

Question 1

All amounts in this case study are in United States Dollars and are exclusive of VAT unless otherwise indicated.

Ewhy Chartered Accountants (Ewhy) Zimbabwe is a firm of registered public accountants and auditors, and is a member of Ewhy Global Limited. Over the past couple of years Ewhy has been on a drive to increase its market presence in the tax advisory business given the fact that of late tax authorities in Zimbabwe have been adapting their enforcement strategies, focus and policies in response to the changing dynamics of business. Also, this increased scrutiny by tax authorities on the tax affairs of tax payers has largely been due to increased pressure from the government for them to collect more revenue.

You have recently been promoted to senior consultant assigned to Ewhy's tax department in the Harare office. The tax partner Harvey Specter informed you that Ewhy recently won the tender to provide tax services to Zimbabwe Distillers Limited (Zimdis) and he wants to work with you on this assignment. To prepare for this assignment, you did some background research on Zimdis and obtained the following information:

Zimbabwe Distillers Limited (Zimdis)

Zimdis is a company listed on the Zimbabwe Stock Exchange (ZSE) and its core business is the manufacture, distribution and marketing of branded wines and spirits and ciders for the Zimbabwean and export market. In April 1944, P J Joubert Limited was registered in Bulawayo. In 1980, this company changed its name to Zimbabwe Distillers Limited. Initially, its activities were centred around the sale and distribution of imported spirits, liqueurs and wines. During the same year, a distillery was acquired in Mutare and the local production of a range of spirits commenced. In 1985 Zimdis was listed on the ZSE.

In 1990, the company moved to its present headquarters at Stapleford, a complex just outside Harare which houses production, warehousing and distribution facilities. The Company has six depots in Bulawayo, Harare, Kwekwe, Masvingo, Mutare and Victoria Falls which ensure a first-class distribution service. These outlets are supplemented by Customer Collection Depots countrywide. Zimdis is a category C registered operator for Value Added Tax (VAT) purposes.

Extract from Zimdis's chairman's Report for 2016 financial year.

"The company has produced commendable results despite the difficult trading environment that persisted in the current financial year. This performance was aided by the ability to exploit opportunities presented by policy measures adopted during the year which favoured local production which has seen the company now only importing the Johnny Walker spirits in its product range with the rest now being produced locally. Foreign currency shortages however, continued to impact negatively on the ability to fully supply the market. All product categories registered volume growth, with ciders well ahead of other segments at 40% over prior year.

Spirits, in particular Vice brandy, showed strong recovery compared to previous periods. Increased market place acceptance of our wine brands spurred growth in this category, registering volume growth of 29%. In the current year we managed to export 35% of our manufactured output.”

At a meeting you had with Zimdis’s Chief Finance Officer and the Group Accountant, they indicated that they would need your firm’s services in the preparation of the company’s 2016-year of assessment income tax return as well as advice on a number of transactions they effected during the year. You were therefore provided with the following information:

Extract of Statement of Profit or loss and other comprehensive income for the year ended 31 December 2016.

	Notes	31-Dec 2016 \$	31-Dec 2015 \$
Revenue	1	13 983 341	12 713 649
Cost of sales	2	(7 402 889)	(6 159 896)
Gross Profit		6 580 452	6 553 763
Other Income	3	67 476	31 643
Distribution costs	4	(344 905)	(366 415)
Administrative expenses	5	(413 546)	(452 810)
Other operating expenses	6	(3 399 370)	(3 646 717)
Operating income		2 490 107	2 119 464
Finance Income/(costs)	7	34 113	(7 472)
Exchange (loss)/gain	8	(121 914)	122 052
Profit before taxation		2 402 306	2 234 044

Extract of Statement of financial position as at 31 December 2016

	Notes	31-Dec-2016 \$	31-Dec 2015 \$
Non-Current Assets			
Property, plant and equipment	9	9 838 663	10 415 355
Current Assets			
Inventories		4 690 236	5 850 705
Trade and other receivables	10	7 073 706	6 839 394
Current Liabilities			
Deferred income	1	-	245 560

Notes

1. Revenue

- 1.1.** Deferred income of \$245 560 from 2015 has been included in the current year revenue and this amount relates to a prepayment received from a customer in Zambia for the purchase of a consignment of spirit wines which were only delivered to the customer in February 2016. At the time Zimdis received this order it was estimated that it would cost them \$180,560 to service this order and this amount was allowable as a deduction in 2015 in terms of sect 15 (2) (cc) of the income Tax Act. The actual cost incurred when Zimdis delivered on the order was determined to be \$169,456 and this has been included under the current year cost of sales figures.
- 1.2.** Also, included in the revenue figure is an amount of \$560 000 related to sales made to a wholesaler who operates in Botswana. In terms of the agreement which was entered on the 1st of October 2016, the wholesaler is to pay Zimdis the full sale price of \$560,000 in 6 equal monthly installments commencing 31 October 2016. Given the nature of the order Zimdis charged a markup of 30% on this order which is 5% more than the markup they normally charge on their sales.

2. Cost of sales

- 2.1.** Included in the cost of sales figure is an amount of \$36 000 which was incurred in marketing Zimdis branded spirits and brandy in the Southern Africa Region. Of the \$36 000, \$10 000 was incurred in the marketing of Johnny Walker whiskey that Zimdis imports from Scotland.
- 2.2.** Also, included in cost of sales are the following amounts:

Depreciation charge on plant and machinery	130 000
Overhead under absorption charge*	53 000
Penalty for late payment of import duties	16 000

* Zimdis uses an overhead absorption system to cost its manufactured products and it has been determined that all their overhead costs are allowable as a deduction for tax purposes.

3. Other Income

- 3.1.** Included in other income are proceeds received from Zimdis' insurers as compensation for one of their delivery trucks which was involved in an accident whilst on route to deliver a consignment to a customer. The compensation amount received of \$15 000 was allocated as follows: \$7 000 as compensation for repair costs to the truck and \$8 000 for the loss of stock destroyed in the accident. As at year end Zimdis was yet to repair the

truck. Initially when Zimdis had acquired the stock items they had claimed an input tax deduction for VAT purposes.

3.2. Also, included in other income is profit on disposal of Zimdis's ageing fleet of delivery trucks. Zimdis sold a total of 5 trucks for \$8 000 each and realised a profit on disposal of \$20 000. The five trucks had initially been bought second hand in 2011 for \$25 000 each.

4. Distribution costs

Included in selling and distribution costs is an amount of \$37 500 which was incurred in a promotion which was run between August and November 2016 to boost sales of a range of products which had been introduced. The costs incurred for the campaign were broken down as follows:

	\$
Travelling and accommodation costs for marketing teams	7 500
Acquisition of 2 Motor Vehicles which were awarded to winners from the promotion	<u>30 000</u>
	<u>37 500</u>

5. Administrative Costs

Below is a breakdown of the administration costs incurred during the year:

	\$
Administration Staff costs	200 000
Cost of shares awarded to directors	63 546
Insurance premiums	14 000
Depreciation	56 000
Sponsorship of premier soccer league Zimdis cup	<u>80 000</u>
	<u>413 546</u>

6. Other operating expenses

It has been determined that all the other operating expenses are deductible for income tax purposes.

7. Finance Income

This amount for the year relates to interest income arising from government treasury bills that were issued to Zimdis as settlement of amounts owed to Zimdis by the government.

8. Exchange loss

The exchange loss relates to loan balances denominated in Chinese yuan. Of the total exchange loss only \$80 000 was realised in the current year. The loan taken out was used to fund the acquisition of new plant and machinery which were brought into use in 2012.

9. Property, Plant and Equipment (PPE)

As at 1 January 2016 Zimdis had exhausted capital allowances on all its PPE. However, during the current year Zimdis imported boiler equipment from Scotland for use in their manufacturing process and incurred the following costs which were all capitalized to PPE:

	\$
Invoice amount (Cost insurance and freight)	784 560
Import duty	156 912
Import VAT	141 221
Cost to transport the equipment from Beitbridge to Harare	5 699
Installation costs	4 300
Staff training costs	<u>1 200</u>
	<u>1 093 892</u>

10. Trade and other receivable

The trade and other receivables balance is made up of the following:

	\$
Prepayment of insurance premiums	4 000
Trade receivables	<u>7 069 706</u>
	<u>7 073 706</u>

Question 2

Peter Nakamba is a 53-year-old retired civil engineer who specialised in road construction. He is married to Naomi and they have been blessed with three children, one boy and 2 girls. In 2016, he was approached by the Mineentra School of Engineering (MSE) to lecture on their new postgraduate Diploma in Civil Engineering (PG Dip) commencing 1 April 2016, which offer he accepted. Details of the terms of Peter's employment follow.

1. Peter has been offered a basic remuneration package for the 2016 academic year consisting of:
 - A lecture fee of \$300 per lecture. He is expected to present all 26 lectures as he will be the sole lecturer on the program until the student numbers increase to beyond 100 enrolments. Peter can conduct up to a maximum of 10 additional lectures during the academic year, which he will be paid at a rate of \$200 per lecture. During the current year Peter managed to present all 26 lectures plus 6 additional lectures.
 - A further lecture flat fee of \$7 500 for the setting and marking of all assignments and examinations, which is payable in equal monthly installments over a period of 6 months.
 - Peter was paid a signing on fee of \$3 000 when he agreed to MSE's offer.
 - Accrue annual leave days at a rate of 30 days per annum. Peter did not take any leave during the year.
2. Peter was given the following benefits:
 - MSE will contribute an annual amount of \$3 400 on behalf of Peter to a registered pension fund.
 - Peter will be allocated a Mazda 6 sedan vehicle with an engine capacity of 2,300ccs that he will be permitted to use to travel between home and work. MSE incurred a total of \$32 000 in purchasing the vehicle in 2015.
 - Peter's eldest son enrolled for the PG Dip programme offered by MSE and Peter only paid \$700 as fees for his child as 40% of the fees was waived.
 - MSE awarded Peter a loan to pay for his wife's studies at a local university where she is pursuing a doctorate degree in Animal Science. Peter was given a loan amount of \$4 000 on the 31st of July 2016 and there is no interest being charged on the loan. In terms of the loan agreement Peter will only start repaying the loan from 1 January 2017.
 - MSE paid for Peter's relocation expenses to MSE's campus in Mutare, as Peter was now residing in Gweru after his retirement. The total amount paid by MSE for Peter's relocation was \$1 500.

- MSE is paying for Peter’s medical aid contributions amounting to \$1 200 for the year. The beneficiaries on Peter’s policy are his wife and 22-year-old son who is undergoing postgraduate studies with MSE.
3. During the year, Peter also incurred the following expenses:
- Peter paid for his annual subscriptions amounting to \$600 for membership to the engineering society of Zimbabwe.
 - Paid for medical expenses amounting to \$800.

Employment Income – 1 January to 31 December 2016

Segment of Income per annum	Amount	Rate within segment (%)	Tax	Cumulative Tax
Up to 3 600	3 600	0%		0
3 601 – 18 000	14 400	20%	2 880	2 880
18 001 – 36 000	18 000	25%	4 500	7 380
36 001 – 60 000	24 000	30%	7 200	14 580
60 001 – 120 000	60 000	35%	21 000	35 580
120 001 – 180 000	60 000	40%	24 000	59 580
180 001 – 240 000	60 000	45%	27 000	86 580
240 001 and above		50%		

- Income from trade or investments – 25 %
- The AIDS Levy of 3% applies on Income tax chargeable after tax credits.

1. Companies

- Basic Income Tax Rate – 25%*
- Manufacturing company exporting at least:
 - 30% of output (by quantity or volume) – 20%
 - 41% of output (by quantity or volume) - 17.5%
 - 51% of output (by quantity or volume) - 15%
- Mining companies – 25% *
- Special mining lease companies – 15%*
- *Plus 3% AIDS levy

2. Allowable pension deductions

	US\$
In relation to employers: in respect of each member	5 400
In relation to employees: by each member of a pension fund	5 400
In relation to each contributor to a retirement annuity fund or funds	2 700
National Social Security contributions (on a maximum monthly gross salary of US\$700)	3.5% of gross salary
<i>Aggregate maximum contributions to all the above per employee per year US\$5 400</i>	

3. Bonus exemption - \$1 000

4. Retrenchment package

The first \$10 000 or one third of the approved retrenchment package whichever is greater, subject to a maximum exemption of \$20 000

5. Credits

- Credit for taxpayers over 55 years of age - \$900*
- Credit for blind or disabled persons - \$900

*The amounts relate to 12 months and should be reduced proportionately, if the period of assessment is less than 12 months.

6. Deemed monthly motoring benefit

Engine capacity	Benefit (\$)
0 – 1 500 cc	300
1 501 – 2 000 cc	400
2 001 – 3 000 cc	600
3 001 – and above	800

7. Capital allowances

Maximum deemed costs to be used in determining capital allowances

Asset	Deemed cost (\$)
Passenger Motor Vehicle	10 000
School, clinic, hospital, nursing home	10 000

8. Capital Allowances: Mining

Maximum deemed costs to be used in determining the capital redemption allowance.

Asset	Deemed cost (\$)
Passenger motor vehicle	10 000
Staff housing, occupied by shareholder	10 000
School, clinic, hospital, nursing home	50 000

9. Rates of capital allowances

- Special Initial Allowance(SIA) – 25%
- Accelerated Wear and Tear – 25%
- Wear and Tear on:
 - Industrial buildings – 5%
 - Farm Buildings – 5%
 - Commercial buildings – 2.5%
 - Motor Vehicles – 20%
 - Movable assets (general rate) – 10%

10. Capital Gains Tax

- On all listed marketable securities – exempt
- On unlisted marketable securities and acquired after 01/02/2009 – 20%
- On other immovable property acquired after 01/02/2009 – 20%
- On unlisted marketable securities acquired before 01/02/2009 – 5% (on gross proceeds)
- On other immovable property acquired before 01/02/2009 – 5% (on gross proceeds)

11. Capital Gains withholding tax on sales proceeds

- On other immovable property acquired after 01/02/2009 – 15%
- On immovable property acquired before 01/02/2009 – 5%
- On all listed marketable securities – 1%
- On unlisted marketable securities acquired before 01/02/2009 – 5%
- On unlisted marketable securities and acquired after 01/02/2009 – 5%

12. Loans

The deemed benefit per annum is calculated at the rate of LIBOR plus 5% of the amount of the loan. The LIBOR rate for 2016 is assumed at 1% unless stated otherwise in the scenario/required.

..... **End**

