D BANK LTD
versus
ZIMBABWE REVENUE AUTHORITY

THE SPECIAL COURT FOR INCOME TAX APPEALS
KUDYA J
HARARE, 1 and 3 September 2014 and 11 February 2015

Income Tax Appeal

AP de Bourbon, for the appellant
T Magwaliba, for the respondent

KUDYA J: This appeal deals with five issues in four categories arising from the disallowance of the tax deductions that were claimed by the appellant in the tax year ending December 2009. The four categories are in respect of expenditure on computer software, foreign currency accruals derived from leveraging a dividend pay-out by a public company quoted on both the Zimbabwe Stock Exchange and the Johannesburg Stock Exchange, a purported loan advanced to the appellant by a related foreign bank, hereinafter referred to as the related party, that was subsequently purportedly written-off and the penalty imposed on the appellant by the respondent over the dividend leverage.

The appellant company is a registered commercial bank. The respondent is a statutory body established in terms of the Zimbabwe Revenue Authority [*Chapter 23:11*].

At the appeal hearing, the appellant called the testimony of six witnesses and produced 5 bundles of documents. Three of the witnesses flew from the headquarters of the foreign based banking group that controls both the appellant and the related party. These were the group general counsel who has been with the group since 2002, the financial controller who has been with the banking group since 2008 and the head of central finance and chief finance officer of the Africa Division of the banking group. The last three witnesses were the chief finance officer and the head of global markets and treasury of the appellant and a tax consultant with a local firm of chartered accountants. The 5 bundles were the 71 paged bundle 1 of the correspondence between the parties in the period 15 May 2012 to 21 November 2013, the 83 paged bundle 2, of which p. 11-83 cover the licence and service agreements and the main agreement between the appellant and the main software licensor, the

41 paged bundle 3 that contains the Reserve Bank of Zimbabwe monetary policy statement on capitalisation of financial institutions, the 29 paged bundle 4 that covers the information on the dividend transaction and the 41 paged bundle 5 that contains the loan agreement and other ancillary documents between the appellant and the foreign related banking group. The respondent did not lead any oral evidence but was content to rely on its 57 paged commissioner's case.

On 18 November 2012, the respondent issued to the appellant three amended assessments in respect of income tax for the tax years ending December 2009, December 2010 and December 2011 [annexures A1, A2 and A3 of the respondent's case and p. 41-43 of bundle 1, respectively]. The appellant objected to these assessments and penalties on 17 December 2012 in accordance with the provisions of s 62 of the Income Tax Act [*Chapter 23:06*] [annexure B of respondent's case]. The respondent failed to determine the matter within three months. By virtue of s 62 (4) of the Income Tax Act, the objection was deemed disallowed. An appeal was duly noted to this Court on 27 March 2013. The noting of the appeal triggered a belated response dated 19 April 2013 to the earlier objection. The response disallowed every objection except the one on interest earned on Nostro accounts and partially allowed the objection to penalties. On 29 April the respondent issued a further amended assessment, annexure G of the respondent's case, for the year ending December 2009. Objection to the further amended assessment resulted in yet another corrected assessment issued on 20 May 2013, annexure H of the respondent's case. The appellant paid the assessed tax on 20 May 2013 in the sum of USD2 038 425.86 in three installments between 1 June and 1 August 2013 [p71 of bundle 1].

This appeal, by consent of the parties, is restricted to the objections in respect of the deductions that were disallowed in the tax return for the year ending 31 December 2009. The appellant indicated its intention to proceed with the other aspects of the appeal, placed in abeyance, soon after the delivery of judgment in this appeal.

THE COMPUTER SOFTWARE

The first issue for determination in regards to the software was whether the expenditure on the software was of a revenue or capital nature.

The appellant contended that the installation of new software for its banking business at a cost of US$ 2 329 776.85 was for the purposes of trade or the production of income and therefore deductible in accordance with s 15 (2) (a) of the Income Tax Act. The respondent

disallowed it on the ground that the expenditure was an expense of a capital nature and was therefore not deductible under that section.

The evidence led by the appellant on the new software explained the justification for the software and how it was implemented. The appellant established through the evidence of both the local and group chief finance officers the objective necessity for the new software. In 2008, world record hyperinflation took its toll on the Zimbabwean economy. The Public Accountants and Auditors Board, Zimbabwe Accounting Practices Board and Institute of Chartered Accountants of Zimbabwe issued a persuasive but not prescriptive 33 page Guidance: Change in Functional Currency 2009 document for use by preparers and auditors of International Financial Reporting Standards compliant financial reports in Zimbabwe, page 9 to 41 of bundle 3. On the basis of hyperinflation estimated by the World Bank at 500 billion percent by the end 2008, multiple exchange rates escalating at corresponding rates and multiple interest rates ranging from 100% to 10 000% per annum the document categorised our moribund economy as a dysfunctional economy.

The digits in our currency grew exponentially to millions, billions, trillions and quintillions. The monetary authorities removed a total of 25 zeroes from the local currency (3 in 2006, 10 in August 2008 and 12 in January 2009). The core banking system, Bankmaster 7, of the appellant could cope with up to 12 digits. Once the balance reached 1 trillion, the system failed to cope and posted wrong customer transaction values and account balances. Internal creation of secondary accounts by splitting customer balances and in some instances splitting a customer's account into 20 accounts to hold various balances just in order to contain the figures, using the manual system and constant removals of zeroes by the bank in addition to those at the national level and advising the customer to multiply by a given figure to know the correct balances to reduce the digits offered temporary rather than permanent relief. [See p5-10 of bundle 2 dated 27 April 2008 on procedures on tactical solution.] These measures failed to curtail the presence of poor accounting records at some of the branches of the appellant as at 13 May 2008 as highlighted in the e-mail at pages 1-4 of bundle 2. The risk of a complete system failure was highlighted by both auditors and internal oversight committees of the bank such as the Executive Management Committee, the Board Audit Committee and the board of directors. Permanent relief came with the use of a new core banking system from Misys International Banking Systems (Pty) Ltd (Misys) that had capacity to accommodate up to 25 digits. The upgrade commenced with the execution of the agreement on 31 May 2008. It was test run on 15 November 2008 and was completed in July

2009 at a total cost of US$2 329 776.85. The total cost of installation was not disputed by the respondent. The computation of the cost is set out at p 20 of bundle 2 and I reproduce it below:

Total cost of MUB system

	GBP	USD
Initial licence fees [BA89-ZIM]	250 000.00	[361 300.00]
System customisation and field configurations (ONO 9232-ZIM)	77 668.00	[112 245.79]
System customisation and field configurations (ONO 9232-ZIM)	56 118.00	[81 101.73]
User acceptance testing, conversion preparation; end		
User training and go-live [BA92 (1) ZIM]	424 342.00	[613 259.06]
Post go-live support [BA 93 (1) ZIM]	113 600.00	[164 174.72]
Administering support, analysing support requests, providing		
Resolution, testing/validating the support		
Request resolution [BA 93 (1) ZIM]	313 819.00	[453 531.22]
Accommodation at Meikles for project team		295 000.00
VAT paid		179 151.00
Project overheads		70 013.33
TOTAL		
	1 235 547.00	544 164.33
RATE	1.45	1.00
TOTAL (USD EQUIV)	1 785 612.52	544 164.33
GRAND TOTAL	2 329 776.85	

The main factual dispute between the parties was whether the appellant purchased the computer software or not. The appellant stated that it purchased the right to use the software and not the software. The respondent contended that it purchased a copy of the computer software and not merely the right of use.

The local chief finance officer of the appellant chaired the implementation team for the new system and was involved in the implementation of the whole project. He described the software that was installed by Misys. It was an intangible program loaded on disc. The licence and services agreement # BA 89-LA at p 70 of bundle 2 was executed on 31 May 2008 between the licensor Misys of Dublin Ireland, the intervener/guarantor for payment by the licensee, the related party and the appellant as the licensee.

The licence was a personal, non-exclusive and non-transferrable one for the use of the software and documentation in exchange for maintenance and services set out in the agreement. Clause 8.0 (i) bestowed:

> "all intellectual property rights in any tailoring or additional functionality either created using the facilities of the software or within the software developed by the licensee pursuant to clause 6 [the right of appellant to alter the software to suit peculiar operational requirements for itself or other users] above shall as between the licensor and the licensee vest absolutely in the licensor and the licensee shall deliver such developments to the licensor and execute such instruments as the licensor may reasonably request, at the licensor's expense to give effect to the licensor's rights as aforesaid."

In terms of clause 8 (ii) (c) where the licensor licenced any additional functionality to other customers it was obliged to provide a credit voucher to the appellant. The maximum value for the appellant was set at 50% of the contract value paid to the licensor by such new customer. The amount due to the appellant was based on the total development time and related expenses incurred in creating such additional functionality. The appellant could offset the credit value against 50% of the prevailing recurring licence fee or 25% of the initial licence fee due. Where it had not been licensed to another, it remained vested in the licensor. In terms of clause 8 (iv) the licensee had the right to withhold the additional functionality from the licensor. The licensor was permitted to develop similar additional functionality on its own initiative but could not utilise inside information to copy, decompile, disassemble, reverse engineer or search for source codes or underlying algorithms of such modifications. The licensor was protected from liability and could be indemnified by the appellant for any claims by other customers arising from the use of the modification.

While the import of clause 8 was to vest the modifications to the software by the appellant to the licensor, the benefit that accrued to the licensee from use of that software by third parties, in my view, demonstrated that such software was an income producing machine. Clause 15.0 provided a notice period of termination by either party of two years and clause 16 placed the duty to pay for the software and other supplies on the related party within 30 days of the due date of invoice once the appellant failed to honour such invoice.

The four schedules to the main agreement are set out on p 21 to 69 of bundle 2. These four schedules to the agreement came into force on the same day as the main agreement. In case of conflict between the documents, the schedules superseded the main agreement.

Schedule No # BA91 (1) –ZIM spells out the services to be provided to the licensee by the licensor in terms of the main agreement. It is in two parts. The first part deals with the

time and material services to be supplied to support user acceptance test, conversion preparation, end-user training and go-live. It sets out the criteria for costing the time and material services provided. The broad areas covered for costing were based on notice period of the personnel and each personnel grade daily fee rate, overtime, travel, accommodation and visa costs. Part two set out the provisions expected from the licensee for the implementation of the project. These were grouped into three categories of technical facilities, business provisions and software. Under technical facilities are listed 8 stages of implementation. The first being the provision of infrastructure described as entire hardware, operating system and standard software necessary for overall licensee solution. The other stages involved connectivity with third-party systems and provision of documentation, installation of operating and other system software and configuration of the hardware. Under business provisions fall testing concepts based on test cases, test data and testing activities, training concepts, documents and training implementation and management of the implementation process.

Schedule No. # BA 93 (1)-ZIM for time and materials was also in two parts. It listed the personnel expected from the licensee from administrative support, analysts to validators and the criteria for the invoicing of the licensee by the licensor. The technical facilities, business provisions and software required were similar to those set out in BA 92(1) ZIM-part 2. Schedule No. # BA 89-ZIM was a statement of the software and documentation to be licenced and maintenance to be provided to the licensee by the licensor. The licensed software was identified as BankFusion Universal Banking [BFUB] release 1.0 consisting of 10 modules and 39 sub-modules, BankFusion Integration Framework for Universal Banking [BFIFUB] release 1.0 consisting of four modules and 12 sub-modules; BankFusion Design Workbench [BFDW] release 1.0 consisting of 7 modules and 22 sub-modules. The licenced software was further confirmed at p33 of bundle 2.

The BFUB modules and sub-modules in parenthesis that were provided were Foundation services[data management, financial processes, charges, interest, limits, static data management, process scheduler, security framework, event framework for authorisations and alerts], customer party management[customer acquisition, party-relationship management],retail deposits[current, time, notice, savings], retail lending [origination, mortgages, consumer loans, commercial loans, offsets], Treasury-Money market [Bills, CDs, securities, bonds], Treasury–foreign exchange[spots, forwards, options, swaps], payments [standing orders, sweeps, batch payment processing, money transmission

services], international payments (including swift)[outward defined list of messages supported, SWIFT statements, financial management [general ledger, profit and loss, balance sheet, FX revaluation, accruals] and collateral management.

The BF Integrated Framework for Universal Banking release 1.0 consisted of Interaction methods being inward notifications, outward notifications, request-response; integration protocols [XML, Byte Stream, SMTP, WSDL JMX] application specific interfaces [branchpower, CR2 ATM Sparrow system, IBSnet, MoneyGram, Fontis] external job scheduler gateway.

The BankFusion Design Workbench release 1.0 consisted of the following modules and sub-modules: Producer design, Process design [business object connector, sub-processor execution, process flow branching, for loop, Do-while lop, While-do-loop, table lop]; external interaction-screen designer[attribute Type definition, Attribute Type validation, screen style definition, attributable event/rule definition, sub-process calling function,] External Interaction-message builder[byte stream, XML, Email (SMTP), Web services, expression/rules builder, software component builder[activity step, feature, extension points] and Business object component builder[user-definition attributes, attribute ID generator, attribute ID valuator.

I have listed the modules and sub-modules of the software to dispel any mystique that may be attached to the term. In my view, the modules and sub-modules listed on p 29-30 of bundle 2 of the appellant's case were the basic structures [frameworks] which produced the income for the bank, they were not the income. They formed an integral and indivisible part of the income generating machine for the bank. They were much like the hardware for the bank.

The initial licence fee [ILF] of GBP 250 000.00 incurred was due on the effective date of schedule #BA 89-ZIM and thereafter a recurring licence fee[RLF] of GBP 37 500.00 was due and payable in advance on 1 May each calendar year following delivery.

Schedule No. ONO 9232-ZIM, was the statement of the services provided to the licensee for specified scope of works. A fixed price of GBP 77 668 was set for the installation, configuration and system test of the software and thereafter appropriate training based on technical facilities, business provisions and software stated on p 37 of bundle 2. The phases of implementation were set out at pages 41-43. The key activities and responsibilities of the parties were shown on p 44 to 48. Interface with third parties was the

subject of pages 45 to 51 and deliverables and change of control from licensor to licensee were stated from 49 to 61.

In the excerpts to the financial statement of the appellant, from annexure J to annexure M3 to the Commissioner's case, covering the 2009, 2010 and 2011 financial years the appellant treated the computer software as an intangible asset and amortised it. In the notes of its accounting policies replicated in the three financial years in annexure M1, M2 and M3, the appellant stated that:

> "Intangible assets: computer software:
> Generally, costs associated with developing or maintaining computer software programmes and the acquisition of software licenses are recognised as an expense as incurred. However, direct computer software development costs that are clearly associated with an identifiable and unique system, which will be controlled by the bank and have a probable future economic benefit beyond one year, are recognised as intangible assets. Capitalisation is further limited to development costs where the bank is able to demonstrate its intention and ability to complete and use the software, the technical feasibility of the development, the availability of resources to complete the development, how the development will generate probable future economic benefits and the ability to reliably measure costs relating to the development. Direct costs include employee costs arising from software development and an appropriate portion of relevant overheads. Subsequent expenditure on computer software is capitalised only when it increases the future economic benefits embodied in the specific asset to which it relates. Direct computer software development costs recognised as intangible assets are amortised on the straight line basis at rates appropriate to the expected useful lives of the assets (two to 10 years) and are carried at cost less accumulated amortisation and accumulated impairment losses. The carrying amount of capitalised computer software is reviewed annually and is written down when impaired."

The economic benefit of the MUB system, as conceded by the local chief finance officer, did not just have a probable future economic benefit beyond one year, but was still in use even as he testified on 1 September 2014, some 5 years later. The respondent contended that the future economic benefit that accrued to the appellant was synonymous with the enduring benefit test propounded in *British Insulated Helsby Cables Ltd* v *Atherton* (1926) AC 205. It was held in that case that where an expenditure was made with a view to bringing into existence an asset or an advantage for the enduring benefit of trade, there was very good reason for treating such expenditure as properly attributable to capital and not to revenue.

In my view, the computer software installed by the appellant was intended to procure an advantage for the enduring benefit of the appellant's banking business. It was not transient but durable in nature. The two year notice period to discontinue use and the length of the future economic benefit of up to 10 years enunciated in the accounting policy is clear testimony of the enduring nature of the software. The expenditure on the software thus amounted to capital expenditure.

The respondent also relied on *Amway India Enterprises* v *Dy CIT* (2008) 111 ITD 112 for the submission that software expenditure was of a capital rather than revenue nature. The case extensively surveyed the Indian tax topography and extensively examined American cases in point. In paragraph [43] and [44] it unveiled the "three tests generally applied to decide the nature of expenditure as to whether it is capital or revenue, (as) the test of enduring benefit, ownership test and functional test" that are based on practical and business point of view and sound principles of accountancy. In India expenditure is treated as capital expenditure either when it results in the acquisition of ownership of a capital asset[ownership test] or when it results in the accrual of an advantage of an enduring nature to the user in the capital field [the enduring and functional test]. Accrual of benefit in the capital field was defined in para [44] to mean a benefit that forms part of the profit–making apparatus of the taxpayer's business.

In the present matter, I agree with Mr *de Bourbon* that the appellant did not acquire ownership of the software. The first arm of the test does not apply to it. The use of the software by the appellant's own admission resulted in accrual of an enduring benefit to its business. The treatment of the software as an intangible asset, albeit in compliance with International Financial Reporting Standards and the recommendations of the Public Accountants and Auditors Board, the potential to derive revenue from tailoring or additional functionality of the software and the close affinity of the software to computer hardware [incorporation of information in the software into the user's computer-programmed at user's site or from remote supplier site by wireless or use of punch cards, discs magnetic tapes], in my view, all form part of the profit making apparatus of the appellant's business. After all software, in my view, constitutes the living and inseparable force of a computer.

My conclusions in this regard resonate with those of the Special Bench in the *Amway* case, *supra*. That Special Bench was set by the President of India, in terms of Indian tax legislation, to determine the issue whether software was of a capital or revenue nature in view of the many conflicting decisions of various Division Benches in India. It was to provide a holistic determination on the issue. The facts were that the assessee, Amway claimed a deduction for expenditure incurred for software in its tax return for 2001-2002 tax year. It acquired 8 computer application software programmes whose nature and purpose were outlined in the judgment. The assessee contended that the expenditure was incurred in obtaining the licence to use the application software was of a revenue nature as it only facilitated its day to day operations and that the life of such software was invariably short and

bound to become technically obsolete pretty quickly. The assessing officer found all the software hand long lasting use of between 3 and 4 years. He dismissed the claim on the basis that the software was part of the plant and machinery of the assessee and gave an enduring benefit to it. The taxpayer appealed to the Division Bench. The taxman contended that acquiring a licence to use software was the common mode of "purchase" of software and that expenditure incurred of such software that gave an enduring benefit to the assessee was of a capital nature. The Division Bench held that computer software was an intangible asset that constituted an integral part of a computer and without which a computer could not function, was of a capital nature.

The appeal was set before the Special Bench. The taxpayer argued before the Special bench much along the lines followed by Mr *de Bourbon* in the present matter, that it was a mere non-exclusive licensee with no title for improvements, modifications and derivatives as these were vested in the licensor. The Special bench held firstly, in para [55] and [61] on the authority of various Supreme Court of India cases that software was not an intangible but a tangible asset "though a licensee, the person purchasing the disk or other medium containing the software is owner to the extent of the rights comprised in the license." Secondly that the acquisition of computer software or for that matter the licence to use such software amounted to an acquisition of a tangible asset for which the assessee became the owner thereof; thirdly that where the life span of the software was under two years it could be considered as revenue expenditure but where the utility value went beyond two years as long as it met the functional test such expenditure would be considered an accrual of an enduring nature and lastly that the application of the functional test was more important and relevant to the consideration of whether software expenditure was of a revenue or capital nature regard being had to its use in the business of the taxpayer.

I am satisfied that applying practical business and sound accounting principles emanating from International Financial Reporting Standards that informed the treatment of software as an amortised intangible asset in the financial accounts of the appellant for three consecutive years all expenditure attaching to computer software was of a capital nature. I, therefore, agree with Mr *Magwaliba* that *Commissioner of Taxes* v *Rendle* 1964 RLR 463(AD) at 466-7 dealt with deduction of designed and fortuitous expenditure of a revenue nature and does not apply in the instant case.

The first issue referred for determination, whether the cost of computer software acquired by the appellant was a revenue expense which was allowable as a deduction in terms

of s 15 (2) (a) of the Income Tax Act or constituted an expenditure of a capital nature and thus not allowable as a deduction is answered in favour of the respondent. The cost of the computer software acquired by the appellant was not deductible as it constituted capital expenditure. It was properly disallowed.

The second issue was whether or not the respondent was bound by a decision made by the Department of Taxes in 1999 regarding the treatment of the cost of acquitting computer software when computing taxable income. It was common cause that the 1999 decision was not a general binding ruling and had no binding effect in 2009 or at all. It does not meet the criteria set out in schedule 4 of the Revenue Authority Act [*Chapter 23:11*]. The decision does not bind the respondent. The tax consultant testified on the purported existence of a tax practice since 18 May 1999. He further indicated that the claim for deduction in the 2009 tax return was submitted on the basis of the purported practice. He stated that the appellant became aware of the change in the purported practice on receipt of the first set of amended tax returns disallowing the claim. In the notice of objection, notice of appeal, appellant's case and reply to the commissioner's case, the appellant raised the doctrine of legitimate expectation arising from the communication of 18 May 1999 between a firm of chartered accountants that acted as the tax consultant to the appellant and the respondent [annexure I of respondent's case and p. 17-19 of bundle 2]. In that letter, the respondent treated computer software as a consumable item and classified expenditure either by purchase or development as revenue expenditure deductible in terms of s 15 (2) (a) of the Income Tax Act. It was common cause that the general letter of enquiry and the response did not constitute a general binding ruling contemplated in general by the 4th schedule and in particular by para 5 (3) thereof of the Revenue Authority Act, *supra*.

Mr *de Bourbon* submitted that proviso (i) of s 47 (1) of the Income Tax Act precludes the respondent from issuing an amended assessment on a tax return submitted in terms of the purported departmental practice reflected in the letter from the respondent of 18 May 1999. The proviso reads:

> "47 Additional assessments
> (1) If the Commissioner, having made any assessment on any the tax payer, later considers that---
> (a) An amount of taxable income which should have been charged to tax has not been charged to tax; or
> (b) In the determination of an assessed loss—
> (c) Any sum granted by way of credit should not have been granted
> Provided that----

(i) No such adjustments or call upon the taxpayer shall be made if the assessment was made in accordance with the practice generally prevailing at the time the assessment was made;

(ii) Subject to proviso (i), no such adjustment or call upon the taxpayer shall be made after 6 years from the end of the relevant year of assessment, unless the Commissioner is satisfied that the adjustment or is necessary as a result of fraud, misrepresentation or wilful non-disclosure of facts, in which case the adjustment or call may be made at any time thereafter;

(iii) The powers conferred by this subsection shall not be construed so as to permit the Commissioner to vary any decision made by him in terms of subsection (4) of section *sixty-two*."

I was able to find four cases from this jurisdiction that dealt with the precursor proviso (1) to s 47 (1). These are *X* v *Commissioner of Taxes* 1978 (1) SA 605 (R) at 614H-615A, 618A and 619G where the taxpayer was obliged to establish on a balance of probabilities the existence of the alleged practice by cogent and not vague evidence ; *LW* v *Commissioner of Taxes* 1967 (3) SA 70 (R) at 77D; *NCGF Ltd* v *Commissioner of Taxes* 1960 (4) SA 919 (SR) at 922 and *Commissioner of Taxes* v *New Consolidated Goldfield Ltd* 1962 (1) SA 886 (FC) at 891-2.

It does not appear to me that the tax consultant established a practice generally prevailing at the time the assessment was made. The tenor of his evidence was a carry-on of the averments in the objection of the existence of a tax ruling issued in 1999. It was clear to me that the letter in question was not a tax ruling. It did not satisfy the requirements of para 2 and 5 of the 4th Schedule of the Revenue Authority Act. The erroneous cancellation of the purported tax ruling by the respondent's chief investigator in the present case in his letter of 7 August did not confirm the existence of the practice. Section 3(4) that he sought to rely on for the cancellation was repealed in its entirety without substitution by the Finance Act No. 8 of 2011 with effect from 16 September 2011. The existence of such practice was disputed by the respondent in its case and was put in issue during the cross examination of the tax consultant. In my view, an opinion wrong at law cannot establish a practice. The respondent was therefore, not precluded by proviso (i) to s 47 (1) of the Income Tax Act from issuing an amended assessment.

In the light of these findings, I agree with Mr *de Bourbon* that the respondent is obliged to allow the deduction of special initial allowance on the cost of the software in question at the rate prescribed in the Income Tax Act.

I, therefore, hold that software expenditure was of a capital nature. The respondent correctly disallowed the claim for deduction of US$2 329 776.85 from the appellant's tax return for the year ending 31 December 2009.

THE DIVIDEND TRANSACTION

The third issue was whether the amount obtained by the appellant in the dividend transaction should be treated as the appellant's taxable income or as non-taxable income when calculating the appellant's taxable income.

The facts relating to the dividend transaction were common cause. The head of global markets for the appellant and the local chief finance officer testified on what transpired. The 29 paged bundle 4 confirmed the paper trail of the events.

On 17 December 2008 the appellant was requested by a foreign based company to act as its agent in payment of an interim dividend for its Zimbabwe registered shareholders. The time table for the last day of trade for receipt of dividend, 2 January 2009, the ex-dividend share trade, 5 January 2009, the currency conversion date, 9 January 2009 and the dividend payment date, 12 January 2009 were all provided. ZAR 45 580 500.00, described by the local chief finance officer as a capital amount to pay the dividend, was transferred into the Nostro account of the appellant on 8 January 2009. It was instructed to pay the non-resident shareholders on the Zimbabwe register in United States dollars. The sum of R366 503.40 was converted to US$38 989.72, according to p. 17 of bundle 4, at the rate ZAR9.40: US$1 and appropriated for that purpose. The balance of R 45 213 996.60 equivalent to US$ 4 521 340.00 was converted to ZW$ 158 729 988 063 723 967.24 (ZW$158, 7 trillion), which at that time was the functional local currency, for payment to local registered shareholders. The exchange rate used for the conversion on 9 January 2009 was ZW$ 3 510 638 287.87 to ZAR1.00 [p. 9 and 16 of bundle 4]. On 12 January 2009 the appellant transferred the sum of ZW$158, 7 trillion to the local transfer secretaries for payment. The local resident shareholders were duly paid in the local functional currency.

The appellant utilized its own stock of local currency of ZW$158, 7 trillion and retained the equivalent sum of US$ 4 521 340.00 in its New York Nostro account. Between 13 and 16 January 2009, the appellant sold US$2 million inclusive of commission of 5% amounting to US$100 000.00 to the Reserve Bank of Zimbabwe and remained with a balance of US$ 2 521 340.00. The commission was accounted for in its income tax return for the tax year ending December 2009.

The introduction of the multicurrency regime on 29 January 2009, practically though not legally, rendered the local currency defunct. In line with the requirements of the International Financial Reporting Standards and recommendations from the Public Accountants and Auditors Board of Zimbabwe the appellant debited the sum of US$2 521 340.44 in its United States dollar balance sheet and made a corresponding credit entry in its Zimbabwe dollar balance sheet. It excluded local currency in its United States dollar denominated financial statements for the period 1 January to 31 December 2009. Its capital account showed United States dollar assets had increased by US$2 521 340.44. A corresponding accounting entry was posted to the income statement to balance the account. The amount was not shown as income but was treated in the same way as were other assets such as buildings, furniture and foreign currency balances acquired in local currency. These were revalued into United States dollar balances and an accounting credit entered in the income statement representing current year reserves, merely to complete the double entry accounting framework. It was the local chief financial officer's uncontroverted testimony that the US$ 2 521 340.44 was credited to the income statement to fulfil these double entry accounting requirements prompted by dollarization. It did not represent taxable income. In the tax return submitted to the respondent, the appellant claimed a deduction against income for the sum in issue. The respondent disallowed the claim made by the appellant that this amount constituted an asset of a capital nature and added it back to income for the appellant for the year ending December 2009 as being an exceptional gain made as result of the introduction of the multicurrency regime. The appellant's objection was disallowed hence the present appeal.

The appellant contended that the sum of US$ 4 521 340.00 from which the balance of US$2 521 340.00 derived was of a capital nature and could not be assessed to tax as income. The respondent contended that it was income.

The local chief finance officer and head of global banking averred that the ZW$158.7 trillion exchanged for US$4 521 340.44 was capital in the hands of the appellant. The appellant used the local currency to purchase the United States dollars, which remained a financial asset in its hands. His evidence was that one asset was disposed of and another purchased. The amount in issue did not change character merely because the appellant held on to it. The basis on which the respondent treated the amount as income is not apparent. Four reasons were advanced in the determination of the respondent of 30 November 2012. The first was the purported absence of proof that the money came from the foreign based

company. The second was the absence of communication between the appellant and the foreign based company in regards to purchase of the dividend outlay. The third was the absence of instructions to transfer the amount to the transfer secretaries and the fourth was the exceptional foreign exchange gain derived from the appellant's ordinary course of trade. The fourth reason was cast in different wording in the para 17 and 19 of the Commissioner's case where it was contended that the appellant benefited from purchasing the amount at favourable exchange rates.

Mr *de Bourbon* contended on the authority of *Meman & Anor* v *Controller of Customs & Excise* 1987 (1) ZLR 170 (SC) at 173G and *Standard Chartered Bank Zimbabwe Ltd* v *China Shougang International* SC 49/2013 at p.3 of the cyclostyled judgment that the appellant became the owner of the funds on deposit. He accordingly submitted that the funds were capital assets in the hands of the bank from which it could derive income.

The approach to adopt was spelt out in *Natal Estates Ltd* v *Secretary for Inland Revenue* 1975 (4) SA 177 at 202G-203A thus:

> "In deciding whether a case is one of realising a capital asset or of carrying on a business or embarking upon a scheme of selling land for profit, one must think one's way through all of the particular facts of each case. Important considerations include, *inter alia*, the intention of the owner; both at the time of buying the land and when selling it (for his intention may have changed in the interim), the objects of the owner, if a company, the activities of the owner's *ipse dixit* as to intention, where the owner subdivides the land, the planning extent , duration, nature, degree, organisation and marketing operations of the enterprise; and the relationship of all this to the ordinary commercial concept of carrying on business or embarking on a scheme for profit. Those considerations are not individually decisive and the list is not exhaustive. From the totality of the facts one enquires whether it can be said that the owner had crossed the Rubicon and gone over to the business, or embarked upon a scheme, of selling such land for profit, using the land as his stock-in-trade. Lastly one does not lose sight of the incidence of onus of proving non-liability, imposed by sec 82 of the Act, on the person claiming such non-liability, in this case the appellant"

The commercial concept of a bank is to mobilise deposits for purposes of earning revenue income from charges and fees, interest and investments. The obvious stock-in-trade of a bank, amongst others, is money. The deposits the bank mobilises according to *Meman* and *Standard Chartered Bank Ltd* cases, *supra,* are owned by the bank in the sense that the bank has ultimate control of those funds. It would seem to me that the deposits held by a bank would constitute trading capital for the bank. It is accepted in banking law and practice that capital exists in two forms. It may either be fixed capital or floating/circulating capital. In *Solaglass Finance Co (Pty) Ltd* v *CIR* 1991 (2) SA 257 (A) 269I-270G Friedman AJA stated:

> "As what the appellant lost was capital which it advanced to the various debtors and which has become irrecoverable, it is necessary to decide whether the capital thus lost was fixed or

floating (sometimes called circulating) capital. If it was fixed capital, the loss was of a capital nature; and if it was floating, the loss was of a revenue nature.

See *Stone* v *Secretary for Inland Revenue* 1974 (3) SA 584 (A) at 595A-B.
The distinction between fixed and floating or circulating capital was explained by Innes CJ in *Commissioner for Inland Revenue* v *George Forest Timber Co Ltd* 1924 AD 516 at 524, as follows:

> "Capital, it should be remembered, may be either fixed or floating. I take the substantial difference to be that floating capital is consumed or disappears in the very process of production, while fixed capital does not; though it produces fresh wealth, it remains intact."

See also the *New State Areas* case *supra* at 620 - 1 where Watermeyer CJ, after quoting the above passage, stated:

> "As to the latter (expenditure of a capital nature), the distinction must be remembered between floating or circulating and fixed capital. When the capital employed in a business is frequently changing its form from money to goods and vice versa (eg the purchase and sale of stock by a merchant or the purchase of raw material by a manufacturer for the purpose of conversion to a manufactured article), and this is done for the purpose of making a profit, then the capital so employed is floating capital. The expenditure of a capital nature, the deduction of which is prohibited under s 11(2), is expenditure of a fixed capital nature, not expenditure of a floating capital nature, because expenditure which constitutes the use of floating capital for the purpose of earning a profit, such as the purchase price of stock in trade, must necessarily be deducted from the proceeds of the sale of stock in trade in order to arrive at the taxable income derived by the taxpayer from that trade."

In *Ammonia Soda Co* v *Chamberlain* [1918] 1 Ch 266 Swinfen Eady LJ defined fixed capital as follows at 286:

> "That which a company retains, in the shape of assets upon which the subscribed capital has been expended, and which assets either themselves produce income, independent of any further action by the company, or being retained by the company are made use of to produce income or gain profits."

At 286 - 7 he described circulating capital in the following terms:

> "It is a portion of the subscribed capital of the company intended to be used by being temporarily parted with and circulated in business, in the form of money, goods or other assets, and which, or the proceeds of which, are intended to return to the company with an increment, and are intended to be used again and again, and to always return with some accretion. Thus the capital with which a trader buys goods circulates; he parts with it, and with the goods bought by it, intending to receive it back again with profit arising from the resale of the goods. A banker lending money to a customer parts with his money, and thus circulates it, hoping and intending to receive it back with interest."

The distinction and its tax ramifications was approved by Botha JA, who delivered the majority decision in *Solaglass*, *supra*, at 277J-278A in these words:

> "I have had the benefit of reading the judgment of my Brother Friedman. In his judgment it is held (a) that the capital which the appellant lost as a result of being unable to recover the loans in question was not fixed, but circulating capital, and therefore of a revenue nature, and that the losses in question were accordingly deductible in terms of s 11(a); and (b) that the losses were not disqualified from deduction by reason of the provisions of s 23(g). I agree with (a), but I respectfully differ on (b)."

The principle that I extract from the distinction set out in the above cited cases is that a gain or loss arising from fixed capital would be of a capital nature while a loss or gain arising from floating capital would be of a revenue nature.

The appellant did not disclose whether ZWD158,7 trillion was fixed capital or floating capital. The evidence of both the local chief financial officer and global head of banking disclosed that the amount in question was derived from the appellant's own funds. The impression I had was that the witnesses were referring to floating capital. In the words of Innes CJ in *George Forest Timber* case, *supra*, the ZW$158,7 trillion was consumed and disappeared in the very process of production. It did not remain intact. It was therefore floating capital. The new product was ZAR 45 213 996.60, which was soon thereafter converted to US$ 4 521 340.40.

Mr *Magwaliba* submitted that the appellant made a profit of US$2 521 340.40 on the dividend transaction for which he is liable to income tax. He relied on the appellant's statement on page 7 of bundle 1. The tax consultant wrote to the appellant on 5 September 2012 that:

> "As explained in the letter of 6th June 2012, [the foreign company] transferred ZAR45 580 499.95 to [appellant] to fund dividend pay-outs to their shareholders (resident and non-resident shareholders in Zimbabwe in January 2009. As the economy had not yet dollarized in January 2009, the dividend pay-out to Zimbabwean shareholders was to be in Zimbabwe dollars thus [appellant] negotiated with the Reserve Bank of Zimbabwe (RBZ) for a rate for the transaction in comparison to the official ZWD:USD exchange rates obtaining then. The ZAR: USD exchange rate at the time resulted in the ZAR amount translating to USD 4 560 330.16. USD 2 000 000.00 of this was sold to the RBZ in exchange for ZWD. A further USD38 989.72 was paid out to non-resident shareholders, and [appellant] then provided the ZWD equivalent of USD2 521 340.44 that was paid to the Zimbabwe residents. This is reflected in the table provided to you showing:" [The table did show that the amount converted to ZWD158, 7 trillion was the sum of USD4 521 340.44 and not USD2 521 340.44.]

Mr *Magwaliba* reasoned that the equivalent amount to ZAR45 213 996.60 of USD4 521 340.40 should have been exchanged at the official exchange and not at the favourable

exchange rate negotiated with the Reserve Bank of Zimbabwe. He contended that the favourable exchange rate resulted in the disposal of USD2 million for ZWD158, 7 trillion that was paid out to the local registered shareholders while the balance of USD2 521 340.40 accrued to the appellant as profit. He suggested that had the appellant exchanged the whole amount at the official rate all the USD4 521 340.40 would have been taken up by the reserve bank and the local shareholders would have received the correct value on the dividends while the appellant as a middleman would have maintained a zero balance. He found confirmation for his contention in annexure N to the commissioner's case, the tax computation by the appellant for the tax year ending December 2009 in which it claimed a deduction of the alleged profit from taxable income as a revaluation of investment property.

The contentions and submissions by Mr *Magwaliba* are not supported by the evidence led in this court. The evidence was that the balance of the rands that remained after appropriating payment for foreign shareholders on the Zimbabwe register was all converted to Zimbabwe dollars at the favourable rate negotiated with the central bank. There is no evidence to support the suggestion that USD2 million was converted to ZWD158, 7 trillion. Had such evidence been adduced, the submission might have had merit. The tenor of the contentions and submissions seeks to deny the appellant the right it exercised to interpose as the purchaser of the rands directly converted into Zimbabwe dollars in accordance with the mandate of the foreign company that paid out the dividend.

In my view, the rands did not constitute revenue income but remained floating capital of equivalent value albeit in form of foreign currency. It seems to me that the ZAR45 million when resident in the Rand Nostro account of the appellant was not revenue income. It was floating capital from which revenue income would be earned on disposal as clearly exemplified by the sale of the US$ 2 million to the Reserve Bank of Zimbabwe or on investment. It would be illogical to aver that the appellant purchased the foreign currency that it already owned. The two local employees of the appellant testified that ZW$158.7 trillion constituted capital in the possession of the appellant. It would also be illogical to aver that the appellant exchanged the local currency it owned for the United States dollars it already owned. In *Meman's* case at 173G McNally JA warned that:

> "whether you could call that the Bank's own money, would depend on the context, in particular what you are contrasting it with."

In the context of the present matter, the ZAR45 million did not become the appellant's money. It was deposited with specific instructions to transmit it in functional

currency to the transfer secretaries for payment of dividends to shareholders in the Zimbabwe register. In my view, whoever the owner of the funds was between the company that transmitted them to the Nostro account of the appellant, the transfer secretaries and the shareholders in the Zimbabwe register, what is clear is that these funds were held in trust by the appellant. The appellant could not in context be the owner of the funds at that stage. The instructions from the company that declared the dividend were that the rands be converted to United States dollars for the payment of the 106 foreign shareholders registered on the Zimbabwe register and the balance in Zimbabwe dollars for the account of the local shareholders. The documentation establishes that this was done at the rate of ZAR 9:40 to US$1 and ZW$3.5 billion to ZAR1. The appellant utilised its own Zimbabwe funds to purchase the rands. The evidence of two of its local employees that it utilised local capital funds to purchase the rands was not disputed. It thereafter converted the rands into United States dollars a portion of which it sold to the Reserve Bank of Zimbabwe. It earned commission from the sale. The respondent did not question this transaction but was happy to treat the amount sold to the RBZ as the income earning apparatus. I am unable to distinguish between the portion that was sold to the RBZ and the one that remained in the appellant's possession. It seems to me that both sums were capital in nature. I am unable to conceptualize how a capital sum in Zimbabwe dollars that is utilised to purchase an equivalent amount in South African rands that are converted to United States dollars could be apportioned to revenue. The RBZ transaction suggests that had the local currency remained functional, the appellant would have had at some stage to dispose it to best advantage or utilize it to earn income.

I am satisfied that the appellant has discharged the onus on it to show on a balance of probabilities that the sum of US$2 521 340.40 constituted capital and not revenue. While I find in favour of the appellant in regards to the nature of the amount in issue, I hold also that it was remiss of the appellant to claim this amount as an allowable capital deduction, in circumstances that are not sanctioned by the Income Tax Act, from taxable income.

LOAN AGREEMENT OR BESTOWED BENEFIT

The fourth issue for determination was whether the amount of R 27 632 759.71 that was provided to the appellant by the related party was a genuine and *bona fide* loan or was in effect a grant camouflaged as a loan.

The facts on this issue are generally common cause. The parties disagree on their interpretation. All the three foreign based witnesses called by the appellant and the local chief financial officer testified on what transpired. The documents in the 41 paged bundle exhibit 5 cover the events connected to this issue.

The appellant executed an agreement of supply with the supplier of the MUB core banking system on 31 May 2008. In terms of clause 16 of that agreement the related party undertook to meet the financial obligations of the appellant to the supplier in the event that the appellant failed to pay for the supplies within 30 days of the due date of invoice.

The appellant entered into an undated one paged loan agreement on pages 2, 4 and 25 of bundle 5 with the related party. The related party and the appellant are both subsidiaries of a foreign based holding company. The agreement was witnessed by two separate witnesses for each signatory. The related party advanced a temporary interest free loan facility to the appellant to cover the costs incurred by the appellant in the development and implementation of the new MUB core banking system already dealt with under the first issue. The loan facility was advanced to enable the appellant to settle financial obligations in foreign currency for the MUB core banking system. It was structured in such a way that the related party paid the relevant charges due from the appellant from 1 May 2008 directly to the suppliers of the hardware and software of the core banking system. The appellant undertook to repay all funds paid by 31 December 2009.

The suppliers of the hardware and software invoiced the appellant within 30 days of rendering each supply and service. The invoiced amounts were honoured by the related party within a further 30 days of the invoiced date. The related party was invoiced with a charge of GBP250 000.00 equivalent to ZAR 4, 3 million by MIBS for BankFusion software supplied to the appellant. On 20 October 2008 the related party successfully applied for exchange control authority [p. 5 of bundle 5] from the South African Reserve Bank to make payment even though it had committed itself to pay without exchange control approval. The retrospective approval of the incurred contractual obligation and authority to make prospective payment[p.6 of bundle 5] dated 12 November 2008 were premised on the undertaking by the related party that the appellant would be invoiced separately to reimburse the related party and that no offset against management fees was contemplated. Again on 14 May 2009 [p7 of bundle 5] the related party applied to the exchange control authority in its country of domicile for payment of US$294 681.94 equivalent to ZAR2 504 796 to TCL of the United Kingdom due for computer parts and accessories essential to support the

appellant's IT systems infrastructure supplied to the appellant. It confirmed that the appellant held Reserve Bank of Zimbabwe exchange control authority to pay but was unable to do so due to the endemic shortage of foreign currency in Zimbabwe. Further, it confirmed that it would recover the amount from the appellant once it was in a position to pay. The application was approved on 25 May 2009 [p8 of bundle 5] on the basis of the anticipated recovery. The appellant established through the evidence of its witnesses and the documents on page of bundle 5 that the related party paid the equivalent of the total sum of ZAR 27 632 795.71 to the three suppliers.

The appellant repaid ZAR 3 597 753.73 to the related party in three tranches on 19 January, 18 June and 6 August 2009. The dates of repayment and amounts paid are set out in the appellant's bank statement of 3 January 2010 with the related party at p. 11 of bundle 5. The debts incurred by the related party on behalf of the appellant between 19 August and 30 September 2008 were all cleared with the payment on 16 January 2009 [p.12 and 26 of bundle 5] of a lump sum of ZAR2 million equivalent to US$200 000.00 for which exchange control applications to purchase such foreign currency was made to the RBZ on 15 June 2009 (for US$150 000.00 and 4 August 2009 for US$50 000.00 on p.12 and 14 of bundle 5] for IT support and development costs. The US$200 000.00 was transmitted from the appellant's Nostro account with the Deutsche Bank Trust Company in New York to the related party on 23 June [p.18-21 and 30-32 of bundle 5] and 5 August 2009 [p 22-24 and 27-29 of bundle 5]. The related party, however, paid the suppliers of the appellant the debit balance due of ZAR24 035 041.98 between 24 March and 6 August 2009. The related party paid the equivalent of ZAR 17 723 954 to MIFS for system development and implementation, ZAR654 429 to TGL for hardware and ZAR 656 659 to OT for training purposes. The breakdown of these payments is set out in the Zimbabwe New Account reconciliation of 19 August 2009 on p. 10 and 35 of bundle 5.

The outstanding loan amount owed by the appellant as at 30 November 2009 in the sum of ZAR 24 035 042 was cancelled by the related party on 31 December 2009. The signatory to the loan agreement and his two previous witnesses appended their signatures on the loan facility cancellation document on p3 of bundle 5. The cancellation recorded that the total loan amount paid to the three vendors was in the sum of ZAR24 035 042 being payments of ZAR 17 723 954 to MIFS for system development and implementation, ZAR654 429 to TGL for hardware and ZAR 656 659 to OT for training purposes.

The cancellation, according to the evidence of the general group counsel, the head group central finance/chief finance officer ,the financial controller of the related party and the local chief finance officer, was prompted by the need to recapitalize the appellant in the wake of new United States dollar denominated prescribed minimum capital requirements for all financial institutions mandated by SI 178/2008 and decreed by the Reserve Bank of Zimbabwe in a mid-monetary policy statement dated 30 July 2009 on pages 39 to 41 of bundle 5. The statement recognised the existence of capital erosion and diminution of bank balances of financial institutions denominated in local currency by chronic hyperinflation and the change-over to the multicurrency system. A phased plan for enforcement of the prescribed minimum capital requirements was outlined. All financial institutions were required to meet one-half of the prescribed capital levels, being US$6, 25 million by 30 September 2009 and the full levels of US$ 12, 5 million by 31 March 2010 for commercial banks such as the appellant.

The e-mail exchanges between the local and group chief finance officers commencing on 4 November and ending on 9 December 2009 is covered from page 15-17 of bundle 5. The appellant requested for its Sundry Creditors account of liabilities as at 31 October 2009. It also requested for the account to be dispatched every month end. The indebtedness as at 12 November 2009 was indicated. In consequence of the write-off of the outstanding debt as at 30 November, a nil debtor book balance was submitted on 8 December 2009. On 9 December the local chief finance officer wrote to his head office counterpart that the write-off would "definitely go a long way toward our capitalisation exercise." He was advised in the response of the same day that the group general counsel was making progress on the legal issue with a likelihood of the related party directors signing off some proposed resolution on capitalisation (transfer to reserves). The e-mail supports that the appellant tracked the debt and the write-off was linked to capitalisation.

In the monetary policy statement, the Reserve Bank of Zimbabwe indicated that the recapitalisation plans submitted by financial institutions showed that capital injections were expected from holding companies, private placements, rights issues, mergers and strategic partnerships with new investors. The appellant did not produce to the respondent or this court the recapitalisation plan it submitted to the Reserve Bank of Zimbabwe. Neither did it produce the resolution, if any, that the directors of the related party passed in regards to the capitalisation of the appellant.

In response to an enquiry of 12 March 2013 from SARS the related party revealed on 5 July 2013[p 36-38 of bundle 5], amongst other things, that the standard repayment terms availed to the appellant was 30 days from the date of payment to the supplier. The related party was invoiced by the suppliers on 24 March, 28 April, 20 May and 8 June 2009. Save for the repayment of ZAR3 597 753.73, the appellant was unable to pay. For tax purposes, the related party debited the appellant's loan account and credited its own income statement. It did not make any tax adjustment in the 2009 income tax return but claimed the loan write off as a deduction of a money lender. The related party wrote-off the outstanding loan account. The related party cleared the appellant's loan account in its balance sheet with a corresponding expense in the related party's income statement.

The evidence of the group general counsel of the holding company and the financial controller of the related party established that intra-group loan agreements were deliberately short form memorials that served the dual purpose of creating joint contractual obligations on the one hand and accounting and audit trail on the other. The group general counsel further established that s 70A of the South African Bank Act of 1990 requires a bank controlling holding company for which the group general counsel worked and which owned both the related party and appellant to meet the minimum capital requirements prescribed by the relevant regulatory authorities in the jurisdiction its subsidiaries operated in. The holding company complied with the Reserve Bank of Zimbabwe directive to recapitalize the appellant by waiving the loan repayment and appropriating the proceeds to capital.

The legal arguments

The respondent basically contented that the appellant and the related party consummated a simulated loan agreement to camouflage a grant or subsidy advanced to the appellant. Accordingly, it treated the sum of ZAR27 632 795.71 as a grant or subsidy as contemplated s 8 (1) (m) of the Income Tax Act and added it back to gross income in the appellant's 2009 tax return.

Mr *de Bourbon* for the appellant submitted that the appellant had discharged the onus on it to establish that the amount in issue constituted a loan and was therefore not subject to income tax. Mr *Magwaliba*, submitted on the authority of *Commissioner for South African Revenue Services* v *MWK Ltd 2010* ZASCA 168; 2011 (2) SA 67 (SCA); (2011) 73 SATC 55 that the loan agreement was a simulated agreement. At para 55 Lewis JA stated that:

> "[55] In my view the test to determine simulation cannot simply be whether there is an intention to give effect to a contract in accordance with its terms. Invariably where parties' structure a transaction to achieve an objective other than the one ostensibly achieved they will intend to give effect to the transaction on the terms agreed. The test should thus go further, and require an examination of the commercial sense of the transaction: of its real substance and purpose. If the purpose of the transaction is only to achieve an object that allows the evasion of tax, or of a peremptory law, then it will be regarded as simulated. And the mere fact that parties do perform in terms of the contract does not show that it is not simulated: the charade of performance is generally meant to give credence to their simulation."

He contended that the loan agreement was not a genuine one notwithstanding that three repayments were made. The disquieting features he advanced were the short form nature of the agreement. It was interest free. It was not dated. It did not set out specific repayment dates. It was apparent that the appellant would not be able to repay within 30 days of the related party's payment. The related party was not the parent company and did not bear the legal obligation to capitalize the appellant both under South African legislation and Zimbabwean law. He contended that the cumulative effect of these factors was that the loan agreement did not make commercial sense and submitted that the real substance and purpose of the loan agreement was to benefit the appellant by bestowing a grant or subsidy to it.

In my view, the loan agreement contained the essential features that constitute such an agreement. The loan amount was not specifically stated but it was easily ascertainable. It was constituted by "all the costs incurred (from 1 May 2008) by the appellant relating to the development and implementation of a new MUB core banking system" paid by the related party to the vendor and suppliers of hardware equipment required to support the new system. It was common cause that the amount expended for this purpose was in the sum of ZAR27 632 795.71. The loan agreement also stated the date on which repayment of the loan was due. It was 31 December 2009. The uncontroverted oral testimony of the group finance officer and the financial controller of the related party was that the understanding between the parties was that repayment was due on each paid invoice thirty days after such payment. The group chief finance officer testified to numerous e-mails and telephone calls made to the appellant for payment of the amounts whenever they fell due while the financial controller stated that she used to dispatch intra-group debtor's statements on a monthly basis to all African entities that fell within her purview reflecting all payments made on their behalf by the related party.

That the amount that was eventually written off constituted a loan was apparent from the short form agreement, the existence of an agreement with the suppliers, the applications to the South African Reserve Bank exchange control for approval to make payments and the reimbursement undertakings made therein. That the loan agreement was genuine was also

demonstrated by the three repayments of 19 January, 18 June and 6 August 2009 in the aggregate sum of ZAR3 597 753.73. It was common cause during the trial that proof of these repayments were supplied to the respondent on 12 September 2012 notwithstanding the averment in paras 22 and 25 the respondent's case filed on 23 August 2013 disputing the submission of such proof. It was established by the appellant that it cleared its indebtedness as at 19 January 2009. The e-mail communication between the local chief finance officer and various personnel in the related party's office culminating in the e-mail of 9 December 2009 established the negotiations preceding the loan cancellation.

The three witnesses from the related party justified the use of the short form agreement. It was an intra-group agreement for which detailed terms and conditions redolent in similar agreements with unrelated parties was not necessary. It was meant to record the existence of the loan and to satisfy accounting and audit requirements. In my view, it does not appear that at the date the agreement was concluded, which preceded the first application to the South African Exchange Control of 20 October 2008, the parties had foreknowledge that Zimbabwe would introduce the multicurrency regime on 29 January 2009 and thereafter rebase capital requirements for financial institutions through the mid-year monetary policy of July 2009. That the related party was not the bank holding company responsible for recapitalizing the appellant actually reinforces the genuineness of the loan. In any event, it cannot from the facts be found that the only purpose for concluding the loan agreement was to evade tax. Accordingly, I hold that the loan agreement did not constitute a simulated agreement.

I am satisfied that the appellant established on a balance of probabilities that the loan amount constituted part of its working capital and not revenue income in its hands. The character of the loan as capital income could not have changed to revenue income by reason of cancellation, for the simple reason, amongst others, that it had already been consumed by capital goods.

The appeal in respect of the loan write-off is allowed.

PENALTIES

In the light of my finding that the amount that accrued to the appellant from the dividend transaction was capital and not revenue, the appeal against the penalty imposed must succeed and is accordingly allowed. Mr *de Bourbon* prayed for costs. I do not consider

the appellant to have succeeded to a substantial degree. I believe that this is a proper case to request each party to bear its own costs.

DISPOSITION

Accordingly,

1. The appeal against the disallowance on the claim for deduction of software expenditure in the sum of US$2 329 776.85 is dismissed.
2. The appeal against the dividend transaction and the loan write-off is allowed.
3. The amended assessment of 20 May 2013 for the year ended 31 December 2009 together with the penalty imposed therein is set aside.
4. The respondent is directed to issue a further amended assessment for the year ending 31 December 2009:
    a. disallowing the deduction of software expenditure in the sum US$ 2 329 776.85;
    b. allowing the deduction of the prescribed special initial allowance in terms of the Income Tax Act in respect of the expenditure on software in (a) above;
    c. disallowing the deduction of US$ 2 521 340.44 from the taxable income of the appellant;
    d. exempting the loan write-off of US$ 485 059.93 from the taxable income of the appellant;
5. The respondent shall refund the balance due to the appellant arising from the implementation of the directive in para 4 (a) to (d) above from the US$ 2 038 425.86 adjustment paid by the appellant to the respondent between 1 June and 1 August 2013.
6. Each party shall bear its own costs.

Atherstone & Cook, the appellant's legal practitioners