HC 2384/03
HC 2383/03

1. MEDIX PHARMACIES (PRIVATE) LIMITED
TANGANDA LIMITED
MIEKLES AFRICA LIMITED
versus
COMMISSIONER-GENERAL OF THE ZIMBABWE REVENUE AUTHORITY
and
BARCLAYS BANK OF ZIMBABWE LIMITED

2. ERNST AND YOUNG CHARTERED ACCOUNTANTS
versus
COMMISSIONER-GENERAL OF THE ZIMBABWE REVENUE AUTHORITY
and
BARCLAYS BANK OF ZIMBABWE LIMITED

HIGH COURT OF ZIMBABWE
CHINHENGO J
HARARE, 7, 23 April and 9 July 2003

Opposed Urgent Application

A.P. de Bourbon, for the applicants
P. Nherere, for the respondents

CHINHENGO J: The applicants in the above-cited cases adopted a system known as the Integrated Remuneration System (IRS) to incentivise and retain their higher level employees by increasing the amount of money in their pockets. This they sought to do by taking advantage of certain provisions of the Income Tax Act [*Chapter 23:06*] ("the Act"). The applicants were, and still are, of the view that the IRS is permissible under the Act. Each of the applicants maintains banking accounts with the second respondent ("Barclays Bank").

The first respondent ("the Commissioner-General") held a different view about the IRS. His view was that the IRS is a tax evasion scheme which was adopted by the applicants for the purpose of avoiding their having to withhold a portion of the tax payable by the employees (PAYE) which, in the absence of the IRS, they would have been required to withhold and to pay to the Commissioner-General.

After adopting the IRS, the applicants withheld lesser amounts of PAYE which were commensurate with the reduced remuneration of the employees. The Commissioner-General took action in terms of s 58 of the Act and availed himself of some of the applicants' funds held by Barclays Bank. In the case of Meikles Africa Limited and Tanganda Limited, the Commissioner-General's officers uplifted from their accounts with Barclays

Bank the sums of $13 261 175,55 and $46 817 107,43 respectively. In the case of Medix Pharmacies (Private) Limited and Ernst and Young Chartered Accounts, the Commissioner-General's officers could not uplift any amount because their banking accounts were in overdraft.

For the reasons that will appear later, the applicants contended that the Commissioner-General was not authorised to act in the manner he did. The applicants accordingly sought -

(a) a declaration that the Commissioner-General is not entitled to issue an assessment in respect of any alleged indebtedness by the applicants for payment of PAYE said to be payable in terms of the 13th Schedule as read with s 73 of the Act.

Alternatively

that the Forms P12 issued by the Commissioner-General are not assessments issued in terms of Part V of the Act and that the Forms ITF 227 also issued by the Commissioner-General are invalid and of no force and effect;

(b) an order that, in respect of Meikles Africa Limited and Tanganda Limited, the Commissioner-General forthwith pay to Barclays Bank the sums of money uplifted from their accounts together with interest at the prescribed rate of interest calculated from 4 April 2003.

The applications were placed before me on an urgent basis. I acceded to the urgency of the applications at the preliminary hearing on 7 April 2003 and I gave my reasons for doing so. I shall not state those reasons now because none of the parties took issue with that decision. At the same hearing, the parties agreed that I should finally determine these matters and not merely determine whether or not I should grant a provisional order as initially requested of me. At the resumed hearing on 23 April, these matters were fully argued after the parties had filed the necessary affidavits and the heads of argument.

The Integrated Remuneration System

It is necessary that I clearly outline the nature of IRS and its implementation. Such an outline will provide a basis for a proper

appreciation of the causes of this application and in particular the conduct of the Commissioner-General.

The applicants adopted the IRS between May 2001 and February 2003. The parties involved with the IRS entered into various agreements as follows.

(a) The Integrated Remuneration System Agreement

This was an agreement entered into between an employer being any one of the applicants and Twinsburg Investments (Private) Limited t/a Remserve ("Remserve"). This agreement was motivated by the employer's wish to assist certain of its higher level employees to obtain loans at concessionary rates. In terms of this agreement, Remserve agreed to make loans to employees nominated by the employer on the conditions that Remserve sourced funds at or below a rate agreed with the employer ("the agreed rate"); the employee signed a loan agreement with Remserve, in terms of which the employee obtained the loan and agreed to invest the whole of the amount of the loan in debentures issued by Rebuttal Trading (Private) Limited ("Rebuttal") and to cede to Remserve his rights in the debentures; Remserve agreed to grant loans to the employees at an interest rate of 16% *per annum*. The employer agreed to pay to Remserve as a loan subsidy an amount equal to the difference between the agreed rate and 16% per annum ("the subsidy payment"). Remserve also agreed to certain other obligations which were in line with its general obligation, assumed in terms of the agreement, to administer the IRS on behalf of the employer. These other obligations encompassed the obligation to –

(i) invest on behalf of the employee the loan amount in debentures;

(ii) ensure that valid debenture certificates were issued in favour of the employee;

(iii) retain the debentures as security for the loan;

(iv) receive payment of interest earned on the debentures on behalf of the employee,

(v) deduct from the interest earned on the debentures the amount due

to Remserve as interest on the loan and pay the balance to the employee;
(vi) redeem the debentures on their maturity on behalf of the employee and use the proceeds to repay the employee loan; and
(vii) provide the employee in each year with a tax certificate detailing the interest income earned by the employee in respect of the debentures for the previous income tax year.

The other provisions of the agreement such as those relating to the rendering of other assistance to the employee upon request by such employee, the payment by the employer of an administration fee, the payment by the employee of the normal fee for the management of the investment, the indemnities granted to some parties involved in the IRS, the termination of the agreement and dispute resolution are not directly relevant to the determination of the issues before me. It is important to appreciate that the IRS is administered by Remserve on behalf of the employer in terms of this agreement.

(b) Employee Loan Agreement

An employee who was nominated by the employer as a beneficiary of the IRS entered into a separate agreement with Remserve. This agreement contained general terms on which the loan was granted by Remserve to the employee. The amount of the loan, its period, the draw-down date, repayment date, interest payment frequency and date were provided for in this agreement. In brief the agreement provided that the employee was granted a specified amount as a loan, he ceded to Remserve as security for the loan his/her rights in terms of the debentures or other acceptable security. Remserve invested the full amount of the loan in debentures on the employee's behalf. These conditions also complied with the terms of the agreement entered into between the employer and Remserve referred to in (a) above.

(c) Investment Agreement

Where an employee elected that Remserve shall invest the amount of the loan granted to him, as he was required to do for all intents and purposes, the employee entered into an investment agreement with

Rebuttal in terms of which the employee invested with Rebuttal the amount of the loan granted by Remserve and Rebuttal issued debentures in respect of that amount. It is really just an investment agreement containing details about the debentures – their date of maturity, issuance, interest payments, transfer, registration, cancellation, redemption and their summary repayment. What is significant about this agreement is that in terms of clause 3, 8 and 12, the employee is bound to invest the loan amount with Rebuttal through Remserve.

(d) Agreement between Employer and Employee

The IRS was seemingly adopted for the benefit of the employee. In order to secure the employee's consent, the employer wrote to the employee along the following lines:

> " Subsidised Loan Facility
> The Board of Directors of [Employer] has resolved to subsidise loans for members of staff:
>
> The salient features of the loan facility are as follows:-
>
> 1. The loan will be advanced directly to you by [Remserve] a registered moneylender. A copy of Remserve's standard loan conditions is attached.
>
> 2. The Company has arranged that the Remserve loan will be made available to you at an interest rate of 16% per annum.
>
> 3. Remserve will advance the loan on the condition that you provide acceptable security.
>
> 4. Interest on the Remserve loan will be payable at the end of each month. The loan will be repayable after 11 months or earlier in the event of termination of your employment or at your request.
>
> I am pleased to inform you that the Company is prepared to subsidise your loan facility from Remserve to the extent of [$….] per month. If you elect to take up the offer of this loan facility, you will be required to accept a reduction in your monthly salary equivalent to the amount of the subsidy. The facility will be conditional upon your acceptance of Remserve's standard loan conditions.

The Company has been advised that while the loan facility is a benefit

taxable in your hands in terms of s 8(1)(f) of the Income Tax Act, no tax arises unless the interest rate of the loan is less than a specified rate, currently 16% per annum. The Company has also been advised that any income earned from the Investment of the loan proceeds will be taxable in your hands, currently at an effective rate of 30.9%. However, neither the Company nor its advisors accept responsibility for this advice and you should consult your own advisors to ascertain the tax implications of the loan facility. The Company also does not accept responsibility for any additional liability that may arise from a change in tax legislation.

Should you wish to accept the offer, please complete the attached Form of Acceptance and return it together with the attached copy of this letter to me as soon as possible.

Also attached is a copy of the Standard terms and conditions for an investment in fixed rate debentures issued by Rebuttal Trading (Private) Limited ("Rebuttal") for a period matching the term of the Remserve loan facility. Should you elect to invest the full proceeds of your loan in debentures issued by Rebuttal, the debenture certificate will be accepted as adequate security by Remserve. Rebuttal will deduct from your investment income and invest on your behalf the amounts necessary to ensure that you are in a position to pay the tax due on the income from your investment in the debentures."

In accepting the terms of the above letter the employee signed a standard acceptance letter which reads:

> "Form of Acceptance in Respect of the IRS Loan Facility ("the Loan Facility")
>
> To. The Board of Directors
>
> [Company]
>
> I the undersigned, confirm that I have full legal capacity and hereby irrevocably accept the offer of the Loan Facility made to me in the attached letter.
>
> I acknowledge that the Loan Facility will be governed by the standard terms of a loan agreement with Remuneration Services (Private) Limited and the provisions of a loan subsidy agreement between (company/Employer) and Remserve, a copy of which is available from the Company on request.
>
> I agree that as a result of my acceptance of the Loan Facility, my monthly salary and pension contributions thereon will be reduced by (X dollars).
>
> I accept that all and any liability for tax arising from the Loan

> Facility or the investment of the amount of the loan, including any such liability arising from a change in legislation or tax practice, shall be for my account and confirm that I have taken such steps as I consider appropriate to ascertain my liability for tax."

The above-mentioned agreements clearly show that the employer entered into two agreements, one with the employee in respect of the salary sacrifice and subsidisation of the loan and the other with Remserve for the administration of the IRS. The employee also entered into two other agreements, one with Remserve, (the loan agreement) and the other with Rebuttal for the investment of the loan amount. All these agreements are fully documented. In my view the whole IRS is a package arrangement involving the employer, the employee, Remserve and Rebuttal. The effectiveness of the IRS depended entirely on all the agreements being implemented as a package.

The Relationship between the Employer and Remserve and between Remserve and Rebuttal

The employer's relationship with Remserve is contractual it being mainly to do with the administration of the IRS. The relationship between Remserve and Rebuttal is that Rebuttal is supposed to provide the funds with which Remserve is able to make the loans to the employee. In turn Rebuttal receives the loan amounts from Remserve as an investment by the employees and issues debentures.

The Commissioner-General commented at length on the relationship between Remserve and Rebuttal. He sought to show that the two companies were not dealing at arms length with each other. He noted that they have common directorships and common bank account signatories. He noted that no money actually changed hands between Remserve and Rebuttal and, as a result, asked the court to examine the substance of the transactions between these companies with a view to unravelling the nature of the IRS. I will revert to this matter later on in this judgment.

Action by the Commissioner-general

From the time that the applicants adopted the IRS pursuant to the agreements to which I have referred above, the applicants withheld PAYE from the employees who had subscribed to the IRS and sacrificed a portion of their salaries so much as was in line with their new salary. This prompted the Commissioner-General to invoke s 58 of the Act, appoint Barclays Bank as its agent and uplift the amounts from the applicants' bank accounts on the grounds that the applicants had neglected, failed or refused to withhold the correct amount of PAYE. In broad terms the Commissioner-general was of the view that the IRS was a tax evasion scheme by means of which the applicants sought to reduce the amount of PAYE payable by their employees to the prejudice of the fiscus. He said that the IRS was merely one way of paying the employees a portion of their salaries not through the payroll but through a tax evasion mechanism. In a letter to each of the applicants dated 3 April 2003 the Commissioner-General advised as follows:

"Failure to comply with Provisions of the 13th Schedule of the Income Tax Act

a) Information held indicates that your organisation has failed to deduct and remit PAYE on amounts paid to some members of staff.

b) It is my opinion that the failure by your organisation was planned and deliberate in order to evade PAYE payable on those amounts.

c) Corrective action is now being taken in order to minimise losses to the fiscus and to recover lost revenue.

d) Find attached schedules showing my estimates of the debt arising from the tax evasion.

e) (not relevant)"

This was followed by standard letters (Forms P12) dated 4 April 2003 in terms of which the Commissioner-General advised the applicants

about the amount owing by each of then arising from what he considered to be an evasion scheme. Medix Pharmacies was adjudged to owe the sum of $96 551 142,85 being as to principal - $50 590 096,27; penalty (100%) - $39 419 271,11 and, interest - $6 541 775,47. Tanganda Limited was adjudged to owe the sum of $75 928 720,24 broken down as follows: principal - $35 462 717,61 penalty (100%) - $5 003 285,01 and interest - $35 462 717,61, Meikles Africa Limited was adjudged to owe $780 572 683,81 broken down as follows: principal - $371 261 510,01 penalty (100%) - $325 334 837,13 and interest - $83 976 336,67.

On the same day that the applicants were advised of the amounts allegedly owing by them, the Commissioner-General appointed Barclays Bank as its agent in terms of s 58 of the Act in order to garnishee the amounts concerned see the ITF 227 Forms. This resulted in the upliftment of the amounts I have mentioned at the beginning of this judgment from the bank accounts of Tanganda Limited and Meikles Africa Limited. By letters dated 7 April the applicants protested to the Commissioner-General against the action taken. In those letters the applicants denied that the IRS was a tax evasion scheme. They indicated that the applicants implemented the IRS for the benefit of their employees and that they themselves did not benefit from it. They stated that they had not failed to withhold PAYE as none was to be deducted after the employees had made salary sacrifices in terms of the IRS. They reiterated their understanding, which they had reached after consulting their tax advisers and legal practitioners, that the IRS was a legitimate and proper method of allowing the employees to take advantage of those sections of the Act which confer favourable treatment to benefits in the form of subsidised loans. They took issue with the legality of the action taken by the Commissioner-General, the calculations of the principal amounts said to be due and the penalties imposed. They complained that the amounts uplifted from their accounts were vital to the continued operations of their companies. They requested that the garnishee orders issued to Barclays Bank be withdrawn until the matter was determined by the court.

The contents of the applicants' letters of protest to the Commissioner-General formed much of the content of the founding affidavit in this application.

<u>The Applicants' case as made in the affidavits</u>

In addition to what I have already stated the applicants contended in their affidavits that the Commissioner-General is only entitled to exercise the powers vested in him by s 58 of the Act if it has already been determined that any tax is due following upon an assessment by the

income tax department or upon a judgment of a competent court. They contended that in the present case the Commissioner-General had taken action before any determination was made that any tax was due by the applicants. They averred that the Commissioner-General has no power to make an assessment in respect of employees' tax said to be due by the employer because an assessment is per definition "the determination of taxable income and of the credits to which a person is entitled" and it is a concept which is not applicable to the levying of employees tax against an employer. In the view of the applicants the remedy available to the Commissioner-General in the circumstances of this case was to sue the employer for payment of employees tax and not to take unilateral and unlawful action and seize the applicants' moneys which had not been found to be due.

The applicants averred that they were entitled to the relief which they sought on the following further grounds:

a) the obligation on the employer to deduct PAYE arises if the employer pays any amount by way of remuneration to an employee. In this case the employer, through Remserve, had extended loans at 16% interest to the employees and, because in terms of s 8(1)(f) of the Act, a loan is deemed to be a taxable benefit only if the rate of interest payable by the employee is less than 16%, the applicants were not obliged to deduct PAYE in respect of the amounts which they had paid to Remserve as loan subsidy payments.

b) the Commissioner-General had in any case, wrongly calculated the amount that could possibly be due. He took the subsidy payment made in each case to Remserve, "grossed it up" to arrive at the pretax income that would leave, after tax, in the hands of the employee the same amount as the subsidy payment. The Commissioner-General then calculated the tax due on the grossed up amount and claimed that figure as the employees' tax that should have been deducted. Such a calculation could not be correct as the employer has no obligation to the employee to meet a tax

that is not due.

(c) The Commissioner-General had ignored the fact that the loans have been applied to earn investment income on which tax is, in any case, payable. This has the effect of imposing a double taxation to the extent that tax will be paid on the investment income.

(d) The Commissioner-General had acted in an unconscionable fashion in that he had been aware of the IRS since early 2002 when his investigation section requested and was immediately given all documentation relating to IRS. He had commenced detailed investigations into IRS in March or April 2002. He had promised to disclose the outcome of his investigations in February 2003. Further efforts had been made by the promoters of the IRS in March 2003 to address his concerns but these had been rebuffed. Despite all these efforts, the Commissioner-General had gone ahead and garnished the applicants' funds.

I may summarise the applicants' case as follows: The Commissioner-General is not entitled to invoke s 58 powers until or unless it has been determined that any tax is due by an employer; the IRS is a legitimate method by which the applicants' employees are able to take advantage of favourable tax provisions in the Act; the salary sacrifice made by the employees is permissible and so is the payment of the loan subsidy by the employer in order to enable the employee to obtain a loan at a non-taxable rate of interest of 16% per annum; if the Commissioner-General's action is not declared to be unlawful, it would result in double taxation of the employees as they would be taxed on the income which they are said to have received and on the investment income which they received in terms of the IRS; the calculations by the Commissioner-General are erroneous as they are based on a grossed up amount; the Commissioner-General acted unconscionably as he should have awaited the outcome of the consultations which were ongoing before he uplifted monies from Barclays Bank.

The Commissioner-General's Case

The position adopted by the Commissioner-General is that this application is an attempt by the applicants to prevent him from exercising the powers vested in him by s 58 of the Act and to prevent Barclays Bank from giving effect to a garnishee lawfully issued. The Commissioner-General averred that the IRS is simply a tax evasion scheme. The so-called salary sacrifice by the employee was in fact an unlawful reduction of the employee's salary so as to evade the payment of PAYE on a portion of the employee's salary. The Commissioner-General expressed concern that the IRS was a gigantic tax evasion scheme which was adopted by more than 160 companies and that the scheme had the potential to deprive the fiscus of about $7 billion per year. He averred that he held a totally different view from that of the applicants about the IRS. He said that he had conducted an audit of the IRS which had shown that –

a) the IRS does not faithfully reflect the real intention of the parties or the relationship of the participating entities;

b) the applicants relied on the tax opinion of Ernst and Young Chartered Accountants and Ernst and Young Tax Consultants (Private) Limited who were interested parties in the tax evasion scheme;

c) the claim by Remserve that it borrowed money from Rebuttal with which to make the loans was not true as the only transactions between them were paper entries with no actual movement of funds. This was shown by the fact that Remserve purported to borrow money from Rebuttal but once the loans were made, the beneficiaries were obliged to invest the whole amount of their respective loans with Rebuttal. Both companies had no money to their credit and as such the transactions between them were paper entries only;

d) the only cost incurred by the applicants was the payment to Remserve of an implementation fee.

In regard to Remserve and Rebuttal the Commissioner-General stated in paragraph 6.5 of the opposing affidavit that –

> "The inescapable conclusion is that the two companies had no financial capacity to advance the loans they allege to have granted to various employees. This is supported by the *contra entries* referred to above, which are merely disguised paper entries. In essence the transaction is dishonesty in that the parties to it did not really intend it to have, as between them, the legal effect which its

> terms convey to the outside world. The purpose of the disguise is to deceive by concealing what is the real agreement or transaction between them. The transaction is in *fraudem legis* and must be interpreted in accordance with what the facts, as stated above, reveal and not what applicant says it is."

The Commissioner-General averred that the employees who opted to participate in the IRS incurred a compulsory reduction of their salaries which in his view is illegal as it is an unfair labour practice. I do not think that this particular averment was fair or justified. The employees signed contracts with their employers with Remserve and Rebuttal. The reduction in salary which they took was voluntary. Any suggestion of illegality cannot be justified.

In dealing with the nature of the salary sacrifice the Commissioner-General averred that the employees' salaries were reduced from the time that they opted to participate in the IRS and their PAYE was proportionately reduced because of the re-direction of part of their salaries to Remserve. In his opinion the purported salary sacrifice was actually just a salary split resulting in only one part of the salary going through the payroll. He therefore rejected the contention that the amount of the salary sacrifice which was, in turn, paid by the employer as a loan subsidy payment was anything other than an amount which must be subjected to PAYE in terms of s 8(1)(b) of the Act.

The Commissioner-General justified his resort to s 58 of the Act on the grounds that there was a potential leakage of revenue of enormous proportions and if the IRS was not arrested the fiscus would continue to be prejudiced. He also said that the tax evasion as represented by the IRS was deliberate and calculated. The Commissioner-General averred that the employees' tax which he sought to recover became due and payable at the time that the salary split occurred. He contended that employers, on his behalf, determine the PAYE due by each employee and as such the concept of assessment as defined in s 2 of the Act was applicable to the levying of employees' tax with the result that the Form P12 and

schedules attached thereto, which he issued, constituted assessments of income tax due. He asserted that he had the option to proceed in terms of s 58 and recover unremitted tax by way of a garnishee or to proceed by court action in order to recover the tax.

Coming to the relationship of some of the entities involved in the IRS, the Commissioner-General averred that Remserve, Rebuttal and Ernst and Young were not dealing at arms length: they shared directorship and bank account signatories; Rebuttal did not declare a profit for the year ended December 2001 yet it was supposed to be charging market rates on the amounts which it loaned to Remserve. In general the Commissioner-General's view of the relationship between Remserve and Rebuttal was that the two entities were involved in sham transactions. It is important to consider his view in some detail.

It is common cause that the employee made a salary sacrifice in terms of his agreement with the employer. It is common cause that the employer made a loan subsidy payment to Remserve and the amount of the salary sacrifice was the amount paid by the employer as such subsidy. So money actually moved from employee to employer and from employer to Remserve. There is some difficulty in clearly understanding the transactions between Remserve and Rebuttal. It is said that Remserve borrowed funds from Rebuttal for onward lending to the employees. The borrowing by Remserve seems to me to be nominal as no actual funds were transferred from Rebuttal to Remserve. But in order for the borrowing to appear to be real, Rebuttal purported to advance monies to Remserve and Remserve purported to lent those moneies to the employees. The employees agreed to invest the full amount of the loans with Rebuttal which then issued debentures to the employees. The debentures issued by Rebuttal were then surrendered to Remserve and retained by it as security for the loans. It seems to me that there was no actual movement of money from the lender (Rebuttal) to Remserve and from Remserve to the employee. The whole

transaction consisted of what has been described by the Commissioner-General as "contra entries", with the result that at the end of the day the amount of the salary sacrifice made by employees assumed the appearance of investment income and was given that label when it was ultimately paid to and received by the employees. This is evident from the following facts as stated by the Commissioner-General:

(a) there is no actual movement of cash from Rebuttal to Remserve and from Remserve to the employee. The paper trail is that Rebuttal purports to lend money to Remserve which purports to lend the same money to the employee. The employee purports to have received a loan and then he purports further to have invested the full amount of the loan with Rebuttal. Debentures are then issued to the employee. These debentures mature at the end of the period of the loan. On their purported maturity the debentures are submitted by Remserve to Rebuttal and purportedly redeemed thereby procuring the full payment of the capital amount of the loan, which had not in reality ever existed. In the meantime interest is calculated on the loans purportedly invested and the employee is paid as income from investment of the loan funds an amount approximating to the amount which he sacrificed. The employee benefits from this arrangement in that had the same amount been taxed in terms of s 8(1)(b) of the Act as income from employment, it would have been taxed at a higher rate whereas, as investment income, it is taxed at a much lower rate in terms of s 8(1)(f) of the Act.

(b) The books of accounts of both Rebuttal and Remserve did not show that any of them had any funds with which to make the purported loans. It seemed to me that the applicants had some difficulty in shedding light on the transactions between Remserve and Rebuttal. This is evident from the averment in para 9 of the answering affidavit where the deponent states:

> "… I am not personally aware of the details of Remserve's source of funding nor am I aware of any dealings between Remserve, Rebuttal and their bankers. I have been under the impression that the level of the subsidy interest payments made by the applicants is set out with reference to interest rates at the time that fixed rate loans are extended to employees and that employees are offered fixed rate investment in the form of debentures issued by Rebuttal."
> (**emphasis is mine**)

Again in para 26 of the answering affidavit the applicants were unable to shed light on the genuineness of the transactions between Remserve and Rebuttal or between Remserve and the employee. The deponent said:

> "I am unable to comment on the various allegations concerning Ernst and Young and Rebuttal contained in paragraph 26 of Mugari's affidavit but I am able to confirm
>
> 26.1 that the dealings of the applicants with Remserve were undertaken at arms length;
> 26.2 that the applicants in no way are related by ownership or otherwise to either Remserve and Rebuttal; and
> 26.3 that there was actual movement of the subsidy payments made by cheque to Remserve by the Applicants and the payment of net interest into the employees bank accounts."

The same caginess is shown in para 29:

> "It is, with respect, quite incorrect to say that the documents show that the alleged "commercial interest" are non existent. Payments were made by the Applicants to Remserve. The monies were then manifestly dealt with as envisaged by the agreements which are before the Court. Employees accounted for the tax in respect of interest earned by them. Rebuttal and Remserve each earned income and were liable to tax in respect of profits earned."
> (**emphasis is mine**)

It is quite apparent that the applicants only confirmed those aspects of the IRS which were not in contention i.e. that the employees made salary sacrifices which were paid to Remserve as loan subsidies and that the employees received interest on investment and paid tax on that income. Obviously the Commissioner-General was not concerned with

these non-contentions aspects of the IRS. He had taken issue with the fact that no loans were in reality advanced by Rebuttal to Remserve or by Remserve to the employees. The applicants did not confirm that loans were actually advanced in such a way that any money would have been transferred from one party to the next. It seems to me that there is substance to the Commissioner-General's objection to the whole of the IRS being a genuine system to achieve the stated objectives. I do not for a moment believe that reputable companies, such as the applicants are or appear to be, would have dealt with Remserve and Rebuttal without any knowledge as to whether they had the necessary funds with which to make the loans. It seems to me that the loan transactions were window-dressing transactions. Annexures "J" to "N2" at pp 134-156 of the papers support this point of view. Annexure J is itself a clear indication that the bankers of Remserve and Rebuttal did not advance any credit to them.

> The Commissioner-General also disclosed that Remserve and Rebuttal had not renewed their money-lending licences for the year ended December 2003 and that they were therefore operating illegally. I do not think that this disclosure, even if true, is relevant to my decision. In regard to the applicants' contention that it was wrong for the Commissioner-General to gross up the amounts in the manner already stated, the Commissioner-General curtly averred that he had reasonable grounds for doing so and that he was open to receive any objections which the applicants may have. He stated further that he had undertaken a thorough investigation of the IRS from early 2002 and that the action he had taken had been well considered and not rushed.

The Submissions by the Parties

It was accepted by the parties that the Commissioner-General can utilise the provisions of s 58 of the Act to require an agent to pay any tax, including employees' tax due from moneys held by that agent. Section 58 clearly authorises the Commissioner-General to do so. It reads:

> "The Commissioner may, if he thinks it necessary, declare any person to be the agent of any other person, and the person so declared an agent shall be the agent of such other person for the purposes of this Act, and, notwithstanding anything contained in any other law, may be required to pay any tax due from any moneys in any current account, deposit account, fixed deposit account or savings account or from any other moneys, including pension, salary, wages or any other remuneration, which may be held by him for, or due by him to, the person whose agent he has been declared to be."

The decision in *Edgars Stores Ltd v Commissioner of Taxes,* 1996 (2) ZLR 747 (SC) supports the proposition that the Commissioner-General may utilise s 58 of the Act for the purposes mentioned above. The position was different before the Act was amended by the Finance Act 4 of 1996 which repealed the definition of tax and substituted it with a definition which included the phrase "employees' tax referred to in section 73 and any additional or other penalty under this Act". The decision in *Endevour Foundation & Anor v Commissioner of Taxes* 1995 (1) ZLR 339 (SC) was, as correctly conceded, overtaken by that amendment.

The applicants submitted that the issues for determination in these matters were these –

(a) whether the sums claimed by the Commissioner-General were taxes due by the applicants thereby justifying his resort to s 58 of the Act. They argued that the sums claimed were not due as they could only become due after an assessment or in terms of the law or an order of court. In this regard the applicants submitted that paragraph 10(1) of the Thirteenth Schedule to the Act makes it clear that the employer is liable to pay an amount equal to the amount of the employees tax which he failed to withhold and not the employees' tax itself. This called upon the Commissioner-General to determine, by way of making an assessment, the exact amount which was not withheld in respect of each employee and only then could he recover from the employer the amount so determined. The applicants submitted that on the basis of paragraph 10(2) of the

Thirteenth Schedule to the Act the Commissioner-General must, if he has not made an assessment of the amount allegedly owed, sue for it in a court of law and only then can he recover it in terms of s 58 of the Act;

(b) whether the IRS is a legitimate method of taking advantage of certain provisions of the Act; and

(c) whether, assuming the Commissioner-General was correct in the action he took, the grossing up of the amount was justified.

The Commissioner-General appears to have agreed that these were the issues to be determined by the Court. I think however that it is important decide on the legality of the IRS so far as it is relevant to the proper determination of the issues before me. It seems to me that this application hangs on the legality or otherwise of the IRS. Had the parties not agreed that I should deal with this matter finally I may not have had to deal with the legality of the IRS. If the IRS is not a legitimate system for taking advantage of certain favourable provisions of the Act, then the salary sacrifices should not have been made and the amounts of the subsidy payments should have remained a part of the income from employment which is subject to taxation in terms of s 8(1)(b) of the Act.

I think I have already sufficiently shown why I am of the view that the loan transactions between the employees and Remserve and between Remserve and Rebuttal were not genuine transactions: no money actually passed or was intended to pass between them nor were the lenders possessed of any money to make the loans. That, to me, leads to the conclusion that the IRS cannot be the device for taking advantage of the provisions of the Act which it was purported to be. This disposes of the issue in paragraph (b) above.

The next issue as in (a) above is whether any tax was due to justify a resort to s 58 by the Commissioner-General. Section 73 of the Act provides the manner in which employees tax is payable i.e. in accordance with the provisions of the Thirteenth Schedule. The

section provides in subs (3) that –

> "If any amount of employees tax is not paid in full within the period prescribed for payment thereof by subparagraph (1) of paragraph 3 of the Thirteen Schedule, interest shall, unless the Commissioner having regard to the circumstances of the case otherwise directs, be paid by the employer at a rate to be fixed by the Minister, by statutory instrument, on so much of such amount as from time to time remains unpaid by the employer during the period beginning on the next day following the last day of the period prescribed as aforesaid and ending on the day such amount is paid in full."

The clear meaning of this provision is that as from the date that the amount of employees tax is due, if not paid as provided, interest shall be charged thereon. It postulates that the amount has been withheld by the employer but the employer has just not remitted it. This provision therefore has nothing directly to do with the issue whether or not the employer has in fact withheld the amount. If he has not withheld the amount different provisions of the Act apply. In terms of para 3 of the Thirteenth Schedule ("the Schedule") the amount which an employer must withhold as employees' tax shall be determined in accordance with such deduction tables as may be prescribed or as provided in other paragraphs of the Schedule. The employer is required to ascertain from the Commissioner-General the amount to be withheld in respect of employees' tax. The failure or refusal by the employer to withhold or remit employees' tax is penalised by the provisions of para 10 of the Schedule which provide that:

> "10(1) Subject to the provisions of paragraph 11, an employer who fails to withhold or to pay to the Commissioner any amount of employees' tax as provided in paragraph 3 shall be personally liable for the payment to the Commissioner, not later than the date on which payment should have been made if the employees' tax had been withheld in terms of paragraph 3, of –
> (a) the amount of employees' tax which he failed to withheld (*sic*) or to pay to the Commissioner; and
> (b) a further amount equal to such employees' tax.
>
> (2) The amounts for the payment of which an employer is liable in terms of subparagraph (1) -
>
> (a) shall be debts due by the employer to the State; and

(b) may be sued for and recovered by action by the Commissioner in any court of competent jurisdiction."

It seems to me that para 10 of the Schedule is concerned with two types of amounts in respect of which an employer becomes personally liable to the Commissioner-General. The two types differ depending on how they have arisen. The first type arises from a failure by the employer to withhold employees' tax either because he has not calculated what it is or because he has simply neglected to withhold it even though he was aware what that amount was. The second type arises from a failure by the employer to pay or remit the employees tax to the Commissioner-General after he had withheld it, i.e. after he has deducted it from the employees' salary. The second type is invariably always readily ascertainable as the employer will have already determined what it is and has deducted it from the employee's salary but has for some reason, or for no reason at all, simply failed to pay or remit it to the Commissioner-General. In respect of this second type I can see no reason why the Commissioner-General may not act in terms of s 58 of the Act to recover it from the employer. The amount would be sufficiently liquidated such that the Commissioner-General could obtain summary judgment on it. The employer would not be able to justify his failure to pay it to the Commissioner after deducting it from the employee's salary.

The first type may or may not be readily ascertainable. If the employer had calculated the amount to be deducted as PAYE but neglected to withhold or deduct it from the employee's salary, that amount would, in all respects, be similar to the second type. The employer would be aware of the amount which he should have deducted from the employee's salary but failed to effect the deduction. Where however the employer has not even calculated or determined how much each employee should pay as PAYE, some difficulty arises. The employer would not be aware of how much he should deduct or withhold. The Commissioner-General would also not know how much the employer should have deducted. This

situation arises only where the employer has not complied with para 3 of the Schedule, that is to say, he has not at all determined the tax payable by the employee. In this situation not only will the employer not know how much should be paid but the Commissioner-General too has no way of knowing how much the employer should have withheld by way of PAYE. It is this kind of situation which Mr *de Bourbon* must have had in mind when he submitted that the Commissioner-General cannot have recourse to s 58 of the Act to exact payment of the employees' tax allegedly unpaid. His argument however seemed to encompass the two types of payments for which an employer is made liable for under para 10 of the Schedule. His general submission was that tax is due when it has been determined by "an assessment or in terms of law or by a court order". He submitted that a distinction must be made between tax which an employee is liable to pay, tax which the employer is liable to deduct and an amount which the employer is liable to pay should he fail to make a deduction. He went on to say that in terms of para 10(1) of the Schedule an employer is liable for an amount equal to the employees' tax itself. He found support for these submission in para 12 of the Schedule which permits an employer to recover the amount paid to the Commissioner-General under para 10(1) of the Schedule from the employee except for any amount paid as a penalty. In his view the Commissioner-General must in all cases of failure to withhold or to pay employees' tax determined by way of an assessment the exact amount not withheld in respect of each employee before he can require the employer to pay, otherwise the employer will not be in a position to exercise his right of recovery in terms of para 12 of the Schedule. He also submitted that whereas in terms of para 10(2) of the Schedule any amount for which the employer is liable becomes a debt due by him to the State and in respect of which the State can sue the employer, the recovery by the Commissioner-General of any such amount can only be by way of action in a court of law and not through unilateral

action, based on an estimate of the amount due as employees' tax, which is what he did in this case. He submitted that the only instances when the Commissioner-General is allowed to make estimates of tax payable are those specified in ss 37(4) and 45 of the Act, none of which are applicable to this case.

I cannot agree with Mr *de Bourbon'*s interpretation of para 10 of the Schedule. I have shown how the amounts for which an employer is liable under that paragraph may arise. I am quite satisfied that where an employer has determined the employee's tax payable or has gone a step further and deducted that amount from the employee's salary and has not paid it such amount is readily ascertainable and the Commissioner-General would be fully entitled to proceed in terms of s 58 to recover it from the employer. The employer in that situation would have no cause either not to deduct an amount he has determined as being employee's tax payable or not to pay it after deducting it from the employee's salary. It must be borne in mind that para 10 of the Schedule is concerned not with the employee's liability but that of the employer and that liability arises from the employer's failure to withhold or to pay employees' tax to the Commissioner-General. And where he has failed to withhold or to pay an amount which he is aware of, his liability for that amount is clearly provided for and that liability does not, to my mind, depend on whether the employer has correctly, in every detail, calculated the amount which is payable as PAYE by the employee. The correct amount is determined when an assessment is made which may result in an overpayment or underpayment of the tax due on the employee's remuneration.

In the situation where the employer has not even determined the amount payable by way of employees tax, the matter may be handled differently for none of the parties i.e. the employer or the Commissioner-General will know what amount should have been withheld. I do not intend to pronounce myself as to what course of action the Commissioner-General would take, but I may express the

view that this may be the situation where Mr *de Bourbon'*s argument may be valid. I have decided not to determine this issue because I think it does not arise in this case. The employees in this case were receiving certain salaries before they joined the IRS and sacrificed a portion of their salaries. The amount which they had paid as PAYE was known. There is no suggestion that their salaries were increased during the period of the loans or the period in question. In the month following their joining the IRS, there was an immediate reduction of the PAYE which had hitherto been withheld from their remuneration by the employers and paid to the Commissioner-General. All else being equal, which appears to be the position, the difference between what had been deducted as PAYE in the month before joining the IRS and the amount which was actually deducted in the month after joining the IRS is the amount which the Commissioner-General should be claiming from the employer in addition to any penalty charges. That amount is readily ascertainable and it is an amount which, in my view, the Commissioner-General can recover by utilising the provisions of s 58 of the Act. Whilst it remains to be determined whether that is the amount actually claimed by the Commissioner-General, I can, for the moment, say that since the IRS was a system devised by the applicants to circumvent the obligation to pay the full amount of PAYE the Commissioner-General was entitled to use his powers under s 58 to recover the amounts concerned i.e. the difference between what was paid before and after the IRS was implemented.

From the foregoing it must be apparent that I, at least, agree with Mr *de Bourbon'*s submission that in terms of para 10(1) of the Schedule the employer is liable to an amount equal to the amount of employees' tax which he failed to withhold and not to the employee tax itself. I do not however agree with his further submission that because in terms of para 12 of the Schedule the employer can recover the amount paid to the Commissioner-General from the employee except for the penalty, the

Commissioner-General must determine the exact amount which was not withheld in respect of each employee otherwise the employer cannot exercise his rights under para 12 of the Schedule. This, to me, is a *non sequitur.* The employer's liability is separate from that of the employee. It is the employee who has to pay an exact amount of PAYE. The employer's right to recover the amount is not dependant on whether there has been an assessment to establish the exact amount owing by the employee but on the fact of his having paid the amount to the Commissioner. I also agree with Mr *de Bourbon'*s general submissions as to what an assessment is and when it must be made. That, however, is not relevant to employees tax which must be withheld by the employer. The positions of the employee and the employer in so far as assessment is concerned are different. The employer is required by law to withhold employees' tax which by the definition in para 1 of the Schedule is "any amount required to be withheld by an employer in terms of paragraph 3" of the Schedule. Its determination is made in terms of sub-para (1) of the para 3 of the Schedule which provides that –

> "(1) Every employer (whether or not he has registered as an employer in terms of subparagraph (1) of the paragraph (2)) who pays or becomes liable to pay any amount by way of remuneration to any employee shall, unless the Commissioner has granted authority to the contrary, withhold from that amount by way of employees' tax an amount which shall be determined in accordance with such tax deduction tables as may be prescribed or as is provided in subparagraph (2), (3) or (4) of this paragraph or in subparagraph (2) of paragraph 20, whichever is applicable, in respect of the liability for income tax of that employee and shall pay the amount so withheld to the Commissioner within fifteen days, or within such longer period not exceeding twenty-one days as the Commissioner may for good cause allow, after the end of the month during which the amount was withheld …."

The determination of the PAYE due is made by the employer. The employer therefore makes an assessment (for lack of a better word) of the PAYE before a proper assessment as defined in the Act is done buy the Commissioner-General.

Subparagraph (1) of para 3 of the Schedule also seems to me to be

supportive of Mr *de Bourbon'*s submission in para 7 of his heads of argument that a tax becomes due "in terms of law". He did not pursue this submission so as to indicate when a tax is due "in terms of law" in the same way that he pursued the submission that a tax becomes due when it has been determined by an assessment or by a court of law. Subparagraph (1) of para 3 of the Schedule is in my view an instance when a tax becomes due "in terms of law". I therefore agree with Mr *Nherere's* submission that tax is due from the date that it is payable.

The Commissioner-General stated in his letter of 3 April (quoted above) that he was "estimating the debt arising from the tax evasion". Mr *de Bourbon* made much of this statement. In my view he should not have done so. In context all that the Commissioner-General must have meant was that he was taking action to recover amounts which he believed were due by the applicants following upon the adoption by the applicants of the IRS, a system which he believed was a tax evasion scheme. I do not read much into the statement because the context in which it was made is clear. The first sentence in the letter of 3 April reads:

"Information held indicates that your organisation has failed to deduct and remit PAYE on amounts paid to some members of your staff".

This clearly laid the basis for the action he intended to take and whether or not the IRS was a tax evasion or a tax avoidance scheme seems to have been of little importance to him. Neither counsel specifically referred to s 98 of the Act as relevant to this case perhaps because such reference would have had no effect on the outcome of this case. Section 98 deals with tax avoidance and empowers the Commissioner-General, where he is of the opinion that any scheme was a tax avoidance scheme, to "determine the liability for any tax and the amount thereof" as if the scheme had not been entered into and to take such action as he considers necessary to prevent such avoidance. Although it seems to me that at worst the IRS was a tax avoidance

scheme, I will not deal with this matter and its implications any further because I was not addressed in detail on it nor was it raised in the papers. I may, however, say that in my view and having regard to the particular facts of this case if the IRS was indeed a tax avoidance scheme and the Commissioner-General had been of that opinion, he would still have "determined" the liability for any tax and would have perhaps arrived at the same determination which he made in this case.

The Commissioner-General conceded that his calculation of the amounts owing by the applicants may be wrong for the reason that the form P12 is an estimate or for the reason that his officers "grossed-up" the amounts. He said that he was open to consider applicants' objections in this regard – see paras 35 and 36 of the opposing affidavit. This concession and the arguments made on behalf of the applicants on the estimates or the grossing-up do not preclude me from making an appropriate order to resolve this dispute. In the same vein the arguments made in respect of the applicants' legitimate expectations do not preclude me from issuing an appropriate order. I do not consider that it is necessary for me to deal with these matters in any detail.

In the result I will issue an order that declares the Commissioner-General's entitlement to utilise the provisions of s 58 of the Act to recover, in the circumstances of this case, the employees' tax which was not withheld by the applicants following their adoption of the IRS and ordering that the amounts specified in the P12 forms be adjusted in order to take into account the fact that some tax had been paid by the employees, albeit at the rate applicable to investment income, and other relevant considerations. The applicants have also pointed out that in any event the Commissioner-General's calculations overstated the amounts by at least 46%. The Commissioner-General did not dispute that this may be so. The order which I will issue will reflect this concession. I think that the appropriate order in this case is one which takes into account the finding that the IRS was not a genuine scheme in the

respects I have outlined and that the Commissioner-General by his own admission claimed more than what he was entitled to. The applicants have substantially failed in this case and they should pay the costs. In the result it is ordered that -

1. It is declared that the respondent is entitled to recover the amount of employees' taxes which the applicants failed to withhold and to pay to him after the applicants implemented the Integrated Remuneration System.

2. It is declared that the Commissioner-General was not required to issue an assessment in respect of the alleged indebtedness by the applicants for the payment of PAYE as that indebtedness is determined in terms of the 13th Schedule as read with s 73 of the Income Tax Act [*Chapter 23:*06] and the order sought by the applicants in paragraph (a) of the draft order is accordingly dismissed.

3. Subject to paragraph 4 hereof, the respondent shall in the interim claim only 46% of the amount claimed from each of the applicants and in respect of Miekles Africa Limited and Tanganda Limited the respondent shall refund any amount to the extent that it exceeds 46% of the amount claimed and shall pay interest on that amount, if any, at the prescribed rate of interest calculated from 4 April 2003 to the date of payment.

4. Without derogation from any right which respondent may have to charge penalties and interest on the amount due by the applicants, The applicants and the respondent shall jointly determine within thirty days of this order the amount due by the applicants as employees tax not withheld taking into account any error in calculation of the amount due as a result of "grossing-up" by the respondent, the tax paid by the applicants' employees on the purported investment income derived from the Integrated

Remuneration System, and adjust the percentages referred to in paragraph 3 hereof in order to arrive at the amount for which the applicants are actually liable.

5. The applicants shall pay the costs of this application jointly and severally the one paying the others to be absolved.

Kantor & Immerman, legal practitioners for the applicants.
Gill, Godlonton & Gerrans, legal practitioners for the respondents.