

Class Test 1 - VAT

You are a recently appointed assistant manager within the tax advisory department of EC Chartered Accountant, one of the big four accounting firms with operations in Harare, Mutare and Bulawayo. Since the turn of 2016, the economic outlook in Zimbabwe has been bleak with the World Bank local Zimbabwe office publishing a paper which indicated that Zimbabwe would most likely experience deflationary conditions for 2016. This negative outlook and the economic reality on the ground has seen EC losing most of its blue chip clients in its audit and assurance portfolio. The firm's problems have also been compounded by a high staff turnover rate which has resulted in EC failing to win new clients due to a shortage of experienced staff, which most potential clients demand when considering awarding tenders. At a recently held partners' meeting, the partner responsible for EC tax department indicated that the drive by ZIMRA to increase collections from tax payers and the garnish orders that they have been issuing, may be an opportunity for the tax department to get more work as most entities in the market did not have the internal expertise to deal with this issues. Therefore, the partners made a strategic decision to invest in marketing and promotions in order to get more tax related work.

As a result of the strategies above the tax department had a major win after being engaged to offer tax advisory services for Telnet Zimbabwe, one of the big three telecommunications entities with operations in Zimbabwe. Since you were the most senior manager left in the tax department you were assigned to be the manager in charge of the Telnet engagement. You therefore arranged an initial planning meeting with Telnet, where you intended to get an in depth understanding of Telnet's business and any other relevant information. Detailed below is the information you were able to gather.

Telnet Zimbabwe

Telnet Zimbabwe is currently the second largest mobile phone network in Zimbabwe, with more than 2 000 000 active subscribers. It is jointly owned by Telnet International and Empowerment Corporation. Telnet International is a 100% owned subsidiary of Vample International Services (VIS), a major international telecommunications company with interests in Europe, Africa, Asia, and the Middle East. The Empowerment Corporation is a Zimbabwean registered company made up of a number of young Zimbabwe entrepreneurs.

Because of this partnership of local and foreign investors and access to training opportunities locally and at other Telnet International companies, Telnet Zimbabwe is well placed to keep abreast of the latest technology available internationally and apply it effectively to local conditions. While, as a Zimbabwean company, it gives preference to local expertise in its recruitment policy, it is also able to make use, where necessary, of expertise from other Telnet International and VIS subsidiaries.

It has been able to use this combined local and foreign expertise effectively to introduce new concepts to the mobile telecommunications sector in Zimbabwe and bring down the costs of mobile phone communication to make it affordable to ordinary Zimbabweans. Over the year

Telnet had been in the process of expanding its network capacity by installing high capacity base stations in new places where previously there was no network coverage, particularly in the rural areas or where it was unsatisfactory.

Below is a summary of the products and services offered by Telnet Zimbabwe:

1. Telnet prepaid

Under the prepaid service platform subscribers have to buy airtime in advance and can only make calls, text, browse the internet if their phones have enough credit. Ordinarily subscribers are able to buy airtime from street vendors, major retail outlets in Zimbabwe or via the telmoney mobile cash platform. This product has allowed to Telnet to completely move away from the postpaid services it used to offer when they 1st entered the Zimbabwe operations.

2. Telmoney

Telmoney is an innovative mobile payment solution that enables Telnet customers to complete simple financial transactions such as sending money to loved ones, buying prepaid airtime for yourself or other Telnet subscribers and paying for goods and services. This mobile solution has been a game changer in the financial services industry in Zimbabwe with most traditional banking institutions crying foul. Telmoney mobile platform has been determined to be a financial service as defined.

During the planning meeting with the Telnet management team they indicated to you that they will need your advice in respect of transactions they had effected during the 2015 year of assessment as well as transactions they are looking to effect during the 2016 year of assessment. The Chief Finance Officer (CFO) for Telnet, Mr Matoho then promised to send you an email with the details of the transactions that they were requesting your advice on. Telnet Zimbabwe has a 31 December year-end.

From: Tmatoho@telnetzimbabwe.co.zw

To: assistantmanger@ec.co.zw

Subject: Tax advisory services.

Dear Assistant Manager

Following on from our meeting we had early January 2016, I have detailed in this email the transactions that we would require your advice. As a point to note, Telnet Zimbabwe is VAT registered operator under category C and the amounts indicated in the transactions below are exclusive of VAT unless otherwise indicated. Also it has been Telnet's policy to always take the most advantageous tax position on all of its tax related matters.

Transactions effected in 2015

1. In February on 2015 Telnet was approached by the Public Accountants and Auditors Board (PAAB) to be a sponsor for the annual Zimbabwe accountancy conference. In terms of the sponsorship package Telnet donated \$10,000 to PAAB in respect of the conference and in return Telnet was given a marketing slot during the conference and also placed its adverts in the information brochures which were used for the duration of the conference. Telnet was also able to send 5 of its staff members to attend the conference at no additional cost. The PAAB is a VAT registered operator under category C.
2. One of the new innovative products launched by Telnet during the 2015 year was a credit facility for its customers on the prepaid platform. This facility allows subscribers to buy airtime on credit and pay for it later when they juice their phones. For example, a subscriber can get airtime credit of \$0.50 and when they later juice up, Telnet debits their account with \$0.55. Currently management are unsure of the implications of this facility in terms of both the Income Tax Act and VAT Act.
3. Telnet pays an annual license fee over the software that they use in their Telmoney mobile money transfer platform. This license fee is payable to OnePlus a company incorporated in Kuwait and during 2015, Telnet paid a total of \$230,000 in licence fees to OnePlus.
4. Also Telnet generated income amounting to \$800,000 from charges on its Telmoney mobile money platform. Telnet's management are unsure on whether this income attracts output VAT.
5. In November of 2015 the board made a decision to write off an amount of \$400,000 in respect of amounts owed from a local construction company which was liquidated in 2014. The full debt related to internet access fees that were provided to the company over a three year period from 2011.
6. As part of the expansion project explained in the planning meeting, Telnet imported base station equipment in October of 2015 and the cost breakdown for the purchase was as follows:

	\$
Invoice amount from supplier in China	1,200,000
Shipping costs – from Chine to Beitbridge port of entry	34,000
Freight insurance	5,000
Transport costs – from Beitbridge to Harare	4,000
Customs duty paid	30,000
	<u>1,273,000</u>

7. Telnet acquired a fleet of 10 brand new Isuzu KB double cab vehicles from a local car dealer for a purchase consideration of \$402,500 (Inclusive of VAT). These vehicles were delivered to Telnet at the beginning of June 2015 and were immediately distributed to the sales team members. In terms of Telnet's accounting policy these vehicles are to be depreciated over 5 years using the straight line method.

8. In March of 2015 Telnet sold one of its office buildings in Gwanda to Safari Limited a company which is 100% owned by VIS. The building was sold for an amount of \$250,000, however the fair market price of the building at the time of sale was considered to be \$300,000. Telnet had initially acquired the building in 2011 for a purchase consideration of \$180,000 from a VAT registered operator and had been using the building as one of their customer call centre. Safari Limited operates a micro finance business and is therefore exempt from being registered for VAT purposes. Soon after the sale of the building Telnet used the proceeds to pay a dividend to its two shareholder VIS and Empowerment Corporation.

9. Launch of Telschool

As part of Telnet's strategy to reach out to the younger generation, the board approved to launch a product called Telschool. This venture would entail Telnet supplying tablets to University students at concessionary prices, however the tablet comes with a Telnet mobile sim card. Telnet management would want to know whether or not this business unit would be subject to VAT requirements since its focus is on the education sector.

REQUIRED

Discuss the VAT Implications of the transactions in Note 1 to Note 9.

40 marks

