**Question 1**

**All amounts are in United States Dollars and are exclusive of VAT unless otherwise indicated**

You have been recently promoted to senior consultant at the firm Castle and Becket Chartered Accountants (C&B), a medium sized firm based in Avondale, Harare. The firm's strategy has been to target small to medium sized businesses with most of them being owner managed and has seen the portfolio of these clients grow in leaps and bounds over the years. Your position within the firm is with the tax department which offers the following services to clients:

- Transactional advisory services;
- Preparation and filing of returns; and
- Assistance with tax disputes.

During a departmental planning meeting, you were assigned to provide tax consulting services to one of the firm's long-standing clients, Aloice Maga. Aloice is a male Zimbabwean resident, who qualified as a Civil Engineer at the age of 25 in 1990 and has been employed by the Harare city council ever since, holding various positions within the local Authority. To supplement his income during the height of hyperinflation in Zimbabwe in 2008, Aloice opened a clothing retail outlet in Harare, commonly known as "boutique shop". Over the years Aloice has been able to expand his venture, which now has 4 shops operating in the CBD of Harare and another 2 shops at the Gazaland shopping complex in Highfields Harare. C&B has always been providing Aloice with accounting services in respect of his retail business, but this year he has requested your firm to also provide advice in respect of the tax affairs of his businesses including his tax position in respect of income he receives from the Harare city council.

Soon after the meeting you organized a meeting between Aloice and yourself to obtain an understanding of the areas in which he would need your firm's assistance. He therefore provided you with the following information in respect of his 2016 financial affairs:

**Part A**

**Harare City Council Related Income:**

In June 2016, Aloice decided to resign from the employment of the Harare City council to enable him to focus fulltime on his retail shops. Aloice officially terminated his employment with the city council on the 31st of August 2016 after serving two months' notice period. Over the years of his employment with the city council, Aloice had never submitted a return to the Zimbabwe Revenue Authority in respect of his employment income as he was informed that he was on the final deduction system. However, a friend of his advised him that now that for the 2016 year of assessment he terminated his employment before the expiry of 12 months he was required to submit an Income Tax Return on Form ITF 1 to the tax authorities. Detailed below is his income and expenditures in respect of his employment:

| | Notes | $ |
|---|---|---|
| Gross Basic Salary (January to August) | | 64,000 |
| Cash in lieu of notice | **1** | 8,000 |
| Allowance | **2** | 4,000 |
| Cash in lieu of leave days | **3** | 10,000 |
| Pension lumpsum | **4** | 50,000 |
| Pension contributions | **4** | (1,200) |
| Loan waiver | **5** | 3,000 |
| Medical Aid contributions | **6** | (3,000) |
| PAYE | **7** | (16,000) |

**Notes**

1. Instead of serving the full three months of notice as per his contract of employment, Aloice only served 2 months with council paying him an amount equivalent to his monthly salary for the remaining month. The council opted to pay him cash in lieu as they had already recruited another employee to replace Aloice effective 1 September 2016. Aloice believes the $8,000 should not be subject to employee tax since he did not render any employment services in relation to this amount.
2. Aloice was seconded to the Tshwane City council in South Africa for a period of 4 months. During his stay in South Africa, the Tshwane City council paid him a monthly allowance of $1,000. Again, Aloice believes this amount should not be subject to tax in Zimbabwe since he received it from a non-resident therefore is not from a Zimbabwean source.
3. Due to the cash flow problems Harare City council is facing, City council agreed with Aloice to pay him the cash in lieu of leave days in 5 equal consecutive monthly instalments starting on the 30th of October. As at 31 December Aloice had received all amounts related to the instalments due in 2016. From discussions with Aloice he is of the view that the instalments

 

which he will receive in 2017 should not be subject to tax in 2016 but would be included in his 2017 taxable income.

4. Following his resignation, Aloice cashed out of the Harare Municipality pension fund (a registered pension fund) to which he had been contributing to during his entire working life. As at the beginning of the 2016 year of assessment Aloice's contributions to this fund to date had been allowed as a deduction in the previous tax years.
5. After his resignation, the Harare city council waived the repayment of a loan which had been advanced to Aloice. As at the beginning of the current year of assessment the outstanding balance on the loan was $5,000 and Aloice made an instalment payment of $2,000 on 30 June. Aloice utilized the loan amount to buy inventory items for one of his retail shops and was being charged no interest on this loan.
6. Aloice contributes a total of $250 per month to a local registered medical aid fund. $200 of the contributions cover for him and his family, with the balance being for his mother's cover.
7. This is the amount of Pay As You Earn (PAYE) withheld from his salary by the Harare City council and remitted to ZIMRA.
8. During his period of employment Aloice had the use of a company allocated Jeep Cherokee (passenger motor vehicle as defined) vehicle with an engine capacity of 3,200ccs. On termination of his employment, Aloice bought the vehicle for an amount of $5,000 and at that time the vehicle had a market value of $7,200.

 

**Part B**

**Details of retail business Activities**

In 2014 Aloice registered his retail businesses for VAT purposes as he had reached the minimum registration threshold of $60,000. Aloice provided you with the following information related to his retail business for the 2016 financial year:

| | Notes | $ |
|---|---|---|
| Sales | 1 | 320,000 |
| Cost of sales | 2 | (105,000) |
| Gross Profit | | 215,000 |
| Loss on Disposal of vehicle | 3 | (2,000) |
| Administration expenses | 4 | (43,500) |
| Staff costs | 5 | (42,660) |
| Net Profit for the year | | **126,840** |

**Notes**

1. Included in the sales figure for the year is an amount of $10,000 related to items that Aloice sold to his twin sister who was also opening a retail outlet of her own. Had Aloice sold these items to his normal customers he would have realized a total of $14,000. Aloice also informed you that his sister has not yet registered her shop for VAT purposes as she is yet to reach the minimum registration threshold.
2. The cost of sales balance is made up of the following amounts:

| | $ |
|---|---|
| Opening stock | 15,000 |
| Purchases of trading stock | 84,000 |
| Stock given as Christmas gifts to Aloice's children | 4,500 |
| Stock write offs – damaged by rats | 3,000 |
| Customs duty – for imported trading stock | 10,500 |
| Closing stock | (12,000) |
| Cost of sales | **105,000** |

**NB:** All the amounts in this computation are recorded at cost; with the exception of the write offs, the stock was written down from a cost of $3,500 to a net realisable value of $500 after extensive damage, the costs to sell the inventory are negligible.

3. In March Aloice sold to his twin sister one of the delivery vehicles that he was using in his retail business. Aloice sold the vehicle for $3,000 and at the time this vehicle had a market value of $4,500 which was determined by a local car dealer. The vehicle had initially been bought in 2014 for a cash price of $15,000 and Aloice had always been using the vehicle in his retail operations. At the time of sale, the delivery vehicle had a net book value of $5,000.

 

Aloice contends that the sale of the vehicle will not have any income tax implications since the proceeds are capital in nature.

4. Included in Administration expenses are the following amounts:

| | $ |
|---|---|
| Shop rentals | 36,000 |
| Shop neon sign | 2,500 |
| Accounting fees | 1,500 |
| Subscriptions to retailers' association of Zimbabwe* | 500 |
| Depreciation | 3,000 |
| | **43,500** |

* The subscription is for the annual period March 2016 to February 2017.

5. Aloice employees 12 shop floor assistants and 1 accountant for his retail business. He pays the shop floor assistants a basic salary of $250 per month each and a monthly transport allowance of $20 each. The accountant who was recruited in April of 2016 is paid a monthly basic salary of $400 and a monthly transport allowance of $20. For the 2016 year of assessment Aloice was not withholding PAYE from his employees' salaries.
6. On 1 June 2016 Aloice took a 50-inch television set that he was using at his residence and started using it in one of his shops. The television is connected to Supersport channels which normally broadcast sporting activities and this was done to create a better shopping experience for Aloice's clients. Aloice had initially acquired the television set brand new in 2014 for an amount of $2,400 from a local shop in Harare.
7. Aloice has the following assets that he uses in his retail business:

| DESCRIPTION | YEAR ACQUIRED | COST ($) | USEFUL LIFE (YRS) |
|---|---|---|---|
| Shop furniture and fittings - 1 | 2009 | 3,000 | 5 |
| Shop furniture and fittings - 2 | 2014 | 5,000 | 5 |
| Pick-up truck | 2015 | 12,000 | 6 |
| Water dispensers | 2015 | 500 | 2 |

 

**Part C**

**Other transactions effected during the year.**

In 2009 Aloice took out a 5-year mortgage bond with a local financial institution to finance the acquisition of a 4-roomed house in Budiriro. The cash price of the house was $20,000. In terms of the loan agreement Aloice was charged an annual interest of 12% with instalments being paid monthly in arrears. Aloice completed repaying the loan in 2014 after paying a total of $ 26,694 to the bank in interest payments and repayments of the principal amount advanced. The interest expense was incurred as follows:

| | $ |
|---|---:|
| Year 1 | 2,232 |
| Year 2 | 1,840 |
| Year 3 | 1,322 |
| Year 4 | 895 |
| Year 5 | 405 |
| | **6,694** |

In 2016 Aloice sold the Budiriro house for an amount of $45,000 as he wanted to raise additional capital for investing in his retail business. Before selling the house, Aloice had been renting out to tenants for a monthly rental of $150. Aloice also informed you that he never paid any taxes in respect of the rental income as he was aware that ZIMRA never made a follow up on these.

**Appendix**
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 |

*Aggregate maximum contributions to all the above per employee per year US$5 400*

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.

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