G BANK ZIMBABWE LTD
versus
ZIMBABWE REVENUE AUTHORITY

HIGH COURT OF ZIMBABWE
KUDYA J
HARARE, 9 and 10 September 2014 and 27 February 2015

Income Tax Appeal

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

KUDYA J: This is an appeal filed on 3 September 2013 by a registered commercial bank in the High Court in terms of s 65 of the Income Tax Act [*Chapter 23:06*]. It arises from taxation in the four areas of staff retrenchment costs, Nostro accounts, Nostro charges [non-resident tax on fees] and offshore loans.

At the appeal hearing, the appellant called the evidence of 6 witnesses and produced a compendium of documentary exhibits encompassing some 1 207 pages. These documents were contained in 2 large box files, 2 lever files and 1 flat file. In addition 10 loose leaf documentary exhibits that served as a useful summary to the compendium were produced. The respondent did not lead any evidence. It was content to rely on the averments made in the 15 paged Commissioner's case and the 76 paged r 11 of the Income Tax rules documents.

On 16 November 2012, the respondent issued to the appellant three amended assessments in respect of income tax for the tax years ending December 2009, 2010 and 2011[p 1-3 r 11 documents], respectively. The respondent objected to the assessments on 12 December 2012. The objections in respect of the subject matter for which the present appeal is concerned with were disallowed on 15 August 2013 [p 4-7 of r 11 documents]. However, on 21 November 2013 the appellant proceeded to issue further amended assessments for the tax year ending 31 December 2010 and 31 December 2011, respectively, after allowing deductions for VAT expenses incurred in the two years in question.

The issues for determination were:

1. Whether the appellant correctly brought the provision for retrenchment costs to account in its income tax return in the 2009 tax year;
2. Whether the respondent was entitled to deem the appellant's offshore Nostro accounts as interest bearing accounts and the appropriate rate of interest;
3. Whether the respondent was entitled to attribute interest earned by non-resident related parties on loans made to businesses in Zimbabwe to the appellant.
4. Whether bank charges raised by offshore banks holding the appellant's Nostro accounts amounted to fees under para 1 of the 17th Schedule of the Income Tax Act.

I will determine each issue in turn.

STAFF RETRENCHMENT COSTS

The facts.

The facts concerning staff retrenchment costs are common cause. They emanate from the comprehensive testimony of the Human Resources manager for the appellant. He relied on the first 535 pages of the appellant's bundle of documents, the 9 paged exh 1 and 15 paged exh 2.

On 26 November 2009 the board of directors for the appellant resolved that:

> "The company undertakes a voluntary retrenchment exercise to reduce its staff head count by up to two hundred and fifty-two (252) staff members."

The minutes of that meeting are found on p 1 and 2 of both the bundle of documents and exhibit 1. The minutes reveal that the foreign based parent company of the appellant pledged an amount not exceeding US$7 million to bankroll the costs of the exercise. The exercise was headlined: Voluntary Separation Scheme in the minutes. The board directed the roll out of an attractive package that would be of interest to all levels of employees. The rationale, process and package for the exercise which were set out on pages 3-6 of the bundle and exh 1 were considered and approved by the board before they were unveiled in country wide road shows to all members of staff. The rationale behind the decision of the board was the down turn in economic activity which triggered a drastic fall in business volumes from average monthly transactions of US$1.9m in 2008 to US$380 000 in 2009 in the face of static staffing levels in excess to capacity.

The process targeted all levels of staff. All interested staff were required to submit formal applications by 31 December 2009. The appellant reserved the right to approve or

decline applications. The separation package consisted of 2 months basic salary for every year served up to a cap of 21 months.

The results and costs of the exercise are set out on p 7 to 9 of both the bundle and exh 1. This is an extract of the information on pages 1 to 535 of the appellant's bundle. The documentation consists of each employee's application letter for consideration in the exercise, the appellant's pro forma letter of acceptance of the exercise and a pro forma confirmation signed by each employee and the Zimbabwe Revenue Authority Employee's Tax Deduction Directive. The bundle of documents in respect of the exercise is in two files. The first file, from p 1 to 395 contains information on the 74 employees while the other file from p 395 to 535 contains information on the remaining 27 staff members whose applications were accepted. A total of 74 members of staff submitted applications for the exercise, which were received by the appellant between 3 and 31 December 2009. All these applications were accepted by the appellant on 31 December 2009. The confirmation certificates in which each staff member affirmed voluntarily and freely terminating employment were all signed by the 74 staff members between 7 January and 14 January 2010. Each applicant was given three months' notice to termination from the date of acceptance. The gross cost of the voluntary retrenchment exercise for the 74 employees was US$1 995 402. A further 27 staff members submitted applications between 6 January and 2 February 2010. These applications were accepted on the respective dates that they were made. The confirmation certificates were signed by each applicant between 13 January and 4 February 2010. Each applicant served three months' notice from the date of acceptance. The gross outlay to the appellant for these 27 members of staff was in the sum of US$550 059.

The dates on which approval for the exercise was sought from and granted by the Minister of Labour and Social Services are summarised in exh 2. Between 8 January and 4 February 2010 the appellant submitted 6 batches of the 101 signed applications of the exercise for approval to the Minister. The correspondence in question was referenced Voluntary Separation Package for Staff. The Minister approved the exercise in respect of 94 staff members in four letters dated between 12 January and 2 February 2010. In ink, the Minister referenced each approval thus: Retrenchment of [the names of the staff members]. The Minister's approval was typeset in these words:

> "The retrenchment Board acknowledges receipt of correspondence referring to the Works/Employment Council Agreement in Form LRR2. Please proceed as per agreement."

The appellant submitted applications for each employee to the respondent for a tax deduction directive. The tax directives were issued for each employee for the tax year ending 31 December 2010 between 28 January and 26 February 2010. The tax deductions and the net amounts received by each employee are summarised on p 7-9 of exh 1. US$433 370 was taxed for all the 74 employees leaving them with a total net amount of US$1 562 032. In regards to the 27, the tax deduction amounted to US$ 101 797 and they received an aggregate amount of US$448 262.

In the return for the tax year ending 31 December 2009, the appellant claimed a deduction of US$2 693 500.00 for the staff retrenchment costs in terms of 15 (2) (a) of the Income Tax Act as an expenditure incurred for the purpose of trade and for conducting its business and earning income in that year of assessment. The respondent disallowed the deduction but included it in the amended assessment for the 2010 tax year.

The dispute

Both Mr *de Bourbon,* for the appellant, and Mr *Magwaliba,* for the respondent, were agreed that the costs of the exercise were deductible in terms of s 15(2) (a) of the Income Tax Act. Counsel were also agreed that the deduction is allowable in the year the expenditure was incurred. In *Caltex Oil (SA) Ltd v Secretary for Inland Revenue* 1975 (1) SA 665 (A) at 674; 37 SATC 1 (A) at 11-2. At 674E Botha JA stated:

> "It is in the tax year in which the liability for the expenditure is incurred, and not in the tax year in which it is actually paid (if paid in a subsequent year), that the expenditure is actually incurred for the purposes of sec 11(a)."

It is accepted following the authority of *Port Elizabeth Electric Tramway C Ltd* v *Commissioner for Inland Revenue* 1936 CPD 241 at 244 and *Commissioner for Inland Revenue* v *Delfos* 1933 AD 242 at 257 that the actual amount of the expenditure incurred can only be ascertained at the end of the year of assessment after the computations have been done.

In *Edgar Stores Ltd* v *Commissioner for Inland Revenue* 1988 (3) SA 876 (A) at 899A-C; 50 SATC 81 (A) at 90 Corbett CJ noted that deduction is allowed where the taxpayer has incurred an unconditional legal obligation during the year of assessment; in that year. He emphasized that for a conditional obligation the deduction is allowable in the year in which the condition is fulfilled. To the same effect are the sentiments of van Dijkhorst J in *ITC 1587* (1994) SATC 197 at 103-104.

In paragraph 3 of his written heads Mr *de Bourbon* submitted in the main that the commitment to the retrenchment exercise as a whole should prevail and in the alternative that the commitment for all the employees whose applications were made and accepted in 2010 should be disallowed as expenditure incurred in the tax year ending 31 December 2009. The main submission runs contrary to the legal principles laid out in the *Edgars Stores Ltd* case and *ITC 1587*, *supra*, in respect of expenditure arising from unconditional legal obligations. It wrongly subsumes, contrary to the evidence adduced during the appeal hearing that the appellant entered into an unconditional legal obligation to pay the 27 employees by 31 December 2009. It was common cause that as at that date the 27 had not yet applied for voluntary retirement nor had the appellant accepted their applications. It could not at that stage have incurred an unconditional legal obligation to pay them.

The correctness of the alternative submission by Mr *de Bourbon* hinges on whether the voluntary separation scheme was a retrenchment exercise or not. A finding that the acceptance of the 74 applications on 31 December 2009 constituted voluntary retirement would inevitably make the expenditure deductible. The basis being that the appellant incurred an unconditional legal obligation to make payment to each of these employees.

Mr *Magwaliba,* however, submitted that the expense in relation to the exercise was properly disallowed as the commitment made by the board meeting was conditional on approval of the exercise by the Minister of Labour and Social Services. He contended that as such approval was only granted in January and February 2010, the expenditure could not be deducted in the tax year ending 31 December 2009.

It is correct that the appellant termed the exercise a voluntary separation scheme on page 1 of the the extract of its minutes of 26 November 2009 [bundle and exh 1] and in correspondence to the Minister of Labour and Social Services and the respondent. It, however, referred to the exercise in the resolution on page 2 of both the bundle and exh 1 replicated on p 75 of the rule 11 documents as a “voluntary retrenchment exercise”. In addition, in the letter of objection of 12 December 2012 on page 8-11 of the rule 11 documents it called them on p 8 and 9 “staff retrenchment costs” and alternatively on page 9 “retrenchment expenses”. All the three terms were again used by the appellant in its letter of 10 December 2012 on page 32 of the rule 11 documents.

Mr *de Bourbon* submitted that the exercise was in reality a voluntary retirement or resignation scheme, which fell outside the purview of the provisions of s 12 C and 12D of the Labour Act [*Chapter 28:01]*. The onus to show on a balance of probabilities that the scheme

was not a retrenchment exercise fell on the appellant. The discharge of the onus was complicated by the sole witness called by the appellant on this aspect. He conceded under cross examination that the scheme constituted a retrenchment exercise. His attempts to correct the picture in re-examination failed to paper the cracks. His prevarication on the point did not paint him as a credible witness in that respect only. The documentation emanating from the appellant is replete with reference to retrenchment exercise, retrenchment costs and retrenchment expenses. The witness intimated that several discussions on the subject, which were not minuted, were undertaken with the Minister of Labour and Social Services. The appellant did not disclose the content of those discussions. The result of those discussions were the approvals in which the Minister treated the applications as retrenchments. The approvals specified the involvement of the Retrenchment Board and Works /Employment Council Agreement in Form LRR2. The contents of these approvals contradicted the sole witness' evidence that the issue was not handled by the workers committee, works council or employment council as contemplated by s 12 C (1).

The procedure set out in s 12 C for retrenchment is that the employer who wishes to retrench more than 4 people must within six months give written notice of its intention to the works council for the undertaking and in its absence to an employment council and in its absence to the retrenchment board. The employer is enjoined to provide the names of the employees and reasons for the proposed retrenchment to the council or board where the notice is given. The Human Resources manager of the appellant stated that this was done. The objective facts show at least that all employees were notified. The rationale, process and package were disseminated in road shows. Section 12 C (ii), in my view, appears to allow the majority of the employees by agreement to supersede referrals to other councils. The retrenchment board is certainly permitted to perform the functions of these councils.

Section 12 C (2) (3) and (4) provide the reason for referrals to the councils. It is to secure agreement between the employer and employees on the need to retrench and the conditions for such retrenchment. The overall duty of the retrenchment board is to recommend to the Minister whether to approve or reject the retrenchment. The Minister, in terms of s 12 (9), then approves or rejects the retrenchment exercise.

In the present case, the employer and employees reached agreement on their own in accordance with s 12 D (2) without the involvement of the workers committee, works council or employment council. The rationale and process followed by the appellant met the requirements of s 12D (1). The exercise carried out by the appellant was aptly described by

the board resolution as a voluntary retrenchment exercise, in my view, to distinguish it from a compulsory or forced retrenchment. It meets the requirements of s 12C and 12D of the Labour Act. In addition the whole exercise falls squarely into the definition of retrenchment. Section 2 of the Labour Act defines the word retrench in relation to an employee as follows:

> "retrench", in relation to an employee, means terminate the employee's employment for the purpose of reducing expenditure or costs, adapting to technological change, reorganising the undertaking in which the employee is employed, or for similar reasons, and includes the termination of employment on account of the closure of the enterprise in which the employee is employed;"

The appellant correctly described in its documentation the process as a retrenchment. That the exercise was a retrenchment is further demonstrated by the provisions of para 4(p) of the 3rd Schedule to the Income Tax Act, which exempts from income tax:

> "an amount accruing by way of the first US$ 5 000 or one third, whichever is the greater, of the amount of any severance pay, gratuity or similar benefit, other than a pension or cash in lieu of leave, which is paid to an employee on the cessation of his or her employment, where his or her employment has ceased due to retrenchment under a scheme approved by the Minister responsible for Labour or the Public Service:
>
> Provided that the exemption provided in this subparagraph shall apply only in respect of the first forty-five thousand United States dollars of any such pay, gratuity or benefit payable to him in any one year of assessment. "

Exemption is due to those employees who are retrenched under a scheme approved by the Minister, in this instance, of Labour and Social Services. It cannot lie in the mouth of the appellant to argue that the Minister, at its behest, approved a retrenchment scheme that was in fact a voluntary resignation scheme. The principle of substance over form satisfies me that the purported voluntary separation scheme in form was in substance and reality a retrenchment scheme.

I agree with Mr *Magwaliba* that the commitment to pay the expenses of, in the words of Gubbay CJ in *Kadir & Sons (Pvt) Ltd* v *Panganai & Anor* 1996 (1) ZLR 598 (S) at 604C, the "proposed retrenchment" scheme was conditional upon approval by the Minister. The condition was fulfilled in January and February 2010. The scheme became an unconditional legal obligation for the parties once approval was granted. The expenditure for the retrenchment scheme was accordingly incurred in the tax year ending 31 December 2010. The respondent properly disallowed the deduction of US$2 693 500.00 in the tax year ending 31 December 2009.

NOSTRO ACCOUNTS

The background

The respondent assessed the appellant for income tax over the 2009, 2010 and 2011 tax years. He observed "huge" balances of non-interest bearing amounts in the Nostro accounts held by the appellant with related parties that were in his view in excess of the monthly transactional requirements of the appellant. Purportedly acting in terms of s 98 of the Income Tax Act he imputed notional interest income to these accounts at the average local rates prevailing in Zimbabwe at the time. It was common cause that the rates in Zimbabwe were much higher than the prevailing rates in the jurisdictions in which the Nostro accounts were held. The local interest rates applied were 12.4% for 2009, 11.65% for 2010 and 8.04% for 2011. Notwithstanding some averments in the respondent's correspondence and commissioner's case to the contrary, it is clear that the appellant did not actually earn such interest. The respondent deemed the appellant to have earned the ascribed interest income. He wrote back into the gross income of the appellant a total of US $5 392 369.88 for the 2009 tax year, US$11 429 964.09 for the 2010 tax year and US$8 065 117.68 for the 2011 tax year. The appellant objected. The objection was disallowed, hence the appeal.

The facts

The appellant relied on the oral evidence of its head of corporate reporting cum deputy chief finance officer who is also member of the bank's asset and liability management committee. In addition it relied on the documents in its bundle running from p 536 to 579. The bundle consists of the list of all the Nostro accounts held by the appellant [p 536-538]. Pages 539-579 consists of the transaction report of the debits from and credits to the Rand Nostro account of the appellant for the period 1 January 2009 to 31 December 2012.

The witness is responsible for all the reporting processes in the appellant including tax payments and the filing of tax returns. In that capacity he superintends over tracking balances, quantification and reconciliation of all the appellant's Nostro accounts. He defined a Nostro account as a current account (also known as a clearing account), which a bank in one jurisdiction opens in another jurisdiction to facilitate customer transactions in the currency of that jurisdiction. It is thus a current account held by a bank in the books of a correspondent bank in another country. Nostro accounts facilitate trade and transactions between countries of varied currencies. He produced the list of all the 22 Nostro accounts,

exh 3 and pages 536-538 of the bundle, held by the appellant throughout the world. The appellant holds Nostro accounts with other banks of the same name worldwide (related parties) and other banks not related to it (unrelated parties). 10 of the accounts were held with related parties. The Nostro accounts, whether with related or unrelated parties, are all held at arm's length. The witness stated that the most active Nostro accounts for the appellant were the Rand account held in Johannesburg South Africa with an unrelated party and the United States dollar account held in New York with a related party. He stated that the deposits into the Nostro accounts are made by customers and not by the appellant. The money is deposited directly into the customer's account and reflected in the Nostro account simply because the appellant is the banker to the customer. The witness testified that Nostro accounts do not earn interest; a fact confirmed by his chief finance officer on p30 of the rule 11 documents. It was evident from the evidence of the head of corporate reporting that the appellant did not earn any interest on the deposits in the Nostro accounts. He produced a letter, exh 5, from the Director Global Head of USD Clearing Product Management, Americas dated 2 September 2014 in response to a query raised on interest rates on clearing accounts. The letter reads:

> "We are writing to you in response to your recent enquiries with regard to the non-payment of interest on your clearing account held with us.
>
> As you will be aware, the global economy entered a recession (the Great Recession) in 2009, which had significant implications on the banking sector. The Federal Reserve took extraordinary actions in response to the financial crisis to help stabilize the US economy and financial system.
>
> The actions included reducing the level of short-term interest rates to near zero. The Federal Fund's average rate since 2009 has been about 13bps (0.13%) whereas the average yields for three month US Treasury Bills since 2009 has been 8bps (0.08%) (refer to appendix to this letter) [produced as exh 4].
>
> As a result of such low yields, interest rates on deposits placed in banks in the United States were significantly impacted, with many banks paying very little or no interest on deposits. We are aware that in some cases some of our competitor banks would in fact charge to hold customer deposits-resulting in 'negative interest' to their customers. The low interest environment continues to persist to date.
>
> [Related Bank] NY in general pays no interest on the majority of the clearing accounts held for our clients, regardless of whether they are from [related bank group] or from external parties.
>
> We therefore confirm that the non-payment of interest on your clearing accounts with us has been and remains in line with market practice."

Exh 5 confirmed that the appellant did not earn interest income on deposits in its United States dollar Nostro account resident in New York in the United States of America. The witness also produced exh 4, the Bloomberg US Generic Government 3 months' bond

yield for any placement funds for the period 2 January 2009 to 14 October 2011. The average interest earned during that period was 0.08%. He confirmed his chief finance officer's observation that call accounts earn the highest rate in those foreign jurisdictions.

The witness indicated that the appellant could only earn interest on transfer of the deposits from the Nostro account to an investment account such as a call account. The bank also earns interest from buying Treasury Bills or other interest bearing instruments. Interest was paid on the placement funds and accounted for in the respective tax years. In 2012 a directive from Reserve Bank of Zimbabwe stopped the offshore investment of funds from Nostro accounts. It was common cause that interest rates offered internationally on placement funds were low as exemplified by the declared income earned on those accounts.

He disputed the averment that the bank did not earn interest on Nostro accounts in order to avoid paying tax and averred that the bank was in the business to earn income. He denied that the bank entered into transactional operation schemes with Nostro banks to deliberately forego interest in order to postpone and avoid paying interest. He stated that the appellant bank operated Nostro accounts not as a vehicle to avoid, postpone or reduce its tax obligations but as an objective banking necessity; as would any other bank worldwide.

His testimony on the prevailing local position before RTGS was introduced tallied with the response of the appellant's chief finance officer to the respondent of 10 December 2012 [p 30-33 of r 11 documents].The chief finance officer indicated that in 2009 and 2010 before RTGS was introduced; the only option for local banks was to hold foreign balances either as cash or Nostro balances. All banks including the central bank opened correspondent bank relationships and used Nostro accounts to hold such funds in foreign banks. The entire Zimbabwe National Payment System in this period was conducted through Nostro accounts and the level of balances was high for all banks reflecting the size of clients for each bank. He set out four reasons for Nostro accounts. These were to ensure bank liquidity to curtail a run on the bank, to maintain minimum liquidity levels set at the time by the Reserve Bank of Zimbabwe at 25% of customer's deposits, to safeguard depositor funds by diligent prudential lending and thorough risk assessments of prospective clients and to support prompt settlement of customers' transactions.

When he was cross examined, he failed to state the balances sitting in the NY Nostro account at the end of 2009, 2010 and 2011 respectively. He did not dispute the averment that the balance in the New York Nostro account at the end of 2009 was US$10.4 million. He, also, did not dispute that the average monthly amounts held over the three years in issue in

that Nostro account was US$18 million of which US$2 million routinely catered for the transactional requirements of customers leaving US$16 million idle. He maintained that the primary purpose of maintaining a Nostro account was to conduct customer business transactions. The witness maintained that the bank was not obliged to lend money to earn income. He revealed that the decision to move money from Nostro to RTGS to cash depended on the risk appetite and assessed needs of the bank. He maintained that at the commencement of the multicurrency regime the bank adopted a low asset to deposit ratio as it needed to fully understand the risk factors bedevilling the local economy.

In my view, the witness acquitted himself very well in respect of the Nostro accounts. He could not term the balances in the Nostro account huge. The respondent averred in the letter of 15 August 2013, disallowing the objection, that the justifications for the balances of liquidity risk management, safeguarding customers deposits and prompt customer transaction settlement support did not eclipse the high balances that remained after these reasons had been taken into account. The magnitude of the balances, as disclosed in the cross-examination of the head of corporate reporting, of US$16million was not disputed. Mr *Magwaliba* suggested to the witness that the average monthly transactions were in the sum of US$2 million and US$16 million remained idle in the Nostro accounts and that this pattern characterised the period from 2009 to April 2012. While the witness disputed they were huge, his immediate supervisor, the Chief Finance Officer conceded they were huge. I am satisfied that in the context of the operational requirements the balances were indeed huge.

The letter disallowing the objection further discloses that the respondent accepted that Nostro accounts did not create an entitlement to interest regardless of whether they were held with related or unrelated parties. It invoked s 98 because the balances went beyond meeting liquidity and transaction purposes. It was unclear why local rates were preferred to call rates prevailing in the jurisdiction of the correspondent Nostro bank. It was also unclear whether the proposal for the appellant to suggest other interest rates was limited to local interest rates or not. Para 14 of the respondent‘s case seems to concede that the computation of applicable interest could be extended to the foreign jurisdiction in which the deposits were made. That attitude is confirmed by the acceptance of the interest income declared on call funds invested in those jurisdictions. The view of the appellant was simply that the respondent had no legal right to intrude into its operational space in the absence of a local law that required it to move funds from the Nostro accounts into Zimbabwe to lend at the prevailing local interest rates.

The legal arguments

The basis for determining this issue lies in the provisions of s 98. It reads:

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

Mr *de Bourbon* submitted that there was no legal obligation for the appellant to have brought those funds onshore, earn interest and avoid the 2009 loss. He further submitted that the respondent had no legal duty to direct how the appellant should run its business affairs. He relied on the sentiments of Watermeyer CJ in dealing with a provision in the South African tax legislation equivalent to our s 98 in *Commissioner for Inland Revenue* v *I H B and AH King* 1947 (2) SA 196 (A) at 207-208; (1947) 14 SATC 184 (A) at 190-191. The essence of the sentiments being that s 98 cannot be invoked against a taxpayer who abstains from earning income by closing his business or resigning from employment or taking a lower paying job. The learned CHIEF JUSTICE listed several circumstances in which the equivalent to our section 98 would be inapplicable. He stated at p 208:

> "These two types of cases may be uncommon but there are many other ordinary and legitimate transactions and operations which, if a taxpayer carries them out, would have the effect of reducing the amount of his income to something less than it was in the past, or of freeing himself from taxation on some part of his future income. For example, a man can sell investments which produce income subject to tax and in their place make no investments at all, or he can spend the proceeds in buying a house to live in, or in buying shares which produce no income but may increase in value, or he may invest the proceeds outside of the Union, or make investments which produce income not subject to normal tax in his hands, e.g. Union Loan Certificates, deposits in the Post Office Savings Bank or shares in public companies. He can also sell shares in private companies, the holding of which may subject

> him to heavy taxation in his hands although he does not receive the income which is taxed, or he can sell shares in companies which pay high dividends and invest in securities which return him a lower but safer and more certain income. He might even have conceived such a dislike for the taxation under the Act that he sells all his investments and lives on his capital or gives it away to the poor in order not to have to pay such taxation. If he is a professional man he may reduce his fees or work for nothing, if he is a trader he may reduce his rate of profit or sell his goods at a loss in order to earn a smaller income. He can also secure deductions from the amount of his gross income, for example by insuring his life. He can carry out such operations for the avowed purpose of reducing the amount of tax he has to pay, yet it cannot be imagined that Parliament intended by the provisions of sec. 90 to do such an absurd thing as to levy a tax upon persons who carry out such operations as if they had not carried them out. Moreover, the problem of deciding what the income of such persons for the tax year would have been if they had not carried out such operations would appear to be insoluble in some cases, if the countless possibilities of what they might otherwise have done with their capital or their labour are borne in mind."

At p 210 he distinguished two meanings to which the term could apply and settled for the latter. He held:

> "In order to answer these questions it should be realised that there is a real distinction between:
>
> (i) the case of a man who so orders his affairs that he has no income which would expose him to liability for income tax, and
> (ii) the case of a man who so orders his affairs that he escapes from liability for taxation which he ought to pay upon the income which is in reality his.
>
> Similarly there is a distinction between:
>
> (i) reducing the amount of tax from what it would have been if he had not entered into the transaction and
> (ii) reducing the amount of tax from what it ought to be in the tax year under consideration."

He held at 210-11 that:

> "If the words 'avoiding liability' and 'reducing the amount' are given the former meanings [(i) above] in sec. 90, then absurd results such as those mentioned above will follow, but if the words be given the latter meanings [(ii) above], though some difficulties will still occur, absurd results are on the whole eliminated. The provision contained in sec. 90, that the taxpayer shall be taxed as if the transaction had not taken place, which suggests that he has escaped from a liability to which he ought to have been subject, strongly supports the view that the expression 'avoiding liability' and 'reducing the amount' should be given the latter meanings, and those are the meanings which should be given to them."

In the present matter the appellant did not earn any income from the Nostro accounts. Exh 5 demonstrates beyond a shadow of doubt that it was not possible for the appellant to have earned income from those Nostro accounts. The reality was that it was not going to earn any income unless it moved the deposits to a call account.

Mr *de Bourbon* submitted that s 98 did not apply to the facts of this matter. In Zimbabwe, Smith J set out the four requirements that must co-exist in order to entitle the

Commissioner to invoke s 98 in *A* v *Commissioner of Taxes* 1985 (2) ZLR 223 (HC) at 232F-233B. The four requisites are:

a. The presence of a transaction, operation or scheme;
b. Intended to avoid or postpone or reduce liability for any tax
c. Through means or ways not normally employed or which create rights or obligations which would not be ordinarily be created by parties dealing at arm's length
d. The commissioner forms the opinion that the avoidance or postponement or reduction of such liability was the sole or one of the main purposes of the transaction, operation or scheme

I deal with each of these requisites in turn.

The appellant lawfully opened the Nostro accounts in question. The amounts in the accounts were deposited by clients in the normal course of business and not by the appellant. The respondent suggested that the holding of funds in excess of the transactional needs for the clients was to the extent of the excess a scheme because this went unabated for three consecutive tax years. I recognise as Smith J and before him McDonald JP, as he then was, in *Commissioner of Taxes v F* 1976 (1) RLR 106 (AD) at 115E did that the words transaction, operation or scheme are all embracing and would apply to any activity carried out by a taxpayer. In the circumstances of this case I would find that holding excess idle funds in the Nostro accounts for three consecutive tax years constituted a scheme.

The second element for determination is whether the scheme had the effect of avoiding or postponing or reducing tax liability. The appellant stated that it could only earn income by moving the funds from the Nostro accounts to call accounts. It established beyond a shadow of doubt, and the point was accepted by the respondent in the letter disallowing the objection, that Nostro accounts whether held with related parties or not do not earn interest. It was also accepted by counsel for the respondent in argument that the rates of interest offered on offshore call accounts was negligible. The appellant did not move the funds from the Nostro accounts onshore for two reasons. The first, proffered by the chief finance officer of the appellant and amplified by his deputy in evidence, was that in 2009 and 2010, before the introduction of the RTGS platform in Zimbabwe, all funds were transacted through Nostro accounts. In my view, that constituted the normal and usual method of operation for local banks including the central bank. The second was that the prudential risk management policies of the appellant dictated that the money be kept in the Nostro accounts rather than be

invested onshore. The bank had a low risk appetite and preferred to safeguard depositors' funds rather than invest the funds in a fragile and uncertain market. It does not appear to me that the scheme was entered into to avoid earning income. It was carried out to preserve the funds.

The third element was not fulfilled. It was the normal method of operation for any bank with a Nostro account. It was not suggested by the respondent that the Nostro accounts with unrelated parties were operated differently from the ones in issue. The treatment and balances were the same for both related and unrelated parties. The deputy chief finance officer established that this was a common worldwide practice amongst all banks holding Nostro accounts. No rights or obligations not normally associated with this type of account were created for the related parties.

The opinion of the Commissioner that the scheme was designed solely or mainly to avoid tax liability was incorrect. It was common cause that the deposit of the funds in the Nostro accounts did not create a tax liability for the appellant. The decision by the appellant to hold the funds in the Nostro accounts rather than investing them could not and did not create any tax liability for the appellant. In the absence of such a tax liability, the Commissioner could not properly come to the opinion that holding the funds in the Nostro accounts was designed either solely or mainly to avoid, postpone or reduce a tax liability that did not exist.

In deeming notional interest on the basis that the holding of huge amounts of idle funds in Nostro accounts did not make commercial sense for a bank that derived most of its income from interest earnings, the respondent lost sight of the fundamental principle behind our income tax legislation. It is designed to tax income that has been created. The income must have accrued to or been received by the taxpayer. It is not designed to tax income which is not in and has not come into existence. That the respondent was aware of this fundamental principle is demonstrated by the contradictory averments that characterise para 13 of its pleadings. It first suggested that the appellant committed tax evasion before imputing interest income that in reality was not earned. The bottom line was that either way income had to exist before it became liable to taxation. The income must either have accrued to or been received or deemed to have accrued or been received by the taxpayer in order to trigger tax liability. In any event, it seems to me that stripped of all the technical points *Kings* case, *supra*, amongst other things established that there is no obligation on any taxpayer to earn income. The examples suggested by Mr *de Bourbon* and conceded by Mr *Magwaliba*

demonstrate the point. A registered legal practitioner in private practice who chooses to do *pro bono* work cannot be taxed on the notional income he could have earned. Nor would he be taxed on the income differential if he elects to take a less paying job in the public service. Indeed neither would a bank be assessed to tax on the highest interest rate offered in its or any other jurisdiction against any lower rate it would have accepted. It is clear to me that where the activities of a taxpayer do not or fail to create income; it is beyond the remit of the Commissioner to wear the mantle of an investment adviser to the taxpayer and suggest to the taxpayer avenues for more income creation. I would add, as an apt reminder to the respondent, the words of Beadle CJ in *Commissioner of Taxes v Rendle* 1965 (1) SA 59 (RAD) at 61B that:

> "It is not for the Commissioner to direct how a taxpayer should run its business."

It further seems to me that the Commissioner has no mandate to usurp the role of the onshore regulatory authority in respect of Nostro accounts. It was up to the appellant to deal with the deposits as it pleased subject of course to the requirements of both onshore and offshore regulatory authorities.

Silke in *Income Tax in South Africa* at para 19:14 is to the same effect. The learned authors suggest that:

> "If by this interpretation Internal Revenue considers that it is entitled to impute rights or obligations to a transaction that do not exist in the actual bargain between the parties, for example, to assume a reasonable rate of interest when none was actually stipulated, it is considered that it misinterprets s 103 (1). On the basis of this principle, it is considered that the Commissioner is not entitled to apply s 103 (1) in order to subject to tax a lender of an interest-free loan on an amount that he could have earned by way of interest had he charged it, a professional man who renders services to another person free of charge or a trader who sells trading stock at a price below its current market price. In all these circumstances there is no amount 'received or accrued' on which an assessment may be framed. The existence of such an amount, it is submitted is an essential requisite for the application of s 103 (1)."

I am satisfied that the respondent wrongly invoked s 98 to the Income Tax Act to bring to account notional interest to the gross income of the appellant in the three tax years in issue.

OFFSHORE LOANS

The respondent wrote back into the appellant's taxable income for the tax years 2009, 2010 and 2011 interest paid by six onshore borrowers on the basis that it was purportedly earned by the appellant. The appellant objected on 12 December 2012. After an exchange of correspondence between the parties, the respondent disallowed the objection on 15 August

2013. The disallowance was based on the nature and scope of the loan agreement and the original approvals from the External Loans Coordinating Committee (ELCC) of the Reserve Bank of Zimbabwe.

In a bid to establish that the loan agreements executed between the appellant and the on shore payers of interest did not reflect the true position governing the loans in issue the appellant called the evidence of 4 witnesses. The first witness on this aspect of the appeal was the head of corporate banking of the appellant. The second was the managing director of a local tobacco company. The third was an executive director of another local tobacco company. The fourth and last witness was the company secretary of a large local manufacturing and distribution conglomerate. In addition it relied on pages 580 to 1037 of the bundle, the 170 paged exh 6 and exh 7, 8, 9 and 10.

The evidence of the head of corporate banking cut across all the six local companies that purportedly executed loan agreements with the appellant. He referred to the Master Risk Participation Agreement (MRPA) [p 9 to 29 of exh 6 and 615-630 of the bundle] concluded on 12 June 2002 between the appellant and the offshore related party. It was conceived as a vehicle to provide suitable local borrowers with offshore funding at a time Zimbabwe was experiencing endemic foreign currency challenges.

The MRPA laid the general framework for the execution of acceptance agreements in the form of Schedule 1 to the MRPA between the two banks. In the event of inconsistency between the Acceptance Agreement and the Master Agreement, the provisions of the Acceptance Agreement prevailed. The Acceptance agreements were of two forms. The first was a Funded Risk Participation agreement and the second was an Unfunded Risk Participation agreement. There were three important designations in the MRPA. These were Grantor, Participant and Obligor. A grantor could be any one of the two banks who offered the other, the participant, a participation in the funding or in the risk associated with the non-payment of the whole or any part of the amounts loaned out. A participant could be any one of the two banks that accepted a participation in the risk that would be assumed or the amount advanced. The obligor was the borrower of the funds.

In a funded participation [clause 3 of the MRPA on p11 of exh 6], the bank providing the funds was the participant. The participant was obliged to deposit the funds representing the extent of the exposure it was willing to assume with the grantor before it was disbursed to the borrower. It was required in terms of clause 3.2 to indemnify the grantor to the extent of the risk percentage on any default by the borrower. The grantor was required to promptly

allocate to the participant its share of the payments made by the borrower inclusive of interest, commission and fees accruing or expenses incurred.

In an unfunded risk participation, in terms of clause 4 of the MRPA, the participant would pay it's pro rata share of the risk percentage of the principal, interest, fees, costs and expenses to the grantor in case of default by the borrower. The participant would pay the participation percentage from any recoveries made from the borrower.

The witness clarified that a funded risk participation was invariably fully funded by the offshore related party while an unfunded risk participation was fully funded by the appellant with the offshore related party sharing in the risk of default to an agreed percentage. In both instances the appellant was the grantor while the offshore related party was the participant. Clause 5 of the MRPA dealt with the appropriation of payments made by either party. Clause 6.4 outlined the relationship between the parties. The parties accepted that the MRPA or any acceptance agreement or any other agreement or understanding did not constitute the grantor an agent, fiduciary or trustee of the participant. The grantor's rights could not be transferred or assigned except for the right in clause 7.5 to sue the borrower for the whole amount owing. The participant had no rights to deal with, make payments to or receive payments from the borrower in the loaned amount. The parties were not in partnership, joint venture or association. The grantor was not required to indemnify the participant on its participation share.

In the event of default by the borrower, the grantor was obliged to notify the participant in terms of clause 7.3. In terms of clause 11.6 privity of contract and associated benefits to third parties who were not party to the MRPA were expressly excluded. In terms of clause 14, English Law and Courts were conferred jurisdiction over both the MRPA and any Acceptance Agreement derived from it.

It was the testimony of the head of corporate banking that despite the contents of clause 6.4 the appellant considered itself an agent of the participant. This was also confirmed by the evidence of the other three witnesses who testified on this aspect. They regarded the appellant (the grantor) as an agent of the offshore related party (the participant).

He established that the Exchange Control (Tobacco Finance) Order 2004 SI 161/2004[p 1-3 of exh 6; p 580-582 of bundle] and the Exchange Control (Cotton) Order 2008 [p 4-8 of exh 6; p 583-587 of bundle] required that offshore funds be utilised for the growth and purchase of auction and contract tobacco and seed cotton. The loans were approved by the ELCC. Tobacco buyers were precluded by s 4 (3) and contract growers by

4A (3) from either drawing on corporate foreign currency account or purchasing, borrowing or raising foreign currency onshore from the interbank market or authorised dealers or any domestic source whatsoever to purchase contract or auction tobacco. A similar bar was placed against seed cotton merchants by the relevant statutory instrument. In both instruments onshore funds were defined as:

> "any funds, moneys, deposit, loan, line of credit advance from customer or parent company or other funds or facility whatsoever(in the tobacco order)/wheresoever (in the seed cotton order) located or obtainable within Zimbabwe".

He identified 2 facility letters pages 30 to 40 and 41 to 51 of exhibit 6 for one of the 3 tobacco merchants. All the other documentation for the tobacco company in question being master participation documents, rate fixed advice and correspondence run from p 631 to 807 in the bundle [p 627 -726 contains acceptance agreements for the facility letter of 29 June 2011 and the various draw downs and security compliance certificates. The facility letter of 29 June 2011 was not produced in evidence or in any of the documents]. The first, dated 4 June 2009 for US$25 million was for the purchase and processing of tobacco for export for the 2008/2009 season and financing inputs and equipment for contract growing and purchase of tobacco in the 2009/2010 season.

The second facility letter, dated 26 August 2010 for US$35 million was for purchase of tobacco in 2009/2010 and inputs for 2010/2011 season. The managing director of the tobacco company in question confirmed accessing these offshore loans. The 3 paged exh 8, dated 17 December 2009 and 31 March 2010, were the bank statements of account produced by the managing director to confirm that his company maintained a current account 0101 2524708 50 with the foreign lender in accordance with the facility letters. The statements showed that the borrower received US$26 million in 2009 and US$3 million in 2010 from tobacco buyers. It paid out capital and interest on in the sum of US$3 031 210 on 9 March 2010. The tobacco company in question repaid the capital and interest into the evidence account 01012 252708 50 of the foreign lender. The acceptance agreement for the first facility letter is at p 727-730 of the bundle. The grantor was the appellant while the participant was the offshore related party. The participant funded the loan in the sum of US$22 million and assumed risk at a margin and interest of Libor plus 4%. The facility letter was for US$25 million with a margin and interest rate of Libor plus 6%. It would appear from these two documents that the appellant might have contributed US$3 million and taken the balance of the risk of Libor plus 2%.

The evidence of the head of corporate was that all the money was supplied from the offshore related party at the margin and interest rate stated in the facility letter to whom all the capital and interest were remitted. It seems to me that he did not fully disclose the nature of the relationship between the appellant and the offshore related party in this regard. I find that he was therefore untruthful in this regard. The acceptance agreement for the facility letter of 26August 2010 was not produced in evidence. It also does not form part of the documents in the bundle.

The facility letters were generally worded thus:

> **"BANKING FACILITIES**
> The appellant (the Bank) is pleased to confirm (subject to the conditions precedent and upon representations and any warranties as set out herein) its willingness to make available to your company (the Borrower) the uncommitted banking facilities (the facilities) outlined below on the terms and conditions set out in this letter, as modified by the Bank from time to time and (where applicable) terms and conditions set out in the appendix."

The facilities became available on receipt of originals security documents, a certified copy of board resolution, the RBZ approval for the facilities, requisite insurance policy and opening of an evidence account at the Bank (the Evidence Account). The interest rate differed in each facility letter. In the first it was set at the aggregate of Libor plus 6%, in the second was risk price of 3.75 and establishment fee of 2.3%.

Other conditions specific to each onshore borrower were stipulated. These were submissions of monthly schedules, management accounts, audited financials, proof of seasonality, and submission of quarterly crop records to the appellant on set timelines. In addition, Customs Declaration Forms (CD1) of the projected export revenue to be routed and processed through the appellant and insurance cover with reputable offshore insurer reflecting the appellant as the loss payee were also stipulated. The borrower undertook to the appellant to take comprehensive insurance.

All sales proceeds from the tobacco sold were to be remitted to the appellant for the credit of the Evidence Account. The balance of the Evidence Account would be applied towards the reduction of any outstanding loans due to appellant and the residue paid to the Borrower. The Bank would only act on instructions received from or verified by the Local Agent for the operations of the Evidence Account. The Borrower was required to issue instructions to its overseas buyers to remit funds to the Bank for credit to the Evidence Account. The evidence account was supplied. The choice of law clause conferred jurisdiction on the local courts. A four paged appendix consisting of 13 clauses was attached. The

appellant was permitted to cede its rights in the facility to third parties. Clause 13 on disclosures identified the appellant as the Bank. The confidentiality clause regarded the contents as the property of the appellant.

The facility letters of the second tobacco company were dated 30 September 2009 [p 61-72 of exh 6] for US$1 million and 6 May 2010 [p 52-60 of exh 6] for US$3 million. The full documentation for the second tobacco company runs from p808 to 854 of the bundle. The acceptance agreements filed are for the facility letter for 6 March 2012. The two facility letters made no reference to the opening of an evidence account. There were no acceptance agreements for the two facility letters for this company that are the subject of the appeal.

The facility letters of the third tobacco company were dated 7 May 2009 [p 111-122] for a loan of US$15million and 21 September 2010 [p 123-135] for a loan of US$45million. There were no documents filed in respect of the third tobacco company in the bundle of documents. The acceptance agreements in respect of the two facility letters for the third tobacco company were not produced in evidence. The accounts director of the third company stated that his company accessed the offshore component of the loans. His company would instruct appellant to pay off the loan on maturity through the evidence account. His company did not access local funds as that would have been contrary to law.

The facility letters for the seed cotton company are dated 3 July 2009 [p 136-149] for US$2.5 million and 29 June 2010 [p 150-158] for US$3 million. The conditions were markedly different to those of the tobacco companies but the framework of the facility letters was similar to the tobacco ones especially the appendices. There were no other documents filed of record or produced in evidence in respect of the seed cotton company. The booking location stated in the facility letters was the appellant. The interest rate was set at Libor plus cost of funds plus 6%.

The facility letters in respect of the second and third tobacco companies and the seed cotton company made no reference to an evidence account. They were all formatted differently from the facility letters of the first tobacco company in that respect. They were formatted much like the three onshore funded facility letters for the manufacturing and distribution conglomerate. Two of the three facility letters for the conglomerate that were admittedly funded onshore by the appellant were dated 24 August 2009 for a loan of US$10 million [p 73-86 of exh 6] and 22 September 2010 for a loan of US$20 million [p 87-103 of exh 6].

The witness averred that the appellant acted as the agent of the offshore related party. He further stated that the appellant did not receive any interest from any of the four clients. The interest was paid to the evidence account of the offshore related party on the instruction of the appellant.

The facility letter for the cement manufacturer was dated 30 August 2010. The loan of US$3 million was required to finance the importation of mobile equipment, compressors, factory consumables and other capital equipment for the quarry and other factory operations. The other documents for the cement company run form p 908 to 1037. The booking location on the facility letter for 30 August 2010 was the offshore related party. The tenor was a year and interest was the aggregate of the cost of the funds to the appellant plus 2.5%. Amongst the conditions, condition (c) and (f) on p 104 of exh 6 stand out like a sore thumb. Both grant the sole discretion to roll over the loan to the appellant. The appendix to the facility letter is a carbon copy of the appendices in the tobacco and cotton facilities. The choice of law clause imbues the appellant with the choice of recovering any outstanding amounts in the Magistrates' Court in Zimbabwe. The acceptance agreement in respect of this facility letter was not produced.

The head of corporate banking disclosed that the facility letters dated 24 August 2010 [p 73-86] for US$10 million and 22 September 2010 [p 87-102] for US$20 million were in respect of onshore funds availed to the manufacturing and distribution conglomerate. He produced the 28 paged exh 7, the facility letter dated 19 October 2011. It differs from all other facility letters thus far analysed in design, content and coverage. The total commitments made in the facility letter were in the sum of US$60 million. It was a revolving loan facility for the general corporate purposes of the borrower. Clause 11.6 and 25 conferred jurisdiction on the English Courts. In schedule 1 para 11 the guarantor provided security in favour of the appellant.

The head of corporate banking claimed that the appellant did not have the capacity to loan out such an amount. He produced exh 9, the loan draw down advice from the offshore related party dated 17 November 2011 as evidence of the direct payment of interest into the evidence account of the offshore related party. It stipulated the loan amount of US$60 million, the tenor of 182 days. The rate setting information was provided as were remittance instructions. The all-in-all rate was 7.43% and the interest in the sum of US$2 253 766.67 was payable on 17 May 2012. He produced exh 10, the acceptance agreement in the format of schedule 1 to the MRPA. It is in respect of the US$60million loaned out to the manufacturing

and distribution conglomerate. The grantor was the appellant. The participant was the offshore related party. The obligor was the manufacturing and distribution conglomerate. The guarantor was the offshore holding company for the borrower. The participation was fully funded by the participant. The interest rate was Libor plus 6.75%.

Exh 9 further stipulates the remittance instructions. It reads:

> "Please arrange to pay us the Total due of US$12 253 766.67 on 17 May 2012 at maturity to the following Standard Settlement instruction:

The nominated account number for payment happens to be the one indicated in Exh 3 as the Nostro account of the appellant, account number 3582 088442 001 Ref: LPU/ [the Conglomerate (Pvt) Ltd.

The appellant sought authority from the ELCC to borrow offshore funds on behalf of non-tobacco clients. On 6 October 2009 [p159-162 of exh 6; p592-595 of bundle] the ELCC approved an ordinary non-tobacco pre and post shipment finance facility in the sum of US$50million. The lender was indicated as the offshore related party and the borrower was the appellant. The approval also covered a further US$50 million for tobacco financing. Again, the borrower was indicated as the appellant and the lender was the offshore related party. Both facilities had an expiry date of 31 August 2010.

Again, on 9 September 2010 [p163-166; p596-599] the External Loan Coordinating Committee approved an enhanced ordinary non-tobacco pre and post shipment facility increasing the loan amount from US$50 million granted on 6 October 2009 to US$100 million sought by the appellant from the offshore related party at an interest rate of Libor plus 4%. The tobacco pre and post shipment facility was also increased from US$50 million to US$100 million with an interest rate of Libor plus 3% expiring on 31 August 2011. The borrower/beneficiary was the appellant while the lender was the offshore related party. The witness characterised the non-tobacco facility as a global arrangement rather than a specific one. He stated that the Reserve Bank of Zimbabwe required approval by the ELCC even for non-tobacco loans from offshore to obviate the need to seek exchange control authority to repay as this would be embedded in the approval before loans were disbursed to clients.

The US$60 million was included in the US$100 million non-tobacco facility approval. He stated that the ELCC was aware of the legal requirement for tobacco merchants to access funds offshore but approved the appellant as borrower well knowing that the money was for clients rather than for the appellant's own use.

He was unable to shed light on the ELCC approval dated 7 December 2011 2011[p167-170 of exh 6; p 600-603 of bundle]. It was for US$200million divided equally between ordinary non-tobacco and tobacco pre and post shipment finance with maturity dates of 31 July 2010 and 31 July 2011, respectively that predate the date of the authority. Both had a coupon rate of Libor plus 6%. The approval in question was, however, corrected by the ELCC on 14 June 2012 [page 36-39 of r 11 documents]. The coupon rate for the non-tobacco loan was reduced to Libor plus 4% and the expiry date was amended from 31 July 2010 to 31 August 2012 while for the tobacco facility the coupon rate was reduced to Libor plus 3% and the maturity date was amended to 31 August 2012. The other information remained the same.

He portrayed the appellant as an agent of the offshore related party in administering the loan. He maintained funds were disbursed to the 6 onshore companies from offshore and that the borrowers also made direct interest payments offshore. In regards to the conglomerate, he averred that the appellant did not have capacity to loan out more than 25% of its capital to any one entity. He confidently affirmed the absence of the interest payments in the profit and loss interest account as proof that the money was never credited to the appellant.

The evidence of the head of corporate banking in respect of the manufacturing conglomerate was confirmed by the company secretary of the conglomerate. He took part in the discussions that gave rise to the loan facility. It was clear to him that the appellant fronted the offshore related party. Representatives of the lender sat in the discussions to acquaint themselves with the borrower. He stated that the money came directly from the foreign bank through the appellant. He stated that the appellant had no capacity to raise such a sum of money. He, however, acknowledged that his company did not execute any agreement with the foreigner lender. The movement of the US$60 million is shown on p 906 and 907 of the bundle. The money was deposited into the appellant’s Nostro account in NY on 17 November 2011 and credited to the local bank account of the borrower on the following day. He confirmed that payment of interest instructions by his company to the appellant were triggered by the interest rate fix, exh 9. The appellant would debit the company’s bank account and credit the offshore related party’s nominated account. The interest repayments in each 6 month period was in the region of US$2.2 million.

The evidence of the head of corporate banking was supported by the three witness who testified on behalf of the borrowers. They all maintained that notwithstanding the contents of the facility letters, they sourced offshore loans from the offshore related party.

They remitted interest to the offshore related party. The appellant was merely a conduit pipe who facilitated easy access of the funds and sought approval from the Reserve Bank of Zimbabwe on behalf of both the borrowers' and the offshore lender.

There was a plethora of disquieting features in the testimony of the head of corporate banking. He disputed that any money was paid to the appellant by the offshore lender contrary to the stipulation in clause 3 of the MRPA. He disputed that the appellant borrowed funds from the onshore lender, again contrary to all the approvals he produced that emanated from the central bank. The lender was clearly indicated as the offshore related party and the borrower and in later approvals the beneficiary as the appellant. The unexplained discrepancy between the first facility letter and the acceptance agreement in respect of the first tobacco company did not engender confidence in his testimony. More importantly, the failure to produce the acceptance agreements of all the other facility letters save for the one in respect of the conglomerate, exh 7, and rate fix documents in respect of all the facility letters undermined his credibility. The impression left in my mind was that the appellant was deliberately hiding information in corporate underbrush. The similarity of all the letters save for the first two for the first tobacco company with the ones the appellant admitted were provided with local funds undermined the appellant's case. There was no reference to any evidence account in these facility letters. The choice of law clause conferred jurisdiction on the local courts. The calculation of the computation of the interest rate in respect of the cement manufacturer demonstrated that it was receiving onshore finance from the appellant.

In my view, it was simply incredible that the appellant did not have the capacity to fund the requirements of the conglomerate. It admitted to funding the conglomerate in the aggregate sum of US$30 million from onshore funds. In any event it held approvals from the ELCC to on lend funds borrowed offshore to both tobacco and seed cotton merchants and other non-tobacco customers. I was satisfied that the head of banking, for reasons best known to himself and the appellant chose to mislead this court about the true nature of the interest payments that were paid by the six onshore companies.

The issue for determination is whether the respondent was entitled to attribute interest earned by non-resident related parties on loans made to businesses in Zimbabwe to the appellant.

It was common cause that the facility letters were all in the name of the appellant. The appellant set the terms and conditions for accessing the loan amounts. The parties were required to provide board of directors' resolutions, various security documents and in some

instances proof of an offshore evidence account. The appellant was the link between the borrowers and the External Loan Coordinating Committee of the Reserve Bank of Zimbabwe. It applied for approval of both tobacco and non-tobacco pre and post shipment offshore loans. The approvals identified the appellant as the borrower and the offshore related party as the lender.

The respondent understandably took the view that the appellant was borrowing offshore funds for onshore lending. This view was in part derived from the letter from the central bank of 12 February 2013 on page 23 and 24 of the Rule 11 documents. The central bank advised that current exchange control regulations allowed authorised dealers to access offshore lines of credit for on lending and own use while local companies were permitted to directly access offshore loans from offshore lenders including their holding and sister companies. The letter further indicated in line with the Exchange Control Directive ECD01 dated 31 July 2009 during the period to 5 February 2013, that authorised dealers were allowed to process offshore loans of up to US$5 million under the advice of the External Loans Coordinating Committee whilst offshore loans in excess of US$5 million required prior approval by the ELCC. The prior approval of the use of the onshore funds borrowed offshore for the purchase and growth of tobacco and seed cotton may have dulled the collective conscience of the parties from the possible breach of the law.

The ELCC approvals granted to the appellant on 6 October 2009, 9 September 2010 and 7 December 2011 as corrected on 14 June 2012 identified the appellant as the borrower of offshore funds emanating from the offshore related party for both tobacco and non-tobacco pre and post shipment loans. It was on the basis of the contents of the paperwork represented by the facility letters and the ELCC approvals that Mr *Magwaliba* maintained that the interest purportedly paid by the borrowers to the related offshore party accrued to the appellant. He forcefully contended that the facility document created legal rights and obligations between the appellant and the specified onshore clients. It created the cause for payment of interest to the appellant and did not establish a similar cause for payment to the offshore related party. He relied on *Commissioner of Inland Revenue* v *Lever Brothers and Unilever Ltd* 14 SATC 1 at p 10 where Watermeyer CJ observed that:

> "The provision of credit is the originating cause or source of the interest received by the lender."

The onus to show that the interest in issue accrued to the offshore related party, in terms of s 63 of the Income tax as interpreted in such cases as *Commissioner of Taxes* v *A*

Company 1979 (2) SA 409 (RA) at 416 lies on the appellant. The thrust of the appellant's case and evidence from the four witnesses it called on this aspect appeared to me to be that the interest was in reality received by the offshore related party. The witnesses indisputably established this fact through a variety of documents such as the interest rate fix and bank statements. Interest, like any other income, is also taxed on the basis of accrual. Accrual denotes legal entitlement. The facility documents seem to appropriate interest to the appellant. They point to the appellant as the provider of the credit to whom interest payments were due. In the parlance of Watermeyer CJ in the *Lever Brothers'* case *supra* the provision of the credit was the originating cause or source of the interest.

The appellant, however, argued that the interest could not have accrued to it because it was not the actual lender of the money. It merely facilitated the provision of the loan amount to the borrower. The four witnesses confirmed this fact. The appellant also relied on the MRPA and acceptance agreements it executed with the offshore lender. The MRPA mandated the execution of an acceptance agreement between the appellant and the lender to record the relationship between the parties in a funded or unfunded risk participation.

The appellant did not produce any acceptance agreement in respect of the cotton company, two of the tobacco companies and the cement company. The acceptance agreement for the one tobacco company that was produced left unanswered questions that undermined its probative value. The appellant, therefore, failed to establish the basis for the remittal of interest to the offshore related party. It produced a relevant acceptance agreement for the loan facility provided to the manufacturing and distribution conglomerate. I would have found for the appellant in regard to the conglomerate were it not for the unexplained remittance details in exhibit 9 which seem to direct payment of capital and interest to the appellant's New York Nostro account listed in exh 3.

I, therefore, hold that the appellant has failed to demonstrate that it did not earn the interest deposited into the offshore evidence account held with the offshore related party.

WITHHOLDING TAX

The last issue for determination is whether the bank charges that were raised by offshore banks holding appellant's Nostro accounts amounted to fees under para 2(1) of the 17th schedule of the Income Tax Act. The para reads:

> "2. (1) Every payer of fees to a non-resident person shall withhold non-residents' tax on fees from those fees and shall pay the amount withheld to the Commissioner within ten days of the date of payment or within such further time as the Commissioner may for good cause allow."

Fees are defined in para 1(1) of the 17th schedule in the following terms:

> "1. (1) In this Schedule, subject to subparagraph (2)—
> "fees" means any amount from a source within Zimbabwe payable in respect of any services of a technical, managerial, administrative or consultative nature, but does not include any such amount payable in respect of—
> (2) For the purposes of this Schedule—
> (*a*) fees shall be deemed to be from a source within Zimbabwe if the payer is a person who or partnership which is ordinarily resident in Zimbabwe;
> (*b*) in determining whether or not non-residents' tax on fees should be withheld, the question as to whether or not—
> (i) the payer is a person or partnership ordinarily resident in Zimbabwe or
> (ii) the payee is a non-resident person;
> shall be decided by reference to the date on which the fees are paid by the payer;
> (*c*) fees shall be deemed to be paid to the payee if they are credited to his account or so dealt with in that the conditions under which he is entitled to them are fulfilled, whichever occurs first;
> (*d*) not relevant"

The averments made by the appellant in para 34 to 37 of its case are that:

34. The foreign banks in which the appellant held its Nostro accounts raised transaction related charges in respect of cash repatriation, cash ordering or Visa card costs.
35. The appellant paid those charges directly to the banks concerned without deducting therefrom any amount in respect of withholding tax.
36. The Respondent contends that the charges raised by the banks holding the Nostro accounts, which were paid by the Appellant constitutes fees
37. The Appellant contends that the payments made were in respect of bank charges and not in respect of fees, whether of a technical, managerial or consultative nature and are not subject to the withholding tax.

The head of corporate banking testified how transactions were conducted in the Nostro accounts. A customer/client would instruct the appellant to make payment to a third party. The appellant generated a telegraphic transfer through SWIFT, a safe international payment processing platform used by all banks to transfer money from one bank to another, to transfer the funds from its relevant Nostro account to the third party's designated bank account. In line with international banking practice, Swift automatically charged a fixed rate against the Nostro account based on the number of clearing transactions that operated through

the system. SWIFT charged the related account directly from that transaction by debiting the account without raising an invoice. He also stated that the Nostro bank charged normal bank charges in line with the requirements of the regulatory authorities in which they reside.

When he was cross examined he equated the Nostro bank charges with fees paid by customers of local banks for services rendered and charges levied for maintaining an account with the local bank. He clarified that the appellant was charged fees for particular transactions that went through the Nostro accounts. He stated that the appellant maintained a mirror account for each Nostro account to track transactions in each account. He conceded that the debit represented money earned by the foreign bank.

Mr *de Bourbon* submitted that the appellant was not liable for withholding tax on two grounds. The first was that the payment was not made from a source within Zimbabwe and the second was that the services for which the charges were levied were not of a technical, managerial, administrative or consultative nature. He relied on *Sunfresh Enterprises (Pvt) Ltd t/a as Bulembi Safaris* v *Zimra* 2004 (1) ZLR 506 (H). In that case, Cheda J held *inter alia* that payment of a commission by a foreign client to a foreign marketing agent of a local Safari operator outside the country did not under para 1 (1) of the 17th Schedule of the Income Tax Act constitute payment of fees from within Zimbabwe even though the originating cause was in Zimbabwe.

It seems to me that the facts in *Sunfresh* are distinguishable from the present facts. In *casu*, the appellant conceded in its pleadings that it paid the charges debited by the Nostro banks. Para 1 (2) of the 17th Schedule deems the source to be from within Zimbabwe if the payer is ordinarily resident in Zimbabwe. The appellant is ordinarily resident in Zimbabwe. If the commission in the *Sunfresh* case was deducted from the overall hunting fee remitted to the safari operator as submitted by Mr *de Bourbon*, I would with respect differ from the finding of Cheda J. The payment by the foreign client to the foreign based agent, in my view, would simply constitute a prepayment on behalf of the safari operator. It would have been subject to withholding tax.

In the present matter, the charges were interchangeably referred to as fees by the head of corporate banking. Mr *de Bourbon* submitted that the Nostro bank charges were not subject to withholding tax as they did not fall under any one of the four categories of technical, administrative, managerial or consultative. It seems to me that the four categories in question are merely adjectives which describe a particular activity. According to the *Shorter Oxford English Dictionary* administer means *inter alia* “to manage;” “to handle”

while administrative is defined as "pertaining to management." One of the many permutations of "to manage" is "to deal with carefully". Like McDonald JP in *Commissioner of Taxes v F, supra,* at 115F where he was off course referring to "transaction, operation or scheme", I would agree that each of the words "technical, managerial, administrative and consultative" that is used in the para under consideration:

> "is of wide and general import and there are a few activities of a taxpayer which will not be appropriately described by one or other of them."

The activities that were carried out by the Nostro banks on the various Nostro accounts and by SWIFT clearances were administrative in nature. The clearing or processing of transactions by SWIFT were in my view both administrative and technical. They involved the use of software that does not issue invoices but systematically and automatically debits the cost of each transaction on the account.

I am satisfied that the charges raised by offshore banks holding appellant's Nostro accounts amounted to fees under para 1 of the 17th schedule of the Income Tax Act.

CONCLUSION

For the avoidance of doubt, I answer the first issue referred to trial against the appellant. It did not properly bring to account the retrenchment costs in its tax return for the year ending 31 December 2009. The respondent properly disallowed it in the 2009 tax year.

In regards to the second issue of imputing notional interest to Nostro accounts I hold that the respondent was not entitled to deem the appellant's offshore Nostro accounts as interest bearing accounts. The respondent erred in adding notional interest back to taxable income.

As for the third issue, on offshore loans, the respondent was entitled to attribute interest earned by non-resident related parties on loans made to businesses in Zimbabwe to the appellant. He correctly added it back to income in the respective tax years that it was earned.

And in respect of the last issue on withholding tax, I hold that the respondent properly raised withholding tax on the bank charges that were raised by offshore banks holding the appellant's Nostro accounts as they constituted fees under para 1 of the 17th Schedule of the Income Tax Act [*Chapter 23:06]*.

COSTS

The appellant did not achieve anything approximating substantial success. I will order each party to bear its own costs.

DISPOSITION

Accordingly it is ordered that:

1. The appeal in respect of retrenchment costs, interest on offshore loans and non-resident withholding tax be and is hereby dismissed.
2. The appeal in respect of Nostro accounts be and is hereby allowed.
3. The amended assessment issued by the respondent on 16 November 2012 for the tax year ending 31 December 2009, and the amended assessments issued on 21 November 2013 for the tax years 31 December 2010 and 31 December 2011, respectively, be and are hereby set aside.
4. The respondent is directed to issue further amended assessments in respect of each of the three years in accordance with the contents of this judgment by:
   - (i) Disallowing the deduction of retrenchment costs in the sum of US$2 693 500.00 in the tax return for the tax year ended 31 December 2009;
   - (ii) Exempting payment of imputed notional interest from Nostro accounts in the tax years ended 31 December 2009, 31 December 2010 and 31 December 2011.
   - (iii) Adding back to income the interest paid by the six companies in each of the three tax years in question.
   - (iv) Adding back to income the withholding tax on the bank charges raised by all the offshore banks holding the appellant's Nostro accounts at the appropriate rate for each of the three tax years in question.
5. Each party shall bear its own costs.

Gill Godlonton and Gerrans, the appellant's legal practitioners