REPORTABLE **(3)**

DELTA BEVERAGES (PRIVATE) LIMITED
v
ZIMBABWE REVENUE AUTHORITY

SUPREME COURT OF ZIMBABWE
GWAUNZA DCJ, UCHENA JA & CHITAKUNYE AJA
HARARE: 1 JUNE 2020 & 18 JANUARY 2022

D. Tivadar, for the appellant

T. Magwaliba, for the respondent

UCHENA JA: This is an appeal and cross-appeal against parts of the judgment of the Special Court (for Income Tax Appeals) dated 11 October 2019 dismissing some of the appellant's objections against the respondent's amended assessments, and setting aside some of the respondent's amended assessments. In this judgment I will refer to the appellant as the main appellant and the respondent as the cross appellant.

FACTUAL BACKGROUND

The detailed facts of the case can be summarised as follows;

The main appellant is a company registered in terms of the laws of Zimbabwe and a subsidiary of Delta Corporation (the Holding Company). The two companies are separate and distinct from each other but share the same acronym. The holding company carries on business in the beverages and agro-industrial sectors of the Zimbabwean economy.

The cross appellant is in terms of the Income Tax Act [*Chapter 23:06*], the authority responsible for the collection of taxes in Zimbabwe

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 is the owner of four local beverage trademarks CL, BL, ZL and GPL. The parties interchangeably referred to trademarks as brands in their franchise agreements.

In terms of the 1970 agreement, 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 and calculated on a cost-recovery basis.

Before the court *a quo*, evidence was led to the effect that in 2002, the Canadian Company was taken over by the Dutch Company, International Management BV, which in turn executed an undated and unsigned Technical Support and Assistance, “TSA”, agreement with the holding company retrospectively to 1 January 2002. The Dutch Company was a subsidiary of SAB Miller International BV 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 of 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 ensure that its subsidiaries 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 percent 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 States 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 the Dutch Company, International BV which replaced the royalty agreement of 14 December 2001.

On 1 February 2008, the main appellant's board of directors 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 resolved 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 main appellant bound itself to assume all royalty and exploitation of user rights and 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 percent to the Dutch Company less withholding tax. Again on 18 March 2013, the exchange control authority granted the main appellant authority to renew the Technical Services Assistance agreement and make payment of fees of up to 1.5 percent of the Group's annual turnover excluding sales of CBL, LL and EL less withholding tax and an additional 1 percent 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.

On 14 April 2016, the cross appellant issued 6 amended Manual Notices of Assessment for Income Tax to the main appellant. The amended assessments related to the tax years ending on 31 December 2009, 2010, 2011, 2012, 2013 and 2014. The cross appellant levied a payment by the main appellant of over US$42 million, including penalty and interest.

By letter dated 20 April 2016 the main appellant objected to the assessments. In response, the cross appellant issued revised assessments and sent these to the main appellant without an explanation. In its revised assessments, the cross appellant conceded several issues raised by the main appellant in its objection and reduced the total amount claimed to around US$30 million.

By letter dated 9 May 2016 the main appellant revised and re-lodged further objections. The cross appellant disallowed all grounds of the main appellant's further objections. Aggrieved by that decision, the main appellant appealed to the Special Court for Income Tax Appeals.

The issues placed before the court *a quo* for determination as per the joint pre-trial conference minute are as follows:

> "1. Whether or not the respondent was correct in disallowing royalties pertaining to the brands/trademarks?

2. Does the fact that a written technical services agreement exists between Delta Corporation and SAB Miller Management BV, prevent the appellant from deducting such fee payments as expenses?
3. Did the appellant incur technical fees, which it sought to deduct as expenses?
4. Was the respondent correct in disallowing technical fees, which are expressed as a percentage of turnover?
5. Had Delta's tax affairs relating to the tax year ending 31 December 2009 prescribed as at the date of the assessment?
6. If not, whether the respondent correctly disallowed the expenditure apportioned by the holding company as management charges?
7. Whether or not the respondent was correct in disallowing consumable stocks claimed by the appellant.
8. Whether or not the respondent was correct in disallowing prepaid expenses claimed by the appellant?
9. Is appellant entitled to deduct the inventory revaluation in question?
10. Whether or not the respondent was correct in disallowing expenses described as computer software cost in the tax computation?
11. Is respondent's imposition of penalties of 50% justified?
12. Whether or not interest should be payable by the appellant".

After hearing the parties and perusing documents filed of record, the court *a quo* 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, 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$150 722.00, in respect of head office expenses to the appellant's taxable income.
   c. Add back all the deductions, if any, made by the appellant in respect of head office expenses to the appellant's taxable income for the years 2010 to 2014.
   d. Add back the deductions for consumable stock in their respective amounts to the appellant's taxable income in respect of each tax year in issue.
   e. Add back the prepayments in their respective amounts in each tax year in issue.
   f. Allow the deduction in the sum of US$ 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."

Aggrieved by the decision of the court *a quo*, the main appellant noted an appeal against part of the judgment to this Court. The cross appellant cross appealed against part of the same decision. The appeals were noted on the following grounds:

<u>GROUNDS OF APPEAL (MAIN APPEAL)</u>

"1. The court *a quo* erred in law by holding that the legislative intent behind the Income Tax Act *[Chapter 23:06]* was clearly to match the expense incurred to the income produced in the same tax year.
2. The court *a quo* erred in law by holding that when determining the deductibility of the expense of unused consumables the relevant question was whether 'the appellant had an unconditional legal obligation to purchase' them.
3. The court *a quo* erred in law by finding that the appellant decided to 'purchase consumables in excess of its annual requirements' in circumstances where there was no evidence warranting such a finding before the court.
4. The court *a quo* erred by disallowing all deductions for consumable stocks in circumstances where it has found that deductions for consumables are allowed in the year when they were consumed.

Relating to issue 5: 'Prepaid expenditure'

5. The court *a quo* erred in law by apparently expecting opinion evidence on a question of law relating to the requirement of paying excise duty from a witness of fact.
6. The court *a quo* erred in law by appearing to hold, without expressly stating its finding, that the appellant's obligation to pay excise duty on clear beer removed from the excise bonded warehouse constituted a 'premature discharge of a contingent liability'.
7. The court *a quo* erred in law by appearing to hold, without expressly stating its finding, that the appellant's obligation to pay for an annual insurance premium that straddled two tax years constituted a 'premature discharge of a contingent liability."

<u>GROUNDS OF APPEAL (CROSS APPEAL)</u>

"1. The Special Court for Income Tax Appeals erred in allowing as a deduction in terms of section 15 (2)(a) of the Income Tax Act *[Chapter 23:06]* expenses relating to royalties in respect of each tax year in issue when the Cross-Respondent was not a party to the agreement in terms of which such royalties were payable.
2. The court *a quo* further erred in finding that payments made in respect of trademarks or brands were expenditure incurred for the purposes of the cross-respondent producing income.
3. The court *a quo* further erred in finding that the cross-respondent was entitled to pay fees in terms of the technical services agreement which was concluded

between Delta Corporation Limited and SAB Miller Management BV to which the cross-respondent was not a party.

4. The court *a quo* erred in finding that the cross-respondent was entitled to pay fees in terms of the technical services agreement at the rate of 1.5% of turnover when it was clear that SAB Miller itself was charged fees on a cost-plus mark-up basis by its South African sub-contractors and when the group policy was that the cost plus mark-up basis was the method of charging such fees.
5. The court *a quo* further erred in finding that the cross-respondent was entitled to pay and deduct the amount of US$ 603 792.00 in respect of inventory revaluation as an expense incurred against its income in terms of section 15(2) (a) of the Income Tax Act when the value of the stock adjusted had already been factored into the computation of the gross profit which was subject to the income tax.
6. The court *a quo* further grossly erred in finding that the cross-appellant was not correct in imposing a penalty of 50% of the taxes due upon the assessments on the cross-respondent.
7. The court *a quo* further grossly erred in setting aside the interest imposed upon the cross-respondent when it was not shown that the Commissioner of the cross-appellant had been grossly unreasonable in imposing such interest at 10%."

THE MAIN APPELLANT'S SUBMISSIONS ON APPEAL AND CROSS APPEAL

Mr *Tivadar* for the main appellant in the main appeal submitted that the appellant bought consumables which did not run out in the first year and were carried into the second year. He further submitted that deductions could only be made in the first year and that the matching principle did not apply. Counsel for the appellant submitted that the matching principle cannot be used as it apportions costs over two tax years as there were unutilised consumables carried over from the year of purchase. He contended that the cause of action arose when the consumables were bought and the expense was incurred in year one. To that end, he argued that the appellant has to deduct the expenses of the purchases in year one and that there should be no splitting of the expenses into both years.

Counsel for the main appellant asserted that the statutory prepaid expenditure on record, establishes that the expenditure was incurred in terms of statute and cannot therefore be a prepayment as alleged by the respondent. He submitted that the court *a quo* was correct in allowing the deductions but it was not clear how it went on to make a finding in favour of the respondent.

Mr *Tivadar* for the main appellant submitted that the court *a quo* erred by disallowing all deductions for consumable stocks in circumstances where it had found that deductions for consumables are allowed in the year when they were consumed.

Concerning the fifth ground of appeal relating to stock and trading stock, counsel for the main appellant argued that deductions were meant for stock in general to avoid double deductions.

On the imposition of penalties Mr *Tivadar* averred that the matter would have to be remitted to the court *a quo* for it to determine whether or not s 98 of the Act applies.

In relating to the cross appellant's grounds of appeal number six and seven on penalty and interest, counsel for the main appellant argued that the proceedings were neither an appeal in the strict sense nor a review as the court *a quo* can consider evidence placed before it and come up with a decision on penalty and interest based on its own discretion.

On whether or not brands and trademarks contribute towards the making of income Mr *Tivadar* submitted that they significantly contribute in the making of income.

In respect of inventory revaluation he submitted that they were correctly allowed in terms of para 4 of the second Schedule of the Income Tax Act.

In respect of the technical services he argued that the court *a quo* correctly found that they were deductible.

THE CROSS APELLANT'S SUBMISSIONS ON APPEAL AND CROSS APPEAL.

Mr *Magwaliba* for the cross appellant submitted that the consumables the main appellant sought to deduct were not utilised in the year of purchase therefore in terms of s 15(2)(a) of the Income Tax Act one cannot interpret the section without taking into consideration the purpose for which the expense was incurred. He argued that the matching principle applied as the purchase of consumables should be for the purpose of making an income in the tax year in which the purchases were made. Counsel for the cross appellant contended that the consumables were bought in excess and could not all be deducted in the same tax year. He submitted that the excess consumables were not consumed and did not generate income. He further submitted that it is by the reasonable interpretation of the law that the matching principle must be applied.

He argued that the deduction for payments of royalties should not be allowed as there is, no nexus between the main appellant and the holder of the royalties.

Concerning ground of appeal number two, he submitted that trademarks, brands, and the know-how generate little money unless advertised. He further submitted that the advertising costs are deductible and that it is the advertising that generates income and that if the products are not advertised they remain as stock. Counsel for the cross appellant asserted that there was no evidence proving that brands and trademarks contribute towards the making of income.

In relation to the main appellant's third and fourth grounds of appeal, he submitted that the court *a quo* found that the main appellant's witness was not a credible witness. He contended that it was the SAB Miller policy to pay on a cost-plus mark-up basis but the court *a quo* found that the appellant was obliged to pay the holding company on a turnover basis of 1.5 percent.

Concerning prepayment of excise duty insurance premiums, Mr *Magwaliba* averred that the court *a quo* did not hear evidence on this issue as none was placed before it.

On technical fees Mr *Magwaliba* submitted that the court *a quo* should have determined whether or not the agreement between the Dutch company and Delta Corporation (Private) Limited and that between the main appellant and Delta Corporation was not aimed at tax avoidance.

In respect of inventory revaluation he submitted that the deduction should not have been allowed as that would amount to a double deduction.

THE MAIN APPELLANT'S RESPONSE

Mr *Tivadar* submitted that the question of whether or not the main appellant was a party to the agreement was a factual finding on which the cross appellant had made a concession to the effect, that the agreement was genuine. He averred that the cross appellant's case was whether or not a deduction could be allowed and on the other hand its case was that deductions were justified if there was an obligation to pay. He therefore argued that the cross appellant was approbating and reprobating.

In respect of the use of trademarks to make an income, Mr *Tivadar* submitted that one can make an income from brands or trademarks, which is a sign of the quality of the product. He argued that s 8(1) of the Act defines gross income and income in a way which establish that income can be generated by a brand or a trademark. Mr *Tivadar* averred that the Exchange Control Act allowed the charging of these fees and sets an upper limit of 3 percent.

<u>ISSUES FOR DETERMINATION</u>

The appeals raise the following issues for determination.

<u>IN RESPECT OF THE MAIN APPEAL</u>

1. Whether or not the court *a quo* correctly found that the legislative intent behind the Income Tax Act was to match the expenses incurred to the income produced in the same tax year and to allow the deduction of statutory prepayments which cover a period beyond the year of taxation in the tax year of payment.

2. Whether or not the court *a quo* erred in ordering the Commissioner to add back to the main appellant's taxable income deductions for consumables used to make an income in the year of taxation.

<u>IN RESPECT OF THE CROSS APPEAL</u>

3. Whether or not the court *a quo* erred in allowing the deduction of royalties, by the main appellant when it was not a party to the agreement between the Dutch Company and its holding company for the use of the Dutch company's brands and trademarks.

4. Whether the court *a quo* erred when it allowed the main appellant's deduction of payments of technical services without resolving whether or not such deductions contravened section 98 of the Income Tax Act.

5. Whether the court *a quo* erred when it allowed the main appellant's deduction of US$603 792-00 for inventory revaluation.

6. Whether or not the court *a quo* was correct in reducing to 10 percent the 50 percent penalty imposed and waiving in full the interest charged.

APPLICATION OF THE LAW TO THE FACTS

IN RESPECT OF THE MAIN APPEAL

It must be stressed that the Special Court for Income Tax Appeals is not a court of appeal in the strict sense because when it hears these appeals, it is a rehearing of the matter and it exercises its own discretion. It can even hear and rely on evidence and submissions which were not placed before the Commissioner. This position was stated in *Sommer Ranching (Pvt) Ltd v Commissioner of Taxes* 1999(1) ZLR 438 (SC) at p 443 A-B where GUBBAY CJ emphasised that:

> "Presently, it is well settled that in an appeal against a decision where the Commissioner exercised a discretion the Special Court is called upon to exercise its own original discretion. Nor is it restricted to the evidence which the Commissioner had before him. The appeal to the Special Court is not only a rehearing but can involve the leading of evidence and the submission of facts and arguments of which the Commissioner was unaware. See also, Commissioner for Inland Revenue v da Costa 47 SATC 87 (A) at 95; 1985 (3) SA 768 (A) at 775B-G; K v Commissioner of Taxes 1993 (1) ZLR 142 (S) at 147B-F; 55 SATC 276 (ZS) at 281."

The appeal before the court *a quo* was therefore not merely a review of the correctness of the Commissioner's determination but the court was required to exercise its own independent discretion unaffected by that of the Commissioner.

1. **Whether or not the court *a quo* correctly found that the legislative intent behind the Income Tax Act was to match the expense incurred to the income produced in the same tax year and to allow the deduction of statutory prepayments in the year of payment.**

The main appellant's counsel submitted that the court *a quo* erred in law by holding that the legislative intent behind the Income Tax Act was to match the expense incurred to the income produced in the same tax year. It is the main appellant's contention that the court *a quo* used the matching principle which is a principle of accounting and not of law in its determination. In its judgment the court *a quo* commented on this issue as follows:

> "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 findings of the court *a quo* are supported by s 15(2)(a) of the Income Tax Act which provides as follows:

> "(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..."

Section 15(2)(a) of the Act provides for deduction of expenditure incurred for the purposes of trade or in the production of income during the income tax year under consideration. Section 2 of the Act defines trade as anything done for the purposes of producing income. Section 8(1) of the Act provides as follows:

> "“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 excluding any amount (not being an amount included in “gross income” by virtue of any of the following paragraphs of this definition) so received or accrued which is proved by the taxpayer to be of a capital nature and, without derogation from the generality of the foregoing," (emphasis added)

It is apparent that gross income is accrued from a source which is used in making it. In the circumstances of this case it is the expenditure spent on materials used to make the gross profit which should be deducted in assessing the tax to be paid by the tax payer in the tax year for the income raised in that tax year. Section 8(1) further defines income as follows:

> "“income” means **the amount remaining of the gross income of any person for any such year after deducting therefrom any amounts exempt from income tax** under this Act". (emphasis added)

Income in respect of any tax year is established by deducting allowable deductions from gross income. It is also apparent that the gross income, income and deductions are linked to a specific income tax year.

Sections 15(2)(a) as read with s 8(1) limits whatever amount received or accrued in favour of a person to “any year of assessment”. It is therefore only that which relates to a particular year of assessment that is taken into account. The inclusion of expenditure not consumed in the tax year and which does not relate to the production of income in that particular year is not permissible. In this regard, unutilized consumables should not have been included in deductions made in the year of purchase. The expenditure not being linked to the production of income in that tax year could therefore not be deductible in that year.

The main appellant further contends that the court *a quo* erred in determining the deductibility of the expense of unused consumables by holding that the relevant question was whether "the appellant had an unconditional legal obligation to purchase" them. In my view, these words were stated in orbiter and were not the reason for the court's determination on the issue of excess consumables. The reason for the court's decision is in the interpretation of s 15 (2)(a) and s 8(1) of the Act. I am therefore satisfied that the court *a quo* correctly determined this issue.

In determining whether or not statutory prepayments can be deducted in the year of payment the court *a quo* said:

> "The witness indicated two types of prepayments made by the appellant in respect of which the claim for the deduction 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 the 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 in 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 the 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 payments in question". (emphasis added)

The determinant words in the quotation are, "The witness did not explain" and the subsequent use of the words "if "and "would". What is apparent is that the court *a quo* was left without information by a party which had the onus to prove the issue. The comment Mr *Tivadar* sought to rely on appeared to be a favourable finding by the court *a quo* when it was infact a supposition based on the court commenting on what would have been the correct legal position if the main appellant's witness had explained the correct position. The court was dealing with two opposed positions. The cross appellant's assertion that these were prepayments in terms of statutory provisions and the main appellant's unclear position on why it was saying they are not statutory prepayments. This led the court *a quo* into stating what the correct position at law would have been if the main appellant had proved that they were indeed statutory prepayments, and what the correct position would have been if the payments were at law prematurely made. Based on the evidence, placed before it, the court *a quo* held that the Commissioner correctly disallowed the deduction of the prepayments in question. It therefore did not find in favour of the main appellant as alleged by Mr *Tivadar*.

I am therefore satisfied that, the main appellant's appeal on issue number one has no merit.

2. **Whether or not the court *a quo* erred in ordering the Commissioner to add back to the main appellant's taxable income deductions for consumables.**

Mr *Tivadar* for the main appellant submitted that the court *a quo* erred by disallowing all deductions for consumable stocks in circumstances where it had found that deductions for consumables are allowed in the year when they were consumed.

Mr *Magwaliba* for the cross appellant submitted that the deductions were correctly disallowed.

The impugned order 2(d) of the court *a quo* reads as follows:

> "2. The Commissioner is directed to issue further revised assessments that incorporate the contents of this judgment. He shall specifically:
> a. ------
> b. ------
> c. ------
> d. Add back the deductions for consumable stock in their respective amounts to the appellant's taxable income in respect of each tax year in issue."

It seems to me that the court *a quo* intended to order that deductions for excess consumable stock in their respective amounts be added back to the appellant's taxable income in respect of each tax year in issue. This is because it had specifically found that what could not be deducted are excess consumables and had found that consumables used in each tax year were deductible. The order of the court *a quo* will be amended to bring into effect the clear intention of the court *a quo*.

<u>IN RESPECT OF THE CROSS APPEAL</u>

3. **Whether or not, the court *a quo* erred in allowing the deduction of royalties, by the main appellant for the use of the Dutch Company's brands and trademarks when it was not a party to the agreement.**

It is the cross appellant's contention in its first ground of appeal that the court *a quo* erred in allowing the deduction of royalties paid by the main appellant in terms of an agreement which did not relate to it but to Delta Corporation (Private) Limited its holding company. It further contented that the brands and trademarks for which royalties were being paid do not produce income and are therefore not allowable deductions in terms of s 15(2)(a) of the Act.

Counsel for the main appellant argued that brands and trademarks produce income and are deductible in terms of s 15(2) (a). The court *a quo* in determining this part of the main issue said:

> "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."

I respectfully agree with the reasoning of the court *a quo.* A product's standing and marketability is enhanced by its trademark which has acquired a reputation and become desirable on the market. The trademarks in issue are of international repute. They in my view add value to the main appellant's beverages and make it possible for the appellant to make an income from the trademarked products. It is apparent from the various agreements entered into between the franchisors and the holding company that what was being sought was to benefit from the reputation of the international brands and trademarks.

In respect of the royalties the issue is whether or not the main appellant was a party to the agreements on the royalties, which were to be paid for or had ratified the agreements entitling it to claim its payments for them as deductions in its tax returns. A reading of the record establishes that the agreements in terms of which royalties were payable were entered into by Delta Corporation or its predecessors in title and there is no specific mention of the appellant. There is however mention of Delta Corporation's subsidiaries. It is common cause that the main appellant is a subsidiary of Delta Corporation (Private) Limited.

The main appellant sought to produce minutes of its Board of Directors to prove that, it had ratified the contract in terms of which royalties were due. The court *a quo* disregarded them as they had not been procedurally produced. It was however, the cross appellant's case that if there existed a resolution to the effect that the appellant ratified the agreement, such ratification would put the appellant's case beyond doubt. However, of importance and not refuted by the cross appellant is the fact that the authenticity of the Administrative, Technical and Contractual Service Agreement was proved before the court *a quo* through the evidence of the main appellant's witness. In its judgment the court *a quo* commenting on this issue said:

> "**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 there from. In my view, the agreement 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". (emphasis added)

The court *a quo* relying on the evidence of the main appellant's witness found the agreement dated 8 February 2008 valid and binding. This finding and the cross appellant's concession proved that the deduction of royalties was in terms of the law.

In any event, evidence on record establishes that the cross appellant's main challenge cannot prevail because the Exchange Control Authority granted authority for the payment of those royalties. The record proves that on 19 August 2011, the exchange control authority granted authority to the holding company to pay royalties of up to 5 percent to the Dutch Company less withholding tax. It is also on record that on 18 March 2013, the exchange control authority granted the appellant authority to renew the Technical Services Assistance agreement and make payment of fees of up to 1.5 percent of the Group's annual turnover excluding sales of CBL, LL and EL less withholding tax and an additional 1 percent 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.

The court *a quo* also found that it was "common ground that the main appellant and not the holding company operated the beverages business in the Group". Once it is established that the main appellant is the one which operated the beverages business and benefited from the contract between the Dutch company and the holding company, it follows that it lawfully deducted the royalties it paid to the Dutch company.

4. **Whether the court *a quo* erred when it allowed the main appellant's deduction of payments of technical services without resolving whether or not such deductions contravened section 98 of the Income Tax Act.**

In determining this issue the court *a quo* commented on its perception that there might have been tax avoidance in the manner in which the technical services agreement was concluded between the parties. It commented that if the Commissioner had attacked the deduction of these services from the main appellant's taxable income it would have been fatal to the main appellant's claim.

In his heads of argument and submissions before this court Mr *Magwaliba* for the cross appellant argued that the court *a quo* erred when it raised this issue and did not deal with it conclusively. He argued that the Special Court for Income Tax has jurisdiction to rehear matters brought before it on appeal. He submitted that such appeals are not appeals in the strict sense therefore the court *a quo* should have fully inquired into whether or not there was tax avoidance in the main appellant's holding company's agreement with the Dutch company. He submitted that the Dutch company, Delta Corporation (Private) Limited and the main appellant are related companies which could have colluded to agree on the payment to the Dutch company at the percentage of 1.5 percent, when services by the Dutch company's South African subsidiaries to the main appellant were being made at cost price plus margin. He submitted that this was meant to benefit the Dutch Company to the prejudice of Zimbabwe's tax collection system.

Mr *Tivadar* for the main appellant submitted that there was no tax avoidance, but concentrated on the deductibility of the technical services instead of the tax avoidance issue. The determinant factor is whether or not the court *a quo* inquired into and determined the issue of tax avoidance. In determining the issue the court *a quo* said:

> "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 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." (emphasis added)

It is apparent from the court *a quo*'s comments that it perceived that there might have been a case of tax avoidance by the main appellant's holding company and the Dutch company. It is also apparent that it took no further steps to inquire into that possibility but proceeded to determine the appeal on other factors not connected to tax avoidance as if the appeal before it was an appeal in the strict sense. It thus left the issue of tax avoidance hanging as no further inquiry into it was made, nor did it make a decision on the issue.

Section 98 provides as follows:

> **"98 Tax avoidance generally**
> Where any transaction, operation or scheme (including a transaction, operation or scheme involving the alienation of property) has been entered into or carried out, which has the effect of avoiding or postponing liability for any tax or of reducing the amount of such liability, and which in the opinion of the Commissioner, having regard to the circumstances under which the transaction, operation or scheme was entered into or carried out-
>
> (a) Was entered into or carried out by means or in a manner which would not normally be employed in the entering into or carrying out of a transaction, operation or scheme of the nature of the transaction, operation or scheme in question; or
> (b) Has created rights or obligations which would not normally be created between persons dealing at arm's length under a transaction, operation or scheme of the nature of the transaction, operation or scheme in question; and the Commissioner is of the opinion that the avoidance or postponement of such liability or the reduction of the amount of such liability was the sole purpose or one of the main purposes of the transaction, operation or scheme,
>
> **<u>The Commissioner shall determine the liability for any tax and the amount thereof as if the transaction, operation or scheme had not been entered into or carried out, or in such manner as in the circumstances of the case he considers appropriate for the prevention or diminution of such avoidance, postponement or reduction."</u>** (emphasis added)

It is clear from the underlined part of the quotation that the issue of avoidance should be determined to enable the Commissioner or as in this case the Special Court to determine how the tax payer should be taxed.

The determination of tax issues require clarity and incisiveness in decision making. This is because the law requires that those who should pay tax should do so and those who fall outside that requirement should not be taxed. There should be no room for those within the group which should be taxed escaping through failure by the Commissioner to net them in and if he fails the Special Court in the exercise of its full jurisdiction should net them in.

In the case of *Parkington v Attorney General*, 1869 LR 4 H.L. 100, 122 LORD CAIRNS commenting on interpretation of fiscal statutes said:

> "As I understand the principle of all fiscal legislation it is this. If a person sought to be taxed comes within the letter of the law he must be taxed, however great the hardship may appear to the judicial mind to be. On the other hand if the Crown, seeking to recover the tax, cannot bring the subject within the letter of the law, the subject is free, however apparently within the spirit of the law the case might otherwise appear to be."

It is therefore my view that once the court *a quo* realised that there might be tax avoidance it should have exhaustively inquired into and made a determination on it. It should have sought to determine the correct position of the law instead of identifying a possible error by the Commissioner and allowing it to pass. Taxation is by the law and not official errors or laxity. See also the case of *Commissioner of Taxes v C W P (Pvt) Ltd* 1989 (3) ZLR 361 (SC) at 372 D-E.

In the case of *Commissioner of Taxes vs Astra Holdings (Pvt) Ltd* 2003 (1) ZLR 417 (S) Malaba JA (as he then was) at pages 427 G-H and 428A –E said:

> “The question must be stated and answered. Can it be said that in writing the letter of 1 July 1995 which contained the error of law the Commissioner, by the revenue officer, purported to contract with Astra Holdings or purported to represent to it that the statement was true and that thereafter he would not asses it to unpaid tax which was by law due to revenue. In other words, did the Commissioner bind himself to accept as valid the actions of Astra Holdings regarding the non-payment of the sales tax based upon the error of law?
>
> There is no doubt that the purported contract would have been born out of the mistake of the law requiring that sales tax be charged and collected by the motor dealer on all motor vehicles sold locally. Although unknown to the parties it would have been in contravention of the law for Astra Holdings not to charge and collect the sales tax which the statute required it to collect.
>
> In my view such an arrangement would be null and void ab initio. It is a bargain the Commissioner could not make at law because it would have the effect of being in breach of his statutory duty to collect tax due to revenue. It is one thing for revenue to enter into an arrangement with a taxpayer on how, in the exercise of its managerial powers, it will collect tax, but it is another for it to seek to decide that a particular tax imposed by Parliament is not due from a taxpayer when in fact it is and in so doing disclaim the right to the tax and abandon the statutory power to collect it. In R v Board of Inland Revenue ex p. MFK Underwriting Agencies Ltd and Ors [1990] 1 All ER 91 Bingham LJ said at110d-j:
>
> ‘I am, however, of opinion that in assessing the meaning, weight and effect reasonably to be given to statements of the Revenue the factual context including the position of the Revenue itself, is all important. Every ordinary sophisticated taxpayer knows that the Revenue is a tax-collecting agency, not a tax-imposing authority. The taxpayer’s only legitimate expectation is, prima facie, that he will be taxed according to statute, not concession or a wrong view of the law (see R v AG ex p. Imperial Chemical Industries’ plc (1986) 60 TC 1 at 64 per Lord Oliver) . Such taxpayers would appreciate, if they could not so pithily express, the truth of Walton J’s aphorism: ‘One should be taxed by law, and not be untaxed by concession”----

I respectfully agree and would add that where a tax matter has been placed before the Special Court for adjudication a taxpayer should not escape liability simply because the Commissioner failed to invoke the appropriate taxing provision. *In casu* the omission by the court *a quo* to determine the issue of tax avoidance will have the effect of allowing the main appellant to get away with tax avoidance, if that can be proved on inquiry. That view is strengthened by the court *a quo's* view that the failure by the main appellant's witness to explain the noted anomaly would have been fatal to its case if the Commissioner had taken into consideration the issue of tax avoidance.

I am therefore satisfied that the decision of the court *a quo* on this issue should be set aside and the case be referred back to it, for it to inquire into and determine whether or not the agreements between the Dutch company, Delta Corporation (Private) Limited and the main appellant do not constitute tax avoidance.

5. **Whether the court *a quo* erred when it allowed the main appellant's deduction of US$603 792-00 for inventory revaluation.**

What has to be determined in this issue is whether or not inventory revaluation which will have been taken into consideration in determining gross income can be deducted from the main appellant's taxable income.

Mr *Tivadar* for the main appellant argued that it can be deducted because it takes into consideration that the main appellant's manufactured goods are valued at cost of direct material and direct labour. He further submitted that the Income Tax Act allows the deduction of operating costs, part of which would have been deferred and carried in closing stock to be deducted at the time the taxpayer prepares its tax returns.

Mr *Magwaliba* for the cross appellant argued that allowing the deduction without taking into consideration the operating costs would result in a double deduction.

The court *a quo* in determining the issue reasoned as follows:

> "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 contented 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 AD157 at 165 and Hlatshwayo 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."

I agree with the reasoning of the court *a quo*. Its analysis together with Mr *Tivadar's*, explanation of the inventory revaluation means that the cost of sales figure comprises only the direct manufacturing and labour costs, leaving out the operating costs to be deducted in the year in which they are incurred.

In my view the inclusion of operating costs in the revaluation, is the determinant factor. Mr *Tivadar* made it clear that in valuing gross profits only direct material costs and direct labour costs are taken into consideration. I am therefore satisfied that the inventory valuation costs were correctly allowed.

6 Whether or not, the court *a quo* was correct in reducing the 50 percent penalty imposed to 10 percent and waiving in full the interest charged by the cross-appellant.

It was submitted for the cross appellant that the court *a quo* erred in finding that it had not correctly exercised its discretion in determining the appropriate penalties on assessing the taxes due from the appellant. It was further submitted that the court *a quo* erred in setting aside the interest imposed against the appellant when it had not been established that the Commissioner had been grossly unreasonable in imposing such interest at 10 percent.

In determining this issue the court *a quo* reasoned as follows:

> "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."

It is trite that the Special Court for Income Tax Appeals exercises its own unrestricted discretion in determining the appropriate penalties. The principles to be taken into consideration in determining the appropriate penalty are set out in *PL Mines (Pvt) Ltd vs Zimra* 2015(1) ZLR 708 at 730C where the court held that:

> "The principles governing the imposition of a penalty are well developed in our criminal law. In S v Zinn 1969 (2) SA 537 (A) at 540G (approved by the Constitutional Court of South Africa in S v M (Centre for Child Law as Amicus Curie) 2008 (3) SA 232 (CC) para [10] at page [109] the triad of the crime, the offender and the interests of society were enunciated and envisaged to holistically embrace all considerations necessary in the imposition of any penalty. The principle has been applied in Zimbabwe in such cases as *S v Gondo* 1990 (2) ZLR 171 (S) at 173A and *S v Mudzamiri & Anor* 1993 (2) ZLR43 (S) at 48A. Since this appeal constitutes a rehearing, **I am not restricted by the considerations of the Commissioner. I will take into account all factors raised by both counsel in their respective oral and written submissions".** (emphasis added)

As pointed out earlier the court *a quo* justified why the penalty of 50 percent was not warranted in the circumstances of this case largely relying on the circumstances leading to the main appellant's objection and the fact that the figure initially claimed by the cross appellant had dropped significantly pursuant to the objections the main appellant had made to the cross appellant. In its judgment which I find to be correct the court *a quo* set aside the Commissioner's revised assessments of 5 May 2016 and directed him to issue further revised assessments allowing the main appellant's deductions specified in its order. This has the effect of further reducing the main appellant's liability for tax from the cross appellant's initial re assessment of USD 42 million which it on objections being filed reduced to USD 30 million.

The amount owed, and the reasons for the delay in paying tax, has a bearing on the penalty and interest to be charged. However when tax is not paid because the taxpayer has legitimate reasons for raising objections and the objections are upheld, the Special Court for Income Tax Appeals can use such circumstances to reduce the penalty and interest imposed by the Commissioner.

The court *a quo's* findings on the main appellant's culpability and level of success on appeal before it should also be considered in determining the penalty and interest it has to pay.

Evasion of tax also plays a role in determining the interest and penalty to be charged. Mr *Tivadar* assuming that the Commissioner's position had been influenced by a perceived tax evasion submitted that the matter should be remitted to the court *a quo* for it to determine whether or not s 98 of the Act applies. Mr *Magwaliba* for the cross appellant argued that the main appellant's argument in this regard was based on a simulated argument which was not pleaded and that if it was simulated the Commissioner did not state anything to that effect. The court *a quo* cannot therefore be faulted in that regard as there was no s 98 case before it. The provision relates to the powers of a Commissioner when it is established that a taxpayer is evading tax.

In casu, no allegations were made entitling the invocation of s 98, therefore the Commissioner could not make adverse decisions in terms of that section. It is in fact common cause that the Commissioner did not act in terms of s 98.

I am satisfied that the court *a quo* correctly determined the issue of penalty and interest.

DISPOSITION

The main appellant's appeal partially succeeds, as the court *a quo* clearly erred in ordering the Commissioner to "add back the deductions for consumable stock in their respective amounts to the appellant's taxable income in respect of each tax year in issue", when it had found that consumables which had been used in each tax year were deductible.

The cross appellant also succeeded in respect of the deduction of technical services as the court *a quo* should after finding that the agreement between the Dutch Company and the appellant's holding company could have been aimed at tax avoidance have determined that issue but did not. The court *a quo*'s decision on that issue will be set aside and the matter will be remitted to the court *a quo* for it to determine the issue of tax avoidance.

Both parties have partially succeeded in their appeals and in resisting the major parts of each other's appeal. Therefore each party shall bear its own costs.

In the result it is ordered as follows:

1. The main appellant's appeal partially succeeds.
2. The order of the court *a quo* in paragraph 2(d)be and is hereby set aside and is substituted as follows:

   d. "Add back the deductions for excess consumable stock in their respective amounts to the appellant's taxable income in respect of each tax year in issue".

3. The cross appellant's appeal partially succeeds.
4. The decision of the court *a quo* on technical services be and is hereby set aside.
5. The case is referred back to the court *a quo* for it to determine whether or not the agreement between the Dutch Company and Delta Corporation (Private) Limited, on the basis of which the main appellant sought the deduction of technical services contravenes s 98 of the Income Tax Act.
6. Each party shall bear its own costs.

GWAUNZA DCJ: I agree

CHITAKUNYE AJA: I agree

Gill, Godlonton & Gerrans, appellant's legal practitioners

Zimbabwe Revenue Authority, legal services division for the respondent