
Answers

1 Butler Broadbend
7 June 2010

XYZ Accountants & Co
215 High Street
Harare

Mr B Broadbend
Broadbend & Co
40 East Street
Harare

Dear Mr Broadbend

Your tax affairs for the year ended 31 December 2009

As requested, we set out below our computations of your tax liabilities for the year, together with explanations where necessary.

(a) (i) Computation of your taxable income from employment for the year

	\$	\$
Gross remuneration		80 000
Pension contribution (maximum)		(3 600)
Medical aid cover: – exempt		–
Motoring benefit: 960 * 10/12		800
Golf club subscriptions		1 200
Restraint of trade – capital (see my notes below)		–
Pension refund (see my notes below)	270 000	
Less exempt portion (see calculation)	<u>(240 000)</u>	
		30 000
Acquisition of vehicle: exempt for those over 55 years		–
Taxable income		<u>108 400</u>

Computation of tax liability from employment income

	\$
36 000 at various rates	10 440
72 400 at 37.5%	<u>27 150</u>
	37 590
Credits: Elderly person's credit	<u>(900)</u>
	36 690
3% Aids Levy	<u>1 101</u>
	37 791
Less PAYE	<u>(18 000)</u>
Shortfall: tax still owed	<u>19 791</u>

(ii) Computation of taxable income from business in your capacity as a partner

	\$
Interest on capital	16 400
Share of partnership profit	120 000
Banker's acceptances	5 000
Less exempt	<u>(3 000)</u>
	2 000
	<u>138 400</u>
Tax liability on business income	
Income per above computation	\$138 400
Less amount subject to withholding tax at source	<u>(2 000)</u>
	\$136 400
Tax at 30.9% (including the AIDS levy)	<u>\$42 148</u>

(b) Classification of accruals

(i) Restraint of trade

By signing the agreement, you are giving up a right to earn income for a period of three years. This is similar to selling a capital asset. The sum is therefore capital in nature and is not taxable in your hands.

This type of asset is not subject to capital gains tax as it is not specified for capital gains tax purposes.

In the partnership hands the amount is also capital in nature as it creates an asset of an enduring nature. It is therefore not deductible for tax purposes.

(ii) Your lumpsum commutation from the pension fund

The commutation is exempt from tax to the extent that it does not exceed an amount equal to one third of your pension entitlement. The amount commuted in this case is equal to 3/8 of your total pension entitlement, which is slightly greater than 1/3. The taxable component of the commutation is computed as follows:

	\$
Proceeds	270 000
Less exempt portion: $1/3 * 8/3 * 270\ 000$	(240 000)
Taxable portion of the commutation	<u>30 000</u>

(iii) Durban rental income

In Zimbabwe income is taxable only on the basis of a Zimbabwean or deemed Zimbabwean source. In respect of rental income, the originating cause of the rent is the property and the location of the source is the place where the property is situated.

In this case the source is therefore Durban, in South Africa. The source of the rent is therefore South Africa, not Zimbabwe and the income is therefore not taxable in Zimbabwe.

The rental income may be taxable in South Africa.

(c) We can now compare the quarterly payments you made during the year with the amounts which ideally ought to have been paid:

	\$		\$
1st instalment due 25 March (10%)	4 215	Amount paid	5 000
2nd instalment due 25 June (25%)	10 537	Amount paid	10 000
3rd instalment due 25 September (30%)	12 644	Amount paid	12 000
4th instalment due 20 December(35%)	14 752	Amount paid	13 000
	<u>42 148</u>		

All the four instalments were paid on time and in the case of the first instalment the payment made was actually a little over the expected.

Although the second and third instalments were slightly below the expected, the difference was less than 10%, which is the legislated tolerance limit. Therefore you will not be charged interest on these underpayments

The fourth instalment was slightly below 90% of the expected and although the Commissioner General is entitled to charge interest on the shortfall, he may be persuaded not to do anything about it if your payment record is very good.

If you have any queries about the contents of this letter, please do not hesitate to contact us.

Yours sincerely

For XYZ Accountants & Co

2 (a) Memorandum to Zambia Metallurgical plc

To: Group Finance Director of Zambia Metallurgical plc
From: Tax advisor
Date: 7 June 2010
Subject: Zimbabwe regulatory implications on Zambia Metallurgical plc (ZMplc)

In accordance with your requirements we have reviewed your contract with the Zimbabwean steel producing company in order to ascertain the Zimbabwe regulatory implications on Zambia Metallurgical plc.

We outline below our comments on each of the identified areas of concern for your consideration:

(i) Whether or not ZMplc will be regarded as having a Zimbabwean permanent establishment

The contract requires the physical presence of company personnel in Zimbabwe for a period exceeding six months. During the presence in Zimbabwe the company will be involved in a reclamation process, after which the company will earn income from the disposal of reclaimed metallurgical coke.

Because of the nature of the projected activities of the company in Zimbabwe and the duration of the project, ZMplc will be regarded as operating a permanent establishment in Zimbabwe in relation to the contract. The basic principles which would lead to the permanent establishment classification include the opening and keeping of an office or place of business in Zimbabwe for a period in excess of six months. ZMplc does have a physical place of business in Zimbabwe and the project is expected to last for more than six months.

The impact of this status is that the company will, for tax purposes be treated like any local company operating in Zimbabwe and will be expected to comply with the regulatory requirements of registering for various tax heads as outlined below.

(ii) The nature and types of Zimbabwean tax registrations which will be required

Income tax

The company will be required to register with the Zimbabwe Revenue Authority for income tax purposes.

Value added tax registration

The products which result from the activities of the company are subject to tax on the basis that the expected income is in excess of the registration threshold of income of \$60 000 per annum. VAT registration should be applied for as soon as a business organisation is aware that its annual income is going to exceed the registration threshold of \$60 000. In the case of a project run by ZMplc, registration should actually be undertaken in the first month of trading as the expected income is clearly more than the threshold.

Exports are zero-rated for value added tax purposes and in that respect if most of the product is exported from Zimbabwe then the company will not have a major obligation in relation to the VAT. However, VAT returns must be submitted at the end of each VAT period. VAT is currently payable to ZIMRA by the 5th of the month following the end of the tax period. By not registering for VAT however, the company will lose out on the VAT input tax that the company is entitled to claim in relation to its own suppliers of inputs.

Failure to comply with the VAT requirements attracts penalties of up to 100% of the unpaid tax.

Employee's tax registration

As the company will have employees operating in Zimbabwe, the company will also be required to register for employee's tax purposes. The registration should be made within two weeks of taking on an employee in Zimbabwe.

The company will then be expected to administer the employee's tax deduction system and remit the deducted employee's tax to the Zimbabwe Revenue Authority within three days after the end of the month in which deductions have been effected.

Non-compliance also attracts penalties of up to 100%.

(iii) Customs duty relief

The Customs legislation provides for relief from duty to companies who are importing equipment or machinery for a temporary period where the company has given assurance of the intention to repatriate the equipment at the end of the planned usage. The company can therefore benefit from a temporary import permit (TIP) license under which duty is suspended.

Furthermore, most heavy-duty machinery and equipment enjoy zero rate duties or minimal rates on importation into Zimbabwe. The company will therefore be in a position to select the appropriate dispensation to apply for.

(iv) Exchange control

In terms of the current exchange control requirements, trading companies are required to bring into Zimbabwe all business proceeds emanating from activities carried out in Zimbabwe. Thus you would not be permitted to proceed with your plan to bank all proceeds in ZMplc's Zambian bank.

However, the permitted expatriation of investment is 100%.

(v) Registration of a company in order to operate in Zimbabwe

This is not necessary as the company can register as Zambia Metallurgical plc with the Registrar of companies.

However, if preferred, a subsidiary company may be registered for purposes of exclusively managing or ringfencing operations carried out in jurisdictions other than the home jurisdiction.

Tax advisor

(b) Interest payable on the Chinese Bank loan and thin capitalisation

In general, interest is deductible to the extent that it is not interest on that portion of borrowings that cause the debt: equity ratio to exceed 3:1.

Whether or not the thin capitalisation regulations would impact on the Zimbabwe operations would depend on the form of business model employed. If the company operates a branch in Zimbabwe, although presumably the loan will sit in the head office books in Zambia, a recharge of the interest expense to the branch operations would have to be scrutinised in relation to the thin capitalisation regulations. The recharge may not be deducted in full if it can be proved that the debt equity ratio of the parent company exceeds the ratio 3:1.

However, if a subsidiary company is formed and the loan is made to the subsidiary, then there may be a thin capitalisation impact, depending on the amount of funds invested by the parent company and the form in which this investment is made (i.e. debt or equity).

The thin capitalisation rules provide that any portion of interest disallowed as a deduction would be classified as a dividend and would be subject to a dividend withholding tax of 20%.

3 Dudzai Mbudzi

(a) Computation of capital gains tax

		\$
Proceeds		1 800 000
Deemed costs: estate valuation		(850 000)
Driveway		(20 000)
New security system		(10 000)
Inflation allowances:		
850 000 * 2.5%		(21 250)
20 000 * 2.5%		(500)
10 000 * 2.5%		(250)
Selling costs:		
Tree	6 000	
Window panes	8 000	
Painting	6 000	
Agent's fees	<u>18 500</u>	
		<u>(38 500)</u>
Capital gains tax		859 500
Less suspensive sale allowance:	<u>1 000 000 * 859 500</u>	(477 500)
	1 800 000	
Taxable in 2009		<u>382 000</u>
Tax at 20%		<u>76 400</u>
Taxable in 2010		
Allowance granted in 2009		477 500
Suspensive allowance for amounts due in 2011	<u>400 000 * 859 500</u>	(191 000)
	1 800 000	
		<u>286 500</u>
Tax payable at 20%		<u>57 300</u>
Payable in 2011		
Allowance granted in 2010		191 000
New allowance		—
		<u>191 000</u>
Tax payable at 20%		<u>38 200</u>

(b) Expense related to the uprooting of the old tree

This expenditure is capital in nature but since it has been incurred to enhance value of the property, it may be classified as a permissible selling cost, which can be deducted in the determination of capital gains tax.

(c) Before the asset can be transferred to the buyer, a capital gains clearance certificate has to be obtained from the Zimbabwe Revenue Authority (ZIMRA). ZIMRA will issue the clearance certificate if a withholding tax of 15% of the proceeds is deposited with ZIMRA; or if the full capital gains tax is paid.

Since the proceeds are payable in instalments, a withholding tax will probably have to be paid to secure the clearance certificate.

As far as paying the capital gains tax is concerned, there is a dispensation, which can be utilised under which capital gains tax will be paid in proportion of the instalment due in each year.

Receipt in lieu of interest

The amount that will be receivable as a share of the doctors' revenue until full payment of the sale price of the building is in essence interest as it is related to the time taken to pay off the total proceeds.

The income is subject to tax at the rate of 30.9% and Dudzai has to make arrangements for the payment of provisional tax in relation to the income.

4 Dutch Boilermakers AG Group

(a) Classification and taxation of amount due to Dutch Boilermakers AG

The essence of the \$25 000 payable to the parent company is that it is being paid in lieu of interest on the loan provided. For tax purposes the amount is, in substance, interest.

Interest payable to non-residents is currently not subject to any withholding tax and in that respect should be paid gross to the beneficiary.

The interest is deductible to Overmaars (Zimbabwe) (Private) Ltd ('Overmaars Zimbabwe') as it is an expense incurred in the production of income.

(b) Structure of Zimbabwe operations

The current structure of operating two companies is not optimum as one of the companies is incurring losses while the other is making taxable income on which tax is payable. Although the companies are under the same effective control, on the basis of majority shareholding, they are assessed separately for tax purposes. In order for there to be an opportunity to underwrite each other, the group operations have to be combined into one operation.

In order to achieve offset of tax losses and profits, an option to be considered is to combine the operations under one entity. In this respect, it is suggested that the Zimbabwean operations be carried out under Overmaars Zimbabwe, while the other company, Industrial Boilers becomes dormant.

This is because the losses are not transferable to any other company even if the trade is transferred, hence it is better to make the profitable operations in Bulawayo a branch of the loss making company.

The transfer of the operations of Industrial Boilers to Overmaars Zimbabwe has some value added tax, income tax and capital gains tax implications. However, since the companies are under the same control, the group can make the following elections to avoid the potential taxes that may arise:

For value added tax purposes, as the operations are being transferred as a going concern, and will continue to operate in Bulawayo as a branch of the Harare company, the transfer can be zero rated for value added tax purposes.

For income tax purposes, an election can be made in terms of the provisions of the 4th Schedule to the Income Tax Act to transfer the assets at their income tax values, thereby eliminating potential recoupment, which would have been subject to income tax.

For capital gains tax purposes an election can also be made in terms of the capital gains tax legislation to transfer the specified assets (subject to capital gains tax) at values equal to the deductions available to the transferor.

The two companies are required to enter into specific agreements to give effect to the above elections.

Thus, in Zimbabwe, Overmaars Zimbabwe will operate two branches, one in Harare and one in Bulawayo and will draw up one set of financial statements and will file one tax return. Industrial Boilers becomes a dormant company, which can eventually be struck off as appropriate.

The minority shareholders in Industrial Boilers will have to be offered shares in Overmaars Zimbabwe equivalent to the value of their holdings in Industrial Boilers before effecting the combination of the businesses.

(c) Resultant tax computation of Overmaars Zimbabwe for the year ended 31 December 2010 after the proposed restructure.

	\$
Projected profit (4 000 000 – 1 200 000)	2 800 000
Dutch Boilermakers AG payment	(25 000)
Capital allowances:	
On new machinery: \$2 000 000 * 50%	(1 000 000)
Scrapping allowance (old machinery)	(300 000)
Assessed loss brought forward	(1 480 000)
Projected assessed loss	<u>(5 000)</u>

5 Rujeko Beauty Parlour

(a) Value Added Tax (VAT) registration

Rujeko Beauty Parlour (Private) Limited ('Rujeko') is engaged in the provision of services, which are potentially subject to value added tax. Rujeko should have registered for VAT purposes on realisation that its annual revenues would exceed the registration threshold of \$60 000.

In this particular case the Zimbabwe Revenue may, for the purposes of determining the unpaid VAT, consider the \$800 000 gross revenue received by the company to be inclusive of the VAT. In that respect the VAT would be \$104 348 ($\$800\,000 \times 15/115$).

VAT on purchases is deductible from the output tax provided that the operation is registered for VAT purposes. In this particular case, the operation was not registered and for it to claim the input tax, it would need to negotiate with ZIMRA.

The Zimbabwe Revenue Authority is entitled to impose a penalty of 100% of the unpaid tax, as well as interest until the amounts have been settled. In addition, the Commissioner General can also decide to instigate prosecution proceedings against the company.

(b) The services provided to relatives should be included as taxable income since the expenses underpinning these services have been incurred and claimed as part of the business expenses.

The proceeds from the insurance claim are similar to disposal proceeds or recoupment and so should be deducted from the capital allowances on the computer equipment claim. As a concession, the amount is not taxed provided that it is applied in the purchase of new similar equipment.

Charitable donations to hospitals and clinics are an allowable deduction for tax purposes.

Contributions to research institutions are allowable costs for tax purposes.

(c) Computation of taxable income for the year ended 31 December 2009

		\$
Profit per accounts		420 000
Preliminary expenses:		
Legal costs re formation of company – capital		–
Purchase of consumables		(32 000)
Purchase of computer ware, furniture and fittings – capital		–
Trademark registration – capital		–
Rent for 12 months		(12 000)
Lease expenses – capital		–
Service to relative		7 000
Donations – charitable – allowable		(12 000)
Research costs		(6 000)
Loan interest: 80 000 * 10%		(8 000)
Capital allowances:		
	\$	
Computer equipment	10 000	
Less damaged	(5 000)	
Add replacement	8 000	
	13 000	
Special initial allowance at 50%		(6 500)
Furniture and fittings	50 000	
Sauna	30 000	
Damaged	(4 000)	
Replacement	10 000	
	86 000	
Special initial allowance at 50%		(43 000)
Mercedes Benz: maximum deemed cost: \$10 000		
Special initial allowance at 50%		(5 000)
Taxable income		302 500

		<i>Marks</i>
1	Butler Broadbend	
(a)	(i) Computation of taxable income from employment for the year:	
	Pension contribution (maximum)	½
	Medical aid cover: – exempt	1
	Motoring benefit: 960 * 10/12	1
	Golf club subscriptions	1
	Acquisition of vehicle: exempt for those over 55 years	1
	Computation of tax liability:	
	At various rates	½
	Remainder at 37.5%	½
	Credits: Elderly person's credit	½
	3% Aids Levy	½
	PAYE deducted	½
		<hr/> 7
	(ii) Computation of taxable income from business:	
	Interest on capital	1
	Share of partnership profit	1
	Banker's acceptances less exempt amount	1
	Income per above computation	½
	Less amount taxed at source	½
	Tax at 30.9%	1
		<hr/> 5
(b)	(i) Restraint of trade:	
	Giving up a right	2
	Not taxable in BB's hands	1
	Not tax deductible to P'ship	1
	Capital gains consequences	1
		<hr/> 5
	(ii) Commutation exempt in general	1
	1/3 exempt portion (240 000)	1
	Taxable portion of 30 000	1
		<hr/> 3
	(iii) Source basis of taxation	2
	Property is the source	1
	Source is South Africa	1
		<hr/> 4
(c)	½ mark on each workings of instalments	2
	First instalment overpaid hence no consequence	1
	Second and third instalment underpaid by less than 10%	1
	Potential interest on 4th instalment	1
		<hr/> 5
	Professional marks:	
	Appropriate style and presentation	1
	Effectiveness of communication	1
	Logical structure	1
		<hr/> 3
		<hr/> 32

2 Zambia Metallurgical plc

(a) (i)	Physical presence for over six months	1
	Engaged in income generating activity: Reclamation process	1
	Any principle for permanent establishment classification	1
	Conclusion that this results in permanent establishment in Zimbabwe	1
	Treated like local company	1
	Expected to comply with regulatory requirements in Zimbabwe	1
		<hr/> 6
(ii)	Income tax:	
	Register for income tax purposes	1
	Value added tax (VAT):	
	Register for VAT as over threshold	1
	No major obligation as exports zero-rated	1
	Submit VAT returns at end of VAT period	1/2
	VAT payment due 5th of following month	1/2
	Failure can result in 100% penalties	1
	Employee's tax:	
	Register for employee's tax purposes	1/2
	Within two weeks of taking on employee	1/2
	Administer tax deduction system and remit to ZIMRA	1
	Within three days of end of month	1/2
	Penalties of 100% for non-compliance	1/2
		<hr/> 8
(iii)	Customs duty relief:	
	Relief for companies importing equipment/machinery for temporary period	1
	Benefit from temporary import permit	1
	Zero rate duties and dispensation	1
		<hr/> 3
(iv)	Exchange control:	
	Bring all proceeds from activities in Zimbabwe into Zimbabwe	1
	Cannot proceed with plan to bank proceeds in Zambia	1
	100% expatriation permitted on investments	1
		<hr/> 3
(v)	Registration of a company in order to operate in Zimbabwe:	
	Not necessary with reason	1
	May register to exclusively manage operations	1
		<hr/> 2
	Professional marks:	
	Appropriate style and presentation	1
	Effectiveness of communication	1
		<hr/> 2
(b)	Interest payable on the Chinese Bank loan and thin capitalisation:	
	Interest not deductible on element of debt/equity ratio exceeding 3:1	1
	Thin capitalisation impact where branch operated in Zimbabwe depending on head office capital structure of debt to equity	1
	Impact with subsidiary, dependent on amounts and form of investment	1
	Disallowed interest classified as dividend	1/2
	Taxed at 20%	1/2
		<hr/> 4
		<hr/> 28

3 Dudzai Mbudzi

(a) Computation of capital gains tax	
Proceeds	1/2
Deemed costs: estate valuation	1
Driveway	1
New security system	1
Inflation allowances:	
Cost	1/2
Driveway	1/2
Security system	1/2
Selling costs (1/2 each)	2
Capital gains tax	1/2
Suspensive sale allowance	1
Taxable in 2009:	
Tax at 20%	1/2
Taxable in 2010:	
Allowance granted in 2009	1/2
Suspensive allowance for amounts due in 2011	1
Tax payable at 20%	1/2
Payable in 2011:	
Allowance granted in 2010	1/2
Tax payable	1/2
	<u>12</u>
(b) Capital in nature	1
Enhancement, therefore permissible selling cost	1
	<u>2</u>
(c) Obtain clearance from ZIMRA	1
Clearance issued if withholding tax or full capital gains tax is paid	1
Withholding tax maybe needed for clearance as paid in instalments	1
Dispensation available to pay tax in proportion of instalments	1
Revenue treated as interest with reasons	1
Subject to 30.9% tax and Dudzai to arrange for payment of QPDs	1
	<u>6</u>
	<u>20</u>

4 Dutch Boilermakers AG Group

(a)	\$25 000 is effectively interest	1
	Interest should be paid gross with reason	1
	Interest is deductible expense for Overmaars Zimbabwe, subject to the thin capitalisation regulations	1
		<u>3</u>
(b)	Combine operations under Overmaars Zimbabwe	1
	Reason	1
	Various tax implications, but elections available	1
	Zero rated as VAT going concern	1
	Election to transfer at income tax values	1
	Eliminating potential recoupment	1
	Capital gains election available	1
	To transfer at value equal to deduction for transferor	1
	Specific agreement required to effect elections	1/2
	Two branches but one set of financial statements and one tax return	1
	Industrial boilers to be struck off as appropriate	1/2
	Minority shareholders offered shares in Overmaars Zimbabwe	1
	Equivalent to value of shares before combining business	1
		<u>12</u>
(c)	Projected profit	1
	Payment to Dutch Boilermakers AG	1
	Capital allowances on new machinery	1
	Scrapping allowance on old machinery	1
	Assessed loss brought forward	1
		<u>5</u>
		<u>20</u>

5 Rujeko Beauty Parlour

(a) Services potentially subject to VAT	1
Should have registered for VAT on realisation of revenues exceeding threshold	1
ZIMRA may consider revenue as gross (inclusive of VAT)	1/2
VAT on gross revenue	1/2
ZIMRA can impose penalty of 100% and interest	1
Can also instigate prosecution proceedings	1
In theory VAT on inputs claimable if company registered	1
In this case company in breach of registration, thereby prejudicing itself re claim	1
Claim possible subject to ZIMRA discretion	1
	<hr/>
	8
(b) Services to relatives:	
Value of services to relatives should be included in income of company	1
Since related expenditures claimed in business	1/2
Insurance claims:	
Insurance claim proceeds are considered to be a taxable recoupment	1
As a concession, if proceeds utilised in the acquisition of a replacement asset, will not be taxed	1/2
Donations:	
Donations in general are not deductible except	1/2
Charitable donations	1
Research costs:	
Expenditure on research costs is allowable if it is in connection with the business of the contributor.	1 1/2
	<hr/>
	6
(c) Legal costs capital	1/2
Computer and furniture capital	1/2
Trade mark capital	1/2
Rent	1/2
Lease expenses capital	1/2
Services to relative	1/2
Donations	1/2
Research costs	1/2
Loan interest	1/2
Capital allowances:	
Computer equipment, including correct deduction of insurance proceeds	1/2
Furniture and sauna, including correct treatment of damaged assets	1/2
Car	1/2
	<hr/>
	6
	<hr/>
	20