between tax depreciation and accounting depreciation?

(b) State any five entities subject to corporate tax in Rwanda.

**(10 marks)**

Answers:

- a. Tax depreciation is a depreciation of assets using depreciation rates specified in tax laws. Accounting depreciation is done by estimating the useful life of the depreciable asset and the Residual value then, using a given method the two elements are used as bases for depreciation. **(5 marks)**
- b. **Entities subject to corporate tax are the following ( 5 marks), (the student will give only 3 and will get 1 mark for each)**
- Companies established in accordance with Rwanda law or foreign law;
  - Cooperative societies and their branches;
  - Public business enterprises;
  - Partnerships;
  - Entities established by Districts, Towns and Municipalities and the City of Kigali, to the extent that these entities conduct business;
- (17) (a) Define the harmonized system of WCO and briefly state how goods are Classified.
- (b) What is the role of the HS in international trade?

**(10 marks)**

**Answers:**

- a. The **Harmonized System** is an international nomenclature for the classification of products (goods). It allows participating countries to classify traded goods on a common basis for customs purposes. (3 marks)
- At the international level, the **Harmonized System (HS)** for classifying goods is a six-digit code **system**. It is classified into: (3 marks)
- Sections
  - Chapters
  - Heading
  - subheading
- b. the role of the HS is to provides a uniform classification, to facilitate international trade and to enable all goods to be assigned a class for a customs tariffs and for the compilation of international trade statistics (4 marks)

- (18) (a) Where the tax payers is required to keep books and record and for how many years?  
 (b) State any three contents of a tax audit notice to be communicated by a tax auditor to the tax payer he intends to audit. **(10 marks)**

**Answers:**

- a. Books and records are to be kept by the taxpayer in his premises or any other place located within Rwanda **(2 marks)**  
 Books and records are to be kept at least for aperiod of 10 years **(2 marks)**
- b. The three content of an audit notice are:
- The fact that the audit is to take place at least 7 days before it is due **(2 marks)**
  - The place where the audit will be conducted **(2 marks)**
  - Specific documents the tax auditor wants to see during the audit **(2 marks)**

**Section III. Choose and Answer any ONE (1) questions 15 marks each**

- (19) COIMEX Ltd is registered for VAT. In March 2018, the company imported goods costing Frw 14.4 million excluding freight charges of Frw 560,000. The company then incurred Frw 916,000 to transport the goods from the port of Mombassa to Magerwa Kigali, and Frw 645,000 to Rubavu warehouse. The processing costs were 28% of the relevant cost incurred up to time of processing. The packaging cost amounted to Frw 342,000. The goods were sold at a profit of 50%. Customs duty was paid at 25% and the VAT rate is normally 18% as per laws.

**Required:**

- Compute the COIMEX Ltd's VAT payable on the above transaction.

**Solution:**

<b>Input VAT</b>		
Cost of goods	14,400,000	
Freight charges	560,000	
	14,960,000	2marks
Custom duties paid: 25% of Frw14,960,000	3,740,000	2marks
Value supply for VAT	18,700,000	2marks
VAT (18% of Frw 18,700,000)	3,366,000	2marks

<b>Output VAT</b>		
Cost of goods	14,400,000	
Freight charges	560,000	
	14,960,000	
Transport	1,560,000	
	16,520,000	1mark
Processing cost: 10% of 16,520,000	1,652,000	1mark
	18,172,000	
Packaging cost	342,000	
	18,514,000	
Mark-up: 50% of Frw 18,514,000.	9,257,000	1mark
	27,771,000	1mark
VAT (18% of Frw 13,800,000)	4,998,780	1mark

VAT Payable = Output tax – Input tax = 4,998,780 – 3,366,000 = Frw 1,632,780.

2marks

**(20)** The statement of Comprehensive Income of ABC Company, a transformation at Nyarutarama Kigali, reveals end December 2017 expenses of Frw 408,600. Its statement of financial position showed that retained earnings grew from Frw 548,600 at the beginning of the year to Frw 520,000 at the end of the year. The company declared dividends of Frw 480,000. The company also pays a corporate income tax at a rate of 30%.

**Required:**

- What about revenues of the period?
- Considering the fact that the revenues of the period included a gain on sale of a used motorcycle for Frw 1,253,800 whereas expenses included a payment of traffic fines by the company's car for Frw 156,000 and a payment for a wrongful termination of the contracts of the former Internal Auditor for Frw 1,146,400, compute the corporate tax payable.

Solution:

Data:

Retained Earnings, beginning 2017	548,600
Revenues 2017	?
Expenses 2017	408,600

Dividend declared in 2017	480,000
Retained Earnings end 2017	520,000

(a) Revenues in 2016 = 520,000 + 480,000 + 408,600 - 548,600 = 860,000

5marks

(b) Income for 2016 = Revenues - Expenses = 860,000 - 408,600 = 451,400

5marks

(c) Adjustment of accounting income for tax income: 5marks

Declared Income	451,400
Add: Non-operating expenses wrongly considered	
- Traffic fines	(156,000)
- Payment for a wrongful termination of the contracts of the former Internal Auditor	(1,146,400)
Less: Non-operating revenues wrongly considered:	
- Proceed of sale of used Motorcycle	1,253,800
Adjusted Income for tax	402,800

Corporate taxes payable for 2016: 30 % of 402,800 = Frw 120,840.

**(21)** Imanzi Ltd, a new business in Kagarama, earned a monthly income of Frw 265,000 in the fiscal year 2016 where an 18% proportional (flat) tax rate was imposed on such a kind of income. Taxpayers in this sector including Imanzi Ltd are normally allowed the following deductions:

- o Locally made raw materials: 14% of annual income.
- o Rural investment incentive: 20% of annual income.
- o Charity actions (contribution to social assistance funds): 4% of annual income.

In 2017, Ineza Ltd's income increased by 10% compared to 2016 and the income tax was imposed on the company's income since then with the following progressive tax rate:

Income bracket	Tax Rate
Frw0 - Frw 282,500	10%
Frw282,501 - Frw 558,250	15%
Frw558,251 - Frw865,400	20%
Frw 865,401-Frw 1,000,000	25%
More than Frw1,000,000	30%

**Required:**

- (a). Calculate the Total Taxes Ineza Ltd paid in 2016 (5 marks).  
(b). Calculate Total Taxes Ineza Ltd owes to the Taxing Authority in 2017.

**Solution:**

**(a). Total Taxes Paid in 2015: Frw 354,888.**

Annual Income 2015: 265,00 x 12	3,180,000	1mark
Less deductions:		
- Raw material : 14% of annual income	(445,200)	1mark
- Rural investment incentive: 20% of annual income	(636,000)	1mark
- Social assistance : 4% of annual income	(127,200)	1mark
Taxable income, 2016	1,971,600	0.5mark
Income tax 2015: flat rate of 18% of 1,971,600	354,888	0.5mark

**(b). Total Taxes Paid in 2017: Frw 516,401.**

Annual Income 2017: 265,00 x 110%	3,498,000	1mark
Less deductions:		
- Raw material : 14% of annual income	(489,720)	1mark
- Rural investment incentive: 20% of annual income	(696,000)	1mark
- Social assistance : 4% of annual income	(139,920)	1mark
Taxable income, 2017	2,172,360	1mark

Income tax 2017: Progressive tax as follows:

Income bracket	Taxable amount	Tax Rate	Calculation	Tax payable
Frw0 – Frw 282,500	282,500	10%	282,500 x 10%	28,250 1mark
Frw282,501 – Frw 558,250	275,750	15%	275,750 x 15%	41,363 1mark
Frw558,251 – Frw865,400	307,150	20%	307,150 x 20%	61,430 1mark
Frw865,401–Frw 1,000,000	134,600	25%	134,600 x 25%	33,650 0.5mark
More than Frw1,000,000	1,172,360	30%	1,172,360 x 30%	351,708 0.5mark
	<b>2,172,360</b>			<b>516,401</b> 1mark

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