

Question 1

Turnkey (Pvt) Ltd ('Turnkey') is a company managed and controlled in Zimbabwe that provides consulting engineering solutions. Turnkey's range of expertise includes water infrastructure, wastewater treatment and flood protection.

Turnkey has established a reputable track record in the water sector in Zimbabwe and is now expanding into the rest of Africa. Projects range from feasibility studies and consulting services to engineering and project management of large water infrastructure projects.

Turnkey is a registered vendor in terms of the *Value-Added Tax (VAT) Act*, Chapter 23:12 and has a June year end that supports the immediately subsequent 31 December 2015 tax year end (i.e. 30 June 2015 supports the 31 December 2015 tax year). Turnkey recently secured three new contracts: two in Botswana and one in Kenya.

1 Botswana contracts

1.1 Water solutions project

In 2014 the Botswana government launched a tender process for consulting engineers to provide water solutions for the Maun area. One of the senior engineers of Turnkey attended a tender briefing in Maun to gather more information about the contract. He stayed in Botswana for three nights and four days from 8–11 December 2014, during which time he undertook some initial feasibility studies. Turnkey prepared and submitted the tender after he returned to Zimbabwe. The costs relating to the visit amounted to the following:

	Botswana Pula (BWP)
Hotel accommodation in Maun (inclusive of Botswana VAT @ 12%)	4 500
Car rental (inclusive of Botswana VAT @ 12%)	2 000
Meals and alcoholic beverages (inclusive of Botswana VAT @ 12%)	1 200

Turnkey was awarded the contract worth BWP10 million on 5 March 2015. The consulting services required to provide the water solutions will be rendered from the head office in Harare, Zimbabwe. Botswana levies a 15% withholding tax on consulting/technical fees.

Turnkey invited one of the senior Botswana officials to visit its head office in Harare, to verify the progress of the consulting work, during which time the work commenced and was completed. Turnkey incurred the following costs relating to his two-night, three-day visit to Zimbabwe:

	USD
Hotel accommodation in Harare (inclusive of VAT)	400
Meals and alcoholic beverages (inclusive of Botswana VAT)	250

Turnkey invoiced the Botswana government BWP3 million for work done to date on 31 May 2015. This amount was still outstanding on 30 June 2015.

Exchange rates for the relevant periods, which are consistent with ZIMRA rates, are as follows:

Date	Spot rate
8 – 11 December 2014	USD1 = BWP8.5
5 March 2015	USD1 = BWP7.0
31 May 2015	USD1 = BWP8.0
30 June 2015	USD1 = BWP8.8
	Average exchange rate
30 June 2014 – 30 June 2015	USD1 = BWP7.5

1.2 Civil construction advice

The Botswana government requested that some expert advice be provided by a civil engineer from Turnkey's Cape Town office with respect to a road construction in Gaborone. The engineer and the relevant Botswana government officials met at Turnkey's Harare office for three days where the engineer provided the necessary advice. Turnkey incurred the following expenses for its engineer:

	USD
Hotel accommodation in Harare (inclusive of VAT)	390
Meals and alcoholic beverages (inclusive of VAT)	210

Turnkey invoiced the Botswana government USD15 000, exclusive of VAT, for the advice offered during the three-day period.

2 Kenya contract

In September 2014 a Kenyan company approached Turnkey for assistance with the project management of a large water infrastructure project in Kisumu. Turnkey was awarded the contract, which amounted to KES24 million (Kenyan Shillings). Because this was a project management contract, Turnkey had to send employees to the water infrastructure site in Kisumu. Turnkey accordingly sent three employees to Kisumu on 1 February 2015. These employees remained in Kenya continuously for nine months before returning to Zimbabwe.

In terms of the agreement, Turnkey invoiced the Kenyan company on 30 June 2015 for work done to that date, to the amount of KES14 million.

Mr Brad Smith (57 years of age), is ordinarily resident in Zimbabwe, and has been an employee of Turnkey for the last ten years. He negotiated the following with regard to his work done in Kenya, over and above his normal Zimbabwe salary of \$5 000 per month:

	USD
Monthly rental paid by Turnkey to the landlord for a fully furnished flat in Kisumu	1 000
Monthly rental, inclusive of Kenyan VAT @ 16%, of a Toyota Hilux Double Cab 3.2 litre motor vehicle paid by Turnkey to the lessor under an operating lease	800
Monthly allowance to cover fuel and maintenance on the vehicle. Mr Smith will not be required to track personal and business use of the leased vehicle but he expected personal use to account for 25% of the total use.	500
The right to participate in the Turnkey share option scheme. This scheme is only available to selected employees. In terms of the scheme Mr Smith became entitled to acquire 10 000 shares in Turnkey at USD0.10 per share on 1 March 2015, when the market value was USD1 per share. He exercised his option and intends to hold the shares for six years. He estimates that the shares will be then be worth USD2.50 per share.	

Mr Smith let his Harare flat to his brother or USD400 per month while he was in Kenya.

Mr Smith had also had use of a motor vehicle provided by the company since 2012. This was a 2.2 litre Ford Ranger single cab which he was entitled to take home with him after working hours. While in Kenya this vehicle was returned to Turnkey, where it was used as a pool car. The vehicle

was returned to Mr Smith immediately upon his return to Zimbabwe. This vehicle will be fully depreciated in the company's records by 30 November 2015. In accordance with the Turnkey motor vehicle scheme, Mr Smith will be entitled to purchase this allocated vehicle for 50% of market value once it becomes fully depreciated. In terms of the scheme the employee must sign the standard motor vehicle purchase agreement within one calendar month of the vehicle becoming fully depreciated, otherwise the motor vehicle will be sold at a public auction. Mr Smith signed the agreement on 31 December 2015, but the purchase price of USD2 000 was only paid by means of a deduction from his January 2016 salary.

Mr Smith is a member of Mega Medical Aid Society ('MMS'), an approved medical aid scheme. Turnkey contributes 2% of his basic pay and Mr Smith contributes 3% of his basic pay to the scheme on a monthly basis. Mr Smith has been a member of MMS for the past ten years. It is also company policy that from time to time in case of medical emergencies, Turnkey will provide medical assistance to employees or their dependents not exceeding USD5 000 in any tax year. Mr Smith's 14-year-old son was admitted to the Harare Critical Care Clinic for a chronic chest infection for four days in December 2015. The hospital bill amounted to USD4 000 and was settled in full by Turnkey. Turnkey wrote this cost off as an employment cost in its financial records in December 2015.

Mr Smith earns interest on money invested in the United States of America. He inherited the money from his grandfather in 2010 and invested it immediately with an American Bank. The interest, which accrues annually on 31 December, amounted to USD3 500 for the 2015 year of assessment.

Mr Smith had no sources of income for the 2015 year of assessment apart from those listed above.

Exchange rates for the relevant periods:

Date	Spot rate
1 March 2015	USD1 = KES78.50
31 July 2015	USD1 = KES78.00
30 June 2015	USD1 = KES80.00
	Average exchange rate
1 January 2015 to 31 December 2015	USD1 = KES79.00
1 March 2015 to 31 July 2015	USD1 = KES78.10

Appendix 1

Extract from the double taxation agreement between Zimbabwe and Botswana

Article 20

Technical Fees

1. Technical fees [means payments of any kind to any person, other than to an employee of the person making the payments, in consideration for any services of an administrative, technical, managerial or consultancy nature] arising in a Contracting State which are derived by a resident of the other Contracting State may be taxed in that other State.
2. However, such technical fees may also be taxed in the Contracting State in which they arise, and according to the laws of that State, but where such technical fees are derived by a resident of the other Contracting State who is subject to tax in that State in respect thereof, the tax charged in the Contracting State in which the technical fees arise shall not exceed 10 per cent of the gross amount of such fees.

- Assume that the agreement has been ratified and is in force and that it contains no special rules on double taxation relief.

Question 2

Mr Alistair Murphy, a widower who is 58 years of age, is a qualified quantity surveyor. He had worked abroad for several years and was then employed by the local government in Bulawayo. With the approval of his employer, he also performed part-time services for another quantity surveyor, Mr. A Moyo.

In February 2015, when Mr. Moyo reached retirement age, he offered to sell his business to Mr. Murphy. As Mr Murphy had to give notice to his employer, it was agreed that the purchase would take place on 1 May 2015.

The terms of the agreement between Mr. Murphy and Mr. Moyo were that Mr. Murphy would register for value added tax (VAT) purposes and acquire Mr. Moyo's business on 1 May 2015 as a going concern in his own name.

The agreed values contained in the agreement were as follows:

	\$
Goodwill	40 000
Debtors	33 000
Office equipment	36 500
Residential property (partially used for business purposes and partially used as Mr Murphy's principal private residence, as he had been living in rented accommodation up to May 2015)	120 000
Total purchase consideration (VAT included at 0%)	229 500

Mr Murphy purchased the following assets in May 2015:

	\$
Computer	1 000
VAT on the computer	150
Generator	300

VAT on the generator	45
	1 495

Mr Murphy prepared the following income and expenditure account for the period 1 May 2015 to 31 December 2015 (net of VAT):

INCOME AND EXPENDITURE ACCOUNT				
FOR THE PERIOD 1 MAY 2015 TO 31 DECEMBER 2015				
Income	Notes	\$	\$	\$
Fees				350 000
Expenditure				
Bad debts			1 397	
Purchased debtors, all irrecoverable		1 220		
Incurred in June 2015, proved to be irrecoverable		177		
Insurance premium			310	
Office and cash in transit		185		
Own life insurance		125		
Legal expenses			210	
Purchase agreement		175		
Debt collection		35		
Medical aid			1 600	
Staff		1 280		
Self		320		
Motor vehicle expenses			1 880	
Staff expenses			36 000	

Staff salaries		32 000		
Cash in lieu of leave paid in December 2013		4000		
Office expenses	1		7 700	
Bulawayo City Council Water Bill		4 400		
Electricity		3 300		
Telephone	2		860	
Alterations to the property to add another toilet			10 220	
Total expenditure			60 177	
Net profit for the period			289 823	
			350 000	350 000

Notes

- 1 It was agreed with the Zimbabwe Revenue Authority (ZIMRA) that 25% of both these expenses were for business purposes and 75% for private purposes.
- 2 It was agreed with ZIMRA that 80% was for business and the balance for private purposes.

In September 2015 the Botswana government requested Mr. Murphy to carry out an assignment in Francistown, for which service he was paid a technical fee equivalent to \$458. He was there for a period of four days and does not have a permanent establishment in Botswana.

Mr. Murphy's remuneration for the period January 2015 to 30 April 2015 was as follows:

	\$
Salary	4 500
Bonus paid in March 2015	500
Medical aid	160
Total	5 160

Mr. Murphy had the use of a vehicle with an engine capacity of 1500 cc for the period January to April 2015. On the termination of his services he was allowed to purchase this vehicle for \$900.

The market value of the vehicle was \$3 750 and the original cost to his employer was the equivalent of \$2 700.

Mr. Murphy used this vehicle in his business, and it was agreed with ZIMRA that 30% was for business purposes and 70% was for private use.

Mr. Murphy owned a flat in Harare which had been let for the period 1 February 2015 to 31 May 2015. Income received from it was as follows:

	\$
Rent	4 750
Levy	(570)
	4 180

Mr. Murphy sold the flat in June 2015 for \$115 000. The flat had been purchased in October 2006 for the equivalent of \$75 000.

Mr. Murphy received a Zimbabwe pension which amounted to \$12 250 for the 2015 tax year.

Mr. Murphy had invested funds in bank acceptances and interest amounting to \$3 500 accrued to him in the 2015 tax year.

Mr. Murphy was diagnosed with cancer and was advised that he required an operation and radio therapy treatment, which was available in South Africa. He therefore decided to close his business at the end of December 2015 and to move to South Africa in the new year.

He was able to sell the house which had been used partially as an office and mainly as his principal private residence for \$167 000 in December 2015.

The other assets were on hand at the year end and Mr. Murphy hopes that he will be able to find a buyer for them in the new year.

QUESTION 1 – REQUIRED		Marks	
		Sub-total	Total
(a)	<p>Draft a memo to the Financial Director of Turnkey in which you advise, with reasons, whether in terms of the VAT Act –</p> <p>(i) the invoices issued by Turnkey in respect of the Botswana contracts should have included VAT and, if so, when and at what rate; and</p> <p>(ii) the VAT paid on the expenses incurred in point 1.1 and 1.2 of the scenario can be deducted as input tax.</p> <p><i>Communication skills – layout and structure</i></p>	<p>6</p> <p>7</p> <p>1</p>	14
(b)	<p>Discuss and conclude on the Zimbabwe income tax consequences for Turnkey of the withholding tax levied by the Botswana Tax Authorities on the consulting fees referred to in point 1.1.</p> <p><i>Communication skills – logical argument</i></p>	<p>7</p> <p>1</p>	8
(c)	<p>Briefly discuss, with supporting calculations, the Zimbabwe income tax implications of the invoiced amounts and the expenses relating to the Botswana contract referred to in point 1.1 for Turnkey's 2015 year of assessment.</p> <ul style="list-style-type: none"> • Ignore withholding taxes. • You do not have to refer to case law in support of your discussion. <p><i>Communication skills – clarity of expression</i></p>	<p>11</p> <p>1</p>	12
(d)	<p>Calculate Mr Smith's taxable income for the 2015 year of assessment. Provide reasons for amounts received but not included in his taxable income.</p>	14	14
Total			48

QUESTION 2 REQUIRED		Marks
(a)	Calculate Mr. Murphy's taxable remuneration income (not his tax liability) for the tax year ended 31 December 2015. In your solution you should provide brief reasons for the inclusion/exclusion of accruals, even in instances where in your opinion there is no tax effect.	6
(b)	Calculate Mr. Murphy's taxable income from business operations (not his tax liability) for the tax year ended 31 December 2015. In your solution you should include brief reasons for the inclusion/exclusion of all accruals and/or expenses for the calculation of taxable income, even in instances where in your opinion there is no tax effect.	25
(c)	State what credits, if any, Mr. Murphy is entitled to claim for the tax year ended 31 December 2015.	2
(d)	Calculate Mr. Murphy's capital gains tax liability for the tax year ended 31 December 2015.	4
(e)	Calculate Mr. Murphy's VAT liability from business operations for the tax year ended 31 December 2015.	15
	Total	52