Answers

1 Water Energy (Private) Limited

MEMORANDUM

To: Financial Director
From: Tax accountant
Date: 1 December 2008

This memorandum considers the taxation and other issues raised in your memo of (date).

(a) Fees paid to Diaspora Frontiers Limited (Diaspora)
The fees paid to Diaspora (cost of salaries plus a 10% mark-up) are a Zimbabwe income source and as such are subject to 20% withholding tax, deductible at source.

The withholding tax is due within two weeks of the accrual of the fees, in this case within two weeks after the end of every quarter. The gross fees will be an allowable deduction for corporate tax purposes.

Since Water Energy is operating in Zimbabwe and is taxable in Zimbabwe on the income it earns in Mocambique, it can claim the costs associated with the Diaspora engineers in Mocambique.

(b) Diaspora engineers posted to Zimbabwe

Periods of less than six months are regarded as temporary, hence there is no tax implication in Zimbabwe for the Diaspora engineers posted to Zimbabwe for six months or less.

However, if the aggregate periods add up to more than six months in Zimbabwe, then their earnings become taxable in Zimbabwe, regardless of whether payment is made in Zimbabwe or overseas.

Thus, engineers sent to Zimbabwe for periods exceeding six months, will be taxable in Zimbabwe on both their offshore and local earnings.

(c) Zimbabwe statutory obligations of Diaspora

In respect of its employees in Zimbabwe for periods exceeding six months, Diaspora would be required to register for employee's tax purposes within 14 days of becoming an employer in Zimbabwe.

Diaspora may employ a Zimbabwe resident agent to administer the employee's tax on its behalf, but whether or not it uses an agent it would also be required to remit the employee's tax on the offshore portion of the remuneration paid to its employees in foreign currency. However, as the provider of these benefits, Water Energy (not Diaspora) will be responsible for the payment of employee's tax on the vehicles, accommodation and subsistence allowances.

(d) Water Energy (Private) Limited (Water Energy) employees posted to Mocambique for short periods

The *per diems* and the living expenses paid for the employees during their stays of four months or less, in Mocambique are classified as subsistence allowances and are not taxable.

The remuneration paid into their Zimbabwean bank accounts continue to be taxable in Zimbabwe and Water Energy is required to administer the employee tax on such earnings.

(e) Permanent establishment (PE) status for Diaspora

PE status is established on the basis of a set of conditions which include the following:

– Conducting business in Zimbabwe for periods in excess of six months through the maintenance of an office or business place.

– Conducting business through an agent who habitually makes contracts on behalf of the enterprise or concludes contracts on behalf of the non-resident principal.

The Diaspora engineers in Zimbabwe will not conclude any contracts on behalf of Diaspora in Zimbabwe and Diaspora does not maintain an office in Zimbabwe. Therefore, Diaspora does not have PE status in Zimbabwe.

(f) Forgiveness of debt or its conversion of capital

On the basis that Water Energy has been claiming a deduction of the management fees in its financial statements, the decision by the parent company to forgive or convert the debt into share capital will trigger a recoupment of the expenses previously claimed as a deduction. The recoupment will be subject to corporate tax in the year that the decision to convert or forgive is made.

Water Energy will thus have to revise its provisional tax payments and make up any shortfalls arising in relation to the recouped management fees.

The prospects of recovering the withholding tax previously paid to ZIMRA are limited and in essence Water Engineering Inc would only be able to make a decision in respect of the net after tax amounts of the management fees.

(g) Other statutory requirements

If the debt is converted to share capital, Exchange Control approval would be required as Water Engineering Inc is a non-resident.

In addition, as the transaction impacts on the ownership level of a local entity and in terms of the provisions of the recently promulgated Indigenization Act, Ministerial approval would need to be obtained in respect of the transaction.

2 Flora World (Private) Limited

(a) Managing Director
Flora World (Private) Limited
Company address

XYZ Tax Consultants
Firm's address

20 September 2008

Dear Sir

Tax implications of the proposed lease agreement

Deductions available to sub-lessee – Flower Movers (Private) Limited (Flower Movers)

Flower Movers will be considered to have a permanent establishment (PE) in Zimbabwe, as the sub-lease will provide it with a place of business in Zimbabwe for a period exceeding six months. It will, therefore, be able to claim the allowable deductions in respect of the sub-lease against its Zimbabwe source income.

Flower Movers will be entitled to claim deductions in respect of the lease premium payable upfront, the monthly lease rentals and the cost of constructing and installing the refrigeration equipment, which qualifies as a lease improvement.

The lease premium deduction will be spread over the period of the lease.

The lease improvement deductions (US$348 000) will only be given with effect from the month the improvement is brought into business use, in this case with effect from 1 February 2009.

The deductions available in each of the years 2008 and 2009 are as follows:

2008 tax year	**US$**
Lease rentals: (3 * US$1 000)	3 000
Lease premium: (3/120 * US$48 000)	1 200
Lease improvement: – for 2008 tax year	4 200
2009 tax year	
Lease rentals (12 months * US$1 000)	12 000
Lease premium (12/120 * US$48 000)	4 800
Lease improvement: (11/116 * US$348 000)	33 000
	49 800

Gross income of sub-lessor Flora World (Private) Limited (Flora World)

Flora World will be taxable on the lease rentals received each year.

The lease premium received is taxable in full in the year that it is received, in this case the whole amount of US$48 000 in 2008.

The lease improvement will also be taxable in the hands of Flora World, but with effect from the month the improvement is brought into use.The amount taxable is a mirror image of the amount deductible in the hands of the lessee.

2008 gross income	**US$**
Lease rentals (US$1 000 * 3)	3 000
Lease premium	48 000
Lease improvement	–
	51 000
2009 gross income	
Lease rentals (US$1 000 * 12)	12 000
Lease premium	–
Lease improvement	33 000
	45 000

(b) Breakdown of the lease arrangement

If the lease arrangement were to break down, the sub-lessee (Flower Movers) would not be eligible for any further deductions related to the lease improvement as the deduction can only be claimed on the basis that the improvement is being used for business purposes.

The sub-lessor (Flora World) would immediately become taxable on the outstanding instalments of the lease improvement as the improvement to all intents and purposes would become the sub-lessor's asset.

Please contact me if you require anything further.

Yours faithfully

Tax Consultant

3 Orania Corporation Limited

(a) Regulatory issues to be considered

Any investment in Zimbabwe involving a non-resident needs to be approved by the Exchange Control authorities. Such authority is usually obtained through the Zimbabwe Investment Authority in liaison with the Reserve Bank of Zimbabwe.

Secondly, the Indigenization Act requires that the transaction has Ministerial approval to ensure that it complies with the ownership structures approved by the Indigenization Act which came into operation from 17 April 2008.

The third dispensation required is the approval by the Commissioner General of ZIMRA to the effect that the taxes are adequately provided for.

(b) Tax implications

Value added tax (VAT)

The transfer of the business is a business transaction for value added tax purposes, which should be subject to VAT. The potential value added tax on the $2 trillion value is $300 billion. There is however a legal dispensation that would allow the transaction to be zero rated for value added tax purposes if it can be demonstrated that the business is being transferred as a going concern.

The current Orania automotive spare parts division would need to be deregistered for value added tax purposes. The deregistration will only be effected once ZIMRA are satisfied that all relevant VAT returns are up to date and that all payments have been made.

Usually the Zimbabwe Revenue Authority would send a review team to the business to satisfy themselves that everything was in order.

The jointly owned company, new Auto Orania (Private) Limited (Auto Orania) would also have to be registered for VAT purposes once it has opened a bank account and its projections of revenue meet the registration thresholds.

Income tax

The long-term assets such as furniture, fixtures and fittings, and motor vehicles included in the transfer, other than trading stock, would be subject to potential recoupments. If the transfer is at market values then certainly there would be recoupment income tax liabilities.

However, on the basis that there is in essence common control of the new company and Orania Corporation Limited (Orania Corporation), there is the scope to seek a tax dispensation from ZIMRA so that the assets can be transferred at their income tax values, thereby avoiding recoupments.

(c) Sale and leaseback of business premises

The disposal of the building by Orania Corporation is a transaction that is subject to capital gains tax. The capital gains tax would be due to be paid to ZIMRA within one month of accrual of the sale price.

The leaseback rentals will be deductible for corporation income tax, but they will also be subject to value added tax and Auto Orania will need to be aware of the cash flow impact of this on the business.

(d) Raising offshore funding

Any Zimbabwean trading entity which wishes to raise offshore funding requires written approval from the Zimbabwe Exchange Control Authorities. Once approved, the interest remittances would be subject to Zimbabwean withholding tax at the rate of 10%. In view of the foreign exchange difficulties in Zimbabwe, the remittance, though permitted in theory, is not guaranteed, the withholding tax is, however, payable within two weeks after accrual of the interest due.

If the debt to equity ratio of the paying company is more than 3:1 then interest on any debt in excess of this ratio would be treated as a dividend and thus would not be tax deductible.

4 Forage Manufacturing Company Limited

(a) In general, any benefits awarded to employees would be subject to employee's tax. The benefits would usually be valued and added to the other remuneration before computing the applicable tax. Where the actual value of the benefit is likely to be in doubt or difficult to determine, it is advisable to make a submission to ZIMRA before the benefit is granted, in order to fix the value of the benefit for the purposes of determining the tax where applicable.

The taxation status of each of the benefits suggested is outlined below:

Provision of canteen meals

The provision of meals is a taxable benefit. The value of the meals would have to be determined for the purposes of determining the benefits tax applicable. Since the meals would be provided on a large scale, there is probably scope for the company to benefit from economies of scale as inputs can be bought in bulk.

Given the above, it would be prudent for the company to approach ZIMRA with an assessed cost per meal so that the taxable benefit is determined upfront.

Provision of transport

In principle both forms of transport benefit would be taxable. However, although in terms of tax legislation travel from home to a place of business is deemed private, the individual benefit from the provision of the staff bus may be difficult to determine and therefore, this benefit is likely to escape taxation.

The benefit related to the provision of vehicles for employee use is usually determined by reference to deemed statutory rates. In the case of a staff bus to be used by many people, the probable method for determining the individual benefits would be to divide the cost to the employer by the number of employee users. The benefit is likely to be minimal.

The value of the provision of fuel coupons would be easily determined by reference to the cost to the employer. This benefit could however be made more valuable as the cost of fuel varies in Zimbabwe as it is a scarce commodity. Employees who receive the coupons could therefore trade them handsomely in the market for their greater benefit.

Provision of food hampers

The provision of food hampers is a taxable benefit. The benefit, based on cost to the employer, is also relatively easy to determine. Employees would probably appreciate this type of benefit more as the market costs of food are high and availability of the basic commodities is difficult.

Provision of security

Although there will be some private benefit to the employees from provision of security, the primary aim is to safeguard the company's assets. Therefore only part of the cost of providing security would be treated as a taxable benefit.

The company should therefore make a submission to ZIMRA with reasoned figures to determine the extent of any benefit.

Provision of medical aid

The provision of medical aid is tax free for the employees.

(b) (i) Impact of the benefits assuming that the employees bear the tax

On the basis that the employees are already getting remuneration which seems to be inadequate to them, if they were to be liable for the tax on the benefit this would be an additional deduction from their disposable income, which would put the employees in a worse position as far as cash flows are concerned. However, the benefits would go a long way in alleviating the position of the employees in terms of their access to food, transport and medical care.

(ii) Impact of the benefits assuming that the employer bears the tax

If the employer pays the tax on the provision of the benefits rather than the employees then the employees would enjoy the full benefits to be provided. However, the overall tax would be increased as if the employer bears the tax, the value of the benefits would have to be grossed up and the tax determined on the grossed up amount.

Thus, for the greater welfare of the employees, it would be more beneficial for the employer to meet the tax cost.

(c) VAT implications of a company providing benefits to employees.

The input tax on the supply of benefits to employees, for example the VAT on the purchase of an asset to be given to an employee for his use, would not be deductible from the output tax.

Companies should therefore appropriately adjust their VAT returns by computing a deemed output tax on benefits which are classified as deemed supplies for VAT purposes; and add it to the overall net output tax payable.

5 Penelope Preston

(a) Tax status of receipts/accruals retirement benefits

The gratuity of $480 billion is taxable in full and the tax will be deducted at source by her employer as the employer is responsible for administering employee's tax.

The medical aid cover, which is paid directly to the medical aid society, is not taxable.

A potential taxable benefit arises in relation to the motor vehicle Penelope will be allowed to purchase from her employer. The benefit is in essence the difference between the market value of the motor vehicle at the time it is purchased; and the cost of the vehicle adjusted for inflation.

The $120 billion lump sum receipt from the pension fund is capital in nature and the whole amount will be tax free as the amount received does not exceed the tax free commutation entitlement, which is the equivalent to one third of the pension entitlement.

Other income

The monthly retirement pension will not be taxable as it will only start accruing when Penelope has attained the age of 55 years.

Since Penelope will also be over 55 years old by the time she will receive the investment income, she can therefore take advantage of the exemption of $3 billion in respect of each type of income, i.e. from Treasury bills and bankers' acceptances respectively.

(b) Potential benefit from the purchase of the car

Formulae: A – (B + C)

		$billion
Market value of the motor vehicle	(A)	1 250·00
Less cost	(B)	(0·15)
Inflation allowance: 0·15 * (1 803 072 110·5 – 225 313)/225 313	(C)	(1 200·22)
Potential benefit		49·63

There will be a potential benefit from the purchase of the vehicle from the employer, but the benefit can be avoided if Penelope can delay her retirement date by one month till she attains the age of 55 years. Employees over the age of 55 can acquire vehicles from their employer without paying any benefits tax.

(c) Disposal of the investment property

On disposal of the property, either capital gains withholding tax of 15% of the gross proceeds, or the actual capital gains tax, would have to be paid to ZIMRA for it to issue a tax clearance, which is required to facilitate the transfer of the property to the buyer.

The withholding tax would be $3 000 billion while the actual capital gains tax would be computed as follows:

	$billion
Proceeds	20 000·0
Less cost	(0·1)
Less inflation adjustment: 0·1 * (974 925 192·9 – 4 880·3)/4 880·3	(19 976·7)
Selling costs	(20·0)
Potential capital gain	3·2

Capital gains tax liability is therefore $640 million ($3·2 billion * 20%).

On comparison, it would be better for Penelope to obtain a tax clearance on the basis of the payment of the actual capital gains tax as that amount is much less than the withholding tax.

			Marks
1	**(a)**	– Fees Zimbabwe income source	1
		– 20% withholding tax	1
		– Payment within two weeks of accrual	1
		– Deductible for corporate tax as business expense	1
		– Including re Mocambique sub-agreement	1
			5
	(b)	– Periods of less than six months classed as temporary	1
		– Aggregate of six months or more: taxable	1
		– Offshore earnings also taxable in Zimbabwe	1
		– Conclude re Diaspora engineers	1
			4
	(c)	– Required to register for employee's tax	1
		– Within two weeks of becoming employer	1
		– Employee's tax payable in foreign currency	1
		– Compliance could be via appointment of agent	1
		– Water Energy responsible for tax on benefits	1
			5
	(d)	– Subsistence expenses not taxable	1
		– Remuneration continues to be subject to employee's tax	1
			2
	(e)	– PE if period exceeds six months	1
		– Decision-making agent also relevant	1
		– Conclusion re Diaspora	1
			3
	(f)	– Previous deduction	1
		– Concept of recoupment	2
		– Impact on provisional tax	2
		– Withholding tax recovery prospects minimal	2
			7
	(g)	– Exchange Control approval, with reason	1·5
		– Indigenization Act, with reason	1·5
		– Ministerial approval	1
			4
		Format and presentation of memorandum	1
		Effectiveness of communication/appropriate written style	1
			2
			32

			Marks
2	(a)	Sub-lessee monthly rentals	1
		– PE, with reason	2
		– Deductible from Zimbabwe source income	1
		– Installation is lease improvement	1
		– Lease premium	2
		– Lease improvement	2
		– 2008 deductions	2
		– 2009 deductions	2
		Sub-lessor monthly rentals	1
		– Lease premium	2
		– Lease improvement	2
		– 2008 taxable amounts	1·5
		– 2009 taxable amounts	1·5
			21
	(b)	– Consequences for sub-lessee	2
		– Consequences for sub-lessor	2
			4
		Format and presentation of letter	1
		Effectiveness of communication/appropriate written style and presentation of numeric data	2
			3
			28
3	(a)	– Exchange control	1·5
		– Indigenization Act	1·5
		– ZIMRA approvals	1
			4
	(b)	– Vatable transaction	1
		– Zero rating if going concern classification	2
		– Potential tax saved identified	0·5
		– Deregistration of division	1·5
		– ZIMRA inspection	1
		– Registration of new company	1
		– Recoupment if transfer at market values	1
		– But ability to transfer at income tax value	2
			10
	(c)	– Capital gains tax	1
		– Income tax	0·5
		– Value added tax	0·5
			2
	(d)	– Exchange control approval	1
		– 10% withholding tax	0·5
		– Limitation on deduction	2
		– Payment issues	0·5
			4
			20

			Marks
4	(a)	– General tax principles	1
		– Submission to ZIMRA to establish value	2
		– Canteen meals	2
		– Transport	2
		– Food hampers	1·5
		– Fuel coupons	1·5
		– Medical aid	1
		– Security	2
			13
	(b)	– Employee burden	2
		– Employer burden	2
			4
	(c)	Input tax	1
		Output tax – self-supply	2
			3
			20
5	(a)	– Gratuity taxable	1
		– Medical cover not taxable	1
		– Potential motor vehicle benefit taxable	2
		– Lump sum from pension exempt since equivalent to 1/3	2
		– Monthly pension not taxable	1
		– Investment income enjoys $3b exemptions per type of income	2
			9
	(b)	Motoring benefit computation	2
		Advise deferring retirement	2
			4
	(c)	– Identify CGT or CGT withholding tax issue	2
		– Computation of CGWT	1
		– Computation of CGT	3
		– Recommendation	1
			7
			20