

GFZ LTD  
versus  
ZIMBABWE REVENUE AUTHORITY

SPECIAL COURT FOR INCOME TAX APPEALS  
KUDYA J  
HARARE, 27 and 28 November 2017 and 24 December 2019

### **Income Tax Appeal**

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

KUDYA J: The two appeals in question were consolidated by consent on 20 September 2017 because it was convenient to do so as they involved the same parties and an overlap of the issues. At the appeal hearing, the appellant called the evidence of two witnesses, SHR, a quantity surveyor and its head of Commercial Inland and MPWF, a chartered accountant and its head of Corporate and Business Structuring. It further relied on exhibit 1, a graph produced by the first witness and the pleadings filed of record. The respondent did not call any oral evidence but sought to rely on the pleadings filed of record.

#### The background

The background giving rise to these appeals predated the registration of the appellant on 18 January 2011 as a Zimbabwean branch of its Mauritian incorporated parent company, Mauritius, by the Registrar of Companies in Zimbabwe in terms of s 330 of the Companies Act [*Chapter 24:03*]. Mauritius was a wholly owned subsidiary of a South African registered company, South Africa. The effect of registration as a branch was that the appellant was treated as a separate entity from its parent company and was, *inter alia*, required under Zimbabwean law to prepare and file its own financial statements and tax returns.

#### *The Contract Agreement*

According to a letter dated 16 August 2010<sup>1</sup>, the initial parties to the Works for the Zimbabwean Roads Upgrade Phase 1, the Project, were the Zimbabwe National Road Administration, ZINARA, and the parent company, Mauritius. However, on 4 August 2011 the appellant executed an agreement, the Contract Agreement, in which it was identified as the Contractor, with a local private company identified interchangeably as the Employer or Client for the design, execution and completion of the Project. The appellant was represented by the first witness, SHR, while the other party, the Employer was represented by FC, its Chief Executive Officer. It is, I think, important to underscore what the contract entailed. It was concerned with “the Works for the Zimbabwe Roads Upgrade Phase 1 and the remedying of any defects” described in the “Contract and the Employers’ Requirements”, which specified the purpose, scope, design, and other technical criteria for the Works. The conditions of the contract comprised the “General Conditions” derived from the “Conditions of the Contract for EPC/Turnkey Projects” First Edition 1999, published by the Federation Internationale des Ingenieurs-Conseils, FIDIC (the international federation of consulting engineers), and the “Particular Conditions of Contract”, which included amendments and additions to the General Conditions.

The contract encompassed some 126 pages consisting of six volumes of documents. The first volume covered the Contract Agreement, Board Resolutions of the signatories of the Contract, particular conditions of the contract, Schedule 1, being the schedule of payments, schedule 2, being the schedule of commencement and completion dates of sections and the Employer’s requirements. Volume 2 consisted of the general conditions of the contract, the Ministry of Transport and Energy Department of Roads Standard Specifications 1989, the SADC Standard Specifications for Road and Bridge Works (as applicable) and the COLTO Standard Specifications for Road and Bridge Works (as applicable). Volume 3, 4, 5 and 6 consisted of Roadworks Drawings, Materials Investigations and utilization, design report and environmental management plan, respectively.

The appellant undertook to design, execute and complete the Project in conformity with the provisions of the contract and the employer’s requirements for the agreed contract price of US\$206 660 000, excluding VAT, which was to be subject to any adjustments agreed or determined in accordance with the provisions of the contract. The Employer undertook to pay the contract price for the execution and completion of the Project. The appellant was permitted

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<sup>1</sup> P225 of r 11 documents.

to co-operate with, and disclose any information concerning the Project to the client's senior debt financiers and the insurers of such senior debt financiers who could, in addition, inspect the works and operational sites of the appellant from time to time. The contract, subject to the conditions in clause 1.1.3.2 of the particular conditions of the contract, which involved the procurement of the necessary permits, licences and approvals for each section of the Project, was to commence 30 days after the date signature.

In terms of the requests for drawdown emanating from the Employer of 27 June 2011<sup>2</sup>, 22 October 2012 and 25 November 2012<sup>3</sup>, the Employer, as the Borrower, concluded a US\$ 206.6 million term loan facility agreement, the loan agreement, on 11 May 2011 with DB, a development bank based in South Africa, as the Lender.

Apparently, by 16 August 2010, ZINARA had entered into an agreement with a South African subsidiary of the South African holding company in which ZINARA allocated US\$6m development funding "to the detailed investigation phase" and the facilitation of "a rapid start-up to the roads rehabilitation programme". The amount was payable to the as yet unborn appellant on the 25<sup>th</sup> of each month commencing on 25 August 2010 in six equal instalments. The money was to be used for "specialist testing of the road pavement structure, materials investigations, data collection and conceptual designs" for the Project. The expended portion of this development fee was to be reimbursed from the first drawdown from DB, anticipated to be in October 2010, being a date prior to the conclusion of the loan agreement.

On 18 January 2011, the appellant was incorporated in Zimbabwe. On 11 May 2011, it entered into the loan agreement with the development bank. On 4 August 2011, it concluded the Contract Agreement with the Employer. The first witness stated that it commenced the design and preparatory "Works" in March 2011 using the US\$6m advanced by ZINARA until October 2011, when it received US\$54m from the Lender and eventually completed the Works on 17 December 2014.

In February 2013 the respondent commenced a tax review of the appellant's operations initially for the period 2009 to 2013 but soon concentrated the review to the 2011 to 2014 tax years. After a series of meetings and an exchange of correspondence and documents, the respondent issued amended annual notices of assessment for income tax on 13 November 2015 in the sum of US\$ 42 107 450.76 for the 2011 tax year and US\$ 46 472 939.82 for the 2012 tax year and US\$ 20 425 199.50 for the 2013 tax year. On 10 December 2015, the appellant

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<sup>2</sup> P 368 of r 11 documents

<sup>3</sup> Pp135 and 148 of r 11 documents, respectively.

objected to the assessments. The respondent failed to determine the objections within the prescribed statutory period of 3 months. The appellant timeously served the appellant with its notice of appeal on 31 March 2016. The appellant's case was filed on 30 May 2016 while the respondent's case was filed on 1 August 2016. However, on 24 June 2016, the respondent issued further amended assessments of US\$38 996 378.11 for 2011, US\$ 35 443 299.88 for 2012 and US\$2 425 522 for 2013<sup>4</sup>.

Notwithstanding the respondent's failure to determine the objection within the prescribed statutory period, it issued a determination on 15 June 2016, in which 7 of the 17 objections were allowed in full. Of the 10 that remained one was disallowed by consent and another disallowed objection simply awaited provision of some requested invoices which the appellant was still to avail to the respondent. By letter of 11 July 2016, the appellant abandoned the issues that had been allowed and pursued those that had been disallowed.

The respondent also added to the 2011 to 2013 tax review, the investigation of the 2014 tax year. On 14 and 28 August 2015, 29 September 2015, 30 October 2015 and 2, 6 and 13 November 2015 and 19 January 2016<sup>5</sup>, the respondent requested a detailed statement of comprehensive income for the 2014 tax year to enable it to finalise the 2014 tax assessments. The respondent eventually issued an amended manual notice of assessment for income tax for the 2014 tax year on 14 October 2016, showing an assessed loss of US\$33 225 105.14. The appellant filed objection with the respondent on 11 November 2016. The respondent made determination to the objection on 3 February 2017, to which the appellant served its notice of appeal on 24 February 2017. The parties filed their respective cases on 23 May 2017 and 14 July 2017.

### The issues

At the pre-trial hearing of 24 March 2017 a total of eight issues were referred for determination on appeal. However, at the commencement of the appeal hearing, the appellant abandoned the two issues arising from its objection to management fees and the one issue concerning the disallowance of the claimed deduction of US\$200 250 for the double payment of a Car Junction motor vehicle. The issues that remained for determination were, therefore, these:

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<sup>4</sup> P249-254 of Commissioner's case and replicated on pp 217-222 of r 11 documents

<sup>5</sup> P para (l) p 359 and 3<sup>rd</sup> para of letter of 19 January 2016 on p209 of r 11 documents

1. Whether the deductions made by the appellant in terms of s 15 (2) (cc) of the Income Tax Act for the tax years 2011, 2012 and 2013 were proper?
2. Whether respondent was correct in deeming appellant to have earned interest on the amounts in question held by GFC and or its head office?
3. Whether the income of US\$ 5 262 730.37 reflected in the appellant's invoice 40 accrued to appellant before or after 30 June 2012?
4. Whether the appellant realised an exchange gain of US\$638 370 in the tax year 2011?
5. Whether it was appropriate for the respondent to raise penalties of 100% or at all?

I deal with each issue in turn.

*Whether the deductions made by the appellant in terms of s 15 (2) cc) of the Income Tax Act for the tax years 2011, 2012 and 2013 were proper*

The facts

On 20 June 2011, the appellant applied to the employer for an “interim payment” of US\$54m for the month of June 2011 as provided in schedule 1, the schedule of payments.” It attached a contractor’s progress report-certificate number 1, copy of schedule 1 and a tax invoice number RI-0013 dated 20 June 2011. In consequence of this letter, the employer, by letter dated 27 June 2011, requested for “the advance on or before 27 June 2011 (or as soon as practicable thereafter) the aggregate amount of US\$54m under the loan agreement (the loan)”<sup>6</sup> from the development bank. The schedule of payments covered the 24 months from June 2011 to May 2013. It comprised of 3 major headings of “Preliminary and General”, P&G, “Roadworks” and “Toll Plazas” with several line items under them. The contract price was apportioned amongst each head and item for the duration of the contract. Under P&G were two items of “establishment” and “time-related”. The payments allocated to “establishment” were US\$ 53 250 000 and to time-related, US\$18m. The “time-related” payments were spread in equal instalments of US\$750 000 per month while the stated “establishment” amount was to be a once off June 2011 payment. The monthly payments for each section of the road were indicated under “Roadworks” as were those related to each “Toll Plaza”, were identifiable by their closest town.

The application was not successful. The quantity surveyor attributed the failure to the absence of some essential documents requested by the Lender from the Employer. He further stated that the Employer, whose duty it was to do so, also failed to timeously procure the

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<sup>6</sup> P368 and 369 of r 11 documents

requisite permits, licences and approvals required for the commencement of the actual physical construction of the road. The r11 documents, *inter alia*, “contain two revised schedules of payment entitled “Scheduled Distribution of Expenditure”. The first, Revision 1a, appears on p 153 while the second, Revision 1c, is on p 140. These two are more detailed than that of 20 June 2011. They contain similar headings and items. They both cover the period October 2011 to March 2014. Under the P&G heading are three items of “start-up cost”, “time-related” and “contingency” while “Direct Roadworks encompass 9 rural and 9 urban sectors covering the length and breadth of the whole road network. The number and names of the “Toll Plaza Works” were unchanged. While the contract price remained constant, the allocation of the payments differed in each of the three schedules. In Revision 1a, the total amount allocated to P&G was US\$87 752 000 comprised of US\$54m allocated to “start-up costs”, US\$28 623 000 to “time-related” and US\$ 4 950 000 to “contingency”. The figures for Revision 1c were US\$ 76 200 000 comprised of US\$53 250 000 for “start-up costs”, US\$ 18 000 000 for “time-related” and US\$4 950 000 for “contingency”. The “start-up cost” was again a once-off payment due in October 2011 while the other items were evenly spread over the tenure of the contract. The total “Direct Roadworks” were US\$ 100 278 000 in Revision 1a and US\$ 111 650 000 in Revision 1c. The payments for the “Toll Plaza Works” of US\$18 750 000 were the same in each Revision.

It was common ground that the contract price was in the sum of US\$206 660 000 and was to be paid “at the times and in the manner prescribed in the contract.” Further, that the parties to the contract agreed on a schedule of payments, which set out the amounts that would be paid as well as the timing of the payments. On 5 October 2011 the appellant received payment of US\$50 384 500 of the US\$54 m drawdown from the Lender, which constituted approximately 25% of the contract price.

The main factual dispute was whether the drawdowns constituted upfront payments or not. A sub-issue that arises from the main issue is whether measurement or certification precipitated the drawdowns. The other minor issues were whether the second drawdown only occurred on 2 July 2012 and whether the contract commenced in May 2012 and ended on 17 December 2014. It is prudent to deal with the minor issues first.

*Whether the contract commenced in May 2012 and ended on 17 December 2014.*

The date of commencement of the contract agreement is prescribed in sub-clause 1.1.3.2, which states:

“Commencement Date” means the commencement date of the Contract Agreement as a whole **and** the commencement date to perform the Works in respect of any section shall be the date of commencement of the Works in respect of the Section that is decided upon by the Contractor in consultation with the Employer, provided that the necessary permits, licences and approvals as required by the Laws (has) been obtained to enable the Works to be executed and completed. The Contractor shall only be required to commence the Works once the necessary permits, licences and approvals as required by the Laws have been obtained.”

The appellant averred that the commencement of the Project was delayed to May 2012 because the Client was awaiting the requisite permits, licences or approvals for the exemption to the Contractor for the payment of duties to import goods and to export the Contractor’s equipment on completion of the contract. The respondent pleaded ignorance of this averment and averred that the contract appeared to have commenced in 2010.

I am satisfied that the commencement of the Contract Agreement was not delayed to May 2012 as averred by the appellant for two reasons. The first arises from the definition of commencement date. It is in two parts. The first relates to the commencement of the whole contract and the second, the Works in respect of each section. The first witness conceded under cross examination that the contract agreement did not commence with the physical Works on sections but with designing a contract plan of action or programme.

Notwithstanding that he limited the prior first drawdown works to ground investigations and the setting up of a local office to the US\$6m provided by ZINARA, I am satisfied for the reasons below that both physical and non-physical work commenced before the October 2011 drawdown. The second reason was that the appellant assumed and continued with the preceding establishment and start-up functions commenced by both its holding company and the South African subsidiary of the South African holding company. It was common cause that ZINARA was the majority shareholder while Mauritius, the appellant’s holding company, was a minority shareholder in the Employer. The inevitable conclusion I draw from these corporate linkages and the agreement concluded between ZINARA and the South African subsidiary referred to in the letter of 20 June 2011 was that those preceding functions were done for the benefit and expense of the as yet unborn appellant. This position was further affirmed by the appellant’s tax consultant in the letter to the respondent of 24 June 2016<sup>7</sup>, which intimated that the purchase of tolling equipment by another wholly owned South African subsidiary of the South African holding company at the special request and instance of ZINARA was paid for by the funds that were later drawn down from the development bank

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<sup>7</sup> P 234 of the r 11 documents

for the account of the Employer. Again, this position was also affirmed by the contents of exhibit 1, the graph produced by the first witness, which attributed stated amounts of revenue, costs, net profit and cumulative cash to the appellant in October 2010 and December 2010; a time before its formation. The self-same graph attributed the same lines of revenue and expenditure to the appellant from October 2010 to July 2011 and even up to September 2011, which periods were prior to the conclusion of the contract on 4 August 2011 and the first drawdown in October 2011, respectively.

It is for these reasons that I am satisfied that the contract agreement did not commence in May 2012 as contended by the appellant but at a much earlier date, possibly prior to the contract agreement date of 4 August 2011.

*Assessment of the first witness*

He was intimately involved in the formation of the contract but did not appear to have been closely connected with its implementation. I agree with the observation made by Mr *Magwaliba*, for the respondent, in his written heads of argument that he was reticent to talk about the contract. The main reason was that his testimony was at variance with some of the provisions of the contract. He vehemently stated, contrary to the available documentation and all reason that measurement of progress ever took place in a bid to divorce the drawdowns to measured progress. Mr *Tivadar*, for the appellant, had great difficulty in reconciling the witness's testimony with the contractor's progress certificates and the third party verification letter from the Employer of 24 November 2015, which effectively established that the drawdowns were made in place of the work done. He wrongly attributed payment of US\$6m to the Employer contrary to documents on record, which showed the active role of ZINARA long before the time frames he gave. He was never able to explain why if the appellant was adversely affected by late payments it was able to on-lend interest free loans to related entities in the sum of US\$ 16 699 399 in 2011, US\$24 796 255 in 2012, US\$8 001 117 in 2013 and US\$26 404 000 in 2014 instead of utilising these amounts as working capital. The use to which these amounts were put had all the hallmarks of earned income rather "income in advance". In any event, the witness failed to appreciate that the outstanding US\$19 186 375.61 that appellant was owed by the Employer at the end of the contract had nothing to do with unpaid or delayed scheduled payments but with variations that arose during the execution of the Project, as intimated in the verification response of 24 November 2015.

*Whether the first drawdown occurred on 2 July 2012*

The onus to establish on a balance of probabilities that the appellant received a further payment in respect of the project on 2 July 2012 lay on the appellant. It did not adduce any evidence to this effect. Rather, that averment contradicted the information in the summaries of the drawdown applications that emanated from the appellant, specifically on Revision 1c on pages 141 and 154 of the r 11 documents pertaining to the Lender's summarised values per month, which recorded that certificates 2 and 3 were paid out in May and June 2012 and the drawdown in July 2012 constituted the 4<sup>th</sup> withdrawal. The summary provided by the Employer in the response to the third party verification letter on page 181 of the r 11 documents also contradicted the assertion in the appellant's pleadings that the second drawdown was met on 2 July 2012. The testimony adduced by the quantity surveyor and backed by his own graph, exh 1, which was designed to establish that actual physical works commenced in July 2012, was, therefore, incorrect.

*Whether the payment of the US\$54 m and other subsequent drawdowns were upfront payments*

There are two principles which guide me in the resolution of this defining issue. The first relates to the sanctity of contracts and the second is the scientific principle that the end is created and known at the beginning, confirmed in part by the testimony of the quantity surveyor by reference to what this "silver book" contract entailed. He testified that the employer demanded the design and implementation of a performance standard that would guarantee a 10 year life span for the completed road. The first is a fundamental principle of the law of contract. The second is foundational to all scientific endeavours such as the construction of a building or as in this case, a road. By the time the physical construction of a building commences, architectural designs would have been completed and would have even culminated in a miniature model building. The same principle applied with equal force to the commencement of the physical works in the execution and completion of the Roadworks and Tolling. The design stage was pivotal. The six volumes that constituted the Contract Agreement underpinned this stage. It was variously described by the appellant, its first witness and the CEO of the employer as the "establishment", the "start-up", "project design work for project mobilisation and security for progress payments"<sup>8</sup> and "detailed investigation phase for rapid start-up"<sup>9</sup>. The

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<sup>8</sup> P 251 of r 11 documents, a letter by the first witness to the respondent dated 9 June 2014 on utilisation of the first disbursement.

<sup>9</sup> CEO's letter of 16 August 2010, *supra*.

physical works merely constituted the execution of a deliberately designed and planned programme.

It is on the basis of these principles that I explore the justifications for the contention made by the appellant that the drawdowns of US\$ 24 752 222 in 2011, US\$ 48 955 073 in 2012, US\$ 40 876 887 in 2013 and US\$ 403 481 in 2014 were upfront payments for which the appellant was entitled to and did elect to deduct from its taxable income future expenditure that it was going to incur in relation to this “income in advance”.

The first ground for justifying the contention was that the payments made from the drawdowns were not for work done but upfront payments. The first witness said as much in his testimony. He even produced exhibit 1, the graph, to demonstrate that the actual costs incurred by the appellant were far below the payments made at the commencement of the physical works and higher towards the end of the Project. The major hurdle that confronted the appellant was the contents of the 22 contractor’s certificates that it furnished with each drawdown application<sup>10</sup>. It was common cause that that certificate constituted one of the forms approved by the employer. The other forms were shown in the contents of the 12 paged drawdown application. These were drawdown schedule-Revision 1c, drawdown schedule summary values per month, Form 1: drawdown progress, Form 2a, measured progress. These forms together with the tax invoice, sector map and sector definitions constituted the full array of the documents that the appellant submitted to the employer and which the employer attached to its request for drawdown. All the sampled contractor’s progress certificates, that is number 7, 8, and 10 to 16 and 19 to 22 were compiled by the appellant and signed by the appellant, employer and lender. Each certificate was based on the provisions of sub-clause 14.3 (a) to (f) of the Contract Agreement. The major headings of the certificate were “value of work” under which were listed P&G, measured work, material on site, variation orders, advance payment and reduced payment. The other two headings were “escalation” and “deductions”, both of which had their own sub-headings under them. In all the certificates the appellant deliberately inserted the amounts sought to be drawn down against “measured work” and painstakingly inserted “0.00” on each of the other sub-headings in the value for work segment, but under reference of Schedule 1.

The first witness averred that the certificate simply meant that the application was being made in terms of Schedule 1, the agreed schedule for the time-related disbursements set out in

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<sup>10</sup> Pp 131-178 of the r11 documents.

that schedule. He maintained that the insertion of the amounts against “measured work” was not only a misnomer but also of no moment. In other words, he asserted that the certificate did not mean what it said. I agree with Mr *Magwaliba* that his explanation was disingenuous. A closer reading of clause 14 of the contract which dealt with contract price and payment clearly shows the error of his explanation. He termed the drawdowns that were in excess of appellant’s costs as income in advance, which he sought to distinguish from advance income provided for in sub-clause 14. 2 of the “General Conditions”. It was common ground that sub-clause 14. 2 did not apply to the Contract Agreement. It was specifically excluded by the “Particular Conditions” which deigned it a “No Clause” provision.

The nature of the advance payment contemplated by the excluded sub-clause was an interest free loan for mobilisation and design backed by the contractor’s guarantee and the terms stated in the pertinent Particular Conditions. The application of the sub-clause was also specifically excluded if the amount of the advance was not stated in the Particular Conditions. The payment of the first or only instalment was conditional upon receipt of an application for interim payments under clause 14.3, performance security and a guarantee in amounts and currency equal to the advance payment. It was repaid, if the relevant amortisation rate provided in the sub clause were applicable in the present case, in four equal instalments.

Now, on 20 June 2011, before the Contract Agreement was consummated, the appellant purportedly applied for an interim payment of US\$54m. In the letter addressed to the lender on 27 June 2011, the Employer described the drawdown sought as “the advance of the aggregate amount of US\$54m under the loan agreement.” In the absence of the loan agreement it is not clear whether “the advance” was a term defined in the loan agreement or not. The appellant did not refer to these letters in its evidence, obviously because the letters could have been based on the excluded clause. The payment was eventually provided to the appellant after the contract had come into effect. It was obviously not made in terms of the inoperable excluded clause.

The payment could only have been paid on the basis of sub-clause 14.4 (a) and (b), which dealt with the Schedule of Payments. In terms of sub-clause 14.4 (a) the instalments quoted in the schedule of payments were mere estimates of the contract values required to seek interim payments under sub-clause 14.3 (a) and sub-para (b) of sub-clause 14.4, which prescribed that if the instalments were not defined by reference to the actual progress achieved in executing the works, and if such actual progress was less than the amount in the schedule the Employer had a discretion to either agree to pay the higher amount or to revise the instalments. It appears that the drawdowns in the present matter utilised Revision 1c, which

may be a pointer to the revision of the three preceding schedules, the original and Revision 1a and b, under sub-para (b) of sub-clause 14.4.

In terms of sub-clause 14.4, the amounts quoted in the schedule of payments Revision 1c were estimated contract values that were linked to sub-clause 14.3 (a). The statement supplied to the Employer by the Contractor, otherwise known as the interim payments would contain in detail the amounts to which the Contractor claimed entitlement and the supporting documents inclusive of the relevant progress report. And more importantly, it was obliged to include “the estimated contract value of the Works executed and the Contractor’s documents.” The contents of a progress report are set out in sub-clause 4.21. These were prepared monthly by the Contractor and one copy was submitted to the Employer, within 7 days of the period to which it related until the project was completed. Each report would include the relevant charts and detailed descriptions of progress, each stage of design, contractor’s documents, procurement, manufacture, delivery to site, construction, erection, testing commissioning and trial operation, photographs showing the progress on site, the records of the contractor’s personnel and equipment, quality assurance documents, tests results and certificates of materials, safety statistics and comparisons between actual and planned progress.

In my view, both sub-clause 14.3 and 14.4 should be read in the context of the aims and objectives of the Contract Agreement and the purposes for creating the Schedule of Payments. The objectives of the Contract Agreement were to upgrade and remedy defects in the road network in question. The Schedule of Payments was a scientific document prepared and implemented with the end in sight. It was based on known and ascertainable variables which were linked to the phased execution and completion of the project in terms of the Programme contemplated by sub-clause 8.3 of the Contract Agreement. A reading of the contract shows that the Employer’s representative, referred to by the first witness as the Employer’s technical advisor, and personnel intimately intermingled and closely co-operated with the Contractor’s own personnel at every stage of the contract. Their involvement at every stage of the Project was part of the contractually devised monitoring and therefore progress measuring mechanism of the Project, which was designed from the very beginning to track the scheduled works embodied in the Schedule of Payments.

It seems to me that sub-clause 14.3 (a) categorically answers the factual question against the appellant. It states, *inter alia*, that the estimated contract value in the Schedule of Payments correlates to the execution of the anticipated Works. That the contractor’s progress

certificate deliberately covered measured progress and not advance payments or reduced payments further confirmed that the drawdowns were estimates for the formerly anticipated work, which had now been done. This finding was confirmed by the appellant's Financial Manager Central Accounting Services in her e-mail of 26 May 2016 to the investigating officer's question on what the US\$29 474 367.53 in Form 2 a: Measured Progress, entailed.<sup>11</sup> She, by reference to sub-clause 4.21, indicated that "Schedule 2a measured progress was the progress against the kilometres covered on the contract against the estimated cost per cubic meter/cost base." Some of the benchmarks for measuring progress were indicated in the measured progress report on page 156 of the r 11 documents as the correction of existing surface defects, recycling bitumen, road surfacing and supplying road furniture. The same point was made by the Employer in the verification letter addressed to Zimra. Indeed, even the quantity surveyor unwittingly conceded that two payments, which he did not identify, were delayed because actual progress was behind schedule.

The appellant and its counsel, prevaricated on whether the contractor's progress certificates spoke the truth about themselves. I agree with Mr *Magwaliba* that the argument of form over substance advanced by Mr *Tivadar* amounted to an explicit concession that the progress certificates did not speak the truth about themselves. Mr *Tivadar* was of course wrong in his construction of the contractor's progress certificate.

The Commissioner's construction of the Contractor's progress report was further confirmed by the Employer's third party verification letter dated 24 November 2015, on page 180 of the r11 documents. The employer was asked by what the Commissioner what the periodic payments entailed. The clear and unequivocal response was that they represented payments for work that had been completed at the time they were made. The suggestion advanced by the first witness and adopted by Mr *Tivadar* that the Schedule of Payments constituted a mere time framed payment mechanism belied the two delays in payment caused by a mismatch in the demand for payment and progress and all the other attachments to the drawdown application that measured the actual work done.

In view of this finding, it is not necessary to deal with all the other arguments raised by Mr *Tivadar* to justify the treatment of the drawdowns as payments of income in advance. Suffice it to say that it is for these reasons that I am satisfied that the drawdowns were payments for work done and not payments of income in advance.

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<sup>11</sup> E-mails on p 375-376 of r 11 documents in reference to the measured progress document on P 143 of r11 documents.

*Whether s 15 (2) (cc) applies to the drawdowns*

It is not necessary to cite the provisions of s 15 (2) (cc) in this judgment. Suffice it to say that its meaning was correctly construed by the parties and their counsel. The sub-para in contention deals with prepayments which are made in the current year of assessment for which corresponding expenses, not of a capital nature, are incurred on that income in subsequent tax years. Such a prepayment would constitute revenue in the tax year that it is received. The sub-para, however, allows a taxpayer to elect to deduct in the tax year of receipt, the expenditure or losses, not of a capital nature, as fixed by the Commissioner, he anticipates to incur in the subsequent tax years, which would have a direct correlation to the gross income of the subsequent year. The deduction claimed would, however, be included in the gross income of the taxpayer in the relevant subsequent tax year.

I have found that the drawdowns did not constitute income in advance but were payments for work done. Accordingly, section 15 (2) (cc) is not engaged. The respondent correctly added these amounts back to the income of the taxpayer in the years in which they were received and deducted them from the income in the future years where the appellant had included them.

*If they were advance payments were they fixed?*

The appellant asserted that in the absence of a statutory prescribed mechanism for engaging the Commissioner to fix the allowance, the s 37A of the Act self-assessments constituted the fixing of the allowance by the Commissioner envisaged by s 15 (2) (cc). In my view, the assertion is devoid of merit. I agree with the contentions made by the Commissioner that the taxpayer was obliged to approach the Commissioner to fix the allowance using the method that taxpayers use to communicate with the Commissioner, by adopting with modifications some of the methods outlined in the Fourth Schedule to the Revenue Authority Act [Chapter 23:11]. I find it highly incredulous that tax consultants, especially of the pedigree at the disposal of the appellant, would not know how to approach the Commissioner to fix an allowance. It is a matter of common sense that they would, as suggested by Mr *Magwaliba*, write, arrange a meeting or seek the assistance of the respondent's Large Clients Office. While a self-assessment is deemed by s 37A to be an assessment under the hand of the Commissioner, the reality of the matter is that the taxpayer is not deemed to be the Commissioner even where the method of approaching the Commissioner is not specifically stated. Accordingly it cannot

fix the allowance. I agree with the Commissioner that the stage at which the allowance is fixed is not on the submission of the return but at the stage the taxpayer becomes aware that the amount constitutes income in advance. In their respective pleadings, both parties suggested the method of computation that could be used. The appellant suggested the utilisation of its projected profit margin to determine the following year's anticipated expenses. The respondent suggested an estimated projection of the future expenses based on a comparison between the existing and anticipated income and expense dynamics in the particular industry the taxpayer operated in. The method used would obviously provide a basis for the Commissioner to fix the allowance. In any event, the fixing of an allowance is a separate and specific event, which precedes the holistic act of assessment.

I do not think that the question of their accuracy in retrospect is paramount. What is pertinent is the legal basis upon which the amounts were computed and inserted into the appellant's tax returns. It was improper for the taxpayer to usurp the function of the Commissioner by fixing the allowance. In the instant case, the appellant was clearly putting the horse before the cart.

*Whether respondent was correct in deeming appellant to have earned interest on the amounts in question held by GFC and or its head office*

It was common cause that the terms of the loan agreement between the Borrower and the Lender were, *inter alia*, that the Lender would disburse the funds due to the Borrower for payment to the appellant directly to the appellant's head office in Mauritius. The head office either retained the funds or rechanneled some of them to its own holding company in South Africa. The appellant and the two foreign entities in question were all related parties. It was further common ground that the appellant would access these funds as and when it required them from these two related parties. It was the evidence of the chartered accountant that in the financial statements of the appellant and the related entities these amounts were treated as interest free loans without a due date. It was further common ground that the respondent invoked the provisions Article IV and Article 9 of the Double Taxation Agreements between Zimbabwe and Mauritius and Zimbabwe and South Africa, respectively, and applied the average interest rates in the these two countries provided by their respective central banks to duly impose notional interest on these balances of US\$939 807.87 for the 2011 tax year, US\$

1 284 601 for the 2012 tax year, US\$ 484 522.59 for the 2013 tax year and US\$ 484 523 for the 2014 tax year<sup>12</sup>.

The appellant did not challenge the method of computation or the amount of notional interest imposed by the respondent. Rather, it attacked the basis upon which the deemed interest was raised. I agree with Mr *Tivadar* that the Income Tax Act does not provide for the deeming of interest in circumstances where a taxpayer advances a tax free loan to any party, whether related or not. In my view, the Commissioner could not have raised notional interest at the time without first invoking the provisions of s98 of the Act. In terms of s 91 (1) of the Act, DTAs are invoked against an income tax liability arising from the Income Tax Act. I agree with Mr *Tivadar* that by applying the provisions of the DTAs before invoking the relevant charging section in the Income Tax Act, the respondent was not only putting the cart before the horse but was also letting the tail wag the dog.

I will direct the respondent to reverse the deemed interest it added to the appellant's taxable income in each of the four tax years.

*Whether the income of US\$ 5 262 730.37 reflected in the appellant's invoice 40 accrued to appellant before or after 30 June 2012.*

The appellant raised invoice 40 for US\$ 5 262 730.37 against the Employer on 25 June 2012. The appellant's 2011 tax year corresponded with its 30 June 2012 financial year. The invoice was certified by the employer on 9 July 2012. In terms of sub-clauses 14.6 and 14.7 of the contract between the parties, the amount only became due and payable to the appellant on certification by the employer or within 28 days if the employer did not object to its contents. The appellant excluded this amount from its 2011 year of assessment income but included it in the 2012 tax year. The respondent deducted it from the 2012 tax year and added it back to the 2011 taxable income. While the appellant contended that the invoiced amount accrued in the 2012 tax year, the respondent contended that it did so in the 2011 tax year.

The contrary position taken by the parties once again brings into focus the difference between accrued to and incurred. The words "accrued to" have been equated with "to become entitled to" in such cases as *Commissioner for Inland Revenue v People's Stores (Walvis Bay) (Pty) Ltd* 1990 (2) ZLR 353 (A) at 362G and 367C while according to such cases as *Lategan v Commissioner for Inland Revenue* 1926 CPD 203 and *Edgars Stores Ltd v Commissioner for*

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<sup>12</sup> The aggregate loan balances were US\$ 16 699 399 in 2011, US\$ 24 796 255 in 2012, US\$ 8 001 117 in 2013 and US\$24 409 000 in 2014 on p 195 of the 1<sup>st</sup> appeal's r 11 documents and p 12 of the r 11 documents of the second appeal

*Inland Revenue* 1988 (3) SA 876 (A) at 889A-C; 50 SATC 81 (A) at 90 and *ITC 1587* (1994) 57 SATC 97 (T) at 103-104 incurred denotes “an unconditional obligation to pay”. The construction given to the words “accrued to” by the respondent was jettisoned in the *Peoples Stores (Walvis Bay) Ltd* case, *supra*, in favour of the one posited by the respondent. HEFER JA, who wrote the judgment for the Appellate Division held that “gross income accrues to the taxpayer in the year of assessment in which he becomes entitled to an amount, irrespective the fact that the amount may only be due and payable in a later year of assessment.”<sup>13</sup> The construction rendered in the *Walvis Bay* case was approved by SANDURA JA in *Standard Chartered Bank (Zimbabwe) Ltd v Zimra* 2009 (2) ZLR 251 (S) at 257B. These cases made distinction between “accrued to” and “incurred”. The former bears a wider meaning than the latter. In terms of sub-clause 14.7, as amended by the “Particular Conditions”, of the Contract Agreement, the timing of the Scheduled Payments was, in context, based on the work done in each sector. In raising invoice 40 on 25 June 2012, the appellant was broadcasting to the whole world that it had executed the sectorial work to which the invoice related and was entitled to payment as of that date. Its entitlement to payment for the work done was irrespective of the certification or the 28 days upon which the actual payment depended. I am satisfied that the amount in invoice 40 accrued to the appellant in the 2011 tax year and was incurred by the Employer in the appellant’s 2012 tax year. In the premise, the respondent correctly added it back to income in the 2011 tax year.

The appellant also objected to the inclusion of US\$2m, which related to certificate number 2 invoice 8 and certificate number 3 invoice 9, into its 2011 taxable income over which a credit note in that amount was passed on 16 November 2010. While the issue was disallowed in the determination, the appellant conceded in para 88 of the Commissioner’s case that the amount should have been remitted in full; a position adopted by Mr *Magwaliba* in para 11.3 of his written heads of argument. I will, therefore, direct the Commissioner to deduct the sum of US\$ 2m from the appellant’s 2011 taxable income.

*Whether the appellant realised foreign exchange gains of US\$638 370 in the tax year 2011 and US\$ 104 285 in the 2014 tax year*

The appellant claimed realised foreign exchange losses of US\$ 403 551 and unrealised foreign exchange gains of US\$ 638 370 in the 2011 tax year. The respondent allowed the losses but added back to the appellant’s gross income the net foreign exchange gains in the sum of

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<sup>13</sup> *Silke: South African Income Tax* 2015 ed para 2.3.2 at page 20

US\$234 818.86, which were purported to have been unrealised by the appellant. The respondent also added back US\$29 740 purportedly unrealised foreign exchange gains to the 2013 tax year. The respondent relied on the ledger of foreign exchange gains and losses running from 24 February 2011 to 25 June 2012 to add back US\$ 234 818.86 to income<sup>14</sup>. That ledger had a positive balance of US\$ 234 818.86. The appellant objected to the refusal to deduct the full amount of the unrealised foreign exchange gains. On disallowance of the objection it appealed to this Court for the deduction of the full amount. While the respondent seemed to suggest in some of its correspondence and findings in the two determinations<sup>15</sup> that it equated the appellant's financial year conversions of the amounts held in Rands to United States dollars with realisation, it maintained that the ledger showed that the appellant had made a net gain of US\$234 818.86 on the 2011 foreign exchange gains and losses account.<sup>16</sup> The respondent also treated the "unrealised gains" for the 2014 tax year in the sum of US\$ 104 285 in the same way.<sup>17</sup>

The second witness called by the appellant stated that the foreign exchange gains were recorded in the appellant's ledger in question and financial statements in compliance with International Financial Reporting Standards, IFRS, but were not realised for taxes purposes. He explained that they would only be realised when the particular obligations had been settled. He conceded under cross examination that the total of US\$234 818.86 in the 18 month running ledger represented the net gains of the realised 2011 exchange rate gains and losses. In that respect, he confirmed the correctness of the averments that had always been made by the respondent in the letter accompanying the assessments of 13 November 2015 and in the Commissioner's case in respect of each appeal.<sup>18</sup> His testimony destroyed the appellant's ground of appeal on this issue. In any event, he failed to produce documentary proof to show that the so called unrealised foreign exchange gains had not been realised in respect of the 2011, 2013 and 2014 tax years and that they were mere bookkeeping entries and restatements calculated and generated by the JDE accounting package used by the appellant.

In view of this factual finding, it is unnecessary to determine whether mere conversion of foreign currency denominated balances into the currency of account in a taxpayer's year-

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<sup>14</sup> On pp128-130 of r 11 documents

<sup>15</sup> P 357 and 216 of r 11 documents in the first appeal and p 6 of the r 11 documents in the 2<sup>nd</sup> appeal

<sup>16</sup> P 357 and 216 of r 11 documents and paras 91 and 93 of respondent case in the first appeal and 92 of the second appeal,

<sup>17</sup> Determination of 15 June 2016 p 6 of r 11 documents of the second appeal

Para 91 and 93 on pp29 and 30 of the Commissioner's case in the 1<sup>st</sup> appeal and para 92 on p 25 of the Commissioner's case in the 2<sup>nd</sup> appeal

end financial statements would constitute the type of realisation envisaged by s 8 (2) of the Income Tax Act. Accordingly, this issue is decided against the appellant.

*Whether a fair value of a long term debt constitutes taxable income*

In the 2014 tax year, the appellant fair valued a long term debt owing by the Employer in the sum of US\$37m, I presume, in terms of IFRS 13: Fair Value Measurement,<sup>19</sup> which came into force on 1 January 2013 and was amended on 1 June 2014. The appellant credited to its income statement the sum of US\$ 268 736 in respect of this unrealised fair value adjustment and but deducted it from its 2014 income. The respondent treated it as accrued income and added it back to income. The appellant contended that it was a mere bookkeeping entry which was not subject to tax. The respondent sought disclosure of the computation methodology used by the appellant and satisfaction that this fair value adjustment was not a disguised adjustment for a bad debt or even a provision for a doubtful debt. These were valid concerns which were not addressed by the appellant on objection or appeal. The appellant has failed to discharge the onus on it to show that the purported fair value of the debt was not a disguised adjustment for a bad debt or a provision for a doubtful debt.

*Whether it was appropriate for the respondent to raise penalties of 100% or at all*

The imposition of penalties is always in the discretion of the appeal court. In regards to s 15 (2) (cc) issue, the appellant submitted that it did not intend to evade tax by either defrauding the revenue or postponing the payment of the tax chargeable. The respondent moved the Court to find that the appellant intended to defraud the revenue or postpone the payment of the correct amount of tax due. I found as a matter of hard fact that the appellant invoked s 15 (2) (cc) in the full knowledge that all the interim payments made to them were made *in lieu* of work done. That the payments could only be made after the work had been performed was clear from the nature of the contract itself and from sub-clause 14.3 (a)'s use of the phrase "the estimated contract value of the Works executed", upon which the Schedule of payments in sub-clause 14.4 (a) were predicated. The appellant deliberately called the quantity surveyor who was not conversant with the compilation of the Contractor's progress report and the other accompanying documents. It was clear to me that the payments that were disbursed in accordance with time-framed schedule of payments were based on the progress of works certified by the contractor and employer's representatives, otherwise the two delayed payments

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<sup>19</sup> Note 1.13 pp316, 319 to 2013 accounting policies and note 1.13 p 289, 295, to 2014 accounting policies I r 11 documents

mentioned by the first witness would not have occurred. I agree with Mr *Magwaliba* that the appellant deliberately intended to evade the payment of the correct tax chargeable by invoking the inapplicable provisions of s 15 (2) (cc). In these circumstance, s 46 (1) (c) as read with (6) of the Income Tax Act, requires the Commissioner on objection and the Court on appeal to impose the mandatory dollar for dollar penalty. The 100% penalty imposed by the Commissioner in regards to the first issue is accordingly confirmed.

The appellant withdrew the appeal against management fees and conceded the correctness of the determination made to the objection on this issue. Counsel for the appellant did not proffer any argument against the penalty of 100% imposed in respect of management fees as circumscribed by the provisions of s 16 (1) (r) of the Act. The penalty imposed on the amounts less those allowable in terms of s 16 (1) (r) is confirmed.

In regards to the 100% penalty imposed on foreign exchange gains, it was always apparent from the evidence proffered by the appellant that the claim for unrealised foreign exchange gains was unjustified. The persistent objection and appeal launched was not based on any true desire to right a wrong but in my view amounted to a deliberate attempt to evade the payment of the correct tax on this issue. It is mandatory in these circumstances to impose the 100% penalty. I, therefore, confirm the penalty imposed by the Commissioner in respect of the foreign exchange gains in question.

I am compelled by the facts to do the same with respect to the fair value of a long term receivable. The appellant failed to provide the factual basis for the remittal of this US\$268 736 it claimed was not accrued income and sought to rely on legal arguments. The required information could only be provided by the appellant. The issue involved the treatment of a long term debt owed to the appellant. The appellant failed to discharge the onus on it to distinguish the amount in question from a doubtful debt provision or a bad debt adjustment. The appellant did not make any argument in favour of reducing the penalty imposed by the Commissioner on this issue. I, therefore, confirm the penalty.

### Costs

The appellant succeeded on appeal on the issue of deemed interest and understatement of income arising from Invoice 8 and 9 in the aggregate sum of US\$2m in respect of the 2011 tax year. There were other issues raised in the second appeal involving the use by the respondent of the appellant's 2013 net profit before tax figure instead of the 2014 figure to compute the 2014 income tax liability and the disallowance of the wear and tear allowance of

US\$ 1 163 432, which respondent conceded were deductible and which the respondent would have to incorporate in the further amended assessments that will result from my decision on this appeal. It is on the basis of these limited successes that I have decided against making an adverse order of costs against the appellant. I will order each party to bear its own costs.

Disposition

Accordingly, it is ordered that:

1. The amended manual notices of assessment for income tax number 20330668 for the 2011 tax year, 20330669 for the 2012 tax year, 20330672 for the 2013 tax year and 496425 for the 2014 tax year issued on 24 June 2016 by the respondent against the appellant are set aside.
2. The Commissioner shall issue further amended manual notices of assessment for income tax to the appellant in respect of each of the four years, which incorporate my findings in this judgment and shall specifically:
  - a. Add back to the appellant's income the sum of US\$ 24 752 222 to the 2011 tax year, US\$ 48 955 073 to the 2012 tax year, US\$ 40 876 887 to the 2013 tax year and US\$403 481 to the 2014 tax year in respect of purported s 15 (2) (cc) allowances.
  - b. Deduct management fees up to the limit prescribed in s 16 (1) (r) of the Income Tax Act from the income of the appellant in respect of each of the four tax years.
  - c. Remit the deemed interest charge imposed in terms of both the Mauritian and South African Double Taxation Agreements in each of the four tax years.
  - d. Deduct the understatement of income in the sum of US\$2m from the 2011 tax year.
  - e. Deduct the amounts in respect of Internal Hire, Minor Purchases, Accruals or Intersite, General Internal Labour, Single Quarters, Survey Equipment and Sundry Expenses and Car Junction in the affected tax years.
  - f. Add back to the income of the appellant the sum of US\$234 818.86 to the 2011 tax year and US\$ 29 740 to the 2013 tax year in respect of foreign exchange gains.
  - g. Amend the appellant's net profit before tax figure for computing the 2014 tax year to the amount indicated in the financial statements to the year ending 30 June 2015.
  - h. Allow the full wear and tear allowance claimed by the appellant in respect of the 2014 tax year of US\$ 1 861 370.
  - i. Disallow the deduction of US\$268 738 purported to be in respect of fair value gain of the long term receivable from the 2014 tax year.

- j. Disallow the expenditure of a capital nature of US\$ 17 647 from the 2014 tax year.
  - k. Impose penalties of 100% on the tax charged in respect of the amounts added back in respect of the purported s 15 (2) (cc) allowances and the excess management fees claimed above the limit specified in s 16 (1) (r) of the Act in each of the four tax years, the foreign exchange gains added back to the income for the 2011 and 2013 tax years and on the fair value of the long term receivable in respect of the 2014 tax year.
3. Each party shall bear its own costs.

*Gill Godlonton and Gerrans, appellant's legal practitioners*