

SZ (PVT) LTD
versus
ZIMBABWE REVENUE AUTHORITY

SPECIAL COURT FOR INCOME TAX APPEALS
KUDYA J
HARARE, 6 March 2018 and 13 February 2020

Income Tax Appeal

D Tivadar, for the appellant
S Bhebhe with *H Muromba*, for the respondent

KUDYA J: The 10 issues raised in this appeal concern the treatment the Commissioner accorded to claims for capital redemption allowances in respect of the 2011 and 2013 tax years, the apparently prescribed 2009 income tax assessment, prepayments, deferred expenses, management fees, canteen meals, bad debts written off in the 2009, 2010 and 2011 tax years, interest in the 2013 tax year and penalties.

The background

On 22 September 2014, the respondent commenced an income tax investigation on the appellant for the tax years 2009 to 2013. The parties held meetings and exchanged communication which culminated in the presentation of the respondent's findings on 2 November 2016, and the issuance of the first set of amended assessments on 4 November 2016. On 12 December 2016, the respondent issued further amended assessments numbers 8267, 8268, 8269, 8270 and 8271 in respect of each of these tax years. The respondent demanded payment of the cumulative sum of US\$ 3 494 139.70 consisting of the principal sum of US\$ 1 329 426.47 and penalties of US\$ 1 164 713.23. On 6 January 2017, the appellant objected to the amended assessments. On 3 March 2017, respondent delivered his determination to the appellant. On 17 March 2017, appellant filed its notice of appeal against all the objections that had been disallowed. The appellant's case was filed on 16 May 2017,

while that of the Commissioner was filed on 6 August 2017. Thereafter, a pre-trial hearing at which the issues for determination on appeal were agreed was held on 7 November 2017.

At the appeal hearing, the appellant abandoned the issue on interest and two claims relating to bad debts. It called the evidence of its management accountant and produced the 33 paged exhibit 1. The respondent did not call any oral evidence but relied on the pleadings filed of record.

The facts

The appellant comprises of a mining division and a manufacturing division located on different locations that are some 9kms apart. The mining division extracts limestone, which is beneficiated and used to make cement in the manufacturing division. The specific facts pertaining to each issue will be set out in the determination of such issue.

The issues

The following issues were referred for determination at the pre-trial hearing held on 7 November 2017.

1. Whether the appellant derived income from the mining operations admittedly carried out by it and whether it was entitled to claim allowances in terms of s 15 (2) (f) (i) as read with the Fifth Schedule of the Income Tax Act of US\$258 214 in the 2011 tax year and US\$90 000 in the 2013 tax year?
2. Whether there was any “fraud, misrepresentation or wilful non-disclosure of facts” on the part of the appellant entitling the respondent to issue an additional assessment in respect of the 2009 tax year?
3. Whether prepaid expenses of a revenue nature are deductible in the tax year in which they are incurred?
4. Whether:
 - a. The quarry stripping expenses incurred in the 2012 tax year were of a capital or revenue nature and deductible in that tax year?
 - b. The treatment of this issue by the respondent in the additional assessment resulted in double taxation of the same income?
5. Whether the claim for management fees was appropriate?
6. Whether the appellant was entitled to claim the cost of provision of canteen meals as a deductible expense or whether it was to be regarded as “entertainment”?
7. Whether the amounts written off in 2009 of US\$ 19 861, 2010 of US\$291.76 and 2012 of US\$102 628.14 constituted bad debts?

8. Whether interest is, in principle, payable in respect of any established tax liability for the 2013 tax year?
9. What measure of penalty, if any, should be imposed?

Resolution of the issues

Whether the appellant derived income from the mining operations admittedly carried out by it and whether it was entitled to claim allowances in terms of s 15 (2) (f) (i) as read with the Fifth Schedule of the Income Tax Act of US\$258 214 in the 2011 tax year and US\$90 000 in the 2013 tax year?

It was common cause that the appellant claimed capital redemption allowances under the provisions of s 15 (2) (f) (i) as read with the Fifth Schedule to the Income Tax Act, which apply to mining operations. In terms of para 4 (2) of the Fifth Schedule to the Income Tax Act any person who carries out mining operations in a mine is permitted to claim all the capital expenditure incurred in that tax year from income derived from the “carrying on of mining operations in a mine of which such company is the owner”. In terms of para 4 (5) such an election binds the mining operator in regards to all claims in subsequent tax years. Again, s 15 (2) (f) (i) of the Act provides that the capital allowances made in terms thereof are in place of the allowances and deductions allowable, *inter alia*, in para 15 (2) (c), which are in respect of “articles, implements, machinery and utensils belonging to and used by the taxpayer for the purposes of his trade provided in the Fourth Schedule”.

Subpara (ii) of s 15 (2) (f) applies to miners and excludes from its purview expenditure for which deduction is allowable under the general deduction formula. A miner is defined therein as “any person who at the time the expenditure was incurred was owner, tributor or option holder of a mining location or the holder of a prospecting licence issued or an exclusive prospecting licence order granted in terms of the Mines and Mineral Act”.

The expenditure covered for a miner is any expenditure, which is proved to the satisfaction of the Commissioner to have been incurred in the year of assessment by the taxpayer on “surveys, boreholes, trenches, pits and other prospecting and exploratory works undertaken for the purpose of acquiring rights to mine minerals in Zimbabwe or incurred on a mining location in Zimbabwe, together with other expenditure (other than expenditure referred to in the definition of capital expenditure in para 1 (a) of the Fifth Schedule), which in the opinion of the Commissioner is incidental to the listed activities. The expenditure listed in para 1 (a) of the Fifth Schedule relates to buildings, works or equipment, shaft sinking and

expenditure incurred before the commencement of production or during any period of non-production on preliminary surveys, boreholes, development, general administration and management and interest payable on loans used for mining purposes. The proviso to subpara (ii) hereof, accords the taxpayer the right to deduct all the expenditure in the year of assessment in which it is incurred or carry it forward for deduction against income from mining operations in subsequent tax years.

The method of computing capital redemption allowances by a mining owner is provided in para 2 of the Fifth Schedule to the Act, which is made subject to para 4. In terms of para 2, the owner estimates to the satisfaction of the Commissioner, the estimated life of the mine and divides the expenditure over such a period and then claims the resultant figure in each year of assessment as a capital redemption allowance. However, in terms of para 4 (2) of the same Schedule he can elect to claim all the capital expenditure in one tax year.

In the amended assessments, the Commissioner disallowed the application of s 15 (2) (f) (i) as read with the Fifth Schedule in preference to s 15 (2) (c) as read with the Fourth Schedule to the Income Tax Act and added back to income the sum of US\$258 214 in the 2011 tax year and US\$90 000 to the 2013 tax year. The subpara favoured by the respondent deals with special initial allowances in respect of *inter alia* articles, implements and utensils belonging to and used by the taxpayer for the purposes of his trade, which are provided in the Fourth Schedule. In terms of para 2 of the Fourth Schedule the taxpayer may make a binding election to deduct expenditure incurred in the use of articles, implements and machinery in the tax year in which they are so used or the following year, only if the Commissioner decides that they were wholly or almost wholly purchased for use in his trade.

The respondent changed the Taxing Act Schedule of claim for three reasons. The first was that the appellant was not a miner. The second was that it did not earn income from mining activities and the last was that it did not derive any income from mining activities. The appellant disputed all the three grounds in question. The onus rested on the appellant to establish by cogent and credible facts, that it was a miner, which earned or derived corresponding income from the quarry. The appellant established that the quarry operation was separate and distinct from the manufacturing one by geographic location, personnel, costing, regulatory licences and approvals. I am satisfied that the quarry held mining claims, which are periodically inspected and licences for the storage and use of explosives at the quarry. It was common cause that the quarry was owned by the appellant and that limestone was extracted therefrom. In terms of the s 2, the definition section of the Income Tax Act,

limestone, though categorised as a stone, is recognised as a mineral¹. The operations conducted by the appellant at the quarry constituted a mining operation, defined in the same section by reference to the recovery of a mineral from the earth. There is no doubt in my mind that the activities conducted by the appellant were mining operations.

The dispute between the parties on appeal revolved upon the application of the words “in respect of income from mining operations” prescribed in s 15 (2) (f) (i) of the Act to the mining operation carried out by the appellant. I agree with the Mr *Bhebhe*, for the respondent that the appellant did not earn any income directly from the limestone unearthed from the ground. Rather, it utilised the mineral together with other raw materials to manufacture cement and its related products from which it earned income. The appellant’s answer to this difficulty was to approbate the “vertically integrated enterprise” position and reprobate the separate and distinct stance. The new approach adopted by the appellant constituted an implicit acknowledgement that its predominant business activities were the manufacture and sale of cement and allied products.

The contention advanced by Mr *Tivadar*, for the appellant that the accrual of income for the appellant commenced with mining operations was given short shrift in *Secretary for Inland Revenue v Cape Lime Company, Ltd* 1967 (4) SA 226, (A), 29 SATC 131 (A). In that case the lime manufacturing taxpayer removed overburden to reach the limestone rock. It blasted the rock and crushed it in the quarry into smaller sizes. The limestone was carried in two Lorries that it had purchased for that purpose to its lime manufacturing factory, some 4kms away from the quarry, where it was further crushed and fed into the kiln to manufacture agricultural lime. The issue for determination concerned the identification of the point at which the manufacturing of lime commenced. The taxpayer sought the deduction of capital allowances for the Lorries on the ground that they had been used for the purposes of its trade and directly in the process of the manufacture of lime. The taxman had disallowed the deduction on the basis that the cartage of the limestone by the Lorries did not constitute the direct use in the process of manufacture envisaged by the relevant section of the South African Income Tax Act. The taxpayer’s contention was upheld on appeal by the Special Court. The appeal by the taxman to the Appellant Division was dismissed on the ground that the process of manufacturing commenced at the quarry, with the blasting of the extracted

¹ “mineral” includes any valuable crystalline or earthy substance forming part of or found within the earth’s surface and produced or deposited there by natural agencies but does not include petroleum or any clay (other than fire-clay), gravel, sand, stone (other than limestone) or other like substance ordinarily won by the method of surface working known as quarrying.

limestone on the floor of the quarry and not from the quarry face such that the transportation of the fragmented stone from the quarry to the kiln constituted direct use of the lorries in the process of manufacture from which the capital allowances were deductible. At page 142-143 SMIT AJA stated that:

“The Special Court’s findings, although described as a factual finding, that the process (of manufacture) begins with the extraction of limestone from the quarry is, in my view, actually an inference of law from the facts the correctness of which this Court can consider and decide on the facts as found. Raw material, in this case the limestone, is necessary for the process of manufacturing of hydrated lime, but I do not think that it can be said that the process of manufacture already begins when the raw material is extracted from the rock. This operation is too remote to form part of the process. One must distinguish between the acts performed in acquiring the raw material for the process of manufacture and those which commence the process. But breaking down the limestone on the floor of the quarry is different.....it is at this stage of the operations that I think the process of manufacture begins. It is necessary to get pieces of stone 1 ½ inches to 4 inches in size for the calcination process which takes place in the kilns. For this process the quarried limestone is broken up into smaller pieces first at the quarry and then in the crushers at the plant. If instead of breaking up the stone by blasting on the floor of the quarry the extracted stone was broken up in coarser crushers at the (kiln) that operation could not be said to be not part of the process when it is conceded that the operation of the crushers at the plant is part of the process, which it obviously is.” (Underlining mine for emphasis)

Notwithstanding that STEYN CJ with whom BOTHA JA concurred, would have upheld the appeal, all the 5 learned judges who heard this appeal unanimously held that the process of manufacturing lime did not commence with the blasting of limestone from the quarry face. This aspect was confirmed by JENNET AJA who stated at p 145 that:

“I respectfully agree with the learned CHIEF JUSTICE that it cannot be properly inferred that the process of manufacture begins with the blasting of the rock from the quarry face. That operation is one carried out to obtain raw material for later processing.”

The principle derived from this finding is that the manufacturing process of lime, in that case, and cement, in the present case, commences with the crushing of the limestone rock and not with its extraction from the belly of the earth. This same point is adopted in para 2 of the “Appellant’s Case”, where the appellant approbates that the mining of limestone is as a separate operation from the use of the limestone in the manufacture of cement. It is apparent to me that in the present case, the appellant did not earn income from the limestone, which was eventually consumed in the manufacture of cement. I, therefore, agree with the contention made by Mr *Bhebhe* in his oral submissions that the appellant was not quarrying or extracting limestone from the land as an end but as a means to an end, which was the manufacture and sale of cement. In any event, the appellant did not and could not obviously sell the limestone to itself.

The source of income doctrine advanced by the appellant to connect its mining operations to the accrual of income from the sale of cement distorts the ordinary business meaning and usage attributed to “income derived from mining operations” found in proviso (c) of s 15 (1) and subpara (i) of the s 15 (2) (f.) The income accruing to the appellant was derived from the manufacture and disposal of cement and not from the mining operation. The connection between the mining of limestone and the income earned from the disposal of cement was, in my view, remote. My finding appears to be in consonant with the refusal by GUBBAY P, as he then was, in the local case *ITC 1249* (1976) 38 SATC 74 (R) at 77 to extend the definition of mineral to the products manufactured from that mineral.

I, accordingly, hold that the appellant wrongly applied the provisions of s 15 (2) (f) (i) in its tax returns.

Whether there was any “fraud, misrepresentation or wilful non-disclosure of facts” on the part of the appellant entitling the respondent to issue an additional assessment in respect of the 2009 tax year?

It was common cause that the appellant claimed non-deductible expenditure in respect of provisions for leave pay and canteen expenses attributed to administrative staff in the 2009 tax year. It was further common ground that when the additional assessments were raised on 4 November 2016, and 12 December 2016, more than 6 years had elapsed from the time the 2009 tax returns were submitted to the respondent. In terms of proviso (ii) of s 47 (1) of the Income Tax Act, any return that is at least 6 years old prescribes unless its presentation was actuated by fraud, misrepresentation or wilful non-disclosure of facts. The respondent inferred misrepresentation from the fact that the appellant employed highly qualified and skilled employees and tax consultants who must have known that the appellant was precluded from claiming the identified leave pay provisions and canteen expense incurred on behalf of administrative staff but nonetheless claimed them with reckless disregard. The respondent founded misrepresentation on legal rather than actual intention. The non-deductibility of these amounts was obvious to anyone with a working knowledge of income tax matters. There were no difficult questions of law that were involved. In fact, the readiness with which the appellant admitted the error of its ways in respect of these deductions during the investigations confirmed that its officials acted with reckless disregard in claiming these non-deductible amounts. The Commissioner had every reason to be satisfied that the conduct of the appellant amounted to a misrepresentation of the true position.

I also had occasion to construe the meaning of “misrepresentation” in *DEB (Pvt) Ltd v Zimra* HH 664/2019 at p 12 and *MAN Ltd v Zimra* HH 78/2010 at p 7. I accorded a wider meaning to the word, which was unaffected by the state of mind of the taxpayer. The essence of my finding was that the making of any incorrect statement, which was prejudicial to the fiscus, constituted the “misrepresentation” contemplated by proviso (ii) to s 47 (1) of the Income Tax Act. That finding, which I still maintain, accords with the submissions made on the point by Mr *Bhebhe* and is contrary to all the submissions made by Mr *Tivadar*. In my view, the incorrect deductions made by the appellant with respect to provisions for leave pay and canteen expenses for administrative constituted incorrect statements which effectively prejudiced the fiscus.

I, therefore, find that the Commissioner correctly re-opened the 2009 tax assessments by reason of the misrepresentation made by the appellant in the tax returns made in that year. *Whether prepaid expenses of a revenue nature are deductible in the tax year in which they are incurred?*

It was common ground that this issue was not raised in the notice of objection. However, by letter of 1 March 2018, the appellant sought the respondent’s consent to have the ground of appeal determined on appeal. It does not appear from the record that the consent sought was granted as in the written heads the appellant sought the leave of Court to raise the issue on appeal. However, at the commencement of the appeal hearing, the respondent gave consent for the matter to be ventilated in this appeal. It was common cause that in each subsisting tax year of assessment, the appellant made payments for expenses that would arise in subsequent tax years. It then deducted them in the tax year of payment. The respondent disallowed the deductions and added them back to the income for the current tax year. He also deducted prior year prepayments from the current year income.

Mr *Bhebhe* sought to justify the treatment accorded to prepayments by the Commissioner on the matching principle. I had occasion to address the subject in *DEB (Pvt) Ltd, supra*, at p 14 where acting on the persuasive authority of *Joffe and Co Ltd v CIR* 1946 AD 157 at 163 I held that the matching principle was part of our law. In coming to that conclusion, I overlooked the construction accorded to the sentiments expressed in *Joffe* by CENTLIVRES JA in *Sub-Nigel Ltd v CIR* 15 (1948) SATC 381 (A) at 394, 1948 (4) SA 580 (A) at 589 that:

“It was contended by Mr *Ettlinger* on behalf of the Commissioner that stress should be laid on the definite article “the” before the word “income” in sec. 11 (2) and that as the expenditure of the amounts by way of premiums produced no income, such expenditure was not incurred

in the production of *the* income and was therefore not deductible. Pressed to its logical conclusion this contention means that if a merchant were to buy goods for the purposes of resale and pay for them on the last day of the tax year, and was to sell none of these goods before the end of the tax year, he would not be able to deduct the purchase price of those goods from his gross income for that year because the expenditure although incurred in that year, produced no income in that year. That this is not so is shown by such cases as *Commissioner for Inland Revenue v Niko* 1940 AD 416 at p.427, for it is clear that the merchant, in determining his taxable income, is entitled to deduct from the proceeds of any re-sales effected by him the purchase price of goods which he has not resold during the tax year. Indeed if Mr *Ettlinger's* argument were correct, the merchant would not be allowed, in the example I have given, to deduct the purchase price of the goods bought at the end of the tax year from his gross income for that year, although he may have disposed of all the goods during the latter year. For the whole scheme of the Act shows that, as the taxpayer is assessed for income for a period of one year, no expenditure incurred in a year previous to the particular year can be deducted.”

He then quoted the relevant sentiments of WATERMEYER CJ at p 591 and continued thus:

“At first sight the third sentence in the above quotation seems to support Mr *Ettlinger's* contention, but it is clear from a perusal of the whole case (see p. 167) that the *ratio decidendi* was that sec. 12 (g) prohibited the deduction which the taxpayer sought to make. The emphasis placed on the article “the” was obiter, and in any event the learned CHIEF JUSTICES did not lay down that non-capital expenditure could not be deducted if no income resulted therefrom in the year in which it was incurred. Nor was he in the passage I have quoted, attempting to construe the phrase “expenditure and losses incurred in the production of the income”.

And lastly, he put the matter beyond doubt by asserting at 592 that:

“The conclusion that I arrive on this part of the case is that there is no reason to think that the Legislature, in using the definite article “the” before “income” in sec. 11 (2) (a), intended the result contended for by Mr *Ettlinger*. It seems to me clear on the authorities that the Court is not concerned whether a particular item of expenditure produced any part of the income: what it is concerned with is whether that item of expenditure was incurred for the purpose of earning income. The reason why the Legislature used the definite article “the” before “income” in s 11 (2) (a) is probably because it had previously used it in the immediately preceding sub-section” (underlining my own for emphasis).

Again, in ITC 815 (1955) 20 SATC 487 at 492 ROPER J stated that:

“As the meaning and effect of these provisions have been exhaustively considered in such cases as *PET v CIR*, *Joffe*, *supra* and *New State Areas Ltd v CIR* 1946 AD 610 and *Sub-Nigel Ltd v CIR* 1948 (4) SA 580 (AD), it is unnecessary for me to discuss them. It is clear from the last cited of these cases that the article “the” in “the income” in 11(2) (a) does not limit the deductible losses to those concerned with the production of income for the particular year in which the losses are incurred. It is also clear that a loss due to an obligation to pay compensation or damages may be a loss “incurred in the production of income” if the obligation arises from the performance of a business operation *bona fide* performed for the purpose of earning income.”

A closer scrutiny of the general deduction formula as read with definition of trade in section 2 and definition of gross income in s 8 (1) of our Income Tax Act do not support the matching principle at all. This becomes obvious when the three sections are juxtaposed against each other. Section 15 (2) a) provides that:

- “(2) The deductions allowed shall be—
(a) expenditure and losses to the extent to which they are incurred for the purposes of trade or in the production of the income except to the extent to which they are expenditure or losses of a capital nature,

And both “trade” and “gross income” are defined in the relevant parts thus:

“trade” includes any...trade, business, activity,.....,carried on, engaged in or followed for the purposes of producing income as defined in subsection (1) of section *eight* and anything done for the purpose of producing such income;

“gross income” means the total amount received by or accrued to or in favour of a person or deemed to have been received by or to have accrued to or in favour of a person in any year of assessment from a source within or deemed to be within Zimbabwe excluding any amount (not being an amount included in “gross income” by virtue of any of the following paragraphs of this definition) so received or accrued which is proved by the taxpayer to be of a capital nature and, without derogation from the generality of the foregoing, includes—

In addition, amount is defined as follows:

“amount”, for the purposes of the provisions of this Act relating to the determination of the gross income, income or taxable income, as defined in subsection (1) of section *eight*, of a person, means—

- (a) money; or
(b) any other property, corporeal or incorporeal, having an ascertainable money value;”

The general deduction formula covers expenditure and losses to the extent that that they are incurred for the purposes of trade or the production of income, not of a capital nature. The expressions “purposes of trade” or “production of income” when read together with the definition of “trade”, to the extent to which it envisages “producing income as defined in subs (1) of section eight” carry the same meaning. However, the production of trade income derived from the definition of “gross income” does not limit such income to a particular year of assessment but encompasses the production of income in “any year of assessment”. It seems to me that while the definition of trade in s 2 links expenditure in s 15 (2) (a) to income in s 8 (1) of the Income Tax Act, it does not match expenditure incurred in a particular tax year with income accruing in the same tax year. Contrary to my earlier findings on the point, I now agree with the submission made by Mr *Tivadar* that the matching principle does not form part of our income tax law.

However, I must hasten to add that the finding does not alter the position I have taken in previous cases that a prepayment is incurred in the tax year (s) subsequent to the tax year in which it is made. The ordinary grammatical meaning of “prepayment” presupposes an

advance payment made for goods or services to be provided in a subsequent tax year, otherwise it would be a misnomer to characterise the payments for goods or service due in the subsisting tax year as prepayments. It seems to me that the prepayments in question related to performance for which the unconditional legal obligation to pay would take place in the subsequent tax year. I, therefore, agree with the alternative contention made by Mr *Bhebhe* in para 8.4.1.2 and 8.9 of his written heads, based as they were on the sentiments expressed in *Nasionale Pers Bpk v KBI* 1986 (3) SA 549 (A) that:

“A prepayment is not a payment which has become due as there is no legal and unconditional liability for the same to be paid. There is no contractual liability to pay the said expenditure at all. Prepayments are not made as a result of any unconditional liability to pay. It is simply a voluntary payment by the taxpayer before the liability becomes legally due.

A prepayment could only be deducted in the year in which it is paid if the provisions of s 15 (2) (cc) are met. The tax payer must make a conscious election, and the deductible amount would have to be fixed by the Commissioner for expenditure to be incurred in a subsequent tax year in which gross income arising from such prepayment will accrue. In the instant case, the appellant did not make the envisaged election nor did the Commissioner fix the deductible amount.

In view of the fact that the prepayments were not actuated by any unconditional legal liability and could not have been incurred in the years in which they were paid, I uphold the treatment accorded to them by the Commissioner.

Whether:

- a. *the quarry stripping expenses incurred in the 2011 tax year were of a capital or revenue nature and deductible in that tax year?*
- b. *the treatment of this issue by the respondent in the additional assessment resulted in double taxation of the same income?*

It was common ground that the mining operations conducted by the appellant involved the removal of overburden, also known as quarry stripping, which according to the testimony of the sole witness called by the appellant connoted the removal of flora and soil to expose the limestone embedded in the belly of the earth. It was further common cause that in the tax years prior to the 2011 year of assessment the appellant used to quarry strip on a monthly basis and claimed the cost as revenue expenses. However, it decided to do so on an area sufficient to permit four years mining during the 2011 tax year at a cost of US\$647 119.32. The appellant treated this amount as a revenue expense, claimed the expense in the year it was incurred and amortised the cost over four year in its book financial standards in

accordance with the accounting principles prescribed in the International Financial Reporting Standards, IFRSs. In the additional assessments, the investigators disallowed the whole amount in the 2011 tax year and added back US\$522 241.35 to the appellant's 2012 taxable income and US\$261 120.63 to the 2013 taxable income, which were reflected in the appellant's financial statements for those years as closing balances of the US\$647 110.32. However, in the determination of the objection the respondent reversed the adding back to income of US\$ 522 241.35 for the 2012 tax year but maintained that the US\$261 120.63 was a separate deduction and not a closing balance in the 2013 tax year. The respondent proceeded to disallow the deduction of the US\$647 110.32 on the ground that it was expenditure of a capital rather than revenue nature. The appellant made the contrary contention that the expenditure in question was of a revenue nature.

The distinction between revenue and capital expenditure has been stated in such cases as *Artheton British Insulated & Helsby Cables Ltd* [1925] TC 155, *CIR v George Forest Timber Company* 1 SATC 20, *New State Areas Ltd v CIR* 1946 AD 610 and *D Bank Ltd v Zimbabwe Revenue Authority* 2015 (1) ZLR 176 (H) . The main principle derived from these cases is that the money spent in creating or acquiring a source of profit constitutes capital expenditure while the money spent in working it or which is incurred as part of the cost of performing the income producing operation constitutes revenue expenditure. In my view, the purpose of removing the overburden was to create an asset or advantage for the enduring benefit of the mining operation, which purpose was unaffected by the period it took to remove the overburden. It seems to me that quarry stripping is analogous to shaft sinking, which is treated in para 1(1) (a) (ii) of the Fifth Schedule to the Income Tax Act as an activity of a capital nature. The purpose of quarry stripping like shaft sinking is to expose the mineral, which is then extracted by blasting and crushing. Again, Mr *Bhebhe* correctly contended that the land on which the soil and flora were removed together with the machinery used to remove them were capital assets. It would be a misnomer for the appellant to argue that it was earning income from quarry stripping. Rather it was acquiring and enhancing the capital asset on which the mineral, limestone, was located. I, therefore, hold that the cost and expenses incurred in removing overburden was part of establishing or improving the income producing structure rather than of performing the income producing operations. In my view, while amortisation constitutes a practical business and sound accounting principle derived from IFRS, it properly resonates with a capital asset and in the instant case constituted an explicit

concession by the appellant that the cost of removing overburden was of a capital nature. *D Bank Ltd v Zimra*, 2015 (1) ZLR 176 (H) at 189E.

In determining the first issue I held that, the appellant was not entitled to claim capital redemption allowances prescribed in s 15 (2) (f) (i) because its income emanated from cement production rather than mining operations. In the alternative, the Mr *Tivadar* contended that if the expenditure was of a capital nature, then the Commissioner should have allowed the deduction on the basis that the mining operation constituted a new mine as defined in para 4 (8) to the Fifth Schedule of the Income Tax Act. His argument overlooked the fact that the expenditure sought to be deducted was not derived from income emanating from mining operations as prescribed by s 15 (2) (f) (i) of the Income Tax Act.

In regards to the US\$261 120.63 that the appellant maintained was a closing balance of the amortised US\$647 000, reversed in 2011, which was added back to income in 2013 and thus taxed twice, it failed to produce any supporting documentary evidence. That assertion was undermined by the contradictory positions taken by the sole witness in his testimony on the point. In his evidence in chief he asserted that the appellant continued to quarry strip every month during the period in question, while during cross examination he limited the monthly quarry stripping to the years prior to the bulk removal of overburden. Such inconsistent evidence seems to confirm the assertion made by the Commissioner that the US\$261 120.63 constituted the quarry stripping expense incurred and deducted by the appellant in its 2013 income tax return.

I am satisfied that the Commissioner correctly added back to the 2011 tax year the deduction of the US\$647 119.32 made by the appellant in that year. And in view of the failure by the appellant to establish on a balance of probabilities that the US\$261 120.63 was wrongly added back to income in the 2013 tax year, I would confirm the treatment accorded to that amount by the Commissioner.

Whether the claim for management fees was appropriate?

It was common cause that the appellant was jointly owned by a Chinese incorporated company and a local parastatal in the ratio 65% and 35%, respectively. The appellant and these two shareholders concluded the Management Services Provision Contract on 6 January 2009, which fixed the management fees payable to them at 2.5% of turnover to be apportioned between them in proportion to their shareholding. In terms of clause 1 of the agreement, the shareholders undertook to select and appoint the senior management team, select and delegate technical training experts, provide technical support in the production

processes, provide staff training, provide support and assistance in financial services accessed at lower interest rates source and supply plant spares on credit without charging interest, provide internal audit services and share valuable global technical and administrative information and provide strategic direction to the appellant. The appellant undertook to pay 2.5% of monthly turnover as management fees, withhold the necessary taxes and remit the due amounts to both the shareholders as and when cash-flow permitted and the Revenue Authorities without fail.

It was also agreed that on 25 November 2009, the appellant entered into an Agreement on Technical Training and Production Assurance, which covered both the quarries and manufacturing plant, with its foreign shareholder. It ran for two years from 1 December 2009 and according to an addendum signed on 24 September 2013, was renewed for a further two to 31 December 2013. In the latter agreement the foreign shareholder undertook to supply 25 training engineers and technicians listed in appendix 1 and conduct the specific training programmes enumerated in appendix 2 to the agreement. In terms of clause 4, the foreign shareholder would train the local employees on rectification of any production problems, daily production management, equipment operation and maintenance, managing the acquisition and inventory of spare parts, match drawings, documents and plant manuals to existing plant and equipment on site. In terms of clause 5, the appellant would be responsible for procuring visas, air tickets, tools of trade, accommodation and insurance for the technical staff and the payment of the training fees and other expenses to the foreign shareholder. The contract price of US\$1.2 million and its method of computation and payment were stipulated in clause 7 of the agreement, in the sum of US\$1 200 000 and how it was calculated was stipulated in clause 7 of the agreement. It was payable in 24 monthly instalments of US\$50 000 over the duration of the agreement.

The foreign shareholder invoiced the appellant management fees of US\$189 184.77 for the 2009 tax year, US\$262 740.08 for 2010, and US\$348 001.35 for 2011 while the local shareholder claimed US\$10 000 in the 2012 tax year. The invoices did not specify the nature of the management services that the two shareholders provided. It was also common cause that during the investigations the appellant did not produce any contemporaneous records of the management services provided by each of the shareholders, despite several requests for these documents, to the respondent for the 2009 to 2013 tax years. What happened was that the appellant produced several documents dated 16 November 2016, which highlighted the services that were alleged to have been provided by the top management, corporate services

division and internal audit and finance division of the local shareholder. These documents indicated that the chief executive officer, chief financial officer and general manager were responsible for the initial promotion and establishment of the appellant and were not relevant to the period under investigation. The services attributed to the Corporate Services Division during the period covered human resources consultancy services such as HR guidelines and policies, skills audit, group training programmes, facilitation of work permits and marketing and public relations services, which included arrangement of media tours and facilitation of exhibitions at the Zimbabwe International Trade Fair. The documents tabulated the three dates in March, July and December 2011, the two dates in July and October 2012 and the three dates in August, September and December 2013 and the scope of the audit services that were attributed to the local shareholder. Lastly, the documents highlighted the ten areas that were serviced by the Finance Division of the local shareholder in each tax year. The probative value of the document covering the Corporate Services Division was undermined by the lack of information on the duration of these services. The document pertaining to the Finance Division had three weaknesses which adversely affected its weight. The first was that it gave the impression that Finance Division permanently managed the appellant, yet the appellant had complement of highly skilled and competent personnel of its own. The second was that in each year it provided the appellant a service identified as “directors valuations as at 1 January 2009.” The third was that some of the listed services, such as sanction busting, advice to government on industrial and economic policy formulation, were services that the local shareholder provided to central government, which had absolutely nothing to do with the appellant.

The respondent disallowed the deductions on management fees in the sum of US\$291 053.50 for the 2009 tax year, US\$ 402 698.43 for the 2011 tax year and US\$ 182 596.69 for the 2011 tax year on two grounds. The first was that the appellant failed to show that the prescribed management services had indeed been rendered and the second was that, the appellant failed to demonstrate the correlation between the percentage of turnover payment method and the actual expenditure incurred by the shareholders in providing those services. The evidence of the sole witness called by the appellant on the point was simply that the invoices and the statement of intention in the Management Services Contract adequately showed that the services were provided. While he accepted that some of the services such as the selection of the top management of the appellant and the technical support personnel and trainers could not have been provided yearly, he then contradicted

himself by listing these amongst the services that he said were provided yearly. He joined the appellant in June 2012 and was not privy to the services that were provided by the shareholders in the 2009, 2010 and 2011 tax years. The sole witness produced a document compiled by the respondent pertaining to the management fees payable to the foreigner shareholder in 2013 and the non-resident tax on fees extracted from the appellant by the respondent in respect of that year. On the basis of this document, Mr *Tivadar* contended the appellant had established that the management services were provided to the satisfaction of the respondent otherwise the respondent would not have retained those fees. There are two answers to that contention. The first is that the respondent is obliged by law to levy withholding tax on management fees payable or paid, which it did in 2013 because the document showed, contrary to the sole witness testimony that other than the tax on fees for October to December 2013, the appellant voluntarily and timeously deducted and remitted the correct monthly tax to the respondent. The second was that the appellant did not establish that any non-resident tax on fees was levied in respect of the 2009 to 2011 tax year but even if it were so levied this would have been on the basis that such fees had actually been paid. After all, in terms of para 1 (2) (b) as read with para 2 (1) of the Seventeenth Schedule to the Income Tax Act, a payer is obliged to deduct non-resident tax on fees from the payee, defined therein as one to whom such fees are payable or paid, and remit it within 10 days to the Commissioner.

I am satisfied that the appellant failed to produce contemporaneous documents to Commissioner and this Court, which showed the services that were provided by the shareholders. The invoices and the documents produced on 16 November 2016 lacked the necessary detail of the services that were provided. Amongst the documents produced by the appellant on 16 November 2016, the documents pertaining to the Corporate Service Division and Finance Division were too general. I had the distinct feeling that the document relating to the Finance Division was contrived. The appellant failed to produce adequate and sufficient evidence to show that the management service that it paid for in 2009, 2010 and 2011 were ever rendered.

Accordingly, the Commissioner correctly disallowed the management fees claimed in the 2009, 2010 and 2011 tax years.

Whether the appellant was entitled to claim the cost of provision of canteen meals as a deductible expense or whether it was to be regarded as “entertainment”?

The appellant provided meals to its employees at a cumulative cost of US\$1 039 316.36 from which PAYE was deducted and remitted to the respondent. The cumulative cost comprised of US\$768 162.62 and US\$271 153.74 expensed against general employees and administrative staff respectively. The respondent disallowed the deductions on the ground that they constituted entertainment as contemplated by s 16 (1) (m) of the Act. In the objection, the appellant acknowledged that canteen provisions constituted entertainment under s 16 (1) (m) of the Act but equated the position at the mine and factory with the one enumerated in *ITC 1394* (1985) 47 SATC 119 (Z) by averring that its employees were served at their work stations, which they could not leave to partake of their meals. In that case it was held that the test was whether it was necessary and reasonable for the staff to remain at their work stations during the lunch-hour. The appellant contended in the objection that the meals constituted staff welfare and their cost to the appellant was deductible in terms of s 15 (2) (a) of the Act.

The respondent correctly observed that the nature of the employees functions at the mine and factory negated the provision of canteen meals at their respective work stations. It was only then that the appellant disclosed that the employees took turns to partake of lunch so as to prevent disruptions in production during working hours, an assertion which was disputed in oral testimony by the sole witness called by the appellant, and contended that the cost of the canteen meals was, therefore, incurred for the purposes of its trade or income production. Clearly, the abandonment of the initial position taken by the appellant in preference to the second, demonstrated that the employees did take lunch breaks during which they took canteen meals. To that extent, the facts in the present matter are distinguishable from those in *ITC 1394*, where it was necessary and reasonable to provide such meals to employees at their work stations and not “at their work place” as contended by Mr *Tivadar* in para 137 of his written heads, which they could not leave, in order to serve customers and do other backroom functions during the universally designated lunch-hour. In the present case, the workers were contractually required to have lunch breaks and did not work during the lunch break at both mine and factory.

Therefore, the provision of canteen meals in the present matter, which the appellant characterised as staff welfare, was a voluntary exercise driven by sympathy rather than the dictates of business necessity. It fell into the wide definition of “entertainment” rendered in *ITC 1394, supra*, in respect of s 16 (1) (m) of the Income Tax Act. I uphold the determination of the Commissioner on the point.

Whether the amounts written off in 2009 of US\$ 60 821.24, 2010 of US\$291.76 and 2012 of US\$102 628.14 constituted bad debts?

It was common cause that the appellant wrote off as bad debts US\$60 821.24, US\$ 291.76 and US\$ 209 681.94 in the 2009, 2010 and 2012 tax years, respectively. These were disallowed by the respondent and added back to income in the respective years in which they were deducted, on the ground that the respondent was not satisfied that they were bad debts

The appellant averred that it recovered US\$37 943.67 of the 2009 debts accounted them in the 2010 taxable income but totally failed to recover bad debts in the sum of US\$19 861. It was common cause that the appellant did not disclose the information on the recovery and treatment of this amount to the respondent during the audit and objection but only raised it for the first time on appeal. The appellant further averred that the 2010 bad debts in the paltry sum of US\$291.76 were owed by 5 ex-employees and remained outstanding after recoveries had been made from their terminal benefits upon termination of their employment contracts. The appellant indicated that it had pursued the outstanding 2009 debts without success before making a business decision to declare them bad. It did not establish in oral testimony or by documentary evidence how it had done so. The documentation in the r 11 documents show that it only wrote letters of demand and issued summons and obtained judgment in respect of some of the outstanding debts in the 2011 tax year. In regards to the paltry 2010 amounts, the appellant simply did not pursue the debtors because the cost of doing so far outweighed the benefits.

In regards to the 2012 debts, it took the same cost and benefit position in regards to debts from one individual and six companies in the cumulative sum of US\$1 521.18. At the commencement of this appeal, Mr *Tivadar* conceded the debts in the aggregate sum of US\$11 518.19 in respect of the 2012 debts had been wrongly claimed as bad debts in the 2012 tax year. The amounts that remained in contention related to the sum of US\$191 988.10 owed in 2012 by a Botswana based company.

The appellant established it was owed US\$720 824.94 by the Botswana company for cement, gypsum and clinker supplied at the special instance and request of that company. Apparently, the appellant also owed that company US\$528 836.84 from the supply of coal fines. In December 2009, the two companies set off their respective accounts, with the result that the Botswana company remained indebted to the appellant in the sum of US\$191 988.10.

The Botswana Company did not settle the outstanding amount prompting the appellant to issue a letter of demand on 24 August 2012. Thereafter, the appellant sued the debtor in the Botswana High Court on some unspecified date in 2013 where judgment was eventually obtained after contest on 3 April 2017, in the sum of US\$90 000. The documentation supplied by the appellant which formed part of the r 11 documents showed that even as the contested action was in progress, the attempt at settlement failed. Indeed, in a letter written to the Reserve Bank of Zimbabwe on 18 December 2013, the appellant's Botswana legal practitioners expressed optimism that the prospect of obtaining judgment in the sum claimed were "extremely bright and hoped to conclude the action by August 2014.

The appellant first contended that the respondent was precluded from reopening the assessment pertaining to the 2009 bad debts. In determining the first issue raised in this appeal, I held that the Commissioner could, once he had properly reopened a prescribed assessment, reassess all tax heads on which such an assessment was based. The first ground of appeal under this issue therefore falls away.

The second contention by the appellant, which was based on the sentiments in *G Bank Zimbabwe Ltd v Zimra* 2015 (1) ZLR 348 (H) at 366D and *CF (Pvt) Ltd v Zimra* HH 99/18 that the Commissioner was precluded from directing how a taxpayer should run its business, does not apply to bad debts. This is because s 15 (2) (g) requires that the Commissioner must be satisfied that any debt declared bad by any taxpayer was truly bad on the date that the declaration is made. In the present matter, the Commissioner was, therefore, entitled to exercise the authority conferred on him by s 15 (2) (g) of the Act.

The law governing bad debts was set out in *BT (Pvt) Ltd v Zimra* 2014 (2) ZLR 640 (H) at. 655D-F. The taxpayer is required to establish facts, which show on a balance of probabilities that the debt was unlikely ever to be paid. It does not seem to me that the mere say so of the appellant discharges this onus. The appellant was required to set out the objective facts upon which the Commissioner, acting as a reasonable man, would have been satisfied that the debt was bad. The appellant did not provide any such evidence to the Commissioner during the audit and objection nor to this Court on appeal in respect of any of the three years in question. It did not disclose the personnel circumstances of each debtor at the time the debts were written off to enable the Commissioner and this Court to assess whether indeed the debtors were unlikely to pay these debts. As it turned out the majority of the 2009 debtors had paid off their indebtedness in 2010. The majority of the remainder

where pursued in 2011 and some had their property attached in execution. The appellant did not explain why it did not take these recovery measures in 2009.

Again, in regards to the 2010 paltry amounts, the basis for writing off was inadequate to satisfy the Commissioner and the Court that the amounts were indeed bad. The appellant did not disclose the employment and personal status of these employees after it disengaged them.

In respect to the 2012 debts, the smaller amounts were owed by companies, whose operational and trading status was not disclosed. One of the companies whose debt was written off was and remains to this day a household name in the Midlands, Masvingo and Matabeleland South Provinces. It does not appear to me that proper thought was given by the appellant to the declaration of these bad debts. In regards to the Botswana debtor, it is clear from the subsequent events that transpired after the set off arrangement, that the declaration of the debt as bad in 2012 was premature. The Botswana debtor was trading and had assets in Botswana, which the appellant could leverage against the debt.

I cannot fault the treatment accorded to bad debts disallowed in the 2009, 2010 and 2012 tax years by the Commissioner. The appellant did not lead any evidence to show that it added back the 2009 recovered debts to the 2010 tax year. I am therefore unable to find that they were subjected to double taxation in both the 2009 and 2010 tax years. I uphold the determination made by the Commissioner on this issue.

Whether interest is, in principle, payable in respect of any established tax liability for the 2013 tax year?

This issue was abandoned by the appellant at the commencement of this appeal, but I believe it is an important issue which requires determination. The respondent levied interest upon the appellant for failing to estimate Quarterly Payment Dates tax due within the 10% margin of error that is stipulated in s 72 (11) of the Income Tax Act in respect of the 2011 and 2013 tax years. The respondent disallowed the appellant's objection in respect of both tax years but conceded on the basis of the decision of the High Court in *Delta Beverages (Pvt) Ltd v Zimra* 2015 (1) ZLR117 that, the 2011 interest was not payable. The interest levied in the 2013 tax year remained in contention between the parties.

The requisite section provides that:

- “(11) If the Commissioner-General is satisfied that a person required to pay provisional tax under this section---
- (a) was, through special circumstances, unable to pay the whole or part of an instalment of provisional tax payable by him or her; or

- (b) underestimated the amount of an instalment of provisional tax payable by him or her by not more than ten *per centum* or through an increase in the rates of tax or for any other sufficient cause;
the Commissioner-General may waive the whole or part of any interest payable under section 71(2).

The appellant advanced five reasons for failing to forecast its annual tax liability and underpaying the provisional tax due within the 10% tolerance range stipulated in s 72 (2) of the Act, which it contended constituted s 72 (11) (a) special circumstances for the full waiver of the interest imposed by the respondent. The first was that, it made stock adjustments to the bulk materials of coal fines, slag, gypsum and clinker on 31 December of each year after the payment of the 4th QPD. The second was that, some customers make advance payments directly into its bank account before placing orders, which the appellant unknowingly include in taxable income. The third was that, there was no predictable historic pattern that it could rely on for the estimation. The fourth was that, its assumptions were not challenged by the respondent at the time and the last was that the shortfall was settled in full as soon as the year end audit was completed and the final figures established.

I agree with the Commissioner that none of the 5 grounds constituted special circumstances for waiver. The first 3 reasons were negated by the ability of the appellant to forecast its profits within the required margin for 3 of the 5 years under review, while operating under the same economic environment. In regards to the fourth, the appellant failed to establish the basis upon which the respondent could have challenged the estimates provided by the appellant. The fifth fails on the simple ground that payment of the difference was mandated by law.

In disallowing the objection, the respondent, *inter alia*, determined that interest levied for the underpayment of provisional tax was neither an assessment nor one amongst the specified decisions that could be objected to in terms of s 62 (1) as read with the Eleventh Schedule of the Income Tax Act. The appellant did not challenge this finding and in his opening remarks, Mr *Tivadar*, conceded that interest followed the principal amount and could not be objected to or appealed against. Accordingly, I hold that the imposition of interest by the Commissioner under s 71 (2) is not subject to objection or appeal as it does not constitute an assessment or any of the decision made in terms of 62 (1) (b) as read with the Eleventh Schedule or s 92, 93, 95 and 96 of the Income Tax Act.

The objection was properly disallowed by the Commissioner.

What measure of penalty, if any, should be imposed?

The investigators initially imposed a penalty of 100% but reduced it to 50% during the audit. The appellant sought a total waiver of the penalty in the objection and on appeal. The Commissioner is empowered by s 46 (6) of the Act to impose any penalty below a 100% or waive the imposition of any penalty if he is satisfied that the failure to render an accurate return was not motivated by any desire to defraud the revenue, postpone the payment of correct tax or even to evade tax. In the objection, the appellant suggested that a total waiver was justified by the full co-operation and detailed disclosures that it made during the audit, which commenced on 22 September 2014 and the genuine differences of opinion on the disputed tax issues. In disallowing the objection, the Commissioner correctly relied on the cases of *CIR v McNeil* (1959) 23 SATC 481 and *ITC 1351* (1982) 44 SATC 58 at 63 and *ITC 1489* (1992) 53 SATC 99 at 107, for the proposition that the imposition of penalty should and in the present case did take into account the appellant's "personal" circumstances, nature of the offence, the benefit that accrued to the tax payer and the corresponding loss incurred by the fiscus and moral turpitude.

The proposition propounded and applied by the Commissioner coincides with the principles I collated in *PL Mines (Pvt) Ltd v Zimbabwe Revenue Authority* 2015 (1) ZLR 708 (H) at 730C of the triad of the infraction, the offender and the interests of society and applied at pp723D-E and 733G-734F.

In the present case, after weighing these factors, the moral turpitude of the appellant arising from the high overstatement of expenses and the corresponding underpayment of taxes in the principal sum of US\$ 1 329 426.47 tilts the scales of justice in favour of a penalty of 50%. I confirm and uphold the penalty imposed by the Commissioner.

Costs

I do not find the grounds of appeal to have been frivolous. I will not impose any adverse order for costs against the appellant but will direct each party to bear its own costs.

Disposition

Accordingly, it is ordered that:

1. The appeal be and is hereby dismissed in its entirety.
2. The additional assessments issued by the Commissioner on 12 December 2016 in respect of the 2009 to 2013 tax years are confirmed.
3. Each party shall bear its own costs.

Gill Godlonton and Gerrans, the appellant's legal practitioners
Kantor & Immerman, the respondent's legal practitioners