DEB (PVT) LTD
versus
ZIMRA

SPECIAL COURT FOR INCOME TAX APPEALS
KUDYA J
HARARE 13 September 2017 and 11 October 2019

Income Tax Appeal

D Tivadar, for the appellant
T Magwaliba, for the respondent

KUDYA J: The major question for determination in this appeal, which was divided into 12 separate issues, is whether the deductions claimed by the appellant were all incurred in the course of trade or for the purposes of the production of income in terms of s 15 (2) (a) of the Income Tax Act [*Chapter 23:06*].

On 14 April 2016 the respondent issued 6 amended manual notices of assessment for income tax against the appellant for the five tax years ending 31 December 2009 to 2014 and demanded payment of an aggregate sum of US$42 million in unpaid principal, penalty and interest. The appellant lodged an objection on 20 April 2016, which impelled the respondent to issue revised assessments reducing the claim to US$30 060 623.16. The revised assessments attracted the supplementary objection of 9 May 2016, which was disallowed in full on 19 July 2016. The appellant filed its notice of appeal on 25 July 2016 and case on 22 September 2016. The respondent filed its case on 21 November 2016.

The facts

The facts in this appeal were generally common ground. They are derived from the testimony of the AM, the Company Secretary and Treasurer of the appellant and its holding company and the documentary exhibits produced and pleadings filed in this matter.

The appellant company is the flagship operating beverages subsidiary of a major industrial blue chip company, the local holding company, listed on the local bourse. The two companies are separate and distinct but share the same acronym. The holding company carried on business activities in the beverages and agro industrial sectors of the Zimbabwean economy. In 1958 the predecessor to the holding company entered into an exclusive franchise

agreement with a Canadian Company, which owned the LL beverage trademark. In 1970, two further trademarks, CB and CBL were included in the franchise agreement. The last trademark, EL, was added to the franchise agreement in 2004. The franchisee was the proud owner of four local beverage trademarks CL, BL, ZL and GPL. The parties interchangeably referred to trademarks as brands in the franchise agreements in question.

In terms of the 1970 agreements the holding company had the right, subject to the terms and conditions of each agreement, to transfer, assign and sub-licence its subsidiaries to manufacture and sell the trademarked beverages. The holding company was obliged to pay to the franchisor royalty fees for the trademarks computed against prescribed sales and technical fees for the technical assistance provided calculated on a cost recovery basis.

It was the uncontroverted testimony of the sole witness called by the appellant that the Canadian Company was taken over by the Dutch Company, International Management BV, in 2002, which in turn executed an undated and unsigned Technical Support and Assistance, TSA, agreement with the holding company retrospective to 1 January 2002. The Dutch Company was a subsidiary of an English public company. The Dutch Company undertook to provide, in person or by proxy, to the local holding company its accumulated international expertise and know-how in the manufacture, management and distribution of beverages.

The Group of the holding company was defined as the holding company and "any existing and future subsidiaries." Know-how was elaborately defined to include all aspects purchasing raw materials, product manufacture and brand development, plant and waste management, packaging and distribution, consumer research and performance management systems. The term subsidiary carried five different meanings which ranged from majority shareholder control to majority votes garnered by agreement with other shareholders in financial policy, management and supervision of the holding company by the Dutch Company. The term turnover encompassed Group gross sales revenue from all beverages and malt inclusive of taxes and excise duties. Clause 3 contemplated the provision of know-how to the Group and "the relevant company in the Group" under the direction of the board of the holding company. The holding company undertook to do all such things and pass all such resolutions necessary to effect the terms of the agreement. It also agreed to procure its subsidiaries to adopt, ratify or confirm any lawful support rendered by the Dutch company to such subsidiaries.

In terms of clause 5, the holding company was responsible for the payment of an annual fee equal to 1.5% of the total Group turnover payable quarterly on a pro rata basis

within 30 days after the end of each quarter. The payment was to be in United Sates dollars at the best available market rate in Zimbabwe but subject to the necessary exchange control and other governmental approvals. In the absence of foreign currency the holding company would apply the fee to purchase its ordinary shares on behalf of the Dutch Company in the name of an affiliate.

A new agreement was concluded on 1 September 2006 and renewed on 1 August 2011. The Dutch Company continued to provide know-how in the production, distribution and management of beverages in the Group and the relevant company in the Group.

In the interim, on 30 April 2007 the holding company executed a royalty agreement with another Dutch Company, International BV, which replaced the royalty agreement of 14 December 2001.

On 1 February 2008, the appellant's board of directors purportedly resolved to execute an administrative and contractual services agreement with the holding company authorising the holding company to enter into administrative, technical and contractual services arrangements with third parties on its behalf. It accepted to be bound by such agreements and to bear the costs and benefits arising therefrom. The contemplated Administrative, Technical and Contractual Service Agreement was concluded on 8 February 2008. The appellant bound itself to assume all royalty and exploitation of user rights on brands and trademarks agreements, services agreements, lease agreements, bonds, supplier contracts, employment contracts and any other routine matters authorised for execution by the board or its management executed by the holding company as its own.

On 19 August 2011, the exchange control authority granted authority to the holding company to pay royalties of up to 5% to the Dutch company less withholding tax. Again on 18 March 2013 the exchange control authority granted the appellant the authority to renew the Technical Services Assistance agreement and make payment of fees of up to 1.5% of the Group annual turnover excluding sales of CBL, LL and EL less withholding tax and an additional 1% of the holding company's turnover less withholding tax on another product, CL in recognition of the invention, design and know-how of the franchisor. The turnover and fees were to be certified by a reputable firm of auditors.

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The issues

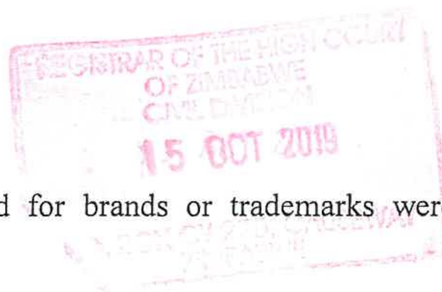
At the pre-trial hearing of 14 March 2017 some 12 issues were referred on appeal for determination. I deal with each in turn.

1. Royalties

Whether or not the respondent was correct in disallowing royalties pertaining to the brands/trademarks

The sole witness confirmed the existence of the royalty agreement dated 30 April 2007 but retrospective to 1 September 2006, between the holding company, the licensee, and the Dutch proprietor of the CBL, BL and EL trademarks, the licensor. In terms of clause 18, the licensee was precluded from assigning or transferring the agreement without the consent of the licensor. The licensee procured the right to use manufacturing technology and know-how on the one hand and the trade marks on the other to produce and distribute CBL, BL and EL beverages. The terms manufacturing technology, general know-how, specialist services and selling price were defined in elaborate detail. The first encompassed methods, processes, formulae and technology. The second involved the application of manufacturing technology to sales, marketing and promotion of the beverages while the third referred to research and technical services related to production and advertising, marketing and promotion of the products. The selling price embodied the licensee's net invoiced ex-works selling price of beverages excluding all levies, taxes or duties for those beverages that were sold at arm's length. The undertakings of the licensee were underpinned by the phrase "brew and deal with" which encompassed the manufacture, packaging, naming and labelling, marketing and distribution of the beverages. The holding company agreed to pay royalties for using the manufacturing technology, trademarks or brands at the rate of 5% of the net selling price of all the products bearing the trade marks.

It was common cause that the royalties were not expenses of a capital nature. It was the uncontroverted evidence of the sole witness that the appellant had been paying the royalties directly to the Dutch licensor since 2001. The respondent disallowed the royalties on two grounds. The first was that the appellant was not a party to the royalty agreement. The second was that even if it were a party, the royalties pertaining to brands and trademarks and not know-how could not be claimed as these did not produce any income as contemplated by s 15 (2) (a) of the Income Tax Act without advertising and promotion expenses. The thus respondent sought to distinguish brands or trade marks from know-how. The contentions advanced by both Mr *Tivadar* for the appellant and Mr *Magwaliba* for the respondent



revolved on whether the royalties paid for brands or trademarks were incurred in the production of income.

Section 15 (2) (a) stipulates that:

"(2) The deductions allowed shall be—
(*a*) expenditure and losses to the extent to which they are incurred for the purposes of trade or in the production of the income except to the extent to which they are expenditure or losses of a capital nature"

The wording of s 15 (2) (a) by use of the words "to the extent to which they are incurred" limits the deduction of the expenses to the purposes of trade, the production of income and non-capital expenditure. The word "incurred" has been judicially construed in such cases as *G Bank Zimbabwe Ltd* v *Zimra* 2015 (1) ZLR 348 (H) at 354G, *Edgars Stores Ltd* v *CIR* 1988 (3) SA 876 (A) at 899A-C and *ITC 1587* (1994) 57 SATC 97 (T) at 103-104 to mean "an unconditional liability or legal obligation to pay" as opposed to the actual payment. In terms of the royalty agreement the unconditional legal obligation to pay arose once the holding company accessed and utilised the manufacturing technology, general know-how and specialist services and trade marks from the Dutch company. It was common cause that these services were provided by proxies of the Dutch company and consumed by the appellant in each of the tax years under consideration. Accordingly the holding company incurred the unconditional legal liability to pay, which arose from the contract.

It was common ground that the appellant and not the holding company operated the beverage business in the Group. The preceding royalty agreements with the Canadian company were contracted by the holding company on its own behalf and on behalf of the "relevant company in the Group". The subsisting royalty agreement, however, did not carry such a phrase and was not entered on behalf of any subsidiary. Mr *Magwaliba* contended that the absence of privity of contract between the contracting parties and the appellant precluded the appellant from relying on the royalty agreement. In a bid to extricate his client from this insurmountable hurdle, Mr *Tivadar* sought to argue that the provisions of s 15(2) (a) were not predicated on a written contract but could be based on contract by conduct, on the concession by the respondent that know-how and not trademark expenditure was deductible, on the claim, acceptance and retention by the Commissioner of withholding fees from the appellant, on the royalty fees paid to the Dutch company and the probable existence of a business relationship between the appellant and the Dutch company. The further difficulty that stood

in his way was that these contentions were not raised with the Commissioner in the notice of objection where the appellant nailed its colours on the royalty agreement.

In his oral submissions, Mr *Magwaliba* unwittingly provided the answer to this issue. He contended that "the absence of that resolution is critical my Lord, it is not a document which the respondent had control over. But it is a document which would put the appellant's case beyond doubt". He was referring to a resolution by the directors of the appellant authorising the appellant to conclude the "Administrative, Technical and Contractual Service Agreement" with the holding company. That resolution was not requested by the respondent's investigating officers during the audit of the appellant's tax affairs. It was not part of the appellant's case during the appeal. The custodian of the appellant's minutes was cross-examined by Mr *Magwaliba* on the whether there was a resolution by the appellant accepting to pay technical fees in terms of the TSA agreement. He responded thus:

> "One would have to go back to the minutes of [Appellant] because it does have a minute book which if the tax authorities had wanted us to go through and inspect it that would have been a requirement that would have been possible, they would have asked for it, it was never inquired whether the specific minutes, they would have had the resolutions that are done at [Appellant] level to accept some of these issues. I cannot tell while sitting here whether there was a specific one but there are minutes for Delta Beverages that the tax authorities never asked for."

Those minutes were unfortunately not produced in evidence. They were, however, smuggled into the record of proceedings under cover of a letter that was written to the registrar and copied to the respondent after judgment had been reserved. It seems to me that the proper course that the appellant's erstwhile legal practitioners should have taken would have been to move the court on notice to the respondent to re-open its case and produce the minutes. The authenticity of the minutes and resolution produced in this unorthodox manner could not be confirmed. They were improperly filed and will not be used in my determination of the issue.

It seems to me that the authenticity of the Administrative, Technical and Contractual Service Agreement of 8 February 2008 was established by the sole witness's evidence. In that agreement, the appellant ratified the royalty agreement concluded by the holding company and accepted the extension of the "user pays" principle to it. It accepted that the royalty agreement was contracted on its behalf. It was agreed that it was the sole user of the know-how and the three trademarks to which the royalty agreement related. It does not seem to me that the respondent can properly protest on behalf of the licensor on the use of the know-how and trademarks and the concomitant payments arising therefrom. In my view, the agreement

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between the appellant and the holding company was valid and binding. It was not impugned by the respondent. The appellant incurred the unconditional legal obligation to pay the licensor in terms of the Administrative, Technical and Services Agreement concluded with the holding company and the Royalty Agreement concluded between the holding company and the Dutch company.

The respondent further contended that while expenses pertaining to know-how, which is analogous to a recipe, could be deducted those pertaining to trademarks or brands could not. Mr *Magwaliba* argued that trademarks without marketing and promotion were worthless and incapable of producing any income. I agree with Mr *Tivadar* that that contention is incorrect for several reasons. The trademark or brand embodies the appearance, prestige, goodwill, reputation and taste of the trademarked beverage. In my view, the product and the trademark are indivisible. The manufacturing technology and the general know-how as defined in the royalty agreement are indivisible. That they cannot be split is further underscored by the termination clauses 21.2.3 and 21.3.2 of the agreement, which provide for the termination of the agreement should the licensee fail to produce the product or if the registration of the trademark is either cancelled or is not renewed. It would therefore be improper to attempt to differentiate between a trademark and know-how. The most telling factor that eschews the respondent's contention is the clear and unambiguous recognition in the extended definition of gross income in s 8 (1) (d) (ii) and (v) of the Income Tax Act that income does separately accrue to both trademarks and know-how, respectively. To the same effect is the definition of royalties in para 1 (1) of the 19th Schedule to the Income Tax Act, which establishes that royalties are *inter alia* derived from trademarks.

I am satisfied that the appellant personally incurred the royalty expenditure in each tax year in question. It did not do so by proxy. The sentiments I expressed in *GC (Pvt) Ltd v C-G Zimra* 2015 (2) ZLR 116 (H) at 133H-134A that one company cannot expense the costs of another in its own tax returns do not apply to the present matter. The appellant was entitled to deduct the royalties that were disallowed in each of the tax years under consideration.

2. Technical fees:

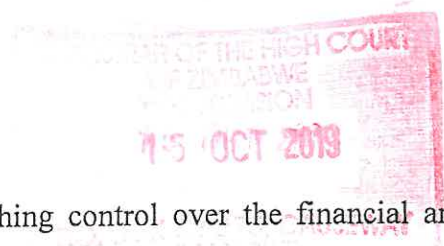
Does the fact that a written technical services agreement exists between Delta Corporation and SABMiller Management BV prevent appellant from deducting such fee payments as expenses?

It was common ground that the technical services contemplated in the TSA agreement were provided to the appellant. The notice of objection and appellant's case affirmed that the

records and schedules of visits by the proxies of the Dutch company and manuals on marketing, human resources and manufacturing were availed to the respondent. These averments were confirmed in oral evidence by the sole witness called by the appellant. The TSA agreement was executed between the Dutch Company and the holding company. The payment for the technical services was set at 1.5% of the Group turnover of the holding company consisting of the turnover of all beverages and malt and their respective taxes and excise duties. The agreement, intrinsically, incorporated subsidiaries of the holding company and specifically referenced "the relevant company in the Group." The unchallenged evidence of the sole witness was that the appellant had been paying the technical services fees on the back of the relevant exchange control authority since 2001.

The appellant disallowed the technical fees on the basis that the Group policy of the appellant required that the payment for technical services rendered between group companies was to be computed on a cost plus mark-up formula and not on a percentage of the turnover of the recipient company. It was the uncontroverted evidence of the sole witness that the local holding company did not have such a policy. He surmised that such a policy was formulated by the Dutch company and applied to its subsidiaries and not to its associates. To his mind a subsidiary was any company in which the Dutch company held at least 50 per cent of the issued share capital. He maintained that as the Dutch company held 36.2% of the equity in the holding company, the holding company was an associate and not a subsidiary to which the Dutch company group policy did not apply.

The definition of subsidiary rendered by the witness was contrary to the definition provided in the TSA agreement executed between the Dutch company and the holding company. Any one of the 5 permutations listed in the definition section found a subsidiary. The first defines a subsidiary as any corporation or other entity in which the local holding company, the Dutch company or its English holding company, as the case may be, had a majority of votes exercisable at the shareholders meeting of such entity, including on the basis of any agreements made with the other shareholders of such entity. The second was in regards to the control over financial policy and the day to day business activities of such an entity. In the TSA agreement, the Dutch company undertook to provide at least 30 technical services, enumerated from clause 3.1 to 3.6, with the approval of the board of directors of the local holding company, which would not be unreasonably withheld. It was common ground that the requisite technical services were ever granted without demur by the board of the local holding company. The nature and scope of the enumerated services satisfied me that the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Dutch company exercised overarching control over the financial and day to day business activities of the local holding company. I find that the witness did not discharge the onus on the appellant to show on a balance of probabilities that the local holding company was not a subsidiary of the Dutch Company.

The witness failed to explain why the Dutch company paid the South African entity that supplied the technical services to the appellant on its behalf on a cost plus mark-up basis but charged the local holding company on a percentage of turnover basis. Such a failure may have been fatal to the appellant's case had the Commissioner disallowed the technical fees in terms of s 98 of the Income Tax Act. In the absence of a finding by the Commissioner that the charging of a percentage of turnover as opposed to a cost plus basis was a transaction, operation or scheme designed to and which did avoid the payment of the appropriate tax due as contemplated by s 98 of the Income Tax Act, the contracted choice between the Dutch Company and the local holding company of applying the percentage of turnover instead of the cost plus mark-up formula cannot be impugned. More so in the circumstances of this case where the TSA agreement was not impeached by the Commissioner. I am, thus, unable to find that the TSA agreement was a simulated or sham agreement. Rather I find that it was a valid and binding agreement.

It seems to me that the appellant established on a balance of probabilities that it received the technical services in each tax year from the Dutch company through the various affiliates of that company. The TSA agreement contemplated the supply of such services to any subsidiary of the local holding company. The appellant concluded a binding agreement on 8 February 2008 with its holding company. It agreed to be bound by any TSA agreement executed by the holding company to the extent of the technical services rendered to the appellant. It did not agree to pay for the technical services rendered to other group companies. Those in my view were the sole responsibility of those other subsidiaries if they had similar agreements with the local holding company and in the absence of similar agreements, of the local holding company. However, it was not disputed by the respondent that despite the reference to Group turnover as defined, as all the beverages and malt were produced by the appellant, that definition was synonymous with the turnover of the appellant. The contention to this effect on para 96(a) of the appellant's written heads of argument was not controverted by the respondent and is therefore upheld by this Court.

The answer to the first sub-issue is that the written TSA agreement between the Dutch company and the local holding company did not preclude the appellant from claiming

expenses relating to the payments that were equivalent to 1.5% of its own turnover, excluding the turnover in respect of the two products that were subjected to royalty fees. The finding is in accordance with the TSA agreement and the Administrative, Technical and Contractual Service Agreement of 8 February 2008.

Did the appellant incur the technical fees it seeks to deduct as expenses?

In the light of my findings on the first issue concerning the technical fees, the answer to the second sub-issue is in the affirmative.

Was the respondent correct in disallowing technical fee expenses which are expressed as a percentage of turnover?

The respondent was wrong to disallow all the technical expenses expressed as a percentage of turnover. The report supplied to the respondent by the appellant which appears on pp 107-126 of the rule 11 documents tended to confirm the existence of an appreciable number of percentage of turnover beverages' technical services agreements between unrelated parties the world over. The minutes of the holding company of 17 May 2002 in which the royalty and technical services agreements were discussed and adopted demonstrated that the board was satisfied that the Group would gain more mileage and leverage from such agreements. It was recorded that the TSA agreement, which had been approved by the central bank, would result in the "transfer of world class management and technical services to the beverages operations and the bottom line of the arrangement would be huge technical advantages, which would normally have been impractical and unaffordable". The TSA agreement and the ratifying agreement were established to have been genuine agreements by the appellant. The respondent failed to lay the basis for its preference of the cost plus mark-up over the percentage of turnover computation of fees formula.

I am satisfied that the respondent incorrectly disallowed the technical services deductions claimed by the appellant in each of the tax years in issue.

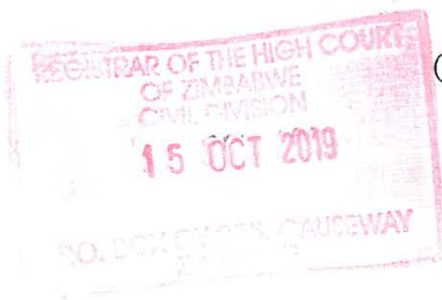
3. Amended assessment for Tax Year 2009

Have the appellant's tax affairs relating to the tax year ending 31 December 2009 prescribed as at the date of the assessment

The amended assessments of 14 April 2016 and the revised amended assessments of 9 May 2016 were issued after the prescribed 6 year period within which the Commissioner

could re-open any assessment. The period is prescribed by the provisions of s 47 of the Income Tax Act, which state:

> **47 Additional assessments**
> (1) If the Commissioner, having made an assessment on any taxpayer, later considers that—
> (*a*) an amount of taxable income which should have been charged to tax has not been charged to tax; or
> he shall adjust such assessment so as to charge to tax such amount of taxable income or ..... and if any tax is due either additionally, or alternatively, call upon the taxpayer to pay the correct amount of tax:
> Provided that—
> (i) no such adjustments or call upon the taxpayer shall be made if the assessment was made in accordance with the practice generally prevailing at the time the assessment was made;
> (ii) subject to proviso (i), no such adjustment or call upon the taxpayer shall <u>be made after six years from the end of the relevant year of assessment</u>, <u>unless the Commissioner is satisfied that</u> the adjustment or call is necessary as a result of fraud, misrepresentation or wilful non-disclosure of facts, in which case the adjustment or call may be made at any time thereafter;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The Commissioner re-opened the 2009 assessment after the six year period on the basis that the appellant deliberately and knowingly misrepresented to the respondent in the 2009 tax year self-assessment by claiming head offices expenses in respect of board expenses and fees and annual report production and transfer secretaries costs, royalties and technical fees deductions when in truth and fact such expenses had been incurred by the local holding company. In my view, the appellant conceded the point that it misrepresented the claims of head office expenses in the 2009 tax year notwithstanding a spirited attempt to confess and avoid the misrepresentation. The first ground of avoidance was that the claims were made in accordance with a practice generally prevailing at the time the assessment was made. The second was that in comparison to the overall turnover of US$324 million and expenses of US$ 285 million, the misrepresented amount of US$150 722 was as insignificant and immaterial as to belie any deliberate intention to mislead or even to attract any opprobrium. These figures related to the 2009 Group figures. The extract to the income statement of the appellant on p 103 of the r11 documents depicted its 2009 turnover at US$317 286 000 against expenses of US$279 943 000. The third was that there was no actual prejudice to the Commissioner as the holding company would merely recharge such costs to the appellant, which as the main operating subsidiary, would have had to meet the bulk of the costs.

In the *Shorter Oxford Dictionary,* misrepresent is defined as "to represent improperly or imperfectly." In Claassen's *Dictionary of Legal Words and Phrases* Vol 1 (1976) misrepresentation is defined as "a false statement of fact made one party to another before a contract is entered into." And lastly, in *Words and Phrases Legally Defined* Vol 3 (1989), 2nd Ed the word connotes a statement false in substance and in fact to which the knowledge, belief or state of mind of the maker is immaterial.

In *casu*, the appellant conceded that in the 2009 tax year, it made a representation of fact relating to the head offices expenses. The truth of the matter was that such expenses had been incurred by the holding company, which was a taxpayer in its own right and not by the appellant. Applying the ordinary meaning of misrepresent, it is apparent that the statement represented facts improperly or imperfectly." Again, the application of the definition provided in *Words and Phrases Legally Defined* undermines the contention made by Mr *Tivadar* that proviso (ii) to s 47(1) (a) of the Act did not apply to innocent misrepresentation for the simple reason that the contemplated misrepresentation is not qualified by such adjectives as fraudulent, reckless, negligent or innocent. It was a false statement which was knowingly and deliberately made by the public officer who filed the tax return. The return falsely claimed that the head office expenses had been incurred by the appellant, when in substance and fact they had been incurred by the local holding company, which was a taxpayer in its own right.

I agree with Mr *Magwaliba* that the appellant could not claim another person, as defined in s 2 of the Income Tax Act to include, *inter alia,* a company's costs in its income tax return for 2009. The duty to establish that there was a practice generally prevailing in the respondent's office to allow a subsidiary company to claim its parent's expenses lay on the appellant. The sole witness did not lead any such cogent evidence nor did the documentary evidence establish such a practice. See *D Bank v Ltd* v *Zimra* 2015 (1) ZLR 176 (H) at 191C.

Mr *Tivadar* contended in the alternative that the respondent was precluded from re-opening the whole 2009 assessment by the misrepresentation of fact relating to the head office expenses. It seems to me that what impels the re-opening is the payment of the incorrect tax by the tax payer. I do not think that the language of s 47 limits the adjustment to the misrepresented tax head only. Rather, it does provide the Commissioner with a foothold to re-open the whole tax return door wide in order to satisfy himself that the taxpayer paid the correct amount of tax due from him. When the Commissioner re-opened the 2009 assessment he was also satisfied that the appellant had wrongly claimed royalties and technical fees in its

own name, which had been incurred by the local holding company. The appellant established on a balance of probabilities that it was a direct beneficiary of the trademarks owned by the Dutch company and technical services rendered by the other Dutch company. It further demonstrated that under the TSA agreement and its own agreement with the local holding company it was entitled to pay for and deduct these expenses. It further established that these expenses were necessary for the production of income. The gross income that accrued to the appellant was derived from the sale of the beverages produced from the brands and trademarks and know-how supplied by the Dutch companies.

The answer to the prescription issue is that prescription was stayed by the misrepresentation in respect of the 2009 head offices expenses.

4. Deductions/Adjustments for consumable stocks:

Whether or not the respondent was correct in disallowing consumable stocks claimed by the appellant

The sole witness explained that at the end of each financial year, the appellant had in stock consumables such as stationery, computer cartridges, marketing material, protective clothing and fuel, which did not form part of its trading stock. The appellant deducted the cost of all the utilized and unutilized consumables in the year in which they were purchased. The respondent disallowed the deduction of the cost of the unutilized stock on the basis that such stock did not produce any income in the year of assessment. In so doing, the commissioner imputed the accounting principle of "matching income to expenditure" into our tax law. Mr *Tivadar* argued that such a principle was alien to our law while Mr *Magwaliba* argued that it was part of our law.

In disallowing the deduction the respondent relied on the main deduction formula, s 15 (2)'s reference to "incurred for the purpose of trade" and the definition of trade provided in s 2 of the Income Tax Act and the limitation of accrued income to the year of assessment in the definition of gross income in s 8 (1) of the Income Tax Act.

Trade is defined in s 2 as follows:

"trade" includes any....trade, business, activity, ...carried on, engaged in or followed for the purposes of producing income as defined in subsection (1) of section *eight* and anything done for the purpose of producing such income;

And s 8 (1) defines gross income thus:

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"gross income" means the total amount received by or accrued to or in favour of a person or deemed to have been received by or to have accrued to or in favour of a person in any year of assessment from a source within or deemed to be within Zimbabwe."

It seems to me that the matching principle has already been implicitly recognised in our law by the different income tax effect posed by the words "incurred" and actually paid". I have already referred to the judicial definition of "incurred" when I dealt with the issue of royalties. The same meaning was rendered in *ITC 1094*, (1966) 28 SATC 275 (R) at 284; *ITC 1117*, (1968) 30 SATC 130 (R) at 132, and *ITC 1121*, (1968) 30 SATC 177 (R). In *Joffe and Co Ltd* v *CIR* 1946 AD 157 at 163 WATERMEYER CJ in reference to s 11 (2) (a) of the South African Income Tax Act of the time, which was equivalent to our s 15 (2) (a) said:

> "Attention should be directed to the definite article 'the'. The income referred to here is, of course, the income as defined by s 7 of the Act, that is, the gross income less any amounts exempt from normal tax, and the gross income is the total amount received or accrued to the appellant in the period of assessment. The damages which were paid are, therefore, only deductible if they constitute expenditure not of a capital nature which was incurred in producing the income in respect of which the tax was levied."

Again, in *G Bank Zimbabwe Ltd, supra* at 354E-F, I had occasion to remark that:

> "Both Mr *de Bourbon* for the appellant and Mr *Magwaliba* for the respondent, agreed that the costs of the exercise were deductible in terms of s 15 (2) (a) of the Income Tax Act. Counsel were also agreed that the deduction is allowable in the year the expenditure was incurred. In *Caltex Oil (SA) Ltd* v *Secretary for Inland Revenue* 1975 (1) SA 665 (A) at 674E; 37 SATC 1 (A) at 11-12 BOTHA JA stated:
>
> > "It is in the year in which the liability for the expenditure is incurred and not in the year in which it is actually paid (if paid in a subsequent year) that the expenditure is actually incurred for the purposes of s 11 (a).""

What is clear from the above cases is that expenditure may be incurred in one tax year and paid in another tax year. However, what governs deductibility is not the date on which the expense is paid but the date on which it is incurred, unless, of course, if both dates fall in the same tax year. It seems to me that the appellant made prudent business decisions to purchase consumables in excess of its annual requirements over the tax years in issue. It is clear to me that the consumables were purchased for the purposes of trade or in the production of income. The only question that remains for determination is whether the appellant had an unconditional legal obligation to purchase the excess consumables. In the circumstances of this case, such an unconditional legal obligation to purchase the excess stock would arise in the subsequent years in which such stock was required for consumption.

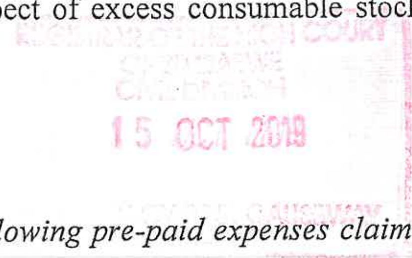
Accordingly I agree with the concluding remarks made by Mr *Magwaliba* on the point in para 13 of his written heads of argument, where he correctly contended that:

> "In view of the fact that payment would be made in respect of stock in a particular year for stock which was not usable in that year, expenditure was therefore properly to be incurred in the subsequent year and not the preceding year."

Mr *Tivadar* contended that the use of trade in the main deduction provision and its definition in s 2 of the Act and reference and application to s 8 (1) did not evidence any legislative intent to match income to expenses because the latter two provisions were concerned with income and not expenditure. It seems to me that he missed the point that the word "trade" in s 15 (2) (a) governs, firstly, the nature and purpose of the expenditure and secondly, what such expenditure effects. In my view, as trade is defined in relation to raising s 8 (1) income, which income is produced in a particular tax year, it must follow that the incurred expenses that are deductible under s 15 (2) (a) must be those that are expended in raising the specific income to be subjected to income tax in the specific year in which such income accrues. It seems to me that by juxtaposing the word trade against expenditure and losses in s 15 (2) (a) and then defining such trade by reference to the s 8 (1) income the legislature was clearly matching the expenses incurred to the income produced in the same tax year.

I am satisfied that the Commissioner correctly disallowed the deduction of the expenses related to the excess consumables that were not utilised in the tax year in which they were purchased. My finding is based on two grounds. The first is that the expenditure on the excess consumables did not constitute necessary expenditure for the production of income in the particular tax year in which such excess consumables were purchased. Such expenditure was not required for the purposes of trade or production of income in the relevant tax year. The second is that the excess consumables expenditure could not be matched to any income produced in the tax year of purchase. In my view, the matching principle constitutes part of our income tax law.

The disallowance of the expenditure in respect of excess consumable stock in each relevant tax is therefore confirmed.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5. Prepaid expenditure

Whether or not the respondent was correct in disallowing pre-paid expenses claimed by the appellant

The witness indicated two types of prepayments made by the appellant in respect of which the claim for deductions was disallowed. These were insurance premium payments that straddled the current and subsequent tax years. The second payments were in respect of excise duty paid at the time the beverages were removed from the appellant's factory to its storage warehouses. The witness did not explain how they came to be treated as prepayments if it was a legal requirement that the excise duty be paid on removal. If that was the legal requirement then the excise duty would have been incurred by operation of law on the date of removal and would be deductible as an expense in the tax year in which such removal took place. In those circumstances it would have been remiss of the Commissioner to disallow such a deduction. However, if the excise duty was required by law to be paid on the removal of the beverages from the appellant's warehouses on a date in a subsequent tax year, payment of excise duty in the tax year on which the beverages were removed from the factory would constitute a prepayment. By operation of law, the payment could only be incurred on removal from the appellant's storage warehouse and not from its factory. In both the insurance and excise duty prepayments, the date on which the appellant was required by law to pay the insurance and excise duty would be the date on which the appellant had an unconditional obligation to discharge such a liability. The premature discharge of a contingent liability in the preceding tax year simply meant that the appellant was discharging a liability that had not yet been incurred. In those circumstances, the Commissioner correctly disallowed the prepayments in question.

6. Inventory revaluation adjustment

Is appellant entitled to deduct the inventory revaluation adjustment in question?

The appellant made a stock or inventory revaluation adjustment of US$603 792 in the 2010 tax year purportedly in terms of para 4 and 5 of the 2nd Schedule to the Income Tax Act and some unspecified provision in the International Financial Reporting Standards, IFRS. The revaluation adjustment sought to reconcile the value of manufactured goods provided in the management accounts, derived from the aggregate direct cost of materials and labour part of which was deferred and carried in closing stock, with the provisions of the 2nd Schedule to the Income Tax Act and IFRS. Para 4, which appears to me to be the relevant paragraph in the circumstances adumbrated by the appellant, of the 2nd Schedule is concerned with the "Valuation of trading stock referred to in subparagraphs (i), (iii) and (iv) of paragraph (h) of the definition of "gross income"". These provisions stipulate:

8 Interpretation of terms relating to income tax

(1) For the purposes of this Part—

"gross income" means the total amount received by or accrued to or in favour of a person ----------includes—

(*h*) an amount equal to the value, determined in accordance with the provisions of the Second Schedule, of the trading stock belonging to a person carrying on a trade which—

(i) has not been disposed of at the end of the year of assessment; or

Valuation of trading stock referred to in subparagraphs (ii), (iii) and (iv) of paragraph (h) of the definition of "gross income"

4. Subject to paragraph 7, the value of the trading stock of a person shall, for the purpose of subparagraphs (i), (iii) and (iv) of paragraph (*h*) of the definition of "gross income" in subsection (1) of section *eight*,
be an amount equal to—
(*a*) the cost price to the person; or
(*b*) the cost of replacement at the date of valuation; or
(*c*) the market value at the date of valuation;
of each item of the trading stock, whichever the person or.... may elect at the time of the return of income of the person in which the trading stock is included:
Provided that— (not applicable)

Valuation of partially manufactured trading stock, etc.

7. The value of the trading stock of a person which, at the date of valuation is partially manufactured, produced, constructed, improved, consumed or used shall, for the purposes of subparagraphs (i) to (iv) of paragraph (*h*) of the definition of "gross income" in subsection (1) of section *eight*, be an amount which the Commissioner considers to be the fair and reasonable value of the trading stock at the date of valuation.

The Commissioner disallowed the objection on the basis that the value of the adjusted closing stock was factored into the computation of the gross profit which was subjected to income tax. In my view, the appellant was required in computing the value of stock on hand to elect to predicate the value of the outstanding stock to an amount equivalent to the cost of the stock to itself, or to the cost of replacement at the date of valuation or to the market value at the date of valuation. The date of election is specified as the date on which the taxpayer submits the income tax return. The facts do not indicate which valuation method was used. But whatever it was, it resulted in an adjustment of US$603 792, by which amount the initial taxable income had been overstated. The appellant was entitled by the provisions of para 4 to

the 2nd Schedule of the Income Tax Act to deduct that amount notwithstanding that there was an original valuation, which had been used to calculate the gross profit relied upon by the respondent. The bringing back of that amount to the closing stock did not result in a double claim for expenditure as contended by Mr *Magwaliba*. This is an instance where an accounting principle, in the lexicon of WATERMEYER JA in *Joffe and Co Ltd v Commissioner for Inland Revenue* 1946 AD 157 at 165 and HLATSWAYO J in *Barclays Bank Ltd* v *Zimra* HH 9/ 2006, coincides with the language of the statute.

Accordingly, I hold that the amount of US$603 792 was wrongly disallowed by the Commissioner in the 2010 tax year.

7. Computer software

Whether or not the respondent was correct in disallowing expenses described as computer software costs in the tax computation

The witness stated that the appellant expensed US$2 059 238 in migrating from an old computer software system to a new one in the 2013 and 2014 tax years. He was adamant that the amount in question did not relate to any licence fees or ancillary services attached to the migration such as customisation and training. In disputing that these expenses were in respect to the licence fees and any ancillary services attached to the migration, the witness implicitly conceded that any expenses related to such licences fees and ancillaries would constitute capital expenses. The concession was in tandem with the finding in *D Bank, supra,* at 191G that expenditure on computer software was of a capital nature. The concession was, however, in contradistinction to the appellant's pleaded position. The appellant pleaded that the expenses were incurred in paying the consultants for mapping its business processes and reconfiguring the new computer system to these business processes, and the customisation, travel and training costs of the appellant's employees on the new features of the system. The areas to which the costs related were all strikingly similar to those set out in *D Bank*, at p 183A-C, which were found to be expenses of a capital nature. These areas of application had more to do with enhancing the efficacy of the capital asset rather than with sweating the capital asset to produce income.

The basis for seeking a deduction proffered in the appellant's pleadings was that such expenses had always been treated by the Commissioner as deductible revenue expenses. The respondent disputed the existence of such a practice. The appellant did not lead any evidence to establish that there was such a generally prevailing practice at the time the assessment was

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made. In any event, by merely expensing these costs in the tax return and not in its statement of comprehensive income the appellant demonstrably appreciated that these expenses were not of a revenue nature.

Again, the appellant sought the deduction of these costs as special initial allowances in terms of para 2 (c) of the 4th Schedule to the Income Tax Act. In order to succeed, the appellant had to show that the expenditure on computer software qualified to be "the purchase of articles, implements, machinery or utensils" as prescribed in para 2(c). This is in view of the correct concession made in para 7 of the letter of objection that:

> "It is noted that the computer software costs were included under the 4th Schedule with effect from 1 January 2015. Hitherto, it was standard practice for costs of developing computer software to be deducted as an expense as these could not have been claimed under special allowances".

The appellant did not seek to rely on the directive made against the Commissioner to deduct software expenses as special initial allowances in the *D Bank*, case, *supra* at p 205A. That directive was discharged on appeal in the Supreme Court in *Zimra* v *Stanbic Bank Zimbabwe Ltd* SC 13/2019. However, in the present appeal the appellant chose to rely on a generally prevailing practice, which it failed to establish.

I, therefore, hold that the Commissioner correctly disallowed these computer software costs.

8. Penalties

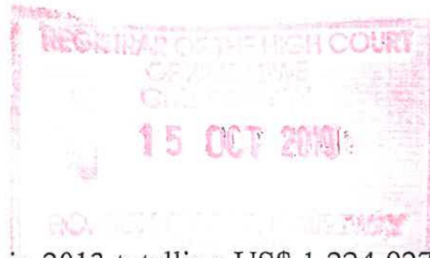
Is respondent's imposition of penalties at 50% justified?

A reading of Mr *Magwaliba's* written heads of argument show that the Commissioner penalized this large conglomerate for the perceived defective tax advice rendered to it by a bevy of internal accountants, reputable external tax consultants and legal practitioners. Additionally, the appellant was punished for failing to consult the liaison officer attached to it by the Commissioner. Apparently, the Commissioner also considered the very substantial outstanding amount in unpaid taxes. It seems to me that a legitimate difference of opinion between the appellant, its employees and advisers on the one hand and the Commissioner on the other can never be regarded as aggravatory. The Income Tax Act contemplates such differences. I do not think that a taxpayer should be precluded from expressing its strong and reasoned opinion for fear that if proved wrong, it might be disproportionately penalized.

Fortunately for the taxpayer, the appeal court exercises its own unrestricted discretion in determining the appropriate penalties. The principles were set out in *PL Mines (Pvt) Ltd* v *Zimra* 2015 (1) ZLR 708 at 730C. The appellant was at the time a corporate behemoth, which had been in existence for more than 60 years. In cross-examining the sole witness Mr *Magwaliba* characterised it as a blue chip, which had been at some point in the distant past the employer of choice in Zimbabwe. It was a good corporate citizen which has immensely contributed to the environmental, manufacturing, economic, financial, social, sporting and entertainment, educational and community and agricultural wellbeing of this country. The 2010 annual report of its holding company was representative of the major contributions that the appellant, as the largest subsidiary, made to the fortunes of this country. It has over the years paid large amounts of income tax, withholding tax and other imposts such as VAT and excise duty. On appeal over 90% of the revised assessments in the aggregate sum of US$26 million has been discharged leaving a balance of about US$4 million of the principal, penalties and interest from the appealed figure of about US$30 million. These factors mitigate any penalty that may be imposed.

The Commissioner strongly expressed his disquiet over the charging of technical fees as a percentage to turnover as against a cost plus margin approach that the proxy providers of the service charged to the licensor. The sole witness confirmed the advice proffered to the holding company's board of directors in the minutes of 17 May 2002 that such an approach was common place across the world. This was confirmed by the approvals granted by exchange control authority to these charges. It was further confirmed by the very detailed 19 page Internal Comparable Analysis Report dated 5 October 2010 conducted by a reputable international firm of chartered accountants, which was commissioned by the Dutch Company to assess internal compliance with the arm's length principles in its transfer pricing policy for trademark royalties of its cross border brands. The commissioned firm looked at 20 comparative agreements, which were submitted to the Commissioner and summarised in the r 11 documents, and confirmed that the percentage of turnover approach was in vogue even amongst unrelated parties in the beverages industry worldwide.

Penalties are imposed to enforce personal and general deterrence and compliance with the provisions of the Taxes Act. Our courts have emphasised the need for all taxpayers to shoulder their fair share of the income tax burden. The amounts that were properly disallowed were the head office expenses of US$150 722 in 2009 and the other head office expenses highlighted on p 104 of the r 11 consisting of US$ 171 453 in 2010, US$245 230 in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2011, US$ 300 791 in 2012 and US$ 356 731.60 in 2013 totalling US$ 1 224 927.60, which if claimed in the appellant's tax returns would have to be disallowed. The prepayments and the excess consumable stocks together with the computer software costs of ofUS$2 059 238 must also be disallowed. While these amounts are by no means small, they constitute a far cry from the US$30m sought by the appellant. In an order by consent granted by this Court on 8 June 2017, the respondent suspended the payment of the assessed tax shortfalls to the conclusion of the appeal process thus saving the appellant from any prejudice arising from the "Pay Now and Argue Later" principle.

It seems to me that a penalty of 50% was unjustified. Rather a penalty of 10% is appropriate for the income tax misfeasance of the appellant.

9. Interest

Whether or not interest should be payable by the appellant

It was common ground that interest on under-estimated quarterly tax payments was charged for the 2013 and 2014 tax years in terms of s 72 (11), which was inserted into the Income Tax Act by the Finance Act No. 4 of 2012. The section provides:

(11) If the Commissioner-General is satisfied that a person required to pay provisional tax under this section—
- (*a*) was, through special circumstances, unable to pay the whole or part of an instalment of provisional tax payable by him or her; or
- (*b*) underestimated the amount of an instalment of provisional tax payable by him or her by not more than ten *per centum* or through an increase in the rates of tax or for any other sufficient cause; the Commissioner-General may waive the whole or part of any interest payable under section 71(2).

The provision accords discretion to the Commissioner and on appeal to the Court, to waive interest on under-estimated quarterly tax payments. The total tax due in 2013 and 2014 were provided on p 91 of the r 11 documents. The figures were extracted from the tax assessments on pp 89 and 90, of the r 11 documents, respectively. The under-estimated quarterly payments for those years were in excess of 10% on the assessed figures. It is apparent to me even without the comparative figures that as a result of this judgment, the under-estimated quarterly payments must now be below 10% in respect of the 2013 and 2014 tax years. That on its own would be sufficient for me to exercise my discretion in favour of the appellant to waive the interest due in terms of s 72 (11) (b) of the Act. In any event, the circumstances of this appeal clearly demonstrated that the appellant had fair and reasonable grounds for making the under-estimation. The contentions raised by the appellant were arguable. The appellant believed that it was not entitled to pay even the amounts from which

additional tax is required to be assessed. These would constitute the type of special circumstances contemplated by the provisions of s 72 ((11) (a) of the Act.

It is for these reasons that I waive the interest on the additional tax in full.

Costs

The appellant did not seek costs in any form or shape. The respondent prayed for the dismissal of the appeal with costs. While the appellant has substantially succeeded if regard is had to the quantum sought by the Commissioner, I do not find the claim by the Commissioner to have been unreasonable especially in view of the lack of privity of contract on the royalties and the failure by the appellant, on whom the burden lay, to establish the cost effectiveness of the percentage of turnover formula over the cost plus mark-up approach. I also do not find the grounds of appeal to have been frivolous. I, therefore make no adverse order for costs against either party. Rather, each party shall bear its own costs.

Disposition

Accordingly, it is ordered that:

1. The revised manual assessments numbers 0006754, 0006755, 0006756, 0006757, 0006758, and 0006759 issued by the Commissioner on 5 May 2016 for the tax years ended 31 December 2009, 2010, 2011, 2012, 2013 and 2014 respectively be and are hereby set aside.
2. The Commissioner is directed to issue further revised assessments that incorporate the contents of this judgment. He shall specifically:
   a. Allow in full the deductions claimed by the appellant for royalties and technical fees in respect of the 2009, 2010, 2011, 2012, 2013 and 2014 tax years.
   b. Reopen the 2009 assessment and add back the sum of US$ 150 722.00 in respect of head office expenses to the appellant's taxable income
   c. Add back all the deductions, if any, made by the appellant in respect of head office expenses to the appellant's taxable income for the tax years 2010 to 2014
   d. Add back the deductions for consumable stocks in their respective amounts to the appellant's taxable income in respect of each tax year in issue.
   e. Add back the prepayments in their respective amounts in each tax year in issue.
   f. Allow the deduction in the sum of US$603 792.00 in respect of the stock revaluation adjustment in the 2010 tax year.
   g. Add back the computer software deductions of US$2 059 238 in their respective amounts in the 2013 and 2014 tax years.

h. Charge a penalty of 10% on the additional tax payable in each respective tax year.

i. Waive in full any interest from the additional tax.

3. Each party shall bear its own costs.

11/10/2019

Gill Godlonton & Gerrans, the appellant's legal practitioners