BARCLAYS BANK OF ZIMBABWE LIMITED
versus
ZIMBABWE REVENUE AUTHORITY

HIGH COURT OF ZIMBABWE
MAKONI J
HARARE, 27 March 2003 and 22nd September 2004

Advocate *AP De Bourbon*, for the applicant
Advocate *P. Nherere*, for the respondent

MAKONI J: This is a matter brought by way of an application where applicant seeks a declaratur from the court. The material facts in this matter are common cause and can be summarized as follows. In or around February 2001 the respondent embarked on an audit of the banking sector to check compliance in respect of tax matters. The applicant was one of the institutions to be audited. The exercise was completed in October 2001 after which the respondent produced a schedule, Annexure A, in respect of its findings on the applicant. Various meetings were held after the schedule was served on applicant by the respondent. The outcome of the meetings was that after an alleged tax shortfall of $301 872 750.00 the applicant conceded owing an amount of $11 783 467.00. Applicant subsequently paid to respondent an amount of $8 881 435.69 which figure took into account $2 904 031.31 which was a duplicated payment. This left an amount of $283 107 759.80 as a disputed amount of tax between applicant and respondent.

Prior to the meetings, the applicant had communicated to respondent over the tax issue through their consultants Messrs Price Water House Coopers. The dispute culminated in the respondent issuing a garnishee order against the applicant, for the disputed amount, through the Reserve Bank of Zimbabwe. After the applicant became aware of the garnishee further meetings were held in which respondent granted an extension to applicant for effecting of the garnishee. The dispute between the parties was not resolved resulting in the garnishee being effected against the

applicant on 6th November 2001 by the Reserve Bank of Zimbabwe. The garnishee was in the disputed amount of $283 107 759.80.

There are five main areas in contention namely:-

1. Withholding taxes on fees
2. Management share option scheme
3. Restraint of trade payments
4. Non-residents tax on interest
5. Excessive penalties on amounts conceded

In addition to the above areas of contention, raised by the applicant in his founding affidavit, an additional area of contention was raised by the respondent in its opposing affidavit. The additional dispute can be summarized-as follows-whether Annexure A constitutes an assessment in terms of the Income Tax Act Chapter 23:06 (The Act) or is a demand of the disputed tax. Dependant on this issue are the questions whether the garnishee was lawful and whether the application is properly before the court.

Before I deal with the 5 main issues, I shall deal with the additional issues first as they determine whether the application is properly before the court or not.

The respondent, in raising this issue, contends in paragraph 44.5 that Annexure A is an assessment in terms of the Act. Being an assessment, the respondent contends that the proper procedure by applicant should have been an objection in terms of section 62(1) of the Act rather than approach the court for a declarator.

On the other hand, applicant contends that Annexure A does not constitute on assessment as it does not reflect the taxable amounts and credits as required by the definition of assessment in terms of section 2 of the Act.

In assessing whether Annexure A is an assessment or not I shall not deal with the aspect of the lawfulness or otherwise, of the garnishee as of

April did not seek an amendment to the Draft Order to incorporate the relevant declarator of the lawfulness of the garnishee.

In terms of section 2 of the Act, assessment is defined as follows:-

"Assessment means

a) determination of credits to which a person is entitled to in terms of the charging Act; or

b) the determination of an assessed loss ranking for deduction.

It is clear from the definition section that an assessment should determine and contain

i) taxable income

ii) credits in which a person is entitled.

This is not disputed by the respondent. In paragraph 6 of its Heads of Argument the respondent clearly lays out the requirements of an assessment.

In addition, in terms of s 51 of the Act, a notice of assessment should be issued whenever an assessment is carried out. Among other things section 51 of the Act stipulates the following:-

i) Section 51(2) - a notice of assessment and the amount of tax payable shall be given to the tax payer.

ii) Section 51(3) - of the notice of assessment shall give the taxpayer notice that any objection to the assessment shall be lodged to the commissioner within 30 days from the date of such notice.

On close scrutiny of annexure A, it is apparent that it does not show any taxable income or credits to which applicant is entitled nor any assessed loss ranking for deductions. Annexure A only reflects the sums due to the respondent in the form of taxes, penalties and interest.

It is imperative that an assessment contains the requirements of the Act as the administrative functions bestowed by the Act on the

Commissioner amount to a determination which is executable through a garnishee. He is also bestowed with the power to hear any objections, in terms of the assessment made, after which he can insist on payment of the tax pending the determination of any dispute arising from an assessment. The legislature could only have envisaged granting the commissioner power to execute pending determination in circumstances where the taxpayer has been clearly advised of the basis for the assessment. In addition section 51 requires the taxpayer to be given due notice of the assessment and the tax payable in the manner stipulated in that section. There should be no doubt as to whether the document sent by the Commissioner to a tax payer is an assessment in view of the taxpayer's right to object within 30 days.

Annexure A is not headed "Notice of assessment" nor assessment and does not give the 30 days notice for an objection as is required by the Act. Further the document cannot be said to constitute an assessment as it falls short of the definition of assessment in terms of Section 2 of the Act. In the process of serving the taxpayer with an assessment and hearing objections, the Commissioner should comply with the provisions of the Act as their administrative acts have far reaching consequences of a garnishee on the taxpayer.

In view of the foregoing I find that Annexure A falls far short from being an assessment or notice of assessment as envisaged by the Act. The applicant could not have lodged an objection within the 30 days without being served with any assessment or notice of assessment. Of interest to note is the fact that the garnishee was effected before the expiry of 30 days within which the applicant is entitled to note the objections. This fact fortifies my view that Annexure A cannot be classified as an assessment or notice of assessment.

I find that applicant is properly before the court.

I will now proceed to deal with the initial five areas of contention as raised by the parties.

WITHHOLDING OF TAX ON FEES

Withholding tax on fees is tax on fees payable to a non-resident which tax should be withheld and paid to the Commissioner of Taxes within 30 days from the date of payment of fees to the non-resident or from the time such fees are dealt with in such a way that the conditions under which the non-resident is entitled to them are fulfilled at which stage the fees are deemed to have been paid.

The contentious issue brought up by the applicant for determination by this court is the interpretation or meaning of paragraph 2(1)(c) of the 17th schedule regarding the issue when fees are deemed to have been paid. The provision reads:-

> "Fees shall be deemed to be paid to the payee if they are credited to his account or so dealt with that the conditions under which he is entitled to then are fulfilled, whichever occurs first…."

The part of the provision which deals with crediting of the fees to the payees account is not in dispute.

It is the second part which reads"

> "….or so dealt with that the conditions under which he is entitled to them are fulfilled, whichever occurs first…."

The applicant contends that the phrase "Conditions under which he is entitled to them are fulfilled…." relates to the granting of the exchange control of authority for payment. In interpreting the phrase in dispute the court shall not have regard to the facts of this matter but will simply interprete the phrase as it stands.

In interpreting a statute, the court starts by ascribing the ordinary grammatical meaning which can be given to the provision. If the first part of section 2(1)(c), whose meaning is not in dispute, is read in context with the second part, and the ordinary meaning of the words is ascribed it becomes clear that the section deals with two scenarios were the withholding tax becomes due. The first scenario is where fees are credited to the non-

residents account. The second scenario are instances where though the fees are not credited to non-residence account, they are so dealt with by the payer in a manner which discharges the payer's obligation to the non-resident. These are instances where payments are deemed to have been made. The legislature saw if fit to make an omnibus reference to various other methods open to the payer to discharge his obligation to the non-resident other than direct payment to his or her account because the list of indirect payments cannot be exhaustive.

If the court were to accept the meaning ascribed by the applicant to the disputed part of the section, the concluding phrase "whichever occurs first" would not make sense. This is so because in both scenarios referred to by the court above, exchange control authority would be imperative. In this regard the credit referred to would not occur first in the absence of exchange control authority. If the meaning ascribed by the applicant is accepted this would mean that the legislature would, in the first scenario, sanction an unlawful crediting of funds to the non-resident in the absence of exchange control authority.

In the circumstances, the court's declines to grant the declarator sought by the applicant in respect of withholding tax. In view of the failure of the application for the declarator I will not grant the corresponding consequential remedies sought by the applicant.

In any event on the facts of this matter he applicant would not have succeeded on the aspect of consequential remedy. The applicant does not dispute that he claimed the expenses incurred, on the fees, in his books of accounts, notwithstanding that exchange control approval had not been granted by the Reserve Bank. Companies have strict obligations to keep accurate records for tax purposes and where inaccurate records are found to have been kept, this may result in a finding in favour of the taxing authority.

1. MANAGEMENT SHARE OPTIONS SCHEME

Under this head the applicant seeks a declarator in the following terms:-

(i) No taxable benefit accrued to employees of the applicant as at the date of exercising rights in terms of the management share option scheme and accordingly that the applicant was not obliged to withhold any employee’s tax in respect of the exercise of such option.

(ii) The management share option scheme does not constitute tax avoidance on the part of the applicant for the purposes of s 98 of the Income Tax Act [*Chapter 23:06*].

The management share option scheme is a scheme introduced by the applicant for the benefit of fulltime managerial employees of grade 8 and above. The main purpose of the scheme, as stated in clause 2 of Annexure II, is:

2. PURPOSE OF SCHEME

To provide further incentives for motivating and retaining management staff for the benefit of the bank.

The scheme operated on the basis that an option was granted, to the beneficiaries, to purchase a specified number of shares allocated under the scheme at the mid market price prevailing on the grant of the option. The main conditions attached to the option were:-

1) Any option or portion of option not exercised by participant would automatically lapse

(a) On the effective date of termination of …….within the bank …resignation or dismissal.

(b) Demotion to a grade lower than managerial grade 8.

(c) On expiry of 12 months from the date participant retired from its bank service after reaching the normal retirement age or from the date which participant dies in the bank service.

(d) On expiry of 10 years on the date upon which the option was granted.

Some of the management employees sold shares which had been obtained by way of the exercise of the option and mAde a profit.

The issue to be determined by the court, as raised by the parties, is whether the difference between the mid-market price as at the grant of the option and the mid market price as at date of exercise of the option constitutes either an advantage or benefit in terms of section 8(1)(f) of the Act.

Applicant's contention is that the difference constitutes a gain which can be classified as capital gains or other income which is taxable in the hands of the employee rather than the employer and the applicant was thus not obliged to withhold any tax from the employee.

The respondent's contention is that the difference in dispute constitutes an advantage or benefit in terms of s 8(1)(f) of the Act AND that the manner in which the shares were dealt with constitutes an enjoyment of property corporeal or incorporeal including a loan or an allowance. Respondent further contends that the granting of options was conditional.

To determine the issue raised by the parties, it is my view that the term advantage or benefit has to be analysed. The relevant portion, under the definition section of S 8(1)(F), of benefit or advantage which requires scrutiny reads as follows:-

1. ADVANTAGE OR BENEFIT

(a) Means

(i) …………………

(ii) …………………

(iii) …………………..

(iv) The use or enjoyment of any other property whatsoever, corporeal or incorporeal, including a loan, whether of the same kind as that referred to in subparagraph (1), (ii) or (ii) or not, which is not an amount referred to in paragraph (a), (b) or (c) of the definition by gross income in the subsection or

(v) ……………..

The key words to be analysed under subparagraph 4 are:-

“Use or enjoyment of any other property whatsoever corporeal or incorporeal”.

The court will also examine whether the circumstances under which the shares were dealt with amounted to a grant of a loan by the applicant to its employees.

In analysing whether the scheme amounts to use or enjoyment of property by the employee arising from his working relationship with employer the court will examine the objects of the share option scheme. The purpose of the scheme was to provide incentives for motivating and retaining managerial staff of grade 8 and above. The scheme further stipulates that on termination of employment either by resignation or dismissal any option which had not been exercised would automatically lapse. The option was exercisable for a period of 10 years at a fixed price.

Applicant did not challenge that the majority of the participants did not pay cash at the time of exercising the share options but paid for the shares from the proceeds obtained after the sale of the shares.

It is the court’s finding that the abovementioned advantages or

benefits fall within the meaning of the phrase "use or enjoyment of property whatsoever, corporeal and incorporeal."

It is clear from the above that the senior management employees of grade 8 and above used and enjoyed their employer's shares in advantageous circumstances which were not open to junior employees or persons outside the applicant's employee. The applicant concedes that the delay of 10 years between the grant and exercise of an option constitutes an advantage in the widest sense. Applicant however, further avers that the advantage does not fall within the ambit 8(1)(f) but does not give reasons why such an advantage cannot fall under the ambit of s 8(1)(f). It is my view that applicant failed to find reasons justifying the exclusion of the conceded advantage in the ambit of s 8(1)(f) in view of the above facts.

The court finds that the difference between the mid maker price on granting and mid market price on exercise of option is an advantage or benefit to the employee constituting gross income and the applicant was supposed to withhold tax.

The issue of whether the scheme falls under an income tax avoidance scheme has far reaching consequences on other similar schemes. The applicant covered this issue in paragraph 28 of its founding affidavit in cursory manner. Likewise the respondent did not take this issue seriously. In the result the court is unable to decide this issue, which has far reaching effects, on the papers before it.

RESTRAINT OF TRADE PAYMENTS

Under this head, the applicant seeks the following declaration

i) The payment of the Zimbabwean equivalent of ₤94 128.66 made by the applicant to Alex Chrispen Jongwe were of a capital nature, and thus not liable to income tax.

ii) The respondent was not entitled to gross up the income received by Mr Jongwe in the form of offshore payments since liability for tax on such income was Mr Jongwe's, as employee rather than the

applicant, as employer, and no scheme of tax avoidance had been entered into between the applicant and Mr Jongwe.

The facts on this issue can be summarized as follows:-

The applicant and Chrispen Alec Jongwe (Jongwe) entered into a contract of employment, Annexure c on the 4th of December 1997. The parties subsequently, on the 28th of March 1998, entered into a further agreement Annexure G. In terms of Annexure G Jongwe was entitled to certain payments. After the audit, carried out by respondent, the respondent effected a garnishee in respect of alleged PAYE which it deemed due from the payments arising from Annexure G.

The issue arising from the above facts is whether the payments made to Jongwe under Annexure G constitute remuneration for which PAYE is deductible in terms of s 8(1)(b) or are payments of a capital nature and not subject to income tax.

The applicant contends that the payments to Jongwe are not connected with services rendered or to be rendered but are of a capital nature. The applicant contends that the sums payable under Annexure G are payments made in return for Jongwe's undertaking noT to work for or consult for any other similar institution while in the employment of the applicant and for 3 years after leaving applicant's employment. It further contends that restraint of trade contract payments are of a capital nature and are not remuneration, in terms of s 8(1)(b) of the Act.

In the alternative, applicant contends that the payments were made in compensation of loss of Jongwe's right to participation in the previous employer's share option scheme and that the payment maintain their capital nature.

The respondent on the other hand, contends that Annexure G was entered into pursuant to the original contract of employment entered on the 4th December 1997 and that Annexure G is not a genuine restraint of trade contract as it refers to the original service contract. The applicant was not

obliged to compensate Jongwe for losing his right to participate is a share option scheme but was making good the loss in appreciation of the services to be rendered by Jongwe.

In analysing the matter, the court notes that in its founding affidavit, Applicant's main argument is that the payments made in terms of Annexure G were in payment of a restraint of trade and that Jongwe's loss of the right to participate in previous employer share option scheme was simply used by the applicant and Jongwe to arrive at the payment figure. The alternative argument in the founding affidavit is that the payments were made as compensation for loss of recipient's right to participate in share option scheme and they retain their capital nature.

This directly contradicts the arguments presented by the applicant in its Heads. In its Heads, applicant submits that the payments were being made to compensate Jongwe for share options relinquished by him and in consideration for those payments Jongwe agreed to the restraint of trade.

On analysing Annexure G the court finds that the position taken by the applicant, in its founding affidavit, on the restraint of trade issue, cannot be sustained by the agreement. Annexure G, paragraph 3, clearly states that payment was to compensate Jongwe for the share options he relinquished and that payment would only be made on production of evidence of forfeiture of the options in the form of the original share option certificates. In addition clause 5 of the same agreement stipulates that if Jongwe leaves service within a period of 5 years from date of commencement of service, he would be obliged to pay the bank, on a pro-rata share, the total payments received by him relating to the unexpired portion of the said five year period. No reference is made to the restraint of trade period in clause 5 of Annexure G. The stipulation in clause 5, regarding pro-rata payment, is itself an indication that the payments granted to Jongwe under clause 3 were made in view of services to be rendered to applicant by Jongwe, which services the bank expected for a certain minimum period.

There was no obligation for the applicant to pay for the loss of the

relinquished shares. The applicant would not have done so were it not to employ Jongwe. A scrutiny of Annexure G does not support applicant's contention that it is a restraint of trade agreement as the restraint factor is a secondary issue.

Clause 6 of Annexure G indicates that Annexure G, is additional to and in no way contradicts or replaces any of the terms of the employment contract entered into between the parties. It is, in essence, part of the contract of employment rather than a separate restraint of trade contract as contended by the applicant.

It is trite law that applicant's case stand on this founding affidavit and where applicant abandons his founding affidavit mid-stream, his case inevitably falls. In view of the above, I cannot grant the relief sought under this head.

DISCOUNTING OFFSHORE DOCUMENTS

Under this head, the applicant seeks a declarator in the following terms:

1. That discounts deducted by Barclay Bank PLC on bills drawn under Tobacco Merchant line of credit and under general offshore lines of credit do not constitute interest for the purposes of the 16th schedule of the Income Tax Act [Chapter 23:06] and are accordingly not subject to withholding of non-resident tax on interest.

The applicant further seeks consequential remedy which is in line with the declarator sought. The consequence remedy sought is that the respondent should refund the relevant amount garnished under this head.

Applicant's contention is that the difference between the discounted value received by the borrower (the cost of the bill) and the face value (also known as the maturity value) of the bill is discount earned and cannot be classified as interest for the purposes of the 16th schedule of the Act.

Applicant further contends that though in banking practice discount and interests are loosely regarded as one and the same thing, in law,

however there is a clear distinction between the two concepts. Applicant also contends that the bench marking of discount yields to interest rates cannot by itself change the nature of the discount yield to an interest yield.

The applicant's basis for the contention is mainly that

1. The 21st schedule of the Act was specifically amended to include discounts earned in the definition of interest. As this was not done in respect of the 16th schedule, discount earned is excluded from the definition of interest in the schedule.
2. The funding agreements with customers were discounting facility agreements rather than loan agreements.

On the other hand respondent's case is that the Act does not give a general meaning for the word interest and as such the ordinary meaning of the word applies in respect of sections were the word is not specifically defined. In addition the respondent contends that the applicant, in all its documents, generated before the dispute arose, described or recorded the discounted payments made and the discount value received as loan and interest respectively.

In analysing the issues raised by the parties, the court notes that the declarator being sought by the applicant is not merely based on the interpretation of the word interest as defined under the 16th schedule. It is also based on the particular facts of this matter. Applicant further seeks consequential remedy based on the facts.

The issue to be determined by this court is dependant on the nature of the transaction. Were the transactions relating to the tobacco lines of credit loan agreements similar to that of PROPACO or were they discount facilities?

The applicants attached to its founding affidavit, Annexure L, as an example of one such agreement under which deductions for withholding tax were garnished by the respondent. On the other hand, the respondent attached Annexure 'OO" as an example of a further agreement under the Tobacco Credit Lines Annexure OO was not challenged by the applicant. It is

apparent from the papers before this court that the sample agreements provided do not relate to the full amount garnished under this heading from the applicant by the respondent.

Annexure L is in the form of a letter and is headed “US Dollar bill discounting facility” and makes reference to bills of exchange. On the other hand Annexure 00 relates to a financing facility which facility is described under clause 1.1 as an agreement by the bank (Barclays Bank PLC) and Barclays Bank of Zimbabwe to advance up to US 45 million to the borrower (Zimbabwe Leaf Tobacco Company).

Annexure L and OO depict totally different positions. The question that arises from the different positions is in which category do the remaining unattached agreements fall into. In the absence of all the agreements pertaining to the sum total deducted under offshore withholding tax, it is difficult for the court to grant the decorator and the consequential remedy sought by the applicant on the facts.

In addition the nature of each agreement falling under this head, has the effect of determining whether the benefit accrued in each of the transactions can be described as an interest or discount yield.

The doubt as to the exact nature of the transactions is worsened by the fact that before the dispute, the bank recorded the transactions as loan and interest as opposed to discounts earned. No plausible explanation has been given by the applicant for such recording.

With regards to the issue of whether the yield rate on a bill of exchange can be classified as interest under the 16th schedule the court notes that there is no general definition given to the word interest under the Act. The court further notes the word interest is not specifically defined in the 16th schedule but the section lists what is included and what is excluded for taxation purposes. The meaning of the word interest ascribed to the 21st schedule by the amendment, particularly relates to that section and does not preclude a different interpretation of the word in relation to sections where the word in not specifically defined.

The court is of the view that the ordinary meaning of the word interest should be given in relation to this definition under the 16th schedule of the Act. The Oxford Concise Dictionary defines interest as an advantage or profit especially when financial, money paid for use of money lent, or for not requiring the payment of a debt. In paying the face value of the bill, on the date agreed, the borrower pays an advantage or profit over and above the value he actually received in exchange of the bill. This brings the definition of the discount earned in the armbit of the ordinary meaning of the word interest as defined in the Concise Oxford Dictionary.

The applicant therefore had an obligation to withhold tax and for the above reasons the application fails.

PENALTIES AND INTEREST

With regards to the issue of penalties, the parties are agreed that issue can be remitted back to the respondent for re-assessment. The court is of the view that the position agreed by the parties is proper and hereby grants the alternative remedy sought by the applicant in the draft order as amended by paragraph 77 of the applicant's Heads of Argument.

In the result the court:-

a) Dismisses with costs the application seeking declarators by applicant in paragraphs 1 to 9 of the draft order.
b) By consent of both parties, remits, the issue of penalties and interest back to the respondent for re-consideration.

Messrs Scanlen &Holderness, applicant's legal practitioners
Messrs Kantor & Immermen, respondent's legal practitioners